



MAKING TAX SIMPLER

INVESTMENT INCOME INFORMATION

A GOVERNMENT DISCUSSION DOCUMENT



Hon Michael Woodhouse
MINISTER OF REVENUE

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

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Making Tax Simpler
Investment Income information

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CHAPTER 1

OVERVIEW

The purpose of this discussion document is to seek your views on proposed changes to the way that tax on investment income is administered and in particular to the way investment income information is collected.

The amount of income New Zealanders earn from savings and investments is likely to grow over the coming years, as our population ages and more capital is accumulated.

The way people invest is also changing. The sharing economy, where consumers interact with each other, bypassing the traditional third-party suppliers¹, is growing rapidly worldwide, with PWC projecting growth in the global sharing economy from USD15 billion in 2013 to USD335 billion by 2023². Peer-to-peer lending platforms are now established in New Zealand, and overseas experience suggests that this type of lending will continue to expand here.

Our tax system needs to be flexible enough to cope with growing levels of investment income, changing sources of investment income and new types of investment products.

For these reasons, it is important to review how this type of income is administered. The Government wants to ensure that it has an accurate understanding of peoples' income. It also wants to ensure that people and organisations pay the right amount

of tax and receive the right amount of social policy assistance, and wants to enable them to do that easily. This discussion document is part of the *Making Tax Simpler* series, which began in March 2015. Ultimately, the *Making Tax Simpler* proposals are about making it easier for people to get their tax right. These are the main underlying principles:

- Improve information flows to Inland Revenue and use the information received to pre-populate information for taxpayers to simplify the requirements for those taxpayers that have to, or choose to, file a tax return.
- Increase the use of digital services to bring that information together.
- Use the information to help ensure that people are on an appropriate tax rate.

The *Making Tax Simpler* proposals are seeking to cumulatively make it easier for people to comply with their tax and social policy obligations, and to ensure they are receiving any tax and social policy entitlements that they are due to receive.

¹ The most relevant part of the sharing economy for this document is peer-to-peer lending.

² <http://www.pwc.co.uk/issues/megatrends/collisions/sharingeconomy.html>

This discussion document looks at how these goals could be achieved in relation to investment income. In addition, the changes proposed in this document will support a number of future initiatives and are designed to gather enough information to give the Government flexibility in areas that will be consulted on in future such as the taxation of individuals and social policy (including Working For Families tax credits and Child Support).

INVESTMENT INCOME AND HOW IT IS TAXED

Investment income is income earned from the investment of capital. It can include:

- interest;
- dividends;
- portfolio investment entity (PIE) income; and
- royalties.

Income distributed by Māori authorities to their members is not strictly investment income but can be subject to resident withholding tax (RWT), and is covered in this document.

Withholding taxes are an efficient means of taxing investment income because they:

- reduce the cost of tax collection by shifting the obligation from many people to one person – i.e. one withholder deducts and pays the tax for all the taxpayers it pays income to;

- support compliance with tax laws as:
 - the investment income payer is reporting the recipients' income to Inland Revenue which reduces the non-declaration of investment income; and
 - people who don't declare their income still have tax withheld;
- ensure taxpayers do not have to pay tax on investment income as one lump sum at the end of the tax year.

Some investment income can have credits attached, as well as the tax withheld. Dividends can have imputation credits, and Māori authority distributions can have Māori authority credits. These credits represent tax paid by the company or the Māori authority. They are also a credit against the income tax owed by the recipient and Māori authority credits are refundable if they exceed the recipient's income tax liability.

THE INVESTMENT INCOME

TYPES ARE TAXED

IN DIFFERENT WAYS



DIVIDENDS

Dividends on shares (or other equity instruments) paid to New Zealand residents have RWT deducted and may also have imputation credits attached. The total RWT and imputation credits will be 33% of the dividend.³ Dividends paid to a non-resident are subject to non-resident withholding tax (NRWT) of up to 30% depending on their country of residence.



INTEREST

When New Zealand residents invest in debt instruments (for example, bonds or bank deposits) they can provide their IRD number and select a tax rate: 0%, 10.5%, 17.5%, 28%, 30% or 33% (ideally they will match it to their own marginal tax rate in other words the correct rate for their last dollar of income)⁴. If the investor doesn't provide their IRD number or doesn't choose a rate, the 33% rate will apply. Interest paid to a non-resident is subject to NRWT at 10% or 15% depending on their country of residence, or the approved issuer levy (AIL) at 2% if elected by the non-resident.



PIE INCOME

If a person invests through a PIE they can provide their IRD number and select their appropriate prescribed investor rate (PIR) based on their income in the last two years⁵. The possible PIRs are 10.5%, 17.5% and 28%. If the investor doesn't provide their IRD number, the 28% rate will apply. The tax on their PIE income is then calculated based on the applicable PIR.

MĀORI AUTHORITY TAXABLE DISTRIBUTIONS

Taxable distributions from a Māori authority will have credits attached at a maximum of 17.5% of the total of the net distribution and the credit. If the Māori authority decides not to attach credits, or if the credits are less than 17.5%, they can deduct RWT to provide the same amount of tax credits to the member. If the distribution is over \$200 and the member has not provided their IRD number, the Māori authority must deduct RWT at 33%, reduced by any credits attached, up to a maximum rate of 17.5%.

ROYALTIES

Royalties with a New Zealand source paid to a non-resident are subject to NRWT at 10% or 15% depending on the recipient's country of residence. International tax agreements between New Zealand and some countries may allow for lower rates of tax.

³The Taxation (Annual rates for 2016-17 Closely held Companies and Remedial Matters) Bill proposes allowing companies paying dividends to companies to elect not to deduct RWT from fully imputed dividends.

⁴ The 0% and 10.5% rates are only available when taxpayers meet specific requirements.

⁵ Income for these purposes includes PIE income.

RWT deducted (withheld) from the income before it is paid to the recipient is allowed as a credit against the recipient's total income tax for the year, in the same way as PAYE on salary and wages. PIE tax is usually a final tax but in situations where a recipient's PIE income does become part of their taxable income the PIE tax is also allowed as a credit against their total income tax for the year.

Royalties and dividends paid to non-residents have been included within the scope of this document as they are subject to the NRWT regime. There are, however, no changes to the administration of the taxation of royalties or dividends paid to non-residents proposed in this document.

The Appendix explains how the rules and processes for tax on investment income currently work. It will help put the proposed changes into context.

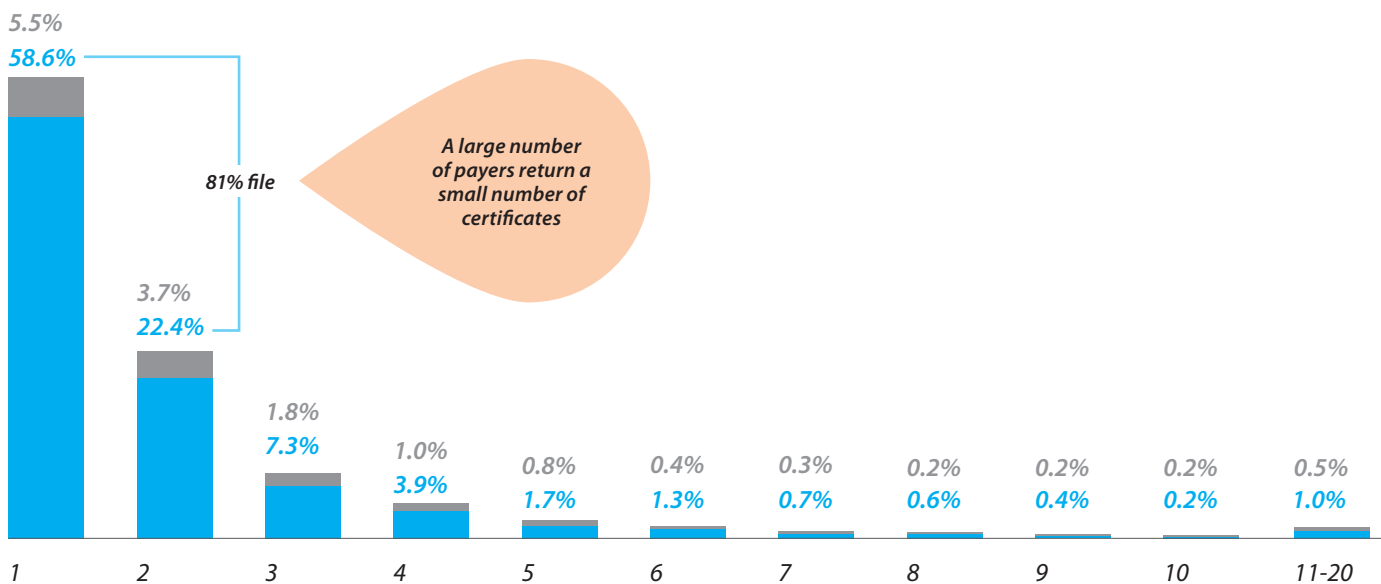
GETTING BETTER INFORMATION

Improving the collection of information about investment income and taxes would give Inland Revenue a more accurate picture of an individual's income during the year, allowing people's tax records to be pre-populated with more information. This in turn should increase voluntary compliance by making it easier for people to get their tax right.

Collecting information from the payers of investment income is

INTEREST RWT CERTIFICATES FOR 2015 INCOME YEAR

- PROPORTION OF TOTAL RWT PAID
- PROPORTION OF INTEREST PAYERS



NUMBER OF CERTIFICATES FILED

significantly more efficient and reliable than collecting the same information from each of the recipients of the income. The most significant efficiency gains would be driven by the collection of information from investment income payers with large numbers of customers as shown in the diagram below.

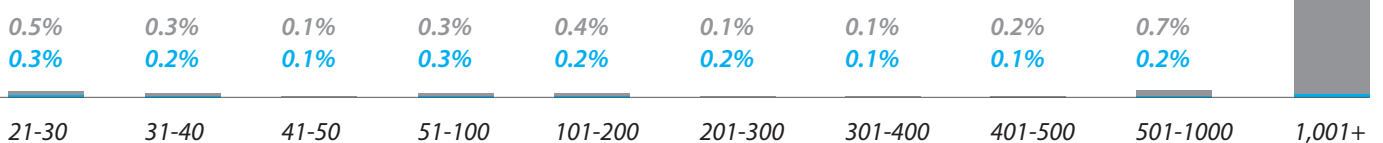
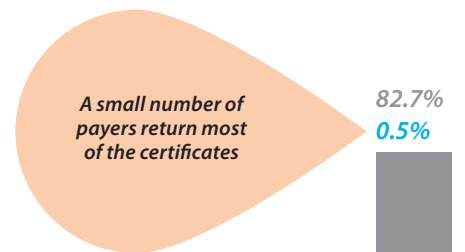
SUMMARY OF PROPOSALS

The main proposals set out in this document are:

- requiring payers of investment income to provide Inland Revenue with taxpayer specific withholding information on a monthly basis (or for the month of the business

process of paying the income if that occurs less often than monthly);

- taxpayer specific information would include:
 - the amount of income paid to the customer;
 - the amount of tax withheld (if any), or imputation or Māori authority tax credits attached;
 - the customer’s IRD number (if held);
 - the customer’s name;



- the customer's address;
- the customer's date of birth (if held);
- if the investment is a joint investment, information on each owner of the investment;
- if the payer is paying approved issuer levy, details of the relevant customers;
- if the payer is paying interest that is exempt from withholding tax, details of the relevant customers;
- removing the need for payers of withholding tax to provide end of year tax certificates to their customers who have provided their IRD number;
- increasing the "non-declaration rate"⁶ for RWT on interest and PIE tax to 45%;
- creating a database of taxpayers holding certificates of exemption from withholding tax; and
- requiring all taxpayers seeking to receive their investment income not subject to withholding tax to obtain a certificate of exemption.

