

# Regulatory Impact Statement

## Tax pooling remedial issues

### Agency Disclosure Statement

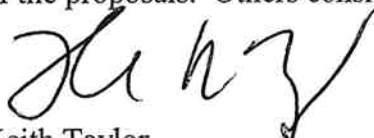
This Regulatory Impact Statement has been prepared by Inland Revenue.

It provides analysis on options to deal with the restrictive and impractical nature of some of the provisional tax pooling rules. The proposals aim to align the policy with its intent and make the rules more practical and easier to understand.

The analysis of options involved examination of the original policy intent of the pooling rules, the previous operational concessions applied, existing tax pooling legislation (amended in 2009) and stakeholder comment.

Most of the preferred options will reduce compliance costs on intermediaries and their clients. However, some options will give rise to increased compliance costs for pooling intermediaries. These are not expected to be significant – for example, intermediaries will need to educate clients about the new rules. Such costs can be ameliorated, to an extent, as Inland Revenue will make information about the rules available in its publications.

Consultation was undertaken with various stakeholders. Most were comfortable with the breadth of the proposals. Others considered that they do not go far enough.



Keith Taylor  
Policy Manager  
Inland Revenue

13 September 2010

## STATUS QUO AND PROBLEM DEFINITION

1. Since 2003, taxpayer pooling rules have allowed taxpayers to reduce their exposure to use of money interest when they were uncertain of their tax liability payments – for example, provisional tax payments.
2. Tax pooling generally involves a taxpayer depositing money with a tax pooling intermediary. The intermediary then deposits that money in their pooling account with Inland Revenue. The deposit earns interest. Tax payments deposited with an intermediary remain part of the tax pool until the taxpayer:
  - directs the intermediary to transfer the credit to the taxpayer’s own account with Inland Revenue; or
  - sells their funds to another taxpayer who is also a client of the intermediary; or
  - requests a refund directly from the intermediary.
3. Taxpayers who avail themselves of tax pooling no longer need to make any payments of provisional tax (and in most cases make no voluntary payments) during a tax year, until they have filed their tax return for that tax year by the relevant return filing date and then arrange for funds to be transferred from their tax pooling account to meet their actual tax obligations.
4. Deposits into a tax pooling account are recognised as “Crown tax receipts” because they are deposited into a Crown bank account and accounted for by Treasury at the end of each day. They are immediately available for use by the Crown.
5. When a payment is transferred from a tax pooling account into a taxpayer’s account with Inland Revenue,<sup>1</sup> it is recognised as Crown tax revenue. There is therefore a timing mismatch between tax receipts (when the deposit is made into a Crown account) and tax revenue (when a deposit is made into a taxpayer’s account). From a tax revenue perspective, it does not matter which taxpayer pays into a tax pool. Rather, it is the taxpayer and which tax year that payment is ultimately transferred to that is important.
6. Prior to the legislative amendments of 2009, administrative practices for using pooling funds were adopted. The amendments:
  - reflected the original policy intent of the tax pooling rules;
  - extended pooling to reassessments of most taxes; and
  - allowed pooled funds to be transferred between intermediaries.
7. Intermediaries and other stakeholders see the rules as restrictive, impractical and hard to understand, which leads to perceptions of unfairness.
8. The fundamental problem with the tax pooling regime is that it is an inefficient way to address high use of money interest underpayment rates and uncertainty in determining provisional tax obligations. Following the legislative amendments made in 2009 the tax pooling rules are now perceived as:
  - complex, which leads to uncertainty of how they operate;

---

<sup>1</sup> The effective date of the transfer is either the date it was deposited to the tax pooling account or a later date as instructed by the intermediary.

- unfair, because of the removal of some of Inland Revenue's pragmatic administrative practices; and
- inconsistent, because of the way the rules interact with the imputation credit system and the way the new rules apply to certain tax types, such as resident withholding tax (RWT) and fringe benefit tax (FBT).

