Reducing tax compliance costs for small and medium-sized enterprises

A government discussion document

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CHAPTER 1

Introduction

1.1 Tax policy has an important role to play in supporting the government's goal of fostering an environment that enables New Zealand businesses to grow and compete successfully in a global economy.

1.2 Compliance with tax laws can entail significant time and costs for many businesses. Compliance costs can arise because of the variety of tax compliance activities involved (for example, performing tax calculations, seeking advice, record-keeping, filing returns and making tax payments) and the complexity of tax law and administrative procedures. These costs often have a disproportionate impact on small and medium-sized enterprises (SMEs), which make up approximately 96 percent of total businesses in our economy.[1]

1.3 The 2006 Business Tax Review noted that reducing tax compliance costs can help boost productivity and competitiveness as it would allow more resources to be applied to core business activities. Submissions on the Business Tax Review broadly supported further moves to reduce tax compliance costs.

Purpose of this review

1.4 The purpose of this review is therefore to reduce tax compliance costs for businesses operating under our tax laws, in order to assist productivity and competitiveness. The emphasis is on measures that may reduce these costs for SMEs. However, where appropriate and/or feasible, measures that might apply to businesses generally are also considered.

1.5 This document seeks submissions on a number of possible measures aimed at eliminating, where possible, the activities that give rise to significant tax compliance costs for SMEs. It also looks at streamlining certain other tax compliance activities, having regard to issues such as the security of tax revenues, fiscal costs and administrative feasibility.

What are SMEs?

1.6 SMEs can be defined in a variety of ways – for example, according to their level of turnover, number of employees or total assets. While it is difficult to precisely define "SME" given the diverse nature of New Zealand businesses, for the purposes of implementing potential measures for SMEs, some broad definition of "SME" may be appropriate, possibly with more than one eligibility criterion.

[1] Ministry of Economic Development, *SMEs in New Zealand: structure and dynamics,* 2006, Wellington, New Zealand.

1.7 The typical characteristics of SMEs include a lower level of specialist tax expertise, greater owner-involvement in day-to-day management, a smaller human capital base, a higher level of debt funding and greater exposure to personal liability. SMEs range from micro-businesses (such as taxi drivers and family-owned dairies) to larger firms with the potential to grow and develop globally connected operations.

1.8 A starting point for a definition of "SME" could be that used by the Ministry of Economic Development, which is "…enterprises with 19 or fewer employees…". Firms with fewer than 20 employees account for approximately 96 percent of New Zealand's enterprises, 39 percent of the economy's total output and 30 percent of all employees.[2] While SMEs are spread widely across most sectors, they feature particularly highly in the construction, agriculture, communication services, finance, insurance, property and business services industries. From 2000 to 2005, SMEs accounted for 57 percent of all new jobs in the New Zealand economy. In the year ended 30 June 2005, incorporated companies (excluding unit trusts) with fewer than 20 employees paid over $6 billion in income tax, over $1.6 billion in GST and $60 million in fringe benefit tax.

1.9 An alternative definition based on turnover could be used to standardise a number of concessions that could apply to SMEs meeting those criteria. This is discussed further in Chapter 2.

Why focus on SMEs?

1.10 Minimising tax compliance costs is an important matter for all businesses. However, research suggests that while SMEs do not bear higher compliance costs than larger businesses in absolute terms, they bear higher relative costs.[3] Consequently, SMEs may bear a disproportionate burden of tax compliance costs. While New Zealand's tax system is ranked highly according to ease of doing business,[4] these higher relative costs can be a barrier to economic growth for a group that constitutes the majority of New Zealand businesses. The government wants to ensure that, by making it easier for business to comply with their tax obligations, valuable economic resources are freed up and re-directed towards more productive activities. This should also improve voluntary compliance in the sector.

1.11 A number of tax simplification reviews have been carried out over the last decade or so.[5] This demonstrates the government's commitment to the ongoing monitoring and reduction of tax compliance costs.

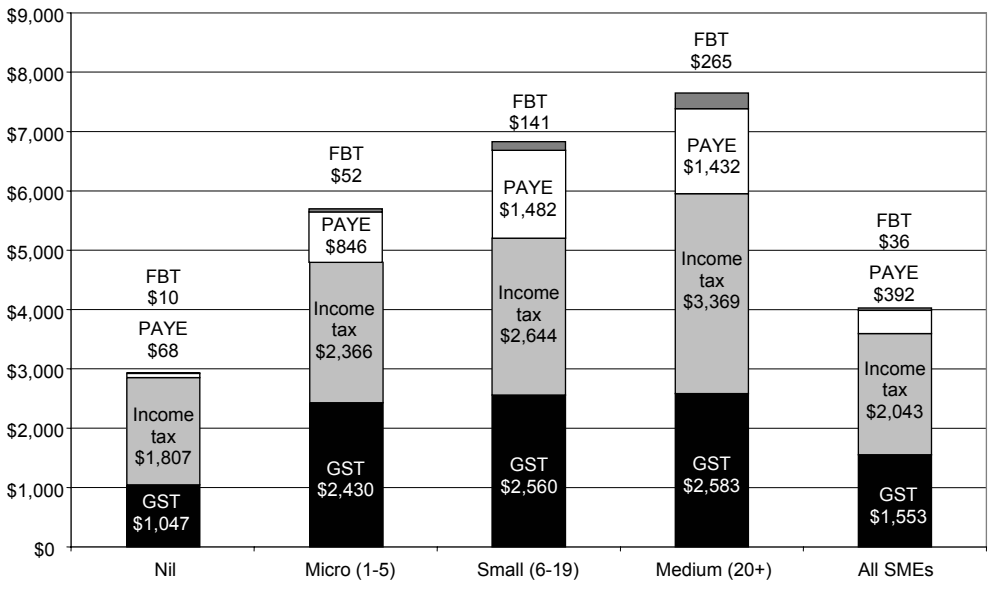
[2] Ministry of Economic Development, *SMEs in New Zealand: structure and dynamics,* 2006*,* Wellington, New Zealand*.*
[3] OECD issues paper, *Implications of tax policy for SME growth and tax compliance,* 2007, para 50.
[4] New Zealand is currently ranked number 2 overall on the World Bank's "Ease of doing business index". The same index reports that medium-sized New Zealand businesses spend 70 hours a year in tax administration, compared with the OECD average of 203 hours a year.
[5] The following government discussion documents have been released: *Simplifying taxpayer requirements,* 1997; *Less taxing tax,* 1999; *More time for business – Simplification for small business,* 2001; *Making tax easier for small businesses,* 2003; and *Streamlining the taxation of fringe benefits,* 2003.

1.12 Areas that have undergone simplification in recent years include goods and services tax (GST), income tax and pay as you earn (PAYE) and fringe benefit tax (FBT). Examples of specific changes include:

- aligning the GST and provisional tax payment dates;
- allowing provisional tax to be paid on the basis of GST taxable supplies;
- increasing the low-value asset write-off threshold;
- introducing a PAYE subsidy to offset costs faced by small businesses in complying with their PAYE obligations; and
- streamlining the FBT rules – including introducing an exemption for the private use of business tools and increasing the minor benefit exemption thresholds.

1.13 The need for further simplification measures follows the results in the most recent survey conducted for Inland Revenue, which shows that SMEs, on average, face an annual total tax compliance cost of $4,024 across all tax types (see Figure 1).[6] Other survey evidence indicates that tax compliance costs remain high.[7]

FIGURE 1:
COMBINED MEAN ANNUAL COMPLIANCE COSTS (INTERNAL AND EXTERNAL)



Source: Colmar Brunton (2005) *Measuring the compliance costs of small and medium-sized enterprises – a benchmark survey.* This is the most recent survey conducted for Inland Revenue.

[6] Colmar Brunton (2005), *Measuring the tax compliance costs of small and medium-sized businesses – a benchmark survey.*
[7] Business NZ – *KPMG compliance cost survey,* 2007.

Tax simplification in other countries

1.14 In exploring possible tax simplification measures in this document, we have considered the approaches taken in other countries such as Australia, Canada, the United Kingdom and the United States, together with relevant OECD work in this area. An appendix to this discussion document provides further details on some of the simplification measures undertaken overseas.

Evaluating potential initiatives

1.15 In deciding whether to proceed with any initiatives, the government will consider the trade-offs involved, and the alignment with broader tax policy design.

1.16 Key considerations will include:

- the extent of the likely reduction in unproductive tax compliance activity and the cost-benefit efficiency of each measure;
- the impact on both economic efficiency and equity – for example, making measures voluntary may mean no firm is disadvantaged, but this can also result in higher economic costs;
- the fiscal cost, including revenue impacts and the administrative costs of implementing, maintaining and monitoring specific measures;
- administrative feasibility and short-term Inland Revenue capacity constraints;
- eligibility rules and boundary issues (determining who can benefit from particular measures);
- likely transitional measures and associated compliance and fiscal costs;
- the potential for reduced accuracy (in terms of calculating tax liability);
- minimising any increased potential for tax avoidance and erosion of the tax base; and
- the potential for introducing undesirable or unintended bias or distortions into economic decision-making.

1.17 These factors will be carefully weighed against the expected benefits arising from each of the measures suggested. The critical focus will be on developing initiatives that genuinely result in greater simplicity in tax compliance – measures that require complex legislation, for instance, could actually increase compliance costs and would not be worth pursuing.

1.18 A question that invariably arises when considering concessions is whether they should be compulsory or voluntary. The benefit of making any threshold concessions compulsory is that it reduces complexity by creating fewer options for businesses to consider. On the other hand, making threshold concessions compulsory may, depending on circumstances, be disadvantageous to both the taxpayer and the tax system. An example of this is the GST six-monthly filing threshold, when many taxpayers that are

entitled to file six-monthly in fact choose not to – for example, to ensure earlier input tax credit entitlement. Making six-monthly filing compulsory may be less convenient for businesses because they would lose the cash-flow benefits of more frequent filing. It may also be disadvantageous to a tax system that is dependent on the better financial management that more frequent filing may provide.

1.19 The opposite is true of voluntary concessions, which generally tend to increase compliance costs for taxpayers and add complexity to the tax system. For example, businesses may wish to operate dual systems in order to choose the result that gives the best financial outcome, even if this outcome increases compliance requirements and results in a more complex tax system.

1.20 The government requests that those making submissions prioritise the measures they consider will genuinely, and in the long term, reduce compliance costs in light of the factors outlined. This prioritisation will allow government to establish those issues that should be progressed, taking into account the fiscal costs and viability of implementing the chosen measures.

Success indicators

1.21 While there is no single method of measuring and monitoring the level of tax compliance burdens, any measures used are likely to include direct and indirect indicators.

1.22 Direct indicators (which largely formed the basis of the results shown in Figure 1) can include the quantum of absolute monetary expenditure on items such as external tax advisor costs and paid internal time spent complying with tax obligations. Importantly, direct indicators may also include non-monetary costs such as stress and unpaid time.

1.23 Indirect measures aim to provide a richer picture, by exploring factors that affect direct costs. These can include proxy measures of the complexity of the compliance process (such as taxpayer filing error rates) and the quality of services (for example, user satisfaction with the legislation, or with Inland Revenue's staff/service lines and products).

1.24 The government plans to review measures such as these periodically to track compliance costs over time.

Summary of possible initiatives

Thresholds (Chapter 2)

- Increasing current thresholds for:
  - PAYE once a month filing – from $100,000 to $250,000
  - FBT annual return filing – from $100,000 to $250,000
  - The provisional tax use-of-money interest safe harbour – from $35,000 to $50,000
  - GST registration – from $40,000 to $50,000
  - GST six-monthly return filing – from $250,000 to $500,000
  - GST change-in-use adjustments – from $90,000 to $100,000
  - Accounting for financial arrangements
  - Low-value trading stock – from $5,000 to $10,000.
- Introducing a single threshold for certain concessions.

