

MAKING TAX SIMPLER

BETTER ADMINISTRATION OF INDIVIDUALS' INCOME TAX-

SUMMARY OF FEEDBACK



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MINISTER OF REVENUE

A summary of the feedback on the *better administration of individual's income tax* public consultation

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An officials' issues paper

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CHAPTER 1

INTRODUCTION

In June 2017, the Government released the eighth document in a series of discussion documents consulting on the Government's proposals for modernising and simplifying tax and social policy administration in New Zealand.

The eighth consultation, Making Tax Simpler: Better administration of individuals' income tax (the discussion document), contained proposals on how individuals' year-end income tax return filing obligations could be simpler and more certain. It also contained proposals for in-year actions that Inland Revenue could take to reduce the number of people who face unexpected tax bills at the end of a year, or have to wait until the end of the year to claim a refund. It had further proposals on donations tax credits and direct crediting refunds.

An online forum at makingtaxsimpler.ird.govt.nz provided another opportunity for the public to provide feedback on the proposals. This online forum was hosted to encourage responses from a wide audience. A targeted survey was also conducted to elicit feedback on specific questions

from a group of people who would be affected by the proposals, but would not otherwise have made submissions. This survey was also translated into other languages and available on the Making Tax Simpler website.

The consultation generated 25 email submissions, 104 comments on the online forums, 96 responses to the survey and 10 responses to the foreign language surveys.

This document summarises the main themes from all of these avenues of consultation. The comments quoted are representative examples of the comments received and are quoted as supplied, apart from the correction of typographical errors.

Submitters tended to be positive about the in-year proposals, under which Inland Revenue would make use of the better, timelier information from withholding tax payers. The objective of these proposals was to avoid individuals unnecessarily ending up with a large tax bill or refund. The discussion document proposed Inland Revenue take proactive action when the information projected that this would occur.



Most submitters commented on the year-end proposals for the filing (or non-filing) obligations of individuals. The key theme coming through from the law and accounting firms was that they thought individuals should be required to confirm a tax statement before being issued a refund or required to pay tax. Conversely, submissions from individuals tended to support not needing to confirm a statement.



CHAPTER 2

PROPOSALS FOR IN-YEAR CHANGES

The discussion document set out a number of proposals about actions that Inland Revenue should take during the tax year. These centred on how Inland Revenue should utilise information it will receive during the year to ensure that the right amount of tax was being withheld. Inland Revenue already conducts a proactive actions process, and these proposals looked to update that process.

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

end-of-year reporting obligations could be simplified for individuals that earn certain types of income.

The recommended updates to the proactive actions process were based on Inland Revenue making use of the better, timelier information which the Act requires withholders to provide. The proposals would see Inland Revenue taking action when the information it held projected that an individual was going to unnecessarily end up with a large tax bill or refund.

The proposals can largely be achieved through changes to Inland Revenue’s operational practices, with only some minor legislative changes required to support them.

Inland Revenue to instruct a withholding tax payer to alter a withholding tax rate (assuming the individual does not respond to Inland Revenue)

Where individuals are using the wrong tax code, Inland Revenue already contacts employers and requests that the code is changed. An individual might use a tax code (with their employer) or tax rate (e.g. with their bank) that is not incorrect per se, but will not match their end-of-year tax liability.

The discussion document proposed that where Inland Revenue observed that an individual was using a tax rate that did not approximate their likely end-of-year tax liability, it would notify the individual that the tax rate did not match their likely end-of-year tax liability. If no response was received, Inland Revenue would instruct the payer (e.g. a bank) to change the tax rate being used. This would ensure that the individual did not have to wait until the end of the year for a refund, or that they would not receive an often unexpected tax bill at the end of the year. Inland Revenue would notify the individual that the payer had been instructed to change the rate.

Submitters generally supported Inland Revenue making use of the additional PAYE and investment income information to correct mistakes (in tax codes or rates) at an earlier stage, subject to concerns about how often payers might be instructed to make changes, how long the individual would be given to respond, and the likelihood of the instructions to payers being accurate.

"It is logical and sensible that Inland Revenue notify the individual that the withholding rate being used is not consistent with their expected marginal tax rate."

"No... this will place additional compliance costs on the payer in receiving, applying and retaining records."

"We are concerned that if Inland Revenue acts sooner to correct mistakes during the year, this action could lead to many corrections of small mistakes, which could potentially net out over the course of the year."

