



MAKING TAX SIMPLER

BETTER ADMINISTRATION OF PAYE AND GST

A GOVERNMENT DISCUSSION DOCUMENT



Hon Todd McClay
MINISTER OF REVENUE

The fourth in a series of government discussion documents looking towards a better tax administration system for New Zealanders

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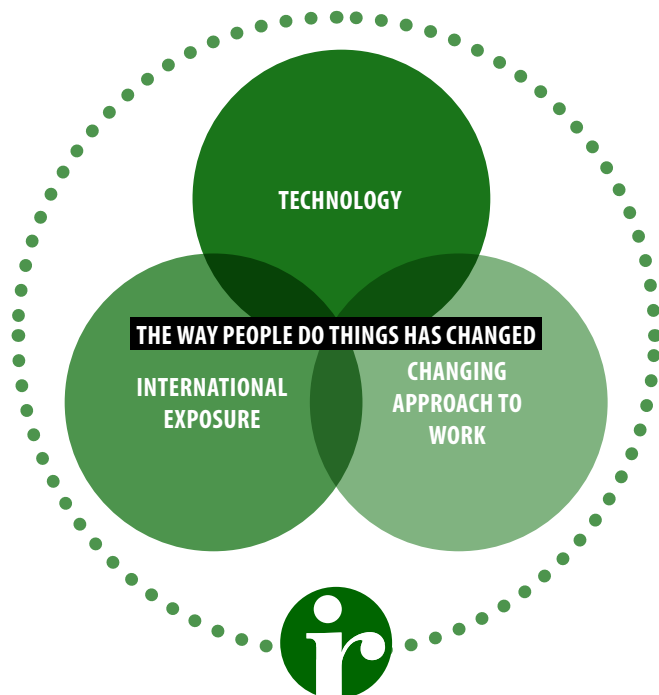
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CHAPTER 1

OVERVIEW



THE WAY THE TAX SYSTEM OPERATES HAS TO CHANGE

In recent decades our world has changed in ways that few could have predicted. The opening of the New Zealand and world economies, the explosion of digital technologies, changing work structures and relationships, and new levels of consumer-driven change have fundamentally altered how businesses and other organisations operate.

New Zealanders have been quick to take up the benefits of digital technologies. Systems such as EFTPOS have become almost universal. We have had one of the highest rates of mobile phone ownership in the world

for many years.

Internet use is a normal part of doing business for most, broadband subscriptions continue to rise, and consumption of mobile data is rapidly increasing. Issues around the “digital divide” still exist, however. There is some evidence that the digital divide is easing as prices become more competitive, and more intuitive services are introduced. It is acknowledged however that digital access is not universal – for example, some rural areas still lack access to broadband internet services.

When there are benefits and a positive experience, businesses and consumers have shown their willingness to use software to undertake previously manual tasks and to use digital communication channels. There has been a rapid increase in the use of payroll and business software and in customers' use of online channels for consumer and financial transactions, including with the public sector.

This change is also taking place in the context of tax administration. People are rapidly adopting Inland Revenue's digital channels¹ :

- Already 63 percent of employer monthly schedules containing pay as you earn (PAYE) information are submitted digitally.
- More than 64 percent of goods and services tax (GST) submissions are made through digital channels.
- 89 percent of individual tax returns are made online.

With rapid uptake, the primary challenge is to ensure that new digital services are well designed, well promoted, and deliver tangible benefits for all parties.

The Government is responding to and leading this shift through a range of responses, including the rollout of ultra-fast broadband, Better Public Services targets, which include reducing the cost for businesses of interacting with government by 25 percent by 2017, and the design of customer focussed digital channels.

The transformation of tax administration in New Zealand is a comprehensive response to these wider changes, based on bringing tax systems into the modern digital world.

The Government's *Making Tax Simpler: A Government Green Paper on tax administration* (the *Green Paper*) and discussion document *Making Tax Simpler: Better digital services* (*Better digital services*) released in March 2015 set out its ideas for modernising New Zealand's tax administration, and identified the major role of digital technology in making tax simpler for New Zealanders.

The Government's proposals to modernise the way tax is administered involve far more than just updating Inland Revenue's computer system. This discussion document builds on the ideas in the *Green Paper* and the *Better digital services* discussion document with specific proposals to design digital services which will, as much as possible, integrate tax requirements into tasks people would already be doing to run their business or organisation.

The *Green Paper* proposed that changes would be considered and introduced in a number of discrete steps. This discussion document is about how the Government proposes to improve the administration of PAYE and GST.

The *Green Paper* identified the likely scope of the review of PAYE and GST processes and the PAYE rules. Most, but not all, of these issues are addressed in this document, some are

still under consideration and others will be included in subsequent *Making Tax Simpler* discussion documents.

The proposals in this discussion document provide the opportunity for:

- Customers to meet their tax obligations at the time they are doing their normal business – for example, submitting GST information direct from their accounting package or meeting PAYE obligations at the time they pay wages or salaries.
- Inland Revenue to use PAYE information more effectively to support existing social policy processes.
- Government to subsequently redesign social policies – for example, by introducing shorter periods of assessment to better match assistance to periods of need.

This document does not propose a timetable for changes to the way PAYE and GST are administered. Inland Revenue has recently begun work to determine the recommended approach to sequencing changes across the system. Until the Government has considered the recommended approach and made decisions it is not possible to outline a timetable. The Government expects to have made sufficient progress with planning, however, to introduce legislation in 2016.

PAYE AND GST BACKGROUND

Together GST and PAYE account for 67 percent of tax revenue².

PAYE is a withholding tax mechanism used by New Zealand employers (or PAYE intermediaries) to deduct income tax and the ACC earners' levy from their employees' salaries and wages and pay it directly to Inland Revenue. The PAYE system is also used to collect payments and information for many income-related social policies. The information employers are required to provide in an employer monthly schedule is referred to in this document as PAYE information.

GST is a consumption tax on most goods and services supplied in New Zealand. It is collected by GST-registered persons from their customers on behalf of the Government.

The Government has the objective of minimising the costs of PAYE and GST processes - for customers and for government. There are also problems with the quality and timeliness of PAYE information, which impose costs on employers and Inland Revenue and limit the Government's ability to provide effective social services.

A Government priority is the delivery of better public services. This includes making it easier for businesses to deal with government so they spend less effort on administration and have more time to focus on their customers. Improving the quality of information held is also central to

agencies achieving the Government's priorities.

To help deliver on these priorities Inland Revenue is working with third parties, including software providers, so that they can design digital services that will integrate tax requirements into normal business practices.

SUMMARY OF PROPOSALS: PAYE

This discussion document proposes that new digital services could be used to:

- Minimise the costs to employers of providing PAYE information, by integrating the process of submitting information to Inland Revenue with the business processes that the employer undertakes for its own purposes (such as adding an employee to the payroll and running the payroll).
- Submit PAYE information to Inland Revenue at the time the business process is run and, by doing so, improve the timeliness and usefulness of the information.

At the same time the Government is also consulting on some potential changes to the PAYE rules to improve their overall workability.

Modernising the PAYE rules

This discussion document asks the following questions:

- Whether the method for determining the amount of tax to be deducted from an extra pay should be changed. There is

a trade-off to be made between simplicity and withholding accuracy.

- Whether the tax treatment of holiday pay should be clarified by legislation or administratively by an Inland Revenue publication.
- Whether a mechanism should be introduced to improve the accuracy of PAYE withholding in years in which an extra pay day will occur.
- Whether legislated rate changes should be applied in the same way across PAYE-related tax types/products.

Modernising how PAYE information is provided

Integrating PAYE obligations with business processes, and providing information to Inland Revenue at the same time, could improve some PAYE processes and eliminate others. This discussion document asks for feedback on the possible changes, which include:

- simplifying the KiwiSaver enrolment process;
- modernising how employers are informed of employee deductions;
- modernising procedures for supplying and amending PAYE information; and
- changes which could eliminate the need to file nil employer monthly schedule returns.

More accurate and timely PAYE information would allow Inland Revenue to intervene more quickly to stop errors continuing and to improve individuals' access to social policy entitlements. The Government envisages that if Inland Revenue receives more timely PAYE information, this will reduce existing pressure points around secondary tax by enabling improved administrative interventions. Better PAYE information would also provide a foundation for future improvements to the delivery of social policy. Finally, better PAYE information could improve the value that the Government obtains from sharing information between government agencies (when appropriate).

For these reasons, the Government is consulting on a number of proposed changes to the law relating to the provision of PAYE information.

PAYE information submitted electronically is quicker and cheaper to process than information submitted on paper. Employers now make much greater use of digital technology than they did in 1999, when the threshold above which employers are required to use electronic means to file their employer monthly schedule was introduced.

Feedback is sought on the proposal that the threshold above which employers are required to use electronic means to file their employer monthly schedule is reduced from \$100,000 a year of PAYE and employer's superannuation contribution tax (ESCT) to \$50,000 a

year. This change would increase the percentage of employers required to file digitally from 11 percent to 22 percent.

Every month employers provide information about PAYE-related deductions made during the previous month. Because timely, accurate PAYE information is important to the delivery of income-related social policies, the Government is considering whether it should require employers to provide PAYE information on a different basis. The Government is therefore consulting on proposals to replace the current obligation to enable or, depending on the option, to require employers to return PAYE information at the time they complete an employment-related process (for example, when they take on new staff and when they run the payroll).

There are several possible approaches to introducing the option or requirement to provide PAYE information at the time of the business process. These are identified for comment, as follows:

- Under a *voluntary-first approach*, employers could choose to meet their PAYE information requirements by providing PAYE information to Inland Revenue at the same time the business processes are run (for example, provide information about PAYE deductions when the payroll is run). After an undefined period a review would be conducted, as described below.

- Under a *review approach*, there would be a defined period during which employers could choose to meet their obligations by providing PAYE information at the time of the business process. This would be followed by a *required review*, when the costs, benefits and experience would be revisited. Depending on the outcome, employers could then be given a lead-in period by the end of which they would have to provide PAYE information at the same time the business process occurs. There could be exemptions for those who could not use digital technology to meet the new requirements.
- Under a *legislated approach*, changes to tax law permitting employers to meet their obligations by providing PAYE information on the new basis would identify a lead-in period, at the end of which employers would be *required* to provide PAYE information at the time of the business process (for example, provide information about PAYE deductions when the payroll is run). As in the review approach, there could be exemptions for those who could not use digital technology to meet the new requirements.

The proposals recognise that some employers have simple payrolls and do not use digital payroll systems. These employers would be catered for with a web-based portal and for those below the digital filing threshold, a paper-based filing option would be

retained, at least for the foreseeable future. As noted above, those who are unable to access the internet or other digital services could be exempt from a requirement to provide PAYE information when the business process occurs.

Feedback is also sought on whether PAYE and other deductions withheld from an employees' salary and wages under the PAYE system should be paid to Inland Revenue at the time employees are paid.

Currently, employers retain PAYE deductions from their employees' salary and wages for a period of time before paying them to Inland Revenue. Pay day payment of PAYE could improve compliance, provide third parties (such as recipients of child support and KiwiSaver contributions) with prompter payments and reduce employers' compliance costs. However, it would involve a trade-off between these benefits and the benefit the delayed PAYE payment currently provides to employers.

SUMMARY OF PROPOSALS: GST

The Government considers that the current GST rules are generally working well and is not proposing to make fundamental changes to how and when to account for or pay GST³. However, there is an opportunity to modernise the processes of how GST-registered persons provide GST information and how they communicate with Inland Revenue:

- by simplifying the process of

providing GST information to Inland Revenue by integrating it with processes and systems used to run the business; and

- as a consequence, improving the quality of GST information provided by businesses and individuals.

It is proposed that the decision to adopt the new integrated GST services for providing GST information should be, for the foreseeable future at least, voluntary.

The discussion document also proposes that GST refunds are only made by direct credit to a registered person's nominated bank account, unless it would cause undue hardship to the person or it is not practicable.

The Government is also interested in feedback on whether, in the future, certain registered persons should be required to file their GST information electronically.

HOW TO MAKE A SUBMISSION

The way in which PAYE and GST are administered depends on the actions of employers and GST-registered persons. This discussion document seeks feedback from those who participate in the administration of these taxes as well as from taxpayers more generally.

The Government invites submissions on the ideas raised in this discussion document. Submissions can be made by emailing "policy.webmaster@ird.govt.nz" with "Better administration of PAYE and GST" in the subject line.

You can also make submissions through the online consultation, at:

payeandgst.makingtaxsimpler.ird.govt.nz

Alternatively, written submissions can be addressed to:

Better administration of PAYE and GST
C/- Deputy Commissioner, Policy and Strategy
Policy and Strategy
Inland Revenue Department
PO Box 2198
Wellington 6140

The closing date for submissions is:

12 February 2016.

Submissions should include a brief summary of major points and recommendations. They should also indicate whether the authors are happy to be contacted by officials to discuss the points raised, if required.

Submissions may be the subject of a request under the Official Information Act 1982, which may result in their release. The withholding of particular submissions, or parts thereof, on the grounds of privacy, or commercial sensitivity, or for any other reason, will be determined in accordance with that Act. Those making a submission who consider that there is any part of it that should properly be withheld under the Act should clearly indicate this.

¹ In this document, a "channel" is a method of communication, or for the transfer of information.

² Approximately 190,000 employers have PAYE obligations and there are nearly 630,000 GST-registered "persons".

³ The Government has recently published a discussion document, *GST: Cross-border services, intangibles and goods*, seeking submissions on new rules for cross-border services and intangibles and also seeking feedback on the collection of GST on goods sourced cross-border. In addition, Inland Revenue has recently published an officials' issues paper, *GST – current issues*, on specific technical and remedial issues.

CHAPTER 2

INTEGRATING TAX REQUIREMENTS INTO BUSINESS PROCESSES USING SOFTWARE

WHAT YOU TOLD US

"We agree that making greater use of a business's own systems to provide information should provide benefits to employers..."⁴

The Government is committed to making it easier for people to interact with government agencies. For tax administration, this means improved services from the tax system, with minimised costs for customers and government.

The Government's *Better digital services* discussion document proposed that for this to happen Inland Revenue would need to offer a wider range of secure digital services. It would need to work with others including business software providers, so that core tax functions such as PAYE and GST are built into customers' regular transactions rather than tax having to be separately managed.

A central premise for minimising the costs of administering PAYE and GST and improving the services that can be delivered is the proposed integration of PAYE and GST requirements into the business software that customers increasingly use. This will require a redesign of tax processes around the customer's normal business activities and would enable the customer to use their business software to also meet their tax obligations.

Integrating tax requirements into business processes using software offers customers a number of benefits, including:

- greater confidence that they are correctly calculating the tax to pay and/or deductions to be made;
- a better customer experience due to less double-handling and improved processes; and
- rapid processing of information so the customer can see an up-to-date view of their account and automatically receive return messages from Inland Revenue.

The discussion document *Better digital services* stated as a core requirement that digital tax services would be designed to be secure and reliable. As an overarching principle it was proposed that "services must be designed for the customer" with three subsidiary principles to guide future development. They were:

- that no one size fits all;
- that tax compliance and access to entitlements are critical; and

- change will not be imposed without careful consideration of costs and benefits.

Feedback on these principles was generally positive. However, submitters suggested that the following additional principles should also guide Inland Revenue’s development of digital services:

- security and privacy;
- reliability and accuracy;
- flexibility and simplicity;
- time and cost effectiveness; and
- equity and support for users.

Some of the issues raised by submitters, such as reliability and simplicity, will inform detailed design of the services, and others will be considered in the context of planning customer engagement and support. A number of the issues raised in feedback on the earlier *Making Tax Simpler* documents are considered in the following discussion.

“cloud”, accessed through a browser or from a mobile phone. Better digital services should be sufficiently flexible to run on new platforms as they emerge.

In a world of rapidly changing technology, the Government does not want Inland Revenue to divert its focus from its core tax and social policy role by developing and maintaining the range of software applications that would be required. Instead, Inland Revenue would work with software providers so that they can design applications to allow a customer’s software to interact with Inland Revenue.

Software providers have already been invited to early discussions with Inland Revenue and will have access to business rules and standards to make the proposed new digital services available to their customers. The Government recognises that some customers have developed or customised their payroll and business systems. The support and information offered to software providers will need to extend to these customers to ensure that they can access the new digital services in a cost-effective manner.

A number of those who provided feedback on the *Better digital services* discussion document suggested that, in addition to working with the private sector to develop software, Inland Revenue must provide a simple “web browser option” through which customers can submit their information. The option of filing through a “web portal” will continue.

WHAT YOU TOLD US

"I use my mobile phone for banking, I'd use it for tax."

"I cannot foresee anyone using a mobile app for tax submissions. Paper or online is sufficient. Response times and communication is the real problem not filing or systems"

"Make use of the private sector that already write tax software"

WORKING WITH SOFTWARE PROVIDERS TO INTEGRATE REQUIREMENTS WITH BUSINESS PROCESSES

Feedback on the discussion document *Better digital services* indicated that to meet varied needs and preferences, services would have to be offered in a variety of ways. Services to support better GST and PAYE processes should be available regardless of whether the software is on a desktop, in the

WHAT YOU TOLD US

"The increased use of digital services must not put taxpayer information at greater risk of loss, unauthorised sharing, or improper use."

It will allow a customer, who does not adopt software that can file directly with Inland Revenue, to enter or attach their data through a secure web-based service.

Information security is a critical concern for many of those who made submissions on *Better digital services*, as it is for Government. Core elements of the proposed future for PAYE and GST information include:

- Ensuring that the customer controls how their software passes data to and from Inland Revenue. For example, the customer would authorise what is transferred to Inland Revenue.
- Ensuring that the external "parties", such as customer business software, that access Inland Revenue services are able to interact securely.
- Requiring that the customers who can use external "parties" to access Inland Revenue's systems are themselves authenticated and have their identity verified.
- Inland Revenue will continue to have robust systems for ensuring that only authorised staff can access customer data. These systems record who has accessed customer data.

PAYE and GST impose obligations on customers to calculate tax owing, file information and pay obligations. The remainder of this chapter outlines how integrating tax requirements into software that customers increasingly

use to manage their business processes could:

- improve the accuracy of calculations;
- modernise the way information is provided; and
- modernise the payments process.

USING SOFTWARE TO CALCULATE OBLIGATIONS

Provided the software a customer is using is up to date (compliant with legislation) and used correctly, using software will generally eliminate calculation errors.

Inland Revenue now has the capacity to "publish" its interpretation of PAYE and GST obligations in a way that can be incorporated directly into payroll and accounting software. The current practice is to provide 'payroll specifications' to software providers when PAYE related legislation changes. Feedback suggests that the specifications can be ambiguous in complex cases.

Incorporating Inland Revenue's tax rules into software would provide customers and the Government with greater confidence that tax and related deductions have been calculated correctly.

It is proposed that software providers would be able to choose whether to directly incorporate Inland Revenue's rules into their software – it would be a commercial decision for them.

WHAT YOU TOLD US

"Human interaction - the ability to make contact with a real person is essential to maintaining a high level of customer service.."

USING SOFTWARE TO MODERNISE THE WAY INFORMATION IS PROVIDED

The new digital services that Inland Revenue proposes to work with the software industry to develop, include the following (which are subsequently referred to as the "new digital services"):

- The ability for customers to submit their PAYE and GST information to Inland Revenue from within their payroll or accounting system.
- The ability to receive and upload information from Inland Revenue directly into their payroll or accounting system.

The objective is to change the focus from filing a return, to submitting required information to Inland Revenue as a by-product of things the customer would normally be doing. Inland Revenue is working with a small number of software providers to develop and pilot services, which do not require law changes, see Chapter 7.

For PAYE, integrating information requirements into software opens up the opportunity to change when PAYE information is provided to Inland Revenue. Details of the proposed business process changes for PAYE are included in Chapter 4.

