Taxation (Simplification and Other Remedial Matters) Bill

Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill

25 August 1998

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Tax Simplification

PROPOSED POLICY

- *Introduce a certificate confirming total earnings.*
- *Replace the income tax return (IR 5) with an income statement issued automatically by Inland Revenue to taxpayers who meet certain criteria, or on request.*
- *Pre-code income statements with wage and salary information and other taxpayer-specific information obtained from employers during the year.*
- *Require taxpayers who now complete an IR 3 tax return to complete a simplified version of the tax return. The main difference between the returns would be that wage and salary information would be pre-coded on the simplified return.*
- *Require taxpayers to advise Inland Revenue of income that has had tax incorrectly deducted at source only if it exceeds $200.*
- *Regard the income statement as an assessment at the terminal tax due date.*
- *Credit refunds into a bank account rather than issue them by cheque.*

Issue: Need for annual contact with IR 5 taxpayers

Submission
(1 0 - ICANZ, 11 - *New Zealand Employers' Federation, 16W - National Council of Women of New Zealand)*

- Inland Revenue should issue an income statement to all individual taxpayers who do not file an individual return. Income statements must be verified, signed and returned. It is not appropriate that even small debits and credits (subject to thresholds) are ignored. If this recommendation is not accepted, income statements should be issued to taxpayers for the first two income years after the system is introduced. *(ICANZ)*

- All taxpayers should be issued with an income statement, and those who receive non-taxed income should be required to file an additional return. This would avoid the need for complex legislation that may be difficult for taxpayers to understand. If this is not undertaken, sufficient publicity will be required to educate taxpayers. *(National Council of Women)*

- Taxpayers should be issued with a statement identifying their gross earnings and tax paid. *(Employers' Federation)*

Comment

ICANZ believes that the compliance costs associated with receiving an income statement, verifying it, signing it, and sending it back to Inland Revenue are not significant.

Officials consider that such a policy would offset the estimated $60 million reduction in taxpayer compliance costs brought about by the changes in filing requirements. Issuing income statements to all eligible taxpayers would bring many more taxpayers into the system than are currently in it, increasing compliance costs for many. These compliance costs include the 'psychic' costs incurred by many people when they receive correspondence from Inland Revenue and must actively consider their tax affairs.

At present, Inland Revenue issues 1.45 million annual IR 5 tax returns, of which 1.2 million are returned. This number is expected to drop to around one million for the 1997/1998 income year. About 2 million taxpayers are eligible to file an IR 5 return at present. Were this recommendation to be implemented, Inland Revenue would have to contact about one million taxpayers who otherwise would not be contacted. It would also result in an increase in administrative costs.

Issuing an income statement to all individual taxpayers and requiring those who receive non-taxed income to file an additional return would also result in increases in compliance and administrative costs. Officials consider that requiring many taxpayers to deal with two separate forms would create an unnecessary level of complexity for taxpayers.

Inland Revenue will be undertaking a major publicity campaign to educate taxpayers about the operation of the new system and their rights and requirements under it.

With regards to the Employers' Federation submission, taxpayers will be able to request an earnings certificate stating their total gross income and the total tax deducted. Officials consider that issuing these certificates only to those who request them will prevent unnecessary contact with taxpayers who would prefer not to be contacted.

Recommendation

That the submissions be declined.

Issue: Requirement for taxpayers to request income statements

Submission
(10 - ICANZ, 7 - Federated Farmers)

The requirement outlined in the new section 80(C) for certain taxpayers to request an income statement should be removed.

Comment

The requirement is necessary because individual taxpayers know more about their specific tax circumstances than anyone else does. The Commissioner is not in a position to know all income details for all taxpayers, especially in the case of those who earn interest, since the Commissioner is unable to determine whether this interest is earned from a joint account. Therefore taxpayers must be required to inform Inland Revenue of any income that has had tax incorrectly deducted, subject to the $200 threshold.

Measures will be adopted to help make taxpayers aware of their obligation to request an income statement. They include such measures as requiring financial institutions to detail the amount of interest taxed at 19.5% and to insert a statement indicating in what circumstances taxpayers should contact Inland Revenue on RWT deduction certificates.

With respect to the possible imposition of penalties, if a taxpayer has taken reasonable care in arriving at a tax position, a shortfall penalty would not be applied, although any tax shortfall would be payable.

Recommendation

That the submission be declined.

Issue: Sufficiency of the $200 threshold

Submission
(7 - Federated Farmers)

The adequacy of the $200 threshold should be reviewed after the new regime has been implemented.

Comment

The threshold represents a trade-off between revenue and administrative costs. The actual impact of this threshold is impossible to calculate until the income statement process has been in effect for a year. At that point it will be possible to determine the number of taxpayers required to return an amended income statement because they have income exceeding $200 which is not recorded on the income statement, and, if necessary, to set a more appropriate threshold. Until that time, officials consider a conservative threshold is appropriate.

After a year, officials will be in a position to calculate the administrative and compliance costs associated with the threshold.

Recommendation

That the submission be accepted.

Issue: Interpretation of the 5200 threshold

Submission
(10 - ICANZ, 16W - National Council of Women of New Zealand)

- The new section 8OF should be rewritten to clarify whether the threshold applies to each of the three specified types of income or gross annual income from all sources in aggregate. *(ICANZ)*

- Section 33A (1) (b) should be reworded so as to replace "and" at the end of every subparagraph with "or". *(National Council of Women)*

Comment

Officials agree that the wording of section 8OF can be improved. The intention of this section is that taxpayers who receive more than $200 of income in aggregate that has not had adequate tax deducted must request an income statement, whether this income is from wages and salary, interest, or dividends, or any combination of these income sources.

Officials do not agree with the National Council of Women's submission to amend the proposed section 33A (1) (b) as this may result in a taxpayer who receives more than $200 of income with tax incorrectly deducted not being required to request an income statement. In the situation where, for example, a taxpayer derives $200 of wages and $200 of interest and $200 of dividends which has all had insufficient tax deducted, officials believe that the taxpayer should be required to request an income statement and declare this income.

Recommendation

That the submission relating to section 8OF be accepted and the submission relating to 33A (1) (b) be declined.

Issue: Clarification of when a tax position is taken

Submission
(10 - ICANZ)

It should be clarified who is to interpret when a tax position is taken by implication in the new section 4A(1) (ca). This section refers to "a tax position taken explicitly or implicitly in the income statement".

Comment

The matter is to be interpreted by the Commissioner. Officials do not see a need to clarify this by way of a legislative amendment. A taxpayer has the right to dispute the Commissioner's position and, ultimately, can appeal to the courts.

Recommendation

That the submission be declined.

Issue: Circumstances likely to give rise to over-deduction of tax

Submission
(10 - ICANZ)

- Income statements should also be automatically issued to taxpayers entitled to the child taxpayer rebate.

- Inland Revenue should publicise circumstances likely to give rise to tax refunds.

Comment

It is not possible for Inland Revenue to accurately identify taxpayers who are eligible for the child taxpayer rebate, so these taxpayers cannot be automatically issued with an income statement.

Officials agree that it is a good idea to educate taxpayers about what they will be required to do to receive the benefits of such rebates. However, instead of attempting to target education at specific taxpayers, Inland Revenue considers that a better approach is to publicise how the new system will operate and the steps that taxpayers must take to calculate their tax position and obtain any refunds. This will involve educating taxpayers as to their right to request an earnings certificate or an income statement.

With regard to a taxpayer's eligibility to receive a deduction for income protection insurance, officials believe that there is an incentive for insurance companies to indicate this fact to taxpayers.

Recommendation

That the submission be declined.

Issue: Objections to income statements by taxpayers

Submission
(10 - ICANZ)

Inland Revenue should clarify the procedure taxpayers must undertake to make an objection to information included on an income statement.

