

MAKING TAX SIMPLER

A GOVERNMENT GREEN PAPER ON

TAX ADMINISTRATION



Hon Bill English
MINISTER OF FINANCE

Hon Todd McClay
MINISTER OF REVENUE

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

First published in March 2015 by Policy and Strategy, Inland Revenue, PO Box 2198, Wellington 6140.

Making Tax Simpler: A Government Green Paper on Tax Administration

ISBN 978-0-478-42408-9



FOREWORD

FROM THE MINISTERS

New Zealand has a very good tax and social policy delivery system.

Taxes are required to finance the government services that New Zealanders expect. They are an important part of a good and inclusive society. At the same time they impose costs which should be kept to a minimum. It is also important that taxes are fair and seen to be fair.

New Zealand came through the recession in good shape and the strength of the tax system played an important part in that. We need to ensure that we continue to be well placed to weather any future economic storms on the domestic or international fronts.

Our tax system works on the principle of voluntary compliance, and the vast majority of people do the right thing and comply with their tax obligations. That's largely because our tax system is reasonably fair and coherent.

A good tax system is good tax policy supported by good administration of tax laws. New Zealand is served well by its broad-based, low-rate tax settings. Our broad bases help

make our tax system less distorting. Our relatively simple and coherent tax system also helps keep costs to taxpayers in complying with the tax system and costs to the government in administering the tax system, relatively low.

But the tax administration system reflects incremental decisions that have been made over many years. We can and must do better.

We want to cut the costs to taxpayers of complying with the tax system and to the government of administering the tax system without making things more distorting.

Some people are unsure about how best to comply with the tax system and we want to make it easier for them.

We want businesses to be able to focus on running their businesses with tax as a secondary consideration. We want it to be more difficult for people to fall into overdue debt and easier for them to manage their tax payments. We want people and resources at Inland Revenue to be focused on outcomes rather than low-

value tasks. We want to boost overall levels of compliance so everyone is paying their fair share of tax. Tax obligations should be easy to comply with and hard to get wrong. Greater use of electronic and internet-based technology is a key enabler to achieve these objectives.

Achieving high levels of compliance will be of greater and greater importance in the future as New Zealand's population ages.

In making these changes, we will have to manage very carefully the cumulative impact on businesses and other customers.

This *Green paper* sets out the Government's initial thinking about a possible future for our tax administration.

We want your thoughts because it's your tax system too. Inland Revenue is the government department that New Zealanders deal with most often, not just on tax matters, but for a range of other services as well. Inland Revenue has responsibility for administering Child Support, Student Loan repayments, Working for Families and KiwiSaver. Furthermore a number of other agencies, such as ACC and MSD, use tax-related information to deliver their services.

Whether the tax system benefits you indirectly through taxpayer-funded services or through its contribution to the economy, or you benefit directly through social policies such as Working for Families, today's tax system is a part of all of our lives. We

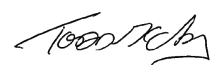
all benefit from its smooth running so it's important that we all consider for ourselves what kind of tax administration we want.

We want your views on whether the ideas outlined in this *Green paper* are heading in the right direction and that we are focused on the right things, before more work is done. It's important for all New Zealanders to have their say because this is an opportunity to help set the priorities for change, and shape the way we administer the tax system.

Over the next few years, you'll see detailed proposals about different aspects of tax administration. The programme of work is very ambitious. We look forward to receiving your views.






Hon Bill English
MINISTER OF FINANCE



Hon Todd McClay
MINISTER OF REVENUE

CONTENTS

	AT A GLANCE	7
	What customers think	7
	Response to feedback	8
	How to use this document	10
	How to make a submission	10
	What the potential changes could mean	11
	WHY FOCUS ON TAX ADMINISTRATION	12
	Background	12
	Modernising our tax administration	15
	We need your feedback	18
	KEY ELEMENTS OF POTENTIAL CHANGES	20
	The future for business processes – PAYE	21
	The future for business tax	25
	Withholding taxes from capital income	30
	Individuals	32
	Social policy	34
	The policy and legislative framework for tax administration	35
	Next steps	37



APPENDICES

Appendix 1 – Policy considerations	39
Appendix 2 – The future for business processes – PAYE	45
Appendix 3 – Business tax	52
Appendix 4 – Withholding taxes on capital income	59
Appendix 5 – Individuals	61
Appendix 6 – Social policy	64
Appendix 7 – The policy and legislative frameworks for tax administration	67



AT A GLANCE

The Government intends to modernise New Zealand's tax administration. The world is changing, with huge improvements in ways of doing business. What was acceptable 10 or 20 years ago no longer meets the demands of customers today.

Inland Revenue not only collects revenue but also administers a number of social policy programmes.

The tax system is important for New Zealand. It helps fund a wide range of government functions such as healthcare, welfare, education, infrastructure, police, border control, emergency response, and many other services.

To protect the Government's ability to keep providing these services, it is important that our tax system keeps pace with change. The tax system should be simple and make it easy for people to get right, but difficult to get wrong. It should be fair and support high levels of overall compliance. Improvements should ensure that businesses spend less time on tax and more time on running their business, supporting Government's wider goal to build a more competitive

and productive economy. Costs to customers of complying and to the Government of administering the tax system, should be kept to a minimum.

This document aims to introduce you to the broad direction the Government intends to take to improve the administration of the tax system. Your views on that direction are important. The ideas in this *Green paper* are in the early stages of development and will be subject to more detailed consultation in the coming years.

WHAT CUSTOMERS THINK

In June 2014, in conjunction with the Treasury and Victoria University, Inland Revenue hosted a conference entitled, *Tax Administration for the 21st century*.

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.

The main points made by attendees at the conference were:

- giving people the ability to self-manage their tax affairs with more speed and predictability but with access to the right staff at the right time with the necessary skills to provide certainty to taxpayers. In other words, Inland Revenue should use new technology to allow more focus on high-value services to taxpayers, to help them manage their tax affairs;
- the need to consider policy and legislative settings (and not merely current business processes) to rethink how tax administration can be improved. It is more than just digitising existing processes and replacing an aging information technology system. Anything within the tax administration system should be up for consideration;
- the importance of involving businesses, other customers, third parties and advisors in the design of the rules and processes that underpin tax administration. The tax administration system has to work for all New Zealanders;
- the cost of change needs to be closely considered and managed to ensure that it is not merely shifting costs from Inland Revenue to businesses and other customers or vice versa. There has to be an overall net benefit to society through a real reduction of compliance and administrative costs; and

- ensuring that there is continued maintenance of the tax system while modernising tax administration;

RESPONSE TO FEEDBACK

After reviewing feedback, the Government is proposing to modernise the way Inland Revenue administers the tax system over a period of years, with particular focus on making better use of digital services for transactions with Inland Revenue. Over the coming years the main emphasis will likely be on the improvements set out on the next page.

IMPROVING TAX ADMINISTRATION FOR:

Employers and businesses by

- streamlining the collection of PAYE and GST and other withholding taxes such as resident withholding tax and related information to integrate these obligations into business processes;
- investigating options for simplifying the calculation of provisional tax;
- helping smaller businesses get their tax affairs and systems correct, right from the start; and
- Inland Revenue being able to focus more resources on high-value tasks, such as providing faster and more predictable views on the application of tax laws.

What it could mean for employers and businesses

- Tax compliance costs would be reduced, in particular for small and medium enterprises.
- Speed and predictability for businesses in their tax affairs, making compliance easier.
- Making tax obligations part of the normal day-to-day business processes, making it harder to get things wrong.
- Simplified calculations for provisional tax – based more on real-time information (for example, when using approved accounting software) – together with payment options that better reflect taxpayers' cash flows.

Find out more on pages 21 to 29

Individuals by

- providing online income tax statements already filled out with your income details (pre-populating) so for the majority all that would be required would be to check and confirm income details, or correct them; and
- more effective use of technology to better manage both overpayments (refunds) and underpayments (debts) of tax.

What it could mean for individuals

- You would be able to quickly and easily manage your tax obligations online.
- Refunds would be made quickly and automatically based on better use of data.
- Any outstanding tax debts would be recovered automatically over time, where appropriate.

Find out more on page 32

Social policy customers by

- designing processes that work for the customer and are fit for purpose;
- using pre-populated information that Inland Revenue or government already holds; and
- providing for timely payments on a more real-time basis, resulting in certainty for individuals and families.

What it could mean for you

- Faster, more accurate information.
- Less chance of going into debt.
- Correct entitlements, reflecting your changing circumstances.

Find out more on page 34

HOW TO USE THIS DOCUMENT

The Government invites submissions on whether the potential changes indicated would likely achieve the intended outcomes for customers. This section provided a very brief overview of the issues and the policy ideas. Your views are welcome on any aspect of these potential changes. You can:

- make a submission based on what has been covered in this section; or
- go directly to the section of this document that interests you to read further detail then make your submission; or
- read the entire document and then make a submission.

HOW TO MAKE A SUBMISSION

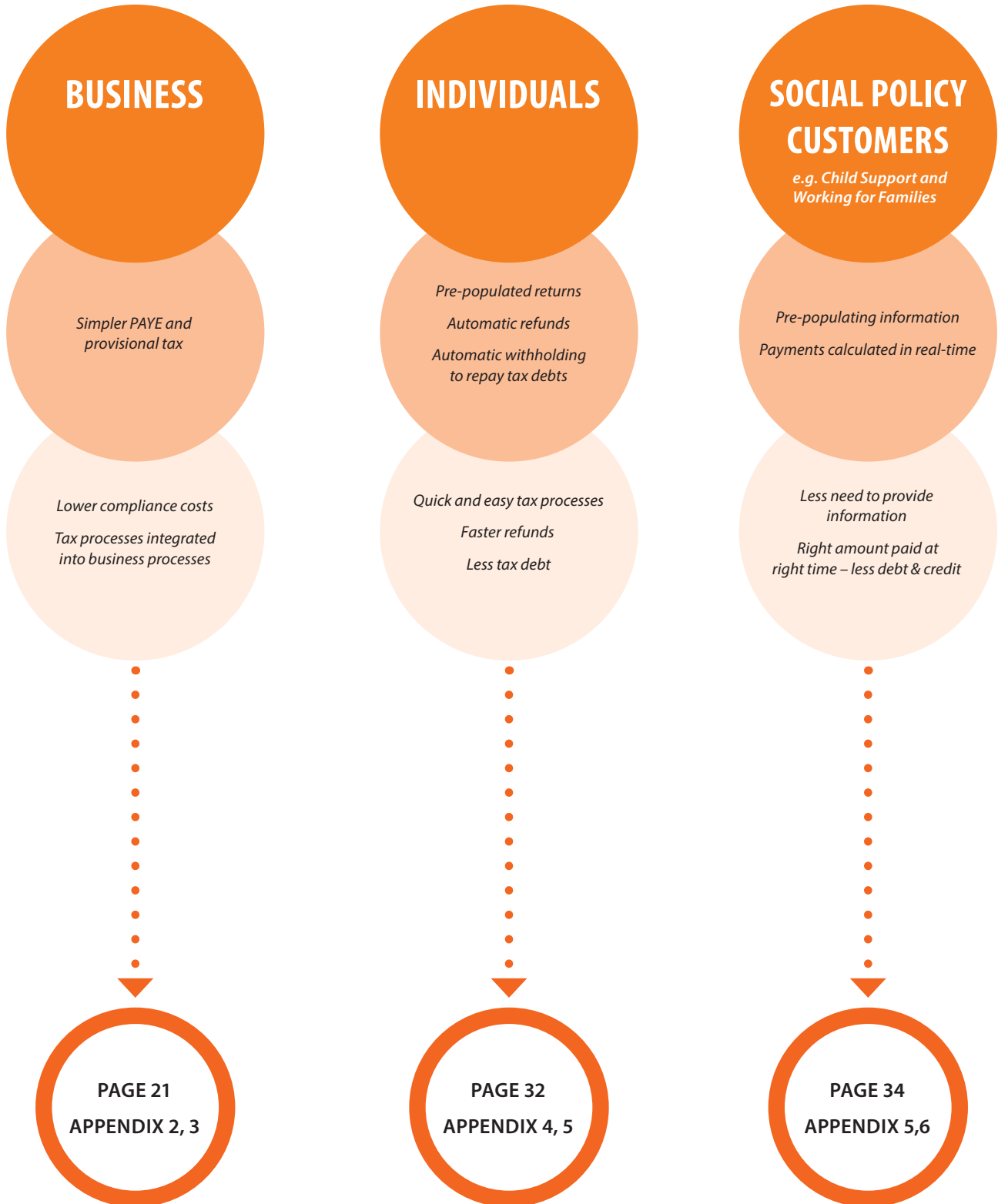
You can make a submission:

- Online at:
makingtaxsimpler.ird.govt.nz
- By email to:
policy.webmaster@ird.govt.nz,
please put "Making Tax Simpler" in the subject line.
- By post, with submissions addressed to:
***Making Tax Simpler
C/- Deputy Commissioner,
Policy and Strategy
Inland Revenue Department
PO Box 2198
Wellington 6140***

The closing date for submissions is **29 May 2015**.

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

**WHAT THE POTENTIAL CHANGES
COULD MEAN FOR YOU**





CHAPTER 1

WHY FOCUS ON TAX ADMINISTRATION?

BACKGROUND

A priority of the Government is an efficient public service. This includes a responsibility to all New Zealanders to be efficient in collecting taxes and paying entitlements. Inland Revenue must deliver on government priorities. It should be a world-class revenue organisation, recognised for service and excellence. This means it must:

- be agile, effective and efficient (for example, by reducing compliance and administration costs);
- enable taxpayers, wherever possible, to self-manage with speed and certainty;¹
- enable the Government to make timely and cost-effective policy changes; and
- work with other government agencies to more efficiently deliver services.

New Zealand's tax system

Having a good overall tax system means having both good tax policies and good administrative systems.

These elements need to go hand in hand. The tax system includes social policies administered by Inland Revenue; Working for Families, Child Support, Student Loan repayments, KiwiSaver and Paid Parental Leave.

The tax system should ensure that it is easy for customers to comply with their obligations. The ease with which customers can comply has an effect on overall compliance and, together with the perception of fairness, is a crucial factor in assessing the overall effectiveness of a tax system.

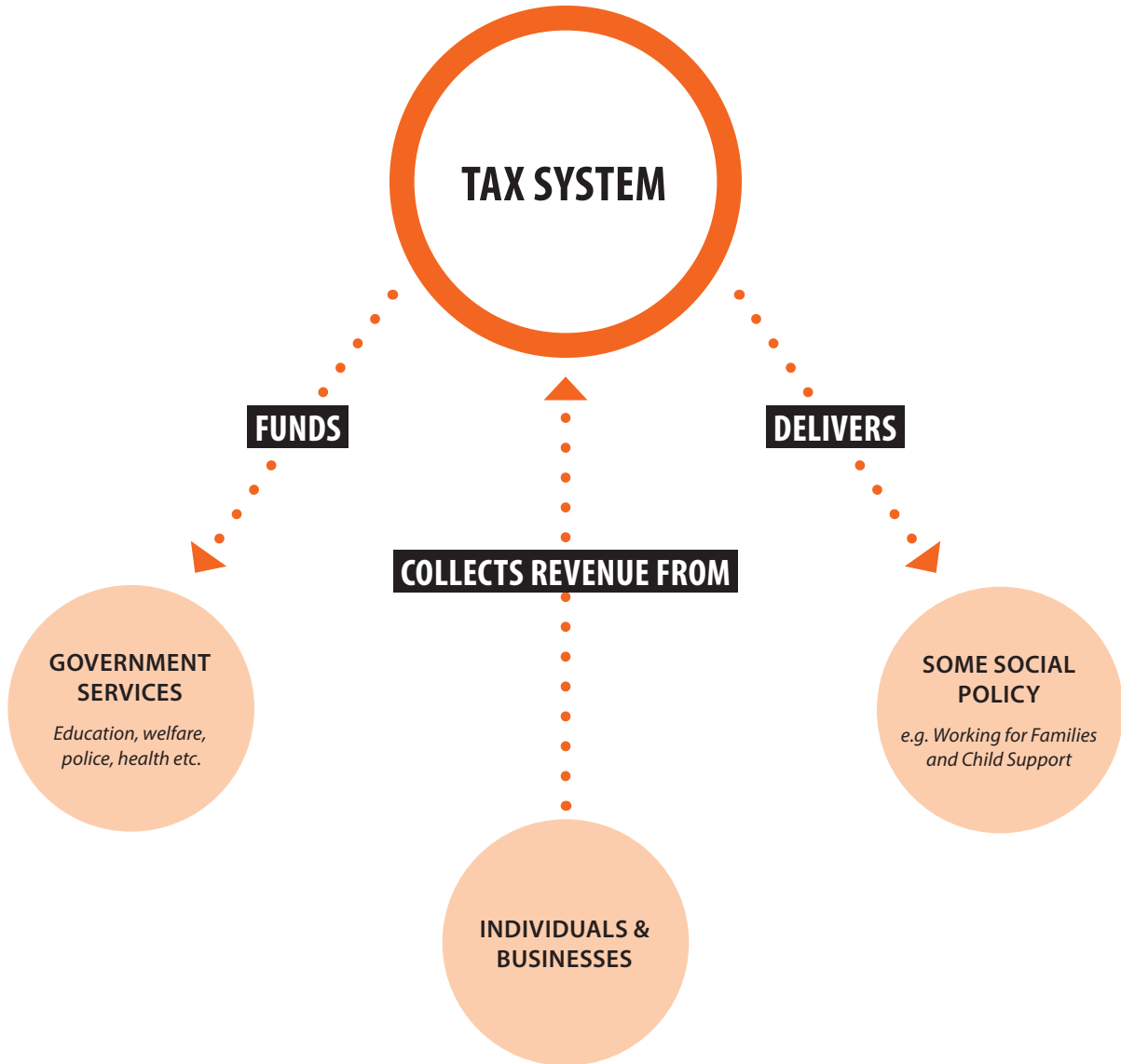
New Zealand's tax policies

The aim of New Zealand's tax policies is to tax as broad a range of income and expenditure as practicable at rates that are as low as possible.