Modernising the special tax code process

A special tax code is one which is tailored to an individual's expected circumstances. The individual's employer can use the special tax code in lieu of a standard or secondary tax code. Individuals currently have to apply to Inland Revenue for a special tax code. They fill out a special tax code application and post it to Inland Revenue. Inland Revenue calculates an appropriate tax rate to be used and issues a special tax code certificate to the individual. The individual then has to advise their employer that they want the special tax code applied to their income. A special tax code is only valid until the end of the tax year. Each individual who receives a special tax code certificate also receives a personal tax summary to complete, or is required to file an IR3 at the end of the year. The discussion document contained the following three proposals for special tax codes:

Introducing an online application process

Submissions were positive about this proposal.

“Individuals should be able to apply for a special rate certificate online. Currently taxpayers must post their applications to Inland Revenue and phone Inland Revenue if they wish to track the progress of the application. This is particularly inefficient.”

“The process of applying for one must be easily carried out.”

Inland Revenue to send the special tax code to the individual’s employer at the same time as sending it to the individual (to save the individual having to pass it on)

Submissions were almost universally in favour of this proposal.

“It would allow employers to respond quickly and change the individual’s tax rate.”

“Where an individual does choose to apply and adopt a special tax code, we agree that Inland Revenue should inform the employer of the special tax code.”

“There seems no reason not to tell them, after all why has the taxpayer applied for the special code if not to amend the amount of tax deducted at source?”

“Inland Revenue should instruct the payer to change a withholding tax rate if the individual does not respond to Inland Revenue, provided the individual is first given a reasonable amount of time to respond, and provided the

individual is notified that Inland Revenue instructed the payer to change the rate.”

Inland Revenue to proactively recommend special tax codes to individuals

An example of when Inland Revenue would be able to tell that a special tax code could be useful is if secondary income resulted in an income tax threshold being crossed. In this case, an individual who remained on the secondary tax code would have more tax withheld than is necessary during the year.

Submitters agreed with the discussion document that Inland Revenue should not insist on an individual changing to a special tax code, as the individual could still be in the best position to determine their expected income for the year.

One submitter questioned the compliance cost this could cause for employers. One asked whether the individual would be held liable for any underpayment of tax if the special tax code ended up being too low to meet their year-end tax liability.

Most submitters who commented on this proposal thought that Inland Revenue should only inform the individual, not the employer as well.

“An individual will be in a better place to determine whether they need a special tax code than IRD. Suggesting a special tax code should be enough to prompt the individual to turn their mind to whether or not they would benefit from using one.”

“A suggestion to use them is far better than a requirement especially when the situation could change next month.”

“IR cannot insist as they are basing the decision on the information supplied to them, an individual should have a better understanding of their full personal position for the year so the decision to apply and/or use a special tax code must rest with them.”

“Inland Revenue should just tell the individual, not the employer. If the employee decides not to proceed with the special tax code, they shouldn't be placed into a position where they feel obliged to give an explanation to their employer regarding why IRD have contacted the employer and why they (the employee) are not proceeding with the special tax code.”

Donations tax credits

In order to claim a credit for a qualifying donation an individual currently needs to file a tax credit claim form (an IR526) with copies of receipts for the donations¹. This is a paper form, and paper versions of the receipts must also be submitted.

The discussion document proposed that people should be able to submit copies of their receipts during the year, and electronically if they chose. This would include scanning or photographing a receipt.

Submitters supported the proposal, noting that this reduces the risk of people forgetting to submit receipts or losing their receipts before they are able to submit them. Submitters

also supported the ability to submit receipts electronically.

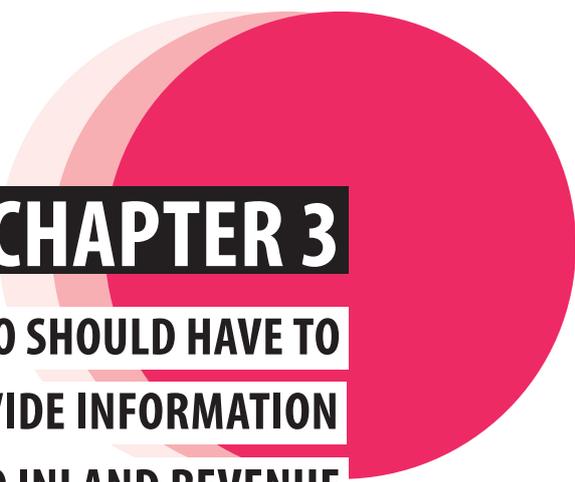
“I fully support the proposal for individuals to be able to upload copies of donations receipts to myIR during the year. I find that when the end of year process comes around I forget where I put paper copies of donation receipts I received during the year.”