Proposals that the Government decides to proceed with would be expected to be included in legislation to be introduced in 2017. The application date of the legislation would follow a period of time sufficient to allow for system changes.

HOW TO MAKE A SUBMISSION

This discussion document seeks feedback from both payers and recipients of investment income. The Government invites submissions on the proposals raised. Submissions should include a brief summary of major points and recommendations. They should also indicate whether the authors are happy to be contacted by officials to discuss the points raised, if required.

You can make a submission:

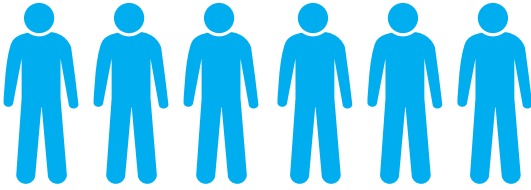
- online at makingtaxsimpler.ird.govt.nz
- by email to policy.webmaster@ird.govt.nz, with "Investment Income Information" in the subject line;
- by post, to:
Investment Income Information
C/- Deputy Commissioner,
Policy and Strategy
Inland Revenue Department
PO Box 2198
Wellington 6140

The closing date for submissions is **19 August 2016**.

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.

⁶ The "non-declaration rate" is applied when a customer does not provide the payer with their IRD number.

OVERVIEW



16,600

interest payers filed

over

5 million

interest certificates [IR15s]

Around

20%

of tax certificates have zero IRD numbers

[this is where someone has not declared their IRD number to the payer]

OF THE PEOPLE WHO FILED IR3 TAX RETURNS OR PERSONAL TAX SUMMARIES

22%

declared more interest income than shown on their interest certificates

70%

declared less interest income than shown on their interest certificates

33%

had RWT withheld at a higher rate than their marginal tax rate

45%

had RWT withheld at a lower rate than their marginal tax rate

OF THE PEOPLE WHO DID NOT FILE TAX RETURNS OR PERSONAL TAX SUMMARIES WITH INLAND REVENUE

38%

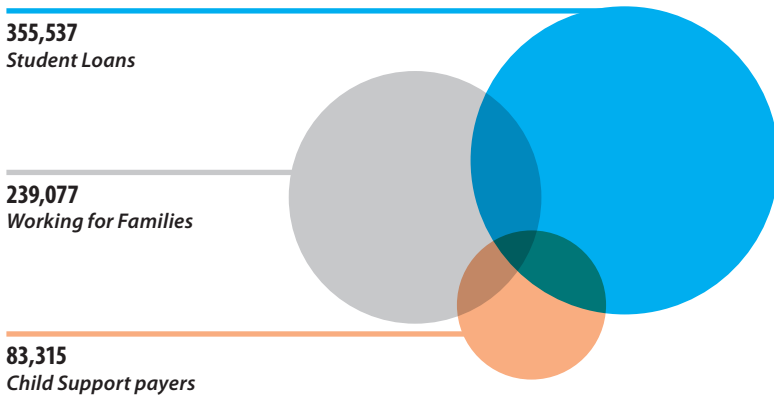
had RWT withheld at a higher rate than their marginal tax rate

37%

had RWT withheld at a lower rate than their marginal tax rate

Percentages taken from analysis of 2015 tax information

RECIPIENTS OF INTEREST INCOME AND SOCIAL POLICY

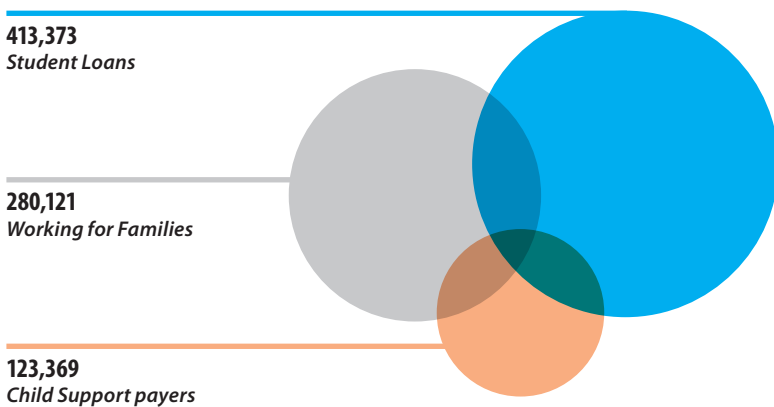


A significant number of recipients of investment income also receive Working for Families tax credits or have student loan and child support payment obligations. The calculation of these entitlements and obligations is based around the taxpayer's total income which includes interest income, dividends and some types of PIE income. By getting details about the recipients of investment income more regularly Inland Revenue will be able to have a more accurate understanding of the total income earned.

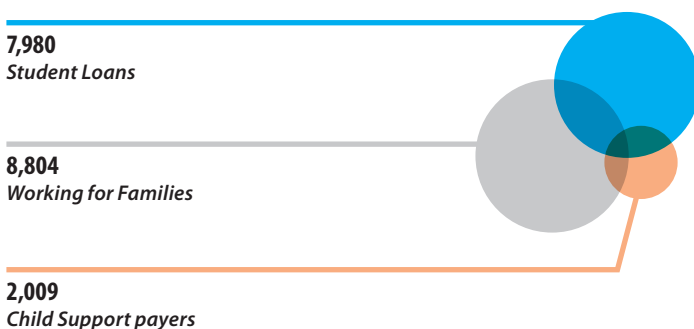
The numbers of recipients of interest and PIE income shown only takes into account those recipients who have provided their IRD numbers to their investment providers or who have returned the interest income in their tax return or Personal Tax Summary (PTS). The dividend income information shown is limited to those dividend recipients who returned the dividend income in a tax return or PTS.

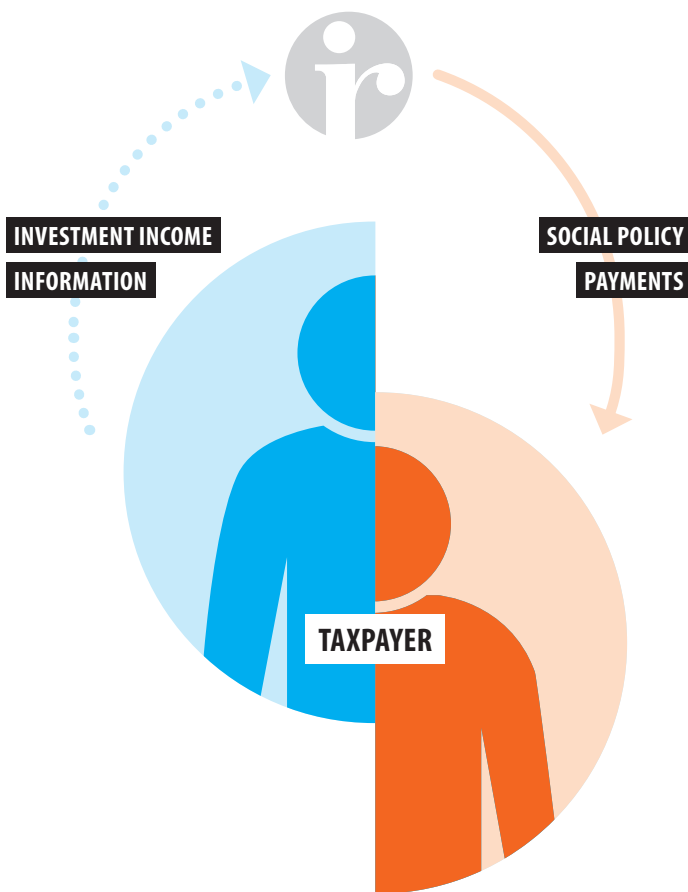
Some recipients of investment income are likely to have more than one of the three types of entitlements or obligations shown and as such the diagrams show overlapping fields. The extent of any overlap has not been quantified at this stage.

RECIPIENTS OF PIE INCOME AND SOCIAL POLICY



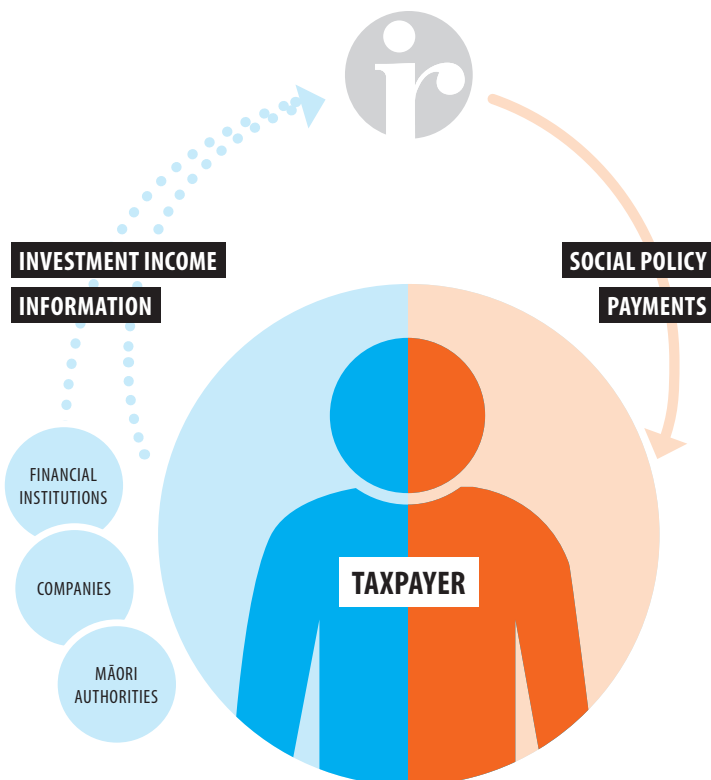
RECIPIENTS OF DIVIDEND INCOME AND SOCIAL POLICY





WHAT CURRENTLY HAPPENS

It can be difficult for individual taxpayers to keep track of their overall tax position based on the statements and certificates that they have received, as well as any other income they earned. This can make it harder for them to know whether they are fully complying with their tax and social policy obligations or receiving the correct level of social policy entitlement.



THE PROPOSED FUTURE

Obtaining detailed withholding information regularly throughout the year would give Inland Revenue a better understanding of taxpayers' income positions and the time at which the income was earned. This would enable Inland Revenue to more accurately determine the amount of social policy payments a taxpayer is entitled to receive or the amount of child support or student loan a taxpayer is liable to pay during the income year.



CHAPTER 2

TAXATION OF INVESTMENT INCOME IN THE FUTURE

BACKGROUND

The proposals in this discussion document are designed to remove or reduce inefficiencies in the current system for investment income payers, recipients and Inland Revenue. These current issues are summarised here.

Tax information is hard to keep track of

Different types of investment income are taxed in different ways. Also, if a taxpayer invests with a number of different investment providers they are likely to receive at least one withholding tax certificate or dividend statement from each of them. It can be difficult for individual taxpayers to keep track of their overall tax position based on the statements and certificates, as well as any other income they earned. This can make it harder for them to know whether they are fully complying with their tax and social policy obligations or receiving the correct level of social policy entitlements.

The proposals in this discussion document would increase the amount of information that Inland

Revenue will be able to pre-populate for taxpayers. For large numbers of taxpayers that would mean all of their taxable income information is available in one place. Taxpayers who receive income from a number of other sources that would not be able to be pre-populated, such as foreign sourced income and rental income, would still need to provide information on that income to Inland Revenue.