Known as the broad-base, low-rate (BBLR) approach, this provides stable revenue and promotes efficiency, equity and fairness. It helps support economic efficiency and growth.

It also helps keep administration and compliance costs low. It is a much more coherent way of levying tax than in most OECD countries.

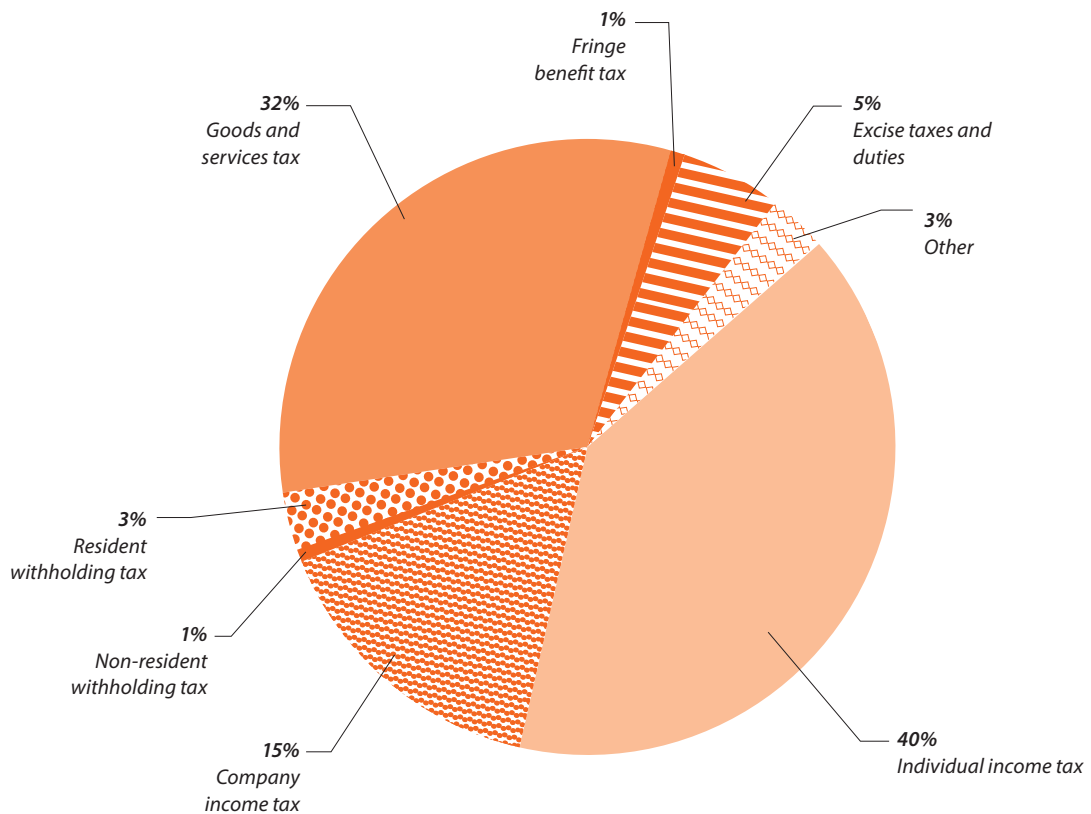
WHAT THE TAX SYSTEM DOES



GOALS OF THE TAX SYSTEM



**COMPOSITION OF TAX REVENUE
YEAR ENDED JUNE 2014**



New Zealand's main tax bases

The chart on page 14 shows the composition of tax revenues in New Zealand. It highlights New Zealand's focus on just three main tax bases (personal income tax, company tax and GST).

All of these have broad coverage, allowing substantial amounts of tax to be collected at relatively modest tax rates, while avoiding the inefficient taxes found in many other countries.

Endorsement of New Zealand's tax policies

New Zealand's tax policies work well and are held in high regard internationally.² A number of independent domestic reviews of the tax system have also been undertaken in recent years, and have fundamentally supported New Zealand's underlying tax system and BBLR framework.³ A high burden of proof is needed for any reforms which move away from BBLR principles.

Future challenges

There are long-term future fiscal pressures that future Governments will need to consider. An ageing population coupled with the increasing demand for world class healthcare and other services, will contribute to these pressures.

We should do everything possible to ensure high levels of compliance to manage these fiscal pressures.

Boosting levels of compliance is an important part of modernising the tax administration.

MODERNISING OUR TAX ADMINISTRATION

The way our tax administration currently runs reflects a series of changes that have been made over the years. Each change has been sensible but not necessarily in relation to the overall coherence of the system.

The Government has not, until now, stood back and had a fundamental look at how tax might best be administered if it were starting from scratch.

Problems with the current system include:

- Compliance and administration costs are too high.
- Some people find it difficult to fully comply.
- There is a lack of flexibility in accommodating future policy changes.
- Stakeholders have commented on a lack of speed and certainty (for example, taxpayer rulings and rectifying defects in legislation).
- There are difficulties for customers and advisors in accessing the right information at the right time.
- There are concerns about customers falling into debt and the difficulties they face in emerging from debt.

- The Government wants to see Inland Revenue providing better value for money. This is not just a matter of reducing administration costs but also ensuring that resources are focused on the highest value tasks.
- Information is often not provided in a way that represents value for money. This makes it difficult to identify key policy concerns and audit risks.
- While most customers voluntarily comply with the tax system, there are some that do not and it is important to continue to improve levels of overall compliance.
- Those who knowingly or unknowingly fail to comply or who otherwise “game the tax system” because of the ability to claim refunds without always paying outstanding tax, can create an unfairness in the tax system.

The Government's proposed modernisation and simplification of tax administration is far more than just updating a computer system. Rather, it is a chance to have a fundamental look at tax administration in New Zealand and see what changes need to be undertaken to meet the challenges of the 21st century.

This includes re-shaping the way Inland Revenue works with customers, and looking at possible changes to legislation including the Tax Administration Act 1994.

This has wider implications beyond Inland Revenue. The information Inland Revenue collects is already critical to the delivery of services by other agencies such as ACC. Consistent with Government’s drive for better public services, information sharing between government agencies is expected to increase to deliver more efficient outcomes for New Zealanders.⁴

It is therefore vital to establish the sort of tax administration services that promote high levels of compliance and deliver the benefits that taxpayers, their advisors, and users of social policy services actually want and need.

Key benefits

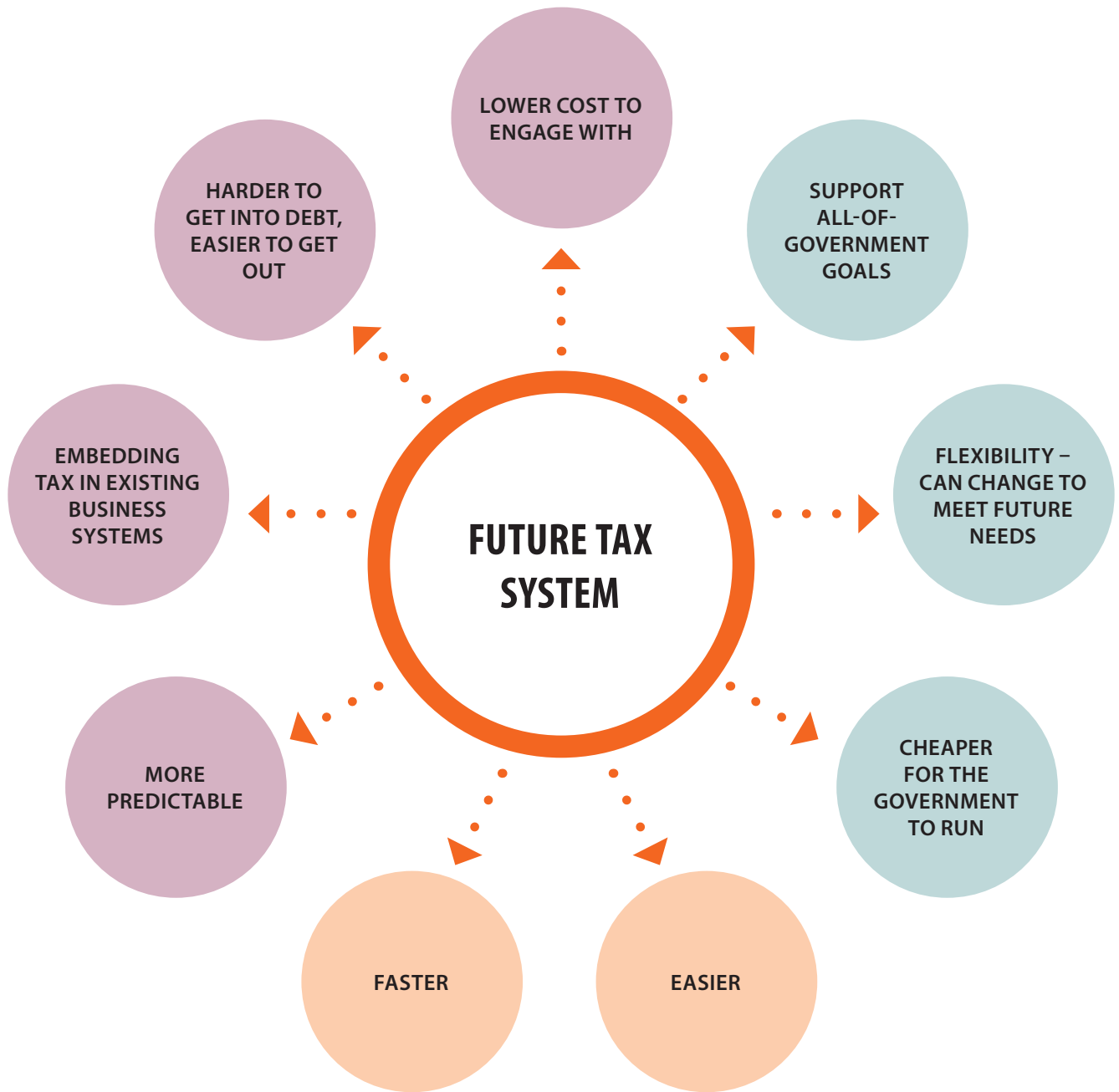
The potential changes discussed in this *Green paper*, when taken as a whole, should help to make the tax administration more customer-focused.




It should be easier for people to see their overall position, and to meet their tax and social policy obligations with greater speed and accuracy.

Predictability for customers should be increased by:

- providing easy digital access to customers’ accounts (and alternatives for those without such access);
- providing earlier and simpler transactions and responding to customers’ issues quickly and effectively;

BENEFITS OF A FUTURE TAX SYSTEM



-  for customers
-  for the Government
-  for both customers and government

- using a business's normal business processes and systems to meet tax obligations; and
- improving the collection, accuracy and timeliness of information to simplify and better tailor interactions.

It should be easier and less expensive for people to get it right and meet their obligations (and harder for them to get it wrong).

It should be harder for people to fall into debt in the first place, and also easier for them to correct if they do.

Compliance and administration costs should be reduced.

It should help ensure the on-going surety and integrity of the tax and social policy system.

A more effective tax administration would support broader 'all-of-government' goals and provide value for money for the Government.

It would provide sufficient information so that key policy concerns and audit risks can be identified easily.

A more effective tax administration would also provide flexibility to cater for future policy changes.

In short, Inland Revenue's processes and systems should be simple, and make it easy to get things right and hard to get things wrong, be quick and low-effort to use, provide more certainty, and should not require duplication of effort by customers or

associated third parties. They should also be flexible enough to move with technology developments.

This will not be an easy shift to make, or a quick one, but it is absolutely necessary.

If you would like to read more about policy considerations that frame New Zealand's tax administration, go to Appendix 1.

WE NEED YOUR FEEDBACK

The Government recognises that many of the opportunities for improvement will be best known by customers, third parties, advisors and the wider business community.

To that end, issuing this *Green paper* formally establishes the start of the consultation process on how to undertake the process of transforming New Zealand's tax administration services.

The Government invites submissions on whether the potential changes discussed in this *Green paper* would likely achieve the intended benefits for businesses and other customers.

The ideas in this *Green paper* are in the early stages of development, and will be subject to their own consultation processes over the coming years. However, even at this early stage, the Government is keen to get your feedback to test whether the general direction and indicative timing of any potential changes outlined in this *Green paper* are valid or not, and to identify any errors or omissions of scope.

KEY QUESTIONS FOR READERS

1 Would the potential changes discussed in this *Green paper* be broad enough to deliver significant improvements to New Zealand's tax administration systems?

2 Are the potential changes heading in the right direction, and have we focused on the right issues?

3 Are there any errors or key omissions? If so, what are they?

4 Is the proposed sequencing and order of the work sensible?

5 Does the current sequencing and order of work ensure the compliance costs associated with implementing change are minimised for business and other customers?

The Government recognises the cumulative impact on business and other customers resulting from possible changes discussed in this *Green paper*. This process will need to be managed to ensure businesses and other customers are not faced with multiple changes occurring throughout the implementation of different streams of work. This is to minimise the one-off compliance cost impact of changing business systems to accommodate changes.

¹ Certainty is defined in the Oxford English Dictionary as "the quality of being reliably true" or "a general air of confidence". In the context of this *Green paper*, the use of the word 'certainty' is not intended to convey any reference to legislative certainty in the context of the statutory time bar, rather it is to be used in its more general meaning.

² See, for example:
- Deloitte's *2014 Asia Pacific Tax Complexity Survey Report* (<http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-ap-2014-tax-complexity-survey.pdf>)
- Washington DC Tax Foundation's 2014 international tax competitiveness index (see <http://taxfoundation.org/article/2014-international-tax-competitiveness-index>)

³ For example the McLeod Review in 2001 and, more recently, the Tax Working Group in 2010

⁴ Such as through Result Area 9; New Zealand businesses have a one stop online shop for all government advice and support to run and grow their business. The Better Business Programme is a recognition that the public sector needs to take a more joined-up approach to achieve better outcomes for business customers and individuals.

CHAPTER 2

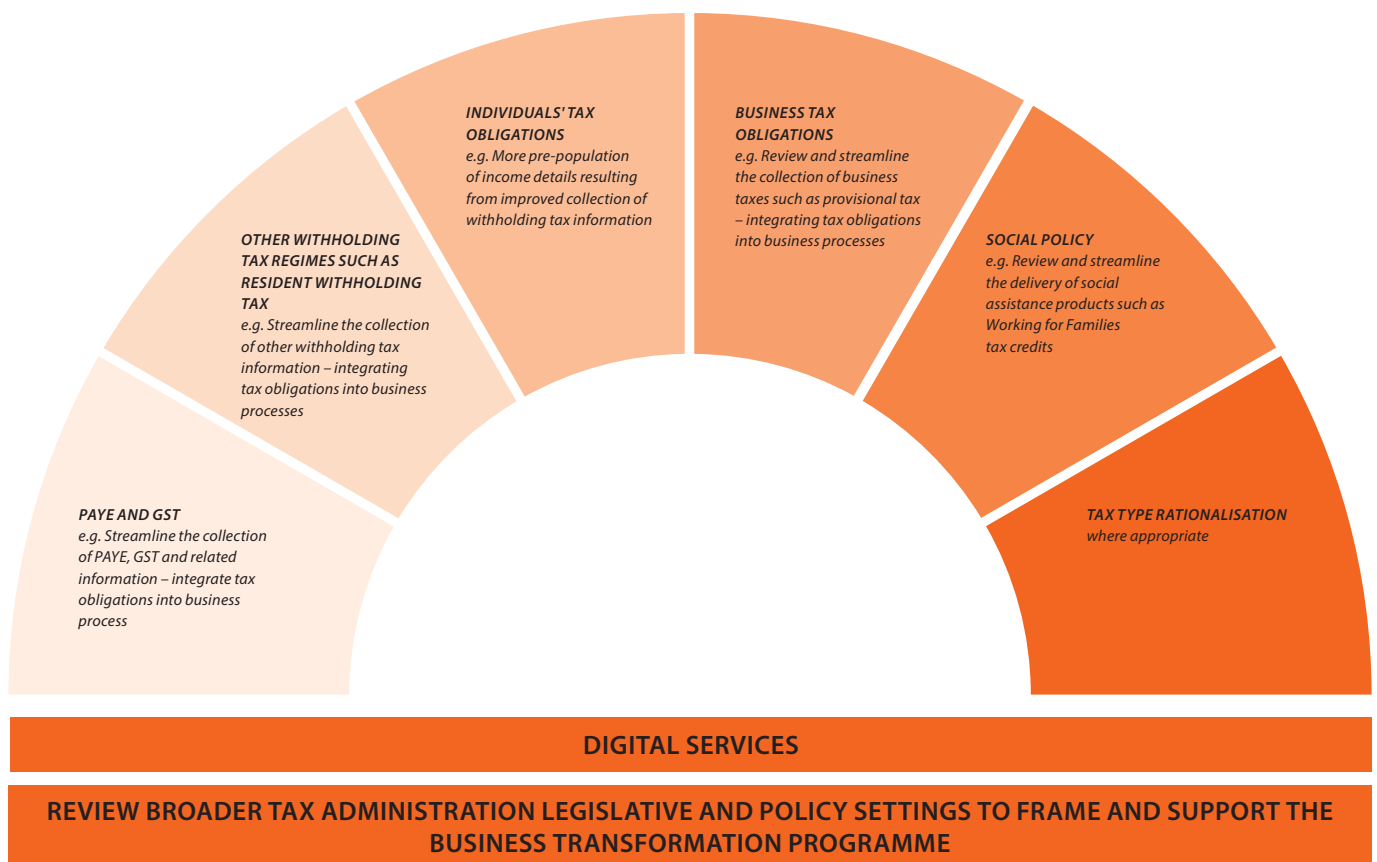
KEY ELEMENTS

OF POTENTIAL

CHANGES

The diagram below shows the key elements of the modernisation programme.

