

September 2001

SIMPLIFICATION

REGULATORY IMPACT AND COMPLIANCE COST STATEMENT

Statement of the problem and need for action

In May of this year the Government released a tax simplification discussion document, *More time for business*. While aimed primarily at reducing tax-related compliance costs for small businesses, the document also contained a number of simplification initiatives for wage and salary earners, companies, non-residents and banks and other financial institutions.

The Government is committed to simplifying the tax system for these taxpayers and proposes to legislate for some of the proposals in *More time for business* in the taxation bill scheduled for introduction in December 2001. The proposals being legislated for include:

- extending the scope of non-filing;
- simplifying family assistance;
- removing the requirement for filing interim imputation returns;
- simplifying non-resident contractors' withholding tax requirements;
- simplifying provisional tax;
- reducing resident withholding tax information requirements; and
- removing the requirement to make adjustments for small amounts of trading stock.

Statement of the public policy objective

The key objective of legislating for the tax simplification proposals discussed above is to reduce the stress, uncertainty and risk taxpayers face in meeting their regular tax obligations.

Statement of feasible options for achieving the desired objective

The necessary measures for implementation of the policy objectives are legislative in nature and will affect the Income Tax Act 1994, the Tax Administration Act 1994 and the Income Tax (Withholding Payments) Regulations 1979.

Statement of the net benefits of this proposal

Benefits

The specific benefits expected to arise from implementation of the tax simplification proposals being legislated for include:

- reduced need for taxpayers to interact with Inland Revenue;
- extension of non-filing;
- reduction of information requirements imposed on taxpayers;
- improved calculation of family assistance entitlements;
- reduction of resident withholding tax communication costs;
- reduction of trading stock valuation requirements; and
- reduction of non-resident contractors' withholding tax compliance requirements.

Costs

None of the tax simplification proposals being legislated for are expected to impose extra compliance costs on taxpayers, given that their aim and design is to reduce tax-related compliance costs. They are also not expected to have any significant economic implications.

The administrative cost to Inland Revenue from implementing the initiatives is not expected to be significant. The fiscal cost of the proposals is expected to be \$1.875 million in the 2001 financial year (for the period 1 April 2002 to 1 July 2002) and between \$7.5 million and \$8.7 million per annum in the period 2002 to 2004. The ongoing cost will be around \$3.7 million each year, thereafter.

Business compliance cost statement

The majority of the proposals being legislated for will reduce compliance costs for businesses. The magnitude of these compliance cost savings is difficult to quantify as they will be both financial and time related. For example, a company will no longer have to file two sets of imputation returns to receive a refund of the credits available in its imputation credit account. Banks and other interest payers will benefit from being able to utilise different media to communicate resident withholding tax information to their customers. Small businesses will benefit from the higher use-of-money interest safe harbour threshold as this will reduce the need for them to estimate income, thereby, providing greater certainty in the calculation of provisional tax. Equally, small businesses will benefit from not having to value small amounts of trading stock and, more importantly, from the reduced risk of penalties applying if they do not value their stock.

Consultative programme undertaken

The tax simplification proposals being legislated for have received support in submissions on *More time for business*. This reflects the consultation undertaken with a wide range of interested parties, including the Institute of Chartered Accountants of New Zealand, when developing these proposals.

GST AMENDMENTS

REGULATORY IMPACT AND COMPLIANCE COST STATEMENT

Statement of the problem and need for action

Three amendments are required to the Goods and Service Tax Act 1985.

- The first amendment concerns the treatment of repair services supplied in respect of these warranty agreements and whether these services should be zero-rated under the GST Act. The amendment addresses concerns the GST Act imposes a double tax impost on the supply of warranted goods in New Zealand.
- Two remedial amendments are also required to assist in the clarification of amendments made to the GST that were included in the Taxation (GST and Miscellaneous Provisions) Act 2000. The remedial amendments address concerns regarding the treatment of default or penalty interest that is charged under an enactment and the timing of “one-off” adjustments for assets with a value of less than \$18,000.

Statement of public policy objective

The first amendment alleviates the current double taxation of certain warranty services and ensures that the GST Act achieves its key objectives of:

- Taxing final consumption in New Zealand, and
- Not generally being a cost imposed on businesses.

The second and third amendments simplify the application of the GST Act and are designed to reduce potential compliance costs arising from amendments made by the Taxation (GST and Miscellaneous Provisions) Act 2000.

