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Our ref 150608KPMGSubMakingTaxSimpler

8 June 2015

Dear Sir

KPMG submission - Making Tax Simpler Green Paper

KPMG is pleased to make a submission on the Making Tax Simpler Government Green Paper on Tax Administration (the “Green Paper”).

We welcome the Government inviting responses to the Green Paper.

This allows stakeholders in the tax system to consider what they expect and need from the tax system and to provide their views to Government. It also allows them to understand the proposed direction and to consider the impact on them. However, one of the challenges will be ensuring continuing stakeholder engagement throughout Inland Revenue’s Business Transformation journey.

We note that providing a reasoned and comprehensive response is a significant task. We recognise that Government and Inland Revenue have committed significant time and resources to get to this stage. In the time available for submissions on the Green Paper, we have not attempted to provide a fully coherent final view of what the tax system should look like. Instead, we have:

- In the framework section, looked at the tax system through a number of lenses. In some cases these overlap and in others they may lead to initially contradictory responses. However, we consider them helpful in framing the required response.
- In the answers section, we answer the questions posed in the Green Paper by reference to those frameworks.

This submission should be read in conjunction with our submission on the *Better Digital Services* discussion document. That submission focussed on:

- the need to differentiate service delivery to taxpayers (“customers”) when they perform different roles in the tax system – e.g. a customer paying their own tax will have different needs to when paying tax, or filing returns, on behalf of others;

- how transactions and events can inform tax interactions and interventions, also discussed in more detail; and
- the need to make tax simpler to enable automation of business systems to comply with any new rules.

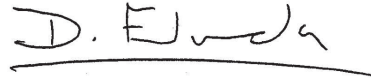
Further information

Please do not hesitate to contact us, John Cantin on 04 816 4518, or Darshana Elwela on 09 367 5940, if you would like to discuss our submission in greater detail.

Yours sincerely



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Frameworks

The current position

Under the current system, the key elements are:

- Assessments;
- Returns;
- Payments.

The system does not generally attempt to distinguish the various roles that taxpayers perform in the tax system. All the roles are labelled “taxpayer”. Accordingly, the obligations and rights of taxpayers and Inland Revenue are generally determined by reference to these key elements.

This means that a “one size fits all” approach is taken. This potentially means that inappropriate outcomes arise.

In this section we discuss a number of ways of approaching interactions between New Zealanders and Inland Revenue. (We use interactions as a more neutral term than intervention which we use to signal a more active interaction by Inland Revenue.)

This approach in our view assists with thinking about what is required.

Is an “event” a data or taxing event?

Our starting point for thinking about tax interactions is to identify whether an event can be classified as a data/information or a taxing event.

If it is a data event, the questions are how and when to collect, verify and certify the information. This should shape the rights and obligations of the provider of the information and Inland Revenue as a user of that information. For example:

- Is a manual return or automatic (digital) data collection the right collection mechanism?
- Is a monetary penalty based on the tax at stake the correct reflection of the harm suffered from a failure to meet an obligation?
- Is the use of taxpayer and assessment the right terminology to correctly signal what is required? What is the right term to describe a “taxpayer’s” interaction with the tax system for such an event?

If the event is a taxing event (that is, one which generates income subject to tax), the key question in the Green Paper is whether tax should be withheld from the income as a final or interim satisfaction of that tax liability? Our response to this question is:

- Can the event be treated as a singular event or is the calculation of the tax liability incomplete? This will depend on whether there are other offsets, such as deductions for expenses, which need to be considered and/or whether later events could have a retrospective effect on the liability calculated. If the event is not complete, this suggests that

a final withholding approach may not be feasible, due to the complexity of incorporating these other variables into the determination of the tax to be withheld. This will have downstream implications.

Alternatively, a potential policy response to such a conclusion is to determine whether simplifying approaches might be able to be taken. An example of this is the “as agent for foreign insurer rules” which deem 10% of the premium to be the taxable income of the insurer rather than the amount calculated under the insurance rules in the Income Tax Act. We note that there are trade-offs to be considered with such simplifications.

- Importantly, does the event create a cash flow from which tax can be withheld and if so when does it do so? A simple example is an employee who provides services to an employer. Those services are provided continuously but the cash flow is generated at intervals. Clearly, PAYE applies when the cash flow is generated. The problems with applying withholding taxes when no cash is generated are illustrated in the recent *Simplifying the collection of tax on employee share schemes* discussion document. The lack of a cash flow suggests an income tax return basis of collecting tax (whatever this may look like in the future state) rather than a withholding tax basis.

