
More time for business: questions and answers

The proposals in general

1. How many businesses will these proposals help?

New Zealand is a country of small businesses. Over 95% of employers have fewer than 20 employees, while 84% have fewer than five employees. In total there are around 450,000 small businesses in New Zealand.

Businesses are very varied, and some of the proposals will reduce costs for some businesses but not for others, while other proposals will help a different group of small businesses altogether. Some of these proposals, like those aimed specifically at reducing the impact of use-of-money interest on provisional tax, will help medium and large businesses as well.

2. What is a small business?

For the purposes of the proposals, a small business is one whose total value of taxable supplies for the last twelve months was \$1.3 million or less. Or whose total value of taxable supplies is not likely to exceed \$1.3 million in any period of twelve months beginning on the first day of any month. This is the same criterion used for determining which businesses may account for GST on a payments (or cash) basis.

3. How are the proposals in this document different from tax simplification in the past?

Tax simplification work in the past has focused on getting rid of unnecessary forms and encouraging voluntary compliance without placing an excessive burden on taxpayers, particularly if they are having difficulty meeting their obligations. This document represents a shift in focus towards reducing the risk of not complying in the first place.

4. What else is the government doing to reduce tax compliance costs?

We are concentrating on increasing taxpayer certainty and making compliance as easy as possible. Other projects to reduce compliance costs are set out in chapter 2 of the document. It is a busy year for tax simplification, with four other consultative documents on different aspects of tax simplification planned for release shortly.

5. What about the work of the Business Compliance Cost Panel?

The government's programme for reducing the costs imposed by the tax system is part of our business compliance cost reduction programme. Recent reviews have identified the main areas of concerns and consultation and work to develop solutions had already started because it is a priority for us. We also see it as a process of

continuing improvement and any new concerns identified by the Panel will be addressed as part of the government's tax simplification programme.

Withholding tax on business income

6. What is the proposal?

The government is proposing that, instead of a small business paying provisional tax, it could deposit its income into a bank account, from which the business's bank would withhold a percentage in lieu of the business's income tax. The bank would pay the tax regularly to Inland Revenue, perhaps on a monthly basis.

7. Who would the proposal affect?

It would be a voluntary option available to small provisional taxpayers (those with an annual turnover of less than \$1.3 million). The proposal would also affect banks who chose to participate and act as intermediaries.

8. Why is the change needed?

The current provisional tax payment system assumes a business has a regular income flow, and a tax liability that can be divided evenly into three equal payments during the year.

This causes problems for businesses that do not have a regular income-flow throughout the year, or who earn seasonal income. Their provisional tax payments often do not match their income, so they can experience cash-flow problems when it is time to pay their provisional tax.

The withholding tax proposal would allow these businesses to make tax payments that would mirror their income, thereby assisting with their cash-flow.

9. Would there be any other benefit for businesses choosing this option?

Businesses that do not have a regular income-flow throughout the year or who earn seasonal income can have difficulty with estimating during the year how much income they will have earned by the end of the year. This sometimes means that they have to pay use-of-money interest. Businesses who choose this option would no longer have to pay use-of-money interest.

The proposal would also ensure that businesses regularly put aside money to meet their tax liabilities. This reduces the risk that they might not be able to pay their tax on time, since tax would be paid on each deposit as it is made.

Businesses would also be able to pay their tax during the year without the need to interact with Inland Revenue and the provisional tax system. This would remove the risks of forgetting to make a provisional tax payment and the need to contact Inland Revenue three times a year.

10. Would all of a business's income have to go into the one bank account?

It might be necessary for a business to establish a second bank account into which capital payments could be deposited without being subject to withholding tax. For example, if a business sold a motor vehicle and intended to use the funds as a deposit for a new vehicle, putting the proceeds from the sale into a separate account would ensure the full sum was there for the deposit. Some businesses may already have multiple accounts that could serve this purpose.

11. Who would set the withholding rate for the tax to be deducted?

Businesses would nominate their own withholding tax rate, which would be based on a ratio of their expected tax liability to their deposits during the year. They would also be able to adjust the nominated withholding rate if they thought it no longer correct, in the same way that provisional tax can be estimated.