Statement of options for achieving the desired objectives

Legislation is the only effective means of achieving the desired objectives. Non-legislative options, such as not amending the GST Act and relying on affected parties to vary their supply contracts, have been considered in relation to the first recommended amendment. Given the nature of warranty contracts, which are often standardised and used internationally, these options are not cost effective relative to the size of the New Zealand market.

Non-legislative solutions are not viable in relation to the treatment of default or penalty interest that is charged under an enactment and the timing of “one-off” adjustments for assets with a value of less than \$18,000.

Statement of net benefit of this proposal

The amendments will:

- remove the GST cost to the non-registered offshore warrantor;
- improve the ability of the GST Act to cater for different business arrangements;
- remove the inefficiency associated with the double impost of GST in this situation; and
- simplify compliance with GST Act in relation to charging default or penalty interest and making adjustments for changes in use for assets with a value of less than \$18,000.

Business compliance cost statement

The zero-rating proposal lowers compliance costs for non-registered offshore warrantors. It potentially results in a small increase in compliance costs for New Zealand repairers who provide services for non-registered offshore warrantors.

The proposed remedial amendments should result in a marginal reduction in compliance costs.

Consultation

The New Zealand Motor Industry Association, Inland Revenue and the Treasury have been consulted.

October 2001

MISCELLANEOUS ISSUES – INTERNATIONAL, BLOODSTOCK

REGULATORY IMPACT AND COMPLIANCE COST STATEMENT

Statement of public policy objective

The key objective of the proposed measures is to align the New Zealand tax system with international trend and to improve the equity and efficiency of the tax system.

Making bribes non-deductible for taxation purposes would align New Zealand's approach with the international trend initiated by the OECD.

Allowing the existing debt forgiveness rule for family trusts to apply in resettlements recognises that resettlements are often necessary in practice and a consistent set of rules will increase the equity and efficiency of the tax system.

Allowing ownership tracing rules to reflect underlying changes in economic ownership caused by a spinout of subsidiary businesses would improve the equity and efficiency of the tax system by reducing compliance costs to taxpayers contemplating a spinout.

Simplifying the administration of the GST adjustment on fringe benefits would improve the efficiency of the tax system by reducing compliance and administration costs.

Statement of problem and need for action

Currently, bribes paid in the conduct of business may be deductible for taxation purposes. This is contrary to the OECD initiative that all other OECD member countries have implemented. New Zealand has an obligation as a member country to make bribes paid in the conduct of business non-deductible for taxation purposes.

Existing family trusts that qualify for a natural love and affection concession are discouraged from resettling into a new trust because it may create additional, unintended tax liabilities.

The existing shareholder continuity rules would treat a change in holding company caused by a 'spinout' of subsidiary businesses as a loss of continuity. Where a substantial amount of ownership was held by the holding company on behalf of small shareholders, the change in holding company could cause a breach of the shareholder continuity rules for the purpose of carrying forward tax losses and credits.

The GST adjustment on fringe benefits is currently characterised as GST rather than FBT. This means that two assessment notices, one for the GST adjustment and one for FBT would have to be issued and dealt with. The requirement to handle two separate returns, instead of one, is not cost effective since the assessment is typically for a very small amount.

Statement of options for achieving the desired objectives

Legislative amendments are required in all cases to achieve the policy outcomes or to provide certainty to taxpayers.

Statement of net benefit

Benefits

The measures proposed will align the New Zealand tax system with the international trend and improve the equity and efficiency of the tax system.

The proposal to deny deductibility for bribes paid in business will align New Zealand's approach with the international trend.

The proposed new depreciation rates for broodmares would better reflect the economic depreciation rates and practice in the bloodstock industry.

The proposal to recharacterise the GST adjustment on fringe benefits will reduce compliance and administration costs, but it is not possible to quantify these reductions.

Costs

There are potential revenue risks associated with the proposal relating to the ownership tracing rules if the proposed rule could be abused. These risks could not be quantified. Furthermore, but these revenue risks have been minimised by limiting the availability of the proposed rules to widely held companies that spin out their 100% owned subsidiary businesses.

There are no additional compliance or administrative costs arising from the proposals.

Statement on business compliance costs

The proposal on the ownership tracing rules would allow widely held companies to continue holding ownership interests on behalf of small shareholders after a restructuring process. Without the proposed rules, these companies would be required to trace their ultimate shareholders when determining shareholder continuity for the purpose of carry forward losses and tax credits. This would mean higher compliance costs.

The proposal on the GST adjustment on fringe benefits would reduce the compliance costs of taxpayers. It means that taxpayers receive one notice of assessment for FBT and the GST adjustment, instead of receiving two notices.

