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Better Business Tax
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**Making Tax Simpler: Better Business Tax**

**Introduction**

1. The New Zealand Law Society (Law Society) appreciates the opportunity to comment on *Making Tax Simpler: Better Business Tax - An Officials' Issues Paper* (Issues Paper).

2. This submission is organised in sections that reflect the structure of the Issues Paper. Set out below are comments on the proposals contained in chapters 2 to 7 of the Issues Paper. In general, the Law Society considers the proposals in the Issues Paper represent positive developments for taxpayers and the administration of the tax system by Inland Revenue.

**Comments**

***Chapter 2: Changes to provisional tax to increase certainty***

3. Chapter 2 sets out two proposals to improve taxpayers' interaction with the provisional tax system:

   (a) an increase in the safe-harbour limit of a taxpayer's residual income tax before use of money interest (UOMI) is imposed from $50,000 to $60,000 and extending this safe-harbour to non-individual taxpayers; and

   (b) removing UOMI from the first two provisional tax instalments for all taxpayers who use the standard (or "uplift") method of calculating their provisional tax payments.

4. The Law Society supports both of these proposals. UOMI is regarded by most taxpayers as punitive in nature due to the rates that apply and the fact that a degree of over- or under-payment is unavoidable, at least in respect of the first two payments. These proposals will significantly mitigate the impact of UOMI for those taxpayers seeking to comply with their obligations and will enhance taxpayer perception of the integrity of the tax system.

5. We make the following comments on certain aspects of the proposals:

   (a) We consider that the proposal that companies in the same "group of companies" (i.e. at least 66% common ownership) be required to use the same method of calculating provisional tax should instead apply only to companies in the same wholly-owned group. Where companies are not wholly-owned, the concern regarding the ability to manipulate where income arises to avoid the provisional tax rules applying (or applying as intended) would not seem to arise.

   (b) Consideration should be given to whether the current 105% that applies under the uplift method should be reduced to better reflect current inflation levels or average increases in residual income tax over the last (say) 5 – 10 years.

   (c) For some taxpayers the estimation method will be more appropriate than the standard uplift method (for example, when it is known that the current year profit will be materially lower than the previous year's due to the loss of a significant contract or a downsizing). The proposals do not include any relief for such taxpayers and so the current situation where taxpayers are incentivised to overpay their provisional tax to avoid UOMI, diverting cash from more productive uses, will remain. Consideration should be given to whether some form of UOMI relief could be provided for taxpayers using the estimation method, for example:

      (i) graduated rates of UOMI applying to the different provisional tax dates (e.g. 50% of the full rate at P1; 75% of the full rate at P2 and 100% of the full rate at P3); and/or

      (ii) a buffer being incorporated into determining whether there has been an underpayment at P1 and P2, so that provided the estimates used for the purpose of paying provisional tax were within certain percentages of residual income tax no UOMI would apply.

6. Finally, the Law Society agrees with the proposal that for reassessments UOMI would apply only from the third provisional tax date where the uplift method has been used. Again, consideration should also be given to whether some form of relief is appropriate for taxpayers who use the estimation method.

***Chapter 3: More accurate and timely payment of provisional tax***

7. Chapter 3 outlines two further proposals to improve taxpayers' experience of the provisional tax system:

   (a) introduction of a new method to calculate and pay provisional tax (the Accounting Income Method (AIM)) for certain taxpayers; and

   (b) allowing for the payment of provisional tax on behalf of related parties.

*Introduction of AIM*

8. The Law Society supports the development of AIM as an available method of calculating and paying provisional tax. Critical to its success will be taxpayer confidence in the calculations and adjustments being made by the relevant software. The ability for a taxpayer or their agent to make corrections and adjustments on a real-time basis will also be important. Taxpayers should also be able to rely on the relevant software given it will have been approved by Inland Revenue and, as a corollary, taxpayers should not be liable for UOMI where any underpayment

results from automatic calculations or adjustments being made by the software (which we understand is consistent with the proposal).