The provision of information to Inland Revenue by payers and taxpayers is inefficient

The organisations that collect withholding tax from investment income have to provide information to their customers. If their customers file a tax return they also provide the information to Inland Revenue. The inefficiency increases for taxpayers who have to collate investment information from a number of statements and certificates from various different investment providers. It would be more efficient if the information only had to be provided to Inland Revenue once, by the investment providers.

The timing of the provision of information, gaps in the information required and significant numbers of records without IRD numbers, mean that Inland Revenue is currently unable to effectively calculate income positions to use for social policy and to ensure returns are correct. This also makes it difficult for Inland Revenue to check that RWT rates and PIRs elected are available to the taxpayer.

Non-declaration rates

To make sure that investment income is taxed appropriately, people are supposed to provide their IRD numbers. A customer who doesn't provide an IRD number is taxed at a non-declaration withholding tax rate, which is at least equal to the top withholding tax rate for people who have provided their IRD numbers. The non-declaration rates are intended to encourage people to provide their IRD numbers but do not create an incentive when the non-declaration rate is lower than or equal to the top marginal income tax rate (currently 33%). In fact, some taxpayers may have effective marginal tax rates that are higher than 33% if they receive social policy payments or have to make child support or student loan payments.

The non-declaration rates are inconsistent across the tax system. PAYE on wages and salaries has a 45% non-declaration rate; the RWT non-declaration rate is 33% and the PIE non-declaration rate is 28%. As the RWT non-declaration rate is equal with the top marginal tax rate and the PIE non-declaration rate is equal with

the top PIR (but lower than the top two marginal tax rates) they do not provide a real incentive for investors to provide their IRD numbers unless the investors are on low marginal tax rates.

A SIMPLER FUTURE FOR INDIVIDUALS

The Government thinks it would be simpler for taxpayers to comply with their tax obligations if Inland Revenue could show them a list of all of the income it knows they've received during a year, and the tax that was withheld from that income. The information could also be useful to taxpayers for non-tax purposes (such as proof of income for borrowing money). This would mean taxpayers with investment income wouldn't have to collect and collate that information from the withholding certificates they receive from the payers of investment income. Having most or all of their income pre-populated in their tax records would save taxpayers time and reduce the risk of errors.

The Government also thinks it would make things easier for taxpayers if Inland Revenue could assist them to work out which tax rate they should select for their investment income, to make sure that they are not overtaxed during the year, or undertaxed and face a tax bill later. Inland Revenue would be in a better position to do this if it received more information about taxpayers' income during the year, rather than after the end of a year.

Obtaining detailed withholding information regularly throughout the year would give Inland Revenue a better understanding of taxpayers' income positions and the time at which the income was earned. This would enable Inland Revenue to more accurately determine the amount of social policy payments a taxpayer is entitled to receive or the amount of child support or student loan a taxpayer is liable to pay during the income year. The ability to make timely adjustments would reduce end-of-year square-up issues such as taxpayers having significant amounts to repay, or having received too little during the year when they needed the assistance.

WHAT WOULD NEED TO CHANGE?

To achieve these goals, Inland Revenue would need to receive information from payers of investment income sooner and more often than it currently does. In some cases Inland Revenue would also require more information than it currently receives from payers (although payers already hold this information and they would not need to collect more details from their customers). Inland Revenue would need to receive and process this information efficiently, and match the income information to individual taxpayers' records.

DIFFERENT PROCESSES FOR PAYERS OF INVESTMENT INCOME

Depending on the type of investment income that they pay and the type of tax that applies, payers currently have different obligations in terms of

the information they are required to provide to Inland Revenue, and how often they provide it.

In the future all payers of investment income would be expected to provide similarly detailed information on the recipients of the income and the amounts of income and tax credits they receive for all tax types and for income that is not subject to withholding tax. This information would typically be provided monthly, or in line with business processes if payments are made less frequently.

The information would be transferred to Inland Revenue through an electronic data transfer process and would go through validation checks so the payer would be advised immediately if the information that they had provided could not be validated. This would enable corrections to be made quickly and save later rework. Payers could alternatively choose to complete an online form if that better suited their technical capability, or if they have a small number of investors.

Payers of investment income and Inland Revenue would be able to communicate via a business-to-business information transfer, allowing the payers to receive electronic notifications of corrections to customer information from Inland Revenue, such as withholding tax rate changes if the customer is using an inappropriate rate.

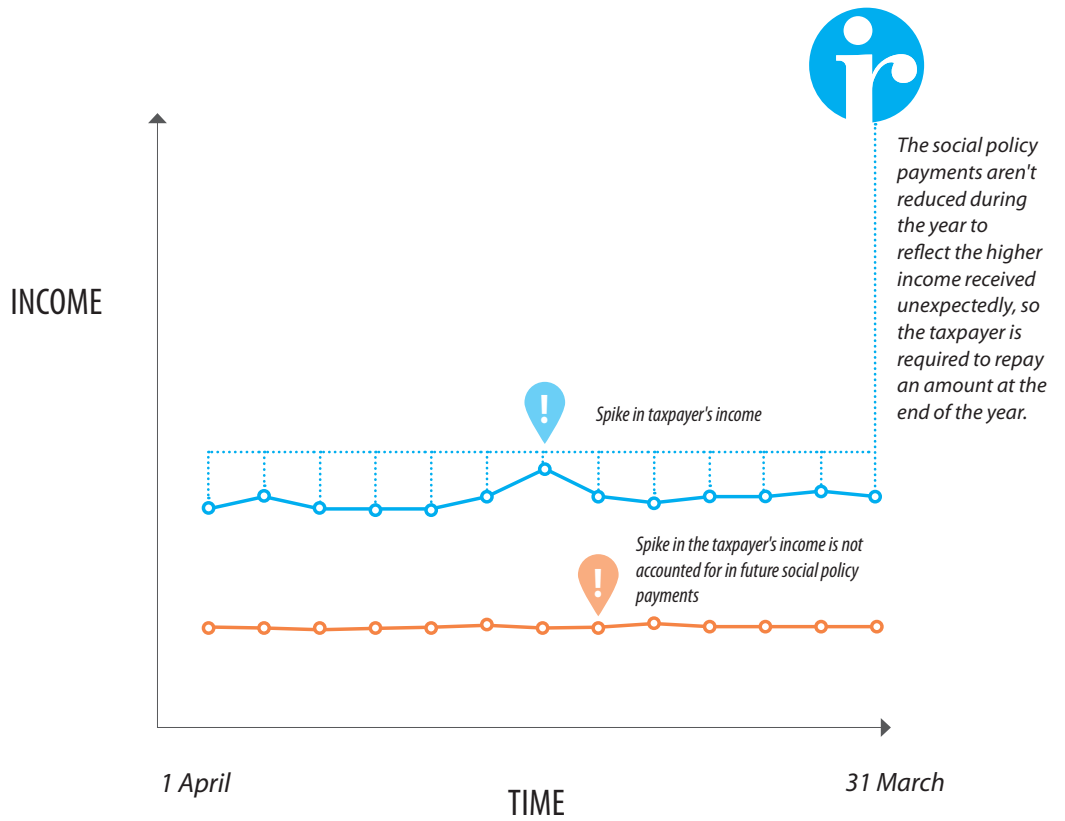
Payers would need to send more information on jointly held investments to enable Inland Revenue

CURRENT

Inland Revenue does an end-of-year square up which can result in issues such as taxpayers being under or over paid in regards to their social policy entitlements.

KEY

- Taxpayer's income
- Social policy payment

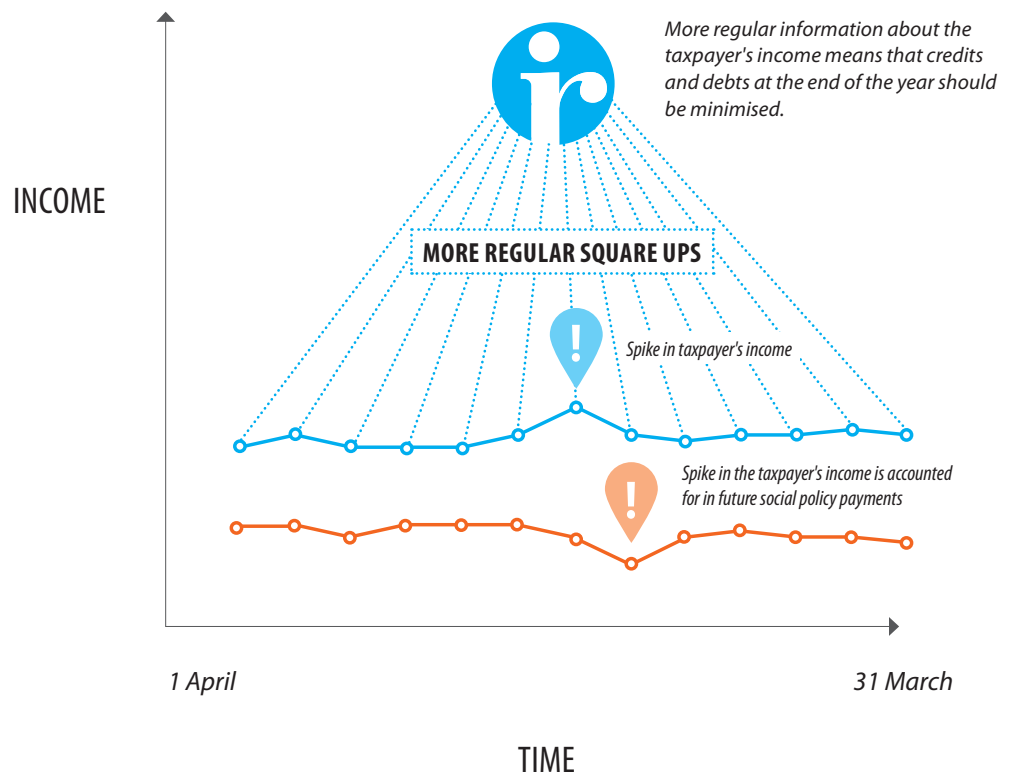


FUTURE

Obtaining detailed withholding information regularly throughout the year would give Inland Revenue a better understanding of taxpayers' income positions so their social policy payments more accurately mirror their income.

KEY

- Taxpayer's income
- Social policy payment



to identify all of the recipients of the investment income.

Inland Revenue would add the information received from payers to the recipients' tax records. Payers would no longer have to prepare end-of-year tax certificates for customers who had supplied their IRD numbers. However, they would still need to prepare an end-of-year tax certificate for customers who hadn't supplied their IRD numbers.

Payers of investment income sometimes have customers who are exempt from withholding tax. Inland Revenue would provide payers with details on their customers who hold valid certificates of exemption, so payers can confirm whether they need to withhold tax.

CHANGES FOR INLAND REVENUE AS WELL

Inland Revenue would receive the validated information through online forms or electronic data transfers and this would allow Inland Revenue's system to match the relevant information with individual taxpayers' tax accounts without manual intervention. This would enable Inland Revenue to much more accurately assess the tax position of individual taxpayers throughout the year.

Using the up-to-date information, Inland Revenue would monitor taxpayers' income levels during the year and be able to increase or reduce income-targeted social policy payments such as Working for Families Tax Credits. This would help to ensure

that people are receiving the correct level of assistance throughout the year and reduce the risk of an under or overpayment at the end of the year.

Inland Revenue could also potentially advise payers of investment income of corrections to withholding tax rates and other information in time for the payers to make any needed adjustments during the income year. This would help to ensure that taxpayers are on an applicable rate for their circumstances and would reduce adjustments at the end of the tax year.

For recipients who haven't given the investment income payer their IRD number, Inland Revenue would use information matching tools to associate the income to the recipient taxpayer, if sufficient identifying information is available.

