

# The Treasury

## Budget 2016 Information Release

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[§18(c)(i)]	that the making available of the information requested would be contrary to the provisions of a specified enactment [the Tax Administration Act 1994]	
[40]	Not in scope	

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) and section 18 of the Official Information Act.



## Tax policy report: **Small business tax measures**

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<b>Date:</b>	5 November 2015	<b>Priority:</b>	<b>High</b>
<b>Security Level:</b>		<b>Report No:</b>	T2015/2588 IR2015/624

## Action sought

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	Action Sought	Deadline
Minister of Finance	<b>Note</b> the contents of this report <b>Refer</b> a copy of this report to the Prime Minister	9 November 2015
Minister of Revenue	<b>Note</b> the contents of this report <b>Refer</b> a copy of this report to the Prime Minister	9 November 2015

## Contact for telephone discussion (if required)

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5 November 2015

Minister of Finance  
Minister of Revenue

## **Small business tax measures**

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You have asked officials to provide advice on tax measures to assist small businesses, for use by Ministers at their Ministerial Retreat at Premier House on Monday 9 November 2015.

This report contains this advice.

## **Recommended action**

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We recommend that you:

(a) **Note** the contents of this report.

Noted

Noted

(b) **Refer** a copy of this report to the Prime Minister.

Referred

Referred

**Matt Cowan**  
Senior Analyst  
Treasury

**Matt Benge**  
Chief Economist  
Policy and Strategy, Inland Revenue

**Hon Bill English**  
Minister of Finance

**Hon Todd McClay**  
Minister of Revenue

## Introduction

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1. You have asked officials to provide advice on tax measures to assist small businesses, for use by Ministers at their Ministerial Retreat at Premier House on Monday 9 November 2015.

## Framework

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2. Clear and coherent frameworks are very important for good tax policy. International tax reviews have cited the importance of deciding what it is a nation wants to tax and then doing so consistently.

3. New Zealand is very fortunate to have a clear and coherent broad-base, low-rate (BBLR) framework for taxation. Broad bases help ensure that taxes are fair and efficient and do as little as possible to impede economic growth. Broad bases also allow the government to collect the revenue that is necessary to fund its spending at as low rates as possible. This, in turn, provides a second-round benefit in promoting fairness, efficiency and growth.

4. This BBLR framework was introduced in the mid-1980s and has a lot of buy-in from the wider New Zealand public. Consistent reviews of taxation, including the McLeod Review in 2001 and the Tax Working Group in 2010 have suggested that there should be a high burden of proof before moving away from BBLR principles.

5. Leading tax practitioners with experience of tax policy reform in both Australia and New Zealand have commented on a very sharp difference between tax debates in Australia and New Zealand based on Australia's lack of a clear BBLR framework. They have warned that the lack of buy-in to a clear framework can create a corrosive tendency to undermine compliance. Clear frameworks also help the courts to determine what is and what is not tax avoidance.

6. Tax concessions for small businesses have the potential to undermine efficiency and growth by encouraging business activities to be undertaken by firms getting the biggest tax break rather than the firms which are intrinsically most efficient.

7. In New Zealand we have been fortunate that tax reform has not been about giving a set of tax breaks to one group and then attempting to match these with a similar set of tax breaks to another. Countries that do so can find that their tax systems quickly become incoherent and this promotes self-interested lobbying. Instead tax reform has been about applying a set of coherent tax principles as consistently as possible. It is important that any initial focus on small businesses, and subsequent focus on larger businesses, does not confuse this clear and coherent approach.

8. Tax concessions also do not take place in a vacuum. They can cost the government considerable revenue that has to be met by increasing tax on others in the community or cutting government spending.

9. At the same time, research shows that tax compliance costs are relatively high for small businesses. It is important to constantly ask whether these costs are excessive. In particular, for small businesses there is the question of whether close enough is good enough and whether there are ways of reducing compliance costs without providing tax concessions.

10. Measures to simplify tax rules often face a trade-off between the accuracy of the rules in question and reduced compliance costs. Where there is a simple tax measure that has a tax result that is close enough to the general rules we believe it is a worthwhile option to consider. We do not, for the reasons noted above, however, favour measures that offer incentives that do not fit within New Zealand's clear and coherent BBLR framework. It is through this lens that the following options have been considered.

## **Options for small businesses**

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11. The options canvassed in the appendices to this briefing note represent only a very initial consideration of a range of measures that could be considered for potential inclusion in Budget 2016. It has not been possible to fully cost all options in the time available. Some of the options that have been costed come at a considerable fiscal cost.

12. Fuller consideration and advice on all options that Ministers would like to consider further will be made by officials in a report to Ministers by the end of November. We will also begin consultation with MBIE on the options in that report.

13. A table containing the key aspects of all the measures considered can be found in Appendix 1. More detail on the BT measures is included in Appendix 2. In addition the following provides a very brief summary of all the options.

### **A. Business transformation (BT) – small business proposals**

14. There are a number of options to make tax easier for small businesses that have been considered as part of the business transformation programme. Some of these measures can be accelerated for announcement as part of Budget 2016. These measures are likely to result in significant compliance cost reductions for small businesses and, as such, are likely to have the greatest impact for such businesses.

15. There are other measures for small businesses that are being considered as part of the business transformation programme that we do not consider as candidates for acceleration. We recommend that these measures continue to be worked on for inclusion in a discussion document in 2016.

