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Tax Administration for the 21st Century Working Papers

WP 01/2014



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Tax Administration for the 21st Century: A policy vision

An officials' draft working paper

May 2014

*Prepared by Policy and Strategy, Inland Revenue, for discussion purposes at the
Tax Administration for the 21st Century conference, Wellington 12–13 June 2014*

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CHAPTER 1

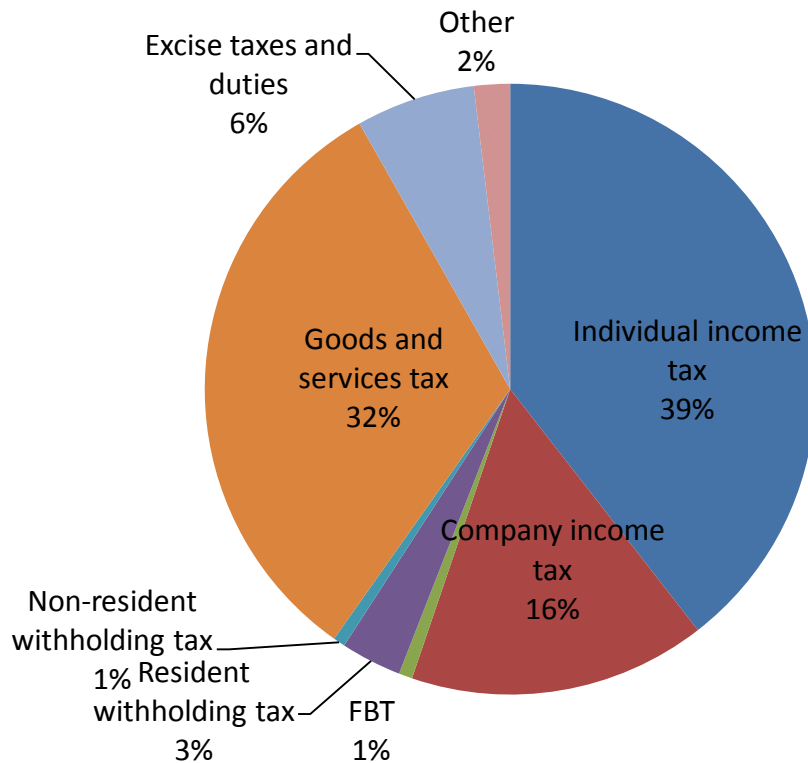
Background

- 1.1 Inland Revenue is responsible for the collection of over 80% of core Crown revenue. It also has an important role in administering social policy programmes, including Working for Families tax credits, student loans, child support, paid parental leave and KiwiSaver.
- 1.2 Inland Revenue has a responsibility to all New Zealanders to be efficient in the collection of tax revenues and the distribution of entitlements. This is reflected in its mission statement, “to contribute to the economic and social wellbeing of New Zealand by collecting and distributing money”.
- 1.3 Inland Revenue’s wider vision is to be a world-class revenue organisation, recognised for its service and excellence. This means it must:
 - be agile, effective and efficient (for example, by reducing administration costs);
 - enable taxpayers, wherever possible, to self-manage with speed and certainty (for example, by reducing compliance costs);
 - enable the Government to make timely and cost-effective policy changes; and
 - work with other government agencies to more efficiently deliver services.
- 1.4 Success is reflected in two key outcomes:
 - revenue is available to fund government programmes through people meeting payment obligations of their own accord; and
 - people receive payments they are entitled to, enabling them to participate in society.

New Zealand’s tax bases

- 1.5 The aim is to tax as broad a range of income and expenditure as practicable at rates that are as low as possible (known as the broad-base, low-rate or BBLR approach). This provides a robust revenue base and promotes fairness, economic efficiency and revenue integrity, and helps keep administration and compliance costs low. It is a much more coherent way of levying tax compared with most OECD countries.
- 1.6 The following charts show the composition of tax revenues in New Zealand, together with an overview of how this compares internationally with other OECD countries. They highlight that New Zealand’s three main tax bases (personal tax, company tax and GST) all have broad coverage, allowing substantial amounts of tax to be collected at relatively modest tax rates.

Composition of tax revenue (year ended June 2013)



Source: Treasury
(Tax Outturn data)

Tax Revenue and Statutory rates (2012)

	Tax rate	Tax type as a percentage of GDP
<u>GST / VAT</u>		
Australia (2011)	10.0	3.3
New Zealand	15.0	10.0
OECD average	18.7	6.4
<u>Corporate tax</u>		
OECD average	25.5	3.0
New Zealand	28.0	4.4
Australia (2011)	30.0	5.2
<u>Personal tax / top personal rate</u>		
New Zealand	33.0	12.4
OECD average	40.7	8.7
Australia (2011)	47.5	10.4

Table is ordered so that the country with the lowest tax rate for each tax type appears first.

Inland Revenue's administrative framework

- 1.7 The New Zealand tax system relies on voluntary compliance. The Tax Administration Act 1994 sets out certain obligations that are imposed on taxpayers and on Inland Revenue. The key obligations for taxpayers are to:
- self-assess;
 - file returns; and
 - pay tax due.
- 1.8 Self-assessment is deemed to occur on the receipt of a return. The Commissioner of Inland Revenue has the ability to amend an assessment, including issuing default assessments. The self-assessment model underpins a number of Inland Revenue's interactions with taxpayers – for example, the binding rulings and determinations regimes and the disputes process.
- 1.9 The Tax Administration Act also sets out a range of rules which relate to the administration of the tax system, including:
- return filing;
 - record keeping;
 - payments;
 - withholding;
 - penalties;
 - recovery powers; and
 - relief and remission powers.
- 1.10 Inland Revenue aims to make it as easy as possible for people to comply with the tax system and to access their social policy entitlements delivered through the tax system. It also aims to make it hard for people not to comply. The goal is to provide services that are value for money. The way that Inland Revenue operates largely reflects a set of decisions on how to make marginal improvements or take on new tasks given the legacy of the systems already in place. It has not stood back and had a fundamental look at how tax might best be administered if we were starting from scratch.