These elements are discussed in greater detail in the appendices attached to this *Green paper*, but the following provides a brief summary.



QUESTIONS FOR READERS

1 The Government's view is that more effective use of a business's own systems to provide PAYE, GST and related information to Inland Revenue would provide real benefits to employers – do you agree?

2 If not, what would be a better focus for future consideration in relation to PAYE processes?

3 Have we considered all likely issues in relation to streamlining the collection of PAYE and related information?



ACCOUNTING
SOFTWARE



THE FUTURE FOR BUSINESS PROCESSES – PAYE

Taxes deducted from salary and wage earners by their employers form a very important part of our tax administration, so streamlining the collection of PAYE, GST and related information, and integrating tax obligations into business processes, is crucial for modernising the tax system.

Pay As You Earn (PAYE) is a system for deducting income tax at source for salary and wages, and all who employ staff use the PAYE system. Every month, employers (or PAYE intermediaries) send PAYE information to Inland Revenue using the Employer Monthly Schedule (EMS).

This process is a crucial part of the administration so the Government wants it to operate as smoothly as possible with minimum compliance costs for employers.

Integrating the collection of this information into normal business processes would be an important first step to reduce the compliance costs for businesses. In doing so, providing PAYE information then becomes part of a wider process rather than an additional step required by the tax system.

Crucially, comprehensive collection of accurate PAYE information is also a pre-requisite to enable Inland Revenue to provide accurate tax information for individuals on an online income statement (see page 32 for more information on this).

In its current form, the EMS has many positive attributes, but it is still largely paper based. Even when electronic filing is used or required, submitting returns is an additional process and not aligned to businesses' accounting or payroll processes. This results in businesses spending extra time inputting data and increases the risk of errors.

Potential benefits from improving the way the EMS operates for employers, intermediaries and Inland Revenue include:

- avoiding unnecessary duplication by integrating PAYE into existing business systems (for example, the payroll system) rather than a stand-alone system and process;
- allowing business systems to talk directly to Inland Revenue systems, and vice versa;
- easy amendment and correction of tax codes;
- ensuring the information provided is validated immediately; and
- up-front verification of information (i.e. tax codes) to allow the EMS to be better used to collect underpayments of tax.

Focussing on the transfer of data, rather than on the current prescriptive filing of EMS returns, means information can potentially be provided and corrected at any time during a period, rather than just at the end of a prescribed period. This will ensure that what is withheld or

REVIEW OF PAYE

HOLIDAY PAY?

EXTRA PAYS?

SECONDARY TAX CODES?

LIMIT TO ADDITIONAL DEDUCTIONS?

ONE-OFF PAYMENTS?

CROSS-BORDER EMPLOYMENT

FRINGE BENEFITS, SUPERANNUATION CONTRIBUTIONS & SHARE SCHEMES

paid during the year more accurately reflects the customer's actual obligation or entitlement. It should also provide additional flexibility for taxpayers.

In order to improve and streamline the collection of PAYE information, the following issues will need to be carefully considered.

- Should the current EMS form be replaced with automatic digital data transfers?
- How should Inland Revenue ideally obtain additional relevant information?
- When will the information be considered accurate?
- Should some employee information be private and not shared with an employer (for example, should child support information be treated differently as it is a matter between the employee and Inland Revenue)?
- Should the timing of PAYE information and payment of PAYE align to when salaries and wages are paid to employees?

Innovation by software developers and payroll providers will be an important ingredient in ensuring that any PAYE changes are successful. In particular this should help ensure that "normal" business processes are used wherever possible.

Such changes will not just be confined to the provision of PAYE information

– the same issues and principles will also apply to other requirements. For example, the ability to use a business's own systems should equally apply to GST information requirements.

If you would like to read more about streamlining the collection of PAYE and GST go to Appendix 2.

But it is not just about streamlining PAYE processes...

It is also timely to look at the PAYE rules more generally to ensure that they work as efficiently as possible. A review of these rules will focus on removing undue complexity and providing more clarity in their application.

The rules have not been fundamentally reviewed since their introduction in 1957. This review of tax administration provides the opportunity to investigate whether improvements can be made to ensure the rules reflect modern employment practices.

A review of the PAYE rules should focus on removing complexity to ensure employers can apply the rules with the least amount of effort resulting in a reduction in compliance costs.

There are a number of factors influencing the accuracy of the amount of PAYE deducted. These include use of the correct tax code, assistance by Inland Revenue in helping to identify incorrect tax codes and calculation accuracy (for both payroll packages and manual

QUESTIONS FOR READERS

4 Are we considering all the relevant issues with the application of the current PAYE rules?

5 Are there any other concerns facing employers that would improve how the PAYE rules work?

calculations), and other changes in employee information.

A review of the existing PAYE rules will focus on:

- Rationalisation of how employment remuneration is taxed and whether all forms of remuneration can be included under PAYE. For example, can some or all of fringe benefits, employer superannuation contributions and employee share schemes income be incorporated into the PAYE rules?
- Whether one-off payments can be included in the PAYE rules to avoid taxpayers becoming provisional taxpayers.
- How the PAYE rules apply to cross-border employment relationships.
- Wage protection for example, ensuring employees receive a sufficient minimum net payment when exploring whether the PAYE system should be used to recover outstanding liabilities.
- Extra pays, due to the complexity of the current calculation.
- Clarifying the taxation of holiday pay.
- Simplifying the application of secondary tax codes due to better income information being received during the year.
- Opportunities for common definitions of salary and wages to

be used for a range of taxes and social policy products, thereby simplifying the rules and reducing complexity.

If you would like to read more about reviewing the PAYE rules go to Appendix 2.

Enhancing withholding taxes to cover 'employment-like' income

Withholding taxes like PAYE are widely considered to be the foundation of an effective tax administration. Such a system requires third parties (for example, employers, financial institutions etc.) to withhold an amount of tax from payments of income.

The existing PAYE model works well for the withholding of employment income where the traditional employee-employer relationship exists. For those who earn their income outside of a true employer-employee relationship, such as the self-employed or independent contractors, the picture is less straightforward.

The current rules only require the payer to withhold tax for payments made to contractors who are in a listed set of industries. For contractors involved in those industries not listed, however, withholding does not currently take place.

The current contractor withholding rules were introduced in 1957, at the same time as PAYE. The labour market has changed since 1957. The rules have only ever been extended

QUESTIONS FOR READERS

6 What factors should Government be particularly conscious of when considering changes to the withholding tax regime in order to cover more employment-like situations?

in an ad hoc way, for example, adding or removing specific industries. A review is needed to develop a more comprehensive and consistent withholding regime to keep up with modern work practices.

Business transformation provides the opportunity to consider whether there are ways to improve and simplify taxpayers' interactions with Inland Revenue when the traditional employer-employee relationship does not exist. A review would consider whether withholding at source could be used in a wider range of situations, including independent contractors, and possibly for particular industries.

Enhancing the withholding regime also provides for the ability to improve compliance from particular participants in the labour market, for example, from migrant workers.

The main objective is the provision of timely information and tax payments from business which are accurate, comprehensive and error free. Information should also be able to be shared with other government agencies where it is appropriate to do so.

Solutions in this area would ideally reduce compliance and administration costs for businesses and Government as a whole, while at the same time increasing compliance levels from all customers. Ideally there would be other benefits as well, such as reducing the possibility of customers falling into debt. In practice there are likely to be trade-offs. An important consideration is to ensure that any

change does not just merely shift the cost of compliance from Inland Revenue to business.

The Government may, where it has concerns with voluntary compliance, look to address the scope of the PAYE and the schedular payment rules.

If you would like to read more about possible changes to the withholding regime go to Appendix 2.

QUESTIONS FOR READERS

7 What are the key tax administration issues currently facing businesses? Are there any particular areas that present concrete ways of increasing speed and certainty?

8 How important is improving the provisional tax rules in reducing compliance costs for business? Are there other more important issues the Government should be focusing on instead, or as well?

9 The Government seeks feedback on more effective and simple methods of calculating and paying provisional tax and, in particular, how provisional tax could be better aligned to other business processes.

THE FUTURE FOR BUSINESS TAX

It is vitally important for the Government to understand what, from a business tax perspective, the fundamental issues are in order to make improvements.

The tax system needs to focus on speed, accuracy, certainty, predictability and low business risk in business taxation matters.

Businesses have stated that speed and certainty, and issues with provisional tax are important concerns. Businesses want access to the right people at the right time at Inland Revenue to ensure they are doing the right thing. But are there aspects of running a business that present specific issues – such as the impact of taking on more staff?

The tax system should be easy for businesses to comply with, ensuring they spend more time on running their businesses and less time on tax. If it is easy to do the right thing, overall levels of compliance will increase.

As mentioned above, the provisional tax rules are an important consideration for businesses as they are the mechanism by which most businesses pay tax during the year. The following discussion provides some initial high-level ideas to improve the calculation and payment of provisional tax.

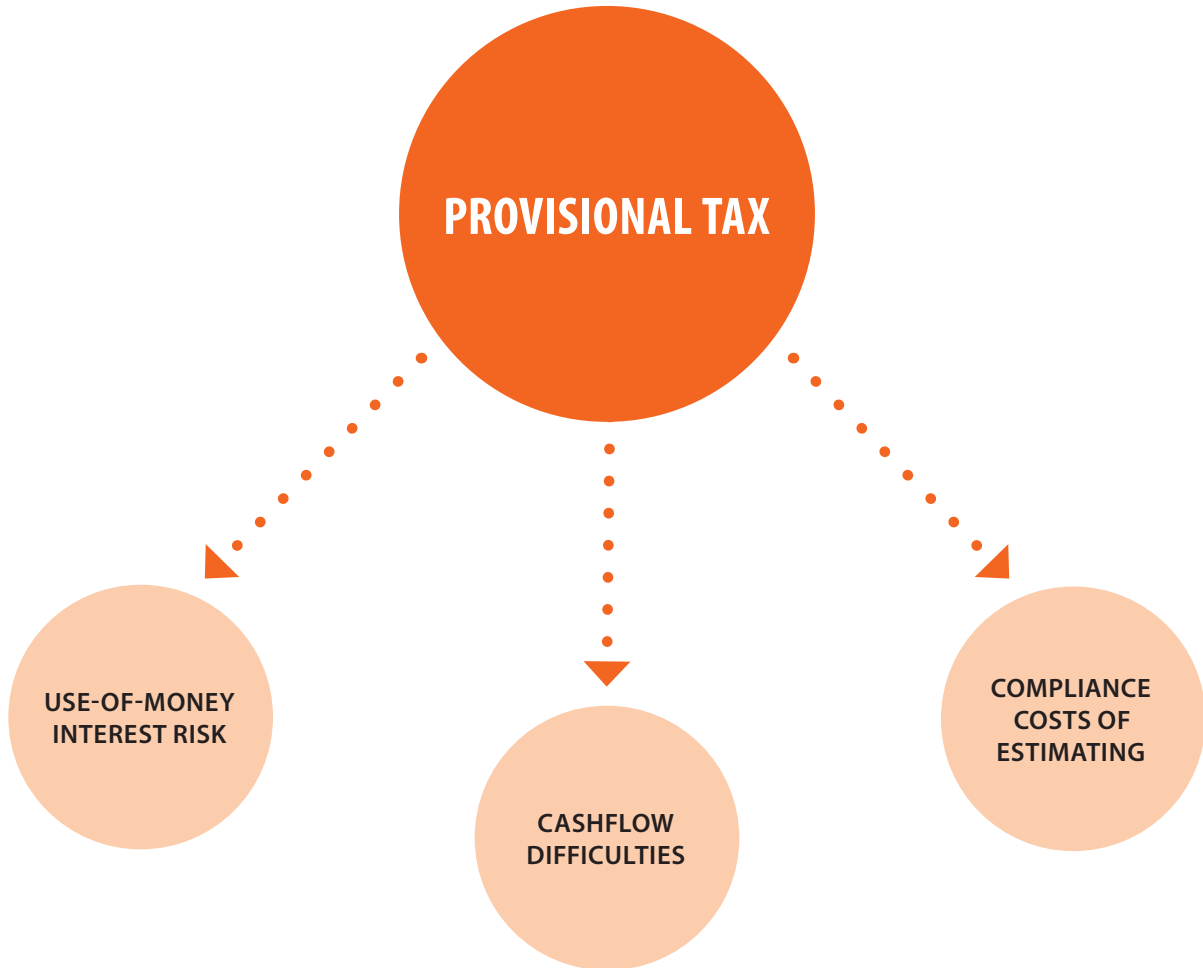
Provisional tax

Businesses are required to pay income tax on their profits. The exact amount of tax that a business is required to pay for each year can only be determined after that year has finished.

The current provisional tax rules, however, are designed to ensure that tax is paid during the year, rather than at the end of the year.

The calculation and payment of provisional and terminal tax currently presents some problems for businesses of various sizes, including:

- use-of-money interest (UOMI) risk for businesses, resulting from the need to estimate annual tax liabilities part-way through a year of assessment for provisional tax purposes;
- the compliance costs associated with estimating liabilities before the year of assessment has ended; and
- the one-off square-up nature of terminal tax can present cash flow difficulties for businesses, in particular, because of the nature of the current rules for new businesses. This also has flow-on effects for Inland Revenue in its enforcement activities.



Any design improvements to the provisional tax rules would need to consider the following:

- the impact on how businesses generate their cashflows;
- the use, as much as possible, of existing business processes and technology;
- encouraging compliance by making it easy to comply and hard not to;
- the reduction of compliance costs;
- the impact of UOMI on underpayments on businesses;
- equity between different taxpayers; and
- maintaining fiscal stability and predictability for the Government.

The calculation and payment of business income tax could be done more “on-account” as income is earned during the year – much like a PAYE system for businesses. One idea is by considering whether accounting profits with a few key adjustments (for example, reversing out capital gains and losses and excluding non-taxable income) could effectively be used as a better proxy for a business’s end-of-year tax obligation. This has the potential to simplify the calculation of provisional tax and create more certainty for taxpayers and reflect cashflow.

Alternatively, a simplified system whereby provisional tax payments are

based on another proxy (for example a bespoke percentage of a business’s turnover) could also be investigated.

Any review of the provisional tax rules would also have to consider changes to the standard uplift method of calculating provisional tax, together with the current safe harbour limits and use of money interest rules.

A review of the tax pooling rules should also be undertaken to see if they can be improved and/or made available to more taxpayers.

If you would like to read more about the future for business tax go to Appendix 3.

Small businesses

A particular focus of modernising the tax administration system is to ensure it becomes easier for small businesses to comply with their tax obligations, thereby reducing their compliance costs and improving overall levels of compliance. Many small businesses have difficulty in meeting their tax obligations. Compliance costs are also higher for smaller businesses compared with larger businesses which tend to have better tax understanding, better financial systems and better business processes.

Therefore, it is important that Inland Revenue is more proactive and sophisticated in its approach to providing assistance to these businesses.

QUESTIONS FOR READERS

10 Is the proposed direction outlined here the correct focus to provide benefits for small businesses or are there other more important ways of helping small businesses?

11 Are there any areas where you think tax for small businesses can be simplified, without creating specific tax breaks?

12 A particular focus is to ensure that small businesses achieve higher levels of compliance – what are the most important practical ways of promoting and achieving higher levels of compliance?

Taxes should not be a minefield for small businesses – complying should be easy. It may be that there is assistance that Inland Revenue could provide to specifically help small businesses, including encouraging the use of improved business systems and accounting software that meets specific standards to ensure the first few years of a business's life-cycle are successful.

Other forms of assistance could involve ensuring that the right support is available at key events that may result in tax obligations, such as taking on new staff for the first time. Ensuring that businesses get it right first time and maintaining that will be a real focus. This is likely to be a more productive use of both business and Inland Revenue staff time than lower-value activities, such as keying in data from paper forms.

Software would have the ability to help users correctly classify transactions to ensure tax obligations are correctly met right from the start. Taxpayers who use the software would benefit from greater certainty as errors and misclassification would be reduced.

A move in this direction could be supported by changes to the penalties regime. The current penalties regime is based on associated shortfalls arising from individual transactions. Where appropriate, the penalties regime could be adjusted to instead focus more on recognising that the taxpayer is attempting to comply. Inland Revenue could provide the support necessary to encourage

taxpayers to remedy systems faults which give rise to tax shortfalls. Adopting business systems and accounting software that meets specific standards would be a key component of this.

Small business may also benefit from tax rules being 'simplified'. By 'simplified' the Government does not mean introducing tax concessions for small businesses. Tax breaks for a particular group or industry are likely to create distortions by encouraging resources to flow into less productive activities, solely to get the tax break. This is inconsistent with the BBLR framework discussed in chapter 1.

However, it may be possible to make some changes that result in tax simplification for small businesses that reduce compliance costs and make it easy to comply without a substantial fiscal impact.

If you would like to read more about proposed improvements for small businesses go to Appendix 3.