9. The Issues Paper proposes that AIM will be available to all provisional taxpayers with a turnover of $5 million or less. A criterion based on turnover alone does not necessarily reflect a logical threshold at which a taxpayer should be entitled to use AIM. The proposal could therefore be improved by introducing a separate (alternative) eligibility criterion based on the amount of a taxpayer's residual income tax.

10. An eligibility criterion based on residual income tax would extend the benefit of AIM to taxpayers who have high turnover, but low margins on their sales. There does not appear to be any particular risk to the integrity of the tax system by introducing an alternative basis for eligibility based on this method.

*Paying tax on behalf of shareholder-employees*

11. Chapter 3 also proposes allowing a company which does not use AIM to make payments of provisional tax on behalf of shareholder-employees.

12. The Law Society supports this proposal as it may mitigate overall UOMI exposure for related parties. Part 10B of the Tax Administration Act 1994 already allows for the transfer of tax payments (including provisional tax) made by one taxpayer to other taxpayers. It seems that the objectives referred to in this part of the Issues Paper could be achieved through simplifying or expanding the rules in Part 10B.

***Chapter 4: Self-management and integrity***

13. Chapter 4 contains the following proposals:

    (a) allowing contractors subject to the schedular payment withholding rules to choose their own rate of withholding (subject to a minimum rate);

    (b) extending withholding rules to cover contractors operating through labour-hire firms; and

    (c) allowing contractors not covered by the schedular payment withholding rules to agree with their principal that payments be subject to withholding.

*Contractors subject to schedular withholding to elect own withholding rates*

14. This proposal is said to improve the ability with which contractors can manage their tax affairs within the self-management system, on the basis that the contractor will be in the best position to know how much their end of year tax liability will be and choose a withholding rate that will best approximate that amount.

15. The Issues Paper notes that this may give rise to certain compliance costs on the part of persons making payments to contractors. The Law Society agrees and submits that the proposals should balance the benefits to contractors with the compliance costs arising for withholders. Consistent with the self-management theme, there should be greater flexibility or encouragement for contractors to be able to make sporadic "top-up" tax payments during the year on their own account in order to reduce potential UOMI exposure.

*Extend withholding rules to contractors engaged through labour-hire firms*

16. The Law Society supports extending the withholding rules to contractors engaged by labour-hire firms, in order to: protect the integrity of the tax system; reduce the incidence of non-compliance by contractors dealing with labour-hire firms; and reduce the exposure of such contractors to the provisional tax regime.

***Chapter 5: Making the system fairer***

17. The proposal in chapter 5 is to reform the approach taken in regard to penalties imposed on the late payment of tax, by removing incremental late payment penalties on certain types of tax debt. The Law Society supports this proposal but does not understand why it is not able to be extended to other tax types until they are transitioned to IRD's computer system "Simplified Tax and Revenue Technology" (START). It is not principled for taxpayers to be subject to different late payment penalty regimes based on different tax types when in every case the penalties are triggered by a late payment of tax.

18. In addition, the Law Society considers that the incremental penalty should also cease to apply to existing debts rather than just new debts.

***Chapter 6: Improving the operation of markets through greater tax transparency***

19. The proposals in chapter 6 are to provide:

    (a) certain information about outstanding tax payments to credit reporting agencies; and

    (b) information to the Companies Office in situations where Inland Revenue has a reasonable suspicion that a serious offence has been, is being, or will be committed.

*Tax debt reported to credit agencies*

20. The rationale for this proposal is that a debt to Inland Revenue should not be treated differently to debts owed to other creditors. For persons interested in doing business with a taxpayer who has a tax debt, this information may be of considerable assistance.

21. While this is a rational position to take, it is important to recognise that Inland Revenue is in a unique position regarding the amount of personal and financial information it holds in relation to taxpayers. Therefore, any reporting of tax debt must be done in a manner that does not prejudice the actual or perceived integrity of the tax system.

22. The Issues Paper sets out a number of criteria for when the existence of tax debt would be able to be disclosed to credit reporting agencies, which should appropriately balance the competing goals of tax secrecy and appropriate disclosure to the business community. In particular, the Law Society agrees that the debt must not be disputed (formally or informally) and that the taxpayer has been made aware of the intention to notify credit reporting agencies of the debt.