COMPLIANCE COSTS

The proposals in this document are part of a wider change to the tax system and the tax obligations of people and organisations. A fundamental reason to collect information from the payers of investment income is that this is significantly more efficient and reliable than collecting the same information from each of the recipients of the income. The greatest efficiency gains come through collecting information from payers with large numbers of customers.

This discussion document proposes changes that are intended to simplify the tax system for individuals and to make more efficient use of

information. By collating all of the information that Inland Revenue holds on a taxpayer's income in one place, and providing easy access for the taxpayer, Inland Revenue will make it easier for taxpayers to manage their tax affairs. It will take less time and effort for the recipients of investment income to understand their tax position and social policy obligations and entitlements, and filing a tax return will be able to be done more quickly.

The proposed increases in reporting obligations would be expected to give rise to some additional compliance costs for payers of investment income. However, this is mitigated by the fact that the payers would not need to seek more information from customers, but rather to report more of the information they already hold.

The adjustments to the reports that are produced by the payer's systems should be a one-off cost, although it is possible that reporting additional information more regularly may give rise to some additional ongoing costs. These costs will likely be limited, as payers already have to calculate the tax when they pay the investment income and the more detailed reporting requirements will replace existing summary reporting requirements.

Other changes are likely to reduce compliance costs for payers of investment income, including:

- changes to make the transfer of information more efficient;

- removal of some requirements, such as the need to send end-of-year certificates to all customers; and
- the creation of a database of current certificates of exemption to make it easier for payers to manage their obligations.

If these changes proceed it will be important to ensure that timeframes for reporting changes are realistic, as payers of withholding income would not be able to make the system changes until the requirements have been fully determined (feedback on realistic timeframes is requested later in the document). Some payers of investment income may also need to make changes to multiple computer systems and need to fit the changes in alongside other system change priorities. A number of other regulatory changes will also require system development, including the international Automatic Exchange of Information which is expected to require financial institutions to begin conducting due diligence and meeting reporting requirements on all new accounts from 1 July 2017.

CHAPTER 3

DETAILED PROPOSALS

QUESTION FOR READERS

1 Would companies have difficulties providing detailed dividend information to Inland Revenue so it can pre-populate shareholders' tax records? If so, why and how could this be made easier?

INFORMATION IRD WOULD NEED

Dividend information

Companies provide detailed information to their shareholders (shareholder dividend statements) for each dividend that they pay but they only provide summary information to Inland Revenue on the total dividends paid, unless additional information is specifically requested. This means Inland Revenue is unable to associate dividend income with each shareholder.

In the future companies would need to provide detailed information to Inland Revenue after paying each dividend, so the dividend information can be pre-populated on the shareholders' tax records.

The information that companies would need to provide would include identifying information such as the name, address and IRD number (if held) of the shareholder, as well as the amount of the dividend, any imputation credits attached and any withholding tax deducted. This is information that the company already holds in order to pay the dividends

and send out the shareholder dividend statements. No changes are proposed for dividends paid to non-residents.

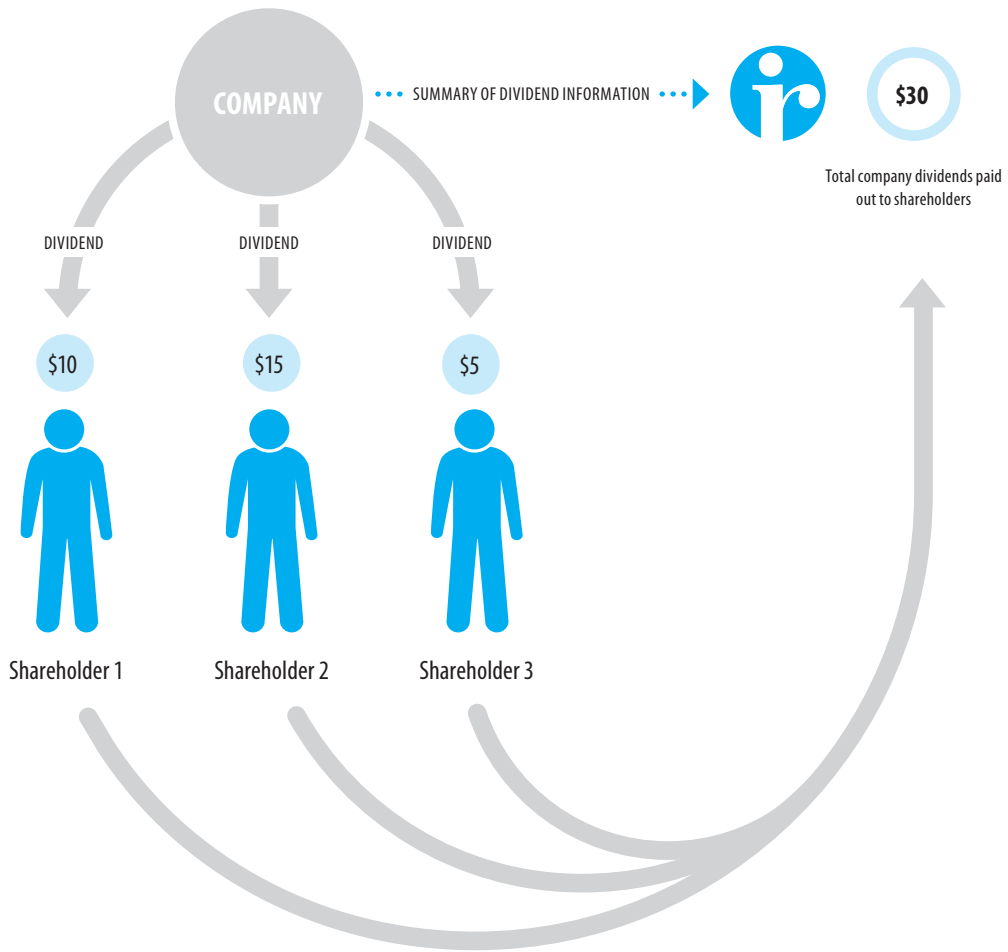
Information for interest subject to RWT and NRWT and PIE income

The detailed information that is currently provided to Inland Revenue after the end of the tax year regarding interest subject to RWT or NRWT and PIE income will still be required going forward (although it is likely to be required more regularly as discussed in the Timing, frequency and method section on page 30). This includes details such as the name, IRD number (if held), address, interest paid and RWT, NRWT, or PIE tax deducted from the interest or PIE income for each recipient.

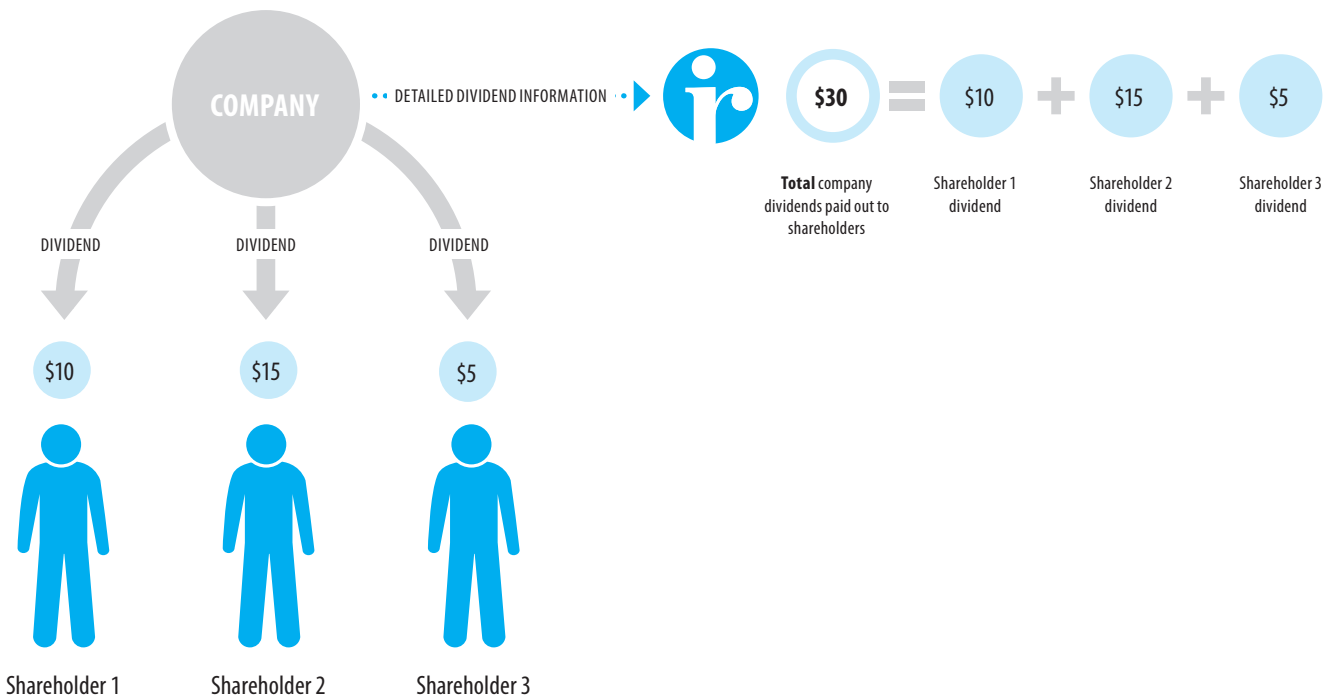
Information for exempt interest and interest subject to approved issuer levy

Inland Revenue receives no detailed information about interest that is exempt from withholding tax or that is subject to the approved issuer levy (AIL). Having this information would allow Inland Revenue to allocate the

CURRENT



FUTURE



QUESTIONS FOR READERS

2 If detailed reporting was required for interest that is subject to AIL to determine the recipients eligibility to be subject to AIL how frequently should that information be provided?

3 If providing detailed reporting on interest that is exempt from withholding tax would be difficult please explain why and how this could be made easier.

4 If you issue debt instruments offshore do you hold information on the investors and if not are you reasonably able to obtain it? Contextual information supporting your answers and your views on the likelihood of New Zealand investors investing directly in these products would be greatly appreciated.

5 Are there any practical problems with providing detailed reporting?

income to people's tax records, if they have an IRD number, and to check that the recipients were entitled to have AIL deducted or claim exemptions from withholding tax.

Under this proposal the payers of exempt interest and interest subject to AIL (potentially limited to domestically issued debt) would provide detailed reporting like the reporting required for RWT, NRWT on interest and PIE tax. For example, payers will provide details such as the name, IRD number (if held), address, interest paid and AIL paid on the interest (if any) for each recipient.

If the interest is paid to a New Zealand resident nominee company or an agent, the first payer would show the payment to the nominee or agent in their reporting, and the nominee or agent would provide detailed reporting for the payments that they in turn make.

Where the interest subject to AIL is paid in respect of debt issued domestically (e.g. New Zealand bank deposits and bonds issued in New Zealand) we would expect the interest payers to hold the details of the investors in order to manage the payment of interest (whether themselves or through a New Zealand registry).

Inland Revenue understands that where debt instruments (typically wholesale) are issued to offshore investors through offshore paying agents the New Zealand interest payer may not hold detailed information on the investors (they simply pay

the interest to the offshore paying agent who pays the investors). Inland Revenue also understand that the offshore paying agents may be constrained in their ability to provide this information by privacy laws in their own jurisdiction. The Government is interested in feedback on whether this understanding is accurate and would welcome suggestions if there are ways that this information could be obtained.

The Government is also interested in feedback from issuers of offshore debt instruments on the practical likelihood of New Zealand resident investors (other than collective investment vehicles) investing in these products.

