Making tax easier for small businesses

A government discussion document

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First published in September 2003 by the Policy Advice Division of the Inland Revenue Department,
P O Box 2198, Wellington.

Making tax easier for small businesses – a government discussion document.
ISBN 0-478-27109-3

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Chapter 1

INTRODUCTION

1.1 The focus of tax simplification for small to medium-sized businesses in this discussion document reflects the importance of the sector to New Zealand. Small businesses form a more significant part of the economy in New Zealand than they do in other OECD countries. New Zealand averages around six employees per firm, whereas most other OECD countries average from ten to twenty employees. In 2000 there were nearly half a million businesses in New Zealand, 86 percent of which employed five or fewer staff.

1.2 Small businesses are important not only in number but also in the extent of their tax contribution. Self-employed individuals who work on their own and businesses that employ five or fewer staff contribute around 40 percent of business income tax revenue. Most of the remainder comes from a small number of large businesses.

1.3 Complying with the tax system is a significant contributor to business compliance costs, which are particularly burdensome for small businesses. Furthermore, as a small business grows, its number of contacts with Inland Revenue and other government departments increases dramatically. For a rapidly growing company this can be a real problem because once it begins employing staff, the number of its yearly contacts with Inland Revenue can easily double.

1.4 Small businesses say that they find it hard to budget for tax payments and that tax payments have a significant effect on their cash flows. They would like to minimise the compliance costs associated with paying tax.

1.5 Small businesses also risk exposure to use-of-money interest on underpayments of provisional tax, especially when they are required to estimate their provisional tax for the current year and their business income fluctuates. Fluctuating and seasonal income can also lead to financial difficulties when a business is required to make provisional tax payments before it has earned the income that is being taxed.

1.6 The proposals in this discussion document aim to resolve these problems by:

- reducing the burden of government-imposed payroll obligations for small employers, thereby giving them more time to grow their business;
- more closely aligning the payment of provisional tax with when income is earned, to reduce the financial strain that businesses face at certain times during the year; and

- reducing the risk that a business may be exposed to use-of-money interest.

1.7 To achieve these aims the government has had to consider a number of trade-offs in relation to the frequency of tax payments, workloads that would be placed on businesses if certain changes were made, businesses' use of tax money versus paying tax when income is earned, and the cost to the government of implementing these proposals. We welcome feedback from businesses, their advisors and other interested parties on whether the results of the trade-offs are acceptable to them.

SUMMARY OF PROPOSALS

Covering part of the cost of using payroll agents (chapter 3)

- The government would cover part of the costs that small employers incur when they use a payroll agent to take over their PAYE and other government-imposed payroll obligations. The subsidy could apply to as many as five employees per business.
- The government would contract with payroll agents and pay the subsidy directly to those agents.
- Government departments would interact directly with an employer's payroll agent rather than the employer, thus freeing the employer to spend more time on business while giving the employer access to specialist payroll resources.
- Payroll agents would largely be paid by the government to help small employers with their PAYE and other governmental obligations.
- Employers could still choose whether to use a payroll agent or do the work themselves.

Improving the timing and frequency of tax payments (chapter 4)

- GST and provisional tax due dates would be standardised, payable on the 28th of the month.
- Provisional tax would be paid with GST, which for many businesses would mean more frequent but smaller provisional tax payments.
- PAYE and terminal tax payment dates would remain the same.

Provisional tax based on GST turnover (chapter 5)

- Provisional tax would be based on a ratio of a taxpayer's two-monthly GST-adjusted sales. It would be a voluntary option.
- GST-registered taxpayers with turnover of less than $1.3 million could qualify for this option. They would have to pay both GST and provisional tax in their own right to qualify.
- Provisional tax would be paid along with GST (two-monthly or six-monthly).
- Businesses that adopted this method would not be subject to use-of-money interest.

A discount for individuals starting a business (chapter 6)

- Self-employed people would be given an incentive to pay tax in their first year of business. It would take the form of a 6.7 percent discount against their end-of-year tax liability for each dollar of tax paid during the first year.
- The discount would apply to individual taxpayers in the year before they are required to pay provisional tax.
- They would receive the discount only once and their entitlement to it would lapse once they became a regular provisional taxpayer.
- Individuals who started a business would be able to choose whether or not to receive the discount and in which year to receive it.
- The discount would be 6.7 percent of the lesser of the amount paid during the year or 105 percent of the end-of-year residual income tax liability.

Electronic tools to answer questions on employment and residence status (chapter 7)

- Inland Revenue would provide on-line tools to clarify employment and resident status, which would reduce compliance costs for employers.

Key questions

1.8 Before making final decisions on whether to proceed with the various proposals discussed here, the government wishes to seek the views of interested people. Key areas in which we seek feedback are:

- proposals in the discussion document that should or should not be adopted and why;
- whether the proposed measures deliver substantial compliance cost reduction benefits; and

- other possible simplification measures for small businesses that the government should consider.

Application date of the proposals

1.9 The proposals could be included in legislation introduced into Parliament in 2004. The actual application dates would depend on the final features of the proposals as well as the administrative work involved in implementing the changes. Furthermore, it is unlikely that all the changes could be implemented in the same income year. Finally, one of the proposals would affect payroll agents, so their views on application dates will be taken into account.

Communicating your views

1.10 The government invites submissions on the proposals set out in this discussion document. Although the document often identifies specific issues for consultation, we are interested in views on any of the issues raised. Submissions should be made by 31 October 2003.

1.11 Written submissions should be addressed to:

Tax simplification
C/- General Manager
Policy Advice Division
Inland Revenue Department
P O Box 2198
WELLINGTON

1.12 If making a submission in electronic form please put "Making tax easier for small businesses" in the subject line. The electronic address is:

policy.webmaster@ird.govt.nz

1.13 Please note that submissions may be the subject of a request under the Official Information Act 1982. The withholding of particular submissions on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. If you feel there is any part of your submission which you consider could be properly withheld under that Act (for example, for reasons of privacy), please indicate this clearly in your submission.

Chapter 2

SMALL BUSINESSES AND TAX

2.1 The government is committed to supporting business growth and innovation. Because New Zealand is a country of mainly small and medium-sized businesses, special attention must be devoted to them.

2.2 We asked Inland Revenue to consult with these businesses, to better understand the common compliance cost concerns they face and to get feedback about initial solutions to those concerns. We wanted to know what small and medium-sized businesses saw as the priority issues – to ensure the issues the government progressed were those of real concern to them. We also wanted to know more about the compliance cost problems facing those who start up a business or try to grow a business.

2.3 It was important to ensure that businesses outside the Wellington region had an opportunity to take part in the research, both to express their concerns and present their ideas for improvements. Although a telephone survey covered the entire country, focus groups and other meetings were deliberately regionally focussed.

2.4 Our initial approach to the research was to identify as many simplification options as possible. The list was then narrowed following consideration and initial consultation. Examples of items that were removed include depreciation issues – the subject of a separate review – and the tax rules on balance day adjustments – which would result in relatively low gains but significant revenue costs.

2.5 Extensive research was undertaken, both formally and informally. As a whole, the research represents the most comprehensive consultation on the tax compliance costs faced by small and medium-sized businesses that we have undertaken. On our behalf Inland Revenue:

- Held 15 formal focus groups with taxpayers as well as a number of focus groups with tax agents. The focus groups had an independent facilitator and were attended by Inland Revenue staff.
- Held a number of informal focus groups and meetings with small businesses.
- Commissioned a market research company to conduct telephone surveys involving 1611 businesses and 400 tax agents. This quantitative research covered 619 employers, with slightly over 50 percent being small employers.
- Had five face-to-face interviews with tax agents.

- Placed on Inland Revenue’s website a self-completion survey on compliance costs that attracted 239 responses.
- Held meetings with 30 small businesses. Senior managers of Inland Revenue were involved in these meetings, which ensured that they better understood the problems faced by small businesses.
- Consulted with various industry representatives such as Business New Zealand and the Institute of Chartered Accountants of New Zealand.

2.6 We would like to thank all those who participated for their generous contribution of time and ideas, especially those small businesses that sacrificed time running their business to discuss their concerns with the government.

Findings from the research

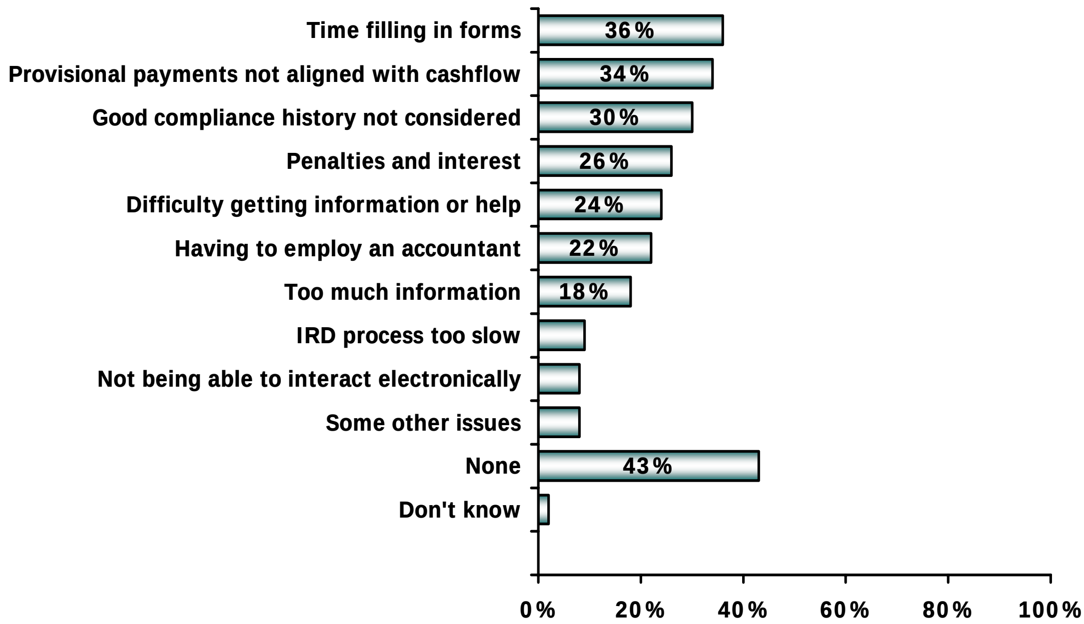
2.7 It is important to bear in mind that small businesses have differing views on tax issues, and all these views have to be taken into account. A business’s approach to tax may vary from highly organised to less organised. What works for those who do their accounting work early, routinely and as information comes to hand will not work for those who rarely plan for tax matters and who collate and file returns at the same time.

2.8 The telephone surveys provided robust information on the compliance cost problems facing small businesses. The businesses consulted were asked to identify the organisations that impose compliance costs on them and rank the compliance costs in order of impact.

2.9 Not unexpectedly, the research shows that having to comply with tax obligations is clearly the largest contributor to business compliance costs, with 70 percent of those surveyed considering tax to have the biggest impact. The significance of this impact can also be judged by comparing tax compliance costs with those associated with other requirements imposed by the government – such as ACC, which was rated by only 12 percent of those surveyed as having the biggest overall impact.

2.10 On tax-related compliance costs, respondents expressed concern about a wide range of tax issues. Although some issues were clearly ranked higher than others, no single issue was dominant. Figure 1 shows the range and extent of these concerns.

Figure 1: Tax compliance costs – what businesses see as a problem



2.11 Many of these concerns seem to reflect an underlying view on the part of small businesses that they are unpaid tax collectors. Some small businesses are of the view, for example, that because they collect PAYE on behalf of the government and are not paid for this work, they should be treated leniently if they pay late. In response, a tax system which minimises the compliance costs of all taxpayers sometimes necessitates placing obligations on people to collect tax and enforcing those obligations. For example, employers help others to pay tax by deducting PAYE from the salaries or wages of their staff. There is some compensation in that employers have the use of the deducted tax for a short period before it must be paid to Inland Revenue, although for some this benefit does not cover their actual PAYE running costs.

2.12 Other issues identified by the research relate to the need for more flexible tax administrative processes that take account of taxpayers' changing circumstances; the need for the tax system to be more tolerant of mistakes; the need for less severe penalties and interest; and taxpayers' need for assistance in using technology-based solutions. These issues have either been addressed through recent legislative reforms or are being dealt with through administrative initiatives, so they are not considered in this discussion document. For example, the government has recently enacted reforms to the late payment penalty to enable Inland Revenue to take into account a taxpayer's previous compliance history. Similarly, the reported problem of taxpayers having difficulty getting information or help from Inland Revenue has reduced as a result of the improvement in call centre performance over the last two years.