USING SOFTWARE TO STREAMLINE THE PAYMENT OF OBLIGATIONS

The electronic process for the payment of PAYE and GST obligations

is developed by software providers and the banks. There is scope, however, to make it faster and easier for customers to pay their obligations.

The objective is to minimise the required reconciliation between information and payment and eliminate errors that arise as a result of manual processes. Possible changes to the timing of PAYE payments are set out in Chapter 6.

SUPPORT FOR USERS

Inland Revenue's proposed approach is to work with third-party providers so that they can design the software that will support the new digital services. Education, promotion and support will therefore be a shared responsibility. The Government recognises, however, that increased outreach, education and communication from Inland Revenue will play a key role in supporting customers to understand and adopt the new digital services.

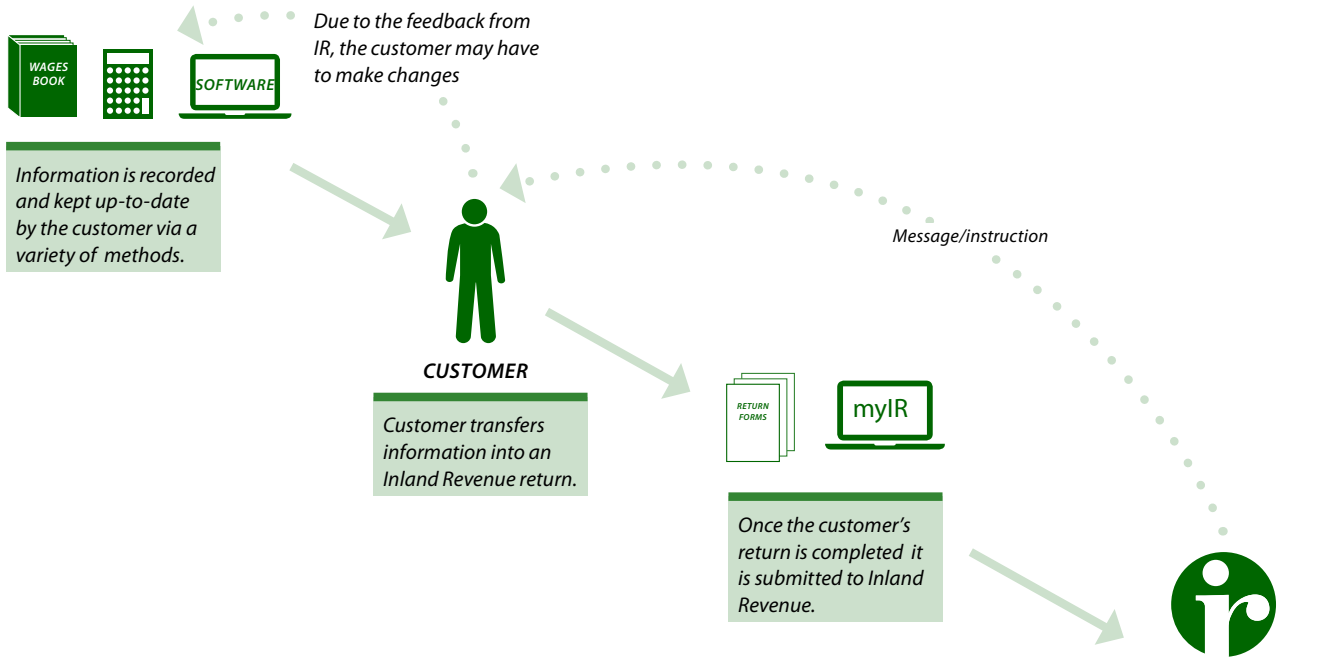
The diagram on page 18 depicts a change from a model where customers interact with Inland Revenue using information that they, or their software, has calculated to a model where, in the normal course of events, customers only interact with their software to meet their tax obligations.

Some submissions on the *Better digital services* discussion document expressed concern that the Government might assume that digital channels could completely replace other means of communicating

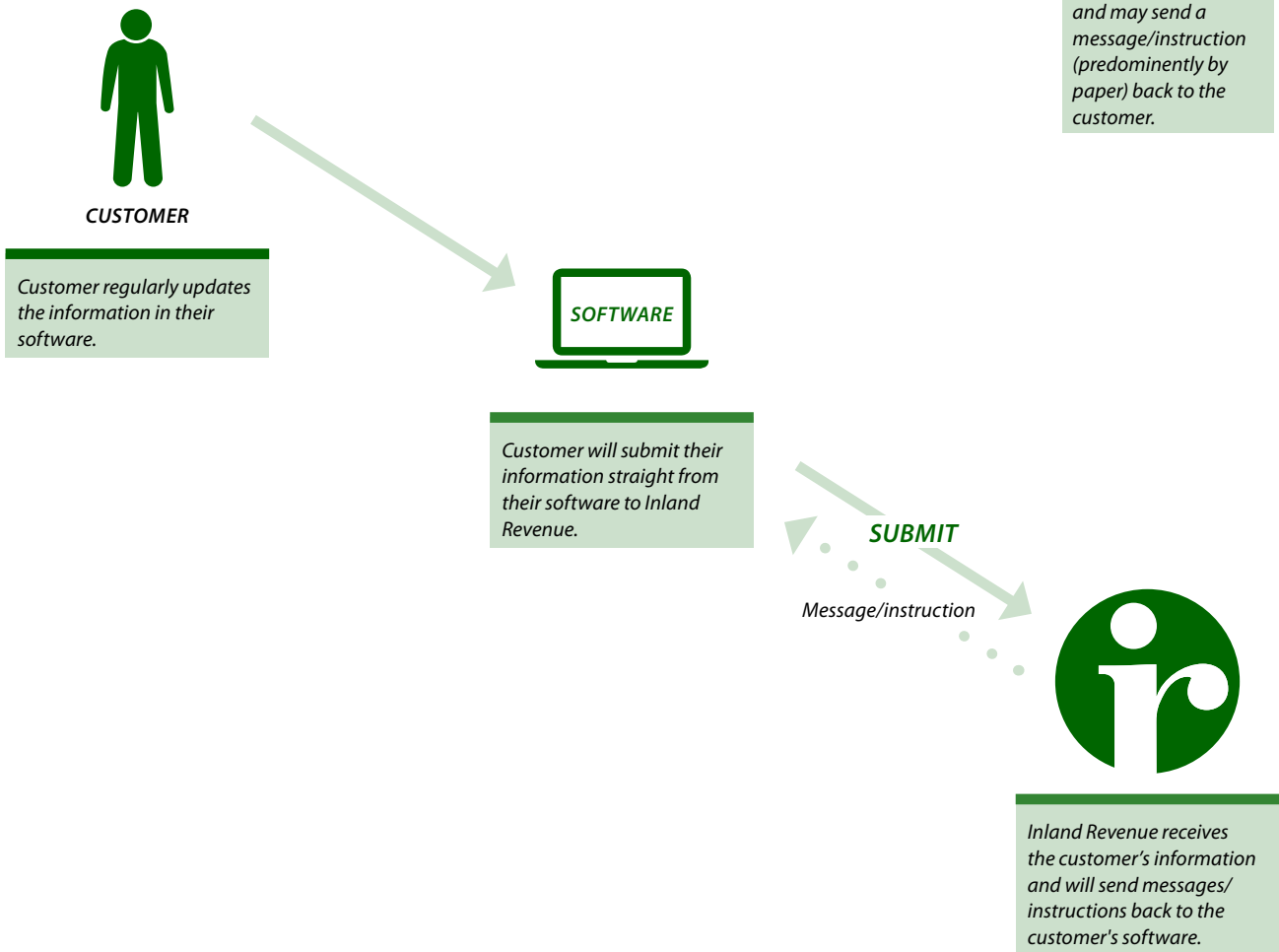
with Inland Revenue on tax matters. The Government recognises that providing appropriate off-line support for users is key to successful change and that not every issue can be appropriately resolved via a digital channel. This is particularly true in the case of PAYE where payroll issues can be complex.

⁴ The quotations are from responses to earlier documents in the *Making Tax Simpler* series

CURRENT STATE



FUTURE STATE



CHAPTER 3

MODERNISING THE PAYE RULES

WHAT YOU TOLD US

"We support the proposal to review and update the PAYE... rules as the original framework of the rules was established in a different era and changes have been made in an ad hoc manner."

At the same time as considering changes to administrative processes relating to the way PAYE information is provided, there is an opportunity to consider modernising the PAYE rules to improve their overall workability.

This chapter discusses some potential changes that could be made to update the PAYE rules. Before discussing specific areas where changes could be made, it is worth outlining the basic framework of our withholding tax system.

PROGRESSIVE INCOME TAX RATES AND OUR WITHHOLDING TAX SYSTEM

New Zealand's income tax system taxes income from labour and capital at progressive rates for individuals. The progressive rates apply to a person's total annual income from all sources, including income from employment.

Where possible, payers of income (employers and banks, for example) are generally required to withhold tax on behalf of the people who earned the income. This applies to income from employment (PAYE) and income

from capital (resident withholding tax – RWT). This promotes revenue integrity, is efficient and reduces compliance costs for individual earners.

The withholding tax system is designed so that the sum of what is periodically withheld from income earned throughout the year is as close as possible to the person's actual annual tax liability on that income. Broadly, the approach adopted is to apply the progressive income tax rate structure to a person's main source of income and a marginal rate to secondary sources of income. Under this system, the reasonable assumption is made that a person's main source of income is their main source of employment.

For example, if Roxy earns an annual salary of \$50,000 from her full-time employment as a café manager, she should advise her employer to use the progressive rate tax code (the "M" code). Roxy's employer would deduct PAYE from her salary using the progressive income tax rate structure. This is achieved in the PAYE tables by using an average tax rate based on applying the progressive tax rate

structure to the projected annual income from that employment on a pay period basis.

If Roxy also had a term deposit on which she expected to receive \$500 of interest during the tax year, she should advise her bank to withhold tax from that interest at her marginal tax rate – in other words, the correct rate for the last dollar of interest income if the \$500 interest is treated as the last income earned. In this case, Roxy should elect a 30 percent RWT rate because annual income in the \$48,001 to \$70,000 income bracket is subject to a 30 percent income tax rate. The approach of taxing at a person's marginal tax rate also applies to salary or wages earned from a second job.

Our approach of using the withholding system to apply the progressive tax scale to a person's main source of income, and marginal tax rates to secondary sources of income works reasonably well in most situations. Provided the income from employment is earned smoothly throughout the year, the amount withheld under the PAYE and RWT rules will closely approximate the person's end-of-year income tax liability on that income. The majority of employees have PAYE deducted to within +/- \$50 for the year (52 percent for the 2013–14 tax year).

Our current withholding system produces some inaccuracies in certain situations, such as when a person's income from their main income source fluctuates over the course of the tax year, and when income

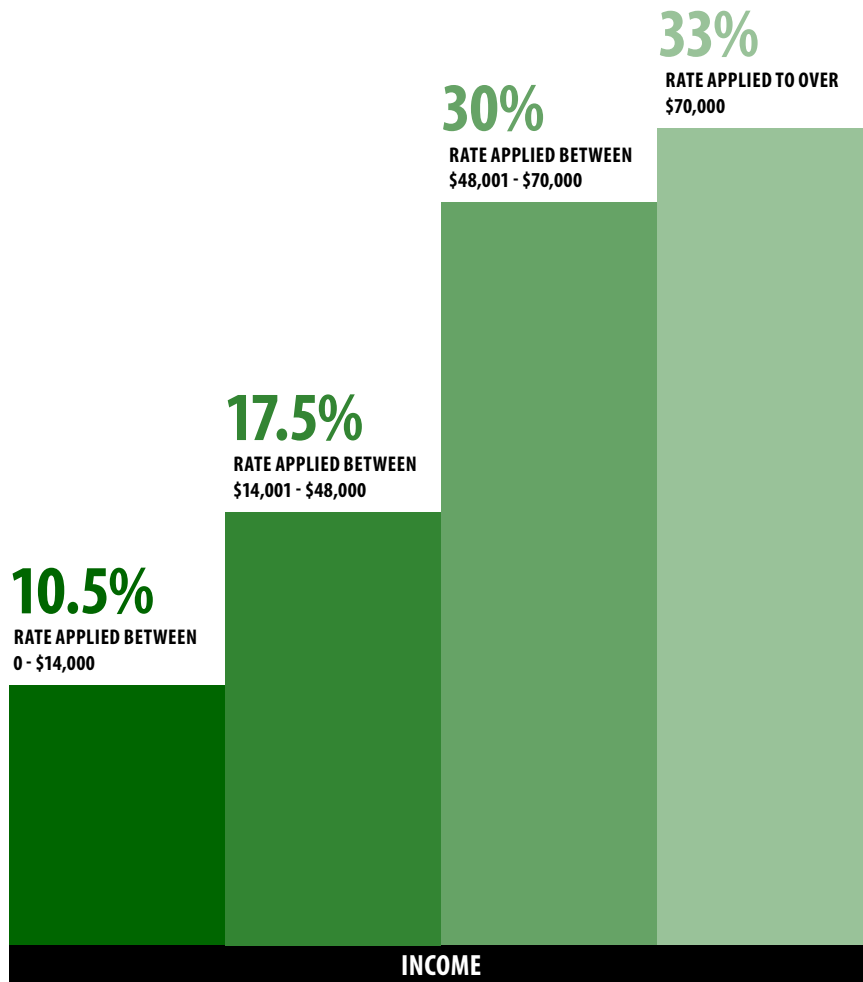
from a secondary source takes a person's total income over an income tax rate threshold. However, our reasonably narrow progressive tax rate scale means that, for most people, the discrepancies are small. The requirement or ability for individuals to file an end-of-year tax return allows any inaccuracies to be dealt with. Special tax codes can be used when the standard tax codes are not appropriate, to improve withholding accuracy during the year.

In future, small under- and over-payments could be dealt with more efficiently in a digital world. Inland Revenue receiving more timely PAYE information during the year should also enable special tax codes to be better used in the future.

Further advantages of the current approach to withholding are that it does not require employers and other withholders to have knowledge of a person's other income sources, or to regularly change tax codes/rates. The Government proposes retaining the current basic framework of our withholding system.

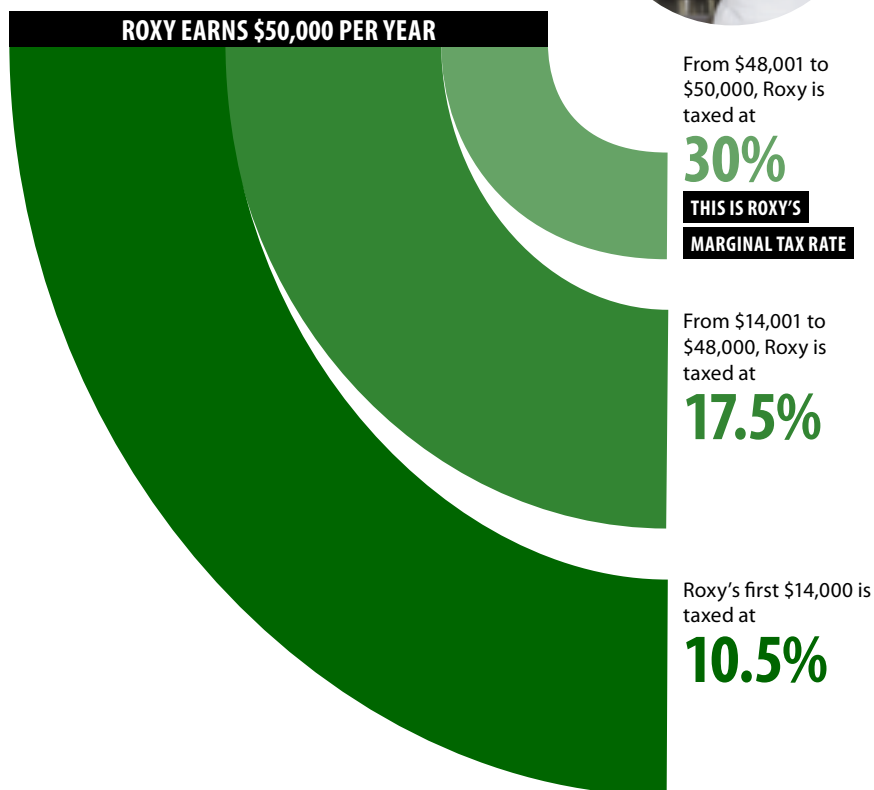
SECONDARY TAX

Secondary tax is an integral part of the PAYE system. Secondary tax aims to ensure that a person earning a given amount of PAYE income from multiple sources pays no more, or no less, tax than a person earning the same amount of PAYE income from a single source.



ROXY: CAFÉ MANAGER

Roxy is a café manager whose annual salary is \$50,000.



WHAT YOU TOLD US

"The secondary tax system seems to penalise people. A client has a part-time job and has been offered another smaller job. She wanted to know whether it would be worthwhile or not given the secondary tax"

When tax is calculated on income earned from a person's main source of employment income or an income-tested benefit, the progressivity of the personal income tax scale is factored in. The tax withheld therefore reflects the person's average tax rate on that income. If a person has multiple jobs (or is a beneficiary or ACC compensation recipient who is also in employment), tax is withheld from their secondary source(s) of PAYE income based on a flat tax rate that reflects the marginal tax rate that the person expects to apply for that tax year.

A common misconception is that secondary tax is unfair because people pay a higher rate of tax on income earned from secondary jobs than their main job. The progressive nature of the personal income tax scale, however, means that this is appropriate. By taxing at the person's marginal tax rate, secondary tax codes prevent inappropriate multiple claims of the lowest (or lower) tax rates for people with concurrent sources of PAYE income, which would result in tax owing at the end of the tax year.

Secondary tax can, however, cause tax to be over-withheld throughout the year if a person's secondary income takes them over an income tax rate threshold. If this occurs, the person can claim a refund for the over-withheld tax at the end of the tax year. Alternatively, they can apply to Inland Revenue for a special tax code so that, over the course of the year, tax is deducted at a rate tailored to their individual circumstances.

Because of the integral role secondary tax plays in our PAYE system, it is set to remain as a feature of our tax system for the foreseeable future. However, the Government envisages that pressure points around secondary tax will be reduced as the administration of tax is modernised.

Modernising the way PAYE information is provided – for example, via businesses' payroll software submitting PAYE information directly to Inland Revenue's systems on a pay period basis – is a crucial step in modernising the tax system. This will result in Inland Revenue receiving more timely PAYE information, which will enable it to more quickly identify taxpayers who are potentially having PAYE over-withheld (or under-withheld). If the over-withholding (or under-withholding) is due to the taxpayer being on an incorrect tax code, Inland Revenue could make an intervention to correct this. If the over-withholding is due to an income tax rate threshold being crossed, this could be addressed through better use of special tax codes, enabled by Inland Revenue receiving better PAYE information during the year. For example, if Inland Revenue's analytics show that an employee is in this situation, Inland Revenue could suggest the use of a special tax code to the employee.

Further, under the Government's idea, set out in the *Green Paper*, to potentially have income tax squared-up annually for all individuals, people should always receive refunds if they overpaid tax.

QUESTIONS FOR READERS

3.1 Do you support the Government's vision for reducing existing pressure points around secondary tax through improved administrative intervention during the year, as a result of Inland Revenue receiving more timely PAYE information?

3.2 While maintaining our current income tax rate structure, do you have any better suggestions for reducing pressure points around secondary tax by improving the accuracy of withholding tax at source?