9. Maintaining the tax pooling regime's status quo could be perceived as unfair by compliant taxpayers who want to meet their tax obligations. This could undermine voluntary compliance. Accordingly, the issues to be addressed are:

- **Issue 1 – removal of the 60 day time limit to access deposit funds.** Taxpayers who want to access their own funds held by a tax pooling intermediary to meet their provisional and/or terminal tax liabilities must, after the 2009 legislation, do so within 60 days of their terminal tax date to use the funds at backdated effective dates. The Government has the use of money from the date of deposit in a tax pool. The time limit treats compliant taxpayers as non compliant. There should therefore be no time limit placed on taxpayers to access their own funds.
- **Issue 2 – obligations that cannot be quantified.** Tax pooling funds can only be used to meet actual tax obligations. However, taxpayers may wish to purchase or acquire tax pooling funds before they file their tax return for the relevant tax year (because they expect to have an obligation but cannot quantify it at that time).
- **Issue 3 – early balance dates and the 60 day time limit.** For certain early balance date taxpayers (particularly December balance dates), a 2009 amendment introduced a 60 day time limit from the terminal tax date to use tax credits from a tax pooling account to satisfy a taxpayer's terminal tax liability. The problem is that this date can fall before the date when the tax returns are due to be filed and therefore potentially before tax liabilities have been determined by the taxpayer. Previously, an operational concession applied for early balance date taxpayers which allowed for requests to be made when returns were filed. The purpose of the concession was to remove the need to request a transfer from a pool prior to filing a return on 31 March.
- **Issue 4 – application of pooling rules to voluntary disclosures.** The 2009 amendments extended the pooling regime to taxpayers who have additional tax to pay following a reassessment (including those resulting from voluntary disclosures, and the resolution of a tax dispute). Currently, the use of pooling funds is limited to cases where there has been a previous assessment. It does not extend to such cases where a tax liability exists without the need for an assessment (because the amount due is an obligation and not assessed tax).

- **Issue 5 – imputation credits and debit closing balances.** There is an unintended ability to use tax pooling funds to eliminate imputation account debit closing balances by choosing to use an effective date for tax pooling funds that is before the tax year in which the tax pooling funds are to be used to meet an income tax obligation.
- **Issue 6 – imputation credits and 10% penalties.** The current rules do not allow tax pooling to be used to meet the 10% imputation penalty that is imposed on all further income tax obligations. Administration costs are created when an increase in further income tax is satisfied by pooled funds but the 10 percent imputation penalty tax, late payment penalties and interest still remain collectible.
- **Issue 7 – deduction notices.** The Commissioner has the ability to seize tax pooling deposits by way of a deduction notice. It is not clear, however, when the Commissioner is able to do this in the case of pooled funds. It is arguable that the deposit date of the funds should be the effective date rather than the transfer date. There is legislative uncertainty on which date the Commissioner can apply a deduction notice.
- **Issue 8 – definition of “amount of tax”.** The definition of “amount of tax” (for the purposes of pooling) in the Income Tax Act 2007 does not reflect the policy intent of the 2009 amendments.

## **OBJECTIVES**

10. The tax pooling rules assist taxpayers to voluntarily comply with their tax obligations. These proposals aim to align the pooling rules with the policy intent and to make the rules less restrictive, where possible, for pooling intermediaries and their clients. The benefits are in building goodwill with intermediaries and their clients, who are generally compliant taxpayers. This would also assist with debt recovery and would enhance the integrity of the tax system.

## **REGULATORY IMPACT ANALYSIS, RECOMMENDATIONS AND CONCLUSIONS**

### **Non-regulatory options**

11. Because these problems were caused by legislative changes in 2009 there are no non-regulatory options that would achieve these objectives.

### ***Issue 1 – removal of 60 day time limit to access deposit funds***

12. Prior to 2009, an operational concession applied so that there was no time limit for taxpayers to use their own deposit funds to meet their tax obligations. The public perception is that the Government has had the use of the funds from the date of deposit and therefore taxpayers should not be disadvantaged.