23. Further, it is positive that Inland Revenue intends to develop frameworks with the credit reporting agencies and the Office of the Privacy Commissioner in order to ensure that data is reported in a consistent and principled manner.

24. In the event that information is incorrectly shared with credit reporting agencies, we consider that Inland Revenue should ensure systems are in place to allow taxpayers to correct errors in their credit reports in a timely manner.

*Offences reported to Companies Office*

25. In principle this proposal requires a similar balancing of competing interests between the public benefit from having offences detected or prevented, versus the actual or perceived integrity of the tax system. For example, one of the primary reasons for imposing an obligation of secrecy on tax information provided to Inland Revenue is to encourage voluntary taxpayer compliance.

26. The merit of this proposal will largely depend on the procedures adopted by Inland Revenue and the Companies Office to ensure that the information exchanged is accurate, and is of sufficient seriousness that there is a high likelihood that the Companies Office will initiate proceedings or take other action. Some breaches will be reasonably obvious, whereas others will be less clear. In particular, the Law Society questions whether Inland Revenue officers are qualified to determine whether a director has committed a serious breach of the duty to act in good faith and in the best interests of the company in contravention of section 138A of the Companies Act 1993.

27. Consideration should also be given to requiring that the relevant person(s) be notified that information about them has been provided to the Companies Office, whether or not a prosecution results.

***Chapter 7: Making the system simpler***

28. Chapter 7 sets out a number of proposals that are intended to simplify tax rules for businesses. In general, proposals that make it easier for businesses to comply with their tax obligations are worthwhile. This is the case for each of the proposals set out in chapter 7 and the Law Society is supportive of them.

29. While recognising the need to protect the integrity of the tax system, one of the principles that should be firmly adopted in the context of a self-assessment regime is the ability for taxpayers to correct their own assessments (or have the Commissioner automatically do so). The concept of the integrity of the tax system encompasses the right of taxpayers to have their liability determined correctly. This is illustrated in the following excerpt from *Arai Korp Ltd v CIR* [2013] NZHC 958, which was considering the adjustment power in section 113 of the Tax Administration Act 1994:

> [35] In exercising the discretion, the Commissioner must use her best endeavours to protect the integrity of the tax system. Inter alia, **this requires the Commissioner to use her best endeavours to protect the rights of taxpayers to have their liability determined fairly, impartially and according to law**.
>
> [Emphasis added]

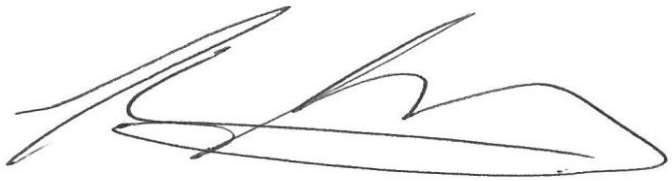
30. However, in relation to the proposal to increase the threshold for self-correcting minor errors under section 113A of the Tax Administration Act 1994 from $500 to $1,000, the proposal in the Issues Paper is too limited to be effective. The Issues Paper acknowledges that the proposal would permit maximum adjustments of "relatively low values". The Law Society considers even the revised threshold is too low to be of any real value to taxpayers. In conjunction with the Commissioner's approach to section 113, taxpayers have very limited ability to have their assessments corrected when an error has resulted in too much tax being paid.

31. The Law Society submits that taxpayers should have much greater ability than they currently do to correct assessments. The Commissioner's concerns (outlined on page 70 of the Issues Paper) could be addressed, for example by requiring notification to the Commissioner of any corrections (but not requiring approval). Notification would bring the correction to the Commissioner's attention and enable the Commissioner to consider the corrected position and challenge it if she disagreed. Timing and resource concerns could be addressed by resetting the time-bar for the particular tax position that has been corrected.

**Conclusion**

32. This submission was prepared by the Law Society's Tax Law Committee. If you wish to discuss this further, please do not hesitate to contact the committee convenor Neil Russ, through the committee secretary Jo Holland (04 463 2967 / jo.holland@lawsociety.org.nz).

Yours faithfully



Kathryn Beck
**President**