12. Could a business get help from Inland Revenue in setting its withholding rate?

As a starting point for determining an appropriate rate for the year, Inland Revenue could provide businesses with a ratio that would have been correct for a previous year. It should then be a simple matter for businesses or their tax agents to work out their ratio for the current year.

13. How careful should a business be in choosing the right withholding rate?

The withholding rate selected by a business would have to be reasonable, in the same way that estimates of provisional tax payable must be reasonable.

14. What if a business fails to pay the right amount of tax during the year because it chooses the wrong withholding rate?

Any difference between the tax withheld during the year and a business's residual income tax (RIT) for that year (basically the total annual tax to pay after subtraction of rebates and tax credits) would be due at the business's terminal tax date.

If the tax withheld for the year was less than, say, 80% of the year's RIT, or if any difference between total tax withheld for the year and the year's RIT was greater than \$2,500, the business would be returned to the provisional tax payment system for a period of four years. This would also apply if the business's lowest elected percentage in the first half of the income year was less than 75 percent of the ratio of its RIT to total income.

15. What benefit would banks get from the proposal?

Participation by banks would be commercially attractive. They would benefit from retaining tax payments for a period before they were paid to Inland Revenue. Their customers would also benefit from the ability to participate.

16. Would the government legislate for the involvement of banks?

The government does not wish to legislate for their involvement. It hopes they would become involved because of the commercial benefits. It is also important to remember that their role would be one of supporting taxpayers in meeting their obligations, rather than one of collecting tax on behalf of the government.

17. Who carries the risk of tax payments not being made to Inland Revenue?

The government's view is that, given that the proposals are intended to reduce risk for taxpayers, if a business has made a payment to its bank, it has met its tax obligations. The government would address risk issues in relation to banks when negotiating contracts with them.

Payments based on GST returns

18. What is the proposal?

The government is proposing that small businesses that file GST on a one-monthly or two-monthly basis could, instead of paying provisional tax, pay a proportion of their GST sales and income along with their GST as instalments of income tax.

19. Who would the proposal affect?

The proposal would be a voluntary option available to small provisional taxpayers (those with an annual turnover of less than \$1.3 million), who file their GST returns once a month or every two months.

20. Why is the change needed?

The current provisional tax payment system assumes a business has a regular income flow, and a tax liability that can be divided evenly into three equal payments during the year.

This causes problems for businesses that do not have a regular income-flow throughout the year, or who earn seasonal income. Their provisional tax payments often do not match their income, so they can experience cash-flow problems when it is time to pay their provisional tax.

The proposal would allow these businesses to make tax payments that would more closely reflect their income, thereby assisting with their cash-flow. As GST sales and income increased, the amount of income tax paid would also increase, while declines in sales would result in less tax paid.

21. Would there be any other benefit for businesses choosing this option?

Businesses that do not have a regular income-flow throughout the year or who earn seasonal income can have difficulty with estimating during the year how much income they will have earned by the end of the year. This sometimes means that they

have to pay use-of-money interest. Businesses who choose this option would no longer have to pay use-of-money interest.

The more frequent tax payments would also result in smaller payments, reducing the risk that a payment was too large to meet or that the tax due had been spent by the business.

22. Who would set the rate for the amount of tax to be paid?

A business would set the amount of tax payable on each GST due date as a percentage of its GST sales, and could vary it as it sees fit.

23. Could a business get help from Inland Revenue in setting its tax payment rate?

As a starting point for determining an appropriate payment rate, Inland Revenue could provide businesses with a guide ratio, although the responsibility for working out an accurate ratio would remain with the business.

24. How careful should a business be in choosing the right tax payment rate?

The tax payment rate selected by a business would have to be reasonable, in the same way that estimates of provisional tax payable must be reasonable.

25. What if a business fails to pay the right amount of tax during the year because it chooses the wrong tax payment rate?

Any difference between the tax paid during the year and a business's RIT for that year (basically the total annual tax to pay after subtraction of rebates and tax credits) would be due at the business's terminal tax date.

If the tax paid for the year was less than, say, 80% of the year's RIT, or if any difference between total tax paid for the year and the year's RIT was greater than \$2,500, the business would be returned to the provisional tax payment system for a period of four years. This would also apply if the business's lowest elected ratio in the first half of the income year was less than 75 percent of the ratio of its RIT to total income.