Inland Revenue's business transformation programme

- 1.11 Inland Revenue is embarking on a once-in-a-generation opportunity to simplify New Zealand's tax system to meet 21st century needs. Government has agreed in principle to a long-term business transformation programme to look at different ways of delivering tax and social policy. This includes re-shaping the way Inland Revenue works with taxpayers, and looking at possible changes to, amongst other pieces of legislation, the Tax Administration Act.

- 1.12 The world is changing, with huge improvements in ways of doing business. Ways of doing business that were acceptable 10 or 20 years ago will no longer meet the demands of taxpayers as Inland Revenue moves further into the 21st century.
- 1.13 This draft working paper outlines, at a very high level, a vision of some of the policy changes that could form part of this future. This will help to inform the discussions that will take place at the conference, *Tax Administration for the 21st Century* (12–13 June 2014, Wellington).
- 1.14 Our vision will, of necessity, be partial and incomplete. Many of the opportunities for improvement will be best known by taxpayers, their advisors and the wider business community. The aim is to start a process of engagement with the private sector and the community on how best to undertake the process of transforming our tax administration.

CHAPTER 2

The policy vision

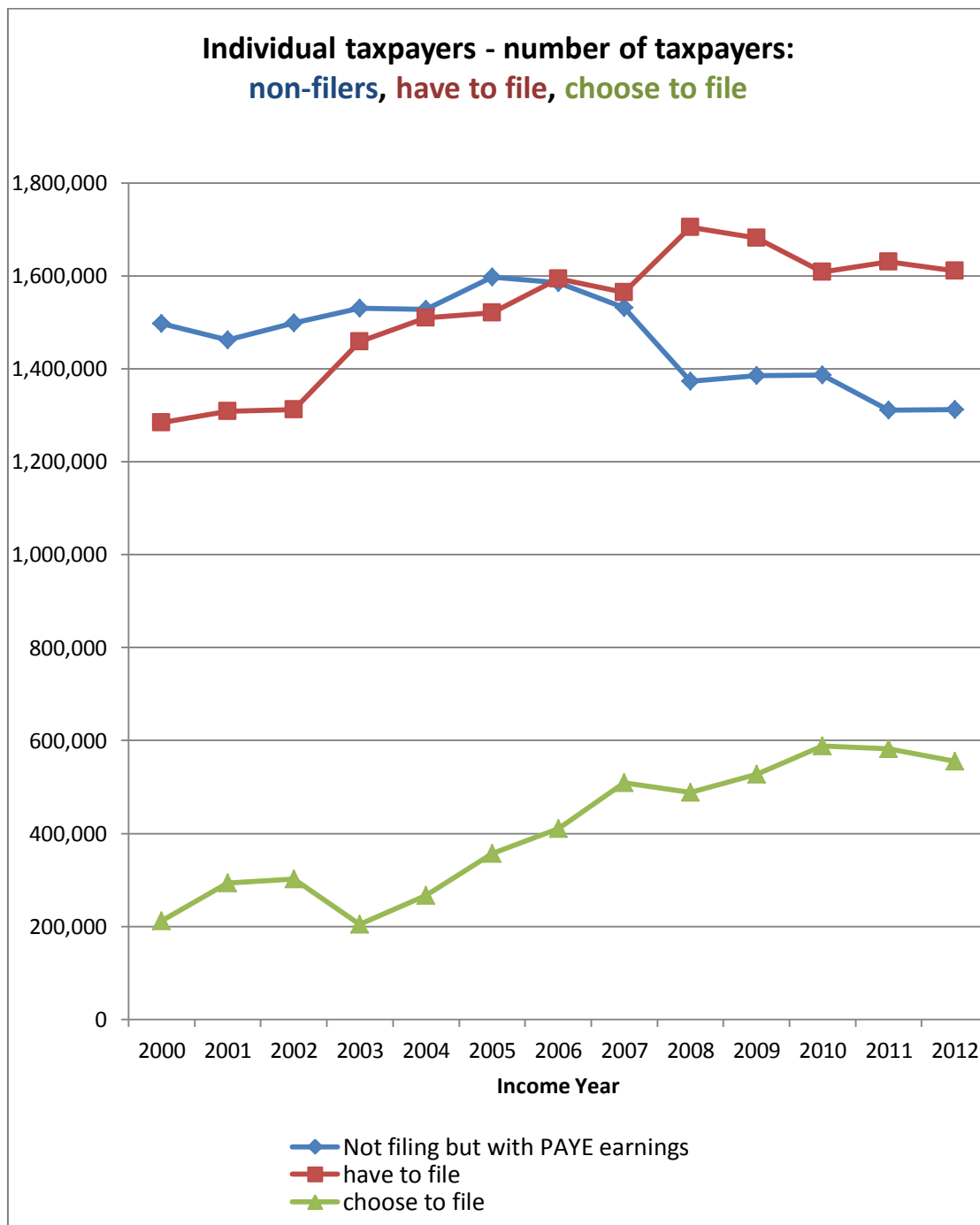
- 2.1 A key part of Inland Revenue's challenges and transformation goals is to provide excellent service.
- 2.2 To transform the way things are done, some of the key features of Inland Revenue's future business should include:
- efficient self-management options for taxpayers, thereby providing speed and certainty for taxpayers and the private sector;
 - a broader approach to compliance based on smarter use of information and a wider range of interventions;
 - a range of different working relationships with other organisations, including strategic partnerships to deliver some services;
 - less direct contact required with taxpayers;
 - more automation and streamlined information flows;
 - greater use of commercial IT products in systems and services; and
 - proper targeting to different taxpayers' needs.
- 2.3 We need a system that makes tax easy and simple for taxpayers, that avoids duplication of effort by taxpayers and associated third parties, and is flexible enough to move with technology developments. Any future changes should also be based on providing certainty to taxpayers.
- 2.4 Inland Revenue's wider vision is to be a world-class revenue organisation, recognised for its service and excellence. It therefore must:
- be agile, effective and efficient (to reduce administration costs);
 - enable taxpayers, wherever possible, to self-manage with speed and certainty (to reduce compliance costs);
 - enable the Government to make timely and cost-effective policy changes; and
 - work with other government agencies to more efficiently deliver services across government.
- 2.5 The current revenue system is under increasing pressure. Major tax and social policy initiatives are difficult to implement given core technology and business processes. These demands have resulted in various system modifications, manual interventions and workarounds that have produced layers of complexity for government and taxpayers.
- 2.6 As a result, current systems and processes pose significant challenges and risks. These include:

- operational failure, potentially impacting the Government's revenue collection and distribution;
- ability to implement the Government's tax and social policy initiatives in a timely and efficient manner;
- inability to provide the services that taxpayers and their advisors are and will increasingly demand in a future digital age; and
- inability to benefit fully from information and expertise used across the wider public sector.

Background

- 2.7 The current tax administration system works well for taxpayers whose income is derived solely from salary and wages which are subject to tax withholding regimes. It works less well, however, in other areas. For example if a person is close to an income tax threshold and earns interest income, that interest income may be withheld at the incorrect rate. This can lead to costly square-ups when returns are filed or unfairness and inefficiencies if they are not. This problem is likely to grow as people earn a larger proportion of their income from capital sources.
- 2.8 The obligations on taxpayers vary, based on historic and somewhat arbitrary distinctions. There is a tension inherent in the tax administration system between taxpayers who are not required to file and those who are. As a taxpayer's circumstances change, their filing obligations can also change.
- 2.9 This adds complexity in meeting obligations and creates fairness and equity concerns for some individuals. A taxpayer who is required to file a tax return might have an underpayment in one year and receive a refund in another year. For taxpayers who are not required to file, however, there is no incentive to square-up in years of underpayments, but they can easily claim any available refunds.
- 2.10 Policy makers have attempted to minimise incentives for these taxpayers to "cherry pick" and file only when they have overpaid tax. Taxpayers have been forced into a gamble. If they enquired about their tax affairs by requesting a Personal Tax Summary (PTS), they are treated as filing even if this leads to a tax liability. This system has led to firms offering a service to determine details of an individual's tax affairs before requesting a PTS to remove this gamble. This compares with those who have business income (for example, rental income) or overseas income who are required to file. These taxpayers do not get the opportunity of "cherry picking".
- 2.11 It should be noted that recent legislative changes that will apply from the 2016–17 tax year will require taxpayers who are not required to file an annual return, but who choose to do so, to file returns or PTSs for the previous four years.
- 2.12 The current rules are based on paper-based processes, and paper is still the predominant channel. Processing paper-based returns is costly and time consuming. The resulting reluctance to push individuals into filing tax returns constrains policy choices.

- 2.13 There are however, as noted earlier, growing numbers of taxpayers who are filing returns, or otherwise interacting with Inland Revenue. Examples include individuals filing donations rebate forms, and Inland Revenue's growing involvement in the delivery of social policies, such as Working for Families which substantially increases the number of taxpayers who file or interact with the Department.
- 2.14 The following graph, which shows the increasing number of taxpayers filing income tax returns or PTSs from the years 2000 to 2012, illustrates this point. In the year 2000, 1.496 million people (or 50% of individual taxpayers) were either required to or chose to file an income return. By 2012 this number had increased to 2.167 million (or 62% of individual taxpayers), an increase of 671,000 taxpayers.



- 2.15 The objective of keeping people away from filing returns has resulted in the creation of complex and inaccurate full and final tax withholding regimes to take people out of the system (for example, the Portfolio Investment Entity (PIE) rules). Normally income between \$14,000 and \$48,000 is taxed at a marginal rate of 17.5 cents in the dollar and income between \$48,000 and \$70,000 at a marginal rate of 30 cents in the dollar. What marginal rate should be applied to a person with \$47,000 of salary and wage income who earns, say, \$2,000 of PIE income? Should this additional income be taxed at a rate of 17.5 cents or 30 cents in the dollar or something in between? In practice this person is permitted to have up to \$23,000 of PIE income taxed at a rate of 17.5 cents in the dollar even though \$22,000 should really be taxed at a rate of 30 cents in the dollar. Similar policy compromises arise when individuals earn superannuation which is subject to employer's superannuation contribution tax (ESCT). All of this is at odds with New Zealand's broad-base low-rate approach to taxation.
- 2.16 This would not be a problem if there were a flat marginal tax rate on all income and tax on all income could be withheld at this rate. But Governments tax income at increasing marginal rates on the grounds of fairness. Also, there has been a growing tendency for social assistance delivered through the tax system to be abated against income. This makes it more difficult to withhold income tax at rates that are likely to be close enough for square-ups to be unnecessary. Furthermore, as some forms of income, such as PIE income, does not form part of the annual income of a taxpayer, additional compliance costs are imposed on recipients of social assistance because they have to return some types of PIE income for social assistance purposes.
- 2.17 All of this has led to significant numbers of people being required to file. As well as those earning foreign income, rental income or business income, or who are receiving Working for Families tax credits, and know they are required to file tax returns, there are some who may not. These include people who have interest or dividend income, or an extra pay or secondary earnings on which tax has been withheld at the wrong rate.
- 2.18 Another challenge for the current tax administration system is in relation to information flows. There are problems with the timeliness of collection of information and the accuracy of that information. When information is inaccurate there are also problems with the timeliness of intervention or correction of that information.
- 2.19 These problems and constraints lead to questions about whether it is still desirable to keep as many individuals as possible away from interacting with the tax system. Would modern technology provide scope for a dramatic reduction in the costs of interacting with the tax system and square-ups?
- 2.20 Parallel questions arise around whether other features of the current tax system are really what taxpayers expect in the 21st century. These include:
- the Employer Monthly Schedule and other withholding systems, together with manual interventions and dated corrections;

- the way that businesses are required to pay tax, including the estimation of provisional tax; and
- the complex interactions between tax and social assistance.