Comment

Taxpayers who object to any information on an income statement may contact Inland Revenue and provide the necessary information to correct the income statement. If they do not do this before the income statement is deemed to become an assessment, they can object by way of the dispute resolution procedures.

Inland Revenue will be use advertising to educate taxpayers about the new system closer to its implementation.

Recommendation

That the submission be accepted.

Issue: Income statement legislation

Submission
(10 - ICANZ, 16W- National Council of Women of New Zealand)

- The words "will not receive an income statement" should be removed from the amended section 33A and inserted in Part IIIA of the Tax Administration Act. *(ICANZ)*
- Section 33A (1) should be rewritten to avoid the use of double negatives. *(ICANZ)*
- The Commissioner should be required to provide an income statement by 30 June. *(National Council of Women)*

Comment

Section 33A stipulates which taxpayers are not required to file returns or are not required to be issued with income statements. Therefore officials consider that this is an appropriate section to include this requirement.

Officials agree that section 33A should be reworded to avoid the use of double negatives, which may create confusion.

Inland Revenue expects that all income statements required to be issued automatically will be issued well before 7 February. Inland Revenue expects the first income statements to be issued around May 2000 for the 1999/2000 income year. The issue of accountability of the timing of income statements is not well addressed through legislative obligation. A more appropriate avenue for ensuring that this target is met on time is through the chief executive's performance agreement. This approach also allows consideration of the administrative capacity of the department.

Recommendation

That the submission to remove the double negatives in section 33A be accepted, but the submissions to amend Part IIIA and to shorten the required date by which Inland Revenue is required to issue an income statement be declined.

Issue: Confirmation of refunds

Submission
(10 - ICANZ)

The requirement in section MD 1 (IA) that taxpayers must confirm that the income statement is correct before they can be issued with a refund exceeding $50 should be removed.

Comment

This measure has been included to protect the taxpayer from the possibility of having to repay a significant amount of money or be subject to penalties.

Officials consider that it is necessary for taxpayers to consider the accuracy of the income statement if they are due a significant refund.

Since taxpayers may be less inclined to actively consider their tax position where a large refund is involved, requiring them to do so may help to prevent a future liability if the initial calculation of the refund turns out to be incorrect.

Recommendation

That the submission be declined.

Issue: Payment of refunds

Submission
(10 - ICANZ)

- Refunds of different tax types should be able to be made to different bank accounts.

- Taxpayers who operate stock and station agent accounts should have refunds paid by cheque.

- The option of paying refunds with cheques should be retained.

Comment

At present, refunds of different tax types can be paid into different bank accounts. This will not be affected by the implementation of these changes.

Officials note that stock and station agent accounts owned by taxpayers can be direct credited. To ensure payment to the account, taxpayers must supply the stock and station agent's bank account number and their own client number. Therefore there is no need for these taxpayers to receive refunds via cheque.

The new section 184A however, provides for the Commissioner to make a refund by means other than direct credit if paying by direct credit would cause undue hardship to the taxpayer or is not practicable.

Recommendation

That the submission for refunds of different tax types to be able to be paid to separate accounts and the retention of a cheque option, if certain criteria are met, be accepted.

That the submission that refunds to taxpayers with stock and station agent accounts be paid by cheque be declined.

Issue: Information for agents

Submission
(10 - ICANZ)

- Inland Revenue should:

- allow for earnings certificates of clients to be automatically issued to agents;

- consider providing agents with a schedule of taxpayer refunds.

Comment

Officials acknowledge that there will be compliance cost benefits in making relevant taxpayer information available directly to agents. However, because the design of the income statement system has yet to be completed, Inland Revenue is not yet able to confirm the exact nature of the information that will be available or the form in which it will be transmitted.

Therefore once these systems have been further developed, Inland Revenue will be able to consider the exact detail of such measures.

Recommendation

That the submissions be accepted.

IMPROVEMENTS IN THE ACCURACY OF THE PAYE SYSTEM

PROPOSED POLICY

- *Simplify the employee declaration form*
- *Introduce a new system of tax codes that is easier to understand.*
- *Increase the non-declaration rate from 33 percent to 45 percent.*
- *Remove the tax codes for special circumstances.*

Issue: Non-declaration rate

Submission
(3W - New Zealand Chambers of Commerce & Industry)

The non-declaration rate should remain at 33%, otherwise incorrect tax deductions at source will occur, increasing costs for the taxpayer, the employer and the Inland Revenue.

Comment

The non-filing and income statement proposals depend on accurate PAYE and RWT systems. For these systems to work, taxpayers must provide their IRD numbers. This necessitates a non-declaration rate sufficient to give all taxpayers an incentive to comply with their obligations. A non-declaration rate above 33% is required if those subject to the various social policy measures administered through the tax system, especially those who have student loans, are to have any incentive to comply.

An increased non-declaration rate may result in an initial increase in compliance costs for some employers because of the systems changes that may be required. However, these increases in initial costs can be offset by the reduction in costs caused by implementation of a clear rule relating to how to deal with non-declaration of a taxpayer's tax code. This prevents employers undertaking ad hoc measures to deal with employees who do not provide an IRD number. Given the strong incentive on employees to provide their number promptly, this measure will reduce the costs imposed on employers having to contact employees several times.

Taxpayers will have the opportunity to request an income statement at the end of the income year. It will allow them to receive a refund of any over-paid tax if they have later supplied an IRD number after being taxed at the non-declaration rate.

Inland Revenue will be giving priority to applications from employees for IRD numbers. This will help reduce the risk of taxpayers having PAYE deducted at the non-declaration rate because of a delay in response to an IRD number request.

Recommendation

That the submission be declined.

Issue: Ability to match employers' records against Inland Revenue's records

Submission
(7 - Federated Farmers)

Employers should be supplied with a schedule that shows a running total of gross wages and tax deductions for the year to date. This would provide a method of cross-checking Inland Revenue's and employers' records.

Comment

At the end of the year Inland Revenue will provide employers with a summary of the total gross payments and tax deductions which can be used to check against their payroll figures if they so wish. Officials do not consider that issuing such a summary at the end of every month is necessary. Employers who wish to receive-year-to date information may contact Inland Revenue at any time to acquire this information.

Recommendation

That the submission be declined.

Issue: Employee using an incorrect tax code

Submission
(16W - National Council of Women of New Zealand)

Inland Revenue should notify the employee as well as the employer as per section NC 12A if an incorrect tax code is being used. This would allow the employee to request a special tax code if necessary.

Comment

When Inland Revenue detects the use of an incorrect tax code it will attempt to contact the employee initially. If this is unsuccessful it may then contact the employer and stipulate the appropriate tax code to be used.

Recommendation

That the submission be accepted.

IMPROVEMENTS IN THE ACCURACY OF THE RWT SYSTEM

PROPOSED POLICY

- *Introduce a new 33 percent withholding rate which taxpayers will be able to select if their income is expected to exceed $38, 000.*
- *Increase the non-declaration rate from 33 percent to 45 percent.*
- *Incorporate a statement in R WT certificates issued by financial institutions, informing taxpayers to contact Inland Revenue if insufficient tax has been deducted from their interest.*

Issue: Implementation date for RWT elections

Submissions
(9W - ASB Bank)

The election to apply RWT at 33% for taxpayers who have declared their IRD numbers should be able to be applied to interest payments from 1 January 1999. The ASB Bank believe it may impose greater costs if it is required to load an election into its system and store it until 1 April 1999 than if it is able to apply an election from when it is received.

Comment

Officials believe that not all financial institutions will be able to have systems in place by 1 January to allow an election by a taxpayer to be applied. Therefore allowing this recommendation could create confusion for some taxpayers if their bank is unable to apply their election until 1 April while other taxpayers' banks can apply their election. Allowing an election to apply from 1 January might also lead to the situation where taxpayers request a bank to back-date their election for the entire income year. Furthermore, this proposal would result in inconsistent, inequitable tax treatment across taxpayers.

