Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Bill

Bill Number 72-1

Regulatory Impact Assessments

1. Fringe benefit tax on employment related loans – market interest rate 3
2. KiwiSaver enhancements resulting from the Retirement Commissioner's review 13
3. Making Tax Simpler: Improvements to the administration of tax for individuals.. 31
4. Making Tax Simpler: Proposals for modernising the Tax Administration Act – collection, use and disclosure of information 47
5. Making Tax Simpler: Proposals for modernising the Tax Administration Act – flexibility for dealing with legislative anomalies 75
6. Making Tax Simpler: Proposals for modernising the Tax Administration Act – rulings, amendments and tax intermediaries 99
7. Modernising the correction of errors in PAYE information..............................127
8. Taxation of non-bank securitisation vehicles 143

Prepared by Policy and Strategy, Inland Revenue

June 2018

Impact Summary: Fringe benefit tax on employment related loans – Market interest rate

Section 1: General information

Purpose
Inland Revenue is solely responsible for the analysis and advice set out in this Regulatory Impact Assessment, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be undertaken by Cabinet.
Key Limitations or Constraints on Analysis
Quality of data used for impact analysis Inland Revenue does not possess information on how much FBT paid by banks and other money lenders relates to employment related loans. Therefore, stakeholders were asked to self-report how much FBT they pay on employment related loans and this information was used to estimate the amount of FBT currently collected on employment related loans from banks and other money lenders. **Consultation and testing** Although there was only a short consultation period, by targeting consultation to relevant stakeholders, Inland Revenue is confident that it got the input it needed to inform the analysis.
Responsible Manager (signature and date):
Chris Gillion Policy Manager Policy and Strategy Inland Revenue 27 March 2018

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

FBT rules

A fringe benefit arises when an employer provides a loan to an employee. There are two ways in which the benefit of an employment related loan can be valued. Most employers are required to use a prescribed rate of interest as defined in section RD 34 on the Income Tax Act 2007 (the Act). The prescribed interest rate is adjusted from time to time by Order in Council and is based on the floating first mortgage new customer housing rate published by the Reserve Bank. However, employers that are in the business of lending money, or are a member of a group of companies with at least one member in the business of lending money, may instead elect to use the market interest rate as defined in section RD 35 of the Act.

If they have elected to use the market rate, banks and other employers in the business of lending money are required to pay fringe benefit tax (FBT) when they provide a loan to an employee at a rate below the market interest rate. The market interest rate for a group of employees is currently defined as the rate their employer would offer to an arm's length group of persons with a comparable credit risk to the group of employees. Different money lenders will therefore have different market rates as the market rate is based on the rates a given lender offers to a group of its customers with a common risk profile.

The market interest rate rules were based on the practices banks and other lenders were using at the time the rules were developed. Money lenders would advertise rates and, in general, customers would receive these rates if they met the necessary conditions for a loan. However, some lenders would also offer discounts to certain groups of customers. For example a bank may have offered employees of a local respected employer a discount of 0.3 percentage points below the advertised rates. The market interest rate rules allow either a money lender's advertised rates or any group discount rates the money lender offers to be offered to employees as the market interest rate without banks and other similar lenders incurring FBT.

FBT should only be payable on employment related loans when a discount is genuinely provided to an employee.

Problem

The method for calculating the market rate is out-dated and no longer reflects the lending practices of banks and other money lenders. It is now common practice for banks and other similar lenders to individually negotiate loan rates with customers. Banks and other money lenders now also consider a broader range of criteria than just credit risk when determining interest rates. Individually negotiated loans cannot be used for determining the market rate as the rates received by customers through this process have not been offered to a group.

As such, the true market rate, being the interest rate an arm's length customer receives, is often lower than the market rate calculated under the current legislation. This can result in the over-taxation of employment related loans and fairness concerns. Furthermore, because of this over-taxation many employees of banks and other money lenders may be able to receive better loan rates from competitors to their employer.

The rules around the market interest rate were introduced to rectify the problem of FBT arising even when the employer is charging an employee the true market rate. As such, changing the method for calculating the market rate to more appropriately reflect the true market rate would be consistent with the original policy intent and the broader FBT policy framework.

2.2 Who is affected and how?

The affected parties are banks and other employers in the business of lending money as well as the employees of money lenders. Banks and other money lenders are affected as they are currently paying too much FBT on loans made to employees.

Employees are affected as the interest rates they receive from their employer may in some cases not be as low as if the over-taxation of employment related loans did not occur.

2.3 Are there any constraints on the scope for decision making?

There are no constraints on the scope for decision making.

Section 3: Options identification

3.1 What options have been considered?

The following criteria have been used to assess the options:

- *Effectiveness:* the option should only result in FBT being payable when a discount is genuinely provided to an employee in order to ensure fairness.
- *Compliance*: compliance costs for banks and other employers in the business of lending money should be minimised.
- *Administration:* implementation and administration costs for Government departments should be minimised.
- *Certainty:* the option should provide certainty as to how to calculate the market rate.

Option one: Status quo

Under the status quo the market interest rate for a given employee is defined as the rate a bank (or other money lender) would offer to a group of persons when:

- The group has a comparable credit risk to the group which the employee belongs to; and
- Membership of the group arises from a factor or factors that do not include a connection between a member and the employer; and
- The group is sufficient in number to ensure a transaction on an arm's length basis.

The main issue with the status quo is its effectiveness. Under the status quo, FBT is often payable even when an employee is receiving the same interest rate they would have received as an arm's length customer and this leads to fairness concerns. Under the status quo, compliance and administration costs are relatively low and money lenders do have certainty around how to calculate the market rate.

Option two: The market rate is the lowest rate given to an arm's length customer

The option is that the market interest rate for a given employee and loan type would be defined as the lowest rate given around the same time in the ordinary course of business to an arm's length customer with a similar profile (based on the lending criteria used by the employer) to the employee.

Under this option, banks and other money lenders would have a choice about what time period they calculate the market rate from. Ideally, money lenders would calculate the market rate based on loans given to arm's length customers in the same FBT quarter as loans made to employees. However, money lenders that do not have readily available data from the current FBT quarter may instead elect to calculate the market rate using data from the FBT quarter immediately prior to the FBT quarter in which an employee received a loan.

This option has been consulted on with the New Zealand Banker's Association, Corporate Taxpayers Group, Chartered Accountants Australia and New Zealand and the Financial Services Council. All Submissions received were supportive of updating how the market rate is calculated and this option.

<u>*Effectiveness*</u>

This option would prevent the over-taxation of employment related loans that occurs under the status quo. Instead, loans made to employees would only be subject to FBT if a genuine discount compared to the rates received by arm's length customers has been provided.

Compliance

Consultation has indicated that this option would have relatively low compliance costs that are comparable to the status quo. This option would simply require them to identify the lowest rate offered over the relevant time period and apply this as the market rate.

Administration

This option would have administration costs for Inland Revenue that are comparable to the status quo.

Certainty

This option would provide certainty for money lenders on how to calculate the market rate. However, submissions did ask for further guidance on when a loan made to a customer was made in the ordinary course of business. This will be provided as part of the bill commentary and in a Tax Information Bulletin following enactment.

Option three: Employers using the market rate can make an election between using the either the status quo or option two for calculating the market rate (proposed option)

This option is that option two would be introduced alongside the status quo. Banks and other money lenders would be given the choice to use either method for calculating the market rate. The method proposed under option two for calculating the market rate will be more taxpayer favourable than the status quo, so we expect most banks and other money lenders to use this method.

However, it is possible that some money lenders may not have the data capabilities available to readily determine the lowest rate given to arm's length customers in either the current or previous FBT quarter. Allowing these employers to still use the status quo method for calculating the market interest rate would ensure they would not be disadvantaged by the introduction of the method proposed under option two.

Effectiveness

As stated above, for employers that choose to use the new method this option would prevent the over-taxation of employment related loans that occurs under the status quo.

Compliance

As above.

Administration

As above.

Certainty

As above.

Option four: Market rate is the average rate given to arm's length customers

This option is that the market interest rate for a given employee and loan type would be defined as the average rate given around the same time to arm's length customers with a similar risk profile to the employee. This option has been consulted on; however submitters were overwhelmingly opposed to this option. This is because this option would still result in some over-taxation of employment related loans.

Other options

A number of other options were considered but were not consulted on as they would not be feasible and would not provide certainty around how to calculate the market rate.

3.2 Which of these options is the proposed approach?

The proposed approach is option three which introduces an additional option for calculating the market rate along with the status quo calculation. The additional option defines the market rate for a given employee and loan type as the lowest rate given around the same time in the ordinary course of business to an arm's length customer with a similar profile to the employee.

This is the preferred approach as it would effectively address the over-taxation that occurs under the status quo without increasing compliance or administration costs. This option would also provide certainty to money lenders on how to calculate the market interest rate, while leaving them the choice of still using the status quo calculation if they wish.

The proposed approach has no areas of incompatibility with the Government's expectations for the design of regulatory systems.

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties *(identify)*	**Comment**: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks	**Impact** *$m present value, for monetised impacts; high, medium or low for non-monetised impacts*
Additional costs of proposed approach, compared to taking no action		
Regulated parties (Banks and other money lenders)	On-going compliance costs of proposed approach are comparable to status quo. One-off compliance costs for employers that switch to using the new method for calculating the market rate will be low.	Low
Regulators (Inland Revenue)	Administration costs of proposed approach are comparable to status quo.	Low
Wider government	Reduction in FBT revenue	$3m per annum over the forecast period
Other parties	None	None
Total Monetised Cost		$3m per annum
Non-monetised costs	Comparable to status quo	Low
Expected benefits of proposed approach, compared to taking no action		
Regulated parties (Banks and other money lenders)	Reduction in FBT payable totalling $3m per annum.	$3m per annum
Regulators (Inland Revenue)	None	None
Wider government	None	None
Other parties (employees of banks and other money lenders)	Potential decrease in interest rates for some employees of some money lenders.	Low
Total Monetised Benefit		$3m per annum
Non-monetised benefits		Low

4.2 What other impacts is this approach likely to have?
It is assumed that the entirety of the $3 million in FBT currently paid by banks and other money lenders for employment related loans will be foregone if the issue is effectively addressed. This is based on discussions with stakeholders in which they have claimed they generally treat employees no different from arm's length customers when offering loans. We do not anticipate the proposed approach would have any other impacts.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?
This problem was initially brought to Inland Revenue's attention by members of the New Zealand Bankers' Association (NZBA) and they have been consulted throughout the policy development process. A targeted consultation letter was recently sent to the NZBA as well as Chartered Accountants Australia and New Zealand (CA ANZ), the Corporate Taxpayers Group (CTG) and the Financial Services Council. The consultation letter asked for their views on options two (the lowest rate) and four (the average rate). The letter also asked for views on whether any new method for calculating the market rate should replace the status quo or be in addition to it. Submissions from CA ANZ, CTG and a number of banks were received. All submissions received were supportive of updating the market interest rate definition and the approach proposed under option two. Submissions were not supportive of option four as it would not fully address the problem and would be difficult to comply with. Most submissions were also supportive of the new option being introduced as an addition the status quo. As such, it was decided to introduce option two as an option alongside the status quo. As a result of stakeholder feedback the proposed approach has been modified. The original option two was that the market interest rate for a given employee and loan type would be defined as the lowest rate given around the same time in the ordinary course of business to an arm's length customer with a similar risk profile to the employee. Banks pointed out that risk profile is only one factor out of many they consider in offering loans and determining interest rates. Therefore, using similar profile as opposed to similar risk profile for comparing employees to arm's length customers is more likely to provide the correct result. The Treasury has also been consulted on the proposed approach and supports the proposed changes subject to consideration of how to prioritise this issue alongside other issues.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?
The proposal will require amendment to the Income Tax Act 2007. Amendments would be included in the next available omnibus tax bill, currently scheduled for introduction in May 2018. The changes would come into effect from the start of the first FBT quarter after the bill is passed into law. It is anticipated this would be 1 April 2019. Inland Revenue will be responsible for the on-going administration of the new arrangements. Inland Revenue officials have assessed the magnitude of these administrative impacts, and consider that they would be manageable to implement in the proposed timeframe.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?
Inland Revenue will monitor the outcomes pursuant to the Generic Tax Policy Process ("GTTP") to confirm that they match the policy objectives. The GTPP is a multi-stage policy process that has been used to design tax policy in New Zealand since 1995. Monitoring the impact of the new arrangements will be done through consultation with the New Zealand Bankers' Association and other relevant stakeholders. Given the relationships Inland Revenue has with relevant stakeholders we would also expect stakeholders to raise any issues they experience directly with us.

7.2 When and how will the new arrangements be reviewed?
Post-implementation review is expected to occur around 12 months after implementation. If the post-implementation review identifies any need for remedial action it would be recommended for addition to the Government's tax policy work programme and could potentially be included in future taxation bills.

Impact Summary: KiwiSaver enhancements resulting from the Retirement Commissioner's review

Section 1: General information

Purpose
Inland Revenue is solely responsible for the analysis and advice set out in this Regulatory Impact Assessment, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with changes to be taken by Cabinet.

Key Limitations or Constraints on Analysis

Scoping of the problems

The problems were identified as part of the Retirement Commissioner's December 2016 review of retirement income policies (the Review) – which was prepared by the Commission for Financial Capability. Therefore, the problems were effectively already identified before Inland Revenue began work on the proposed regulatory approaches.

Range of options considered

As the problems were identified as part of the Review, the options considered were also based on the recommendations made in the Review.

The Retirement Commissioner has a legislative mandate to review retirement income policies every three years, as a result the Commission for Financial Capability is experienced in considering ways to improve the effectiveness of retirement income policies (including KiwiSaver). The recommendations in the Review were made after problem definitions and solutions had been tested with the public, the private sector and Government agencies during 2016. (This consultation involved interviews with the public, a range of online surveys taken by approximately 11,200 members of the public and consideration of substantive written submissions).[1] The nature of the Commission for Financial Capability's expertise and the significant scoping done as part of the Review indicates that the recommendations it proposed are likely to be the most viable options to address the problems it had identified.

Quality of data used for impact analysis

It is not possible to accurately determine how many KiwiSaver members will be encouraged by the proposed approaches to increase their contributions and therefore their long-term

[1] Surveys were available on the Commission for Financial Capability's website.

KiwiSaver savings. However, results of a public survey undertaken as part of the Review generally signalled support for the recommendations.[2]

The estimated impacts of the proposed options are dependent on the behavioural response of KiwiSaver members. Previous changes to the scheme have been more restrictive in nature, so cannot be used as a basis for predicting responses to the proposals.

Assumptions underpinning impact analysis

Both proposals assume KiwiSaver members would be responsive when presented with voluntary (rather than compulsory) options that increase their long-term savings.

Responsible Manager:

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1 March 2018

[2] Out of 1,830 survey responses, 85.4 percent of respondents were in support of more flexible contribution rates while 51.6 percent of respondents supported reducing the maximum period of a contributions holiday from five years to one year.

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

The KiwiSaver Act 2006 sets out the requirements for KiwiSaver members and their employers. Under the KiwiSaver policy framework, although KiwiSaver remains voluntary, contributions are encouraged in several ways. For example, employees' contributions are facilitated by being deducted directly from their pay (if the employer receives a deduction notice from the member or Inland Revenue), and members are incentivised to make contributions to their KiwiSaver account so they receive the Government subsidised member tax credit (an annual maximum payment of $521.43, to members who contribute upwards of $1,042.86).

This regulatory impact analysis deals with two specific problems:

Part A problem – low employee contribution rates

Currently, KiwiSaver members have contributions deducted at a rate of 3% (the minimum default rate), 4% or 8% from their salary and wages. Approximately 90 percent of members were contributing at the lowest 3% or 4% employee contribution rates in the 2016-17 year.

Population demographics are changing, with New Zealander's living longer into retirement. Life expectancy for New Zealand females is 83.2 years and 79.5 years for males,[3] with these numbers expected to continue to rise. The Review signalled that KiwiSaver members contributing at a low rate, may not have accumulated sufficient savings to financially support themselves during the entire duration of their retirement, in a way that meets their individual retirement needs and preferences.

Part B problem – long contributions holidays

For the year ending 31 June 2017 131,710 members were on a contributions holiday, with 84 percent of these contribution holidays being five years in duration (contribution holidays can be for any period between three months and five years, five years is the default period). This means these members were not making contributions, or were only making minimal voluntary lump sum contributions during this period (voluntary contributions are generally not at the level the member would have saved were they not on a contributions holiday).

Stopping contributions for five years has a significant impact on members' savings, and also means members generally do not receive the member tax credit or employer contributions during this period.

The purpose of the contributions holiday is to ensure members can take a break from making contributions when they are not in a financial position to do so. However, having a default five year contributions holiday period is likely to be longer than necessary for many members (whose financial position is likely to improve in the interim period).

[3] *Statistics New Zealand* 'New Zealand Period Life Tables: 2012-14'

Who should address the problems and when?

KiwiSaver is the only Government subsided retirement savings scheme offered to the public. Therefore, the Government has a responsibility to ensure it is fit for purpose. This should include making sure members are given as many options as possible to effectively save.

These problems should be addressed now. They were identified as part of the December 2016 Review. It would be prudent for the Government to respond to problems identified in the Review within a reasonable timeframe, because the longer that nothing is done to address the problems, the more savings KiwiSaver members potentially lose out on.

The problem definitions and recommendations in the Review were formed after consultation with the public, the private sector and Government agencies, meaning there is agreement across a variety of sectors that the problems are an issue.

2.2 Who is affected and how?

Part A problem – low employee contribution rates

KiwiSaver members (who are salary and wage earners) who are not contributing enough to their KiwiSaver account to meet their specific retirement preferences would be affected. The aim of this change is to get these members to start contributing at a higher rate, in a manner that is still flexible enough to respond to changes in their financial circumstances. The purpose of this is to increase KiwiSaver members' retirement savings, so that they can achieve retirement outcomes aligned with their specific retirement needs.

The proposed option would address this problem by introducing additional 6% and 10% employee contribution rates.

KiwiSaver scheme providers and other Government agencies jointly responsible for KiwiSaver (MBIE and the Treasury) support this option. This approach should not have financial implications for the Government.

Part B problem – long contributions holidays

KiwiSaver members (who are salary and wage earners) who are taking breaks due to contributions holidays would be affected. The aim of this change being to prompt members to resume making contributions sooner, so that they increase their savings and maximise their member tax credit entitlement (which they would not receive while contributions are paused).

The proposed option would reduce the maximum period of the contributions holiday from five years to one year. This would limit the time during which members make no contributions (it would still be possible for members to indefinitely renew contributions holidays, but they will have to do so more frequently, ensuring they actively consider the matter).

KiwiSaver scheme providers and other Government agencies jointly responsible for KiwiSaver also support this option. There may be some cost to the Government. If reducing the contributions holiday has the desired effect and results in members resuming contributions earlier, this would result in an increase in the aggregate amount of member tax credits payable.

The majority of the administrative costs for implementing the proposed approaches to address the problems would be borne by Inland Revenue and could be accommodated in existing baselines. There would not be any significant compliance cost for scheme providers or employers.

There is not known to be any group that does not support the proposed approaches.

2.3 Are there any constraints on the scope for decision making?

Constraints

As the problems were identified by the Review, the options in scope to address them have been limited to the recommendations made in the Review. However, the Retirement Commissioner's experience in considering the effectiveness of retirement income policies, as well as the consultation process undertaken as part of the Review to identify problems and solutions (as outlined in more detail above), suggest the recommendations made in the Review are likely to be the most appropriate options to address the problems.

The previous Government approved its letter of response to the Review for public release in May 2017. As part of the process of inputting into this letter of response Inland Revenue officials considered how effectively the options outlined below would address the problems.

When it approved the release of the letter of response to the Review, the previous Government also invited the Minister of Revenue to report back to Cabinet specifically on implementation details for:

- providing additional optional employee contribution rates;
- reducing the maximum permitted renewal time of the contributions holiday; and
- changing the name of the "contributions holiday" to "savings suspension".

Connections to other existing issues

At the time of writing this regulatory impact analysis Cabinet were also considering:

- a change to the name of the contributions holiday;
- a change to the name of the member tax credit; and
- consequential issues related to the previous Government's decision that over 65 year olds should be eligible to join KiwiSaver.

Section 3: Options identification

3.1 What options have been considered?

Part A deals with low employee contribution rates and aims to get these members to start contributing at a higher rate, in a manner that is still flexible enough to respond to changes in their financial circumstances.

Part B aims to prompt members to resume making contributions sooner, so that they increase their savings.

In contributing to the Government response to the 2016 Review Inland Revenue conducted a high-level assessment of the options to the two problems using the following criteria:

- *Effectiveness*: the option must address the problems in a manner that is appropriate within wider KiwiSaver policy settings.
- *Compliance*: compliance cost for employers and KiwiSaver members should be minimised.
- *Administration:* implementation and administration costs for Government departments should be minimised.
- *Equity:* as far as practical the option should be available to all KiwiSaver members.

Part A problem

Four options are considered for dealing with low employee contribution rates.

Option one: Add additional employee contribution rates of 6% and 10%

Effectiveness

Additional 6% and 10% employee contribution rates are likely to have a positive impact on savings, and would give members greater flexibility to achieve retirement outcomes aligned with their specific retirement savings needs and to adjust their contribution rate to suit their current financial circumstances. The additional 6% rate would also address the gap between the current 4% and 8% contribution rates, which the Review indicated many members think is too large. This view is supported by the fact that 24 percent of members contribute at the 4% rate, but only 9 percent of members contribute at the 8% rate.[4]

Compliance

Members would have to self-select onto one of the new employee contribution rates (as members wanting to contribute at 4% or 8% currently have to). Employee deductions would continue to be made out of members' salary or wages, meaning there would be no on-going additional compliance costs for employees.

The range of rates at which employers would be required to deduct contributions from employees' salary or wages would increase. This could result in a small increase in compliance costs for employers not using a commercial payroll system.

Administration

This option would require building additional employee contribution rates into Inland

[4] The other 67 percent of members contribute at the minimum 3% rate.

Revenue's administrative system. However, this impact would be a one-off cost.

Equity

Members on a higher salary or wage are more likely to be in a financial position to self-select onto a high rate than lower salary and wage earners. As the additional contribution rates are voluntary their introduction would not result in lower income earners being financially worse off as a result of them.

Option two: Add automated option to allow members to increase their contribution rate over time

Under this option members would choose an automated annual increase in their contribution rate of 0.25%, 0.5% or 1% up to a capped maximum rate.

Effectiveness

This option would provide more flexible contribution rates. This could have a positive impact on savings, as well as allowing members to personalise their contribution rate more specifically to their retirement savings needs.

Compliance

As contribution rates would automatically increase members would not be required to self-select onto a higher contributions rate which could be seen as a reduction in compliance costs. However, this option would significantly increase compliance costs for employers, and could require them to modify their payroll systems. The automated contribution rates could also be complex for payroll and software providers to implement in the first instance.

The automated rates would also add complexity to KiwiSaver rules, which could be difficult for scheme providers to explain to members.

Administration

Introducing increasing contribution rates which are not whole numbers would require changes to Inland Revenue systems and could be difficult to administer.

Equity

There is a possible inequity, in that members on a higher salary or wage are more likely to be in a financial position to choose to annually increase their contribution rate. However, as the automated annual increases would be voluntary their introduction would not result in lower income earners being financially worse off.

Option three: Increase the minimum employer and employee contribution rate from 3% to 4%

Effectiveness

This option would result in a compulsory increase in costs for KiwiSaver members and employers contributing to KiwiSaver. This could detrimentally impact on members and employers' current financial position and short-term savings. We note there is limited evidence this recommendation would raise savings rates (as it may result in KiwiSaver members substituting away from other savings).

Compliance

Employee deductions would continue to be made out of members' salary or wages, meaning there would be no additional compliance costs for employees.

The minimum rate employers would be required to deduct contributions from employees' salary and wages would increase. This could result in a one-off increase in compliance costs for employers not using a commercial payroll system.

Administrative

This option would require changes to Inland Revenue's administrative processes for validating minimum contribution rates. However, these impacts are likely to be small and one-off in nature.

Equity

This option would make it more difficult for low-income earners to contribute to KiwiSaver. This could adversely impact whether they are in a financial position to adequately support themselves in the short term or alternatively it could force members to go on a contributions holiday (and therefore negatively impact on their long-term savings).

Option four: Status quo

Effectiveness

The status quo does not address the problem, as it does not give members the opportunity to self-select onto new higher contributions rates and therefore it is unlikely to have any positive impact on members' long term savings. It also does not give members more flexibility to personalise the amount they contribute to align with their retirement savings needs.

Compliance

There would be no additional compliance costs.

Administration

There would be no additional administrative costs.

Equity

Members on a higher salary or wage are more likely to be in a financial position to self-select onto a high rate than lower salary and wage earners. Notably the gap in affordability between the 4% and 8% rate is a financial obstacle preventing many members from contributing at a higher rate. If members are not in a financial position to opt onto a higher contribution rate, it would mean these members would not have the opportunity to save more for their retirement.

Part B problem

Two options are considered for dealing with long contributions holidays.

Option One: Reduce the maximum contributions holiday period from five years to one year

Under this option the maximum length of a contributions holiday would be one year. Contributions would automatically resume after the one year, unless the member renewed their contributions holiday for another year.

Effectiveness

Although some members on a contribution holiday continue to make lump sum contributions, stopping regular contributions for five years is likely to significantly impact on members' long-term savings. Reducing the maximum period from five years to one year encourages members to more frequently re-engage with KiwiSaver and to assess whether they are in a position to resume making contributions.

Compliance

Members wanting to remain on a contribution holiday would have to renew their holiday each year rather than every five years, resulting in a small increase in compliance costs.

Administration

This option would require Inland Revenue to contact members on a contributions holiday more frequently. This would result in an on-going increase in the resources Inland Revenue would need to allocate to processing contribution holiday renewals. This impact would be manageable, and the on-going administrative cost of renewing contributions holidays could be reduced once KiwiSaver is transferred into the new START system, as part of Inland Revenue's business transformation programme.

Equity

Members on a contributions holiday because of financial hardship are unlikely to be in a position to resume contributions after a year. Therefore, this option would only benefit members whose financial position had improved since going on a contributions holiday. If, at the expiry of the shortened holiday period the member's financial situation has not improved they could still renew their holiday, but this option would ensure that they actively consider their financial position on a more regular basis.

As part of the detailed design of this option, transitional arrangements would be put in place for members on a contributions holiday longer than a year when the reduced period comes into effect. This would ensure these members would be entitled to complete the duration of their existing contributions holiday under the rules that applied when they opted to go on a holiday.

The proposal potentially creates an equity issue between members (in otherwise identical situations) applying for a contributions holiday prior to this change being enacted and those applying after this change is enacted. However, as transitional arrangements would only apply until members completed an existing contributions holiday there would not be an ongoing equity concern (beyond five years).

Option two: Status quo

Effectiveness

The status quo does not address the problem. Going on a five year contributions holiday is likely to significantly impact on members' savings. As members are not prompted to reconsider the length of their holiday during the five year period, it also means they could stay on a contributions holiday for longer than is financially necessary.

Compliance

There would be no additional compliance costs.

Administration

There would be no additional administrative impacts.

Equity

If members do not select a duration end date for their contributions holiday, the default five year period applies. As they are not prompted to reconsider whether they are in a financial position to resume making contributions during the five year period, they could continue to be on a contributions holiday when their current circumstances do not require it. Therefore, the long term savings of a member on a five year contributions holiday are more likely to be negatively impacted, than members on a contributions holiday who select a (shorter) duration end date.

3.2 Which of these options is the proposed approach?
Part A problem The proposed approach to address the problem of low contribution rates is to introduce additional 6% and 10% optional employee contribution rates. These additional rates would give members more flexibility to meet their specific retirement savings needs and have the potential to positively impact KiwiSaver members' long term savings. A member with an annual gross income of $50,000 gains an additional $1,000 in savings by increasing their contribution rate from 4% to 6% or from 8% to 10% each year. As the additional rates are voluntary the current financial needs of low-income earners will not be adversely affected. **Part B problem** The proposed approach to address the problem of long contributions holidays is to reduce the maximum period of the contributions holiday from five years to one year. This approach would prompt members to reassess whether they were in a position to resume making contributions after one year rather than five years. For every additional year a member contributing at the default 3% rate with an annual gross income of $50,000 resumes contributions, they gain up to $3,258.93 in savings (including the full member tax credit and compulsory employer contributions). Members would still be able to renew their holiday if their financial circumstances continue to require it and members who do not use KiwiSaver as their primary retirement savings vehicle would not have to substitute away from their other savings. The proposed approaches are not incompatible with the Government's '*Expectations for the design of regulatory systems'*.