“Straw man” proposal of a policy vision to underpin business transformation

2.21 A good tax system requires both good tax policy and good tax administration. Both are pre-requisites for a tax system to operate to its full potential. This draft working paper provides a “straw man” proposal for a policy vision of some of the changes that would be required to reach that potential. It is a first step to start the debate on what changes are required to move our tax administration further into the 21st century.

Key assumptions

2.22 Some key assumptions have been made during early consideration of the policy issues that are likely to underpin Inland Revenue’s business transformation. These include:

- Key tax bases will remain substantially in place – for example, there are no fundamental changes currently planned to either income tax (individuals and corporates) or GST. Previous tax reviews, including that by the 2009 Tax Working Group, provide a high degree of support for this assumption.
- Social policy and other non-tax functions currently administered by Inland Revenue (for example, in relation to Working for Families, child support, student loans and KiwiSaver) will continue to be a key part of Inland Revenue’s portfolio of work.

Objectives

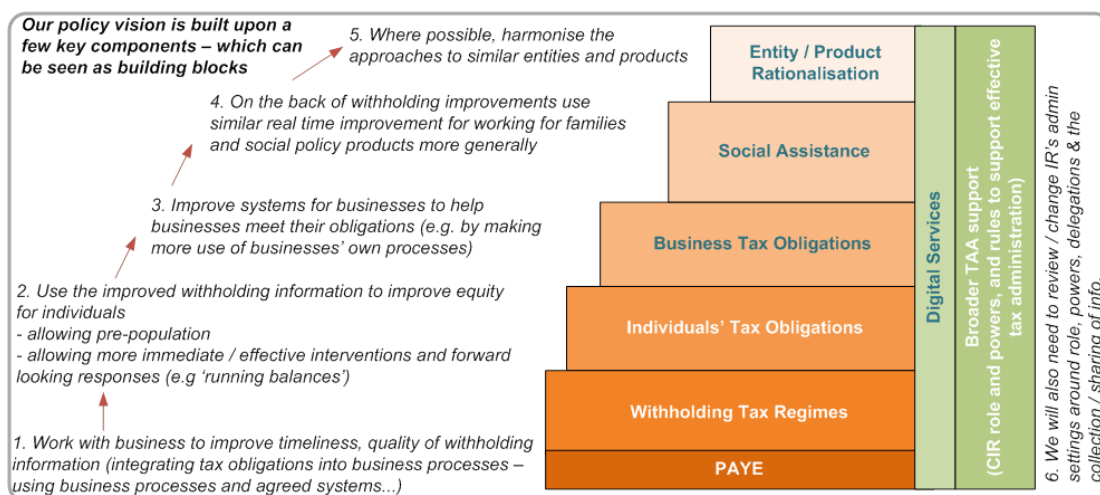
2.23 Some of the specific objectives that the policy vision should achieve include:

- Making it easier for taxpayers and others (hereafter referred to as “taxpayers”) to pay tax and meet social policy obligations.
- Increasing certainty for taxpayers, by:
 - providing easy digital access to taxpayers’ accounts (and alternatives for those without such access);
 - providing earlier and simpler transactions;
 - using a taxpayer’s normal business processes and systems to meet tax obligations;
 - improving response times; and
 - improving the collection, accuracy and timeliness of information to simplify and better tailor interactions.
- Increasing the efficiency of debt collection.
- Reducing compliance and administration costs.

- Supporting broader “all-of-government” goals.
- Ensuring the ongoing surety and integrity of the tax and social policy system.
- Making it easier and less expensive for taxpayers to get it right and meet their obligations (and harder for them to get it wrong).

2.24 These objectives and any proposed outcomes will, of course, still need to have regard for the usual elements and trade-offs that are considered in any policy change. Factors such as efficiency (including compliance and administrative costs), equity (recognising other economic and social objectives), together with applicable revenue and fiscal impacts, will need to be taken into account when assessing options.

2.25 The following diagram depicts the key elements (or building blocks) on which the policy vision described in this paper is based.



CHAPTER 3

PAYE

- 3.1 The policy vision described in this paper is premised on the provision of data, in particular the timely provision of data that can be effectively used by taxpayers, Inland Revenue and, where appropriate, wider government.
- 3.2 Currently, all employers and payroll intermediaries are required to file an Employer Monthly Schedule (EMS) form at least once a month. In this context the EMS has, in theory at least, a lot of positive attributes. It provides a wealth of relevant information that is imperative when determining the tax status of New Zealand salary and wage earners.
- 3.3 The EMS therefore provides the starting point for any wider policy-led transformation changes, in particular, addressing some of the problems that limit its current effectiveness.

Current problems

- 3.4 These include, amongst other things:
- the timeliness and accuracy of information currently received;
 - the level of duplication, correction or other interventions required by employers or Inland Revenue before the information can be effectively used; and
 - the paucity of use of available information from an all-of-government perspective.

