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The Chair
Finance and Expenditure Select Committee
Parliament Buildings

Our ref 9131841_1.docx

9 September 2016

Dear Sir or Madam:

KPMG submission - Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill

KPMG is pleased to make a submission on the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill (the "Bill").

Our detailed submissions are attached. In summary:

- We understand the policy for the proposed exchange of information rules in Part 1 of the Bill. However, the policy must be implemented as efficiently as possible. We consider there are opportunities to further rationalise the requirements as well as a need to clarify the rules.
- We support the Accounting Income Method (AIM) proposal. However, the proposal continues to mix collection with liability calculation objectives. We are concerned that requirements for accuracy have not been sufficiently traded off against the ability to have more and more frequent information and certainty for taxpayers. We consider there is room to provide further certainty for taxpayers so that the AIM method is attractive.
- We generally support the business tax measures in Part 3. However, as with the AIM proposal, we consider that accuracy at the time of collection is inappropriately overriding ease of collection. This is especially the case as final tax liabilities are generally unaffected by the business tax proposals.
- We support the policy intention of the Supplementary Order Paper (SOP) but consider it needs significant work to achieve that intention. We note that the Generic Tax Policy Process (GTPP) has not been followed which has contributed to this.

We provide some general comments as well.

Organisation of Parts

We appreciate the organisation of the Bill into topic parts. This has made it easier to understand the total effect of a proposed change.

Regulatory Impact Statements

The Regulatory Impact Statements (RIS) are repetitive. This makes it difficult to ensure that relevant points are identified. Any simplification of the RIS that the Select Committee can recommend would be appreciated.

We acknowledge the irony of the length of our submission. We have attempted to avoid repetition.

Subordinate legislation

The Bill and the SOP to the Bill have subordinate legislation proposals (i.e. determinations and regulations). The SOP has made this a particular point of contention. This is unfortunate. We should instead be having a reasoned conversation on the role and boundary for subordinate legislation in the tax system.

At a high level, we consider:

- There is a good case to be made for having more subordinate legislation; but
- Their status and clear constraints on what they are able to achieve is required.

Taking the proposals in the Bill as examples, the proposals in Part 1 do not clearly state the objective of determination and regulation powers so that it is difficult to test their validity. Part 3 contains business tax proposals (e.g. motor vehicle and premises expenditure calculation proposals) which could instead be candidates for determination or regulation.

We acknowledge that the Bill consultation process does not allow time to consider these issues. We submit that the Select Committee should recommend its inclusion on the policy work programme.

We would like to present our submissions to the Committee. Please contact me on (04) 816 4518 or jfcantin@kpmg.co.nz for any questions.

Yours faithfully

JF Cantin

John Cantin
Partner

Part 1 Exchange of Information

General Approach

Part 1 of the Bill proposes changes to require disclosures by New Zealand foreign trusts and to implement New Zealand's commitment to the automatic exchange of information ("AEOI") and to the Common Reporting Standard ("CRS") in particular.

We appreciate that the New Zealand Government has made commitments to ensure that New Zealand is not used to evade foreign income tax.

We acknowledge that:

1. CRS is a global initiative;
2. CRS is connected to Anti-Money Laundering (AML) and Counter-Financing of Terrorism (CFT) obligations;
3. New Zealand needs to be able to show that it is acting consistently with the global standards.

However, we equally consider that:

1. These obligations have attendant costs, of time and money, for investors and financial institutions;
2. The main effectiveness of the regimes is for their deterrent effect rather than their ability to actually capture mis-behaviour (i.e. the regimes make it harder to hide).

This means that implementation in New Zealand should minimise the additional costs to investors and financial institutions by using, as far as possible, existing systems and processes.

General submissions

Tax-based "Know Your Client" rules

Proposal

The specific CRS requirements for due diligence will apply for non-residents and non-resident controlled financial accounts ("non-resident accounts").

Submission

Consideration should be given to implementing general tax-based "know your client" rules, which apply to residents and non-residents.

Comment

New Zealand imposes withholding taxes on residents as well as non-residents. Accordingly, an investor's status will affect the withholding tax that applies.

Put simply, if the investor is established as a non-resident, the NZ financial institution is entitled to apply non-resident taxes (NRWT or AIL) and at Double Tax Agreement rates (where applicable). If the investor is established as a resident, the appropriate resident withholding tax rules apply.

The proposals establish “know your client” rules for non-residents only. There is an opportunity to establish tax-based “know your client” rules, which establish a person’s status and on which investors and NZ financial institutions can rely, for multiple tax purposes (i.e. withholding and exchange of information).

We note that:

- The Government is consulting on investment income reporting more generally (refer discussion document) which raises similar issues;
- New Zealand entities, which are controlled by a foreign person but correctly treated as resident, do not fit easily into this scheme as the CRS requires them to be reported. However, a suitable set of rules should be able to be designed.

Duplication of Business as Usual and Need for Separate Reporting

Proposal

Separate reporting regimes are proposed for New Zealand foreign trusts and also for NZ financial institutions with non-resident account holders.

Submission

Such reporting is likely to duplicate other reporting and existing processes and returns should be considered instead. This will also provide the opportunity to rationalise reporting to Inland Revenue.

Comment

Business Transformation should allow Inland Revenue to extract information from a variety of sources to be able to report information to other countries.

An additional report should only be required where the entity’s systems is unable to provide the required information in a single return.

The investment income reporting proposals will further duplicate the information provided to Inland Revenue. Although it is likely that these proposals will not be implemented in time for the first CRS reporting in 2018, the requirements likely to be imposed under those proposals should be considered in the design of CRS reporting.

Reliance on AML processes

Proposal

The CRS requirements are to be legislated as standalone requirements.

Submission

The ability to rely on AML processes and procedures, to the extent they support CRS compliance, should be explicitly provided.

Comment

In the main, we see the CRS and AML requirements as complementary. CRS's additional requirements are with respect to the tax status and data of the investor.

We understand that Officials rejected reliance on AML processes in the mistaken belief that this would mean that CRS would be implemented to a lesser standard than the global standard.

Our submissions on the consultative document (available here) were aimed at reducing duplication. This was so that AML processes could be relied on to the extent they cover and require the same information as CRS. It is only the additional requirements of CRS which need to be focussed on. (See further the submission on the trust problem below).

Further, NZ financial institutions are required to make reasonable efforts and take reasonable care to ensure they are not penalised.

NZ financial institutions should be able to rely on their AML processes to the extent that they require the same information as CRS.

The Trust problem

Proposal

Trusts will be reportable investors, under CRS, if the trust is controlled by a non-resident. A controlling person includes a beneficiary. For discretionary beneficiaries, they become controlling persons, at the choice of the NZ financial institution, when a distribution is received.

Submission

Trusts should be treated as financial institutions and the information required by CRS should be reported with the trust's income tax return.

Comment

The treatment of a trust, as a financial institution or not, and determining its controlling persons will be difficult for other financial institutions with CRS reporting obligations.

The persons with the knowledge are the trustees. They should know what the trust invests in and who distributions have been made to as beneficiaries.

Practically, financial institutions will not have the systems or knowledge to determine if a distribution has been made.

This means the CRS reporting obligations should sit with the trustees. The information can be reported as part of the tax return process.

This solution could equally apply to trustees of New Zealand foreign trusts.

We acknowledge that this solution may:

- delay the time for first reporting of trust information as income tax returns for 31 March 2017 may not be due until 31 March 2019. However, this could be offset by making all beneficiaries reportable (i.e. the thresholds for high and low value accounts due diligence under CRS would not apply);
- not be suitable for AML purposes. This should be considered independently of the CRS solution;
- be more difficult for New Zealand to show that it is compliant with the CRS given that there would not be separate CRS reporting on trusts and their controlling persons. However, we consider that making that effort is in the best interests of the tax system.