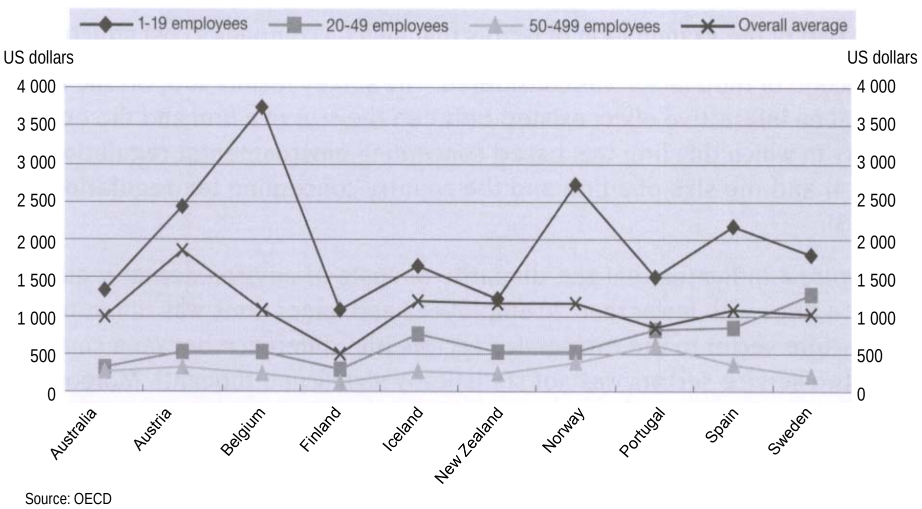
2.13 Concerns relating to fringe benefit tax are being considered as part of the specific review of the tax, and will be the subject of a forthcoming discussion document.

SMALL BUSINESS COMPLIANCE COSTS IN OTHER COUNTRIES

An OECD survey[1] on compliance costs in ten countries for 1998 and 1999 sought respondents' views on employment, tax and environment regulations and the direct administrative costs of complying with those regulations for small businesses. The survey found that:

- On average, small businesses spent US$27,500 a year (US$4,100 per employee) on compliance costs, of which 46 percent related to tax, 35 percent to employment regulations and the balance of 19 percent to environmental regulations.
- The regressive nature of compliance costs seen in other surveys was confirmed. Smaller businesses (0-19 employees) spent on average $US4,600 per employee per year, medium-sized businesses (20-49 employees) $US1,500, and large businesses (50-500 employees) US$900. There appear to be three reasons for this: the scale of the costs, their largely fixed nature, and diversion of entrepreneurial attention from business activity to compliance with regulations.
- New Zealand was at the lowest end of the scale and had the lowest aggregate annual compliance cost per small business (US$8900) and the third lowest cost per employee (US$2,600).
- When the compliance costs associated with tax regulation are considered separately, New Zealand had the second lowest tax compliance cost per employee for small businesses (one with fewer than 20 employees). For tax compliance costs per employee for larger firms (20-49 and 50-499 employees), New Zealand ranked in the middle of the ten countries. Figure 2 shows the effect of company size on compliance costs for the countries participating in the survey.

Figure 2: The effect of company size and country on per employee compliance costs – tax regulations



[1] *Business views on red tape: administrative and regulatory burdens on small and medium-sized enterprises*, OECD, 2001.

HOW INLAND REVENUE IS HELPING TO REDUCE COMPLIANCE COSTS

Inland Revenue is increasing its electronic services and simplifying its processes to help reduce compliance costs for businesses.

On-line services for businesses

Most information needed by small businesses can be found on Inland Revenue's website at www.ird.govt.nz. Businesses can now file income tax, GST and PAYE returns on-line and pay tax electronically. They can use on-line calculators for tasks such as finding out the depreciation rate for business assets and calculating fringe benefit tax, and they can send and receive password-secure correspondence.

Business tax advice

Inland Revenue's business advisory services range from helping businesses with record-keeping through to assisting them when their first GST and PAYE returns are due. Inland Revenue is continuing to make improvements to the services, including tailoring them to meet different businesses' needs.

Streamlining start-stop processes

Inland Revenue is streamlining its processes for dealing with small businesses when they stop or start employing staff, or cease operation. Improvements will see, for example, a faster departmental response to businesses when they stop employing staff, which will reduce the number of unnecessary returns that are sent to them.

Industry partnerships

Over a year ago Inland Revenue began an "Industry Partnership" initiative aimed at building relationships with industries in which a significant number of businesses have tax compliance concerns. The idea is to work with businesses and individuals to identify barriers to compliance, explore ways of streamlining compliance for them and tailor services to improve compliance. So far, relationships have been formed with the electrical, painting, agricultural contracting, entrepreneurial, hairdressing, collision repair, automotive repair, plumbing, and bus and coach driving industries.

Chapter 3

COVERING PART OF THE COST OF USING PAYROLL AGENTS

Proposed policy

- The government would cover part of the costs that small employers incur when they use a payroll agent to take over their PAYE and other government-imposed payroll obligations. The subsidy could apply to as many as five employees per business.
- The government would contract with payroll agents and pay the subsidy directly to those agents.
- Government departments would interact directly with an employer's payroll agent rather than the employer, thus freeing the employer to spend more time on business while giving the employer access to specialist payroll resources.
- Payroll agents would largely be paid by the government to help small employers with their PAYE and other governmental obligations.
- Employers could still choose whether to use a payroll agent or do the work themselves.

3.1 The PAYE system was introduced in 1958 and today collects about 46 percent of the tax collected by Inland Revenue. Introduction of the PAYE system effectively moved many income tax obligations from employees to their employers. Employers were thought to be more efficient and were compensated for this burden through the right to retain the deducted PAYE until it had to be paid to Inland Revenue.

3.2 Over the last ten or so years the PAYE system has undergone many changes. They include the introduction of the ACC earner levy, child support and student loan payment obligations and replacement of the monthly summary and year-end square-up process with the employer monthly schedule.

3.3 Apart from the important commercial decisions involved when a business takes on its first employee, it also accepts a series of government-imposed obligations, including deducting PAYE from employees' wages. This can be a large step for small businesses as the impact of government-imposed obligations is often directly borne by business owners. Furthermore, the costs tend to be regressive, meaning they fall disproportionately on small businesses.

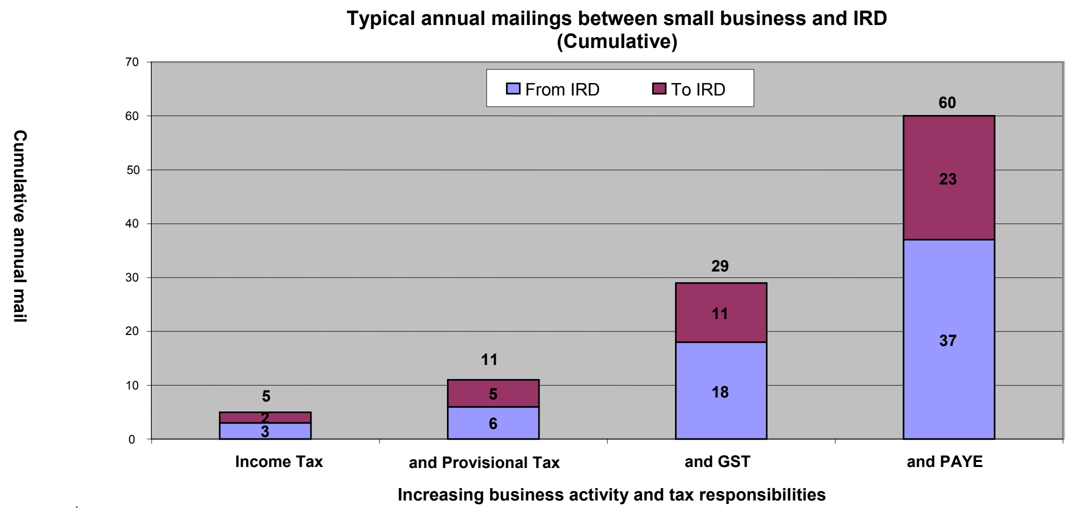
How PAYE is deducted

Employers are required to deduct tax from payments of salary and wages to employees and pay it to Inland Revenue on the 20th of the month in the case of small employers, and twice monthly in the case of large employers. The deducted PAYE is credited towards the income tax liability of the employee. As it represents tax payment by the employee, the employer must hold it in trust.

3.4 Significant fixed costs associated with PAYE are incurred when a business takes on its first employee. They include learning the PAYE system, completing returns and paying PAYE. Because most small businesses have two or fewer staff, these fixed costs are likely to be their main compliance costs. They are also difficult to reduce.

3.5 Figure 3 shows the increasing contact a growing small business has with Inland Revenue through its early years of growth: moving from income tax through to paying GST and, finally, PAYE as an employer.

Figure 3: Increasing contact with Inland Revenue as a business grows[2]



3.6 The government is especially concerned about the fact that when a small business takes on its first employee it receives an additional 19 pieces of paper from Inland Revenue and sends an additional 12 pieces of paper to Inland Revenue. This level of contact is high for small employers and represents a substantial increase over the level of contact that a small business without employees has with Inland Revenue. The significance of the level of contact must not be overstated, however. It is not a robust measure of the compliance burden imposed on a taxpayer overall, since

[2] The figure represents an average of actual mailings to GST and PAYE payers. Actual mailings will vary between taxpayers. (For example, exporters who regularly receive GST refunds will get more assessment notices than others.) Special information mailings, such as the annual issue of tax tables, are estimated and there is an assumed average of one automatic seizure notice for employee arrears. PAYE detail excludes FBT information as this applies to relatively few employers.

many contacts simply provide necessary forms or information and make little demand on a small employer's time.

3.7 In recent years there has been increasing scope for the use of information technology to provide significant compliance cost benefits. It previously made little difference in time and effort whether the PAYE process was completed by a small employer or a payroll business. Now the marginal cost for a payroll business doing the PAYE electronically for an additional employee is very low, but the cost to a small employer of doing that work manually continues to be high.

3.8 The scope for increased use of technology has not been reflected in a corresponding increase in its application in this area, however. Although around 70 percent of employers with one to five employees have Internet access, only four percent file their employer monthly schedules electronically. Moreover, only 18 percent of *all* employers file their employer monthly schedules electronically, and many of these are large employers, who are required to file electronically.

3.9 The opportunity presented by payroll agencies to allow small businesses to move their focus from tax compliance to running the business is not reflected in the statistics. Only eight to ten percent of employers use an accountant, tax agent or payroll business to complete their PAYE, although payroll businesses indicate they are trying to increase use of their services by small employers.

3.10 The government believes these potential gains should be realised. We want small employers to focus their efforts on their business, rather than tax, and payroll agencies to use their skill and economies of scale to help small employers.

What business says

3.11 Preliminary research showed employers were affected by a wide variety of government agencies other than Inland Revenue, but they were required to have a high level of interaction with Inland Revenue. A common concern expressed by many employers was that they were unpaid tax collectors for Inland Revenue.

3.12 Many small businesses consider the time spent keeping up to date with PAYE and calculating deductions could be better spent running their business. They also commented that their payroll obligations were met outside core working hours, affecting the business owner's time.

3.13 The PAYE system is an example of a tax system designed for a "stable state": it is easy to comply with if a business's circumstances do not change, but costs increase when they do. Our research revealed a high level of support for the current PAYE system from employers who maintained a stable state.

3.14 Employers were less accepting of their child support and student loan collection responsibilities. Much of their frustration and resentment related to their forced involvement in the private affairs of their employees, and the effort required in being involved. This is a significant issue given that only about ten percent of employers deduct child support. Fringe benefit tax was also an area of concern for larger employers, although, once again, only a minority of employers are affected by these rules.

3.15 Beyond our consultation with small employers, other research shows that the costs associated with the PAYE system are regressive, meaning they fall disproportionately on smaller businesses, which tend to have manual rather than computerised systems.[3] Furthermore, the payroll and PAYE work of a small business is often undertaken by the entrepreneur rather than a skilled wages clerk.