Potential changes

- 3.5 Potential changes to improve the way the EMS operates, and provide a platform for wider changes in the way that Inland Revenue could interact with individual taxpayers, include:
- avoiding unnecessary duplication by integrating PAYE into existing business systems (for example, the payroll system), so that EMS becomes part of a wider process rather than an additional process;
 - allowing business systems to talk directly to Inland Revenue systems, and vice versa;
 - easy amendment and correction of tax codes;
 - ensuring that information provided is validated immediately; and
 - up-front verification of information to allow EMS to be better used to collect underpayments

- 3.6 A focus on the transfer of data, rather than on the current prescriptive filing of “returns”, means information can be provided any time during a month (or any applicable period) rather than just at the end of a period. Although there will still likely be time limits by when information (and payment) must be made, this will none-the-less provide more flexibility for employers.
- 3.7 Any future changes will still require data to be accurate and timely before any new process can be considered effective. Innovation by the private sector will therefore be an important ingredient in ensuring that any PAYE changes are successful, in particular in relation to making sure that “normal” business processes are used wherever possible.
- 3.8 Conceptually, this EMS model could also be used for other tax types, potentially allowing the rationalisation not only of taxes, but also returns and processes. For example, fringe benefit tax could feasibly be incorporated into wider PAYE records.
- 3.9 Rationalising withholding tax could also be applied to all forms of employment remuneration. For example, the withholding regime could be extended to other forms of labour or services income, and the EMS model applied to those.

CHAPTER 4

Resident withholding tax

- 4.1 As income from capital is likely to grow in the future, as the population ages and more capital is accumulated, it will become more important to ensure that such sources of income, and associated resident withholding tax (RWT), are accurately and promptly recorded.

Current problems

- 4.2 Current problems with RWT systems include:
- Annual RWT systems are slow, and often inaccurate, meaning square-ups are frequently required.
 - Administration and compliance costs are high, in particular, in relation to the benefits realised.
 - Duplication of compliance from entities recording/deducting RWT and taxpayers.
 - RWT systems currently cannot be used as effective debt recovery tools.

Potential changes

- 4.3 Potential changes to improve the way that RWT operates, and lead to wider changes in the ways Inland Revenue could interact with individual taxpayers, include adopting the previously noted proposed EMS model, whereby:
- Information is passed automatically to Inland Revenue whenever payments are made, rather than as part of a separate return.
 - The information becomes an integral part of the business system, rather than a separate process.
 - Business systems interact directly with Inland Revenue (and vice versa), with up-front validation of information.
 - Information, including withholding rates, is verified up-front, allowing RWT systems to be better used as a debt recovery tool.
 - Inland Revenue uses the information to pre-populate “tax returns” and informs taxpayers of gross income and tax withheld.
 - All that a financial institution has to do is withhold the tax, pay the tax to Inland Revenue, and provide the relevant information.

- 4.4 Again, any changes will require data to be accurate and timely before any new RWT process can be considered effective. Collaboration with financial institutions and other businesses deducting RWT will therefore be essential to ensure that any RWT changes are successful, in particular, to ensure that compliance costs are efficiently managed.

CHAPTER 5

Individual income tax

5.1 The vision outlined in this paper for an income tax system for individuals is premised on the following framework – it should:

- provide a high level of certainty for taxpayers;
- provide for a low cost of contact for all parties, including Inland Revenue, individuals and third parties (for example, employers);
- be designed for a digital world, not a paper world;
- work in a way that efficiently allows for the recovery of debts, not just refunds;
- provide for one process that applies for all individual taxpayers, regardless of different information requirements; and
- be flexible enough to allow future changes.

5.2 In terms of sequencing, there is an interdependency on improving and expanding the withholding tax mechanisms noted in chapters 3 and 4 (PAYE and RWT). Changes to the way these operate are necessary to achieve a critical mass of accurate information that covers the majority of individuals taxed in New Zealand.

Current problems

5.3 The current method of taxing individuals, with a combination of: non-filers, those who request PTSs, and those who file income tax returns, was designed in a paper world. It works reasonably well if someone has a single source of labour income (and negligible other income), but less so when there are multiple sources.

5.4 In trying to keep as many people as possible from having to file, policy compromises have been made to try and provide proxies for final withholding rates (for example, the PIE regime which is based on previous years' income). More people are, however, now squaring up their tax liabilities at the year-end, for example, if they realise they are entitled to a refund.

5.5 The current problems with individuals' current filing requirements include, amongst other things:

- the need for policies that can sometimes create artificial and unclear boundaries;
- the ability for taxpayers to cherry-pick refunds, without a mirror requirement to always pay outstanding tax, leading to fairness and equity concerns;

- pre-population of taxpayer information is currently limited for salary and wage earners' information;
 - the fact that the current system is not efficient in managing small debts; and
 - high administration and compliance costs for Inland Revenue, taxpayers and third parties.
- 5.6 As previously noted, increasing numbers of individuals are interacting with Inland Revenue. Common areas relating to income tax where multiple interactions are occurring between Inland Revenue and individuals include filing income tax returns, requesting personal tax summaries and donation rebates; and also with regard to Working for Families tax credits, student loans, and child support issues.

Potential changes

- 5.7 Technological changes and improved data could provide more options for individuals to interact with the tax system in the future.
- 5.8 For example, one option could be for everyone to file, albeit in a much easier form than currently. Alternatively, some taxpayers could be given the option of not filing, for example, if they have no income that does not have tax deducted at source. This could potentially give more taxpayers an option of not interacting with the tax system than at present.
- 5.9 This policy vision envisages an electronic filing system that is pre-populated by timely and accurate withholding systems. The majority of taxpayers would then, at worst, only be required to check and confirm their details and, where applicable, report non-prepopulated income such as overseas income or income where there is no deduction at source (for example, rental income). In most cases, square-up amounts of tax would be dealt with by either refunds being automatically released or debts paid by automatically adjusting withholding rates on future income sources.
- 5.10 In short, the focus would be on making “filing” simpler and less onerous for individuals' tax obligations using pre-population, better technology and the use of “rolling balances” (for example, income tax). A “rolling balance” could allow Inland Revenue to automatically adjust withholding rates to collect prior underpayments of tax.
- 5.11 This could be facilitated, in part, by a personalised web page containing:
- pre-populated income;
 - prompts based on third party data and/or previously provided information;
 - a tax liability calculated by Inland Revenue; and
 - a digital notification of the resulting assessment provided.