“I am also finding that some charities are no longer sending me paper receipts but instead email through the receipt, either as an attachment or as part of the email. It would be useful to be able to somehow forward or attached these emails to my secure account.”

A small number of submitters did not see any need to allow receipts to be submitted during the year.

“I would suggest that all taxpayers need to have a sense of accountability, and be proactive in what they do and don't do. Getting the IRD to store documents on behalf of the taxpayer in case you forget is not what the IRD do, nor what they are there for.”

¹ Unless the donation is made through the Payroll Giving scheme.



CHAPTER 3

WHO SHOULD HAVE TO PROVIDE INFORMATION TO INLAND REVENUE

The current rules which set out which individuals are required to file year-end tax returns are quite complex and can be difficult for individuals to understand. In order to know whether it is necessary to file a return, an individual must consider all of their income sources, the tax rates that were applied to them, and whether the tax was withheld at either the correct rate, or close enough. Some individuals are simply unaware that they need to provide any information to Inland Revenue. A person who is required to file an income tax return must square up any over-or under-payments, whereas a person who is not required to file a return is not.

The discussion document set out two main options about which individuals should have to provide information to Inland Revenue at the end of a tax year. These were:

The “improved status quo”

Under this approach individuals who only earned income through withholding tax systems would be required to complete a personal tax summary if they had more than \$200 of income which was not taxed, or was taxed incorrectly.

Inland Revenue would issue more personal tax summaries than it currently does to individuals for them to confirm or complete. The increased number would be as a result of including interest, dividend and Māori authority distributions. If the individual was not required to complete a personal tax summary, they could choose to if they wanted to receive a refund or pay tax.

The “alternative approach”

Under this approach individuals who only earned income through withholding tax systems would not have to provide any year-end income information to Inland Revenue. Inland Revenue would calculate the difference between the tax that was paid during the year and the individual's tax liability. The individual could choose to confirm their statement, but if they did not Inland Revenue would automatically issue refunds or request payments of amounts over certain thresholds. This approach would separate the requirement for an individual to provide information about their income to Inland Revenue from the question of whether their tax position should be squared up.

The majority of submitters commented on these proposals. Their submissions were relatively evenly split between supporting the “alternative approach” (these tended to be submissions from individuals), and proposing a variation on the alternative approach, which would require individuals to confirm their tax position before an assessment is finalised (“an interaction approach”) (these tended to be submissions from professional firms). The discussion document expressly noted that an interaction approach had been ruled out by the Government.

Submitters who supported the “alternative approach” noted that it would impose the lowest cost on individual taxpayers. They also did not believe it would be practical to require all individuals to interact with Inland Revenue. Submitters tended to agree with the proposition that individuals who only earn income that has already been reported to Inland Revenue by a withholding tax payer should not have to provide year-end information about that income.

“As one of the group used as an example in your presentation, a person with State pension and a modest income from investments, I approve the proposed changes to the tax rules to simplify the end of the year tax ‘round up’.”

We do not believe it would be practical to require all individuals to interact with Inland Revenue, and we would have concerns about the ability of individuals without access to the internet or not proficient in technology to satisfy their obligations.”

“I completely agree with this suggestion. Once systems are in place to collect the dividend and interest information, it would be simple for Inland Revenue to calculate a customer’s refund or bill. This proposal would save both Inland Revenue’s time and customer’s time.”

“With proper execution, it should result in reduced costs and stress; reduce the number of late filers; and allow people who are not confident doing their own returns to avoid tax return companies.”

Submitters who proposed an interaction approach did so for the following reasons:

- To ensure the individual declares income which is not already included in their statement;
- To ensure that Inland Revenue can expressly prompt individuals about specific types of income they might have earned which is not already included in their statement;
- To protect the integrity of the tax system by requiring individuals to think about their tax position, which could also give them an understanding of the tax system and possibly also where the Government allocates money;
- To ensure that individuals were engaged with Inland Revenue, and that their awareness of tax was raised.