TAXATION OF EXTRA PAYS

Lump sum payments made in connection with a person's employment are known as "extra pays". These are payments that are not regularly included in the employee's salary or wages for a pay period, and are not for overtime. They include bonuses, gratuities, back-pay, profit shares, redundancy payments and retirement allowances. The Taxation (Transformation: First Phase Simplification and Other Measures) Bill, introduced on 30 June 2015, proposes to allow employers, on a voluntary basis, to also treat employee share scheme benefits as an extra pay.

The PAYE rules are designed to tax extra pays at the employee's marginal tax rate. A graduated flat tax rate is applied to an extra pay which is determined by adding the amount of the extra pay to a proxy for annual employment earnings (excluding the extra pay). The proxy used is the annualised value of all PAYE income payments made to the employee in the period starting four weeks before the payment date.

The rationale for taxing extra pays at the employee's marginal tax rate is that taxing them as ordinary salary or wages may result in too much tax being withheld. It would assume that an extra pay represented a permanent increase in salary or wages, rather than an additional one-off payment.

The current formula for determining the amount of tax for an extra pay is perceived as complex by some employers.

On the other hand, some believe that the formula is not accurate enough in all situations. For example, the formula does not take into account that previous pays may have also contained an extra pay, which causes an over-estimation of annual earnings, and can result in tax being withheld from the extra pay at too high a rate. Another issue is that the formula is based on the assumption that the employee is being paid according to their normal pay frequency, which may not always be so. An additional pay date or an incomplete pay period, within the four-week period can affect the estimation of annual earnings and, hence, the rate at which tax is withheld from the extra pay.

SIMPLE = LESS ACCURATE



COMPLEX = MORE ACCURATE

The consequence of a simpler method for determining the amount of tax to be withheld from an extra pay would be less accuracy. A more accurate formula implies more complexity. The question is how we reconcile these conflicting perceptions.

The *Green Paper* set out the Government's idea of potentially requiring all individuals to undertake an annual square-up of income tax. The process is envisaged to be less onerous than at present as a result of greater pre-population of information in the future. If all taxpayers will have any under- or over-payments of tax squared-up, this suggests that withholding accuracy should become less important, which would point towards simpler tax rules. The

WHAT YOU TOLD US

"Why not just look at year-to-date earnings?"

simplest way to tax an extra pay would be to treat these payments in the same way as ordinary salary or wages. For an employee on an "M" tax code, this would be to apply the PAYE tax tables published by Inland Revenue. However, the consequence of this would be that tax would frequently be over-withheld on extra pays. While this would be squared-up at year-end, this will affect the employee's cash-flow. The simpler the tax rules are for employers, the greater the adverse impact on employees. A balance is needed.

If treating extra pays in the same way as ordinary salary or wages fails to strike the right balance between simplicity and accuracy, consideration could be given to whether there is a proxy for annual employment earnings that is preferable to the proxy used in the existing formula.

An alternative proxy could be to divide year-to-date (YTD) employment earnings by the number of weeks (or pay periods) to which they relate and multiply this by 52 (or the number of pay periods in the year – for example, 26 for a fortnightly pay cycle) to get an annualised value. A proxy based on average YTD earnings would be relatively accurate for extra pays that occur late in the tax year, but could be quite inaccurate for extra pays that occur earlier in the tax year. This is because if an employee receives a pay rise during the year, their earnings for the rest of the year would reflect their increased salary or wages, not their average YTD salary or wages. The existing approach can also be relatively inaccurate for extra pays

that occur before a mid-year salary or wage rise. The advantage, however, of looking back only four weeks is that, if the extra pay occurs after a mid-year pay increase has occurred, there is a good chance the previous four weeks' pay will reflect what the employee will earn in each following four-week period in the tax year.

There is another tension at play. Employers using payroll software should be able to cope relatively easily with a complex extra pay formula. For employers calculating the tax on extra pays manually, however, a complex formula presents a problem. If all employers were using software, it would seem reasonable for the extra pay formula to focus on accuracy at the expense of simplicity, even in a tax system with a mandatory annual square-up. However, given that some employers will continue to manually calculate PAYE for the foreseeable future, the calculation needs to be relatively simple.

If a method that determines the proxy for annual earnings based on the last four weeks' pay remains the preferred approach, should there be any fine-tuning of the existing formula? One way of improving the accuracy of the formula could be to exclude any previous extra pays made in the four-week period when calculating the proxy for annual earnings, then add all extra pays made in the current tax year (rather than just the latest extra pay) to this proxy for annual earnings. This result would be used to determine the rate of tax on the extra pay. Such an approach would mean that employers would have to keep

QUESTIONS FOR READERS

3.3 What do you think is more important – making the method for calculating tax on extra pays simpler for employers, or making the method for calculating tax on extra pays more accurate, to reduce instances of too much tax being withheld for employees?

3.4 How do you think the amount of tax to be deducted from an extra pay should be determined? Do you think the current method is acceptable, or can you suggest a better alternative?

3.5 What do you think about the idea of introducing two options – a simple method or a complex, but more accurate, method – that an employer could use to determine the amount of tax to be withheld from an extra pay? If you like this idea, what do you think the two calculation methods should be?

track of all extra pays made during the year. This should not be a problem for employers using payroll software, but could be an additional compliance cost for employers doing their payroll manually. Again, it comes back to a trade-off between accuracy and simplicity.

Another option would be to give employers two options for calculating the tax on extra pays – a relatively complex, but more accurate, method suited to employers with payroll software and a relatively simple, but less accurate, method suited to employers without payroll software. This is the approach that has been taken in Australia.

Australia's complex method is considerably more complicated than New Zealand's current method. For back payments relating to specific periods in the current financial year, withholding is recalculated for each pay period to which the back payment relates. For back payments relating to an earlier financial year, or any additional payments (including commissions, bonuses or similar payments) that do not relate to a single pay period, withholding is calculated by averaging all additional payments made in the current financial year over the number of pay periods in a financial year, and applying that to the average total earnings to date.

Australia's simple method calculates withholding by apportioning additional payments made in the current pay period over the number of pay periods in a financial year, and

applying that average amount to the gross earnings in the current pay period. If an employer is paying a commission, bonus or similar payment for a defined period of less than 12 months, they can choose to calculate withholding tax by using the number of pay periods the payment relates to rather than the number of pay periods in the financial year.

New Zealand's existing method is simpler for employers than Australia's simple method. It involves fewer steps and does not introduce additional complexity by offering employers choices depending on the period the payment relates to.

The Government is interested in feedback on the idea of introducing two calculation method options in New Zealand and, if this is preferred, what the calculation method options should be.

WHAT YOU TOLD US

"It [holiday pay] can be confusing for employers"

"Legislation is silent [on the taxation of holiday pay] or at least not explicit so some new wording would be good to clarify."

QUESTIONS FOR READERS

3.6 Are you unclear about when holiday pay should be treated as an extra pay and when it should be treated as salary or wages?

3.7 If you think clarifying the tax treatment of holiday pay is desirable, do you think it should be clarified by legislation, or do you think clarification in an Inland Revenue publication would be sufficient?

LUMP SUM PAYMENT?



INCLUDED AS PART OF REGULAR PAY?

or

EMPLOYEE PAID HOLIDAY PAY WHEN ON LEAVE?

TAXATION OF HOLIDAY PAY

How payments of holiday pay should be taxed has long been an area of uncertainty and confusion for payroll software providers and employers alike.

The policy intent is that the tax treatment depends on whether the holiday pay is a lump sum payment (in which case it should be treated as an extra pay) or is included in an employee's regular pay or paid in substitution for an employee's ordinary salary or wages when annual paid holidays are taken (in which case it should be treated as salary or wages).

There are two ways to clarify the

correct treatment of holiday pay. One way would be by providing legislative clarification, perhaps by amending the lists of the kinds of payments included in the definitions of "salary or wages" and "extra pay" in the Income Tax Act 2007. Alternatively, Inland Revenue could clarify the treatment (under existing legislation) administratively via some form of publication.

EXTRA PAY DAY IN A TAX YEAR

In a tax year an extra pay day sometimes occurs. For example, there may be 53 weekly pay days in a tax year instead of the usual 52, or 27 fortnightly pay days instead of the usual 26. When this occurs, it results in tax being under-withheld compared with a calculation of a

person's annual tax liability on their total annual income. This occurs because the amounts to be withheld under the Commissioner's PAYE tables are based on the standard number of pay days occurring in the tax year (for example, 26 pay days for a fortnightly pay period). If an individual is a filing taxpayer, there will be a square-up and, all other things being equal, they will have tax to pay for the year. These tax bills are often unexpected and can result in employees blaming their employer, in the mistaken belief that tax has been withheld from their pay incorrectly.

This problem could be amplified in the future, if all individuals are required to undertake an annual income tax square-up. This is because currently, the income tax liability for a year of a non-filing taxpayer is the total tax withheld throughout the tax year, so there is no square-up if they have received an additional payment in a tax year.

The problem currently occurs because the Commissioner's PAYE tables and payroll software assume the usual number of pay days will occur in a tax year. One way to address this could be for the Commissioner to also publish PAYE tables that are based on an extra pay day occurring in a tax year, and programming payroll software to detect if an extra pay day will occur in a tax year, and adjusting calculation of the amount to be withheld from payments of salary or wages accordingly.

The Australian approach to this problem is to allow an employee

to ask their employer to withhold an additional amount per pay. Employers are encouraged to inform their employees if they will receive an additional pay during a tax year, and that this will likely mean they will have tax under-withheld. They are also encouraged to put processes in place so their employees can request additional amounts to be withheld.

The Government is interested in your feedback on whether New Zealand should introduce a mechanism for withholding additional amounts in years when an extra pay date will occur. If your answer is "yes", feedback is sought on whether it should be:

- Mandatory for all employers who know they will have an extra pay day in a tax year to withhold additional amounts from affected employees.
- Optional for employers who know they will have an extra pay day in a tax year to withhold additional amounts from affected employees. If this is your preferred option, feedback is also sought on whether it should be compulsory or optional for those employers who chose not to implement additional withholding for all their affected employees to withhold additional amounts from employees who have specifically requested this.
- Only required by employers for employees who have specifically requested their employer to withhold additional amounts.

QUESTIONS FOR READERS

3.8 Do you think a mechanism should be introduced for withholding additional amounts of tax from employees' salary or wages in years when an extra pay day will occur?

3.9 If you think that a mechanism should be introduced, which of the options outlined would you prefer?

- Optional for employers whose employees have specifically requested their employer to withhold additional amounts

Another option would be to preserve the status quo for the next few years and deal with the problem in the future, if and when a requirement is introduced for all individuals to undertake an annual income tax square-up. This could mean giving the individual the option to either pay the tax owed, or have withholding rates adjusted until the under-withheld tax has been recovered.

PAY PERIODS VS PAY DATES – WHAT TO DO WHEN THERE IS A LEGISLATED RATE CHANGE

Current state

Currently, different tax types/products have different rules on what is to be done when there is a change to a legislated rate during a pay period. The rates that apply for some PAYE-related tax types/products are based on the pay date, others on the pay period end-date or pay period start-date, while apportionment of a payment between the old and new rates sometimes applies. This has been raised as a source of complexity and confusion, which adds to compliance costs

PAYE income payments

When the tax rates for salary or wages are changed during a pay period, the amount of tax is determined as follows:

- For a pay period of one month or less, the amount of tax for the full payment for the pay period is based on the new tax rates.
- For a pay period of more than one month, the amount of tax is determined by apportioning the payment between the old and new tax rates.

When salary or wages are paid after a date on which a rate change comes into force and the payment relates to a pay period ending before the change, tax should be deducted based on the previous rates.

The tax rate to be applied to an extra pay is the relevant rate in force at the time the payment is made.

The ACC earners' levy payable on behalf of an employee is based on a rate set in regulations, which applies to liable earnings for pay periods ending in the applicable tax year.

Student loan deductions

When the student loan repayment rate or annual repayment threshold are changed during a pay period, the same rules that apply for PAYE deduction purposes apply for student loan deduction purposes.

KiwiSaver contributions and ESCT

For KiwiSaver, when the minimum employee contribution and compulsory employer contribution rates for a payment of gross salary or wages have been changed, the approach that has been taken is

that the new rates apply from the first pay period starting on or after 1 April. The ESCT rate to be applied to the employer's superannuation cash contribution is the relevant rate in force at the time the payment is made.

Options for change

To simplify the process for employers, the Government is exploring the possibility of aligning the rules about what to do when there is a legislated rate change during a pay period across the different tax types/products. The rules could be aligned based on either:

- the pay date;
- the pay period end-date;
- the pay period start-date; or
- apportionment.

Not all payments relate to a specific pay period (for example, extra pays). This points towards a pay date-based approach, if alignment is seen as a preferred option.

A pay date-based approach would be simpler for employers, but the trade-off would be reduced withholding accuracy in some circumstances.

The current rules promote better withholding accuracy than a pay date approach when tax rate changes occur during a tax year. For example, assume that there was a flat income tax rate of 30 percent from 1 April 20X1 to 30 September 20X1 and then it is cut to 20 percent from 1

October 20X1, and it remains at this rate for the remaining six months of the tax year. Because a tax rate cut occurred half way through the tax year, a composite income tax rate of 25 percent would apply for the tax year. Assume an employee was paid for a six-week pay period that ended on 7 October 20X1. If tax was withheld entirely at the new rate of 20 percent, then assuming the employee earned income smoothly over the entire year, the employee would have had tax under-withheld for the year. Assuming that the employee was a filing taxpayer, they would have tax to pay. Apportionment provides a solution to this problem. However, because apportionment is more complicated, the existing rules strike a balance with simplicity by only requiring apportionment for pay periods longer than one month, where withholding inaccuracies would be more significant. For pay periods shorter than one month, tax is simply deducted from the full payment at the new rate.

A pay date approach would, however, improve withholding accuracy when a tax rate change comes into force at the start of a new tax year. A tax year runs from 1 April to 31 March. Employment income is derived by an employee (other than a shareholder-employee) when it is received. For example, if a payment of salary or wages is made to an employee on 5 April 20X2 for a pay period that ran from 18 to 31 March 20X2, the payment is treated as derived during the tax year running from 1 April 20X2 to 31 March 20X3. To maximise accuracy, it would be preferable to

QUESTIONS FOR READERS

3.10 Do you think that legislated rate changes should be applied in the same way across PAYE-related tax types/products?

3.11 Do you think that a pay date approach is the best option for alignment?

base the amount of tax to be withheld from the payment of salary or wages on the tax rates in force on the pay date.



CHAPTER 4

PAYE – MODERNISING HOW INFORMATION IS PROVIDED

PAYE is a withholding tax mechanism where New Zealand employers (and PAYE intermediaries) deduct income tax and the ACC earners' levy from salaries and wages and pay it directly to Inland Revenue.

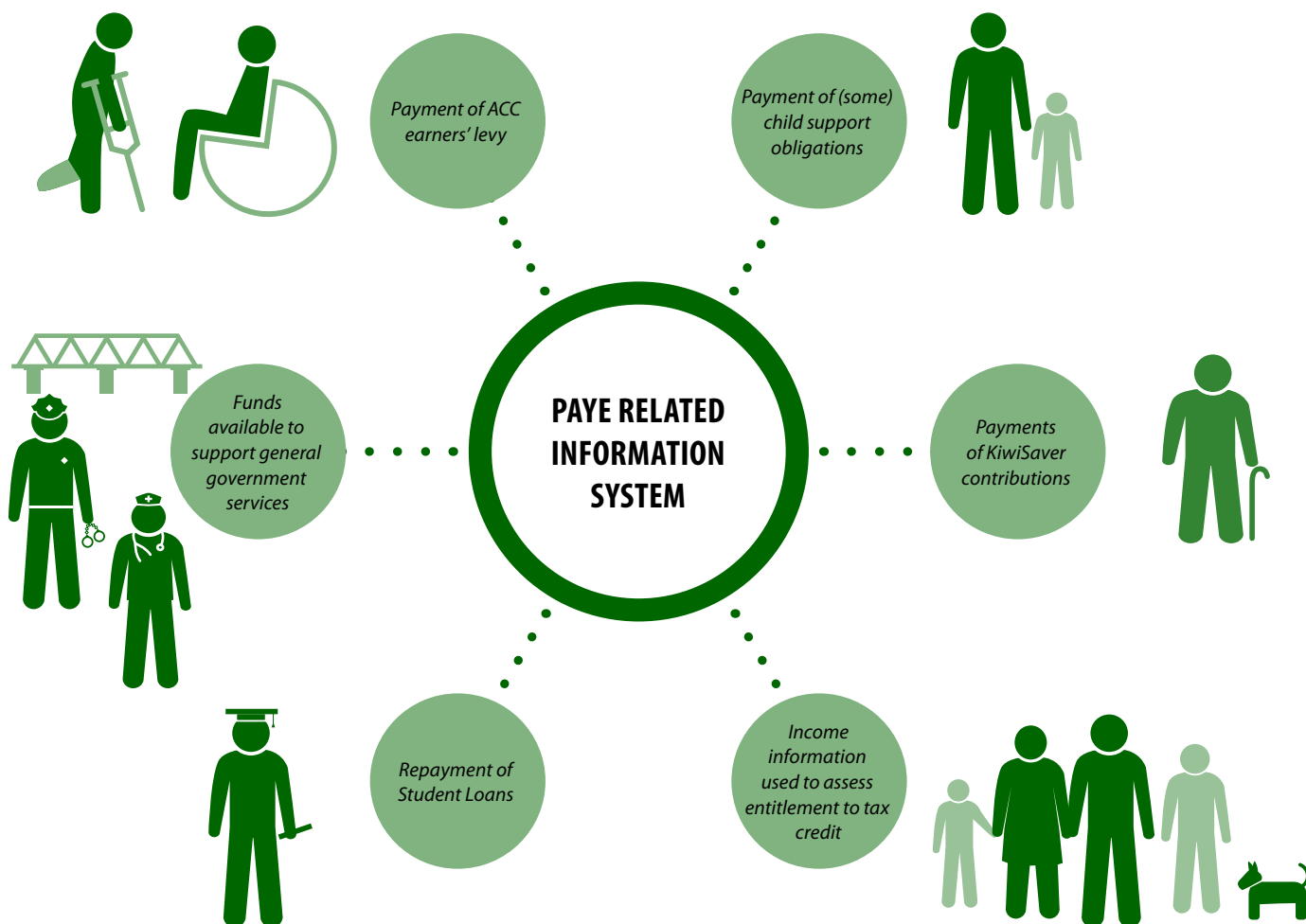
Employers range from large multi-nationals to small businesses and individuals, and also include trusts, not-for-profit organisations, central and local government, partnerships and sole traders. Government agencies including the Ministry of Social Development (MSD), ACC and Inland Revenue are also subject to PAYE obligations where they pay taxable benefits.⁵ For the purposes of this discussion document, they are all referred to as "employers", as are payroll intermediaries who assume PAYE obligations on behalf of employers.

The PAYE process is also used to collect other payments and information, including the repayment of student loans, KiwiSaver contributions and some child support obligations.⁶ PAYE income information is used in the calculation of an employee's eligibility for Working for Families tax credits, in determining

child support obligations and in determining whether the correct benefit entitlement from MSD has been received.

The PAYE process is also used by employers to deduct and report PAYE withheld from income that falls within the "schedular payment rules"⁷. Changes to the scope of these rules are being considered and may be included in a subsequent *Making Tax Simpler* discussion document.

In response to consultation on the *Green Paper* and *Better digital services* documents, some employers described themselves as "unpaid tax collectors for government" and said they would like to be either compensated or have their compliance burden materially reduced. Minimising compliance costs is an important objective in reforming the tax administration system, but so are improving the services to the various customer groups shown in the following diagram and reducing administration costs.



PROVIDING PAYE INFORMATION TO INLAND REVENUE - CURRENT OBLIGATIONS

Every month employers provide information to Inland Revenue in the employer monthly schedule about PAYE, and related deductions, made during the previous month.

