

The Treasury

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[1]	to prevent prejudice to the security or defence of New Zealand or the international relations of the government	6(a)
[4]	to prevent prejudice to the maintenance of the law, including the prevention, investigation, and detection of offences, and the right to a fair trial	6(c)
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[33]	to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials	9(2)(f)(iv)
[34]	to maintain the effective conduct of public affairs through the free and frank expression of opinions	9(2)(g)(i)
[36]	to maintain legal professional privilege	9(2)(h)
[37]	to enable the Crown to carry out commercial activities without disadvantages or prejudice	9(2)(i)
[38]	to enable the Crown to negotiate without disadvantage or prejudice	9(2)(j)
[39]	to prevent the disclosure of official information for improper gain or improper advantage	9(2)(k)
[s18(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: Additional information on small business tax measures

Date:	27 November 2015	Priority:	High
Security Level:		Report No:	T2015/2800 IR2015/661

Action sought

	Action Sought	Deadline
Minister of Finance	Note the contents of this report Agree to the recommendations	4 December 2015
Minister of Revenue	Note the contents of this report Agree to the recommendations Refer a copy of this report to the Prime Minister	4 December 2015

Contact for telephone discussion (if required)

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27 November 2015

Minister of Finance
Minister of Revenue

Additional information on small business tax measures

Executive summary

You have asked for further information on the small business tax measures previously outlined to Ministers (T2015/2588, IR2015/624 refer). This report provides this information.

Maintaining a clear and coherent framework is very important for good tax policy. New Zealand is well served by its broad-base low-rate (BBLR) tax framework and we would caution against measures that are inconsistent with this.

We would therefore recommend focusing on measures that are within existing agreed frameworks, but also reduce compliance costs for businesses.

We previously reported on a range of measures that could be considered for inclusion as part of a small business tax package for Budget 2016 (A1-A12, B1-B5, C1-C3). At Ministers' request, officials have identified four additional items that could potentially also be included in a business tax package (B6-B9).

We believe that the following measures would form a sensible tax package for Budget 2016¹:

Stage 1: Measures coming into force on 1 April 2017

Changes to provisional tax to increase certainty

- A2. Increasing the current \$50,000 residual income tax limit for use-of-money interest to \$60,000 (for individuals and non-individuals)²
- A3. Removing use-of money interest for the first two provisional tax payments for all taxpayers who use the uplift method

¹ For ease of reference and consistency we have used the same numbering identification as used in the previous report.

² This measure is an extension of item A1 (non-individuals with less than \$50,000 residual income tax not be required to pay use-of-money interest) which we previously reported to you on. As we are recommending A2, A1 does not need to proceed as a separate item.

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

Supplementary tax simplifications

- B2. FBT simplification for closely-held companies
- B3. Simplified calculation of deductions for vehicles and premises

Supplementary tax simplifications (New measures)

- B6. Increasing threshold for adjustments in subsequent returns
- B7. Remove requirement to renew RWT exemption certificates annually
- B8. Increase the threshold for annual FBT returns from \$500k to \$1m of PAYE/ESCT
- B9. Modify the 63 day rule on employee remuneration

Stage 2: Measures coming into force on 1 April 2018

More timely payment of provisional tax

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

We consider that even the ‘A’ measures alone would provide a package that would be well received by small businesses as well as large businesses. It would help reduce compliance costs for businesses while maintaining New Zealand’s BBLR framework. The ‘B’ measures we are recommending are likely to make the package more attractive still.

This package would come with a revenue cost of approximately \$105m over four years (and a cashflow cost of \$430m).

[33]

We also discussed in the previous report measures that were not consistent with our BBLR framework (C1-C3). This included a reduced company tax rate for small businesses, accelerated depreciation for small businesses, and a turnover tax for small businesses. These measures would be significant departures from our BBLR framework and would have the risk of impeding productivity and growth, and would create some perverse incentives. We strongly recommend against these measures and understand that Ministers are comfortable with this approach. These measures are therefore not developed further in this paper.

We recommend that, even though it is a Budget package, the package be consulted on. It is important that any package agreed to provides the highest value for businesses. Without consultation, it is possible that there may be other measures that would be of greater benefit to businesses, that are consistent with good tax policy and come at a similar or lower fiscal cost.

We recommend that the proposed package be consulted on through a Government discussion document. We consider that a discussion document released in February 2016 would provide sufficient time for a package to be included as part of Budget 2016.

Prior to the release of any discussion document we would also see substantial benefits in a very limited pre-consultation process with a few key stakeholders. This is desirable because the industry is changing rapidly and some measures we are considering may no longer be of substantial concern to businesses.

Our initial advice is that Inland Revenue can implement the recommended package. Our initial indicative estimate of the overall implementation cost of the package is between \$3.5m and \$7m (with on-going costs of between \$0.5m and \$1.1m), which Inland Revenue would seek in full from the Crown. However, the package will absorb much of Inland Revenue's capacity to change heritage systems over 2017-2018. As a result, Inland Revenue will have negligible capacity to deliver further reforms with systems impacts over these years.

Recommended action

We recommend that you:

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

Referred

- b) **Agree** to progress a business tax package for consideration as part of Budget 2016 that consists of:

Stage 1: Measures coming into force on 1 April 2017

Changes to provisional tax to increase certainty

- 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

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 the 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

Supplementary tax simplifications

- B2. FBT simplification for closely-held companies
B3. Simplified calculation of deductions for vehicles and premises
B6. Increasing threshold for adjustments in subsequent returns
B7. Remove requirement to renew RWT exemption certificates annually
B8. Increase the threshold for annual FBT returns from \$500k to \$1M of PAYE/ESCT
B9. Modify the 63 day rule on employee remuneration

Stage 2: Measures coming into force on 1 April 2018

More timely payment of provisional tax

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

Agreed/Not agreed

Agreed/Not agreed

- c) **Agree** to consult on this package through a government discussion document, accompanied by an online forum, and to launch these at an event in February.

Agreed/Not agreed

Agreed/Not agreed

- d) **Agree** for officials to conduct targeted consultation on the package with trusted private sector stakeholders before the release of the discussion document.