16. The BT options considered as part of this briefing note are as follows:

#### *Changes to provisional tax to increase certainty*

- A1. Non-individuals with less than \$50,000 residual income tax not required to pay use-of-money interest

- A2. Increasing the current \$50,000 residual income tax limit for use-of-money interest to \$60,000 (for individuals and non-individuals)
- A3. Removing use-of money interest for the first two provisional tax payments for all taxpayers who use the uplift method

*More timely payment of provisional tax*

[33]

- A5. Adopting an Accounting Income Method for paying provisional tax
- A6. Paying provisional tax on behalf of related parties

*Self-management and integrity*

- A7. Pay as you go for contractors- electing own withholding rate
- A8. Pay as you go for contractors - labour-hire firms
- A9. Voluntary withholding agreements

*Making system fairer*

- A10. Removal of incremental late payment penalties on tax payments

*Making markets work better through tax transparency*

- A11. Credit reporting of tax debt
- A12. Information sharing with the Registrar of Companies

*Changes in provisional tax to increase certainty (options A1-A3)*

17. These measures address concerns raised by small and large businesses that they are required to calculate their provisional tax payments and are being charged use-of-money interest when they get their calculation wrong even though they have taken due diligence in undertaking that calculation. While having periodic payments throughout the year is consistent with the principle that taxpayers should pay tax as they earn income, interest can penalise taxpayers for unforeseen events. These three proposals should result in more taxpayers being removed from the application of interest.

*More timely payment of provisional tax (options A4-A6)*

18. In general, we attempt to ensure that taxpayers pay tax as they earn their income. PAYE, RWT and schedular payments are examples of this principle. Provisional tax is an attempt to have those who don't have tax deducted at source to also pay tax as income is earned, although it starts with the presumption that income is earned evenly over the year.

19. This doesn't work for those who have seasonal or volatile incomes. [33]  
[33] A5 and A6 attempt to deal with seasonality and volatility by allowing taxpayers to pay on a more pay as you earn basis.

*Self-management and integrity (options A7-A9)*

20. These measures address concerns raised by some small businesses about difficulties with provisional tax and the appeal of a more 'pay as you go' approach to income tax. Options A7 and A9 give some small businesses greater flexibility to use the existing schedular payment withholding tax rules to self-manage their tax payments throughout the

year. Option A8 also addresses integrity concerns arising from recent audits of labour hire firms. These proposals pilot an approach that could subsequently be expanded further.

*Making system fairer (option A10)*

21. Over the course of their life, many businesses find themselves in debt with Inland Revenue. The late payment penalty proposal is to allow those businesses a chance to trade their way out of the debt, without having onerous financial penalties being continually imposed. This will shift the focus away from repaying penalties and towards repaying overdue tax.

*Making markets work better through tax transparency (options A11-A12)*

22. Currently Inland Revenue keeps its tax debt information secret, up until a business is insolvent and facing legal proceedings. The result is that other small businesses are unable to react in time and consequently are wound up as well. By making these businesses more aware of an indebted business' financial position, they will be able to take a more pro-active approach to their lending decisions, and have greater confidence that they are making the right decision.

23. Inland Revenue is aware of certain businesses that are operating well outside the law. The harm they cause to other businesses and the New Zealand community is significant; however Inland Revenue is required to keep their offending secret. The proposal to share certain information with the Registrar of Companies and the Companies Office will assist their efforts in prosecuting those companies and individuals that are damaging the New Zealand economy.

*Preliminary advice*

[33]

25. Introducing A1, A2 and A3 and not introducing A4 would come at a fiscal cost (revenue costing) of about \$54 million over 4 years. This is largely a one-off cost in the initial year. This is the costing that would impact on the Government's measured fiscal surplus. There would be a larger cash flow cost mainly because A3 is estimated as deferring \$334 million of cash flow from one fiscal year to the next, but this would not have an impact on the measured fiscal surplus.

26. Officials consider that if Ministers were willing to accept a fiscal cost of this magnitude, this package merits serious consideration.

## **B. Supplementary income tax simplifications**

27. The business transformation proposals could be supplemented with sensible supporting measures to simplify the income tax rules for small businesses.

28. We consider that there are possible changes to the [33] and fringe-benefit tax rules that could be made to simplify the income tax rules for small businesses while still maintaining New Zealand's BBLR tax framework. There are other threshold adjustments that could also possibly be considered but this has not been possible in the limited time available.

29. We have considered the following options for this briefing note:

[33]

B2. FBT simplification for closely-held companies

B3. Simplified calculation of deductions for vehicles and premises

[33]

30. More detail on these measures is contained in Appendix 3.

31. In submissions on the Governments Green Paper on Tax Administration it was noted that [33] and fringe-benefit tax were areas creating significant compliance costs for small businesses. However, as is discussed further below, there is a danger that these measures are not the best value for money because some of these measures are likely to have large fiscal costs and there has been no further consultation on these proposals. It is possible that these measures are not the highest priority for the private sector and that there are other measures with similar fiscal impacts that would have greater impact.

32. There are also a number of items in the tax policy work programme and business transformation that are actively being worked on that will also reduce tax compliance costs for small businesses. These include the work to provide better administration of PAYE and GST and the closely-held company review. These items could be included as part of any wider communications material.

## **C. Measures not consistent with current tax framework**

33. We have briefly considered the following three possible changes each of which we would see as inconsistent with the current tax framework.

C1. Reduced company tax rate for small businesses

C2. Accelerated depreciation for small businesses

C3. Turnover tax for small businesses

34. C1 and C2 are tax concessions for SMEs. These have the potential to reduce efficiency, productivity and growth. C3 is an intended simplification but would mean that small businesses were taxed on a very different basis from other businesses and would likely create some perverse incentives.

35. We would strongly counsel against these measures and instead recommend focusing on the other proposals which are within existing agreed frameworks, but also reduce compliance costs for small businesses.

36. More detail on these measures is in Appendix 4.

## **Fiscal impact**

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37. As previously noted, only a small subset of the total package of measures has been costed. The estimates discussed are therefore indicative, especially considering they are based on very conservative behavioural assumptions, and provide only a feel for the scale of the costs at this stage.

38. The fiscal impact of the measures covers both the revenue impact as well as the cashflow impact. For option A3 there is a significant difference between the two as it has a modest revenue impact and significant cashflow impact. The revenue impact is the more significant measure of the two and is the measure that affects the Government surplus.