Recommendation

That the submission be declined.

Issue: IRD numbers for joint accounts

Submission
(10 - ICANZ)

More than one IRD number should be lodged for accounts owned by more than one investor.

Comment

Officials consider that it is necessary to consider the compliance cost impact on financial institutions of this recommendation. Although it would enable Inland Revenue to include interest details on income statements, it would also impose excessive compliance costs on financial institutions. The proposals contained in the bill represent a compromise between the impact on financial institutions and the risk to voluntary compliance presented by incorrect deductions.

Taxpayers with interest income will be required to declare that income, assuming they receive an income statement, only if it, and any other income they earned not included on the income statement, exceeds $200. For a taxpayer on the top 33% marginal tax rate, this means a revenue cost of $27.

Recommendation

That the submission be declined.

Issue: RWT Certificates

Submission
(10 - ICANZ, 9W - ASB BANK)

- The requirement to disclose interest subject to 19.5% withholding tax on the RWT deduction certificate should be removed. *(9W – ASB Bank)*

- The requirement to include on the RWT deduction certificate a statement from the Commissioner referring to the need for a taxpayer to contact Inland Revenue should be more specific. *(10 - ICANZ)*

Comment

The requirement to disclose interest taxed at 19.5% is necessary to enable taxpayers to identify instances of tax being incorrectly deducted.

Officials recognise that the proposals will increase the compliance costs imposed on financial institutions. They increase the complexity of RWT, but do not require the introduction of a whole new system on the part of financial institutions. Furthermore, financial institutions will benefit to the extent that the proposals increase the RWT deducted from certain groups of taxpayers, and they can retain those amounts until they are required to be paid to Inland Revenue.

Although the proposals do increase compliance costs on financial institutions, they act to reduce compliance costs on both employers and wage and salary earners. Overall, then, compliance costs are decreased.

To further alleviate these concerns, officials have proposed the use of a formula to enable interest payers to estimate the amount of interest taxed at 19.5% in order to reduce the compliance burden on them.

Officials note that a draft statement to be included on RWT deduction certificates has been distributed to all interest payers.

Recommendation

That the submission be declined.

Issue: Implementation date for RWT elections

Submission
(9W - ASB Bank)

The date for taxpayer elections of the lower or higher rate of RWT should not be earlier than the current proposed date of 1 January 1999.

Comment

Officials consider that bringing forward the date on which interest payers must accept elections may impose significant costs on some financial institutions. Therefore no change is proposed to the current bill on this matter.

Recommendation

That the submission be accepted.

SIMPLIFYING EMPLOYER PAYE OBLIGATIONS

PROPOSED POLICY

- *Introduce a simplified monthly schedule.*
- *Require employers to provide information on gross wages and PAYE deductions for all employees on a monthly basis.*
- *Eliminate IR 12 and IR 13 forms.*
- *Eliminate the end-of-year PAYE reconciliation.*

Issue: Electronic filing

Submission
(11 - Employers Federation, 3W - New Zealand Chambers of Commerce & Industry, 7 - Federated Farmers, 13W - Greg Keymer)

- Employers should not be required to file the employer monthly schedule electronically unless they have over 20 employees and are twice-monthly payers of PAYE. This would give small employers certainty as to their filing requirements. *(Chambers of Commerce)*
- The electronic filing of employer monthly schedules be voluntary. Federated Farmers are concerned that the costs incurred by the employer are not considered. *(Employers' Federation, Federated Farmers)*
- Small employers should be given the option of filing electronically or manually. *(Chambers of Commerce, Greg Keymer)*
- No employer should be forced to file electronically.

Comment

Officials consider that the bill is sufficiently clear. All employers who are twice-monthly payers of PAYE are required to file electronically, as outlined in section NC *15* (1) of the Income Tax Act 1994. Officials believe making this requirement compulsory is necessary to ensure timely and accurate processing of the substantial amount of information large employers will provide.

The new section 36B provides for the Commissioner to grant an exemption, however, for certain employers who would otherwise be required to file electronically. Providing for this discretion on the part of the Commissioner is necessary because there are likely to be employers who would experience significant compliance costs otherwise.

The exemption applies to employers who would face costs considered by the Commissioner to be material, whilst also having regard to the costs that other employers face, the costs Inland Revenue would incur if the employer filed manually, and the number of employees. If the number of employees is less than 100 for the 1999/2000 income year, or less than 50 for subsequent years, this exemption can apply. The Commissioner will provide further guidelines on what costs will be considered material once the format of the electronic filing methods has been finalised.

It is crucial to the success of the proposals that the data in question are filed electronically. If this did not occur, the administrative costs imposed would seriously undermine the feasibility of the proposals.

Recommendation

That the submissions be declined.

Issue: Implementation date of electronic filing

Submission
(3W - New Zealand Chambers of Commerce & Industry)

Because the format of the electronic filing system has not yet been prescribed, and the system must be implemented in less than seven months, the requirement for employers to file electronically should be deferred to 1 April 2000.

Comment

Officials have identified that there is a risk of incurring systems errors if employers are not provided with adequate assistance in the implementation of the new system. Therefore a significant amount of Inland Revenue's implementation resources will be allocated to the provision of appropriate assistance and communications with affected employers.

Inland Revenue will also be using its Relationship Managers, who currently work with major corporate taxpayers on a variety of issues, to work through the implementation of this system.

Inland Revenue is also working with software developers and computer payroll personnel to develop a defined format for electronic filing.

Recommendation

That the submission be declined

Issue: Compliance costs associated with twice-monthly payment of PAYE

Submission
(7 - Federated Farmers, 11 - New Zealand Employers' Federation)

- All employers should be permitted to make PAYE payments on a monthly basis to allow a reduction in compliance costs. *(Federated Farmers, Employers Federation)*

- These payments should be required to be made by the 20'h of each month following the month in which the earnings were paid. *(Federated Farmers)*

Comment

Officials believe the compliance cost reduction would be of a relatively minor nature. In many cases large employers actually receive a net benefit from the deduction of PAYE. This is because of the interest they are able to earn on the deductions before the PAYE collected is paid to Inland Revenue. Thus such a proposal would only serve to increase the benefits that large employers receive, while reducing the amount of Government revenue in net present value terms. It would provide little or no benefit to small employers.

Although requiring those paying fortnightly to provide an employer schedule rather than a pay-in slip would reduce their compliance costs, it would be very difficult for the administration to handle the amount of information it would be receiving. It would allow very little time for Inland Revenue to process information before further information was received from the same employer.

Officials believe that if the Government wished to reduce compliance costs and suffer a resulting negative revenue impact, it would be better served by targeting a measure at smaller employers. Inland Revenue will be considering measures to reduce compliance costs on small businesses in the near future.

Recommendation

That the submission be declined.

Issue: Liability for incorrect tax code declaration

Submission
(7 - Federated Farmers)

Employers should not be held liable for incorrect PAYE deductions if they are based on an employee's incorrect tax code declaration.

Comment

Inland Revenue will monitor the monthly information it receives from employers and when it identifies that an incorrect tax code has been used it will contact the employee. Use of an incorrect tax code will result in employees being provided with an income statement at the end of the income year to ensure their tax liability is assessed correctly. Therefore an employer will not be liable if an employee provides an incorrect tax code.

Recommendation

That the submission be accepted.

Issue: Flexibility during transition to new system

Submission
(7 - Federated Farmers, 11 - New Zealand Employers' Federation)

- There should be a transitional period in which a degree of tolerance and flexibility is provided as employers become acquainted with the new regime. *(Federated Farmers)*
- The new sections 139A and 139AA do not allow for any flexibility in applying *penalties. (Employers' Federation)*

Comment

Officials note that there is scope for discretion on the part of the Commissioner with respect to the imposition or remission of penalties for late filing or non-electronic filing. The amended section 139A allows the Commissioner discretion in applying a late filing penalty. Remission of both these penalties is provided for in the amended section 183A.

