MAKING TAX SIMPLER
BETTER ADMINISTRATION OF
INDIVIDUALS' INCOME TAX

The eighth in a series of government discussion documents looking towards a better tax administration system for New Zealanders
AT THE END OF THE TAX YEAR

Current rules
Two options for end-of-year filing obligations
The improved status quo
The alternative approach
How the “alternative approach” would be different to the “improved status quo”
What will Inland Revenue do under the alternative approach
The specific thresholds

AT THE END OF THE TAX YEAR – OTHER INFORMATION

Interacting with Inland Revenue
Digital interaction
Using myIR
Due dates for information
Results of interaction
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AFTER THE END OF THE TAX YEAR
INTRODUCTION

Inland Revenue is conducting a large scale transformation programme, which provides an opportunity to make changes to New Zealand’s tax administration system to meet current and future needs. This includes re-shaping the way Inland Revenue works with taxpayers, and looking at possible changes to the Tax Administration Act 1994. This document discusses how to improve the administration of income tax for individuals, particularly those who only earn salary or wages and/or investment income that has been subject to withholding tax at source.

The Government released a consultation paper called Making Tax Simpler: A Government Green Paper on tax administration (the Green Paper) in March 2015. This set out its ideas for modernising New Zealand’s tax administration. The ideas presented...
in the Green Paper were in the early stages of development, and each area canvassed in that document would be consulted on separately. In relation to individuals’ filing obligations, the initial option outlined for consultation in the Green Paper was for all individuals to interact with Inland Revenue. Having considered the submissions received on the Green Paper and carrying out further work, the Government is not proposing that all individuals should have an obligation to interact with Inland Revenue on an end-of-year basis (i.e. have to provide an income tax return).

The Better Administration of PAYE and GST and the Investment Income Information discussion documents contained proposals to require income payers to provide more information, more often to Inland Revenue about who they paid. These documents were released for consultation in November 2015 and July 2016 respectively. Changes to legislation as a result of the proposals in both those documents are contained in the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill, which is currently before Parliament. This document contains proposals about how Inland Revenue should utilise information during the year to ensure that the right amount of tax is being withheld.

This consultation focuses on how the Government can make tax obligations more simple, open and certain for individuals. This document discusses some proposed changes and, if they go ahead, proposals for how Inland Revenue could work with individuals to ensure the right amount of tax is paid, and that individuals receive the correct entitlements.

WHAT THIS DOCUMENT COVERS

Chapter 2 outlines the framework for how individuals’ income is taxed in New Zealand and recaps the proposal that was in the Green Paper. Chapter 3 discusses proposals for what could occur during the tax year. Chapter 4 sets out two options about which individuals should have to provide information to Inland Revenue at the end of a tax year. The first is an improvement on the status quo and the second would further simplify the rules.

The Better Administration of PAYE and GST and the Investment Income Information discussion documents contained proposals to require income payers to provide more information, more often to Inland Revenue about who they paid. These documents were released for consultation in November 2015 and July 2016 respectively. Changes to legislation as a result of the proposals in both those documents are contained in the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill, which is currently before Parliament. This document contains proposals about how Inland Revenue should utilise information during the year to ensure that the right amount of tax is being withheld, and how end-of-year reporting obligations could be simplified for individuals that earn certain types of income.

Some of the things described in this discussion document happen already. They are set out here alongside the proposals to give a fuller picture of what the future would look like if the proposals are adopted.
SUMMARY OF PROPOSALS

During the year – chapter 3

• Inland Revenue will monitor the information it receives to help individuals get their tax payments right, and contact them to suggest changes.

• Inland Revenue will make information held about an individual available to that individual during the year.

• Individuals will be able to upload copies of donation receipts to myIR during the year.

At the end of the year – chapter 4

• The discussion document sets out two options about which individuals should have to provide information to Inland Revenue at the end of a tax year.

Improved status quo

• With better, timelier third-party information, Inland Revenue will better target the issue of personal tax summaries.

Alternative approach

• Individuals would not have to provide any information to Inland Revenue if they only earn “reportable income”:
  o This is currently PAYE income.
  o Changes to legislation in the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill in relation to investment income information will add interest income, and New Zealand-sourced dividends and Māori authority distributions from 1 April 2018 and 1 April 2020 respectively.

• On the basis of information it holds about reportable income, Inland Revenue would calculate whether people are due a refund or have tax to pay.

• If refunds or amounts of tax to pay are above specified thresholds, Inland Revenue would issue the refund or request payment. If the amounts are smaller than these thresholds Inland Revenue will not take any action.

  o The document asks if the current $5 threshold for refunds should be retained for refunds by cheque, or if all refunds should be issued, no matter how small.
  o The document notes the current $20 threshold for small amounts to pay and also the current threshold for not having to file ($200 of income,
which can be up to $66 of tax). It asks what factors the Government should take into account in setting a specified threshold for amounts of tax to pay.

**At the end of the year – chapter 5**

- Individuals would be able to provide details about donations they would like to claim at the same time as they check or provide information about their income.

- This document proposes that income tax refunds should be direct credited, rather than issued by cheque unless that would cause undue hardship.

**After the end of the year – chapter 6**

- Individuals can ask Inland Revenue to change a return if they believe it does not correctly reflect their tax position.

**NEXT STEPS**

Following consideration of the submissions received about the proposals in this discussion document, the Government will refine the proposals and consider what items to proceed with. It will also consider when it would be best to implement any changes. These proposals would require changes to legislation and an amending bill is likely to be introduced to Parliament and considered in 2018. There will be further opportunity to comment on the legislative changes as part of the Parliamentary process.

**HOW TO MAKE A SUBMISSION**

You can make a submission:

- online at: www.makingtaxsimpler.ird.govt.nz

- by email to: policy.webmaster@ird.govt.nz, with “Making Tax Simpler: Better administration of individuals’ income tax” in the subject line.

- by post, to: “Making Tax Simpler: Better administration of individuals’ income tax” C/- Deputy Commissioner, Policy and Strategy Inland Revenue Department PO Box 2198 Wellington 6140

The closing date for submissions is **28 July 2017**.

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.
This chapter discusses the framework for thinking about how individuals’ income is taxed, and how individuals and other entities should interact with the tax system to ensure that they are meeting their income tax obligations. It also outlines the ideas proposed in the Green Paper about improving tax administration for individuals and the feedback received. Finally, it sets out the opportunities for modernising and simplifying tax administration for individuals to achieve the following outcomes:

• A tax system that is fair and supports high levels of compliance.

• Payment requirements that are easy to get right and difficult to get wrong.

• Compliance obligations that are quick and low effort for individuals.

• Processes that are more certain and provide confidence that the right thing has been done.

• A tax administration that costs less to administer and that lowers overall compliance costs.

FRAMEWORK FOR TAXING INDIVIDUALS’ INCOME

Income tax is charged on a person’s annual taxable income. Generally, a person’s taxable income is the sum of the gross income received, minus any deductions for expenditure or losses to the extent to which they are incurred in deriving that income, or incurred in carrying on a business. Income tax is calculated on the person’s total taxable income for the year at the applicable tax rates.¹

There are two basic approaches used to administer income tax:

• Payers of certain types of income, such as salary or wages, are required to withhold tax from the income they pay to individuals, remit the tax withheld and report the income and tax information to Inland Revenue (a withholding tax system).

• Individuals are required to report the taxable income they have earned to Inland Revenue, calculate any tax payable and pay the tax due either during the tax period or after the end of the tax period (a tax period disclosure system).

¹Certain types of income are treated as schedular income and taxed in their own right. These are not included in a person’s total taxable income, such as certain kinds of non-resident passive income.
the tax due either during the tax period or after the end of the tax period (a tax-period disclosure system).

These two approaches are supplemented with additional third-party reporting to increase overall compliance. Regardless of which approach is used, the underlying requirement to comply with income tax obligations ultimately lies with, and will continue to lie with, the individual. This is because they fully understand what income they have earned and expenses they have incurred. In other words, income tax will continue to be based on a self-assessment model.

The Government intends to continue using these two approaches to administer income tax. Depending on the sources of their income, a person may be covered by one of these approaches or both. The Government will look to increase the use of withholding tax systems where appropriate in order to reduce compliance costs on individuals and ensure tax is paid accurately during the year. The Government recently extended the schedular payments withholding tax system to labour hire firms. Inland Revenue will continue to supplement these approaches with third party reporting under existing rules. The Government is also considering a more transparent framework for large third-party dataset collection, where the dataset is to be collected regularly, as discussed in Making Tax Simpler: Proposals for Modernising the Tax Administration Act.

The Government recognises that withholding tax systems impose compliance costs on the payers of income subject to these rules. However, such systems reduce compliance costs for the recipients of the income, reduce administrative costs and increase overall compliance. These benefits usually outweigh the compliance costs imposed on payers. The key is getting the balance right.