Importing the CRS standard and commentary

Proposal

The OECD's CRS standard and commentary at the time will apply to obligations of NZ financial institutions and investors.

Submission 1

Inland Revenue should publish and keep-up-to-date a New Zealand version of the CRS and commentary (i.e. as modified by Part 1 and any subsequent amendments, regulations and determinations). It should also publish any proposals to change them.

Submission 2

Explicit transitional rules for changes to the CRS and commentary should be legislated.

Comment 1

On balance we consider making the CRS part of New Zealand law is the best answer.

We understand that there is a trade-off between ready accessibility and remaining globally consistent. If Inland Revenue published a New Zealand version, this would make it easier to apply the CRS as modified by New Zealand's own rules.

OECD updates to the CRS and commentary will be less transparent, for a New Zealand taxpayer, than changes to New Zealand law and commentary. Keeping up-to-date is therefore more difficult if changes to the OECD rules automatically become part of New Zealand's law. The New Zealand Government is involved, through OECD working parties, in proposals for change. It should therefore be in a position to publish proposals for change as they are proposed by the OECD. This will also assist New Zealand taxpayers respond to requests for comment.

Comment 2

The more difficult problem is that the CRS and commentary as it stands at a particular time must be applied by NZ financial institutions.

The CRS imposes due diligence rules and requirements to obtain certain information and report it. This is not a costless exercise. Changes should therefore apply prospectively and ideally for a subsequent reporting period.

For example, a change to the CRS which is published on 31 March should apply not to that 31 March reporting period but, at a minimum, to the next 31 March reporting period to allow time for information systems and processes to be updated.

Specific New Zealand transitional rules are required as New Zealand's reporting period is different to the 31 December reporting year in the CRS adopted by most others. Further, there is no evidence that the OECD would promote reasonable transitional rules.

Determination and Regulation Powers

Proposal

The Commissioner and the Governor General by Order in Council are provided with certain determination and regulation making powers. There is no explicit test for making valid determinations and regulations. There are no transitional rules proposed.

Submission

The objective for the relevant determinations and regulations should be included in the legislation so that their validity can be readily tested.

Transitional rules which govern their effective date and period should also be included in legislation. This should refer to a reporting period.

Comment

It is implicit that the determinations and regulations are to give effect to the CRS and should be made to achieve CRS objectives. However, for example, the legislation does not specify how the Commissioner should determine whether a country is a reportable jurisdiction for CRS purposes. Explicit tests/guidance should be provided.

As with changes to the CRS and commentary, a determination or regulation or a change has the potential to require re-work if it has application part way through a reporting period. A legislative rule should be implemented to give effect to a future application of the determination or regulation.

For completeness and the public record submission

Efficacy of the CRS

Proposal

The CRS is to be implemented by New Zealand.

Submission

The Select Committee should confirm that it considers the CRS is effective in achieving its objectives.

Comment

Although we support the proposal, Officials appear to have concerns regarding the effectiveness of the CRS regime.

In a draft internal memo provided to the Inquiry on Foreign Trust Disclosure Rules (available here), Inland Revenue appears to advise the Inquiry that the CRS is easy to avoid (as well as not always applying). This appears to have influenced the Inquiry in its recommendations for a separate reporting regime for New Zealand foreign trusts.

We have found no explicit consideration of those concerns in the RIS or other statements accompanying the CRS policy. (We acknowledge that we may have missed the relevant discussion.)

We assume New Zealand's global commitments and the deterrent effect are considered to outweigh the potential ineffectiveness and the costs of implementing and maintaining the CRS regime. It also appears that Officials consider that OECD monitoring of the effectiveness of the regime will result in a more effective regime.

However, we consider it important that, as a matter of public record, Officials concerns should be expressly addressed by the Select Committee.

Specific submissions on account information sharing

Provisions to apply CRS and general provisions for CRS and FATCA (clause 24)

Section order for CRS

Proposal

Requirements for a financial institution precede (in proposed 185N) the application of the Common Reporting Standard (proposed 185O).

Submission

The order of the relevant sections should be reversed.

Comment

It is more logical to implement the require application of the CRS before dealing with the specific obligations of financial institutions and information providers.

Requirements for financial institutions

Proposal (section 185N(3))

Each financial institution must do certain things for each financial account (as required by the CRS standard).

Submission

It should be made explicit that a financial institution can meet its obligations by relying on information provided to other financial institutions (e.g. operated by the same fund manager or provider) or for other financial accounts.

Comment

The efficient implementation of the CRS will require the use of existing information and processes. As drafted, it is not clear that information, directly or indirectly, already available to a financial institution can be used to satisfy the CRS requirements.

For example, a licensed fund manager may offer 10 different funds to the public. Each of these is likely to be a financial institution. An existing investor in one fund opening an account in another of those funds would create CRS obligations for the second fund. The second fund should be clearly able to rely on information held by the fund manager to discharge its CRS obligations.

We acknowledge that appropriate safeguards may be required. We further acknowledge that the financial institution's AML processes with regard to determining the source of funds would still need to be applied.

Proposal section 185N (10))

A financial institution must have safeguards and procedures to identify when a distribution is made to a beneficiary.

Submission

See our general submission on the trust problem.

Implementation of the CRS

Proposal (section 185O (3))

The CRS applies at a time.

Submission

See our submission on transitional rules and also publication of the CRS and proposed changes by Inland Revenue.

Proposal (section 185(4))

A term defined in the CRS or the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MCMAA), and used in the Inland Revenue Acts, has the meaning under the CRS and MCMAA.

Submission 1

This should be restricted to provisions of the Inland Revenue Acts which apply the CRS.

Comment 1

The broad importation of CRS and MCMAA definitions has the potential to override existing rules and tax concepts in unintended and unexpected ways.

For example, the Income Tax Act already has a definition of "financial institution" which applies for specific purposes. The drafting in section 185O(4) would appear to override (expand) that definition.

Submission 2

The reference to "used in the Inland Revenue Acts" should be removed.

Comment 2

As the CRS will be imported into New Zealand law, it is by definition used in the Inland Revenue Acts. This requirement adds nothing to the provision.

Proposal (section 185O(5))

A financial institution can choose certain actions if the choice is not contrary to the Tax Administration Act 1994 (TAA) and not otherwise contrary to New Zealand law.

Submission

Further clarity on the ability to exercise choices is required.

Comment

The requirement that the election is not contrary to the TAA is unnecessary and complicating. Section 185O itself imports the election into the TAA. By definition, the election should not be contrary to the TAA.

A concern with complying with the Foreign Account Tax Compliance Act (FATCA) rules was the privacy impact of those rules. The FATCA requirements were legislated to allow NZ financial institutions to report to Inland Revenue without breaching the Privacy Act.

Section 185N(7) allows a NZ financial institution a choice to apply the wider reporting approach or not. Section 185O(5) suggests that this choice is subject to Privacy Act compliance. We understand that it is intended that the choice is freely available. That intention should be clearly expressed.

Requirements to provide information (section 185P)

Proposal

Persons associated with a financial account will be required to provide information when requested by a financial institution.

Submission 1

Requirements for the account holder and others who may be required to provide information should be separately stated.

Comment 1

A failure to provide information may be penalised. An account holder can be expected to have more control and more knowledge than another person who may be required to provide information on the account holder.

Achieving clear obligations and clear consequences is better achieved by separating account holders from others.

Submission 2

The reference to “associated with” should be replaced.

Comment 2

"Associated with" is a broad term. Further, in the income tax and GST contexts it has a defined meaning (through the associated persons definition). This means there is a lack of clarity.

If our first submission is accepted, the appropriate terms would appear to be "account holder" and "information provider".

We acknowledge that these submissions will require re-drafting section 185P. We would be happy to discuss this with Officials.

Requirements for entities that are not persons (section 185Q)

Proposal

Specific rule is proposed for entities which are not "persons".

Submission

These rules may not be required or, if required, may be ineffective.