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties	Comment:	Impact
Additional costs of proposed approach, compared to taking no action		
Regulated parties (*KiwiSaver members, employers*)	**Part A** Employers could see a marginal rise in compliance costs, as there would be additional rates at which employee contributions are made. It is estimated between 38 percent to 55 percent of employers use commercial payroll systems,[5] therefore it is anticipated these employers should not have difficulty with this. The additional rates would be a low level change for payroll system providers and should not be difficult for them to implement. Previous changes in contribution rates (such as the movement in the minimum rate from 4% to 2% and then 3%) have not caused significant issues for employers or payroll system providers. **Part B** Additional on-going compliance costs for members wanting to renew a contributions holiday, as they would have to actively consider renewal of their holiday each year, rather than every five years.	Low Low
Regulators (*Inland Revenue)*	Communicating the proposed approaches to the public, employers and scheme providers would have an estimated one-off cost of up to $300,000. **Part A** Changes to Inland Revenue's operational systems would have an estimated one-off cost of up to $90,000. **Part B** Changes to Inland Revenue's operational systems would have an estimated one-off cost of up to $18,000. Having to renew members' contributions holidays each year, rather than every five years, would also result in an increase in estimated on-going administrative cost	One-off communication cost of up to $300,000. One-off implementation cost of up to $90,000. One-off implementation cost of up to $18,000. Administrative cost of up to $71,000 for 2019-20 and $184,000 for 2020-21. KiwiSaver is scheduled to

[5] Based on the 198,000 employers who filed with Inland Revenue in 2016. The 38 percent using a file transfer filing method use commercial payroll software, it is anticipated over half of the 34 percent of employers using an onscreen filing method also use commercial payroll software.

	for Inland Revenue of up to $71,000 for 2019-20 and $184,000 for 2020-21.	be transferred into Inland Revenue's new computer system (START) in 2020, which may reduce on-going delivery costs.
Wider government	**Part A** The additional rates should not have a fiscal impact (members earning an annual gross income of $26,071.50 contributing at the existing 4% rate contribute enough to receive the full member tax credit). **Part B** Assuming the proposed approach encourages members to come off contributions holidays earlier more members would be entitled to the member tax credit.	Low If all members currently on a contributions holiday resumed making contributions the fiscal cost would be approximately $30 million. If only members on a five year holiday resumed contributions the fiscal cost would be approximately $23million.[6] Actual fiscal costs are likely to be significantly less, as costs would consistently decline based on the members on a contributions holiday that decided to renew their holiday.
Other parties	No other parties are impacted.	No impact.
Total Monetised Cost	*Administrative costs for Inland Revenue.*	*One-off cost of $408,000, on-going cost of up to $71,000 for 2019-20 and $184,000 for 2020-21 period.*
Non-monetised costs	*Compliance costs on KiwiSaver members and employers and increase in member tax credit payable by the Government.*	*Low*

Expected benefits of proposed approach, compared to taking no action		
Regulated parties (*KiwiSaver members*)	**Part A** Additional 6% and 10% employee contribution rates could encourage members to self-select a higher rate and increase their savings.	Low (as both Part A and Part B would be voluntary, the aggregate increase in members' savings is difficult to predict).

[6] Based on number of people on a contributions holiday at 30 June 2017 and assumes each person would receive a member tax credit payment of $380.00 – the average member tax credit amount claimed by members on a contributions holiday (who were making voluntary contributions).

	Part B Reducing the maximum contributions holiday period to one year prompts members to reassess whether they are in a financial position to resume contributions. Resuming contributions earlier would increase members' savings.	
Regulators (*Inland Revenue*)	N/A	N/A
Wider government	N/A	N/A
Other parties	N/A	N/A
Total Monetised Benefit	*N/A*	N/A
Non-monetised benefits	*Increase in KiwiSaver members long-term retirement savings*.	*Low*

4.2 What other impacts is this approach likely to have?
The exact impact the proposed approaches would have on KiwiSaver member's contribution behaviour cannot be anticipated. As the proposed changes are voluntary there is the risk they might not have the desired effect of increasing the amount KiwiSaver members are contributing. However, consultation and surveys undertaken as part of the Review suggested there was public support for the proposed approaches: • 85.6 percent of respondents were in support of more flexible contribution rates (the proposed approach to address low employee contribution rates); and • 51.6 percent of respondents supported reducing the maximum contributions holiday period (the proposed approach to address long contributions holidays). This suggests there should be a notable group of KiwiSaver members who would be responsive to the proposed approaches (particularly in respect of the approach to address low employee contribution rates).

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?
As part of the previous Government's response to the Review (which was co-ordinated by MBIE) the Treasury, MBIE, and MSD had the opportunity to express their views on the proposed approaches. Inland Revenue has also separately consulted with the agencies jointly responsible for KiwiSaver – MBIE and the Treasury, who agreed with the proposed approaches. Inland Revenue has consulted with KiwiSaver scheme providers, and they generally support the proposed approaches. A working group made up of representatives from 11 KiwiSaver scheme providers also made a written submission as part of the Review consultation process. Inland Revenue have not consulted further with employers or KiwiSaver members, relying instead on the public consultation which was undertaken as part of the Review - in the form of interviews, written submissions and surveys (approximately 11,200 surveys were completed on retirement income policy, with 1,830 of those being specifically on KiwiSaver). Members and employers would also have had the opportunity to provide feedback on the proposed changes after the Government's letter of response to the Review was released publicly.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?
The proposals will require amendment to the KiwiSaver Act 2006. Amendments would be included in the next available omnibus tax bill, currently scheduled for introduction in May 2018. The changes would come into effect once this bill has been enacted into law. It is anticipated this would be in early 2019. We are proposing that transitional arrangements be put in place for KiwiSaver members on contributions holidays of longer than a year, when the changes are enacted. These members would not be subject to the reduced maximum contribution holiday period, until their current contribution holiday expires. Inland Revenue would be responsible for the on-going administration of the new arrangements. Inland Revenue officials have assessed the magnitude of these administrative impacts, and consider that they would be manageable to implement in the proposed timeframe. The Minister of Revenue would make an announcement, on the contents of the proposed omnibus tax bill (including these proposals) when it is introduced in the House.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?
Inland Revenue would monitor the outcomes pursuant to the Generic Tax Policy Process (GTTP) to confirm that they match the policy objectives. The GTPP is a multi-stage policy process that has been used to design tax policy in New Zealand since 1995. Inland Revenue also currently collects data on members' employee contribution rates and contributions holiday duration periods. This data could help inform an assessment of how many members' contributions behaviour has changed as a result of the proposed approaches.

7.2 When and how will the new arrangements be reviewed?
The final step in the GTPP is the implementation and review stage, which involves post-implementation review of legislation, and the identification of remedial issues. Post-implementation review is expected to occur around 12 months after implementation. Opportunities for external consultation are built into this stage. Any necessary changes identified as a result of the review would be recommended for addition to the Government's tax policy work programme. As the Retirement Commissioner's review of retirement income policies is conducted every three years, the next review in 2019 would also provide an opportunity to reflect on the level of support for the proposed approaches.

Impact Summary: *Making Tax Simpler* – Improvements to the administration of tax for individuals.

Section 1: General information

Purpose
Inland Revenue and Treasury are solely responsible for the analysis and advice set out in this Regulatory Impact Assessment (RIA), except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by or on behalf of Cabinet.
Key Limitations or Constraints on Analysis
The proposals were developed as part of the overall business transformation programme that Inland Revenue is currently working through; they build on other changes being made within that programme with a view to improving the overall administration of the New Zealand tax system by reducing compliance and administrative costs as well as looking to simplify the system for taxpayers and give them certainty about their obligations. As a result of the extensive public consultation there are few limitations or constraints on the analysis of the final proposals as there was a high level of engagement from stakeholders in the policy development process. There were, however, two constraints to the analysis of the financial impacts of the proposal: • For those taxpayers who have treated themselves as not being required to file tax returns under current law it has been assumed those individuals do not have other income that should have been separately returned to Inland Revenue. This may include rental income, dividend income or other non-source deducted income. It may be that those taxpayers should have been filing a tax return; and • For those who have used the correct tax code/rate and would therefore not be required to pay any resulting tax liability the analysis has been constrained by the frequency on which Inland Revenue currently receives that tax deduction data. It is currently received on a monthly or twice monthly basis whereas in the future this will be on a payday basis which should enable correct tax rates to be more accurately monitored. This limitation may suggest that tax rates are more or less correct than they actually are if more frequent information was used in the analysis.
Responsible Manager (signature and date):

Mike Nutsford
Policy Manager
Policy and Strategy
Inland Revenue
14 March 2018

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

The current law generally allows those taxpayers who derive only source deducted income (reportable income[1]) not to file a tax return. However, the rules around when a person should file a return are not well understood by taxpayers. In addition, the current "non-filing" regime incentivises taxpayers to actively seek out tax refunds by filing a return and not returning when a debit arises, requiring them to determine if they are in an over-withheld or under-withheld position.

The filing of a tax return can be difficult for individuals; many find it difficult to obtain and retain records relating to their income and the process of filing the return is seen as complex. Although Inland Revenue automatically releases refunds of less than $600 after a personal tax summary has been issued many taxpayers continue to engage intermediaries to determine whether they are due a tax refund.

The more timely information that will shortly be received by Inland Revenue[2] from those who deduct tax at source will allow Inland Revenue to undertake more proactive actions to ensure that the level of withholding during the year is more accurate which should reduce the number and level of tax "square-ups" required at the end of the year.

The changes proposed in this RIA build on this increased provision of information to, for most taxpayers, automatically calculate their year-end square up. This will either automatically send them a refund or a notice to pay under limited situations[3]. These changes will mean that approximately three million taxpayers will have their tax position automatically dealt with and save these people either having to file a return, engage with a tax agent to receive a refund or interact with Inland Revenue to determine their own tax position (either through MyIR[4] or by phone).

The proposals will also simplify the claiming of donation tax credits[5] by moving these into the income tax return process and allowing taxpayers to supply receipts during the year through an on-line portal rather than at the end of the year when receipts may have been misplaced.

The counterfactual to the proposal is to leave the current rules in place and although Inland Revenue could still be more pro-active during the year to reduce any over or under payments there will be no corresponding reduction in compliance costs for taxpayers at the end of the year to determine whether they are due a tax refund or there is a balance to pay. The proposal will decrease these compliance costs and deliver any refunds directly to taxpayers without any cost to them.

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[1] Reportable income is income that has tax deducted at source. This includes income from employment, interest, dividends, Māori Authority distributions and employee share scheme benefits.

[2] Due to changes to information gathering contained in the Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Bill

[3] These will only be issued where the tax liability is over a $20 threshold or where the person has advised their correct tax code or rate but that tax has not been deducted correctly.

[4] MyIR – is Inland Revenue's web based platform.

[5] A tax credit against taxable income is available for donations of $5 or more to approved organisations.

The proposals in this RIA align with the information gathering changes contained in the *Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Bill* and as a consequence to obtain full benefit of the proposals they need to be implemented at the same time, starting 1 April 2019 for the 2018-19 tax year.

In addition the timing of the introduction of these new rules is aligned to release three of the business transformation programme which will enable these changes to be implemented at the same time individuals' income tax is brought within the new START[6] computer system. This release is scheduled for April 2019.

2.2 Who is affected and how?

The proposals will affect the approximately three million taxpayers who currently only derive reported income. It will enable those taxpayers who are overtaxed for some reason to directly receive their refund without having to engage with Inland Revenue or an intermediary no matter what the level of that refund rather than being restricted to refunds less than $600.

For those who have an underpayment in certain, limited, circumstances they will receive a notification of any debt. However, those taxpayers who have had tax withheld in accordance with the deduction rules will not have to pay any resulting shortfall.

The proposal will reduce taxpayer compliance costs in having to determine their final tax position and obtain any associated refund. It will be paid in full to them automatically notwithstanding the level of that refund.

It will also simplify the claiming of donation tax credits and allow taxpayers to supply receipts during the year instead of having to retain these and claim them at the end of the year. Again this will assist people in claiming tax credits for donations and bring these within the automatic square up process for year-end for most taxpayers.

Officials consider these proposals, in conjunction with the increased levels of proactive actions Inland Revenue will take based on more frequent income information, very beneficial for the affected taxpayers.

2.3 Are there any constraints on the scope for decision making?

There have been no constraints on the scope for decision making. The proposals consider in this RIA have been subject to public consultation with some changes being made to the final proposals as a result of that consultation.

These proposals are dependent on the more timely information reporting of payroll and investment income that is included in the *Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Bill* as this provides the platform to enable Inland Revenue to more proactively ensure that taxpayers have the correct rate and tax code

[6] START - Simplified Tax and Revenue Technology – the new information technology platform being introduced by Inland Revenue as part of its business transformation programme.

during the year to minimise the amount of any end of year square up.

Section 3: Options identification

3.1 What options have been considered?

The overarching objective is to minimise the interaction required by individual taxpayers.

This has been assessed against the following criteria:

- Compliance costs – Compliance costs are minimised as far as possible
- Administration costs – Administration costs are minimised as far as possible
- Sustainability – The options should collect the revenue required in a transparent and timely manner while not leading to tax driven outcomes and enable the efficient administration of the social policies administered by Inland Revenue

Year End Process

Three options were considered:

- Option 1: The status quo
- Option 2: An improved status quo
- Option 3: An automatic square-up process

Option 1: status quo

Taxpayers who derive only source deducted income (reportable income[7]) are not required to file a tax return. At the end of the year those taxpayers who have only reportable income and have a refund owing because of over taxation of under $600 have that refund automatically issued along with a personal tax summary. Those taxpayers who have over $200 of non-reportable income must file either a personal tax summary or a tax return to claim any refund, or square up any liability.

Option 2: an improved status quo

Under an improved status quo Inland Revenue would use the information provided by the more timely reporting of payroll and investment income to issue more personal tax summaries to taxpayers where under or over payments were identified. This would require taxpayers to confirm or otherwise complete the personal tax summary (unless any refund arising was less than $600 in which case it would continue to be automatically released along with a personal tax summary). Once that had been done a resulting refund would be issued, alternatively a debt would be issued.

This option has the benefit of a taxpayer turning their mind to their tax position and confirming that position before a refund is issued which can increase the integrity of the system where a taxpayer earns other non-source deducted income. The downside of this is the increased interaction for the majority of taxpayers who only have reportable income. It also has the disadvantage where a taxpayer does not automatically receive a personal tax

[7] Reportable income is income that has tax deducted at source. This includes income from employment, interest, dividends, Mãori Authority distributions and employee share scheme benefits.

summary they have to assess whether they need to request one.

Option 3: automatic square-up process (preferred option)

This option is based on the premise that for the majority of taxpayers Inland Revenue will hold all the information required to enable it to calculate an end of year tax position for a taxpayer and the step of having a person confirm through the compilation of a personal tax summary is unnecessary.

The advantage of this proposal is that it is much easier for taxpayers to understand, offers a better balance between compliance costs and accuracy than option 2, better utilises the increased information available to Inland Revenue from third parties and reduces the number of taxpayers who will have to provide information to Inland Revenue.

The disadvantage to this option is that some taxpayers who do not currently interact with the tax system (on the assumption that their reported income has been accurately withheld from) may now have to interact. In the majority this will be receiving a refund where previously they may not have claimed one but the interaction may cause taxpayers some concern.

Flow-on effects

In addition to these overriding options, a number of other flow-on effects of the year-end process were considered under two headings:

- Who has to "square-up" at year end ?; and
- How should donation tax credits be dealt with in the future?

Who has to square-up at year end?

Three options were canvassed in respect of who should have to square up at year end:

- Option 1: The status quo – taxpayers are required to obtain a personal tax summary where they have more than $200 of reportable income taxed at the incorrect rate and have to square up any tax shortfall. Those who have a refund of greater than $600 are required to confirm a personal tax summary and automatic refunds for those less than $600;
- Option 2: A monetary threshold – taxpayers who have tax to pay or a refund under a certain level would not receive notification for payment or a refund; or
- Option 3: The notification model – taxpayers who have advised the payers of their reportable income their correct tax code or rate and the payers are correctly using that code but have still ended up with a shortfall should not have to square up any shortfall as they have met their obligations in respect of their tax affairs. Any refunds arising would be automatically refunded.

How should donation tax credits be dealt with under the new proposal?

Donation tax credits are currently claimed annually using a specific form issued by Inland Revenue. There were a number of options considered to improve this process given the proposed changes to the way the end of year square up was undertaken.

Three options were considered:

- Option 1: The status quo with taxpayers either supplying receipts during the year or saving their receipts until the end of the year and then filing a rebate claim form at the end of the tax year to claim the credit;
- Option 2: Remove the need for a separate rebate claim form and have taxpayers complete the claim as part of an end of year square up process either through filing a tax return or a personal tax summary; and
- Option 3: Allow taxpayers to submit their donation receipts to Inland Revenue during the year which could then form part of their year-end square-up process through either an automatic square-up or tax return process.

3.2 Which of these options is the proposed approach?

Year End Process

Officials consider that option 3, an automatic square-up process for taxpayers who only derive reportable income, is the preferred option. Essentially these proposals will result in only those taxpayers who derive more than $200 of non-reportable income[8], are a non-resident, have tax losses, are subject to the financial arrangement regime or pay provisional tax will need to file a tax return or personal tax summary.

It provides taxpayers with a large reduction in compliance costs while not adversely affecting those taxpayers who are using the correct tax codes and rates and who do not currently interact with Inland Revenue (as option 2 might have, depending on the level of the tax to pay threshold).

Option 3 also better utilises the more timely information provided to Inland Revenue by third parties in respect of reportable income than the other options. Although all options would allow Inland Revenue to closely monitor and correct any tax code or rate issues which should result in a more accurate tax position for taxpayers, option 3 uses those pro-active actions more fully for taxpayers.

In the majority of cases option 3 will ensure that taxpayers receive a refund automatically and not receive a bill where they have ensured that their rate and tax code are correct. This has the benefit of no interaction with Inland Revenue for those taxpayers where option 1 required an interaction prior to the issue of a refund (except for those less than $600). It also provides taxpayers with the certainty that unless they earn non-reportable income they don't need to consider if they need to file a return or personal tax summary as it will all be completed for them automatically.

Who has to square-up any underpayments?

[8] Non-reportable income will include amounts not subject to tax at source this would include contracting income or other income not subject to withholding taxes.

The status quo did not ultimately fit with the objective of attempting to minimise the interaction required by taxpayers and, in fact, may have had the opposite effect and was discarded.

After consultation it was decided that a combination of the latter two options provided the best outcome for taxpayers and Inland Revenue. Two monetary thresholds will apply, one for refunds paid by cheque where only refunds above $5 will be issued by cheque (there is no threshold for electronic payments) and the other for debts less than $20 which will not be assessed/collected from taxpayers. The $5 limit recognises the cost of processing a manual payment. The $20 limit reflects the approximate cost of collection of the small balance. Any credits not refunded under that threshold may be carried forward to future periods any debits under the threshold will be extinguished, rather than being carried forward.

In addition, there is an overriding assumption the correct tax code/rate has been used on reportable income. In that case no square-up will be required no matter what the level of the liability. Further, even where an incorrect rate has been used, a square-up will only be required if the incorrect rate was applied to more than $200 of income. Officials consider this combination of the two options provides the best outcome for taxpayers who only derive reportable income, in that, as long as they have ensured that the correct rate or code has been supplied to the payer they have discharged their obligation to ensure their tax position is correct.

How should donation tax credits be dealt with under the new proposal?

Because donation tax credits could be claimed by a taxpayers who follow differing year-end square up processes it is necessary to have multiple options for taxpayers to use. In addition, there may be a number of options that taxpayers want to enable them to claim their tax rebates. Some maybe comfortable with saving their receipts and claiming these at the end of the year as they already do, others may want to supply receipts when they get them and those who are still required to file a tax return because they have other non-reportable income may want the convenience of claiming their rebate as part of that tax return process.

Ultimately officials' preference is to proceed with all these options as each option has merits for taxpayers dependent on their year-end square up process but also allowing flexibility for taxpayers as to the best way for them to claim their donation tax credits.

The proposal is that taxpayers have three ways to claim their donation rebate:

1. They can continue with the current process of filing a separate rebate claim form and either save the receipts until the end of the year or provide these during the year. They could do this whether or not they are required to file a tax return or are part of the automatic square-up process; or

2. For those who are required to file a tax return because of non-reportable income they can choose to include the donation tax credit claim on their tax return for the year supplying the receipts at that time; or

3. A taxpayer could upload their donation receipts to Inland Revenue during the year and these could be automatically refunded at the end of the year (or potentially prepopulated on their tax return should they be required to file one).

Officials consider this reduces taxpayer compliance costs and also provides taxpayers with flexibility for the particular system that they are comfortable with to make their donation tax credit claim.

The preferred options are not incompatible with the Government's "Expectations for the design of regulatory systems".

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties *(identify)*	**Comment**: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks	**Impact** *$m present value, for monetised impacts; high, medium or low for non-monetised impacts*
Additional costs of proposed approach, compared to taking no action[9]		
Regulated parties	Monetary costs for non-filing taxpayers who will be required to pay tax	Up to $50m[10] in tax to pay. This is not a forecast, but rather a static analysis of unpaid sums larger than $20 in the 2016 tax year. The $50m does not take account of the amounts that would not have to be paid (because they were withheld in accordance with the rules) suggesting that the total will be lower than $50m. Inland Revenue is not able to quantify what proportion of the $50 million would not be payable.
Regulators	Administrative costs for Inland Revenue of dealing with customer enquiries or contacts, these are likely to be transitional as people get used to the new rules.	These will be accommodated within the Business Transformation programme funding allocated to Inland Revenue.
Wider government	Reduction in Government revenue through issuing refunds which are not currently issued.	$150m[11]

[9] Business transformation has committed to deliver additional Crown revenue of $2,880m - $6,175 million (including inflation) by 2023/24 as a result of improved voluntary compliance and better use of information and analytics to identify and address non-compliance. The Government has already accounted for the lower end of this range in its fiscal forecasts. These numbers took into account the broad direction of policy intent, as signalled through the Government's discussion document, *Making Tax Simpler: A Government Green Paper on Tax Administration* (including early thinking on individuals' income tax returns), in addition to the further changes that will be delivered as part of Business Transformation.

[10] The data is based on a sample of taxpayers and has been scaled up to population estimates. This data only looks at non-filing individuals earning employment income which is reported on Employee Monthly Schedules, and calculates their likely refund or tax to pay by comparing the actual tax withheld on this income with the amount of tax that should have been withheld.

[11] Inland Revenue will be taking proactive action during the year to reduce the number and size of end-of-year discrepancies by moving people to better tax rates and codes so that they only pay what they need to during the year. Accordingly, total year-end refunds issued and total year-end tax to pay will not reflect this static analysis of the quantum of unclaimed refunds or amounts of tax to pay, as year end refunds/amounts to pay will reduce over time.

Other parties		
Total Monetised Cost		$200m
Non-monetised costs	Negative impact on business models of agents or intermediaries who currently file personal tax summaries for customers	

Expected benefits of proposed approach, compared to taking no action		
Regulated parties	Monetary benefits for current non-filing taxpayers who will automatically receive refunds Cost saving for taxpayers who currently prepare and file personal tax summaries	$150m
Regulators	Reduced administrative costs for Inland Revenue over time	These will be accommodated within the Business Transformation programme funding allocated to Inland Revenue.
Wider government	Increase in Government revenue through collecting amounts of tax which are not currently collected	Up to $50m
Other parties		
Total Monetised Benefit		$200m
Non-monetised benefits	The macroeconomic impacts of the flow-on effects from private individuals consuming, investing and/or saving their refunds and, conversely, the private economic activity forgone by individuals who have more tax to pay have not been quantified.	

4.2 What other impacts is this approach likely to have?
The associated simplification of the year-end system and perceived fairness to those who are over taxed during the year should have a positive benefit on the way taxpayers view Inland Revenue and the tax system as whole. It also provides a clear tangible benefit to taxpayers from the business transformation programme. The automatic year-end square-up of most taxpayer tax affairs may mean a significant number of clients will no longer need to use an intermediary to file a tax return or personal tax summary on their behalf.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?
The proposals and preferred options outlined in this RIA were subject to public consultation in the discussion document *Making Tax Simpler – Better Administration of Individuals' Income Tax* released by the Minister of Revenue in June 2017. There was also an online forum for the public to make comment on the proposals and a survey was undertaken to gain insights to the final proposals. The submissions on the options were evenly split between supporting the preferred option and proposing a variation on the preferred option which would require individuals to confirm their tax position before an assessment was finalised and a refund issued. This latter approach had been previously ruled out by the Government. A further approach was proposed by two submitters and this was incorporated into the final proposals. This approach was to eliminate a year-end square up for underpayments where the taxpayer had met all their obligations to advise payers of reported income their correct tax code or rate. The other proposals were supported by submitters, including those relating to small balance square-up amounts and claims for donation tax credits. None of the proposals specifically affect iwi and although they had an opportunity to submit on the proposals through the public consultation process it was not considered necessary to separately consult on the proposals with them.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?
The proposed changes are expected to be included in a tax bill to be introduced in early 2018 with application from 1 April 2019 for the 2018-19 income year as this is when the associated changes to the provision of information by payers of reportable income will become mandatory. This date will allow Inland Revenue to commence its proactive actions to ensure that taxpayers are using the correct tax rates and codes and suggest alternatives when that is not the case. The first returns that will be subject to the new year-end square-up process will be for the tax year ended 31 March 2019. Inland Revenue will have responsibility for the implementation and ongoing operation and enforcement of the proposals and will have a communications programme for educating taxpayers of these changes at the time they are implemented. Inland Revenue has extensive experience in implementing, operating and enforcement of these types of changes.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

As part of the implementation and operation, Inland Revenue will be continuously monitoring the effectiveness of the proposals. This is a normal part of the work Inland Revenue does in respect of the tax system to ensure that the rules and processes are fit for purpose.

Monitoring and enforcement can only be effective once Inland Revenue is receiving the additional and more timely information from payers of reportable income as it is only at this time that Inland Revenue can increase its proactive actions to ensure taxpayers are using the correct tax code and rates.

7.2 When and how will the new arrangements be reviewed?

As part of the ongoing monitoring and evaluation, Inland Revenue will be constantly reviewing the outcomes of the proposals with a view to assessing the effectiveness of the changes.

As with all aspects of the tax system Inland Revenue is constantly reviewing the outcomes to identify any issues that may need remediation. Inland Revenue also has a number of channels for taxpayers and the public in general to raise any specific concerns with the tax system and it has appropriate pathways to address those concerns.

Coversheet: Making Tax Simpler: Proposals for modernising the Tax Administration Act – collection, use and disclosure of information

Advising agencies	*Inland Revenue*
Decision sought	*Update aspects of the legislative frameworks in the Tax Administration Act dealing with collection, use and disclosure of information*
Proposing Ministers	*Minister of Revenue*

Summary: Problem and Proposed Approach

Problem Definition **What problem or opportunity does this proposal seek to address? Why is Government intervention required?**
Information flows are key to Inland Revenue's ability to carry out its functions and to fulfil its role in wider government. Business Transformation provides both a need and an opportunity to examine the rules regarding information to ensure they are fit for purpose for a modern tax administration. The current rules, particularly in relation to information disclosure, have developed in an ad hoc fashion and are complex, inflexible and lacking transparency. While the information collection rules generally work well, there is an opportunity to improve transparency with two minor enhancements.

Proposed Approach **How will Government intervention work to bring about the desired change? How is this the best option?**
The proposals aim to make the information disclosure and use provisions clearer and more principled and to provide greater flexibility and transparency. A new, more targeted confidentiality rule will better focus the rule on protecting what should be protected, namely taxpayer-specific information, while allowing disclosure of a wider range of non-taxpayer information. A clearer, more principled exceptions framework will provide greater transparency. The proposed enhancements to the information collection rules will also provide greater certainty and transparency regarding Inland Revenue's regular collection and use of certain third party information.

Section B: Summary Impacts: Benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?
In relation to information sharing the main expected benefits will fall to other agencies who are able to more easily access Inland Revenue's information for service provision or enforcement. This will also have benefits for customers where it reduces the need to provide the same information to multiple agencies and/or ensures they receive more accurate, up-to-date entitlements. For information collection the main expected benefits will be administrative for Inland Revenue in having regular access to datasets that can be used for compliance, service delivery and education purposes. There may also be compliance cost reductions to taxpayers from improved service, including from increased pre-population of returns.

Where do the costs fall?
There may be increased administrative costs to Inland Revenue in developing and administering increased numbers of information shares, however Business Transformation provides the opportunity to do this in a more efficient manner. New regulations for repeated collection of datasets may impose costs on the entity from which the information is collected. When considering proposed new collection regulations these potential costs will be taken into account. It is not possible to quantify the costs at this time, as the changes that may result in additional costs will occur when regulations are made under the new information sharing and collection empowering provisions.

What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?
With all information sharing there is a risk of privacy breaches. This also raises a concern that increased sharing or any breaches might reduce the willingness of customers to provide their information to Inland Revenue. Consideration of privacy impacts (including consultation with the Office of the Privacy Commissioner) and potential impacts on the integrity of the tax system are built into the proposed information sharing rules.

Identify any significant incompatibility with the Government's 'Expectations for the design of regulatory systems'.
There is no significant incompatibility with the Government's "Expectations for the design of regulatory systems".

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?
Inland Revenue is confident that the evidence supports the proposal. Inland Revenue has extensive experience working with the confidentiality rules and the issues that arise with the current framework. While the total costs and benefits cannot be quantified at this time as they primarily arise from regulations that would be made under proposed empowering provisions, past experience with both ad hoc large dataset collection and with information sharing arrangements entered into under current provisions has seen the generation of significant benefits.

To be completed by quality assurers:

Quality Assurance Reviewing Agency:
Inland Revenue
Quality Assurance Assessment:
The Quality Assurance reviewer at Inland Revenue has reviewed the *Making Tax Simpler: Proposals for modernising the Tax Administration Act – information collection, use and disclosure* Regulatory Impact Analysis and considers that the information and analysis summarised in the Regulatory Impact Analysis meets the Quality Assurance criteria.
Reviewer Comments and Recommendations:
The reviewer's comments on earlier versions of the Regulatory Impact Assessment have been incorporated into the final version.