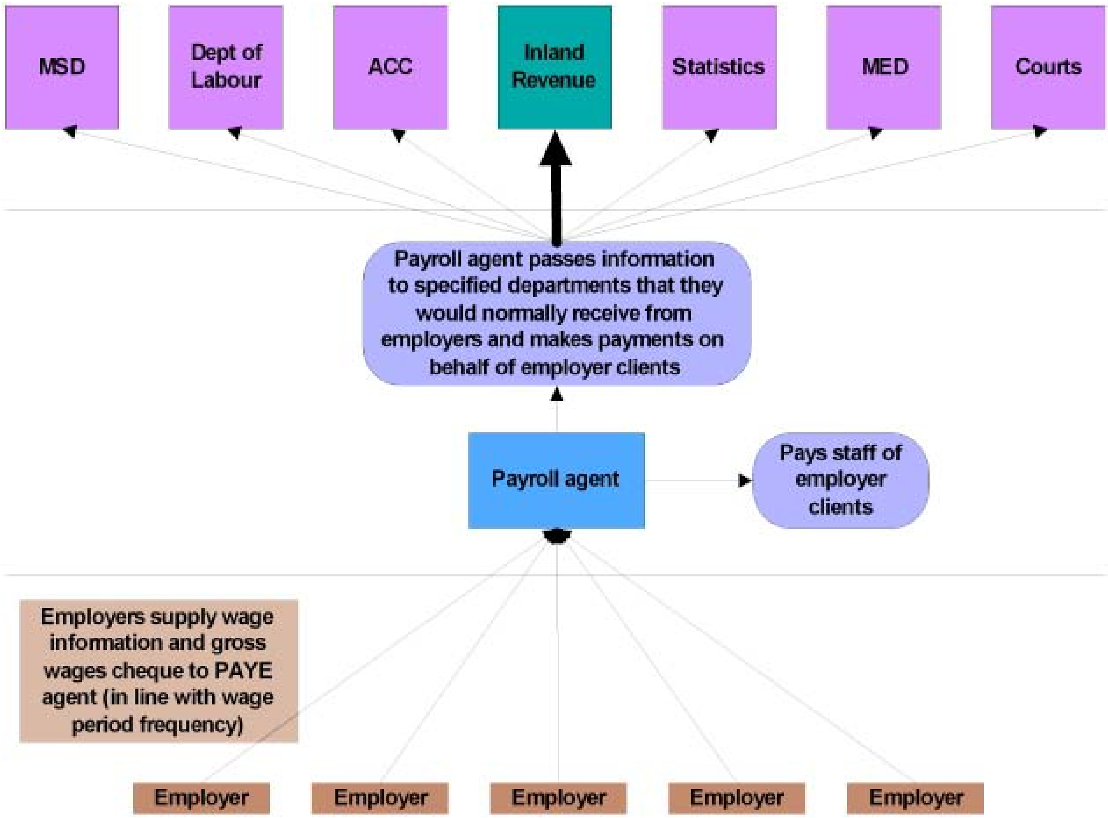
3.16 Our conclusion is that the solution to the current employer concerns is not further simplification of the PAYE system, since it is likely that would deliver only marginal improvements. Instead, a different approach is required.

Proposal

3.17 The government is committed to ensuring its impact on a business's decision to become an employer and then, later, to take on further employees is minimised. Therefore we propose moving much of the government-imposed payroll obligations from small employers by paying payroll agents to undertake the work for a certain number of employees. This would help cover the payroll-related obligations that the government imposes through Inland Revenue, the Accident Compensation Corporation, Statistics New Zealand, the Ministry of Social Development and the courts. The payroll agents involved would have a contract with employers and the government. The role of the payroll agent under the proposal is shown in figure 4.

[3] *Compliance costs of business taxes in New Zealand*, Cedric Sandford and John Hasseldine, Institute of Policy Studies of Victoria University of Wellington, 1992. Sandford and Hasseldine found that PAYE compliance costs are significantly regressive and tend to be concentrated among employers with fewer than five employees, who accounted for 65 percent of the total PAYE compliance costs.

Figure 4: Role of payroll agent under proposed legislation



3.18 Employers' use of a payroll agent would be voluntary. Small employers could choose to continue to meet their various payroll obligations and be compensated for this through the retention of PAYE, or use a payroll agent who meets those obligations on their behalf, but forgo the retention of the PAYE. Losing the benefits of retaining PAYE deductions may not be a significant problem for small employers, since they have indicated in discussions that that the benefit of retaining PAYE has not equalled the work the PAYE system imposes.

3.19 Those who consider that retaining the PAYE is adequate compensation for the work involved would be able to continue deducting and paying PAYE to Inland Revenue.

3.20 The proposal is limited to smaller employers because they bear the highest compliance burden and have the least access to skilled help. It is intended, if possible, to apply the proposal to the first five employees of a business.

3.21 As table 1 shows, under the proposal, 71 percent of all employers should be able to employ a payroll agent at no cost. The payment would not stop when an employer took on a sixth employee but would be capped at the five-employee level. The employer would be required to pay the payroll agent the balance of any costs.

3.22 The payment would stop only if a business became classed as a large employer, which is defined as one that deducts over $100,000 in PAYE and specified superannuation contribution withholding tax a year (having about ten or more employees). On this basis, a further 22 percent of employers would benefit from a payment covering part of the cost of employing a payroll agent.

Table 1: Number of employees and social policy obligations by employer group

Yearly PAYE liability	Number of employers	Percentage of active employer bases	Average number of employees	Percentage of group paying student loans	Percentage of group paying child support
Less than $10,000	103,761	56%	2	10%	2%
Between $10,001 and $20,000	28,069	15%	5	23%	8%
Between $20,001 and $50,000	27,633	15%	8	37%	14%
Between $50,001 and $100,000	12,402	7%	15	53%	27%
Between $100,001 and $200,000	7,084	4%	25	69%	40%
>$200,001 PAYE	7,388	4%	291	88%	62%
Percentage of employers				22%	10%

Note: Owing to rounding, results will not add up to 100%

Key points

Who is a payroll agent?

3.23 To be a payroll agent an entity would have to be willing to meet the information technology and integrity requirements determined by the government. Payroll agents might include existing payroll service providers, accountants and other tax professionals, and anyone providing business services.

3.24 The proposal takes into account the privacy and secrecy concerns that many businesses have. It is not proposed to increase the information provided to Inland Revenue, and the current legislative constraints on the PAYE information that Inland Revenue can provide to other government departments would remain.

Limits on government subsidy

3.25 The proposal involves a considerable commitment to helping small employers with their payroll-related government obligations. Table 2 gives indicative figures showing the current level of benefit provided to employers through retention of PAYE, and a possible direct level of subsidy that would result if the proposal were implemented. The level of subsidy that the government would provide would be announced before employers engaged a payroll agency, and any future changes to the subsidy level would be signalled in advance.

Table 2: Level of current annual benefits from PAYE retention and possible level of direct payment

Number of employees	Assumed annual PAYE	Current benefit from retention of PAYE	Possible new payroll agent funding ($2.50 subsidy per employee)
1	$10,000	$45	$130
2	$20,000	$89	$260
5	$50,000	$223	$650
10	$100,000	$445	$650
15	$150,000	$668	$0

Note: Current benefit to employers from retention of PAYE is calculated at an interest rate of 5% net of tax and with employees paid weekly. Net benefit to employers varies with the pay-day assumption applied. The information presented is indicative only; for example, the amount of subsidy would be the subject of negotiation.

3.26 The cost of implementing the proposal is highly sensitive to the following factors:

- the number of employers who ultimately take up the proposal;
- the frequency that their employees are paid;
- the composition of employers who use this option – small employers with one or two employees may require a higher subsidy to cover the high fixed costs of undertaking the payroll function, whereas larger employers may require a lower subsidy; and
- the amount per employee a payroll agent is paid.

3.27 In the end, the desirability of promoting the use of payroll agents by small businesses will have to be balanced against the funding available to do so. Therefore it may prove necessary to reduce the number of employees per employer, or the amount paid for each employee.

How the proposal would work

3.28 Employers already use payroll agents, and nothing major in that relationship – or in the relationship of payroll agents and Inland Revenue – would change as a result of implementing the proposal.

The small employer

3.29 Each pay-day the employer would have to pay gross wages to a payroll agent and provide the necessary supporting wage book details. The responsibility for PAYE would move from the employer to the payroll agent, although the employer would still have some responsibility for ensuring the accuracy of information provided, including, for example, information concerning new employees and those who leave. The payroll agent would also have various other responsibilities such as answering information requests from government departments.

The administering department

3.30 Although the government has not yet decided who should administer the contracts with payroll agents, the administrator would have two roles. The first would be to oversee the registration process. This is likely to involve ensuring that a prospective payroll agent:

- has approval from the various government departments that the agent meets their individual information technology requirements and other requirements; and
- is of good character.

3.31 The second role of the administering department would be to pay payroll agents for their work and audit compliance by payroll agents with their contract.

The payroll agent

3.32 The core of the proposal is that payroll agents would register with the administering department to help small employers with their PAYE and other payroll obligations in return for payment from the government.

3.33 The payroll agent's role in helping a small employer would be to:

- ensure the employer pays the gross wages and provides the payroll information to the payroll agent each pay-day;
- calculate and deduct PAYE, student loan and child support payments and any deductions required by Inland Revenue, the courts, or other government departments;
- pay employees their net wages on their pay-day;
- file the employer monthly schedule and forward the PAYE deducted to Inland Revenue when required;
- answer queries from Inland Revenue, the Accident Compensation Corporation, Statistics New Zealand and other government departments;
- undertake any actions instructed by a government department – for example, if an employee does not provide a valid IRD number Inland Revenue might instruct that a non-declaration rate of PAYE applies and the payroll agent would be expected to apply this rate;
- check that employees have valid IRD numbers; and
- link and de-link employers for whom they are responsible in a timely manner.

Other government departments

3.34 Businesses are legally required to provide information to Statistics New Zealand, the Ministry of Social Development and ACC.

3.35 The legality of collecting information direct from the agent would need to be worked through. Also, to ensure that government departments did not contact employers directly if the employer had a payroll agent, the administering department would need to keep a list of payroll agents and their clients and make this information available to departments.

3.36 The proposal would potentially remove the requirement for small businesses to complete the quarterly employment survey provided additional information such as hours worked and hourly pay rate for each employee was provided by the payroll agent to Statistics New Zealand. If enough small businesses engaged a payroll agent and, therefore, provided a statistically robust sample, it should be possible to remove all small businesses from the requirement to provide quarterly employment survey information.

3.37 Payroll agents could also remove the requirement for employers to make benefit debt deductions from salary and wages and forward the payment to the Ministry of Social Development. There may also be some limited scope to reduce the information requests of employers to verify benefit entitlement.

3.38 Not all information required by other government departments relates to payroll information and could be obtained through a payroll agent. Therefore contacts with employers would remain, albeit at a reduced level.

Benefits of the proposal

3.39 The principal benefit of the proposal is that it would allow small employers to devote more time to running and growing their businesses. Less time would be taken up by tax and other payroll issues.

3.40 Other benefits would be:

- **Increased accuracy of pay calculations.** The calculation of an employee's pay can be complex, and it is likely that the payroll agent could also help employers with these calculations.
- **Increased accuracy of PAYE calculation.** All parties would benefit from the increased accuracy in PAYE calculation provided by payroll agents and their application of information technology. Employees would benefit by receiving the correct net pay each pay-day, reducing the need for a year-end personal tax summary or return filing to square up mistakes. Employers would gain through being removed from the risk of penalties for non-compliance, such as late payment penalties, and the government would benefit from the accompanying increase in voluntary compliance and possible reduction in processing costs.

- **Reduced risk of PAYE payment default.** Employers generally use PAYE deductions to run their business, even though it is money held in trust, until it must be paid to Inland Revenue. Sometimes an employer may not be in a position to pay the deducted PAYE to Inland Revenue, in which case penalties and recovery action will follow, with a possible significant impact on the small business involved. The requirement that the gross wages be paid to the payroll agent would reduce this risk.
- **Reduced bias against those with child support and student loan obligations.** Some employers dislike collecting child support and student loan payments on behalf of their employees. The problem would be reduced if payroll agents did the job.
- **Efficient communication.** Payroll agents would be required to communicate with government departments electronically, thus minimising administrative costs for the government and reducing re-work by all in resolving errors common to paper-based systems, such as transposition errors.

3.41 There may also be other, less tangible benefits. For example, the proposal would establish a regular link between payroll agents and small businesses. There may be opportunities for payroll agents to leverage off this service to provide other business services – for example, advising on occupational safety and health standards or establishing good employment practices.

3.42 Payroll agents might, over time, be able to facilitate better communication between the government and small employers and, possibly, between small employers. For example, they could raise with the government improvement that could be made by different departments in the efficiency of their processes. Payroll agents could also become a conduit for improving small business networks as they identified possible beneficial linkages.

Risks of the proposal

3.43 A number of risks are associated with the proposal.

3.44 The first is that the government subsidy might simply benefit payroll agents and not be passed on to small employers by way of low or no fees for the services provided. The government would minimise this risk by considering the issue in negotiation with payroll agents.

3.45 The second risk is that the impact of the subsidy might distort the market by encouraging the use of payroll agents over other alternatives such as the increased use of payroll software. Many employers are likely to choose to continue to administer PAYE themselves, and because they use software, the government considers this risk minimal.