Comment

The CRS includes as "entities", partnerships and trusts which are not legally persons. Generally, these types of entities are not taxpayers (it is the partners or trustees and beneficiaries who pay the tax).

However, we understand that a "person" is defined by the Acts Interpretation Act 1999 for the purposes of New Zealand law. This definition includes as a person an unincorporated body of persons. This would normally include partnerships and trustees of trusts. (See for example the GST Act which does not separately define a partnership as a person. It is assumed that a partnership is a person because it is an unincorporated body of persons.)

As the TAA does not have a separate definition of person, the Acts Interpretation Act definition appears to apply. This may mean that section 185Q would not apply as the entities described in that section would appear to be persons.

CRS and FATCA Definitions (clause 8)

1. Financial institution

Proposal

There is no definition of "financial institution" in the TAA.

Submission

A definition of "financial institution" which applies for the CRS and FATCA rules should be included.

Comment

We understand that a standalone New Zealand definition of "financial institution" is not required. However, we consider that a definition which references the CRS and FATCA IGA definitions would be helpful. The definition would need to be limited to when applying the CRS and FATCA rules.

It could also be usefully used when establishing what a financial institution must do. It would avoid the need to refer to an "entity other than a person" when a financial institution is meant. (See for example clause 9(2) of the Bill).

2. Passive income

Proposal

A definition of "passive income" is proposed for CRS and FATCA purposes to apply from 1 July 2017.

Submission

The proposed definition should not apply for FATCA purposes.

Comment 1

There is no specific definition of passive income for FATCA purposes. The definition that has been applied is "income from financial assets". Importantly, this means that income from real property is excluded.

This affects the characterisation of entities for FATCA purposes. A new and different definition will require reconsideration of their characterisation.

There does not appear to be any requirement from the United States that the definition for FATCA purposes should be changed to align with CRS. It should not be changed without their confirmation of the need for change and then only with a suitable lead time.

Comment 2

We note that the particular definition will mean an entity would need to consider its status annually as a particular entity's position could change with, for example, exchange rate movements. This will impose costs on investors and financial institutions.

Determinations (clause 12)

Suspension of reportable jurisdictions (section 91AAV(2))

Proposal

A determination suspending reporting jurisdictions should last for a 3 month period.

Submission

The determination should not be limited to 3 months.

Comment

It is not clear why such a determination should only last for three months. The result appears to be that to continue to suspend a jurisdiction as a reportable jurisdiction will require a rolling series of determinations, which is inefficient.

We also refer to our general submission that the objective for which, or basis upon which, the determination is to be made should be stated in the legislation. This may clarify why a three month period is necessary.

Penalties (clause 13)

1. Penalties for a financial institutions failures (proposed section 142H (1) and (3))

Proposal

A financial institution will be subject to a $300 penalty for failing to meet the requirements of the CRS and for failing to obtain a self-certification on opening an account.

Submission

Clear rules as to when self-certification is required should be legislated. To be consistent with the CRS associated guidance, this should be within 90 days.

Comment

The legislation proposes an "opening an account" self-certification requirement. This suggests that all of the required information is provided at the time (i.e. a "Day 1" process).

Practically, this may not be commercially appropriate or possible. An investor may not have with them all the details required to provide a self-certification when physically present at the financial institution. This may need to be provided subsequently.

Given that an objective of the CRS is to make it more difficult to evade tax, investors should have a common experience (at least as to the tax requirements) when opening an account. Any differences should not arise due to interpretation but due to choices made by financial institutions to be more stringent than the law requires. This can only be achieved by having a clear rule as to when the requirements must be satisfied.

Further, the OECD's FAQs on the CRS imply that a financial institution has 90 days from opening an account to obtain valid self-certifications. Inland Revenue has used this to confirm that a similar period is available for obtaining FATCA self-certifications.

The requirement imposed by the legislation therefore appears to be a more stringent test and is a departure from the CRS guidance. This suggests that financial institutions should have 90 days from an account opening to obtain a self-certification (that is, complete all steps).

Note, we understand that the AML rules would treat a failure to provided requested information as an indicator of a suspicious transaction. To some extent, a delay would be potentially self-policing if the AML rules also apply to require reporting.

2. Defences to penalties for a financial institution (section 142H (2) and (4))

Proposal

A penalty does not apply if the failure occurs before 1 April 2019 and:

- reasonable efforts have been made to obtain the self-certification or correct the failure; and
- reasonable efforts have been made to correct the failure within a reasonable time of becoming aware of the failure.

Submission

The 1 April 2019 limitation should be removed and that the reasonable effort and time requirement should be clarified.

Comment

CRS will impose on-going requirements to obtain information. Despite the best systems and processes, errors will occur.

The reasonable effort and time tests are subjective. We refer to our submission on AML processes. A financial institution that follows its tested AML processes should also be able to claim a reasonable effort defence. (For any financial institution which is not subject to AML, implementing AML aligned processes should be an acceptable defence).

3. Failure to take reasonable care (section 142H (5))

Proposal

A $20,000 first penalty and $40,000 subsequent penalties are proposed for a financial institution which does not take "reasonable care" in meeting the CRS requirements.

Submission

This should not apply if either subsections (1) or (3) of section 142H apply.

Comment

This proposal appears to overlap with the proposed penalties for specific failures. Only one potential penalty should apply.

4. Penalties for information providers (section 142I)

Proposal

A $1,000 penalty will apply to various failures by information providers to comply with the CRS requirements. Separate defences apply if the information is within the control of the information provider or not.

Submission 1

Consideration should be given to separate penalties for failures by account holders and others required to provide information.

Comment

See our comment and submissions on proposed section 185P.

Submission 2

That the defences to the application of penalties should be reconsidered and clarified.

Comment

If a failure to provide information is within the control of the person, the person needs to show that the failure is not due to their fault. It is difficult to see in what circumstances this could apply.

For an information provider without control of the information, the defence is if they have made reasonable efforts.

See our submission above for the financial institution's defences.

See also our submission on proposed section 185P on whether it is appropriate to require information to be provided in those circumstances.

Specific submissions on foreign trust disclosure rules

Proposal

A separate reporting regime be established for foreign trusts.

Submission

That a separate regime is not required.

Comment

See our submission on the trust problem for the application of CRS. We consider that this is a more efficient way of achieving the tax objectives.

Proposal

That "foreign trust" is not defined for TAA purposes.

Submission

A specific definition is required.

Comment

As the term is undefined, it takes its meaning from the definition in the Income Tax Act 2007. A foreign trust is defined by reference to a distribution.

This appears to mean that on establishment and until a distribution is made, a trust will not be a foreign trust. The proposed sections would not appear to apply in the interim.

Proposal (59B (3))

On applying to register, the date and detail of each settlement of the trust must be provided

Submission

That this requirement be expressly limited to settlements made to the date of application.

Comment

Read literally, no trust will be able to comply as settlements can and do occur over time. A trustee will not have any details of future settlements.

We note that future settlements are covered by the requirement to notify changes in 59B (5) and reported in the annual return required by section 59D(2).

We further note that our submission that information is provided with an annual tax return would capture this information.

Proposal (59B (5) and 59D (2)

A trustee is required to notify changes and also provide an annual return which contains the same information.

Submission

That the duplication of notification is eliminated.

Comment

We assume that this can be achieved by limiting the application of 59B (5) to any matters which are not required to be included in an annual return by section 59D.

Proposal

All foreign trusts with New Zealand trustees will be subject to the rules. A failure to comply will mean that world-wide income is taxable in New Zealand.

Submission

The proposal should be limited to trusts established or administered in New Zealand.

Comment

We expect there will be trusts settled by non-residents which have NZ resident trustees (family or friends of the settler). We consider these are not trusts which are of concern.

If a comprehensive regime is required, such trusts could be excluded on filing of a copy of a tax return for the settler or other trustees tax jurisdiction.