These questions will require a particular focus as the journey extends beyond PAYE to “employee like” payments and business scenarios. A likely consequence of moving to withholding regimes is that the time of payment of tax will need to be deferred to match cash – a shift from an accrual to a cash basis of taxation.

Inland Revenue’s role and its impact

Under the current system, Inland Revenue’s role can be divided into:

- A processor of returns and payments (which is also collection function) through its Service Delivery function;
- An auditor through Services Delivery and the Office of the Chief Tax Counsel (“OCTC”); and
- An advisor to taxpayers and Government through Service Delivery, OCTC and Policy & Strategy (“PAS”).

From the Green Paper, the vision is that Inland Revenue should be able, from the information that it holds, to tell New Zealanders what their tax liability is. We see that as move from a processor to an assessor (used in the current sense of determining a tax liability) role.

This raises some very important questions.

The first is one of completeness. At one level this is about having information regarding all sources of income. It requires thinking about potential sources of income and who might provide that information. PAYE and resident passive income is generally easier to determine from information provided. However, would a rental property manager be required to provide information to Inland Revenue? (Which reinforces the question above regarding the nature of the event.)

It also raises significant questions about income which is outside the system and how Inland Revenue will assess that income. A taxpayer issued with an assessment might think twice about confirming it without disclosing a “cash job”. On the other hand they might also consider that if Inland Revenue has not advised of the cash income there is a lower chance of being caught (i.e. they may consider that such payments are outside the system). As last year’s Tax Administration Conference highlighted, limiting the opportunity not to comply significantly increases compliance. (This is no doubt a significant driver of the shift to have more and not less tax withheld at source). Our point nevertheless is that an information driven assessment system works only within the confines of that system. Business Transformation cannot ignore New Zealanders and income which is outside the system, such as the cash economy.

The second question is one of capability. Our experience is that many tax issues are complex. They require a good understanding of the facts and of the requisite rules and good judgement to solve. As well as Inland Revenue ensuring it has all the required information, it will need people capability. We refer to our submission on the *Better Digital Services* discussion document which highlighted the need to be able to access people with expertise to resolve complex issues. In our view, Inland Revenue should not underestimate the continued demand for such expertise in the future state.

End to end view of the system

In this section we use a simple version of the current system for individual and business income tax to illustrate our comments.

Current process

Generally, the first interaction that Inland Revenue has is when an individual income tax return is filed. The return is simply processed and acknowledged, the taxpayer’s view is accepted. That taxpayer view is compared to tax payments already received and a further payment is requested or a refund is made.

In some situations, Inland Revenue will seek to verify that the taxpayer’s view is correct. If it accepts that is the case, no further action is taken.

In other cases, Inland Revenue will dispute the taxpayer’s view. A dispute can be settled by the taxpayer and Inland Revenue or the dispute can be taken to Court (by either party). In the latter case, the tax liability is settled only by a Court judgement.

This process leads to a focus on assessments and returns and disputes.

Impact of the underlying event

However, there must be an underlying event to generate the need for this interaction in the first place. In our view, the Green Paper signals a need to consider the underlying event and the interactions that taxpayers might have with Inland Revenue.

Impact on Inland Revenue’s advisory role

That also raises Inland Revenue’s advisory role. If the interaction is moved to the time of the underlying event from the current return (which is post the event), what is the nature of that

advice? Is it reliable and enforceable? Is the binding ruling regime too rigid in its constraints? If Inland Revenue would have to make a decision on investigation or audit to reassess, what prevents it from making that decision before an assessment by the taxpayer?

Impact on disputes

At the other end of the process, there is very little focus on disputes and how they are settled. Although disputes are not necessarily significant in number, they affect the health of the tax system and perceptions of fairness. Included in the questions that we would ask are:

- Are specialists required throughout the Court system to decide disputes? We ask this question because it seems to us that the Courts are particularly focused on the facts and arguments in front of them. They appear less able to appreciate the broader policy consequences of their decisions. (We refer for example to the High Court’s judgement in *Westpac* on the application of section 138P of the Tax Administration Act. This in our view has significant implications for the conduct of tax disputes if it is correct. The difficulty that this decision poses is in our view highlighted by the fact that Inland Revenue has issued no comment on the impact of the decision.)
- Is the adversarial approach the best way for tax disputes to be managed through the system? The adversarial approach encourages opposite “winner take all” positions and discourages potential and alternative middle positions where both parties may win/lose and which may have a better effect for the tax system. We note as a possible example the *Wattie* decision where such an approach would have allowed the Commissioner to argue for the spreading of the inducement payment over the term of the lease as well as the all or nothing revenue on receipt argument.