Agreed/Not agreed

Agreed/Not agreed

- e) **Note** that this package has a revenue cost of approximately \$105m over four years and a cashflow impact of \$430m.

Noted

Noted

- f) **Note** that our initial estimate of the implementation cost of the package is between \$3.5m and \$7m (with on-going costs of between \$0.5m and \$1.1m).

Noted

Noted

g) **Note** that Inland Revenue will be seeking full crown funding for the package.

Noted

Noted

h) **Note** that officials are working with the assumption that any final package would be announced as part of Budget 2016 with legislation implementing the package subsequently introduced.

Noted

Noted

i) **Note** that officials plan to report to you further on some of the items in the recommended package before the end of 2015.

Noted

Noted

j) **Agree not** to progress the following measures:

A1. Non-individuals with less than \$50,000 residual income tax not required to pay use-of-money interest (as this is a subset of A2)

[33]

C1. Reduced company tax rate for small businesses

C2. Accelerated depreciation for small businesses

C3. Turnover tax for small businesses

Agreed/Not agreed

Agreed/Not agreed

k) **Agree** for officials to continue to progress other business tax measures not addressed in this report as part of Business Transformation for inclusion in a separate discussion document later in 2016.

Agreed/Not agreed

Agreed/Not agreed

l) **Agree** that officials may consult with stakeholders on these other business tax measures not addressed in this report.

Agreed/Not agreed

Agreed/Not agreed

m) **Indicate** if you wish to include any of the MBIE small business work of Result 9 or Business.govt.nz with the tax package recommended in this report.

Include/Don't include

Include/Don't include

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Minister of Finance

Hon Todd McClay
Minister of Revenue

Introduction

1. You have asked for further information on the small business tax measures previously outlined to Ministers (T2015/2588, IR2015/624 refer). This report provides this information.

Tax frameworks

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.

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 consistently 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. Of course, it is important where possible to reduce compliance costs for all businesses rather than solely small businesses.

10. The measures discussed in this report are a response to Minister’s request to consider a tax package for small businesses with a subsequent report on large businesses in the second half of 2016. However, it is important that any initial focus on small businesses, and subsequent focus on larger businesses, does not confuse New Zealand’s clear and coherent approach to tax reform. As a result, the package we are recommending is one that should be favourably received by both small and large businesses. We recommend that other measures which are not discussed in this report be progressed as part of Business Transformation for a discussion document later in 2016.

11. 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.

Recommended business tax package

12. We previously reported on a range of measures that could be considered for inclusion as part of a small business tax package for Budget 2016. Following this, you requested that officials consider any sensible additional measures that could be included in the package. Officials have identified four additional items that we believe could be included in a business tax package (see B6-B9 outlined below).

13. These measures collectively would form a sensible tax package that would provide significant compliance cost reductions, while maintaining New Zealand’s BBLR framework. Such a package would likely be well received by both small and large businesses. As a result, we would recommend the following items be progressed for inclusion as part of a business tax package for Budget 2016:

Stage 1: Measures coming into force on 1 April 2017

Changes to provisional tax to increase certainty

- 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

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 the 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

Supplementary tax simplifications

- B2. FBT simplification for closely-held companies
- B3. Simplified calculation of deductions for vehicles and premises
- B6. Increasing threshold for adjustments in subsequent returns
- B7. Remove requirement to renew RWT exemption certificates annually
- B8. Increase the threshold for annual FBT returns from \$500k to \$1m of PAYE/ESCT
- B9. Modify the 63 day rule on employee remuneration

Stage 2: Measures coming into force on 1 April 2018

More timely payment of provisional tax

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

Summary of package

Stage 1: Measures coming into force on 1 April 2017

Changes in provisional tax to increase certainty (A2-A3)

14. These measures address concerns raised by small and large businesses that they are required to calculate their provisional tax payments in advance and are being charged use-of-money interest (UOMI) 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 adversely affect taxpayers for unforeseen events. These two proposals should result in more taxpayers being removed from the application of UOMI.

Self-management and integrity (A7-A9)

15. These measures address concerns raised by some 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 businesses greater flexibility to use the existing schedular payment

withholding tax rules to self-manage their tax payments throughout the year. [34, s18(c)(l)]

The aim is to make the tax system fairer. These proposals pilot an approach that could subsequently be expanded further. It should be noted that addressing these compliance concerns will inevitably be seen as business unfriendly by some.

Making the system fairer (option A10)

16. 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 (A11-A12)

17. Currently Inland Revenue keeps its tax debt information secret, up until a business is insolvent and facing legal proceedings. The result is that other businesses will not know that they are dealing with firms that are in a precarious financial position. They may be unable to react in time and consequently be wound up as well. The purpose behind making these businesses more aware of an indebted business' financial position is that they will be able to take a more pro-active approach to their lending and credit decisions, and have greater confidence that they are making the right decision.

18. 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 legally 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.

Supplementary tax simplification measures (B2-B3, B6-B9)

19. These measures cover sensible supporting measures to simplify the tax rules for businesses. This includes simplified methods for businesses to calculate fringe benefit tax (FBT), deductions for vehicles and premises, and deductions for employee remuneration. It also includes some threshold adjustments to enable more small businesses access to simplified rules for filing and correcting errors.

Stage 2: Measures coming into force on 1 April 2018

More timely payment of provisional tax (A5-A6)

20. 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 aims to

have those who don't have tax deducted at source also pay tax as income is earned, although it starts with the presumption that income is earned evenly over the year.

21. This doesn't work, however, for those who have seasonal or volatile incomes. A5 and A6 attempt to deal with seasonality and volatility by allowing their income tax to be paid on a more pay as you earn basis.

22. These stage 2 measures cannot apply prior to 1 April 2018 as they cannot be implemented until Inland Revenue's Gentax income tax module is operational and until third party software providers have made changes to their systems.