Part 2 Business tax: AIM provisional tax method

Part 2 of the Bill proposes changes to the provisional tax provisions to incorporate a new method for eligible taxpayers to calculate and pay provisional tax; the Accounting Income Method ("AIM").

We broadly support the proposals and the AIM as an alternative provisional tax method for small to medium sized entities.

In order to adequately service these taxpayers, the AIM must maintain the key features of being simple and low cost to implement and process throughout the year, as this will likely be undertaken by the businesses themselves. The AIM will not serve smaller taxpayers if the overall cost of compliance in a tax year is increased as a result of implementing the method.

To achieve this, the Commissioner must be willing to sacrifice a certain level of accuracy in the periodic calculations and information submitted, and accept a higher threshold for year-end adjustments not processed throughout the year using the AIM.

Our submissions are in line with these principles.

Approval and revocation of approved AIM providers

Proposal

That the Commissioner may publish a notice in a publication chosen by the Commissioner in relation to approved or revoked AIM providers.

Submission

That the Commissioner publish a comprehensive register of approved AIM providers on its website, which a taxpayer can access.

Comment

We support the public publishing of this information, and acknowledge the importance of this information to the public. Given the proposals are aimed at small to medium sized businesses, these businesses are unlikely to monitor IR alerts, newsletters, or other publications with the same level of rigour as do larger corporations.

The current status of approved AIM providers must be easily found on the IR website. For preference, this should be a comprehensive current list rather than a string of approval/revocation notices contained in IR distribution notices or Business Tax Update publications.

AIM-capable system requirements

Proposal

Self-certification for AIM-capable providers.

Submission

That the Commissioner revise the self-certification process to place responsibility for ensuring AIM-capable providers meet the criteria on Inland Revenue, rather than a self-certification process.

Comment

It is our view that the Commissioner must take a more involved role in the assessment and certification of AIM-capable accounting systems.

We emphasise the need for certainty and reliability on the part of the taxpayer. It will be important for Inland Revenue to ensure that the systems offered as being AIM-capable are sufficient in order to provide reasonably accurate estimation of tax liabilities; particularly where the Commissioner has the ability to determine what is "reasonably accurate" and reassess amounts which do not meet this threshold under proposed section 119 of the Tax Administration Act 1994 ("TAA").

It would be unreasonable if the Commissioner were not to actively assess and approve the systems on offer, on which a taxpayer relies, and can then be penalised should the system later prove to be insufficient for meeting the Commissioner's needs.

The Commissioner is concerned about the resource constraints in putting in place a pre-approval eligibility assessment process. However, in our view protecting the integrity of the AIM and ensuring taxpayers are able to meet their obligations in using these systems justifies the costs in doing so.

We acknowledge that there may be time constraints in putting in place and approving these systems prior to the commencement of taxpayers' 2018/2019 tax years. If necessary, we would suggest an interim self-certification process, which is migrated towards a Commissioner-certified approach over (for example) a year.

Eligibility Criteria

Proposal 1

Eligibility criteria excludes a taxpayer who has "consistently and systematically returned tax liabilities using the AIM that are inaccurate assessments of their tax liabilities".

Submission

That this provision be excluded from the Bill.

Comment

The Commissioner's commentary describes the AIM as a "click, review, send" methodology. The emphasis is on systems which are capable of dealing with ordinary tax adjustments, with the flexibility to deal with additional adjustments particular to the taxpayer's individual circumstances as necessary.

We believe the use of an AIM-capable system should be considered to be sufficient to meet the taxpayer's provisional tax obligations. If the system is, in the Commissioner's view, incapable of producing reasonably accurate assessments, the responsibility for correcting this should lie with the provider and should not give rise to an ineligibility of the taxpayer to use the AIM.

If proposed section RC 5B(e) if the Income Tax Act 2007 ("ITA") is intended to apply to situations where the taxpayer has deliberately used an AIM-capable system to avoid provisional tax implications of ordinary transactions (for example, by deliberately miscoding the purchase of a new vehicle to motor vehicle expenses), then this is better dealt with as gross carelessness. Such a taxpayer would then be subject to a shortfall penalty in relation to their use of the AIM and would be covered by proposed section RC 5B(d).

Proposal 2

Revocation of AIM-eligibility part way through a tax year

Submission

That the Bill be amended to include a process for the revocation of the AIM due to the taxpayer ceasing to meet the eligibility requirements part way through a tax year.

Comment

The Bill is silent on any procedures for notifying or advising the taxpayer that they are no longer eligible to use the AIM.

In order to promote certainty, we recommend the Bill include a notification period by which the Commissioner is required to notify the taxpayer that they are no longer eligible to use the AIM, and will now be subject to the estimation method for the year. This will be particularly important as the taxpayer will be subject to use of money implications on estimations throughout the year.

We also recommend the Commissioner be required to consult with the taxpayer in order to rectify any failure to meet the eligibility criteria where possible, particularly if this is due to the application of proposed subsection 5B(e) of the ITA.

We further recommend the estimation be limited to a prospective basis, rather than applying to the whole of the tax year. It would be unfair to penalise a taxpayer and cause them to be subject to use of money interest under the estimation method where, at the time the provisional tax payments were made under the AIM, they were eligible to use that method.

Proposal 3

Revocation of AIM where a taxpayer has failed to provide the Commissioner with required Statements of Activity more than twice for the current tax year.

Submission

That the subsection be amended to exclude situations which are out of the control of the taxpayer.

Comment

It is foreseeable that there will be situations in which the required information is not provided to the Commissioner through no fault of the taxpayer; such as a system error or failure on the part of the software provider.

We recommend that subsection 5B(g) of the ITA be amended so as to ensure a taxpayer does not become ineligible in such a situation.

Proposal 4

Eligibility for taxpayers to use the AIM be restricted to those with gross annual income of $5,000,000 or less, except for certain limited circumstances.

Submission

That the eligibility be extended to large taxpayers generally but that complexity of adjustments may be a relevant factor in excluding certain taxpayers.

Comment

We acknowledge that the Commissioner intends to exclude large businesses from the AIM in the first instance. As in our initial submission in respect of the issues paper, we reiterate that we see no reason why the AIM should not be available to those whose gross annual income exceeds this threshold.

We acknowledge that above a certain threshold taxpayers are likely to have more complex tax adjustments. We consider that complexity rather than turnover which is the appropriate eligibility criteria.

Determinations

Proposal 1

Required adjustments under AIM to be issued by way of determination.

Submission

That the required considerations for making this determination pursuant to proposed section 91AAX of the TAA be extended.

Comment

Proposed section 91AAX (2) outlines that the Commissioner have regard to a number of qualitative criteria when making determinations. We suggest the constraints on the Commissioner be increased such that she is only able to require adjustments which are shown to generally cause significant differences between accounting and taxable income.

We acknowledge that the proposed section includes a notification period prior to amending or revoking a determination under proposed subsection (4). We propose that the Commissioner be required to consult with the public in relation to the above prior to making a determination. This will ensure she has a full understanding as to the considerations under subsection (2) and (if our proposal above is accepted) that the adjustments proposed are significant enough to justify inclusion.

Proposal 2

Commentary by the Commissioner as to the proposed tax adjustments which might be required under a determination.

Submission

While we acknowledge that the Commissioner has proposed further consultation on the specific adjustments required prior to issuing her determination, we make a number of comments on those outlined in the Commentary below.

Comment

Our proposals below emphasise that, in order to be successful, the AIM must not excessively increase the reporting obligations of taxpayers.

If the AIM results in a taxpayer calculating and re-calculating year-end adjustments on a period-by-period basis, the adjustments will overcomplicate and increase the compliance cost of an otherwise relatively simple provisional tax regime.

- *Temporary differences*

  The Commissioner has accepted that some degree of tolerance is required where timing differences are expected to balance out in a subsequent AIM provisional tax period. She has proposed that adjustments only be required where the timing difference spans more than two provisional tax periods.