Pooling of provisional tax

26. What is the proposal?

The government proposes that businesses be allowed to pool their provisional tax payments with those of other businesses, with the result that underpayments can be offset by overpayments within the same pool. The arrangement would need to be made through an intermediary, who would also arrange for the businesses to be charged or compensated for the offset.

27. Who would the proposal affect?

Pooling of provisional tax would be a voluntary option available to all provisional taxpayers.

28. Are there any restrictions on participation by businesses?

In order to match underpayments with overpayments, each pool would be restricted to businesses with common due dates for provisional tax. For administrative simplicity, participants would need to be identified to Inland Revenue before the due date of their first provisional tax payment, and would have to participate in the arrangement for the whole year. Transfers between pools would not be permitted, but businesses could make payments to Inland Revenue in addition to those made to the intermediary.

29. Why is the change needed?

The difference between what some businesses pay during the year as provisional tax and their total income tax liability for the year attracts use-of-money interest. About one in five provisional taxpayers falls into this group.

Difficulties in forecasting income mean that some taxpayers underestimate their income and are charged use-of-money interest, whereas others overestimate their income and are paid use-of-money interest. The proposal is specifically designed to reduce the impact of the use-of-money interest rules. Interest paid to or paid by businesses participating in a pooling arrangement would be more favourable than the use-of-money interest rates applied by Inland Revenue.

30. Why is it important that businesses be able to access more favourable rates of interest?

Many business taxpayers feel that the use-of-money interest rates applied by Inland Revenue do not adequately compensate them if they overpay their tax, and that they are over-charged if they underpay their tax.

31. Why doesn't the government just change the use-of-money interest rates?

The rates reflect the fact that the government is an involuntary borrower if taxpayers overpay and an involuntary lender if they underpay.

The underpayment use-of-money interest rate is roughly equivalent to the cost of unsecured bridging finance borrowed by small firms. Lowering this rate would reduce the incentives for taxpayers to pay tax on time, probably resulting in smaller businesses not paying provisional tax till the terminal tax date.

Increasing the overpayment rate might result in some taxpayers overpaying tax simply to have access to an interest rate better than that provided by the private sector.

32. Are there any circumstances in which use-of-money interest would still apply?

Inland Revenue would still apply use-of-money interest if, after the pool was divided and transferred to taxpayer accounts, underpayments or overpayments remained. Interest on underpayments or overpayments would be charged or paid directly to the businesses concerned.

33. Would there be any other benefit for participants?

The risk to businesses of late payment penalties would be reduced, since the obligation to make payment to Inland Revenue on the due dates would be passed to intermediaries.

34. Who are the intermediaries who would arrange the pooling and what role would they play?

Intermediaries would be either financial institutions, for example, banks, or tax agents. Participation in a pool would be by arrangement between businesses and intermediaries. Participating businesses would make provisional tax payments during the year in the same way as they do now, but to their intermediaries. The intermediaries would send the pooled payments as one total payment to Inland Revenue.

Once the participants' tax liability was determined at the end of the year, businesses would know whether they had underpaid or overpaid their provisional tax. At that stage the intermediaries would offset underpayments against overpayments within each pool, give instructions to Inland Revenue as to how the pool should be divided between the participants, and charge or compensate the participants for the offset.

35. How many pools could one intermediary manage?

One intermediary could coordinate multiple pools. Each pool would need to contain a minimum number of participating businesses – at least one hundred. Otherwise the costs associated with running smaller pools would outweigh any benefits. There is also a risk with small pools that there would be insufficient underpayments and overpayments to provide any real benefits to the participants.

36. What benefit would intermediaries get from pooling arrangements?

Participation by intermediaries would be commercially attractive. Intermediaries would benefit from retaining tax payments for a period before they were paid to Inland Revenue. Intermediaries would also gain from the opportunity to manage the arbitrage between those in a pool who overpay and those who underpay. Their customers would also benefit from the ability to participate.

37. Would the government legislate for the involvement of intermediaries?

The government does not wish to legislate for their involvement. It hopes they would become involved because of the commercial benefits. It is also important to

remember that their role would be one of supporting taxpayers in meeting their obligations, rather than one of collecting tax on behalf of the government.