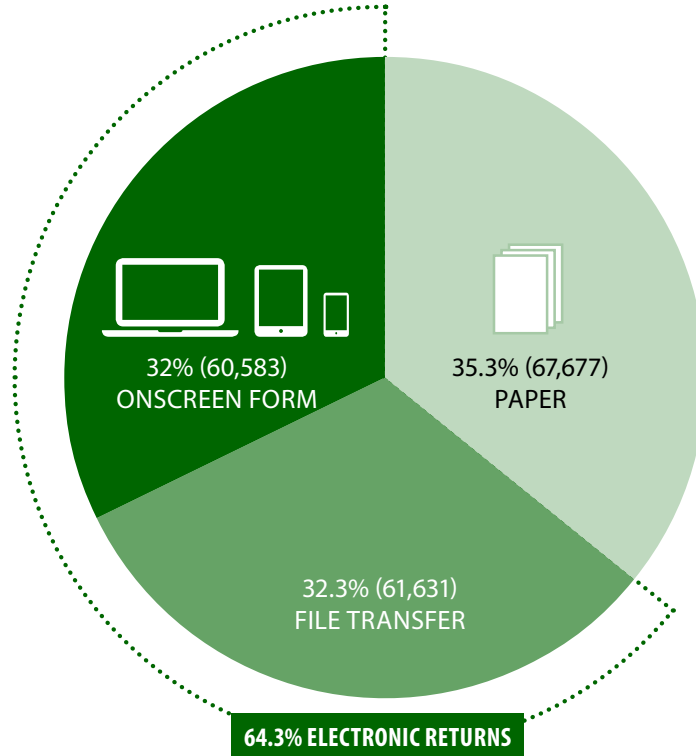
Employers with more than \$500,000 a year of PAYE and ESCT must generally provide the employer monthly schedule by the 5th of the month following that in which they withheld the tax.⁸ Employers with less than \$500,000 in PAYE (including ESCT) must provide this information by the 20th of the month following the month in which they withheld the tax.

Employers with over \$100,000 a year of PAYE (including ESCT) must provide their employer monthly schedule and their employers' deductions form, in an electronic format.⁹

Employers can file their employer monthly schedule in a range of ways:

- 'Electronic file transfer', which is accessed through Inland Revenue's secure web based portal (myIR). This method is used to send Inland Revenue a file which has been electronically filled out by the employer's payroll software. Thirty two percent of employers use this method.
- By typing the PAYE information into an 'onscreen' employer

PAYE RETURNS: MAIN FILING METHOD¹⁰



monthly schedule form accessed through myIR and using ir-File to electronically send it to Inland Revenue. Another 32 percent of employers use this method.

- By manually completing and sending a paper IR348 (employer monthly schedule form) to Inland Revenue. The remaining 36 percent of employers use this method.

PROBLEMS WITH THE CURRENT PAYE INFORMATION PROCESS

As noted in the *Green Paper*, the current process for submitting PAYE information using the employer monthly schedule has many positive attributes. It is, however, constrained by the largely paper world for which

it was designed. The current PAYE information process creates problems for employers and employees and limits Government’s use of the information.

Problems for employers

Inland Revenue conducts a periodic survey of tax-related compliance costs among small and medium enterprises (SMEs). The most recent survey was conducted in 2013. It indicated that the median value for SMEs with PAYE obligations was 12 hours a year on PAYE and a further 9 hours on KiwiSaver or a total of 21 hours a year. The median SME compliance cost was valued at \$550 a year for PAYE and \$188 a year for KiwiSaver, a combined value of \$738 a year.

QUESTIONS FOR READERS

Feedback from employers has identified the following concerns with the current PAYE information process:

- difficulties in setting up new staff;
- problems changing deductions;
- difficulty in making changes to information already filed;
- problems with understanding and reconciling the information Inland Revenue makes available to employers; and
- concerns about the time it takes Inland Revenue to process employer monthly schedules and action amendments.

4.1 Are these the key areas of concern with the PAYE information process from an employer's perspective?

4.2 Are there other aspects of the process of providing PAYE information that are significant sources of frustration/wasted time that should be rectified?

WHAT YOU TOLD US

"social policy should be de-linked from the annual tax cycle."

QUESTION FOR READERS

4.3 Do current PAYE processes cause other problems for employees that should be addressed?

The following comments are representative of those made in focus groups, pre-consultation discussions and in feedback on the *Green Paper* and the *Better digital services* discussion document:

- *Employers would like to be advised of the correct deductions from day one.*
- *There are too many forms.*
- *The IR344 (employee monthly schedule amendment form) is cumbersome and time-consuming – not set up for multiple entries.*
- *Mail is a poor channel to stop and start deductions; things get delayed.*
- *Why doesn't Inland Revenue send bulk data (for example, child support or tax code changes) in a form that can be automatically uploaded?*
- *The Inland Revenue website is not optimised for relevance; it is hard to find information.*
- *The examples Inland Revenue provides are simplistic and do not provide guidance in complex cases.*
- *All information from Inland Revenue (regardless of how it is delivered) should be clearer and easier to understand.*
- *We have difficulty in reconciling with Inland Revenue records.*
- *Why does it take Inland Revenue so long to process the employer monthly schedule and to action amendments?*

Problems for employees

It is not just the interface with employers that requires improvement. Accurate PAYE information is critical to the proper operation of income-related social policies. The fact that PAYE information is aggregated into a monthly return is a key limitation in the current system as it is not possible for government agencies that use the information to accurately calculate weekly or fortnightly income.

Inland Revenue's ability to effectively use PAYE information is further constrained because PAYE information is not received until the following month. For example, as outlined in Chapter 3, under the secondary tax system, employees whose secondary income takes them over an income tax rate threshold are at risk of having tax over-withheld. If Inland Revenue had more timely information, it could intervene more quickly, perhaps to suggest a special tax code to the employee.

As illustrated in the following examples, problems with the timeliness and accuracy of PAYE information limit the extent to which social policy recipients can be confident of receiving their correct social policy entitlements during the year and avoiding social policy debt.

The problems illustrated in these examples take time and effort to resolve, and because employees usually go to their employer when something is 'wrong' with their pay, they can impose costs on employers as well as employees.

EXAMPLE 1

Income is a key determinant of eligibility for Working for Families tax credits, and despite contact from Inland Revenue to identify the possibility of over- or under-payment, more than 52,000 families who received Working for Families tax credits in the year to 30 June 2014 were under- or over-paid during the year, by more than \$500. Effective redevelopment of the systems that support Working for Families customers requires accurate, timely income information.

EXAMPLE 2

Employees with student loan obligations, who earn above a minimum income threshold, repay their loans through the PAYE system. If borrowers fall behind in their repayments they can be required to make additional repayments which are imposed through additional deduction notices. These notices generally have the effect of increasing the student loan repayment rate from 12 percent of salary to 17 percent.

In the year ended June 2015 more than 18,700 borrowers could have avoided additional deductions if they had been on the correct tax code. Because PAYE information, including the tax code for new employees, is provided after employees are first paid it is not possible under the current system for Inland Revenue to pre-empt the use of incorrect tax codes by student loan borrowers. The diagram on the next page illustrates what would be possible if tax codes were checked before employees were first paid.

Better PAYE income information would also create opportunities to improve the future administration of social policy, for example by reducing the annual period over which many social policies are currently assessed. Entitlement to Working for Families tax credits is, for example, currently assessed and “squared up” on an annual basis. A shorter period of assessment could allow assistance to more effectively match periods of need.

Problems for Government

There are also opportunities to reduce the administrative costs of processing PAYE returns and make better use of PAYE information including, where appropriate, sharing it with other government agencies.

The estimated administrative cost for the Government to collect \$100 of PAYE in 2013-14 was \$0.25. While this is lower than the cost across all tax types where the average is \$0.86, there is scope for further reduction. If PAYE information showed the detail of what was paid on a pay day basis, was submitted digitally, and was accurately calculated, the following administrative costs could be reduced:

- processing paper returns;
- contacting employers and employees to correct inaccurate information;
- using PAYE information to support the effective operation of social policies such as Working for Families and Student Loans; and

- helping employers and employees to understand the information held about them.

Opportunities to improve the use of PAYE information across government include:

- ensuring ACC has the information it needs to accurately calculate the ACC Workplace Cover (employers) levy;
- making better use of income information to ensure individuals receive their social policy entitlements;
- redesign of social policy to better match income assistance to the recipient’s needs; and
- detecting fraud, including through more timely matching of data with MSD.¹¹

PROVIDING PAYE INFORMATION AT THE SAME TIME AS THE EMPLOYER’S BUSINESS PROCESS

The idea that PAYE obligations could be integrated into normal business processes (for example, adding, paying and removing staff from the payroll), and information sent to Inland Revenue directly from payroll software, was included in Chapter 2 of the *Green Paper*. The concept received general support although submitters noted the likely cost for employers of upgrading their systems and the need to cater for those who do not use payroll systems.

Chapter 2 identified at a high level

MINIMISING ADDITIONAL STUDENT LOAN REPAYMENTS

CURRENT STATE

18,700

Student loan borrowers had to pay 17% instead of the 12% obligation rate because they had previously used the wrong tax code.

NEW EMPLOYEE

New employee provides their details to their employer. In some situations, the employee gives the employer the wrong tax code for their situation.



EMPLOYER

Employer receives details from new employee and puts it in their payroll records. This will include the new employee's selected tax code.



EMS SUBMITTED TO INLAND REVENUE

Employer uses their payroll information to pay staff and prepare their EMS.

Inland Revenue receives and processes EMS. This includes checking that the employee's student loan status aligns with what the employer has filed.



Inland Revenue sends message back to employer and employee informing them that the tax code for the employee with a student loan is incorrect.

FUTURE STATE



NEW EMPLOYEE



EMPLOYER



Employer uses payroll software to communicate details to Inland Revenue.



Inland Revenue's system checks the employee's details against its record of student loan status and pushes back the appropriate tax code. The employee is also informed. The employer uploads and uses the correct code in the first pay run.

New employee provides their details to their employer.

Employer receives details from new employee and puts it in their software.

how PAYE obligations could be integrated into payroll software to make providing PAYE information largely a by-product of the processes the employer would be using to employ and pay their staff.

The remainder of this chapter looks at PAYE processes in more detail. It seeks feedback on whether the proposed use of payroll software to provide information at the time of the payroll process would reduce compliance costs. Options for employers without payroll software that supports the “new digital services” (essentially the ability to send information directly from payroll software to Inland Revenue and to receive information back), are outlined in the section on providing information through a web portal and, for those without digital access, in Chapter 5.

The diagrams on the next page summarise the differences between the current process and the proposed new processes.

As part of modernising the tax administration, Inland Revenue is thinking more widely about taxpayer needs and behaviours, and building an environment that supports taxpayers right from the start. Processes which make it easy for an employer to get an employee on the right deductions from the beginning of their employment and easy for both the employer and Inland Revenue to update information are consistent with this new direction.

BECOMING AN EMPLOYER/CEASING TO BE AN EMPLOYER

When someone decides to become an employer they are asked to register with Inland Revenue. Following registration they are provided with information about their PAYE and related obligations, and Inland Revenue sets up their details.

Proposed change

In future it is proposed that payroll packages and services would include an option to notify Inland Revenue of the decision to become an employer. Existing options such as registering as an employer at the time a company is registered with the Companies Office would remain.

Similarly, it is proposed that payroll software could be used to advise Inland Revenue of a decision to permanently, or temporarily, cease to employ staff. This would eliminate the risk of an ex-employer being wrongly pursued for failure to file PAYE information, and would eliminate the need to file nil returns when someone has temporarily ceased to be an employer.

The current requirement to register as an employer is an operational matter. It is not a legal requirement and there is no current requirement to advise Inland Revenue of a decision to cease to employ staff.

QUESTIONS FOR READERS

4.4 Do you support the proposal that employers should notify Inland Revenue of a decision to commence, temporarily cease or permanently cease to be an employer?

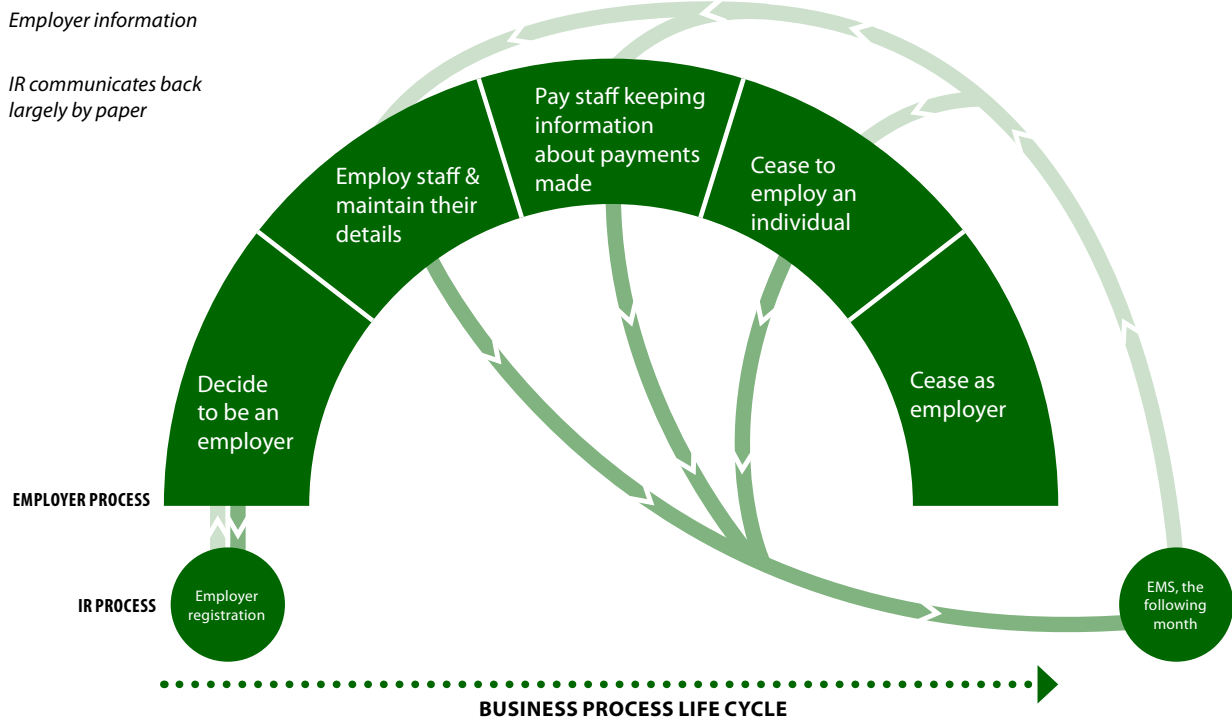
4.5 Should these requirements be included in legislation?

INTEGRATION OF PAYE INFORMATION REQUIREMENTS WITH BUSINESS PROCESSES

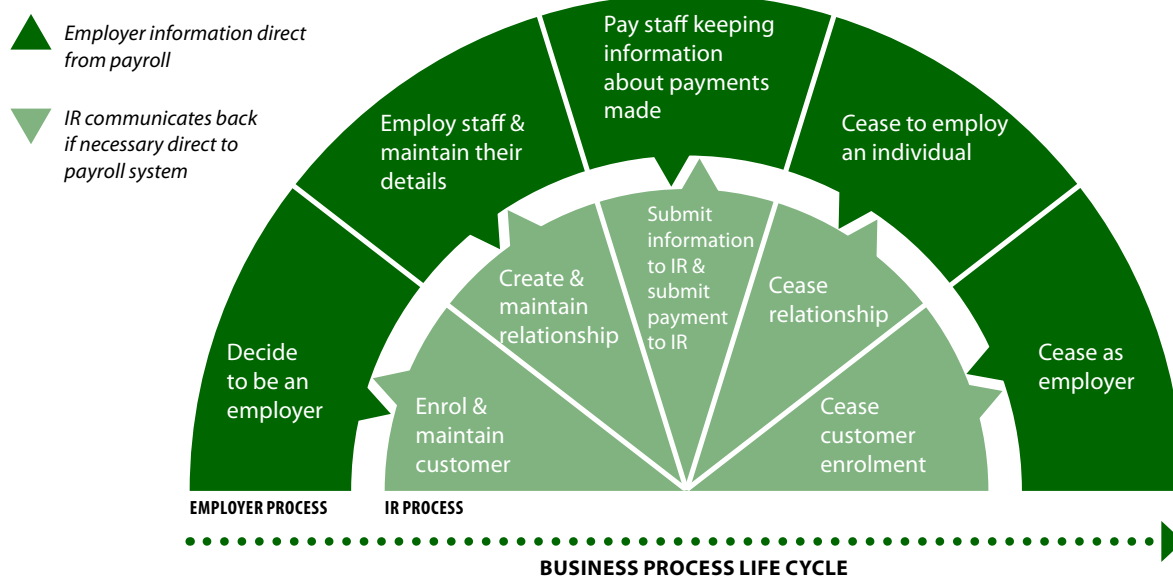
PAYE information is submitted in the month after the business process has been completed.

Inland Revenue communicates back to employers by paper, phone and email, usually several pay days after the event.

Current Processes



Possible Future Processes



PAYE information could be communicated to Inland Revenue from the payroll software at the time the employer completes the business process (for example takes on a new employee or, runs the payroll). Much of the return communication from Inland Revenue could be sent automatically, arriving much more quickly, eliminating some errors, limiting others and providing more timely information.

SEFA - WORKER FOR A MEDIUM SIZED EMPLOYER

Sefa is a payroll officer for a construction firm. Turnover is relatively high amongst their labourers. When they first start, Sefa spends a lot of time sorting out their tax codes and deductions. Some have left before Sefa sorts out their details. Inland Revenue keeps sending information to him about them after they have left.

What if Sefa could use the payroll software to send the details of new employees to Inland Revenue and get an automatic response advising of their KiwiSaver status and any required deductions, before the business starts to pay them? This ensures he gets the new employee set up right from the start. He could also use the payroll system to send a message to Inland Revenue when he takes an employee who has left, off the payroll. This would stop Inland Revenue sending him further information about that ex-employee.

EMPLOYING STAFF, MAINTAINING THEIR DETAILS AND CEASING TO EMPLOY STAFF

Currently an employer must include information about a new employee on the employer monthly schedule in the month following when the employee was first paid. The employer has a further obligation to provide employee details, on a KS1¹¹, to Inland Revenue about a new employee who is eligible to join KiwiSaver.

Proposed change

It is proposed that instead of information about new employees being due in the month after the employee is first paid, the following information could be provided to Inland Revenue directly via the payroll system, when the new employee's details are added to that system:

- employee's name;
- IRD number;
- tax code;
- contact details (physical address, phone number and email);
- start date; and
- date of birth – this would be a new requirement and would be used to verify identity and ensure that deductions and contributions are correctly assigned.

Inland Revenue could then use information in its system to automatically respond to the employer before the employee

was first paid. Once the new digital services are fully operational,¹² the response could:

- Advise whether the IRD number is correct. If Inland Revenue could not positively verify the employee's identity, messages would be generated to both the employer and employee asking the employee to make contact to verify the IRD number.
- Once the employee's identity is confirmed Inland Revenue would:
 - identify if the proposed tax code is incorrect, for example it may be that a new employee should be using a student loan tax code;
 - advise the employer of the employee's KiwiSaver status, and if a contributing member, indicate the appropriate deduction rate; and
 - advise of any child support deductions or deductions required because of tax arrears.

Providing the information at the same time as the employee information is added to the payroll system should ensure the employee is set up correctly from the start. This would reduce the likelihood for under- or over-deductions from the employee and reduce the need for subsequent contact between Inland Revenue and the employer.

QUESTIONS FOR READERS

4.6 Do you agree with the proposal that employers should be able to use their payroll software to provide relevant employee details to Inland Revenue at the time those details are entered, changed, or removed from the payroll system?