3.46 There is a third risk that individual employers may begin to feel locked into using a payroll agent. The government would welcome views on the scale of this risk.

3.47 Finally, there is a risk that a payroll agent might default on a significant tax payment.

Submissions

3.48 Because this proposal was developed later than the others there has been no formal research on the proposal, especially quantitative market research. For this reason the government would particularly welcome views on this proposal, including:

- whether the proposal will provide significant benefits to small employers;
- the key costing factors as they apply to small businesses or payroll agents to allow the government to fine-tune its costing and minimise the need to adopt fiscal constraints; and
- the extent to which employers might feel they were locked into using a payroll agent, and the associated costs to the employer if the number of employees increased beyond the level the government might subsidise.

Chapter 4

IMPROVING THE TIMING AND FREQUENCY OF TAX PAYMENTS

Proposed policy

- GST and provisional tax due dates would be standardised, payable on the 28th of the month.
- Provisional tax would be paid with GST, which for many businesses would mean more frequent but smaller provisional tax payments.
- PAYE and terminal tax payment dates would remain the same.

4.1 A small business paying PAYE and GST has 22 dates[4] on which tax has to be paid during the year, with payments falling due on three different dates in the month: one on the seventh – the due date for provisional tax, the 20th – the due date for PAYE, and the end of the month – the due date for GST.

4.2 The government has previously considered this issue but it has been difficult to make a decision because there are strong reasons supporting both more frequent payment dates – mainly issues of cash flow and work-flow management – and less frequent payment dates and, therefore, less contact with Inland Revenue for provisional tax purposes. For this reason we have looked to our market research and consultation to provide guidance as to ways to improve both the frequency of tax payment and the dates on which tax is paid.[5] The research focussed on improving the timing of GST and provisional tax payment and the best date or dates in the month for the payment of these taxes.

4.3 The consultation showed that small businesses generally supported aligning provisional tax payments with GST payments, with the due date for this combined payment being the end of the month to assist with budgeting. This would result in three fewer payment dates a year.

[4] 12 (monthly) PAYE due dates, six (two-monthly) GST due dates, three provisional tax due dates, and one terminal tax due date.
[5] Aligning tax payment dates has been proposed by a number of reviews. The Ministerial Panel on Business Compliance Costs, which reported in November 1998, and the Committee of Experts on Tax Compliance, which reported in December 1998, both recommended that the government investigate amalgamating tax payment dates. The government discussion document *Less taxing tax*, released in 1999, outlined proposals to align tax payment dates to one date, either the fifth, 20th or last working day of the month. From this work the government concluded that the problem could be resolved only by undertaking consultation and market research on the matter.

4.4 We therefore propose to make provisional tax payable with GST and to standardise the due date for the payment of provisional tax and GST, making it the 28th of the month. This would also assist the proposal discussed in chapter 5, to base provisional tax on a percentage of GST-adjusted sales.

What business says

Frequency of payment

4.5 Initial consultation with small businesses revealed very strong support for the concept of aligning the payment dates of various taxes, with two key themes emerging:

- Many business operators expressed the desire to pay provisional tax more often.
- Relatively few wanted to reduce their GST filing frequency.

4.6 These views were somewhat surprising given that a common concern of business was the high volume of interactions they have with Inland Revenue each year.

Quarterly payment of GST and provisional tax

The government's initial starting solution was, in fact, to reduce interaction with Inland Revenue by suggesting small businesses file and pay GST less often – perhaps quarterly, as the Australians do. We researched aligning the payment of provisional tax with GST and having both payments due on a quarterly basis, but the research showed majority support for no change in the GST filing frequency. A key concern on the part of the businesses consulted was that such a change would result in a delay in receiving GST refunds. Nevertheless, quarterly payments do hold some appeal to the government, and submissions on this matter would be welcome.

4.7 The research showed the position of unchanged frequency of GST and more frequent payment of provisional tax reflected the view that:

- Provisional tax, which requires the payment of three large instalments four months apart, must be diligently budgeted for. For many this is a challenge, and they think it would be easier to pay smaller amounts more frequently, reducing the chance that the tax money will be spent on something else.
- Regular GST filing provides some benefits that would be diminished if a longer filing period were adopted. These benefits include:
  - regularly keeping bookwork up to date (including invoicing and debtor control);
  - regularly monitoring cash flow and profitability;

– being able to remember the detail of transaction within the two month period; and

– a relatively short period to wait for GST refunds when a large capital item is purchased or when seasonal cash flow problems are encountered.

4.8 Because of the apparent support for aligning provisional tax payment with GST payment, the concept of aligning the GST and provisional tax dates was tested in the market research. Businesses were also asked what payment frequency they thought would be appropriate for the payment of GST and provisional tax. There was a great deal of support for tying provisional tax payments to GST and for both payments being made every two months. This is not surprising as 63 percent of GST-registered persons file GST every two months. There was much less support for paying GST quarterly, or even less frequently. Table 3 summarises the position.

Table 3: Ideal frequency of GST and provisional tax payments

Frequency	**% of businesses surveyed**
Every month	16
Every two months/six times a year	50
Every three months/quarterly	22
Every four months/three times a year	6
Every six months/twice a year	4
Once a year/annually	1
Other/don't know	1
Total	**100**

Alignment of payment dates

4.9 Our consultation to date with small and medium-sized businesses shows that 79 percent of the businesses surveyed support a single payment date for all taxes, with 87 percent of small employers supporting a single payment date.

4.10 Businesses were asked which date in the month they would prefer to be set as the due date. At this point the consensus ceased. No one date was liked by the majority of those surveyed, although there was a strong preference for a payment date late in the month rather than early in the month, with 43 percent of those surveyed supporting the last day of the month as a due date. The results are outlined in table 4.

Table 4: Preferred single payment date

Preferred single payment date	% of businesses surveyed
Last day in the month/30th	43
21st to 29th days of the month	15
20th day of the month	28
Between 2nd and 20th days of the month	7
1st day of the month	2
Don't know	3
Would not like having one payment date	2
Total	**100**

4.11 More detailed analysis showed that small employers were the group most likely to support this option, while businesses with no employees are least likely to support it. Nevertheless, even in this case support for one payment date was high. Of the non-employer businesses surveyed, 76 percent rated the concept of one payment date at least a six out of ten as an idea. Finally, businesses that considered their biggest compliance cost to be provisional tax payments not being aligned to their cash flow were more likely than average to favour this option.

4.12 Although support for one payment date remained, some small businesses commented that it would put financial pressure on their cash flows. There was also comment that a single payment date for all the main taxes (GST, PAYE, fringe benefit tax and provisional tax) would also concentrate the compliance effort for businesses, tax agents and Inland Revenue into a short period of time.

4.13 Although there was support for a payment date being the 20th of the month, this date is not being proposed as half of businesses surveyed believed it would be more difficult to file GST returns on time if the payment date were changed to the 20th. The tax agents surveyed were even more concerned, with 64 percent saying that it would be more difficult for their clients who file on a payments basis to pay on the 20th. Sixty-one percent considered it would be more difficult for their clients who file on an invoice basis to pay on time.

4.14 Separate payment frequency proposals were tested in relation to PAYE. The first idea was that small employers file only every second month. The second idea was that fringe benefit tax be included on the PAYE form and payable along with PAYE. Reaction to both these concepts were relatively positive, although for a number of reasons they are not proposed at this time (including their implications for child support payment transfers).

4.15 We also considered whether all taxes paid by small and medium-sized businesses could be aligned to one date. We rejected this proposal on the basis that neither monthly payment of GST nor two-monthly payment of PAYE was feasible. In the latter case we were concerned about the delay in payment affecting those receiving child support payments and those repaying student loans. The size of any resulting payment was also of concern.

4.16 We concluded that there may be merit in aligning taxes of a similar nature. For example, the employment-related taxes, PAYE and fringe benefit tax, are currently due on the 20th, except for the final quarter's fringe benefit tax return, which is due on 31 May, to allow employers more time to calculate their final liability. The question now is whether there is merit in aligning the taxes that vary with cash flow – GST and provisional tax.

International comparisons

Businesses in New Zealand pay provisional tax three times a year, relatively infrequently compared with businesses in other countries. In Australia, France, Germany, the United Kingdom and the United States businesses are required to pay provisional tax four times a year, and in Canada and Sweden businesses are required to make monthly instalments.

Individuals tend to pay tax less frequently than businesses. Individuals in three countries out of the seven surveyed pay tax four times a year. Individuals are required to make 12 instalments of tax in France and Sweden (although in France they have the option of making two instalments). Australia and the United Kingdom require only two instalments. In New Zealand, individual taxpayers who pay provisional tax are required to make three payments a year.

The due date for the payment of provisional tax also varies, although the 15th is the most common, having been adopted in Canada, France and the United States. Only Germany, France and the United States have the same due date for individuals and companies.

The proposed changes

4.17 It is proposed that GST-registered businesses generally pay provisional tax at the same time as they make their GST payments and that the due date for this combined payment be the 28th of the month. This change would result in the following:

- Businesses that pay GST every two months would pay provisional tax every two months.
- Businesses that pay GST every six months would also pay provisional tax every six months.
- For those paying GST monthly, application of the principle would result in monthly payment of tax. We are concerned about the compliance costs associated with more frequent payments. We are therefore proposing that this group pay provisional tax two-monthly. We are also concerned about the impact of two-monthly payment on

the largest corporates, so the government is prepared to consider alternative payment options for this group as well.

- Non-registered taxpayers whose turnover exceeds $1.3 million would be required to pay provisional tax every two months, on the 28th of June, August, October, December, February and April.
- Other businesses and individuals that are not registered for GST would pay provisional tax every six months.

4.18 The 28th is being proposed as the due date, since small businesses prefer a date towards the end of the month for purposes of cash flow. Rules can be formulated for when the 28th falls on a Saturday or Sunday. The present due date for GST reverts to the earlier working date, being the Friday. Under this proposal the due date for payment would move to the Monday, which we consider small businesses would find is an easier rule to understand and comply with.

4.19 Table 5 sets out the current and proposed systems for payment of provisional tax and GST and the number of taxpayers who would be affected by the proposed changes.

Table 5: Current and proposed systems

Class of provisional taxpayer	Number of taxpayers affected	Current system	New system
Businesses with taxable supplies over $250,000 or that choose two-monthly payments	54,000	GST paid monthly or two monthly on last working day. Provisional tax paid three times a year on 7th	GST paid monthly or two-monthly on 28th of every month or every two months and provisional tax paid along with GST on the 28th of every second month.
Businesses paying GST on six-monthly basis (whose turnover does not exceed $250,000)	25,000	GST paid every six months Provisional tax paid three times a year on 7th	GST and provisional tax paid twice a year on 28th of October and April or their GST period
Non-GST-registered businesses with turnover over $1.3 million	358	Provisional tax paid three times a year on 7th	Provisional tax paid six times a year on the 28th of every second month
Businesses with taxable supplies over $24 million	1,620	GST paid monthly on last working day. Provisional tax paid three times a year on 7th	GST paid on 28th of every month and provisional tax paid along with GST on 28th of every second month
Non-registered businesses and individual provisional taxpayers	171,000	Provisional tax paid three times a year on 7th	Provisional tax paid twice a year, on 28th of October and April

4.20 The alignment of payment dates for provisional tax and GST, if it were to proceed, would have to apply to all businesses. It could not be optional, since the complexity of an alternative payment date system on top of the current GST and provisional tax rules would simply be too complex, both for taxpayers and Inland Revenue.

4.21 Figures 5 and 6 show how the change in timing of payments would affect a two-monthly GST filer. The taxpayer is an individual whose taxable supplies are $300,000 and who pays $9,259 in GST and $17,270 in provisional tax a year.