Simplified rules for certain expenses (Chapter 3)

- Introducing simplified rules for deducting legal expenditure.
- Introducing simplified rules for deducting entertainment expenses.

Fringe benefit tax (Chapter 4)

- Introducing a single category of restricted private-use motor vehicles for SMEs.
- Simplifying record-keeping requirements for private use of motor vehicles.

GST tax invoices (Chapter 5)

- Simplifying GST invoice disclosure requirements, including:
  - Changing the content requirements of tax invoices
  - Allowing alternative documentation
  - Broadening the scope of shared tax invoicing.

Tax administration (Chapter 6)

- Allowing the correction of minor errors in subsequent returns.
- Reviewing record-keeping periods.
- Reviewing withholding tax exemption certificate requirements.
- Reviewing application of the PAYE intermediaries' subsidy.

Timing of possible reforms

1.25 Many of the measures suggested in this discussion document are threshold-related and therefore relatively simple to legislate for. The government plans, subject to consultation and prioritisation, to include some of these measures in the next available taxation bill.

1.26 The application date for these measures would generally be from 1 April 2009, subject to this being administratively and fiscally feasible.

1.27 A number of the other suggestions contained in this discussion document represent a more fundamental departure from the standard tax rules and will require a longer consultation period. If adopted, these will be included in a later tax bill, with the likely application date being 1 April 2010.

How to make a submission

1.28 The government invites submissions on the merits of the suggested initiatives. The government also welcomes submissions on any similar measures that meet the objectives of this review. Those who make submissions are asked to:

- discuss whether, and how, the suggested changes would deliver substantial compliance cost reduction benefits; and
- prioritise these initiatives and any others put forward.

1.29 Submissions should include a brief summary of major points and recommendations. They should also specify whether it would be acceptable for Inland Revenue and Treasury officials to contact those making submissions and discuss their submission if required.

1.30 Submissions may be the subject of a request under the Official Information Act 1982, which may result in their publication. The withholding of particular submissions on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. Those making a submission who feel there is any part of it that should be properly withheld under the Act should indicate this clearly.

1.31 Any legislation relating to increases in thresholds is intended to be included in a taxation bill to be introduced in 2008. The closing date for submissions on thresholds is therefore 31 January 2008, so that submissions can be considered before the bill is introduced. The closing date for submissions on all other matters is 29 February 2008.

1.32 Submissions should be addressed to:

Reducing SME Compliance Costs
C/- Deputy Commissioner
Policy Advice Division
Inland Revenue Department
PO Box 2198
WELLINGTON

Or email: policy.webmaster@ird.govt.nz with "Reducing SME Compliance Costs" in the subject line.

CHAPTER 2

Thresholds

2.1 The New Zealand tax system uses a variety of monetary thresholds in defining taxpayers' obligations. It also sets limits for certain rules, generally with the aim of reducing compliance costs for taxpayers that fall below those limits.

2.2 The possibility of increasing current thresholds with the aim of reducing compliance costs was raised in the *Business Tax Review* discussion document, and received general support from submissions. Thresholds can be changed by increasing the level at which they are set and by extending the types of taxpayers that may elect to use them.

2.3 From a taxpayer's perspective, changing a threshold may reduce compliance costs in several ways. For example, it may reduce the number of tax returns that must be completed and the amount of information or the number of calculations required to complete each return, or reduce the number of payments the taxpayer must make to Inland Revenue. Together, these measures would reduce the number of interactions taxpayers have with Inland Revenue and the amount of time taxpayers must spend on complying with tax rules.

2.4 Reducing the complexity of the tax rules means that taxpayers are less likely to require expert assistance and are less likely to make errors. As well as reducing tangible costs, such as hours spent and expenditure on accounting fees, reducing the complexity of the tax rules can reduce the stress associated with completing tax requirements.

2.5 This chapter suggests, for the purpose of discussion, a number of changes to the following thresholds by:

- increasing the threshold for paying PAYE deductions once a month;
- increasing the threshold for filing FBT returns annually;
- increasing the provisional tax use-of-money interest safe harbour threshold;
- increasing the registration threshold for GST;
- increasing the threshold for filing GST returns six-monthly;
- increasing the threshold for making GST output tax change-in-use adjustments;
- changing thresholds relevant to accounting for financial arrangements; and
- increasing the threshold for low-value trading stock valuation rules.

2.6 The possibility of using just one threshold to define a number of tax obligations is also considered in this chapter.

2.7 When determining the level at which the individual thresholds should be set, the trade-offs discussed in Chapter 1, including the level of compliance-cost saving, fiscal cost, and the need to minimise economic distortions will be taken into account.

2.8 Each change may make only a small difference to individual taxpayers. However, there could be a significant reduction in compliance costs overall if a number of cost-reducing thresholds apply to the same taxpayer.

Current thresholds and suggested changes

Paying PAYE deductions once a month

2.9 All employers are required to deduct pay as you earn (PAYE) and specified superannuation contribution withholding tax (SSCWT) from their employees' wages or salaries, and pay the deductions to Inland Revenue. If, in the previous year, the total amount deducted for PAYE and SSCWT for all employees was $100,000 or more, the employer must pay the deductions to Inland Revenue twice each month, on the 5th and the 20th. If the total amount deducted for PAYE and SSCWT is less than $100,000, the employer may pay the deductions once each month, on the 20th.

2.10 If the threshold for paying PAYE twice-monthly were increased, some employers could reduce the number of payments they make to Inland Revenue, thereby decreasing transaction costs and record-keeping costs.

2.11 If the threshold were lifted to $250,000, an additional 24,000 employers could file once-monthly. This equates to 96 percent of all employers – approximately the same percentage of businesses considered to be SMEs under the definition used by the Ministry of Economic Development, as noted in Chapter 1.

2.12 Employers that are above the current threshold but below a new threshold could still file twice-monthly if that better suited their business systems.

2.13 Increasing the threshold for paying deductions from employees' wages to Inland Revenue once a month instead of twice a month from $100,000 to $250,000 would cost the government an estimated $8 million a year.

Seasonal employers

2.14 Some employers employ large numbers of people for short periods – for example, the horticultural industry. This can mean that they deduct more than $100,000 per year in PAYE and SSCWT, but those deductions are often made in just a few months. The employers are then required to make twice-monthly payments for the remainder of the year when they have just a few employees. There is currently no capacity for them to revert to once-monthly payments at these times.

2.15 One suggested way to reduce compliance costs for these employers would be to allow industry members to make monthly payments at certain times of the year, but require them to make twice-monthly payments when they have large numbers of employees. However, this could lead to greater rather than less complexity.

2.16 Lifting the PAYE twice-monthly payment threshold to $250,000 would incorporate about 91 percent of horticultural employers. In large part, this would meet the needs of that industry without having to put special rules in place.

Using an employee count to determine once-monthly or twice-monthly payments

2.17 Instead of using a monetary threshold to determine whether an employer should pay deductions once or twice-monthly, once-monthly filing could be restricted to businesses with up to, for example, 20 employees.

2.18 Calculating the number of employees could, however, be complicated. In seasonal industries, for example, it can be difficult to predict how many employees will be employed in a particular year. Even if the overall headcount of employees is known, part-time employees can complicate calculations further.

2.19 Using an employee count could unduly influence business decisions, such as an employer's decision whether or not to employ a new person. It would also require increased record-keeping on the part of both employers and Inland Revenue, thus increasing rather than decreasing compliance costs.

The PAYE intermediaries' subsidy

2.20 The PAYE intermediaries' subsidy is currently paid for employers employing payroll agents to manage their PAYE obligations. Only small employers are eligible for the subsidy. Employers are considered to be small employers if, among other things, they pay less than $100,000 in PAYE and SSCWT. An increase in this threshold, in line with the increase for paying PAYE deductions once a month, would allow more employers to receive this subsidy.

2.21 Other issues relating to the broadening of the PAYE intermediaries' subsidy are discussed in Chapter 6. Given that the PAYE intermediaries' subsidy is a relatively new measure, the government is interested in receiving submissions on its effectiveness before proceeding with any changes in this area.

E-filing employer monthly schedules

2.22 Employers with more than $100,000 in PAYE and SSCWT deductions are required to file their employer monthly schedules (EMS) electronically, instead of completing a manual return. As discussed in Chapter 8, over time Inland Revenue envisages ongoing improvements to its systems, aimed at encouraging an improvement in the take-up of e-filing by taxpayers. Accordingly, the threshold for filing EMS electronically will remain at $100,000.

Filing FBT returns annually

2.23 Employers who pay $100,000 or less in PAYE and SSCWT annually may file FBT returns and pay FBT on an annual basis. All other employers must pay their FBT on a quarterly basis.

2.24 Raising the current $100,000 threshold would mean that fewer FBT returns and payments would need to be filed by small businesses, therefore reducing compliance costs for eligible employers. This possibility was first raised in the *Business Tax Review* discussion document, and received general support from submissions.

2.25 If the threshold were set at $250,000, a further 3,000 employers (or approximately 18 percent of employers currently eligible) would be able to file FBT returns annually instead of quarterly.

2.26 Increasing the threshold for annual FBT filing from $100,000 to $250,000 would cost the government an estimated $4 million a year.

Provisional tax use-of-money interest safe harbour

2.27 Taxpayers are liable to pay provisional tax if their residual income tax in the previous year is greater than $2,500. Residual income tax is the amount of tax payable after any credits have been deducted. There are two methods for calculating provisional tax – the estimation method and the standard uplift method.

2.28 Under the estimation method, taxpayers must estimate their residual income tax liability for the year and pay provisional tax in three instalments to meet that tax liability. If the residual income tax liability is underestimated, and therefore the provisional tax payments are not sufficient to meet the taxpayer's tax liability, the taxpayer must pay use-of-money interest. If residual income tax is overestimated, and provisional tax overpaid, the Commissioner must pay use-of-money interest to the taxpayer.

2.29 Estimating residual income tax can be a difficult task. Businesses must make accurate forecasts, which can be complicated by both internal and external factors. This in itself can be a substantial compliance cost, especially for smaller businesses, which may not have access to specialist expertise to assist in the task. Further, if the forecast is wrong, the amount of use-of-money interest charged can be substantial. This is because the use-of-money interest rate may be higher than most business borrowing rates, so that taxpayers do not delay tax payments. Likewise, the rate the Commissioner uses for paying use-of-money interest to taxpayers is set lower than bank deposit rates, so that taxpayers do not use the Crown as an investment opportunity.

2.30 The standard uplift method takes a taxpayer's previous year's residual income tax, and increases this by 5 percent to determine the current year's provisional tax liability. If the previous year's residual income tax liability is not yet known, residual income tax from two years earlier is increased by 10 percent to determine the current year's provisional tax liability.

2.31 No use-of-money interest is payable by individuals who use the standard uplift method (that is, those who do not estimate their provisional tax) if their residual income tax is less than $35,000 in the relevant year and they meet their terminal tax obligations.

2.32 It is not recommended that the $2,500 threshold above which taxpayers are required to pay provisional tax be increased. Increasing this threshold would be expensive relative to the compliance cost savings likely to arise. In addition, increasing this threshold is more likely to benefit individual taxpayers, predominantly earning income from employment or investments, rather than SMEs.