4.7 Would using payroll software to provide Inland Revenue with details of new employees before they are first paid and being notified of deductions as set out above, reduce or increase compliance costs? If you can quantify the effect please do so.

4.8 Do you support the proposal that Inland Revenue should continue to communicate any change of employee obligations or details to the employee?

It should also allow for:

- the elimination of the KiwiSaver enrolment forms;¹³ and
- deductions for recovering overdue tax to be integrated with the PAYE process.

While it is intended that Inland Revenue's system should automatically respond to the employer, it is not intended that failure to resolve an identity issue would prevent the employer paying the employee on the basis of the information supplied by the employee. Even if it took until the second or third pay cycle to correctly identify an employee it would be an improvement on the current situation.

The payroll system could also be used to advise Inland Revenue of relevant updates to an employee's details. This might include changes to their contact details, or close-off details when they leave the employer. Advising Inland Revenue of the end of the employment relationship would immediately de-link the employer and employee in Inland Revenue's records, and would prevent further communication about that employee being sent to the employer.

More timely advice about employees who cease employment would also improve Inland Revenue's ability to correctly advise a subsequent employer whether the employee's proposed tax code is correct. Advice to Inland Revenue at the time an employee is removed from the payroll should represent an improvement

over the current situation where the information is included in an employer monthly schedule the following month. It is understood however that employer practice around ceasing casual employees and the rapidity with which employees are removed from the payroll system can vary and the proposal may therefore not be 100 percent effective.¹⁴

Current practice is for Inland Revenue to communicate with both the employer and the employee when an employee's obligations change. It is proposed that when employee obligations are communicated to an employer or employee details are updated to Inland Revenue by the employer this information would also be communicated to the employee by Inland Revenue. This would provide the employee with the opportunity to correct any information they consider to be wrong.

Date of birth

Security and privacy were raised as concerns by those who responded to the Government's *Green Paper*. To help confirm an individual's identity and provide greater assurance it is proposed that information provided to Inland Revenue when a new employee is added to the payroll should include their date of birth.

Some people use multiple spellings or versions of their name. It is not uncommon for two or more people to have the same name and people can incorrectly transcribe or otherwise wrongly cite an IRD number. Providing an employee's date of birth

MICHAEL - NEW EMPLOYEE

Michael started his first job in April. His father's name is also Michael and when the young Michael gives the payroll officer his IRD number he provided his father's number by mistake - it was the first one he found in the desk drawer where the family papers were stored.

At year end his father requested a personal tax summary because he thought he was probably due a refund for the short period he had had between jobs. He was amazed to find that his income was reported as \$31,000 higher than he thought and that he had significant tax to pay. This happened because the son's income was attributed to the father's IRD number. Although the problem got sorted out relatively quickly once he contacted Inland Revenue it caused considerable stress in the interim. If Michael had had to provide his date of birth along with his IRD number the problem could have been avoided.

QUESTIONS FOR READERS

4.9 Do you agree with the proposal that employers should obtain date-of-birth information and provide this information about their new employees to Inland Revenue?

4.10 Should the requirement on the employee to provide date-of-birth information be included in legislation?

would significantly increase Inland Revenue's confidence in confirming a person's IRD number and hence their identity.

It should reduce, if not eliminate, confusion over obligations (for example, for child support) or deductions (for example, on whose behalf KiwiSaver contributions or student loan repayments have been made). An employee's date of birth is also critical to determining eligibility for KiwiSaver. Without it Inland Revenue would be unable to confirm a new employee's eligibility for KiwiSaver auto enrolment.¹⁵

Employers are not permitted to discriminate on the basis of age, but once an employee has been appointed, they are allowed to collect and record date-of-birth information. It is recognised that some employers currently collect date-of-birth information and others do not. Under the new system it is proposed that employees would still be required to advise their employer of their tax code and this legal obligation could be extended to include providing a date of birth.

PAYING STAFF

Employers pay staff on different periods, some pay daily, some weekly, others fortnightly, or monthly. Some large employers run multiple payrolls paying different classes of employees on different cycles. All employers are required to aggregate information about the PAYE and related deductions they have withheld during the month, and provide that

information to Inland Revenue the following month, using the paper IR348 form or an electronic format acceptable to the Commissioner.¹⁶

Many employers operate electronic payroll systems which build the required information up over the month and the employer then transfers the PAYE information to Inland Revenue using an electronic file transfer.

Other employers combine the output from their payroll system, spread sheets or wages book, and enter the monthly figures on the paper IR348 form or log onto myIR and then type the information into an onscreen form in ir-File and send it electronically to Inland Revenue.

Whenever information is manually calculated and/or transcribed onto paper or into the onscreen form, there is potential for error.

Proposed change

It is proposed that PAYE information should be able to be provided to Inland Revenue directly from payroll software at the time the payroll runs. This would eliminate the need to file an employer monthly schedule. Compared with manually calculating and aggregating PAYE information and typing it into an onscreen form or completing a paper form, using payroll software which communicates with Inland Revenue, would save the employer time and effort. It should also reduce, if not eliminate, the calculation and transcription errors which often require the employer to

ERIN - SMALL EMPLOYER

Erin and Mike run a motel in a popular holiday destination. Erin does the books and the weekly payroll and supervises the staff. Two years ago the business invested in a basic payroll package, but Erin still finds filing PAYE information a pain. Before the 20th of the following month, on a completely different cycle from her payroll, she files the previous month's PAYE information from her payroll system, goes into myIR and uses ir-File to attach the information and then send it to Inland Revenue.

What if Erin's payroll package alerted her with a message when the payroll was finalised "submit details to Inland Revenue?" and presented her with the information that was to be submitted? Erin could meet her PAYE information obligations there and then.

QUESTION FOR READERS

4.11 If your payroll software could send payroll information to Inland Revenue at the time staff are paid, would it increase or reduce your compliance costs? If you can quantify the effect please do so.

subsequently spend time reconciling the PAYE information on the employer monthly schedule (IR348) with the information that accompanies payment on the IR345.

For employers already using payroll software and "file transfer" to submit their employer monthly schedule information, digital submission of data from a payroll system at the time the business process occurs would eliminate the steps of saving the file of PAYE information, logging into ir-File through myIR and sending the employer monthly schedule to Inland Revenue.

It is intended that payroll software would present the employer with the PAYE information following the point in each process when the information is finalised – for example, when the payroll has been finalised. There would be a "submit information to Inland Revenue" step in the process.

Similarly, some inward messages from Inland Revenue for example, updating child support deductions, could present the information to the employer, and on acceptance, would automatically update the relevant fields without further intervention by the employer.

AMENDING PAYE INFORMATION

It is important that the process for making amendments to payroll information is as simple as possible. Under the current delayed arrangements for filing PAYE information, payroll staff can amend matters that come to their attention

before the information is sent to Inland Revenue the following month. Some readers responded to the proposals in the *Green Paper* noting that if information was supplied to Inland Revenue more quickly there would be more errors, and there would need to be a simple process for correcting them.

Using payroll software can reduce the need for some types of amendments but others will remain, for a number of reasons. These include receipt of information after the payroll has closed, manual input errors by payroll staff, failure to cease payments and reconsideration of the tax treatment applied to payments (for example the taxation of allowances).

Unless the amendment to PAYE information is straightforward and can be reflected in the next return or done over the phone, employers who amend their information currently do so using an IR344 form. A separate form must be filled out for each month, which requires amendment, and employers are required to advise Inland Revenue of what *was* paid in each period and what *should have been* paid. This process is cumbersome. Payroll intermediaries have the ability to amend PAYE information electronically on an "electronic amendment schedule" and it is proposed that this facility should be improved and made available to employers using payroll software.

Once a need for amendment has been discovered, an employer using payroll software uses the system to calculate the PAYE and any other deductions

AWHINA - MANAGES A LARGE PAYROLL

Awhina manages a complex fortnightly payroll for a large employer. Her staff spend a significant amount of time processing amendments to PAYE information. The payroll software is good at working the changes out, but because amending information has to be provided on a monthly basis to match the employer monthly schedule, the information has to be manually aggregated and entered onto amendment forms and sent to Inland Revenue.

Under the proposals Awhina's staff could send details of amendments, for the weekly records that needed changed, to Inland Revenue direct from the payroll software, without the need for aggregation or form filling. Because the amending information automatically adjusts the balance due in the PAYE payment the reconciliation process is also simplified.

under- or over-paid.

- Under-payments of gross income are usually corrected in a subsequent payment and Inland Revenue receives PAYE information after that payment is made. No IR344 is required in these circumstances.
- Over-payments of income are more complicated. An employer needs the employee's consent to any repayment, which is usually either repaid in a lump sum or deducted from the person's subsequent net salary. Inland Revenue treats the overpaid PAYE and other deductions as "made in error" and once notified, refunds or credits them to the employer.
- Employers use a variety of means to advise Inland Revenue when the tax treatment is incorrect and there has been an under-payment of PAYE or employer deductions, such as when a taxable allowance is initially treated as non-taxable. Some employers simply use the IR344 form, providing information for each month in which the error occurred, with a reason. Others send an Excel spread sheet with IR344 equivalent information and others will send a letter including the IR 344 information.

Proposed Change

In the future, it is proposed that the employer's payroll system should be able to calculate and submit amending data to Inland Revenue at the same time the changes are made

to the employer's own record.

Consideration has been given to whether Inland Revenue should require the details of the correction in every previous pay period in which the error occurred, or simply the changes that should be made to the employee's year-to-date record.

Correcting previous pay periods would ensure that Inland Revenue has an accurate record of the basis for the PAYE and other deductions that have been made. Information about the period over which the error has been occurring also provides the basis for the calculation of late payment penalties should they be appropriate.

The requirement to aggregate the pay day information and fill out a form, for each month in which the error occurred, is however known to impose compliance costs, which some employers have told us are significant.

The proposal is that payroll software would both calculate and transmit the amending information reducing compliance costs although employers would still need to either select or insert a reason for the change. Feedback is sought on two options for what information is required:

- For each pay period requiring amendment, payroll software could be used to advise Inland Revenue what *was* paid and deducted and to separately identify what *should have been* paid and deducted. This would automate the current process and provide the information on a pay

QUESTIONS FOR READERS

4.12 If payroll software could calculate the information required to amend payroll records and could be used to send that information to Inland Revenue at the time payroll records are amended, would that increase or reduce your compliance costs? If you can quantify the effect please do so.

4.13 Do you prefer one or other of the two options outlined above for the information to be provided when PAYE information is amended?

4.14 Do you think there is a need for legislation to explicitly provide for the correction of minor errors in a subsequent pay period? If so, at what \$ value should the threshold be set?

WHAT YOU TOLD US

"Some flexibility around timeliness and ability to correct errors without penalty or interest costs should be considered."

day basis.

- Alternatively, payroll software could simply advise of the change required to income and deductions for each pay period in which the error occurred.

The Government understands that the majority of amendments to PAYE information and payments arise because of changes to the payroll, not because of changes to the tax treatment. In other words, the income reported has had PAYE deductions correctly calculated but the income amount paid was wrong, and needs to be corrected, with a consequent adjustment to PAYE and other deductions.

Where income and deductions have been underpaid this is usually corrected in a subsequent pay and it is at that time that the obligations to notify and pay Inland Revenue would arise. These amendments do not currently, and would not in future, give rise to any liability for late filing or late payment. Where income is overpaid PAYE and other deductions are refunded or credited by Inland Revenue.

There are situations, however, where an employer needs to change their tax position and it is not intended that submission from the payroll system would be the only way in which they could do this. The employer will be able to choose how this is communicated.

There is currently no PAYE equivalent of section 113A of the

Tax Administration Act 1994 which provides for the correction of minor errors in subsequent periods. The Government is interested in feedback on whether section 113A needs to be extended to cover minor alterations to the tax position employers take when they return PAYE information.

Many other changes that are currently notified to Inland Revenue as amendments, such as a change of employee name, could come through the proposed process for changes to employee details.

SUBMITTING INFORMATION THROUGH A WEB-BASED PORTAL

Inland Revenue currently operates myIR, a web-based portal for accessing information and filing, including filing the employer monthly schedule. It is planned that this portal will be modernised to offer more reliable, secure and user friendly services.

Employers not using payroll software supporting the planned new digital services, but who have digital access, could use the portal to submit PAYE information. This could include:

- a decision to begin to employ;
- details of new employees and people who have ceased employment;
- pay day information about PAYE and other deductions;
- amendments to PAYE information; and

QUESTION FOR READERS

4.15 Would the following attributes of the proposed new PAYE processes be of value? If you can quantify the effect please do so.

- faster processing of PAYE information by Inland Revenue;
- greater access to your PAYE information;
- the ability to filter and drill into your PAYE information; and
- the ability, if necessary, for you and an Inland Revenue staff member to see the same information.

- a decision to permanently or temporarily cease employing staff.

Submission of PAYE information through the portal would be a separate process, and while the portal would allow an employer to receive information back from Inland Revenue, it would not offer the speed of response of the software-enabled services. In addition, features like automatically uploading advice from Inland Revenue of deductions would not be available.

INFORMATION HELD BY INLAND REVENUE

It is intended that employers would no longer be reliant on “statements” from Inland Revenue but will be able to see their PAYE information in an on-line account. The employer will be able to view their on-line account via payroll software that supports this new service, or via the web portal. It is possible that employers would be able to tailor and filter the presentation of their information to suit their needs.

Information received via the new digital services from employers would be processed and updated much more rapidly than at present. The objective would be for customer accounts to be updated on a daily basis and for updated information to then be visible to the employer.

The combination of faster processing and more user-friendly display of information should enable some queries that currently prompt phone calls to be resolved on a “self-service” basis.

In addition, it is intended that an employer and a staff member at Inland Revenue would be able to see information formatted in the same way, which should reduce the time taken to resolve queries that cannot be resolved on a self-service basis.

INFORMATION PROVIDED TO OTHER AGENCIES

The Government has ambitious goals to achieve better outcomes for New Zealanders by delivering better public services. This includes:

- creating more value from New Zealand’s “data assets” by making better use of the information held by government agencies; and
- reducing duplication by sharing information between government agencies so businesses and individuals only have to tell government once.

At present information is only provided to other agencies where there is specific legal authority or an “approved information sharing agreement” (AISA) authorised by an Order in Council. The discussion document *Making Tax Simpler: towards a new Tax Administration Act* explores matters of tax secrecy and cross government information sharing. As set out in that discussion document, any move to share information on a different basis, for example with customer’s consent, will require a change to the underlying law.

Under current law PAYE information is already used by a number of other

QUESTION FOR READERS

4.16 Do you provide information to other government agencies that you think would more appropriately be provided to and passed on by Inland Revenue as part of the PAYE information process?

government agencies, including by ACC to set the ACC WorkPlace cover levy, by MSD to check benefit eligibility and by Statistics New Zealand for delivery of statistical information. If PAYE information were available on a more timely basis, and identified the pay periods in which payments were received, it would improve MSD's ability to ensure customers receive the correct benefit entitlements. Currently people are both under- and over-paid benefits during the year.

The Government is conscious that other agencies also require information from employers and there may be scope to rationalise the number of separate processes, although as set out above, a law change or an Order in Council would be required to permit greater sharing.

⁵ ACC payments, most MSD benefits, student allowances, pensions and paid parental leave.

⁶ The Taxation (Transformation: First Phase Simplification and Other Matters) Bill currently before Parliament includes proposals to change the disclosure requirements for employment income received under an employee share scheme and require amounts to be reported on the employee monthly schedule. More information can be found at <http://taxpolicy.ird.govt.nz/publications/2015-commentary-tfpsom/overview>

⁷ Section RD 8 of the Income Tax Act 2007.

⁸ The exceptions to the employer monthly schedule being due on the 5th of the month from large employers are in January: section RD 22(2B) of the Income Tax Act 2007, and from new employers: section RD 22(4) of the Income Tax Act 2007.

⁹ Section 36A(2)(B) of the Tax Administration Act 1994

¹⁰ Some employers have more than one registration and use different methods they have only been classified once under their 'main method'.

¹¹ KiwiSaver 1 form which provides employee and employer contact details and IRD numbers.

¹² The migration of existing products to Inland Revenue's new software platform will happen progressively.

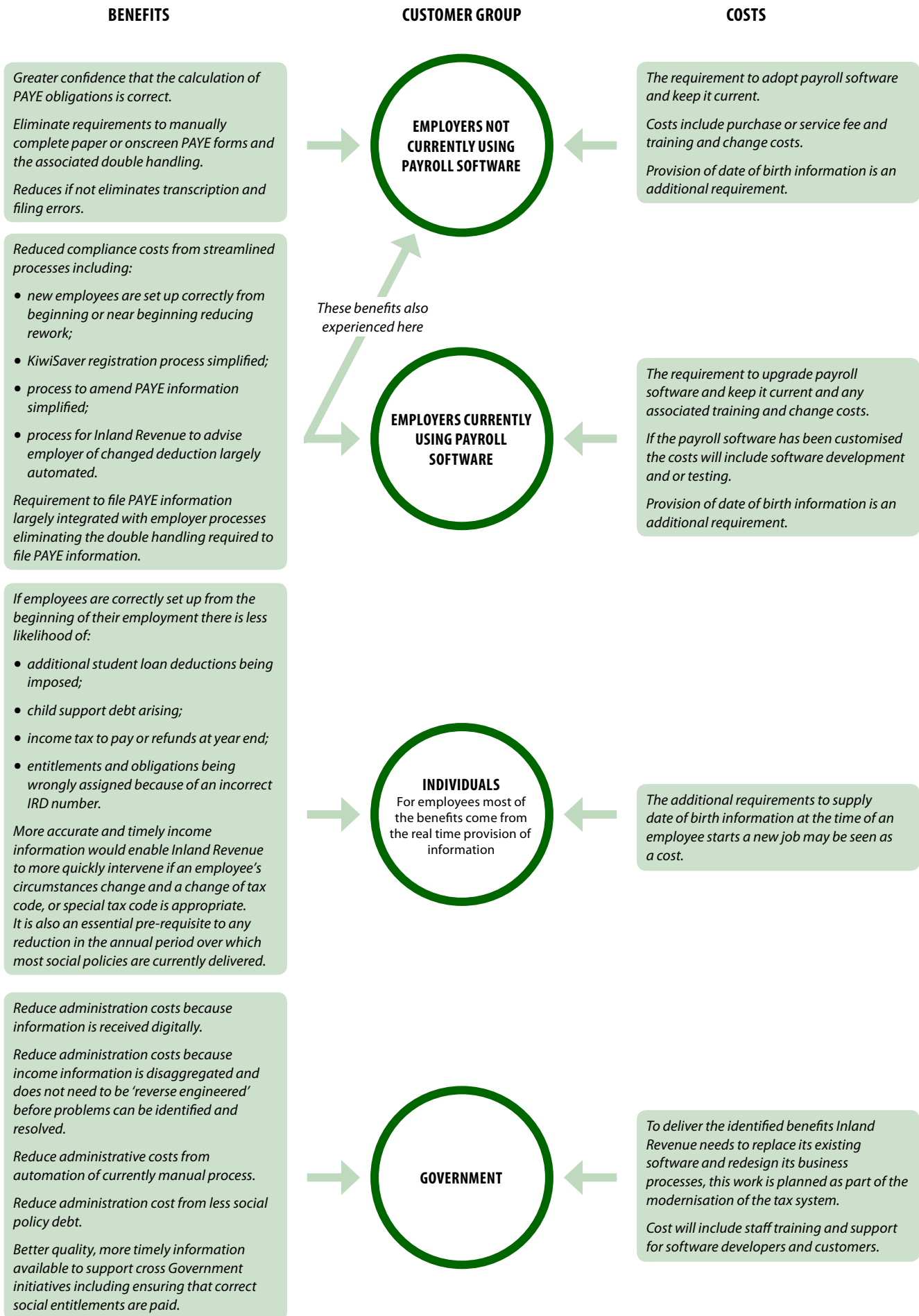
¹³ The KS1 and KS2. An employer would still need a process for existing employees to inform them of a decision to enrol or to change their deductions. It is envisaged that this information could be communicated to Inland Revenue by way of a change to employee details.