-
- *"I suggest that taxpayers have to confirm the assessment before the return is processed (which should be as simple as clicking a button confirming the return is correct)."*

"One of the key challenges for Inland Revenue under the alternative approach will be encouraging individuals to review the income information held by Inland Revenue and to take action if they have received income which has not been captured by Inland Revenue during the year."

"One possible option would be to send individuals a summary of their earnings and a series of targeted yes/no questions. This would act as a prompt to those individuals who seldom receive non-reportable income and it would ensure they are engaged in the process."

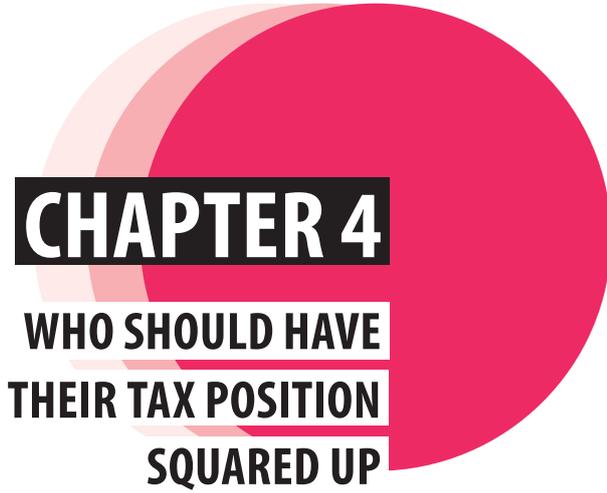
"Under the alternative approach, with no explicit year-end touch point with the tax system for individuals, there appears to be no opportunity for Inland Revenue to directly prompt those who may have derived income other than reportable income (i.e. "non-reported income"). This appears to be particularly problematic in the year in which a person first derives non-reported income (e.g. starts deriving rental income, invests in foreign shares, or receives a distribution from a trust)."

"We have concerns about what the alternative approach may mean for the integrity of the tax system as it effectively removes the need for individuals to think about their tax affairs."

"One of the problems of simplifying year-end tax obligations is that taxpayer engagement may reduce."

A further variation to the alternative approach was proposed by two submitters ("the withholding tax approach"). The submitters did not feel that using a simple monetary threshold to determine which amounts of tax needed to be paid was sufficient as individuals could end up with an amount of tax to pay larger than the threshold, even where the PAYE rules have been complied with. Individuals who only earned income through withholding tax systems and who had used the correct tax rates would not have to file returns, and Inland Revenue would automatically issue refunds.

"It seems hard to justify sending an unexpected tax bill to a wage earner who has done all that can be expected of them in terms of tax compliance. It could make June/July a worrying time for many households. While in most cases any tax bill might be small, even small unexpected bills can cause family hardship."



CHAPTER 4

WHO SHOULD HAVE THEIR TAX POSITION SQUARED UP

A person who is required to file an income tax return or a personal tax summary must square up any over-or under-payments, whereas a person who is not required to file does not need to, but can if they choose to. Under the “improved status quo” this would not alter. The discussion document sought feedback on which individuals’ should have their tax position squared up if the “alternative approach” was adopted. It suggested using a monetary threshold as the determinant of whether a square up was required.

Inland Revenue can currently refrain from collecting small amounts of tax owed (under \$20) or issuing small refunds (under \$5), and can refrain from making assessments for these amounts. This reflects the disproportionate costs collecting and paying small amounts can impose on Inland Revenue and individuals. Historically, the small refund threshold has taken into account the administrative cost of issuing a refund (usually the cost of posting a cheque), and the costs individuals incur to bank the cheque.

The other relevant threshold in the current law which permits individuals

to not pay some tax is the rule that individuals who only earn income from withholding tax regimes are not required to file a tax return if they (in addition to satisfying a number of other criteria) derive \$200 or less of certain types of income from which tax has not been withheld, or not withheld correctly. Depending on an individual’s marginal tax rate, this \$200 of income could equate to up to \$66 of tax that does not need to be paid.

Refunds

Most submitters thought that all refunds should be payable to customers, no matter how small.

“All direct credit refunds to a bank account should be issued to the customer regardless how small”

“All refunds should be paid out. It is the taxpayer’s money”

“There should be no threshold for paying refunds. All refunds should belong to the taxpayer”

“There should be no threshold for refunds. All refunds should be paid out to ensure the equability of the tax system.”

Some submitters felt that a small refund threshold should be retained, with either amounts under this threshold being written off, or carried forward as a credit for future years. Those who responded to the targeted survey thought the refund threshold should be anywhere between \$0 and \$200.