Impact Statement: Making Tax Simpler: Proposals for modernising the Tax Administration Act – collection, use and disclosure of information

Section 1: General information

Purpose
Inland Revenue is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by Cabinet.

Key Limitations or Constraints on Analysis
The impact analysis is limited because there is some uncertainty about: • The number of new information sharing arrangements that may be sought by other agencies; • The timeframe and resource that might be involved in moving existing sharing arrangements from the current rules into the proposed new framework; and • The scope of datasets to which regular access might be sought under the proposed regulatory framework. **Number of information sharing arrangements that may be sought by other agencies** At any given time Inland Revenue has several proposals from other agencies for information sharing under consideration or development. These are assessed using a set of internally developed principles and prioritised accordingly. Inland Revenue has a dedicated team and governance structure that monitors and prioritises these requests. The number of requests in train at any one time can vary, as can the complexity of the requests. At the time of this analysis there were nine new information sharing proposals at various stages of being considered or progressed. The current framework means that some of these proposed arrangements can be dealt with by way of regulation; however, others involve statutory amendment. This can be a time consuming process. The proposed new rules will mean arrangements can be more flexible and completed more quickly. However there is some uncertainty about how many new or amended arrangements may be sought and therefore the extent of any administrative impacts. In general this will be able to be managed by the prioritisation process; however, at times agencies or Ministers may not have aligned priorities, placing pressure on resources. **Timeframe and resource for moving existing arrangements to the new framework** Alongside new requests for sharing, Inland Revenue and partner agencies also review and consider potential changes to existing arrangements. For example, changes have recently been made to information sharing with the Ministry of Social Development, moving the arrangements into the Approved Information Sharing Agreement framework rather than the previous information matching rules which required very specific legislative exceptions. It is proposed that existing legislative provisions will be grand-parented into the new rules and then gradually replaced by arrangements under the new framework as and when they are updated. Again, while there is some uncertainty about the timeframe and resource requirements for this work, and when other agencies will look to alter their arrangements, this can generally be prioritised using established procedures. At the time of this analysis, there were nine existing agreements under review, or where alterations have been proposed. **Scope of datasets** Inland Revenue already has the ability to collect and work with large datasets; however, these datasets are generally obtained on an ad hoc basis. The availability and usefulness of 'big data' is an area that is evolving rapidly. Business Transformation will provide Inland Revenue with increased capability to work with such datasets. There is currently scope to obtain and use certain datasets for compliance, educative and pre-population purposes – this is occurring for example in Australia and the United Kingdom. However the benefits of any given dataset will vary and the identification of potentially useful datasets will be an iterative process.

As a general rule, Inland Revenue would have previously trialled the collection of data (or data of a similar type) using its general collection power before seeking a regulation. Previous collection and analysis of the dataset will assist to demonstrate the benefits of collecting the data regularly. Prior collection will also enable prioritisation of datasets for regular collection.

While overseas experience indicates certain areas where repeat dataset collection would be valuable, the number or scope of datasets that might be sought under the proposed new rule is unclear at this time, which constrains the analysis of the benefits.

Responsible Manager (signature and date):

Chris Gillion
Policy Manager
Policy and Strategy
Inland Revenue

15 February 2018

Section 2: Problem definition and objectives

2.1 What is the context within which action is proposed?

For most public sector agencies the primary rules governing collection and disclosure of information are found in the Privacy Act 1993 and the Official Information Act 1982. For Inland Revenue, however, the primary rules are contained in Part 4 of the Tax Administration Act 1994.

The efficient and effective administration of the tax system depends on taxpayers disclosing often significant amounts of information to Inland Revenue. Information is provided by both individuals and corporates and may be about themselves or about others, for example, employers provide information both about their own affairs and abut their employees. The types of information collected covers a considerable range, including identity and contact information, income details, for social policy customers information about relationships and household income, for businesses detailed commercial information. This need for information and the broad powers Inland Revenue is granted to obtain it are seen as balanced by a strict rule of confidentiality, often referred to as the "tax secrecy" rule.

The right of taxpayers to have their information kept confidential is also specifically recognised in section 6 of the Tax Administration Act in defining the integrity of the tax system.

Over time, increasing numbers of ad hoc exceptions have been added to the tax secrecy rule. The primary exception, in place since the inception of the rule, permits Inland Revenue to disclose information in order to carry out its functions. Many other exceptions, however, relate to disclosure to other agencies for purposes not related, or not directly related, to Inland Revenue's functions (for example to administer the accident compensation scheme, or the benefits system).

Inland Revenue already shares a significant amount of information, primarily with other government agencies; therefore the proposed changes are not a new concept. The proposals are intended to clarify and update the confidentiality and sharing rules. A key aim is to more clearly balance the trade-offs inherent in decisions about whether to share. The current rules, due to the ad hoc nature of amendments over time, could be seen to lack cohesion, transparency and clear unifying principles. In addition, the breadth of the core rule itself (protecting all matters relating to the legislation administered by Inland Revenue) appears much wider than the rationale for the rule would suggest is necessary.

The previous Government, through initiatives such as Better Public Services, has been focused on improving the use of information within and across agencies. Achieving better outcomes for New Zealanders through wider and smarter use of data is a key focus. The Data Futures Forum, and subsequent Data Futures Partnership have been considering how to get the best value from data in a rapidly changing environment. Rather than taking a siloed approach, agencies are encouraged to work together to provide services.

Other related work includes reviewing the settings in the Privacy Act and the Statistics Act, and a focus on the social investment approach which is strongly data-driven. Draft Customs and Excise legislation before Parliament also contains modernised information sharing rules.

2.2 What regulatory system, or systems, are already in place?

The information and confidentiality ("tax secrecy") rules form a key aspect of the Tax Administration Act framework, with confidentiality of taxpayer information specified as an important aspect of the integrity of the tax system. Inland Revenue has broad powers to obtain the information it needs to fulfil its function of managing the tax system. These powers are balanced with a requirement to keep information confidential.

Inland Revenue has a Regulatory Stewardship Strategy published in August 2017 (EGI-17-MIN-0210) that has assessed the fitness for purpose of Inland Revenue's regulatory systems. The Tax Administration Act generally falls within the revenue raising and collection regulatory system and the strategy also includes a specific information sharing regulatory system. As noted in the Regulatory Stewardship Strategy, information sharing arrangements aim at improving the efficiency and effectiveness of government and to provide better services and outcomes to customers. This is balanced against the need to maintain taxpayer trust that their information is not disclosed inappropriately. The strategy notes that the rules are constantly being looked at and that this review has been carried out to modernise and clarify the rules to better balance the inherent trade-offs and provide for confidentiality and sharing in a customer centric and intelligence led environment.

2.3 What is the policy problem or opportunity?

The Business Transformation programme provides both a need and an opportunity to consider the regulatory settings relating to Inland Revenue's information. Increasing digitisation of information and processes provides opportunities to better utilise data, both within Inland Revenue to assist taxpayers, and, where appropriate, across government to improve the provision of public services. The current rules regarding information collection, use and disclosure were developed in a paper-based environment, and while many of the underlying principles remain applicable, Business Transformation provides the opportunity to ensure the rules continue to be fit for purpose and make the most of the improved technology.

The confidentiality of taxpayer information is a key component of the integrity of the tax system and remains the norm among international revenue agencies. Information flows are crucial to the efficient and effective administration of the tax system. Confidentiality rules are seen as facilitating this in three ways:

- encouraging people to provide information with the confidence it will be used and protected appropriately;
- acting as a balance for the broad information collection powers of Inland Revenue; and
- acting to protect taxpayer privacy.

The current confidentiality or "tax secrecy" rule is extremely broad and covers all matters relating to the legislation administered by Inland Revenue. However, the reasons for the rule indicate the primary concern is information about taxpayers. The existing rule can lead to tensions between confidentiality and the Official Information Act's principle of open access to government information. The current rule can also give rise to tensions between confidentiality and wider government objectives that can be achieved through increased information sharing.

Inland Revenue deals with large numbers of documents, forms, letters and tax returns that contain information about matters such as taxpayers' circumstances, income or assets. Outside of the tax return process, Inland Revenue can require a person to provide any information considered "necessary or relevant" to Inland Revenue's functions. The information collection powers work well and no significant change is recommended. However, two areas have been identified where change is considered of benefit - the regular collection of large datasets and the re-use of information within Inland Revenue. In both cases a key benefit is increased transparency for taxpayers regarding the collection of information about them and the possible uses of this information. The proposed empowering provision for regulations governing repeat collection of large datasets would provide a more efficient mechanism for Inland Revenue to regularly obtain necessary or relevant information for compliance, analytical and educative purposes.

2.4 Are there any constraints on the scope for decision making?

There were no particular constraints on the options considered.

In considering the wide spectrum of options the importance of confidentiality rules to robust international tax information exchange (countries can choose not to exchange information with jurisdictions if they are not satisfied with their confidentiality laws) and to the concept of tax system integrity, narrowed the analysis to looking at options which maintained some form of confidentiality rules. The analysis then focused on the degree to which the confidentiality rules might be updated.

Another relevant consideration was ensuring, insofar as appropriate, that the rules are aligned with other government frameworks for information – in particular, the Approved Information Sharing Agreement framework in the Privacy Act, the Official Information Act, and reviews being carried out in relation to bespoke legislation such as the Statistics Act and the Customs and Excise Act. Work relating to the social investment approach, in particular data frameworks to support this approach, and the Data Futures programme were also relevant considerations.

2.5 What do stakeholders think?

The treatment of taxpayer information affects all taxpayers and there are various stakeholders that have an interest. The issue will not affect Māori in particular.

Formal public consultation has been undertaken via two Government discussion documents: *Making Tax Simpler: Towards a new Tax Administration Act* released in November 2015 and *Making Tax Simpler: Proposals for modernising the Tax Administration Act* released in December 2016. Both discussion documents had an accompanying online forum.

Towards a new Tax Administration Act generated 18 written submissions and 34 comments on the online forum. In relation to information the key themes were:

- Mixed reactions to the proposal to narrow tax secrecy, coupled with particular concern about the need to protect commercial information and the need for adequate confidentiality protections.

- A mixed response to greater information sharing within government – some submitters were supportive but others felt information sharing should be confined to tax-related purposes only. Concern was expressed about agencies being able to obtain information they would not be entitled to collect in their own right. The importance of transparency around sharing was emphasised.
- Consent-based disclosure of information was favoured by a narrow majority, so long as it was confined to within government. Some submitters considered that a taxpayer's ability to access their information themselves (or have an agent access it) was sufficient.
- There was general support for clarification regarding collection of large datasets and remote access searching. Some submitters were in support of new rules that would provide more transparency but not of expanding the search powers.

Towards a new Tax Administration Act provided a high-level framework for key areas of tax administration. The consultation process indicated that the issues were wide-ranging and complex and would benefit from further, more detailed consultation. Therefore a second discussion document *Proposals for modernising the Tax Administration Act* was released in December 2016. The more detailed proposals in this document took into account the feedback received on *Towards a new Tax Administration Act*.

There were 15 written submissions and 19 online comments of *Proposals for modernising the Tax Administration Act*. Submissions were generally supportive of the proposals relating to information, provided appropriate safeguards were in place. Key themes were:

- General support for limiting the coverage of the secrecy rule so long as commercial information was protected.
- Support for clarifying the framework of exceptions and for the proposed cross-government information-sharing framework, so long as other agencies cannot obtain information they are otherwise not entitled to. Consultation was seen as an important component of the framework.
- Support for maintaining and clarifying the rules regarding improper disclosure.
- Submitters generally favoured the proposed regulation-making power for repeat dataset collection and the additional transparency this would provide.

Submitters on both discussion documents comprised a mixture of professional services firms, business, citizen and professional representative bodies, accounting and digital technology businesses, and some private individuals.

Inland Revenue has also recently carried out a statutory review of section 81BA of the Tax Administration Act. This provision enables regulations to be made to authorise sharing with other government agencies and is the basis for the proposals regarding enhanced cross-government sharing. The review[1] included consultation with the two departments with whom agreements have been entered into (ACC and the Ministry of Social Development) and with the Office of the Privacy Commissioner, The Treasury, and the Ministry of Justice. In general there was support for retaining the provision, preferably with some guidance regarding when it would be more appropriate to use section 81BA than the Approved Information Sharing

[1] http://taxpolicy.ird.govt.nz/sites/default/files/2017-other-report-review-s81b-taa.pdf

Agreement framework in the Privacy Act.

The review concluded that section 81BA should be retained pending the outcome of the wider consultation regarding the confidentiality and information sharing rules addressed in this regulatory impact analysis.

Section 3: Options identification

3.1 What options are available to address the problem?

The options for analysis fall into three broad categories – collection, use and disclosure of information and have been analysed within these categories. The three categories can be viewed as stand-alone, and are not interdependent. The recommended package of options (summarised at 5.1) contains options from all three categories.

The most significant parts of the package are the proposals that will make it easier for Inland Revenue to undertake repeat collection of large datasets from external sources and for Inland Revenue to share its information with other agencies.

COLLECTION OF INFORMATION

The status quo information collection rules broadly work well. One aspect has been identified where there is an opportunity to make the rules more efficient and to improve transparency. This relates to the repeat collection of large datasets – under the status quo this can be done on an ad hoc basis by issuing a section 17 request, but this process is not well suited to situations where the information is sought on a repeating, regular basis. There are two alternative options:

Collection option 1: Amend the information collection power to provide specifically for repeat collection of large datasets

This option would see an amendment to the existing information collection power to specifically cover repeated collection of large external datasets. Such collection can already be carried out on an ad hoc basis, however for regular collection of the same datasets it is considered that more specific rules are required. Such collection would continue to be based on the existing "necessary or relevant" standard.

Submitters on *Towards a new Tax Administration Act* generally agreed that a more explicit collection power was appropriate, but did not consider there should be expanded powers as Inland Revenue already has broad collection powers. There was unanimous support for retaining the "necessary or relevant" standard. Several submitters considered that if there were to be more explicit powers in relation to bulk data (external datasets) there should be greater transparency about this collection. Some suggested a process similar to the Australian Tax Office publication of data matching protocols should be followed. These protocols set out the bulk datasets collected and broadly the uses to which this information is put.

Collection option 2: Introduce a regulation-making power governing repeat collection of large datasets (part of recommended package)

Under this option, a specific regulation-making power would be introduced, allowing regulations to be made governing repeat collection of large external datasets. This option responds to submissions seeking greater transparency about this form of collection and was detailed in the second consultation document *Proposals for modernising the Tax Administration Act*. Submitters generally favoured this option, with the attendant increased transparency, provided there was consultation on the development of regulations and consideration of compliance costs.

USE OF INFORMATION

In many cases interactions with a customer are related to a particular purpose, or relate to a particular product type – for example personal income tax or Working for Families tax credits. However the information obtained may also be relevant for other purposes, for example the customer's student loan or child support accounts. In many cases customers, both business and individual have a range of different interaction needs with Inland Revenue and therefore information can be relevant for a range of purposes related to Inland Revenue's various functions. Under the status quo there is no express statement about the use of information in the Tax Administration Act. However, the Kiwisaver Act 2006 does contain a rule that information collected under that Act can be used for the purposes of any other Inland Revenue Act (and vice versa)[2].

Information use option 1: Express clarification that information gathered for one purpose can be used for other purposes within Inland Revenue (part of recommended package)

Under this option, the legislation would expressly state the principle that information collection for the purpose of one of Inland Revenue's functions can be used for any of its other functions. This is consistent with the approach in the equivalent UK legislation which states "information acquired by the Revenue and Customs in connection with a function may be used by them in connection with any other function."

Submitters were supportive of this option and emphasised the importance of clarity for taxpayers regarding the circumstances in which their information could be used.

DISCLOSURE OF INFORMATION

There are two key areas regarding disclosure for which options have been considered – the scope of the confidentiality rule (that is, what should be the starting point for what can and cannot be disclosed) and the rules regarding sharing information across government. Two additional options for improvements to the rules are also considered.

A: Scope of confidentiality rule

We have identified a single alternative to the status quo for the scope of the confidentiality rule. This option has been broadened in scope from the original proposal as a result of consultation.

Disclosure option 1: Better target the confidentiality rule (part of recommended package)

The initial proposal set out in *Towards a new Tax Administration Act* was to narrow the "tax secrecy" rule to a "taxpayer confidentiality" rule, namely one that was limited to information

[2] Kiwisaver Act 2006, section 223.

that would identify (directly or indirectly) a taxpayer. Narrowing the rule in this way would continue to protect taxpayer information, the core reason for the confidentiality rules, but more easily allow the release of anonymised, aggregated information, together with information that did not identify taxpayers – for example, policy information, procurement information, training information and finance and planning information.

A more targeted rule is consistent with the confidentiality rules in jurisdictions such as Australia, Canada and the United States. In the United Kingdom the rule extends to information held in connection with the functions of Her Majesty's Revenue and Customs, however only information that identifies, or could identify, a taxpayer is exempt from disclosure under the freedom of information laws.

Submitters expressed concerns about information that, while it might not identify a taxpayer, could still be very sensitive, in particular commercially sensitive information. Several submissions also highlighted the need for safeguards, and for protections to remain in place for commercially sensitive information. A narrowly drafted rule focused on information that identifies a taxpayer would provide a clear boundary but would risk narrowing the protection too far. In order to adequately protect sensitive taxpayer information, the rule should extend past information that is identifying to a rule such as that in Australia, where the protection protects information "that relates to the affairs of, or identifies an entity".[3] This means that information that does not directly identify a taxpayer will also be protected, as will information that may not even indirectly identify the taxpayer but relates to their affairs – for example, information about a commercially sensitive process that would not identify the taxpayer but is intellectual property that relates to that taxpayer.

The new targeted confidentiality rule should also retain protection for certain sensitive non-taxpayer information. Inland Revenue holds certain very sensitive information, besides that relating to taxpayers, the release of which could damage the integrity of the tax system. Such information would include audit and investigative techniques or strategies, compliance information, thresholds and analytical approaches. Releasing this information could affect the Crown's ability to collect revenue, for example by enabling taxpayers to defraud the system.

The Official Information Act allows information to be withheld if the release would prejudice the maintenance of the law, but there is no specific protection for public revenue. In contrast, the Australian Freedom of Information Act 1982 contains a number of protections that are used as grounds by the Australian Tax Office to withhold sensitive non-taxpayer information. Similarly, the United Kingdom freedom of information legislation also contains broader protection for non-taxpayer, sensitive revenue information. The "maintenance of the law" protection may cover some of the sensitive non-taxpayer information outlined above, but it is not clear this would always be the case. The protection of public revenue is considered of sufficient importance that a residual protection should be retained in the confidentiality rule in the Tax Administration Act.

[3] Taxation Administration Act 1953 (Commonwealth) Schedule 1, Chapter 5, Division 355.

B: Information sharing

The status quo is a combination of specific legislative provisions for each information sharing arrangement and utilising regulatory frameworks set out in section 81BA of the Tax Administration Act and Part 9A of the Privacy Act 1993. The regulatory frameworks provide greater flexibility than specific legislative provisions, however, there is an opportunity to improve the flexibility and usefulness of these rules.

Disclosure option 2: Retain a regulatory sharing model with broader principles and extend to "public service provision" (part of recommended package)

Section 81BA was put in place prior to the Approved Information Sharing Agreement rules in the Privacy Act. Sharing under 81BA is limited to government agencies, where that agency is lawfully able to collect the information but the provision, collection and verification by that agency is inefficient. While this is, and has been, a useful provision, the criteria are not as flexible as they could be, in particular as regards the limitation to "government agency" and the requirement that it be inefficient for the requesting agency to carry out the collection itself.

Under this option, the basic model of section 81BA (information-sharing authorised by regulation) is retained but some greater flexibility would be introduced to allow sharing for "public service provision" rather than only with government agencies.

Under this option the criteria would be modernised to permit sharing where:

- providing the information will improve the ability of the government to efficiently and effectively deliver services or enforce laws; and
- the information is more easily or more efficiently obtained from or verified by Inland Revenue than from other sources; and
- the amount and type of information provided is proportionate given the purpose for which it is being shared; and
- the information will be adequately protected by the receiving agency; and
- sharing the information will not unduly inhibit the provision of information to the Inland Revenue Department in the future.

These criteria are similar to those in 81BA, the key differences being a relaxation in the requirement that information sharing occur only when direct collection/verification is inefficient, to permitting sharing where it is more easily or efficiently obtained from, or verified by, Inland Revenue, and the introduction of an express proportionality consideration. Consideration of any impacts on future information provision to Inland Revenue, and requirements for adequate protection by the receiving agency are similar to those in section 81BA. Extending the provision to sharing for "provision of public services" rather than limiting to government agencies makes this option more consistent with the Privacy Act Approved Information Sharing Agreement rules.

The Office of the Privacy Commissioner has expressed concern about the proliferation of information sharing frameworks, and expressed a preference for agencies to use the rules in the Privacy Act. Inland Revenue does utilise these rules where appropriate, however they primarily focus on sharing personal information, and are therefore not appropriate for information shares that primarily concern non-personal (business) information. This option provides rules, similar to those in the Privacy Act, to deal with situations where the information to be shared is mainly of a non-personal nature.

Disclosure option 3: Authorise all sharing by agreement between Chief Executives

Under this option, a legislative provision would authorise the Commissioner of Inland Revenue to enter into agreements with other Chief Executives regarding the sharing of Inland Revenue's information, without any requirement for regulations. A similar model was proposed by the New Zealand Customs Service, however has been modified during the legislative process to now propose requiring Ministerial authorisation. While this would provide a highly flexible model, the importance of taxpayer confidentiality is considered to be such that a regulatory model, with Cabinet and Regulations Review Committee oversight was more appropriate. A regulatory model is also more consistent with the Approved Information Sharing Agreement model in the Privacy Act, which Inland Revenue will continue to utilise where appropriate, namely where the agreement primarily involves sharing personal information.

Disclosure option 4: Authorise consent-based sharing for public service provision by agreement between Chief Executives (part of recommended package)

While an agreement-based model was not considered appropriate for all information sharing (in particular sharing that is done without need to seek consent or advise those whose information is shared), under this option information sharing done with the consent of the taxpayer concerned could be governed by agreement, without need to seek a regulation. This option is intended to facilitate more flexible information sharing for public service provision, carried out with the informed consent of the taxpayer concerned.

This option would cover situations such as, for example, where a regional non-governmental agency (NGO) has a service agreement with the Ministry of Social Development to assist people to find affordable housing and access their housing-related (or other) government entitlements. To provide the best service, the NGO needs access to up-to-date information about the customer, including their income and other social policy entitlements and obligations. The NGO obtains the informed consent of the customer to access this information. Under this option Inland Revenue, the Ministry of Social Development and the NGO (and potentially other NGOs offering the same service) would sign an agreement. Inland Revenue could then provide the information to the Ministry and/or the NGO in accordance with the terms of the agreement.

Consent-based sharing was raised in *Towards a new Tax Administration Act*, noting the risk of coerced consent. It was therefore suggested that limiting consent-based sharing government agencies might be appropriate in the first instance. This was a position supported by submitters, and reiterated in *Proposals for modernising the Tax Administration Act,* with the modification of permitting this form of sharing for the provision of public services (consistent with the regulatory government information sharing proposal and the Approved Information Sharing Agreement framework).

Also noted in *Towards a new Tax Administration Act* was the possibility that the eventual development of integrated online services might largely remove the need for this form of consented sharing as the customer would be to access the information themselves and forward it in a digital format to the agency or agencies with whom they wished to share it. However, this option is not yet available, and while some submitters considered that the existing ability to access one's own information and pass it on (in a non-digital format) sufficient, enabling a consent-based system for sharing information for public service provision will provide for a more flexible and responsive approach to be taken to improving services for customers seeking optional cross-government services.

C: Other options for improvements

We have identified two additional options to improve the rules relating to information disclosure, primarily focused on providing additional clarity.

Additional option 1: Provide a more cohesive and transparent framework of exceptions to the confidentiality rule (part of recommended package)

The current legislative set of exceptions has developed in an ad hoc matter over a long period of time. This has led to a framework that could be seen as lacking in transparency and clear unifying principles. Under this option the legislation would set out four clear categories of exceptions: disclosures for purposes related to the tax system; disclosures to taxpayers and their agents; international disclosures; and disclosures to other government agencies for non-tax-related purposes. Setting out clear categories of exceptions would provide greater transparency and clarity to the legislation.

Additional option 2: Retain the existing penalties for knowing breach of confidentiality and clarify their application to third parties with access to Inland Revenue's information (part of recommended package)

This option is largely a reflection of the status quo, updated to take account of changes proposed by disclosure option 1. There are existing penalties for Inland Revenue officers and certain other persons who knowingly fail to maintain secrecy. This option proposes to carry over those penalties to the new confidentiality rules proposed in option 1.

This option also proposes clarification/modernisation to the penalty as it applies to persons other than Inland Revenue officers. As the exceptions to the confidentiality rule have been updated in an ad hoc manner over time, the attendant penalty rules have not always received the corresponding updates. Under this option the penalty rule will be updated to clearly apply to all situations where someone with access to confidential Inland Revenue information knowingly improperly discloses that information. The penalty – imprisonment for a maximum of 6 months, or maximum fine of $15,000, or both – would remain the same as currently.

3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The criteria used to assess the likely impacts are:

- Transparency;
- Efficiency – of both administration and compliance, so options should both reduce compliance costs and administrative effort;
- Flexibility – options should provide a level of flexibility or future-proofing for ongoing changes in information collection and sharing;
- Integrity of the tax system – information is critical to the functioning of Inland Revenue and therefore any impacts on integrity, or perceptions of integrity, that might in some way affect the quality of information Inland Revenue is able to obtain are key considerations.

In general these criteria work together and do not require significant trade-offs. However the criterion of integrity, as defined in section 6 of the Tax Administration Act, includes the "rights of taxpayers to have their affairs kept confidential". When it comes to exceptions to confidentiality, including information sharing, there is an inherent trade-off between confidentiality and efficiency or, in some cases, transparency. It should be noted however, particularly in relation to disclosures for tax-related purposes, that the statutory concept of integrity also includes the responsibility of taxpayers to comply with the law.

3.3 What other options have been ruled out of scope, or not considered, and why?

An option that was ruled out of scope early in the analysis was removing the specific tax secrecy rules and instead relying on the Privacy Act. The key issue with this approach is that a considerable amount of taxpayer information held by Inland Revenue relates to companies, trusts and other entities, and would therefore not be covered by the Privacy Act. Therefore, rules for the non-personal information would still be required. There are also potentially issues with the boundary between personal and non-personal information – for example, when considering company information that includes information about the directors.

Other factors that saw this option ruled out of scope early were the importance of confidentiality rules to robust international tax information exchange (noting that countries can choose not to exchange information with jurisdictions if they are not satisfied with their confidentiality laws) and to tax system integrity more broadly. As a result, the analysis was confined to looking at options which maintained some form of confidentiality rules.

Section 4: Impact Analysis

Marginal impact: How does each of the options identified at section 3.1 compare with the counterfactual, under each of the criteria set out in section 3.2?