Option identified	Costs and risks	Recommendations and conclusions
<b>Option one:</b> status quo.	The economic costs have not been quantified, as the status quo was not considered viable. Taxpayers who deposit funds (and whose funds are immediately available for use by the Government) should not be restricted by the time limit for using these funds. No environmental impacts have been identified. However, the status quo's social impact is that the public perceive that the Government has had the use of the money and therefore taxpayers should not be penalised.	This option is not viable.
<b>Option two:</b> remove the time limit for taxpayers using their own deposited funds, provided a tax return has been filed on time ( <b>preferred option</b> ).	No revenue impact is expected. We have been unable to identify any environmental or social impacts.	This option is preferred as it will encourage voluntary compliance by enabling compliant taxpayers to benefit from using their own deposits with no time limit.

*Issue 2 – obligations that cannot be quantified*

13. The tax pooling rules only permit tax pooling funds to be used to meet an actual tax obligation. This is consistent with the original policy intent that funds transferred from the tax pool to a taxpayer's own tax account is limited to the extent of the tax owed. However, there may be situations where a taxpayer wishes to purchase tax pooling funds before they file their return for the relevant year, as they expect to have an obligation but cannot quantify it at that time.

Options identified	Costs and risks	Recommendations and conclusions
<b>Option one:</b> status quo.	The economic cost of this option has not been quantified, as this option is not considered viable. The current system is perceived as unfair and not consistent with the objective of encouraging voluntary compliance.	This option is not viable. The status quo is too restrictive, in that it does not recognise the reality that obligations may not be able to be quantified. The status quo does not support voluntary compliance.
<b>Option two:</b> allow taxpayers who cannot quantify their actual obligation to purchase funds for that tax year, provided certain criteria are met ( <b>preferred option</b> ).	There are no economic costs as the proposed modification would be accompanied by strict measures on the earliest effective dates that pooling funds can be applied to. We have not identified any environmental or social impacts.	This option is preferred as it allows for tax pooling funds to be obtained prior to the obligation having been quantified but also ensures that the transfer rules are not circumvented. This option addresses the current perceived unfairness and encourages voluntary compliance.



*Issue 3 – early balance dates and the 60 day time limit*

14. For early balance date taxpayers (particularly December balance dates) the 60 day time limit means that the last day for taxpayers to use funds from a tax pooling account to meet their terminal tax liability obligations falls before the date when tax returns are due for filing.

Options identified	Costs and risks	Recommendations and conclusions
Option one: status quo.	The economic cost of this option has not been quantified as this option is not preferred. This is a complex rule that places compliance costs on taxpayers with no real benefit. It does not encourage voluntary compliance.	This option is not viable. The status quo is an unnecessary rule and means funds have to be transferred from tax pooling to a taxpayer's tax account before they know the amount to transfer.
Option two: extend the time limit to access pooling funds by 15 days for all balance dates ( <b>preferred option</b> ).	The proposed extension will not impact on the Government's cash flow. There is some risk that this option does not allow adequate time for October and November balance dates to acquire funds. However, the number of taxpayers who will be impacted under such an approach is small. This option would better match buying and selling opportunities in the tax pooling fund and thereby increase the efficiency of tax pooling.	This option is preferred as it addresses the problem identified by stakeholders by dealing with December balance dates (where there is most issue) and is a simple rule for all. It has negligible economic impact. For the above reasons it is preferred.
Option three: extend the timeframe for October, November and December balance dates to 30 April while other balance dates remain at 60 days.	Although this option is more equitable for all taxpayers and would be easy to administer, the revenue impact is in the vicinity of \$4 million per annum (consisting of use of money interest and lost penalties as more provisional tax from the affected taxpayers will be paid on time using backdated pooling credits).	This option is not preferred as the fiscal costs involved and the complicated rules (one for early balance date and one for late balance date) are likely to outweigh the benefits of extending the rule. The impact on the October and November balance date taxpayers was not identified as a significant issue for stakeholders.