  We propose that the requirement for adjustment of timing differences be excluded altogether. This approach would encourage the alignment of tax and accounting income, especially where most taxpayers using the AIM will be eligible for Special Purpose Financial Reporting and applying Inland Revenue's minimum reporting requirements.

  If the Commissioner does not accept this proposal, we propose that the expressed tolerance for short-term timing differences be extended to those which are expected to balance out within the current tax year. This would reflect that AIM is intended to be the collection of current-year taxes in order to mitigate year-end tax liabilities, rather than the early collection of tax which will not be payable at year-end.

- *Provisions*

  We further recommend that a similar approach be taken in respect of provisions; that these be excluded (particularly if the Commissioner intends on working toward the long-term alignment of accounting and tax principles for eligible taxpayers), and at least in cases where the provisions are expected to reverse within the current tax year.

  As the Commissioner acknowledges, most taxpayers falling within the AIM eligibility criteria do not commonly account for substantial provisions. Common examples include the accrual of accounting or audit fees. The potential cost to the Commissioner of not requiring adjustment of these items is minor.

  In situations where a taxpayer has significant provisions which could cause a difference between accounting and tax income at year-end, we propose that the adjustment of these on a periodic basis be at the taxpayer's discretion.

  We acknowledge that in some instances a taxpayer could manipulate the accrual of provisions in order to gain provisional tax benefits. However, in most cases the cost of monitoring and adjusting for these on a periodic basis will outweigh the temporary timing benefit to IR. In extreme cases, this can be dealt with under the avoidance or gross negligence provisions.

- *Financial arrangements and foreign exchange*

  The Commissioner has acknowledged that further consultation is required in respect of potential adjustments of financial arrangements and foreign exchange, and that the intention is to keep as close to accounting treatment and cashflow impacts as possible.

  We emphasise that accounting treatment and cashflow can lead to two very different results depending on the taxpayer's circumstances. The financial arrangement rules are overly complex for their circumstances. Regular adjustments in this area will unnecessarily increase the cost of complying with AIM, and could lead to significant fluctuations in the provisional tax position depending on the movement of foreign exchange.

  In our view, the better approach is to align the treatment of financial arrangements and foreign exchange under AIM with cashflow movements, in order to reduce the cost of compliance.

- *Shareholder salary accruals*

  The Bill proposes to exclude shareholder salaries from the calculation of provisional tax under AIM, unless they have been paid in the relevant period. This is coupled with the proposals which enable Companies to collect provisional tax on behalf of shareholders and transfer this to its shareholders once the actual year-end position has been determined and salaries declared.

  While we are broadly in support of the new shareholder provisional tax collection and transfer provisions, we note that there may be those shareholders who choose not to utilise these provisions. We believe the treatment of shareholder salary within AIM should be flexible depending on the mechanisms employed.

  We further note that in practice, most companies do not accrue shareholder salaries throughout the year. Rather, these are likely to be applied to a shareholder current or loan account and treated as "paid" under the current definition in the ITA. In these cases, we anticipate the proposed AIM adjustment to exclude shareholder salaries would not occur.

- *Accruals*

  The PIE rules allow expenditure to be deducted and income to be taxed as and when these are recognised by the PIE. This reduces "lump" taxable income during a PIE year.

  An equivalent rule should be considered for AIM.

- *Other common adjustments*

  Other common year-end adjustments for eligible taxpayers include prepaid expenditure and income in advance. We propose that the Commissioner consider an appropriate threshold under which the Commissioner does not require periodic adjustments to be made. We further propose the Commissioner consider extending this threshold treatment to all non-permanent adjustments, to more closely align the accounting and tax treatment of these items.

Providing data to Inland Revenue – the Statement of Activity

Proposal

The Bill proposes to require AIM taxpayers to submit an agreed set of information prior to each instalment.

Submission

That proposed section 45 TAA be amended to outline the process by which the Commissioner determines the information required.

Comment

We acknowledge that AIM signals a desire for the Commissioner to obtain earlier information from taxpayers as to their financial position. This communication, if conducted appropriately, will benefit the taxpayer and the Commissioner and improve the quality and efficiency of the taxpayer's communications with Inland Revenue.

However, the provision of financial data is a sensitive matter for taxpayers and needs to be managed with appropriate safeguards, and disclosures as to the purpose of and process for those communications.

Proposed section 45 of the TAA outlines the obligation for the taxpayer to provide information as required by the Commissioner in the form prescribed by the Commissioner. However, it is silent as to any process by which these requirements would be determined. We recommend that the provision be amended to require a consultation process prior to the setting, revocation, or amendment of any information requirements.

We further recommend that the consultation process require the Commissioner to outline how this information will be used, and the parties/agencies/government bodies who will have access to this information.

Interest and penalties

Proposal 1

The Bill proposes to remove UOMI and penalties where payments are made correctly under AIM. Where the Commissioner determines the amount of provisional tax as calculated under AIM is not reasonably accurate, the Commissioner may re-calculate the liabilities under proposed section 119 of the TAA.

Submission

That the proposed section 119 be removed.

Comment

In the Commissioner's words, the AIM is intended as a "click, review, send" method by which the taxpayer uses approved software to determine an estimate of its tax liabilities throughout the year.

Taxpayers eligible for the AIM are small to medium sized entities. These entities tend to have relatively limited knowledge of the taxation of complex transactions. While the tax complexity of transactions is ordinarily of a lower level in these taxpayers, we note that for many areas in tax, frequency of occurrence does not correspond with a respective reduction in complexity of analysis.

One common example is that of revenue vs capital expenditure, such as repairs and maintenance. The development of case law over time has led to a complex overlay of considerations which must be borne in mind when analysing whether a particular transaction can be considered repairs and maintenance or must be capitalised. This is reflected in the uncertainty in the industry of earthquake strengthening expenditure.

Likewise, the uncertainty which arose around tax avoidance arrangements and funds allocated to owners following the *Penny and Hooper* decision highlights that common treatment within the accounting industry does not necessarily indicate a straightforward analysis for taxation. The recent decisions in *CIR v Vector Ltd* and *Trustpower Ltd v CIR* also illustrate this principle.

In our view, it is unfair to put in place a provisional tax methodology which is designed to be inherently simple, and yet penalise taxpayers where they fail to consider complex tax obligations.

It is our belief that section 119 is unnecessary. Where a taxpayer acts in good faith, follows good accounting practice in identifying the correct accounting treatment and uses the AIM, it should be accepted that the provisional tax payments are reasonably accurate, and not be subject to reassessment. In cases where a taxpayer has not acted in good faith, we believe the existing provisions and penalties for gross carelessness would be sufficient to penalise the taxpayer.

Proposal 2

Proposed section 120KBC of the TAA proposes that UOMI does not apply where payments are made correctly under the AIM. Where the Commissioner determines the amount of provisional tax as calculated under AIM is not reasonably accurate, the Commissioner may re-calculate the liabilities under proposed section 119.

Submission

That the UOMI and penalty implications of a reassessment under proposed section 119 be clarified.

Comment

The Bill is silent on the interaction between proposed section 119 and proposed section 120KBC. In the absence of any provision to the contrary, we presume a reassessment under proposed section 119 would not cause interest to be payable. However, we recommend that the Bill be amended to clarify this matter.

Tax pooling

Proposal

The Bill proposes to remove the AIM from eligible tax pooling provisions.

Submission

That the AIM be retained in the tax pooling provisions to the extent that reassessments give rise to penalties and/or interest.

Comment

We note that we have requested clarification of the UOMI implications of a reassessment under proposed section 119. If a reassessment does not give rise to any UOMI, we support the removal of AIM from the tax pooling provisions.

We further suggest clarification is required as to the interaction between proposed section RC 5C of the ITA and section 120KBC. We presume that, if the taxpayer ceases to be eligible for the AIM and is treated as using the estimation method for the year under proposed section RC 5C, the taxpayer will then be eligible to use tax pooling as they are no longer treated as using the AIM. However, we believe clarification on this matter in the Bill would also be beneficial.