Information provision

In a digital world, providing paper tax returns is an out-dated concept.

Taxpayers are often forced to duplicate processes in order to comply with current information requirements. The information required may also be out of sync with the business's size or risk profile.

From Inland Revenue's perspective, it may not be receiving from businesses the type of information that would

QUESTIONS FOR READERS

13 What are the key considerations that should be taken into account when looking at the provision of business income information?

most effectively allow it to carry out its debt recovery, audit and other core functions.

There is also an efficiency cost to taxpayers and Inland Revenue in processing non-digital and/or superfluous information.

New technology provides an opportunity to rationalise current tax returns for businesses. The focus in the future should be on providing relevant and timely information efficiently. This will therefore form the basis of a review of information requirements facing businesses.

If you would like to read more about business income information provisions go to Appendix 3.

WITHHOLDING TAXES FROM CAPITAL INCOME



QUESTIONS FOR READERS

14 Is there anything else a review of the RWT rules should consider?

Income earned from savings and investments is likely to grow in the future, as the population ages and more capital is accumulated. It is therefore important to ensure that such sources of income, and associated resident withholding tax (RWT) deducted at source, are accurately and promptly recorded.

A review of the current RWT rules should build on improvements arising from more effective and streamlined collection of PAYE information. Any improvements in this area will also help facilitate changes to how Inland Revenue interacts with individuals and businesses.

A particular focus is how to enhance the provision of information about RWT on interest and dividends by integration into existing business processes – similar to the process envisaged for an improved PAYE information-gathering process.

This information should be obtained from those who are able to provide it at the lowest cost and where that information is most likely to be accurate. Although there may be some short-term costs for financial institutions and other businesses in order to provide this information, there are longer term benefits to those businesses and their customers – for example, more accurate and automatic withholding and increasing levels of compliance. There will also be long-term benefits to financial institutions as tax is integrated into business processes.

Collaboration with financial institutions and other businesses deducting RWT will be essential to ensure that any RWT changes are effective in keeping overall compliance costs in this area to a minimum.

In particular, a review needs to look at:

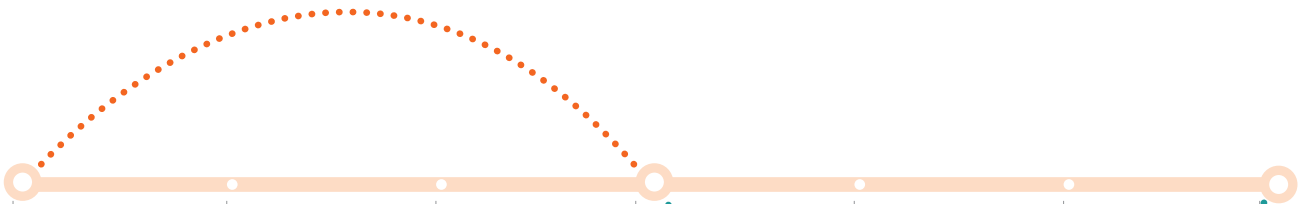
- improving the timeliness of information to Inland Revenue;
- the type of information provided;
- how to best incorporate the requirement to provide information into normal business processes, in order to reduce compliance costs;
- whether changes could remove the need for financial institutions to provide annual tax information to customers if it was already being provided directly to Inland Revenue; and
- whether RWT systems could be used as an efficient method of collecting underpayments of tax.

If you would like to read more about a review of the RWT rules go to Appendix 4.

**CONCEPTUAL VIEW OF
INDIVIDUALS' INCOME TAX IN
THE FUTURE**



CUSTOMER
PERSPECTIVE



PERSPECTIVE

Third parties would use software that meets Inland Revenue (IR) standards

Information from the software would flow through to IR during the year. IR would use the information to detect risk

Data is converted into usable information which could then be used for online income statement purposes

Customers would simply check and confirm income details or correct those details and add additional income

Assessment created

Credit/debit outcome

Customer decides how to pay or receive monies

INDIVIDUALS

Streamlining PAYE and withholding tax mechanisms will be the building blocks on which an individual's improved experience of the tax system will be based. More comprehensive and accurate information received from these changes will allow for a fundamental review of how individuals interact with the tax system in the future.

By way of background, a policy decision was made in the 1990s to try and remove the requirement to file income tax returns from as many individuals as possible. However, over time, this approach has created tension in the tax administration system between taxpayers who are not required to file, and those who are or who chose to do so in favourable circumstances (for example, to claim a refund). This creates fairness concerns for those who have to file and have tax to pay.

Significant numbers of individuals are now either required to file returns or are choosing to do so. It is therefore timely to consider whether it is still desirable to keep as many individuals as possible from actively interacting with the tax system.

This is particularly so as new technology now affords the possibility of Inland Revenue receiving accurate income information from employers, (see page 21) allowing Inland Revenue to provide an individual with a secure online tax statement showing those income details. This could include amalgamation of various tax interactions in one place (for example, including donations rebates). The

key would be to make customers' interaction with Inland Revenue as simple as possible.

The only action required for the vast majority of customers would be to check and confirm their details. Where applicable, certain individuals would also need to report other income received – such as overseas income where there was no deduction of tax at source. International initiatives on the exchange of income information may also provide opportunities to provide overseas income details in the individual's tax statement.

More effective use of technology could allow Inland Revenue to automatically adjust withholding rates to collect any underpayments of tax, making it easier for individuals to meet their tax payment requirements. Refunds could be made quickly and automatically.

This level of simple engagement would help ensure that individuals better understand what their tax obligations are, and how the wider tax system works. Over time, this would help improve voluntary compliance.

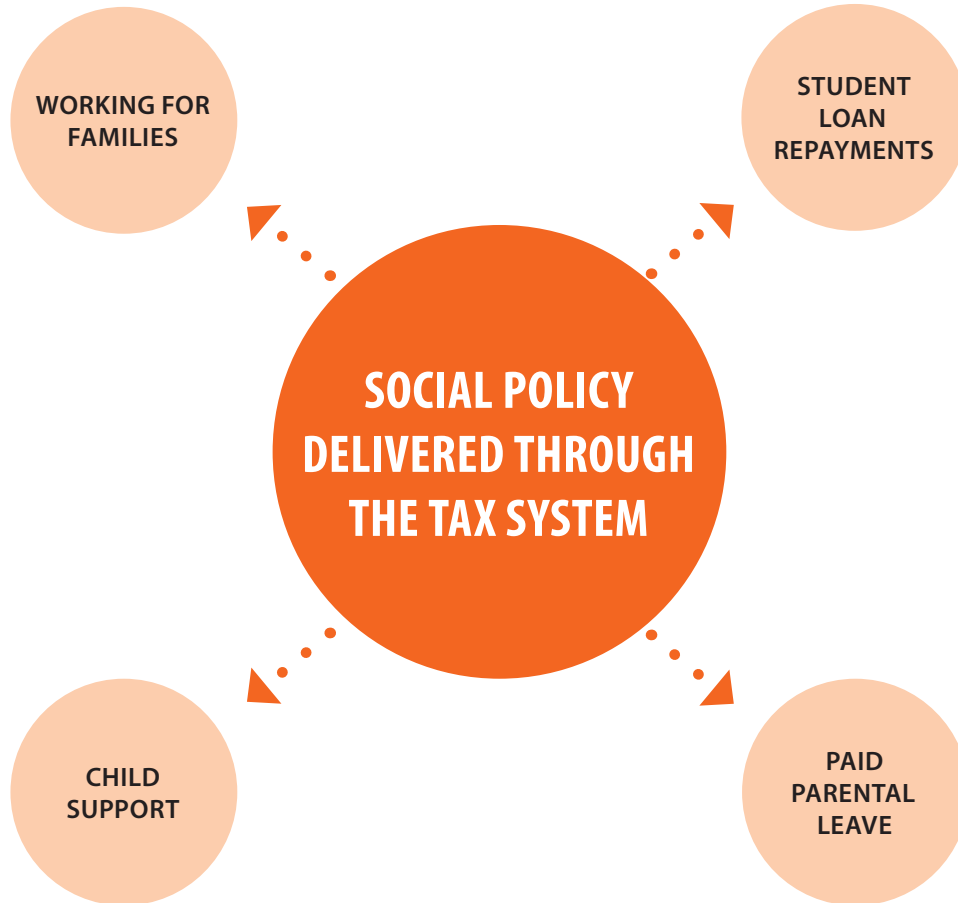
If you would like to read more about how individuals could interact with the tax system in the future go to Appendix 5.

QUESTIONS FOR READERS

15 Do you agree with the idea of interacting with the tax system by online tax statements?

16 If not, why not?

17 Is there anything else we should consider?



SOCIAL POLICY

Social policies administered by Inland Revenue (primarily Working for Families and Child Support) generally operate within the tax system on a yearly basis. Some of the potential changes may also affect Paid Parental Leave, Student Loan repayments and KiwiSaver.

Some Working for Families and Child Support customers will go into debt, or are already in debt unnecessarily because of out-of-date information held about an individual or family.

For Working for Families, debts or underpayments generally arise because of the annual assessment period, with payments made in advance or concurrently with the entitlement. This type of system requires upfront estimates of entitlement together with an end-of-period square-up.

However, circumstances often change throughout the year, resulting in multiple contacts between Inland Revenue and individuals, or no contact at all (and therefore outdated information). Neither situation is a good result.

The intention is to design processes that work for the customer and are fit for purpose. Processes should ideally match the timeliness of payments to customers' needs, and ensure payments are received on a real-time basis.

Reviewing the administration of these areas should include consideration of the suitability of the annual cycle and how to make better use of information from other sources.

Any change to the annual cycle would be a fundamental shift in the administration of Child Support and Working for Families. More accurate and timely information, on a more regular basis, is likely to be achieved by advances in technology, ensuring easy and low-cost interactions with the people involved.

Debt prevention would be the main benefit arising from improvements in this area. A system based on the ability to make frequent adjustments because of changing circumstances should mean less chance of going into debt.

If you would like to read more about re-designing processes for administering social policy go to Appendix 6.

QUESTIONS FOR READERS

18 Do you agree with the proposed direction of re-designing processes for administering social policies in the future?

THE POLICY AND LEGISLATIVE FRAMEWORK FOR TAX ADMINISTRATION

Simplifying the tax administration system requires consideration of key tax administration and legal issues that frame and underpin much of New Zealand's tax administration system.

Changes to the way that taxpayers interact with Inland Revenue through digital services provide an opportunity to consider fundamental issues contained within the Tax Administration Act 1994.

This section considers some of those changes.

The role of Parliament and the Commissioner of Inland Revenue

Parliament both guides and constrains the role of the Commissioner of Inland Revenue, and the relationship between the Commissioner of Inland Revenue and taxpayers.

The power to levy taxes belongs to Parliament. Legislation is necessary to ensure certainty in the rules and to determine how much prescription versus Commissioner administrative decision-making is desirable.

To a reasonable extent, the role of the Commissioner is clear and adequately expressed in the Tax Administration Act. 'Care and management' is a key component of this and works well as a mechanism to reflect that the Commissioner needs to apply her limited resources effectively and efficiently.

However, there are areas in which the Commissioner's role should be reviewed, such as how the 'care and

management' provisions can be made more effective, and how they apply in non-tax areas.

The role of taxpayers and third parties

Self-assessment is a feature of the current New Zealand tax administration. It reflects the fact that, traditionally, a taxpayer has the information to best determine their own income and tax liability.

Even in a world where assumptions about information collection and calculations are challenged, and online income tax returns are provided and calculated by Inland Revenue, the liability and obligation to pay tax ultimately still belongs to a taxpayer. This is known as 'self-assessment'.

However, it will be important to test this assumption and consider the implications of any changes concerning the roles and obligations of taxpayers. An understanding of taxpayer obligations is core to the compliance and penalties legislation. Any changes to these obligations could have implications for penalties.

A review of these policy and legislative settings needs to be considered in the context of any changes to the self-assessment framework.

Information and secrecy

Inland Revenue holds a lot of information, and has more interactions with New Zealanders than any other agency. Using and analysing information in a timely and

QUESTIONS FOR READERS

19 Do you agree that the correct areas are being looked at in reviewing the policy and legislative framework for tax administration?

more efficient way will become more critical in the future. Consideration of the use, collection and disclosure of information will also be crucial.

Critical to the effective administration of the tax system is the trust that customers have that their information will not be disclosed inappropriately – and this is reflected in the secrecy rules. Equally, Inland Revenue sometimes needs to disclose information to third parties when it is reasonable to do so.

One of the Government's objectives for the future tax administration is to use information more effectively within Inland Revenue and to facilitate greater co-operation across government. The Government wants agencies to 'to use information as an asset'. In doing so, a number of potential tensions will need to be reconciled to meet these objectives, including:

- the interplay between information sharing and tax secrecy, and any potential impact on the integrity of the tax system;
- the differences (if any) between non-taxpayer-specific information and taxpayer-specific information;
- the treatment of information for social policy purposes;
- intelligence sharing and participation in cross-agency initiatives;
- co-location and joint service provision with other government agencies;

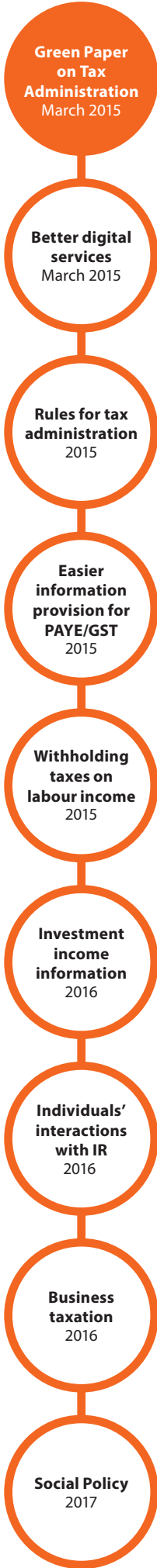
- the implication of greater information collection via accounting software and/or intermediaries; and
- how to manage the collection, storage and use of large external data sets.

Legislative structure of the Tax Administration Act

As an umbrella act the Tax Administration Act should provide a consistent administrative framework across the Inland Revenue Acts. Consideration would need to be given not only to the interplay of the Tax Administration Act with the Income Tax Act and the Goods and Services Tax Act, but also to the level of consistency that is necessary or desirable between the legislation dealing with tax matters and various social policy functions.

Specific tax policy work in this area will necessitate their own changes to the Tax Administration Act. As a result, certain provisions will become obsolete. A starting point for a new Tax Administration Act could be to re-order provisions, including those that can sensibly be carried over from other Inland Revenue Acts.

If you would like to read more about the policy and legislative framework for tax administration go to Appendix 7.



NEXT STEPS

The following sets out a very high-level summary of the scope of the tax policy work discussed in this *Green paper*, together with indicative dates when subsequent public consultation may occur.

Enabling secure digital services

In tandem with this *Green paper* a discussion document on *Providing better digital services* in a tax administration context has been released.

That paper considers whether secure digital services can be delivered using the current policy and legislative framework.

In particular, it identifies legislative and other barriers to moving to digital services, and discusses options to help move people to digital services (including incentives, disincentives and, where appropriate, requiring people to use of digital services).

The policy and legislative framework for tax administration

In the second half of 2015 a discussion document on developing a tax administration framework fit for the 21st century will be released. This will discuss, for example, the respective roles of Parliament, the Commissioner of Inland Revenue and customers.

Employment income

In the second half of 2015, two discussion documents on employment income will be released.

The first will focus on:

- the collection of information for PAYE purposes; and
- modernising the PAYE rules more generally.

The second will focus on:

- enhancing withholding taxes to cover ‘employment-like’ income.

Withholding taxes on capital income

In 2016 a discussion document on streamlining the collection of information relating to other withholding regimes will be released. This document will look at ways of ensuring that sources of income with tax deducted at source (for example, interest and dividends) are accurately and promptly recorded.

Individuals’ taxation

In 2016 a discussion document on improving the tax system for individuals – for example, in relation to the pre-population of tax returns and more efficient payment and debt mechanisms – will be released.

Business taxation

From 2015–2016, a number of discussion documents focussed on improving the tax system for businesses will be released. These will look at streamlining business tax processes, for example, in relation to provisional tax, small businesses, the collection of information, and on penalties and interest.

Social policy

From 2017 onwards, a number of discussion documents on various social policy issues such as encouraging people to update or confirm personal circumstances during the assessment period – will be released.

Other areas of potential focus may include:

- periods of assessment and payment;
- aligning definitions and rules across common social policy elements; and
- debt prevention and collection.

APPENDIX 1

POLICY CONSIDERATIONS

NEW ZEALAND'S TAX SYSTEM

1.1 Having a good overall tax system means having both good tax policies and good administrative systems. Both of these elements need to go hand in hand.

Costs associated with raising taxes

1.2 Taxes create costs. As well as the taxes themselves, there are additional costs that are sometimes referred to as 'deadweight costs'. These include compliance costs to customers and administrative costs to Inland Revenue, and also distortionary costs due to the way that taxes influence behaviour. For example, they can discourage people from working, saving, starting a business or increasing their skills. Taxes can bias the ways in which people work or save. Taxes can also discourage firms from investing or cause them to invest in inefficient ways. It is important to keep the overall costs of raising tax to a minimum.

1.3 Reducing compliance costs for businesses, in particular small and medium enterprises (SMEs), is an important goal for the Government. Although there is evidence that tax compliance costs for New Zealand individuals and SMEs are likely to be low by international standards, given the large number of SMEs operating in New Zealand, overall tax compliance costs for this group as a whole are likely to represent a significant cost to the economy. In 2009, compliance costs for SMEs alone were estimated at \$2.5 billion which was more than 1% of GDP. Total compliance costs in the United States have been estimated as 10% of tax collections which in New Zealand would amount to 3-4% of GDP. It is therefore very important that we continue to contain tax compliance costs.

