

Submission

By



To The

Inland Revenue Department

On

Reducing Tax Compliance Costs for Small and Medium-Sized Enterprises – Part Two (Other Issues)

29 February 2008

PO Box 1925
Wellington
Ph: 04 496 6555
Fax: 04 496 6550

**REDUCING TAX COMPLIANCE COSTS FOR SMALL AND MEDIUM-SIZED
ENTERPRISES – OTHER ISSUES
SUBMISSION BY BUSINESS NEW ZEALAND¹
29 FEBRUARY 2008**

1. INTRODUCTION

- 1.1 Business New Zealand welcomes the opportunity to comment on the remaining sections of the *Reducing Tax Compliance Costs for Small and Medium-Sized Enterprises* discussion document (referred to as ‘the document’), released by the Inland Revenue Department (IRD). As stated in our submission for part one, we believe the proposed changes are generally a step in the right direction, with further scope for improvement as discussed below.

2. SUMMARY OF RECOMMENDATIONS

- 2.1 Business New Zealand makes the following **recommendations** with regard to chapters three through to eight of the *Reducing Tax Compliance Costs for Small and medium-Sized Enterprises - Thresholds*, namely that:
- (a) ***The Government undertakes the majority of proposals outlined in chapters’ three to eight in the short-medium term. Also, a timeline of implementation is compiled by the Government regarding the proposals agreed upon once the views of submitters have been taken into account. (p.2);***
 - (b) ***Allowing businesses to deduct all business-related legal expenses up to a GST-exclusive cost of \$10,000 a year should proceed (p.3);***
 - (c) ***The minimum threshold for non-deductible entertainment expenditure rules involves a threshold of at least \$5,000 (p.3);***
 - (d) ***As a matter of principle, FBT be fundamentally reviewed by the Government, with alternative proposals put forward to examine ways in which the tax could be more efficiently and effectively run. (p.4);***
 - (e) ***The introduction of a single category of restricted private-use vehicle with FBT rates of 10% of the vehicle’s cost price (or 18% of their tax value) proceeds. However, the new definition of a restricted private use vehicle should not include a cap on the value or type of vehicle (p.5);***
 - (f) ***Removing the requirement to continue monitoring private use during the three-year application period to ensure that actual private use is not 20% or more than the three-month test results proceeds (p.5);***
 - (g) ***The various proposals outlined for GST invoices proceed if supported by the majority of submitters (p.5);***

¹ Background information on Business New Zealand is attached in the appendix.

- (h) ***The proposal to correct minor tax errors in subsequent returns proceeds, and that the threshold amount is increased somewhere in the range of \$2,000-\$5,000 (p.6);***
- (i) ***The proposal to lower the record keeping requirements from seven to four years proceeds, along with a general consultation concerning an alignment between the revised tax record keeping time frame, and other regulatory record-keeping requirements (p.6);***
- (j) ***The number of employees covered by the subsidy of payroll agents should be lifted from five to ten employees, subject to a cut off of \$120,000 PAYE liability (p.8); and***
- (k) ***The information sharing initiatives outlined in the document proceed, with necessary steps taken to ensure privacy and security of information that is of a sensitive nature for businesses (p.9).***

3. OPTIONS OUTLINED

- 3.1 This submission represents the second part of our overall submission on the document. Whereas the first submission dealt specifically with the threshold chapter, this submission outlines our views on the remaining issues discussed.
- 3.2 This submission is different from the first as there is not the level of trade-offs or priorities to be undertaken that was discussed with our first submission. While there are some proposals that still have a direct cost to the tax revenue base, many are proposals that only involve a change to systems that better accommodate the needs of reducing tax compliance on SMEs. Simply put, many of the proposals discussed in the remaining chapters of the document should automatically occur, as they provide a direct compliance benefit for SMEs, without the issue of any significant cost to the Government. Also, once views are taken into account by submitters, some form of timeline regarding the agreed upon proposals would be useful, as it would outline steps taken beyond the threshold changes included in the May Tax Bill.