Withholding tax systems are generally considered to be the foundation of an effective tax administration for the reasons outlined above. They ensure that an appropriate amount of tax is withheld from the income earned and are most efficient in getting it right if the gross income and taxable income are the same. That is, if the recipient of the income has not incurred any deductible expenditure or losses in earning that income.

One important caveat to the general ability to claim deductions is that employees cannot deduct costs incurred in deriving income from employment. The Government has no intention to change that policy setting. Individuals can claim for income protection insurance, and the costs associated with preparing an income tax return. Tax credits can also be claimed for qualifying donations made to donee organisations by individuals if they earned taxable income in the period they are claiming for.

For individuals who only earn income that has tax withheld from it and paid to Inland Revenue, the amount of tax paid during the year is generally close...
A key component of a withholding tax system is the reporting of the underlying income information and tax withheld. The more frequently this information is received, the greater the ability for Inland Revenue to monitor whether tax is being withheld at the appropriate rate and, if not, to take corrective action. This will ensure that the right amount, or close to the right amount, of tax is withheld during the year and reduce the number of individuals who should need to file income tax returns at the end of the year.

The proposals in this discussion document primarily focus on the end-of-year obligations for individuals who earn only income that is subject to withholding.

to being right. However, withholding tax systems do not ensure perfect accuracy as they are still based on expected income. Any difference between the income that was actually earned, compared with what was anticipated, will mean that the withheld amount will vary from the ultimate tax liability. This can occur when there are multiple sources of income and/or when tax on income is not withheld or withheld at a rate that is too high or low. For example, when someone receives a bonus or promotion, or takes leave without pay, the withholding rate can be incorrect.

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IMPLICATION FOR INCOME TAX RETURNS

This framework allows for the income tax system to be administered as follows:

- An individual who earns income that is not subject to withholding (such as business income or foreign income) is required to report the taxable income earned to Inland Revenue, calculate the tax payable and pay the tax due either during or after the tax period.

- An individual who earns income subject to withholding as well as income not subject to withholding is required to report all the income earned to Inland Revenue, calculate the tax payable and pay the tax due either during or after the tax period. Income information Inland Revenue holds is provided to the individual to assist them in meeting their tax obligations.

- For an individual who earns only income subject to withholding, the Government can either:
  - require the individual to report (or confirm) the taxable income earned to Inland Revenue, which would then result in a tax refund or further tax to pay; or
  - treat the amount withheld as the final tax liability for the year, which means the individual's tax obligations will be totally managed via the withholding tax system.

The proposals in this discussion document primarily focus on the end-of-year obligations for individuals who earn only income that is subject to withholding. It is recognised that an individual may move between these categories over their lifetime as their income sources change.
As noted in chapter 1, the Government is not proposing that all individuals should have to provide information to Inland Revenue on an annual basis in a process similar to the current obligations on individuals who are required to file income tax returns. Throughout this document that is referred to as “providing information to Inland Revenue”.

OTHER APPROACHES USED TO REDUCE END-OF-YEAR FILING OBLIGATIONS

Cumulative withholding

New Zealand requires withholders to deduct tax according to tax codes that are based on an individual’s expected annual income, and requires individuals to undertake an annual process to ‘square up’ their tax position each year if necessary.

Some countries use a cumulative model of withholding tax instead. A cumulative model means the withholding tax rates are adjusted throughout the year. Such a system endeavours to attain accuracy of tax withheld throughout the year. The rationale behind a cumulative system is that if the correct amount of tax is deducted during the year, the total amount of tax collected will equal the individual’s overall liability. This theoretically eliminates the need for most employees to file a tax return.

Under the cumulative withholding system, an individual’s tax liability is not calculated on the payment they receive for a period in isolation. Instead, the actual amount of tax deducted in a pay period depends on the income already received in the tax year, as well as the income received in the current period. The tax, which must be deducted in each pay period, is the cumulative tax due from the beginning of the year to that date, reduced by the amount of tax already deducted in other pay periods. Consequently, this type of system can be complex for those who are required to withhold the tax, such as employers.

The cumulative model does not always achieve the accuracy it is designed to achieve. When an individual works more than one job, it is complex to administer as each withholder needs to understand the total amount of tax already deducted. This document does not propose changing to a cumulative withholding model in New Zealand.

"Full and final" taxation in a period

A discussion document called Making tax easier was released for public consultation in June 2010. One item which was considered in that document was an option to treat PAYE as a “final tax”, so the amount of tax actually deducted from PAYE would be treated as the individual’s final tax liability (even if it was over- or under-deducted). Inland Revenue would not collect some amounts of tax to pay, and would not pay out some refunds. This option was not supported by submitters and was not pursued. This document does not propose changing to a final tax approach.
BACKGROUND – GREEN PAPER AND FEEDBACK

The Green Paper outlined an initial option for consultation that could require all individuals to interact at some level with Inland Revenue, albeit in a much easier way than currently.⁴ It suggested an electronic filing system pre-populated by information from timely and accurate withholding systems. The majority of individuals would then only be required to check and confirm the information held by Inland Revenue and include any income that had not been pre-populated.

One of the premises underpinning this option was that it would allow individuals to understand their own tax obligations and how the wider tax system works, which would support compliance over time. The current filing obligations for individuals vary, based on historical and sometimes arbitrary distinctions. This results in some individuals being unaware of their filing obligations.

As discussed in the Green Paper, the key to modernising and simplifying tax administration is the use of digital services and channels, the pre-population of information held by Inland Revenue and the use of analytics to achieve the above outcomes.

Feedback about the initial option to require all individuals to interact with Inland Revenue via pre-populated digital tax statements was divided.⁵ Some submitters were concerned about whether people without easy access to internet or who were not proficient technologically could effectively manage this interaction. Others saw any increase in interaction with Inland Revenue as undesirable. A few also queried Inland Revenue’s ability to pre-populate information such as donations. Other saw the proposals as positive, particularly those who currently file returns, believing it would make the return filing process easier. Finally, some submitters also noted that some interaction with Inland Revenue might encourage people to better understand their tax circumstances and obligations.

The following chapters discuss approaches and options to make tax obligations more simple, open and certain for individuals. The chapters outline what interactions could happen during the tax year to assist with getting the withholding more accurate and what interactions could occur at year-end.

THE OPPORTUNITY FOR CHANGE

As noted earlier, the Government has recently introduced legislation into Parliament that once passed, will give effect to the proposals outlined in the Better administration of PAYE and GST and the Investment Income Information discussion documents. These proposals will require income payers to provide more information more often about the individuals to whom they pay income. This better and timelier information allows the Government to re-think tax administration for individuals, particularly those who only receive employment and/or investment income.

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⁴ See Appendix 5 page 61 to 63 and in particular paragraphs 5.15 to 5.20 of the Green Paper.

employment and/or investment income.

Furthermore, the current tax rules for individuals who earn most of their income from employment and/or investment sources that are subject to tax at source are complex to understand and administer.⁶ For example, based on the information it holds, Inland Revenue will issue personal tax summaries to some people at year-end. If a personal tax summary is not issued, individuals need to determine whether they need to request a personal tax summary. If they do not need to, they may still do so in order to receive any tax refund they are entitled to.

This better and timelier information allows the Government to re-think whether the current rules for the administration of income tax for individuals can be improved to simplify the rules and reduce compliance and administration costs. This can be achieved by re-thinking how Inland Revenue can:

• deliver better in-year services to assist individuals in ensuring they are using the correct tax code, or a tax code (such as a special tax code) that will meet the needs of their circumstances; and

• simplify the end-of-year obligations by reducing the complexity of the current rules for people who only earn employment income and/or investment income that is subject to withholding at source.

⁶Section 33AA of the Tax Administration Act allows a person to earn up to $200 of income that is not subject to withholding tax and still not be required to request a personal tax summary.
A large number of individuals do not need to do anything once they have provided the correct tax code to their employer or bank (and this will continue).

In earlier Making Tax Simpler consultation documents, the Government proposed that more complete information from third parties should be provided to Inland Revenue throughout the year. Inland Revenue will check information when it is received and fix errors whenever possible, which will mean fewer over or under-payments for individuals during the year. This information will be displayed in digital accounts.

Increasingly, individuals will not have to do anything at the end of the year as more information is passed to Inland Revenue on their behalf. As the quality and frequency of information available to Inland Revenue improves, payments made by and to individuals during the year will be more accurate. In turn, this will reduce the number of individuals who have large refunds or tax to pay at the end of the year.

**INFORMATION ABOUT INDIVIDUALS IS PROVIDED TO INLAND REVENUE BY OTHERS**

Inland Revenue receives a range of information about individuals from other people and/or organisations who are required to report it. A lot of this information is provided under specific information reporting requirements set out in tax legislation. Inland Revenue also receives other information, for example, about income, entitlements, relationships and transactions on an as-required or one-off basis.