Drafting amendments

In our consideration of the above, we have noted apparent drafting errors, which we propose be considered and amended as necessary:

Section Reference	Current wording/placement	Proposed wording/placement
Section 2C(b)	the amount of the shareholder's tax credit under section LB 2 for the tax year less the shareholder's residual income tax for the tax year, treating a negative amount as zero; and	the amount of the shareholder's residual income tax under section LB 2 for the tax year less the shareholder's tax credit for the tax year, treating a negative amount as zero; and
Schedule 3, Part AB, after "How to use this table:"	…use the period for that instalment in the second column if section RC9(4B)(a) applies or use the period in the third column if section RC9(4B)(c) applies	…use the period for that instalment in the second column if section RC9(4B)(a) or section RC9(4B)(b) applies, or use the period in the third column if section RC9(4B)(c) applies
Section 45C	Currently placed within Part 3 – Information, Record-Keeping and Returns	To be placed within Part 2B – Intermediaries for PAYE, Provisional Tax, and Resident Passive Income, at circa section 15

Part 3 Business tax and remedial matters

Safe harbour for all provisional taxpayers using standard uplift method

Proposal

Remove use-of-money interest ("UOMI") for the first ("P1") and second ("P2") provisional tax instalments for taxpayers using the standard uplift method to calculate their provisional tax liabilities.

Submission 1: supportive of the proposal

We support this proposal.

Comment

In our experience, taxpayers find it difficult to get the provisional tax instalments right at P1 and P2 due to the complexity and uncertainty associated with projecting annual income. Deferring UOMI risk until the third instalment ("P3"), which is approximately one month after balance date, should provide greater certainty and fairness to taxpayers in forecasting their tax position.

Submission 2: extend safe harbour to estimation method

The proposals only defer UOMI to P3 for taxpayers who use the standard uplift method. We consider that the UOMI safeguard should also be extended to taxpayers who estimate their tax liability on a fair and reasonable basis.

Comment

This proposal only applies to taxpayers using the standard uplift method. Accordingly, this change will create a powerful incentive to taxpayers to use the standard uplift method to mitigate their UOMI exposure, even in situations where a fair and reasonable estimate provides a more accurate projection of their financial performance.

For example, in situations where the estimate method forecasts financial performance to be worse than the prior year (or two years prior), the taxpayer may nonetheless select the standard uplift method purely to safeguard against UOMI, despite the fact that the estimation method would be more accurate.

We therefore consider the proposal should be extended to include users who estimate their provisional tax on a fair and reasonable basis. This addresses the inequitable result illustrated above, provides greater fairness for taxpayers facing different financial and economic situations and would also meet the objective of provisional tax: to collect *broadly* the right amount of tax throughout the income year.

Submission 3: consistency requirements – for associated persons

The Bill requires that "standard method associates" must use either the GST ratio method or the standard method.

The commentary to the Bill clarifies that an associated person for the purposes of the new proposal is:

- A company in the same wholly owned group per section IC 3 of the Income Tax Act 2007 ("the Act"); or
- Persons associated under YB 3 of the Act, modified to require a 50% voting interest rather than 25%.

We do not consider that this proposal should be enacted.

Comment

We understand the rationale for this rule is to prevent taxpayers "gaming" the system. However, we note that there may well be valid commercial reasons for associates to use different provisional tax methods. For example, the main operating entity may have variable financial performance such that the estimation method is more appropriate, but a subsidiary with nominal taxable income does not justify the additional time and cost of using the estimation method. However, the proposal as it currently stands would require both the main operating entity and the subsidiary to use the standard uplift method to benefit from no debit UOMI.

Submission 4: consistency requirements – switching between methods

We consider that a taxpayer should be allowed to switch to the estimate method on or before the final instalment of provisional tax rather than before the second instalment date, as proposed.

Comment

We believe taxpayers should be able to switch between the standard and estimation methods up to the date of P3 in order to account for unexpected downturns in business which may occur between P2 and P3. Otherwise, taxpayers would be forced to overpay their provisional tax simply to mitigate their UOMI exposure.

Changes to UOMI safe harbour threshold

Proposal

Increase the safe harbour threshold at which the UOMI applies, from $50,000 to $60,000 and extend the safe harbour to non-individuals.

Submission 1: supportive of the proposal

We support this proposal.

Comment

This proposal is welcomed as it will reduce compliance costs by removing small taxpayers such as micro and small businesses from the interest rules.

Submission 2: increase the residual income tax threshold for provisional tax

The Government should consider reviewing the residual income tax threshold of $2,500 for becoming a provisional taxpayer.

Comment

Given that the provisional tax rules are the subject of review currently, we consider that thought should be given to the $2,500 RIT threshold for becoming a provisional taxpayer. This equates to less than $9,000 of business or other income from which tax has not been withheld (at the 28% tax rate). It is well beyond time for this threshold to be raised to a more reasonable level (e.g. $5,000 or $7,500).

Provisional tax attribution

Proposal

A shareholder-employee and the company can agree that the shareholder-employee's provisional tax payment obligations on their shareholder salary are transferred to the company. At the end of the year, the company can transfer a tax credit, out of its provisional tax payments, to the shareholder-employee.

Submission 1: supportive of the proposal

We support this proposal.

Comment

We also acknowledge the clarification from the Bill Commentary that shareholder-employee's whose only income not subject to tax at source is their salary will be able to use these rules to completely remove themselves from the provisional tax system.

Submission 2: clarity in relation to insolvent liquidations

It is not clear how the proposed rule would work in an insolvent liquidation of the company. That is, where a company has deducted provisional tax on behalf of shareholder employees prior to liquidation (and has adjusted employees' drawings accordingly).

Comment

Technically, the amount paid would be treated as income tax of the company, not an amount held in trust for another person (such as PAYE or GST). This will have implications for shareholder employees, who may find they will still face a liability on their gross earnings because a receiver or liquidator does not attribute the payment to them.

Allowing contractors to elect their own withholding rate

Proposal

Allows contractors who are subject to the schedular payment rules to elect their own withholding rate without having to apply to Inland Revenue for a special tax code.

Submission 1: qualified support of the proposal

We provide qualified support for allowing contractors the ability to self-assess their withholding tax rates. We believe this proposal should incentivise greater compliance by contractors (compared to the current withholding rate options, which can be penal, while the process to request a special rate certificate from Inland Revenue can be time consuming).

However, we do not agree with the setting of the minimum and non-declaration withholding rates.

Comment

A 10% minimum rate assumes a margin of approximately 30% on a contract payment. In our view, this seems excessive. If a minimum rate is desired, this should be set lower (say around 5%).

While Officials' concern seems to be that this may incentivise selection of the lowest possible rate, in practice, we expect that most contractors will accurately self-assess to avoid an end of year tax bill.

Similarly, the proposal to increase the non-declaration contractor rate from 20% to 45% seems overly harsh. We do not believe that the PAYE non-declaration rate is the appropriate benchmark as contractors can deduct their business costs (i.e. unlike employment income, the payment is gross not "net").

Further, if the rate is set too low, the contractor will still have provisional tax liabilities. As Inland Revenue will have income and IRD number information it is protected from having a rate that is too low being applied.

Submission 2: clarification of whether the certificate of exemption regime remains

It is not clear whether a minimum 15% rate for non-resident contractors will mean that they will no longer be able to apply for certificates of exemption. We strongly recommend that certificates of exemption be retained (e.g. if income is DTA relieved).

Comment

We view these withholding proposals not as an end but potentially a starting point for inclusion of more business taxpayers in the withholding tax rules (as the Business Transformation process continues).