The proposed FBT amendment relating to low-income rebates will reduce compliance costs for employers in not having to apportion the rebate based on the individual periods of residency in New Zealand of their employees.

Consultation

The proposal to make bribes non-deductible has been discussed with the Institute of Chartered Accountants of New Zealand. The Ministry of Justice and the Ministry of Foreign Affairs and Trade have also been involved in the policy development process.

The Institute of Chartered Accountants of New Zealand and the New Zealand Law Society have been consulted on the proposals relating to debt forgiveness rules for family trusts.

The proposals relating to the ownership tracing rules have arisen from submissions made by a corporate taxpayer. The proposals would allow it to carry out its planned restructuring program after 1 March 2001. Its legal adviser and tax accountant have been consulted and both have been involved in the policy development process.

October 2001

FINANCIAL RELIEF

REGULATORY IMPACT AND COMPLIANCE COST STATEMENT

Statement of the problem and need for action

The Government is committed to the creation of an environment that is conducive to taxpayers meeting their obligations effectively, thereby facilitating the efficient administration of the tax system. This commitment involves ensuring that the current compliance and penalties legislation is clear as to what is expected of taxpayers, in terms of the standards of care and the penalties if they fail to meet these standards and their obligations in general. It also involves ensuring that the application of sanctions is fair and consistent across tax types and taxpayers. Amendments are needed to meet these objectives in relation to debt and hardship. The current rules are both unclear and arbitrary.

In relation to transfers of overpaid tax there is currently little legislative guidance, resulting in inconsistent treatment between taxpayers. Amendments are required to clarify the rules and ensure equitable treatment between taxpayers.

Statement of the public policy objective

The key objective of the debt and hardship legislation review and the review of the rules relating to transfers of overpaid tax is to clarify the rules governing taxpayer obligations and the Commissioner's powers and to ensure a transparent and equitable treatment of taxpayers.

Proposals relating to debt and hardship and transfers of overpaid tax were contained in the discussion document *Taxpayer compliance, standards and penalties: a review*. The other measures in the discussion document will not be included in the December tax bill. This will provide time for more consultation and fine-tuning of the proposals.

Statement of feasible options for achieving the desired objective

In relation to transfers of excess tax, legislation is the only means of achieving the desired objectives.

In relation to debt and hardship the legislation will make clear the broad principle with administrative guidelines providing more detail. The current problems are a consequence of the provisions in the Tax Administration Act. Any solution necessarily involves amendment to the legislation.

Statement of the net benefits of this proposal

Benefits

The specific benefits expected to arise from the proposals include:

- A reduction in the incentives for non-compliance with taxpayer obligations to assess liability and return and pay tax on time.
- The alignment of the compliance and penalties legislation with the intended policy so that the desired policy outcomes can be achieved.
- The clarification of the debt and hardship rules, so that taxpayers genuinely negotiating payment of outstanding debt are not subject to penalties, and taxpayers who would be placed in serious hardship if debt recovery was actioned are entitled to relief.
- Clarification of the rules relating to transfers of overpaid tax. There is much uncertainty over the existing rules.

Costs

None of the proposals are expected to impose significant extra compliance costs on taxpayers.

The proposed changes to the debt and hardship rules will have a one-off administrative cost and on-going operating costs. The benefits of these proposals exceed these costs.

None of the proposals are expected to have significant revenue implications, and a positive revenue effect is expected from increasing incentives to voluntarily comply with taxpayer obligations.

Business compliance cost statement

The compliance costs on business are the result of trading off the competing factors of equity and efficiency in the tax system and will arise from having to comply with the relevant legislative requirements. The parties affected will be all taxpayers who are required to meet their obligations, as defined in the Inland Revenue Acts. Businesses (small, medium and large) will be affected by the proposals, as will their tax advisers.

The compliance cost effects on businesses are difficult to quantify but I consider that the proposals will have a positive effect. The debt and hardship proposals will reduce compliance costs for businesses, principally in the areas of risk, clarity of treatment and quick resolution of taxpayers' concerns. Under the proposed debt and hardship provisions, decisions on these issues will be made more quickly, meaning that businesses will be able to make their decisions with greater certainty. This will, for example, reduce the impact of tax debt on cash-flow.

Clarification of the compliance and penalties legislation based on the recommendations of various Committees will also reduce compliance costs for businesses, primarily in the area of tax debt write-offs.

The compliance cost implications of the proposals will be ongoing but the magnitude of these effects will depend on future policies to complement and or amend their effectiveness.