Payers of some types of income are required to inform Inland Revenue about the income paid, the tax withheld and the recipient. In some cases this information is reported to Inland Revenue during the year, and in other cases it is required after the end of the year.

Not all types of income carry the requirement for the payer to report the amount and the recipients to Inland Revenue.

Reporting information about an individual imposes costs on the
provider and this must be weighed against the benefit to Inland Revenue and the individual. Over time, the Government may require information about more types of income to be reported regularly, but that is not proposed in this discussion document.

Inland Revenue does not generally receive information about income that does not have tax deducted from it as part of regular information reporting systems. This document does not propose to alter this position at this time.

SOME INDIVIDUALS PROVIDE INFORMATION ABOUT THEMSELVES TO INLAND REVENUE DURING THE YEAR

Outside of the return filing process, under current settings some individuals are required to provide some information during the year. For example, if they are required to make provisional tax payments.

When an individual starts a new job they must choose a tax code and their employer then withholds tax at a rate based on their expected annual income. It is currently the individual’s obligation to update Inland Revenue if a change in their circumstances means they should change to a different code. The onus is on the individual to be aware of circumstances that would require a change in code.

Individuals can also claim tax credits for gifts of $5 or more made to donee organisations such as charities.⁷ These can currently be claimed by filling in a claim form and submitting this to Inland Revenue with receipts. Individuals can also claim for the cost of income protection insurance. Rather than waiting until the end of the year and posting copies of their donations receipts or their income protection insurance to Inland Revenue, the Government proposes that individuals would be able to scan or photograph and upload copies of their receipts directly into myIR either during the year or at the end of the year.⁸ This information would then be available to be used by Inland Revenue in determining an individual’s tax position.

WHAT INLAND REVENUE DOES WITH THE INFORMATION IT RECEIVES

Receiving information, whether directly from individuals or from third parties, allows Inland Revenue to ensure that individuals pay the right amount of tax and receive the correct social policy payments. It also helps other government agencies to accurately assess a range of entitlements and can be used for statistical analysis by the Government and community.

After the information is received, Inland Revenue:

- checks its accuracy;
- proposes adjustments to future withholding or past periods if necessary;
- includes it in an individual’s account to:

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⁷The amount of this credit is 33 1/3% of the total qualifying gifts made in the year, with the limitation that the total donations claimed for cannot be more than the person’s taxable income for the year.

⁸myIR is Inland Revenue’s web based digital service channel.
The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill contains proposed changes about the frequency with which information about income must be provided to Inland Revenue. These changes relate to PAYE, interest income, New Zealand-sourced dividends and Māori authority distributions.

Getting more detailed income information more frequently will enable Inland Revenue to help individuals get their tax and social policy payments right. Inland Revenue will be able to act sooner to correct mistakes during the year, which should reduce the number and size of year-end issues. Inland Revenue will also be able to provide a greater number of taxpayers with a complete and accurate picture of their income position at the end of the tax year. That is why the Government has proposed that more information be provided to Inland Revenue during the year.

Inland Revenue will process the information and let the individuals or third parties know if any errors or omissions need to be fixed.

**Giving individuals visibility of their income and payments**

All the information Inland Revenue receives about an individual will be held in their tax account, which an individual can view through myIR.

As information is received, it will be added to an individual’s myIR account.

This can save the individual time if they choose to or need to file a return at the end of the year, as information received before the person files would already be shown.

Information received later cannot be used to help an individual complete a return, but can be used by Inland Revenue to check whether all the necessary information was provided by the individual in their return.

As at 1 December 2016 there were almost two million customers with active myIR accounts. The myIR account will show income earned, obligations, entitlements, liabilities and personal details. Inland Revenue would progressively add information to the account as it is received.

The individual and anyone else they have authorised to see it are the only ones who can access their myIR account. At any point in time a myIR account will give an individual a personalised and complete view of their income position and social policy entitlements that Inland Revenue has received information about.
If an individual receives income that is not shown on their myIR account, this means that either it is not required to be reported to Inland Revenue by a third party, or it is required but has either not been reported or cannot be linked with the individual. If it was not able to be linked with the individual, it is likely the income is being taxed at the higher non-declaration rate.

Income information will generally be shown as totals, however further details will also be available to be viewed. For example, total income for the year-to-date would be shown and an individual could view this by employer or time period if they wanted to.

The individual would not be able to directly alter any income information in myIR during the year, but would be able to at the end of the year. Third parties can update Inland Revenue at any time about information they have provided, and as the displayed information is based on information received from third parties, any corrections the third party makes to that information will flow through the system and be updated in the appropriate myIR accounts.

**HOW INLAND REVENUE WILL HELP TO ENSURE INDIVIDUALS GET THEIR TAX AND SOCIAL POLICY PAYMENTS RIGHT**

As Inland Revenue analyses information about an individual, it may become apparent that the individual is not using the best tax code for their personal circumstances. Inland Revenue will automatically calculate whether the tax that is being remitted by the withholder is likely to match their end-of-year tax liability.

The nature of the withholding tax system (the use of tax codes based on expected annual income), means that mistakes made in selecting codes, or unexpected changes in income can lead to refunds or tax to pay at the end of the year. Actions that Inland Revenue can take to stop errors will mean fewer people end up with tax to pay or refunds at the end of the year, and therefore fewer people will need to interact with Inland Revenue.

Inland Revenue monitors information provided by employers about income they have paid and tax they have withheld. When an individual is using the wrong tax code (such as using the main job “M” tax code for two jobs) Inland Revenue contacts the employer asking them to change the tax code. If the employer does not correct the tax code in their next monthly schedule, Inland Revenue follows up with them. Individuals are contacted by phone or in writing, advising them of the possible discrepancy and what action they can take to remedy the situation. At the same time Inland Revenue advises them what actions will be taken if there is no response to the correspondence.

Inland Revenue can also identify situations when a systemic error seems to be occurring on the part of the withholder, for example, they are inadvertently using an outdated PAYE code table. Inland Revenue can intervene to ensure the information provider corrects this error.
In some cases individuals use a withholding tax rate that is not incorrect per se, but will not match their end-of-year tax liability. Inland Revenue could do more in these circumstances to help the individuals during the year so that they do not have to wait until the end of the year for a refund, or receive a tax bill at the end of the year. The benefit of changing to a different tax rate sooner is that it should better approximate the person’s ultimate tax liability, and therefore reduce the size of a debt or refund position the person would otherwise be in at the end of the year.

Similarly, an individual might have selected a withholding tax rate at their bank that is higher or lower than their marginal tax rate. If Inland Revenue thinks a resident withholding tax rate being used is not consistent with a person’s marginal tax rate, it already has the ability to provide a new rate for the payer to use.⁹

Inland Revenue will notify an individual if the tax rate or code they are using does not reflect their marginal tax rate and suggest they change it to ensure they do not significantly over-or under-pay their tax during the year. The proposed process in these cases is that Inland Revenue would notify the individual that the tax rate does not match their likely end-of-year tax liability. If no response is received, Inland Revenue would instruct the payer to change the tax rate being used. Inland Revenue would notify the individual that the payer had been instructed to change the rate.

The ability for Inland Revenue to help people get things right is dependent on it receiving quality information in a timely manner rather than receiving it when it is too late to help. This is a major reason behind the Government’s recommended changes to the timing of information about PAYE and investment income. It will still be the individual’s responsibility to let Inland Revenue know if their circumstances change materially, but if Inland Revenue has more regular and timely income information it will be better placed to help individuals.

Inland Revenue will proactively contact more individuals during the year to ensure the tax withheld during the year more closely matches their likely end-of-year liability.

**Special tax codes**

Over-and under-payments can still happen even when an individual is using the correct tax code. Some individuals, for example, those who have multiple jobs, might be better off using a special tax code tailored to their personal circumstances instead.

For some people the standard tax codes do not result in the right amount of tax being deducted during the year. In this case individuals can apply for a special tax code.

Special tax codes can be applied to:

- salary/wage income;
- NZ Superannuation; and
- schedular income sources.

A special tax code cannot be applied

⁹Section 25A of the Tax Administration Act.
to an income-tested benefit payment, such as Jobseeker Support.

Individuals can apply to Inland Revenue for a special tax code. They currently have to fill out a special tax code application and post it to Inland Revenue. Inland Revenue calculates an appropriate tax rate to be used and issues a special tax code certificate to the individual.

The individual then has to advise their employer that they want the special tax code applied to their income. A special tax code is only valid until the end of the tax year. Each individual who receives a special tax code certificate also receives a personal tax summary to complete, or is required to file an IR3 at the end of the year.

The disadvantages of the current rules about special tax codes are that an individual first needs to know about special tax codes, secondly needs to realise that using one would benefit them, and thirdly needs to be able to estimate their likely annual income.