This has the following implications:

- Imposing a 10% minimum withholding tax rate on each payment to a resident contractor will mean there is reduced cash-flow to support their business (including funding). This will have an economic impact as more contractors are included in the rules.
- The application to labour hire firms will move Inland Revenue to the front of the queue as a secured creditor of those businesses.
- The inclusion of labour hire firms within the contractors' withholding tax rules will change the dynamics of current engagements. For compliant contractors (currently paying provisional tax on contract receipts) this will be a new set of rules to understand and apply.
- For New Zealand businesses using contractors, there will be withholding system impacts. There may be multiple rates to apply if different contractors are hired. This will encourage automation which will come at a cost for business. The systems change costs of this proposal should not be underestimated. Accordingly, we do not expect there to be significant uptake of the voluntary withholding option.

Extending withholding to labour-hire firm contractors

Proposal

Extends schedular payment rules to contractors that work for labour-hire firms.

Submission 1: qualified support of the proposal

We broadly support this proposal, but we reemphasise the potential implications noted above.

Voluntary withholding agreements

Proposal

Allow contractors not covered by the schedular payment rules to opt in to the rules with the consent of the payer.

Submission 1: support of the proposal

We support the rationale of this proposal on the basis that it provides an option to contractors to have tax withheld to manage their cashflow.

Late payment penalty

Proposal

Removes 1% monthly incremental late payment penalty on unpaid tax from Goods and Services Tax ("GST"), income tax and Working For Families tax credits overpayment.

Submission 1: support the proposal

We support this proposal.

Comment

We consider the current penalties regime is excessive particularly when combined with UOMI. Inland Revenue needs to consider whether the current compliance and penalties framework is generating the desired outcome, given the increasing amount of penalties debt (which is generally non-collectible and ends up being written-off).

Disclosing reportable unpaid tax to credit reporting agencies

Proposal

Allows the Commissioner to disclose a taxpayer's information and their significant tax debt to approved credit reporting agencies. This proposal is currently limited to non-individuals.

Submission 1: qualified support of the proposal

We provide qualified support for this proposal.

Comment

We are concerned about the commercial ramifications of misreporting and the lack of guidance on redress in such situations.

Submission 2: managing misreporting

Any misreporting by Inland Revenue or misuse by the credit reporting agency will have significant commercial implications for the business involved. Therefore, there needs to be clear guidance on how these situations will be managed, including sanctions for offenders and redress for those affected.

Comment

As a practical matter, we note there may be a delay between the creation of tax debt in Inland Revenue's system, the reporting of that debt to credit reporting agencies, and the use of the information by prospective lenders. There needs to be a process to ensure that any shared information is updated by Inland Revenue on a timely basis (with a similar requirement imposed on the credit reporting agency to update their records and information communicated to any third parties).

Information sharing with the Registrar of Companies

Proposal

Inland Revenue can share information with the Registrar of Companies, for the purposes of enforcing certain offences against the Companies Act 1993.

Submission 1: supportive of the proposal

We support this proposal.

Motor vehicle expenditure of close companies

Proposal

Extends motor vehicle "private expenditure" rules in subpart DE of the Act to allow certain close companies to use these rules as an alternative to filing FBT returns.

Submission 1: supportive of the proposal

We support this proposal.

Submission 2: removal of the interest allocation rule

We do not support the enactment of this rule, which requires that the interest costs incurred by a close company to be apportioned between private and business use.

Comment

We understand the rationale for this rule is to prevent a close company obtaining a full interest deduction for a motor vehicle which is used 100% privately by the shareholder-employee. Addressing this concern is not straightforward given the fungibility of money.

We have considered the following options:

- Disallowing the taxpayer's election into the Subpart DE regime where there is an "interest allocation avoidance arrangement", defined as an "arrangement that involves the manipulation of the private/business use ratio with the purpose or effect of defeating the intent and application of the motor vehicle expenditure rules in Subpart DE".
- A two tiered objective test:
    - A prescribed private/business ratio;
    - Complemented by a "brightline" threshold between when the motor vehicle is acquired by the close company and when the motor vehicle reaches the prescribed ratio of private/business use above.

For example, if a motor vehicle is used for more than 50% private use during any income year within 5 years of acquisition by the close company, this could be deemed to be an interest allocation avoidance arrangement.

- A simpler solution could simply be to allow a close company a prescribed 50% deduction of interest regardless of the private/business use ratio. This represents a compromise between accuracy and simplicity, being the main objective of the proposals.

All of these require some element of tracing and are not therefore ideal. Further consideration is required.

Increased threshold for taxpayers' self-corrections of minor errors

Proposal

Increasing the threshold for self-correction of errors from $500 to $1,000 of tax.

Submission 1: supportive of the proposal

We support this proposal, but there should be a broader review of the process for correction of errors.

Comment

For errors that have a tax effect of greater than $500 (or $1,000 under the new proposal) there is no option but to make a voluntary disclosure (or section 113 request) to Inland Revenue. The compliance costs and administration costs associated with the voluntary disclosure (and section 113) process are high.

Consideration should be given to:

- setting the self-correction threshold by reference to materiality for a particular taxpayer (e.g. tax effect of the error as % of their total tax liability, or gross or net income) or;
- allowing taxpayers to self-correct errors, but with compulsory disclosure in the relevant tax return.

The latter would address Officials' concerns of the rule being abused. It would allow Inland Revenue to further investigate issues of interest.

Simplified calculation of deductions for dual use vehicles and premises

Proposal

Allows taxpayers to use a simplified method for the calculation of deductions for premises and vehicles that are used for both business and personal purposes.

Submission 1: supportive of the proposal

We support this proposal.

Remove the requirement to renew RWT exemption certificates annually

Proposal

This proposal will legislatively require most resident withholding tax ("RWT") certificates to be issued for an unlimited period.

Submission 1: supportive of the proposal

We support this proposal.

Increased threshold for annual FBT returns from $500,000 to $1 million of PAYE/ESCT

Proposal

The threshold for calculating and returning FBT on an annual basis be increased from $500,000 to $1 million of PAYE/ESCT.

Submission 1: supportive of the proposal

We support this proposal.

Modifying the 63-day rule on employee remuneration

Proposal

Allows taxpayers to choose whether to apply the existing rule in section EA 4 of the Act for expenditure on employee income paid within 63 days of balance date. If section EA 4 is not applied, the taxpayer receives a deduction on employment income that is paid during the income year.

Submission 1: we are not supportive of the proposal

That the 63 day rules should be removed except for related party employee remuneration.

Comment

Given the 63 day adjustment is a temporary tax difference only (i.e. a matter of timing as the deduction will ultimately be allowed), we consider the better option is to simply allow the deduction. This would not apply to accrued shareholder-employee income which is not recognised as taxable income in the same income year. This carve-out is necessary to ensure that deferral advantages are not sought due to a difference between deduction and income for related entities.

General submission – Design of START

We strongly support the proposals to ensure that the transition from FIRST to START is simple and efficient as well as ensuring that the integrity of the tax system is preserved. Further, we agree that any changes should support fairness in the tax system and minimise the compliance costs for both Inland Revenue and taxpayers alike.

Our detailed submissions on the proposed changes relating to the design of START are outlined below.

Administration of the late payment penalty rules *(clauses 112 and 113)*

Proposal

Currently, the tax rules impose a late payment penalty if a taxpayer does not pay the required tax liability on time. However, the rules allow for a "grace period" to apply where the taxpayer has had a good compliance history in the previous two years, which gives the taxpayer time to make the payment owing before the late payment penalties are imposed.

Inland Revenue's current system, FIRST, determines the application of the grace period on the basis of the taxpayers' previous compliance in terms of payment of tax across all relevant tax types. However, the transition to the START system will be done on a tax-type basis and, therefore, determining the application of the grace period on the same basis will require significant manual intervention as the information will be contained in two separate systems (being FIRST and START).

To pre-empt this manual intervention from occurring, the proposed amendment (and inclusion of new section 139B(1B)) will enable the Commissioner to look only at the tax information in respect of the taxpayer's compliance history held in the system from which the tax type in payment default is being administered.