Provision of IRD numbers

Associating income information with the right taxpayers is vital for pre-populating the income information into taxpayers' Inland Revenue records. Successful pre-population will make it simpler for taxpayers to complete tax returns if they need to or choose to. If people do not provide their IRD number to the organisation that pays them investment income, it is difficult for Inland Revenue to associate the income with a particular taxpayer and to gain an accurate understanding of their tax position. This limits Inland Revenue's ability to give the taxpayer the details they need to complete a tax return, and to calculate any social policy entitlements or obligations. It may also make it difficult for the taxpayer to calculate the prescribed investor rate (PIR) available to them in a future year.

QUESTIONS FOR READERS

6 Should a higher non-declaration rate be put in place for RWT on interest and/or PIE income? If not, please explain why.

7 Would there be administrative difficulties in applying an additional tax rate for non-declared taxpayers? If so, please explain the nature of the problem.

8 If a higher non-declaration rate is put in place for PIE income should the PIE income taxed at the non-declaration rate be treated as taxable income of the recipient to allow them to claim the tax credits in their tax return?

As the top (and default) withholding tax rate for RWT is 33%, there is no incentive for investors who are already on the top tax rate to provide their IRD number to the organisations that they invest with as their investment income will be taxed at the right rate regardless. Similarly there is no real incentive for taxpayers to provide their IRD number to their PIE when they are on the 30% or 33% marginal tax rate, as their PIE income would likely be taxed at the 28% default PIR.

The Government proposes making the non-declaration rates for RWT on interest and PIE income 45%. This gives an incentive for investors to provide their IRD numbers and aligns the non-declaration rates for these taxes with the non-declaration rate for PAYE.⁷ It would be important for investors to be adequately informed of this change, if it was made, to allow reasonable time for them to provide their IRD number and not be subject to the higher tax rate.

The RWT non-declaration rate on dividends and taxable Māori authority distributions would remain at 33%. Company dividends have a flat tax rate of 33%, so requiring additional rates would cause significant compliance costs to change systems as they have not been set up to collect tax at different rates. Many Māori authorities also have significant administrative and system constraints and would be likely to have difficulty complying with more complicated requirements.

If the PIE income non-declaration rate was increased to 45% this could be seen as unduly harsh as PIE tax is

usually a final tax. Under the current PIE rules the recipient could not get a refund of the tax even if they filed a tax return. This could be alleviated by making PIE income that has been taxed at the non-declaration rate part of the recipient's taxable income. They could then include it in their tax return and get a tax credit for the 45% PIE tax deducted. Alternatively, the tax deducted at the non-declaration rate could be left as a final tax as this would provide the strongest incentive for people to provide their IRD number to their PIE manager.

Joint ownership of investments

A proportion of the income from jointly owned investments is taxable to each of the owners based on their proportion of ownership of the investment. It is important to accurately allocate the income to each owner to ensure that their tax and social policy obligations and entitlements are correctly calculated.

Joint bank accounts, other jointly owned interest-bearing investments and jointly owned PIE Investments

Currently Inland Revenue receives only one IRD number for each jointly owned investment when interest and PIE income is reported, and has to rely on the owners correctly allocating the interest income in their tax returns (shown in the diagram on the next page as Option 1). The current method of reporting jointly owned investment income is not considered to be sustainable going forwards. To have some basis for allocating interest and PIE income to each owner for

⁷ The "Better Business Tax" issues paper issued in April 2016 also proposes a 45% non-declaration rate for contractors.

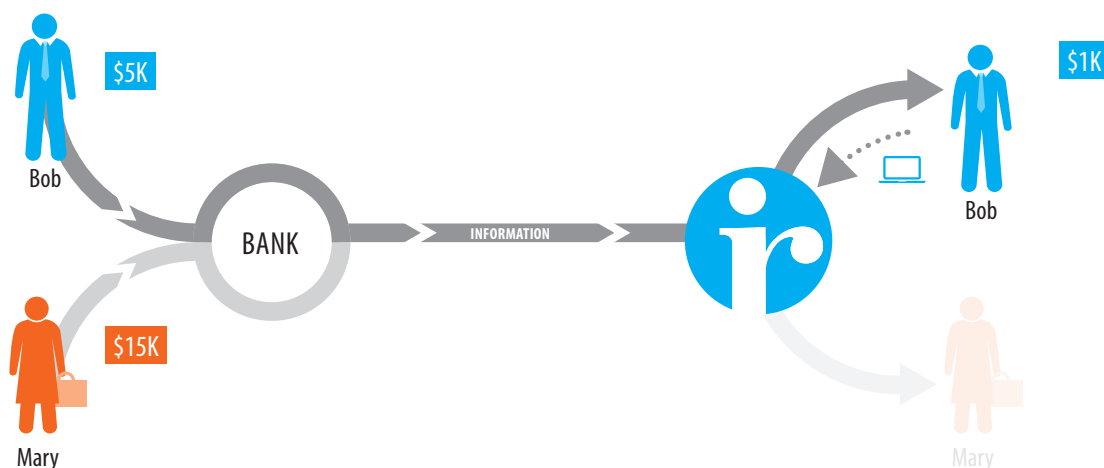
pre-population, Inland Revenue will need some identification details such as IRD number, name and address for each owner.

Jointly owned investments are currently treated as a single record in withholding tax returns (Option 1), which is consistent with the way they are treated by the PIEs' and interest payers' systems. In order to include all of the owners' details it might be necessary for the investment income payer to split the income and the tax withheld among the owners and then treat each portion as an individual record in the withholding tax returns (shown in the diagram as Option 2). The Government is aware that this

could cause system difficulties for investment providers and also that the investment providers may not hold information on the proportions of the investment owned by each of the joint owners.

As the joint owners may not own the investment in equal proportions there would need to be a way for owners to correct the income attributed to them if the investment provider cannot provide the ownership proportions to Inland Revenue. This would also need to be able to be cross-checked against the proportion attributed to other owners to ensure that all of the income is being returned. It may be possible for the owners to inform

OPTION 1

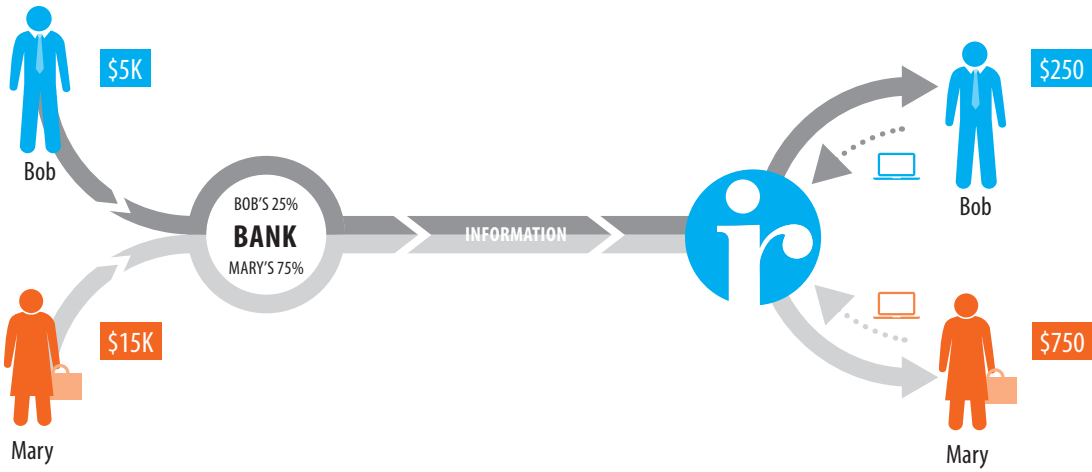


1 Bob and Mary's money goes into their interest bearing joint account at bank.

2 \$1,000 interest income goes into the bank account which is registered to Bob's IRD number. The income information is then sent to Inland Revenue with Bob's details.

3 Inland Revenue pre-populates the information to Bob who should then allocate a proportion of the income to Mary (\$750).

OPTION 2

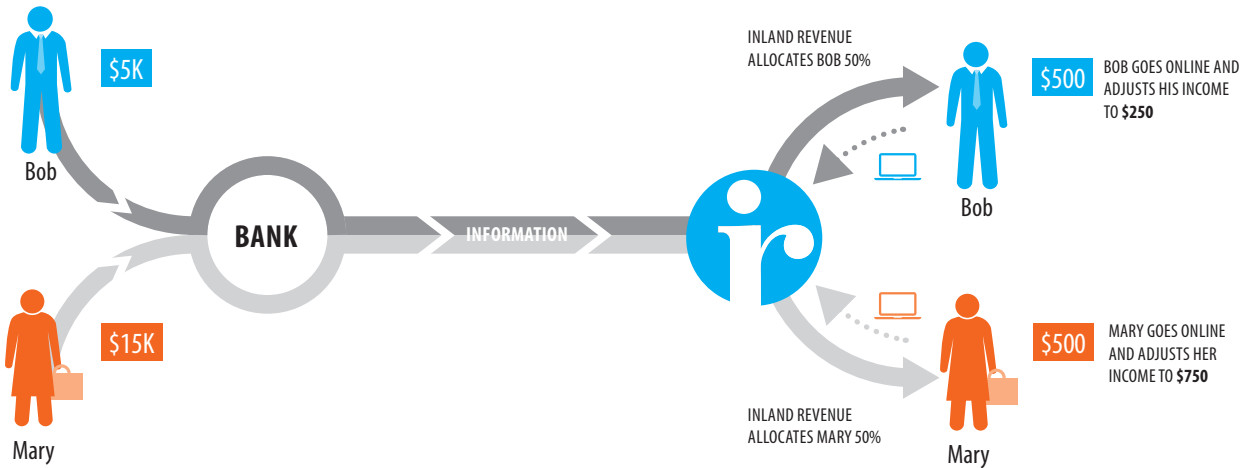


1 Bob and Mary's money goes into their interest bearing joint account at bank.

2 \$1,000 interest income goes into bank account registered to Bob's IRD number. Bank sends Bob and Mary's details to Inland Revenue allocating each their proportion of the investment.

3 Inland Revenue pre-populates the information to Bob and Mary. Bob and Mary can verify or change these details online.

OPTION 3



1 Bob and Mary's money goes into their interest bearing joint account at bank.

2 \$1,000 interest income goes into bank account registered to Bob's IRD number. Bank gives Inland Revenue a file telling us that Bob and Mary jointly own the account.

3 Inland Revenue pre-populates the information to Bob and Mary and evenly proportions the investment to each. Bob and Mary are able to adjust the income levels if they do not hold the ownership of the investment in equal proportions and in this case Mary should adjust her income up to \$750 and Bob's should decrease to \$250.

QUESTIONS FOR READER

9 Are there better ways to deal with the allocation of joint interest income to the owners?

10 For interest payers and PIEs, how should joint interest information be provided to Inland Revenue?

11 How should the interest or PIE income be attributed to each joint owner?

12 If you think that it would be difficult for Māori authorities to provide detailed distribution information to Inland Revenue, please explain why and how this could be made easier.

Inland Revenue directly if changes to the proportions allocated to the various owners are required.

Alternatively, the jointly owned investment could remain as a single record and the investment provider could provide a supplementary return setting out the details for each joint owner (shown in the diagram on the previous page as Option 3). This would need to be linked to the record in the main withholding tax return by some form of unique identifier so Inland Revenue could split the income and the tax credits. The income could be split on a pro-rata basis unless the investment provider had details of the ownership proportions for the investment that could also be provided with the return.

Joint ownership of other investments

If shares are held jointly, the shareholder dividend information will need to include details for each joint owner to the extent that these are held by the company. The ownership of the shares and the entitlement to the dividend income will be treated as being held in even proportions.