New Zealand's tax policies

1.4 The aim of New Zealand's tax policies is to tax as broad a range of income and expenditure as practicable at rates that are as low as possible. Known as the broad-base, low-rate (BBLR) approach, this provides a coherent and robust revenue base and promotes equity and fairness, economic efficiency and growth, and revenue integrity.

1.5 It also helps keep administration and compliance costs low. It is a much more coherent way of levying tax compared with most OECD countries.

Endorsement of New Zealand's tax policies

1.6 New Zealand's tax policies work well and are held in high regard internationally.¹ A number of independent domestic reviews of the tax system have also been undertaken in recent years, and have fundamentally supported New Zealand's underlying tax system and BBLR framework.²

Future challenges

1.7 There are long-term fiscal pressures that future Governments will need to consider. An ageing population, coupled with the increasing demand for world class healthcare and other services, will contribute to these pressures.

1.8 We should do everything possible to ensure high levels of compliance with the tax system to manage these fiscal pressures. Boosting levels of compliance is an important part of the Government's review of tax administration.

Inland Revenue's tax administrative framework

1.9 Inland Revenue aims to make it as easy as possible for people to comply with the tax system and to access their social policy entitlements delivered through the tax system. It also aims to make it hard for people not to comply. The goal is to provide services that are value-for-money while maintaining the integrity of the tax system.

1.10 The way that Inland Revenue currently operates administratively largely reflects a set of sensible decisions on how to make marginal improvements or take on new tasks given the legacy of the systems that are already in place. The Government has not, until now, stood back and had a fundamental look at how tax might best be administered if it were starting from scratch.

INLAND REVENUE'S BUSINESS TRANSFORMATION PROGRAMME

1.11 Inland Revenue is embarking on a once-in-a-generation opportunity to make changes to New Zealand's tax administration system to meet current and future needs. The Government has agreed in principle to a long-term business transformation programme to look at different ways of delivering tax and social policy. This includes re-shaping the way Inland Revenue works with taxpayers, and looking at possible changes to, amongst other pieces of legislation, the Tax Administration Act 1994.

1.12 This is far more than just updating a computing system. Rather, it is a chance to have a fundamental look at tax administration in New Zealand and see what changes need to be made as Inland Revenue moves further into the 21st century.

1.13 The world is changing, with huge improvements in ways of doing business. Ways of doing business that were acceptable 10 or 20 years ago will no longer meet the demands of customers. This also has wider implications beyond Inland Revenue – appropriate information sharing between Government agencies is also important to deliver efficient outcomes for New Zealanders.

1.14 It is therefore vital that Government and Inland Revenue establish the sort of tax administration services that taxpayers, third parties, advisors, and users of social policy services actually want and require, and which minimise the additional effort required to meet tax obligations and receive payments.

1.15 Any future tax administration system should also be effectively enforced and produce high levels of voluntary compliance. We want to achieve this while reducing the administration and compliance costs associated with raising tax.

1.16 Tax administration requires integrity and coherence – customers need to believe in the value of the system and feel as if there is a level playing field for all concerned, with people who do not comply being treated effectively and consistently.

1.17 New Zealand's very simple policy framework sets a sound base for such a transition, and should help ensure a much simpler tax administration than is required in other countries.

CURRENT PROBLEMS AND ISSUES TO CONSIDER

Systems and processes

1.18 The current revenue system is under increasing pressure. Major tax and social policy initiatives are difficult to implement given core technology and business processes. These demands have resulted in various system modifications, manual interventions and workarounds that have produced layers of complexity and cost for government and taxpayers.

1.19 As a result, current systems and processes pose significant challenges and risks. These include:

- inability to provide the services that customers are and will increasingly demand in a future digital age;
- inability to fully support the delivery of business initiatives across the wider public sector;
- inability to benefit fully from information and expertise used across the wider public sector;
- operational failure, potentially impacting the Government's revenue collection and distribution; and
- ability to implement the Government's tax and social policy initiatives in a timely and efficient manner.

1.20 Business transformation affords Inland Revenue the opportunity to address these issues.

Compliance and administration costs

1.21 As part of the trade-offs considered in any changes, it is crucial not to fall into the trap of merely shifting costs away from government onto taxpayers. Reforms will not be successful if they cut administration costs but these are

more than offset by additional compliance costs on the private sector.

1.22 Nor should measures be considered that reduce administration or compliance costs but lead to higher overall costs as a result of greater distortionary costs. Some simplistic options that may reduce compliance costs (for example, a turnover tax) might have relatively low administration and compliance costs but extremely high distortionary costs.

1.23 Although it is likely that New Zealand SMEs individually have low compliance costs by international standards, given the large number of such firms in New Zealand, aggregate compliance costs for these firms are large. It is important to focus on containing these costs.

1.24 This does not mean that tax concessions should be introduced for SMEs, however, as tax costs and tax compliance costs should not be confused. Tax breaks for a particular sector are likely to reduce economic efficiency and growth by encouraging resources to flow into less productive activities. They are counter to the BBLR philosophy. It may, however, be possible to make some changes that result in tax simplification measures that reduce compliance costs for SMEs without a substantial fiscal impact.

1.25 There are also reasons to be wary of creating too much choice. Compliance costs tend to rise in countries that give SMEs too many options for paying tax. This can encourage SMEs to calculate their tax liability a number of ways to find which involves the lowest tax payments (perversely, at the cost of increased compliance).

1.26 Also, as much as possible, it is undesirable to have rules that create difficult boundaries and disincentives for successful firms increasing in size.

1.27 In addition to core policy changes, there will be other opportunities for simplifying the tax system by more effective reliance on technology and existing business systems (see Appendix 2 for more details).

Facilitating compliance

1.28 Effective tax systems rely on facilitating compliance by customers. Addressing errors or mistakes after the event imposes significant costs on both Inland Revenue and the customer. It is more effective and efficient to consider what can be done to facilitate compliance and enable customers to file tax returns and make entitlement claims that are correct, for example, to get it right from the start.

1.29 The elements of an approach that facilitates compliance include:

- designing a tax system which makes it easy to comply and difficult not to;
- directing attention to the pre-filing stage and proactively targeting high risk areas and segments; and
- where possible, incorporating tax and social policy processes within a customer's everyday life – that is, designing systems that align or build off the customer's own processes and lifecycle.

1.30 To effectively facilitate compliance, Inland Revenue must continue to build its understanding of different groups of customers, their environments, and the factors that drive their behaviour (capability, motivation and opportunity). This will help shape the necessary actions that Inland Revenue needs to take to help promote compliance.

Increased use of effective withholding regimes

1.31 International studies have found very high levels of compliance for certain forms of tax (in particular, for withholding taxes, such as PAYE) and considerably lower rates of compliance for others, such as self-declared income. This suggests that greater use of withholding schemes, wherever possible (and appropriate) should be encouraged.

1.32 The effectiveness of withholding at source is reflected in the fact that the current New Zealand tax administration

system generally works well for individuals whose income is derived solely from salary and wages that are subject to tax withholding regimes. This is consistent with the experiences faced by other modern tax systems. In operating withholding taxes, governments recognise the reliance placed on businesses that operate the withholding in question.

1.33 The system works less well, however, in other circumstances – in particular, when tax on investment or other income is either not withheld or withheld at the incorrect rate. This can lead to costly square-ups when returns are filed, or unfairness and inefficiencies if they are not. This particular problem, if not addressed, is likely to grow with the onset of an ageing population where more people earn a larger proportion of their income from capital sources.

Filing obligations

1.34 The current tax obligations on individuals vary, based on historic distinctions made. A policy decision was made previously to try and remove the requirement to file income tax returns from as many individuals as possible. This resulted in relatively few salary and wage-earners in New Zealand filing income tax returns compared with other countries.

1.35 This, over time, created a tension in the tax administration system between customers who are not required to file and those who are. As a customer's circumstances change, their filing obligations can also change, for example, becoming eligible for Working for Families tax credits.

1.36 In addition, significant numbers of individuals are now either required to file or are, in certain circumstances, given the option to do so in favourable circumstances.

1.37 Individuals earning foreign income, rental income or business income, or who are receiving Working for Families tax credits, are required to file tax returns. Others are not required to do so. These differences in filing requirements may result in some being completely unaware that they may not be complying with their obligations.

1.38 It may now be more appropriate, and fair, to treat individual customers more consistently than at present. Modern technology could provide scope for a dramatic reduction in the costs of interacting with the tax system, and allow for an efficient squaring-up of refunds or liabilities where required.

1.39 Appendix 5 will explore the possibility of whether Inland Revenue can provide more extensive pre-populated information on tax returns available to individual taxpayers. For those with simple affairs and without business, rental or foreign income, filling a tax return might be no more complex than confirming whether the sources of income that Inland Revenue identifies are the only sources of income.

1.40 A practical difficulty is in getting effective withholding rates in place, and minimising the costs involved in squaring up liabilities and refunds when tax has been withheld at rates that do not reflect the true end-of-year tax position. The trade-off with trying to make withholding tax more accurate is the potential increase in compliance costs for the withholder and administrative costs for Inland Revenue.

1.41 Again, technology may help this by making square-ups much less costly. This *Green paper* will also be exploring whether it is possible to simplify square-ups with automatic bank transfers to those who have paid too much and higher rates of future withholding on those who have paid too little. Automatic square-ups could reduce pressure points around 'secondary tax', along with improvements to the rates at which secondary tax is withheld.

Other issues

1.42 Other issues to consider include problems relating to the provision of information. There are currently problems with the sufficiency and timeliness of collection of information, and the accuracy of that information.

1.43 When information is inaccurate there are also downstream problems with the timeliness of intervention or correction of that information.

1.44 Parallel questions arise around whether other features of the current tax system are really what customers expect in the 21st century. These include:

- the Employer Monthly Schedule and other withholding systems – are they required to be updated to meet employers’ needs;
- whether businesses, in particularly those with complex tax affairs, are afforded the right level of certainty to effectively manage their tax affairs in a timely and efficient manner;
- the way that businesses are required to pay tax, including the estimation of provisional tax;
- whether compliance with FBT can be simplified; and
- are the interactions between tax and social assistance overly complex.

KEY BENEFITS ARISING

1.45 Some of the benefits that the potential changes discussed in this *Green paper*, when taken as a whole, should ideally achieve include:

- Making it easier for customers to see their overall tax and social policy position, and to pay tax and meet social policy obligations.
- Increasing predictability for customers, by:
 - providing easy digital access to their accounts (and alternatives for those without such access);
 - providing earlier and simpler transactions;
 - providing effective and timely solutions to their pressing issues and problems (for example, when providing binding rulings);
 - access to the right information and help at the right time;

- using a business's normal business processes and systems to meet tax obligations;
- having a low cost of contact;
- being designed for a digital world, not a paper world;
- improving response times; and
- improving the collection, accuracy and timeliness of information to simplify and better tailor interactions.
- Making it harder for customers to fall into debt in the first place, and also making it easier for them to correct if they do.
- Reducing compliance and administration costs.
- Supporting broader 'all-of-government' goals and providing value-for-money for the Government.
- Ensuring the on-going surety and integrity of the tax and social policy system.
- Making it easier and less expensive for customers to get it right and meet their obligations (and harder for them to get it wrong).
- Providing sufficient information so that key policy concerns and audit risks can be identified easily.
- Providing flexibility to cater for future changes.
- Having an increased customer-focussed approach.

1.46 In short, Inland Revenue’s tax and social policy systems should be simple and make it easy to get right and hard to get wrong, be quick and low effort to use, provide more certainty, and should not require duplication of effort by customers or associated third parties. The systems should help customers to get things right from the start. They must also be flexible enough to move with technology developments.

1.47 This will not be an easy shift to make, or a quick one, but it is absolutely necessary for change to happen.

KEY ASSUMPTIONS

1.48 Some key assumptions have been made during the early development of the policy issues that are likely to underpin Inland Revenue's business transformation. These include:

- Key tax bases will remain substantially in place and New Zealand will continue with its BBLR approach. There are no fundamental changes currently planned to either income tax (individuals and corporates) or GST. Previous comprehensive tax reviews, most recently by the 2010 Tax Working Group, provide a high degree of support for this assumption.
- Social policy and other non-tax functions currently administered by Inland Revenue (for example, in relation to Working for Families, Child Support, Student Loans repayments and KiwiSaver) will continue to be a key part of Inland Revenue's portfolio of work.

¹ See, for example:
- Deloitte's 2014 *Asia Pacific Tax Complexity Survey Report* (<http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-ap-2014-tax-complexity-survey.pdf>)
- Washington DC Tax Foundation's 2014 international tax competitiveness index (see <http://taxfoundation.org/article/2014-international-tax-competitiveness-index>)

² For example the McLeod Review in 2001 and, more recently, the Tax Working Group in 2010

APPENDIX 2

THE FUTURE FOR BUSINESS PROCESSES – PAYE

2.1 PAYE (pay as you earn) is a tax withholding regime for salary and wages. PAYE information is received monthly from employers (or PAYE intermediaries) through the provision of Employer Monthly Schedules (EMS). Income, tax code, and tax deduction information is accumulated on an income year basis and used to support the administration of the income tax and social policy systems.

2.2 The PAYE system is also used to collect:

- ACC earner levies;
- Child support obligations;
- Student loan repayment obligations;
- Employer superannuation contribution tax;
- tax arrears; and
- KiwiSaver and complying superannuation fund contributions (both employer and employee contributions).

2.3 This appendix looks at three issues relating to employment income and similar income types. These are:

- the collection of PAYE information;
- modernisation of the PAYE rules more generally; and
- enhancing withholding taxes to cover 'employment-like' income.

COLLECTION OF PAYE INFORMATION

2.4 The changes described in this *Green paper* are premised, amongst other things, on the efficient provision of information – in particular the timely supply of information that can be effectively used by taxpayers, Inland Revenue and, where appropriate, wider government.

2.5 The EMS has, in theory, a lot of positive attributes. It provides a wealth of relevant information that is vital when

determining the tax position of New Zealand salary and wage earners.

2.6 The EMS therefore provides the starting point for any wider policy-led transformation changes, in particular, addressing some of the problems that limit its current effectiveness.

Current problems

2.7 The methods used by employers to submit PAYE information is still largely paper-based. Even when electronic filing is used or required, the submission of returns is often an additional process for businesses and is not aligned to businesses' accounting or payroll processes.

2.8 From an Inland Revenue perspective, there is also currently limited validation occurring at the time information is submitted, meaning that inaccurate information is being accepted. The information collected also lacks sufficient detail to allow deduction accuracy to be checked. This, in turn, places limitations on downstream interventions.

2.9 The level of duplication, correction or other interventions required by employers or Inland Revenue before the information can be effectively used is a severe shortcoming in the current provision of EMSs. Also, the inefficient use of available information from an all-of-government perspective, where appropriate, is not realising the full potential of information held.

Potential changes

Objectives

2.10 Greater use of digital services provides an opportunity to:

- make better use of businesses' natural systems to provide information;
- improve the timeliness and accuracy of information received;

-
- have accurate business rules incorporated into software packages;
 - reduce the level of duplication, correction and other interventions required by employers, intermediaries or Inland Revenue before the information can be effectively used; and
 - improve the use of available information from an all-of-government perspective, and to help ensure customers only have to supply information to government once.

2.11 Some specific objectives for streamlining the collection of PAYE information are that any proposed solution should:

- wherever possible, be integrated into employers' own systems;
- be low effort for customers, and reduce compliance costs for all, including reducing the need for employers to contact Inland Revenue;
- produce timely information from employers which is accurate (right amount), complete (error free);
- be shared with other agencies (where appropriate);
- allow Inland Revenue to pro-actively identify any incorrect data or assumptions, so that employers can correct information immediately and not have to deal with errors at a later date;
- deliver digital and paperless interactions – for example, transactions that are processed directly from employers' own systems to Inland Revenue, with certainty of delivery and outcome;
- be co-designed with taxpayers and their intermediaries (e.g. software developers and agents);
- be able to be reused for other products and services; and

- be agile and allow future changes (to policy and processes) to be made easily, quickly and cheaply.

Likely scope of review

2.12 The policy and legislative framework must be fit-for-purpose to improve and streamline the collection of PAYE information. In developing this framework, the following issues will need to be carefully considered.

2.13 Systems issues – Replacing current EMS and employer deduction (and GST return) forms with automatic digital data transfers – for example, via payroll/accounting software rather than as a separate manual intensive process. However, this begs the question about what to do for employers that do not currently use electronic business processes.

2.14 Information requirement issues – How should Inland Revenue ideally obtain information about employees? For example, employees could themselves provide or update information directly to Inland Revenue through digital channels, rather than via their employer. Alternatively, employers could provide employee information to Inland Revenue for subsequent validation.

2.15 At what point is information considered accurate and complete? If Inland Revenue does not accept a return until it is correct, or rejects it, what is the status of the information in the meantime? What happens if a taxpayer challenges the information?

2.16 Privacy and employee information – Should employees be able to keep private information (for example, child support information) between themselves and Inland Revenue rather than involving their employer, with employers seeing only the overall deduction amount or rate?

2.17 Timing issues – Should the timing of PAYE information provided to Inland Revenue align to the time that salaries are paid to employees? Or, should payment dates for PAYE align to the time that salary/wages are paid to employees, or continue to be paid at a later date?

2.18 Validation issues – Receiving information in a more timely manner will likely give Inland Revenue the ability to determine whether there are mistakes – for example, when an individual clearly appears to be on an incorrect tax code. What interventions could Inland Revenue potentially make to remedy likely mistakes more quickly?