Integration and rationalisation

The system has duplication and separation. From our experience with the impact of the Foreign Account Tax Compliance Act (“FATCA”), and looking at future Automatic Exchange of Information requirements, we can see the potential for increased duplication in reporting.

Within the system

The tax system itself has this problem. For example, interest income is potentially subject to Resident Withholding Tax (“RWT”), Non-resident Withholding Tax (“NRWT”) and Approved Issuer Levy (“AIL”). This requires three systems for interest payers to manage and comply as there are separate payment, returns and periods to consider.

Further, with the implementation of FATCA and Automatic Exchange of Information, the core tax obligations will be supplemented with reporting obligations. Much of the information required will already be reported through the NRWT system. (We acknowledge that is not currently the case with AIL).

We consider that Inland Revenue should consider the ability to integrate these taxes and the reporting and other obligations that go with them. As an example, we note the Foreign Investment PIE regime reporting collects information that is required for Inland Revenue to

provide to other Revenue Authorities, under exchange of information protocols. The single PIE return captures that information.

Another example is PAYE and FBT. In one case, the tax is interim and in the other a final tax (but increasingly being taken into account for non-income tax purposes). However, both are a means to assess and collect tax from employee remuneration. This generally means that the same business system is used to capture the information (to ensure that the employee is correctly remunerated).

Across Government

We also consider there are opportunities to integrate and rationalise “across Government” obligations.

For example, Anti-money Laundering rules (“AML”) apply to many New Zealand businesses. These tend to be the same businesses as those which are subject to withholding tax and reporting obligations. The rules for complying with tax withholding obligations tend to be established independently of AML and Know Your Customer obligations.

A preferable approach is to have regard to existing obligations and to build on those where necessary.

A further example is the requirement for many companies to comply with International Financial Reporting Standards (“IFRS”). Simplification can be achieved by using IFRS principles for determining a tax liability. This would mean that a good reason would need to exist for the tax rules to be different to accounting principles.

For completeness and to be clear, we accept that under current policy settings, there are good reasons for maintaining the distinction between capital and revenue income and for taking a realisation approach to certain property. There are however many other tax rules which are not aligned and for which alignment could provide simplification benefits.

Whose tax liability is it? (I.e. what role does the person play in the tax system?)

In this section we return to the theme that treating all those obliged to provide information or pay tax as taxpayers is misleading. We understand the driver to impose withholding tax obligations – it minimises the opportunity to evade tax and makes tax collection more efficient.

However, a person with a withholding tax obligation is not the person with the tax liability. The tax is being collected and paid on behalf of someone else.

This means that a withholder does not necessarily benefit from a failure to comply with a withholding obligation.

For example, an agent may receive interest for another person. They have an RWT obligation. If they do not withhold the RWT (in error) but pass on the whole amount to their principal, the cash benefit of the failure to withhold is gained by the principal. However, the agent faces consequences based on the assumption that they fully benefit from the non-payment of the withholding tax.

This creates significant exposures for withholders in the system.

We accept that a failure to comply should have consequences but the design of the system should have regard to the benefit that is derived when imposing penalties and interest.

The difficulty of designing a complete and correct system

There are complexities in the system. These have been built up over time and reflect the inflexibility of the technology. However, it is important that the system properly reflects the rules and allows easy administration and compliance.

We recently became aware of the following situation.

An agent received foreign income for a resident. The agent correctly deducted RWT for the difference between the person's RWT rate and the foreign tax withheld.

When the resident sought to complete Inland Revenue's online tax return, the online tool could not cope with foreign income from which RWT is deducted. It appears that the rule that has been implemented does not acknowledge the rule that RWT applies to foreign income derived by a resident.

When this arises, we are required to make manual adjustments to ensure that the RWT is correctly accounted for by Inland Revenue's system.

It is important that the design of the new system takes this into account.

Questions for submitters (and our responses)

In this part we answer the questions posed in the Green Paper. We have attempted to have regard to the thinking in the frameworks section above. However, given the significant time to provide a fully comprehensive and coherent solution, instead we have attempted to provide specific responses to the questions posed. Some of these answers may therefore be contradictory.

Would the potential changes discussed in the Green Paper be broad enough to deliver significant improvement to New Zealand's tax administration systems?