Further details

23. Further information on all of these measures is contained in appendices 1 and 2 of this report.

Overall impacts of package

24. The overall impact to businesses of our recommended package is that it would:

- Remove approximately 67,000 provisional taxpayers from the requirement to pay UOMI (this makes up 78% of all taxpayers currently exposed to UOMI) (A2).
- Remove approximately 19,000 additional provisional taxpayers from the requirement to pay UOMI up to the last instalment date (this allows the remaining 22% of taxpayers to reduce the impact of UOMI) (A3).
- Provide a means for businesses to use their accounting results to ensure their provisional tax payments more accurately match income as it is earned (A5-A6).
- Provide greater flexibility for 130,000 businesses currently subject to schedular payment withholding (A7).
- Bring at least 4,200 labour-hire contractors into withholding, therefore providing them with the means to manage their obligations without having to comply with provisional tax (A8).
- Remove incremental late payment penalties for 65,000 taxpayers with income tax debt (A10).
- Remove incremental late payment penalties for 67,000 taxpayers with GST debt (A10).
- Help businesses make better lending and credit decisions through providing information about those with tax debt (A11).
- Enable 1,500 businesses to more easily manage their FBT filing obligations through allowing them to file FBT returns annually (B8).

- Provide simpler methods for small businesses to calculate their deductions for vehicles and premises and provide simpler FBT calculations for some closely held companies (B2-B3).
- Provide sensible supporting simplifications for adjusting errors, RWT exemptions, and the calculation of employee remuneration that will help reduce compliance costs for small and large businesses. (B6-B9).

25. This package would come with a revenue cost of approximately \$105m over four years and a cashflow impact of \$430m³. Some cash flows are deferred by a year but that does not affect the revenue costing.

26. It is important that the final package agreed to represents the highest value for businesses for its fiscal cost. Without consultation, it is possible that there may be other measures that would be of greater benefit to businesses, consistent with good tax policy principles and which come at a similar or lower fiscal cost.

27. The items recommended in this package are based on our initial consideration of these proposals within the time available. As more detailed policy work is done, and with further consultation with the private sector it may be that some of the measures have pitfalls that we have not yet identified or are found not to be, relatively speaking, good value for money. If this happens, we will report to Ministers and seek your agreement on any changes to the recommended package.

Implementation impacts

28. A consequence of the transformation Inland Revenue is undertaking is that the department has very limited capacity to make additional change over the next three years. There is a need to ensure that what change capacity Inland Revenue does have is used on the Government's highest priority items.

29. Our initial advice is that Inland Revenue can implement the recommended package. However, a number of the proposals considered but not recommended for progression have major administrative implications (in addition to us not considering them good policy measures). If these measures were to be progressed we would have to report further on the administrative implications. It is not clear that Inland Revenue would have the capability to deliver these additional measures without significant risk, cost and need for reprioritisation of other tax policy work programme commitments.

30. Inland Revenue has a very full tax policy work programme. If additional measures are added that have delivery outcomes over the same period this is likely to necessitate reconsideration of the administrative feasibility of delivering the work programme.

31. The main constraint facing Inland Revenue is that there are only a small number of people with the required skills to make changes in heritage systems and these individuals are

³ The revenue impact is the more significant measure of the two and is the measure that affects the Government surplus.

also key contributors to the design of our new system. In addition to the technology matters there is a need to have regard for the significant change during this period impacting on Inland Revenue's front line staff and customers.

32. The recommended package is proposed to be implemented over the 2017 and 2018 income years and therefore will absorb much of Inland Revenue's change capacity within our heritage systems over this period. Consequently Inland Revenue will have negligible capacity to deliver further reforms over the 2017 and 2018 income years in heritage systems.

33. In addition a number of items on the current tax policy work programme have administrative implications and are also drawing Inland Revenue's non-Business Transformation change capacity. Inland Revenue's commitment to deliver this business package may reduce delivery choices in relation to those measures.

34. Business tax reforms after 2018 will be in the new technology environment and can be accommodated.

Funding

35. Our initial estimate of the overall implementation cost of the package is between \$3.5m and \$7m (excluding capital charge and depreciation). There would be on-going costs of between \$0.5m-\$1.1m. However, due to the low level of confidence in these costs stemming from being in early stages of policy development and within limited timeframes, these figures include contingencies.

36. Inland Revenue will be seeking full Crown funding on the proposed initiatives contained in the business tax package to the extent they impact on Inland Revenue's heritage systems and associated customer interactions.

37. Inland Revenue has made some significant contributions from its out-year operating baselines and capital reserves to funding Business Transformation. When Inland Revenue made this commitment it was made clear that any significant external imperatives (i.e. Government policy changes) that require changes to heritage systems would be fully funded. Bringing forward the business tax package has necessitated that it be implemented in Inland Revenue's heritage system. Inland Revenue has made some allowance in its out-year baseline for policy changes, however the collective impact of this package exceeds the provision Inland Revenue has made.

Proposed consultation

38. There has been limited consultation on taxpayers' views on these measures as a potential package. Without this consultation, there is a risk that the measures are not, as a whole, the highest priority for the private sector. As a result they may not be as well received as could otherwise be the case. We would therefore recommend that there should be consultation to ensure that these measures are the highest priorities for the private sector for their fiscal cost.

39. We consider that a discussion document released in February would be the best method to achieve this consultation and ensure the package is of high value. A discussion document released in February would still provide sufficient time for a package to be included as part of Budget 2016.

40. The goal of this consultation would be to:

- obtain feedback on the merit of the proposed measures; and
- identify if there are any other measures that would be of greater benefit to businesses that have similar or lower fiscal costs while still being consistent with good tax policy principles.

41. The package recommended in this report forms a complex set of measures and it would be valuable to have targeted consultation with private sector stakeholders before a discussion document is released. This would help ensure that the discussion document is well received.

Consultation package

42. We recommend the following as part of a consultation package for these measures:

- a high level summary document and outlining the key benefits of the package;
- a more detailed outline of the proposal to ensure that submitters fully understand the proposals;
- an online forum; and
- an event to launch all three parts (above) at the Beehive.