Recommendation

That the submission be declined because the concerns raised are addressed through appropriate remission provisions.

Issue: Costs to employers of electronic filing

Submission
(10 - ICANZ, 11 - New Zealand Employers' Federation)

- The costs of upgrading from a manual to electronic payroll, or refining existing software, to comply with the new filing requirements should be funded by the Government. *(Employers' Federation. ICANZ)*
- Alternatively, any software costs should be fully depreciable in the year in which they are incurred. *(Employers' Federation)*

Comment

Officials consider that the exemption available in the new section 36B will sufficiently target those employers who would face excessive compliance costs if required to file electronically.

One of the selection criteria that Inland Revenue is using in its decision as to what the prescribed electronic format for electronically filing will be, is that the cost of the software for employers is kept as low as possible. Therefore officials do not believe that it will be necessary for the Government to fund the costs involved with electronic filing.

With respect to the deductibility of these software costs, the existing deductibility provisions of the Income Tax Act 1994 apply. Therefore all costs incurred will be fully deductible. Whether they are deductible immediately or over time via depreciation depends on whether the expenditure is of a revenue or capital nature.

Officials do not consider that offering a specific deduction for these expenses would be justified.

Recommendation

That the submission be declined.

Issue: Options for filing electronically

Submission
(10 - ICANZ)

- If the costs to employers of complying with electronic filing are not borne by the Government, more than one format should be prescribed by the Commissioner as acceptable.

- When finalising the details of the electronic filing options, provision should be made for employers that may have difficulty in complying.

Comment

Officials agree that allowing more than one format for electronic filing is desirable. Inland Revenue is currently considering various options and will inform employers of the relevant details when the options have been finalised.

Officials understand that many employers may experience difficulty when attempting to comply with the new requirements. Inland Revenue will be using resources to educate and assist employers with the transition.

Recommendation

That the submission be accepted.

Issue: Adjustments for errors

Submission
(10 - ICANZ)

The system must be able to deal with errors that are detected after the filing of an employer monthly schedule.

Comment

Amendments correcting errors can be made by re-submitting the appropriate employer monthly schedule or by making adjustments in later schedules, provided the error is detected before the final employer monthly schedule for the income year is submitted.

Officials consider a legislative change would be useful in clarifying how errors will be corrected. Officials recommend that the definition of 'employer monthly schedule' be amended to include errors identified by the employer in relation to an earlier PAYE period in the same income year.

No legislative amendment is proposed for corrections detected after the end of the income year. This will leave the communication of errors detected after the end of the end of the income year to the discretion of the Commissioner and the taxpayer.

Recommendation

That the submission be accepted.

Issue: Exemption from electronic filing

Submission
(10 - ICANZ)

The number of employees referred to in the new section 36B should be specified as full time equivalent employees. This would prevent employers of large numbers of casual employees from having to upgrade from a manual payroll system to a computerised system.

Comment

The objective of the proposal is to ensure that employers with large numbers of employees, whether temporary, casual or part-time, provide information electronically. Exempting employers of casual employees from this requirement would mean that some large employers might still provide information in a manual form. Even so, some flexibility is appropriate for employers with large numbers of employees for short-periods - such as an orchardist who employs extra staff for the picking and pruning seasons.

Officials recommend that if the exemption is to apply, the daily weighted average of the number of employees (whether full-time, temporary, casual or part-time) for the year should

not exceed 100 in the 1999/2000 income year, or 50 in subsequent years. For example, an employer of 200 staff for 60 days and 80 staff for 305 days would have, on average each day 99.72 employees [((200 staff x 60 days) + (80 staff x 305 days)) / 365)l and therefore may apply for the exemption in the 1999/2000 year. To minimise compliance costs when staff numbers continually fluctuate, officials recommend that Inland Revenue have a discretion not to require the calculation if it considers, from other information provided by the employer, that the employer would meet this requirement.

Officials also recommend that an exemption from electronic filing continue to apply until the employer considers he/she no longer meets the threshold or the exemption is cancelled, except if the employer had over 50 employees and fewer than 100 employees in the 1999/2000 year. Finally, to prevent the cancellation of the exemption resulting in an immediate obligation on the employer to file electronically, officials propose that electronic filing must begin on the later of six months after cancellation or the start of the subsequent income year.

In the case of those with more than 50 employees but fewer than 100 in the 1999/2000 year, no grace period should apply, as it is clear they will have to begin filing electronically in the 2000/2001 year.

Recommendation

That the submission be declined but that the method of counting the number of employees be clarified, that the exemption does not have to be renewed each year, and that employers have a minimum of six months or the start of the next income year to begin filing electronically. Officials recommend that these measures, except for the employee counting rule, should not apply to employers with more than 50 but fewer than 100 employees in the 1999/2000 income year.

Issue: Bonuses and executive salaries

Submission
(10 - ICANZ)

- Provision should be made for executive salaries and bonuses that are not included in current payroll systems to be filed separately.

- Different passwords should be required for different types of accounts.

Comment

There will be scope in the new system for these payments to be filed separately. Employers will be able to request a separate IRD number and file this information under a separate name. This will allow this information to be filed on a separate employer monthly schedule.
This process will enable separate passwords to be used for each payroll system.

Recommendation

That the submission be accepted.

THE REBATE CLAIM FORM

PROPOSED POLICY

- *Introduce a new claim form for donation and housekeeper-childcare rebates.*
- *Continue the existing annual maximum claim thresholds.*
- *Limit the amount of donations and housekeeper-childcare payments that can be claimed to the amount of taxable income, up to a maximum of $1,500 for donations and $940 for the housekeeper-childcare rebates in the year before payments.*
- *Repeal the extra pay rebate.*

Issue: Separation of the rebate claim form

Submission

(10 - ICANZ, 16W - National Council of Women of New Zealand)

- Individual return filers (currently IR 3 taxpayers) should be able to claim donations and childcare rebates in a tax return. If this is not acceptable, the deadline for filing the rebate claim form should be extended to 31 Marc tie following year. *(ICANZ)*
- There should be provision to E-file rebate claim forms. *(ICANZ)*
- All taxpayers should be issued with a rebate claim form. *(National Council of Women)*

Comment

The abolition of IR 5 tax returns will mean that many taxpayers will no longer be required to have contact with Inland Revenue. For these people to claim rebates without having to file a return or request an income statement a separate rebate form is necessary.

Having a separate rebate claim form for all taxpayers, regardless of whether they are required to file returns, maintains the simplicity of the new system. If a taxpayer changes from one who has no contact with Inland Revenue to one who must file a return, or vice versa, the taxpayer may become confused about whether a rebate claim form must be filed in order to claim rebates. Therefore having all taxpayers subject to the same rebate claim requirement avoids undue complexity.

Officials consider the new rebate claim form to be very simple and easy to complete. Therefore agents should not have to complete this new form as individuals will be able to do it themselves. Maintaining the 30 September deadline will help to relieve agents of the burden of completing these forms and will allow them to ensure their resources are used on higher value added tasks.

For those who do wish to use agents to administer their rebate claim forms the option of E-filing the claims may be satisfactory to Inland Revenue. Inland Revenue will consider this an option.

Recommendation

That the submissions to allow rebates to be claimed via the individual tax return and for the rebate claim deadline to be extended be declined.

Issue: Donations rebate

Submission
(4 - Inter Church Working Party on Taxation, 5 - Philanthropy New Zealand)

- The maximum claim limits should be increased to allow for inflation and because of the increasing use of donations to fund activities that were previously taxpayer funded.

- This increase would also assist in offsetting the fact that fewer taxpayers will be reminded of their entitlement to claim the donations rebate.