¹⁴ If final holiday pay and retirement pay are paid out over a number of weeks an employee may appear to have two source of main ("M" tax code) income at the same time.

¹⁵ An employee must be over 18 and under 65 to be eligible for auto enrolment. The employer would retain responsibility for ensuring that the employee was a New Zealand citizen or entitled to live here indefinitely.

¹⁶ Section RD 22 of the Income Tax Act 2007 and section 36A of the Tax Administration Act 1994.

COSTS AND BENEFITS OF USING PAYROLL SOFTWARE TO PROVIDE PAYE INFORMATION WHEN THE BUSINESS PROCESS OCCURS





CHAPTER 5

PAYE INFORMATION – IMPLEMENTING CHANGE

This Government is not, at this stage, proposing a timeframe for changes to PAYE processes. Inland Revenue has recently begun work to determine the recommended approach to sequencing change across the tax administration system. Until Government has considered the recommended approach and made decisions it is not possible to outline a timetable. The Government expects, however, to have made sufficient progress with planning to introduce legislation in 2016.

A STAGED APPROACH

This chapter consults on how the law relating to the provision of PAYE information might be changed. The current legislation must be amended before an employer can meet PAYE obligations by submitting information at the same time the business process occurs. Because customers' needs will vary, it is clear that the development and adoption of software to support the services outlined in the previous chapter, would follow a staged approach.

It is likely that services which will allow for direct submission of *existing* PAYE

returns from an employer's payroll system (for example the employer monthly schedule and KiwiSaver enrolment forms) will be available in the market from late 2016. These services will not allow for submission of PAYE information at the time the business process occurs, or allow for Inland Revenue to automatically communicate back, as outlined in the previous chapter. Developing and releasing services progressively will, however, provide a valuable opportunity to pilot and refine the services.

It is anticipated that software providers targeting the small and medium enterprise (SME) market would be the first to release the new digital services and a subset of small and medium employers are expected to dominate the early uptake.

Large employers often have customised systems and need to allow adequate time to plan and implement change.

IMPLEMENTING THE NEW PAYE SERVICES

The fundamental approach to

WHAT YOU TOLD US

"Yes certain taxpayers (e.g. employers) should be required to use digital services but only where it is feasible. The strategy for moving reluctant taxpayers to digital should be transparent and widely communicated."

"we do not agree that certain taxpayers (e.g. employers) should be required/forced to use digital services.. Digital services should be about making it easier for taxpayers to get things done for their own convenience."

implementing change is to build effective customer focussed systems that customers wish to use. Inland Revenue will also use strategies to encourage new customers to use digital services to meet their PAYE information obligations.

Because timely, accurate PAYE information is a pre-requisite for future changes to social policy delivery and is also important to the correct delivery of current social policies, the Government has considered whether it should require employers who can access digital services to use payroll software that supports the new digital services outlined in the previous chapter.

The central question for the Government in considering proposals to modernise PAYE information is "do the system-wide benefits justify the costs of change?" In assessing the costs and benefits the Government will consider the transition costs as well as on-going costs and take care that the change is not just shifting costs from the Government to employers. Feedback from this discussion document will inform this process.

Feedback on the earlier proposal in the *Better digital services* discussion document, that the Commissioner of Inland Revenue could use her powers to require employers who could use digital services but choose not to, and who thereby impose costs on others (in this case employees), was mixed. Some submitters proposed that using digital services could be required where it is feasible, and others

suggested that it should eventually be compulsory.

A significant number of submissions were, however, opposed to the idea that digital services might be made compulsory for all employers, with many submissions stating that paper filing should remain, not just to assist those who cannot adopt digital services, but because paper filing might be preferred.

As a result of this feedback, the Government is consulting on implementation options that focus on two issues, which are covered in more detail below:

- whether it is appropriate to revisit the current thresholds for electronic filing that were established in 1999; and
- whether employers should be required to provide PAYE information when the business process occurs. Focusing on *when* information is provided rather than on *how* that information is provided leaves the decision about whether or not to use payroll software up to the employer.

THRESHOLDS FOR ELECTRONIC FILING

PAYE information submitted electronically is quicker and cheaper to process than information submitted on paper. The current requirement, that employers with more than \$100,000 a year of PAYE and ESCT deductions must file their returns electronically unless they have an

exemption from the Commissioner of Inland Revenue,¹⁷ dates from the introduction of the employer monthly schedule in 1999.

Electronic filing means either:

- using payroll software to complete an electronic version of the employer monthly schedule and using ir-File and the internet to send the information to Inland Revenue; or
- typing information into the onscreen form on Inland Revenue's website and using ir-File to send it over the internet to Inland Revenue.

In 1999, the threshold for electronic filing was set at \$100,000 of PAYE and ESCT a year. Since 1999, the availability and use of digital services has increased dramatically and more than 60 percent of employers who are *not* currently required to file their employer monthly schedule electronically nevertheless do so.

Access to and use of the internet by New Zealand businesses is known to be influenced by geographic location¹⁹ and demographic factors such as the age of the business operator.²⁰ It may also be that some employers including non-profits, may not have any access to digital services. It is therefore considered reasonable that there should continue to be an exemption provision for employers who do not have access to digital services.

Proposed changes

It is proposed that the threshold for electronic filing, using either payroll software or the internet-based portal, should be reduced from \$100,000 a year to \$50,000 of PAYE and ESCT. This figure would increase the percentage of employers required to file digitally from 12 percent to 22 percent. It would require an employer with more than ten full time employees at the minimum wage, or more than four full time employees at the average wage, to file electronically.

A process for obtaining an exemption would remain, and would focus on whether the employer is unable to access digital services. Inability to access digital services might be defined as an absence of possible access in that location (for example no suitable internet services are available) or alternatively, that the employer does not already have a device that they use to connect to the internet for business/organisational purposes. Feedback on how inability to access digital services should be defined is sought in the questions that follow.

It has been suggested that the threshold should be based on staff numbers rather than the dollar value of PAYE and ESCT deductions. While increased complexity is often what drives an employer's decision to invest in digital systems, in the context of flexible working arrangements with part time and casual staff it is not clear how a staff number threshold would be operationalised by Inland Revenue. Comment from readers is invited in the questions which follow.

Research by Sapere based on Statistics New Zealand's 2012 Business Operations Survey found that 96 percent of businesses with more than 5 employees have access to the internet with 90 percent of them using it for financial services (assumed to be internet banking) and approximately 75 percent using it to interact with government.¹⁸

QUESTIONS FOR READERS

5.1 Provided a straightforward internet portal exists do you agree that employers with more than \$50,000 a year of PAYE and ESCT obligations should be required to file PAYE information electronically?

5.2 If you believe the threshold for electronic filing should be based on something other than the value of PAYE and ESCT deductions please describe how the alternative would work and where you think the threshold should be?

5.3 Are there factors, other than inability to access digital services, which should be grounds for an exemption from a requirement to file PAYE information electronically?

5.4 How should “inability to access digital services” be defined for the purposes of an exemption to a requirement to file PAYE information electronically?

5.5 Do you think there should be a more flexible framework under which changes to the threshold for electronic filing are considered in future?

5.6 If you think so, which of the options outlined above do you prefer?

CURRENT

If an employer pays over

\$100,000

PAYE* annually they are required to file electronically.

This happens to be 12% of employers.

* plus ESCT

The requirement to file employer monthly schedule information electronically is included in section 36A (2B) of the Tax Administration Act 1994 and can only be changed by a law change. At a time when the use of digital services is rapidly increasing, it is proposed that the legislative framework for adjusting the threshold should be more flexible.

The power to update the threshold could be given to the Commissioner of Inland Revenue. Alternatively, it could require an Order in Council. Giving the power to the Commissioner could be seen as a logical extension of her current power to prescribe forms and formats, including for classes of employers. If instead a change to the threshold required an Order in Council, it would be subject to parliamentary scrutiny.

PROVIDING PAYE INFORMATION WHEN THE BUSINESS PROCESS OCCURS - IMPLEMENTATION OPTIONS

As outlined in Chapter 4, many of the proposed benefits from better PAYE

FUTURE

If an employer pays over

\$50,000

PAYE* annually they may be required to file electronically.

This would be 22% of employers.

* plus ESCT

services depend on PAYE information being provided to Inland Revenue at the same time as the business process occurs.

Feedback is welcomed on the three possible implementation approaches discussed below.

Voluntary-first approach

Under a “voluntary-first” approach, legislation would be amended to allow employers to meet their PAYE obligations by submitting PAYE information when their business processes occur (for example, when the payroll is run). Submitting PAYE information on this basis would eliminate the need to file an employer monthly schedule.

After a range of payroll software packages and services with the new PAYE services have become available, and following significant voluntary uptake, the situation would be reviewed.

The review would examine the experience of employers who have

VOLUNTARY-FIRST APPROACH

Mary runs a small café business with three part time employees and uses broadband to do her banking and order and purchase stock. She uses a wages book to manually calculate the weekly pay for her employees before adding it up over the month and returning it to Inland Revenue on a paper employer monthly schedule.

Under the voluntary-first approach she would be able to listen to those she knows who are using the new PAYE services and decide if she wants to adopt payroll software, either a service or package, which can provide PAYE information to Inland Revenue at the time the business process occurs.

If she continued to use a wages book and file on paper, and a subsequent review of the costs and benefits of the new digital services justified requiring employers to provide PAYE information when the business process occurs, Mary would have some choices.*

She could choose whether to continue to manually calculate the payroll and because she is below the electronic filing threshold, she could continue to provide the PAYE information on paper. She would, however, have to submit PAYE information each week rather than once a month.

If she decided not to use payroll software, or a payroll service or an intermediary, she may find internet filing through the portal a better option than posting weekly returns.

**with the exception of those who could not access digital services.*

adopted the new digital services and the reasons why others have chosen not to use them. If the Government considers the costs and benefits to the system as a whole justify change, and a legislative response is appropriate, employers would then be required to provide PAYE information when the business processes occur. This requirement would:

- Provide a sufficient lead-in period to allow systems changes to be made. The implementation period could be different for different-sized employers. Twelve to twenty four months has been suggested by some large employers as the minimum timeframe they would require.
- Exempt or substantially exempt employers who could not use digital services to meet the new requirements. Other employers, below the digital filing threshold, could continue to use paper to provide PAYE information but would be required to submit their PAYE information more frequently.

A voluntary-first approach would create the right incentives for Inland Revenue and software providers to make the new digital services easy to use and beneficial to employers.

It would also provide an opportunity to learn from experience before consideration is given to requiring employers to change the way they provide PAYE information.

The downside is that it would be hard

to say when a sufficient proportion of employers would be providing PAYE information on the new basis to enable the expected wider system gains to be achieved.

Legislated approach

A second approach would be for the Government to set a time-line identifying when employers will have to provide PAYE information when the business process occurs. Legislation would be amended to:

- Allow employers, from the implementation date, to meet their obligations by submitting PAYE information when they run their business processes.
- Require employers, by a specified future date, to provide information when they run the related business process. This requirement could be staged for different classes of employers, and would exempt or partially exempt those who cannot use digital services.

This approach would clearly signal a timeframe to employers and would be an incentive for overseas-based software providers to support the upgrade of their products.

The legislated approach would leave “Mary” the employer in the previous example with the same choices. The difference is that she would know from the time the legislation was passed when the deadline would be for her to begin submitting PAYE information on a weekly basis.

QUESTIONS FOR READERS

5.7 Do you agree that Government needs to be able to balance the employer's interest in choosing how to provide PAYE information against the wider system benefits?

5.8 Do you think Government should require employers to use payroll software capable of providing PAYE information at the time of the business process?

5.9 If you prefer one or other of the outlined implementation approaches to the provision of PAYE information at the time of the business process (voluntary-first, review or legislated) please identify your preferred option.

5.10 If you would prefer another approach entirely please outline it.

5.11 If you support the 'review approach' how long after it first becomes possible to meet PAYE obligations by submitting PAYE information at the time of the business process, should the review occur?

5.12 If your answer to any of the above questions would vary depending on an employer's size or other characteristics, please outline the considerations you think are relevant.

5.13 If you were required to provide PAYE information at the time the business process occurs, would you seek to change the frequency with which you paid your staff?

Setting out an explicit timeframe in legislation would provide more certainty for employers and would give the Government more confidence about when wider system benefits would be achieved.

The trade-off for greater certainty would be less time for learning from experience and no explicit reassessment of costs and benefits in the light of that experience.

Review approach

A review option would take a middle path. Amending the legislation would permit employers to meet their obligations by submitting PAYE information when the business process occurs. In addition there would be an obligation for a review of the costs and benefits and the experience of those adopting the new digital services within a stated period. The period might, for example, be between 12 to 36 months after the legislation takes effect.

The review would operate in the same way as the voluntary-first option but the review would be time-tabled from the outset. It would provide an opportunity to evaluate progress before revisiting the question of whether employers should be required to provide PAYE information when the business process occurs.

Unlike the legislated approach, there would be an explicit review of the costs and benefits of providing PAYE information at the time of the business process. By limiting the period before the question is reviewed, the possible

delay to benefit realisation would be limited.

Relevant considerations

It is not proposed that the due dates for PAYE information would change in the initial voluntary stage of each of the possible approaches outlined above. An employer which chose to send PAYE information at the time of the business process would be meeting their current obligations (to file PAYE information for the month by the 5th or 20th of the following month) by submitting information progressively.

If, under any of the alternative approaches, employers came to be required to provide PAYE information at the time the business process occurs, the question of due dates would require further consideration to reflect the new obligations.

The previous options for implementation have been framed in terms of requiring the employer to provide information at the time the business process occurs. Focusing on when information is provided reflects the feedback that some small employers with simple payrolls may wish to continue to use paper forms to meet their obligations and should not be compelled to use the new digital services.

An alternative approach is for the Government to require employers to adopt payroll software and use it to provide PAYE information at the time the business process occurs. If you think this approach is preferable

LARGE EMPLOYERS

There are more than 5,700 employers with over 50 “employees” (this definition of employees includes ACC recipients, those on student allowances, pensions and taxable benefits).

Large employers, defined as private-sector enterprises with more than \$80 million annual turnover, central and local government and the government agencies that pay taxable benefits make up 3 percent of employers but employ over half of all employees.²¹

QUESTIONS FOR READERS

5.14 If you have a large payroll, what factors would influence whether you would upgrade it to take advantage of the new PAYE services?

5.15 Does an upgrade to your payroll system to provide PAYE information at the time of the business process depend on the law being changed to make this a legal requirement?

SMALL AND MEDIUM-SIZED EMPLOYERS

58 percent of small and medium-sized employers (109,289) have less than 5 employees; they employ 6 percent of employees.

23 percent of employers (44,201) have between 5 – 10 employees; they employ 8 percent of employees.

16 percent of employers (30,451) have between 11 -50 employees, they employ 17 percent of employees.

please provide feedback to that effect.

It is possible that requiring employers to submit PAYE information at the time the business process occurs may incentivise some employers to consider changing the frequency with which they run their payroll - for example, to change from fortnightly to monthly. This would be undesirable.

The statistical snapshots and categorisation of issues which follows reflects feedback already provided. It is not intended to be definitive or exclusive and some employers may identify with issues across several categories.

LARGE EMPLOYERS AND BESPOKE SYSTEMS

Large employers, including large public-sector organisations, often have customised business systems and complex payrolls that require significant lead times for change.

The core technology in these systems is often supplied by overseas corporations that may be unwilling to support upgrades in response to developments in the New Zealand market unless it is a legal requirement to do so. There are also employers using “bespoke” payroll systems they have developed themselves.

In addition to developing and testing the software, time may be required to schedule the change and train staff. If the employer operates internationally and its payroll is sourced from, or shared with, overseas operations this can be problematic. Feedback on

the *Better digital services* discussion document and early discussion with some large employers suggests a minimum of 12 – 24 months’ notice would be required.

SMALL AND MEDIUM-SIZED EMPLOYERS

Early engagement with employers and discussions with software providers indicate that software providers servicing SMEs are likely to be first to make software available that can submit PAYE information at the time the business process occurs.

The Government recognises that employers will vary in their willingness to adopt or upgrade to software that supports the new digital services. Early adopters will move quickly, or will be moved when their service provider adopts the new services, while others will wait to see how the services are received.

For small employers, doing the payroll is often the role of the business owner or a family member. While simple software which automates functions could be expected to be attractive, cost may be a barrier. So too could be the need to set time aside to learn a new way of doing things.

For small and medium employers that do not adopt payroll software but can access digital services, the proposed new portal providing an on-line channel to submit information, is intended as a suitable option.

Employers not using payroll software but with digital access could use the

WHAT YOU TOLD US

"Not all businesses stand to benefit from the proposals."

QUESTIONS FOR READERS

5.16 Do you think that financial assistance, such as the existing payroll subsidy or something else, should be available to assist employers take advantage of the new digital services proposed to modernise PAYE information?

5.17 If so what factors should any such assistance target?

portal to receive PAYE information from Inland Revenue and to submit the following information:

- a decision to begin to employ;
- details of new and ceased employees;
- pay day information about PAYE and other deductions;
- amendments to PAYE information; and
- a decision to permanently or temporarily cease to be an employer.

Cost as a barrier

For some employers, especially smaller ones, the cost of adopting payroll software or upgrading their software, may be a barrier to benefitting from the proposed new PAYE services.

With over 50 different payroll providers active in the New Zealand market it is expected there will be competition between providers which should limit the cost of payroll software and the cost of upgrades.

Under a government programme, a payroll subsidy is available to employers with less than \$500,000 a year of PAYE deductions (including ESCT). The subsidy discounts the cost of payroll services by \$2 per employee each pay period, for up to five employees, provided the employer uses a listed payroll intermediary. At least one intermediary uses this

subsidy to make a free payroll service available.

To retain eligibility for the subsidy it is likely that after a transition period listed payroll intermediaries would have to upgrade their services to provide PAYE information at the time the business process occurs.

Feedback on the *Better digital services* discussion document showed mixed support for further subsidies; some submitters were opposed and others suggested the existing payroll subsidy might need to be extended.

Some submitters made the point that some employers have such simple payrolls that the cost and effort of transferring to a software-based system cannot be justified. Alternatives for these employers are addressed below.

Those with very simple payrolls

A significant number of New Zealand employers are very small. Some find payroll software appropriate and affordable and it is expected that the new digital services will attract more. A simple payroll, perhaps available as an app over a mobile phone or tablet, is likely to be an attractive option for some very small employers.

As previously noted, an upgraded portal will be available for employers to upload or enter their PAYE information. To submit payroll information through a portal would require internet access. This could be achieved from an internet connected computer or through a mobile

Simple payrolls

Almost 45,000 employers have only one employee.

QUESTIONS FOR READERS

5.18 If you run a small or medium payroll, what factors would be most influential in determining whether you would choose to upgrade to software offering the new PAYE services?

5.19 If you run a small or medium payroll and were required to provide PAYE information at the time of the business process what options would you consider and why?

REGISTERED CHARITIES

8,900 registered charities are employers, employing 186,000 staff.

48 percent of registered charities have less than five employees.

QUESTION FOR READERS

5.20 Are there additional issues beyond those identified for small and medium organisations, and those with very simple payrolls, that need to be considered when thinking about how the proposed new PAYE services would work for not-for-profit organisation?

connection.