*Issue 4 – application of pooling rules to voluntary disclosures*

15. Taxpayers are unable to use funds in tax pooling accounts to satisfy an increased liability resulting from a voluntary disclosure where there has not been a previous assessment. This is inequitable because it differentiates taxpayers based on whether or not they have been reassessed.

Options identified	Costs and risks	Recommendations and conclusions
<b>Option one:</b> status quo.	The economic costs have not been quantified as the option is not preferred. This option would be perceived as unfair and will not encourage voluntary compliance.	This option would retain perceived unfairness and is therefore not recommended. The tax rules do not require an assessment to be issued in all instances. The requirement for an assessment to be issued is perceived as an unfair outcome compared to situations where an assessment has been made.
<b>Option two:</b> extend the use of pooling funds to voluntary disclosures when there has not been a previous assessment, provided the relevant return has been filed for that year ( <b>preferred option</b> ).	This option has limited application, so taxpayers do not have an incentive to not file. A small revenue gain is expected and the option is likely to encourage compliance.	This option is preferred because it allows pooling funds to be used for voluntary disclosures without impacting on compliance. It limits the use of pooling to when a return has been filed.
<b>Option three:</b> extend the use of pooling funds to all voluntary disclosures (including when no return has been filed).	The cost of this option has not been quantified as it was not considered viable. Extending the use of pooling funds to all voluntary disclosures would discourage compliance.	Option three is not preferred, as it is likely to encourage non-compliance. It would likely create an incentive for taxpayers to not meet their tax obligations, as they could use pooling funds to comply retrospectively.

***Issue 5 – imputation credits and debit closing balances***

16. There is an unintended ability (as a result of the amendments) for taxpayers to use tax pooling funds to eliminate imputation account debit closing balances by choosing to use an effective date for tax pooling funds that is before the tax year in which the tax pooling funds are to be used to meet an income tax obligation. This effectively allows a company to receive a backdated effective date for imputation purposes while paying a current provisional or terminal tax obligation. This circumvents the imputation rules, which set out how companies are to meet debit imputation account balance requirements.

Options identified	Costs and risks	Recommendation and conclusion
<b>Option 1:</b> Status quo.	The revenue cost is estimated to be between \$20 and \$40 million. The status quo provides an unintended benefit to taxpayers and undermines compliance.	This option is not preferred as it does not meet the policy intention. It was never intended that pooling funds are able to be used to eliminate imputation account debit closing balances.
<b>Option 2:</b> taxpayers who use purchased pooling funds are not able to elect an effective date prior to the earliest relevant due date for the tax period or year to which the funds will be applied to meet obligations of paying tax ( <b>preferred option</b> ).	This will result in a revenue gain of between \$20 and \$40 million, over a number of years. The option is expected to encourage voluntary compliance.	This option is consistent with the policy intent and is a base maintenance issue.

**Issue 6 – imputation credits and 10% penalty tax**

17. Where too many imputation credits are paid out relative to amounts of tax paid and 10% additional tax is payable, officials propose that tax pooling funds are able to be used to pay this additional tax for imputation purposes. This pragmatic proposal will make the imputation regime easier to comply with and administer.

Options identified	Costs and risks	Recommendations and conclusion
<b>Option 1:</b> status quo.	Administration costs are created when an increase in further income tax is satisfied by pooled funds but the 10 percent imputation penalty tax, late payment penalties and interest still remain collectible.	Not preferred as the current administration costs would remain.
<b>Option 2:</b> allow pooling funds to be used to pay the 10% imputation penalty ( <b>preferred option</b> ).	No revenue impact, as the 10% penalty will still be required to be paid. Taxpayers can more easily comply with their imputation penalty tax obligations. Also, income tax mistakes flow through to imputation resulting in an imputation penalty tax being imposed. Allowing tax pooling funds to be used for imputation penalty tax would encourage taxpayers to voluntarily disclose their mistakes.	This is the preferred option as it encourages voluntary compliance.