Comment

The proposals are aimed at reducing the compliance costs imposed on taxpayers. Considering issues in relation to the thresholds and maximum claims that can be made under the various rebates is outside the scope of these proposals.

With respect to taxpayers' reduced awareness of their rebate entitlement, Inland Revenue will be putting resources into advertising and communicating the changes in taxpayer requirements when they are introduced. As a supporting administrative measure, rebate claim forms will be automatically distributed to all taxpayers who made a claim in the previous year. Separating the claiming of rebates from the income tax system may allow charities to distribute rebate claim forms to those from whom they receive donations, further ensuring that taxpayers who wish to make a claim will have ready access to a claim form.

At present, 15 percent of IR 5 tax returns are filed simply so taxpayers can claim these rebates. This places compliance costs on taxpayers, costs that will be avoided by using a stand-alone form. This new process would also bring administrative benefits to Inland Revenue, as the department would not have to issue an income statement merely for the purpose of allowing a rebate to be claimed.

Recommendation

That the submissions be declined.

Issue: Deadline for taxpayers with a non-standard balance date

Submission
(10 - ICANZ)

The new section 41A should be amended by replacing the words "in the case of other taxpayers" in subparagraph (6) (b) with "in the case of taxpayers with a balance date between 1 April and 30 September".

Comment

Rebates allowable under sections KC 4 and KC 5 of the Income Tax Act 1994 are calculated from qualifying payments made during the taxpayer's income year. The proposed section 41A ensures that taxpayers with a balance date other than 31 March have six months to file their rebate claim form to be eligible to receive a rebate.

Recommendation

That the submission be declined.

OTHER ISSUES RAISED BY SUBMITTERS

Issue: Tax codes for special circumstances

Submission
(10 - ICANZ, 7 - Federated Farmers)

- The tax codes SSH, CAW and SHR should be retained.

- If these codes are removed they should be replaced by a means of enabling accurate tax deductions for casual workers in the new system. This would be the introduction of a new code, CS, for casual workers, which attempts to apply the appropriate average tax rate to an employee's wages. This should apply to all casual employees, not merely those in the agricultural industry.

Comment

Submissions on the Government discussion paper *Simplifying Taxpayer Requirements* generally supported the removal of these codes. Removal of the codes was presented as an option rather than a firm proposal because of the potential issues now being highlighted in the submissions received by the Committee.

The concerns regarding removal of the codes include the resulting inaccuracy of deductions and the fact that the codes allow a simple tax deduction calculation by an employer, thus preventing an increase in compliance costs which would occur if these employers were required to use PAYE tables.

Officials consider that the concerns being raised can be addressed by retention of a tax code for casual agricultural employees, which will adequately address these concerns.

Officials propose a single code, casual agricultural employee (CAE), which would have a flat rate of 21%. This code would apply to all employees to whom the current codes CAW, SHR, and SSH apply. The rate of 21% is used to bring it in line with the middle effective marginal rate, and therefore to avoid the need for these taxpayers to request an income statement unless they earn more than $38,000.

With respect to the submission concerning different casual codes, officials note that employees can currently apply for a special tax code for this purpose. These codes will be easier to apply for in the future, and employees will be able to do this via the telephone.

Recommendation

That the submissions be accepted and that a single code for agricultural employees which has a rate of 21 % be retained.

Issue: Contact with family assistance recipients

Submission
(10 - ICANZ)

Inland Revenue should maintain appropriate contact with family assistance recipients to ensure that when a change in circumstances gives rise to an obligation to deregister they are reminded to do so.

Comment

Officials believe that the benefits from the reduction in compliance costs from relieving recipients from their obligation to complete an annual application form outweighs the likely effects of recipients failing to indicate when there is a change in their family circumstances.

To ensure those who receive family assistance are reminded of their obligations, they will be contacted regularly throughout the year, as at present.

Recipients of family assistance will all receive an income statement and so will be under an obligation to declare their tax position. Given the increased information available to the Commissioner through the employer monthly schedule, the scope for Inland Revenue to detect any changes in a taxpayer's circumstances promptly will be greatly increased.

Recommendation

That the submission be accepted.

Issue: System implementation

Submission
(10 - ICANZ)

The new system should be phased in gradually. Employers should continue with annual reconciliations and the issuing of IR 12s and IR 13s to 31 March 2000. Income statements should be prepared and issued using these reconciliations, and employers then be required to comply with the current proposals from 1 April 2000.

Comment

While the proposals require Inland Revenue's PAYE systems to be amended by 1 April 1999, the bulk of system and other process amendments are required to be in place by 1 April 2000.

Inland Revenue has undertaken a major exercise to establish the implications of these measures. This review established the system and organisational changes required by the proposals and the effort required to successfully implement the necessary amendments. On the basis of this review, Inland Revenue considers it has the capability to deliver required changes by the implementation dates chosen by the Government.

Inland Revenue will be undertaking a major education campaign and providing assistance to taxpayers affected by the changes, particularly employers, to ensure that taxpayers are able to comply with the changes.

Recommendation

That the submission be declined.

Issue: IR 56 Taxpayers (Home care workers and embassy workers)

Submission
(10 - ICANZ)
The treatment of these taxpayers under the new system should be clarified
Comment
To incorporate IR 56 taxpayers into the new system, section NC 16 (a) of the Income Tax Act 1994 is being amended to provide for these taxpayers to furnish an employer monthly schedule instead of a IR 66N return. IR 56 taxpayers are also relieved of the obligation to undertake an annual reconciliation.

Other than these changes there are no specific changes for IR 56 taxpayers. Those who are private domestic workers will continue to file tax returns.

Recommendation

That the submission be accepted

Issue: ACC reconciliation return

Submission
(10 - ICANZ)

Compliance costs for employers may be reduced if ACC obtained the necessary information directly from Inland Revenue and then assessed taxpayers.

Comment

While Inland Revenue will have considerable PAYE details, it will not hold information such as the appropriate ACC codes. This means employers must complete a return, although they will be supported in this activity as Inland Revenue will provide summary PAYE details to them. At the end of each income year all employers will be issued with a summary of total gross wage and salary payments and total tax deductions for each employee.
This will act to reduce employer compliance costs over the current position.

Recommendation

That the submission be declined.

Issue: Withholding tax and contractors

Submission
(7 - *Federated Farmers)*

Inland Revenue should investigate the effects of this bill's proposals on the current withholding payment regime.

Inland Revenue should investigate and resolve the current problems associated with verifying the tax status of contractors and potential liabilities.

Comment

Officials note that this bill does not have any implications for the withholding payment regime.

The submission to resolve issues with the withholding payments regime is outside the scope of this bill.

Recommendation

That the submission be declined.

Issue: Provision to allow small employers to file electronically

Submission
(Officials)

A provision should be inserted to allow small employers to voluntarily choose to file an employer monthly schedule electronically.

Comment

Currently the provision relating to filing the employer monthly schedule does not provide scope for an employer who is only required to pay PAYE to Inland Revenue monthly (a small employer) to file electronically.

This was unintended. Employers who wish to file the employer monthly schedule electronically should be able to do so.

Recommendation

That a provision be inserted to allow small employers to elect to file the employer monthly schedule electronically-

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Issue: Provision of remittance certificate electronically

Submission
(Officials)

Section NC 15 should be amended to provide scope for electronic lodgement of remittance certificates.

Comment

As currently drafted, section NC 15 does not provide for electronic lodgement of remittance certificates owing to the requirement that such certificates be signed. This reflects the fact that currently the Commissioner is not in a position to receive that information electronically. However, this position is likely to change in the future, so it would appear sensible to provide scope for electronic provision.

To achieve this, the proposed section NC 15 (1) should be amended to remove the references to the remittance certificate having to be signed by the employer. A new section NC 15 (2B), providing that only non-electronic remittance certificates must be signed by the employer, is required.

Recommendation

That the submission be accepted.