Collection and use of information options

	No action	Amend collection power to authorise repeat external dataset collection	*Regulation-making power for repeat external dataset collection*	*Clarify use of information for multiple revenue purposes*
Transparency	**0**	0 This option would not see any greater transparency of collection than the current ad hoc approach.	++ Regulations and associated material are published meaning there is a public record of this type of collection along with information about what the data will be used for.	++ While this is largely viewed as the current position by Inland Revenue, it may not be clear to taxpayers. A clear statement in the legislation will assist transparency.
Efficiency	**0**	+ Providing specifically for repeat collection would improve administrative efficiency.	++ Where a case for repeat collection is made, this process provides greater administrative efficiency than ongoing ad hoc requests. While provision may impose costs, there may be greater efficiency in a standard process for data holders.	+ Appropriate reuse of data is more administratively efficient than repeat requests for the same information from the customer. This is also more efficient for the customer. Care must be taken, consistent with the privacy principles, to ensure information remains accurate and up-to-date.
Flexibility	**0**	++ A legislative power would provide some flexibility but may require a greater degree of specificity in the primary legislation than a regulation-making approach.	++ A regulation-based approach provides for greater flexibility in relation to each individual regulatory instrument, as broader principles can be specified in the legislation.	+ This approach gives Inland Revenue clearer administrative flexibility with information.
Integrity	**0**	+ Access to large datasets enables more compliance, educative and service activity that will improve integrity.	++ Access to large datasets enables more compliance, educative and service activity that will improve integrity. Greater transparency also contributes to improved integrity.	++ Transparency about information use would enhance integrity.
Overall assessment		+	++ **Recommended option**	++ **Recommended option**

Disclosure options – Scope and information sharing

	Better target the confidentiality rule	***Enhanced regulatory sharing model***	**Authorise sharing by agreement between agencies**	***Consent based sharing for public service provision***
Transparency	++ Inland Revenue can release more information and the rules are clearer about what is protected. Submitters support this option provided commercially sensitive information is protected.	++ This option will see, over time, many of the existing legislative sharing arrangements moved into the regulatory framework which will provide greater transparency because the regulations and agreements are published.	- Agreements could be required to be published which would enhance transparency, however, this model has no Ministerial or Parliamentary oversight which could be seen to reduce transparency.	++ Customers will be aware of the information sharing as informed consent is required.
Efficiency	++ The current rule is inefficient as it protects information it does not need to protect. The narrower rule would allow non-taxpayer information to be released or shared more efficiently.	+ Improved information sharing improves efficiency for both customers who do not have to provide information multiple times, and for government as it can be reused rather than collected multiple times.	++ Improved information sharing improves efficiency both for customers who do not have to provide information multiple times, and for government as it can be reused rather than collected multiple times.	++ Improves efficiency both for customers, who do not have to provide their information multiple times and for wider government as, rather than needing to seek information from customers, it can directly verify from Inland Revenue.
Flexibility	++ The proposal provides greater flexibility to release information while protecting a broad range of information about taxpayers and sensitive non-taxpayer information.	+ A regulatory model is more flexible than legislative exceptions – broadening the application of the regulatory model will enhance flexibility.	++ An agreement based model is more flexible and allows agreements to be updated more quickly.	++ An agreement based model is more flexible than legislative or regulatory options, allowing for faster deployment of new services and changes to agreements.
Integrity	++ The rule remains protective of taxpayer information rather than a wider set of information. This better focus enhances integrity.	+ Enhancing the regulatory model, with clear principles will improve integrity.	-- Oversight of information sharing proposals is considered important to ensure that it does not overstep or risk unduly affecting the ability to collect information, or the quality of information in the future.	++ While there is less oversight than regulatory options, as it is for consented sharing and limited to public service provision, the impact on integrity is considered to be positive.
Overall assessment	++ **Recommended option**	**+ Recommended option**	-	**++ Recommended option**

Additional disclosure improvement options

	More cohesive exception framework	***Clarify penalty rules***
Transparency	++ The current framework lacks transparency and is hard to draw cohesive principles from. This option makes clearer the classes of situation in which exceptions are considered appropriate.	+ The current rules regarding non-Inland Revenue officers are difficult to follow. A clearer rule would be more transparent.
Efficiency	+ A clearer framework (in particular coupled with the preferred information sharing option) will be more efficient to administer.	+ A clearer rule is more efficient to administer.
Flexibility	+ Drawing the exceptions together into a more principled and cohesive framework is intended to provide greater flexibility within the classes of exception than the current very specific ad hoc exceptions.	+ A clear rule that the confidentiality obligation follows the information, as does the penalty, provides greater flexibility than the current rules tied to specific provisions and secrecy certificates.
Integrity	++ Greater transparency and cohesion in the framework enhances integrity.	++ Clearer rules capturing all recipients of confidential information emphasise its importance and enhance integrity.
Overall assessment	**++ Recommended option**	**+ Recommended option**

Key:

++ much better than doing nothing/the status quo

+ better than doing nothing/the status quo

0 about the same as doing nothing/the status quo

- worse than doing nothing/the status quo

- - much worse than doing nothing/the status quo

Section 5: Conclusions

5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?

The proposed package of options considered to best address the problem, meet the policy objectives and deliver the highest net benefits is:

- *Collection* – collection option two: regulation-making power for repeat collection of external datasets.
- *Use* – use option one: express clarification that information gathered for one purpose can be used for other purposes within Inland Revenue.
- *Disclosure:*
    - o *Scope* – disclosure option one: a better targeted confidentiality rule focused on protecting information about taxpayers and sensitive non-taxpayer information.
    - o *Information sharing* – disclosure options two and four: an enhanced regulatory sharing model together with consent based sharing governed by agreements. Both options are limited to information sharing for public service provision.
    - o Other enhancements – additional options one and two: a more cohesive and transparent framework of exceptions and clarification of the penalty rules, namely retaining the existing penalties for knowing breach of confidentiality and clarifying their application to third parties with access to Inland Revenue's information.

This package of options has been assessed as providing improved transparency, efficiency and flexibility, while maintaining or improving the integrity of the tax system. In general, stakeholders expressed support for the proposed package, provided sufficient safeguards were in place for commercial information and to ensure that information sharing did not allow other agencies to access information they were not entitled to. The proposals have been designed to ensure these concerns are addressed. Stakeholders were keen to see enhanced transparency around Inland Revenue's collection, use and disclosure of information and this package of proposals will ensure improvements in this respect.

Inland Revenue has extensive experience with the application of its information collection, use and disclosure rules and therefore has a good understanding of the areas that work well and not so well. This package of reforms has been designed to improve the rules without undermining the fundamental areas that continue to work well, primarily confidentiality of taxpayer information and collection rules based on a 'necessary or relevant' standard.

As shown in 5.2 below, the main impacts of the package relate to the proposals that will make it easier for Inland Revenue to undertake repeat collection of large datasets from external parties and for Inland Revenue to share its information with other agencies. The other proposals have limited impacts.

5.2 Summary table of costs and benefits of the preferred approach

Affected parties *(identify)*	**Comment**: *nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks*	**Impact** *$m present value, for monetised impacts; high, medium or low for non-monetised impacts*	**Evidence certainty** *(High, medium or low)*
Additional costs of proposed approach, compared to taking no action			
Regulated parties – Information holders	Costs for affected information holders associated with regular repeat dataset provision where regulations are put in place. These costs will vary depending on the information sought and the systems of the information holder. In cases where information is currently sought on an ad hoc basis, making provision regular may have minimal additional impact.	Low	Medium
Regulators – Inland Revenue	There may be increased costs for Inland Revenue associated with increased information sharing.	Low	High
Wider government			
Other parties			
Total Monetised Cost	It is not possible to quantify the costs at this time, as the changes that may result in additional costs will occur when regulations are made under the new information sharing and collection empowering provisions.		
Non-monetised costs		Low	Medium
Expected benefits of proposed approach, compared to taking no action			
Regulated parties - customers	Information sharing can provide compliance cost savings to customers where it reduces the need for them to provide their information to multiple agencies.	High	High

Regulators – Inland Revenue	Improved information holdings for compliance, educative and pre-population work from repeat dataset collection.	High	High
Wider government – departments and NGO service providers	Improved ability to share information and more flexibility to make changes to existing arrangements. This should lead to improved efficiency across government. By way of example from some of the existing information sharing arrangements in the year ending 30 June 2017: • The proactive share with MSD to prevent benefit fraud identified an estimated $46.3 million in overpayments; • Information Inland Revenue shared with the Ministry of Justice enabled it to collect more than $11.2 million in overdue fines; • Inland Revenue shared information 39 times in response to 45 valid requests for information from WorkSafe New Zealand and the Labour Inspectorate, which is part of the Ministry of Business, Innovation and Employment. This is helping them to investigate breaches in workplace legislation.	High	High
Other parties			
Total Monetised Benefit	It is not possible to quantify the benefits at this time, as the specific changes will occur when regulations are made under the new information sharing and collection empowering provisions.		
Non-monetised benefits		High	High

5.3 What other impacts is this approach likely to have?
Nothing not already covered elsewhere in this analysis.

5.4 Is the preferred option compatible with the Government's 'Expectations for the design of regulatory systems'?
The preferred options are consistent with the Government's 'Expectations for the design of regulatory systems'. The preferred options should deliver a more appropriately targeted, transparent set of rules for the collection, use and disclosure of information by Inland Revenue. The preferred options aim to minimise cost across the system, better align with related requirements in the Privacy Act and Official Information Act, conform with established legal and constitutional principles and are generally similar in nature to rules in place in the United Kingdom and Australia. The preferred options have the scope to evolve in response to changing circumstances or new information on the regulatory system's performance. Regulations provide a more flexible and adaptive approach to managing information sharing, and the proposed regulatory approach to repeat dataset collection provides a more transparent and certain process for both data holders, and those whose information is being collected.

Section 6: Implementation and operation

6.1 How will the new arrangements work in practice?

The preferred options will need to be implemented by legislative amendment to the Tax Administration Act 1994. For the most part the preferred options will require amendment to, and consolidation of, existing provisions. It is intended that Part 4 of the Act will be substantially redrafted to give effect to the preferred options.

A new empowering provision will be required to enable the making of regulations governing repeat collection of data. The empowering provision for information sharing regulations will require amendments to an existing provision (section 81BA).

Transitional provisions will be required to grandparent existing information sharing arrangements. Over time these can be moved within the new regulatory framework and the provisions removed.

The amendments could be included in the first omnibus taxation bill of 2018. The amendments could apply from date of enactment. Explanation of the amendments and their effect would be contained in a Tax Information Bulletin released shortly after the Bill received Royal assent.

Inland Revenue's internal and external guidance will be updated and where necessary, new guidance developed, to assist staff and taxpayers with the application of the new rules.

Once implemented, Inland Revenue will be responsible for the ongoing operation and enforcement of the rules.

Other agencies with an interest, in particular those with whom information is shared, will, as now, be involved in an ongoing relationship with Inland Revenue relating to the operation of that information sharing. Relevant stakeholders will be involved in consultation where any new information sharing or information collection regulations are proposed.

6.2 What are the implementation risks?

There is a risk there could be a large number of agencies that seek new or amended information sharing arrangements following the enactment of the proposed information sharing rules. Inland Revenue has a set of principles that are applied to the prioritisation of information sharing proposals that can be used to help deal with this situation should it arise. As the proposed new rules are an extension of existing rules, rather than a completely new regime, this risk is considered relatively low.

With use and disclosure of information, in particular information sharing, there is always a risk of a privacy or information breach. Consideration of these risks and protections that should be put in place will be built into the proposed rules. Information sharing agreements will also deal with agreed uses and disclosure of information provided by Inland Revenue. The preferred options also include proposals to maintain the obligation for staff to keep Inland Revenue information confidential and to clarify the corresponding obligation on those in receipt of Inland Revenue information.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

Inland Revenue would monitor the effectiveness of the proposed changes in the first 12 months of operation. The monitoring would involve a review of regulations made under the proposed information sharing and dataset collection enabling provisions within that period to ensure they were consistent with the intended policy. The empowering provision for dataset collection regulations will contain a requirement that the operation of the provision is reviewed after 5 years. This will include consultation with external parties and reviewing the costs and benefits of regulations made under the empowering provision.

In general, Inland Revenue monitoring, evaluation and review of new legislation takes place under the generic tax policy process (GTPP). The GTPP is a multi-stage policy process that has been used to design tax policy (and subsequently social policy administered by Inland Revenue) in New Zealand since 1995. The final step in the process is the implementation and review stage, which involves post-implementation review of legislation and the identification of remedial issues. Opportunities for external consultation are built into this stage. In practice, any changes identified as necessary following enactment would be added to the tax policy work programme, and proposals would go through the GTPP.

The Regulations Review Committee would also have a role in monitoring and reviewing any regulations made. The Committee examines all regulations, investigates complaints about regulations, and examines proposed regulation-making powers in bills for consistency and good legislative practice. The Committee reports to the House and other committees on any issue it identifies. The House can “disallow” a regulation, meaning it no longer has force.

7.2 When and how will the new arrangements be reviewed?

The proposals relating to both information sharing and repeat information collection are to be governed by regulations. As part of the regulation making process consultation will be required. This will give stakeholders an opportunity to make comment and raise any concerns about the proposed sharing or collection. The proposals also require regulations and underlying agreements to be published, making available a greater level of information about information shared and collected than is currently the case. Greater awareness of these matters provides greater opportunity for people to raise any concerns they may have, either with Inland Revenue, or with a relevant regulator, such as the Privacy Commissioner. As above, the Regulations Review Committee also has a role in this regard.

Coversheet: Making Tax Simpler: Proposals for modernising the Tax Administration Act - flexibility for dealing with legislative anomalies

Advising agencies	*Inland Revenue*
Decision sought	*How best to reduce compliance costs and administrative costs by providing earlier certainty to taxpayers and Inland Revenue about the application of tax law when there is a legislative anomaly that results in an inconsistency with policy intent and practice.*
Proposing Ministers	*Minister of Revenue*

Summary: Problem and Proposed Approach

Problem Definition **What problem or opportunity does this proposal seek to address? Why is Government intervention required?**
The Commissioner of Inland Revenue (the Commissioner) has limited ability to deal with situations when a provision is not consistent with the intended policy (legislative anomalies). This ties up taxpayer and Commissioner resources in outcomes that are inconsistent with both parties' practice and/or expectations. Taxation laws are public goods provided by the government. Only government action can remedy uncertainty caused by a legislative anomaly.

Proposed Approach **How will Government intervention work to bring about the desired change? How is this the best option?**
The proposed approach would enable regulations or determinations to be made, or administrative action to be taken, to address legislative anomalies. The power would be subject to safeguards including consistency with the existing policy and the principles supporting the integrity of the tax system; the outcomes would be optional for taxpayers to apply and would expire in three years.

Section B: Summary Impacts: Benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?
The proposed approach would have no direct impact because it would only enact an empowering provision. The main expected beneficiaries of any regulations or determinations made under the power would be the full range of taxpayers, including individual taxpayers through to large corporates. The expected benefit would be increased certainty for taxpayers and reduced compliance costs.

Where do the costs fall?
The main costs of the proposal would fall on Inland Revenue in having to administer the system. Some minor costs would fall on taxpayers in having to maintain awareness of any regulations or determinations made, or administrative action taken.

What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?
The introduction of the power could raise risks for the rule of law. However, there are various elements of the proposed approach that would mitigate the risks to the rule of law including the limited scope of the power, the procedural safeguards (including parliamentary oversight), and the temporary nature of any exemptions.

Identify any significant incompatibility with the Government's 'Expectations for the design of regulatory systems'.
There is no significant incompatibility with the Government's 'Expectations for the design of regulatory systems'.

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?
Inland Revenue is confident that the evidence supports the policy proposal. Analysis has been undertaken to determine the impact of the current problem, including the length of time taken to remedy anomalies under the current system. Analysis has also been undertaken of comparative regimes overseas, including the recently enacted Australian regime.

To be completed by quality assurers:

Quality Assurance Reviewing Agency:
Inland Revenue.
Quality Assurance Assessment:
The Quality Assurance reviewer at Inland Revenue has reviewed the *Making Tax Simpler: Proposals for modernising the Tax Administration Act – flexibility for dealing with legislative anomalies* Regulatory Impact Analysis and considers that the information and analysis summarised in it meets the quality assurance criteria of the Regulatory Impact Analysis framework.
Reviewer Comments and Recommendations:
None.

Impact Statement: Making Tax Simpler: Proposals for modernising the Tax Administration Act - flexibility for dealing with legislative anomalies

Section 1: General information

Purpose
Inland Revenue is solely responsible for the analysis and advice set out in this Regulatory Impact Assessment, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by or on behalf of Cabinet.

Key Limitations or Constraints on Analysis
There are two limitations on the analysis because there is some uncertainty about: • the number of suggested applications of the exemption power that could be proposed by taxpayers, and so the resource impact on Inland Revenue in having to deal with the proposed applications; and • any possible increase in judicial review applications. **Level of suggestions** Taxpayers would be able to suggest instances when the proposed power could be used. There is some uncertainty about the number of suggested applications that might be submitted by taxpayers, so there is some uncertainty about the resources Inland Revenue would need to process them. There is only a small risk that there would be a significant number of suggestions because there is evidence of the number of legislative anomalies that are discovered each year and the number suitable for the remedial power is likely to be a subset of those issues.[1] Inland Revenue received 140 referrals from all sources for remedial amendments between October 2015 and October 2017. Only a small subset of those referrals is likely to be appropriate for the proposed option. Furthermore, under the similar Australian provision only 22 applications were received in the first six months. Of those only two were considered appropriate for the remedial power. It is acknowledged that although the Australian provision is similar to the preferred option discussed below, the differences in the tax systems might lead to a different number of suggestions being made. Overall, the evidence suggests that the proposed option is unlikely to require a significant amount of resource for Inland Revenue to manage the process, and the analysis proceeds on that basis. **Increase in judicial review applications** There is some uncertainty about the impact of any possible judicial review of the use, or failure to use, the proposed power. However, Inland Revenue considers the risk to be small because the application of any exemption is optional so taxpayers are unlikely to judicially review the application of the exemption power and the courts have been reluctant to allow judicial review challenges that are seen as collateral attacks on a tax assessment.[2]. Inland Revenue considers the risk is so small that it will not have any meaningful impact on the analysis.

[1] The number of remedial referrals is contained in an internal database.

[2] *Tannadyce Investments Limited v Commissioner of Inland Revenue* [2011] NZSC 158.

Responsible Manager (signature and date):
Chris Gillion Policy Manager Policy and Strategy Inland Revenue 15 February 2018

Section 2: Problem definition and objectives

2.1 What is the context within which action is proposed?

Taxation laws are public goods provided by the government. Only government action can remedy uncertainty caused by a legislative anomaly. If the government does not remedy the anomaly, then the taxpayer bears the risk of being found not to have complied with the law, or they must bear the unintended costs.

New Zealand's tax system is very complex, and it undergoes significant change regularly. The nature and volume of the tax law changes mean that unforeseen or unintended outcomes (legislative anomalies) arise often. This is likely to continue to be the case into the future given the increasing complexity of tax law and rapidly evolving business practices.

Ideally, any such anomalies would be remedied by an amending Act, given the constitutional importance of tax and the certainty that primary legislation gives to both taxpayers and Inland Revenue. In some cases this will be both necessary and achievable.

However, under the current approach, it takes on average 670 days to remedy a legislative anomaly through primary legislation once it has been identified as needing legislative change. During that time, taxpayers are required to file different returns in different periods. For example, GST returns often need to be filed every two months and income tax returns every year. Taxpayers, therefore, might need to file several returns in the period during which an anomaly is being remedied.

It is noted that similar problems arise in Inland Revenue's non-tax functions (such as the administration of social policies). Clarifying that the care and management provision applies to the Commissioner's non-tax functions is intended to be progressed as part of the Making Tax Simpler project to modernise the administration of social policy.

2.2 What regulatory system, or systems, are already in place?

The elements of the current regulatory system that are relevant for dealing with legislative anomalies are set out below:

- In some situations, a purposive approach to interpreting the relevant legislation will mean that an anomaly that may arise on the plain reading of the relevant provision does not arise. However, sometimes the legislation cannot be interpreted in a way that is consistent with the policy intent.

- Some anomalies can be remedied quickly through the legislative process if their discovery aligns with an existing bill. However, this does not often happen and so the average time to remedy a remedial issue is approximately 670 days.

- The Commissioner also has some administrative flexibility under the existing care and management provision. The current provision does not allow the Commissioner to administratively remedy legislative anomalies.[3] Instead, the flexibility allows the

[3] Interpretation statement "Care and management of the taxes covered by the Inland Revenue Acts – section 6A(2) and (3) of the Tax Administration Act 1994", Tax Information Bulletin Vol 22, No 10 (November 2010).

Commissioner to decide not to allocate her resources to investigate situations when there is a known anomaly. This does not provide certainty for a taxpayer when Inland Revenue becomes aware of an issue because the Commissioner does not have a general power to suspend the application of the law. As it is only an administrative undertaking by the Commissioner, it provides limited protection for taxpayers who rely on it and so do not comply with the law. In those circumstances, the Commissioner would continue to have a duty to apply the law, even when it would produce outcomes that are not consistent with the purpose or object of the law.

2.3 What is the policy problem or opportunity?

The existing approach to resolving legislative anomalies in tax law can create uncertainties and is costly for taxpayers and Inland Revenue.

The process creates uncertainties because when the legislation does not align with the intended policy, then taxpayers are unsure how to apply the law. To a limited extent this uncertainty can be resolved by binding rulings and other forms of advice. However, such advice can only clarify the meaning of the legislation and cannot resolve issues when the legislation cannot be interpreted consistently with the intended policy. Taxpayers either have to comply with the legislation as interpreted either by themselves or the Commissioner, so incurring unintended costs or compliance requirements; or comply with the intended policy and risk being penalised for not complying with the law. The uncertainty makes it harder for taxpayers to organise their affairs, invest or plan for the future.

The uncertainty can also undermine the integrity of the tax system, by encouraging taxpayers to ignore the relevant tax law and comply with the policy. It can also be seen to undermine the rule of law when there is uncertainty about whether the law is intended to be complied with.

The rule of law has been described as an elusive constitutional principle that includes at its heart the requirement that all persons (including the State) should be bound by the laws publicly made.[4] This has been developed further to suggest that the law should be clear, predictable, accessible and not made arbitrarily.

When the only avenue to resolve the issue is through legislative amendment, then there can be a substantial period of uncertainty. This can create compliance costs for taxpayers by requiring them to seek advice either from an external advisor or Inland Revenue as to the correct approach to the relevant provision in the interim period. This also increases the administrative costs for Inland Revenue in dealing with the issue.

[4] Ross Carter et al *Subordinate Legislation in New Zealand* (LexisNexis, Wellington, 2013) 26.

2.4 Are there any constraints on the scope for decision making?

There were no particular constraints on the scope of options considered.

The options tie in with the broader work that is being undertaken to modernise the Tax Administration Act 1994. Specifically, the work on updating the type of advice provided by Inland Revenue deals with situations when the legislation can be interpreted in a way that aligns with the policy intent. The work on advice is aimed at better communicating the Commissioner's position to taxpayers through different forms of advice tailored to the needs of different taxpayers. The current issue deals with situations when the legislation cannot be interpreted consistently with the policy intent.

2.5 What do stakeholders think?

The problem affects all taxpayers and there are various stakeholders that have an interest.

Significant consultation has been undertaken which has resulted in four options being developed. The consultation process is set out below.

Problem identification

Taxpayers highlighted the lack of speed and certainty in rectifying legislative anomalies in the *Tax Administration for the 21st century* conference in June 2014. The conference's purpose was to explore options for making tax easier (by reducing both compliance and administration costs) and increasing voluntary compliance balanced against core tax policy objectives such as raising revenue, and ensuring fairness and efficiency.

First discussion document proposed options

In response to the identified problem (and other problems), the Government released a discussion document *Making Tax Simpler: Towards a new Tax Administration Act* in 2015 which suggested two possible options:

- extend the Commissioner's current discretionary or determination-making powers that attach to specific provisions (referred to as "option 3" in this RIA); or
- a clarification to the care and management provision to deal with some legislative anomalies (referred to as "option 4" in this RIA).

The consultation included an online forum and presentations to submitters.

The proposal to clarify the care and management provision was based on some criteria set out in *R v Inland Revenue Commissioners; Ex parte Wilkinson* [2005] UKHL 30, which discussed the scope of the Commissioners' discretionary powers under the similarly worded United Kingdom care and management power. The option would allow the Commissioner to use her discretion in relation to:

- minor legislative anomalies;
- transitory legislative anomalies;

- cases when the relevant legislation has failed to adequately deal with the particular situation because a statutory rule is difficult to formulate;
- a long-standing established practice of both the Commissioner and taxpayers;
- cases of unfairness at the margins.

The discretion would only be exercised consistently with policy intent, and not allow for a policy-making ability. The exercise of the discretion would be time-limited and could not exceed three years. After this time, if the issue was on-going, an amendment to the primary legislation would be required. Consultation prior to the exercise of the discretion would be required, and any exercise of the discretion would be published to ensure transparency. The discretion would also be exercised only by Inland Revenue officers with an appropriate level of expertise.

Submissions on the care and management proposal suggested various safeguards

Submissions were generally supportive of the proposal to clarify the care and management provision. They commented that it should be a positive step for taxpayers and ensure the Commissioner had the ability to direct her resources where they were most needed. It was also noted that the proposal needed to be supported by a change in mind-set within Inland Revenue to support use of the care and management provision.

Submissions suggested:

- Any enhanced administrative flexibility should only be exercised in favour of the taxpayer, and the amendment should expressly state this rule to avoid any doubt.
- Any care and management power should be guided by a set of principles – including those in sections 6 and 6A of the Tax Administration Act.
- There needed to be a principle which establishes whether the policy is clear enough such that the Commissioner could depart from the ordinary meaning of the words – for example, "persons reading the relevant legislation would in most cases agree what the policy intent of the legislation is".
- A balancing of a collection of factors was suggested, including: cost to the taxpayer; cost to the Commissioner; a ceiling of an amount of tax at issue if the legislation is applied as written (compared to if the Commissioner has the flexibility to take another approach); and perhaps a time period.

Submissions reflected in proposed safeguards and options

The submissions were taken into account in developing a refined proposal that was consulted on in a subsequent Government discussion document, *Proposals for modernising the Tax Administration Act* (December 2016). The consultation included an online forum and workshops with submitters. The revised proposal retained the listed criteria and set out the relevant safeguards that would apply, including that it would be optional for taxpayers.

The submissions on the specific criteria and safeguards suggested:

- While there was support for each of the listed criteria for when the discretion could be exercised, there was some uncertainty about the scope of the criteria.
- There were differing views on whether the exercise of the discretion should be limited to taxpayer-friendly situations or whether it should be optional for taxpayers to apply.

- The discretion should be applied consistently and only in appropriate circumstances, but that these safeguards should not impede the exercise of the discretion in an effective manner.
- Guidance was needed to ensure taxpayers had a clear understanding of how the provision would apply.
- The power should not be exercised if it would not be in the public interest to do so.
- The exercise or non-exercise of the discretion should be a reviewable decision.
- There should be some flexibility around the requirement to consult as whilst consultation might be beneficial in some cases, in many cases it would result in significant delay of the effective exercise of the discretion.
- The requirement to publish the exercise of the discretion should be subject to a public interest requirement.

Submitters proposed other options

A concern was raised that not all taxpayers would have access to decisions made by the Commissioner under an extended care and management power, which would result in a body of private law. Some submitters suggested exploring further the option of granting the Commissioner a regulation-making power in the form of disallowable legislative instruments like those proposed in Australia.

Alternatively, it was suggested that the Commissioner should be allowed to anticipate legislative changes by issuing interpretation statements that then apply as binding interpretations.

Submitters, and the Legislation Design and Advisory Committee, supported having a range of options by which the discretion could be exercised (a "tool box approach"). This approach is similar to the suite of powers available to the Financial Markets Authority under the Financial Markets Authority Act 2011 and Financial Markets Conduct Act 2013.

The Crown Law Office was concerned about the implications for the rule of law of the proposed extension to the Commissioner's care and management power, but noted that those concerns were, to a limited extent, addressed by the specific safeguards. The Crown Law Office considered that it would be preferable if the power could be exercised only by Order in Council.

These concerns and comments led to the development of the proposal referred to as "option 5" in this RIA.

Workshop with submitters

Following the submissions on the discussion document, and the comments above, Inland Revenue organised a workshop with submitters (including Crown Law) on the various proposals. The discussion focused on option 5.

During the workshop, submitters suggested:

- The proposal should adopt a principle-based approach. This would allow the discretion to be used when the legislation did not align with the intended policy without being limited by any specific criteria.

- There should be a tool-box of options by which legislative anomalies could be dealt with, including Orders in Council, Commissioner-made determinations, and administrative action.
- Any exercise of the discretion should be optional for taxpayers to apply.

Summary

The consultation comments were taken into account in developing the options discussed below.

Section 3: Options identification

3.1 What options are available to address the problem?

There are five options considered in this analysis:

- **Option 1**: Address legislative anomalies using existing processes (status quo).
- **Option 2**: Increase resources to address legislative anomalies using existing processes. Increasing the resources directed at remedying legislative anomalies would involve redirecting existing resources or increasing the resources directed to law development. This option does not require legislation and could be used in conjunction with any of the other options.
- **Option 3**: Provide for more discretionary provisions in legislation. This option would extend the Commissioner's current discretionary or determination-making powers that attach to specific provisions. It would provide the Commissioner with increased administrative flexibility to deal with legislative anomalies in specific situations.
- **Option 4**: Administrative flexibility in limited circumstances. This option would extend the Commissioner's care and management provision to provide some more administrative flexibility in limited circumstances.
- **Option 5**: Determinations and regulations to temporarily remedy anomalies (preferred option). This option would provide a power to make regulations, determinations or take administrative action to remedy a legislative anomaly.

3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The overarching objective is to reduce compliance costs and administrative costs by providing earlier certainty to taxpayers and Inland Revenue about the application of tax law when there is a legislative anomaly that results in an inconsistency with policy intent and practice.

The options have been assessed against the objective and the following criteria:

- **Sustainability:** The options should support the rule of law and maintain the integrity of the tax system.

- **Compliance costs:** Compliance costs for taxpayers should be minimised as far as practicable.

- **Administrative costs:** Administrative costs for Inland Revenue should be minimised as far as practicable.

The objective of the proposal is to balance the compliance cost and administrative cost reduction objective against the sustainability objective. This would be achieved through the limitations included in the options considered.

Overlaps between criteria

There is likely to be an overlap between reductions in compliance costs for taxpayers and reductions in administrative costs for Inland Revenue, in that a reduction in the former is likely to cause a reduction in the later under the relevant options. This is because the simpler the option for taxpayers the less likely they will need advice from Inland Revenue.

3.3 What other options have been ruled out of scope, or not considered, and why?

Some submitters suggested that one option could be to re-interpret the current care and management provision, so as to provide the Commissioner with greater administrative flexibility without the need for a legislative amendment. The current proposal suggests retaining the current care and management provision but supplementing it with further flexibility in certain circumstances. As a result, the proposal does not prevent a broader interpretation being taken of the scope of the current provision.