Figure 5: Current payment profile for two-monthly GST filer

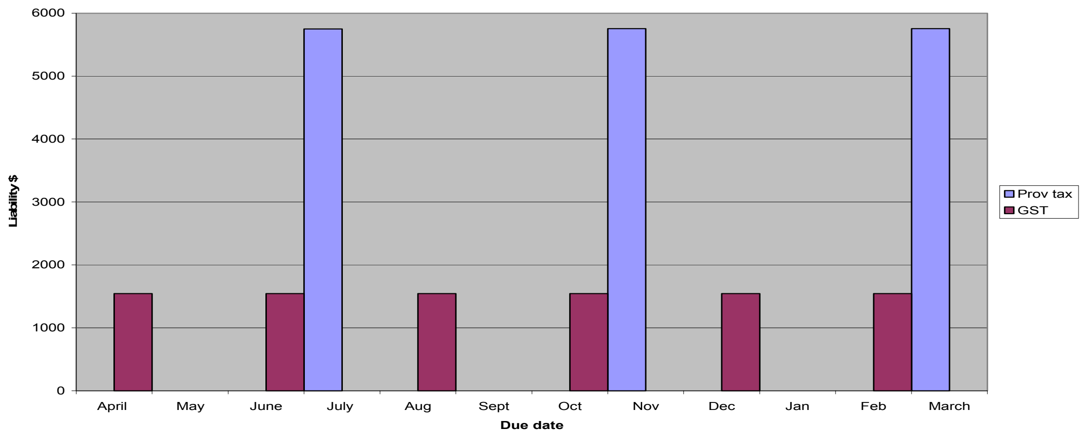
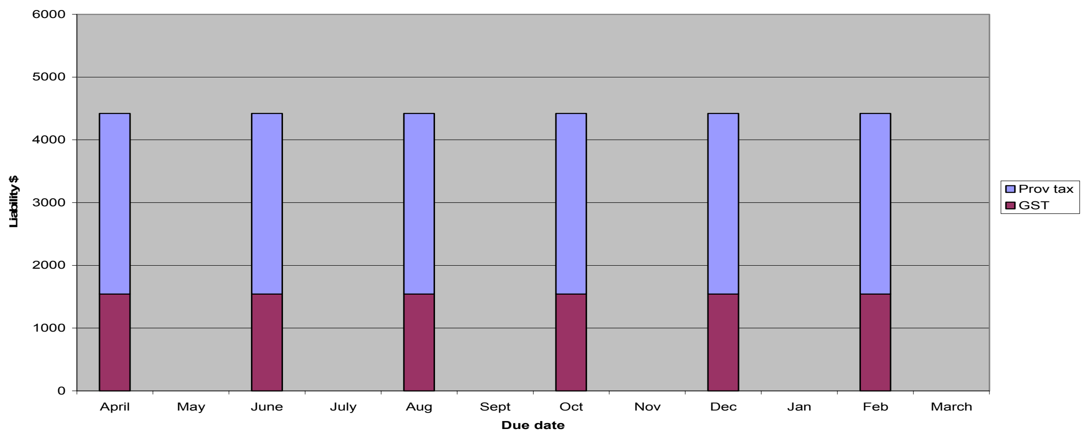


Figure 6: Proposed payment profile for two-monthly GST filer



4.22 Figures 7 and 8 show how the change would affect a six-monthly GST filer. The taxpayer is a sole trader with $70,000 of taxable supplies who pays $4,320 in GST and $5,963 total in provisional tax a year.

Figure 7: Current payment profile for six-monthly GST filer

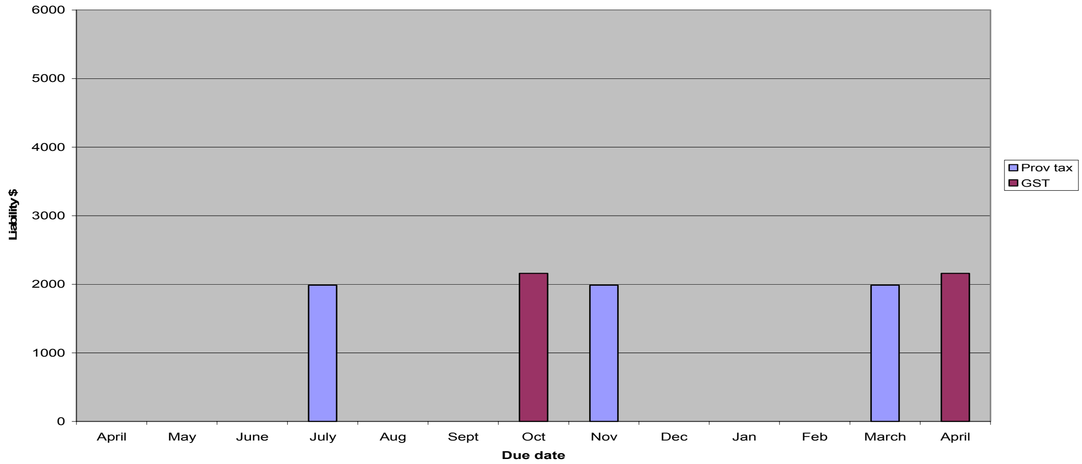
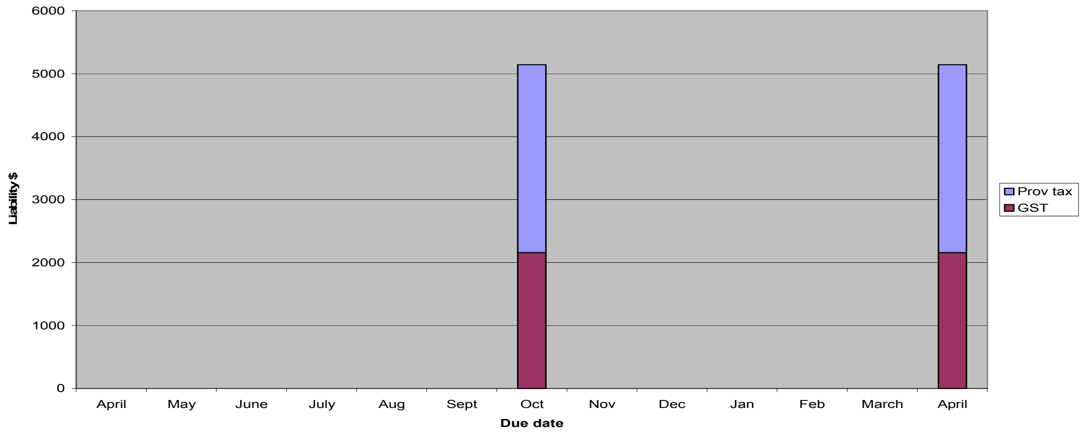


Figure 8: Proposed payment profile for six-monthly GST filer



4.23 Figures 9 and 10 show how the change would affect an individual who is not registered for GST. The individual pays $3,525 in provisional tax.

Figure 9: Current payment profile for non-registered taxpayer

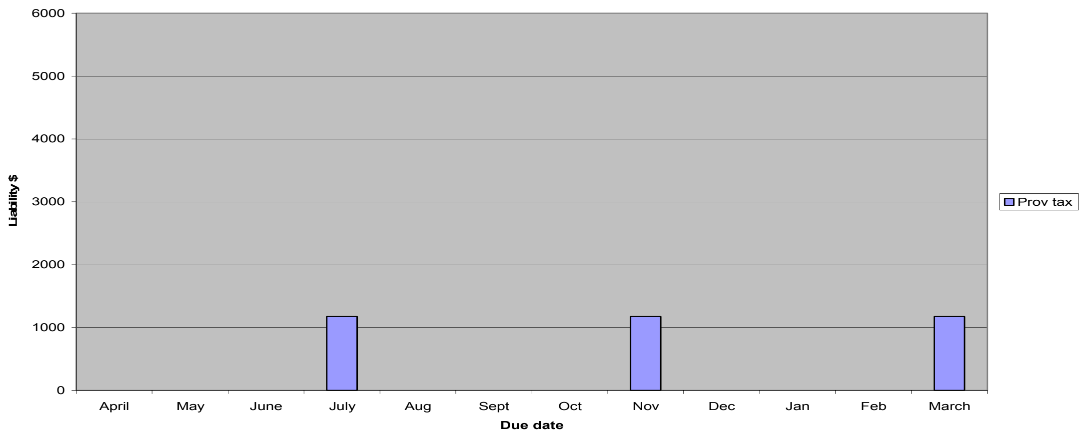
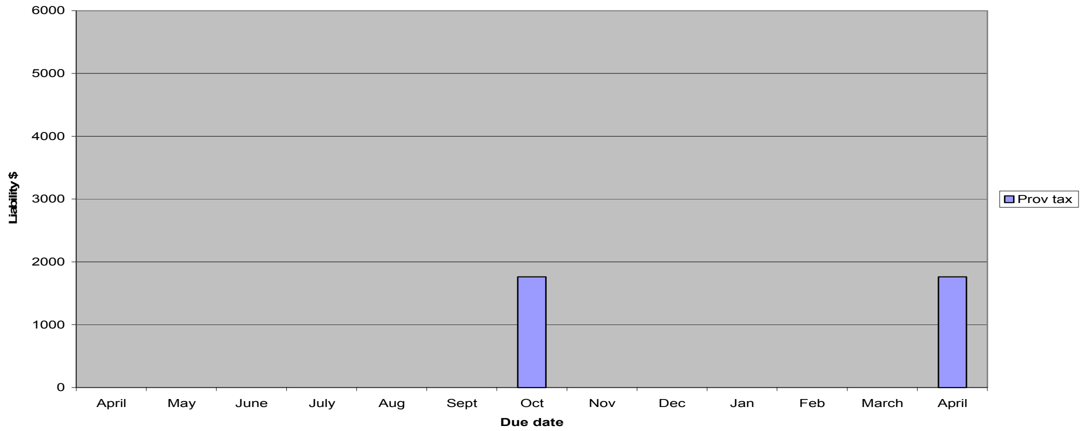


Figure 10: Proposed payment profile for non-registered GST filer



Non-registered, non-business and GST-registered businesses paying every six months

4.24 A key decision in developing the proposal has been the treatment of non-registered taxpayers and GST-registered taxpayers who pay GST every six months. We have considered the options of keeping the current three provisional tax payments dates for these groups or moving them either to two payment dates or six payment dates.

4.25 Having six payment dates would mean that these taxpayers' payments would be more closely aligned to when the relevant income is earned, although this benefit seems small. For example, taxpayers who have just exceeded the $2,500 residual income tax threshold are currently required to pay provisional tax of about $835 on three provisional tax payment dates. With six provisional payment dates the amount due on each due date would reduce to about $420. Their compliance costs would increase significantly as a result of their increased contact with Inland Revenue, an increase that would be only partially offset by two of those payment dates aligning with GST every six months.

4.26 Keeping three payment dates would prevent GST-registered businesses in this group of taxpayers from easily qualifying for the proposal outlined in chapter 5, to base provisional tax on GST sales. We have therefore concluded that two provisional tax payment dates a year is the better option for this group. It is important to note that the two payment dates proposed are the compulsory payment dates, and there is nothing stopping taxpayers who want to make earlier or more frequent payments from doing so.

4.27 This issue will be the subject of further market research, to ensure that the assumption is valid that this group of taxpayers is more concerned about the compliance costs associated with payment than with problems relating to cash flow. Our concern is that this group is significant in size, and our research to date has concentrated on somewhat larger businesses.

Benefits of the proposal

4.28 Alignment of payment dates would help businesses generally by making provisional tax easier to budget for by way of more frequent and smaller instalments. We see some smaller businesses, those with poor accounting systems and tight cash flows, finding it easier to comply with evenly spaced, more predictable tax payments with lower "peak" payments. They would also have fewer payment dates to remember.

4.29 We also expect that different businesses will have different views on the trade-offs involved in aligning payment dates, and whether the overall proposal would be beneficial. Businesses that want the use of tax money for as long as possible for business purposes and to reduce the need for other forms of finance are likely to find little benefit in this proposal.

4.30 In the end, we have tried to develop a proposal which deals with the problems identified by smaller businesses, benefits the majority of taxpayers, and is in keeping with the payment frequency of other countries. The research to date says this proposal is a step in the right direction; however, the government has no fixed view on the frequency of payments and takes a pragmatic view of the proposals. We seek submissions on whether the result of the trade-offs made are appropriate, especially the key decisions as to the frequency of payment for the largest and smallest of taxpayers.

Risk of the proposal

4.31 Aligning the payment of provisional tax with GST could also lead to difficulties when the GST return is prepared by a small business but an external accountant prepares its provisional tax returns. This would probably not be a major problem for most small businesses, but it might be for larger businesses, where considerable effort is required to determine the amount of provisional tax payable. More frequent payment in this case may result in a compliance cost increase.

4.32 The proposed changes would affect accountants, who would be required to change systems to cater for more frequent tax payments. We are unsure as to the scale of this impact and how the transition to the proposal should be managed. We are also conscious that the role of explaining the reforms should be led by the government rather than imposed on tax agents. We would welcome comment on both the transitional and communication issues involved. At present, we envisage Inland Revenue playing a significant role in this communication by way of consultation with small businesses.

Submissions

4.33 The government has made a series of judgements about what it considers are the most important factors in determining the most appropriate tax payment dates. Although these judgements are based on research, the goal is a pragmatic outcome that resolves small businesses' concerns about both the frequency and timing of tax payments. We seek submissions as to whether we have identified the appropriate trade-offs and whether a different solution should be adopted.