Issue: Clarifying the election of the 33% deduction rate for RWT purposes

Submission
(Officials)

The proposed section NF 2A should be re-worded to make it clear that the election for the 33% deduction rate applies to accounts, rather than the current provision's application to a payment.

Comment

The current wording of section NF 2A requires an election in relation to a payment of interest. This effectively requires an election for each interest payment by the taxpayer. This was not intended and officials propose an amendment to allow an election in relation to a payment or payments (effectively by account).

Recommendation

That the submission be accepted.

Issue: Removal of need to retain a signed hard-copy of employer monthly schedule

Submission
(Officials)

Employers should not be required to keep a paper copy of an employer monthly schedule filed electronically.

Comment

For larger employers who are required to file electronically, the employer monthly schedule could be a substantial document. As the draft legislation is currently worded, employers must retain a paper copy of this document. Officials consider that employers should be able to retain an electronic copy of the employer monthly schedule as a substitute for a paper copy. This will reduce compliance costs on employers, possibly significantly in the case of very large employers.

To ensure that employers do not have to retain a paper copy of the employer monthly schedule the following amendments are required:

- to section 23 of the Tax Administration Act, to exclude employers from having to retain a signed hard copy of each employer monthly schedule they provide to Inland Revenue.

- to section 24, which covers records to be kept by employers, to allow electronic retention of records.

- inclusion of a new subsection in section 40, to remove the requirement that electronic returns must be signed.

- to section 36(3), to remove the requirement to a hard-copy of any employer monthly schedule furnished in accordance with section 36A.

- to section 110(2), to provide that a hard-copy of information transmitted in accordance section 36A is sufficient evidence of the information electronically transmitted.

- removal of clause 10 of the bill, as this clause effectively requires employers to keep a paper copy of the employer monthly schedule.

Recommendation

That the submission be accepted.

Issue: Non-New Zealand sourced interest or dividends

Submission
(Officials)

Taxpayers who receive New Zealand sourced wages or salary, interest, or dividends and non-New Zealand sourced interest and dividends should not be required to file a tax return or receive or request an income statement if the amount of gross annual income that has had tax incorrectly deducted does not exceed $200.

Comment

Taxpayers who earn salary and wages and/or interest and dividends sourced solely from New Zealand and who earn $1 or more of non-New Zealand sourced interest and dividends, must file an IR 3 tax return. This, in effect. removes them from the non-filing system.

Officials propose these taxpayers should be included in the non-filing system. This would mean that they would not be required to request an income statement if their overseas interest and dividends and any other income that has had tax under-deducted does not exceed $200 and provided the other non-filing criteria apply. If income has had tax under-deducted they would be required to request that an income statement be issued. Upon receipt of an income statement they would be required to return details of their non-New Zealand sourced income to ensure that their tax liability can be accurately calculated.

These taxpayers will be tied into the standard $200 income threshold so as to avoid unnecessary complexity for individual taxpayers. The revenue loss from not requiring these taxpayers to file is estimated to be less than $110,000. This arises as in the majority of cases interest or dividends will be sourced from countries with which New Zealand has a double tax agreement (DTA). This means that New Zealand will give credits for tax withheld at source. In many cases these credits will mean that there is little or no tax left to pay to Inland Revenue.

The effect of this proposal is that it will reduce compliance costs on those taxpayers who would otherwise have to file an individual return, and administrative costs for Inland Revenue.

Based on 1996 figures, this measure removes up to 5,000 taxpayers from the obligation of having to file an IR 3 return. A further maximum of 27,000 would be required to request a simple income statement. Those taxpayers who wished to claim losses from overseas would still be required file an individual return. Present figures indicate that about 180 taxpayers would remain as individual return filers because they claim losses from overseas.

Inland Revenue will target education campaigns at those who earn foreign sourced interest or dividends to ensure that they are aware of their requirement to declare any foreign sourced interest or dividends that does not come under the $200 threshold so as to inform taxpayers of the need to request an income statement. This will involve fewer than 27,000 taxpayers.

Recommendation

That the submission be accepted.

Issue: ACC to make a return as an employer

Submission
(Officials)

Amendments to correct the section references used in the bill in respect of measures related to the ACC are required. These incorrect references arise because of consequential amendments that were not made to earlier bills.

Comment

Officials propose several minor amendments to clause 17 the bill regarding section 46 of the Tax Administration Act 1994:

- Subsection 4, subparagraph (iv) refers to "earnings related compensation". This is now known as "weekly compensation".

- Sections 38, 39 and 43 referred to in subparagraph (v) are contained in the Accident Rehabilitation and Compensation Insurance Act 1992, not the Accident Compensation Corporation Act 1982.

- The vocational allowance referred to in paragraph (v) has been repealed.

- The references to sections 58,59,60 and 138 are unnecessary as they are covered by the reference to weekly compensation payable under the Accident Rehabilitation and Compensation Insurance Act in subparagraph (iv).

As these amendments are in effect correcting consequential amendments arising from previous legislation, these errors exist currently in the Tax Administration Act 1994. Officials recommend that the amendments above be applied to the existing section 46 (6) (c). Because of the nature of the provision there is no need for these amendments to be retrospective. They can apply from the date of enactment.

Recommendation

That the submission be accepted.

Issue: RWT Formula

Submission
(Officials)

The bill should be amended to allow for interest payers to use a formula to estimate the amount of interest that was taxed at 19.5%.

Comment

The requirement to state the amount of interest earned at 19.5% figure is intended only as a guide to whether a taxpayer may need to request an income statement. It is not used in any income or tax calculation. Therefore the compliance costs that can be imposed on financial institutions to provide that information must be considered carefully.

In discussion, the Bankers' Association indicated that the requirement for interest payers to state the exact amount of interest that was taxed at 19.5% will impose significant compliance costs on some interest payers. Officials consider this compliance cost should be reduced.

Officials have established a simple decision tree and a formula which *approximates* the result that would arise if a financial institution actually tracked the withholding applied to each dollar of interest. Overall, the use of the formula will result in estimations which are considered by officials to be satisfactory.

To allow for the use of this formula an amendment is required to allow the Commissioner to accept a formula instead of an actual amount of RWT deducted at 19.5%. This requires an amendment to section 25 (6) (g) so that RWT deduction certificates using this formula comply with the legislation.

Recommendation

That the submission be accepted.

Issue: Start and stop dates for interest calculation

Submission
(Officials)

The lodgement date for income statements should be deemed to be the date on which an income statement was issued.

Comment

Part VII of the Tax Administration Act provides that interest on overpaid tax begins on the later of the due date for the payment of the tax or the date the tax return is filed. The purpose of this measure is to prevent Inland Revenue having to pay interest to taxpayers who are due significant refunds which the department cannot refund as no return has been filed. In effect, this provision prevents the Crown being exposed to increasing unquantified interest on possible refunds. Officials consider a similar provision is required in the case of income statements.

For the interest provisions of the compliance and penalties legislation to be applied to the new income statement process, the lodgement date should be deemed to be the date on which the income statement was issued by Inland Revenue. This is regardless of whether the income statement was requested or automatically issued.

If a taxpayer returns an amended income statement resulting in a new income statement being issued, the lodgement date should be deemed to be the date the initial income statement is issued.

Part VII also provides that interest on an overpayment ceases on refund of the overpayment. For refunds exceeding $50 arising from the issue of an income statement, officials propose that the date the interest period ceases is the date the taxpayer can claim the refund, not the date it is actually claimed. As with the interest commencement provision, the intention is to prevent payments of interest on amounts taxpayers can choose to have refunded should they wish.

Recommendation

That the submission be accepted.

Issue: Nominated persons

Submission
(Officials)

Section 81(4) (1) of the Tax Administration Act 1994 should be amended to allow persons to nominate another person (the "nominated person") to take care of their tax affairs on their behalf by telephone as well as in writing.