Membership of a Māori Authority is held individually rather than jointly and as such the discussion of joint ownership is limited to PIE income, interest bearing investments and shares.

Māori authority distribution information

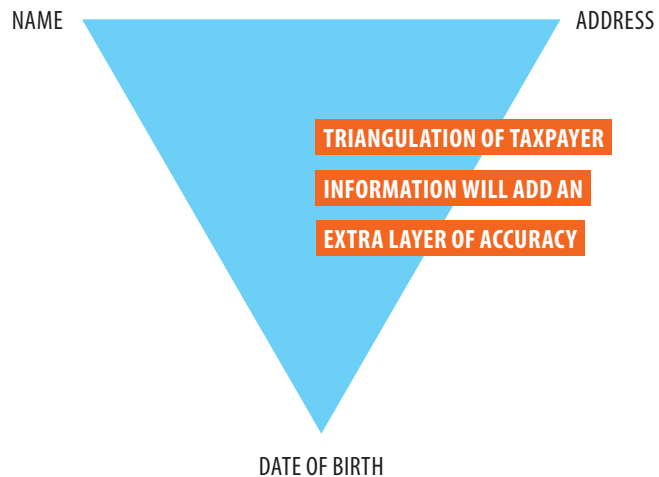
Māori authorities provide detailed information to their members

(distribution statements) for each taxable distribution, but they only provide Inland Revenue with summary information on the total distributions, unless additional information is specifically requested. This makes it impractical for Inland Revenue to associate distribution income with each member unless they file a tax return and declare the distribution income.

Taxable Māori authority distributions are taxable income to the member that receives them. The member's tax liability on their taxable Māori authority distributions may be covered by the attachment of Māori authority credits to the distribution, or the deduction of RWT. Inland Revenue proposes to include taxable Māori authority distributions and any attached Māori authority credits or RWT credits in the pre-population process.

Māori authorities are not currently required to provide detailed distribution information to Inland Revenue. In order to pre-populate the information on taxable Māori authority distributions, Inland Revenue will need detailed information from the Māori authority on the amount of the distribution, the recipient, the amount of the Māori authority credits and the amount of any RWT credits.

The information that would be required would be the same as the information that Māori authorities are currently required to send out to their members when they make the distributions, and would include



QUESTIONS FOR READERS

13 Should investment income payers provide Inland Revenue with date of birth information for their customers? If not, please explain why.

recipient details such as name, address and IRD number, as well as the amount of the distribution and any credits attached. It is similar to the type of information provided by banks in relation to interest that they pay to their customers.

Date of birth information

The Government proposes that date of birth information should be provided if it is held by investment income payers. Privacy concerns have been raised by submitters who responded to the Government's Green Paper; however, having date of birth information would significantly increase Inland Revenue's confidence in confirming the identity of the recipient of the income and ensuring that the income is allocated to the correct IRD number. There is also a proposal to collect date of birth information for PAYE purposes in the *Making Tax Simpler – Better Administration of PAYE and GST discussion document*.

Some people use multiple spellings or versions of their name and it is not uncommon for two or more people to

have the same name. People can also give incorrect IRD numbers in error. Where people have not provided their IRD number or have given an incorrect IRD number, providing the date of birth will improve Inland Revenue's ability to match income to a taxpayer. Inland Revenue currently receives name and address information but adding date of birth information adds another layer of accuracy to the matching process and can make it possible to identify people even if they have had a change of name or address.

Example

Jenny and her mother have the same name and live at the same address. Jenny hasn't given her interest payer her IRD number, but her mother has supplied hers. There is a risk that Jenny's investment income could be matched with her mother's Inland Revenue records. If they both had their date of birth recorded with their investment providers, Inland Revenue could be sure to allocate their income to the right accounts.

QUESTIONS FOR READERS

14 Should the Government remove the requirement for interest payers to provide end-of-year tax certificates for customers that have provided their IRD numbers?

WHO SHOULD PROVIDE THE INFORMATION?

The key driver of efficiency in withholding tax systems is large payers of investment income deducting tax from many recipients and paying that to Inland Revenue. This also drives compliance as there is third party reporting of the recipients' income. Given these benefits, it is logical for these responsibilities to remain with the payers of investment income. There may, however, be the opportunity to remove some other obligations from the payers.

End-of-year tax certificates

Tax certificates – usually printed – are provided to taxpayers by each organisation that they invest with. Taxpayers with multiple investments can end up with dozens of different tax certificates (such as year-end interest certificates, shareholder dividend statements and Māori authority distribution statements) that they need to keep track of in order to understand their tax position. In recognition of this difficulty, some share registries offer their customers a summary of all of the certificates that the share registry has provided to the customer. The recipients then include the collated investment information in their tax return. This seems more difficult than it needs to be, particularly as some of the information has already been provided to Inland Revenue by the payers.

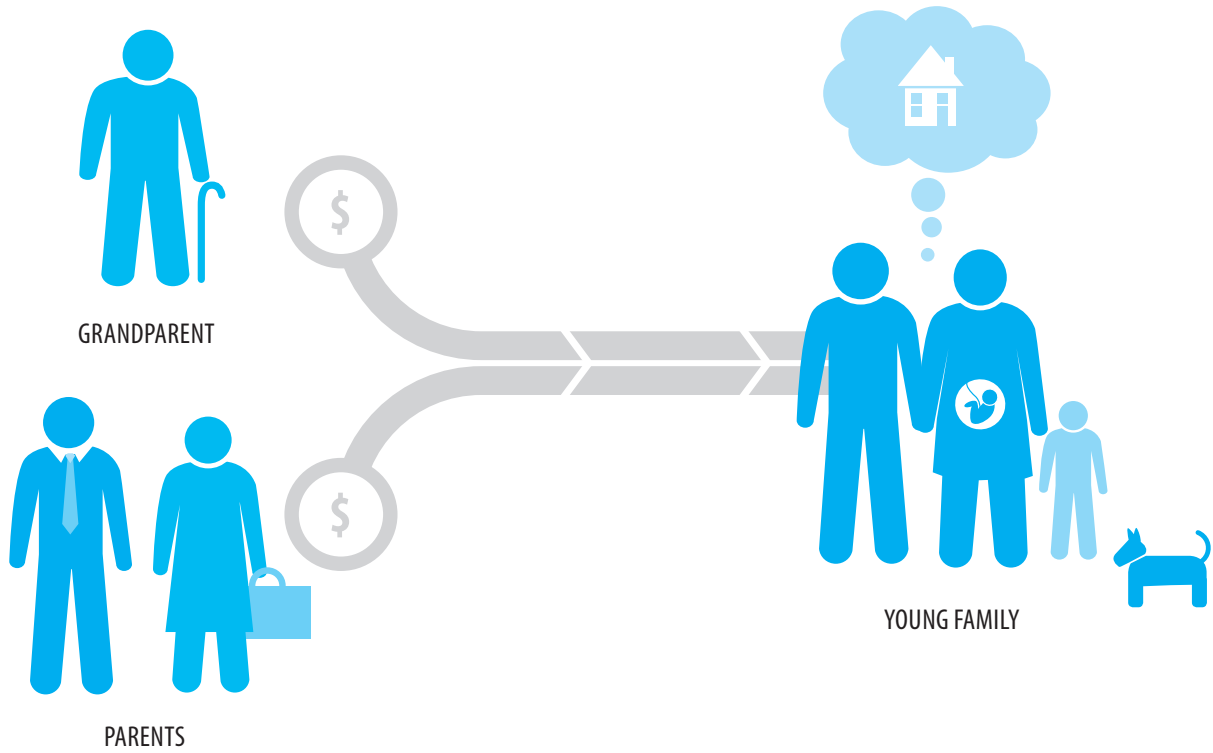
If the income details can be pre-populated cumulatively through the year, taxpayers would be able to

get a summary of their end-of-year position by logging onto the Inland Revenue website. This would make it easier for taxpayers that need, or want, to complete a tax return. Once this is working effectively it could be appropriate to remove the obligation for interest payers to provide end-of-year tax certificates to customers who have supplied their IRD numbers, as all their information would be in their Inland Revenue record. This could be a significant saving in time, effort and cost for interest payers. They would still need to provide end-of-year certificates to customers who had not supplied an IRD number, as Inland Revenue may not be able to match the income to the right person. In addition, if the non-declaration rate was increased to 45%, the end-of-year certificate would be a reminder to these people that they are being taxed more heavily because they haven't supplied their IRD number to their investment provider.

Private peer-to-peer lending

The current withholding system typically requires payers to provide the information to Inland Revenue. This is most efficient for larger organisations who are paying interest and dividends to many customers, but is not as suitable for private peer-to-peer lending. This is not, however, a problem for peer-to-peer lending arranged through a commercial peer-to-peer lending platform as the commercial lending platforms undertake the withholding obligations and provide the required information to Inland Revenue.

PRIVATE PEER-TO-PEER LENDING



QUESTIONS FOR READERS

15 How can disclosure of this type of interest income be encouraged?

16 Do you agree that adding a question to the tax return could be useful to encourage disclosure of this type of income?

Interest on private loans (for example, loans between family members) is taxable to the recipient but is unlikely to be subject to withholding tax (if the interest is less than \$5,000 per annum it is unlikely to be subject to RWT). The lenders receiving interest from private loans may be unaware that they should be declaring it as income, and there is no third party reporting to help ensure that this type of income is declared. We do not propose extending withholding tax to include this type of lending if it is not included already. Instead, we propose adding a specific question to the tax return asking people whether they have received any interest income that has not had withholding tax deducted from it (this could have a

note explaining that this includes private loans).

The use of a specific question would aim to ensure that people knew that they had to declare this income and to encourage people to correctly declare their interest income without causing a major increase in compliance costs.

QUESTIONS FOR READERS

17 If taxpayer-specific information is to be provided more frequently, would it make a significant difference to compliance costs to provide the information monthly rather than quarterly or would the difference be marginal as system changes would be needed either way?

18 For organisations affected by the proposed increased reporting requirements, what would be a realistic timeframe for making changes to systems?

TIMING, FREQUENCY AND METHOD

Timing

The timeframes for filing withholding tax returns and making payments will remain the same, with the exception of March end-of-year returns. It is proposed that the detailed March returns would be filed by 20 April for RWT, NRWT and AIL and 30 April for PIE tax to enable pre-population of the investment income into taxpayers' records. This will be necessary to give taxpayers access to complete records so they can use the information in their tax return and to support rate choices and social policy income calculations.

Frequency of receipt of information

Organisations paying investment income only supply customer-specific withholding information to Inland Revenue after the end of the tax year (and only for some types of income and some tax types). This information is received after Inland Revenue has prepared personal tax summaries and summaries of earnings (these currently only show employment, benefit and some pension income, for people to transfer to their IR3 tax return). The withholding tax information is not matched up with PAYE information, so Inland Revenue cannot intervene if withholding tax rates are not in line with a taxpayer's marginal tax rate until well after the end of the tax year. This means that a taxpayer may have been overtaxed during the year and need a refund, or undertaxed and have more tax to pay. Inland Revenue is also unable to make

adjustments during the year (based on the income for the year to date) to people's social policy entitlements and obligations.

For Inland Revenue to use information during the year to pre-populate taxpayers' records, check tax rates, adjust social policy entitlements and obligations, and make better informed compliance management choices, it needs to receive taxpayer-specific withholding information more regularly.

The Government proposes that taxpayer-specific withholding information should be provided monthly (or for the month of with the business process if the income is paid less frequently than monthly with the returns being due in the following month). This would include information on interest, dividends, royalties and Māori authority distributions subject to RWT, NRWT and AIL, and exempt interest and dividend income. The specific information required would be similar to the end-of-year information currently provided for RWT, NRWT and PIE with some enhancements, as discussed in the "Information IRD would need" section from page 20.