Proposed timeline for discussion document

43. If you wish to have consultation on this package and final decisions made prior to the Budget moratorium, the time available to achieve this is limited. To ensure adequate consultation can take place, officials will need early direction from Ministers on what measures Ministers want to include in the consultation package and what form the consultation package will take.

44. In addition, Ministerial and Cabinet approvals for the release of the discussion document would need to be made by early February 2016 and the final policy approval would need to be made in April 2016.

45. An indicative timeline is outlined below:

Item	Date
Reports providing supplementary information on specific items	Late 2015
Draft discussion document provided to Ministers	Late January 2016
Final discussion document and Cabinet paper provided to Ministers	Early February 2016
Discussion document released (3-4 week submission period)	Mid February 2016
Submissions close	March 2016
Final policy decisions	April 2016

46. We plan to report to Cabinet Ministers giving further information on some of the recommended measures (A5-A12) prior to us providing a draft discussion document to Ministers. This additional information is intended to allow Ministers to consider these proposals further before a draft discussion document is provided to Ministers.

Legislative implications

47. Given the nature of the measures considered, most of the items in our recommended package would benefit from being subject to Select Committee consultation and scrutiny. As the measures come into force from 1 April 2017 this consultation is possible.

48. As a result, our initial view is that the measures could be announced in Budget 2016, with the legislation implementing the package subsequently introduced in July 2016 with a truncated Select Committee process. As some of the measures require a lead-in time for businesses to implement, any legislation would likely need to be passed before the end of 2016.

Measures we do not recommend progressing

49. We previously provided advice on the following measures:

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

[33]

C1. Reduced company tax rate for small businesses
C2. Accelerated depreciation for small businesses

C3. Turnover tax for small businesses

50. For the reasons outlined below we do not recommend progressing these measures further.

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

51. Option A1 is a subset of option A2. As we recommend progressing A2, A1 does not need to be included in the package as a separate item.

[33]

Measures inconsistent with tax policy framework (C measures)

59. In our previous report we outlined the following three measures:

- C1. Reduced company tax rate for small businesses
- C2. Accelerated depreciation for small businesses
- C3. Turnover tax for small businesses

60. As outlined in the previous report we do not believe that these measures are good tax policy. The measures are not consistent with New Zealand's BBLR framework and have the potential to reduce efficiency, productivity, and growth. As a result, we would strongly counsel against these measures. We would instead recommend focusing on the other proposals which are within existing agreed frameworks, but also reduce compliance costs for small businesses.

61. Officials were instructed to focus on the other measures outlined in the previous report rather than these measures. As a result, we have not considered these items further.

Other business tax measures

62. There are other measures that are being considered as part of the Business Transformation programme that would reduce compliance costs for small as well as large businesses. This includes items that were included in the previous discussion document provided to Cabinet (CAB-15-MIN-0117.01 refer) as well as other sensible additional measures that have since been identified.

63. These measures cannot be accelerated to be included in this package as the policy work on those proposals is not sufficiently developed. Instead, we recommend that these measures continue to be worked on for inclusion in a Government discussion document later in 2016. We recommend that as part of this work, officials be permitted to consult with stakeholders.

Non-tax business measures being considered by MBIE

64. Ministers have requested an update on non-tax regulatory initiatives for small businesses being considered by MBIE. These are measures that are currently underway rather than new initiatives. Below is further information on some of the measures actively being considered by MBIE to support small business through Result 9 (Better for Business) and Business.govt.nz.

65. For Result 9 MBIE have confirmed that they are working on the following:

- A number of projects going through the Accelerator early next year have a strong small business focus, for example creating a single point of contact within Government for business and reducing the cost to business of tendering for government contracts.
- Testing service delivery models with the aim of creating a single cross-Government approach to service delivery for business customers.

66. For Business.govt.nz, MBIE have confirmed that they are working on the following:

- A new website that will display resources and information in a far richer way, with a modern, mobile responsive interface taking into account different learning styles and the milestones that small businesses experience.

67. If you wish to announce any of the small business work of Result 9 or Business.govt.nz along with the tax package recommended in this report, then further advice about the initiatives above can be provided.

68. We, note however, that these initiatives would have complex implementation challenges for Inland Revenue.

MBIE comment

69. Small businesses can operate on slim margins and cashflow management matters significantly for small businesses. To manage these cashflow difficulties, small businesses need certainty about what tax they owe and when it is due for payment, easy interaction with government, and confidence that they have fulfilled their obligations.

70. The measures outlined go some way to address these issues and would be beneficial to small businesses. MBIE therefore supports progressing the recommended package.

71. MBIE agrees that [33] and the measures not consistent with current tax frameworks (C1-C3) should not proceed.

Appendix 1: Summary table
Recommended 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 Government⁴</i>	<i>Do we recommend including in package?</i>
<i>A2. Increasing the current \$50,000 residual income tax limit for interest to \$60,000 (for individuals and non-individuals)⁵</i>	Yes	Positive	No impact	\$47m revenue cost \$47m cashflow cost	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 \$334m cashflow cost	Yes
<i>A5. Adopting an accounting income method for paying provisional tax</i>	Yes	Positive	We are working with large businesses to see if can apply to them	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	Potential revenue cost up-front, but broadly neutral	Yes
<i>A8. Pay as you go for contractors – labour hire firms</i>	Yes	Mixed	Compliance impact for some	Revenue gain of at least \$20m Cashflow gain of at least \$20m	Yes
<i>A9. Pay as you go for contractors – voluntary withholding agreements</i>	Yes	Positive	Neutral	Neutral	Yes
<i>A10. Removal of incremental late payment penalties on tax payments</i>	Yes	Positive	Largely neutral	\$65m revenue cost \$65m cashflow cost	Yes
<i>A11. Credit reporting of tax debt</i>	Yes	Positive	Positive	Likely revenue benefit	Yes
<i>A12. Information sharing with the Registrar of Companies</i>	Yes	Positive	Positive	No impact	Yes

⁴ Fiscal costs are across four years

⁵ A1 is a subset of this measure. As a result, A1 is not separately included in this table.