5.12 The key benefits potentially arising would include:

- greater fairness and transparency;
- simplification of withholding regimes;
- improved automation of debt collection;
- flexibility for dealing with future policy changes, and future opportunities to support all-of-government outcomes;
- administration efficiencies (for example, less “exception” processing) and lower taxpayers’ compliance burden over time; and
- better use of information and data across government (both internationally and nationally).

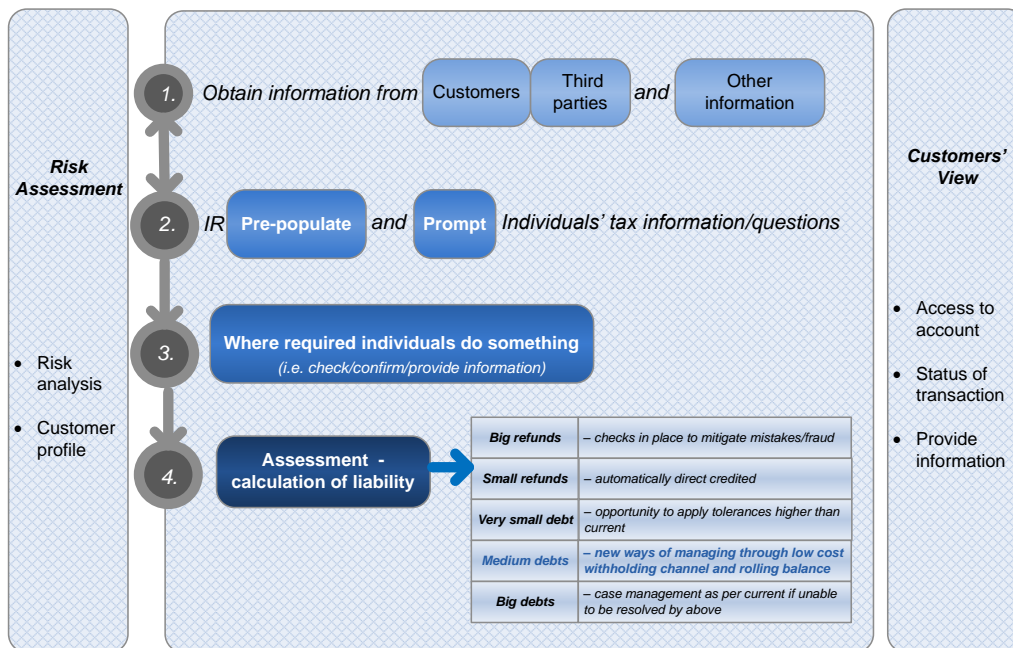
5.13 In addition, the policy vision for individuals provides opportunities to extend the philosophy of using “rolling balances” for debt from a product level (for example, income tax) to a customer level (for example, across all products delivered by Inland Revenue), and even across other government agency products.

5.14 The change in focus towards providing data also allows a move away from concepts like “filing” and “returns” per se, and enables associated information to be consolidated (for example, charitable rebates can be dealt together with income tax rather than as a separate form). From a taxpayer perspective, it would allow individuals to understand what their obligations are and how the wider tax system works.

Conceptual views of individuals’ income tax in the future

5.15 The following graphics present some conceptual summaries of what a “year-end” process might look like for individuals’ income tax in the future.

A conceptual view of Individuals' income tax in the future



To illustrate: Individuals with multi-income sources

Stage 1: Individual account overview

Our records show you have the following income type for the period of 1 April 2014 to 31 March 2015:

Salary/wage
Dividends/interests

We notice that you had rental income last year, do you still have rental income for the period of 1 April 2014 to 31 March 2015?

☒ Yes, I still have rental income.
☐ No, I don't have rental income, please select the reason from the drop- down list.

Tab for reasons ▼

Do you have any other types of income?

☐ No, I don't have any other type of income.
☒ Yes, I have other types of income, select the relevant income type from a drop-down list.

Tabs for income types ▼

Your Summary

Income Tax
Child Support
.....
.....
.....
.....
.....
.....

Stage 2: A tab view

Salary/wage

Add/edit your dividends/interests income details
Here is our record of your dividends/interests income details:
XXXXXXXXXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXXXXXXXXX
Do you have anything else to add?
+

Add your rental income details
Please provide your rental income details for the period (1 April 2014 to 31 March 2015):
XXXXXXXXXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXXXXXXXXX

Add business income details
Please provide your business income details for the period (1 April 2014 to 31 March 2015):
XXXXXXXXXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXXXXXXXXX

Add XXXXX income details
XXXXXXXXXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXXXXXXXXX

Stage 3: Calculation/Assessment

CALCULATION / ASSESSMENT

XXXXXXXXXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXXXXXXXXX
= \$XXX, XXX

DEBIT
REFUND/Nil

Stage 4: Result Statement

Based on the assessment or calculation, you are entitled of refund (or nil) of \$xx,xxx.

We will process a payment of \$xxx,xxx to your bank account xx-xxxx-xxxxxxx within xx working days.

OR

Based on the assessment or calculation, you need to make payment of \$xxx,xxx .

Please make your payment electronically within 30 days, otherwise it will be deducted from your salary/wage commencing in 40 days.

CHAPTER 6

Business tax

6.1 The initial vision outlined in this paper is a tax system for businesses premised on the following framework – it should:

- provide a high level of certainty for taxpayers;
- provide effective and timely solutions to taxpayers’ pressing issues and problems (for example, when proving binding rulings);
- have a low cost of contact;
- be designed for a digital world, not a paper world;
- work in a way that efficiently allows for the recovery of debts;
- provide sufficient information so that key policy concerns and audit risks can be identified easily, cognisant that businesses that are low risks have lower information requirements;
- collect revenue as companies earn their income without imposing excessive compliance costs on taxpayers;
- provide value for money for the Government; and
- be flexible enough to cater for future changes.