We note that the frameworks section of our submission raises a number of questions and suggests a number of approaches which it is not immediately clear from the Green Paper have been considered. To the extent that is the case, we consider there are significant potential areas of focus which are not addressed.

We agree that New Zealand's tax administration needs to be modernised. We also agree with the goals of the tax system, set out in the Green Paper. The ability to achieve these goals (which will in turn deliver the improvements being sought) will depend on the commitment to, and speed of, change.

The success of Business Transformation will depend on the degree of stakeholder engagement and support. In relation to the latter, we consider the success (or failure) of the first phase, the modernisation of the PAYE regime, will set the tone for the success of the overall transformation project.

Are the potential changes heading in the right direction, and has Government focused on the right issues?

See our comment above and in the frameworks section. While there are other focus areas which will also need to be considered, in principle, we agree with the focus areas identified in the Green Paper.

We note that the Green Paper discusses tax administration reform in broad terms. That is not a criticism, as the purpose of the Green Paper is to outline the overall vision. However, the challenges in a number of the areas being targeted will be at the granular or detailed level.

For example, the proposal to integrate PAYE, GST and withholding tax obligations into business processes seems reasonable in principle, but without knowing what this will actually mean practically for business' systems, it will not be possible for business and other taxpayers to provide informed comment on whether the changes will achieve the desired simplification benefits. This will require taxpayers to wait until the detailed proposals are released.

Are there any errors or key omissions? If so, what are they?

We refer your attention to the frameworks sections which outlines some alternative approaches and perspectives to thinking about Business Transformation.

We are not sure whether this is a deliberate omission, but we note that the discussion in the Green Paper on any changes to GST processes is limited, in comparison to the significantly more detailed discussion about potential changes to PAYE, withholding, business and individual taxes.

It is not clear whether this is because Officials and Government consider that little, or no, change is required to current GST processes, whereas more fundamental reform of PAYE and other tax types is required, or whether the intent to simply rely on business' accounting systems to source GST information. We expect this will be clarified in due course?

Is the proposed sequencing and order of work sensible?

We can understand the proposed sequencing of work as the need for more accurate PAYE and RWT withholding systems is to ensure that the individual tax obligation changes can proceed.

However, we are concerned the review and streamlining of business tax obligations is intended to follow the changes to individual tax obligations. In our view, the review of business tax obligations should proceed alongside the various withholding tax system considerations. This would allow the impact of the tax system on business obligations, both as taxpayers in their own right and as tax collectors for Government, to be considered holistically.

The proposed sequencing de-links these two areas which is not optimal, in our view. However, we acknowledge the problems of a "big bang" approach to reform. What we do suggest is that a broad design for other areas should be considered in parallel so that the specific areas being considered can have regard to other areas which may be affected.

Does the current sequencing and order of work ensure the compliance costs associated with implementing change are minimised for business and other customers?

Refer to our response to the question above. The Green Paper notes that there will be transitional costs for taxpayers. Our concern is that de-linking the changes to PAYE, GST and other withholding tax obligations for business, from the business's own tax obligations, could result in business having to make multiple changes to their systems, increasing the costs of change. Therefore, our suggestion that the broad design of these areas be considered in parallel.

Do you agree with the Government's view that more effective use of a business's own systems to provide PAYE, GST and related information to Inland Revenue would provide real benefit to employers?

We agree that there may be benefits for employers from more efficient PAYE and withholding processes. However, business will also be asked to bear a cost from upgrading their systems. The net benefit, if any, will depend on whether the proposed changes will be successful in addressing some key bugbears for business, which in the PAYE area includes the ability to easily correct PAYE/tax code errors and to validate employee information.

The key proposal is to replace the current Employer Monthly Schedule (“EMS”) process with a process which integrates into the employer’s payroll process. We support reform of the current EMS process. The biggest concern, however, is with Inland Revenue’s administration of the current PAYE system as this is the cause of much of the inflexibility. For example, the need to re-open past EMS returns to correct even minor PAYE errors, due to Inland Revenue’s reluctance to accept prospective amendments.

However, even with more real time exchange of PAYE information, accuracy will not be achieved 100 percent of the time as reality is much messier than the theoretical world in which the changes are being designed. Errors will therefore still exist in the future state (see below). There needs to be a change in mind set on how employers are allowed to deal with these.

For example, there will be limits in the ability of payroll systems to deal with more complex employee circumstances, such as changes to their tax residence status. These situations will generally arise “after the fact”. Therefore, some degree of manual intervention will still be required and that flexibility will need to be built into the system. The PAYE reforms therefore need to include a streamlined process for dealing with PAYE errors, due to changes in employees’ situations.