**Issue 7 – deduction notices**

18. When a taxpayer has made a deposit and fails to instruct their tax pooling intermediary to transfer the funds to meet their tax obligations, the concessions available for using tax pooling funds voluntarily should not apply.



Options identified	Costs and risks	Recommendations and conclusion
<b>Option 1:</b> status quo.	The economic costs have not been quantified because this option is not preferred. The status quo results in legislative uncertainty and potential administrative costs.	This option is not viable as it would result in potential legislative uncertainty about when the Commissioner can make a deduction.
<b>Option 2:</b> when a deduction notice is used to obtain funds the effective date is the date of transfer ( <b>preferred option</b> ).	No revenue impact. This option would provide legislative certainty and would remove the need to calculate backdated interest and penalties.	This proposal clarifies the policy intent. It resolves potential legislative uncertainty and removes the need for backdated calculations.

### *Issue 8 – definition of “amount of tax”*

19. The definition of “amount of tax” requires clarification so that it includes reassessments of income tax, FBT and goods and services tax (GST). In addition, the definition of “amount of tax” should be amended to extend to imputation tax types.

Options identified	Costs and risks	Recommendations and conclusions
<b>Option 1:</b> status quo.	The economic cost was not quantified as this option is not consistent with policy intent. No social or environmental costs were identified.	This option is not consistent with policy intent and is therefore not recommended. These tax types should have been included in the November 2009 pooling amendments. The current wording does not reflect the decisions made at that time.
<b>Option 2:</b> amend definition of “amount of tax” in section YA 1 of the Income Tax Act 2007 so that it extends to income tax, FBT, GST and imputation tax types ( <b>preferred option</b> ).	No revenue impact is expected, as the amendment is aimed at clarifying the existing legislation. No social or environmental costs have been identified.	This proposal will align the legislation with the policy intent.

## CONSULTATION

20. The following stakeholders have been consulted on these proposals: Chapman Tripp, Deloitte, Tax Management New Zealand (TMNZ), Provisional Tax Finance Limited and Electronic Tax Exchange (ETX). The other two intermediaries were not consulted due to time constraints. Additionally, one of these two intermediaries is a small accountancy firm that only offers tax pooling to their own clients and the other only commenced business about four months ago. Consultation included exchanging correspondence by letter and email and meetings. A letter on the imputation base maintenance issue was sent to intermediaries earlier this year, advising them of the intention to make the change. This issue was flagged to TMNZ in April 2010.

21. Most of the proposals are supported. Some stakeholders consider that two of the proposals may be considered to be too narrow, and therefore do not go far enough.

22. The modification of the term “obligation” has strict rules imposed, some of which TMNZ consider should not apply. It is their view that there should be no need for an obligation to exist. The modification does relax the current rule to some extent, but has restrictions imposed. These restrictions are necessary otherwise historic debts, including amounts owing for revenue types for which tax pooling is not available, could be met with backdated tax pooling funds. The absence of these restrictions would also have the effect of circumventing the transfer rules that restrict transfers of excess tax to legislatively defined criteria.

23. TMNZ felt that the use of pooling funds for voluntary disclosures is not wide enough. Officials consider it is not desirable that this proposal be widened, as this will create significant risks to the revenue by enabling taxpayers to access pooling funds at backdated dates and avoid interest and penalties associated with non-filing. This would undermine voluntary compliance.

## **IMPLEMENTATION**

24. Implementation will be via a taxation bill scheduled for introduction in November 2010. No implementation risks have been identified.

## **MONITORING, EVALUATION AND REVIEW**

25. There are no plans to evaluate the particular provisions on an ongoing basis. If any issue is raised with them, officials will determine whether there are substantive grounds for review. The Income Tax Act 2007, which is the Act to be amended, will be subject to regular review by officials.