However, it is considered that while the current provision does provide the Commissioner with flexibility about the allocation of her resources, it does not provide her with the flexibility to administratively remedy legislative anomalies. Further, it is considered that the scope of any such power, and the safeguards that would apply, should be specified in the legislation to protect the integrity of the tax system and the rule of law. As a result, the option of re-interpreting the current provision was ruled out because it would risk the integrity of the tax system and the rule of law.

Section 4: Impact Analysis

Marginal impact: How does each of the options identified at section 3.1 compare with the counterfactual, under each of the criteria set out in section 3.2?

	No action Option 1	Option 2 (Providing greater resources)	Option 3 (Enact more discretionary provisions)	Option 4 (Administrative flexibility in limited circumstances)	Option 5 (Determinations, regulations, and admin action) (Preferred option)
Criterion (Sustainability)	**0**	**0** Although remedying all issues through legislative amendment would seem to support this criterion, the lengthy legislative process would mean taxpayers would be required to follow either the policy or the law for a substantial time. This would harm the integrity of the tax system and the rule of law.	+ This option would support the integrity of the tax system and the rule of law, but it would be difficult to predict any issues so the problem is likely to still arise in many cases. As a result, in most cases taxpayers would be required to follow either the policy or the law, harming the integrity of the tax system and the rule of law.	- This option would support sustainability by remedying anomalies quicker. However, it would be at the discretion of the Commissioner and it would not be subject to Parliamentary oversight.	+ This option would remedy the anomalies and would be subject to parliamentary scrutiny, thereby supporting the rule of law. This option would mean taxpayers could choose the best option so supporting the integrity of the tax system.
Criterion (Compliance costs)	**0**	+ It would reduce taxpayers' compliance costs because more attention would be paid to problematic issues but it would still take time to resolve, so taxpayers would incur costs working out what to do in the interim.	0 – It would only be effective when the problem could be anticipated so taxpayers would still likely have significant compliance costs in most cases. Relying on discretions would involve moving away from the efficiency objective of self-assessment, and so would incur further compliance costs for taxpayers than the status quo.	+ The speed by which the issues could be resolved would reduce taxpayers' compliance costs. However, the remedy would not provide legal certainty so taxpayers might still need to seek advice as to the consequences.	+ Anomalies could be resolved quickly, and this would reduce taxpayers' compliance costs. However, taxpayers would incur some costs associated with understanding the process and choosing whether to apply the remedy or the black letter of the law.
Criterion (Administrative costs)	**0**	- Devoting more resources to the policy development process would divert resources from elsewhere, or require more funding.	- Additional administrative costs in determining on a case-by-case basis whether the issue is within a discretionary power.	+ The ease of remedying anomalies would reduce administrative costs but there would be risks of challenges to the use of the discretion.	+ This option would reduce administration costs by quickly remedying anomalies. However, there would be some increased costs for Inland Revenue in deciding whether the discretion should be exercised.
Overall assessment		**0**	**0**	+	++

See below for more detailed analysis

Key:

++	much better than doing nothing/the status quo
+	better than doing nothing/the status quo
0	about the same as doing nothing/the status quo
-	worse than doing nothing/the status quo
- -	much worse than doing nothing/the status quo

Further analysis:

Option 2 (Increase resources)

Sustainability

This option would seem to support the integrity of the tax system and the rule of law as it reflects the constitutional importance of tax and the certainty that primary legislation gives to both taxpayers and Inland Revenue. However, under the current approach it takes on average 670 days to remedy a legislative anomaly through primary legislation once it has been identified as needing legislative change. It is not clear that increasing the policy resources would substantially reduce this time period, as it is mainly driven by the legislative process. The time period involves the lead-in time to get a remedial item added to a bill (including the relevant reporting requirements) and the passage of the bill through the House.

As a result, it is likely that even with more policy resources it might still take a similar time to resolve the relevant legislative anomalies. The substantial time taken by the legislative process would mean taxpayers either comply with the legislation as interpreted, so incurring unintended costs or compliance requirements; or comply with the intended policy and risk being penalised for not complying with the law. This would result in no change from the status quo for the integrity of the tax system and the rule of law. The uncertainty makes it harder for taxpayers to organise their affairs, invest or plan for the future.

Compliance costs

Under this option there would be some reduction in taxpayers' compliance costs because more attention would be paid to problematic issues, and so taxpayers could be better informed about the correct approach. However, the Commissioner could only provide administrative guidance prior to the legislation being enacted and so taxpayers would not have any certainty about the outcome in that period. Taxpayers would still need to decide during the time taken to remedy the problem whether they would follow the existing law or the policy. Often this would require taxpayers to consult a professional advisor or Inland Revenue to work out what to do in the interim. In some circumstances, taxpayers and Inland Revenue might still end up in disputes that are inconsistent with both parties' expectations. This would impose compliance costs on taxpayers.

Administrative costs

Increasing resources, or directing existing resources towards fixing anomalies, both come with an opportunity cost for Inland Revenue for other functions those resources could have been directed towards. As a result, this option would increase administrative costs for Inland Revenue.

Overall assessment

Increasing resources to policy development to fix more anomalies would result in some compliance gains for taxpayers while maintaining the sustainability under the status quo. However, the option would increase administrative costs for Inland Revenue.

Option 3 (Provide for more discretionary provisions)

Sustainability

Enacting the discretionary provisions as part of the primary legislation would support the integrity of the tax system and the rule of law. However, if an issue can be foreseen then they are currently addressed in the primary legislation. This might be through a specific discretion or by allowing determinations to be made on the relevant issue. As a result, it is considered that the current problem is unlikely to be one that can be foreseen. Taxpayers, therefore, would still be required to follow either the policy or the law in most cases, so harming the integrity of the tax system and the rule of law.

Compliance costs

Given that the problem really relates to those situations when it is not possible to anticipate the likely issue, adopting this option is unlikely to reduce compliance costs for taxpayers compared with the status quo. In addition, relying on Commissioner discretions would mean that taxpayers would not have certainty from the legislation and would need to consider when the Commissioner would exercise her discretion. There may also be compliance costs in applying to the Commissioner to exercise her discretion or make a determination and the approach could in any case be inconsistent with a tax system based on self-assessment.

Administrative costs

This option would impose additional administrative costs on the Commissioner because she would be required to consider whether to exercise a particular discretion in a situation. The consideration of the use of the discretion would require resources. The amount of resources would depend on the number of discretionary provisions and the number of possible situations when the discretion could apply. As a result, the more discretionary provisions included in the Revenue Acts to deal with anticipated anomalies, the more resources the Commissioner would potentially have to commit to the various issues.

Overall assessment

This option would meet the criteria for the issues that could be identified in advance. However, Inland Revenue considers that the majority of anomalies could not be foreseen, and this option would not satisfy the criteria for those issues.

Option 4 (Administrative flexibility in limited circumstances)

Sustainability

Option 4 would reduce sustainability because it would be subject to challenge and would raise rule of law concerns that the Commissioner was not bound to the published law. The proposed safeguards would limit the concerns to some extent. Specifically:

- The limited criteria, and the requirement that any exercise of the discretion must be consistent with existing policy, would mean that the scope of the discretion is very limited;
- The requirement to consult on any exercise of the discretion would reduce the risk of challenge because concerns could be dealt with before any exercise of the discretion; and
- The time limitation would mean any exemptions would only be temporary, which would reduce rule of law concerns.

Compliance costs

This option would allow anomalies to be remedied quickly. This would reduce compliance costs for taxpayers by providing them guidance on the intended policy outcome. However, as the remedy would not be legislative and would only be administrative, it would not provide legal certainty for taxpayers. This would mean that taxpayers might still need to seek advice as to the likelihood of the remedy being overturned. There would also be a small increase in compliance costs in having to become familiar with the new process, and having to keep up-to-date with any exercise of the discretion. Taxpayers would also have to monitor any challenges to the exercise of the discretion.

Administrative costs

The ease of remedying anomalies would reduce administrative costs for Inland Revenue in having to provide less advice about the anomaly, and having less disputes about outcomes that were not intended. However, there would be some increase in administrative costs in having to set-up and administer the new process. This would include providing guidance to taxpayers about how the new process would work, although this is expected to taper over time. There might also be additional costs from any challenges to the exercise of the administrative power. Even so, it would be optional for taxpayers to apply, and so the risk would be small.

Overall assessment

This option would reduce compliance and administrative costs but could undermine the sustainability of the tax system. The lack of any parliamentary oversight of the process might raise rule of law issues.

Option 5 (Determinations, regulations, and administrative action)

Sustainability

Using Orders in Council or disallowable determinations to remedy anomalies would support the sustainability of the process of remedying the anomalies by enabling parliamentary oversight of the process. Parliamentary oversight would be provided by the disallowance process and the oversight of the Regulations Review Committee. In many cases, the issue would still need to be resolved through the normal legislative process, with the new process providing a temporary bridge until that could occur.

This option would support the rule of law by enabling Parliament to disallow any remedies that were considered to be the proper domain of Parliament. The temporary nature of the remedies and the fact that they do not override the primary law also support the sustainability of the system.

The optionality of the remedies would mean taxpayers could choose the best option so supporting self-assessment and the integrity of the tax system.

Compliance costs

This option would reduce compliance costs for taxpayers by providing them with faster remedies for legislative anomalies. As noted previously, this would overcome a specific issue raised by taxpayers. It would reduce the need for taxpayers to seek advice either from professional advisors or Inland Revenue on the operation of the relevant provision (when it seems to be inconsistent with the intended policy). It reduces the risks for taxpayers of getting it wrong, and so encourages investment and planning for the future.

The option would increase compliance costs for taxpayers to a limited extent. There would be a small increase in compliance costs in having to become familiar with the new process, and having to keep up-to-date with any exercise of the discretion. It would increase the overall complexity of the tax system. This option would be more complicated than Option 4 given the three possible remedies. However, the use of regulations and disallowable determinations under Option 5 would make it easier to keep track of any remedies, so reducing the increased compliance costs to some extent. Some compliance costs may be incurred by taxpayers in having to submit on the draft remedies during the process. Finally, taxpayers would need to determine whether any remedy would be favourable for them in their own circumstances, which would increase compliance costs for them. Inland Revenue considers the reduction in compliance costs from providing certainty for taxpayers more quickly under this option would significantly outweigh the increased compliance costs.

Administrative costs

The option would reduce the overall administrative costs for Inland Revenue. Providing greater certainty for taxpayers more quickly would reduce the need for them to contact Inland Revenue seeking advice and would prevent disputes arising when the legislation does not align with the policy. This would reduce the resources Inland Revenue needed to commit to such issues.

As previously noted, the average time taken to remedy an anomaly spans several return periods so providing certainty to taxpayers sooner could reduce the resources Inland Revenue needs to assist to amend previous tax positions.

There will be an increase in administrative costs for Inland Revenue in establishing the process and processing any suggested applications of the power from Inland Revenue staff or taxpayers. The Australian experience would suggest there would not be a large number of applications so this cost is not expected to be large.

When the anomaly needed to be fixed subsequently through the normal legislative process, the costs incurred in providing a temporary solution could be seen as a duplication, but many of the subsequent elements of the process would not need to be repeated. For example, if the problem had been identified and a remedy consulted on before the making of a regulation, then it may not need to be repeated to the full extent when the permanent legislative amendment is being subsequently proposed.

Overall assessment

Inland Revenue prefers this option. It would support the sustainability of the tax system by incorporating Parliamentary oversight through the disallowance process and the Regulations Review Committee. The option would also reduce compliance and administrative costs. As a result, this option best meets the stated criteria.

Section 5: Conclusions

5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?

Inland Revenue prefers option 5 for the following reasons:

- It provides a process by which legislative anomalies could be quickly dealt with, while supporting the integrity of the tax system and the rule of law.
- It would reduce taxpayers' compliance costs in dealing with legislative anomalies, while aligning with the self-assessment system.
- It would reduce the administrative costs for Inland Revenue in dealing with anomalies. Although there would be some increased costs in identifying and providing a remedy for the relevant issues, the current number of remedial issues and the Australian experience with their similar provision, suggest these costs would be relatively small.
- It is the option most favoured by submitters because it has sufficiently broad scope, it is optional for taxpayers to apply, and because it has appropriate safeguards in place.

5.2 Summary table of costs and benefits of the preferred approach

Affected parties *(identify)*	**Comment**: *nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks*	**Impact** *$m present value, for monetised impacts; high, medium or low for non-monetised impacts*	**Evidence certainty** *(High, medium or low)*
Additional costs of proposed approach, compared to taking no action			
Regulated parties (taxpayers)	Cost of gaining an initial understanding of how the new process would operate.	Low	High
	Cost of being involved in consultation process for any new regulations or determinations.	Low	High
	Cost of choosing whether to apply the remedy or the black letter of the law.	Low	High

Regulators (Inland Revenue)	Costs of the process of determining whether to apply remedial process. Cost of process of remedying anomaly. Increased risk of judicial review for using, or failing to use, remedial power.	Low Low Low	Medium Medium Medium
Wider government	N/A	N/A	N/A
Other parties (Courts) Regulations Review Committee	Cost for very small risk of increase in judicial review requiring further resources. Cost for reviewing any regulations made under the preferred option.	Low Low	High High
Total Monetised Cost	-	-	-
Non-monetised costs	-	Low	Medium

Expected benefits of proposed approach, compared to taking no action			
Regulated parties (Taxpayers)	Increased certainty would allow taxpayers to better organise their affairs and plan for the future. Reduced need to seek advice on legislative anomalies. Less risk of getting into dispute with Inland Revenue over a legislative anomaly.	Medium High Medium	High High Medium
Regulators (Inland Revenue)	Reduced administrative costs dealing with taxpayers affected by a legislative anomaly, including less need to give advice and less risk of disputes.	Medium	High
Wider government	N/A	N/A	N/A
Other parties	N/A	N/A	N/A
Total Monetised Benefit	-	-	-

Non-monetised benefits	-	Medium	High

5.3 What other impacts is this approach likely to have?

There is a risk of adverse public perception that tax laws are being changed through Order in Council, through a determination made by the Commissioner or by administrative action. Such a perception could undermine the integrity of the tax system and the perception of the rule of law. This risk would be mitigated by several elements. The most important element would be the fact that the tax laws would not be overridden, and it would be optional for taxpayers to apply any remedial actions. Further, any substantive issues would be subject to parliamentary disallowance, so protecting the role of parliament in the process. In addition, any remedial actions would be only temporary and would expire in three years.

Another risk could be that the public perceive that lobby groups influence issues which are considered. The consultation and publication requirements would mitigate this risk to some extent. Further, the fact that any regulations or determination made under the power would be subject to disallowance would add to the transparency.

5.4 Is the preferred option compatible with the Government's 'Expectations for the design of regulatory systems'?

The preferred option is compatible with the Government's 'Expectations for the design of regulatory systems'. The preferred option should deliver, over time, a stream of benefits in terms of lower compliance and administrative costs that are in excess of its costs or negative outcomes.

The optional nature of the preferred option means that it has the least adverse impact on property rights and individual autonomy.

It conforms to established legal and constitutional principles and is similar in nature to the statutory remedial power recently enacted in Australia.

The empowering provision under the preferred option would have scope to evolve in response to changing circumstances or new information on the system's performance. The three methods of exercising the remedial power in the preferred option provide that flexibility to evolve.

Section 6: Implementation and operation

6.1 How will the new arrangements work in practice?
The preferred option will need to be implemented by a legislative amendment to the Tax Administration Act 1994. Specifically, an empowering provision would need to be enacted to allow regulations or determinations to be made. The amendment could be included in the next available tax bill. The amendment could apply from the date of enactment. Explanation of the amendment and its effect could be contained in a *Tax Information Bulletin*, which would be released shortly after the bill received Royal assent. The implementation of the preferred option would require an internal Inland Revenue process to determine if a recommendation should be made to use the power, a determination made, or administration action taken. The internal process will be developed in conjunction with the organisational design process that is currently being undertaken within Inland Revenue. Taxpayers and agents will be able to suggest cases when it could be appropriate to use the power. They will also be involved during the consultation process examining any proposed use of the power.

6.2 What are the implementation risks?
There is a risk that there could be a large number of issues raised by taxpayers with Inland Revenue that need to be considered under the proposed power. However, as noted above, this risk is considered to be low because there is evidence of the number of legislative anomalies that are discovered each year and the number suitable for the remedial power is likely to be a subset of those issues. Inland Revenue received 140 referrals from all sources for remedial amendments between October 2015 and October 2017. Only a small subset of those referrals is likely to be appropriate for the proposed option. Furthermore, under the similar Australian provision only approximately 22 applications were received in the first six months. Of those only two were considered appropriate for the remedial power. It is acknowledged that while the Australian provision is similar to the preferred option discussed below, the differences in the tax systems might lead to a different number of suggestions being made. Overall, the evidence suggests that the proposed option is unlikely to require a significant amount of the resources for Inland Revenue to manage the process, and the analysis proceeds on that basis. There is a small risk of an increase in judicial review but as discussed above this risk is considered to be small.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?
Inland Revenue would monitor the effectiveness of the proposed changes in the first 12 months of operation. The monitoring would involve a review of any regulations and determinations made, and administrative action taken, under the empowering provision within that period to see whether they were consistent with the intended policy.

7.2 When and how will the new arrangements be reviewed?
In general, Inland Revenue monitoring, evaluation and review of new legislation takes place under the generic tax policy process (GTPP). The GTPP is a multi-stage policy process that has been used to design tax policy (and subsequently social policy administered by Inland Revenue) in New Zealand since 1995. The final step in the process is the implementation and review stage, which involves post-implementation review of legislation and the identification of remedial issues. Opportunities for external consultation are built into this stage. In practice, any changes identified as necessary following enactment would be added to the tax policy work programme, and proposals would go through the GTPP. The Regulations Review Committee would have a role in monitoring and reviewing any regulations or determinations (being disallowable instruments) made. The committee examines all regulations, investigates complaints about regulations, and examines proposed regulation-making powers in bills for consistency with good legislative practice. The committee reports to the House and other committees on any issues it identifies. The House can “disallow” a regulation, meaning it no longer has force.

Impact Summary: Making Tax Simpler: Proposals for modernising the Tax Administration Act – rulings, amendments and tax intermediaries

Section 1: General information

Purpose
Inland Revenue is solely responsible for the analysis and advice set out in this Regulatory Impact Assessment, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by Cabinet.

Key Limitations or Constraints on Analysis

The limitations around the analysis are the following:

Simplified Rulings

Various factors have been taken into account in trying to determine the number of ruling applications that could be expected under the preferred option (introducing a simplified rulings regime). However, it has been difficult to predict the possible number of ruling applications because of the difficulty in determining the elasticity of demand, and so how any changes in the price may affect the demand for rulings. Inland Revenue has consulted with a limited number of tax agents that represent small and medium-sized taxpayers. The consultation suggested that some small and medium-sized taxpayers would see significant value in applying for a ruling, while other submitters suggested that they would not see value in such rulings.

Analysis was also undertaken of the Australian rulings regime. The Australian Tax Office (ATO) receives about 1,200 complex rulings applications per year. The complex rulings applications are of a nature similar to ruling applications under the current New Zealand regime. Of those received by the ATO, 400-500 relate to large corporate taxpayers. This would be similar given the relative sizes of the countries to the number of rulings applications received in New Zealand from large corporates under the current rulings regime (being approximately 80-100). Given the number of rulings for large corporates in Australia, it is estimated that 700-800 complex rulings per year relate to smaller taxpayers. Adjusting this to reflect the relative size of New Zealand would suggest that approximately 140-160 rulings from small and medium-sized taxpayers could be expected in New Zealand. However, the ATO does not charge any fees for providing rulings so it is unclear how the proposal to charge a fee for simplified rulings in New Zealand would impact on demand.

Minor errors

There is some uncertainty as to the number of taxpayers that are carrying forward errors into subsequent returns that are larger than the current statutory threshold. During consultation on the proposals, submitters suggested that it was common practice for taxpayers to carry forward larger errors, and that the current threshold was being largely ignored. As a result, there is some uncertainty about whether the proposed increased limit will change behaviour or simply endorse existing practice.

Tax preparers

There are currently 31 payroll service providers registered as PAYE intermediaries with Inland Revenue who would be eligible for extended service offerings under the preferred option. However, the total number of non-tax agents who would be eligible under the preferred option to register to receive extended service offerings for tax preparers is unknown, as no good data exists for the number of payroll bureaus and bookkeepers in New Zealand who offer tax preparation services.

Responsible Manager (signature and date):

Chris Gillion
Policy Manager
Policy and Strategy
Inland Revenue

15 February 2018

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

Simplified Rulings

The binding rulings regime is a fee-based service provided by Inland Revenue and governed by Part 5A of the Tax Administration Act 1994. Binding rulings, in particular private rulings and product rulings, apply to a specific taxpayer or transaction.

The problem with the current binding rulings regime is that, in practice, it is generally only available to large taxpayers as small and medium-sized taxpayers are priced-out due to the cost involved.

The current rulings regime was set up to provide certainty to taxpayers on arrangements being carried out by them. This was seen as providing taxpayers with a private benefit, so the fees for rulings were determined on a full cost-recovery basis. Currently, private, product and status binding rulings all incur an application fee of $322 (GST inclusive) which covers the costs of receiving and reviewing the ruling application and a fee of $161 (GST inclusive) per hour spent by Inland Revenue considering the application and the issues it raises. This includes time spent consulting with the applicant. Inland Revenue's costs in obtaining independent advice from external professionals are also passed on to the applicant (although this is rare). As the rulings bind the Commissioner of Inland Revenue (the Commissioner), Inland Revenue commits significant resources to each ruling to ensure that the correct position is taken. This resulted in the fees charged for rulings being higher than originally estimated. In the year ended 30 June 2017, the average fee charged was $11,200. Further, taxpayers usually engage tax advisors to assist in the rulings process, which has added significant advisor costs to the process. The overall cost of the rulings process has meant that small and medium-sized taxpayers generally do not apply for rulings. This has meant that they have not been able to obtain the same level of certainty as larger taxpayers, and they are more likely to enter into a dispute with Inland Revenue as a result.[1]

Justice Glazebrook suggested that the inability of small and medium-sized taxpayers to get binding rulings was inconsistent with the principle of equality before the law.[2] Further, participants at the *Tax Administration in the 21st Century* conference in June 2014 commented that the lack of access to rulings meant that it was difficult to get certainty.

Private sector tax advisors can provide a certain level of assurance as to the tax outcome of a particular transaction. However, under the Tax Administration Act 1994 only Inland Revenue can provide certainty as to the tax treatment by providing a binding ruling.

Taxpayers can obtain certainty by taking a conservative tax position in a tax return, and then seeking to reduce the amount of tax payable through the disputes process. This process is referred to as a taxpayer-initiated notice of proposed adjustment. While this process does not have any fees, the costs for taxpayers and Inland Revenue is more than the rulings process

[1] Figures from 2013, which are the most recent available, show that 75% of disputes commenced in that year related to amounts less than $100,000 suggesting they were initiated by small and medium-sized taxpayers.

[2] Address to 2015 CA ANZ Tax Conference (November 2015).

because of the numerous stages and the time taken. As a result, it does not resolve the problem identified above.

Minor errors

Currently, genuine tax errors of less than $1,000 can be included in a subsequent return, rather than the original assessment having to be corrected. The process is intended to reduce compliance and administration costs for minor errors. The policy was intended to assist small and medium-sized taxpayers the most. However, the threshold is not limited to such taxpayers and can be used by larger taxpayers as well.

Generally under accounting standards, material changes must be included in the latest financial statements as comparatives for the past periods, including, where relevant, cumulative adjustments to any balances brought forward.[3] Materiality in accounting standards means a change that could influence the economic decisions that users make on the basis of the financial statements.[4] Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor. Anecdotal evidence suggests most accounting corrections are made in the current period because they are considered not to satisfy the materiality threshold under accounting standards. This means that some minor errors can be included in the current set of accounts for accounting purposes, but must be included in the assessment for the original period for tax purposes. Having two different processes for minor errors adds compliance costs for taxpayers.

Tax preparers and nominated persons

As part of Inland Revenue's Business Transformation[5] programme (and related to the Government's wider *Better Public Services* initiative), Inland Revenue intends to offer more online services to tax agents as well as to other intermediaries. Given that these expanded services will include more self-service options and may potentially enable intermediaries to work more in real-time than at present, a concern is protecting the revenue base and the integrity of the tax system against any potential risks arising from intermediaries' use of these services.

Inland Revenue currently provides a range of services specifically for tax agents, including a dedicated phone service for tax agents to communicate with Inland Revenue and use of the E-File software package which allows tax agents to file their clients' tax returns electronically.

The statutory definition of a "tax agent" is used for determining who can access these services. This means that other tax service providers (such as those who only file GST returns and employer monthly schedules for their clients, or who provide budget advice and assist with tax return preparation and claiming social policy entitlements) are not at present given access these services, even though it would be desirable in many cases to do so. These providers can still look after their clients' tax and social policy affairs as nominated

[3] See NZ IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

[4] See NZ IAS 1 Presentation of Financial Statements.

[5] Business Transformation is a multi-year, multi-stage programme to modernise New Zealand's tax administration.

persons (with similar access to the client through online services in myIR, including return filing), but without the services specifically for tax agents.

Restricting additional services to persons who are listed as tax agents is not required by law, but is an administrative decision by the Commissioner. The Commissioner can offer these services as widely or narrowly as she considers appropriate. However, revoking access to these services once granted can be difficult.

Provided that the Commissioner had the ability to withdraw these services from a non-tax agent if necessary to protect the integrity of the tax system, there would be no good reason for restricting these online services (including the new online service offerings that will become available under Business Transformation) to only tax agents. In a number of cases, these services would make it easier and more efficient for other tax service providers to manage their filing and payment performance, compared with using the limited services available to them under the status quo.

Inland Revenue's view is that a person who is nominated by a taxpayer to act on their behalf is the agent of the taxpayer under common law. Therefore, even if the Commissioner has reasonable tax integrity concerns about allowing a person to act for other taxpayers (for instance, because the person has convictions for fraud), the Commissioner cannot refuse to recognise that person as a taxpayer's nominated person because it is up to the taxpayer whether the nominee should act (or continue to act) on their behalf. However, there are concerns about the risk of persons who have been removed from the list of tax agents (due to tax integrity concerns) coming back into the system as nominated persons.

2.2 Who is affected and how?

Simplified rulings

Inland Revenue anticipates that most of those affected by the current cost barriers to getting a binding ruling are small and medium-sized taxpayers. The cost barrier prevents these taxpayers from obtaining greater certainty, which increases the likelihood of them entering into disputes with Inland Revenue. As noted above, the majority of tax disputes involve small and medium-sized taxpayers.

Minor errors

While the current threshold for including minor errors in a subsequent return affects taxpayers of all sizes, Inland Revenue anticipates that the major beneficiaries of the preferred option will be small and medium-sized taxpayers, as they are likely to have issues that fall within the relevant thresholds. However, the proposal is not limited to such enterprises and any taxpayer would be able to use the increased threshold. Taxpayers using the proposed increased threshold would not need to incur the cost of requesting a reopening of the original return and could instead include it in a subsequent return. Inland Revenue would benefit from reduced administrative costs in not having to reopen the relevant assessment.

Tax preparers

Inland Revenue expects that the group of tax preparers who currently do not receive Inland Revenue's services for tax agents consists mostly of bookkeepers and payroll intermediaries. Hence it is expected that the major beneficiaries of the proposal to clarify the group of persons who are eligible for the services for tax preparers that will become available under Business Transformation would include bookkeepers, payroll intermediaries and their clients.

Nominated persons

The current inability for the Commissioner to refuse to recognise a person as a taxpayer's nominated person may potentially advantage or disadvantage taxpayers that nominate a person to act for them. In some instances the exercise of a discretion to refuse to allow someone to be another taxpayer's nominated person, if legislated, may help to protect taxpayers from fraudulent or unscrupulous behaviour; on the other hand, it is possible (especially if there are not sufficient constraints on the Commissioner's ability to refuse to recognise a nominated person) that the taxpayer may be unfairly disadvantaged by the Commissioner's exercise of the discretion. This is the reason for limiting the exercise of the proposed discretion to circumstances where the person is acting on behalf of a taxpayer for a fee or is otherwise acting in a professional capacity. Situations where a person is acting for a family member are not proposed to be covered by the discretion.

2.3 Are there any constraints on the scope for decision making?

There are no constraints on the scope of options considered.

Section 3: Options identification

3.1 What options have been considered?

Assessment criteria

The following criteria were used to assess the options:

- **Sustainability:** the option should support the coherence and integrity of the tax system;
- **Compliance costs:** the compliance cost for taxpayers and their agents should be minimised as far as possible; and
- **Administrative costs:** the administrative costs to the Government should be minimised as far as possible.

Options

Two Government discussion documents in the *Making Tax Simpler* series on the Tax Administration Act were released in 2015 and 2016 (*Towards a new Tax Administration Act* and *Proposals for modernising the Tax Administration Act*). A number of the options discussed below were the subject of public consultation in the latter discussion document. Where the preferred options below differ from those consulted on in *Proposals for modernising the Tax Administration Act*, this is primarily as a result of the submissions received on the discussion document and of further consultation with stakeholders.

Simplified rulings

The main objective is to enable more small and medium-sized taxpayers to obtain rulings to increase the level of certainty they have. The sustainability criterion has greater weighting because it supports the integrity of the tax system.