2.33 The use-of-money interest safe harbour threshold could be increased, however. This would allow more individual taxpayers to use the standard uplift method of calculating provisional tax rather than estimating, thus reducing compliance costs for those taxpayers and reducing exposure to use-of-money interest. Currently, about 238,000, or 95 percent of all individual provisional taxpayers have residual income tax of less than $35,000. If the threshold were lifted to $50,000, about 243,000, or 97 percent of all individual provisional taxpayers, could potentially rely on the use-of-money interest safe harbour threshold.

2.34 Therefore it is suggested that the use-of-money interest safe harbour threshold for using the uplift method for calculating provisional tax be increased from $35,000 to $50,000.

Registration for GST

2.35 Taxpayers that carry on a taxable activity are required to register for GST if their turnover, arising from the regular or continuous supply of goods and services, exceeds $40,000 in a 12-month period.[8] Voluntary registration is permitted for taxpayers that have an annual turnover of less than $40,000. Over 630,000 taxpayers are currently registered for GST, about 40 percent of whom have an annual turnover of less than $40,000.

2.36 By international standards, the registration threshold for GST in New Zealand is low. For example, Australia has recently increased its registration threshold to $A75,000.[9] In the United Kingdom the threshold is £64,000.[10] Canada, on the other hand, has a registration threshold of $CAN30,000.[11] These countries also permit registration below these amounts and often have special compulsory registration rules that apply to some economic activities – such as for taxi drivers in Australia.

[8] Originally set at $24,000, when GST started, the threshold was increased to $30,000 in 1990 and then to its current level in 2000. These adjustments have largely been directed at indexing the threshold to take into account movements in the price of goods and services.
[9] About NZ89,000 assuming $A0.84:$NZ1
[10] About NZ182,000 assuming £0.35:$NZ1
[11] About $NZ40,000 assuming $CAN0.75:$NZ1

2.37 A low registration threshold results in most businesses facing the same pricing considerations. This means they are less likely to be placed at a competitive disadvantage than taxpayers who are below the registration threshold. In competitive markets, the pricing effect from registering for VAT can lead to businesses engaging in undesirable activities, such as sales suppression, in order to stay below the threshold.

2.38 Importantly in the New Zealand context, a low registration threshold is consistent with the objective of maintaining a GST system that applies at a low to moderate rate to a very broad range of goods and services.

2.39 A high registration threshold, on the other hand, could allow sectors that have a higher proportion of final consumers as customers, such as the personal services sector, to exit the GST base. The result would be a substantial reduction of the GST base, which may lead to a need to increase taxes in other areas. A higher threshold could also increase compliance costs for businesses generally, as determining the supplies that did or did not give rise to input tax deductibility might become more complex.

2.40 The government recognises, however, that registering for GST imposes compliance costs for individual businesses as a result of the requirement to file regular returns and other obligations imposed by the Goods and Services Tax Act 1985. These costs can be particularly high for smaller businesses.

2.41 Increasing the registration threshold for GST from $40,000 to $50,000 should allow about 24,000 taxpayers to exit the GST base if they wish to do so, while still maintaining the real level of the threshold. The estimated cost to the government of implementing this change would be about $15 million a year.

Filing GST returns six-monthly

2.42 In general, GST-registered entities must file GST returns every two months. However, taxpayers with a turnover of more than $24 million are required to file every month, while taxpayers with a turnover of less than $250,000 may elect to file returns every six months.

2.43 The threshold for filing GST returns every six months could be increased, which would allow more taxpayers to file GST returns on that basis if they wished. Taxpayers with highly seasonal activities and small businesses may find this helpful.

2.44 Not all taxpayers that are able to file GST returns six-monthly choose to do so. About 400,000 taxpayers are eligible to file GST returns every six months, but only about one-third do, with the remainder opting for two-monthly returns. This may be because two-monthly returns provide an earlier input tax credit entitlement and may also make cash-flow management easier for these businesses. In addition, in order to use the GST-ratio method for calculating provisional tax, businesses must file GST returns monthly or two-monthly. As the benefits of the GST-ratio method become apparent to them, more taxpayers may elect to move from six-monthly filing to two-monthly filing so they can use this method for

calculating provisional tax, with the result that fewer taxpayers will file six-monthly.

2.45 Based on current figures, however, increasing the threshold to $500,000 would mean that an extra 58,000 taxpayers would be able to file GST returns six-monthly if they wish to do so.

2.46 The estimated cost to the government of increasing the GST six-monthly filing threshold from $250,000 to $500,000 would be about $12 million a year.

Making GST output tax change-in-use adjustments

2.47 Special rules apply if an asset (goods or services) has been acquired or produced by a GST-registered person for the principal purpose of making taxable supplies, and is later applied for a non-taxable purpose or for mixed taxable/non-taxable purposes.

2.48 In either case, an output tax adjustment must be made to reflect the person's non-taxable use. However, no output tax adjustment is required if goods and services are used for making exempt supplies and the total value of the exempt supplies over the next 12 months does not exceed the lesser of:

- $90,000; or
- 5 percent of the total of all supplies made (taxable and exempt) in the 12-month period.

2.49 The rule is designed to simplify accounting for GST for taxpayers who supply a small proportion of exempt goods or services in relation to their total business.

2.50 The estimated cost to the government of increasing the threshold for making GST output tax change-in-use adjustments from $90,000 to $100,000 would be about $24 million a year.

Other GST issues

Requirements for accounting on a payments basis

2.51 A GST-registered person may account for GST on a payments, invoice or hybrid basis. The basis used determines when output and input tax is taken into account for GST-return purposes.

2.52 If the invoice basis is used, tax is brought to account at the earlier of the time an invoice is issued or when any payment is made. If the payments basis is adopted, tax is generally brought to account when payment is made.

2.53 GST-registered persons may adopt the payments basis if their total value of taxable supplies (excluding GST) has not exceeded or is not likely to exceed $1.3 million in a year. Because of possible revenue base concerns associated with the GST accounting bases, an increase to the payments basis threshold is not proposed in this discussion document. Instead, the GST accounting bases will be reviewed at a later date.

Thresholds relevant to accounting for financial arrangements

2.54 Accounting for income tax in relation to financial arrangements, such as futures contracts, swaps, foreign currency hedging and overseas loans, is determined by the financial arrangements rules. These rules are complex because of the underlying nature of financial instruments.

2.55 SMEs sometimes use such financial arrangements, but do not always have the expertise to account for them. In addition to complexity issues, the tax treatment of financial arrangements means that income must often be recognised before any cash transactions take place, creating cash-flow management problems for SMEs.

2.56 Currently, individuals are able to account for financial arrangements on a cash basis, subject to certain conditions. The conditions are that either their total income or expenditure in the income year from their financial arrangements does not exceed $100,000, or the total value of their financial arrangements on every day in the income year does not exceed $1 million in value, and that using the cash basis does not defer more than $40,000 of income. Other types of taxpayers (such as companies and trusts) are excluded from using this rule.

2.57 If entities other than individuals were able to use the cash basis to account for financial arrangements, it would be possible for a tax advantage to be gained in related-party transactions by one entity being able to account for the transaction on a cash basis, but a related entity in the same transaction being able to account for it on an accrual basis.

2.58 If the ability to use the cash basis were extended to non-individuals, rules would therefore be needed to ensure that related-party transactions adopted the same accounting basis or were otherwise unable to use the cash basis to artificially reduce tax liabilities. This may entail extra requirements for accounting for financial arrangements. Submissions are sought on whether this would increase compliance costs and negate any benefit.

2.59 Another issue is that, under current law, if an individual or other entity is a party to financial arrangements that have a total value of $1.5 million or less on every day in the income year, the income or expenditure from those financial arrangements may be accounted for on a straight-line basis. This avoids the need for more complex calculations, although it does mean that in some circumstances income may be taxed before cash is received.

2.60 It is therefore suggested that the threshold could be extended to $1.85 million, either in addition to, or instead of, extending the cash basis.

Low-value trading stock valuation rules

2.61 Businesses that sell stock as part of their business activity must value stock on hand at each balance date in order to calculate the cost of sales for the year for tax purposes. Keeping stock records and counting and valuing stock on hand at balance date can be complex and time-consuming, particularly if selling stock is not the primary activity of the business. For example, tradespersons such as plumbers and electricians may keep a small amount of stock on hand so they can complete jobs for customers quickly, without having to make extra trips to pick up parts.

2.62 Businesses with a turnover of $1.3 million or less in a year, that reasonably estimate their closing stock is worth less than $5,000, are not required to calculate its value at year-end. Instead, they may use the value of opening stock as the value for closing stock. This reduces record-keeping for businesses and reduces the amount of time that must be spent each year counting and valuing stock.

2.63 The $5,000 stock threshold could be increased to $10,000, which would allow more businesses for which stock on hand is an incidental part of their business to use this simplified valuation rule.

2.64 It is therefore suggested that the low-value threshold for using the opening value of trading stock as the closing stock value be increased from $5,000 to $10,000.

Consideration of a single threshold for concessions

2.65 Instead of having a particular threshold for each type of transaction that a business may engage in, an option might be to set one threshold and apply it to a number of available concessions. From a tax compliance perspective, having one single threshold across a range of activities should reduce costs.

2.66 The first question to consider is the underlying basis for the single threshold. The threshold concessions noted earlier in this chapter are based on different tax types, which can create problems for determining an appropriate basis.

2.67 Potentially, thresholds could be based on the following:

- *PAYE and SSCWT deductions:* This may not be a satisfactory basis as these deductions are only applicable to businesses that have employees. Among those that do, some large businesses may have few employees, while other small businesses may have many employees. As a result, the single threshold would not be well targeted.
- *Number of employees:* This may not be a satisfactory basis, for the same reasons as using a PAYE and SSCWT basis. There is also a compliance cost in trying to calculate full-time equivalents, especially when there are seasonal and holiday workers.

- *Turnover:* This would seem to be the best method, as most businesses can reasonably estimate the level of their turnover, and it is a reasonable measure of the size of a business.

2.68 Turnover is the measure by which Australia decided to differentiate between small and large entities when it recently adopted a single threshold approach, based on a turnover of A$2 million or less. In Australia, businesses with a turnover of A$2 million or less are now eligible to:

- choose to account for GST on a cash basis;
- choose to pay GST by instalments;
- make an annual apportionment of GST input tax credits;
- use simplified trading stock rules;
- use simpler depreciation rules;
- use the "entrepreneurs' tax" offset;
- use various capital gains tax concessions;
- make pay as you go (PAYG) instalments based on GDP-adjusted notional tax;
- use a two-year period for amending assessments (exceptions may apply);
- make immediate deductions for certain prepaid business expenses; and
- use a FBT car-parking exemption.

2.69 Australian businesses can choose whether or not to apply each of the concessions.

2.70 A similar approach could be taken in New Zealand. That is, a single threshold could be set for certain tax obligations of small businesses. This could reduce the complexity for businesses in terms of having to determine which concessions do or do not apply to them when a variety of thresholds is used. It would also create greater transparency around the rules, which would simplify their administration.

2.71 On the other hand, there are a number of inherent risks and concerns in adopting a single threshold. In particular, the threshold would not differentiate between businesses. For example, it would classify a business with a turnover of say, under $1.3 million as a small business, and therefore eligible for concessions, while a business with a turnover of over $1.3 million would be classified as a large business and be ineligible for the concessions. In particular, basing a threshold on turnover does not take into account the fact that businesses may have different features such as different profit ratios. The following examples illustrate this point:

- A petrol station would ordinarily have a large turnover owing to volumes of sales. Profit margins of petrol stations are, however, quite small. It may also employ relatively few people and deduct little by way of PAYE and SSCWT. As a result, a petrol station could exceed a $1.3 million turnover threshold, but could, in fact, be a small business in terms of its profits and the number of employees it has.
- A self-employed professional services firm may have a turnover under a $1.3 million threshold, but most of this turnover may be profit and form the bulk of the remuneration of an individual partner of the firm.