Our suggestion in the frameworks section (and *Better Digital Services* submission) is that events should drive the interactions by Inland Revenue. This will have implications for the type of response and requires understanding what the appropriate interaction point should be (for example, when dealing with a change to an employee’s situation, this may not be waiting until this is reflected in the account or payroll system of their employer).

What would be a better focus for future consideration in relation to PAYE processes?

Has Government considered all likely issues in relation to streamlining the collection of PAYE and related information?

See our response to the question above.

Is Government considering all of the relevant issues with the application of the current PAYE rules?

Are there any other concerns facing employers that would improve how the PAYE rules work?

We consider that the range of issues to be covered in the review of PAYE is appropriate. It is unclear how the review process will be managed (such as, the sequencing of the issues to be reviewed) as the various items will have different priorities for different stakeholders. We assume more detail will be provided in the upcoming discussion document on changes to PAYE obligations, providing opportunity for stakeholder comment? This will then allow different stakeholders to make informed comment on the issues that are important for them.

What factors should Government be particularly conscious of when considering changes to withholding taxes in order to cover more employment-like situations?

As noted in the frameworks section, while withholding systems may be preferred they will not be appropriate in all cases. The impact on withholders' systems also needs to be taken into account.

In particular, care needs to be taken to ensure that the types of income to which a withholding tax is applied can be easily calculated and verified.

A withholding tax will not be suitable where there is uncertainty about the taxable income component. As an example, we note that one of the proposed changes in the *NRWT: related party and branch lending* issues paper is to apply NRWT to a financial arrangements definition of income in certain cases. Given the complexity, we do not believe that such income is suitable for a withholding tax, which will need to be automated in business' systems.

A proposal in the Green Paper is to extend withholding tax to "employment-like" income. The Green Paper suggests that the scheduler payments tax regime, rather than PAYE, should apply although we note this distinction could disappear depending on the objectives of the PAYE review. The two situations identified are payments to independent contractors and migrant workers.

Extending withholding obligations on payments to all independent contractors could impose significant compliance costs on business. Business will need to track each withholding payment (similar to PAYE) to ensure their tax obligations are met. Their systems will need to be updated to capture this.

It also raises design issues, such as the appropriate withholding rate (e.g. will this vary by industry as is the case currently with some scheduler payments). On the assumption the withholding tax is not a final tax, these taxpayers will still have year-end filing liabilities. It is also not clear how the application of withholding tax will interact with existing provisional (or future business) tax obligations for those affected. There may be support for such a measure, however, if this is combined with the removal of provisional tax obligations and the associated exposure to use of money interest and penalties.

What are the key tax administration issues currently facing business? Are there any particular areas that present concrete ways of increasing speed and certainty?

We believe speed, accuracy, certainty, predictability and low risk are all features that business should reasonably expect in the future state.

At present, the predictability of Inland Revenue's view is a major concern. Recent examples illustrating the lack of predictability and therefore certainty in Inland Revenue's administration of the tax system include the recent positions taken by the Commissioner on the taxation treatment of employee allowances (which required a law change to provide certainty), tax residence (no law change but significant clarification required) and debt capitalisations (for which a law change is being proposed). A number of these changes in view also had retrospective effect, further exacerbating the uncertainty for taxpayers.

Predictability (if not necessarily certainty) of outcomes is a cornerstone of a good tax administration and this needs to be front and centre in the objectives of the Business Transformation reforms. It should also be a focus of the tax administration legislative framework discussed later in the Green Paper. This will also need a shift in Inland Revenue's operational focus.

One concrete way of increasing predictability in the tax system is to ensure (as part of the legislative tax administrative framework) that the Commissioner cannot take an operational position that is contrary to the stated policy intention and legislative enactment to give effect to that policy intent.

For example, if it is clear from the policy documents and commentary that a legislative change is designed to achieve outcome (A), (B) and (C), taxpayers should be able to rely with a high degree of certainty and predictability that those outcomes will not be challenged by Inland Revenue taking a different interpretation (and/or applying the anti-avoidance rules to cancel the outcome). (We note that if a different outcome, (D), was also being asserted by a taxpayer, this would still be open to challenge by Inland Revenue.)

How important is improving the provisional tax rules in reducing compliance costs for business? Are there other more important issues the Government should be focussing on instead, or as well?