## **Impacts on Inland Revenue's heritage systems**

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39. This report contains initial high level advice on the impact of the measures on Inland Revenue's heritage systems. This advice is indicative and further analysis will need to be completed before we can provide advice with greater confidence.

## **Consultation**

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40. Outside of the BT measures there has been limited consultation on taxpayers' views on such changes. As a result, it is possible that there may be other measures that would be of greater benefit to businesses and which come at a similar fiscal cost.

41. As a result, absent such consultation, there is a risk that these measures are not the highest priorities for the private sector. One way to mitigate this risk is for Budget 2016 to announce potential changes but invite submissions as to whether these measures are the highest priorities. However, this would present some challenges to manage for commencement dates commencing 1 April 2017.

42. MBIE have not been consulted on this briefing note. However, they will be consulted in the preparation of the report to Ministers for the end of November.

## Conclusion

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43. Maintaining a clear and coherent framework is very important for good tax policy. New Zealand is well served by its BBLR tax framework, and we would caution against measures that are inconsistent with this.

44. There are sensible measures available that would increase certainty and decrease compliance costs for small businesses while maintaining New Zealand's BBLR framework. We believe that the business transformation measures provide the greatest impact on small businesses while maintaining this framework. They are also, in some instances, likely to be well received by larger business as well. However, a package of measures that is welcomed by both smaller and larger businesses is likely to come at a significant fiscal cost. If this were acceptable to the Government, we consider that these measures are the best candidates for progression.

45. However, other measures including the supplementary tax simplifications come with some risks. Some of the measures are likely to have substantial fiscal costs, there has been no time for consultation, and some of them may not be viewed as high priorities by all businesses.

**Appendix 1: Summary table  
Business transformation measures**

	<i>Consistent with tax policy framework?</i>	<i>Positive for SMEs?</i>	<i>Positive for large businesses?</i>	<i>Fiscal cost/benefit to the Government</i>	<i>Do we recommend considering further?</i>
<i>A1: Non-individuals with less than \$50,000 residual income tax not required to pay use-of-money interest</i>	Yes	Positive	No impact	\$33m revenue and cashflow cost <sup>1</sup>	Yes
<i>A2. Increasing the current \$50,000 residual income tax limit for interest to \$60,000 (for individuals and non-individuals)</i>	Yes	Positive	No impact	\$14m additional revenue and cashflow cost above A1 (total cost of \$47 m) <sup>1</sup>	Yes
<i>A3: Removing use-of money interest for the first two provisional tax payments for all taxpayers who use the uplift method</i>	Yes	Positive	Positive	\$7.5m revenue cost <sup>1</sup> \$334m cashflow cost	Yes
[33]					
<i>A5. Adopting an accounting income method for paying provisional tax</i>	Yes	Positive	Likely negative reaction as not available to large businesses	Broadly neutral	Yes
<i>A6. Paying provisional tax on behalf of related parties</i>	Yes	Positive	Positive for some	Broadly neutral	Yes
<i>A7. Pay as you go for contractors – electing own withholding rate</i>	Yes	Mixed	May have compliance impact	Broadly neutral	Yes
<i>A8. Pay as you go for contractors – labour hire firms</i>	Yes	Mixed	Compliance impact for some	Fiscal benefit	Yes
<i>A9. Pay as you go for contractors – voluntary withholding agreements</i>	Yes	Positive	Neutral	Neutral	Yes

<sup>1</sup> Fiscal costs are across four years

<i>A10. Removal of incremental late payment penalties on tax payments</i>	Yes	Positive	Largely neutral	\$65m revenue cost <sup>1</sup> .	Yes
<i>A11. Credit reporting of tax debt</i>	Yes	Positive	Positive	Likely fiscal benefit	Yes
<i>A12. Information sharing with the Registrar of Companies</i>	Yes	Positive	Positive	No impact	Yes

**Supplementary income tax simplifications**

	<i>Consistent with tax policy framework?</i>	<i>Positive for SMEs?</i>	<i>Positive for large businesses?</i>	<i>Fiscal cost/benefit to the Government</i>	<i>Do we recommend considering further?</i>
[33]					
<i>B2. FBT simplification for closely held companies</i>	Yes	Positive	No impact	Expected to be minimal depending on design	Yes
<i>B3. Simplified calculation of deductions for vehicles and premises</i>	Yes	Positive	No impact	Expected to be minimal depending on design	Yes
[33]					

**Measures not consistent with current tax framework**

	<i>Consistent with tax policy framework?</i>	<i>Positive for SMEs?</i>	<i>Positive for large businesses?</i>	<i>Fiscal cost/benefit to the Government</i>	<i>Do we recommend considering further?</i>
<i>C1. Reduced company tax rate for small businesses</i>	No	Positive	Likely negative reaction	Fiscal cost	No
<i>C2. Accelerated depreciation for small businesses</i>	No	Positive	Likely negative reaction	High fiscal cost	No
<i>C3. Replace income tax with turnover tax for small businesses</i>	No	Positive	No impact	If voluntary would have fiscal cost	No

## **A: BT business tax measures**

## Appendix 2: BT Business tax measures

### Changes to provisional tax to increase certainty

#### A1: Non-individuals with less than \$50,000 residual income tax not required to pay use-of-money interest

<b><i>Proposal</i></b>	Extend the safe-harbour threshold of \$50,000 residual income tax before use-of-money interest (UOMI) applies to non-individuals. UOMI would continue to apply to any unpaid tax after terminal tax date.
<b><i>Problem</i></b>	Too many taxpayers are exposed to UOMI and therefore incur costs and stress disproportionate to the benefits of more accurate tax payment.
<b><i>Who does this affect?</i></b>	Companies and other non-individuals who pay relatively small amounts of provisional tax by way of tax uplift. This would mainly affect SMEs. This would not affect companies who pay provisional tax by the estimation method.
<b><i>Pros</i></b>	Provides certainty to non-individual taxpayers who earn relatively small amounts of income over the application of UOMI.  This proposal would remove approximately 63,000 non-individuals from UOMI.
<b><i>Fiscal impact</i></b>	The approximate fiscal costs of the proposal across four years would be \$33 million in revenue and there would be a negative cashflow impact. <sup>2</sup>
<b><i>Constraints</i></b>	Requires modification to Inland Revenue's heritage systems.
<b><i>Potential application date</i></b>	1 April 2017

<sup>2</sup> Fiscal costs are across four years. Most of the cost is incurred in the first year with some provisional tax being deferred until the subsequent year. The reduction in use-of-money interest has been discounted, showing only that which is currently collected. It also assumes no increase in the current three instalments.