2.72 Another concern is that if it were possible to choose to apply or not apply each concession, as in Australia, the simplification benefits would be quickly eroded. Further, the incentive to remain under the single threshold would be much stronger as the compliance cost increase to a person who exceeded the threshold could be significant.

2.73 The incentive to remain in such a simplified system could be reduced to some extent if two parallel schemes operated – the current rules with their individual thresholds and concessions, and a single threshold scheme. Taxpayers that satisfied the single threshold would be eligible for all the concessions available under this rule. However, taxpayers that failed to satisfy the standardised threshold would still be eligible to access individual concessions if they satisfied the relevant individual thresholds.

2.74 The individual thresholds discussed in this chapter could be considered for the single threshold approach. If a turnover threshold applied – for example, at $1.3 million – these concessions could potentially be applicable, irrespective of whether each individual threshold was satisfied:

- paying PAYE deductions once a month instead of twice a month;
- filing FBT returns annually instead of quarterly;
- using the provisional tax use-of-money interest safe harbour;
- accounting for financial arrangements;
- using the low-value trading stock valuation rules;
- using the GST payment basis (although this will be considered at a later date); and
- using a reduced rate for restricted private use vehicles (discussed in Chapter 4).

Special submission points

The government is interested in receiving submissions on the following matters.

Whether compliance costs for SMEs would be significantly reduced (and if so, how) by increases to the following thresholds discussed in this chapter:

- paying PAYE deductions once a month;
- filing FBT returns annually;
- using the provisional tax use-of-money interest safe harbour;
- registering for GST;
- filing GST returns six-monthly;
- making GST output tax change-in-use adjustments;
- accounting for financial arrangements; and
- using the low-value trading stock valuation rules.

Whether compliance costs would be significantly reduced if a single overall threshold were introduced for certain concessions.

CHAPTER 3

Simplified rules for certain expenses

3.1 Many businesses find that the rules determining the deductibility, for tax purposes, of business-related legal expenses and business-related entertainment expenses are complicated. This can lead to high compliance costs for SMEs in particular.

Simplified rules for deducting legal expenditure

3.2 In general, legal expenses are tax deductible if they are incurred in the course of earning income. Legal costs in relation to events such as setting up a business, increasing capital or changing the business ownership structure may not, however, be tax deductible as these costs may represent capital rather than revenue expenditure.

3.3 Many SMEs are likely to be unfamiliar with the intricacies of, or the distinction between, expenditure incurred for capital or revenue purposes. Seeking the advice of experts on these issues in relation to relatively small amounts can be time-consuming and expensive.

3.4 One possibility to alleviate this problem would be to allow businesses to deduct all business-related legal expenses up to a GST-exclusive cost of $10,000 a year, without having to distinguish between legal expenses incurred for capital or revenue purposes. This would remove the uncertainty and complexity associated with differentiating legal expenses for the purposes of calculating allowable deductions.

3.5 One consideration is whether this suggested change should be limited to businesses that met a certain turnover threshold. However, if the concession applied only to certain businesses there would be equity issues between those who would qualify for the concession and those who would not. This could give rise to undesirable distortions in the tax system.

3.6 Under this suggested change all businesses would be allowed to deduct the first $10,000 of business-related legal expenses in an income year without having to distinguish between those incurred for capital or revenue purposes. This concession would have general application, but would be of greatest benefit to SMEs, which are less likely to have very large legal expenses.

3.7 There would need to be an associated persons test so that legal expenses are not inappropriately divided among separate but related entities. It may be possible that other limitations of a similar nature would also need to be introduced.

3.8 The estimated cost of implementing this change would be about $6 to 10 million a year.

Simplified rules for deducting entertainment expenditure

3.9 Current tax rules provide that 50 percent of certain business-related entertainment expenditure is non-deductible. The purpose of these rules is to ensure that any private benefit received by employees for entertainment provided by an employer is effectively taxed. This could not easily be achieved under the FBT rules.

3.10 Many SMEs find that these rules cause undue compliance costs compared with the non-deductible business entertainment incurred by businesses. Unlike other tax rules, there is no minimum amount built into the non-deductible entertainment expenditure rules (for example, the FBT rules have a minimum-value threshold on the value of unclassified benefits).

3.11 The government considers that, as with legal expenses, a minimum threshold should be built into the non-deductible entertainment expenditure rules. In practice, this would mean that a business incurring entertainment expenses below a particular level would not need to account for non-deductible entertainment expenditure. This would lower compliance (and tax) costs, particularly for small and medium-sized businesses.

3.12 There would need to be an associated persons test to use these rules. It may be possible that other limitations of a similar nature would also need to be introduced.

3.13 The estimated costs to the government of allowing businesses, subject to an associated persons test, to deduct an amount of business-related entertainment expenses without having to account for non-deductible expenditure would be:

- for a threshold of $2,500 – $20 to 30 million a year;
- for a threshold of $5,000 – $25 to 40 million a year; and
- for a threshold of $10,000 – $30 to 50 million a year.

Special submission points

The government is interested in receiving submissions on whether compliance costs for SMEs would be reduced (and, if so, how) if rules were introduced to allow businesses, subject to an associated persons test, to fully deduct the first $10,000 of business-related legal expenses, and an amount (to be determined) of business-related entertainment expenses.

For business-related entertainment expenses, what threshold should be introduced, bearing in mind the ongoing annual costs involved to the government relative to other priorities?

CHAPTER 4

Fringe benefit tax

4.1 Fringe benefit tax (FBT) is a tax payable on the value of fringe benefits provided to employees by an employer. FBT was introduced in 1985 in response to the growing trend at the time to provide in-kind benefits in lieu of cash remuneration. The FBT rules buttress the PAYE system so that all forms of employee remuneration are taxed more or less equally. FBT therefore continues to play an important role in maintaining the integrity of the tax base.

4.2 One of the reasons the employer, rather than the employee, is subject to FBT is to help control administration, as it is more efficient for one employer to pay FBT rather than a multitude of employees. The number of businesses that file FBT returns is relatively small, at approximately 24,000.

4.3 Changes made last year following a review of FBT, such as increases to the minor benefit threshold and the introduction of a business tools exemption, are expected over time to provide a number of compliance-cost savings and other benefits to taxpayers. (There is often a time lag before the benefit of any change is fully realised.)

4.4 Early consultation has, however, revealed that many SMEs still consider that compliance with the FBT rules can be unduly complicated, particularly those concerned with the taxation of motor vehicles predominantly used for business purposes.

4.5 This chapter examines the possibility of introducing changes to the FBT rules for motor vehicles used by SMEs in this way. In particular, it discusses a new single category of vehicle for FBT purposes which would apply when private use is largely restricted to travel between home and work. The logbook requirements for calculating the private use of motor vehicles by employees for FBT purposes are also examined.

Current FBT rules in relation to motor vehicles

Summary of current rules

4.6 A fringe benefit arises when a motor vehicle is made available to an employee for his or her private use. This includes travel in the vehicle to and from work.

4.7 If an employee is considered to have private use of a motor vehicle the benefit is calculated, on a daily basis, when the vehicle is available for private use, using either 20 percent of the vehicle's cost price, or 36 percent of the vehicle's tax book value.

4.8 Vehicles that fit the definition of "work-related vehicle" in the Income Tax Act 2004 are exempt from FBT. In broad terms, a motor vehicle is treated as a work-related vehicle if it is not a motorcar and has the employer's name or logo prominently and permanently displayed on the outside of the vehicle. The exemption applies for any day on which the vehicle is not available for private use by an employee. For this purpose, private use excludes travel between the employee's home and place of work that is necessary for, and is a condition of, the person's employment, or other travel in the course of employment conferring only an incidental private benefit.

Problems with the work-related vehicle exemption

4.9 Many employers consider that the definition of "work-related vehicle" is too restrictive. The main reason for this is that passenger-carrying vehicles are not included in the definition of "work-related vehicle", even though they may be used primarily for business purposes. This has led to the practice of bolting down the back seats of cars and incorporating the necessary signage to ensure the work-related vehicle exemption applies.

4.10 Employers consider that the FBT rules should be amended both to reduce compliance costs and to better reflect circumstances when employees' private use of motor vehicles is significantly restricted.

4.11 While recognising employer concerns, the government considers that it is appropriate to continue to calculate any employee benefits arising from the availability of an employer-provided motor vehicle on the basis of the vehicle's availability for private use. This approach remains valid even if the vehicle is used predominantly for business purposes, as if there are no restrictions placed on private use an employee would, in most instances, still benefit from cost-savings associated with owning a vehicle.

4.12 It is, however, recognised that the current definition of "work-related vehicle" can be anomalous, especially for SMEs, and can distort decisions about what type of vehicle to buy. It is also recognised that there can be circumstances when employers, who need or choose to use cars rather than work-related vehicles in their business, may be overpaying FBT when private travel is restricted.

Calculating the benefit received by an employee

4.13 The private benefit that an employee obtains when the availability for private use of a vehicle is purely restricted to home-to-work travel will vary depending on each employee's preferences. Employees who would otherwise use public transport to travel between home and work will undoubtedly save on costs, whereas employees who would have walked, or made other alternative arrangements, may save nothing.

4.14 For employees who would normally travel to work by car, the saving would be the vehicle running costs and depreciation they would have incurred in using their own vehicles or, if a private vehicle had to be purchased, the full fixed and variable costs associated with owning a vehicle.

4.15 The value of the availability of the vehicle to the employee also depends on non-cash factors. Employees may or may not value the convenience and flexibility that having a car provides, even if its use is restricted to home-to-work travel. For example, some employees may find having to park or garage a vehicle at their home an inconvenience, particularly if they also have their own vehicle.

4.16 These considerations aside, there is still, on balance, a benefit to employees who have the use of an employer-provided vehicle, even when that use is largely restricted to home-to-work travel. In these circumstances, however, that benefit is likely to be less than the 20 percent of the vehicle's cost price, or more than the effective percentage applicable to exempt work-related vehicles, as specified in the current FBT rules.

4.17 The following suggestion of a lower rate for all vehicles used predominantly for business purposes has been considered to help alleviate some of the concerns raised by business. It is expected that, at least over time, this measure would be largely revenue-neutral.

Introduction of a single category of restricted private-use vehicle

4.18 A new, single category of restricted private-use vehicles could be introduced for employers with a turnover of less than $1.3 million. Motor vehicles (including those currently within the definition of "work-related vehicle") that are considered to be restricted-use vehicles would be valued for FBT purposes based on a rate of 10 percent of the vehicle's cost price (or 18 percent of their tax value).

4.19 The availability of the work-related vehicle exemption would be phased out for an employer falling into the new rules. At a minimum, work-related vehicles on hand before the introduction of any new rules would not lose their status as work-related vehicles.

4.20 Having just one category for all restricted private-use vehicles would remove problems at the margin over whether a particular type of vehicle is within one category or the other, and reduce associated compliance costs. It would also remove the costs associated with bolting down the back seats to cars and applying signage. Significantly, the lower rate would better reflect the predominantly business-related purpose of the vehicle, while at the same time reducing compliance costs by lowering the incentives to engage in tax planning with respect to FBT.