We believe the risks associated with the provisional tax rules are a significant issue for business to manage. The key risks include:

Use of money interest and penalties risk

This is a significant challenge for taxpayers (particularly ones where seasonality plays a big part in the derivation and timing income) to get provisional tax right, to mitigate use of money interest and penalties risk. We believe there are a number of issues at play here:

- The residual income tax thresholds at which the provisional tax rules and use of money interest rules apply. Currently, these are \$2,500 (for all taxpayers) and \$50,000 (for individuals only that use the standard uplift method for calculating provisional tax), respectively. Both the levels of these thresholds (e.g. the \$2,500 threshold has been unchanged since the introduction of the provisional tax rules) and their limited application (e.g. the applicability of the \$50,000 interest safe harbour to individuals only) need to be reviewed.
- The setting of use of money interest rates. At present the use of money interest rate on tax underpayments is effectively a sanction on taxpayers, not a finance charge for Government not having the use of the funds. (This is in addition to the late payment penalty regime, which is explicitly meant to be the sanction.) This has necessitated the need for alternative mechanisms, such as tax pooling, to mitigate these costs for business. The Business Transformation project needs to consider the role of use of money interest and penalties in the wider compliance framework.

- The functioning of the tax pooling rules and greater flexibility in the use of those rules. In the absence of any meaningful reform of the use of money interest and penalties rules, there need to be a focus on the current operation of the tax pooling rules and whether this is fit for purpose. We do not believe it is, based on Inland Revenue's interpretation of the rules and inflexibility this has created for tax pooling users and intermediaries.

Cash flow risk

By its very nature the provisional tax rules are a blunt instrument and assumes business revenues are earned equally during the year, hence the difficulty in estimating and having the cash flow to pay provisional tax liabilities. However, we acknowledge that any alternative method may pose similar concerns unless explicitly linked to a business's cash flow.

The Green Paper asks whether a business income tax could be done more on an "on account" basis as income is earned during the year.

A suggestion in the Green Paper is to use accounting profits with some key adjustments to proxy a business's income, for tax collection purposes. In principle, we agree that greater reliance on accounting measures of income would be positive step. However, this will still require business to forecast their accounting profits for a year and it is unclear what sanction, if any, will apply if forecast profit is less than actual profit for the year (this could be for a number of acceptable reasons). The detailed design of such a regime will therefore need to be carefully considered.

Further, there has been a reluctance by Officials to consider a "near enough is good enough" approach in the design of tax policy. We believe this mind set needs to be cleared when designing a business tax system, particularly for small business. For example, we question the need for, and value of, end-of-year tax adjustments (e.g. 63 day adjustments for holiday pay).

Another suggestion is that provisional tax payments could be based on another proxy, such as a percentage of turnover. We note that such an approach was considered for small business in 2001 by the then Government (in its *More time for business* discussion document) in the form of the GST ratio method for calculating provisional tax. The GST ratio method is aimed at small business (as a taxpayer's residual income tax liability must be less than \$150,000 to qualify). It is unclear how successful this initiative has been, particularly as it increases the instalment dates from three to six. Any new initiatives should test the assumptions of the past.

What are more effective and simple methods of calculating and paying provisional tax and how can provisional tax be better aligned to other business processes?

As noted in the response to the question above, we believe the bigger issue is not the provisional tax regime itself, but the consequences of "getting provisional tax" wrong. Therefore, we believe the most urgent consideration needs to be given to the current sanctions regime, including how use of money interest rates are set.

We believe that current calculation basis for provisional tax will be less of an issue for large and medium sized businesses as these are likely to have appropriate procedures and tools to comply (although as above, the cost of getting this wrong will be a concern). For small business,

however, the complexity of provisional tax will be an issue. Therefore, consideration should be given to simplifying the regime (such as allowing the use of accounting estimates) and taking more micro businesses out of provisional tax altogether by increasing the \$2,500 residual income tax threshold to a more meaningful level (such as \$10,000 or \$15,000)

Is the proposed direction the correct focus to provide benefits for small business or are there other more important ways of helping small businesses?

The proposal to assist small businesses to comply, through provision of (or funding support for) accounting and business software, more timely interventions, changes to the penalties regime and simplification of the rules are broadly supported.

As noted in responses to earlier questions in the Green Paper, we believe a review of the penalties and interest regimes (and the provisional tax thresholds for application of the rules/interest) and making the rules easier to comply with (e.g. by better aligning taxable and accounting income) should be considered.