Method of reporting

The detailed income could be reported for each period or cumulatively to date. Reporting period by period would mean that after validation an amount would be added (or subtracted if there had been a correction) to the pre-populated amount in the recipient's

QUESTIONS FOR READERS

19 Would it be preferable for payers of withholding income to provide the information for each individual period or for the year to date?

20 If you are a manager of a PIE fund (or funds), would your systems be capable of providing monthly income calculations (and investor details) or would the alternative reporting option be necessary for locked in PIEs?

21 What other alternatives should be considered for reporting investor details and PIRs and income reporting for locked in PIEs?

tax records. Alternatively, year-to-date reporting would enable the pre-populated information to be replaced as the new figures are transferred to Inland Revenue. Only one option will be made available to avoid confusion and unnecessary complication.

PIEs

Under the PIE tax rules investors have to select their PIR based on their income in the previous two years. Given the difficulties that taxpayers face in working out their income, there is a reasonable chance that taxpayers will be basing their choice of PIR on incorrect calculations of income. Taxpayers could also fail to complete a tax return when they are required to if they forget to update their PIR as their income level increases (or if they don't realise that their income has reached an income threshold that requires them to select a higher PIR). If PIE information was provided more regularly Inland Revenue could help taxpayers to fix incorrect rate choices.

The majority of PIEs are exit PIEs, which means they only pay tax on income at the end of the income year (unless an investor exits the PIE). This means that while PIE providers regularly calculate income and accrue tax some may not carry out a full and final tax calculation process until the end of the tax year. It could impose an additional compliance burden to require these full and final processes to be carried out during the year, and this may not be justified in cases where taxpayers do not need to include the PIE income for social policy calculations.

It may be appropriate to only require monthly investor detail and income reporting for PIE income that is not locked in, as only this PIE income is included in the income calculations for social policy. PIE income that is "locked in", such as income from KiwiSaver funds and complying superannuation funds with withdrawal restrictions, is not included in income calculations for social policy purposes, so such income may not need to be reported as frequently.

An alternative option for locked in PIE funds might be to provide reporting on investors' details and their current PIRs at some points during the year to allow Inland Revenue to check that the rates are available to the investors. This could perhaps be done quarterly or six-monthly. This reporting could also include the current level of PIE income and therefore the expected PIE tax on that income at the end of the year, to help to inform Government forecasting.

Māori authorities

As Māori authorities typically make distributions once or twice a year, the information requirement would be connected to the time of payment rather than requiring monthly returns.

Companies paying dividends

As companies typically pay dividends once or twice a year (and sometimes don't pay a dividend) the information requirement would also be connected to the time of payment with a return for the month in which the payment was made being required (this

QUESTIONS FOR READERS

22 Do you agree that there should be a simple dollar threshold and a percentage based threshold for error correction?

23 How should thresholds setting a limit on the size of the errors allowed to be self-corrected be calculated and what levels are reasonable?

return would be due on the 20th of the following month) rather than requiring monthly returns.

Error correction

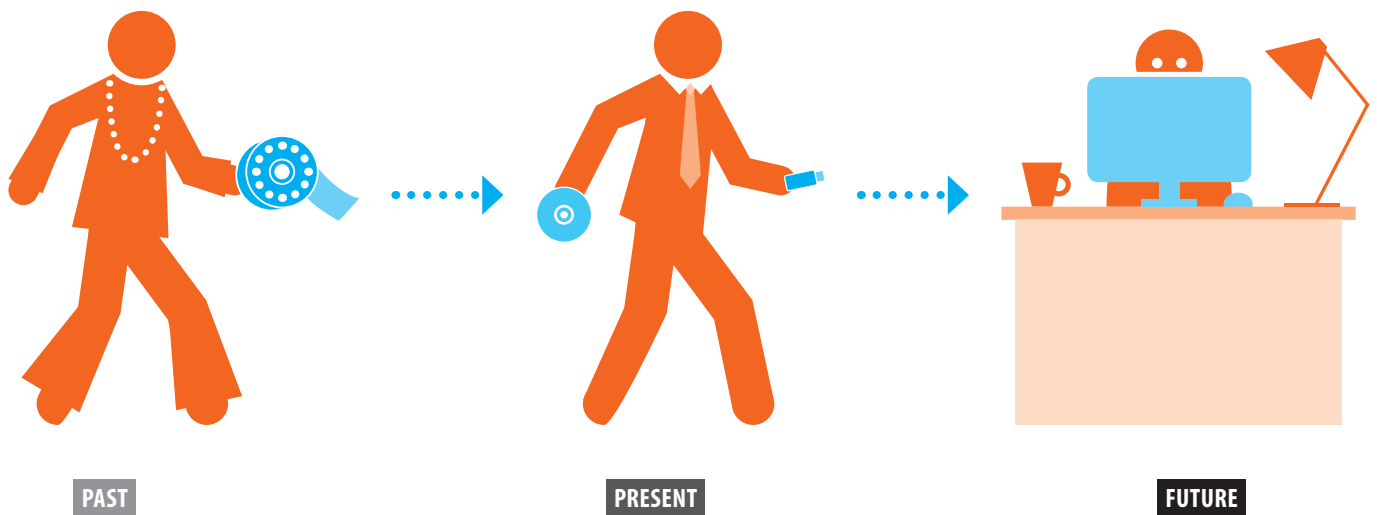
If detailed information is required more often, it is inevitable that there will be some errors in it. While Inland Revenue would expect withholding tax payers to use due care in their reporting, there does need to be a mechanism for error correction.

Minor errors should be allowed to be corrected in subsequent periods as long as the amounts are not significant. A minor error in programming a withholding tax system of a large interest payer could result in errors in the withholding from payments to tens of thousands of recipients. Even though the error for each recipient of the interest income might be very small, the cumulative error could easily be thousands of dollars without being significant compared to the total withholding tax being paid by the interest payer. If possible these types of errors should be corrected in subsequent filings to avoid recalculations for all of the recipients and refilings for the periods in error.

There would need to be some restriction on the size of the errors that could be self-corrected in subsequent periods. This could be set as a threshold for the size of the error. Setting a simple dollar value threshold would either be too low to correct relatively minor errors for large payers (as discussed above a very small error across a large number of customers

quickly adds up) or would be far too high in relation to smaller payers (as a suitable threshold for large payers would be likely to exceed the annual total of withholding tax remitted by smaller payers). The Government therefore proposes that the relative size of the error compared to the amount of withholding tax being paid should be taken into account in setting the threshold.

It would also be inefficient to only have a percentage based threshold as a small payer might make a \$50 error that equated to 20% of their total payment of \$250. This could be far higher than a percentage based threshold but be too small to justify requiring the payer to resubmit the period that the error related to. For these reasons we propose that it would make sense to have a simple dollar value threshold for self-correction as well as a percentage threshold based on the amount of withholding tax the payer remits to Inland Revenue. As long as the error was lower than the higher of the two thresholds the payer would be entitled to self-correct in a subsequent period.



METHODS FOR PROVIDING THE INFORMATION

Making it easier to get information to Inland Revenue

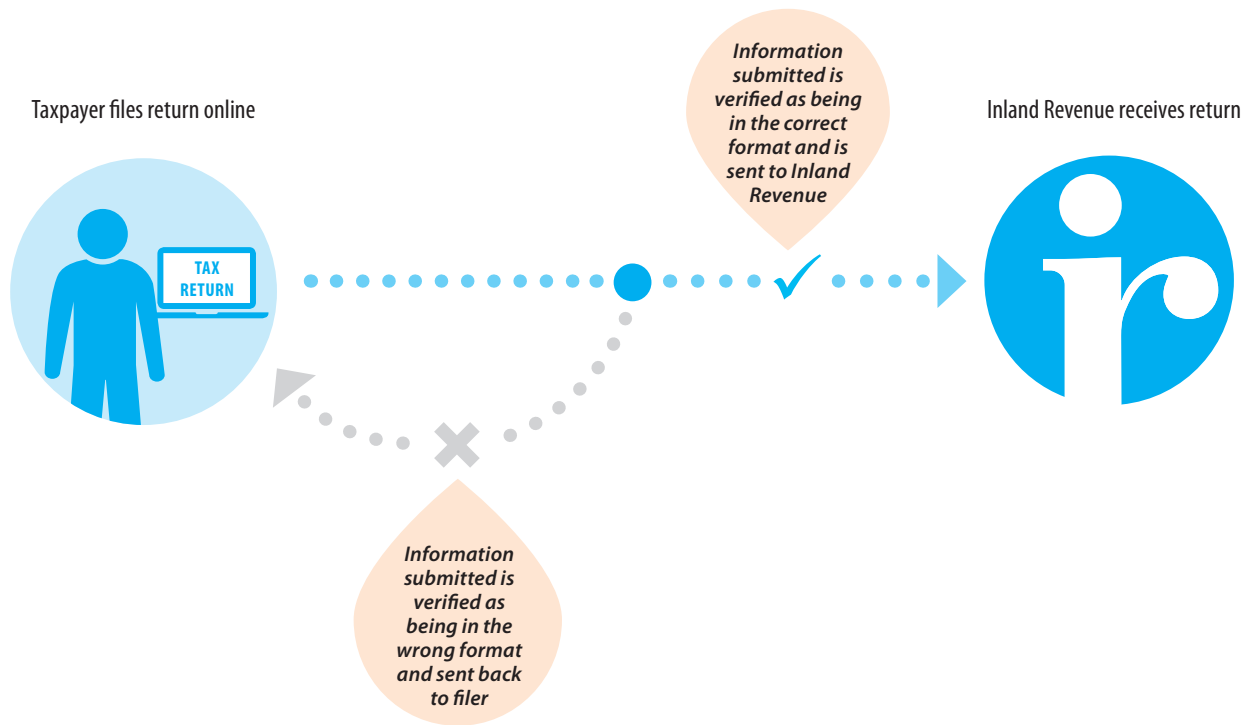
Currently a number of the withholding tax returns are paper-based (with no option for electronic filing) and the detailed information that accompanies the end-of-year reconciliation can be sent electronically or on paper.

There are difficulties with the current methods for transferring electronic information to Inland Revenue as there is a 20 megabyte size limit for files attached to emails. This means that larger payers of withholding tax cannot email their information

to Inland Revenue. The only way to provide electronic information is to store it on a CD or a USB stick and deliver that to Inland Revenue. The information is then processed and validated, which can take some time.

Inland Revenue's new technology platform will include changes to the way that withholding information can be provided. This will make it easier for payers to file their returns electronically with Inland Revenue. A key change for RWT, NRWT and AIL will be a gateway to upload information (similar to that already used by PIEs to file returns). Returns filed will go through an automatic validation process (as shown in the diagram on the next page), which means that any errors that

AUTOMATIC VALIDATION PROCESS



would prevent Inland Revenue from using the information would be communicated back to the filer immediately. These changes would allow larger files to be transmitted to Inland Revenue electronically.

In addition to the electronic gateway, there will be an option of an online form for payers who choose not to use the electronic gateway. The online form would be able to be populated with the required information. This option may be particularly useful for smaller withholding taxpayers as it would enable them to provide the information electronically without having to make their information fit the electronic gateway requirements.

The pre-population of tax records is best supported by the provision of information electronically rather than by paper. However, we recognise that different types and sizes of investment income payers will have different levels of ability to file information electronically. In particular we acknowledge that some payers of investment income will not be ready to file electronically at this stage.