The following options were considered:

- **Option 1 – Status quo:** The first option would be to retain the current rulings regime with the current fees and administrative requirements. As noted above at 2.1, the overall cost of the rulings regime has meant that small and medium-sized taxpayers have not been able to use the rulings regime, and this has raised questions about equality before the law.
- **Option 2 – Free rulings:** Many similar jurisdictions, including Australia, offer free rulings for taxpayers. Accordingly, the second option would be to remove all fees for rulings. This would achieve the main objective of enabling more small and medium-sized taxpayers to obtain the certainty afforded by rulings. It would significantly reduce the compliance costs for taxpayers because they would be able to apply for rulings for many more issues, and so they could ensure that they took the correct tax position. However, the extent to which this option would improve access to rulings is uncertain as taxpayers would still generally have to incur significant external advisor costs to satisfy the requirements of the current rulings regime. Also, this option could significantly increase the administrative cost for the Government because Inland Revenue would need the resources to deal with all the additional rulings applications.

Further, it would not reflect the private benefit that rulings applicants obtain through the rulings process.

- **Option 3 – Lower overall flat fee for all rulings:** The third option would be a lower flat fee for all rulings based on a schedule of the size and type of taxpayer. This option was proposed in *Proposals for modernising the Tax Administration Act*. The proposal was to allow small and medium-sized taxpayers to use the current rulings regime but with lower fees. While this would reduce the compliance costs for taxpayers to some extent, they would still generally need to incur significant external advisor costs to satisfy the requirements of the current rulings regime. As a result, it is unlikely to significantly achieve the objective of making rulings more accessible for small and medium-sized taxpayers. Inland Revenue would also incur significant administrative costs in ruling for small and medium-sized taxpayers under the current regime given the current administrative process. However, using a schedule of fees based on the size of the entity may in most instances mean that the cost for a ruling roughly approximates the private benefit (being the economic value of the ruling) that the applicant received.[6]

- **Option 4 – Simplified rulings:** The fourth option (the preferred option) would be to introduce a simplified rulings regime with reduced fees, which is focused on the needs of small and medium-sized taxpayers.

  Under this option, the simplified rulings regime would be available to entities whose annual gross income was $5 million or less for the tax year before the current tax year (aligning it with the Accounting Income Method (AIM) threshold). AIM is a new method for paying provisional tax based on current year tax-adjusted income. The AIM threshold covers a significant number of taxpayers and excludes large corporates with complex tax adjustments.[7] Also, the new regime would only be able to rule on issues when the tax at stake was less than $1 million (if calculable). This amount would be close to the highest amounts subject to audit or dispute involving small and medium-sized taxpayers as determined from 2016 data. Also, this threshold would include approximately 99% of both voluntary and audit reassessments in the 2015 income year.

  The option would involve removing some of the requirements for a ruling application and would streamline the administrative process for obtaining a ruling. Specifically, the application would only need to identify the applicant and to disclose all the relevant facts and documents. The application would not be required to state the specific taxation laws or the propositions of law. Applications would also not need to specify a particular arrangement. However, the applicant would need to state the general tax outcome that was being ruled on; eg, that the income is not taxable, that the expenditure is deductible, or that the applicant is resident for tax purposes. This would significantly reduce the compliance costs for small and medium-sized taxpayers by reducing the fees and possibly external advisor costs involved in the process, and so would make rulings more accessible for small and medium-sized taxpayers.

[6] While the private benefit of the ruling will be a function of the ruled transaction rather than the size of the applicant, the dollar value of the transaction in question and the size of the taxpayer will be correlated.

[7] The estimated number of provisional taxpayers with annual turnover of $5 million or less in 2016 was around 149,000.

The Commissioner would retain the discretion to decline to rule under the simplified regime if the characteristics of the application were such that the Commissioner deemed it appropriate to be dealt with under the current rulings regime. Examples of when an appropriate simplified ruling would not be available may include when the application:

- Raises issues where there is a significant absence, or perceived deficiency, in the relevant policy;
- Directly challenges an existing Inland Revenue policy or technical position; or
- Raises issues having significant national implications or a wide precedential effect.

The option would increase Inland Revenue's administrative costs of setting up the new process and dealing with any rulings under the process. To some extent Inland Revenue is currently providing advice in a less formal format, and only a small increase in resources will be needed to convert the advice into a ruling. Further, Inland Revenue anticipates that some of the simplified rulings will avoid the need for the taxpayer and Inland Revenue to enter into a dispute, so will divert resources from the disputes process to the rulings process.

Minor errors

The main objective is to better align the tax process for remedying minor amendments with the accounting treatment to reduce taxpayers' compliance costs. The sustainability criterion has greater weighting because it supports the integrity of the tax system.

The following options were considered:

- **Option 1 – Status quo:** The first option would be to retain the current $1,000 threshold for carrying forward minor errors into a subsequent return. As noted above at 2.1, this means that some minor errors can be included in a subsequent set of accounts for accounting purposes, but must be included in the assessment for the original period for tax purposes. Having two different processes for minor errors adds compliance costs for taxpayers.
- **Option 2 – Raising the threshold to $5,000:** The second option would be to raise the threshold for correcting minor errors in a subsequent return from a total tax discrepancy in a single return of $1,000 to $5,000. This would go some way to aligning the tax and accounting processes but it would have a relatively low limit. As a result, it would allow a better alignment than the status quo but it would not align as well as the other options. This option was suggested by one submitter on *Proposals for modernising the Tax Administration Act*.

  The option would reduce compliance costs for all taxpayers by allowing them to put errors up to $5,000 in a subsequent return rather than having to request to reopen the original assessment. Retaining a single monetary threshold would retain the simplicity of the current approach, so it would make it easier for taxpayers to determine when they could include an error in the subsequent return compared with the other options.

  This option would, however, raise concerns about the integrity of the tax system. The flat threshold would allow relatively large errors for small taxpayers to be included in a subsequent return without Inland Revenue becoming aware of the error. Taxpayers could include errors up to a maximum adjustment of income or deductions of $17,855 for a company, $15,150 for an individual on the top personal tax rate and $38,335 for GST. For small taxpayers these amounts are relatively significant, and may encourage them to be less careful about first time accuracy which may harm the integrity of the tax system.

The option would reduce the administrative costs for Inland Revenue of reopening the original assessment for errors less than $5,000.

- **Option 3 – Introducing a supplementary threshold (up to 2% of taxable income or GST output tax if the error is $10,000 or less):** The third option (the preferred option) would supplement the current $1,000 threshold with an optional additional threshold that relies to some extent on the significance of the error for the particular taxpayer. This would allow taxpayers to include any error in a subsequent return if the amount of the error was equal to or less than both $10,000 and 2% of their taxable income or output tax in the return in which the taxpayer sought to include the error. It would be optional for taxpayers, and they could still include errors up to $1,000 in a subsequent return. This would further align the tax and accounting processes for small and medium-sized taxpayers in line with the original intent of the threshold.[8] The option would not provide a significant alignment with the accounting treatment for large enterprises.

The option would reduce the compliance costs for all taxpayers for errors up to $10,000 (subject to the 2% threshold) by allowing them to include such errors in a subsequent return. This would remove the need for taxpayers to request to reopen the original assessment.

Data from the 2014 and 2015 income years suggests that a maximum adjustment threshold of $10,000 would include 97-98 percent of amendments by number and 84-86 percent of adjustments by value. However, it is difficult to determine the additional number of errors that could be included in a subsequent return under this option. This is because it is unclear the extent to which taxpayers are complying with the current threshold. In addition, the data on the number of amendments made in the 2014 and 2015 did not link with the size of the taxpayer making the amendment. As noted above, the size of the error that a taxpayer would be able to carry forward into a subsequent return would be dependent on the amount of their taxable income or output tax.

This option would continue to require larger errors to be included in the original return period, reflecting the lower compliance costs of amending previous assessments under the new computer system (START). For those more significant errors, the costs of reopening the original assessment under START would be less than the possible detrimental effects to the integrity of the tax system, which include:

- Undermining the focus on taxpayers getting the original assessment right from the start;
- Reducing the ability of Inland Revenue to identify the cause of the error, and

[8] See the commentary to the Taxation (Consequential Rate Alignment and Remedial Matters) Bill 2009.

to assist taxpayers to prevent it from happening again; and

- Creating opportunities for taxpayers to gain advantages from delaying the payment of tax.

The supplemental threshold would cause a very small increase in compliance costs for taxpayers in having to determine whether a specific error was within the threshold. However, taxpayers could avoid the additional compliance costs because the supplementary threshold would be optional, and they could either seek to have the original assessment reopened or they could continue to rely on the existing $1,000 threshold.

As such errors could be included in a subsequent return, the option would reduce the administrative costs for Inland Revenue. There may be a small increase in costs dealing with queries from taxpayers about whether an error comes within the threshold.

- **Option 4 – Introducing a larger supplementary threshold (up to 5% of taxable income or GST output tax if the error is $100,000 or less):** The fourth option is essentially the same as option 3 but with higher thresholds. The option would supplement the current single monetary threshold with an approach that relies to a much greater extent on the significance of the error for the particular taxpayer. This would allow taxpayers to include any error in a subsequent return if the amount of the error was equal to or less than both $100,000 or 5% of their taxable income or output tax in the return in which the taxpayer sought to include the error. It would be optional for taxpayers. This option would best align with the tax and accounting processes for small, medium and large enterprises. This option was suggested by some submitters on *Proposals for modernising the Tax Administration Act*.

The larger supplementary threshold would increase risks to the integrity of the tax system. It would reduce the incentives for taxpayers to get their assessments right from the start, and would create opportunities for taxpayers to gain advantages from delaying paying tax. The option would reduce Inland Revenue's ability to ensure compliance with the relevant timing rules. These effects could undermine taxpayers' perceptions of the integrity of the tax system.

The option would reduce the compliance costs of taxpayers by allowing them to avoid having to request the original assessment be reopened. The size of the threshold would mean that nearly all errors could be included in a subsequent return. In other countries with high error correction thresholds, there is a requirement on taxpayers to declare any errors over a lower threshold. Such a declaration process is to protect the integrity of the tax system. A similar requirement is likely to be necessary in New Zealand for a high error correction threshold. However, Inland Revenue considers that the manual process of declaring an error through a separate process may outweigh the compliance benefits under START of reopening the previous assessment.

The option would reduce the administrative costs of Inland Revenue in dealing with errors that are included in a subsequent return. However, there could be additional compliance costs in dealing with any manual declaration process.

Tax preparers

The main objective is to reduce compliance costs for taxpayers and their agents (by expanding access to value-added services for tax preparers) while protecting the integrity of the tax system. The means via which this objective is to be achieved include providing transparency and clarity around the group of persons who are eligible for Inland Revenue's service offerings for tax preparers; and improving Inland Revenue's ability to refuse to allow a person to act on behalf of other taxpayers, where necessary, to protect the integrity of the tax system. The sustainability and compliance costs criteria therefore have greater weighting.

On the basis that Inland Revenue will make its extended self-service options for tax preparers available to intermediaries who do not meet the current tax agent definition, overall, compliance costs under each of the options detailed below should decrease compared with the status quo. This is because use of the online self-service options by tax preparers who opt to receive them would allow these intermediaries to work more efficiently over the longer term, and may assist them to carry out tax compliance tasks to a higher standard (which, in turn, would yield benefits for their clients and Inland Revenue).

Inland Revenue will also bear some administrative costs under each of the options, in the form of:

- information technology systems costs associated with the implementation of the new online services and extending these to a wider group;
- screening those applying to receive Inland Revenue's extended service offerings and processing the relevant forms;
- dealing with an initial increase in queries from tax preparers when the new service offerings are implemented in Stage 2 of Business Transformation[9];
- on-going support with the use of online services.

However, the increased take-up of online self-service options may lead to some reduction in administration costs for Inland Revenue over the longer term (for instance, as a result of a smaller volume of phone calls from tax preparers).

The following options were considered:

- **Option 1 – Status quo – non-tax agents continue to act as nominated persons:** The first option would retain the current definition of 'tax agent' in the Tax Administration Act. Non-tax agents would continue to look after their clients' tax and social policy affairs as nominated persons.

  Inland Revenue would still be able to offer the expanded online services for tax preparers to non-tax agents; however, maintenance of the status quo would not address the current uncertainty around the Commissioner's ability to revoke these services, along with access to clients' information, if necessary to protect the integrity of the tax system.

  On the other hand, if the proposed discretion for the Commissioner to not recognise a nominated person if doing so would adversely affect the integrity of the tax system

[9] Stage 2 of Business Transformation involves streamlining personal and business income taxes.

(as discussed under the nominated persons heading below) is proceeded with, then this may provide sufficient clarity around the Commissioner's ability to withdraw these services.

Option 2 – Change the tax agent definition to include other intermediaries: The second option would expand the group of persons who are eligible to apply for listing as a tax agent beyond just those who prepare 10 or more income tax returns per year. It would not be compulsory for persons who meet the eligibility criteria to apply for listing, as nominated person access is likely to be sufficient for some people who act on behalf of other taxpayers.

This would allow other tax preparers, such as bookkeepers and payroll intermediaries, to apply for listing as a tax agent to receive Inland Revenue's extended service offerings. It would also mean that a person could be removed from the list of tax agents and have their access to client information and tax agent services withdrawn if they adversely affect the integrity of the tax system.[10]

This option would impose some compliance costs on tax preparers (and on their clients) in the form of applying for listing, and gaining authorisation from their clients to act for them and to access the extended online services on their behalf. However, they would not be required to be listed as tax agents in order to act for their clients, but could instead continue to act as nominated persons without the additional services. Tax preparers would therefore only bear the compliance costs associated with becoming listed as a tax agent if they determine that doing so is worthwhile to receive the extended services.

Bringing other persons within the scope of the tax agent definition would require a contingent provision to clarify the group of persons who are eligible for an extension of time (since the extension of time criteria, which are currently linked to the tax agent definition, are not proposed to change). Given the purpose of the tax agent list is to keep track of the persons who are eligible for an extension of time, it is unnecessary to impose a requirement on the Commissioner to maintain a list that would include a number of persons who are not eligible for the extension of time. To keep track of the subset of tax agents who are eligible for an extension of time, this option would in practice require the maintenance of two lists – the tax agent list, and a list of those who are eligible for an extension of time.

This option would impose further administrative costs on Inland Revenue in the form of: processing an increased number of applications to be listed as a tax agent (including the associated screening processes); processing removals from the list of tax agents; and auditing authorities to act.[11]

- **Option 3 – Two-tier agency system:** Under the third option (the preferred option), the current definition of 'tax agent' would be retained and another term would be separately defined in the Tax Administration Act to include other tax preparers. Like the existing section dealing with tax agents, the new provision would set out the

[10] The existing discretion for the Commissioner to (if necessary) remove a person from the list of tax agents is subject to judicial review, which provides a check over the exercise of the discretion.

[11] While a process exists for tax agents to obtain the "authority to act" on behalf of their clients client via electronic means, many tax agents still have their clients sign a written authority to act form, which the tax agent is required to hold on file. Inland Revenue audits each tax agent's authorities to act by selecting 10 of the agent's clients and requesting to see the completed and signed authority to act forms for those clients.

Commissioner's ability to deregister the person if necessary to protect the integrity of the tax system. The Commissioner's exercise of this discretion would be a judicially reviewable decision.

This option would be more transparent and would provide more clarity for tax preparers and Inland Revenue than option 1. It would not only make the Commissioner's discretion to revoke tax preparer service offerings from a person if necessary to protect the integrity of the tax system explicit in the legislation, but would also make it clear exactly who is entitled to receive these extended service offerings.

Compared with option 2, this option would also better recognise the differing roles of tax agents and other tax preparers and would avoid conflating the two concepts. However, like option 2, this option would impose some compliance costs on tax preparers (and on their clients) in the form of registering with Inland Revenue to receive the extended services, and gaining authorisation from their clients to act for them. However, registration would not be compulsory; instead, they could continue to look after their clients' tax and social policy affairs as nominated persons. Therefore, tax preparers would only bear the compliance costs of registering if they determined that doing so was worthwhile to receive the extended services.

Eligibility to be registered as a tax preparer would be restricted to those who have 10 or more clients[12] and are in the business of acting on behalf of taxpayers in relation to their tax affairs or who carry on an occupation or professional public practice in which tax returns are prepared. This would also include those who perform pro-bono tax preparation services, provided that the requirement for at least 10 clients is met.[13]

Compared with the status quo (option 1), this option would impose further administrative costs on Inland Revenue in the form of processing registrations and deregistrations and auditing authorities to act. Unlike option 2, the Commissioner would not be statutorily required to maintain a list of tax preparers (other than the list of tax agents which is already required by law).

Nominated persons

The following options were considered:

- **Option 1 – Status quo:** The first option would maintain the status quo where a person who is nominated by a taxpayer to act on their behalf in dealing with Inland Revenue is viewed as the agent of the taxpayer under common law. Under this view, a nominated person's authorisation to act for a taxpayer can only be revoked by the taxpayer notifying Inland Revenue that the person is not to act for them any longer. This means that the Commissioner cannot unilaterally refuse to recognise the person

[12] This may include multiple entities within a group.

[13] Those with less than 10 clients will be able to use the online services that will be made available to taxpayers and their nominated persons who have a myIR account. The services that taxpayers and nominated persons with 'token access' will be able to access include changing registration details, registering new accounts, filing returns, making payments, setting up instalment arrangements, accessing transactions summaries and GST returns summaries, and sending and viewing email. The main difference between token access and access for tax preparers is that tax preparers will be able to link and delink their own clients (whereas nominated persons will only be able to access their clients' account information and return filing in myIR once the client has approved their access). There would also be some additional reporting which would likely only be useful for those with at least 10 clients.

as the taxpayer's nominated person, even if the person has been convicted of fraud.

The integrity risk of persons who have been removed from the list of tax agents (or deregistered as tax preparers) for tax integrity reasons coming back into the system as nominated persons, with no clear ability for the Commissioner to refuse to allow them access to taxpayers' account information and online filing for these other taxpayers, would therefore remain.

- **Option 2 – Limited discretion for the Commissioner to not recognise a nominated person:** The second option (the preferred option) would allow the Commissioner to choose not to recognise a person as a taxpayer's nominated person if she has reasonable tax integrity concerns about giving the person access to taxpayers' account information and online filing on behalf of that taxpayer. This would strengthen both the Commissioner's existing power to remove a person from the list of tax agents and the proposed discretion to deregister a tax preparer if necessary to protect the integrity of the tax system. However, the circumstances in which the Commissioner could refuse to recognise a nominated person would be limited to where the person is acting for a fee or is otherwise acting in a professional capacity.

  "Acting for a fee or otherwise acting in a professional capacity" would not cover situations where the person is acting for a family member or friend. "Acting in a professional capacity" would however cover situations where a person is performing pro-bono work for a number of taxpayers.

  Ensuring that the Commissioner can refuse to recognise a person who would not be allowed to be a tax agent would help to safeguard the integrity of the tax system by reducing the likelihood of that person being able to commit fraud. However, there is a risk that this may give tax officials too much discretion, which could result in use of the rule in some instances where a refusal to deal with a person nominated by a taxpayer is undue.

  The proposal is not aimed at subjecting nominated persons to more stringent regulation than that faced by tax agents. The proposal is instead intended to ensure that, if a person would not be allowed to be listed as a tax agent for tax integrity reasons, the Commissioner can choose, if necessary to protect the integrity of the tax system, to refuse to allow them to act for other taxpayers under the nominated person regime in appropriately limited circumstances. This is the reason for the proposed restrictions on the discretion (that is, the discretion can only be exercised where the person is acting for a fee or is otherwise acting in a professional capacity), which should help to ensure that the Commissioner's exercise of the discretion does not go too far. Further, the exercise of the discretion would be subject to judicial review.

3.2 Which of these options is the proposed approach?

Simplified rulings

Inland Revenue prefers option 4 (simplified rulings regime) because it:

- reduces the overall cost of rulings for small and medium-sized taxpayers, and should reduce the time to obtain a ruling;
- protects the rulings regime from excess demand or a need for increased Inland Revenue resources (as opposed to free rulings or reduced fees for all rulings)
- reflects the dual private and public benefit of the rulings regime for small and medium-sized taxpayers.

Minor errors

Inland Revenue prefers option 3 (introducing a supplementary threshold (lesser of $10,000 or 2%)) because it:

- better aligns with the current practices and accounting treatment of small and medium-sized taxpayers;
- produces a lower risk to the integrity of the tax system than option 4 (Introducing a larger supplementary threshold);
- enables the Commissioner to allocate her limited resources to collecting over time the highest net revenue that is practicable within the law by better focusing on significant risks (as the data suggests the threshold will include the majority of amendments); and
- reduces compliance costs for taxpayers and administrative costs for Inland Revenue.

Tax preparers

Inland Revenue prefers option 3 (two-tier agency system) because it:

- reduces the potential harm to the integrity of the tax system (compared with option 1); and
- allows for recognition of the differing roles of tax agents and other tax preparers (compared with option 2).

Nominated persons

Inland Revenue prefers option 2 (limited discretion for the Commissioner to not recognise a nominated person) because it reduces the harm to the integrity of the tax system.

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties *(identify)*	**Comment**: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks	**Impact** *$m present value, for monetised impacts; high, medium or low for non-monetised impacts*
Additional costs of proposed approach, compared to taking no action		
Regulated parties (Taxpayers)	**Simplified rulings** Optional cost for taxpayers that choose to apply for a ruling under the simplified regime.	Low
	Minor errors Optional cost for taxpayers in determining whether an error comes within the proposed threshold.	Low
(Tax preparers)	**Tax preparers** Optional cost for tax preparers in determining whether or not they register with Inland Revenue to receive extended online services.	Low
	Costs for tax preparers and their clients associated with the linking process.	Low
	Potential costs for tax preparers as a result of being unduly deregistered – this may include costs associated with getting the decision judicially reviewed.	Low
(Nominated persons)	**Nominated persons** Potential cost to persons that have been nominated by taxpayers to act on their behalf if they are unduly prevented from acting on behalf of others when dealing with Inland Revenue – this may include costs associated with getting the decision judicially reviewed.	Low
Regulators (Inland Revenue)	**Simplified rulings** Increased administrative costs setting up the proposed simplified regime, processing rulings applications and writing the rulings.	Medium
	Minor errors Small unquantified cost of explaining the threshold to taxpayers.	Low
	Less knowledge of errors being made by taxpayers	Low
	Tax preparers Increased administrative costs making systems changes and processing	Low

	registrations and deregistrations. **Nominated persons** Where the proposed discretion is exercised, there would be minor administrative costs associated with delinking a nominated person from a taxpayer's account (so that the person no longer has systems permissions to file and access account information on behalf of the taxpayer).	Low
Wider government	N/A	N/A
Other parties (Taxpayers that use a nominated person)	**Nominated persons** Potential costs to taxpayers which may arise if their nominated person's authorisation to act for them is unduly revoked.	Low
Total Monetised Cost		N/A
Non-monetised costs		Low

Expected benefits of proposed approach, compared to taking no action		
Regulated parties (Taxpayers)	**Simplified rulings** Increased certainty and reduced risk of entering into disputes	Medium
	Minor errors Lower compliance costs in dealing with minor errors	Medium
(Tax preparers)	**Tax preparers** Access to online self-service options that would allow them to work more efficiently and view clients' tax accounts information in real-time.	Medium
(Non-tax agent intermediaries – tax preparers and nominated persons)	**Tax preparers / Nominated persons** Transparency around the Commissioner's discretions and the group of persons who are eligible to apply to receive Inland Revenue's extended service offerings.	Low
Regulators (Inland Revenue)	**Simplified rulings** Fewer taxpayers making mistakes, better compliance leading to a possible reduction in audits and disputes	Medium
	Better information about emerging issues	Medium
	Minor errors Reduced administrative costs of dealing with minor errors;	Low
	Increased ability for the Commissioner to allocate her limited resources to	Medium

	collecting over time the highest net revenue that is practicable within the law by better focusing on significant risks **Tax preparers / Nominated persons** Certainty around the Commissioner's ability to deregister a tax preparer or to refuse to allow a nominated person to act for taxpayers if necessary to protect the integrity of the tax system. Ability to revoke access for third parties with a history of tax fraud would reduce the risk to the Crown's revenue and to the integrity of the tax system. Transparency around the Commissioner's discretions and the group of persons who are eligible to apply to receive Inland Revenue's extended service offerings would promote the integrity of the tax system.	Low Low / Medium Low
Wider government	N/A	N/A
Other parties (Taxpayers – clients of tax preparers) (Taxpayers – clients of tax preparers and nominated persons)	**Tax preparers** Reduced compliance costs and/or increased standard of service for clients of tax preparers, as a result of tax preparers carrying out tax compliance tasks more efficiently with the use of online self-service options. **Tax preparers / Nominated persons** Potential taxpayer protection benefit associated with being able to deregister or refuse to recognise a person who has previously been removed from the list of tax agents for tax integrity reasons or who would otherwise very likely to adversely affect the integrity of the tax system (for instance, by defrauding their clients).	Medium Low / Medium
Total Monetised Benefit		N/A
Non-monetised benefits		Medium

4.2 What other impacts is this approach likely to have?

Simplified rulings

There is a possible fiscal risk from providing simplified rulings. The risk arises if taxpayers are given a ruling that later turns out to be incorrect (for instance, because not enough time was spent on the ruling), and that opens a fiscal risk for the Crown. The proposed thresholds under the preferred option reduce the monetary level of the risk. However, given the reduced scrutiny under the proposed option, as compared with the current rulings process, there is a greater risk of this occurring more frequently. The grounds for withdrawing a simplified ruling would be the same as the existing grounds in the Tax Administration Act for withdrawing binding rulings.

It is difficult to predict how much demand there would be for simplified rulings; hence there is some risk that there will be significantly higher demand for rulings than has been predicted, which may require further resourcing. Inland Revenue considers this risk would be mitigated to some extent by the fee charged for the simplified rulings, the entry requirements for when a simplified ruling can be applied for, and the application requirements for a ruling. The aim is to strike a balance between enabling small and medium-sized businesses to obtain simplified rulings to improve voluntary compliance without requiring significant additional resources for Inland Revenue to meet the demand.

Minor errors

There is a potential risk that increasing the threshold will encourage taxpayers to change their behaviour to include even larger errors (above the increased threshold) in subsequent returns. Submitters suggested that taxpayers may in practice be including errors larger than the current threshold in subsequent returns. Any increase in the threshold, therefore, may lead to an extension of this approach. This could have fiscal implications.

Tax preparers

There is a possible risk that a minority of tax preparers might use online services to carry out fraud which, due to the real-time nature of online services, would mean that fraudulent transactions would be quicker and easier to carry out. This is the reason for the proposed discretion for the Commissioner to deregister or to refuse to register a tax preparer if she has reasonable tax integrity concerns about allowing the person to access online services on behalf of other taxpayers.

Nominated persons

No other risks arising from this proposal (aside from the possible costs outlined in Section 4) have been identified.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?

These proposals were foreshadowed in a green paper and a discussion document, *Making Tax Simpler: A Government green paper on tax administration* (released in March 2015) and *Making Tax Simpler: Towards a new Tax Administration Act* (November 2015). The specific proposals were included in the discussion document *Making Tax Simpler: Proposals for modernising the Tax Administration Act* (December 2016). An online forum was also provided at makingtaxsimpler.ird.govt.nz. There were 15 written submissions on the discussion document and 19 comments on the related online forum. The submissions are discussed below.

Simplified rulings

To make the binding rulings regime more accessible to small and medium-sized taxpayers, the discussion document included a proposal to reduce the fees for binding rulings. Submitters were generally in favour of the proposal, however, submissions disagreed over how fees should be decreased. Some submissions favoured retaining an hourly rate while others suggested flat or graduated fees. Supporters of a graduated fee suggested it would be fairer across different types of taxpayers. Others suggested that such an approach may discriminate between taxpayers.

Three submissions also raised concerns that the time required for a ruling was a disincentive to their use. It was suggested that small and medium-sized taxpayers were often focussed on growth and needed to make quick decisions, while all taxpayers have business opportunities that develop unexpectedly and need rulings quickly.

Submissions suggested that merely reducing the fees charged for rulings would not increase the use of them. The preparation costs with the current rulings regime would still be a barrier. Some submitters suggested that a simplified regime should be put in place to reduce the preparation costs of a binding ruling.

Concerns were raised about whether the rulings team would be adequately resourced to cope with the increase demand for binding rulings that may come from reduced fees. It was noted that the rulings team currently provides a high standard of service and the standard and timeliness of rulings may suffer if further resourcing is not provided to the rulings team to cope with any increased demand.

The above submissions were taken into account in designing the preferred option of a simplified rulings regime for small and medium-sized taxpayers. In particular, the simplified regime has been designed to be quicker and cheaper overall, and to complement the current rulings regime.

Submitters also submitted that small and medium-sized taxpayers should be given greater access to less formal forms of advice, as they may be more suitable for the less complex tax issues raised by these taxpayers. As noted in *Proposals for modernising the Tax Administration Act*, Inland Revenue is in the process of designing its future organisational structure which will be crucial in determining how it will balance its resources and provide more effective advice. This will include consideration of giving greater access to less formal advice.

Questions were also raised as to why the proposal placed such a high priority on small and medium-sized taxpayers as opposed to the range of other taxpayers that may wish to access binding rulings. Other submitters noted that large taxpayers were well-serviced by the current rulings regime, and preferred no changes be made for those taxpayers. Inland Revenue considers that larger taxpayers are adequately serviced by the current rulings regime, and that the problem relates to the difficulty of small and medium-sized taxpayers obtaining the same certainty.