6.2 We recognise that the important issues for businesses will only be fully discovered by engagement with them to establish existing concerns. A key aim of future consultation will therefore focus on exploring these concerns.

6.3 Two issues briefly explored as part of this paper are:

- moving away from the current focus on detailed tax “returns” to a concept where the focus is instead on providing key information, where this information is provided digitally, and in a way that suits the size and nature of individual businesses; and
- on the issue of provisional tax, in particular, exploring whether company accounting data (with some minor adjustments) can be better used as a basis for calculating provisional tax.

6.4 Other issues that, although not discussed in this paper, will also need to be considered as part of any changes in this area include:

- a review of current taxable entities and their treatment; and
- potential simplification options for small- and medium-sized business entities.

Information provision

Current problems

- 6.5 The current design of a tax return is based on the provision of a paper “return”. These typically have three main purposes:
- providing updated non-annual factual information (for example, address and other contact information);
 - providing information to support decision making – such as information for policy or audit targeting; and
 - providing the final top-level calculations of a taxpayer’s tax liability, for checking by Inland Revenue.
- 6.6 Providing tax returns, in particular for businesses, is out-dated in a digital world. It does not add value to either Inland Revenue or taxpayers.
- 6.7 Taxpayers are often forced to duplicate processes in order to comply with return requirements. This increases compliance costs and can cause errors in transposing information from one form to another. The information required may also be out of synch with the business’s size or risk profile.
- 6.8 On the other hand, from Inland Revenue’s perspective, current tax returns may not be providing the type of information from businesses that would most effectively allow it to carry out its debt recovery and audit functions. There is also an efficiency cost to Inland Revenue in processing non-digital and/or superfluous information.

Potential changes

- 6.9 Digital technology provides an opportunity to rationalise current tax returns for non-individual entities more efficiently where the focus is on providing relevant up-to-date information in an efficient manner.
- 6.10 The focus of any such shift should be to best utilise businesses’ existing processes and systems to make it easier for businesses to provide their information to Inland Revenue.
- 6.11 The focus on information provided should also be more focussed on information that is necessary to support such matters as audit activities and policy advice or audit.
- 6.12 In addition, introducing a differential reporting approach to the company income tax return would also reduce the reporting requirements for the majority of non-individual entities, and would be in line with recent changes to financial reporting requirements. In this vision, smaller businesses, which often have disproportionately high compliance costs, will have to produce significantly less information.

Provisional tax

Current problems

- 6.13 There is an inherent trade-off between the accuracy of the payment of business income tax as income is earned, and compliance costs.
- 6.14 The calculation and payment of provisional and terminal tax currently presents a number of problems for both businesses and Inland Revenue. Key amongst these are:
- use-of-money interest risk for businesses, resulting from the need to estimate annual tax liabilities part-way through a year of assessment for provisional tax purposes; and
 - the one-off square-up nature of terminal tax can present cashflow difficulties for businesses, in particular, because of the nature of the current rules for new businesses. This has knock-on effects for Inland Revenue in its enforcement activities.

Potential changes

- 6.15 In the future, the calculation and payment of business income tax could be done more “on-account” as income is earned during the year – akin to a PAYE for businesses. This would simplify the calculation of provisional tax and create more certainty for taxpayers.
- 6.16 This could make more use of interim accounting calculations of a business’s net profit rather than the far more difficult task of estimating the actual taxable income for the year.
- 6.17 As with other parts of this policy vision, innovation through the private sector will be an important ingredient in ensuring that provisional tax changes are successful, in particular in relation to making sure that normal business processes are used wherever possible.
- 6.18 For example, examining whether accounting profits with a very few adjustments (for example, reversing out capital gains and losses and excluding foreign non-taxable income) could effectively be used as a proxy for provisional tax in practice. Accounting software packages would have a key role to play in this regard.
- 6.19 Issues regarding terminal tax could be addressed by rolling outstanding tax liabilities into the provisional tax payments for future years, rather than by one-off payments.
- 6.20 Another potential area for investigation is the concept of a “tax bank” – an account where taxpayers could make deposits that would be held on account to use to meet tax obligations as they arise. This could allow businesses and intermediaries to innovate and develop new products as this account need not be managed by Inland Revenue, but could perhaps be operated by banks or other third parties. Whether this account would be mandatory or voluntary would have to be explored.

- 6.21 As mentioned earlier, the fiscal implications of any changes would need to be carefully scrutinised when assessing the merit of that change. As part of this, the design of any changes would have to be very carefully worked through with businesses and their advisors, so that any impacts on businesses' cashflows can be fully considered.

CHAPTER 7

Social policy

- 7.1 Although many social policies use household income as a base for entitlement, other non-income information is also often brought into account when calculating entitlements. This can take a number of forms, for example, living arrangements and family size are often taken into account, as are other sources of income that are not included as income for individual income tax purposes (for example, some benefits that attract fringe benefit tax).

Current problems

- 7.2 Some of the more common problems associated with administering social policy are:
- Changes in individuals' circumstances are often required during the year, necessitating contact to be made between individuals and Inland Revenue, often several times a year.
 - Current rules often provide little incentive for a taxpayer to initiate that contact, particularly if it would result in a reduction in payments received.
 - These often result in square-ups being required, resulting in problems with year-end debt.

Potential changes

- 7.3 Potential changes that could be considered in the future to help address some of these issues include:
- reconsidering the annual approach often taken for social policy purposes (for example, for Working for Families tax credits);
 - making greater use of information from other sources (including other government agencies) as a trigger that a taxpayer's circumstances may have changed;
 - ways to incentivise more frequent contact, as this allows for a better reflection of real-life circumstances. This could include a reduced or ceased entitlement if there is no confirmation provided in a given period;
 - more frequent contact should be able to be facilitated by advances in technology that allow for easy, more active, low-cost interaction; and
 - debt recovery could, in some circumstances, be offset against future entitlement payments.