B2. FBT simplification for closely held companies	Yes	Positive	No impact	Expected to be minimal depending on design	Yes
B3. Simplified calculation of deductions for vehicles and premises	Yes	Positive	No impact	\$4m revenue cost \$4m cashflow cost	Yes
B6. Increasing threshold for adjustments in subsequent returns	Yes	Positive	Positive	No impact	Yes
B7. Remove requirement to renew RWT exemption certificates annually	Yes	Positive	No impact	No impact	Yes
B8. Increase the threshold for annual FBT returns from \$500k to \$1M of PAYE/ESCT	Yes	Positive	No impact	No impact	Yes
B9. Modify the 63 day rule on employee remuneration	Yes	Positive	Positive	No impact	Yes

Measures not recommended

	<i>Consistent with tax policy framework?</i>	<i>Positive for SMEs?</i>	<i>Positive for large businesses?</i>	<i>Fiscal cost/benefit to the Government⁶</i>	<i>Do we recommend including in package?</i>
[33]					
C1. Reduced company tax rate for small businesses	No	Positive	Likely negative reaction	Revenue cost	No
C2. Accelerated depreciation for small businesses	No	Positive	Likely negative reaction	High revenue cost	No
C3. Turnover tax for small businesses	No	Positive	No impact	If voluntary would have revenue cost	No

⁶ Fiscal costs are across four years

Appendix 2: Further information on recommended measures

Changes to provisional tax to increase certainty

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

<i>Proposal</i>	Increase the safe-harbour threshold of \$50,000 residual income tax before UOMI applies to \$60,000 residual income tax and extend this so that it applies not only to individuals but also to non-individuals.
<i>Problem</i>	<p>Too many taxpayers are exposed to UOMI and therefore incur costs and stress disproportionate to the benefits of more accurate tax payment.</p> <p>Currently individuals with residual income tax of less than \$50k are “safe-harboured” and are not exposed to UOMI. Small companies and other non-individuals cannot obtain this safe-harbour. This means these small companies incur costs that appears disproportionate to the benefits of more accurate tax payment.</p> <p>In addition, this \$50,000 limit 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 in 2009.</p>
<i>Who does this affect?</i>	<p>Provisional taxpayers with an income level of around \$180,000, for an individual or trust and \$214,000 for a company.</p> <p>This option should remove 67,000 taxpayers from UOMI with the bulk of these being non-individuals.</p>
<i>Pros</i>	Provides certainty to taxpayers who earn relatively small amounts of income over the application of UOMI.
<i>Fiscal impact</i>	Approximately \$47 million in reduced revenue and cashflow cost of the same amount. ⁷
<i>Constraints</i>	Will require changes to Inland Revenue’s heritage systems (including FIRST). The level of complexity to change FIRST has been assessed at medium to high.
<i>Potential application date</i>	1 April 2017

⁷ 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

<i>Proposal</i>	<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 proposal A2 in that UOMI would apply from the last instalment date (which occurs after a business' year end) whereas under A2 UOMI would only apply from the terminal tax date.</p> <p>Those who do not pay the minimum uplift amounts in the first two instalments will automatically default into the estimation regime and be subject to UOMI from the first instalment.</p>
<i>Problem</i>	<p>Taxpayers who use the uplift method base their provisional tax payments on the 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 increases certainty of tax payments for the year.</p>
<i>Who does this affect?</i>	<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 proposal A2.</p>
<i>Pros</i>	<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>
<i>Fiscal impact</i>	<p>Approximately \$7.5 million⁸ impact to revenue and a \$334 million cashflow cost⁹.</p>
<i>Constraints</i>	<p>Will require changes to Inland Revenue's heritage systems (including FIRST). The level of complexity to change FIRST has been assessed at medium to high.</p>
<i>Potential application date</i>	<p>1 April 2017</p>

⁸ Fiscal costs are across four years as noted earlier.

⁹ 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

More timely payment of provisional tax

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

<i>Proposal</i>	Taxpayers use their accounting results to calculate their provisional tax and pay more regularly during the year.
<i>Problem</i>	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.
<i>Who does this affect?</i>	Up to 110,000 small businesses could be eligible to use this method.
<i>Pros</i>	Provisional tax payments more accurately match income as it is earned (i.e. pay as you go).
<i>Cons</i>	Note that development and costing work is on-going to identify a stable and robust payment calculation.
<i>Fiscal impact</i>	Expected to be neutral
<i>Constraints</i>	<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. The design changes required will be made within their systems to ensure an operational product is released to the market, ready for the 1 April 2018 implementation date.</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 may be interested in using this method to calculate their provisional tax. We continue to work with large businesses to see how this option may be adapted for their use.</p>
<i>Potential application date</i>	1 April 2018

A6: Paying provisional tax on behalf of related parties

<i>Proposal</i>	<p>An entity could be used to make tax payments on behalf of closely related parties.</p> <p>It would need to be voluntary 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>
<i>Problem</i>	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.
<i>Who does this affect?</i>	<p>Closely held companies and their shareholders, and partnerships and their partners, are the target group.</p> <p>Up to 110,000 small businesses could be eligible to use this method.</p>
<i>Pros</i>	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.
<i>Cons</i>	<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>
<i>Fiscal impact</i>	Expected to be neutral.
<i>Constraints</i>	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.
<i>Potential application date</i>	1 April 2018

Self-management and integrity

A7: Electing own withholding rate

<i>Proposal</i>	Allowing contractors subject to the schedular payment withholding rules to choose their own rate of withholding (with a minimum rate of 10%).
<i>Problem</i>	<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 submitting an application and information to Inland Revenue to demonstrate why a different rate is appropriate.</p>
<i>Who does this affect?</i>	<p>Small businesses and contractors subject to the schedular payment withholding rules (there are 130,000 taxpayers currently 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 would apply.</p>
<i>Pros</i>	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.
<i>Cons</i>	<p>Increases compliance costs for some payers.</p> <p>Some contractors may deliberately pick an artificially low rate in order to avoid their obligations. To mitigate this risk, we recommend that the Commissioner be able to override the rate a contractor has provided and require a higher rate when the Contractor is non-compliant.</p>
<i>Fiscal impact</i>	Potential revenue cost up-front, but broadly revenue neutral over four years.
<i>Constraints</i>	<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 minimum 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>Does not require changes to Inland Revenue's heritage systems, although some internal/external calculators and payroll specifications will need to be updated. Software developers will need to be given sufficient time to allow them to update software with the new requirements.</p>
<i>Potential application date</i>	1 April 2017