2.19 Other issues:

- What happens when a business starts or ceases to be an employer?
- What happens when a new employee is taken on, or one leaves?
- What happens to casual or seasonal employees who work for several employers, or to beneficiaries who are also working?
- Should there be consistency between paper returns (to the extent they remain) and new electronic processes?
- What are the likely impacts for agents, nominated persons, software providers etc?
- Is it appropriate to review the policy settings for the current payroll subsidy to assess if it could be used more?

2.20 At this stage, no specific proposals are being made on any of these issues. The comments here are a series of considerations that are required to be worked through by further policy development and consultation.

Initial options for consideration

2.21 Potential high-level changes that could be made to improve the way the EMS operates for employers, intermediaries and Inland Revenue, and to provide a platform for wider changes include:

- avoiding unnecessary duplication by integrating PAYE into existing business systems (for example, the payroll system), so that EMS becomes part of a wider process rather than an additional process;

- allowing business systems to talk directly to Inland Revenue systems, and vice versa;
- easy amendment and correction of tax codes;
- ensuring that information provided is validated immediately; and
- verification of information to allow EMS to be better used to increase accuracy of payments and to collect any underpayments of tax.

2.22 A focus on the transfer of data, rather than on the current prescriptive filing of 'returns', means information can potentially be provided any time during an applicable period, rather than just at the end of a month. Although there will still likely be time limits by when information (and payment) must be made, such a change will nonetheless provide more flexibility for employers. For example, it might allow for corrections to be made on an on-going basis rather than at a later date.

2.23 Any future changes will still require data to be accurate and timely before any new process can be considered effective. Innovation by the private sector will therefore be an important factor in ensuring that any PAYE changes are successful, in particular in relation to making sure that 'normal' business processes are used wherever possible.

2.24 These changes will not just be confined to the PAYE information – the same issues and principles will also apply to other requirements. For example, the ability to use a business's own systems should equally apply to GST information requirements.

MODERNISING THE PAYE RULES MORE GENERALLY

2.25 In addition to looking at issues connected to potential changes to the way that PAYE information is provided, it is also timely to look at the PAYE rules more generally, to ensure that they remain fit-for-purpose.

2.26 The rules have not been fundamentally reviewed since

their introduction in 1957, so it is important to investigate whether improvements can be made and to investigate whether the rules still reflect modern employment practices.

Current problems

2.27 PAYE is an efficient and effective means to collect income tax from salary or wage income. It is important to note that the underlying policy for PAYE remains sound.

2.28 That said, as part of the focus to remove salary or wage earners from the requirement to file annual tax returns, some complexity has been added to the PAYE rules to ensure that tax is withheld at the correct current marginal rate wherever possible.³

2.29 Further complexity has also been added due to the non-alignment of rules in certain circumstances – for example, separate rules exist for income tax rates and KiwiSaver rates. This can cause practical difficulties when these rates change.

2.30 There may now be an opportunity, therefore, to review the PAYE rules to see if they can be simplified. This is because the need for precise accuracy could potentially be reduced if there is no longer a desire to reduce the number of individuals required to interact with the revenue system (for further details see Appendix 5 on individuals).

Potential changes

Objectives

2.31 Removing undue complexity and providing more clarity in the application of the PAYE rules so that they are more user-friendly is likely to be positive for employers.

2.32 One of the key objectives should be to reduce some of the unnecessary compliance costs currently experienced by employers in applying the current rules. Employers and payroll developers frequently experience a number of issues in relation to the application of the PAYE rules. Although individual issues may be minor, they can cause annoyance.

2.33 Inland Revenue's business transformation programme affords the opportunity to review these rules as part of the wider review of tax administration. This is particularly important given the fact that PAYE collects such a significant part of New Zealand's revenue.

Likely scope of review

2.34 There are a number of factors influencing the accuracy of the amount of PAYE deducted. These include use of the correct tax code, calculation accuracy (for both payroll packages and manual calculations), and other changes in employee information.

2.35 The scope of any wider look at the PAYE rules will likely cover:

- A review of existing PAYE rules to ensure that they are fit for purpose under a future PAYE (where calculations are, in general, done by software and not manually), with a particular focus on:
 - extra pays, due to the complexity of the current calculation;
 - holiday pay, due to the lack of clarity over how holiday pay is to be taxed (lump sum payments versus regular payments of holiday pay in lieu of actual salary or wages);
 - IR 56 payers – whether the payer should be made to withhold and deal with the PAYE obligations rather than the recipient;
 - the employer superannuation contribution tax (ESCT)⁴ deduction rate, due to the compliance costs associated with the annual calculation of the rate to be applied for the current year;
 - secondary tax codes and other flat PAYE rates – for example, is it possible to deal with these rates through the use of special tax codes (due to better income information being received during the year); and

- how to apportion tax when there is a change in the rate of withholding during a pay period.
- Rationalisation of how employment remuneration is taxed and whether all forms of remuneration can be brought under the PAYE umbrella. For example, can some or all of fringe benefits, employer superannuation contributions and employee share schemes income be incorporated into the PAYE rules?
- Whether one-off payments can be included in the PAYE rules to avoid taxpayers becoming provisional tax payers.
- Review of how the PAYE rules apply to cross-border employment relationships (for example, a New Zealand business setting up a branch in a foreign jurisdiction, and whether the PAYE rules apply to the employment of workers resident in the foreign jurisdiction).
- Wage protection – in exploring whether more deductions through PAYE is appropriate, consideration of a cap on the level of these deductions to ensure employees receive a sufficient minimum net payment will be important.

2.36 Again, it should be noted that no firm proposals are being made at this stage – instead, the issues noted above need to be explored in more detail before this can occur.

ENHANCING WITHHOLDING TAXES TO COVER 'EMPLOYMENT-LIKE' INCOME

2.37 Withholding tax arrangements are generally considered to be the foundation of an effective tax administration. Such arrangements impose an obligation on third parties (such as employers or banks) to withhold an amount of tax from payment of income to taxpayers.

2.38 Withholding taxes are a more cost-effective way for taxpayers and the revenue authority to transact. They help reduce the ability to understate income, and reduce the incidence of unpaid taxes.

2.39 New Zealand currently has a robust framework for the withholding of employment income as it relates to those in a traditional employer-employee situation. Such workers are subject to PAYE on progressive income tax rates. For many of these workers these source deductions provide a fairly accurate withholding of their tax obligation.

2.40 For those people who earn their employment income in less standard work arrangements (for example, as self-employed or independent contractors) the picture is less simple. Certain types of income fall within the 'schedular payment' rules (a subset of the PAYE rules) and deductions at a flat rate must be made by the payer.

2.41 Independent contractor income that does not fall within the schedular payment rules is not subject to source deduction. These taxpayers must instead file income tax returns each year and pay their tax themselves and, if they have a year-end tax liability of greater than \$2,500, pay provisional tax. In this case it is not clear that the framework is as robust.

2.42 Business transformation provides an opportunity to consider whether there are ways to improve and simplify taxpayers' interactions with Inland Revenue in this area.

2.43 As the tax administration system works well in respect of salary and wages – where there is a well-established withholding regime – consideration should be given to whether there is scope to expand withholding to cover a greater range of employment-like payments. This could provide scope to improve compliance, fairness and efficiency.

Current problems

2.44 The schedular payment rules were introduced in 1957, alongside the introduction of PAYE. The rules generally cover situations when there is no true employment relationship (noting that since 1986 receivers of schedular payments are able to claim expenditure incurred in deriving their income, while employees are not).

2.45 The rules apply to payments for certain listed

activities. Activities subject to this form of withholding range from the provision of personal care, to agricultural services and non-resident contractors, and include proceeds from the sales of goods such as whitebait and sphagnum moss. There are a number of exclusions, including salary and wages, extra pays and any payments covered by an exemption certificate.

2.46 Although the scope of the rules and the tax rates have been reviewed from time to time, the rules have evolved through piecemeal extension, rather than as a result of a fundamental review of the type of tax deduction system needed to complement the PAYE system.

2.47 Given there have been significant changes to the economy and to the way in which some people are engaged during this period, inconsistencies in the rules have emerged. For example, there has been growth in new industries which provide for stand-alone contractors who have few, if any, expenses.

2.48 Those industries with low or no expenses might be considered good candidates for inclusion in a more comprehensive withholding regime, as the lack of expenses would indicate that withholding at (or near) marginal tax rates would be reasonably accurate. This would likely have the benefit of taking a number of contractors out of the provisional tax regime, and reduce the added compliance this brings.

2.49 Another area of concern is potential non-compliance by migrant workers. For example, preliminary analysis over the past three years indicates that some migrant workers are incorporating companies, which are excluded from withholding requirements, and entering into contracts to provide their services to New Zealand businesses. There is a risk that these individuals may leave New Zealand within two years and not comply with their tax obligations – that is, not file tax returns and not pay tax.

2.50 This tax compliance concern could potentially apply to certain geographical areas as well as to industries that heavily rely on migrant workers operating as contractors (for example, some parts of the tourism industry).

2.51 As previously noted, another important aspect of the Government's modernisation programme is improving the information that Inland Revenue collects and holds regarding taxpayers and their obligations, and streamlining and improving the collection of this information.

2.52 Expanding withholding taxes would assist in improving gaps in information collected. Indeed, there may be a case for some payments to not require withholding, but rather to have enhanced reporting requirements imposed on some people who engage contractors or make significant payments in cash.

Potential changes

Objectives

2.53 As the Government envisages a future where customers' systems are able to interact more freely with Inland Revenue's system, there is an opportunity to expand withholding and/or reporting without significantly increasing the compliance costs of the parties making payments (provided the design of systems allows the required information to easily be extracted from customers' systems and passed through to Inland Revenue).

2.54 The main objective is the provision of timely information from businesses which is accurate, comprehensive, error-free and able to be shared with other government agencies, where appropriate.

2.55 Solutions in this area would ideally reduce the sum of compliance and administration costs for customers and the Government as a whole, while at the same time increase compliance levels from all customers. Ideally there would be other benefits as well, such as reducing the possibility of customers falling into debt. In practice there are likely to be trade-offs in all of this. An important consideration is to ensure that any change does not just merely shift the cost of compliance from Inland Revenue to business.

Likely scope of review

2.56 This review will initially look at withholding taxes in situations that are similar to employment – such as those characterised as independent contractors. This means predominantly focussing on contracts for the supply of labour (and labour and materials).

2.57 In particular, key areas that are proposed as part of this work include:

- Whether withholding at source can also be considered in a wider range of situations (for example, to cover particular industries)?
- What degree of accuracy is desirable when withholding – for example, the use of a single flat rate, a range of flat rates, or some degree of greater accuracy via the use of PAYE rates or special tax codes?
- Who specifically will be subject to withholding – which payees and which payers?
- Are there situations when reporting requirements rather than withholding would be sufficient?
- What is done for those people in situations when withholding is not possible (either in part or in full)?
- To what extent would corporate contractors fit within any new rules (given currently, in most circumstances, withholding only applies to individuals, not corporates). For example, would it only cover individuals and entities with one employee, or might it extend further?

2.58 The review will also include consideration of the existing schedular payment rules and whether this is a model that should remain, be expanded upon, or be included in any new withholding rules.

2.59 The Government may, where it has concerns with voluntary compliance, look to address the scope of the PAYE and the schedular payment rules.

2.60 Also, implications outside of the tax system will need to be taken into account – for example, ACC levies, minimum wage obligations and other general employment law considerations.

³ The marginal tax rate is the tax on the next dollar earned.

⁴ Employer superannuation contribution tax is the tax deducted by the employer on employer contributions to a superannuation fund for example, KiwiSaver.

APPENDIX 3

BUSINESS TAX

3.1 Initial feedback (including from the *Tax Administration for the 21st Century* conference, and from business groups) has primarily focussed on a need for speed, predictability, resolving issues with provisional tax, and low business risk in business taxation matters. Inland Revenue should use new technology to allow more focus on high-value services to taxpayers, to help enable them to better manage their tax affairs.

3.2 This, together with a desire to see improved compliance levels and lower tax compliance costs (which are seen as deadweight and unproductive to the New Zealand economy), are key factors to consider in any business tax changes.

3.3 It is important to consider, and develop further with relevant stakeholders, what the key issues are. Businesses want access to the right people at the right time to ensure that the business is doing the right thing. Are there aspects of running a business that present specific issues – such as the impact of taking on more staff or other key events? Although thinking in the business tax space is less developed currently than for other areas being considered, the scope of any change investigated will likely involve developing responses to the following issues:

- What are the actual tax compliance issues being faced from a business's perspective – for example, what is the real scope of the problems being considered?
- How big are these problems and what are the relative priorities?
- What would the impact be if these problems are not solved?
- The potential cost implications of any possible solutions.

3.4 Although this *Green paper* explores, at a high level, some initial issues for feedback reflecting initial concerns raised by businesses, the Government is particularly interested to find out if there are other, or more important areas of focus that would deliver the most benefits to business.

OVERALL OBJECTIVES

3.5 It is worth restating that, wherever possible (and appropriate), any proposed business tax changes should fit within the existing broad-base, low-rate tax policy framework.

3.6 In addition to the policy framework considered in Appendix 1, there are other more specific objectives for potential business income tax changes that should result in the following outcomes:

- reduced overall compliance and administration costs for businesses and the Government;
- better voluntary compliance;
- a high level of predictability for taxpayers;
- effective and timely solutions to taxpayers' pressing issues and problems (for example, when providing binding rulings);
- where possible and appropriate, have a low cost of contact;
- be designed for a digital world, not a paper world, using existing business processes wherever possible;
- work in a way that helps prevent tax debt arising in the first place, while efficiently allowing for its recovery when this is not possible;
- provide good information so that key policy concerns and audit risks can be identified easily, recognising that businesses that are low risks should have lower information requirements;
- collect revenue as companies earn their income without imposing excessive compliance costs on taxpayers;
- provide value-for-money for the Government; and
- be flexible enough to cater for future changes.

3.7 The issues briefly explored as part of this *Green paper* are:

- In relation to provisional tax, in particular exploring whether there are more effective, or more certain, methods available for calculating and paying provisional tax.
- Exploring ways to simplify interactions with small businesses, to reduce compliance costs and provide more assistance to these businesses.
- Moving away from the current focus on detailed tax 'returns' to a concept where the focus is instead on providing key information, and this information is provided digitally, in a way that fits the size and nature of individual businesses.

PROVISIONAL TAX

3.8 Initial feedback indicates that the calculation and payment of provisional and terminal tax currently presents a number of problems for many businesses.

3.9 While acknowledging that there are pressure points associated with the payment of provisional tax, it is important to reiterate that, to the extent possible, it is desirable that firms pay tax as their income is earned. This is consistent and equitable with the way in which other taxpayers are taxed, and is necessary to ensure government finances are effectively managed.

3.10 The fiscal implications of any changes will need to be carefully scrutinised when assessing the merit of any changes.

3.11 Also, the design of any changes will have to be very carefully worked through with businesses and their advisors, so that any impacts on businesses' cashflows can be fully considered.

3.12 The process of paying provisional tax should be as painless and easy to comply with as possible.

Current problems

3.13 There is an inherent trade-off between the accuracy of the payment of business income tax as income is earned, and compliance costs.

3.14 The calculation and payment of provisional and terminal tax currently presents a number of problems for both businesses and Inland Revenue. Key amongst these are:

- use-of-money interest risk for businesses, resulting from the need to estimate annual tax liabilities part-way through a year of assessment for provisional tax purposes;
- compliance costs associated with estimating liabilities before the year of assessment has ended. Initial feedback has centred around a desire for businesses to be able to focus more on growing their businesses rather than estimating future tax liabilities; and
- the one-off square-up nature of terminal tax can present cashflow difficulties for businesses, in particular, because of the nature of the current rules for new businesses. This also has knock-on effects for Inland Revenue in its enforcement activities.

Objectives

3.15 Any changes ultimately proposed for provisional tax should take into account, and balance, the following specific objectives and considerations:

- To the extent possible, provisional tax payments should align with when and how firms generate their cash flows.
- Where appropriate, businesses should be able to rely on existing business processes and technology (for example effective third-party accounting software providers).

-
- The impact that any change has on encouraging compliance – making it easy to comply and difficult to get wrong.
 - Compliance cost savings for customers.
 - The impact that use-of-money-interest on underpayments has on businesses.
 - Helping to prevent businesses from falling into tax debt.
 - The need for the Government to effectively and responsibly manage the country's finances – for example, fully consider the fiscal implications of any change.
 - Equity issues between different customers.

Initial options for consideration

Business PAYE

3.16 In the future, the calculation and payment of business income tax could be done more 'on account' as income is earned during the year – akin to a PAYE for businesses. This has the potential to simplify the calculation of provisional tax and create more simplicity for taxpayers.

3.17 More use of interim accounting calculations, rather than the more difficult task of estimating the actual taxable income for the year, could better align to a business's own processes.

3.18 This is an example where, as with other parts of this *Green paper*, innovation through the private sector (for example, through third-party accounting/tax software providers) could be an important ingredient in ensuring that any potential changes are successful.

3.19 The review could consider whether accounting profits with a very few key adjustments (for example, reversing out capital gains and losses and excluding non-taxable income etc.) could effectively be used as a proxy for provisional tax in practice. As noted above, accounting software packages

would likely have a key role to play in developing options in this area.

3.20 Another potential proxy that could be investigated, at least for some taxpayers (such as SMEs), would be to develop a simplified system whereby provisional tax payments are based on a percentage of a business's turnover. Systems improvements could potentially allow for a bespoke provisional tax rate to be calculated based on a business's previous tax position.