Businesses will receive compliance cost benefits from having a clear set of legislative provisions governing the transfer of overpaid tax. The ability to transfer between certain family members, companies in the same group, shareholder/employees and companies, partners in the same partnership, and family trusts and beneficiaries as at the date of overpayment will reduce the compliance costs associated with meeting tax liabilities where overpayments are available in other accounts.

Consultative programme undertaken

Consultation has been undertaken externally with the Institute of Chartered Accountants of New Zealand, and various small tax agents. The areas for reform were identified in the terms of reference for the compliance and penalties legislation post-implementation review as well as the reports of the Committee of Experts on Tax Compliance and the Finance and Expenditure Committee in their 1998 and 1999 reports respectively. Submissions received on the discussion document have been considered in making these recommendations.

October 2001

MISCELLANEOUS ISSUES – BASE MAINTENANCE, ETC

REGULATORY IMPACT AND COMPLIANCE COST STATEMENT

Statement of the problems and the need for action

Five problems are addressed:

Unit trust base maintenance

As a result of an unintended interpretation of the Income Tax Act 1994, a unit trust manager may have excess imputation credits when it redeems units with the unit trust in the ordinary course of its business. This is inconsistent with the economic reality of the transaction and provides an unintended windfall gain to the unit trust manager.

Unit trust negative dividend issue

As a result of the application of the company taxation rules to the normal operation of unit trusts, unit trusts are currently overtaxed due to the loss of the paid-up capital that unit-holders invest in the trust. Conceptually this paid-up capital should be able to be returned tax-free.

Unit trust remedial issue

Currently, a unit trust's imputation credit account may be inappropriately debited twice when a debit occurs due to a significant change in the shareholding of the unit trust and a debit is made in respect of dividends received by the unit trust manager in that year.

Holiday pay

Under current law, there is considerable doubt as to the ability of either the purchaser or the vendor of a business to obtain a deduction for monetary remuneration provisions, such as holiday pay. This is an inappropriate outcome. The monetary remuneration provisions have been or will be incurred and generally have sufficient nexus to assessable income so should be deductible.

Partnership pensions

There is considerable uncertainty as to whether a pension paid by a partnership to a former partner is deductible. If such a payment is not deductible, this is inconsistent with the tax treatment of pensions paid by an employer to a former employee. These pensions are deductible.

Statement of the public policy objective

The key objective of the proposed measures is to improve the equity and efficiency of the tax system.

Statement of net benefit

Benefits

The proposal to ensure that unit trust managers do not obtain excess imputation credits will prevent a possible interpretation of the law that is unintended and contrary to policy. This proposal will therefore prevent a potentially significant loss of tax revenue.

The negative dividend proposal and the unit trust remedial proposal will ensure equity and efficiency of the tax system by preventing the over-taxation of unit trusts that arises as a result of the application of the company tax rules to unit trusts.

The proposal to allow the vendor of a business a deduction for monetary remuneration provisions will reduce compliance costs because the parties to the transaction will be able to achieve an appropriate and certain outcome.

The proposal to clarify that pensions paid by a partnership to a former partner are deductible to the partnership, will provide certainty and consistency of treatment for pension payments.

Costs

The unit trust base maintenance and remedial proposals, and the holiday pay and partnership pensions proposals are not expected to impose any significant administrative, compliance or revenue costs.

The negative dividend proposal is likely to result in unit trusts paying less tax. This is because previously they have been paying additional tax so they could fully impute returns to shareholders as a result of the lost available subscribed capital (ASC). There may also be some revenue implications from reducing or removing the debit balance where this arises as a result of something other than the negative dividend issue. It will generally be hard to determine when this is the case, but it appears to give rise to a timing advantage only. Consequently the revenue effects of the proposal are unquantifiable, but are unlikely to be significant. There are also low-level administration costs.

Statement of feasible options for achieving the desired objective

Legislative amendments are required in all cases to achieve the policy outcomes or to provide certainty to taxpayers.

The unit trust base maintenance issue arises as the result of an unintended interpretation of current legislation. This interpretation is the subject of a dispute between Inland Revenue and some unit trust managers and may result in litigation. One option was to await the outcome of any litigation on this issue. However, if Inland Revenue is unsuccessful with its arguments, further applications seeking refunds are likely from unit trust managers. This is estimated to have a revenue cost of approximately \$30 million. Consequently, given the revenue at risk the legislation should be amended to reflect the intended policy outcome. The proposed amendment will not apply where Inland Revenue knows a manager has taken a different position prior to the amendment being announced.