There are several approaches we could take in relation to the filing options available to different payers of investment income. For example, we could:

- Continue to provide all investment income payers the option of filing

QUESTIONS FOR READERS

24 What specific technical constraints or limitations should be considered when designing the electronic gateway?

25 If some investment income payers were to be required to file information electronically based on the number of recipients that they pay investment income to, what number of recipients should result in an investment income payer being required to file electronically?

26 Does the concept of having a database of the currently valid certificates of exemption have merit? If not please explain why.

27 Should people and organisations who are exempt under other Acts need to apply for a certificate of exemption in order to be treated as exempt from RWT?

by paper, subject to a review after a given period of time, or until a given future date;

- Require larger investment income payers to file electronically, for example those with more than a certain number of recipients to whom they pay investment income; or
- Require almost all investment income payers to file electronically, with some exceptions, for example for those who do not have access to digital services.

The second approach would require a threshold to be set. Setting an appropriate threshold would involve balancing the Government's desire for earlier investment income information in a digital format and smaller payers' concerns about the feasibility of accessing digital services. The Government welcomes feedback on these options.

MISCELLANEOUS MATTERS

Certificates of exemption

When customers claim tax exempt status, the organisations paying interest and dividends have to manually check certificates of exemption from withholding tax and have no easy way of checking the status of these certificates. They may also have to ascertain whether the customer can appropriately claim to be exempt under non-tax legislation, in which case they may not even need a certificate of exemption. These challenges make it difficult for paying

organisations to test whether all of the exemptions claimed by their customers are valid.

Certificates of exemption issued and cancelled are currently published in the New Zealand Gazette each quarter. Inland Revenue proposes to create an electronic database of certificates of exemption that are currently valid. This would allow withholding tax payers to check whether a customer's claim for an exemption is correct, and could remove the need for customers to supply a copy of their certificate to their investment provider.

The database would be kept up to date for any new issues or cancellations and would offer a real-time source of information for withholding tax payers. It would also enable payers to review their customer files to confirm that all customers who are currently being treated as exempt actually are.

Some people and organisations are also able to claim exemptions under Acts other than the Income Tax Act 2007 and the Tax Administration Act 1994. These exempt people and organisations would not be included in the exemption certificate database unless they chose to get an exemption certificate.

A database could reduce both the risk of people incorrectly claiming RWT exempt status and the compliance costs of investment providers if people with exemptions under other Acts were required to hold a certificate of exemption. They would

therefore be included on the database of exempt people and organisations. The disadvantage would be a one-off administrative requirement for those people who were exempt under other Acts to get an RWT certificate of exemption when they may not otherwise have chosen to do so.

Closely held company dividends and interest

The *Closely held company taxation issues* issues paper (September 2015) discussed issues relating to the application of RWT to dividends and interest payments made by closely held companies (these are companies where five or fewer shareholders control more than 50% of the direct voting interests in the company). The paper referred some of these issues for consideration in the wider context of work being undertaken to streamline business tax processes. These issues are still under consideration and are not included in this discussion document.

APPENDIX – CURRENT STATE

This appendix summarises the current tax rules and processes applying to the parties involved in investments and withholding tax.

INDIVIDUALS

If tax is deducted at a person's marginal tax rate (the rate that applies to their top dollar of income) from their investment income, it is unlikely that they will have to pay any more tax at the end of the tax year. However, if tax is not deducted from their investment income at their marginal tax rate, they may need to request a personal tax summary (PTS) (or file a tax return if they also meet other criteria for needing to file). The following table from the Inland Revenue website sets out when a person is required to request a PTS:

<i>You must request a PTS if you...</i>	<i>and you received...</i>
received income from \$14,001 to \$48,000	more than \$200 of interest taxed at less than 17.5%
received income from \$48,001 to \$70,000	more than \$200 of interest taxed at less than 30%
received income over \$70,000	more than \$200 of interest or dividends taxed at less than 33%
received income over \$48,000	more than \$200 of taxable Māori authority distributions
paid child support through Inland Revenue	more than \$200 of interest, dividends or taxable Māori authority distributions

The PTS only contains information about salary and wages, and taxpayers have to enter details of their other income (such as investment income that has been incorrectly taxed) in order to confirm their tax position.

At the end of the tax year, organisations that deduct tax from interest income are required to send their customers a certificate showing the interest income and the withholding tax. Each organisation that a person has been paid more than \$50 of interest by will send the person at least one certificate (they may send more than one if the person has invested in multiple products). The person

is then required to look at all of the certificates to determine if they have received interest income totalling \$200 that has had withholding tax deducted at a rate that is lower than their marginal tax rate. If they have, they are required request a PTS and potentially file a tax return.

The portfolio investment entity (PIE) tax regime has specific rules around the availability of each different portfolio investor rate (PIR). If a person selects a higher PIR than they need to, the PIE tax deducted is a final tax and cannot be refunded. However if a person selects a lower PIR than they are allowed to, their PIE income is not covered by the PIE rules and they have to pay income tax on it. If their income tax rate is 30% or 33% they would end up paying more tax than the highest PIR of 28%. Taxpayers may be unaware that they have selected a lower PIR than they should, and may inadvertently not include their PIE income in a tax return.

If people do not provide their IRD number to the PIE administrator they will be put on the top PIR of 28%. The PIE administrator is required, at least once a year, to ask these investors to provide their IRD number, but there is no real incentive for those on the 30% or 33% income tax rates as the PIE tax non-declaration rate is 28% (the same as the top PIE rate for people who have provided their IRD numbers).

Even if tax has been deducted correctly from a person's investment income and they don't have any further tax obligations, they may still have social policy obligations

resulting from that income. For example, even though PIE tax is a final tax, the income from some PIEs (essentially those PIEs where the funds are not locked in for superannuation purposes) has to be included in a person's social policy calculations. People may be unsure which PIE income they should include in their social policy income estimate and end-of-year calculation.

Social policy entitlements such as Working for Families Tax Credits are calculated during the year based on an estimate of income for the year.⁸ Estimates are often wrong, so a square-up calculation needs to be made at the end of the year when a person's income is finalised. The person will then have to either pay back some of the money received during the year if they had underestimated their income or receive an extra payment if they overestimated.

Payers

Payers of investment income deduct withholding tax from the payments to investors. They remit the withholding tax to Inland Revenue with their monthly withholding tax returns. The payers provide the following information to Inland Revenue:

- summary information (total income paid, total tax deducted) to Inland Revenue for RWT, NRWT, AIL and PIE tax each month; and
- more detailed information (identifying the recipients and giving the investment income and

⁸ Child support obligations and entitlements for a year are usually calculated before the beginning of the year based on the liable parent's income for a previous year rather than being based on an estimate.

tax withheld for each recipient) for RWT and NRWT (on interest) and PIE tax at the end of the year with their annual reconciliation return.

Payers provide an annual summary return to Inland Revenue for interest subject to AIL and Māori authority distributions. Payers are not required to provide any detailed information to Inland Revenue on interest subject to AIL, dividends, Māori authority distributions and interest paid to recipients who are exempt from withholding tax.

Currently a number of the withholding tax returns are paper forms. The detailed information that accompanies the end-of-year reconciliation can be provided to Inland Revenue electronically or on paper. There is a 20 megabyte size limit for files attached to emails sent to Inland Revenue. This means that larger payers of withholding tax cannot email their information to Inland Revenue as their files are often much larger than 20 megabytes. The only way to provide large files of electronic information to Inland Revenue is to store it on a CD or a USB stick and deliver that to Inland Revenue. The information provided is only validated once Inland Revenue processes the information.

If errors are detected during the year to 31 March they can often be corrected in the next monthly summary return, but if an error occurs before 31 March and is not found until after 31 March the return for the period to 31 March must be adjusted to correct the error so that the total

information for the income tax year is correct. This can result in a significant amount of additional work for both the payer and Inland Revenue.

Payers of interest provide tax certificates to their customers at the end of the tax year. When customers receive their certificates from one provider, some quickly decide to call their other investment providers to ask for their tax certificate. This puts pressure on payers to get the tax certificates out as soon as possible after year end to avoid spikes in customer calls. The certificates are usually posted to the customers, which can be a significant cost.

If customers have an exemption certificate from RWT they have to show the payer a copy of the certificate before the exemption can be applied to their account. They are also required to advise the payer if the certificate is cancelled. The issue and cancellation of exemption certificates are published in the New Zealand Gazette each quarter, and payers should check this and update their records. This can cause issues if the Gazette shows a customer has had their exemption certificate cancelled in the previous three months and the customer has already provided a copy of their replacement exemption certificate, as the payer may incorrectly think the cancellation applies to the new certificate.

Companies

When companies pay dividends to their shareholders they deduct RWT at 33% (less any imputation credits

attached). The company sends a shareholder dividend statement to each shareholder, setting out the dividends paid, the imputation credits attached and RWT deducted. The company also sends a summary showing the total dividends paid and the RWT withheld to Inland Revenue. The company must keep records of the dividend payments to each shareholder in case it is requested but otherwise does not provide the detailed information to Inland Revenue.

The dividends are subject to RWT at 33% (less any imputation credits attached) regardless of the shareholder's marginal tax rate. This means that shareholders may be overtaxed when the dividend is paid and then have to file a tax return to claim a refund some time later.

Inland Revenue

Inland Revenue receives annual information about RWT that has been deducted. This information is manually uploaded and validated. This usually takes some time.

The annual interest and RWT information is due to Inland Revenue after Inland Revenue has prepared the summaries of earnings (SOEs) and PTSs for individual taxpayers. Accordingly, the investment income and tax information cannot be included in the SOEs and PTSs provided to taxpayers.

The timing of receiving and processing RWT information means that the square-up processes for

RWT do not match the timing of other square-up processes, such as those for social policy payments. This process is inefficient and reduces Inland Revenue's ability to effectively manage compliance in a number of areas.

The information that Inland Revenue receives has a number of limitations. If a person has not provided their IRD number to their payer it is difficult for Inland Revenue to associate the income with the person. Income from joint accounts (accounts owned by more than one person) is only reported to Inland Revenue under one IRD number, which makes it hard for Inland Revenue to correctly associate the income with all of the owners of joint accounts.

Māori authorities and their members

Māori authorities can attach credits to taxable distributions to their members. A taxable Māori authority distribution is paid out of the Māori authority's taxable income for the 2004–05 or later tax years. Māori authorities advise their members of any taxable distributions made to them by sending them a notice.

Taxable Māori authority distributions are taxable income to the member that receives them. The member's tax liability in relation to the distributions may be covered by the credits attached to the distribution and in some cases the RWT deducted from it.

Māori authority credits represent the tax paid by the Māori authority on its income. The member receiving a

credit can use it to offset their own tax liability (ensuring that the income isn't subject to double taxation). Tax credits are a maximum of 17.5% of the gross distribution – which means that up to \$17.50 of Māori authority credits can be attached to every \$82.50 of income distributed.

Taxable Māori authority distributions are also subject to RWT if the:

- Māori authority decides not to attach any credits to the distribution,
- credits attached are less than 17.5% of the gross distribution,
- Māori authority does not hold the member's IRD number and the distributions exceed \$200, in which case the withholding tax rate is 33%, reduced by any Māori authority credits attached, up to a maximum rate of 17.5%.

The member can offset the Māori authority credits and any RWT against their own income tax liability. They may get a refund if their marginal tax rate is less than 17.5%, or may have to pay more if their marginal tax rate is higher than the rate of credits or RWT.

The Government understands that while some Māori authorities do still have balances relating to years before 2004–05 these balances are running out. As a result it is likely that most Māori authority distributions in the future will be taxable, with Māori authority credits attached.