**A2: Increasing the current \$50,000 residual income tax limit for interest to \$60,000 (for individuals and non-individuals)**

<b><i>Proposal</i></b>	Increase the safe-harbour threshold of \$50,000 residual income tax before UOMI applies to \$60,000 residual income tax for both individuals and non-individuals.  This measure is an extension of the previous proposal ( <i>A1: Non-individuals with less than \$50,000 residual income tax not required to pay use-of-money interest</i> )
<b><i>Problem</i></b>	Currently the safe harbour threshold of \$50,000 residual income tax represents an income level of approximately \$180,000 for a small business taxpayer. This level may now be too low given the movement in incomes since the value was originally set.
<b><i>Who does this affect?</i></b>	Provisional taxpayers with an income level of around \$180,000, for an individual or trust and \$214,000 for a company
<b><i>Pros</i></b>	Provides certainty to taxpayers who earn relatively small amounts of income over the application of UOMI.  This option should remove an additional 4,000 individuals and non-individuals from UOMI (over and above the extension of the current threshold to non-individuals).
<b><i>Fiscal impact</i></b>	The approximate fiscal cost of the proposal across four years would be an additional \$14 million in reduced revenue and negative cashflow impact over the extension of the safe-harbour to non-individuals (total cost of \$47 million). <sup>3</sup>
<b><i>Constraints</i></b>	Requires modification to Inland Revenue's heritage systems
<b><i>Potential application date</i></b>	1 April 2017

<sup>3</sup> Fiscal costs are across four years as noted earlier.

**A3: Removing use-of money interest for the first two provisional tax payments for all taxpayers who use the uplift method**

<b><i>Proposal</i></b>	<p>Remove the application of UOMI from all taxpayers who use the uplift with UOMI only applying from the last instalment date until the terminal tax is paid.</p> <p>This proposal differs from proposals A1 and A2 in that UOMI would apply from the last instalment date (which occurs after a business' year end) whereas under A1 and A2 UOMI would only apply from the terminal tax date.</p> <p>This proposal is likely to be popular with larger businesses.</p>
<b><i>Problem</i></b>	<p>Taxpayers who use the uplift method base their provisional tax payments on previous year's tax liability. This provides the Government with a certain level of tax payments throughout the year. Removing these taxpayers from the risk of UOMI when that uplift amount is different from their actual liability reduces both the stress of attempting to estimate their income and also certainty of tax payments for the year.</p>
<b><i>Who does this affect?</i></b>	<p>All taxpayers who pay provisional tax by way of tax uplift, not estimation. Will affect both large and small taxpayers with most smaller taxpayers also being taken out of the application of interest through the increase in the safe harbour thresholds in proposals A1 and A2.</p>
<b><i>Pros</i></b>	<p>Provides certainty to taxpayers over the application of UOMI.</p> <p>Removes approximately 19,000 additional taxpayers from UOMI up to the last instalment date by increasing the current safe harbour to all taxpayers who use the uplift method.</p>
<b><i>Fiscal impact</i></b>	<p>The approximate fiscal costs of the proposal across four years would be a \$7.5 million<sup>4</sup> impact to revenue but a \$334 million negative cashflow impact<sup>5</sup>.</p>
<b><i>Constraints</i></b>	<p>Requires modification to Inland Revenue's heritage systems.</p>
<b><i>Potential application date</i></b>	<p>1 April 2017</p>

<sup>4</sup> Fiscal costs are across four years as noted earlier.

<sup>5</sup> Fiscal costs are across four years as noted earlier. The cash flow impact arises as amounts delayed until the third provisional instalment can cross June fiscal years for some taxpayers with late balance dates

[33]

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[33]

**A5: Adopting an Accounting Income Method (AIM) for paying provisional tax**

<b><i>Proposal</i></b>	Taxpayers use their accounting results to calculate their provisional tax and pay more regularly during the year.
<b><i>Problem</i></b>	For some taxpayers provisional tax payments are not well matched to the income stream of the business and are not integrated into the daily business practice.
<b><i>Who does this affect?</i></b>	Small to medium businesses.
<b><i>Pros</i></b>	Provisional tax payments more accurately match income as it is earned (i.e. pay as you go).
<b><i>Cons</i></b>	<p>Large businesses may be interested in using this method to calculate their provisional tax, especially when they have seasonal or volatile income. There may be some negative reaction from large businesses as they would be excluded from using this option.</p> <p>Note that development and costing work is on-going to identify a stable and robust payment calculation.</p>
<b><i>Fiscal impact</i></b>	Expected to be neutral
<b><i>Constraints</i></b>	<p>[25, 26] are working with Inland Revenue in a collaborative co-design approach assisting with practical implications, customer profiling and design implications ensuring their products can meet the requirements for this option to be viable. Software providers will also require changes to enable this method within their systems. That design process should align with the delivery timetable for GenTax.</p> <p>Large system changes are required to Inland Revenue's heritage systems which would restrict the application date until 1 April 2018 when the Gentax income tax module is operational.</p> <p>Large businesses have been excluded from AIM as they have bespoke accounting systems that may not produce results that are able to be standardised and verified. In addition the complexity of large businesses would not enable the calculation of tax payments at low compliance costs.</p>
<b><i>Potential application date</i></b>	1 April 2018