Feedback on the *Better digital services* discussion document identified the importance of ensuring that those who cannot use digital services are still able use other services to meet their obligations.

This discussion document responds to those concerns by proposing that paper forms would remain as a filing option, for the foreseeable future. The option would be available to those who cannot access digital services and also for employers, below the threshold for digital filing to whom none of the digital options are attractive.

If providing PAYE information when the business process occurs becomes a requirement, those small employers who have digital access and who choose to continue to submit their PAYE information on paper would have to submit PAYE information more frequently.

Because of the time taken to receive and process paper these employers would be unlikely to fully benefit from the process changes outlined in Chapter 4.

NOT-FOR-PROFIT SECTOR

The not-for-profit sector includes registered charities and entities such as sports clubs, associations and societies whose activities are not carried out for the gain or profit of any member. Non-profit employers range from the very small to large organisations.

Small non-profit organisations are likely to combine payroll responsibilities with other duties, and payroll responsibilities may even be discharged by a volunteer.

PAYROLL BUREAUS, PAYROLL INTERMEDIARIES AND OTHER THIRD PARTIES

Some employers use third parties such as bookkeepers, accountants, payroll bureaus or payroll intermediaries to run their payroll and pay staff. In the case of payroll intermediaries the third party takes over the employer's legal obligations to Inland Revenue. Third parties play an important role in the PAYE system as they free the employer from these processes, while bringing a professional level of skills and knowledge to these tasks.

In general the proposed new digital services should work for third parties as they do for employers. The information that could be provided through business software to Inland Revenue at the same time the payroll runs is a subset of the information that the third party needs to run the payroll.

There may, however, be some situations when the proposed new digital services might work less well. For example, a third party might not hold the full range of employee details that it is proposed would be required by Inland Revenue to set the employee up correctly from the beginning, or near the beginning of employment.

It is recognised that a third party may

QUESTION FOR READERS

5.21 Are there additional issues that need to be considered when thinking about how the proposed new PAYE services would work for third parties such as bookkeepers, accountants, payroll bureaus and payroll intermediaries?

WHAT YOU TOLD US

"[We] agree that customers' needs vary ...Areas that are not covered by internet services will be disadvantaged."

QUESTIONS FOR READERS

5.22 If there is a general requirement to provide PAYE information when the business process occurs, is it reasonable to expect employers who have an exemption because they cannot use digital services, to nonetheless provide disaggregated PAYE (pay day) information?

5.23 If there is a general requirement to provide PAYE information at the time the business process occurs, is it reasonable to expect that exempt employers should be required to provide PAYE information by the 5th of the following month?

play different roles, such as being a nominated person for one taxpayer and a person with delegations of authority for another. The current processes to manage different roles are often convoluted, requiring client input and multiple logons. It is intended that a single customer will be able to have multiple roles but maintain a single identity with Inland Revenue.

THOSE UNABLE TO ACCESS DIGITAL SERVICES

Implementation approaches discussed earlier, propose that those unable to use digital services to meet their PAYE obligations would be exempt, or partially exempt, from any requirement to provide PAYE information at the same time the business process occurs. Employers operating in rural areas without broadband internet or mobile phone coverage are an obvious example of a customer group who lack digital access. It is proposed that the exemption process would require an application to the Commissioner of Inland Revenue.

Significant advantages for the Government and social policy recipients would be derived from PAYE information being provided on disaggregated basis showing what has been deducted each pay day. Employers already calculate this information as part of doing the pay and are required to retain the information. Under the current system these pay day records are added together, either by software or manually and submitted the following

month.

If there is a general requirement to provide information at the time of the business process, it is proposed that employers exempt from that requirement would be required to submit information that reflects the detail of what was actually paid and deducted each pay day, but they would only have to submit the information once a month.

Because of the benefits that would arise from earlier provision of PAYE information, it is further proposed that in the event that there is a general requirement to provide PAYE information at the time of the business process, employers who have an exemption would be required to provide the information by the 5th, rather than the 20th, of the month following the month in which PAYE deductions were withheld.

The monthly submission would also include details of new employees and the employer would have the option of advising of amendments to previously provided PAYE information in the monthly submission, or earlier.

IR56 TAXPAYERS

Currently, certain types of employees are responsible for paying their own PAYE instead of their employer being required to deduct PAYE from their earnings. These employees are known as "IR56 taxpayers" and include private domestic workers, embassy staff, New Zealand-based representatives of overseas companies, and United States Antarctic Program personnel.

IR56 taxpayers are currently required to file an employer monthly schedule (IR348) and employer deductions form (IR345), and pay the PAYE deductions to Inland Revenue, by the 20th of the month following receipt of payment from their employer(s).

Inland Revenue receiving (near) real-time PAYE information is crucial for realising the Government's vision for a modern tax administration. Real-time information at the point of payment is, however, incompatible with the recipient of the payment being responsible for providing the information.

Proposal

While imposing relatively onerous tax compliance obligations on individual employees is generally not desirable, employers of private domestic workers may be even less well equipped to fulfil PAYE compliance obligations. PAYE compliance obligations could not be enforced against foreign states, and may be difficult to enforce against non-resident companies that do not have a substantial presence in New Zealand. Furthermore, making the employee responsible for fulfilling the PAYE obligations, allows them to add all their payments from their numerous employers together and calculate PAYE deductions monthly using one of the "M" tax codes (assuming they do not have another "M" tax code job). For these reasons, the Government proposes that IR56 taxpayers continue to be responsible for submitting their own PAYE information, and paying their own PAYE deductions, to Inland Revenue.

For IR56 taxpayers, continuing to operate on a monthly PAYE cycle is probably sufficient. Digital solutions may allow an option for these taxpayers to operate on a weekly or fortnightly basis. IR56 taxpayers will likely be able to provide their PAYE information via a digital portal on Inland Revenue's website, although, as previously mentioned, it is proposed that a paper channel will remain open for the foreseeable future.

There is a question about whether the timeframe an IR56 taxpayer has for providing their PAYE information to Inland Revenue should be reduced. In the previous section, it was proposed that, in the event that there is a general requirement for employers to provide PAYE information at the same time the business process occurs, employers who have an exemption would be required to provide the information by the 5th, rather than the 20th, of the month following the month in which PAYE deductions were withheld. To be consistent, IR56 taxpayers could be dealt with in the same way, and be required to provide PAYE information to Inland Revenue by the 5th, rather than the 20th, of the month following payment.

Earlier PAYE information from IR56 taxpayers might also be important for future improvements to the delivery of social policy. On the other hand, there may be less compelling reasons for requiring IR56 taxpayers to provide their PAYE information to Inland Revenue earlier. Delayed PAYE information from employers could mean that their employees are denied the benefits a modern

QUESTIONS FOR READERS

5.24 Do you agree that IR56 taxpayers should remain responsible for submitting their own PAYE information and paying their own PAYE deductions to Inland Revenue, rather than their employers?

5.25 Do you think that IR56 taxpayers should have to provide their PAYE information to Inland Revenue earlier (for example, by the 5th of the following month), or do you think that by the 20th of the month following payment is still sufficient?

tax administration could deliver. By contrast, delayed PAYE information from IR56 taxpayers would not have this negative impact.

¹⁷ Sections 36A(2B) and 36B of the Tax Administration Act 1994

¹⁸ The value of internet services to New Zealand businesses 2014. Sapere research group p7. In addition to having more than 5 employees the businesses in the sample had more than \$30,000 of GST turnover and had been operating for more than a year.

¹⁹ The Government's broadband initiative intends to connect 90 percent of rural homes and businesses with broadband at peak speeds of at least 5mbph by 2016. Broadband Deployment Update June 2015 p3

²⁰ MYOB Business Monitor The Voice of New Zealand Business Owners and Operators February 2014 p13 reported that Generation X (often defined as born 1965 - 1977) and Generation Y (born 1978 - 1994) are less likely than baby boomers (1946 - 1964) to use email as an on-line service, but Generation X are more likely than baby boomers to use online accounting solutions.

²¹ Employees in this context includes those on student allowances, pensions and recipients of taxable benefits.



CHAPTER 6

PAYE – ALIGNING PAYMENTS

Previous chapters discussed proposals to modernise the way employers might provide PAYE information to Inland Revenue. This chapter explores the possibility of aligning the payment to Inland Revenue of PAYE deductions and related payments with the payment of employees' salary and wages.

As previously discussed, under the current PAYE system employers withhold PAYE and related deductions, such as child support, student loan and KiwiSaver deductions, from salary and wages when they pay their employees. They hold this withheld amount for a period of time before they are required to pay it to Inland Revenue.

Integrating the remittance process with other PAYE business processes (payment of employees, withholding PAYE deductions, remittance and providing information to Inland Revenue) at the same time has the potential to reduce an employer's compliance and administrative costs. It could also provide others (such as recipients of child support and the Crown) with prompter payments. KiwiSaver deductions could also

be passed on faster and it may improve compliance by removing the possibility of employers getting into difficulties by using PAYE held in trust to cover other expenses.

The Government is interested in receiving feedback from employers and other interested parties on whether employers should make PAYE and related payments to Inland Revenue at the same time, and as part of the business process of paying their employees.

CURRENT PAYE PAYMENT OBLIGATIONS

An employer's PAYE obligations can broadly be described as deducting PAYE from an employee's wages each pay day, providing the information on the employee's gross wages and deductions to Inland Revenue once a month, and paying the withheld PAYE amount to Inland Revenue once or twice monthly.

Whether an employer is required to pay PAYE to Inland Revenue monthly or twice-monthly depends on the employer's annual PAYE (including ESCT) payments. Small employers

whose annual PAYE and ESCT is less than \$500,000 are required to pay PAYE once monthly, by the 20th of the following month. Large employers whose annual gross PAYE and ESCT is \$500,000 or more are required to pay PAYE twice-monthly, on the 20th of the same month for deductions made during the 1st to the 15th of the month, and on the 5th of the following month for deductions made during the 16th to the end of the month.

All employers have the advantage of interest on the PAYE deductions they hold between the time they pay salaries and wages to their employees and the time they pay the PAYE deductions to Inland Revenue (time value of money). This period is generally between 20 to 50 days for small employers and between 5 to 20 days for large employers. The delayed PAYE payment offsets some of the employer's costs incurred in complying with their PAYE obligations. However, it also creates an additional compliance process and costs.

The PAYE payment must be accompanied by an "employer deductions" form. The form records the total PAYE and the totals for each of the other categories of deductions and contributions. These might include, for example, any KiwiSaver, child support and student loan deductions, KiwiSaver employer contributions or ESCT deductions.

MAKING PAYE PAYMENTS ON A PAY DAY BASIS

If the process of making PAYE payments to Inland Revenue ceased to

be a separate process and was aligned with the timing and process of paying salary and wages to employees, this could provide the following improvements:

- PAYE and deductions of KiwiSaver contributions, student loan repayments and child support payments could be passed on to individuals and the Crown more quickly.
- Employers would be less likely to get into financial difficulties by using amounts they hold in trust to cover other expenses.
- Employers that are having problems meeting payment obligations would be identified earlier so earlier support could be provided, which would improve compliance.
- Lower compliance costs by eliminating the separate process involved in remitting PAYE payment to Inland Revenue.

Together with the proposal for providing PAYE information to Inland Revenue on a pay day basis discussed in previous parts of this discussion document, an employer could have one combined pay day process of paying their staff, paying PAYE deductions and providing the associated PAYE information to Inland Revenue at the same time.

This combined pay day process could become part of the business payroll process and make PAYE processes simpler and reduce compliance costs

and risks for employers. For example, if PAYE information and payments are all derived directly from the payroll the step of submitting an employer deduction form may be able to be eliminated.

The question arises as to whether the proposal that PAYE deductions should be remitted to Inland Revenue on a pay day basis should only proceed if information is also provided on a pay day basis. The Government is interested in hearing readers' views on this point.

Any move to pay day payment of PAYE would, however, involve a trade-off between these benefits and the current benefit employers have in retaining PAYE and related deductions until it must be paid to Inland Revenue. Some employers may value a reduction in compliance costs and effort rather than the benefit provided by the delayed PAYE payment. However, some employers may rely on the benefit provided by the current PAYE rules.

PAYE payment on a pay day basis would increase the frequency of payments to Inland Revenue for most employers. For example, a small employer who pays their staff fortnightly is currently required to pay the withheld PAYE to Inland Revenue once a month. If pay day payment was adopted they would pay PAYE to Inland Revenue each fortnight when they pay their staff. Any increase in PAYE payment frequency may increase employers' costs associated with payment transactions (for example bank transaction fees).

However, employers who currently choose to keep a separate bank account to set aside PAYE deductions may, under the proposal, be able to save account maintenance costs previously associated with such a separate account.

PAYE payment on a pay day basis would also reduce the risk of PAYE payment default. PAYE deductions made by an employer are from money belonging to the employee. They are to discharge the tax liability of the employee to the Crown. PAYE deducted is money that the employer holds in trust until it must be paid to Inland Revenue. Despite this some employers use PAYE deductions as working capital for their business. Sometimes an employer may not be in a position to pay the deducted PAYE to Inland Revenue, in which case penalties and recovery action will follow, with a possible significant effect on the business involved. Failing to pay PAYE is a serious offence and can result in prosecution. PAYE payment on a pay day basis would reduce the risk of payment default and its consequences.

If pay day payment was adopted, an unintended consequence may be that cash flow considerations and additional transaction fees influence some employers' preferences on the frequency with which they pay their staff.

Chapter 5 discussed the Government's proposal that IR56 taxpayers continue to be responsible for submitting their own PAYE information and paying their own PAYE deductions to

QUESTIONS FOR READERS

6.1 Should the timing and process of employers' PAYE payment obligations be aligned with the process of paying salary and wages to employees?

6.2 Do you think this alignment would increase or reduce compliance costs and effort? If you can quantify the effect please do so.

6.3 Do you believe that the timing of PAYE payments made to Inland Revenue is necessarily linked to when PAYE information is provided?

6.4 Do you think PAYE payment to Inland Revenue on a pay day basis would influence the frequency with which you will pay your staff?

6.5 Do you think, for IR56 taxpayers, the due date for payment of PAYE deductions should remain aligned with the due date for providing PAYE information to Inland Revenue?

Inland Revenue. It is also suggested that they continue to operate on a monthly PAYE cycle. The Government proposes that for IR56 taxpayers the timing of PAYE information provision and payment to Inland Revenue should continue to be aligned. This means that if IR56 taxpayers continue to be required to file PAYE information monthly, this monthly cycle would also continue to apply to PAYE payments they are required to make to Inland Revenue. If the due date in the following month for providing their PAYE information is earlier, the due date for payment of PAYE deductions could be aligned with this earlier date to retain alignment of information and payment due dates.



CHAPTER 7

GST – MODERNISING HOW INFORMATION IS PROVIDED

Goods and Services Tax (GST) is central to New Zealand’s tax system. It accounts for 32 percent of total tax revenue collected, with 21 percent collected by Inland Revenue and 11 percent by Customs.

The Government considers that the current GST rules are working well overall. New Zealand’s GST system is regarded throughout the world as a model consumption tax. It is broad-based – meaning that it applies to a wide range of goods and services with very few exemptions. It is therefore relatively simple and easy to comply with compared with other countries’ systems. This is reflected in the relative simplicity of the GST filing and return processes. In line with the broad-base framework, the Government has recently released a discussion document *GST: Cross-border services, intangibles and goods* seeking submissions on proposed new rules that would apply GST to cross-border services and intangibles and is also seeking feedback on the collection of GST on goods. Inland Revenue has also recently published an officials’ issue paper *GST – Current Issues* on a range of specific technical and remedial GST issues raised mainly by private sector stakeholders.

As part of this discussion document on how the way GST information is provided can be simplified, the Government is not proposing to make changes to the legislation on how and when to account for or pay GST. However, despite the relative simplicity of our GST system, there are compliance costs incurred by registered persons accounting for GST and filing GST returns – for example, through performing GST calculations, seeking advice, record-keeping, filing returns and making GST payments.

The proposals for GST can improve the processes for how customers provide GST information and how they communicate with Inland Revenue, reducing compliance costs for GST-registered persons as well as administrative costs for the system overall. As such, proposals for GST involve process changes rather than changes to the GST rules.

This chapter presents a proposal on how to create an easier, cheaper and more effective system for customers to comply with their GST information and payment obligations by:

- simplifying the process of

providing GST information to Inland Revenue by integrating it with processes and systems used to run the business; and

- as a consequence improving the quality of GST information provided to Inland Revenue by businesses and individuals.

It also describes how new integrated services could contribute to faster processing of GST refunds.

GST SYSTEM AND OBLIGATIONS

GST is a consumption tax on most goods and services supplied in New Zealand. Taxpayers that are GST-registered with Inland Revenue collect GST from their customers on behalf of the Government by charging GST on their sales (known as output tax) and claiming back a tax credit on their purchases and expenses (known as input tax). GST-registered “persons”, can be businesses, non-profit bodies or individuals. They calculate the difference between the GST they charge on their sales and the GST they pay on their expenses to work out if they have to make a GST payment or receive a refund from Inland Revenue.

GST is based on a system of self-assessment. It is the responsibility of registered persons to calculate the amount of GST output tax they are required to pay and any input tax deductions they are eligible to receive, and provide this information to Inland Revenue by way of a GST return.

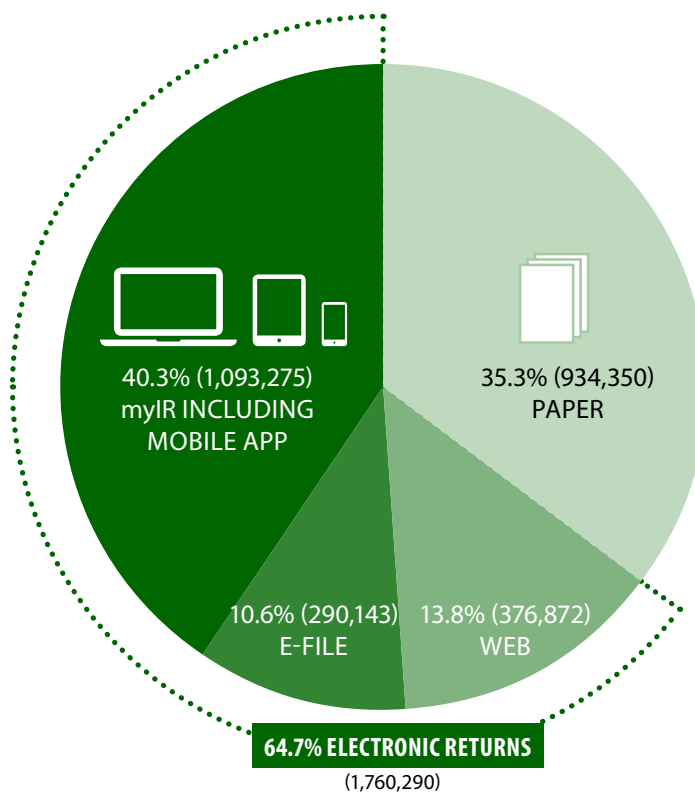
GST-registered persons must file a GST return for each taxable period. A person’s taxable period is one, two or six months, depending on the amount of taxable supplies made in a 12-month period, or in some cases, on the election of the GST-registered person. Generally, a taxable period ends on the last day of a month. However, a registered person can apply to use a different end-date to their taxable period up to seven days before or after the end of the month. This provides some flexibility to allow registered persons to adopt a taxable period which is consistent with their accounting procedures or tax balance date.

GST returns must be filed along with any payment by the 28th of the month following the end of the taxable period (with two exceptions for November and March).