Defining restricted private use

4.21 Some necessary constraints would need to be in place for SME taxpayers to qualify for the restricted private-use category. These could include:

- Only private travel between home and work, and other incidental travel that was necessarily undertaken in the course of, and as a condition of, employment, would be permitted.
- The work use of the vehicle would need to account for at least 75 percent of its total use. This could be measured by a representative three-month test period in which the kilometres travelled would be recorded and allocated between business and private use. Results from the three-month test period could be relied on for a three-year application period. Alternatively, if the number of kilometres travelled on business could be reasonably estimated to exceed 21,000kms during the income year, the 75 percent test would be assumed to have been met.
- A restriction on the value or type of vehicle, to ensure that inappropriate vehicles (such as expensive sports cars) could not qualify as a restricted private-use vehicle. This could be linked, for example, to twice the average value of motor cars.

4.22 These restrictions would ensure that the vehicle was predominantly used for work purposes, and that clear restrictions on private use were in place. One question is whether employees who have no fixed place of work (such as plumbers) would be regarded as undertaking any private home-to-work travel. To provide greater certainty in this area, a specific exemption from FBT could be provided for employees who had no fixed place of work and used the vehicle just for work purposes.

4.23 FBT liabilities are calculated on a daily basis so that a vehicle may be exempt as a work-related vehicle one day and subject to FBT at the full rate the next. This causes compliance costs and would be inappropriate if a lower rate were to apply for restricted private use. To overcome this, it is proposed that the lower rate applicable to restricted private-use vehicles would apply at all times.

Example

An employer with a turnover of less than $1.3 million uses three motor vehicles in its business. All vehicles are used for predominantly work-related purposes, with employees' private use being restricted, under the terms of their employment contracts, to travel between work and home. One of the motor vehicles currently qualifies as a work-related vehicle, whereas the other two do not.

Under the suggested restricted private-use vehicle initiative, the employer would include all three vehicles in the restricted private-use vehicle category for FBT purposes. All three vehicles would therefore be subject to FBT, but would be valued at a lower rate of 10 percent of the vehicles' cost price (or 18 percent of their tax value).

Vehicles would not have to satisfy the work-related vehicle requirements to qualify, so that passenger-carrying vehicles with no signage could be included in the rules.

Test period for establishing the private use of motor vehicles

4.24 Employers who provide vehicles to their employees can currently use a three-month test period to establish the number of days that a motor vehicle is available for private use, and therefore liable to FBT. The result of this test can then be used to calculate the employer's FBT liability for the next three years. The test period used by the employer must be representative of the three-year application period.

4.25 This concession relieves employers and employees from having to continually record a vehicle's use during this three-year period. However, the legislation currently also states that if the actual private use in any quarter, year or income year is 20 percent or more than the test period result, the application period will end on the last day of that quarter, year or income year. This requirement has the effect of requiring continual monitoring of actual private use during the three-year application period.

4.26 It is proposed to remove the requirement to continue monitoring private use during the three-year application period to ensure that actual private use is not 20 percent or more than the three-month test results. This will help ease compliance requirements on both employers and employees when measuring the private use by employees of employer-provided motor vehicles. However, the existing requirement that the three-month test period for measuring private use must be representative of the three-year application period would continue to apply.

Special submission points

Submissions are sought on whether a new FBT rule for employers with a turnover of less than $1.3 million, which is based on a 10% rate for all vehicles used predominantly for business purposes (restricted private-use vehicles), would ease compliance and cost concerns for SME employers.

CHAPTER 5

GST invoices

5.1 GST is based on a system of self-assessment. It is the responsibility of taxpayers to calculate the amount of GST output tax they are required to pay and any GST input tax deductions that they are eligible to receive.

5.2 A "tax invoice" is the key instrument used in these GST transactions, since GST may be deducted only if the GST-registered person holds a valid tax invoice at the time the return is filed.

5.3 This chapter looks at possible measures to simplify the requirements associated with tax invoices. It suggests that compliance costs could be reduced if taxpayers were able to use, as tax invoices, other documents produced in the ordinary course of business, such as receipts.

Current law

5.4 While the Goods and Services Tax Act 1985 makes a number of concessions on the use of tax invoices (for example, allowing buyer-created invoices), the standard requirements for a GST tax invoice are relatively prescriptive. To be a tax invoice, section 24 of the GST Act requires that a document must contain:

- the words "tax invoice" in a prominent place;
- the name and registration number of the supplier;
- the name and address of the recipient of the supply;
- the date of issue;
- a description of the goods and services supplied;
- the quantity or volume of the goods and services supplied; and
- the taxable amount, the tax, and the tax-inclusive amount, or the consideration and a statement that it includes GST (at 12.5% or 0%).

5.5 These requirements are broadly similar to those that would appear on an invoice for accounting purposes. However, the prescriptive nature of tax invoices can easily give rise to taxpayer errors.

5.6 A simplified tax invoice has slightly more relaxed requirements than a "full" invoice. This type of invoice may, however, be issued only when the consideration for the supply does not exceed $1,000.

5.7 The current rules for both full and simplified tax invoices could be simplified by:

- reducing the number of details that must be contained on a tax invoice;
- broadening the scope of the recently proposed shared invoice change;
- allowing taxpayers to outsource the requirement to prepare tax invoices;
- reducing the requirements for buyer-created tax invoices; and
- clarifying the legislative consequences in relation to "copy only" invoices.

5.8 Consideration will also be given, following further consultation, to the use of bank statements and receipts in place of tax invoices.

Suggested changes

Changes to content requirements of tax invoices

5.9 The prescriptive nature of tax invoices requires taxpayers to establish a system to manage and create invoices. It is proposed that, provided adequate regard is had to the need for efficient tax administration, a wider range of ordinary business-created documents could be used as tax invoices.

5.10 It would not be practical to remove the requirements to have the name and registration number of the supplier, and the name and address of the recipient on a tax invoice for supplies over $1,000. The former is needed to identify the taxpayer who supplies the goods and services; the latter is necessary to ensure that the correct person receives any corresponding tax deductions.

5.11 Since a tax invoice may trigger the time of supply, it is also important to know on which date the invoice is issued.

5.12 A description of the goods and services supplied is necessary to identify the transaction and ensure that only one input tax deduction has been claimed in relation to the specified supply.

5.13 Finally, the requirement to state the tax-exclusive amount of the consideration, the tax, and the tax-inclusive amount of the consideration is necessary to identify whether the supply has been subject to GST and therefore subject to output tax and any related input tax deduction.

5.14 On the other hand, the requirement to have the words "tax invoice" displayed in a prominent place and to provide details of the quantity or volume of goods and services supplied could be removed.

Removing the requirement for the words "tax invoice"

5.15 Requiring the words "tax invoice" to appear in a prominent place on a tax invoice is meant to provide certainty that there is only one unique identifiable document that can be used to ascertain either a GST output tax liability or a GST input tax entitlement.

5.16 Nevertheless, removing this requirement would reduce compliance costs for suppliers by enabling them to use documents that are produced in the ordinary course of business as tax invoices. For example, this might include receipts or web-based documents, provided that the documents contain all the other information prescribed for a tax invoice.

5.17 There is a risk that removing the requirement could lead to more than one document being used for a single supply and more than one deduction being claimed for a single supply of goods or services. To reduce this risk, Inland Revenue could issue guidelines outlining the types of documents that would be acceptable as tax invoices.

Removing the requirement to state the quantity or volume of goods and services supplied

5.18 The requirement that a tax invoice must state the quantity or volume of the goods or services supplied is meant to assist Inland Revenue's audit processes and help businesses to manage their trading stock inventories.

5.19 Any assistance this requirement provides businesses could be achieved through other commercial or business documentation (which under the suggested changes in this chapter could themselves become tax invoices), and does not need to be a requirement for tax purposes. It is therefore suggested that this requirement be removed.

Broadening the scope of the shared invoicing proposal

5.20 Modern business practices often make it more convenient for consumers to be invoiced by suppliers for multiple goods and services on one bill. For example, a consumer may receive one bill for electricity and gas from two different respective suppliers.

5.21 The current GST legislation generally does not accommodate this practice of shared invoicing by multiple suppliers.

5.22 A recently proposed legislative change allows a single shared tax invoice to be issued by one "principal supplier" on his or her own behalf and on behalf of other GST-registered suppliers. The proposal specifies that shared invoices can be issued in two situations:

- when suppliers face statutory obligations (for example, a levy imposed by statute) that make it practical to use a single invoice; or
- when suppliers are part of the same GST group of companies.

5.23 To avoid risk to the tax base, the proposed changes are deliberately narrow. The government does, however, recognise that there may be potential for the proposed shared tax invoicing rules to apply more broadly, if this extension does not unduly jeopardise the integrity of the GST base.

5.24 This could be achieved by allowing one GST-registered party to issue tax invoices on behalf of other GST-registered suppliers. The individual suppliers themselves would remain responsible for payment of the GST. Controls could also be put in place to further reduce the risk of suppliers failing to account for GST, such as approval of shared invoice arrangements by Inland Revenue, a minimum turnover requirement for a party responsible for issuing an invoice, and requiring the invoice issuer to retain documents to enable the other suppliers and the supplies to be identified.

5.25 This change would allow a number of independent suppliers to offer their goods or services (such as internet, mobile, parking and television service providers) to customers with a shared invoice acting as a single clearing point.

5.26 Submissions are sought on the possible extension of the shared tax invoice proposal and ways to minimise the risks associated with an extension.

Outsourcing the requirement to prepare a tax invoice

5.27 Under the current rules, the obligation to prepare a tax invoice rests with the supplier (unless it is a buyer-created tax invoice). For some suppliers, having the invoice prepared by a third party may save time and money.

5.28 There may be some compliance savings to businesses in allowing suppliers to outsource the responsibility of creating tax invoices. Under the change suggested, a supplier would contract a third party (a billing agent) and provide the billing agent with the information required to create a valid tax invoice. The billing agent would then be responsible for creating the invoice and delivering it to the relevant customer on behalf of the supplier.

5.29 To ensure that tax invoices prepared by a billing agent are based on correct information, the billing agent would be required to keep the records of any information provided to them by suppliers. The supplier would still be responsible for filing GST returns and for the associated liabilities, even in the case of error by the agent. Billing agents would be responsible for retaining copies of tax invoices prepared for their clients.

5.30 If the suggestion to extend the scope of shared tax invoicing proceeds, billing agents would be able to issue a single tax invoice on behalf of a number of suppliers.

Tax invoices and input tax deductions

5.31 Suppliers are prohibited from issuing more than one tax invoice for a single supply unless the other document is a copy and clearly marked as such. A criminal penalty, by way of prosecution and fine, can apply when more than one tax invoice is issued in connection with the same taxable supply.

5.32 A change could be made to replace the penalty for issuing more than one tax invoice with a penalty to taxpayers who claim more than one input tax deduction in relation to the same supply of goods and services. The requirement that GST-registered suppliers must issue a tax invoice within 28 days, and the penalty for not doing so, would be retained.

5.33 The normal penalty rules would continue to apply for incorrect tax positions. Claiming multiple input tax deductions for one supply will result in a tax shortfall. Depending on the facts of the case, shortfall penalties, ranging from not taking reasonable care to evasion, may apply.

Buyer-created tax invoices: removing the requirement for Inland Revenue's approval

5.34 Ordinarily, the responsibility to create a tax invoice lies with the supplier of goods or services. In certain circumstances, a recipient of a supply may create a tax invoice (a "buyer-created" tax invoice).

5.35 Parties must seek Inland Revenue's approval before a buyer-created tax invoice can be issued. This requirement is to avoid the possibility of both the supplier and the recipient of the supply creating a tax invoice.