**A6: Paying provisional tax on behalf of related parties**

<b><i>Proposal</i></b>	<p>An entity could be used to make tax payments on behalf of closely related parties.</p> <p>It would need to be voluntary (with the exception of those using the AIM method where this would be compulsory to assist in the viability of the AIM method) as it would only be practical when the same person assumes responsibility for tax compliance for the entity and the owners/partners.</p> <p>A similar rule already allows trustees to pay provisional tax on beneficiary income on behalf of a beneficiary so this proposal is new in application but not in concept.</p>
<b><i>Problem</i></b>	Income may be earned in one entity but tax has to be paid by those who are then allocated the income, rather than the one head entity. This increases the numbers of entities in provisional tax.
<b><i>Who does this affect?</i></b>	Closely held companies and their shareholders, and partnerships and their partners, are the target group.
<b><i>Pros</i></b>	This could remove a number of taxpayers from the provisional tax rules, and remove companies from resident withholding tax obligations, lowering compliance costs for owners and partners.
<b><i>Cons</i></b>	<p>It may be difficult to determine the right rate of payment when owners and partners have other income, social policy obligations or tax losses.</p> <p>A number of taxing points are collapsed into a single taxing point. This is a risk if the entity is non-compliant.</p>
<b><i>Fiscal impact</i></b>	Expected to be neutral.
<b><i>Constraints</i></b>	The proposal would require changes to Inland Revenue's heritage systems.
<b><i>Potential application date</i></b>	1 April 2018

## Self-management and integrity

### A7: Electing own withholding rate

<b><i>Proposal</i></b>	Allowing contractors subject to the schedular payment withholding rules to choose their own rate of withholding (with a minimum rate of 10%).
<b><i>Problem</i></b>	<p>When a contractor is subject to withholding they have a flat rate of withholding apply to payments made to them.</p> <p>In many cases this rate will not accurately match the taxpayer's actual income tax liability.</p> <p>Taxpayers can apply for a special tax code to alter their rate; however, this requires providing an application and information to Inland Revenue to demonstrate why a different rate is appropriate.</p>
<b><i>Who does this affect?</i></b>	<p>Small businesses and contractors subject to the schedular payment withholding rules. These businesses and contractors will have an easier means to choose a more accurate withholding rate.</p> <p>Payers of these contractors will have to apply the specific rates received from contractors – this may have a compliance cost. To the extent that a payer cannot accommodate a different rate (e.g. system constraints) the current default rate could apply.</p>
<b><i>Pros</i></b>	This proposal enables contractors to select a withholding rate that better matches their income tax liability for the year. This is more consistent with a self-management system and a “pay as you go” principle.
<b><i>Cons</i></b>	<p>Increases compliance costs for some payers.</p> <p>Some contractors may deliberately pick an artificially low rate in order to avoid their obligations.</p>
<b><i>Fiscal impact</i></b>	Expected to be broadly neutral.
<b><i>Constraints</i></b>	<p>Payers may incur system costs, and this will include Government agencies.</p> <p>Contractors will need to determine an accurate rate.</p> <p>Non-resident contractors will retain their existing withholding rate of 15%. This is because these contractors have little connection with New Zealand and therefore pose a greater risk of non-compliance if the withholding rate is too low.</p> <p>Low impact on Inland Revenue's heritage systems.</p>
<b><i>Potential application date</i></b>	1 April 2017

**A8: Labour hire firms**

<b>Proposal</b>	<p>Extend withholding tax rules to contractors engaged through labour hire firms. This will mean labour hire firms are required to deduct tax from payments to the contractor.</p> <p>A labour hire firm is in the business of arranging workers to perform work or services directly for the clients of the labour hire firm.</p> <p>The proposed rules are:</p> <ul style="list-style-type: none"> <li>• A contractor who provides their IRD number can elect their rate of withholding;</li> <li>• A minimum rate of 10% (which also acts as the default rate if no other rate is specified by the contractor);</li> <li>• No company exemption – so withholding will apply to the contractor regardless of whether they operate as an individual or via a company;</li> <li>• A 45% non-declaration rate will apply if an IRD number is not provided.</li> </ul>
<b>Problem</b>	<p>The current withholding system has limited coverage and significant exemptions.</p> <p>We believe there are a number of contractors not subject to the withholding rules who are non-compliant with their tax obligations.</p> <p>These contractors can unfairly compete against other businesses. Their non-compliance also damages the integrity of the tax system and reduces tax revenue which forces other taxpayers to pay more to fund government services.</p> <p>[34, s18(c)(l)]</p>
<b>Who does this affect?</b>	<p>Contractors engaged through labour hire firms.</p> <p>Labour hire firms will be required to deduct withholding tax and pay to Inland Revenue along with reporting of the amounts paid and deducted.</p>
<b>Pros</b>	<p>A reduced number of contractors falling within the provisional tax rules (if they select an accurate rate). This would reduce the compliance costs of these contractors.</p> <p>Inland Revenue will have better information on the income of contractors operating through labour hire firms.</p> <p>Current work has identified compliance issues with this group of contractors – withholding and the accompanying better information will improve compliance.</p> <p>In addition there is an equity issue arising from the fact that many of these contractors appear very much like employees but because of the non-standard structure of the hiring relationship they are not subject to source deductions as their income is earned.</p> <p>The proposed change is similar to the treatment of labour hire arrangements in Australia, where the payments are subject to the equivalent of PAYE.</p>
<b>Cons</b>	<p>Labour hire firms will incur compliance costs. These costs could be significant for small and medium size labour hire firms.</p>