With small business (and a clear definition of what is a small business is needed – see response to question below) care needs to be taken to ensure that Inland Revenue is not simply forcing such businesses to adopt complex accounting software and business systems (that are well beyond their needs and capabilities), simply to make administration of the future state tax system simpler. This is particularly the case if the cost of upgrading will be imposed on business. We would support an approach where Inland Revenue actively assists business to upgrade their systems based on their actual needs. We envisage a degree of financial support may be necessary to facilitate this.

Are there any areas where tax for small business can be simplified without creating specific tax breaks?

We have outlined earlier our comments on business tax simplification.

Before considering what tax simplification may look like for small business, it is important to first define what a small business is. For example, is it measured by turnover, by assets or a combination of both, or some other metric (like number of employees)?

We note that the new minimum financial reporting requirements that apply from 1 April 2014 apply to companies with annual revenue of \$30 million or less and asset of \$60 million or less. Is this the suggested threshold for a small business? In contrast, Australia which has special tax rules for small business classify these as having turnover of less than A\$2 million. The definition of small business should guide what type of simplification should be targeted.

As a matter of tax policy design, we note that specific tax breaks for small business would be inconsistent with the Broad Base Low Rate (“BBLR”) approach which underpins current New Zealand tax system. We support tax simplification as this is an opportunity to alleviate the unique compliance challenges facing smaller taxpayers.

What are the most important practical ways of promoting and achieving higher levels of compliance for small business?

It is unclear from the question whether there is a specific issue with non-compliance by small business (compared to medium and larger sized businesses) that Government and Inland Revenue is seeking to address. The nature of non-compliance should drive the tax administration (and policy) response.

For example, if the issue is the cash or informal economy, we believe there needs to be a mix of better taxpayer education and assistance to comply and appropriate enforcement if there is unwillingness to comply.

What are the key consideration that should be taken into account when looking at the provision of business income information?

We agree that removing duplication of information would be helpful to taxpayers and business. An example of duplication, we have noted earlier, is the need to provide information separately under automatic exchange of information regimes (such as FATCA) when much of this information is already collected in relation to withholding taxes on passive income (e.g. NRWT certificates). Therefore, instead of requiring financial institutions to develop new reporting systems to accommodate FATCA (and other automatic exchange regimes), consideration could have been given to how existing reporting systems could have been amended to incorporate this information.

A key concern for business will be security and control over the information collected by Inland Revenue from their systems. If the proposed approach is to use technology and existing business systems to access information electronically, there needs to be done securely with appropriate safeguards over the protection of that information.

Taxpayers should also be able to control access to the information flow. A concern with automatic information exchange is that there will be no way for taxpayers to confirm what information has been provided to Inland Revenue and verify and validate whether this is correct. Taxpayer validation and verification of information to be built into the design of the future system (as well as a feedback loop to confirm what information has been transmitted).

From Inland Revenue's perspective, the focus should be on data quality not quantity. An approach which allows taxpayers to control the information provided will assist with this. This is also needed to ensure there are constraints on the information Inland Revenue can legally access from business' systems. This should be limited to information that would be collected for assessment purposes (e.g. under the current EMS, GST or withholding returns). Electronic access to business systems should not be used as an opportunity for widespread data collection for use in Inland Revenue's compliance/risk assessment programme, for example.

Is there anything else a review of the RWT rules should consider?

We agree that there needs to be close collaboration with financial institutions and other interest payers in the design of any changes to the withholding tax system to minimise transition costs

for business. In particular, the impact on smaller interest payers (i.e. non-banks) needs to be kept in mind when designing the system, as not all business will have sophisticated systems.

We have outlined in the response to the question above, the duplication between information required to be reported for automatic exchange of information purposes and RWT/NRWT purposes.

From a tax policy perspective, the *NRWT: related party and branch lending* issues paper proposes expanding the definition of non-resident passive income to non-resident financial arrangements income. (That is, applying NRWT to financial arrangements income calculated under the expected value or yield to maturity methods, rather than interest coupons.)

While KPMG will submit separately on that issues paper, this proposal highlights the potential practical difficulties of applying withholding tax when there is no clear trigger point. This is because business' withholding systems will currently be automated to deduct NRWT on interest payments (a clear trigger point). If a different basis of withholding is required, these new rules will need to be built into the system. The more complex the rule, the more difficult it will be to automate systems. We have similar concerns with using withholding systems as a method of collecting underpayments elsewhere in the tax system. While convenient for Inland Revenue, we consider that this will add considerable complexity to business' systems.

We have discussed earlier, in relation to PAYE, the need to be able to fix errors more easily. The same applies for withholding taxes, such as a RWT and NRWT (and a number of the reforms being proposed in this area will increase the probability of errors). We believe the biggest improvement can be achieved if error correction can be forward, rather than backward, looking.