4.34 In particular, the government seeks the views of small business people on the following:

- Would you support the proposal to pay provisional tax along with GST?
- The proposed payment date is the 28th of the month for both GST and provisional tax. Are there any significant problems that would prevent you adopting a single date of the 28th for payment of GST and provisional tax?
- If you currently pay GST six-monthly, or are not registered for GST, would you face any problems in paying provisional tax twice a year instead of three times a year?
- If you are a six-monthly GST filer and file GST on a date other than October and April, would you prefer your filing date for provisional tax to be aligned with your balance date for income tax?
- If you do not support the proposal to pay provisional tax and GST together, how could the proposal be improved to make it more attractive to you?

Chapter 5

PROVISIONAL TAX BASED ON GST TURNOVER

Proposed policy

- Provisional tax would be based on a ratio of a taxpayer's two-monthly GST-adjusted sales. It would be a voluntary option.
- GST-registered taxpayers with turnover of less than $1.3 million could qualify for this option. They would have to pay both GST and provisional tax in their own right to qualify.
- Provisional tax would be paid along with GST (two-monthly or six-monthly).
- Businesses that adopted this method would not be subject to use-of-money interest.

5.1 In discussion, many small businesses expressed concern as to the inflexibility of the provisional tax rules. Beyond the issues of payment dates, the subject of the preceding chapter, small businesses were also concerned that their tax payments did not match their income earning process. This was felt most by seasonal businesses, who often find it difficult to budget for their provisional tax payments. Businesses were also concerned about being exposed to use-of-money interest if they get their provisional tax estimate wrong.

5.2 Reducing these concerns is difficult because businesses are requesting a method of payment which is flexible, recognises their cash flow profile during the year, does not require use-of money interest to ensure accuracy of payment and has low compliance costs.

5.3 This chapter proposes an option which delivers many of those requested benefits, but at the cost of the proposals not being right for all and use having to be restricted to smaller businesses.

5.4 The proposal is not new – it appeared in the discussion document *More Time for Business*, released in 2001. However, this chapter extends that proposal in a number of ways, gives more detail on the proposal and, most importantly, highlights that it is not a panacea for small businesses' provisional tax problems. Rather, it is merely another tool that will help in some cases and, like any tool, it needs to be used wisely for it to work well.

What business says

5.5 The most significant compliance cost for the small businesses surveyed was provisional tax not aligning with cash flow. This issue was rated by 18 percent of businesses as their most significant problem, and a further ten percent rated it as the second most important problem (second to the time taken to fill in tax forms). There is a clear message that a new option for paying provisional tax is desired by small to medium-sized businesses.

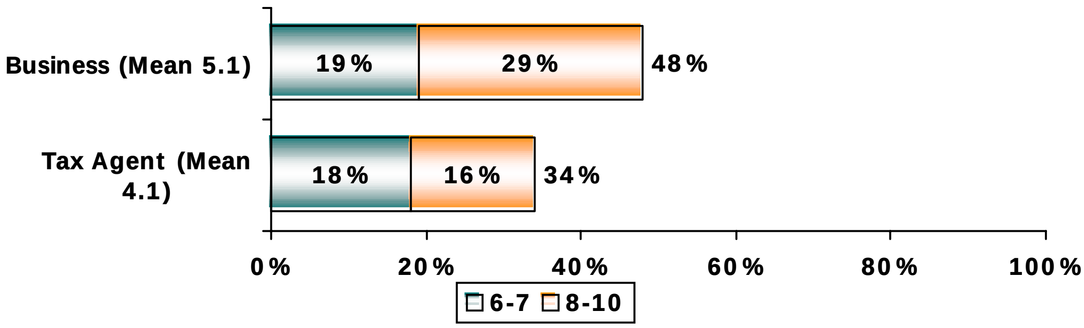
5.6 Our research showed strong support for aligning provisional tax payments to GST payments. Forty-eight percent of those small businesses surveyed indicate that they would take up the option if it were provided and, within this group, 29 percent indicated a very high probability of taking it up. Not unexpectedly, those businesses that have problems with provisional tax supported the option, with almost two-thirds saying they would use an option that allowed provisional tax to be based on GST turnover.

5.7 Although support for basing provisional tax on GST was lower among tax agents, 34 percent said there was still a good chance that they would recommend it to their clients. This lower support reflects a concern by tax agents that the proposal could result in their clients paying more provisional tax than at present. Anecdotal evidence also indicated there was a concern that the proposal would affect the systems that tax agents have established to help taxpayers pay their provisional tax on time.

5.8 Figure 11 shows the amount of support from the businesses and tax agents surveyed for the idea of basing provisional tax payments on GST turnover.

5.9 Of those businesses surveyed, 19 percent rated their prospects of taking up this initiative at least six to seven out of ten, and 29 percent rated it eight or higher.

Figure 11: Support for allowing provisional tax payment to be based on GST



Base: Business – GST registrants (N=1,589); tax agents – total sample (N=400)
Source: Small Business Survey and Tax Agents Survey

Provisional tax

5.10 The current provisional tax system of using last year's residual income tax figure plus an uplift factor of 5 percent is a rough gauge of the amount of provisional tax a taxpayer is liable for in the current year. Variations between years in the taxpayer's income, other factors such as cost structure or the business activities undertaken can lead to variations in provisional tax liability from year to year. Requiring taxpayers to estimate their provisional tax liability provides a more accurate result, but there is the associated increase in compliance costs and exposure to use-of-money interest if they get their estimates wrong.

How provisional tax is calculated

Provisional taxpayers can choose between two methods of calculating their provisional tax: the estimation method or the standard method of using last year's residual income tax plus an "uplift factor" of 5 percent. In both cases, a final terminal payment may be required once a taxpayer completes the end-of-year return and income tax liability is determined. Provisional tax is normally due in three equal instalments, except in the case of a new business or those changing balance dates.

Individual taxpayers whose residual income tax is less than $35,000 a year and who use the standard method of calculating provisional tax are generally excluded from use-of-money interest on provisional tax payments. This is known as the "safe harbour" from use-of-money interest.

Non-individual provisional taxpayers are subject to use-of-money interest on underpayments and overpayments.

5.11 To work, the proposal to base provisional tax on a percentage of GST sales would require provisional tax payment due dates to be aligned with GST due dates. Preferably, the provisional tax payment period would be the same as the GST period, to reduce compliance costs for businesses. Therefore it is conditional on implementing the previous proposal to align provisional tax payment dates with those of GST. Although theoretically feasible, without aligning the two sets of dates it would not be feasible in practice.

Proposal

5.12 We are proposing that, in addition to the standard and estimation methods of calculating provisional tax, taxpayers have the option of basing their provisional tax payments on their GST-adjusted sales for the period. Taxpayers using this option would not be charged use-of-money interest on underpayments of tax, nor would they be paid interest if they overpaid their tax for the year.

5.13 Provisional taxpayers whose turnover is less than \$1.3 million a year (excluding asset sales) would qualify to use this option. The \$1.3 million threshold mainly reflects the fact that at high turnover levels, the option becomes more and more inaccurate. Furthermore, the threshold would limit the government's fiscal risk if the option were selected only to defer tax payment rather than with the aim of integrating provisional tax payment into business processes.

5.14 The option would work only when the same entity paid both income tax and GST. It would not work where one entity paid GST and another paid income tax – for example, when a partnership paid GST but the individual partners paid income tax. It would be difficult to link the two entities to verify that they were using the correct ratio.

5.15 Two steps would be involved. First, a business would work out the ratio of its previous year's residual income tax to its adjusted GST sales. The ratio would then be applied to GST sales for each GST period, to determine the amount of provisional tax payable. This tax payment would be added to the business's GST liability and paid along with the GST or, if the business is due a GST refund, the provisional tax due would be offset against that refund.

5.16 It should be pointed out that this approach removes the option of a taxpayer receiving a GST refund and choosing to apply that refund to a use other than paying the tax due.

Key points

5.17 The key issue in this option is determining the GST sales figure to be used in determining the ratio. It is possible to make adjustments to the GST sales figure reported on the return to improve the accuracy of provisional tax payment. However, each additional adjustment increases complexity, and some significant sources of inaccuracy cannot be incorporated into the ratio. For example, the ratio cannot readily be adjusted for changes in business structure or for the fact that the ratio of provisional tax to GST sales will not be constant for all levels of GST sales.

5.18 We have identified two different adjusted GST sales bases for the calculation of provisional tax.

Option one: GST taxable supplies as the main base

5.19 This option involves using GST taxable supplies (less the GST charged) as the basis for calculating provisional tax. It involves a very simple calculation because the taxable supplies figure can be readily ascertained from the GST return. The calculation is as follows:

OPTION ONE FORMULA

Step one: **Income tax return**

$$\text{Ratio} = \frac{\text{Last year's residual income tax}}{\text{Last year's GST sales figure}}$$

The GST sales figure equals GST taxable supplies less GST on those supplies after adjustment for capital assets sold for more than $1,000.

Step two: **GST return**

Provisional tax due = GST sales figure for each future GST period x ratio

5.20 This option results in a higher overpayment of tax balanced by a lower underpayment of tax but with an overall reduction in tax payment compared with the current non-estimation provisional tax payment option. See figure 12 for the overall impact of this option.

Option two: Modification for other income

5.21 This option requires adding other income not subject to GST to the GST taxable supplies base, both at the income tax return stage and at the GST return stage. This results in a more accurate outcome but at the cost of increased complexity.

OPTION TWO FORMULA

Step one: **Income tax return**

$$\text{Ratio} = \frac{\text{Last year's residual income tax}}{\text{Last year's GST-adjusted sales figure plus non-GST income}}$$

The GST-adjusted sales equals GST taxable supplies less GST on those supplies after adjustment for capital assets sold for more than $1,000.

Non-GST income equals the income earned by the business that is not subject to GST. This would include interest and dividends, partnership income, estate and trust income, overseas income, business income, self-employed income, rental income and shareholder-employee income.

Step two: **GST return**

Provisional tax liability = (GST-adjusted sales figure for each future GST period plus one-sixth[6] of last year's non-GST income) x ratio

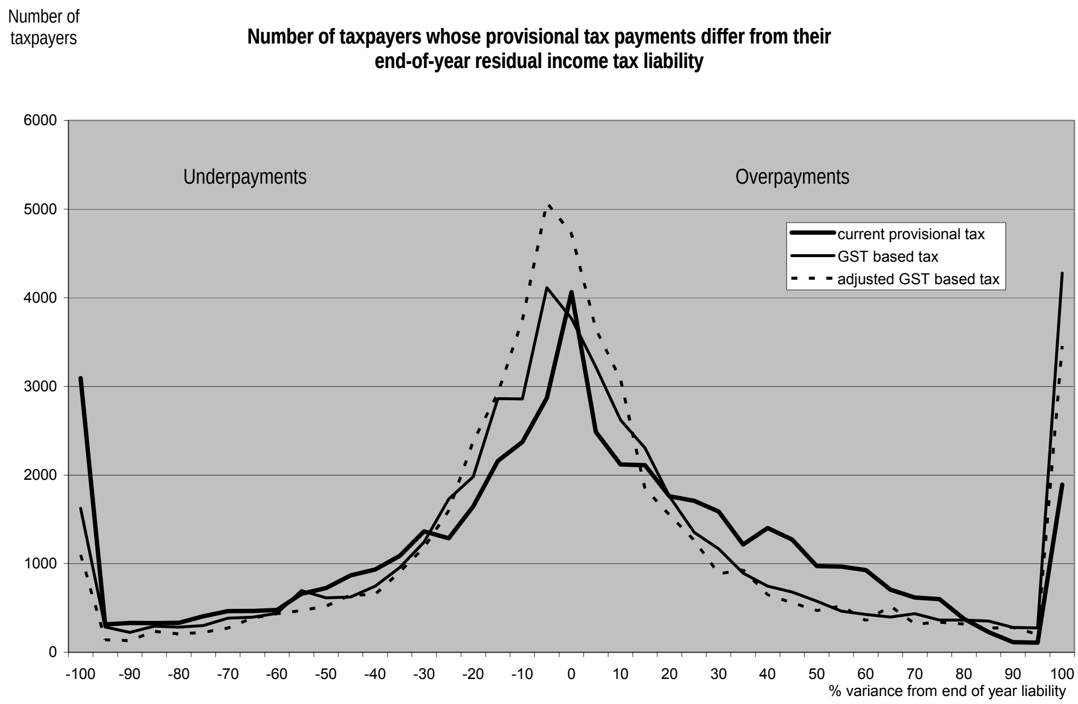
The GST-adjusted sales figure for the GST period would not include actual income received in that period but, rather, half or one-sixth of last year's non-GST income.

[6] One or one-half of last year's non-GST income if the taxpayer accounts for GST on a six-monthly basis.