5.36 It is proposed that the requirement to seek Inland Revenue's approval be removed, and the recipient be able to create a buyer-created tax invoice if:

- the supplier and the recipient agree that the recipient should issue a tax invoice;
- the document is provided to the supplier and a copy is retained by the recipient; and
- the words "buyer-created tax invoice" are contained in a prominent place on that document.

5.37 In case both the supplier and the recipient accidentally issue a tax invoice in relation to the same supply, the recipient of the supply will have to ensure that they do not claim more than one input tax deduction for the supply. Should more than one tax invoice exist, the supplier's tax invoice will take precedence in deciding the time of supply in relation to the goods or services in question.

"Copy only" invoices

5.38 If a taxpayer has lost the original tax invoice, the supplier or the recipient, as the case may be, may provide a duplicate of the tax invoice, provided that it is clearly marked "copy only".

5.39 The current rules are too prescriptive, at times resulting in invalid invoices. A possible solution is for the rules to be changed so that the exact term for "a copy" is not legislatively prescribed. Instead, all that would be required would be a clear statement that makes it obvious that the tax invoice is not the original (for example, "copy only", "copy" or "duplicate").

The "no tax invoice" threshold

5.40 Among GST/VAT jurisdictions, New Zealand is unusual in comprehensively waiving the requirement to hold a tax invoice for low-value transactions (when the GST-inclusive cost of a supply is $50 or less).[12]

5.41 It is not proposed to increase the level of the threshold. The "tax invoice" is Inland Revenue's primary method for verifying GST input tax deduction claims. While the amount of revenue involved in a transaction of less than $50 is small, the large volume of these transactions means that the revenue risk of any increase to this threshold is significant.

5.42 The changes suggested in this chapter are seen as a better response in dealing with compliance cost issues arising from the use of tax invoices.

Invoice requirements for regular transactions

5.43 It has been suggested that GST tax invoice requirements could be simplified by reducing the requirements for regular transactions. For example, commercial leases are typically the same amount each month. As a result, once this figure and the other information required in a tax invoice is documented, there should be no further need for GST invoices to be issued each month.

5.44 Inland Revenue is considering ways that regular transactions can be accommodated within the current legislative framework. Submissions on whether legislative change would assist in this area are also welcome.

Electronic invoicing

5.45 Modern businesses find themselves increasingly involved in electronic communication and delivery of information. The government's position is that tax and other legislation that affects business should reflect this.

5.46 Under current rules, taxpayers may issue both paper and electronic versions of invoices and tax invoices. Submissions are sought on whether any improvements in the GST legislation could further facilitate the use of electronic invoicing.

Bank statements and receipts

5.47 The government is interested in submissions, including from the financial sector, on whether bank statements, such as EFTPOS and credit card statements, could be used to support the deduction of input tax by GST-registered persons.

[12] The United Kingdom provides some industry concessions. For example, VAT invoice requirements have been waived for the retail sector (the justification being that the majority of invoices are issued to unregistered parties). Canada imposes a graduated scale of disclosures, depending on the value of the transaction. For transactions below CAN$30, the vendor's name, the amount paid and sufficient information to establish that GST was paid on the supply must be disclosed.

5.48 If the changes suggested in this chapter were to go ahead, the documentation used would need to include a similar level of detail as that required for a tax invoice.

Special submission points

Submissions are invited on the following matters:

- The removal of the words "tax invoice" and the requirement to state the quantity or volume of goods and services supplied, with the ability to use alternative commercial documentation for output tax and input tax purposes.
- The suggestion to extend shared tax invoicing and how to minimise any associated risks.
- The use of billing agents to issue tax invoices.
- Invoice requirements for regular transactions.
- Electronic invoicing.
- The use of bank statements, EFTPOS receipts and similar documents to support the deduction of input tax by GST-registered persons.

CHAPTER 6

Tax administration

6.1 The processes involved in calculating and paying tax require businesses to interact with their employees, their customers, other businesses and Inland Revenue. Minimising and streamlining administrative processes can reduce the compliance costs of these interactions and are just as important (if not more so) than legislative amendments.

6.2 There are two broad areas in which tax administration could be made more efficient:

- Businesses are required to calculate tax liabilities, document transactions and calculations, hold files that record all their transactions, and authenticate their tax affairs. The requirements for acquiring and holding this information could, in some cases, be relaxed.
- Businesses must interact with Inland Revenue, file tax returns and make payments regularly, and provide information as needed. These interactions could be streamlined by introducing changes to Inland Revenue's procedures and to some legislative processes.

6.3 The following areas have been identified where changes could possibly be made to reduce tax compliance costs:

- correcting minor errors in subsequent returns;
- using the GST ratio to pay provisional tax;
- the record-keeping requirements period;
- withholding tax exemption certificates; and
- reviewing the PAYE intermediary subsidy.

Correcting minor errors in subsequent returns

6.4 Taxpayers are required to correctly determine the amount of tax payable under tax laws. If an amount is not correctly calculated, or not paid on time, penalties can apply. Use-of-money interest applies if the correct amount of tax is not paid when due.

The issue

6.5 For GST returns, registered persons are generally able to correct minor errors in a subsequent (current) return-period. For revenue types other than GST, errors will generally be required to be corrected in the returns in which they arose. Recently proposed rule changes to remove shortfall penalties for most voluntary disclosures should mean taxpayers that make such adjustments in a current year return will not be unduly penalised. However, use-of-money interest may still apply if the adjustment is not in the taxpayer's favour.

Possible solution

6.6 A solution is for the legislation to allow taxpayers to rectify minor errors in previous returns by including them in the current tax return. This change could provide taxpayers and their agents with a greater level of comfort in making such changes.

6.7 As taxpayers will no longer need to contact Inland Revenue to correct minor errors, this would also reduce the number of interactions taxpayers have with Inland Revenue.

6.8 It is suggested that there be a single threshold of $500 of tax to which this proposal would apply. This change would apply when the error is less than the threshold – that is, when the error or total errors involve less than $500 of tax.

6.9 The threshold would apply to the error or errors made in one return and not affect the level of error/s that could be corrected in a later return.

Special submission points

- Would an amount of $500 of tax be sufficient to include most minor errors?
- Are there other measures for achieving the same result?

Using the GST ratio method to calculate provisional tax

6.10 From the 2008–09 income year, taxpayers will be able to use the GST ratio method to calculate their provisional tax. To be eligible to use this method, taxpayers must:

- file GST returns either monthly or every two months;
- have been GST-registered and filing returns for all of the preceding income year; and
- have residual income tax greater than $2,500 and less than $150,000 in the preceding income year.

6.11 The ratio must be between 0 and 100 percent.

6.12 If taxpayers meet these criteria, they may apply to use the ratio method and Inland Revenue will calculate the applicable ratio. Taxpayers will then apply the ratio to their taxable supplies for a two-month period to determine their provisional tax liability. The calculation may exclude major asset sales.

6.13 Provisional tax is paid at the same time as any GST owed to Inland Revenue. Any GST refund due to the taxpayer is offset against the taxpayer's provisional tax liability. Taxpayers that use the GST ratio method must make six provisional tax payments, either with each two-monthly GST payment, or with every second monthly GST payment.

The issue

6.14 The alignment of GST and provisional tax payments was designed as a simplification measure for SMEs. Using the ratio method means that taxpayers are not required to estimate provisional tax and are not therefore subject to use-of-money interest.

6.15 However, the current rules apply only to taxpayers that pay income tax and GST within the same entity. There are some business structures that are excluded from the rules, because the income tax paying entities are separate from the GST-registered entity.

6.16 For example, many SMEs use a company structure. At the end of each income year, all or most of the profit in the company is paid out to shareholder employees as salary. The company then has no or very little taxable income, and therefore it is not required to pay income tax. Shareholder employees, however, must pay income tax and, if their residual income tax is over $2,500, they must pay provisional tax. If their residual income tax liability is over $35,000 (which may rise to $50,000 – see Chapter 2), and their provisional tax liability is wrong, they will be liable for use-of-money interest. Partners in partnerships and beneficiaries of trusts can also face this problem.

Possible solution

6.17 A possible solution would be for the GST ratio method for calculating provisional tax payments to be extended so that salaries paid to shareholder employees are added back to a company's taxable income before the GST ratio is calculated. The resulting provisional tax payments would cover both the income tax liability of the company and the provisional tax liability of the shareholder employees.

6.18 The provisional tax paid at the company level would be attributed to the shareholder employees when salaries are paid to them.

6.19 A similar process could be used for partners in partnerships and beneficiaries of trusts.

6.20 Provided the company and its shareholder employees, and likewise, the partnership and its partners or the trust and its beneficiaries, met the rules for using the GST ratio method for determining provisional tax, and paid their provisional tax liability by the due date, they would not be liable to pay use-of-money interest on underpayments of provisional tax. Nor would they be able to earn use-of-money interest on overpayments of provisional tax.

6.21 Income from other sources earned by shareholder employees, partners and beneficiaries will, in many instances, be subject to withholding taxes. Any provisional tax liability from other income would continue to apply in the usual way.

Special submission points

- Would expanding the GST ratio method to cover shareholder employees, partners in partnerships, and beneficiaries of trusts reduce the amount of time spent and stress involved in estimating and paying provisional tax?
- If you are currently excluded from the ratio method, would you consider taking it up under the suggested change?

Record-keeping requirements

6.22 Taxpayers are generally required to keep their tax records for seven years. This period can be extended by three years if the taxpayer's affairs are audited by Inland Revenue. Taxpayers can apply to Inland Revenue to keep records for shorter periods and, if granted, this period is usually reduced to four years. Taxpayers may keep their records electronically.

6.23 Inland Revenue cannot amend an assessment if more than four years have passed since the end of the tax year in which the taxpayer provides the return. There are two exceptions to this rule:

- if the tax return provided by the taxpayer is fraudulent or wilfully misleading; or
- if the tax return does not mention income of a particular nature or source.

The issue

6.24 In complying with the record-keeping requirements, taxpayers may incur costs. While the majority of these costs are incurred when the records are made, on-going compliance costs may also be incurred.

Possible solution

6.25 The record-keeping period could be reduced to four years to align it with the time-bar for amending assessments. The period could be extended if Inland Revenue were auditing the taxpayer or had notified them they were about to be audited. The advantages to taxpayers of a reduced period are a reduction in storage costs and possibly also the ability to move more quickly to electronic filing systems.

6.26 Before making this change, however, other business record-keeping periods will also need to be considered, and consultation undertaken. There are other New Zealand statutes which require businesses to keep records – for example, the Companies Act 1993 requires records to be kept for seven years, and the Employment Relations Act 2000 requires that employee records be kept for six years.

6.27 It is also worth noting that in overseas jurisdictions the length of time tax records are required to be kept varies:

- In Australia, records are required to be kept for five years after they are prepared, obtained or the transactions completed (whichever occurs later).
- In the United Kingdom and Canada, business records generally must be kept for six years. In the United Kingdom, if the six-year rule causes serious storage problems or undue expense, the taxpayer may be allowed to keep some records for a shorter period.
- In the United States, the period is dependant on circumstances and can vary between three years and an indefinite period.

Special submission points

- What compliance costs are incurred in keeping records for a seven-year period?
- How would these costs reduce if records could be kept for a shorter period of time?

Withholding tax exemption certificates

6.28 The Income Tax (Withholding Payments) Regulations 1979 apply to taxpayers that receive withholding payments – that is, payments made for the provision of certain services listed in the regulations. These include, for example, payments to sheep shearers, company directors' fees and fees for setting examination papers or questions.