For the 2015 tax year, only 7,975 individuals used a special tax code.

This process will be modernised so an individual who wants a special tax code can request one online rather than by completing a paper form.

If Inland Revenue identifies that an individual would be better off using a special tax code, it would contact them, explain why, and suggest a special tax code. If Inland Revenue identifies that an individual would be better off using a special tax code, it would contact them, explain why, and suggest a special tax code. It would still be up to the individual to decide to change their tax code. This is because the individual will be in the best position to evaluate how their circumstances might change over time.

A special tax code is still based on expected annual income. While it takes the progressivity of the income tax scales into account, it can still result in a refund or tax to pay if income is variable or does not remain at the level the individual predicted. For this reason, the Government is not proposing to mandate the use of a special tax code.

Special tax codes are particularly useful for individuals who are receiving a benefit and working. Staff from the Ministry of Social Development will be able to advise clients of the simple online application process.

An example of when a special tax code is useful is when secondary income results in an income tax threshold being crossed. In this case, an individual will have more tax withheld than they need to during the year. This is explained in the diagram on page 23.

Secondary tax codes are an integral part of the PAYE system. They aim to ensure that a person earning a given amount of PAYE income from multiple sources pays the same amount of tax as a person earning the same amount

QUESTIONS FOR READERS

3.2 Do you support the proposal that Inland Revenue should only suggest special tax codes, rather than insist that an individual should use one? If not, why?

3.3 Do you agree that if an individual applies for a special tax code Inland Revenue should tell their employer what the code is?

3.4 If Inland Revenue thinks an individual would benefit from using a special tax code, should Inland Revenue just tell the individual or their employer too?

3.5 Can you think of other areas where Inland Revenue should work during the year with other agencies that pay income to individuals to help individuals get their tax right? If so, what are the areas and agencies?
New Zealand has a progressive rate system for individuals’ income tax. The rate of tax increases as income increases. The part of a person’s taxable income that falls into a band is taxed at the rate for that band.

1. $0 – $14,000: 10.5%
2. $14,001 – $48,000: 17.5%
3. $48,001 – $70,000: 30%
4. $70,000+: 33%

This example shows a person with one job and a salary of $53,000. Total tax paid is $8,920.

It would be unfair if a second job was taxed at the rate for the first band, because part of the person’s first job was already taxed at that lower rate. If this happened, a person earning income from two jobs would pay less tax than a person earning the same amount of income from one job. Total tax paid is $7,945.

This example shows a person with two jobs, earning $48,000 from their first job and $5,000 from their second job ($53,000 total). A secondary tax code means that they pay the same amount of tax as a person who earns the same amount of money from one job. Total tax paid is $8,920.

When income from a second job takes a person’s total income over a tax threshold however, the person will have more tax withheld during the year than is necessary. This example shows a person with two jobs, earning $35,000 from their first job and $18,000 from their second job ($53,000 total). Total tax paid is $10,545.

A special tax code can be used to ensure that no more tax is withheld than is necessary. The person in the previous example would be better off using a special tax code. Total tax paid is $8,920.

Changes to the tax thresholds were announced in Budget 2017 and are due to come into effect from 1 April 2018.
of PAYE income from a single source.

Secondary tax codes ensure tax is withheld from secondary incomes at the person’s marginal tax rate. This is usually higher than their average tax rate, which is applied to their main job. The progressive nature of the personal income tax scale means that this is appropriate. By applying the person’s marginal tax rate, secondary tax codes prevent inappropriate multiple claims of the lowest (or lower) tax rates for people with concurrent sources of PAYE income, which would result in tax owing at the end of the tax year.

If secondary income results in an income tax threshold being crossed, Inland Revenue would suggest the individual uses a special tax code instead of their secondary tax code in order to ensure the individual is not over-taxed during the year. From the information held about the individual’s income, Inland Revenue would suggest an appropriate rate.

Hayley works 20 hours a week at a clothes store earning $16 an hour, and is also receiving the Jobseeker Support benefit. The Ministry of Social Development always uses a primary tax code for anyone receiving a benefit, even when the benefit is not the person’s largest source of income.

This means Hayley uses a secondary tax code for the income from her job. This results in her being overtaxed during the year.

Hayley’s income per week after tax using a secondary tax code for her job:

Benefit = $42.13
Work = $264¹ using the S tax code

Hayley’s income per week after tax if she used a special tax code:

Benefit = $42.13
Work = $279.55

Using a special tax code Hayley would receive an extra $15.55 per week, or $808.60 extra during the year rather than having to wait until the end of the year to get this refunded.

¹These numbers do not take the ACC earner levy into account.
SARAH

Sarah has two jobs, giving her a total annual income of $55,000 ($35,000 from her main employer, and $20,000 from her second employer). The combination of these two sources of income means that her total income will cross the income tax threshold at $48,000.

Sarah’s tax codes are:

- M for her main job
- SH for her secondary income

The secondary tax code taxes the total $20,000 from Sarah’s second job at her marginal rate of 30%, even though income between $24,000 and $48,000 is usually taxed at 17.5%. This means $13,000 of her income from her second job is being taxed at 30% rather than 17.5%, so she is being overtaxed by 12.5% on that portion of her income.

Sarah’s second employer would withhold $1,625¹² more tax during the year than was necessary to meet Sarah’s ultimate tax liability (which could be refunded to Sarah at the end of the year).

If Sarah used a special tax code instead of the SH secondary tax code she would have an extra $31.25 per week in her take home pay, rather than having too much tax withheld and having to wait for a refund.

Sarah would be better off using a special tax code than a secondary tax code.

Future possibilities:

- Sarah will be able to apply for a special tax code online. Inland Revenue would notify her second employer to use the special tax code rather than the secondary tax code.

- If Sarah does not apply for a special tax code but Inland Revenue notices that the income from her second job is likely to take her income over a tax threshold it would notify Sarah and suggest she might like to use a special tax code. It would explain the difference that it would make for Sarah.

¹²These numbers do not take the ACC earner levy into account.
Some individuals are required to provide information by filing income tax returns so Inland Revenue can ensure that they are paying the right amount of tax on the income they have earned. If an individual files an income tax return that results in a refund or tax to pay, an obligation is created for payment of this amount. However, individuals who are not required to file returns do not have their tax position squared up, so there is no payment obligation.

As discussed in the Green Paper, the Government wants it to be simpler for taxpayers to work out what, if anything, they need to do to pay and receive the right amounts. This involves the Government reviewing which individuals should be required to provide information to Inland Revenue and those who should not. Similarly, it needs to be quicker and require less effort for individuals to do what they need to do.

**CURRENT RULES**

Only some individuals are required to report income to Inland Revenue at the end of the tax year. The rules were changed in the 1990s as part of a package of reforms intended to reduce compliance costs and simplify tax administration by reducing the number of people required to file returns.

Section 33 of the Tax Administration Act imposes a general obligation on all individuals to file annually for the purposes of disclosing their taxable income. That section then excludes from its scope anyone who meets the requirements of section 33AA(1), or is issued an income statement or is required to be issued an income statement.

Individuals are responsible for determining whether they are required to file a return, or request a personal tax summary (or correct one that Inland Revenue has issued to them), or whether they do not need to take any action to finalise their tax position. They are required to do this by considering their income position and deciding whether they meet the requirements of section 33AA based on:

- their tax residency status;
- whether they have any tax credits or losses;
When the changes to the filing rules were made in the late 1990s, it was expected that only 400,000 people would need to receive a personal tax summary each year. Filing to claim refunds and for social policy reasons, however, means that in the 2015 tax year approximately 1,100,000 people submitted a personal tax summary and an additional 1,100,000 filed an IR3 tax return form.

- the amounts of income they have derived from particular sources; and
- the amounts of certain types of income from which tax has been withheld at an incorrect rate.

These rules are quite complex and can be difficult for individuals to understand. In order to know if any income has been taxed at an incorrect rate, and whether it is necessary to file a return as a result, an individual must consider all of their income sources and the tax rates that were applied to them. Some individuals are unaware that they need to provide any information to Inland Revenue.

Section 33AA(1) of the Tax Administration Act sets a monetary threshold which relates to when an individual must file a return. A person is not required to file a return if they (in addition to satisfying a number of other criteria) derive $200 or less of certain types of income from which tax has not been withheld or not withheld correctly. These types of income include employment income, interest and dividends. This $200 of income will translate to different amounts of tax depending on a person’s marginal tax rate.

This means a person who is required to file an income tax return must square up any over-or under-payments, whereas a person who is not required to file a return is not. A central tenet of New Zealand’s tax system is that everyone should pay their fair share of tax. People who earn the same amount of taxable income should pay the same amount of tax, regardless of how they earn that income.