CHAPTER 8

Potential TAA implications

- 8.1 As noted previously, the Tax Administration Act 1994 sets out a range of legislative settings for the administration of the tax system. In particular, the Act:
- creates the concepts of the Commissioner and Inland Revenue;
 - promotes voluntary compliance – with shared responsibility for all (including Ministers, officials and taxpayers);
 - sets out concepts of confidentiality and tax integrity;
 - sets out the Commissioner’s statutory independence;
 - imposes obligations on taxpayers (for example, self-assessment, requirement to furnish returns, payment of tax due, etc.); and
 - sets out the Commissioner’s powers (for example, information collection, enforcement of compliance, and application of sanctions).
- 8.2 Any fundamental changes such as those mooted in the previous chapters of this document will either necessitate, or alternatively provide an opportunity for, an investigation into many of the wider and more fundamental issues contained within the Tax Administration Act (and other governing pieces of legislation).
- 8.3 Some of the key implications that may arise from the policy vision outlined earlier include:
- The use of digital channels (digital by choice / incentive) become vital, as business systems and Inland Revenue systems would need to interact to deliver future changes.
 - Opportunities to harmonise or standardise definitions and rules across products (to deliver a common services approach).
 - Opportunities to improve debt collection and the application of available sanctions (for example, penalties, use-of-money interest, etc.).
 - Opportunities to look at the construct of Inland Revenue’s legislative framework (for example, the degree of prescription, role of discretion, etc.) to enable greater future policy and administrative flexibility.
 - The implications of changing obligations on intermediaries, Inland Revenue and taxpayers.
 - Potentially moving away from self-assessment and “year-end” terminal tax models for some taxpayers.

- 8.4 There are also other broader environmental issues to consider which may affect future legislative settings. These include:
- changes to public sector settings, including the creation of functional leadership roles, enhanced leadership expectations, and new accountabilities around all-of-government contributions;
 - government and taxpayers' expectations on the delivery of services will require Inland Revenue to both provide and receive services for broader government outcomes;
 - the collection of more specific data to pre-populate returns, to provide better joined-up services, to ensure compliance, and to facilitate better analytics. There will be an expectation that this data is shared with other agencies for broader outcomes and to reduce duplication of effort from taxpayers. This will have implications for when such information will need to be provided; and
 - taxpayers' data will continue to need to be appropriately safeguarded across government and within Inland Revenue.
- 8.5 These issues all have implications on the concepts of privacy, tax secrecy and upon Inland Revenue's future settings on information collection, sharing and use.
- 8.6 The Tax Administration Act and other associated legislation have laid the base for much of how the tax administration functions today. It has much that should be protected and built upon. However, it is also perhaps more reflective of a siloed public service, and can be very prescriptive in its approach, whereas the visions contained in this paper require a more flexible world.
- 8.7 Some of the specific issues that need to be considered more closely include:
- The structure and re-organisation of the Tax Administration Act to deliver on a future vision – for example, the degree of legislative prescription that may be required to administer the tax system in the future.
 - Implications on the obligations on taxpayers in regard to:
 - providing information;
 - record keeping; and
 - clarity on what the concept of self-assessment is in the future.
 - Implications on obligations on intermediaries, including:
 - accountabilities (in a world where Inland Revenue collects information on a more regular basis); and
 - tiers of trust opportunities (for example, Inland Revenue approving and providing differentiated service to certain parties).
 - Implications of obligations placed on Inland Revenue.

- The role of the Commissioner, including:
 - clarity on what the Commissioner’s role looks like (for example, in the future, what does the legislative obligation to collect “highest net revenue” in a more joined up government look like?);
 - protecting tax integrity; and
 - impacts on existing powers and delegations.
- Self-assessment vs Commissioner-assessment models as, in the future:
 - Inland Revenue’s computer coding will likely be more determinative;
 - information will come in over time, not necessarily in a single return; and
 - information required from taxpayers and third parties will vary.
- Opportunities to revisit penalty and use-of-money interest rules.
- Implications on Inland Revenue’s data collection, including:
 - regular bulk information provision;
 - collection powers and consequential impacts; and
 - meeting international expectations.
- Implications on information-sharing and use, including:
 - information transparency and use;
 - taxpayer confidentiality;
 - future expectations on those whom information is shared with; and
 - other related aspects of sharing digitised information (for example, agencies access to shared spaces, e-mail, security, etc.).
- Tax secrecy rules.

CHAPTER 9

Policy vision on a page

9.1 Withholding regimes:

- EMS model in a digital world
- Timely information
- Tax obligations integrated into business systems
- Allows withholding to be used to collect underpayments
- Reduces complexity of withholding systems.

9.2 Individuals' income tax:

- Pre-population of income and tax paid
- Low-cost square-up process
- Allows withholding to be used to collect underpayments.

9.3 Business income tax:

- Simplify calculation of provisional tax (integrate with business systems)
- Shortfall of provisional tax collected in subsequent provisional tax obligations (removal of terminal tax).

9.4 Social policy:

- What is the appropriate assessment period for social assistance – annual or something shorter?
- How to get better and more timely information
- Overpayments collected through future entitlements.

9.5 Tax Administration Act:

- Opportunities to review current policy and legislative settings, including:
 - Role of Commissioner
 - Self-assessment vs Commissioner assessment model
 - Penalty and use-of-money interest
 - Tax secrecy
 - Construct of legislative framework (degree of prescription).

9.6 Next steps:

- The aim is to extend the vision by discovering what the wider community sees as possible gains from business transformation
- A conference, *Tax Administration for the 21st Century*, on 12 and 13 June 2014 in Wellington
- A series of discussion documents, starting in 2014 or 2015
- Changes progressively made over the next 10 years in line with the proposed phases of Inland Revenue's transformation programme.

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