Minor errors

Submissions on the proposal to expand the current approach to minor errors were favourable of the concept. However, differing views emerged as to how minor errors should be approached.

Submitters suggested options including:

- A single threshold increased from $1,000 to $5,000
- A threshold with a significantly higher monetary threshold based on materiality to the taxpayer; for example, the lower of $100,000 or 5% (or 1%) of the taxable income or output tax.
- A threshold based on the use-of-money interest implications of the error rather than the amount of tax or income involved.

The first two options suggested are reflected in the options discussed above. Inland Revenue considered:

- the second and third options suggested above raised too many risks to the integrity of the tax system; and
- the third submission would be too difficult to work in practice.

A number of additional comments were also made on this proposal. It was submitted that a more useful remedy would be to extend the statutory response period in which a taxpayer may dispute their own assessment, as New Zealand currently has a uniquely brief period in which this may occur (within 4 months from the date of the return). Inland Revenue considers that the response period would need to be considered as part of a broader review of the disputes process.

Tax preparers

Proposals for modernising the Tax Administration Act consulted on a proposal to amend the statutory tax agent definition to include a wider group of "tax intermediaries", such as those who may file only GST and/or PAYE returns (option 2 discussed in section 3.1). However, submitters made a number of comments as to exactly how the definition of a tax agent should be amended. This included that there should be no fee earning criterion to be a tax agent as proposed in the discussion document. In particular, submitters said the proposed fee earning criterion should not apply to agents or intermediaries performing pro bono work for charities and not-for-profits, and that tax agents and other intermediaries who prepare tax returns on behalf of their employers should also remain eligible to be tax agents.[14]

A few submissions stated that tax intermediaries and tax agents are distinct and the terminology should not be conflated. One submitter suggested that a better way to achieve both recognition and regulation of tax intermediaries who do not meet the current tax agent definition is to create a separate "tax intermediary" definition, as doing so would allow the retention of the current tax agent definition (which already sets out the eligibility criteria for an extension of filing time) and would recognise important differences between the two groups.

It was further submitted that the majority of those currently meeting the definition of "tax agent" are subject to high levels of scrutiny and accountability and are required to have certain qualifications and meet continuing professional standards. As such, this will continue to justify the recognition of tax agents as distinct from intermediaries, despite the expansion of the role of tax intermediaries. Another submitter supported combining tax agents and intermediaries but submitted that, if the distinction between the two remains, then the distinction needs to be clear.

These submissions are reflected in the discussion of the options above. Inland Revenue agrees with submitters that there should be no fee-earning criterion to be registered as either a tax agent or a tax preparer. Those who prepare income tax returns for their employers (such as in-house accountants preparing tax returns for multiple entities within a group) or who perform pro-bono income tax preparation services for 10 or more taxpayers are not currently excluded from being tax agents and Inland Revenue does not consider this should change. Further, there is no reason to exclude those preparing returns for other tax types (such as GST and PAYE) from accessing the new services for tax preparers on the basis that they do not earn a fee.

In light of the submissions received on the differing roles of tax agents and other intermediaries, Inland Revenue considers it is appropriate to recognise these two groups as distinct. The boundary between how the two groups are defined should be clear, as the preferred option (option 3) would retain the current tax agent definition.

Nominated persons

Three written submissions and one online forum comment expressed support for the proposal to provide the Commissioner with a legislated discretion to not recognise someone as a nominated person, if doing so would adversely affect the integrity of the tax system. One submitter commented that the Commissioner's use of this discretion should be a reviewable decision. Two commentators on the online forum were opposed to the proposal, one stating that it is up to the taxpayer who represents them and should not be a matter for the

[14] The intention behind the fee-earning criterion proposed in the discussion document was to differentiate between intermediaries who carry out a business or occupation that involves the preparation of tax returns, versus those who only act for other taxpayers in a small-time capacity. This is because the additional services would be of greater benefit to those in the former group, while the nominated person regime should be sufficient for those in the latter group. It was never intended that the likes of in-house accountants and those preparing GST and PAYE returns for multiple charities and non-profit bodies on a pro-bono basis be excluded from the scope of the proposal. Exceptions to the fee-earning criterion for these intermediaries were proposed in the discussion document, but it seems these were not as clearly explained as they could have been.

Commissioner.

Inland Revenue recognises that the exercise of such a discretion, especially if it is drafted too widely, may in some instances unfairly disadvantage taxpayers that have nominated a person to act for them. This is the reason for limiting the exercise of the proposed discretion to circumstances where the person is acting on behalf of a taxpayer for a fee or is otherwise acting in a professional capacity. Inland Revenue therefore expects that the potential risk would be outweighed by the tax integrity benefit from not allowing clearly unfit persons (who are acting in a paid or professional capacity) to file returns on behalf of other taxpayers and access their information.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?

The preferred options will need to be implemented by legislative amendments to the Tax Administration Act 1994.

The legislative amendments could be included in the first omnibus tax Bill in 2018. The amendments would apply from the date of enactment. Explanation of the amendments and their effect would be contained in a *Tax Information Bulletin*, which would be released shortly after the bill received Royal assent.

Simplified rulings

The simplified rulings regime would need similar provisions to the current rulings regime to be enacted. The current requirements for a taxpayer to apply for a ruling would be tailored for the simplified regime. The thresholds would also be specified in the legislation. The fees for the simplified rulings regime would be specified in regulations (as is currently the case) or by the Commissioner at a later date and subject to the regulatory impact analysis requirements as necessary.

The implementation of the preferred option would require an internal Inland Revenue process to issue the simplified rulings applications. The internal process would be developed in conjunction with the organisational design process that is currently being undertaken within Inland Revenue.

There is a risk that there could be a significantly larger number of ruling applications than currently anticipated (being approximately 140-160 rulings per year). This would require Inland Revenue to commit significantly more resources to processing the rulings. Given the fees and likely advisor costs for applying for a ruling, the risk of a significantly larger number of rulings than anticipated is considered to be small. In any event, any further resources committed to the simplified rulings regime may be in substitution for other forms of advice currently provided or for disputes that would otherwise occur. As a result, if further resources are required for the simplified rulings regime these may to some extent come from a reduction in resources needed in other areas.

Minor errors

The proposed increase in the threshold for amending minor errors in a subsequent return would require an amendment to the Tax Administration Act 1994.

Tax preparers and nominated persons

The proposed provision to define the group of persons who are eligible to receive Inland Revenue's extended services for tax preparers, along with the discretion for the Commissioner to deregister or refuse to register a tax preparer if necessary to protect the integrity of the tax system, would require an amendment to the Tax Administration Act 1994, as would the proposal to provide the Commissioner with a discretion to choose not to recognise a nominated person if doing so would adversely affect the integrity of the tax system.

The number of persons who would apply for registration as a tax preparer is unknown, so there is a risk that a large volume of applications may require Inland Revenue to commit more resources to processing the applications in the short term. However, given the compliance costs involved in registering and in getting authorisation from clients to access these services on their behalf, it is expected that a number of those eligible, particularly those who are less technologically savvy, may prefer to remain in the nominated person regime. The proposed restriction on eligibility to those who carry on a business or occupation in which tax returns are prepared, or who prepare tax returns for an employer, and who act on behalf of 10 or more taxpayers[15], would also constrain the number of those eligible to apply for the services.

[15] This may include several entities within a group.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

Inland Revenue will monitor the outcomes of the changes pursuant to the Generic Tax Policy Process (GTPP). The GTPP is a multi-stage policy process that has been used to design tax policy (and subsequently social policy administered by Inland Revenue) in New Zealand since 1995.

For the simplified rulings proposal, the monitoring would involve a review of the number of rulings made, and the types of taxpayers applying for rulings. Further indicators of the effectiveness of the policy may include the average time taken to make the rulings and the overall costs incurred by taxpayers in obtaining the rulings.

For the proposal to increase the threshold to carry minor errors into a subsequent return, monitoring would more problematic. The fact that taxpayers would not be required to notify Inland Revenue when they had included a minor error in a subsequent return would make it difficult for Inland Revenue to monitor the effectiveness of the proposal. Two possible indicators of the effectiveness of the policy may be:

- Feedback from taxpayers and representative groups that the amendment had reduced compliance costs for taxpayers; and
- A reduction in taxpayers contacting Inland Revenue to remedy minor errors within the proposed threshold.

For the proposal to introduce a new provision in the Tax Administration Act to clarify the persons who are eligible to register with Inland Revenue to receive the extended service offerings for tax preparers, the monitoring would involve feedback from tax preparers and representative groups on the extended service offerings, and may include a review of the number of tax preparer registrations processed and the number of deregistrations.

For the proposed Commissioner discretion to refuse to recognise a nominated person (if allowing the person to act for other taxpayers would adversely affect the integrity of the tax system), a possible indicator of whether the policy is appropriate may be the number of Commissioner-initiated revocations of access rights for nominated persons, as well as feedback from taxpayers, tax service providers and operational staff within Inland Revenue.

7.2 When and how will the new arrangements be reviewed?
The final step in the GTPP is the implementation and review stage, which involves post-implementation review of legislation and the identification of remedial issues. Post-implementation review is expected to occur around 12 months after implementation. Opportunities for external consultation are built into this stage. Any necessary changes identified as a result of the review would be recommended for addition to the Government's tax policy work programme, and any resulting proposals would go through the GTPP.

Impact Summary: Modernising the correction of errors in PAYE information

Section 1: General information

Purpose
Inland Revenue is solely responsible for the analysis and advice set out in this Impact Summary, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by Cabinet.

Key Limitations or Constraints on Analysis

The key limitations on the analysis that follows are:

- *Consultation and testing:* Although there has been consultation with employers and payroll providers employers with small payrolls who do not use payroll software were underrepresented in submissions.
- *Quality of data used for impact analysis:* We have been unable to accurately estimate the monetary value of expected changes in administrative costs for Inland Revenue and compliance costs for employers and payroll software developers.

Neither limitation materially affects the analysis.

Responsible Manager

Mike Nutsford
Policy and Strategy
Inland Revenue

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

PAYE error correction

"PAYE error correction" describes the process by which employers advise Inland Revenue of changes to income, PAYE and other deductions, such as KiwiSaver when an error has been made in, or an adjustment is required to, the information originally filed with Inland Revenue.

For many reasons, including human error and late receipt of information, payroll errors[1] are inevitable.

There are three types of errors that require amendment to PAYE information:

1. **Reporting errors** arise when the employee(s) were paid and taxed correctly but reporting to Inland Revenue does not accurately reflect what was paid and/or withheld.

2. **Payroll overpayment errors** arise when an employee is overpaid, correcting the overpayment requires consequential change to the amounts withheld for PAYE and related deductions such as KiwiSaver.

3. **Interpretation errors** arise when the employee receives the correct pay but an incorrect tax treatment is applied, for example a benefit is treated as tax free when it should have been subject to PAYE.

Because salary and wage earners are taxed when they are paid underpayments are taxed when they are paid and so there is no requirement to correct the information already provided to Inland Revenue.

The current PAYE error correction process is set out in operational guidance from Inland Revenue and is largely manual.

The current PAYE error correction guidelines require all errors to be corrected by filing an amendment to the original return. This requirement imposes considerable compliance costs on employers and administrative costs on Inland Revenue.

The guidelines would need to be updated to reflect the changes proposed in the *Taxation (Annual rates for 2017-18, Employment and Investment Income, and Remedial Matters) Bill* (The Bill).

This Bill introduces "payday reporting"[2]. In general, payday reporting would require employers to file "employment income information" with Inland Revenue within 2 to 10 working days of payday. This information is currently provided to Inland Revenue on a

[1] Payroll staff often distinguish between "errors" and "adjustments" with the latter category arising from timing events such as the late receipt of information. For simplicity these are all referred to in this document as errors.

[2] This Bill is currently before the Finance and Expenditure Committee and the proposed changes are due to be mandatory from April 2019, employers can voluntarily adopt payday filing from April 2018..

monthly basis. Payday reporting will allow some errors to be identified and corrected more quickly but it will reduce the amount of time available to employers to correct information before it is sent to Inland Revenue and, when an error has continued for several pay periods, it will require more returns to be amended. Therefore, in the absence of any other changes, payday reporting will increase the overall number of errors reported to Inland Revenue. This is the status quo position.

Inland Revenue's business transformation programme provides an opportunity to reduce compliance costs for employers and administrative costs for Inland Revenue by modernising the PAYE error correction process using employers' payroll software and taking advantage of the capabilities in Inland Revenue's new computer system. This could be achieved by revising some of Inland Revenue's requirements and coding PAYE error correction requirements into payroll software and Inland Revenue's system.

To achieve this outcome the requirements would need to provide certainty and must be accessible to employers and developers of payroll software. The requirements must also cater for those organisations which do not use payroll software. We note that the Bill proposes that the requirements for PAYE error correction can be set out in regulations.

Other problems with PAYE error correction

In addition, a matter affecting PAYE error correction has arisen which relates to the definition of PAYE income in the Income Tax Act 2007. The objective of providing certainty in relation to the requirements for PAYE error correction requires that this issue should be resolved as soon as possible so that it can be included in advice to providers of payroll software and employers.

The problem concerns the taxable status of overpaid PAYE income which is not repaid. Inland Revenue's legal position is that an overpayment which is not repaid is not taxable unless it has been obtained fraudulently or has become a debt remittance income.

Consultation with employers suggests that at least some employers treat this income as taxable and that any change to their approach would incur additional compliance costs and could reduce the likelihood of the employee agreeing to repay the net amount overpaid. Some employers who treat overpaid income which is not repaid as subject to PAYE seek a refund of PAYE and other deductions, when they obtain agreement from the employee that the net amount will be repaid[3], others wait until the net amount is fully repaid.

[3] If the employee subsequently defaults on the repayment these employers submit a further error correction to reinstate the outstanding amount as income and pay PAYE on it.

2.2 Who is affected and how?

Employers would be most affected by the current situation and those who responded to consultation generally supported the proposed changes on the basis that they would help to reduce their compliance costs.

Payroll software developers would also be affected by the proposals for PAYE error correction. They generally support the proposed changes because they would provide certainty and would simplify reporting.

Employees could be potentially affected. If the requirements for PAYE error correction are unclear or too complex employers could ignore them and adopt approaches which could be unfair for employees whose records of income and deductions might be affected.

Some tax professionals do not support the proposed change to the status of overpaid PAYE income which is not repaid because it would tax an amount which is not currently defined as PAYE income and denies the employer the refund of PAYE that is currently available. The individual employers who responded to consultation on this point nevertheless supported the proposed change.

2.3 Are there any constraints on the scope for decision making?

The common law principle that wage and salary earners are taxed when they are paid is a constraint. This principle means that underpayments are taxed when they are paid; there is therefore no "error" from a tax perspective and no requirement on the employer to amend earlier tax returns. No change is proposed and this issue is not analysed further in this impact summary.

The Bill's changes to PAYE reporting are a constraint as they require more frequent filing of PAYE information. These changes form part of Inland Revenue's business transformation programme. One objective of this programme is to, as much as possible; integrate tax obligations with normal business processes by using business software to automate processes.

Automation requires the rules to be set out clearly and centrally so that they can be coded. The proposed changes would be consistent with a largely automated approach to error correction. In most cases, this would allow an employer using payroll software to generate the information required by Inland Revenue as a consequence of updating their own records.

Because a significant group of employers do not use payroll software the requirements for PAYE error correction should also cater for employers who would manually correct their PAYE information.

Section 3: Options identification

3.1 What options have been considered?

Modernising PAYE error correction

Criteria

- Minimise compliance costs to the extent possible for employers and payroll software developers:
- Minimise administrative costs for Inland Revenue, including consistency with the objectives of Inland Revenue's business transformation.
- Maintain the equity of the tax system. This means allowable approaches to PAYE error correction should not disadvantage employees to whom the income and deductions belong.
- Maintain the integrity of the tax system.

Options for error correction

- Option 1: All corrections would be made by amending the original return (status quo).
- Option 2: Employers would be able to make corrections by either; amending the original return or reporting the correction in a subsequent return. The ability to amend in a subsequent return would exist even if the error occurred in a previous tax year. Additional sub-options have been considered for interpretation errors and these are discussed below.

Analysis of options for each error type against the stated criteria

1. *Reporting errors*

   Option 1 is preferred over option 2 for dealing with reporting errors. If reporting errors were not corrected in the original return there could be a mismatch in the reported information and the amount paid. This would give rise to reconciliation problems which give rise to compliance costs and administrative costs. Amending the original return would also ensure that employees would not be disadvantaged by the income or deductions actually received being reported in a later period.

   Option 2 does not address the problem.

2. *Overpayment errors*

   Option 1 would involve higher compliance costs for users of payroll software, compared with option 2. This is particularly true in the context of payday reporting - that is, if an error has continued for more than one payday, an employer who pays more often than monthly would have more returns to correct.

   Option 2 would involve a reduction in compliance costs for employers using payroll software, compared with option 1. These reductions would arise because employers would be able to report overpayment errors in a subsequent return which would eliminate the requirement for a separate error correction return. Because it provides choices option 2 would also cater for employers who do not use payroll software and who prefer to make corrections by amending the original return. Option 2 would not give rise to integrity concerns.

If the overpayment error occurred in a previous tax year option two would more often ensure that the reduction in an employee's income feeds through into their annual assessment and social policy position. For this reason option 2 is also preferred on equity grounds as fewer employees would need to seek a reassessment to ensure the reduction in their income feeds through to an assessment.

Option 2 would not be fully available to employers until Inland Revenue's new computer system takes over the full processing of PAYE; this is not expected until 2020. Until then employers would only report overpayment errors in a subsequent return if the net amount reported were a positive number.

3. *Interpretation errors*

Option 1

Requiring all interpretation errors to be corrected by amending the original return (the status quo) would impose higher compliance and administrative costs than option 2. There would not be equity or integrity of the tax system concerns with this option.

Option 2

Allowing the employer to choose to correct the error either by amending the original return or by including the correction in a subsequent return would have lower compliance and administrative costs than option 1.

However if the ability to correct interpretation errors in a subsequent return is unconstrained employees could be disadvantaged by having a significant increase in their income reported in a single payday return when they have not had an increase in available cash[4]. This concern led to consideration of sub option 2a below.

In addition, concern for the integrity of the tax system led to consideration of a further sub option as set out in sub option 2b below.

Option 2a

This sub option would permit employers to choose to correct small interpretation errors in a subsequent return up to a threshold of PAYE on the error being less than 10% of the employee's PAYE in the payday return. Larger interpretation errors would need to be corrected by amending the original return(s).

Option 2a would mitigate the risk of disadvantaging employees but it would impose higher compliance and administrative costs than option two.

[4] This situation could arise if a taxable benefit such as subsidised accommodation had been treated as tax free, if the value of this benefit is all reported in one payday return the employee has higher income reported but no more cash.

Option 2b

In addition to the 10% threshold proposed in sub option 2a concern for the integrity of the tax system lead to a further proposal: that an employer could only correct interpretation errors in a subsequent return if they had made less than $10,000 of upward reassessments in that tax year.

This sub option would have significantly higher compliance costs that options 2 and 2a but it has the advantage of reducing the likelihood that the correcting interpretation errors in a subsequent return could conceal widespread non-compliance.

Options for amending definition of PAYE income

Three options are considered using the criteria set out at the beginning of this section.

- Option 1: no amendment to the Income Tax Act 2007. This is the status quo option.
- Option 2: no amendment to the Income Tax Act and a significant investment by Inland Revenue in employer education in an effort to change employer behaviour.
- Option 3: amend the Income Tax Act 2007 so that overpaid PAYE income that is not repaid remains subject to PAYE.

Analysis of options

Option 1

This option retains the current definition of PAYE income. Some employer submissions indicated that this option would be inconsistent with current employer practice and with how their payroll software is currently configured.

Continuing with the status quo may undermine the objective of automating error correction through software and is likely to result in continuing non-compliance which undermines the integrity of the tax system.

This option could also be seen as inequitable because it treats an employee who repays overpaid PAYE income as having the same income as an employee who does not repay it.

Option 2

Under this option there would be no change to the definition of PAYE income in the Income Tax Act 2007 and Inland Revenue would widely publicise its view of the law in an effort to change employer practice and how payroll software is configured. The objective would be to enable payroll software to be used to report such errors to Inland Revenue and recover overpaid PAYE and other deductions as soon as an overpayment is identified and regardless of whether it is repaid or not.

This option would have significant one-off educational costs for Inland Revenue and might not be successful. Those employers consulted view the status of overpaid PAYE income as wages or salary subject to PAYE. In addition, employers have reasons under employment law for not coding the amount as an overpayment in their payroll system until agreement to repay has been reached.

If this option resulted in a change in employer behaviour employers would benefit by being able to recover PAYE and other deductions from Inland Revenue regardless of whether they had recovered the net amount from the employee.

Option 3

This option would expand the definition of PAYE income so that overpaid PAYE income not repaid would be subject to PAYE. This option would have lower compliance and administrative costs than the alternatives as it accords with how (some) employers currently treat such income and with how their software is configured.

This option supports the integrity of the tax system as overpayments not repaid would generally become taxable as debt remittance income. However, because employees would be unlikely to be aware of this obligation it is unlikely that tax would be paid on such income.

Option 3 would expand the definition of PAYE income and could be seen as unfair for employers because it denies employers refunds of PAYE and related deductions that they are currently entitled to.

It could also be seen as unfair to employees who have been overpaid because that amount would be taxed before it becomes debt remittance income. As noted above, there are countervailing equity arguments that suggest that Option 3 is preferable on equity grounds because for social policy purposes it would recognise an employer who repaid overpaid income as on a lower income than someone who received an equivalent overpayment but did not repay it.

3.2 Which of these options is the proposed approach?
Error Correction 1. **Reporting errors:** Option 1 (all corrections to be made by amending the original return) is the proposed approach as it is preferable on all criteria. 2. **Overpayment errors:** Option 2 (allowing the employer the choice between amending the original return and correcting in a subsequent period) is the proposed approach as it reduces compliance and administrative costs and is preferable on equity grounds. 3. **Interpretation errors:** Option 2a (allowing the employer the choice between amending the original return and correcting in a subsequent period subject to PAYE on the correction being less than 10 percent of the employee's PAYE in the return) is the preferred approach. This option represents the best trade-off between reducing compliance costs for employers and administrative costs for Inland Revenue without the possibility of unfair impacts on employees. **Definition of PAYE income** **The taxable status of overpaid PAYE income which is not repaid**: Option 3 (amending the definition of PAYE income so that overpaid PAYE income which is not repaid remains subject to PAYE) is the preferred approach as it is preferable on all criteria.

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

PAYE Error correction: the error correction items are considered together as costs are principally driven by the requirement to amend original returns. When there is a continuing requirement to correct errors by amending the original return employers who use software should experience reduced compliance costs owing to automation.

Employers who do not use payroll software but who have internet connectivity would be able to access their already filed and processed returns through myIR and self-correct earlier returns; this should reduce costs for this segment. Employers who report PAYE on paper would continue to have access to a paper form for PAYE error corrections and for simple corrections should be able to make them over the telephone.

Additional costs of proposed approach, compared to taking no action		
Regulated parties	**Providers of payroll software** would need to upgrade their products to support the electronic submission of error corrections in line with the proposed methods for error correction. Software providers could integrate this change into the regular update cycle. Work to create an automated channel for the status quo position is already underway in advance of the proposed regulations, as part of business transformation changes. These are transitional costs. **Employers** would have transitional costs of understanding the new approach in order to take advantage of it.	Very low Very low
Regulators	**Inland Revenue** would need to ensure that employers and payroll providers are provided with appropriate education and support and that its new computer system is effectively set up and tested in order to receive negative values from 2020. These are transitional costs.	Very low
Wider government	NA	NA
Other parties	NA	NA
Total Monetised Cost	NA	NA
Non-monetised costs		**Very low**
Expected benefits of proposed approach, compared to taking no action		
Regulated parties	**Providers of payroll software:** Have additional certainty that their payroll offerings are compliant with requirements. **Employers** (including payroll intermediaries). Once it becomes possible in 2020 for employers	Very low Medium

	to file negative values to correct overpayment errors in a subsequent return, compliance costs to correct overpayment errors, are expected to materially reduce. The ability to correct small interpretation errors in a subsequent return should reduce costs of reporting these errors. These benefits are ongoing.	
Regulators	**Inland Revenue** once the new system has bedded in and employers can use their payroll systems to correct overpayment errors and minor interpretation errors in a subsequent return, including those showing negative values the cost of administering the PAYE system should reduce.	Low
Wider government	**Government** employers are expected to have the same experience as private sector employers. The changes are also expected to benefit the Ministry of Social Development and the Accident Compensation Corporation which pay PAYE income to beneficiaries and to recipients of New Zealand superannuation and accident compensation.	Medium
Other parties	NA	NA
Total Monetised Benefit	NA	NA
Non-monetised benefits	.	**Low/medium**

Overpaid PAYE income subject to PAYE		
Additional costs of proposed approach, compared to taking no action		
Regulated parties	**Software providers** would have no costs as we understand their systems currently support the proposed approach. **Employers**: we understand that what is proposed aligns with how (some) employers currently treat this income and reflects how their systems work. Even though the proposed change would preclude employers from receiving a refund of PAYE on the overpaid income (some) employers are not currently claiming this refund. Unless this practice changed the increased cost would be theoretical, rather than real. Further, employers argue that continuing to treat overpaid income as subject to PAYE would make it more likely that the employee would repay the employer because repayment would be the only way their record of income for social policy purposes is corrected. To the extent this view is valid the theoretical increase in costs	

	identified below would reduce. Employer costs have been estimated as very low; this reflects the fact that the situation is not a common one and assumes that some employers do seek a refund of PAYE on overpaid PAYE income that is not repaid.	 Very low
Regulators	**Inland Revenue:** the proposal reflects the way the system is currently operating so no additional costs would be incurred.	No change
Wider government	NA	NA
Other parties	NA	NA
Total Monetised Cost	NA	NA
Non-monetised costs	As noted above (some) employers have advised us that what is proposed is how they currently operate. For these employers there would be no increase in costs. The costs have been entered as very low on the assumption that some employers are recovering PAYE on overpaid income not repaid.	**Very low**

Expected benefits of proposed approach, compared to taking no action		
Regulated parties	**Payroll providers** will have certainty that their systems could be used as currently configured to seek a refund of overpaid income when repayment is agreed or made. **Employers** would have certainty that the widespread current approach, that treats this income as subject to PAYE, is consistent with the law. **Employees** would be freed of any obligation to pay tax on the overpaid PAYE income when and if it becomes debt remittance income.	Low
Regulators	**Inland Revenue** would no longer have to deal with ambiguity around the current position.	Low
Wider government	NA	NA
Other parties	NA	NA
Total Monetised Benefit		
Non-monetised benefits	The primary benefit is increased certainty around how this income should be treated for tax purposes.	**Low**

4.2 What other impacts is this approach likely to have?

The proposed legislative change to deem overpaid PAYE that is not repaid as subject to PAYE would improve equity between overpaid employees. Under existing law two employees who are overpaid the same amount of PAYE income should be treated as having the same income for social policy purposes (for example working for families payments, student loan repayments and child support payments) despite one employee having repaid the money and the other not having done so.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?

Inland Revenue consulted with a number of providers of payroll software and employers and with the Corporate Taxpayers Group and Chartered Accountants of Australia and New Zealand prior to releasing an official issues paper in August 2017.

An officials' issues paper, *PAYE error correction and adjustment,* was released through Inland Revenue's normal channels and in addition was sent to the members of the Payroll Practitioner's Association, to providers of payroll software and to representatives of more than thirty employers who had indicated interest in the subject.

Thirteen submitters responded some representing more than one employer. Submitters generally agreed with the problem analysis and the proposed regulatory approach with the exception of the original proposal for an employer level threshold for interpretation errors.

Submitters argued that the employer level threshold could not be automated and that manual tracking would involve disproportionate compliance costs. In response to feedback the employer level threshold has been dropped.

Concern was also expressed by some respondents that the 10% threshold for interpretation errors at the employee level was unduly low. This threshold has been retained at 10% because the amount could be material for someone on a low income.

One respondent felt that the proposals were unduly complex. However an employer who wishes to minimise complexity will have the option to correct all errors by amending the original returns. No change has been made in response to this submission.

Most respondents agreed with the proposed amendment to the Income Tax Act 2007, deeming overpaid PAYE income not repaid as subject to PAYE. The Corporate Taxpayers Group and Chartered Accountants Australia and New Zealand however disagreed. The Corporate Taxpayers Group considered that the proposal would disadvantage employers by taxing an amount that is not employment income. Chartered Accountants Australian and New Zealand submitted that whether the net amount was recovered or not was a private matter between the employer and employee and the amount should not be taxed unless it became debt remittance income.

In addition one software provider submitted that if an employer had made an adjustment when agreement to repay the overpaid amount was repaid they should not be required to make a further adjustment if the employee subsequently defaulted on the repayment.

No changes we made in response to the submissions received on the proposal to amend the definition of PAYE income so that overpaid income not repaid is subject to PAYE.