Comment

At present, nominated persons are able to act on behalf of another taxpayer only if they have been nominated in writing by that taxpayer. With the increasing use of telecommunications systems, officials believe that it is appropriate that the legislation be amended to allow persons to nominate another to act on their behalf via the telephone.

This would reduce taxpayer compliance costs and greatly reduce the time taken for tax affairs to be dealt with.

If this proposal is adopted, the systems will be designed so that security of a taxpayer's affairs is maintained by the use of confidential passwords applying to both the nominating and nominated persons. A number of questions will be asked over the phone to ensure correct identification of persons nominating another to act on their behalf. A letter will be issued to the persons nominating another to act on their behalf to confirm the nomination, to provide a further check on the nomination, and to provide a permanent record to the taxpayer.

Implementing this measure will require section 81(4)(1) of the Tax Administration Act 1994 to be amended so that the words "or in another method as prescribed by the Commissioner" are included.

Recommendation

That the submission be accepted.

Issue: minor omissions

Submission
(Officials)

A number of minor errors in the draft legislation have been identified.

Comment

- The amendments to the definition of "non-filing taxpayer" requires amendment to cover taxpayers not required to receive an income statement.

- Section NC 15(2) needs amendment to omit an unnecessary "by".

- Section 36B (1) needs insertion of a reference that the Commissioner's authority to authorise non-electronic filing of the employer monthly schedule relates only to those required to file electronically.

- Section 36B(2)(d) needs amending by substituting "current income year" for "income current year".

- Section NC 6 needs amending to set the rate of deduction paid under section 303 of the Education Act 1989.

Recommendation

That the submission be accepted.

Issue: Requirement that information be provided on Inland Revenue form

Submission
(Officials)

A provision should be inserted to require those filing paper employer monthly schedules to complete the form provided by Inland Revenue.

Comment

The change to the employer monthly schedule, with its increased information provision, places a significant obligation on Inland Revenue to process the information it receives both accurately and in a timely manner. This information will become the basis of income statements prepared by the Commissioner for approximately 300,000 taxpayers.

To ensure accurate, timely processing of the employer monthly schedule, the schedules issued by Inland Revenue will contain various information for tracking the forms through departmental processes and is likely, in the future, to contain significant amounts of information in bar code form. Given the inclusion of this additional information on the return, officials recommend that employers be required to return the form issued by Inland Revenue.

At present, some employers print their own forms. The continuation of employers using their payroll package to generate their own form under the new system is not feasible as the coding information cannot be generated by a pay-roll package. Even if it could, Inland Revenue would be required to establish manual checking procedures to ensure that information provided was in fact correct.

Furthermore, the department has already encountered major problems with the quality of paper, the types of ink used and the fonts in forms prepared by employers, problems that have often required manual intervention. Were employers to continue to print their own forms, these problems would likely increase in significance under the new system.

To balance the proposed restriction, officials note that employers will now have new options as to provision of information to Inland Revenue:

- manual completion of the pre-printed form provided by Inland Revenue;
- online transfer of an employer monthly schedule, file directly from the employer's payroll package;
- online completion of employer monthly schedule, probably using internet technology.

Officials believe in most cases where employers have the necessary technology to print the information to exact IRD specifications they would also have the technology to file electronically, which is the preferred option for speed, accuracy and both compliance and administrative cost minimisation.

Recommendation

That a provision be inserted requiring employers to compete the employer monthly schedule provided by the Commissioner rather than prepare their own form.

Other Matters

THIN CAPITALISATION

Issue: Extension of on-lending concession to associated persons

Clause 44 Section FG 6(1A) Page27

Submission
(10-ICANZ; 14-Toyota Finance New Zealand Limited)

1. Section FG 6(IA) does not achieve its intended objective and should be redrafted *(ICANZ, Toyota Finance).*

2. There should be no requirement for an associated person to which a loan is made to be subject to the thin capitalisation rules if the on-lending concession is to apply *(ICANZ).*

Comment

Section FG 6(IA) is intended to extend the on-lending concession in the thin capitalisation rules to loans made to associated persons, provided those persons are subject to the thin capitalisation rules and are not members of the taxpayer's New Zealand group. This ensures that debt originating from a single source is not subject to the thin capitalisation rules separately in the hands of two different companies.

Officials agree that redrafting of section FG 6(IA) is required if the intent of the amendment is to be effected (the first submission point). However, officials do not consider it appropriate to remove the requirement for associated persons to be subject to the thin capitalisation rules if the on-lending concession is to apply (the second submission point).

Officials agree that if on-lending is done at arm's length rates, likely avoidance opportunities will be reduced. However, because such opportunities will not be eliminated completely, it is prudent to retain the requirement that the associated person be subject to the thin capitalisation rules. Transactions involving associates have the greatest potential for circumventing the rules.

Officials note further that the requirement for the associated person to be subject to the thin capitalisation rules if the concession is to apply is likely to be of only limited practical consequence. It would require quite an artificial structure for an associated person to be not subject to the thin capitalisation rules, and it is unlikely, therefore, that it will impact on commercial structures.

Recommendation

That submission point one be accepted, but that submission point two be declined.

Issue: Rules for determining New Zealand parent

Clause 43 Section FG 4(11) Page 26

Submission
(1 - Chapman Tripp)

The rules concerning the ability to group a foreign company's New Zealand branch operation with its New Zealand subsidiaries should be clarified.

Comment

The rules for identifying a taxpayer's New Zealand group are intended to ensure that groups for thin capitalisation purposes are determined consistently. In other words, if Company A's New Zealand group includes Company B, Company B's New Zealand group should include Company A. This prevents companies from manipulating the thin capitalisation rules through their choice of grouping arrangements.

The submission identifies an anomaly if a non-resident has a branch operation in New Zealand and also controls a New Zealand subsidiary. The rules currently require the branch to include the subsidiary in its New Zealand group, but generally exclude the branch from the New Zealand group of the subsidiary. This result was unintended, and a clarifying amendment is desirable to remove the anomaly.

Recommendation

That the submission be accepted.

GROUP INVESTMENT FUNDS

Issue: Scope of the amendment

Clauses 42 and 47

Submission
(8 - Investment Savings & Insurance Association of NZ Inc)

The amendment should not proceed. If there is a problem with revenue account investment in passive funds, the solution should address it specifically, and not make a major broad-brush change to the group investment funds regime to treat the group investment fund effectively as a unit trust/company in relation to superannuation funds' investment. The amendment will mean that superannuation funds investing in passive group investment funds on capital account will pay tax on their capital gains.

Comment

Investors who hold their investments in a listed group investment fund on capital account will not pay tax on any capital gains, if they sell their units on the market. Three of the largest passive group investment funds are listed: TENZ (NZ Equity), AMP WINZ (International Equity) and Tower Tortis Ozzy (Australian Equity). Investments in these three funds accounted for $735 million of the approximately $1 billion invested in passive group investment funds as at 31 March 1998. Therefore superannuation funds which invest in passive group investment funds on capital account will not be taxed on capital gains if they invest in a listed fund and sell their investment on the market.

Superannuation funds investing in passive group investment funds on revenue account are not paying tax on their gains. This is a loophole, which the proposed amendment will close. As noted in the commentary to the bill, it is arguable that removing superannuation funds from "designated sources" should have occurred along with the 1989 changes to superannuation taxation.

The solution treats superannuation fund investments the same as all other 4 o commercial" type investments in a group investment fund. This is the same tax treatment as for investors in unit trusts and companies.

Recommendation

That the submission be declined.

Issue: Incentives for retirement savings

Clauses 42 and 47

Submission
(12 - Trustee Corporations Association)

Superannuation funds should not be removed from the definition of "designated sources" as such a move will not encourage or promote retirement savings, but instead will be a disincentive to investors saving for their retirement in a responsible manner through the use of professionally managed superannuation funds.