“Smaller refunds could be held as a credit towards any future debt and or accumulate until they reach the threshold point.”

“Small credit balances under say \$20 should be carried over to the next tax year.”

“There should definitely be a threshold for sending cheques out, but I think if we can't immediately issue such a small refund, it should be moved forward each year so it can be sent out with a larger refund or eventually be released when the customer's small refunds add up to exceed the threshold.”

Submitters tended to agree that a threshold should be retained for refunds issued by cheque.

“Yes there should be a threshold for small refunds if they are paid by cheque. It is not sensible to refund an amount that will be less than the fee charged by a bank for receiving a deposit.”

Tax to be paid

Most submitters thought the small balance threshold should be retained and suggested it be set at levels ranging from \$5 to \$1000.

Submitters thought the following factors should be taken into account:

- The costs for Inland Revenue to issue the request for payment,
- The cost for an individual to pay an amount;
- The cost of collecting a debt if the amount is not paid by the due date.

“The compliance costs involved for the individual to pay the debt. For most people, paying their debt is as simple as logging on to internet banking and shouldn't take more than a few minutes. For people who will only pay amounts in person by visiting the bank, the compliance cost is slightly higher. Therefore a threshold of around \$20 seems appropriate.”

“Inland Revenue's administrative costs, direct and indirect.”

“The costs associated to both parties in either making or receiving and administering the payment.”

Some suggested that all amounts should be payable, but sums below a threshold could be carried forward to future years and only payable at that later stage.

"A threshold of around \$20 sounds reasonable. If a taxpayer has a debt of less than \$20, it could be carried forward to the next tax year and offset against a refund (if any) due in that year."

"If an amount is outstanding it doesn't mean that collections activity needs to be undertaken. It can be retained in the system until the individual has a positive tax year which can be applied to the debt."

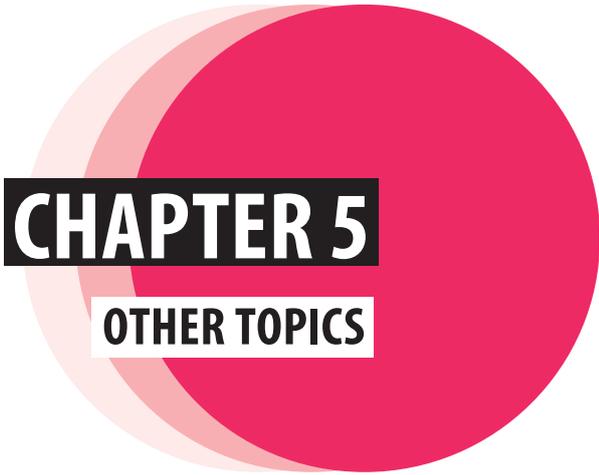
Two suggested that there should be no obligation for individuals to pay tax if the discrepancy arose from income they earned from withholding tax regimes (for example employment or interest income).

"If a person is only earning income that is taxed at source by an employer or bank for instance, it is the employer's responsibility for deducting the right amount of tax. If tax is owed at the end of the year, it is the employer at fault not the taxpayer therefore the employer should be the one that sorts it out. I realise we have a system where the individual has ultimate responsibility for their own affairs but in this instance that responsibility has been explicitly delegated to the employer and the employer has a legal duty to do it right. I don't believe any salary and wage earner should ever have a tax debt."

"With respect to end of year demands for tax from the Inland Revenue, this would seem a very unwelcome initiative. It seems hard to justify sending an unexpected tax bill to a wage earner who has done all that can be expected of them in terms of tax compliance. It could make June/July a worrying time for many households. While in most cases any tax bill might be small, even small unexpected bills can cause family hardship."

Some submitters noted that while a small amount should not be payable, an assessment should crystallise as this would mean all individuals would have a clear, and locked-in tax position.

"In the case where an amount is smaller than the threshold, the amount of tax withheld and paid to Inland Revenue should be treated as the individual's tax liability."



CHAPTER 5

OTHER TOPICS

After the end of the year

Two submitters commented on what happens after a tax position is finalised at year-end. One raised some questions on the details of this (which spans both the proposal in the discussion document and a proposal in a previous Making Tax Simpler discussion document, Proposals for Modernising the Tax Administration Act). They noted it would be helpful if the detailed points they raised could be clarified. The submitter also raised the relationship between self-correction and the disputes process.