Use-of-money interest and penalties

3.21 Issues relating to UOMI and penalties are inevitably closely related to provisional tax concerns. The following paragraphs discuss specific areas of focus that are likely to form part of the review of provisional tax.

3.22 Currently, individuals using the standard uplift method for calculating their provisional tax obligations are not subject to UOMI if their residual income tax is less than \$50,000 (referred to as safe harbour taxpayers). This only applies to individuals at present, not to other entities. Options for change to safe harbour limits that could be considered include:

- providing safe harbour for taxpayers using new payment calculations (as discussed above) – for example, for certain businesses using such calculations on approved software; and/or
- increasing the existing monetary threshold (\$50,000) for those using the standard uplift option. It should be noted that this change, in isolation, would merely take more individuals into the safe harbour limits, not other business entities; and/or
- in order to bring other businesses into the safe harbour net, the safe harbour limits could also be extended so that they also apply to non-individuals when using the standard uplift method. This would mean that entities with residual income tax of less than \$50,000 (or some other criteria) would no longer be subject to UOMI throughout the year.

3.23 Another option could be to look at the current standard uplift methods available to taxpayers more generally – for example, a review of a combination of uplift rates, safe harbour limits and payment dates.

3.24 UOMI rates could be re-considered, in particular in relation to overpayments of tax (the current rate of interest for overpayments is 1.75%). One of the reasons customers spend a lot of time on their provisional tax calculation may be because they do not want to overpay and receive a perceived low interest rate if they pay more than is required.

Increased use of tax pooling

3.25 Tax pooling allows taxpayers to pool their provisional tax payments in order to arbitrage better rates than standard rates of UOMI provide. A review of provisional tax would also therefore investigate whether changes could be made to the tax pooling rules to see if they can be improved and/or made available to more taxpayers in practice.

Terminal tax

3.26 Any residual issues relating to terminal tax could be addressed by rolling outstanding tax liabilities into future provisional tax payments, rather than by separate one-off payments.

'Tax bank' / tax accounts

3.27 Some individuals or businesses might want to make regular tax payments, or to put money aside as they earn income, to make sure they have sufficient to meet future tax liabilities.

3.28 A potential area for investigation is whether there should be some sort of organised 'tax bank' – in effect, a tax account where taxpayers could make regular deposits that would be held on account to meet tax obligations as they arise.

3.29 Timing and perceived ownership would be important factors in this process. Where tax is regularly provisioned and settled with Inland Revenue, this would most likely promote compliance. However, if tax is regularly provisioned, but the money sits in the account for an extended period, customers would likely perceive the funds as belonging to them. This would likely lead to decreases in compliance as customers would perceive the funds as being available for other purposes.

3.30 A product of this nature would not necessarily need to be managed by Inland Revenue – it could instead be managed by appropriate third parties. This could potentially allow businesses and intermediaries to innovate an efficient solution to meet market needs.

MICRO AND SMALL BUSINESSES

3.31 Given the large number of small and micro businesses in New Zealand, and the fact that this sector bears a large proportion of overall compliance costs, making tax easier for this group is a real priority. Compliance costs are also higher for smaller businesses compared with larger businesses which tend to have better tax understanding, better financial systems and better business processes.

Current problems

3.32 Many small businesses have poor financial systems and business processes which affect their ability to meet their tax obligations. Poor business systems are one of the causes of the following compliance problems with small business taxpayers:

- under-reported income;
- errors (for example, incorrect classification of capital expenditure, claiming private expenditure as business expenditure, or failure to make trading stock adjustments); and
- failure to register for tax types, file tax returns, and make tax payments on time.

3.33 Public feedback from the *Tax Administration for the 21st Century* conference indicated there are opportunities for Inland Revenue to be more proactive, sophisticated and agile in how future business tax and advice is provided to these businesses to get it right from the very start of their business operations.

3.34 It is important that taxes are not a minefield for small businesses – complying should be easy. It may be that there is assistance that Inland Revenue could provide to specifically help achieve this, including encouraging the use of improved business systems and accounting software that meets specific standards to ensure the first few years of a business’s lifecycle are successful.

3.35 Other forms of assistance could involve ensuring that the right support is available at key events that may result in tax obligations, such as taking on new staff for the first time.

3.36 Ensuring that businesses get it right first time and maintaining that level of compliance will be a focus of any on-going changes in this area.

Objectives

3.37 The overarching objective of any changes to the tax rules for small and micro businesses should be to improve compliance levels, reduce compliance costs, and encourage improved business systems, while maintaining the Government’s revenue from this sector.

3.38 The following objectives should also be taken into account:

- using customers' normal business processes and systems to meet tax obligations and lower their compliance burden;
- making it easy for small business customers to comply, and difficult not to;
- improving predictability for micro and small business customers; and

- reducing the following compliance issues for small and micro businesses:
 - under-reported income;
 - errors; and
 - failure to file tax returns and pay on time.

Initial options for consideration

3.39 In addition to general efforts to improve compliance and reduce the time and effort required of small and micro businesses to deal with their tax affairs, a specific option that could be explored further is encouraging small businesses to use accounting software that meets Inland Revenue standards.

3.40 Small businesses are very diverse and feature a range of different business models, so any such software would need to capture a number of different transactions and systems.

3.41 The type of software envisaged would capture transactions from the customer's business and automatically transfer these to the customer's accounting records and tax return. The software would have features to help users correctly classify transactions. For new micro and small businesses these features should allow them to meet their tax obligations correctly from the very start of their business operations.

3.42 Businesses that use the software would benefit from greater certainty as the types of difficulties they currently face from errors and misclassification would be reduced. This would:

- reduce the level of under-reporting by automatically capturing transactions;
- reduce the number of errors by assisting customers to classify transactions;
- increase filing on time through automated processes; and

- reduce customer effort by aligning with their normal business processes.

3.43 This option could be supported by changes to the penalties rules. The current penalties rules are based on associated shortfalls arising from individual transactions. Where appropriate, the rules could be adjusted to instead focus more on the processes and systems of the customer, thus encouraging customers to remedy systems faults which give rise to tax shortfalls.

3.44 This option would also further enable Inland Revenue to focus its top-end interactions (investigations etc.) away from post-return audits on individual businesses towards greater focus on systemic issues within high-risk sectors or industries.

3.45 Small business may also benefit from tax rules being simplified. By 'simplified' the Government does not mean introducing tax concessions for small businesses. Tax breaks for a particular group or industry are likely to create distortions by encouraging resources to flow into less productive activities, solely to get the tax break. This is inconsistent with the BBLR framework previously discussed in Appendix 1.

3.46 However, it may be possible to make some changes that result in tax simplification for small businesses that reduce compliance costs and make it easy to comply without a substantial fiscal impact.

INFORMATION PROVISION

3.47 The provision of information from businesses to Inland Revenue currently focuses on a detailed one size fits all tax return and associated disclosures. This *Green paper* explores placing more focus on instead providing key information, in a digital form, in a way that suits the size and nature of individual businesses, and the government.

Current problems

3.48 Currently, a tax return is based on the provision of a paper 'return'. These typically have three main purposes:

- providing updated factual information (for example, address and other contact information);
- providing information to support decision making – such as information for policy or audit targeting; and
- providing the final top-level calculations of a taxpayer's tax liability, for checking by Inland Revenue.

3.49 Physical tax returns, in particular for businesses, is out-dated in a digital world. It does not add value to either Inland Revenue or businesses.

3.50 Businesses are often forced to duplicate processes in order to comply with return requirements. This increases compliance costs and can cause errors in transposing information from one form to another. The information required may also be out of synch with the business's size or risk profile.

3.51 On the other hand, from Inland Revenue's perspective, current tax returns may not be providing the type of information from businesses that would most effectively allow it to carry out its debt recovery and audit functions. There is also an efficiency cost to Inland Revenue in processing non-digital and/or superfluous information.

Potential changes

3.52 Digital technology provides an opportunity to rationalise current tax returns for non-individual entities more efficiently where the focus is on providing relevant up-to-date information in an efficient manner.

3.53 The focus of any such shift should be to best utilise businesses' existing processes and systems to make it easier for businesses to provide their information to Inland Revenue.

3.54 Further, the focus on information provided should be more focussed on information that is necessary to support Inland Revenue in higher value matters – such as helping improve customers' compliance, better targeting of audit activities, informed policy advice, risk evaluation, and pre-population of income for other taxpayers.

3.55 Introducing a differential reporting approach to the company income tax return would also reduce the reporting requirements for the majority of non-individual entities, and would be in line with recent changes to financial reporting requirements. Smaller businesses, which often have disproportionately high compliance costs, would ideally have to produce significantly less information.

3.56 Finally, any review should also ensure that:

- information received from, or in relation to, new businesses starting up is fit-for-purpose and received in a timely fashion;
- the rules around when binding rulings can be provided (for example, as part of the assessment process) are also fit-for-purpose.

APPENDIX 4

WITHHOLDING TAXES ON CAPITAL INCOME

4.1 As income from savings and investments is likely to grow in the future – as the population ages and more capital is accumulated – it will become more important to ensure that such sources of income, and associated resident withholding tax (RWT) deducted at source, are accurately and promptly recorded.

4.2 A review of the current RWT rules and practices is planned follow and build on improvements arising from more effective and streamlined collection of PAYE information. This would look to enhance the provision of information relating to, primarily, RWT arising from interest and dividends. This would be achieved by integration with existing business processes (similar to the process envisaged for an improved PAYE information-gathering process).

CURRENT PROBLEMS

4.3 Where applicable, Inland Revenue currently receives information from financial institutions on RWT on an annual basis. There are, however, problems with the way this information is received and used:

- Annual RWT systems are often slow, and often inaccurate, meaning further information and subsequent square-ups from customers are frequently required.
- Administration and compliance costs are high, in particular in relation to the benefits realised.
- There is duplication of compliance from entities recording and deducting RWT, customers and Inland Revenue.
- RWT systems cannot be used as effective debt recovery tools.

4.4 In relation to dividends, Inland Revenue does not currently receive timely or effective information on dividends payments that are made.

4.5 For interest received, taxpayers can select the RWT rate they believe their interest should be taxed at. When a clearly incorrect tax rate is chosen (for example, one that is not at the margins), this will often result in tax being underpaid (or overpaid), leading to difficulties and extra compliance for customers to make up the shortfall or otherwise rectify.

4.6 Alternatively, issues can also arise in correctly identifying income from joint accounts or sources.

POTENTIAL CHANGES

Objectives

4.7 The fact that Inland Revenue does not have good information on capital income, or alternatively does not receive or use it in a timely manner, means it is not able to assist taxpayers in assessing their tax rate or completing their income tax returns (if required). Improvements in the way that RWT operates should help facilitate wider changes to the ways Inland Revenue interacts with individual customers (see Appendix 5).

4.8 However, effective collaboration with financial institutions and other businesses deducting RWT will be essential to ensure that any RWT changes are successful and, in particular, to ensure that overall compliance costs are efficiently managed. This means:

- Information should ideally be processed automatically as part of existing business systems, for example, when payments are made (or another suitable time), rather than as part of a separate return. The information then becomes an integral part of the business system, rather than a separate process.
- Business systems should interact directly with Inland Revenue (and vice versa), with up-front validation of information.
- Upfront validation of information could ensure that the correct amount of tax is paid throughout the year. This could in turn reduce the number of customers who have tax to pay at a later stage.

- Upfront validation would also potentially allow RWT systems to be used as an efficient method of collecting underpayments of tax.
- Inland Revenue would be able to use the information to pre-populate 'tax returns' to inform details of customers' gross income and tax withheld (and social policy entitlements).

Likely scope of review

4.9 This review would look at:

- The timeliness of information provided to Inland Revenue – could information be provided at the time income from capital is made or soon after the year-end, rather than later or not at all.
- The type of information provided (for example, should Inland Revenue receive information on capital balances)?
- How the requirement to provide information could be incorporated into normal business practices, thereby reducing compliance costs.
- Whether information could be validated when received by Inland Revenue. This would allow for proactive advice that a different tax code might be more appropriate.
- Whether RWT systems could be used as a debt recovery tools, for example, by using variable withholding rates.
- Whether changes could remove the need for financial institutions to provide annual tax information to customers, as they would already be provided directly to Inland Revenue.
- The compliance cost burden that would be faced by financial institutions and businesses deducting RWT.
- What alternative processes could be put into place for businesses that cannot incorporate real-time

information provision into their normal business practices.

4.10 Consultation with financial institutions and other businesses deducting RWT will be essential to ensure that any RWT changes are successful. In particular, consideration should be given to institutions that may also be subject to other changing information requirements (for example, in relation to the OECD's Automatic Exchange of Information proposals) who will need to consider the timing and impact of the changes.

4.11 The review should also consider the potential application of withholding tax on other sources and forms of capital income – for example, on approved issuer levies, Māori Authority distributions, portfolio investment income and royalty payments.

APPENDIX 5

INDIVIDUALS

5.1 In terms of sequencing, there is a heavy interdependency on improving and enhancing the withholding tax mechanisms noted in Appendices 2 and 4. Changes to the way these operate are necessary to achieve a critical mass of accurate information that covers the majority of individuals taxed in New Zealand.

5.2 The current New Zealand tax administration system generally works well for individual customers whose income is derived solely from salary and wages which are subject to tax withholding regimes. It works less well where tax on investment income is either not withheld or withheld at an incorrect rate.

5.3 The current filing obligations on individual customers vary, based on historic and sometimes apparently arbitrary distinctions. This can result in customers being genuinely unaware they even have an obligation. There is a tension inherent in the tax administration system between customers who are not required to file, those who are, and those that choose to do so.

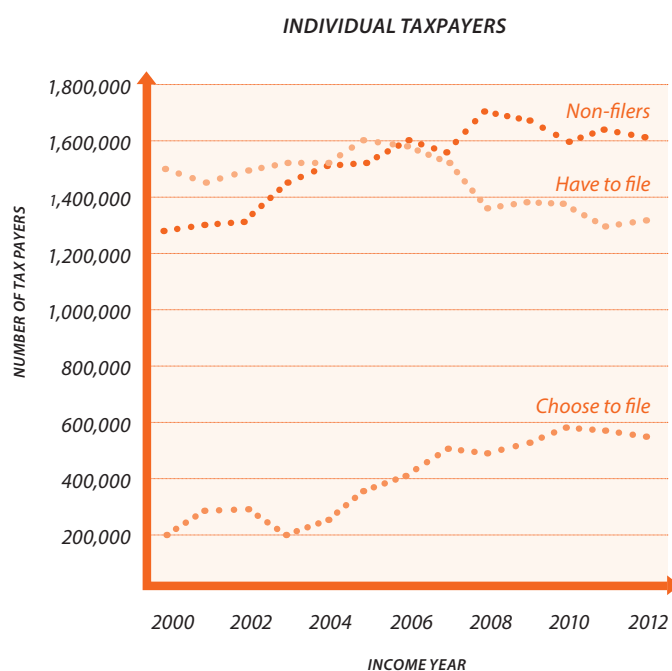
5.4 This adds complexity in meeting obligations and creates fairness and equity concerns for some individuals. A customer who is required to file a tax return might have an underpayment in one year and receive a refund in another year. For customers who are not required to file, however, there is no incentive to square-up in years of underpayments, but they can easily claim any available refunds.

5.5 Policy makers have attempted to minimise incentives for these customers to 'cherry pick' and file only when they have overpaid tax. Customers have, in effect, been forced into a gamble – if they enquire about their tax affairs by requesting a Personal Tax Summary (PTS), they are treated as filing even if this leads to a tax liability. This system, however, has led to firms offering a service to determine details of an individual's tax affairs before requesting a PTS to remove this gamble.

5.6 This compares with those who have other forms of business income (for example, rental income) or overseas income who are required to file. These taxpayers do not get the opportunity to 'cherry pick'.

5.7 There are now growing numbers of customers who are filing returns, or otherwise interacting with Inland Revenue. Examples include individuals filing a donations rebate form or those that have in excess of \$200 of interest or dividends. Likewise, Inland Revenue's growing involvement in the delivery of social policies, such as Working for Families tax credits, has also substantially increased the number of customers who file or interact with the Department.

5.8 The following graph, which shows the increasing number of individuals filing income tax returns or PTSs from the years 2000 to 2012, illustrates this point. In the year 2000, 50% of individual taxpayers were either required to or chose to file an income tax return. By 2012 this number had increased to 62% of individuals, an increase of 12%.



CURRENT PROBLEMS

5.9 The objective of keeping people away from filing returns has also resulted in the creation of complex and inaccurate rules in some areas of the tax system. For example, the income earned from investments in portfolio investments entities (PIEs) is taxed at the PIE rate rather than in the hands of the PIE investors. The rules are very complex because of the need to ensure that investors are taxed on their portion of the PIE income at a rate that approximates their own personal tax rate. Similar policy compromises arise when individuals earn superannuation which is subject to ESCT.

5.10 Such complexities can make it difficult for customers to understand what rates should apply to their circumstances, making it difficult for them to accurately comply with their requirements.

5.11 As highlighted above, all of this has led to significant numbers of people being required to file. As well as those who know they have to file tax returns – for example, those earning foreign income, rental income or business income, or who are receiving Working for Families tax credits – there are others who may not know they have to. This includes people who have interest or dividend income, or an extra pay or secondary earnings on which tax has been withheld at the wrong rate.