Comment

As the submitter points out, individual investors will still be able to make tax-free capital gains if they invest on capital account in a passive group investment fund that is listed, and they sell their investment on the market. However, this treatment also applies to superannuation funds which invest in listed group investment funds on capital account. They will also be able to obtain tax-free capital gains by selling their investment on the market.

However, it is not appropriate for superannuation funds investing in group investment funds on revenue account to obtain tax-free gains. Revenue account gains are taxable, whether they are made by individuals, superannuation funds or other entities. The proposed amendment will close this loophole.

It is interesting to note that there was no submission from the Association of Superannuation Funds of New Zealand on this issue, nor in relation to the proposed amendment generally. The submitter represents the four trustee companies (through which group investment funds are formed) and the Public Trust.

Recommendation

That the submission be declined.

Issue: Timing of the amendment

Clauses 42 and 47

Submission
(8 - Investment Savings & Insurance Association of NZ Inc)

If the amendment is to proceed, it should be deferred either:

- until there has been a specific review of the group investment fund taxation provisions; or

- at the very least, until completion of the Government's review of the tax treatment of superannuation funds investing through other superannuation funds.

Comment

Superannuation funds investing on revenue account in passive group investment funds and passive superannuation funds has the potential to create a significant revenue cost. The current tax advantage for this type of investment is creating distortions in the financial markets, with greater levels of investment from superannuation funds being diverted into passive group investment funds and passive superannuation funds, than passive unit trusts or other investments.

There is no reason to delay an amendment to the group investment fund rules because the Government has signalled that it will be considering a proposed solution to investment in superannuation funds, following consultation. At the time of the introduction of the proposed changes to the group investment fund rules, the Government announced that a paper would be circulated shortly on treatment of superannuation fund investment into superannuation funds. The issues and potential solutions relating to superannuation fund investment in other super funds are more complex than for group investment funds.

It is not appropriate to delay making amendments until there is a wider review of the group investment fund rules. It is important to address the loophole now because of the significant revenue cost. Making a legislative change will also give superannuation funds greater certainty about their tax treatment as they have been expecting the Government to address the problem for some time now.

Recommendation

That the submission be declined.

Issue: Available subscribed capital

Clauses 42 and 47

Submission
(8 - Investment Savings & Insurance Association of NZ Inc)

In the event the amendment does proceed, the Income Tax Act should provide explicitly for the value of a unit in a GIF immediately prior to the application date of the amendment to be the available subscribed capital once the amendment becomes effective.

Comment

The effect of the proposed amendment is to change an investment that is subject to trust tax treatment to one that is subject to company tax treatment. The definition of available subscribed capital, which applies to company share repurchases, would not take into account investments made before 1 April, without amendment.

The effect of making the change recommended in the submission would be to ensure that the proposed amendment would only apply to gains made by group investment funds after 1 April 1999.

Recommendation

That the submission be accepted.

THE TAX CREDIT SYSTEM AND TAX PAID BEFORE 1 APRIL 1998

(Clause 56)

Issue: Imputation credits transferred to a life office's policy holder credit account before 1 April.

Submission
(10W- Institute of Chartered Accountants of New Zealand)

Submission 1 - Superannuation schemes and life offices should be able to credit imputation credits to the tax credit accounts even where those imputation credits arose from tax paid by wholly owned entities before 31 March 1998.

Submission 2 - The amendment should contain an ordering rule for identifying imputation credits attached to dividends paid from wholly-owned entities.

Official's comment

As a general policy, tax changes should affect only income earned after the date of implementation. Consequently, in moving to the tax credit system, only tax paid after the implementation date should be used to provide tax credits. Imputation credits reflect tax paid. Imputation credits that have accumulated in the wholly-owned entities of life insurers or superannuation funds before the tax credit system's implementation reflect tax paid. Therefore they should not be available to be used to provide tax credits when they are attached to dividends paid to a fund from its wholly-owned entities.

An ordering rule is required to identify which imputation credits are attached to dividends. Officials propose an ordering rule to ensure that imputation credits are paid out in the same order as they were earned. This also prevents a possible avoidance technique.

Recommendation

That the first submission be declined, but the second submission be accepted.

PAYE TAX TREATMENT FOR ELECTED MEMBERS OF LOCAL AUTHORITIES

(Clauses 66 and 67)

Issue: Proposed PAYE tax treatment for elected members of local authorities

Submission
(2, 2A, 2B and 2C - Auckland City; 15 - Local Government New Zealand)

The proposed amendment subjecting elected members to PAYE tax treatment should be removed from the bill.

Comment

The tax legislation currently treats elected members as self-employed. Their remuneration is subject to a 33% withholding tax under the Income Tax (Withholding Payments) Regulations 1979, and they are able to claim deductions for work-related expenditure. However, in practice, elected members are treated in a variable manner for tax purposes - some as self-employed, others as employees, while still others have a mix of the two (with part of their remuneration treated as employee income and the balance as self-employment income).

Recognising the need for a consistent approach, officials consulted with Internal Affairs and local authorities' national representative body, Local Government New Zealand ("LGNZ") on a proposal that elected members be subject to PAYE tax treatment, that is, the same tax treatment as employees (while still retaining their status as office holders).

Internal Affairs advised officials that they had no fixed view on the proposal. However, LGNZ expressed support, stating that the overwhelming majority of elected members would be made better off by the change in tax treatment. Consequently Ministers gave their approval to the proposed amendment, and it was included in the bill. When the bill was introduced into the House, on 24 June 1994, LGNZ sent a memorandum to all local authority Mayors, Chairs, and Chief Executives concerning the proposed amendment, stating, "We have advised Inland Revenue of our support for this aspect of the Bill."

However, LGNZ's submission to the Committee states that it opposes the proposed amendment on the basis that it will disadvantage elected members. Speaking to officials concerning their submission, LGNZ has advised that its shift in view is largely due to communications it received from local authorities voicing disapproval for the proposed amendment. This disapproval is based on the fact that if elected members were made subject to the same tax treatment as employees, they would no longer be able to claim deductions for work-related expenditure. LGNZ is now of the opinion that the proposed amendment should not be passed.

Officials are of the view that, from a policy perspective, either employee or self-employed tax treatment is acceptable (although, from an Inland Revenue administrative point of view, employee tax treatment is marginally preferable).

The current legislation subjects elected members to a 33% withholding tax. Therefore, whether elected members remain self-employed, or are moved to employee tax treatment, either will result in consistent deduction of tax at source (although self-employed treatment enables elected representatives to claim deductions for work-related expenditure). Whichever tax treatment is chosen, it will be accompanied by moves by Inland Revenue to clear up current inconsistent practice.

Recommendation

That, should the Committee choose to accept LGNZ's and Auckland City's submission, the proposed amendment subjecting elected members to PAYE tax treatment be removed from the bill.

Should the current legislative treatment be confirmed, Inland Revenue will take steps to ensure that councils and elected members are familiar with the appropriate compliance requirements. That is, councils will have to deduct withholding tax from all payments made to elected members (including allowances) at the rate of 33%, and elected members will be able to claim deductions for work related expenditure.

MINOR CORRECTIONS

Issue: Cross-referencing errors in Taxation (Tax Credits, Trading Stock and other Remedial Matters) Bill

Submission
(Matter raised by officials)

Officials have identified five cross-referencing errors in the bill:

1. Section CB 9(2) should refer to section LH 19 (4) as well as section LH 19 (3).
2. Sections CL 3 (1) and CM 19 (1) should refer to section LH 19 instead of section LH 20.
3. The new section DI 3A should follow section DI 3 instead of section DK 3.
4. The word "estimated" should be removed from section MJ 7 (1)(a).
5. In section OB 1, in the "first superannuation fund" definition, "section LB 1 A" should be omitted.

Recommendation

That these corrections be included in the slip to the bill.