An example of the equity concerns this can raise occurs in years in which there is an extra pay-day. For example, some tax years can have 53 weekly or 27 fortnightly pay-days. When this happens, not enough tax is deducted because typical PAYE withholding calculations are based on standard years of 52 weekly or 26 fortnightly pay-days.¹³ People who are required to file returns will typically end up with an unexpected tax liability, whereas those who are not required to file returns will not have to pay this extra amount.

If a person is not required to file a return (“a non-filer”), it does not necessarily mean they do not file. A lot of “non-filers” are due refunds and they may still choose to file if they wish to claim these refunds. In addition, the revenue system now supports a range of social policy entitlements and obligations¹⁴ that require individuals to provide information to Inland Revenue, such as information about family circumstances, and confirm their income through a tax return.

When the changes to the filing rules were made in the late 1990s, it was expected that only 400,000 people would need to receive a personal tax summary each year. Filing to claim refunds and for social policy reasons, however, means that in the 2015 tax year approximately 1,100,000 people submitted a personal tax summary and an additional 1,100,000 filed an IR3 tax return form.¹⁵

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¹³ The amount of extra tax to be paid will depend on the individual’s salary, and how frequently they are paid. In a year when they are paid 53 times, rather than 52, the extra tax will be $0 if their marginal tax rate is in the lowest tax band, $19 if in the second tax band, $134 if in the third, and $175 if in the top band. In a year in which they are paid 27 times rather than 26, the extra tax will be $0 if their marginal tax rate is in the lowest tax band, $38 if in the second tax band, $268 if in the third, and $350 if in the top band.


¹⁵ An IR3 must be filed if an individual earns income which has not been taxed during the year.
TWO OPTIONS FOR END-OF-YEAR FILING OBLIGATIONS

The discussion document sets out two options for which individuals should have to provide information to Inland Revenue at the end of a tax year. The “improved status quo” simply builds on earlier legislative changes in the Making Tax Simpler series, namely improved PAYE and investment income information. Under the improved status quo, Inland Revenue would issue more personal tax summaries to individuals for them to confirm or complete.

The “alternative approach” further simplifies the rules about filing annual tax returns. Individuals whose only income came through withholding tax systems would not have to provide any information to Inland Revenue. Inland Revenue would calculate the difference between the tax that was paid during the year and the individual’s tax liability. If the individual does not interact by a set time, Inland Revenue would issue refunds or request payments of amounts over thresholds.

THE IMPROVED STATUS QUO

As a result of the proposed changes to the reporting of investment income information in the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill, Inland Revenue will be able to more accurately determine who should be issued a personal tax summary. By receiving information about interest, New Zealand-sourced dividends and Māori authority distributions during the year, Inland Revenue will be able to determine if tax was withheld at a rate that would require the individual to complete a personal tax summary. Under the improved status quo, Inland Revenue would issue personal tax summaries when appropriate, requiring the individuals who received them to square up their tax position. If a personal tax summary is not issued, individuals will still need to determine whether they need to request a personal tax summary.

THE ALTERNATIVE APPROACH

As noted earlier, when individuals file an income tax return, the consequence is that if the return results in a refund or tax to pay, an obligation is created for payment of this amount (subject to rules around very small balances). Under the current law individuals who are not required to file returns do not have their tax position squared up. The alternative approach would separate the requirement to provide information to Inland Revenue from the question of whether an individual’s tax position should be squared up.

Ultimately, the purpose of requiring individuals to interact with Inland Revenue is to ensure the right amount of tax – or close to the right amount – is paid at the right time. To reduce compliance costs, individuals should need to interact only when it is necessary for that purpose. Under the alternative approach, individuals would only be required to provide information to Inland Revenue if that is necessary to ensure that the right amount of tax is paid.
Under the alternative approach, individuals would only be required to provide information to Inland Revenue if that is necessary to ensure that the right amount of tax is paid.

Individuals who earn only income that is reported to Inland Revenue by a third party during the year (or shortly after the end of the year) have no additional information to provide to Inland Revenue. …they would not be required to provide income information to Inland Revenue.

**QUESTIONS FOR READERS**

4.1 Which do you prefer, the “improved status quo” or the “alternative approach”? Why?

4.2 Do you agree with the proposal that people who earn only “reportable income” should not have to provide information about it to Inland Revenue?

4.3 Can you think of any other types of income that would fit the definition of “reportable income”? If so, what are these?

“Reportable income”

“Reportable income” is intended to cover all the sources of income in respect of which Inland Revenue receives third party reporting during the year, or very shortly after the end of the year.

Employment income is already reported to Inland Revenue during the year. The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill includes a proposal to change the due date to 15 May for payers of interest income to provide yearly information to Inland Revenue. This would allow Inland Revenue to include this information on an individual’s account by the time the individual might be required to file a personal tax summary and become “reportable income”. Further changes in that bill would add dividend income and Māori authority income to the list of reportable income sources. From the time these changes take effect, these would all be included in the definition of “reportable income”.

From 1 April 2017, employers will be required to report the taxable value of employee share scheme income through the employer monthly schedule.¹⁶ This will also be included in the definition of “reportable income”.

Other forms of income are reported by third parties to Inland Revenue, for example, income arising from partnership and look-through company interests, and trust income. These are examples of income information that is not provided in time to be included in a tax return. These types of income are not included in the definition of “reportable income”. Inland Revenue will use the information when it is received to ensure that individuals have met their tax obligations.

Since 2015 financial institutions have been required to send information about some of their clients to Inland Revenue under the Foreign Account Tax Compliance Act (FATCA) requirements. Following the adoption of financial institutions have been required to send information about some of their clients to Inland Revenue under the Foreign Account Tax Compliance Act (FATCA) requirements. Following the adoption
The individual would be responsible for considering whether:

- they have received non-reportable income; and
- they are not a New Zealand tax resident; and
- they have any tax credits they wish to carry forward, a tax loss balance or a tax loss component; and
- they are not a “cash basis” person for the purposes of the financial arrangements rules; and
- they pay provisional tax.

If the individual meets any of these conditions they will be required to provide information to Inland Revenue.

**The individual would be responsible for considering whether:**

- they have received non-reportable income; and
- they are not a New Zealand tax resident; and
- they have any tax credits they wish to carry forward, a tax loss balance or a tax loss component; and
- they are not a “cash basis” person for the purposes of the financial arrangements rules; and
- they pay provisional tax.

If the individual meets any of these conditions they will be required to provide information to Inland Revenue.

Analysis of an individual’s account and history may indicate that it is likely that a particular individual has earned non-reportable sources of income. In this case, Inland Revenue will prompt that individual to include information about the income.

**How the “Alternative Approach” Would Be Different to the “Improved Status Quo”**

New Zealand’s tax system operates using a model of self-assessment. This means it is the responsibility of each person to determine the amount of tax payable in relation to their income. That responsibility would remain.

Individuals are currently required to consider the correctness of the withholding on their income. Under this proposal they would no longer be required to do so. Inland Revenue would determine whether there was a difference between the amount of tax remitted through withholding tax, and an individual’s tax liability on this income. It would follow up if any action should be taken.

Currently, if an individual or their spouse is receiving Working for Families tax credits they are sent a personal tax summary or are required to file a tax return at the end of the year. This is to confirm their income for the year to enable a square-up of their entitlement. If a person has to make child support payments, they are required to complete a personal tax summary if they earn more than $200 of interest, dividends or taxable Māori authority distributions. For individuals who only earn reportable income there would be no need to provide income information as Inland Revenue would hold information on all of their income already.

The Government proposes that individuals in this situation would no longer be required to file tax...
Would you need to provide information to Inland Revenue at the end of the tax year?

1. Are you a New Zealand resident?
   - Yes
   - No

2. Do you earn any non-reportable income?
   - Yes
   - No

3. Are you on a “cash basis” for financial arrangements?
   - Yes
   - No

4. Do you pay provisional tax?
   - Yes
   - No

5. Do you have a tax credit or a tax loss component to carry forward?
   - Yes
   - No

6. Do not need to provide income information

Need to provide information
returns solely because they receive Working for Families tax credits or child support or have a student loan. They will still be required to confirm their family circumstances information and non-taxable income information, although it is expected this would be separate to the income tax return.

While people who use special tax codes are currently required to file a personal tax summary or IR3 return, this would not be necessary under the alternative approach. Inland Revenue would know which individuals were issued special tax codes, and if that special tax code was being applied to their income. The individual would not need to notify Inland Revenue that they had used a special tax code.

Individuals who use a special tax code currently have to reapply for a new one each year. Under the alternative approach, this would no longer be necessary. If a special tax code continued to be used after it was no longer providing the correct outcome for an individual, this would be picked up by Inland Revenue monitoring the individual’s income and withholding rates during the year. Inland Revenue would contact the individual about changing the code.

Individuals who earn salary or wages from employment as either an election day worker, or a casual agricultural employee currently have to file income tax returns if they earn more than $200 of that type of income. This would not be necessary under the alternative approach.