	<p>The proposal may introduce a market distortion by incentivizing contractors to engage directly with businesses rather than operating through labour hire firms.</p> <p>The withholding rules would be extended to a greater range of contractors but only those engaged through labour hire firms. It is possible that this measure could be avoided by some people through choosing to contract directly rather than through labour-hire firms. In the long term we recommend consideration of a wider expansion of the withholding rules to capture more contractors regardless of how they are engaged.</p>
<b><i>Fiscal impact</i></b>	<p>The fiscal impact of this measure relies on estimations of the hidden economy, and as a result is difficult to estimate. A conservative estimate shows a revenue benefit of \$5m - \$10m per annum.</p> <p>If this proposal is implemented, Inland Revenue would have better information about contractors in the hidden economy and therefore would enable better estimates of the fiscal impact of further proposals to extend withholding.</p>
<b><i>Constraints</i></b>	Low impact on Inland Revenue's heritage systems.
<b><i>Potential application date</i></b>	1 April 2017

**A9: Voluntary withholding agreements**

<b><i>Proposal</i></b>	Allowing contractors not subject to the schedular payment withholding rules to elect into withholding (if the payer agrees). If an accurate rate is selected the contractor may no longer be subject to the provisional tax rules. This model is used in Australia.
<b><i>Problem</i></b>	Withholding tax may be a preferred payment channel for some contractors, especially coupled with an option to choose the withholding rate applied.
<b><i>Who does this affect?</i></b>	Those not covered by the withholding rules that would prefer withholding to provisional tax.  Payers who may have to withhold when they currently do not – however the proposal is for mutual agreement for withholding to apply.
<b><i>Pros</i></b>	This proposal provides an option for contractors to elect into a “pay as you go” approach to paying their income tax and is consistent with self-management. If an accurate rate is chosen the contractor may no longer fall within the provisional tax rules.
<b><i>Cons</i></b>	This proposal is voluntary for both the contractor and payer. The voluntary nature reduces the impact on payers (as where they are concerned about compliance costs they can choose not to agree). However, this may mean that there will be situations where a contractor would like withholding but the payer refuses.
<b><i>Fiscal impact</i></b>	No impact
<b><i>Constraints</i></b>	Contractors will need to select an accurate rate to receive the full benefit (if the rate is too low provisional tax may still apply).  Low impact on Inland Revenue’s heritage systems.
<b><i>Potential application date</i></b>	1 April 2017

## Making system fairer

### A10: Removal of incremental late payment penalties on tax payments

<b><i>Proposal</i></b>	<p>[33] the removal of the monthly one per cent incremental late payment penalty, for provisional and terminal income tax, and GST.</p> <p>Use-of-money-interest will still apply to late payments.</p>
<b><i>Problem</i></b>	<p>[33] In the first year, the combined penalty and interest rate is approximately 27% per annum. This is high by international comparison and may deter some businesses from proactively resolving their tax debt. The automatic growth of financial penalties can frustrate businesses attempts to address their tax debt and move to being compliant in the future.</p> <p>Many businesses and media commentators have commented on Inland Revenue's penalty and interest regimes, and how they do not effectively encourage compliance once a business has fallen into debt.</p>
<b><i>Who does this affect?</i></b>	Those who do not pay their tax on time.
<b><i>Pros</i></b>	<p>Significant reduction in financial penalties imposed on small businesses by reducing the combined penalty and interest rate to approximately 15% per annum.</p> <p>By removing the continuous monthly financial penalties, the debt's growth is reduced, resulting in the business instead focusing on resolving their tax debt with Inland Revenue. Therefore the business will become voluntarily compliant sooner.</p> <p>Also, with less financial penalties being imposed, less tax debt will be required to be written off by Inland Revenue.</p>
<b><i>Fiscal impact</i></b>	There would be a negative revenue impact of approximately \$65 million <sup>7</sup> . While Inland Revenue imposes additional financial penalties, these are uncollected and are reversed, remitted or written off.
<b><i>Constraints</i></b>	<p>Medium system implications for Inland Revenue's heritage systems.</p> <p>[33]</p> <p>[33] Debt periods that arose prior to 1 April 2017 will continue to have the incremental late payment penalty regime apply to it. The proposal would only apply to new tax after that date that is unpaid.</p>
<b><i>Potential application date</i></b>	1 April 2017

<sup>7</sup> Fiscal costs are across four years as noted earlier.

## Making markets work better through tax transparency

### A11: Credit reporting of tax debt

<b><i>Problem</i></b>	<p>The existence of tax debt is currently protected by tax secrecy. Unlike commercial lenders and other government agencies, Inland Revenue does not disclose the identity of indebted taxpayers until legal proceedings are well under way.</p> <p>The lack of visibility means other businesses are completing their due diligence, including credit checks, and entering into commercial agreements based on incomplete information. These businesses tend to be unsecured creditors if the indebted business subsequently fails.</p> <p>Many businesses have commented that they continue to be frustrated that they are unaware of another business's credit worthiness, due to not being aware of potentially unpaid tax debt.</p>
<b><i>Proposal</i></b>	Inland Revenue would disclose some taxpayers' tax debt to credit reporting agencies. These measures would help to protect small businesses who are suppliers to businesses which are having problems paying tax.
<b><i>Who does this affect?</i></b>	Primarily those who supply labour, goods or services to failing businesses.
<b><i>Pros</i></b>	<p>A small business will know when a key customer or a key business partner is accruing significant tax debt or has stopped filing tax returns. This will allow the business to make decisions that are in its best interests, rather than being unaware until the indebted business is wound up.</p> <p>By providing this information, via credit reporting agencies, businesses are able to incorporate the information into their commercial decision making and make better business decisions, such as lending or other commercial arrangements, resulting in increased market efficiency.</p> <p>Businesses will be encouraged to file and pay their tax obligations.</p>
<b><i>Cons</i></b>	Due to the number of indebted business taxpayers that may have their tax information disclosed, and the technological nature of how the information would be exchanged there is risk that some taxpayer's information may be inadvertently released to the credit reporting agency. Officials understand that the established credit reporting agencies have significant experience in handling credit information and have robust policies and practices in place when information has been unintentionally released.
<b><i>Fiscal impact</i></b>	The fiscal impact of this measure is difficult to quantify but likely to be positive.
<b><i>Constraints</i></b>	The proposal may require some changes to Inland Revenue's heritage systems for information exchange between Inland Revenue and the credit reporting agencies
<b><i>Potential application date</i></b>	1 April 2017