5.22 To reduce compliance costs, the non-GST income would not have to be determined on a two-monthly (or six-monthly) basis. Instead, the taxpayer would use the total adjustment figure from last year's return, divided by six (or by two for six-monthly filers) when computing the two-monthly GST-adjusted sales figure on which to apply the percentage figure to determine provisional tax liability.

5.23 As pointed out earlier, the existing system leads to significant overpayment and underpayment of tax. Figure 12 shows the number of taxpayers whose provisional tax payments differ from their end-of-year residual income tax liability under the existing system and options one and two. Option two, the more complex option, is clearly the most accurate option in preventing underpayments of tax. However, option two does produce a higher level of overpayment of tax than does the existing system.

Figure 12: Accuracy of different provisional tax payment options



5.24 The following example illustrates when using the GST-adjusted sales option would provide a more accurate result than the GST sales option.

Example

A company has interest and dividends amounting to $80,000 (no tax deducted at source) which is not included in GST taxable supplies. It also has GST taxable supplies amounting to $50,000 for a year. Its residual income tax liability on a total income of $130,000 is $42,900, which produces a ratio of 0.85 (85%).

The ratio and provisional tax liability under options one and two are as follows.

<u>Option one</u>

Ratio =	42,900 50,000	=	0.85%

<u>Option two</u>

Ratio =	49,200 130,000		0.33%

The outcome under option one is that significant changes in interest or dividends would not be reflected in adjustments in provisional tax payments during the year since interest and dividends are not included in the GST base.

Under option two, if GST taxable supplies increase during the year (from $50,000 to $60,000) and the amount of interest and dividends remains constant, the rate would produce the correct tax deduction ($3,300), whereas under option one too much tax would be deducted during the year relative to the increase in GST taxable supplies. (An additional $8,500 would be deducted during the year under option one, whereas the actual tax liability on the increase in taxable supplies is only $3,300.)

5.25 We seek submissions on whether businesses consider the additional compliance costs in basing the calculation on GST-adjusted sales outweighs the increased accuracy of provisional tax payments from undertaking the income adjustments.

Limitation on use of the proposal

5.26 As figure 12 shows, this option can result in ratios which are inaccurate. The consequence would be that taxpayers too far from the ratios that applied to the majority of other businesses would expose the revenue to risk and result in changes in taxpayers' income not being reflected in changes in their provisional tax payments. To reduce the extent to which this might occur, the government proposes to cap the ratio range so that taxpayers with ratios below 0 and above 1 (100 percent) would not qualify to base provisional tax payments on GST turnover.[7]

[7] Taxpayers whose ratio was outside the range of 0-1 (100 percent) should consult their tax agent/accountant to see which other provisional tax method would best suit them.

5.27 Even a ratio of 1, however, seems high, given that income tax is a maximum of 33 percent of a business's sales or up to 39 percent of a self-employed person's income after deducting expenses. The government seeks feedback on whether the upper threshold is too high and whether a lower threshold – say, 0.5 (50 percent) – would be more appropriate.

Calculating provisional tax liability

5.28 Examples in the appendix to this report give more detail about the calculation that would be required if provisional tax liability were based on GST sales or on GST-adjusted sales.

5.29 Taxpayers would be required to elect into the scheme and advise their ratio before the due date for the first GST return during the income year. The election could be made by way of telephone, Internet or post. Once in the scheme, taxpayers would remain there in subsequent years until they elected to estimate or calculate provisional tax using the standard method. If they left the scheme part-way through the year, they would be required to estimate future provisional tax instalments, which would be subject to use-of-money interest.

5.30 If a taxpayer had an extension of time to file an income tax return, the ratio would have to be based on information from the income tax return of the year before last and the corresponding year's GST information. This might result in the ratio not accurately reflecting the current year's provisional tax liability, so the initial provisional tax payments might be underpaid or overpaid.

5.31 Under this option, statements would not be issued for correct payments of provisional tax. Taxpayers would be able to access their account on-line if they wanted to check account transactions and balances.

Six-monthly GST filers

5.32 About 150,000 registered persons (27 percent of the total number of registered persons) file GST on a six-monthly basis. There are benefits and drawbacks to extending the scheme to these registered persons. If they earn their income solely in the latter part of the year they may make only one payment a year. The six-month GST return period could also result in a delay between when they earned the income and when they paid their provisional tax in relation to it. However, the option would provide them with a method for catering for seasonality, so the government proposes that six-monthly GST filers qualify to use it.

Sanctions for non-compliance

5.33 Taxpayers who underpaid their provisional tax liability could be subject to late payment penalties because the assessed amount would have been entered on the GST return. The late payment penalty would be imposed once the return was filed.

5.34 If a taxpayer failed to file and pay GST and provisional tax for a period, the last period's provisional tax liability or last year's residual tax liability divided by the number of instalments would be used as a basis for calculating penalties. However, if at the end of the year it was determined that the taxpayer actually paid the correct amount of tax, any penalties would be recalculated.

Benefits of the proposal

5.35 The major benefit from the proposal is that tax payments made during the year would be more closely aligned with when a business earned the income, which could also reduce its end-of-year tax liability.

5.36 It would also provide greater certainty for taxpayers with seasonal income as businesses for whom the standard method is not appropriate could choose between it and the estimation method of calculating provisional tax. It could reduce the need for businesses to re-estimate their provisional tax liability during the year to take account of fluctuating incomes and could reduce their borrowing costs to finance tax payments.

5.37 The proposal could have significant benefits. Provisional tax payments would better reflect a business's cash flow, which means that a business that had suffered a downturn would automatically have a reduced provisional tax liability, without having to make a provisional tax estimate. Correspondingly, businesses whose turnover increased during the year would pay more provisional tax than they would have under the current provisional tax rules, thus reducing their year-end tax bill and the risk of default in payment. The measure would work without the need for use-of-money interest.

5.38 Overall, the measure should reduce the level of concern business have expressed in relation to provisional tax, while ensuring the goals of provisional tax are maintained and possibly enhanced.

Risks of the proposal

5.39 The key risk of the proposal is that it might be used in cases where it caused more problems than it solved. The first major problem would occur if the ratio was clearly incorrect but the business still chose to apply the option, resulting in significant overpayment or underpayment of tax. A second problem would arise if the ratio was right initially but later changed and the business persisted in using the inaccurate ratio.

5.40 To keep the option simple, we have not proposed significant restrictions on its use. If significant underpayment of provisional tax was to occur as a result, restrictions could be needed – such as restricting access to the option if it looks like it might be being used for deferring tax payment rather than improving the accuracy of tax payment.

5.41 A final risk of this option is that it might be incorrectly perceived as a solution to the problem of provisional tax payment not aligning with business cash flow, rather than a tool that will allow some taxpayers, but not all, to manage their tax payments better.

Submissions

5.42 The government seeks views on the following, in particular.

- Do the features of the proposal provide a good balance between ensuring that taxpayers who have seasonal income can qualify and preventing abuse of the proposal?
- Are the sanctions for non-payment of provisional tax under this option an effective deterrent?
- If an entity was GST-registered but the provisional tax was paid by another entity, neither entity would be able to benefit from the option. If these categories of taxpayers were allowed to use the option what would be the best way of linking their payment of provisional tax with GST?
- Do the additional compliance costs in basing the calculation on GST-adjusted sales outweigh the increased accuracy of provisional tax payments from undertaking the income adjustments?

Chapter 6

A DISCOUNT FOR INDIVIDUALS STARTING A BUSINESS

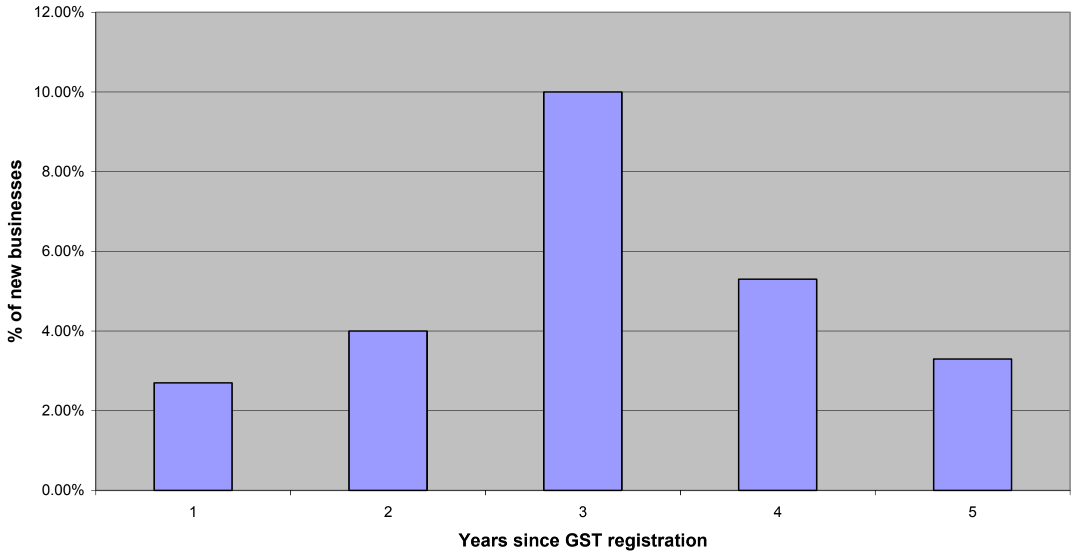
Proposed policy

- Self-employed people would be given an incentive to pay tax in their first year of business. It would take the form of a 6.7 percent discount against their end-of-year tax liability for each dollar of tax paid during the first year.
- The discount would apply to individual taxpayers in the year before they are required to pay provisional tax.
- They would receive the discount only once and their entitlement to it would lapse once they became a regular provisional taxpayer.
- Individuals who started a business would be able to choose whether or not to receive the discount and in which year to receive it.
- The discount would be 6.7 percent of the lesser of the amount paid during the year or 105 percent of the end-of-year residual income tax liability.

6.1 Businesses have said they want to minimise the impact of tax payments on the business by more closely aligning the payment of tax with when the associated income is earned.

6.2 Anecdotal comment and Inland Revenue's payment default rate suggests that the first three years are the most difficult for new businesses. Figure 13 shows that the income tax default rate of businesses that are newly registered for GST peaks in their third year in business. The peak default rate is about twice the normal default rate for all businesses. There could be a variety of reasons for this, but having to pay both provisional tax and terminal tax in a short period of time at the end of the second year in operation is probably a contributing factor. This figure is conservative because not all new businesses will be GST-registered, and some newly registered businesses will have been in business before or in business for a few years before registering for GST.

Figure 13: Percentage of new GST-registered businesses that incur a late payment penalty for income tax

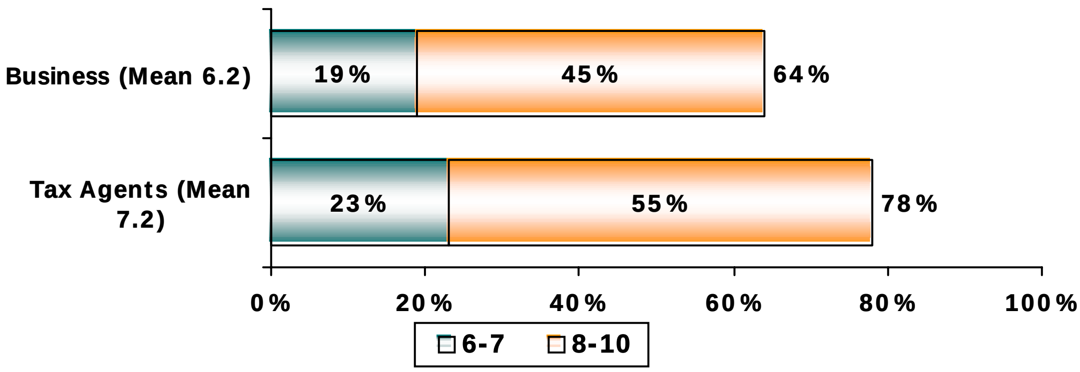


What business says

6.3 A survey of small and medium-sized businesses posed the question to those who had been in business for three years or less whether they would have taken up the option of making voluntary tax payments in their first year of business had they been given a 7 percent discount on their tax bill.

6.4 Tax agents were also asked whether they would recommend this option to their clients, although the amount of the discount was not specified to them.

Figure 14: Support for voluntary provisional tax payments



6.5 There was strong overall support for the proposal, with 64 percent of businesses indicating they would take up the option by rating it six or higher out of ten, and 78 percent of tax agents saying they would recommend it to their clients. It is interesting to note that 45 percent of businesses rated it eight or higher out of ten.

6.6 The proposal was expressed in terms of a discount, rather than a tax credit, for ease of presentation. Support for the proposal is shown in figure 14.