The flowchart on page 29 sets out which individuals would have to provide information to Inland Revenue. Individuals are unlikely to need to work their way through the flowchart, as they will generally know whether they are required to provide information or not.

The advantages of this proposal, compared with the improved status quo are that it would:

• be easier for individuals to understand;
• offer a better balance between compliance costs and accuracy;
• take advantage of the increased information available to Inland Revenue from third parties;
• require fewer individuals to provide information to Inland Revenue; and
• remove the inequity whereby people who are not currently required to file do not have their tax positions squared up.

Will individuals be in the same position every year?

Whether someone is required to provide information to Inland Revenue at the end of a tax year will depend on their personal circumstances in that year.
Some individuals will find that they never have to provide information to Inland Revenue. If, for example, someone receives only reportable income such as a salary and some interest they would not need to provide any information to Inland Revenue.

Conversely, some individuals will find that they have to provide information to Inland Revenue in most years, or every year. This will be the case if they earn non-reportable income or want to claim a deduction for tax purposes. These individuals are already required to file income tax returns under the current law.

Other individuals will find that whether they are required to provide information will vary between years. If, for example, a person had always worked for an employer who deducted PAYE from their wages, but then started earning non-reportable income, they would need to start providing information to Inland Revenue. If, in a later year, they stopped earning that extra income and reverted to earning only reportable income, they would no longer be required to provide information to Inland Revenue.

If other sources of income are added to the list of those required to be reported to Inland Revenue by third parties during the year, or shortly after the end of the year, individuals will not need to provide information to Inland Revenue about that source of income.

WHAT INLAND REVENUE WILL DO UNDER THE ALTERNATIVE APPROACH

Inland Revenue will remind individuals generally about their obligations every year, such as through advertising and awareness campaigns.

The Government proposes that Inland Revenue will take different approaches to individuals depending on what information it holds about them. The flow chart on page 35 sets these out.

Inland Revenue will consider what it knows about an individual, their income sources, their tax history and their circumstances.

If Inland Revenue has no reason to believe that the individual needs to provide information, it will move to the calculate stage. Individuals who only earn reportable income will know that they do not need to provide information to Inland Revenue, and that Inland Revenue will let them know if there happens to be a refund or amount of tax to pay.

If Inland Revenue needs more information from the individual it will not move to the calculate stage. Inland Revenue may have reason to believe that the individual has received non-reportable income (for example, the individual has earned rental income in a previous year), or has to provide information because of one of the other requirements on page 28, or Inland Revenue may have
questions about some information it holds, and needs the individual to clarify.

If Inland Revenue considers that the individual will need to provide more information, it will remind them of their obligation to provide the information, to confirm that they earned no income, or only earned reportable income. If this is not provided by their filing date, non-filing penalties could be applied, and a default assessment may be issued. A default assessment is an estimation of tax liability made by Inland Revenue that remains in place until the individual files a return. This could be made based on the amount of income previously returned by the taxpayer.

If an individual ceases to earn income from a non-reportable source, they should advise Inland Revenue that they no longer earn that income. If an individual begins to earn non-reportable income but Inland Revenue is not aware of this and deems the individual to have accepted the position shown on their statement if they do not interact, it is still the individual’s responsibility to ensure that the correct amount of tax is paid.

**Inland Revenue will calculate if there is a refund or tax to pay**

As discussed in chapter 2, certain types of income are subject to a withholding tax system, which means the payer of income withholds tax from the income the individual has earned, and pays this money to Inland Revenue.

Although withholding systems are generally accurate, there can sometimes be a difference between the individual’s ultimate tax liability and the amount of tax that was remitted to Inland Revenue.

Individuals are currently required, for each source of income, to calculate the amount of tax that should have been paid and compare this to what was paid. Under the alternative approach Inland Revenue would compare the tax credits and payments it has received with the person’s income tax liability for that year, and calculate the difference (if any). This difference calculation will be displayed on myIR for the individual to see.

All relevant income information that Inland Revenue holds about an individual will be used in this calculation. If Inland Revenue has only linked income to one individual, but the income actually belongs to more than one individual, it would be included in its entirety in that one individual’s account, and therefore their calculation. An example of when this could happen would be a joint investment if the payer does not hold details about all of the owners of the investment. The individuals would be able to tell Inland Revenue that the income should be shared between all the joint owners.

If this calculation shows no difference, or only a small difference, nothing will happen.

The thresholds defining small differences are discussed later in this chapter.

**QUESTION FOR READERS**

4.7 If an amount is smaller than the threshold, do you agree that an assessment should not crystallise?
The assessment will crystallise

The information will be shown on myIR, and individuals can log on and confirm the information if they wish. If Inland Revenue has calculated an amount above the threshold, the individual will have a prescribed period to respond. If they do not respond, Inland Revenue will consider that they have accepted the information as shown. It will become their assessment at this time. The reason for leaving a prescribed period before Inland Revenue deems the individual to have accepted the information is to allow for the individual to make any necessary changes, for example, to add any non-reportable income or claim a tax deductible expense.

If the difference is less than the threshold, the amount of tax withheld and paid to Inland Revenue will be treated as the individual’s liability, as happens now for non-filing taxpayers.

Inland Revenue will complete the process

If Inland Revenue has moved through all three previous steps it will act to complete the process. It will do this by:

- issuing a refund;
- requesting payment; or
- carrying forward a loss balance.
What happens if the Individual does not provide information to Inland Revenue?

Does Inland Revenue believe information should be provided?

**YES**
- A default assessment might be issued

**NO**
- Is the difference between the payments received and your tax liability larger than the specified thresholds?

**NO**
- There will be no assessment

**YES**
- You will be deemed to have accepted the information. Refund or payment issued

QUESTIONS FOR READERS

4.9 Should there be a threshold for small refunds, or should all refunds, no matter how small, be automatically paid out?

4.10 Should there be a threshold for small refunds if they are paid by cheque?

As at 1 December 2016, 94.5% of refunds that Inland Revenue paid were made electronically.

THE SPECIFIED THRESHOLDS

Inland Revenue can refrain from collecting small amounts of tax owed or issuing small refunds. This reflects the disproportionate costs small amounts can impose on Inland Revenue and individuals. This should continue. Where the amount of tax to pay or refund is less than the "specified threshold", the amount of tax withheld and remitted to Inland Revenue will be treated as the taxpayer's liability, as happens now for non-filing taxpayers.

Feedback is sought on the thresholds. Depending on the levels, there is a trade-off between accuracy, fairness, revenue, compliance and administration costs.

The two existing thresholds are:

- $20 for tax owed; and
- $5 for refunds.

The threshold for refunds

Individuals will still be able to claim a refund below the threshold if they wish. This means individuals have to expend effort to obtain the smallest of refunds, whereas they automatically receive larger refunds. This seems counter-intuitive.

Historically, there has been a small refund threshold to take into account the administrative cost of issuing a refund (usually the cost of posting a cheque), and the costs individuals incur to bank the cheque. As at 1 December 2016, 94.5% of refunds that Inland Revenue paid were made electronically. The very high percentage of refunds paid through digital channels brings into question the need to retain a small refund threshold, or perhaps to only retain one for payments requested by cheque.
The cost to Inland Revenue of issuing a refund digitally, regardless of the size, is negligible, so all refunds could be crystallised and paid. Some individuals might find it odd to receive a refund of a few cents or dollars, but there would be no compliance cost to them if it was received digitally. Most banks charge a nominal fee for depositing cheques, so this option would work best for digital refunds. A small threshold could be retained for cheques.

For the 2015 tax year there were 778,000 people with refunds who did not file or request a personal tax summary.¹⁸ If the alternative approach had applied in that year, with the current refund threshold of $5, Inland Revenue would have issued refunds to an additional 456,000 people. The following table sets out the numbers of people potentially affected at other monetary levels.

<table>
<thead>
<tr>
<th></th>
<th>Filed an IR3</th>
<th>Filed a PTS</th>
<th>Did not file</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0</td>
<td>346,000</td>
<td>909,000</td>
<td>778,000</td>
</tr>
<tr>
<td>$5</td>
<td>332,000</td>
<td>810,000</td>
<td>456,000</td>
</tr>
</tbody>
</table>

¹⁸In the 2015 tax year 3,246,000 individuals were reported as receiving PAYE income. If those people submitted an IR3 or a personal tax summary the following data includes the other income they declared, but if they did not file, then the data is based only on their employment income. 1,851,000 of those people filed a return, while 1,395,000 did not. People who filed returns but were not reported as earning any PAYE income are not included in the following data. Accordingly, the data in the tables will not show the exact number of people who would be affected by the alternative approach at any specified threshold level. For example, a person who did not file might have had interest withheld at a rate that would mean they would also be due a refund or have an amount of tax to pay, but will not show up in this data.
QUESTIONS FOR READERS

4.11 Should there be a threshold for small amounts owed, or should all amounts to pay, no matter how small, be payable? If so, what should this level be?