Statement on business compliance costs

Unit trust base maintenance

The proposal to ensure that unit trust managers do not obtain excess imputation credits will impose some compliance costs on unit trust managers, as they will have to ensure that they do not include the imputation credits in their annual return. However, the additional compliance costs will be minimal. This is because unit trust managers are already required to track imputation credits received from unit trusts on redemption.

Unit trust negative dividend issue

The negative dividend proposal also has some compliance costs. The funds that adopt the solution will be required to keep a record of the lost ASC in a supplementary ASC account. This account will need to be filed with Inland Revenue together with a fund's imputation credit account. If necessary, the fund will also need to convert and transfer imputation credits at the end of the imputation year. This step is not seen as being onerous from a compliance perspective. Funds may also incur some additional compliance costs in calculating ASC that has been lost before the legislation is enacted. Furthermore, funds will be able to elect whether they use the proposed solution. Officials consider that the long-term benefit of this proposal (in paying less tax) will outweigh any compliance costs associated with implementing this system. The industry is fully supportive of this proposal.

Unit trust remedial issue

This proposal imposes some additional compliance costs on unit trust managers that have suffered a loss of continuity, as it will be necessary to check whether imputation credits received on manager buy-backs have been previously offset by a debit at the time of a shareholding continuity breach. However, the additional compliance costs are relatively minor and are outweighed by the fact that this proposal will prevent double taxation occurring in this situation.

Holiday pay

The proposed amendment to allow the vendor of a business a deduction for monetary remuneration provisions reduces present compliance costs because the parties to the transaction will be able to achieve a certain and sensible outcome without having to structure the transaction to achieve this outcome.

Partnership pensions

The proposal to clarify that partnership pensions are deductible will not impose any compliance costs.

Consultation

Officials have not consulted on the unit trust base maintenance proposal given the risk of further applications seeking a refund on this basis being filed. It will be possible to make submissions on the draft legislation at the select committee stage. This lack of consultation is appropriate under the generic tax policy process given that this is a base maintenance proposal.

Representatives of the Investment Savings and Insurance Association and New Zealand Fund Management have been involved in the development of the proposed solution to the negative dividend issue. In addition, the Institute of Chartered Accountants of New Zealand (ICANZ) and Tower have been briefed on the issue and the proposed solution.

The potential solution to the issue of the deductibility of monetary remuneration provisions has been briefly discussed with ICANZ, the New Zealand Law Society and three private sector experts.

The partnership pensions issue has been discussed with an industry expert.

October 2001

PETROLEUM MINING – BASE MAINTENANCE

REGULATORY IMPACT AND COMPLIANCE COST STATEMENT

Statement of the public policy objective

The proposals contained in the report aim to provide base maintenance to the Income Tax Act 1994 to maintain the Government's current year fiscal provisions.

Statement of the problem and the need for action

The petroleum mining taxation legislation taxes the net proceeds from the sale of ownership interests in a controlled petroleum mining entity (CPME). The legislation was designed to prevent investors using a CPME to structure around the tax payable on disposal of petroleum mining assets.

Officials have identified that these rules do not achieve their policy objectives. Instead, petroleum miners use them to obtain deductions in excess of 100% of the amount of their capital invested in petroleum mining exploration and development expenditure.

Statement of feasible options for achieving the desired objective

This most appropriate option is to repeal the legislative rules giving rise to this issue and replace them with rules ensuring that the disposal of ownership interests in a CPME is on capital account.

Alternative solutions considered were:

- Continuing to tax the disposal of ownership interests in a CPME and amending some provisions relating to deductions. However, this option does not prevent petroleum miners from obtaining deductions in excess of 100% of the amount of their capital invested in petroleum mining exploration and development expenditure.
- Treating the disposal of ownership interests in a CPME as a disposal of the underlying assets. However, this option would require complex legislation and would require full consultation under the generic tax policy process, as it involves more than base maintenance.

Statement of the net benefits of the proposal

Benefits

Under the existing legislation there is the potential for the tax base to be eroded by between \$85 million and \$100 million in the 2001/02 income year, with the potential for further significant erosion in future years. The proposal is designed to prevent this from happening.

Costs

The proposal is expected to be either cost-neutral or result in a small reduction in compliance and administrative costs.

Business compliance cost statement

The proposal does not involve an increase in compliance costs. It is expected that it will provide a small measure of simplification to the petroleum mining regime and result in a minor decrease in compliance costs.

Consultative programme undertaken

Confidential consultation has taken place with two industry experts as contractors to Inland Revenue. This consultation has been subject to the secrecy provisions of the Tax Administration Act 1994.