CURRENT GST INFORMATION COLLECTION CHANNELS AND PROCESSES

GST was introduced in 1986 using paper-based return filing. Since then, the way New Zealanders run their businesses has changed significantly. This is reflected in the channels currently made available by Inland Revenue to file GST returns. Today GST returns can be filed electronically for example, via myIR (also referred to as e-GST), mobile application and E-File (data transmitted from a tax agent’s computer system), as well as through paper-based returns.

GST RETURNS FILED AUGUST 2014 TO JULY 2015



From 1 August 2014 to 31 July 2015, over 2.8 million GST returns were filed. More than 64 percent of registered persons filed their returns electronically during this period of time, compared with more than 53 percent for the 2013–14 financial year. However, a significant number of GST returns (35.3 percent) are still filed on paper.

Creating and filing a GST return and paying GST involves time and effort. The majority of registered persons have to transcribe GST information from their accounts (paper-based or digital) to their preferred GST filing channels; information cannot be transferred automatically and must be re-entered manually.

The calculation of GST can also add to compliance costs. Manual calculations can result in errors, leaving registered persons exposed to the risk of penalties. It also affects efficiency and results in additional costs to registered persons as well as Inland Revenue in fixing these errors.

Furthermore, the time and effort involved in communicating with Inland Revenue imposes costs on registered persons. Some seek confirmation from Inland Revenue that their return has been received and others seek advice or progress reporting on the payment of refunds.

ROB - SMALL BUSINESS OWNER

Rob runs a plumbing business. He does all the administration and the books himself using accounting software. Rob is GST-registered and files his GST return online through Inland Revenue's MyIR service. Rob enters all the information he needs to file his GST return in his accounting software. However, he is frustrated that every time he files a GST return he has to manually transcribe the information needed from his accounting software to the electronic GST return form in MyIR, needing to switch back and forth between screens.

What if Rob's accounting software would automatically populate the GST information needed for his GST return and Rob could, after checking that all the information is there and correct, file his return with Inland Revenue directly from his accounting software.

WHAT YOU TOLD US

"Tax could be simplified by accounting software being able to send this data off to the IRD... the administrator needs to authorise the transfer.. otherwise if there were unfinished workings or an error this would create nightmares."

USING INTEGRATED ACCOUNTING SOFTWARE TO PROVIDE GST INFORMATION

The central proposal for simplifying the way GST information is provided is to create a new channel that allows direct interaction between the accounting software people use to run their business or organisation, and Inland Revenue's systems.

The proposed new channel would offer opportunities to simplify the way GST information is provided. Early consultation suggests that the new digital services would particularly appeal to small and medium-sized customers, as some large GST-registered businesses have indicated that they do not use their accounting software to calculate their GST obligations.

Reducing time, effort and costs

The proposal would allow registered persons to provide GST information to Inland Revenue directly from their integrated accounting software used as part of their business processes rather than producing and filing a GST return as a separate manual process. This would remove the need to duplicate or transcribe information from business systems to the current GST return and reduce the GST compliance burden for registered persons by eliminating or automating some activities and processes. It would also mitigate the costs and risks associated with manual intervention.

Once the GST information has been received by Inland Revenue systems, a confirmation of acceptance could

be sent to the customer through their integrated accounting software. This should provide greater certainty and confidence to customers and would eliminate the need some customers feel to contact Inland Revenue for confirmation.

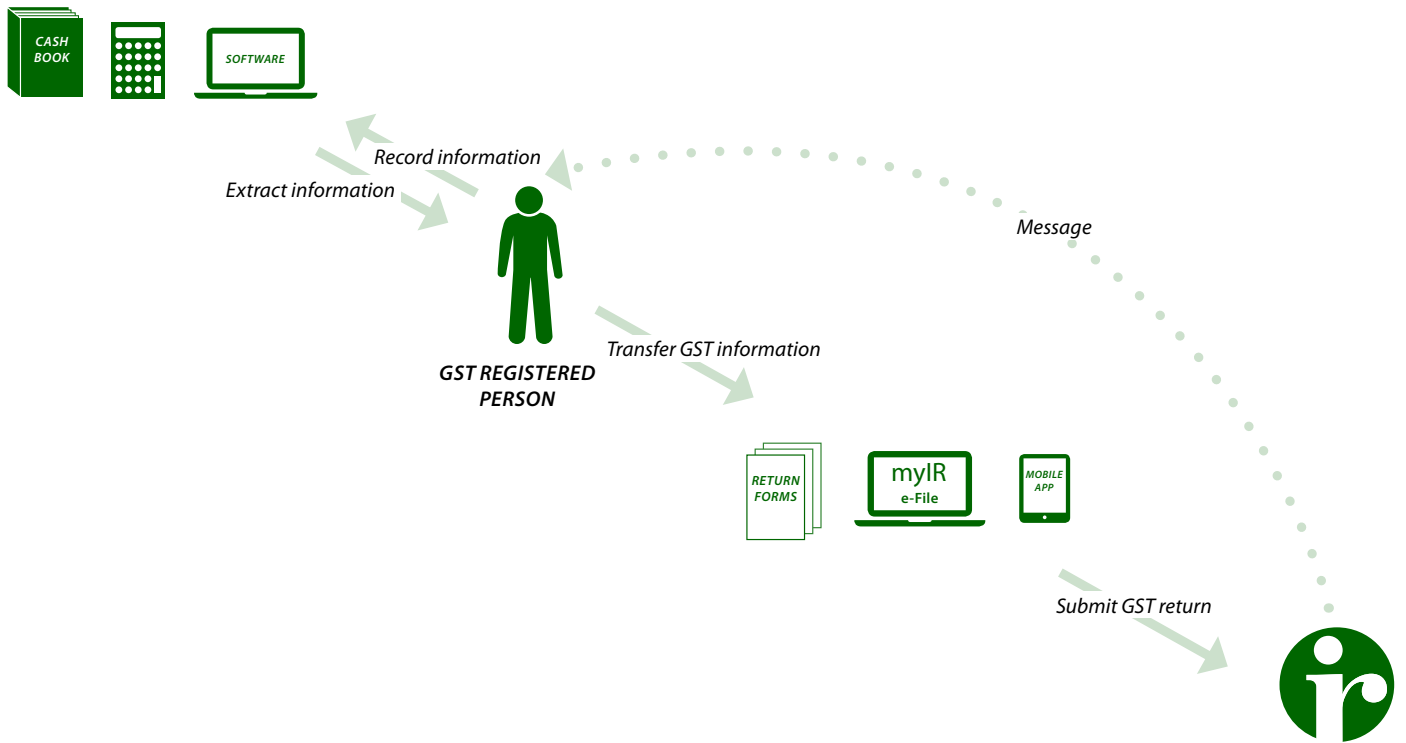
The diagram on the next page shows how the proposal would work.

Providing GST information to Inland Revenue will not be an automated process, but will involve a "submit information now" step. Registered persons will continue to be required to self-assess (determine the amount of GST payable by or refundable to them for the taxable period) and provide a return setting out the amount of GST payable by them. The submission of a GST return is creating an assessment and should be a deliberate step, where the registered person is still in control of the submission of their GST information.

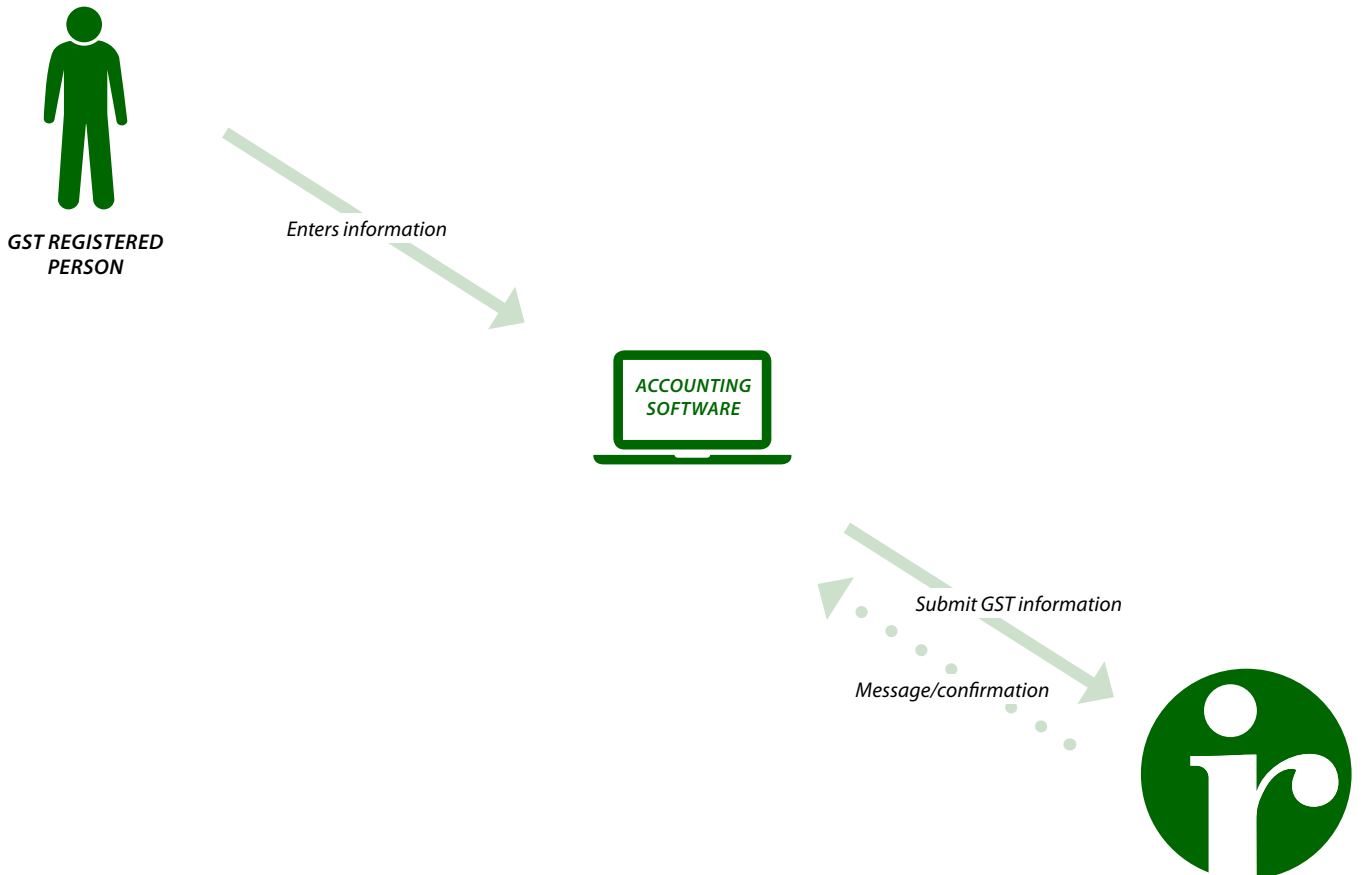
A significant number of GST-registered persons use third parties, such as tax agents, tax advisors, accountants or bookkeepers, to help them with meeting their GST obligations. About a third of GST returns filed with Inland Revenue are filed by tax agents.

The professional services that tax agents and other third parties provide to their clients make a significant contribution to the quality of returns and hence compliance. Generally, the proposed new digital services are expected to provide the same benefits to third parties submitting GST information on behalf of their clients as they will for GST-registered persons themselves.

CURRENT STATE:



FUTURE STATE USING INTEGRATED ACCOUNTING SOFTWARE:



WHAT YOU TOLD US

"Yes. A move to digital services is definitely the way to go. Currently I use digital services to do everything except pay IRD. The digital services effectively give me a GST return, but there is no button marked "submit to IRD" or "submit and pay."

QUESTIONS FOR READERS

7.1. If you could submit GST information directly from integrated accounting software in the way described above, would this reduce or increase your compliance effort and costs? If you can quantify the amount please do so.

7.2. Are there additional issues that need to be considered when thinking about how the proposed new digital services would work for third parties, such as tax agents, tax advisors, accountants and bookkeepers, in relation to the provision of GST information?

Improving the quality of GST information

Under current systems GST returns often require manual intervention and "rework" before GST information can be processed and used by Inland Revenue. This is because the GST return is often incomplete, contains errors or is unreadable. Time and effort is involved, both for registered persons and Inland Revenue, in identifying and fixing these errors.

The proposal to enable direct interaction between a business's integrated accounting system and Inland Revenue's systems presents an opportunity to eliminate or reduce some of the current error sources. It also allows for improvements to the quality of GST information provided by taxpayers and collected by Inland Revenue. GST information will be more accurate and reliable, because errors that occur under the current processes are reduced.

An improvement in the quality of GST information would reduce the compliance effort and cost for taxpayers, as well as the administration costs of the tax system. More reliable GST information would improve the effective use of available information for both customers and Inland Revenue.

GST information provided

An important aspect of modernising New Zealand's tax administration is improving the information provided to and collected by Inland Revenue. Earlier this discussion document outlined how the Government

proposes to achieve this through more integrated and streamlined information flows and enabling better use of information. This also involves consideration of the information needed to ensure the tax administration system operates effectively and to explore whether the information currently collected is sufficient for a modernised tax administration.

For GST the return is the key source of information provided to Inland Revenue. A GST return contains the registered person's self-assessment of the amount of GST payable or refundable for the taxable period.

The information collection framework for GST has not significantly changed since the introduction of GST in 1986. At this point Government is not suggesting any changes to the information required through a GST return although it may in the future consider this.

It is, however, envisaged that under the new digital services a registered person will be able to attach accompanying documents or correspondence to a GST return if they wish. They will, for example, have the opportunity to attach documentation on an unusually large input tax claim to support the GST return. This could have an impact on the speed of processing the return and may result in the input tax claim being released faster. However, attaching additional documentation to a GST return will be on a voluntary basis.

The GST filing option through myIR currently includes a feature that helps

customers with their GST adjustments calculation. This information is then submitted through myIR as part of the GST return process. It is proposed that the new service include a similar feature for the calculation of GST adjustments.

Payment of GST

The payment of GST is currently aligned with the due date for GST information (the GST return). It is not proposed to make any changes to GST payment frequencies.

The proposal for enabling direct interaction between a business's integrated accounting system and Inland Revenue's system does, however, provide new opportunities for simplifying the making of GST payments and for streamlining the receipt of input tax.

It is envisaged that accounting software offering the new digital services will have enhanced payment solutions that make it faster and easier for registered persons to make a GST payment. This may include a link from the GST information submission process to a payment routine that will allow payment of the GST amount due. This would also allow faster acknowledgement of payment.

Implementing the change

It is intended that new GST services will be able to run on a wide variety of platforms, including through a desktop, in the "cloud", accessed through a browser, a mobile application or on new platforms that may emerge in the future.

The *Better digital services* discussion document identified the importance of ensuring that taxpayers who cannot use new digital services can still use other channels to comply with their tax obligations. It is proposed that paper filing will remain available as a way to submit a GST return for the foreseeable future. Simple solutions will be available for very small GST-registered persons, for whom the cost of entry level accounting software may be a barrier for example, in the form of an improved portal for the online submission of their GST returns.

To ensure a diverse range of products that support the proposed new digital services, Inland Revenue has started work with software providers so that they can design software which will support the new digital services.

An "early release" of services allowing direct submission of GST information from some integrated accounting software to Inland Revenue systems is envisaged for December 2015. Functionality, such as attaching documents to GST returns, would likely be added in subsequent releases.

Small and medium GST-registered persons are likely to be the main group of early adopters. Early feedback from some large enterprises has indicated that they do not expect material benefit from the proposed changes. This is because their GST return processes are often largely manual and managed through different accounting systems. This is especially so for financial institutions whose core business is generally exempt from GST.

QUESTIONS FOR READERS

7.3 Do you support the proposal that adopting the new digital services should be voluntary for GST information?

7.4 Would you take up the new GST services? If your answer is “it depends”, what does it depend on?

A GST-registered person’s decision whether to adopt the new digital services to submit their GST information does not have a direct effect on third parties or the delivery of social policy. In addition, the Government is committed to the objective that a change to the way GST information is provided should minimise compliance costs. It is therefore proposed that the decision to adopt the new digital services for providing GST information should be, for the foreseeable future at least, voluntary. This creates incentives for Inland Revenue and software providers to make the new GST services easy, cost-effective and beneficial to GST-registered persons.

DIRECT CREDITING OF GST REFUNDS

As part of modernising the administration of GST, the Government proposes that GST refunds are only to be made by direct credit into customers’ nominated bank accounts in New Zealand, unless it would cause undue hardship to a customer or is not practicable. This proposal could speed up the GST refund process, reduce compliance costs for business and decrease administrative costs for Inland Revenue.

Current refund process

Currently Inland Revenue makes most GST refunds through direct crediting into a registered person’s bank account in New Zealand and through issuing cheques. The majority of Inland Revenue’s customers prefer direct crediting as a safe, secure and

convenient way of receiving refunds. Currently Inland Revenue makes about two-thirds of all GST refunds through direct crediting and one-third through cheques. For a refund by cheque it takes on average 10 working days from the time a GST refund is released to the time the funds are available to the customer. A GST refund that is released for payment and is direct credited into the customer’s bank account is generally available to the customer in two days.

Eighty percent of all GST refunds made by cheques are for clients of tax agents. Inland Revenue has recently contacted agents who receive a large number of cheques on behalf of their clients. A significant majority of these agents indicated that they would agree to change to receiving refunds by direct credit into bank accounts of their clients.

The Tax Administration Act 1994²² provides for the progressive implementation of compulsory direct crediting of tax refunds for the various types of tax administered by Inland Revenue by Order in Council. This provision was enacted with effect from 1 April 2000 as part of a major tax simplification package. It was intended that it would eventually apply to all tax types administered by Inland Revenue.

The measure benefits customers by eliminating time delays associated with the postal system, time taken to clear funds between banks, and by eliminating costs relating to the banking of cheques. There is also a benefit to Inland Revenue in terms of reduced administration

QUESTIONS FOR READERS

7.5 Do you support the proposal that GST refunds should only be made by direct credit into a customer's nominated bank account unless it would cause undue hardship to a customer or is not practicable?

7.6 Do you think GST-registered persons over a certain threshold should be required to submit their GST information to Inland Revenue in an electronic format?

7.7 At what level do you think such a threshold should be set?

costs. Compulsory direct crediting has already been implemented for donations tax credits.

Proposed change

The Government proposes to extend compulsory direct crediting to GST refunds. Receiving refunds straight into bank accounts could mean money will reach customers faster, customers do not need to bank the cheque and there is no waiting for the cheque to clear.

Nevertheless, it may sometimes be necessary to make a GST refund by cheque or other means, so an exemption to this rule would be available if a customer experiences undue hardship or direct crediting is not practicable. Making GST refunds by other means, such as cheques, would be considered on a case-by-case basis.

ELECTRONIC SUBMISSION OF GST INFORMATION FOR SOME REGISTERED PERSONS

Effective, timely and accurate GST administration can best be achieved through the electronic transfer of information. To minimise compliance and administrative costs Inland Revenue has and will continue to encourage electronic methods for communicating with and providing information to Inland Revenue.

Every year more GST registered persons choose to provide their GST information to Inland Revenue via electronic channels. As outlined earlier, the electronic filing rate for GST returns is relatively high, but a

large number of GST returns are still filed on paper (over 35 percent of GST returns filed from August 2014 to July 2015).

GST information submitted through electronic channels, rather than on paper, is faster and cheaper to process. While this discussion document does not propose compulsory adoption of the new digital services, the Government is interested in feedback on whether some GST-registered persons should be required to provide GST information in electronic format. Customers would comply with an electronic filing requirement if they submit their GST information through any electronic channel, new or existing.

An electronic filing requirement could apply to registered persons over a certain threshold (for example, dependent on the total amount of taxable supplies made by the person in a 12-month period) so that these registered persons would be required to provide all GST information to Inland Revenue electronically.

²² Sections 184A and 184B of the Tax Administration Act 1994.