A8: Labour hire firms

<i>Proposal</i>	<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>
<i>Problem</i>	<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)(i)]</p>
<i>Who does this affect?</i>	<p>Contractors engaged through labour hire firms would be affected. From an Inland Revenue audit project we know that the largest 11 labour-hire firms in New Zealand engage 4,200 contractors. The total number of contractors affected by this change would be greater than this.</p> <p>Labour hire firms will be required to deduct withholding tax and pay it to Inland Revenue along with reporting of the amounts paid and deducted.</p>
<i>Pros</i>	<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>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>
<i>Cons</i>	<p>Labour hire firms will incur compliance costs. These costs could be significant for small and medium size 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</p>

	regardless of how they are engaged.
<i>Fiscal impact</i>	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 \$20m-\$40m over four years.
<i>Constraints</i>	Does not require changes to Inland Revenue's heritage systems, although some internal/external calculators and payroll specifications will need to be updated. Software developers will need to be given sufficient time to allow them to update software with the new requirements.
<i>Potential application date</i>	1 April 2017

A9: Voluntary withholding agreements

<i>Proposal</i>	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.
<i>Problem</i>	Withholding tax may be a preferred payment channel for some contractors, especially coupled with an option to choose the withholding rate applied.
<i>Who does this affect?</i>	Those not covered by the withholding rules that would prefer withholding to provisional tax (in Australia at least 4,500 contractors have voluntary withholding agreements). Payers who may have to withhold when they currently do not – however the proposal is for mutual agreement for withholding to apply.
<i>Pros</i>	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.
<i>Cons</i>	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.
<i>Fiscal impact</i>	No impact
<i>Constraints</i>	Contractors will need to select an accurate rate to receive the full benefit (if the rate is too low provisional tax may still apply). Does not require changes to Inland Revenue’s heritage systems, although some internal/external calculators and payroll specifications will need to be updated. Software developers will need to be given sufficient time to allow them to update software with the new requirements.
<i>Potential application date</i>	1 April 2017

Making the system fairer

A10: Removal of incremental late payment penalties on tax payments

Proposal	<p>[33] the removal of the monthly one per cent incremental late payment penalty, for provisional and terminal income tax, and GST.</p> <p>In addition to income tax and GST, officials are currently considering whether we could extend this proposal to Working for Families tax credit overpayments. However, this requires further analysis and therefore we will report back on this option in greater detail before the end of the year.</p> <p>Use-of-money-interest will still apply to late payments.</p>
Problem	<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>
Who does this affect?	<p>Those who do not pay their tax on time.</p> <p>Each year, approximately 65,000 taxpayers would benefit from removing incremental late payment penalties on their income tax debt, and 67,000 taxpayers would benefit from removing incremental late payment penalties on their GST debt.</p>
Pros	<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>
Fiscal impact	<p>There would be a negative revenue impact of approximately \$65 million¹⁰. While Inland Revenue imposes additional financial penalties, these are uncollected and are reversed, remitted or written off.</p> <p>Officials are unable to measure the expected change in compliance behaviour as a result of the reduced financial penalties. While it is expected that due to the reduced financial penalties, some taxpayers may decide to delay their tax payments, analysis of other tax jurisdictions with similar financial penalties and</p>

¹⁰ Fiscal costs are across four years as noted earlier.

	interest have similar rates of voluntary compliance.
<i>Constraints</i>	Requires a small change to Inland Revenue's heritage systems [33] Tax periods 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.
<i>Potential application date</i>	1 April 2017

[33]

Making markets work better through tax transparency

A11: Credit reporting of tax debt

<i>Proposal</i>	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.
<i>Problem</i>	<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>In recent years, the business community has commented that they have been frustrated that they are unaware of any tax debt until Inland Revenue winds up the taxpayer, despite the business completing all the necessary credit checks.</p> <p>Credit reporting agencies have also indicated that visibility of tax debt will likely result in improved market efficiency, as businesses will have better visibility of the commercial risk, and will incorporate it into their commercial decision making and therefore make better business decisions, such as trade lending or other commercial arrangements.</p>
<i>Who does this affect?</i>	<p>Primarily those who supply labour, goods or services to failing businesses.</p> <p>In order to ensure the robustness of the information sharing infrastructure and to measure the impact of disclosing tax debt, officials only expect to share information of approximately 500 cases in the first year of operation.</p>
<i>Pros</i>	<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>
<i>Cons</i>	Due to the technological nature of information exchanges, there is risk that Inland Revenue may inadvertently disclose a compliant business to a credit reporting agency, as a non-compliant business. This information may be subsequently released to other businesses, resulting in the business gaining a negative reputation. Officials continue to work towards reducing this risk, and understand that along with their significant experience handling credit information, credit reporting agencies have robust policies and practices in place, when information has been unintentionally released.

<i>Fiscal impact</i>	The fiscal impact of this measure is difficult to quantify but likely to be positive.
<i>Constraints</i>	Initial analysis indicates this could be implemented by utilising a tactical/manual solution and therefore would not impact Inland Revenue's heritage systems.
<i>Potential application date</i>	1 April 2017

A12: Information Sharing with the Registrar of Companies

Proposal	<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>
Problem	<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 rules¹². 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> <p>This issue was raised by the Companies Office and some insolvency industry members.</p>
Who does this affect?	<p>This enforcement measure is targeted at directors and companies that engage in unlawful conduct. As the provision of information will only be available for serious cases of non-compliance, officials only expect to share information in [s18(c)(i)] in the first year of operation.</p> <p>This proposal will benefit those businesses that are currently negatively affected by the director's or company conduct.</p>
Pros	<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>
Cons	<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>
Fiscal impact	No impact.
Constraints	Initial analysis indicates this could be implemented by utilising a tactical/manual solution and therefore would not impact Inland Revenue's heritage systems. Inland Revenue has previously implemented the Targeting Serious Crime information share and this proposal could potentially utilise this same mechanism.
Potential application date	1 April 2017

¹² 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.