38. Who carries the risk of tax payments not being made to Inland Revenue?

Intermediaries would inform Inland Revenue of the payments they have received from their clients, and that information would be available to the clients from Inland Revenue. This means that clients could check the transfer of payments by intermediaries. On this basis, the onus for ensuring that tax payments have been made to Inland Revenue would remain on the clients.

PAYE proposal

39. How will this proposal help employers?

Any employer who uses a recognised payroll firm to calculate and pay PAYE will to a large extent not be exposed to penalties and interests if the calculation is wrong or if the payment is late. Lots of employers already use payroll firms to do this work but the responsibility for the tax calculation and payment still rests with employers. This proposal lets employers get on with what they do best, running their businesses and moves the responsibility for meeting PAYE obligations to experts

In particular, the PAYE rules can seem daunting for new employers, and this proposal means that they don't have to spend time and resources to become experts at PAYE to employ staff.

40. How many employers are there, and how many of them are small employers?

In New Zealand there are about 160,000 employers and 95,000 of them employ five or fewer staff.

This is an option. It is not compulsory, so we don't know how many of them will use this option. Some employers are quite happy with what they do now.

41. Will employers have to pay for this service?

Employers who use payroll firms do pay for those services. Technological changes in the industry and tools like the internet have meant that those costs have reduced significantly making them very cost effective.

Employers have the use of the PAYE deductions until they are paid to Inland Revenue. That can be up to 50 days for small employers and 20 days for large employers, and there is an option under this proposal to use that benefit to reduce the costs of using a payroll firm.

42. What if employers don't want to give up the use of their PAYE deductions?

There is an option under this proposal that will help those employers reduce the risk of getting the calculations wrong or paying their tax late.

43. What makes the government think that payroll firms will participate?

It's a commercial opportunity for them, expanding on the type of services that they currently provide.

End of year adjustments

44. How many businesses will benefit from the proposal not to value small amounts of trading stock?

About 12,000 businesses make tax calculations for small amounts of trading stock. There are many more businesses who have very small amounts of trading stock but fail to count it. This proposal will reduce risk for those businesses too.

45. Why was a \$5,000 threshold chosen?

Like all tax thresholds, going over this threshold would create some compliance costs. Those costs, for example a sudden increase in tax liability and moving away from accounting treatment, become more significant with a larger threshold.

Increasing non-filing and simplifying family assistance

46. How will these proposals help businesses?

Some taxpayers who are basically wage and salary earners are treated like businesses because they may have income that does not have tax withheld on it. The proposals extend non-filing to these people reducing the risk of not complying with tax requirements that are designed for businesses.

Non-resident Contractors' Withholding Tax

47. What is NRCWT?

Since 1982, contract payments made to non-resident contractors have been subject to a 15% withholding tax under the Income Tax (Withholding Payments) Regulations 1979. This is known as non-resident contractors' withholding tax (NRCWT).

48. What are the proposals?

The government proposes to simplify the NRCWT rules by introducing an exemption for most short-term contracts; and by not applying penalties in circumstances when employers have exercised reasonable care, but have still failed to comply with the rules.

49. Who would the proposals affect?

Non-resident contractors and their New Zealand employers.

50. Why are the changes needed?

Currently, if non-resident contractors wish to be exempt from the NRCWT rules they, or New Zealand employers on their behalf, must apply to Inland Revenue for a certificate of exemption. The government is concerned that the process for applying for exemptions may create unnecessary compliance costs in cases where it is later confirmed by Inland Revenue that no tax liability existed in the first place.

The government is also concerned that employers are required to withhold NRCWT regardless of whether non-resident contractors have a New Zealand tax liability, and are exposed to penalties if they do not.

51. How would the exemption for short-term contracts work?

The government proposes to remove the need to apply for exemptions for non-resident contractors from countries with whom New Zealand has a double tax agreement (agreements between countries to prevent taxpayers being taxed in both countries on the same income) if they are present in New Zealand for less than 62 days.

Short-term contract activities are usually exempt from tax in New Zealand under our double tax agreements, so the requirement that certificates of exemption be obtained in relation to such activities normally has little benefit.