Submission

We support this proposed amendment and consider it a reasonable and practical approach that will assist Inland Revenue and taxpayers alike during this transitional phase.

Amending the rules for new and increased assessments by the Commissioner *(clauses 113(1) and (5), 115, 117 and 118)*

Proposal

Under the current legislation, a new due date is set for the payment of tax when the Commissioner makes a new assessment, or increases an assessment less than 30 days before, on or after the original due date for payment of the tax. It is proposed that an amendment be made to remove this requirement and to allow the Commissioner to apply credits or refunds that become available in payment of the taxpayer's tax liability from the moment the Commissioner has made a new or increase assessment.

The proposed amendment will not change the timing and application of use-of-money interest ("UOMI") and late payment penalties.

The amendment to allow the automatic offset of credits or refunds is intended to reduce taxpayers' interactions with the tax system and their risk of exposure to penalties and UOMI.

We submit that it is unlikely that these objectives will be achieved by the proposed amendment on the basis that it is more than likely that taxpayers' who receive a new or increased assessment will have been interacting with Inland Revenue (and the tax system) in respect of that new or increased assessment in any event.

Further, since the timing and application of UOMI and late payment penalties will remain unchanged, we do not consider that automatic offset of credits or refunds would necessarily achieve a reduction in taxpayers' exposure to either.

Submission

We submit that the proposal for automatic offset of credits or refunds against a new or increased assessment from the date of that new or increased assessment does not proceed. Instead, the status quo should remain whereby a new due date within 30 days of the reassessment is set and any credits or refunds should only be offset automatically once this new due date has passed.

Use-of-money interest and transfers of tax *(clauses 106,119 and 120)*

Proposal

Currently, taxpayers are able to transfer amounts that exceed the amounts owing in previous periods and are then paid UOMI from an earlier date than if they had not transferred the money back.

It is proposed that amendments be made that will:

- limit transfers of excess tax within the taxpayer's accounts or to another taxpayer to the total of the amount in debt and/or in dispute in the requested period;
- clarify when UOMI starts to accumulate; and
- when a transfer takes effect for GST refunds and GST overpayments.

Submission

We support the proposed changes to limit the sum transferred to an earlier period to the amount in dispute or the amount owing and agree that taxpayers should only receive the correct UOMI (i.e. should not receive more UOMI than they would be entitled to but for the transfer to earlier periods).

Comment

Under the current legislation, there is no distinction between a GST refund and a GST overpayment, which means that a GST overpayment constitutes a “refund” and, thus, is eligible for the transfer date applicable to GST refunds (which is earlier than that applicable to overpayments). This has flow-on implications for the amount of UOMI the taxpayer stands to receive.

We agree with the proposed amendment to the Tax Administration Act 1994 to distinguish between a GST refund and a GST overpayment for transfer eligibility date purposes.

Supplementary Order Paper 190 to the Bill

Proposal

To enact an empowering provision to provide for transitional regulations and exemptions to be made by Order in Council during the business transformation process. This is intended to support an orderly transition from FIRST to START, and avoid delays and increased costs for the business transformation process, while minimising the administrative costs and compliance costs.

Submission 1 the policy is correct but the execution is poor

We support the intent of the proposal but consider that significant work needs to be done to ensure that the regulatory power is sufficiently described and circumscribed so that any regulations made are clearly valid and that taxpayer rights are sufficiently protected.

Comment

We accept the position that in a project of the size and scale of Inland Revenue's Business Transformation that it is difficult to "know what you don't know". Although there is significant policy (and private sector) resource devoted to the project, perfect foresight is difficult to achieve.

A regulation making power to allow time for appropriate legislative amendments is we consider necessary.

However, as drafted, the regulation making power is unfettered. This means that taxpayer rights contained within the TAA may be abrogated.

This is compounded by the fact that the object is indirectly described. There is no definition of the "business transformation process".

Submission 2 the object of the regulations is poorly described

That the object of the regulation making power needs to be more precisely stated than" as necessary or desirable for the orderly implementation of the business transformation process".

Comment

The fact of Inland Revenue's Business Transformation process is widely known and understood. However, it is not defined.

At a high level, any tax matter may affect the orderly implementation of the process. Although we understand the regulation making power is not intended to affect the substantive rules in the Income Tax Act or the GST Act, the border between what is and what is not allowed is unclear. (See further below).

We understand that the focus of the power is on what, how and when taxpayers must report, collect and pay under the Inland Revenue Acts.

We would expect therefore that a regulation which allows a delay in a payment of core tax is anticipated as a valid exercise of the power. However, a regulation which increases the amount due or removes it entirely is not valid.

Focusing on what the regulations are intended to cover and on what the business transformation process is should assist in a better description of the key issue the Minister must consider.

Submission 3 the regulation making power is too wide

That the regulation making power should not apply to the whole of the TAA or that the regulation making power should be limited so that it does not remove a taxpayer protection or increase a taxpayer obligation.

Comment

We have not done a comprehensive analysis of every provision. We consider that this should have been done to determine appropriate limits on the regulation making power.

For example, we note that Parts 4A, 8A and 8A provide taxpayers with rights of challenge to the Commissioner's decision. It imposes time obligations on taxpayers and the Commissioner. It would be inappropriate for the regulations to waive requirements on the Commissioner to do certain things within a certain time to the detriment of taxpayers. This limitation is not obvious on the face of the proposed section.

We acknowledge that an alternative approach to achieving this may be to draft a wide limitation which prevents a regulation from increasing taxpayer liabilities or abrogating taxpayer rights.

Submission 4 the border between substantive and procedural issues

It should be made clear that the substantive tax rules should not be affected by any regulation made.

Comment

The other Inland Revenue Acts provide the substantive rules for determining the core tax due. The administrative requirements in the TAA do not generally affect the amount due. They will specify how a taxpayer notifies the Commissioner of the obligation (returns) and what happens if payments are not made (penalties and interest) or if obligations are not met (shortfall penalties).

However, the border between the two can blur. For example, if a regulation was made, that due to work being done on the computer system, that no returns of Approved Issuer

Levy were to be made for a six month period. This would affect the substantive liability (assuming that no return meant no payment).

Submission 5 parliamentary and other protections

We support the use of regulations rather than determinations or other administrative procedures but parliamentary scrutiny should be required within a short time of issue of the regulations.

Comment

We understand that regulations are subject to parliamentary scrutiny and revocation if found to be invalid. We consider that this is important protection for taxpayers.

However, we note that regulations made are likely to be time critical. They will likely apply within a short time of being issued as well as lasting only for a short time.

Judicial review and other protections for taxpayers are unlikely to be of practical use to aggrieved taxpayers.

The section should therefore require immediate reference to the Regulations Review Committee for early review.

Submission 6 the consultation process is too truncated

That any amendments to the SOP should be further publically consulted.

Comment

New Zealand's generic Tax Policy Process allows for a robust process for the development of tax policy. It allows issues to be highlighted and where possible resolved. This results in better quality legislation and a better understanding of the policy.

We understand that consultation was undertaken within government. However, no consultation public or private was undertaken. The issues identified in this and other submissions would have been dealt with in a more considered fashion.

Any amendments to the SOP would normally only be apparent when the Bill is reported back by the Select Committee. Given the potentially wide application of this provision, the Select Committee should invite further submissions on any proposed amendments to the SOP.

Submission 7 that past examples would assist with confirming the policy

That the intended policy should be tested against existing business transformation issues to better illustrate the intended outcome and the choices that could be made.

Comment

The RIS and other documents proceed on the basis that the potential regulations are unknown. However, in the "grace period" rules, the Bill already contains an example of a business transformation issue against which the regulation making power can be tested.

If the regulation making power was already in place, potentially, this issue could have been dealt with by regulation.

A published case study on this (whether a regulation would have been made, why or why not, its detail) would provide comfort on the intended effect and application of the power.