Do you agree with the idea of interacting with the tax system via online tax statements?

If not, why not?

Is there anything else Government should consider?

As noted in our submission on the *Better Digital Services* discussion document we consider that greater use of technology in the tax system is inevitable. Therefore, we support the use of technology to simplify how individuals interact with the tax system. The use of a secure online tax statement and personalised web page is supported, subject to the following comments:

- The statement and web page should be designed with the end-user in mind. Information on income subject to withholding at source should automatically be pre-populated (we note this is a concern with RWT information, which is not currently populated in Personal Tax Summaries). This also goes to the completeness of withholding systems and transactions.
- Simplicity is important. If taxpayers are required to confirm a tax liability calculated by Inland Revenue, rather than undertake the calculation themselves, in the majority of cases, this should improve compliance. This is also important keeping in mind that a number of individual taxpayers, who are currently non-filing taxpayers, will be brought back into the

system and will have had limited exposure to assessment processes (many will never have filed a return). Therefore there will need to be an accompanying taxpayer education exercise.

- Information will need to be available in “real time” rather than being a snapshot in time (which is the case now with Personal Tax Summaries). In today’s digital world, we expect taxpayers’ expectations of interacting with Inland Revenue will be similar to how they interact with their bank (e.g. able to access account balances, make transfers in real time, and from a variety of different devices – phones, tables, PCs.)
- However, digital interaction cannot be the only medium available to individuals to interact with Inland Revenue, including as part of the assessment process. While the ideal future state for Inland Revenue may be to move all individual assessments online, there will be those who are unable or unwilling to move. Therefore, there will need to be a programme of “assisted digital” support for these taxpayers rather than a cliff face, where they are not able to comply.
- The proposal to use technology to automatically adjust withholding rates needs to be considered not only with individuals in mind, but also the impact on the withholder. As noted above, any changes to business’ withholding systems will impose costs on business. If withholding systems also have to accommodate Inland Revenue requests to change rates, this will add to the transitional costs. It would also mean businesses having to hand over control of their systems to Inland Revenue (e.g. what happens if a rate change request is incorrect?).

Do you agree with the proposed direction of re-designing processes for administering social policies in future?

We agree that social policy delivery should be de-linked from the annual tax cycle. The delivery should be consistent with the needs of the social assistance recipient/users and Government’s objectives of reducing social policy debt and better targeting its interventions.

Do you agree that the correct areas are being looked at in reviewing the policy and legislative framework for tax administration?

We consider that this has potentially the widest impact on the success of the future tax administration. We have covered some of these points in the frameworks section. Essentially, the review of the legislative framework needs to cover these following areas:

- The rights of assessment and dispute taxpayers will have in the future states;
- What obligations taxpayers will have (and the sanction for non-compliance) when:
 - (i) they provide information
 - (ii) collect tax from others
 - (iii) manage their own tax liabilities; and

- The use of information provided to Inland Revenue by the Commissioner and other Government agencies.

The review also needs to address business' ability to gain certainty (or at least have predictability) that their tax position is acceptable and final. We have outlined in our response to one of the earlier questions, an important way in which certainty/predictability of Inland Revenue's approach can be achieved through constraints on Inland Revenue's ability to argue against an established position.

Other – structure of data

The other point we would make is that even in a digital world, there will need to be some structure to the information that taxpayers' systems will need to provide to Inland Revenue.

While we expect paper returns and forms will largely disappear in the future state, we expect information provision will still need to be structured in a way that is compatible with Inland Revenue's new system. The ability to prescribe this will need to be reflected in the tax administration framework.

From a practical perspective, we expect future information exchange between taxpayers and Inland Revenue to be based on an electronic "schema" approach. We note that Inland Revenue has already prescribed reporting schemas for electronic provision of information by PIEs and for Financial Institutions that are required to report under FATCA, so this is not a new development. However, in our experience, those reporting formats are not the most user-friendly (that is, there is conversion required from normal business' systems output to the output required for PIE/FATCA reporting).

The extension to all tax types will have major implications for business, particularly those taxpayers not used to interacting digitally with Inland Revenue.

It is therefore important that Inland Revenue work collaboratively with both taxpayers and intermediaries in the tax system, such as payroll firms and accounting software providers to ensure that any electronic information reporting/exchange solution is feasible.

There may also need to be consideration given to an accreditation regime for third party providers, to give certainty to business that their software/systems will be compliant.