52. How would the proposal concerning penalties apply?

Although a non-resident contractor may not initially have a New Zealand tax liability, subsequent events might result in a liability arising. This can occur, for instance, when the non-resident is present in New Zealand for a longer period of time than initially expected, or if he or she creates a permanent establishment in New Zealand. In these cases, employers who do not withhold NRCWT from the beginning of the contract will face penalties. The result is that employers genuinely endeavouring to comply with the law could be penalised.

The government proposes to prevent penalties from applying if employers exercise reasonable care in determining that non-resident contractors initially do not have a New Zealand tax liability, and it later transpires (through an unforeseen circumstance) that NRCWT should have been deducted.

53. Would these employers be required to make catch-up payments for the NRCWT that should have been deducted?

The employers would be required to make catch-up payments, and to do so within, say, 30 days of the change in circumstances that caused the NRCWT liability to arise. Use-of-money interest would still apply from the original due date.

54. *The discussion document also says that the government is considering employer assessment of NRCWT. How would this work in practice?*

The exact form of this proposal is still under consideration. Nonetheless, it centres around employers determining themselves whether NRCWT should be deducted from contract payments made to non-resident contractors. The employers would be required to take reasonable care in making this determination, otherwise they would face potential penalties. It is likely that the employers would be required to send some information to Inland Revenue, advising the department of their decision to withhold or not, as the case may be, and providing a copy of the relevant contracts.

Resident Withholding Tax certificates

55. *What are the proposals?*

Banks, financial institutions and other payers of interest are required to give resident withholding tax (RWT) information in the form of a certificate to earners of interest. The government proposes to change the legislative requirements on how the information in the certificates can be communicated, to keep up to date with technological changes in the banking industry.

The government also proposes to increase the threshold under which interest payers do not automatically send RWT deduction certificates to savers, from \$20 to \$50.

56. *Who would the proposals affect?*

All interest payers, for example, banks and financial institutions, and interest earners.

57. *Why are the changes needed?*

In order to reduce their compliance costs, interest payers need to be able to take advantage of new opportunities provided by technology for the communication of information. Interest earners may also wish to utilise these opportunities, for example, by way of internet banking.

Increasing the threshold under which interest payers do not automatically send RWT deduction certificates to savers will also reduce compliance costs.

58. *Would interest earners still receive information about RWT deducted from their savings?*

Neither the type of information provided to interest earners, nor the time by which it must be provided, would change.

59. *In what new ways might interest earners receive RWT information?*

New ways of receiving RWT information could include by way of bank statement, by e-mail or fax, or on bank web sites.

60. *Would earners of less than \$50 interest still be able to receive RWT information?*

Earners of interest of less than \$50 would still be eligible to receive their RWT information, if they requested it.

Imputation Credit Accountant refunds

61. *What is the proposal?*

Companies applying for a refund of imputation credit account (ICA) credits are sometimes required to file what is known as an interim IR4J return, despite having earlier provided the necessary information. The government proposes that the requirement for providing the interim IR4J return be removed, thereby making the refund process faster and less costly.

62. *Who would the proposal affect?*

All businesses who maintain an ICA, who may find themselves required to file an interim IR4J return before they can receive a refund.

63. *What is the intended purpose of the interim IR4J return?*

Companies must file an imputation return at the end of the year, either on an IR4J return form or as part of a company income tax return form (IR4). Even so, despite having already filed an IR4J or IR4, if a company applies for a refund and Inland Revenue has not processed the return form, the company must also file another, interim, IR4J return. This is to prevent refunds exceeding the credit balance in the ICA as at the previous 31 March.

64. *Won't removal of the requirement to file the interim IR4J return put company tax revenue at risk?*

The requirement to file an interim return creates unnecessary compliance costs. ICAs with a debit balance attract a penalty of 10% of the debit. This penalty is sufficient discouragement to prevent companies applying for refunds in excess of their balance.

65. *Why couldn't the Commissioner just use his discretion to waive the requirement for the interim IR4J return to be filed?*

The legislation requiring the filing of the interim IR4J is clear and unambiguous. Removal of the requirement to file must be done by way of legislative amendment.