The other submitter suggested that individuals who become aware that their tax return was incorrect after it is finalised are penalised for contacting Inland Revenue to correct the error.

Donations tax credits

In order to claim a credit for a qualifying donation an individual currently needs to file a tax credit claim form (an IR526) with copies of receipts for the donations. This is a paper form, and paper versions of the receipts must also be submitted.

Partial reincorporation of donations into tax form

The discussion document proposed partially reincorporating the donations tax credit claim into the year-end income tax process so that people would only need to fill out one form, rather than two separate forms. People could still claim their donations tax credits in a separate process to finalising their income tax if they chose to.

Submitters tended to support Inland Revenue adding a donations tax credit claim box into whichever year-end form individuals might be completing, whether in paper or online so that only one interaction would be needed.

“Definitely. The fewer forms the better.”

“We support the proposal to allow people to claim donations credits without having to fill in a separate form.”

“Yes [to combining the forms], although there has to be a system for those that do not have the access or ability to electronic means to file them.”

Submitters supported retaining the option to claim a donation tax credit in a separate process to income tax, noting for example that they used an accountant to help with their income tax but would not need their accountant to assist with their donations claim.

“My accountant does my IR3/10, but I do my own rebate return once those are processed. I do not want to have to hand them over to my accountant, I would prefer for them to stay separate so I can maintain independence with what is within my ability to do.”

One submitter questioned whether this would mean an individual’s income tax position might be finalised before they had an opportunity to submit donations receipts.

Donations/ charities issues not proposed in the discussion document

The inclusion in the discussion document of proposals on certain aspects of donations tax credits led some submitters to raising other donations tax credit, or charities points. These have been referred to Inland Revenue’s Charities Steering Group.

Submitters asked whether the Government had considered requiring (or allowing) donee organisations to provide information about their donors to Inland Revenue, so that individuals would not have to provide proof of their donations to Inland Revenue. They noted that if the donee organisations provided the information directly to Inland Revenue

this would reduce the compliance cost for donors in claiming their credits.

“...if an obligation was imposed on charitable organisations to report details of gifts received this would enable Inland Revenue to pre-populate the return with gift deduction related information.”

One submitter suggested that donors ought to be allowed to elect that their donation tax credit should instead be given to the donee organisation.

“Consideration should also be given to giving individuals the option of transferring their donation tax credit to the charity.”

Some submitters suggested that if receipts were submitted during the year, donations tax credits could be credited against income tax obligation at the same time, rather than at year-end. When donations are made through Payroll Giving, the credit is assigned in the current pay period. Donations made in any way other than Payroll Giving are not assigned until the end of the tax year.

“I’d like to move away from the idea that you look at all your donations for the year once and be more ‘real-time’ like [...] payroll giving.”

One submitter also objected to donations made to religious organisations qualifying for tax credits.

Another submitter suggested that all donations should be paid to Inland Revenue, who could then distribute the donations to the relevant charities.

Direct crediting refunds

The discussion document sought feedback on whether income tax refunds should be made only through direct credit into the taxpayer's nominated bank account, with exemptions being available in limited circumstances. In this context the tax type "income tax" would cover individual, as well as non-individual, income tax and include tax on individual, employment (PAYE), investment and business income, as well as special categories of income tax such as fringe benefit tax.

Submissions were almost all positive on this point.

"We agree that income tax refunds should be made only by direct credit, with exemptions available for undue hardship or circumstances where it is impracticable to refund through direct credit."

"Yes - most people have a bank account so there is little need to issue refunds via cheque."

"This will save time and money. But you'll always have to ensure there are more traditional ways people like my elderly Mum can collect their refunds/ pay their taxes."

One submitter questioned if this would also include foreign bank accounts.

"It is not clear whether direct crediting of refunds would be limited to New Zealand bank accounts only. In our view, there should be no distinction between a NZ and foreign bank account, for refund purposes, if the driver is to reduce processing times and compliance costs for taxpayers and administrative costs for Inland Revenue."

Another submitter noted that since Inland Revenue only issues a small proportion of refunds via cheque, cheques should continue to be issued, at least for the next couple of years.

There was also a suggestion that tax agents would prefer to receive cheques, as these could be returned if they spotted a problem with the amount.

"A lot of tax agents still like getting cheque refunds as if the refund is wrong, they can simply send the cheque back."