B2: FBT simplification for closely held companies

<i>Proposal</i>	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.
<i>Problem</i>	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.
<i>Who does this affect?</i>	At least 5,900 closely held companies who provide a motor vehicle to shareholder employees.
<i>Pros</i>	Reduction in compliance costs to smaller businesses that fit the target group.
<i>Cons</i>	Definitional issues will be important to work through to ensure the proposal is not open for abuse.
<i>Fiscal impact</i>	This proposal still needs to be costed but it should have a reasonably neutral effect on revenue.
<i>Constraints</i>	Does not require any changes to Inland Revenue's heritage systems and has minor administrative impacts.
<i>Potential application date</i>	1 April 2017

B3: Simplified calculation of deductions for vehicles and premises

<i>Proposal</i>	<p>Allow or require small businesses to use a simple method for calculating their deductions for use of premises or vehicles.</p> <p>For vehicles this would enable businesses to deduct a fixed amount for their vehicle based on the number of kilometres travelled for business purposes. This calculation method is currently allowed for small business taxpayers who travel less than 5000km for business purposes. This proposal would remove this 5000km limit and split the rate into two tiers (so fixed costs are not over-recovered). This method would be optional.</p> <p>For premises, this would be a new regime allowing a deduction at a fixed rate, for all expenses other than mortgage interest and rent based on the area of the premises used primarily for business purposes. This would be independent of actual expenses such as electricity bills or rates incurred. Interest and rent would continue to be claimed based on their actual costs. Officials' current preference is for this to be compulsory on simplicity grounds however we would recommend consultation on this point.</p>
<i>Problem</i>	<p>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.</p>
<i>Who does this affect?</i>	<p>We estimate that 3,100 small businesses would have reduced compliance costs as a result of this measure.</p> <p>If compulsory, there will be winners and losers from the proposals as some businesses will have higher deductions and other businesses will have lower deductions.</p>
<i>Pros</i>	<p>Reduces the compliance costs for small businesses without significantly lowering the average tax paid by small businesses. As a result, it is arguably consistent with New Zealand's broad-base, low-rate framework.</p>
<i>Cons</i>	<p>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.</p>
<i>Fiscal impact</i>	<p>There would be an estimated negative revenue impact of approximately \$4m over four years.</p>
<i>Constraints</i>	<p>Does not require any changes to Inland Revenue's heritage systems and has minor administrative impacts.</p>
<i>Potential application date</i>	<p>1 April 2017</p>

B6: Increase threshold for adjustments in subsequent returns

<i>Proposal</i>	Increase the self-adjustment threshold to allow taxpayers to correct simple errors of up to \$1,000 or \$2,000 in their next return. This would represent maximum gross adjustments of \$7,142 for a company, \$6,060 for an individual and \$15,333 for GST.
<i>Problem</i>	If a taxpayer makes a small error in their tax return of less than \$500 they can self-adjust this error in their next tax return. If an error is greater than \$500 the taxpayer must make a request to the Commissioner to correct the error. This \$500 limit represents gross adjustments of \$1,785 for a company, \$1,515 for an individual on the top marginal rate or \$3,833 in GST. These are relatively low values.
<i>Who does this affect?</i>	Those who make simple low value errors in their returns. It will remove a level of compliance cost of having to apply to the Commissioner for a small adjustment. It will also reduce the administration costs as Inland Revenue will not have to manage these low value items. This proposal fits with the self-assessment basis that our tax system relies on as well as the self-management proposals elsewhere in this package.
<i>Pros</i>	Remove compliance costs from SME taxpayers through not having to make application to IR for small value errors discovered in returns.
<i>Cons</i>	A \$1,000 or \$2,000 limit represents a relatively low amount for large businesses. As a result, the measure may not be as well received by large businesses (although even larger businesses are likely to see the higher limit as being better than the status quo).
<i>Fiscal impact</i>	Unlikely to be any fiscal costs. This is because it is likely that taxpayers are already self-correcting these errors without making an application to the Commissioner.
<i>Constraints</i>	Does not require any changes to Inland Revenue's heritage systems and has minor administrative impacts.
<i>Potential application date</i>	1 April 2017

B7: Remove the requirement to renew RWT exemption certificates annually

<i>Proposal</i>	<p>Legislatively require RWT exemption certificates to be issued for a longer period (for example 5 years).</p> <p>There will still be a requirement for taxpayers to surrender their exemption certificates when they fail to meet the requirements of holding it. Inland Revenue may also cancel an exemption certificate at any time.</p> <p>If there are integrity concerns, an alternative is that there could be a simple “tick the box” requirement that a taxpayer provides every year where they state that they continue to meet the requirements for an exemption certificate.</p>
<i>Problem</i>	<p>Currently most taxpayers who hold RWT exemption certificates need to renew these annually. This is because of an operational decision made by Inland Revenue. Taxpayers have argued that this is creating relatively large compliance costs for those who are required to renew for relatively little value.</p>
<i>Who does this affect?</i>	<p>An estimated 6,900 taxpayers who hold an exemption certificate from RWT.</p>
<i>Pros</i>	<p>Remove compliance costs from taxpayers through not having to make application to IR to renew RWT certificates. Reduces administration costs for Inland Revenue as Inland Revenue would not need to issue these certificates annually.</p>
<i>Cons</i>	<p>There could be integrity concerns where a taxpayer no longer meets the requirements to hold an RWT certificate, but because they are not required to renew this is not known to Inland Revenue. However, we consider that the impact of this would be minor and is able to be mitigated.</p>
<i>Fiscal impact</i>	<p>Unlikely to be any fiscal costs.</p>
<i>Constraints</i>	<p>Does not require any changes to Inland Revenue’s heritage systems and has minor administrative impacts.</p>
<i>Potential application date</i>	<p>1 April 2017</p>