**A12: Information Sharing with the Registrar of Companies**

<b><i>Proposal</i></b>	<p>Provide information to the Registrar of Companies to support any action being considered against a director.</p> <p>The proposal would contain similar safeguards and protections that feature alongside the existing information sharing agreements.</p>
<b><i>Problem</i></b>	<p>Inland Revenue holds information about serious offending being committed by directors. However, Inland Revenue must keep this information secret due to its tax secrecy rules<sup>9</sup>. This means that these non-compliant directors are able to continue to trade and continue to receive a commercial advantage over other compliant businesses. This offending causes serious harm to businesses and the New Zealand economy.</p>
<b><i>Who does this affect?</i></b>	<p>Primarily directors who engage in unlawful conduct as well as other compliant businesses negatively affected by the director's conduct.</p>
<b><i>Pros</i></b>	<p>These measures will help protect New Zealand's business community against businesses that seek to do harm. The sharing of this information would likely lead to an increase in non-compliant businesses being charged and prosecuted, and the harm they cause being reduced.</p> <p>In addition, these non-compliant businesses pose a risk to New Zealand's business community and New Zealand's reputation as a safe and renowned country in which to invest and do business.</p>
<b><i>Cons</i></b>	<p>Due to the information being released likely forming an important part of a criminal case against a director, the information will need to be true and correct, to the best of Inland Revenue knowledge. There is a significant reputation risk to Inland Revenue if the accuracy of the information changes over time.</p> <p>The disclosure of taxpayer specific information is based on an existing list of offences. This list may change in the future and Inland Revenue may be bound to release further information, in accordance with the law.</p>
<b><i>Fiscal impact</i></b>	<p>No impact</p>
<b><i>Constraints</i></b>	<p>The proposal may require changes to Inland Revenue's heritage systems.</p>
<b><i>Potential application date</i></b>	<p>1 April 2017</p>

<sup>9</sup> Currently Inland Revenue has an information sharing agreement with the New Zealand Police. However, this agreement relates only to offences that are punishable by imprisonment. Many of the offences targeted at businesses are not punishable by imprisonment and so this agreement will not apply.

## **B: Supplementary income tax simplifications**

### **Appendix 3: Options to simplify income tax for small businesses**

[33]

**B2: FBT simplification for closely held companies**

<b><i>Proposal</i></b>	Remove the requirement for closely held companies to register and pay FBT when the only benefit they provide is a motor vehicle and allow them to make a private use adjustment instead. This would be voluntary.
<b><i>Problem</i></b>	Currently small companies who have a single fringe benefit (usually a motor vehicle) provided to shareholder employees are required to register and pay FBT on that benefit. If the business were a sole trader or partnership a private use adjustment would be made to reduce deductions to the extent the vehicle was used for private use.
<b><i>Who does this affect?</i></b>	Closely held companies who provide a motor vehicle to shareholder employees are the target group.
<b><i>Pros</i></b>	Reduction in compliance costs to smaller businesses that fit the target group.
<b><i>Cons</i></b>	Definitional issues will be important to work through to ensure the proposal is not open for abuse.
<b><i>Fiscal impact</i></b>	This proposal still needs to be costed but it should have a reasonably neutral effect on revenue.
<b><i>Constraints</i></b>	No impacts on Inland Revenue's heritage systems.
<b><i>Potential application date</i></b>	1 April 2017

**B3: Simplified calculation of deductions for vehicles and premises**

<b><i>Proposal</i></b>	<p>Allow or require small businesses to use a simple method for calculating their deductions for use of premises or vehicles. For premises, this would be based on hours of use of premises. For example a deduction of \$X might be allowed if a home is used for 25-50 hours per month for business purposes and a larger deduction of \$Y if it is used, say, for 51-100 hours per month. This would be independent of actual expenses such as electricity bills or rates incurred.</p> <p>For vehicles this would be an extension of the current mileage system for the small business self-employed.</p>
<b><i>Problem</i></b>	To work out the allowable deductions for vehicles and premises, a business must calculate the actual deductions incurred and then apportion them according to their private and business use of the asset. This can be a time consuming exercise and impose large compliance costs.
<b><i>Who does this affect?</i></b>	<p>Small businesses would have reduced compliance costs.</p> <p>There are likely to be winners and losers as some businesses will have higher deductions and other lower deductions.</p>
<b><i>Pros</i></b>	Reduces the compliance costs for small businesses without lowering the average tax paid by small businesses. As a result, it would not be inconsistent with New Zealand's broad-base, low-rate framework.
<b><i>Cons</i></b>	Decreases the accuracy of deductions for vehicles and premises. This could blur the distinction between private and business expenditure and could result in people being able to deduct expenditure that is primarily private.
<b><i>Fiscal impact</i></b>	This proposal still needs to be costed but should have a reasonably neutral effect on revenue.
<b><i>Constraints</i></b>	For this measure to have compliance cost savings it would need to be compulsory. This is because if voluntary, businesses would likely calculate their depreciation deductions using both available methods and then choose the method that leads to a lower tax bill.
<b><i>Potential application date</i></b>	1 April 2017

[33]