6.29 A business that engages contractors is required to deduct withholding tax from any payments made to the contractors – unless the contractor holds a valid certificate of exemption from withholding tax.

6.30 Persons can apply to Inland Revenue for a certificate of exemption if they:

- are in business;
- receive withholding payments; and
- have a good record in New Zealand for filing returns and paying their tax when it is due.

Recent changes

6.31 There have been a number of recent administrative changes aimed at reducing the compliance costs faced by contractors in obtaining certificates of exemption. For example, contractors can now apply online for a certificate of exemption and, since 1 April 2007, Inland Revenue has issued a new style of certificate which is a convenient credit card size, with more security features.

The issue

6.32 When a business engages a contractor, it can be difficult to ascertain whether the contractor has an exemption certificate. If a business engages a contractor who does not have an exemption certificate and does not withhold tax, the business can be liable to pay Inland Revenue the amount that should have been withheld (even though the full amount has been paid to the contractor).

Possible solution

6.33 One possible solution has been raised during initial consultation, and also by the Committee of Experts on Tax Compliance in its *Tax Compliance* report to the Treasurer and Minister of Revenue in December 1998. That is, to allow businesses employing contractors to assume that the contractor has a certificate of exemption, and not deduct withholding tax if the contractor is registered for GST and gives the business a tax invoice for its services. Contractors who are not registered for GST would still be able to obtain a certificate of exemption in the usual way.

6.34 If the contractor is GST-registered and the business engaging the contractor assumes that the contractor holds a certificate of exemption, Inland Revenue would no longer be able to collect from the business any withholding tax owed.

6.35 The suggested change could not, however, realistically proceed without addressing the potential base-maintenance risk that it could cause. GST-registered persons are already in the tax base and therefore pose less of a tax-base risk than other contractors. Nevertheless, an important purpose of the withholding tax rules is to protect the tax base, and this is why the contractor's compliance history is an important consideration in issuing exemption certificates.

6.36 Possible options for dealing with this concern include:

- giving Inland Revenue the power to allow GST registration as a means of determining exemption for certain approved types of consultant or industry; and
- requiring the contractor to supply the business with a statutory declaration that they have a good tax compliance history and/or that they have no outstanding tax debts.

6.37 The main compliance costs in this area may, however, be due to businesses being unaware of the Income Tax (Withholding Payments) Regulations and the possibility that the business employing the contractor could be liable for any tax that should have been withheld. It is questionable whether these concerns can be resolved through legislation.

Special submission points

- Would compliance costs be significantly reduced if businesses were able to assume that contractors they engage have a certificate of exemption if they are registered for GST?
- What options are available to deal with the compliance-risk concern?

Reviewing the PAYE intermediaries' subsidy

6.38 Since 1 October 2006, the government has subsidised the use of payroll agents (known as PAYE intermediaries) to meet the PAYE obligations of small businesses. The subsidy is available to employers with up to five employees.

6.39 The aim of the subsidy is to offset some of the costs of complying with PAYE by contributing towards a small employer's cost of using a PAYE intermediary for assistance in meeting its PAYE obligations. The benefits include:

- reduced compliance costs and penalties for non-compliance for smaller businesses;
- more time for smaller employers to focus their efforts on their business, rather than compliance activities;
- an improvement in the timeliness of payments and quality of information supplied to Inland Revenue; and
- increased efficiency in the PAYE system in general, as PAYE intermediaries provide services to a large number of employers, using their skills and technology to increase the accuracy and timeliness of returns.

The issue

6.40 While still in its infancy, the PAYE subsidy has not had significant take-up by employers. This may be for a variety of reasons, such as the negative impact on an employer's cash-flow of not retaining PAYE deductions, the costs of engaging a PAYE intermediary to handle the payroll, the fact that the subsidy does not cover assistance with other employment-related taxes such as FBT, or the fact that it only applies to the first five employees. The government welcomes submissions on whether the existing PAYE subsidy is effective and why taxpayers are not yet taking up this opportunity.

6.41 If retention of the PAYE subsidy is preferred by taxpayers, there are possible ways in which it may be improved. These are discussed below and those making submissions are asked to rank these in order of perceived importance.

Possible solutions

Extending subsidy application to other taxes

6.42 A question for consideration is whether the PAYE subsidy should be extended to other employment-related taxes – for example, FBT. This would improve SMEs' access to expert assistance, decreasing the likelihood of errors. The estimated cost to the government of implementing this change would be about $1 million a year.

Increasing the rate of subsidy

6.43 Increasing the rate of subsidy would mean that greater assistance from PAYE intermediaries would be possible. However, increasing the subsidy may entail a significant fiscal cost (for example, an estimated ongoing annual cost to the government of about $10 million to raise the subsidy to $3 per employee). Accordingly, this option may need to be ranked in terms of its priority and considered alongside other simplification initiatives.

Increasing the number of employees covered

6.44 There are a number of factors to weigh up in considering an increase to the number of employees covered by the PAYE subsidy. For example, in order to use a PAYE intermediary, a business typically must pay over the entire amount of an employee's salary or wages at the time that they are due to be paid to the employee.

6.45 The PAYE intermediary will pay the employee's net wages immediately, but it pays PAYE and other deductions over to Inland Revenue at a later date. This means that the PAYE and other deductions will enhance the intermediary's cash-flow, earning income through the time-value of money. The employer foregoes this time-value of money by using the PAYE intermediary. Larger businesses may be able to negotiate lower fees in return for the time-value of money advantage the payroll firm will receive, but smaller businesses may not be able to do so.

6.46 Accordingly, once a business has a certain number of employees, given the time-value of money consideration, it may be more cost-effective to manage payroll transactions within the firm instead of engaging a PAYE intermediary to perform the service.

6.47 The estimated cost to the government of extending the PAYE subsidy to six or seven employees would be about $4 to 8 million a year.

Special submission points

Is the existing PAYE subsidy effective and should it be retained?

If the PAYE subsidy should be retained, please rank the following options as possible improvements to the system:

- extending the subsidy's application to other employment-related taxes;
- increasing the rate of subsidy; and
- increasing the number of employees covered by the subsidy.

CHAPTER 7

Information sharing

7.1 The government wants to create a business environment which minimises compliance requirements and costs so that businesses can focus on their domestic and international growth.

7.2 Multiple requests for the same business information from a range of government agencies can be an irritant and can impose unnecessary compliance costs on businesses. Requests to fill in different forms with the same core business information (company name, physical and email addresses and registration details) on every form used in a transaction between business and government may result because government agencies are unable to share information.

7.3 This chapter aims to open up discussion around the issue of information sharing and compliance. The government would like to gauge the extent to which businesses, and in particular SMEs, consider current levels of co-ordination of information between specific government agencies impose an unnecessary compliance burden. It would also like feedback on measures that the government could take to deal with any problems and mitigate any associated risks.

The current situation

7.4 A significant number of government agencies request information from businesses annually,[13] but are unable to share it because of incompatible IT systems, a lack of formal co-ordination, and privacy concerns. Table 1 provides a broad summary of the government information requirements for a typical SME.

[13] The Companies Office, Department of Labour, Inland Revenue, Statistics New Zealand, Ministry of Agriculture and Forestry, New Zealand Customs, Food Safety Authority, Ministry of Transport, Accident Compensation Corporation, Ministry of Social Development, Ministry of Health, Immigration New Zealand, Environmental Risk Management Authority, Ministry of Education and various local authorities. Source*: Business NZ KPMG compliance cost survey 2007.*

TABLE 1:
INFORMATION REQUESTED FROM SMES BY GOVERNMENT AGENCIES

	Inland Revenue	ACC	Statistics NZ	Companies	MSD	Health & Safety	Justice
Business contact details	Registration[1]	Registration[1]	Annual Enterprise survey[5]	Registration[1a] Annual return[5a]		Incident investigation[6]	
Owner information	Tax return[5]	Registration[1]	Annual Enterprise survey[5]	Registration[1a] Annual return[5a]		Incident investigation[6]	
Turnover		Registration[1]	Annual Enterprise survey[5]				
Employee details	On employment[1]	Registration[1]	Annual Enterprise survey[5]		Start & finish dates[1]	Incident investigation[6]	Garnishing wages[6]
Wages	Payroll[2] Student Loans[2] Child Support [2]	When employees go on ACC[6]	Annual Enterprise survey[5]		When employees leave and go on a benefit[1]		Garnishing wages[2]
Tax	Tax returns[6] GST[3] PAYE[2] FBT[4/5] WHT[2] Student Loans[2] KiwiSaver[2] Child Support[2]	-					PAYE when Garnishing wages[2]
Others			Accommodation survey[2b] Manufacturing survey[4b]		Super payments, other income[1]		
ANZSIC		Registration[1]	Annual Enterprise survey[5]			Incident investigation[6]	

Frequency:

1. Once only
2. Monthly
3. Two or six-monthly
4. Quarterly
5. Annually
6. As required

Business Type:

a. Companies and partnerships only
b. Sector-specific only

7.5 To improve the efficiency in transactions between business and the government, one option for information sharing would be a co-ordinated, minimised, verified, secure and up-to-date electronic collection and storage system for core business information. This system might include elements such as:

- a single point of entry for business and government departments to all government services and interactions;
- greater information sharing between government agencies to prevent repeat information requests, brought about by improving compatibility between IT systems;

- "pre-population"[14] of forms after businesses provide their core information to the government;
- online completion of necessary business-government interactions;
- online alerts for upcoming information/filing requirements;
- personal log-ons that allow businesses to access all personal information held by government; and
- using business reporting protocols (Standard Business Reporting).

7.6 Submissions on what features might be considered necessary in an electronic information sharing system are welcomed.

7.7 It is acknowledged that certain legislation, such as the secrecy provisions contained in section 81 of the Tax Administration Act 1994 and the Privacy Act, are there to protect and ensure the confidentiality required by taxpayers and citizens in general. It is critical that any system intended to maximise the efficiency of government transactions with taxpayers does not compromise these rights.

Initiatives to effect compliance cost reductions and information sharing

7.8 Some recent or current information sharing initiatives are:

- The Ministry of Economic Development, in conjunction with Inland Revenue, ACC and Statistics New Zealand, is preparing a report on Standard Business Reporting in New Zealand, investigating the feasibility of developing a centralised repository for duplicated business information, with the need for taxpayer confidentiality in mind.
- Information sharing between the New Zealand Companies Office (NZCO) and Inland Revenue means the allocation of a tax number and GST registration can now occur simultaneously with online company incorporation.
- The 2006 Australian and New Zealand Standard Industrial Classification (ANZSIC) provides a framework for grouping companies by industrial classification and contains information on a company's "main business activity". This information could be stored and shared for statistical research, policy and analysis purposes by both the public and private sectors as a "real time" snapshot of the business activities of New Zealand firms at any time. This has the potential to reduce some of the survey burdens on business.

[14] The automatic generation of completed or partially completed information in an electronic form from previously supplied information.

- The State Services Commission (SSC) is enforcing standards across all government websites to aid accessibility and information sharing. SSC aims to have all government transactions online by 2010, and has begun implementing the Government Logon Service, which will enable users to adopt the same log-on to access all central government sites.

Planned or possible future initiatives

7.9 Initiatives currently underway or planned include:

- Future collaboration with the Companies Office so that Inland Revenue will be able to access real-time NZCO data updates to find out contemporaneously when a company has gone out of business. Start-up firms will also be able to register for PAYE at the point of incorporation.
- Work investigating the appropriateness and feasibility of implementing a Standard Business Reporting system is being undertaken. This would enable a business's financial data to be posted once and then drawn down as required by government agencies.
- Making the business.govt.nz portal (launched in August 2007) the sole entry point for businesses seeking to interact with government.
- Enabling businesses to provide commonly sought data (such as the number of employees, physical address and changes of address) only once to government, with all agencies advised of this information and subsequent forms being pre-populated for the business.