Provisional tax on first-year income

6.7 Individual taxpayers who start up a business are not required to pay provisional tax in their first year in business. However, they are still required to pay income tax for the first year in business, but it becomes due shortly before or shortly after the end of their second year in business. If their residual income tax for the previous year exceeded $2,500 they will also be paying their provisional tax for their second year in business around this time. This combination of tax payments can have a big impact on a business's cash flow and can sometimes cause financial difficulties. At present, these taxpayers have no incentive to make voluntary payments of tax in their first year in business, closer to when they earn the income that is being taxed.

Example of how tax on first-year income is paid

An individual taxpayer stops paid employment and begins to earn income from self-employment on 1 April 2000. She earns $45,000 from self-employment in her first year in business (1 April 2000-31 March 2001). She files her 2001 income tax return on 12 December 2001 (having an extension of time to file her return) and has an income tax bill of $9,720, which is due for payment on 7 February 2002.

Her residual income tax for the 2001 year was $9,720, so she is required to pay provisional tax during the 2002 income year (1 April 2001-31 March 2002). As she has an extension of time to file her return, and filed it on 12 December, the whole provisional tax liability of $10,200 ($9,720 + an uplift of 5%) is due on the next provisional tax instalment date, 7 March 2002.

In a one-month period (7 February 2002-7 March 2002) she is required to make two tax payments – one of $9,720 and the other of $10,200 – for a total of $19,920. This could place an individual on an annual income of $45,000 under some financial strain.

Proposal

6.8 The government proposes an incentive for individual taxpayers who start a business to make voluntary payments of tax on first-year income during that year. The incentive would be by way of a discount that would encourage early payment and thereby better align the payment of tax on first-year with the timing of when that income is derived. The discount would be available to individual taxpayers who receive either partnership or self-employed income.

6.9 Qualifying businesses would receive a 6.7 percent discount against their end-of-year tax liability for each dollar of tax voluntarily paid during that year. Providing a discount net of tax is broadly equivalent to giving a 10 percent pre-tax discount on tax payable for early payment. We recognise that this may mean that some businesses might pay at the end of the first year to qualify for the discount, when payment throughout that first year might better help minimise the impact of income tax. Even so, the proposed discount is the simplest way of providing an incentive to pay tax in the first year.

Example of how the discount would work

The taxpayer in the previous example, who started business on 1 July 2000, chooses to be part of this scheme in her 2000-01 return. She makes a voluntary payment of $11,000 on 31 March 2001.

She files her 2000-01 income tax return on 12 December 2001, and the return is assessed. Her residual income tax liability for the 2001 income year is determined to be $9,720.

The discount is calculated on the residual income tax amount uplifted by 5 percent ($10,200) as this is lower than the $11,000 paid during the year.

The discount is 6.7% x $10,200 = $683.00, which is credited as part of the income tax assessment process.

The taxpayer's statement would be:

Details	**Amount**
Payment received 31 March 2001	$11,000.00
Discount payable	$683.00
Balance	$11,683.00
Less 2001 tax assessed	$9,720.00
Refund	$1,963.00

The taxpayer must also pay provisional tax of $10,200 on 7 March 2002. The refund of $1,983 could either be refunded or go towards reducing her $10,200 provisional tax liability due on 7 March 2002.

6.10 If a business voluntarily paid more tax during the year than it was required to, the overpayment would be refunded. The 6.7 percent discount would be paid on the lower of:

- the amount paid during the year; or
- 105 percent of the taxpayer's residual income tax liability for the year, in recognition that the amount of tax payable is uncertain.

Key points

6.11 The key problem with this proposal is defining the "first year in business". It is difficult to determine when the discount should be provided to individual taxpayers who are newly in business. If it is given strictly in the first year an individual is in business it may be of little use as the business may have a low or no tax liability or may even be in loss. These problems may occur also in subsequent years. However, if the discount is applied in a year the business is required to pay provisional tax, little benefit by way of early payment arises as the provisional tax rules ensure more timely payment.

6.12 To help target the measure, we propose that taxpayers be able to choose to receive the discount in their end-of-year income tax return for the income year to which they want to apply the discount. The amount of the discount would then be calculated on the basis of the voluntary tax payments made in that year. This would provide an opportunity for taxpayers to ensure the discount was used in a year when the business considered it was of significant benefit. For those businesses that start business slowly, the year chosen is more likely to be closer to the point when they would normally become liable for provisional tax (when the previous year's residual income tax exceeds $2,500) than their actual first year in business. No discount would be available in subsequent years if they began another new business while continuing with a first business. However, if they stopped receiving business income for a period of four years they would again qualify should they start a new business.

6.13 A final key feature of this proposal would be the involvement of private sector advisors. We see tax and business advisors having a key role in informing new businesses of the availability of the discount, encouraging them to start saving, and recommending the best time to apply for the discount. In effect, we see the measure as a tool to be used by these groups in their work with small businesses. Without this contribution from the private sector we are concerned that the businesses that need encouragement to manage their tax affairs better would not do so.

Benefits of the proposal

6.14 The proposal would reduce default in tax payment by individuals starting a new business. The flow-on benefits are that the taxpayers involved could concentrate on running their businesses rather than devoting their time to managing a possibly deteriorating tax position, and there would be fewer late payment penalties.

6.15 Previous consultations with small businesses have indicated support for this proposal, with the majority indicating they would have taken up the option.

Risks of the proposal

6.16 The principal risk is that the proposal simply does not work in its goal of encouraging earlier tax payment for those who need support in managing their cash flow and that the measure ends up only being used by those businesses who would naturally manage their tax affairs efficiently. This could occur because:

- New small businesses remained unaware of the discount until after it was of practical use.
- They considered the discount insufficient.
- The discount would require businesses to be able to identify when they should make a voluntary payment to best manage their cash flow, prevent an accumulating deferral of tax and maximise the benefit of the discount. Perhaps small businesses are not in a position to make this decision in their first year.

Submissions

6.17 The government seeks submissions on the following points, in particular:

- whether the 6.7 percent discount (net of tax) would be effective at encouraging new small businesses to pay provisional tax during their first year in business;
- whether other measures to encourage payment during the year should be considered, rather than the discount described here, which effectively encourages payment only towards the end of the year;
- whether the discount should be restricted to the first year in business or available, as proposed, to be used before regular provisional tax payments begin; and
- how the risks associated with the proposal could be mitigated.

Chapter 7

ELECTRONIC TOOLS TO ANSWER QUESTIONS ON EMPLOYMENT AND RESIDENCE STATUS

Proposed policy

Inland Revenue would provide on-line tools to clarify employment and resident status, which would reduce compliance costs for employers.

7.1 Understanding tax law and undertaking complex tax calculations impose compliance costs on businesses – either in time or in the money they pay others to do it for them.

7.2 Some of the costs, however, could be reduced by increasing the number of on-line tools that Inland Revenue provides to businesses. It is therefore proposed to offer a service that clarifies issues of employment and residence status for tax purposes. For example, if a business had a question about whether someone was an employee or independent contractor, it could fill in an electronic questionnaire on Inland Revenue's website. The answer it received would be legally binding, provided the information the business supplied was correct.

What business says

7.3 The provision of on-line tools to clarify employment and residence status has appeal among businesses, with 48 percent of those surveyed indicating that they would take up this proposal if provided. It has most appeal to large employers and companies.

Proposal

7.4 The proposal is to extend the tools provided on-line by Inland Revenue by providing an electronic calculator that would help apply certain tax laws such as determining whether someone is an employee or independent contractor.

7.5 The law would be amended to specify criteria which, when met, would provide taxpayers with certainty of tax treatment in respect of such issues as residence status and status as an employee or contractor. Taxpayers could be certain of the accuracy of the answers received from Inland Revenue, provided the information they supplied was correct.

Benefits of the proposal

7.6 The proposal would reduce the compliance costs for businesses in obtaining reliable information, either in seeking help from accountants or tax professionals or spending time searching out the answer.

7.7 It would also make it easier for businesses that have computer technology to have access to tax information.

Risks of the proposal

7.8 Tax agents may see the move as an intrusion into their domain of providing tax advice. Although there could be a reduction in the number of enquiries to tax agents as a result, there may also be gains in that tax agents could use the electronic calculator themselves to provide certainty for their clients as to the position they have take in providing that advice.

Submissions

7.9 The government seeks submissions on whether businesses would use the on-line tools to clarify the residence status or employment status.

APPENDIX

BASING PROVISIONAL TAX PAYMENT ON GST TURNOVER – EXAMPLE OF THE CALCULATION REQURIED

Example 1 - GST taxable supplies

A taxpayer has self-employed income, interest and dividend income, income from a trust and rental income. He completes his 2001 income tax return and determines his residual income tax liability to be $22,080.

The taxpayer advises Inland Revenue by telephone that he wants to pay provisional tax for the 2002 year based on a percentage of his GST sales figure.

Calculating GST sales figure
The taxpayer calculates the GST sales figure for the 2001 year as follows.

GST taxable supplies (exclusive of GST)[8]	$83,000
Less asset sales	$nil
GST sales figure	**$83,000**

Calculating the ratio

The ratio is:	Residual income tax	$22,080	**= 0.26 (26%)**
	GST sales figure	83,000	

Calculating provisional tax liability
The taxpayer's business income for a two-monthly period is as follows.

Period April/May 2002 (payment due on 28 June 2002)

GST taxable supplies (GST-exclusive)[9]	$7,463
Less asset sales	nil
Equals GST sales figure	$7,463

Provisional tax liability for two-month period is GST sales multiplied by the ratio:
$7,463 * 0.26 = **$1,940**

This calculation would be repeated for the remaining taxable periods as follows.

	28 Aug	**28 Oct**	**28 Dec**	**28 Feb**	**28 April**
GST taxable supplies[10]	$8334	$11534	$16834	$26334	$20334
Less asset sales	$0	$0	$0	$0	$0
times ratio 0.26 (26%) equals provisional tax	$2167	$2999	$4377	$6847	$5287

[8] The GST-exclusive sales figure is determined by subtracting box 8 from box 5 on the GST return for each taxable period in the year.
[9] Determined by subtracting box 8 from box 5 of the GST return for taxable period.
[10] Determined from GST return by subtracting box 8 from box 5.

Example 2 – GST-adjusted sales

The same taxpayer has self-employed income, interest and dividend income, income from a trust and rental income. He completes his 2001 income tax return and determines his residual income tax liability to be $22,080.

He advises Inland Revenue by telephone that he wants to pay provisional tax for the 2002 year based on a percentage of his GST-adjusted sales.

Calculating GST-adjusted sales
The taxpayer calculates the GST-adjusted sales for the 2001 year as follows.

GST taxable supplies (exclusive of GST)[11]		$83,000
plus non-GST income		
Net rental income[12]	$5,000	
Interest and dividends[13]	$2,000	
Estate and trust income[14]	$3,000	
less asset sales	$nil	
GST-adjusted sales		**$93,000**

Calculating the ratio

The ratio is: $\frac{\text{Residual income tax}}{\text{GST-adjusted sales}} \quad \frac{\$22{,}080}{93{,}000} = 0.23\ (23\%)$

The shaded non-GST income adjustments are divided by six to give the fixed amount ($1,666) to be added to GST taxable supplies each two-month period.

Calculating provisional tax liability
The taxpayer's business income as well as the income adjustments for a two-monthly period are as follows.

Period April/May 2002 (payment due on 28 June 2002)

GST taxable supplies (GST-exclusive)[15]	$7,463
plus proportionate non-GST income adjustments from 2001 return	$1,666
equals GST-adjusted sales	$9,129

Provisional tax liability for two-month period is GST-adjusted sales multiplied by the ratio: $9,129 * 0.23 = **$2,099**

[11] The GST-exclusive sales figure is determined by subtracting box 8 from box 5 on the GST return for each taxable period in the year.
[12] Determined from box 20 on the IR3 return or box 18B on the IR4 return.
[13] Determined from boxes 13B and 14B of the IR3 or IR4 return.
[14] Determined from boxes 15B and 15C on the IR3 return.
[15] Determined by subtracting box 8 from box 5 of the GST return for taxable period.

This calculation would be repeated for the remaining taxable periods as follows.

	28 Aug	28 Oct	28 Dec	28 Feb	28 April
GST taxable supplies[16]	$8334	$11534	$16834	$26334	$20334
plus non-GST income adjustments	$1666	$1666	$1666	$1666	$1666
equals GST-adjusted sales	$10000	$13200	$18500	$28000	$22000
times ratio 0.23 (23%)					
equals provisional tax	$2300	$3036	$4255	$6440	$5060

[16] Determined from GST return by subtracting box 8 from box 5.