5.12 The current problems with individuals' current filing requirements include:

- policies that can sometimes create artificial and unclear boundaries;
- the fact that the system works well for individuals with one source of income, but less so if there are multiple sources of income;
- customers 'cherry picking' refunds, without the requirement to always pay outstanding tax, leading to fairness and equity concerns;
- the fact that the current system is not efficient in managing small debts;
- high administration and compliance costs for Inland Revenue, customers and third-parties; and
- Inland Revenue pre-populating some, but not all, information for individuals (for example salary and wages information, but not interest). In addition to inefficiencies, lack of visibility of information means customers can be unaware of mistakes or evasion occurring (for example, by their employer).

5.13 As previously noted, increasing numbers of customers are now interacting with Inland Revenue. Common areas where multiple interactions are occurring between Inland Revenue and customers include filing income tax returns, requesting personal tax summaries and donation rebates, Working for Families tax credits, Student Loans repayments, and Child Support issues. Customers currently can have these multiple interactions with Inland Revenue for various products dealt with separately – there is scope to have at least some of these issues considered together.

POTENTIAL CHANGES

Objectives

5.14 The direction outlined in this *Green paper* for individuals is premised on the following framework – it should:

- reduce effort and provide a high level of uniform outcome for customers;
- provide for a low cost of contact for all parties, including Inland Revenue, individuals and third parties (for example, employers);
- be designed for a digital world;
- realise the full potential of all information sources, whether these are generated internally (for example, cross-referencing information from other related tax returns) or externally (for example, from information arising in the future from automatic exchange of information agreements);

- provide for one process that applies for all individual taxpayers, regardless of different information requirements;
- be flexible to allow for future changes (for example, the introduction of new tax bases or new forms of technology);
- pre-populate as much information as possible (in a timely manner), and prompt for information which cannot be pre-populated;
- efficiently allow for the recovery of underpayments through the use of variable withholding rates; and
- make effective use of on-going analytics and risk assessment tools to deliver a better service to customers.

Initial option for consultation

5.15 One option for consideration could be for all customers to interact at some level with Inland Revenue, albeit in a much easier form than currently.

5.16 The potential changes discussed in this *Green paper* envisage an electronic filing system that is pre-populated by timely and accurate withholding systems. The majority of customers would then, as a maximum, only be required to check and confirm their details and, where applicable, report unlisted income such as overseas income or income where there is no deduction at source (for example, rental income). In most cases, square-up amounts of tax would be dealt with by either refunds being automatically released or debts paid by automatically adjusting withholding rates on future income sources.

5.17 In short, the focus would be on making “filing” simpler and less onerous for individuals’ tax obligations using pre-population and better technology to automatically adjust withholding rates to collect prior underpayments of tax.

5.18 This could be facilitated, in part, by a personalised web page showing:

- known income;
- other sources of taxable income, such as PIE income;
- prompts based on third-party data and/or previously provided information;
- a tax liability calculated by Inland Revenue and confirmed by the taxpayer; and
- a digital notification of the resulting tax position.

5.19 The key benefits potentially arising would include:

- greater fairness and transparency;
- potential simplification of regimes such as the PIE rules;
- improved automation of debt collection;
- flexibility for dealing with future policy changes, and future opportunities to support all-of-government outcomes;
- administration efficiencies (for example, less 'exception' processing) and lower compliance burden for taxpayers over time; and
- better use of information and data across government (both internationally and domestically).

5.20 The change in focus towards providing data also allows a move away from concepts like 'filing' and 'returns', and enables associated information to be consolidated (for example, charitable rebates can be dealt together with income tax rather than as a separate form). From a customer perspective, it would also allow individuals to understand what their obligations are and how the wider tax system works, which would support compliance over time.

APPENDIX 6

SOCIAL POLICY

6.1 Inland Revenue administers a number of social policies, either directly or on behalf of other agencies. The social policy areas primarily considered as part of this *Green paper* are:

- Working for Families tax credits; and
- Child Support.

6.2 Some of the potential changes discussed may, however, also affect Paid Parental Leave, Student Loan repayments and KiwiSaver.

6.3 Currently, social policies administered by Inland Revenue generally operate within the tax system. This has sometimes resulted in changes being made to social policy settings to ensure they fit within existing tax system parameters. An example of this is having annual return cycles for social policies linked to the tax year (for example, having annual entitlements from 1 April). These can sometimes limit potential policy outcomes and customer experiences.

6.4 Although many social policies use household income as a base for entitlement, other non-income information is also often brought into account when calculating entitlements.

6.5 This can take a number of forms – for example, living arrangements and family size are often taken into account, as are other sources of income that may not be included as income for individual income tax purposes.

CURRENT PROBLEMS

6.6 Some Working for Families and Child Support customers will go into debt, or are already in debt, due to out-of-date information held about an individual or family. Others are receiving less than they are entitled to during the year, with payments instead being made late or not at all.

6.7 This clearly affects their overall well-being and may have a negative effect on their families, work incentives and economic situation.

6.8 This debt (or underpayment) tends to arise from having an annual assessment period, but requiring payments to be made in advance or concurrently with the assessment entitlement. Such a system requires an upfront estimate together with an end-of-period square-up, with a requirement for changes of circumstances to be notified during the year.

6.9 The alternative to estimates is using verified information. This usually means income or circumstances from 1 or 2 years prior. For many people this information is out of date and may no longer be relevant. For people who do have changing circumstances, this approach often produces inaccurate results.

6.10 Even if information is correct at the beginning of the year, changes in individuals' circumstances are often required during the year, necessitating contact to be made between individuals and Inland Revenue, often several times a year.

6.11 However, the current rules often provide little incentive for a customer to initiate that contact, particularly if it would result in a reduction in payments received. Ultimately, this frequently results in square-ups being required, again causing year-end debt, and penalties.

6.12 Social policy entitlements are generally based on the combined circumstances of the parents (whether together or separated) and their dependent children. This is at odds with the overall tax system which focuses on the individual taxpayer with secrecy provisions in place to prevent information being shared with other family members. The result is often higher compliance and administration costs. If this results in people not taking up the assistance (or complying with obligations), it could have a detrimental effect on the social policy outcome the Government wishes to achieve as well as affect the families directly.

6.13 While the social policies have common features (for example, the support of children) they operate as separate products, requiring duplication and additional contacts. They can also develop and evolve differently over time, leading to complex interactions for families who are subject to more than one set of rules.

OBJECTIVES

6.14 The intent is to design a process that works for the customer and is fit for purpose. It should match the timeliness of payments to the need to receive (or ability to pay) on a real-time basis.

6.15 Key objectives for any change should be:

- to make it as easy as possible for people to:
 - understand;
 - comply on time; and/or
 - receive their correct entitlements in a timely manner
- to provide a reasonable level of certainty for individuals and families (for example, to help with budgeting);
- to minimise an individual's debt, and assist recovery of any overpayments arising;
- to provide sufficient information so that key policy and operational concerns can be identified easily and resolved quickly;
- to provide value-for-money for the government;
- to allow for cross-agency interaction and outcomes; and
- to be adaptable, flexible and scalable to cater for future changes.

6.16 It is likely that future changes would have the following characteristics:

- a low cost of contact;
- be designed for a digital world, but allow for multiple customer channels;
- be designed for the family household rather than just the individual members; and

- cater for multiple changes in members of a household over time.

LIKELY SCOPE OF REVIEW

6.17 The scope of the review on Inland Revenue's social policy administration is likely to be wide and varied, and will likely include the following general issues:

- reconsidering the annual approach often taken for social policies administered by Inland Revenue (for example, for Working for Families tax credits);
- making greater use of information and services from other sources (including other government agencies) as a trigger that a customer's circumstances may have changed;
- consideration of ways to encourage more frequent contact from customers – as this allows for a better reflection of real-life circumstances;
- allowing for more frequent contact, facilitated by advances in technology that allow for easy, more active, low-cost interaction;
- looking at other ways of minimising debt, and consideration of whether debt recovery could, in some circumstances in the future, be offset against future entitlement payments;
- potential greater alignment of definitions and rules across various social policy services;
- whether a different, low-cost approach could be taken for families with simple arrangements and minimal changes in circumstances; and
- how best to administer unique or complex family situations.

6.18 Some of the more fundamental issues that will likely form a significant part of the scope of the review of Inland Revenue's social policy administration are considered

briefly below. Given their linkages and dependencies, these will likely be considered after potential changes to withholding taxes and individuals' taxation have been explored further.

Time periods

6.19 Any change to the annual cycle would be a fundamental change to the way social policy is administered by Inland Revenue, having a big impact on both individuals and Inland Revenue.

6.20 The scope of this review will assess whether changing periods is feasible and sustainable. It will cover issues such as:

- Period of assessment: looking at what the best period of assessment for families/individuals for social policies is, covering criteria such as residency, age, family status, relationships, employment status and income. Should it be annual, quarterly, monthly, weekly or daily?
- Period of payment: consideration of whether arrears, current periods or prospective periods, should form the basis for making payments. Alignment of payment period options between Working for Families, Child Support and Paid Parental leave should also be considered (currently some are paid weekly, others fortnightly or monthly).
- Period of income measured: looking at whether current, future or prior period income should form the basis for measuring income. The need for estimates and subsequent square-ups (or otherwise) will be a key factor here.

6.21 There will be advantages and disadvantages in each of these considerations. For example, on the face of it, a shorter period of assessment may intuitively seem more appropriate for many social policies as it may better mirror changing family circumstances. On the other hand, such an approach can help some people to try and structure, their affairs to arrange outcomes for their own purposes.

Debt prevention and collection

6.22 The scope of the review on debt prevention and collection will likely cover, as a minimum, the following issues and considerations:

- Removal of an annual terminal assessment and subsequent debt collection approach for Working for Families, replaced by a system based on on-going accumulative adjustments taking into account changing circumstances. Under such a system, any over-or under-payments are adjusted for in later payments with a final square-up only at the end of entitlement. Debt would then only arise when entitlement ends, and then on a smaller scale.
- Reducing interim entitlements for Working for Families, resulting only in end-of-year payments and not debt.
- Reviewing penalty rules, debt collection and write-off rules to see if any changes can be made that better reflect the social policy environment.
- Improving upfront debt prevention by reviewing rules such as those backdating requirements to pay, payments in advance of eligibility confirmation, and use of default assessments where information is lacking.

Better alignment of definitions and rules

6.23 As part of the wider Government review of social policy administration, it is likely that a review will be conducted of all common definitions and rules across different social policy elements. This will help to determine whether there are valid reasons for variations or, if not, to determine what the default setting should be across these policies.

6.24 This review could indicate if it would be helpful to have a simplified policy and legislative system that covers the large majority of families and circumstances supplemented by a special delegated arrangement to address unique or complex situations.

APPENDIX 7

THE POLICY AND LEGISLATIVE FRAMEWORK FOR TAX ADMINISTRATION

7.1 Changes to the way customers interact with Inland Revenue provides an opportunity to investigate the fundamental issues contained within the primary legislative vehicle for tax administration, the Tax Administration Act 1994.

7.2 In considering specific enabling legislation that would be required for any particular change as part of Inland Revenue's business transformation programme, a policy review of key tax administration and legal issues that frame and underpin much of our tax administration system is needed.

7.3 This review will involve consideration of:

- the roles of Parliament and the Commissioner of Inland Revenue in tax administration;
- the role of customers and third parties in the transformed administration and the implications for current obligations and sanctions;
- principles underpinning information and secrecy; and
- the legislative structure of the Inland Revenue Acts.

7.4 This *Green paper* does not seek to address these issues at this time, but rather raises awareness that these issues will be considered at an early stage in the business transformation programme.

ROLES OF PARLIAMENT AND THE COMMISSIONER

Role of Parliament

7.5 Parliament both guides and constrains the role of the Commissioner of Inland Revenue, and the relationship between the Commissioner and taxpayers.

7.6 The first point to note is that the power to levy tax belongs to Parliament alone. Parliament also prescribes the tax laws on what the Commissioner and the taxpayer must do to discharge their respective tax administration and tax compliance functions.

7.7 It is accepted that legislative prescription is necessary to ensure certainty in the rules and to retain a perception by taxpayers of impartiality by the Commissioner. It is for Parliament to determine how much prescription (versus Commissioner administrative decision-making) is desirable for these purposes.

Role of the Commissioner of Inland Revenue

7.8 To a reasonable extent the role of the Commissioner is clear and adequately expressed in the Tax Administration Act. 'Care and management' is a key component of this and works well as a mechanism to reflect that the Commissioner needs to apply his/her limited resources effectively and efficiently. However, there are some areas in which the Commissioner's role could be reviewed.

7.9 The areas for consideration include:

- how 'care and management' applies in the context of the responsibilities in the Inland Revenue Acts that are not about core tax matters; and
- whether the Commissioner should be provided with greater discretion or flexibility so that resources of both the Commissioner and taxpayer are not unduly tied up in outcomes that are impractical to apply and are inconsistent with clear policy intent.

ROLE OF TAXPAYERS AND THIRD-PARTIES

7.10 Self-assessment is a feature of the current New Zealand tax administration rules, and provides an efficient basis for tax collection. While definitions of the term may vary, self-assessment fundamentally reflects the fact that, traditionally, a taxpayer has the information and has often been in the best position to determine their own income and tax liability.

7.11 It can be assumed that taxpayers will still be in the best position to verify the accuracy and completeness of their own income or circumstances. However, it will be important to test this assumption and carefully consider the full implications of any changes concerning the roles

and obligations of taxpayers. An understanding of taxpayer obligations is core to the compliance and penalties legislation. Any changes to these obligations could have implications for the penalty rules.

7.12 Self-assessment shapes the dispute resolution procedures, binding rulings regime and other key features of the current tax administration framework. A review of these policy and legislative settings needs to be considered in the context of any changes to the self-assessment framework.

INFORMATION AND SECRECY

7.13 Inland Revenue is a highly information-driven government agency and has more interactions with New Zealanders than any other agency. Information flows and analytics will be increasingly critical to its ability to perform its core functions effectively in the future. Likewise, the ability of Inland Revenue to assist in improving the efficiency and effectiveness of government more widely, by working with other agencies and organisations, is dependent on timely and accurate information.

7.14 As the Government's modernisation programme is developed, various key questions will need to be asked and considered. These include:

- Where will core information that is required come from (for example, taxpayers, employers, financial institutions, other third parties)?
- What other information might Inland Revenue need to share, and with whom would it be shared?
- To what extent should Inland Revenue collect information on behalf of other government agencies (that it can collect easily) that may not necessarily be required for tax or social policy purposes?

The secrecy rules

7.15 The effective administration of the New Zealand tax system relies on the voluntary compliance of customers.

Critical to this compliance is customers having trust in Inland Revenue that their information will not be disclosed inappropriately. However, to operate the tax system efficiently, Inland Revenue sometimes needs to disclose information to third parties when it is reasonable to do so. An appropriate balance is needed when these principles are inconsistent.

7.16 Provisions protecting customer confidentiality have been in place for over 100 years. The secrecy rules in section 81 of the Tax Administration Act provide a strict rule of secrecy for Inland Revenue officers, subject to a number of specific and general exemptions.

7.17 Other pieces of legislation are relevant to information collection, use and disclosure. The Privacy Act sets out information privacy principles relating to the collection, use and disclosure of personal information, and contains specific frameworks for the sharing of personal information by government agencies.

Information sharing

7.18 In 2013 new rules were put into place in the Privacy Act permitting and governing 'approved information sharing agreements' (AISAs) between agencies delivering public services. A specific exception to the general secrecy rules allows Inland Revenue to share certain information under an AISA. This framework applies to 'personal information about an identifiable individual' and does not cover all taxpayer-specific information held by Inland Revenue. A broader consideration of information sharing in the cross-agency setting, and if appropriate beyond, may therefore be warranted.

Issues to consider

7.19 The ideas discussed in this *Green paper* aim for the more effective use of information within Inland Revenue and greater cooperation across government to, where appropriate, increase efficiencies. These goals will involve consideration of how Inland Revenue obtains, uses and releases the information it holds, and whether the current legislative framework is fit for purpose.

7.20 A number of potential inconsistencies and tensions will therefore be considered as part of on-going policy considerations, such as:

- the interplay between information sharing and tax secrecy, and any potential implications for the integrity of the tax system;
- whether non-customer-specific information (for example, statistical information or organisational information) should be treated differently from customer-specific information;
- whether information for social policy purposes (which relates to family circumstances) should be treated differently to an individual's tax information;
- intelligence sharing and participation in cross-agency initiatives – i.e. whether Inland Revenue should have the ability to collect more data than it strictly requires if associated information is required for wider government requirements (for example, numbers of hours worked)?
- sharing of information both generally (with reference to the AISA framework), and in particular about non-individuals (i.e. those not covered by the AISA framework, such as businesses);
- potential co-location and joint service provision with other government agencies;
- the implications of greater provision of information via business accounting software and/or intermediaries;
- how best to source information that will enable Inland Revenue to identify and assist customers to get it 'right from the start'; and
- how to manage the collection and use of large external data sets.

LEGISLATIVE STRUCTURE

7.21 Inland Revenue's functions now include administering a wide portfolio of major social policy functions (Working for Families, Student Loans, Child Support and KiwiSaver). This is reflected in the legislation, collectively known as the Inland Revenue Acts, that Inland Revenue administers. Determining the purpose of the Tax Administration Act in relation to the Inland Revenue Acts will be critical to ensuring the Tax Administration Act has a logical and coherent structure.

7.22 Specific business transformation work streams will necessitate particular changes to the Tax Administration Act. Changes to the Tax Administration Act will give rise to a significant level of legislative redrafting. As a result, certain provisions will become obsolete. A starting point for a new Tax Administration Act could be to re-order provisions, including ones that can sensibly be carried over from other Inland Revenue Acts.