B8: Increase the threshold for annual FBT returns from \$500k to \$1M of PAYE/ESCT

<i>Proposal</i>	Increase the threshold to file annual FBT returns from \$500k to \$1m of PAYE/ESCT
<i>Problem</i>	Current rules allow businesses who have PAYE and ESCT deductions of less than \$500k to account for FBT on an annual basis rather than a quarterly basis. This value was last increased in 2009. As smaller businesses become bigger businesses that employ more staff this threshold may be imposing undue compliance costs on smaller businesses.
<i>Who does this affect?</i>	Approximately 1,500 taxpayers currently fit within the current and proposed threshold and file fringe benefit returns.
<i>Pros</i>	Remove compliance costs from smaller taxpayers from having to deal with FBT quarterly and instead permitting this to be done on an annual basis.
<i>Fiscal impact</i>	There would be no fiscal impact other than a \$1m time-value of money impact each year ¹³ . This is because FBT for a particular year is payable within the government's fiscal year (payments in July, Oct, Feb and May).
<i>Constraints</i>	Does not require any changes to Inland Revenue's heritage systems and has minor administrative impacts.
<i>Potential application date</i>	1 April 2017

¹³ This is a within-year timing impact.

B9: Modify the 63 day rule on employee remuneration

<i>Proposal</i>	<p>Allow taxpayers to choose whether to make an adjustment for employee remuneration paid within 63 days after the income year.</p> <p>The taxpayer could make this choice on a class of payment basis which would allow different treatments for different classes of payment (e.g. bonuses v.s. holiday pay). This would apply to both smaller and larger firms.</p>
<i>Problem</i>	<p>Taxpayers who incur the cost of monetary remuneration within an income year and pay it out within 63 days after the income year must take the deduction for the remuneration in the income year it is incurred.</p> <p>This rule increases compliance costs for taxpayers as they must track payments of employee remuneration that were accrued at year end and paid within 63 days.</p>
<i>Who does this affect?</i>	Taxpayers who pay monetary remuneration and want to reduce compliance costs around dealing with the 63 day rule adjustment.
<i>Pros</i>	Removes the compliance costs of tracking and determining amounts incurred at year end and paid within 63 days after year end at the taxpayers option.
<i>Cons</i>	<p>May result in additional taxable income for employers who have large annual leave balances that are taken within 63 days of the end of the income year.</p> <p>However, we consider this cost is minor as taxpayers may choose whether or not to make this adjustment.</p>
<i>Fiscal impact</i>	No fiscal cost.
<i>Constraints</i>	Does not require any changes to Inland Revenue's heritage systems and has minor administrative impacts.
<i>Potential application date</i>	1 April 2017

**Appendix 3:
Measures we do not recommend
considering further**

A1: Non-individuals with less than \$50,000 residual income tax not required to pay use-of-money interest¹⁴

<i>Proposal</i>	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.
<i>Problem</i>	Too many taxpayers are exposed to UOMI and therefore incur costs and stress disproportionate to the benefits of more accurate tax payment.
<i>Who does this affect?</i>	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.
<i>Pros</i>	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.
<i>Fiscal impact</i>	The approximate fiscal costs of the proposal across four years would be \$33 million in revenue and there would be a negative cashflow impact. ¹⁵
<i>Constraints</i>	Will require changes to Inland Revenue's heritage systems (including FIRST). The level of complexity to change FIRST has been assessed at medium-high.
<i>Potential application date</i>	1 April 2017

Note: we do not recommend considering this proposal further because it is a subset of A2 which we recommend progressing.

¹⁴ This was an item that was part of the previous small business tax discussion document presented to Cabinet

¹⁵ 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.

¹⁸ Fiscal costs are across four years as noted earlier.
T2015/2800, IR2015/661: Additional information on small business tax measures

C1: Reduced company tax rate for small businesses

Option	A lower company tax rate for small businesses
Who does this affect?	Small companies. Does not affect small business that are sole traders or who operate through trusts.
Pros	Makes small companies more competitive.
Cons	<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>
Fiscal impact	Negative revenue impact
Constraints	Would have high impacts on Inland Revenue's heritage systems.
Potential application date	1 April 2018

C2: Accelerated depreciation for small businesses

<i>Option</i>	Allow small businesses to accelerate their depreciation deductions above the economic rate.
<i>Who does this affect?</i>	Small businesses would be positively impacted.
<i>Pros</i>	Reduces the cost of capital and encourages investment in machinery.
<i>Cons</i>	<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>
<i>Fiscal impact</i>	High negative revenue impact
<i>Constraints</i>	Would have low impacts on Inland Revenue's heritage systems.
<i>Potential application date</i>	1 April 2017

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

<i>Option</i>	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).
<i>Who does this affect?</i>	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.
<i>Pros</i>	Provides a significantly simpler method for calculating tax for small businesses.
<i>Cons</i>	<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>
<i>Fiscal impact</i>	If voluntary, likely to be revenue negative.
<i>Constraints</i>	Would have high impacts on Inland Revenue's legacy FIRST system.
<i>Potential application date</i>	1 April 2018

Appendix 4: Australian small business tax concessions

Small business tax concessions currently available in Australia

<i>Company tax rate</i>	Small businesses have a reduced company tax rate of 28.5% (30% for other companies).
<i>Depreciation</i>	<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>
<i>Trading stock</i>	Small businesses can estimate the value of trading stock rather than require a stock-take in some circumstances.
<i>Fringe benefit tax</i>	Small businesses are exempt from FBT for car parks.
<i>Time-bar</i>	A two-year time bar for small businesses returns (i.e. the ATO cannot review a return two years after it was filed)
<i>GST</i>	<p>Small businesses can:</p> <ul style="list-style-type: none"> • account for GST on a cash basis; • pay their GST by instalment; and • make a single adjustment at the end of the year on GST credits for items partly used for private purposes.
<i>PAYG instalment (provisional tax)</i>	Small businesses can pay PAYG instalments according to an ATO calculation (rather than calculate themselves).