4.12 What factors should be taken into account in setting a threshold for small amounts of tax owed?

The threshold for tax to pay

Having a threshold under which small amounts of tax are not payable is a trade-off between accuracy, fairness, revenue, and compliance and administration costs. Individuals will incur a compliance cost in paying small amounts. The Government is interested in the factors submitters think should be taken into account when setting a threshold for amounts of tax to pay.

Under the alternative approach, amounts of tax to pay that are smaller than the specified threshold would not be crystallised, unless the individual chose to pay the amount. It is unlikely that individuals will choose to pay amounts that they are not required to, so the level of the specified threshold for amounts of tax to pay will, in effect, determine the number of individuals who have their tax position “squared up”.

As noted earlier, under the current law, an individual is not required to interact with Inland Revenue if they (in addition to satisfying a number of other criteria) derive $200 or less of certain types of income from which tax has not been withheld, or withheld correctly. Depending on an individual’s marginal tax rate, this $200 of income could equate to up to $66 of tax.

For the 2015 tax year, 617,000 people with tax to pay did not file or request a personal tax summary.¹⁹ If the alternative approach had applied in that year, with the current threshold of $20, Inland Revenue would have required 179,000 of these people to pay, but the 36,000 people who filed a personal tax summary with tax to pay under $20 would not have had to file. If the specified threshold for debts was $66, Inland Revenue would have required 136,000 of these people to pay, but the 58,000 people who filed a PTS with an amount of tax to pay less than $66 would not have had to file.

| Number of people with amounts of tax to pay above monetary thresholds |
|-------------------------------------------------|-----------------|-----------------|
| Filed an IR3 | Filed a PTS | Did not file |
| $20 | 433,000 | 114,000 | 179,000 |
| $66 | 423,000 | 92,000 | 136,000 |

¹⁹As at footnote #18.
Sarah has two jobs and uses a special tax code.

Under the current rules, Sarah is required to complete a personal tax summary because she used a special tax code.

Under the improved status quo, Sarah would be required to complete a personal tax summary because she used a special tax code.

Under the alternative approach, Sarah would not have to provide any income information to Inland Revenue.

Inland Revenue would consider what is known about Sarah. It would have no reason to believe that Sarah needs to provide any information to Inland Revenue.

Inland Revenue would calculate the total amount of PAYE it received during the year from Sarah’s two jobs and compare this to Sarah’s income tax liability for the year based on these two sources of income. Because Sarah used the special tax code, there would be no difference.

Her assessment would not crystallise (i.e. nothing would happen).

Maura is retired. She receives New Zealand Superannuation, and interest income from money she has in a bank. She uses the correct withholding rate for her interest.

Under the current rules, Maura is not required to request a personal tax summary. She can complete one if she would like to.

Under the improved status quo, Maura would not be required to request a personal tax summary. She could complete one if she would like to.

Under the alternative approach, Maura would not have to provide any income information to Inland Revenue.

Inland Revenue would consider what is known about Maura. It would have no reason to believe that Maura needs to provide any information to Inland Revenue.

Inland Revenue would calculate the total amount of PAYE and RWT received during the year from Maura’s superannuation and interest income and compare this to Maura’s income tax liability for the year based on these two sources of income. There would be no difference.

Maura’s assessment would not crystallise (i.e. nothing would happen).
Nico is an employee earning only wage income, from which his employer deducts PAYE every fortnight.

Last year, Nico only ended up working for nine months of the year before quitting his job to travel. His annual salary was $60,000 and he was paid monthly. Because the PAYE calculations assume a person will work for the entire year, each pay period is annualised and taxed at the rate that would apply if they had worked the entire year.

Each month Nico earned $5,000. Nico’s employer withheld tax at a rate that would apply to an annual income of $60,000. This totalled $8,265 tax on the income Nico earned until the end of December. Because his total income for the year was only $45,000 rather than $60,000 his final tax liability is only $6,895. Nico is due a refund of $1,370.

Under the current rules, Nico is not required to file a personal tax summary. He will need to complete one if he would like to claim his $1,370 refund.

Under the improved status quo, Nico would not be required to file a personal tax summary. He would need to request one if he would like to claim his $1,370 refund.

Under the alternative approach, Nico would not have to provide any income information to Inland Revenue.

Inland Revenue would consider what is known about Nico. It would have no reason to believe that he needs to provide any information to Inland Revenue.

Inland Revenue would calculate the total amount of PAYE it received from Nico’s employer was more than his tax liability.

Nico’s assessment would crystallise and Inland Revenue would complete the process by issuing Nico a refund of $1,370.
Liam is an employee earning wage income. His employer deducts PAYE every week when Liam is paid. Liam also gets dividends from a utility company each year on which the company pays tax on behalf of Liam.

Liam’s employer reports Liam’s wage income to Inland Revenue. The utility company provides information about the dividends they pay to Liam and the related tax.

Last year Liam earned $46,000 wage income from which his employer withheld $7,070 of tax (for income up to $14000 at 10.5% and for the income over $14000 at 17.5%).

Liam also received dividends of $1,500 from a utility company which include $495 tax ($420 paid by the company at the corporate tax rate of 28% and $75 of RWT withheld by the company so that the total tax equates to the top tax rate of 33%).

Because Liam’s marginal tax rate is only 17.5%, he is entitled to a refund of $232.50 of the tax that was paid on his dividends.

Under the current rules, Liam is not required to file a personal tax summary. He will need to complete one if he would like to claim his $232.50 refund.

Under the improved status quo, Liam would not be required to file a personal tax summary.

Inland Revenue would observe that Liam was due a refund because of the additional tax paid on his dividends. It would issue him a personal tax summary.

Under the alternative approach, Liam would not have to provide any income information to Inland Revenue.

Inland Revenue would consider what it knows about Liam. It would have no reason to believe that Liam needs to provide any information to Inland Revenue.

Inland Revenue would calculate the total amount of PAYE and tax received during the year from Liam’s wages and the dividends and compare this with Liam’s income tax liability for the year based on these two sources of income. Inland Revenue would calculate the total amount of tax it received was more than Liam’s tax liability.

Liam’s assessment would crystallise and Inland Revenue would complete the process by issuing Liam a refund of $232.50.
Sam is an employee earning salary income from which his employer deducts PAYE every week when he pays Sam.

Last year Sam’s annual salary was $78,000. Each week Sam earned $1,500 from which Sam’s employer withheld $320 PAYE (excluding ACC earners’ levy) each pay-day. Because of the day on which his salary is paid, last tax year Sam received 53 weekly salary pays in the tax year (a standard tax year has 52 pay-days).

Because the PAYE system and PAYE tables are based on 52 weekly pay days occurring in a tax year, Sam has a tax shortfall of $175. (He received $79,500 salary income in the tax year, but his weekly PAYE was based on $78,000).

Under the current rules, Sam is not required to complete a personal tax summary.

Under the improved status quo, Sam would not be required to complete a personal tax summary.

Under the alternative approach, Sam would not be required to provide any income information to Inland Revenue.

Inland Revenue would consider what it knows about Sam. It would have no reason to believe that he needs to provide any information to Inland Revenue.

Inland Revenue would calculate the total amount of PAYE it received during the year from Sam’s job and compare this to his income tax liability for the year based on that sources of income. Inland Revenue would calculate the total amount of tax it received was less than Sam’s tax liability.

Sam’s assessment would crystallise and Inland Revenue would complete the process by requesting a payment of $175 from Sam.
Lexie has been self-employed for five years. She buys run-down vintage cars, restores them and then sells them online.

After receiving a large inheritance payment a few years ago she invested some money overseas and now earns a substantial amount of overseas interest income.

In addition to owning her own home, Lexie owns two apartments that she rents out.

None of Lexie’s income is reported to Inland Revenue by a third party during the year.

Under the current rules, Lexie is required to file an income tax return.

Under the improved status quo, Lexie would be required to file an income tax return.

Under the alternative approach, Lexie would be required to provide information because she earned non-reportable income.

Inland Revenue would consider what is known about Lexie. Since Lexie has been declaring self-employed income, overseas income and rental income in previous years, Inland Revenue would consider that Lexie is likely to have non-reportable income this year too.

Inland Revenue would issue a request for Lexie to provide the necessary information.

If Lexie does not do that, Inland Revenue would issue a default assessment for Lexie.
INTERACTING WITH INLAND REVENUE

As shown in the flowchart on page 29, while only some individuals will have an obligation to provide information to Inland Revenue at the end of the year, all individuals can choose to interact with Inland Revenue. This interaction could simply be viewing their online statement, adding or amending any information if they do not think the statement is accurate, claiming a refund or paying an amount of tax that is less than the specified threshold.