Special submission points

The government is interested in receiving submissions on the following matters:

- How significant a concern for business is the current lack of information sharing, and to what extent would dealing with those concerns reduce the compliance burden for businesses?
- What information, in particular, should be shared across government departments? What information should specifically not be shared?
- Are there any initiatives described in this chapter that stand out as being of immediate importance?
- If a centralised data system were to be developed, what specific concerns would there be regarding taxpayer confidentiality?

CHAPTER 8

Other matters

8.1 In addition to the changes suggested in this discussion document, the government is looking at a number of other ways to reduce the amount of time that businesses must spend on dealing with their tax obligations.

Use-of-money interest

8.2 The government is reviewing the existing use-of-money interest rate-setting methodology as a result of concerns raised by taxpayers over its appropriateness and sustainability. Decisions are expected on this in 2008.

Making better use of technology

8.3 In developing tax policy, one of the factors taken into account is the effect a proposal is likely to have on the compliance costs of taxpayers. Inevitably, some proposals will increase compliance costs for businesses, although government makes every effort to minimise these costs. For example, to minimise compliance costs associated with KiwiSaver, the scheme is administered through Inland Revenue, thus ensuring that many of the costs of running employee superannuation schemes are borne by the government. KiwiSaver was also designed to work within existing systems, and the KiwiSaver rules use concepts and definitions that are already used in tax law.

8.4 Better ways of using technology can also help to reduce compliance costs. In this respect Inland Revenue is constantly looking at ways to improve its systems – by promoting electronic filing of returns and providing online calculators.

8.5 Some of the issues raised in this chapter concern areas where systems could in future be redesigned to reduce compliance costs (bearing in mind redesigning systems is time-consuming and costly). Views are sought on what measures should be prioritised for future change.

Employer monthly schedules

8.6 Some recent tax changes, such as KiwiSaver, have been implemented using the employer monthly schedule (EMS). The EMS is the form which is completed by an employer or PAYE intermediary monthly (or, in the case of a larger employer, twice-monthly) setting out the gross earnings of employees and the deductions made from those earnings. This includes PAYE, withholding tax deductions, child support and student loan deductions, KiwiSaver deductions and KiwiSaver employer contributions.

8.7 Reducing the compliance costs associated with the EMS – for example, by creating a more user-friendly form that is better able to interface with payroll systems, would require a redesign of Inland Revenue's systems and, in particular, the IT systems used for processing PAYE and KiwiSaver.

8.8 Redesigning systems is a lengthy process. Inland Revenue has undertaken some initial analysis which suggests that any redesigned system would benefit from the following features:

- an electronic interface over the internet;
- systems support;
- filing and payment services;
- "real-time" processing of information;
- a two-way exchange of information between employers and Inland Revenue;
- tailoring of services to support employers' circumstances; and
- use of Standard Business Reporting to support system-to-system filing and payment services.

8.9 Before a project of this nature could be undertaken, Inland Revenue would work alongside businesses to understand how they produce information and how systems should be redesigned to work smoothly with existing business processes.

8.10 In the longer term, systems would be designed so that all taxpayers could file EMS schedules and other returns electronically. If Inland Revenue systems are designed to integrate electronically with employers' payroll systems, and with payroll processing firms' systems, compliance costs could be significantly reduced because taxpayers would no longer be required to transfer data from one system to another. In the meantime, some costs could be reduced by redesigning existing paper-based processes so they fit better with information produced by employers' payroll systems.

Personal tax summaries

8.11 A personal tax summary (PTS) shows salary or wage earners their income and tax deduction details for the year. These details are based on the employment, New Zealand superannuation or benefit information provided to Inland Revenue each month. Inland Revenue automatically issues a PTS to some taxpayers (for example, because they have used an incorrect tax code) in June or July each year. Other taxpayers may request a PTS.

8.12 One of the matters raised during initial consultations was whether interest and dividend income and the resident withholding tax deducted from that income could be included in PTS. This could be achieved, for example, by requiring corporates to file dividend statements electronically and then linking this information to the PTS.

8.13 Making this change would require major changes to Inland Revenue's systems and would be more likely to benefit individual taxpayers rather than SMEs more generally. In addition, requiring corporates to file their dividend statements electronically could result in an increase in compliance costs for this group, which would need to be balanced with the compliance cost savings of other taxpayers such as SMEs.

Cash-basis accounting for tax purposes

8.14 Consideration has been given to the possibility of allowing small taxpayers to use cash-basis accounting for income tax purposes in order to reduce the number of adjustments required when preparing an income tax return. However, because of tax-base risks, concerns over the potential fiscal cost of this measure and significant transitional and boundary issues, such a change is not proposed at this stage. Submissions on this matter, along with ways of addressing tax-base risks and fiscal costs are, however, welcome if this change would substantially reduce business tax compliance costs.

Accrual adjustments to tax deductible expenditure

8.15 Expenditure that is deductible for income tax purposes must generally be adjusted for accruals that exist at the end of the income year. Determination E11 specifies certain circumstances where accrual expenditure adjustments are not required for income tax purposes.[15]

8.16 There are three components to Determination E11:

- a description of expenditure potentially exempted from the prepayments provisions;
- details of a maximum amount of the applicable accrual, if the exemption is to be available; and
- details of a maximum term for some applicable expenses, if the exemption is to be available.

8.17 Submissions on possible changes that could be made by the Commissioner to this determination are welcome if the changes would substantially reduce tax compliance costs without raising tax-base concerns.

Depreciation rules

8.18 In recent years, following a comprehensive review of the depreciation rules, the government has made a number of improvements to these rules. Among these changes was an increase to the low-value asset write-off threshold, which served to reduce the number of assets that are required to be capitalised and depreciated for income tax purposes, thereby reducing compliance costs in this area.

[15] *Tax Information Bulletin*, Vol. 16, No. 3, April 2004.

8.19 Given that a comprehensive review of depreciation has already recently taken place, and that the fiscal cost of changes in this area are generally high relative to the marginal compliance cost saving opportunities, the government does not consider further changes in this area are warranted at this time.

APPENDIX

SME measures in other countries

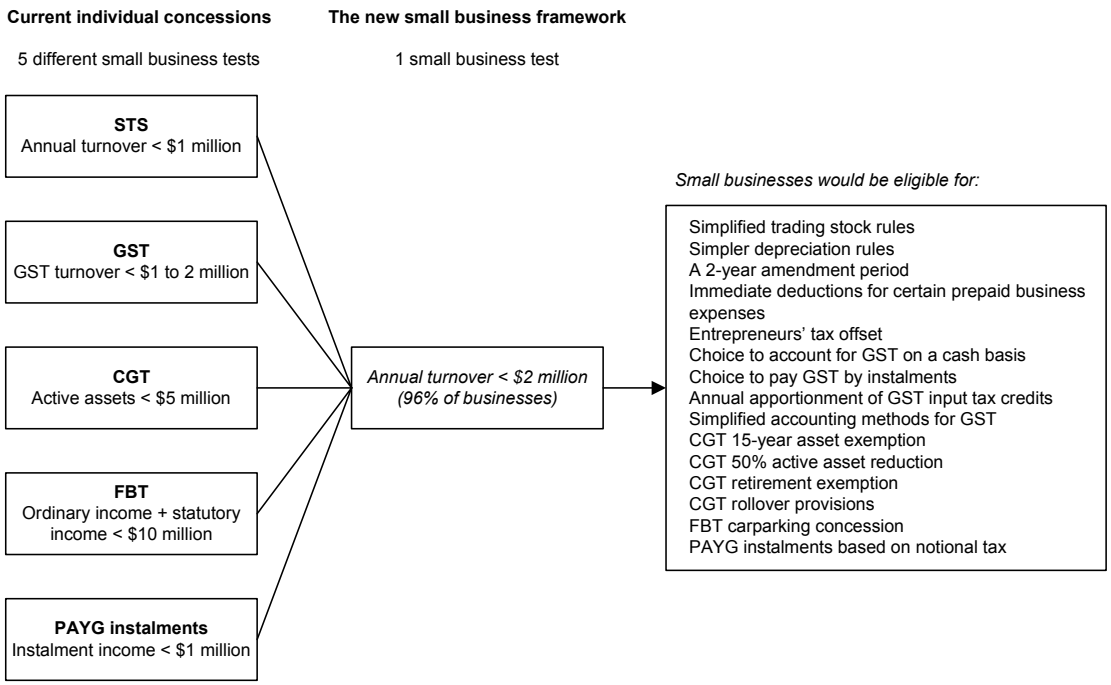
Australia

Australia operates a simplified taxation system (STS) for smaller businesses that meet certain requirements. Under this system, eligible businesses have simplified requirements for tax purposes, such as the ability to:

- calculate certain income and deductions on a receipts or payments basis;
- immediately expense depreciating assets costing A$1,000 or less;
- use simplified tax depreciation rules for depreciating assets; and
- use simplified rules for calculating the value of closing trading stock.

The Australian government recently passed legislation to standardise the eligibility criteria for access to small business tax simplification concessions. Applying from 1 July 2007, these measures include the adoption of one definition for "small business" that enable a business with an annual turnover of less than $2 million to access the various small business concessions available for capital gains tax (CGT), pay as you go (PAYG) instalments, GST and FBT. Businesses meeting the $2 million annual turnover test can choose which concessions apply.

Australia's recent simplification package



Canada

In Canada, businesses must generally pay income tax in instalments and account for GST or harmonised sales tax (HST). Further, they are required to make deductions from employees' wages for income tax, pensions and employment insurance contributions, and remit these to the government.

In an effort to further reduce the tax compliance burden of small businesses, the 2007 Canadian Budget proposed to allow small businesses to reduce the number of tax remittances and filings they are required to make. The proposed measures include:

- introducing quarterly instalments of corporate income tax to replace monthly instalments for certain small companies;
- increasing the corporate income tax payable threshold (at or below which corporations may pay annually) to $3,000;
- increasing the average monthly withholdings threshold (below which businesses may be eligible to pay source deductions quarterly) to $3,000;
- increasing the taxable supplies threshold (at or below which businesses can annually file a GST/HST return) to $1.5 million; and
- increasing the net tax threshold (below which annual GST/HST return filers can remit the tax annually) to $3,000.

United Kingdom

The United Kingdom has recently completed measuring the administrative burden[16] of the tax system and percentage reduction targets have been set to reduce this by up to 15 percent over five years. The United Kingdom has also increased the VAT registration threshold, reducing the number of taxpayers required to file. There are a number of methods by which VAT can be returned to ease compliance and match the nature of a taxpayer's business (for example, a cash or payments-basis method). In addition, a rewrite of the United Kingdom tax legislation into clearer, simpler language has been largely completed.

United States

The United States Internal Revenue Service provides a website for small business and the self-employed, which brings together helpful tax-related information in relation to starting, operating, and ceasing a business. The United States has also for some time been looking to reduce the burden of tax administration. Since 2006, certain employers can file their employment tax returns annually and pay the taxes with their returns. Further, in November 2005, the President's Tax Advisory Panel recommended two tax reform plans. These plans for small business included simplified cash-basis accounting or business cash-flow tax and the immediate expensing of certain business assets.

[16] Comprising activities such as: return, application, and form filing and other interactions with HM Revenue & Customs such as audit activities.