A number of technical questions were raised by payroll software providers and these will be considered in the process of developing the technical specifications.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?
The proposals related to reporting errors, overpayment errors and interpretation errors would be given effect through regulations. Clause 235C of the Taxation *(Annual Rates 2017 -18, Employment and Investment Income and* Remedial Matters) Bill proposes that the Governor General may, by Order-in-Council on the recommendation of the Minister of Revenue and following appropriate consultation, make regulations for the correction of errors in employment income information. The proposed timing provides adequate time for employers to understand the proposed changes and become familiar with the new options. In general the proposed regulations introduce additional options, with continuing to file amendments on the current basis being one option. Having options provides a means of managing implementation risk including risks that arise from a relative lack of engagement with employers with small payrolls. Inland Revenue's systems are being upgraded to accept automatic error correction schedules from 1 April 2018. Issues relating to the effectiveness of the automated process should be resolved by the time the regulations, which permit a greater number of errors to be correcting in a subsequent return, come into effect on 1 April 2019. The proposal related to the tax status of overpaid PAYE income not repaid will be managed through a proposed amendment to the Income Tax Act 2007. It is intended that the amendment will be included in the next available taxation omnibus bill with a proposed effective date of 1 April 2019. Consultation by select committee is expected to provide a further opportunity for interested parties to express their views on this proposed change. The proposed change to the legislation reflects how many employers are understood to currently treat such income, implementation risks are not therefore considered to be material.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

Information on the number of errors and adjustments to employment income information that are corrected at the employer's request is currently available. There is no way to decompose the totals into different error types.

Once the systems changes are made and the regulations are in place Inland Revenue will know how many automated error correction schedules are filed and the number of changes made. If the system is working as intended the number of changes that are made by amending earlier returns should reduce after it becomes possible for employers to file returns which include negative values (estimated as 2020).

Inland Revenue will not know how many employers exercise the option of correcting overpayment and small interpretation errors in a subsequent return as this option eliminates the need to separately file error correction information.

Implementation and operational issues will be identified through feedback from payroll software providers and through our call centres, account managers and specialised units such as those established to support large enterprises.

7.2 When and how will the new arrangements be reviewed?

The arrangements will be reviewed as part of the post implementation review of phases three and four of Inland Revenue's business transformation.

In addition if monitoring shows unanticipated spikes in the numbers of error corrections being made to employment income information Inland Revenue will investigate the reasons and consider whether the issue:

- is insufficient education;
- reflects a problem with the specifications for payroll software or with Inland Revenue's processing of error correction information;
- stems from the regulations.

Employers will have the opportunity to raise any concerns with our call centres and account managers and payroll software providers can do so through Inland Revenue's Software Liaison Unit.

If employees consider that they are unfairly affected by the actions of employers pursuant to the proposed regulations or legislative change they will be able to make their concerns known through our call centres or by asking the Commissioner to reassess their income.

Coversheet: Taxation of non-bank securitisation vehicles

Advising agencies	*Inland Revenue*
Decision sought	*The analysis and advice has been produced for the purpose of informing final decisions to proceed with policy changes to be taken by or on behalf of Cabinet*
Proposing Ministers	*Steven Joyce (Finance) and Hon Judith Collins (Revenue)*

Summary: Problem and Proposed Approach

Problem Definition **What problem or opportunity does this proposal seek to address? Why is Government intervention required?**
Securitisations can have several commercial benefits, compared with other funding mechanisms, such as risk management, balance sheet improvement, credit enhancement, lower cost of funding, and access to a wider pool of lenders. An important commercial objective of a securitisation is maintaining tax neutrality for the special purpose vehicle (SPV) used. There is a concern that the current tax rules may not allow for tax neutrality for the SPV to be achieved, and so may be discouraging securitisations. The Government wants to ensure that tax settings are not discouraging some businesses from realising the commercial benefits of securitisations.

Proposed Approach **How will Government intervention work to bring about the desired change? How is this the best option?**
There is currently a securitisation regime in the Income Tax Act 2007 which applies in respect of certain securitisations undertaken by financial institutions. The effect of the regime is that there are no tax consequences arising from the transactions between the financial institution and the SPV. Extending that regime to cover businesses that are not financial institutions would ensure that securitisations that meet the criteria of the regime are tax neutral. This would remove a tax disincentive to undertaking securitisations, which is likely to produce growth given the commercial benefits securitisations provide.

Section B: Summary Impacts: Benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?
The main expected beneficiaries of the proposal are New Zealand businesses with large books of trade credits or other receivables (Originators) that may wish to raise funding by using those receivables as security. The proposal should reduce compliance costs by removing the requirement for the SPV to return tax itself, and by removing the need for the Originator to calculate and return tax where the transferred receivables remain economically within the Originator's group. In terms of equity and fairness, taxing securitisations in accordance with their economic substance, would ensure that tax does not penalise (or incentivise) securitisations compared with other forms of fund raising. This would mean that the benefits of securitisations can be enjoyed more broadly.

Where do the costs fall?
The fiscal cost of the proposal for the Government is expected to be minor, as securitisations are typically structured to prevent tax arising where possible. There could be a fiscal cost from not recognising the transfer of assets to the SPV, although this would be the same as if the securitisation had not occurred. It is not expected that implementation of the proposal would raise any administrative issues for Inland Revenue. The proposal would reduce compliance costs for taxpayers, and would reduce tax costs to the extent that securitisations are not currently structured to prevent tax arising.

What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?
A potential risk that was identified is that expanding the securitisation rules could open up the possibility of those rules being used to avoid tax on what is in substance a true sale to a third party. However, it is proposed that the expanded rules include a requirement that the securitised assets are treated as held by the Originator or another company in the group in its consolidated accounts under the International Financial Reporting Standards (IFRS). It is considered that this requirement should mitigate the risk that the new rules could be used to avoid tax on what is in substance a true sale to a third party.

Identify any significant incompatibility with the Government's 'Expectations for the design of regulatory systems'.
There is no incompatibility between this regulatory proposal and the Government's 'Expectations for the design of regulatory systems'.

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?
We are reasonably confident in terms of the evidence on which the proposal is based, given that we have undertaken targeted consultation with interested and affected parties involved in New Zealand's securitisation market.

To be completed by quality assurers:

Quality Assurance Reviewing Agency:
Inland Revenue
Quality Assurance Assessment:
The Quality Assurance reviewer at Inland Revenue has reviewed the *Taxation of non-bank securitisation vehicles* Regulatory Impact Assessment prepared by Inland Revenue and associated supporting material and considers that the information and analysis summarised in the Regulatory Impact Assessment **meets** the Quality Assurance criteria.
Reviewer Comments and Recommendations:
The reviewer's comments on earlier versions of the Regulatory Impact Assessment have been incorporated into the final version.

Impact Statement: Taxation of non-bank securitisation vehicles

Section 1: General information

Purpose
Inland Revenue is solely responsible for the analysis and advice set out in this Regulatory Impact Assessment, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by or on behalf of Cabinet.

Key Limitations or Constraints on Analysis
It is understood that the current tax settings could be discouraging some businesses from realising the commercial benefits of securitisations. We cannot be sure of the scope of the problem, but have gleaned from consultation that the current tax settings are a disincentive to many taxpayer's undertaking securitisations. We also understand that currently securitisations are typically structured to prevent tax arising where possible. However, the extent to which tax is currently paid in respect of securitisation transactions is not known, so the potential revenue cost is not able to be quantified. That said, removing a tax barrier would be expected to result in more businesses being able to enjoy the commercial benefits of securitisations, and the tax neutrality of those transactions would be no different than if the securitisation had not occurred.
Responsible Manager (signature and date):
Peter Frawley Policy Manager Policy & Strategy Inland Revenue July 2017

Section 2: Problem definition and objectives

2.1 What is the context within which action is proposed?

A securitisation is a funding mechanism that involves issuing marketable securities that are backed by the expected cash flows from specific assets. New Zealand businesses with large books of trade credits or other receivables (Originators) may wish to raise funding by using those receivables as security. To do this, the Originator of the receivables transfers them to a special purpose vehicle (SPV), and the SPV then issues securities (typically debt instruments) to lenders. The SPV is structured to be bankruptcy remote from the Originator, so that the SPV's assets cannot be accessed by the Originator's creditors. In New Zealand (and internationally, in most cases) this means that the SPV is typically a trust.

A securitisation can have several commercial benefits compared with a regular loan, such as risk management, balance sheet improvement, credit enhancement, lower cost of funding, and access to a wider pool of lenders.

An important commercial objective of a securitisation is maintaining tax neutrality while ensuring the SPV is bankruptcy remote from the Originator. It is particularly important to ensure that the SPV itself is not exposed to a tax liability, as this can affect its credit rating.

2.2 What regulatory system, or systems, are already in place?

There is currently a securitisation regime in the Income Tax Act, but it applies only in respect of certain securitisations undertaken by financial institutions. Those rules were introduced as a result of the Reserve Bank of New Zealand's (the RBNZ's) response to the global financial crisis. Broadly, the RBNZ agreed to provide additional liquidity support for banks, provided the bank offered collateral securitised AAA rated residential mortgages as securities. As part of the security arrangements for this funding, the RBNZ required these mortgages be held by a bankruptcy remote special purpose vehicle (SPV).

In the absence of a specific regime, there would have been potential tax consequences arising from the use of SPVs, as required to access the RBNZ's liquidity support. The government determined that the tax rules should not impede the RBNZ measures assisting the stability of the financial system at that time. As a result, new provisions were introduced into the Act in 2009 to achieve tax neutrality.

Those provisions were extended in 2010, after the RBNZ introduced a new bank liquidity policy which included measures to require banks and certain finance companies to lengthen their funding to better match their lending terms. The provisions in the Act now apply to financial institutions generally (not just registered banks) and to covered bond programme SPVs (economically very similar to the residential mortgage-backed security SPVs).

The tax effect of the provisions is that the SPV is treated as transparent. The SPV's property, activities, status, intention and purpose are attributed instead to the financial institution. The financial institution is also treated as being party to any arrangement to which the SPV is a party, and the SPV is treated as not being that party to the arrangement.

Practically, this means that there are no tax consequences arising from the transactions between the financial institution and the SPV, while the SPV remains qualifying. Also, all transactions between the SPV and third parties are included in the financial institution's tax return.

The restriction of the current rules to securitisations by financial institutions is a consequence of the rules being introduced to facilitate financial institutions accessing the RBNZ's liquidity support during the global financial crisis. Wider application of the rules was not necessary for that purpose. However, there is no particular policy reason why the rules should not apply more broadly to corporate securitisations.

2.3 What is the policy problem or opportunity?

There is a concern that the current tax rules may not allow for tax neutrality for the SPV to be achieved, and so may be discouraging securitisations. The current rules can also trigger a tax liability on transfer of the receivables into the SPV. While potentially less serious than SPV taxation, this issue can create a large administrative burden, as all the receivables need to be valued for tax purposes. The concern in relation to the tax treatment of securitisations by businesses that are not financial institutions arises as a result of the application of the general trust rules and the financial arrangements rules.

Trusts can derive non-cash income, and there is an issue about whether this can be distributed as beneficiary income (in which case the beneficiary pays the tax on the income) or whether it must remain as trustee income (in which case the trustee pays the tax). In 2012, Inland Revenue published Interpretation Statement *IS 12/02 "Income Tax – whether income deemed to arise under tax law, but not trust law, can give rise to beneficiary income"*. The Interpretation Statement concluded that non-cash income can only be distributed to a beneficiary where there is a cash amount available for distribution. This can be an issue for SPVs, as securitisations are typically structured so the SPV has no cash income. This means that any non-cash income derived could result in a tax liability at the trust level.

There is also an issue arising because of the application of the financial arrangements rules, which require a "base price adjustment" to be carried out when any financial arrangement is transferred, which can trigger a tax liability. Although potentially less serious than SPV taxation, this issue can create a large compliance burden and result in compliance costs for taxpayers (the Originator and the SPV), as all the receivables need to be valued for tax purposes.

New Zealand has a small but active securitisation market, although there has been reduced activity following the global financial crisis. If the problem is not addressed, then the current tax settings may discourage some businesses from realising the commercial benefits of securitisations.

2.4 Are there any constraints on the scope for decision making?

There are no particular constraints on the scope for decision making.

2.5 What do stakeholders think?

As noted above, this issue was originally raised by the private sector, with the suggestion that the current securitisation regime in the Income Tax Act be extended to other corporate securitisations to remove the tax disincentive to undertaking securitisations.

Inland Revenue has undertaken targeted consultation on the proposal with interested parties. Given that the proposed amendments would only be relevant to those involved in New Zealand's securitisation market, officials considered that targeted consultation was sufficient. We consulted, by letter and subsequent discussions, with:

- Chartered Accountants Australia and New Zealand;
- the New Zealand Law Society (the NZLS);
- the Corporate Taxpayers Group;
- the Financial Services Council of New Zealand;
- the Financial Services Federation;
- Chapman Tripp on behalf of the Trustee Corporations Association and New Zealand Guardian Trust;
- EY;
- Bell Gully (who received the consultation proposed through the NZLS); and
- PwC.

Submitters were supportive of the proposal to extend the securitisation regime beyond financial institutions to other corporate securitisations. Submitters commented that widening the scope of the regime in this way would ensure a tax neutral outcome for securitisations undertaken by corporates that are not financial institutions. The issues raised at consultation are discussed in section 3 below.

Section 3: Options identification

3.1 What options are available to address the problem?

Option 1 (status quo)

Option 1 is to retain the status quo. Under the status quo, the tax settings may discourage some businesses from realising the commercial benefits of securitisations, as these arrangements can have higher tax costs and compliance costs than other funding arrangements.

Option 2 (extension of current rules)

Option 2 is to extend the current securitisation regime (in sections HR 9 to HR 10) beyond financial institutions to other corporate securitisations.

Option 3 (extension of current rules with requirement of recourse to the Originator)

Option 3 is to extend the current securitisation regime beyond financial institutions to other corporate securitisations, but with an additional requirement of the lenders having recourse to the Originator.

Arguably there is a potential risk that just extending the current rules (option two) could provide opportunities for the rules to be used to avoid tax on what is in substance a true sale to a third party.

Introducing an additional requirement (for non-financial institution securitisations) of recourse to the Originator is one possible way of reducing the risk of the provisions being used to avoid the tax consequences of a true sale to a third party. However, it would seem that this risk would be mitigated by the requirement in the current provisions that the financial arrangements (the receivables) held by the SPV are treated as held by the Originator in its consolidated accounts under IFRS.

Option 4 (extension of current rules with additional modifications)

Option 4 is to extend the current securitisation regime beyond financial institutions to other corporate securitisations, but with a number of modifications, as suggested by submitters during consultation (discussed further in section 5, below), namely:

- The regime could be extended in scope for financial institutions, beyond the types of securitisations currently covered (those involving residential mortgage-backed securities and covered bond programmes). The regime would apply more broadly for non-financial institutions, so it makes sense for financial institutions to also be able to benefit from the regime for other securitisations they may undertake.
- The regime could be extended to cover securitisations involving assets/receivables other than financial arrangements. For example, it is common for trade receivables and operating leases, which are excepted financial arrangements, to be securitised.
- The requirement for the securitised assets to be recognised in the Originator's consolidated IFRS financial statements could be amended so that recognition in the consolidated IFRS financial statements of a company in the same group would suffice.
- The regime should be elective, given that it removes a tax barrier. This would ensure that existing arrangements are not adversely affected if they have been structured to achieve a different result than what would arise under the regime.

3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The generic tax policy process (GTPP) includes a framework for assessing key policy elements and trade-offs of proposals. This framework is consistent with the Government's vision for the tax and social policy system, and is captured by the following criteria:

- *Efficiency and neutrality* – the tax system should bias economic decisions as little as possible;
- *Fairness and equity* – similar taxpayers in similar circumstances should be treated in a similar way;
- *Efficiency of compliance* – compliance costs for taxpayers should be minimised as far as possible;
- *Efficiency of administration* – administrative costs for Inland Revenue should be minimised as far as possible.

Efficiency and fairness are the most important criteria. It is generally worth trading-off increased compliance costs or administration costs for gains in these two criteria.

3.3 What other options have been ruled out of scope, or not considered, and why?

No other options have been ruled out of scope.

Section 4: Impact Analysis

Marginal impact: How does each of the options identified at section 3.1 compare with the counterfactual, under each of the criteria set out in section 3.2?

	Option 1 (status quo)	**Option 2 (extension of current rules)**	**Option 3 (extension of current rules with requirement of recourse to the Originator)**	**Option 4 (extension of current rules with additional modifications)**
Equity (fairness)	**0**	+ Taxes securitisations more fairly compared with other fund raising.	+ Taxes securitisations more fairly compared with other fund raising.	+ Taxes securitisations more fairly compared with other fund raising.
Economic (including efficiency)	**0**	+ Removes a tax disincentive to undertaking securitisations. More efficient, as removes need to recognise a transfer that does not have economic consequences.	+ Removes a tax disincentive to undertaking securitisations. However, narrows the scope of the rules, so reduces the potential efficiency and economic gains.	++ Removes a tax disincentive to undertaking securitisations. More efficient, as removes need to recognise a transfer that does not have economic consequences. Broadening of scope means the benefits of securitisations can be enjoyed more broadly.
Administrative	**0**	**0** No significant change in costs for Inland Revenue.	**0** No significant change in costs for Inland Revenue.	**0** No significant change in costs for Inland Revenue.
Compliance	**0**	++ Significantly reduces compliance costs for securitisers, as they will not have to have valuations of the receivables.	+ Significantly reduces compliance costs for securitisers, as they will not have to have valuations of the receivables. But narrowed scope means compliance savings will be enjoyed by fewer taxpayers.	++ Significantly reduces compliance costs for securitisers, as they will not have to have valuations of the receivables.. And by broadening scope, compliance savings will be enjoyed by more taxpayers.
Overall assessment	**0**	+	+	++

Key:

++ much better than doing nothing/the status quo
+ better than doing nothing/the status quo
0 about the same as doing nothing/the status quo
- worse than doing nothing/the status quo
- - much worse than doing nothing/the status quo

Section 5: Conclusions

5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?

We consider that option 4 is the best option to ensure that the commercial benefits of securitisations are achieved while maintaining the integrity of the tax rules. As noted, this option would extend the current securitisation regime beyond financial institutions to other corporate securitisations, but with a number of modifications (discussed below). The suggested modifications arose out of feedback received during consultation, so officials consider that these modifications would best ensure that the objectives of the proposal are met, while ensuring the regime does not provide tax incentives for securitisations, or facilitate tax avoidance.

Option 1, retaining the status quo, would mean that the tax settings would continue to discourage some businesses from realising the commercial benefits of securitisations, which can have higher tax costs and compliance costs than other funding arrangements. The Government wants to remove a tax disincentive to undertaking securitisations, given the commercial benefits they provide. The status quo is not supported.

Option 2 is to extend the current securitisation regime to non-financial institutions. The extended regime would apply to a broader class of securitisable assets than those currently covered for financial institutions, as the type of securitisations currently within the scope of the regime (residential mortgage-backed securities and covered bond programmes) are not typically undertaken by non-financial institutions. However, the current consolidation requirement may be too restrictive for securitisations other than those currently covered. The current consolidation requirement is that the securitised assets are treated as held by the Originator in its consolidated financial statements under IFRS. However, as discussed further below, submitters have commented that it is often the case in corporate securitisations that the securitised assets are de-recognised by the Originator but are recognised in the consolidated financial statements of another group company. Option 2 would be somewhat limited in terms of the securitisations it would apply to, which means the tax settings would continue to discourage some securitisations. As a consequence, option 2 is not supported.

Option 3 is to extend the current securitisation regime to non-financial institutions to a broader class of securitisable assets than those currently covered for financial institutions, but with the additional requirement of the lenders (the investors in the SPV) having recourse to the Originator. The possibility of an additional requirement of recourse to the Originator was suggested as an option in consultation to ensure that the provisions could not be used to avoid tax on what is in substance a true sale of financial assets to a third party. However, we consider that a requirement of recourse to the Originator is less preferable to other options for mitigating that risk. In particular, as discussed further below, the additional requirement of recourse to the Originator would be inconsistent with the commercial objective of ensuring that the SPV is bankruptcy remote from the Originator, and so would undermine the benefits of a securitisation. Submitters commented that from a practical point of view the Originator would not want to guarantee the SPV's obligations, and would just borrow itself if it were necessary for the investors to have recourse to the Originator. This would mean that from a practical point of view option 3 might be little utilised, which is contrary to the objective of removing a tax disincentive so that the benefits of securitisations can be enjoyed more broadly. Therefore option 3 is not supported.

The modifications to the proposed extended securitisations regime under the preferred option (option 4), and the reasons for them, are discussed below.

Extension to assets / receivables that are not financial arrangements

The current regime is limited to certain financial arrangements – New Zealand residential mortgages or loans secured by such mortgages.

Submitters noted that it is common for excepted financial arrangements such as trade receivables and operating leases to be securitised, and submitted that the regime should be extended to include the securitisation of such assets.

The intention of this proposed amendment is to extend the current securitisation regime so that New Zealand businesses with large books of trade credits or other receivables can securitise those assets in a tax neutral way. It was always intended that the amended securitisation regime (whether option 2, option 3 or option 4) should apply to a broader class of securitisable assets than those currently covered for financial institutions. These submissions are, therefore, consistent with the proposed amendments.

Extension to all securitisations by financial institutions

The current regime applies only to certain types of securitisations undertaken by financial institutions. Submitters have commented that if the regime is extended to non-financial institutions (who would typically not undertake the types of securitisations that are currently within the scope of the regime), then it should also be extended to other types of securitisations undertaken by financial institutions.

Officials agree with this submission, and consider that financial institutions should be able to use the regime for the same transactions as other corporates, in addition to the residential mortgage-back securities and covered bond programme transactions currently covered.

Amended consolidation requirement

The current rules require that the securitised assets are treated as held by the Originator in its consolidated financial statements under IFRS. Submitters have observed that this requirement is suitable for residential mortgage-backed securities and covered bond programmes, but might be too restrictive for other securitisations.

Submitters have commented that it is often the case in corporate securitisations that the securitised assets are de-recognised by the Originator but are recognised in the consolidated financial statements of another group company. It has been submitted that the consolidation requirement should be amended to accommodate such situations, and that if the group entity that recognises the securitised assets in its consolidated financial statements is separate from the Originator, the transfer of the receivables by the Originator should also be disregarded.

One submitter suggested that it should be sufficient for the consolidation requirement if the SPV[1] is included in the IFRS consolidated accounts of the Originator, or a group that includes the Originator, the Originator's parent company, or the beneficiary of the SPV.

Officials agree with the submitters who suggested that the consolidation requirement could be amended so that it is sufficient if the securitised assets are recognised in the consolidated financial statements of the Originator or another group company. This would mean the benefits of the regime can apply more broadly. In addition, officials consider that such an amended consolidation requirement would be sufficient to ensure that the provisions do not apply where there is a true sale to a third party.

Officials do not think it would be appropriate for it to be sufficient that the SPV or the securitised assets are included in the consolidated financial statements of the beneficiary of the SPV, if the beneficiary is not in the same group. It is considered that this could open up the possibility of the

[1] As opposed to the securitised assets.

provisions being used in a situation where there is in fact a true sale of the assets to a third party.

Requirement of recourse to the Originator

One of the proposed options, raised as a possibility as part of consultation, was for the extension of sections HR 9 to HR 10, with the additional requirement of the lenders (the investors in the SPV) having recourse to the Originator. This was suggested as a way of ensuring that the provisions could not be used to avoid tax on what is in substance a true sale of financial assets to a third party.

Submitters commented that the additional requirement of recourse to the Originator would be inconsistent with the commercial objective of ensuring that the SPV is bankruptcy remote from the Originator. Submitters commented that this would undermine the benefits of a securitisation, and from a practical point of view the Originator would not want to guarantee the SPV's obligations, and would just borrow itself if it were necessary for the investors to have recourse to the Originator.

Officials agree. However, as noted in section 4, officials consider that the risk that the regime could be used to avoid tax on what is in substance a true sale of the assets to a third party could be appropriately mitigated by the requirement that the receivables held by the SPV be treated as held by the Originator or another group company in its consolidated accounts under IFRS. As such, it is not considered necessary to include an additional requirement of recourse to the Originator.

Elective regime / application only to future securitisations

Submitters suggested that the proposed extended regime should be elective, or otherwise apply only to future securitisations, to ensure that existing arrangements are not adversely impacted if they have been structured to achieve a different result than that arising under the extended regime.

Officials agree with this submission. The regime is less burdensome than the current rules – ensuring tax neutrality for securitisations, so there is no issue with the regime being applied electively.

The current regime is not framed as being elective. However, there is no particular policy reason why it should not be, given that it removes a tax barrier. Officials therefore recommend that the regime be explicitly elective for financial institutions and other corporates alike.

Explicit tax neutrality

One submitter commented that the legislation, or associated commentary, should make it clear that transactions within the scope of the extended regime do not give rise to tax consequences (such as a disposal for tax purposes).

There was concern that the recent debt remission reforms indicate that loans made by the sole shareholder of a look-through company (LTC) to the LTC are not disregarded and that the shareholder would be required to account for the tax consequences of the loan essentially as both a deemed lender and borrower. It was suggested that this might indicate that the Originator in a securitisation would be treated as both disposing of and acquiring the securitised assets, given that section HR 9 shares similar statutory language to the transparency provisions in the LTC rules. It was also noted that there is uncertainty around the tax effects of a contribution of property to an LTC or partnership by a shareholder/partner. The submitter commented that general transparency principles would suggest that no disposal occurs, however alternative views had been put forward, and it was noted that this issue would be of particular importance in terms of the proposed expanded securitisation regime.

Officials will ensure that the legislation and associated commentary make it clear that the intention is for there to be no tax consequences for transactions within the scope of the regime.

5.2 Summary table of costs and benefits of the preferred approach

Affected parties *(identify)*	**Comment**: *nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks*	**Impact** *$m present value, for monetised impacts; high, medium or low for non-monetised impacts*	**Evidence certainty** *(High, medium or low)*

Additional costs of proposed approach, compared to taking no action			
Inland Revenue	Cost of legislative changes / process changes. This is a one-off cost.	Low	High
Wider government	Cost of legislative changes / process. This is a one-off cost.	Low	High
Total Monetised Cost	No monetised costs identified.		
Non-monetised costs	One-off cost of legislative amendment.	Low	High

Expected benefits of proposed approach, compared to taking no action			
Businesses wishing to undertake securitisations	Removes a tax disincentive to undertaking securitisations as a funding mechanism, so the commercial benefits of securitisations can be enjoyed by broadly. This is an ongoing benefit. Reduces compliance costs. This is an ongoing benefit.	Medium Medium	Medium Medium
Total Monetised Benefit	No monetised benefits identified.		
Non-monetised benefits	Removes tax disincentives and reduces compliance costs.	Medium	Medium

5.3 What other impacts is this approach likely to have?

As noted in Section 1, the extent to which tax is currently paid in respect of securitisation transactions is not known, so the potential revenue cost is not able to be quantified. However, we understand that currently securitisations are typically structured to prevent tax arising where possible, so any revenue cost is expected to be minimal. Further, removing a tax barrier would be expected to result in more businesses being able to enjoy the commercial benefits of securitisations, and the tax neutrality of those transactions would be no different than if the securitisation had not occurred.

In terms of the fiscal impacts of all of the options considered, as noted in Section 3, arguably there is a potential risk that expanding the regime could result in the rules being used to avoid tax on what is in substance a true sale to a third party. Introducing an additional requirement (for non-financial institution securitisations) of recourse to the Originator is one possible way of reducing the risk of the provisions being used to avoid the tax consequences of a true sale to a third party (Option 3). However, it would seem that this risk could be adequately mitigated by the requirement in the current provisions that the receivables held by the SPV are treated as held by the Originator in its consolidated accounts under IFRS (Option 2). Inland Revenue considers that the risk would be similarly mitigated by a requirement that the securitised assets are treated as held by the Originator <u>or another company in the group</u> in its consolidated accounts under IFRS (Option 4).

5.4 Is the preferred option compatible with the Government's 'Expectations for the design of regulatory systems'?

Yes.

Section 6: Implementation and operation

6.1 How will the new arrangements work in practice?

If approved, these proposals, which require legislative change, would be included in the next available taxation bill after the general election and would apply from the 2018/2019 income year.

Given that the ability to use the regime for corporate securitisations would be optional, there is no need for any transitional arrangements. Taxpayers could simply file their returns on the basis of their decision to use the regime or not. We do not see any need for an election to use the regime to be specifically brought to Inland Revenue's attention.

When introduced to Parliament, commentary would be released explaining the amendments, and further explanation of their effect would be contained in a Tax Information Bulletin, which would be released shortly after the bill receives Royal assent.

6.2 What are the implementation risks?

The proposals would have no system implications for Inland Revenue, and implementation would not incur additional administrative costs.

No issues concerning implementation have been raised through consultation.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

In general, Inland Revenue's monitoring, evaluation and review of new legislation takes place under the Generic Tax Policy Process (GTPP). The GTPP is a multi-stage tax policy process that has been used to design tax policy in New Zealand since 1995.

7.2 When and how will the new arrangements be reviewed?

The final stage in the GTPP is the implementation and review stage, which involves post-implementation review of the legislation, and the identification of any remedial issues. Opportunities for external consultation are also built into this stage. Inland Revenue's Policy & Strategy unit monitors the first year of operation of new legislation. If there is a need to make remedial amendments to the new rules these will be prioritised for inclusion on the Tax Policy Work Programme, and the proposal would go through the GTPP.