Using intermediaries

Many taxpayers choose to engage a tax professional to help them to comply with their tax obligations and others nominate a friend or relative to act on their behalf. It is expected that tax intermediaries, whether paid or not, will continue to play a vital role in supporting taxpayers with their interactions with Inland Revenue.

A key driver of the proposals in this document is to simplify the rules so that more individuals can understand their obligations and meet those obligations with minimal effort.

DIGITAL INTERACTION

There is already significant use of Inland Revenue’s digital services, including use of myIR and payments being made digitally. Less than five percent of the nine million returns that Inland Revenue receives each year are submitted on paper now.

Online forms allow Inland Revenue to present only the questions that are relevant, with later questions not appearing if an answer to a previous question makes them irrelevant. Prompts tailored to the individual can be presented online based on information from previous years, or other information Inland Revenue holds about an individual. That same level of service cannot be provided through paper channels. While tax returns will still be available through non-digital channels, the experience will not be as simple or as adaptive as through myIR. As is currently the case, income information would still be pre-populated on paper returns for individuals who choose not to interact through myIR.
Inland Revenue’s records of an individual’s reportable income will be displayed in the individual’s myIR account.

The myIR account would also include questions or prompting statements that are tailored to what Inland Revenue knows of the individual’s circumstances.

**USING myIR**

Inland Revenue’s records of an individual’s reportable income will be displayed in the individual’s myIR account. If they have uploaded copies of donations receipts during the year, these will be shown on their myIR account.

The myIR account would also include questions or prompting statements that are tailored to what Inland Revenue knows of the individual’s circumstances. These could be related to income that the individual had declared in previous years (for example, “You had rental income last year, do you still rent out a property?”). Or they could be based on information Inland Revenue received from the person during the year (for example, “You’ve already filled in some foreign-sourced income details, do you have more to add?”). They may also be based on information Inland Revenue has received from other sources.

If an individual has received non-reportable income (for example, rental income), that income will not be displayed. In these circumstances, the individual will need to provide information about this income to Inland Revenue.

In addition, while the information Inland Revenue presents in an individual’s information statement will generally be accurate, errors may still occur. If their information statement does contain errors, the individual will be responsible for amending these before confirming their information statement.

As well as adding information that is not already shown, individuals will be able to amend the information that Inland Revenue has displayed, or confirm it as correct and complete.

Some individuals with more complex tax affairs will find that the information that Inland Revenue makes available is not useful to them when completing their return filing obligations. For example, an individual on an accruals basis would probably not find interest information useful. They could amend or delete the amounts shown to reflect their circumstances.

Any obligations or entitlements will be clearly stated. If the account shows that the individual has tax to pay, the payment options will be given. There will be a simple “pay-now” functionality. If the individual has a refund, they will be able to request that it be paid.

**DUE DATES FOR INFORMATION**

No changes are proposed to the due dates for filing annual returns. For the majority of people who are required to provide information, they must do this by 7 July, subject to extension of time arrangements.

**RESULTS OF INTERACTION**

If the individual interacts before 7 July (or other relevant date) and confirms their statement, it will become an assessment on the day they confirm the statement. The effect of the
amount calculated crystallising into an assessment is that the customer is liable to pay the amount to Inland Revenue, is entitled to receive the amount as a refund, or is entitled to carry the amount forward as a net loss.

DONATIONS TAX CREDITS

Credits for donations can be claimed at the end of a tax year by filling in a Tax Credit claim form (IR526), or during the year through a system called Payroll Giving, where the credits are received immediately. An individual who claims a tax credit for a donation does not also need to file an income tax return (unless they are required to for other reasons).

Donations tax credits can be claimed for a previous tax year (1 April to 31 March) from the following April each year. This can be weeks or months before an individual files a personal tax summary or IR3. If the individual is also required to file an IR3, the credits are not released until the IR3 has been filed.

Approximately 80 percent of individuals filing an IR526 are also filing a personal tax summary or IR3 form.

In 2014/15, about 85 percent of the nearly two million individuals’ income tax refunds were made by direct credit. A larger percentage of non-individuals received their income tax refund through cheques in the same income year - about 56% of the nearly 170,000 refunds.

DIRECT CREDITING REFUNDS

People who are entitled to an income tax refund currently receive it either by direct credit or a posted cheque. Direct crediting is a much faster process with lower compliance costs for the recipient and lower administrative costs for Inland Revenue. The Government seeks feedback on whether income tax refunds should be made only through direct credit into the taxpayer’s nominated bank account, with exemptions being available in limited circumstances.

The majority of Inland Revenue’s customers prefer direct crediting as a safe, secure and convenient way of receiving refunds. In 2014/15, about 85 percent of the nearly two million individuals’ income tax refunds were made by direct credit. A larger percentage of non-individuals received their income tax refund through cheques in the same income year – about 56 percent of the nearly 170,000 refunds.

The proposal would benefit taxpayers by eliminating time delays associated with the postal system as well as the costs and effort of banking a cheque. Direct crediting also has the benefit of reduced administration costs for Inland Revenue. A direct credit refund is generally available to the taxpayer in two working days.

The proposal would be implemented by Order in Council through an existing legislative framework²⁰ which provides for the progressive implementation of compulsory direct

QUESTIONS FOR READERS

5.1 Do you support the proposal to allow people to claim donations credits without having to fill in a separate form?

5.2 Do you support the proposal that income tax refunds should be made only by direct credit, with limited exemptions being available?

²⁰Sections 184A and 184B of the Tax Administration Act.
crediting of refunds for the various types of tax administered by Inland Revenue. In this context the tax type income tax would cover individual, as well as non-individual, income tax and include tax on individual, employment (PAYE), investment and business income, as well as special categories of income tax such as fringe benefit tax. An exemption is available under the framework for customers who would experience undue hardship or for circumstances where it is impracticable to refund through direct credit.

Compulsory direct crediting already applies to donations tax credits for charitable gifts and GST refunds.²¹

**COLLECTING TAX TO PAY**

When an income tax assessment shows tax to pay, this amount is due by 7 February of the following year. If the individual has a tax agent, they have until 7 April to pay.

In the future, amounts to pay will be able to be paid directly through myIR, as well the current payment mechanisms, which include:

- transferring money to Inland Revenue through internet banking; and
- paying by debit or credit card on Inland Revenue’s website.

Inland Revenue issues reminders in the lead up to the payment dates, as well as communicating with people who have not paid by the due date. Inland Revenue has a range of debt collection powers which can be used as appropriate.

Determining the appropriate action involves balancing the obligation to maximise recovery of tax with Inland Revenue’s resources and the financial position of the customer.²² Options currently available for debts include:

- exercising a discretion to write off the tax if it is under the $20 threshold);²³
- issuing a “notice to deduct” to a third party payer (such as the customer’s employer or bank) requiring them to deduct the debit amount from payments to the customer;²⁴
- setting up an instalment arrangement for the customer to pay the amount owing,²⁵ and
- if the amount cannot be recovered or in cases of serious hardship, writing it off.²⁶

²¹Tax Administration (Direct Credit of GST Refunds) Order 2016, date of enactment 5 December 2016.
²²Tax Administration Act, section 176.
²³Tax Administration Act, section 174AA.
²⁴Tax Administration Act, section 157.
²⁵Tax Administration Act, section 177B.
²⁶Tax Administration Act, section 177C.
As noted in Making Tax Simpler – Proposals for Modernising the Tax Administration Act, there are inevitably going to be situations when either the individual or Inland Revenue will seek to amend or correct the initial assessment. Correcting tax positions is an integral part of tax administration, and will continue to be so under the modernised tax administration system.

That discussion document outlined the assessment and amended assessment rules and how they apply generally. Those rules will apply in relation to the proposals in this discussion document.

Under current law, Inland Revenue is able to issue an electronic default assessment when a person has not filed a return. The assessment should be based on the information Inland Revenue holds and reflect what Inland Revenue thinks the person’s liability is.

When an electronic default assessment is issued, the liability is subject to use-of-money interest and late payment penalties from the original due date. When the person files a return in response, seeking to amend the electronic default assessment, the current practice is to accept the request for amendment, and make an amended assessment based on the return filed. The person is given a new due date for the payment of the tax assessed under section 142A of the Tax Administration Act before late payment penalties are imposed.²⁷

The Government proposes to clarify that a return filed following the issue of an electronic default assessment will be treated as a request for Inland Revenue to use the discretion to amend the assessment to ensure that the assessment is correct.

If a person wishes to issue a notice of proposed adjustment (NOPA) in response to an electronic default assessment, they will continue to be able to do so but not simply through filing a return.

²⁷The Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Bill proposes a change to the setting of a new due date for amendments to electronic default assessments. The change proposes that the due date for all default assessments and any amendments to a default assessment will be the original due date for the tax that is subject to the default assessment.