## **C: Measures not consistent with current tax framework**

## Appendix 4: Measures not consistent with current tax framework

### C1: Reduced company tax rate for small businesses

<b>Option</b>	A lower company tax rate for small businesses
<b>Who does this affect?</b>	Small companies. Does not affect small business that are sole traders or who operate through trusts.
<b>Pros</b>	Makes small companies more competitive.
<b>Cons</b>	<p>This measure is not consistent with tax policy frameworks. It provides a significant tax concession for small companies inconsistent with New Zealand's broad-base low-rate system.</p> <p>This measure would only provide a reduced rate for companies. Small businesses operating as sole traders, or through partnerships or trusts would not be impacted. It would also create an incentive for small businesses to structure as companies or for large companies to split up into smaller companies. This would reduce the coherence of the tax system.</p> <p>This measure would increase the complexity and reduce the coherence of the company tax rules. It would create difficulties for companies who are on the boundary between small and large and the required transitional rules would likely be complex. It would also mean different rates of imputation credits for small and large businesses.</p> <p>The benefit of this concession would be washed out as a result of the imputation system when dividends are paid. Small businesses operating as companies are likely to quickly distribute earnings to their shareholders. As a result, this measure is unlikely to have significant effect for these businesses.</p> <p>A lower company tax rate for small businesses would create a disincentive for small companies to grow.</p> <p>This option could create a high effective marginal tax rate for companies that are moving out of the definition of small business. A company could find that as it earns more income, its after tax income decreases as its company rate goes up due to no longer being considered a small business.</p> <p>Large businesses may see the measure as inequitable and creating unfair competition</p>
<b>Fiscal impact</b>	Negative revenue impact
<b>Constraints</b>	Would have high impacts on Inland Revenue's heritage systems.
<b>Potential application date</b>	1 April 2018

**C2: Accelerated depreciation for small businesses**

<b><i>Option</i></b>	Allow small businesses to accelerate their depreciation deductions above the economic rate.
<b><i>Who does this affect?</i></b>	Small businesses would be positively impacted.
<b><i>Pros</i></b>	Reduces the cost of capital and encourages investment in machinery.
<b><i>Cons</i></b>	<p>This option is inconsistent with tax policy frameworks. It creates a significant tax advantage for small businesses and under-taxes businesses with depreciable assets. This option would also not decrease compliance costs.</p> <p>This option decreases economic efficiency as it creates an incentive for businesses to invest in depreciable assets over other investments</p> <p>The measure would be fiscally expensive. It would increase the complexity of the depreciation rules and therefore may increase compliance costs.</p> <p>This option would reverse the decision made as part of Budget 2010 to remove accelerated depreciation.</p> <p>Large businesses may see the measure as inequitable and creating unfair competition.</p>
<b><i>Fiscal impact</i></b>	High negative revenue impact
<b><i>Constraints</i></b>	Would have low impacts on Inland Revenue's heritage systems.
<b><i>Potential application date</i></b>	1 April 2017

**C3: Turnover tax for small businesses ([34] Proposal)**

<b>Option</b>	Income tax for small businesses is replaced with a turnover tax. [34] proposal was for a 7% rate for those dealing in goods and 14% for all other businesses).
<b>Who does this affect?</b>	If voluntary, small businesses would likely to be positively impacted. If the turnover tax was compulsory there would likely be winners and losers. Businesses with high margins would be winners and those with low margins likely to be losers.
<b>Pros</b>	Provides a significantly simpler method for calculating tax for small businesses.
<b>Cons</b>	<p>This measure is not consistent with tax policy frameworks. The measure creates a separate tax regime for small businesses which can result in small businesses being over or under taxed compared with other businesses.</p> <p>This arises because a business' turnover is not necessarily reflective of their net income. A turnover tax can result in over-taxing low margin businesses and under-taxing high-margin businesses.</p> <p>It is likely to lead to perverse incentives. For example because there would be no deduction for labour costs, it would discourage a small business from taking on staff. Instead possible staff would have incentives to form their own businesses instead.</p> <p>If the turnover tax was voluntary, it is likely that businesses would only choose to use it if it reduced their cost of taxation. This would likely decrease tax revenue. There may also be an increase in compliance costs as taxpayers try to calculate which system results in a reduced tax cost.</p> <p>This measure would increase the complexity and reduce the coherence of the income tax rules. It would create difficulties for businesses who are on the boundary between small and large and the required transitional rules would likely be complex.</p> <p>Several social policies are dependent on the current definition of income. Changing to a turnover tax would require that either businesses must also calculate their income for social policy purposes or require changing the calculation for these social policies to be based on turnover. This would increase compliance costs</p>
<b>Fiscal impact</b>	If voluntary, likely to be revenue negative.
<b>Constraints</b>	Would have high impacts on Inland Revenue's legacy FIRST system.
<b>Potential application date</b>	1 April 2018

# **Australian small business tax concessions**

**Appendix 5: Small business tax concessions currently available in Australia**

<b><i>Company tax rate</i></b>	Small businesses have a reduced company tax rate of 28.5% (30% for other companies).
<b><i>Depreciation</i></b>	<p>Small businesses can immediately write-off depreciable assets that are worth less than \$20,000 (From 1 July 2017, this will only apply to assets worth less than \$1,000).</p> <p>Small businesses can pool most other depreciating assets and depreciate them by a fixed rate.</p>
<b><i>Trading stock</i></b>	Small businesses can estimate the value of trading stock rather than require a stock-take in some circumstances.
<b><i>Fringe benefit tax</i></b>	Small businesses are exempt from FBT for car parks.
<b><i>Time-bar</i></b>	A two-year time bar for small businesses returns (i.e. the ATO cannot review a return two years after it was filed)
<b><i>GST</i></b>	<p>Small businesses can:</p> <ul style="list-style-type: none"> <li>• account for GST on a cash basis;</li> <li>• pay their GST by instalment; and</li> <li>• make a single adjustment at the end of the year on GST credits for items partly used for private purposes.</li> </ul>
<b><i>PAYG instalment (provisional tax)</i></b>	Small businesses can pay PAYG instalments according to an ATO calculation (rather than calculate themselves).