Recommendation: That the Government undertakes the majority of proposals outlined in chapters three to eight in the short-medium term. Also, a timeline of implementation is compiled by the Government regarding the proposals agreed upon once the views of submitters have been taken into account.

- 3.3 Notwithstanding our main recommendation above that most, if not all, of the proposals outlined in the remaining chapters are a step in the right direction, there are some that we would like to comment on, either because they should be given higher priority, or because we would like to add comment to the proposal to ensure it has greater success in reducing compliance costs for SMEs.

4. SIMPLIFIED RULES FOR CERTAIN EXPENSES

Simplified Rules for Deducting legal Expenditure

- 4.1 Business New Zealand agrees that many SMEs are unlikely to be familiar with the intricacies of, or the distinction between, expenditure incurred for capital or revenue purposes when assessing when legal expenses are tax deductible. Costs on SMEs are exacerbated when external advice is sort on the matter.
- 4.2 Therefore, we support moves to allow businesses to deduct all business-related legal expenses up to a GST-exclusive cost of \$10,000 per year, without having to distinguish between legal expenses incurred for capital or revenue purposes. Also, given the distortion aspect that could arise, we would want the allowance to apply across the board, and not subject to any turnover threshold. Given the limited resources many SME have at their disposal, the introduction of the allowance would tend to benefit SMEs the greatest.

Recommendation: That allowing businesses to deduct all business-related legal expenses up to a GST-exclusive cost of \$10,000 a year should proceed.

Simplified Rules for deducting Entertainment Expenditure

- 4.3 The document proposes that like legal expenses, a minimum threshold should be built into the non-deductible element of the entertainment expenditure rules. In doing so, the document outlines three options and their associated costs:
1. \$2,500 threshold (costing \$20-30 million per year);
 2. \$5,000 threshold (costing \$25-40 million per year); and
 3. \$10,000 threshold (costing \$30-50 million per year).
- 4.4 Business New Zealand fully supports a threshold being built into the non-deductible entertainment expenditure part, as it would clear up the compliance cost issues with having to apportion out the expenditure even if the yearly total is minimal, as well as aligning itself with existing policies in other tax areas, such as FBT.
- 4.5 While we do not have any specific threshold value in mind, we would support the threshold amount being a minimum of \$5,000.

Recommendation: That the minimum threshold for non-deductible entertainment expenditure rules involves a threshold of at least \$5,000.

5. FRINGE BENEFIT TAX

- 5.1 As a matter of principle, Business New Zealand maintains its long-held position that Fringe Benefit Tax (FBT) in New Zealand should be fundamentally reviewed, with proposals put forward to examine ways in which the tax could be more efficiently and effectively run, such as the benefits

moved to form part of an employee's income and the tax paid as PAYE tax. Examining viable options going forward has the potential to unpick much of the compliance headaches employers have with calculating FBT, and would show a willingness by the Government to make significant changes that positively affect all businesses, not just SMEs.

Recommendation: Business New Zealand recommends that, as a matter of principle, FBT be fundamentally reviewed by the Government, with alternative proposals put forward to examine ways in which the tax could be more efficiently and effectively run.

- 5.2 Notwithstanding our overarching view of FBT, we agree with the views expressed in the document relating to the definition of “work-related vehicle” being too restrictive, primarily because passenger-carrying vehicles are not included. In turn, for many SMEs the preferred work vehicle is not purchased, or major modifications have to take place.
- 5.3 The document seeks to introduce a single category of restricted private-use vehicle, along with lowering the fringe benefit rate when the vehicle is available for private use from 20% of the vehicles' cost price (or 36% of the vehicles' tax book value) to half that, namely 10% of the vehicle's cost price (or 18% of their tax value). This lower rate would apply for all vehicles predominantly used for business purposes and for those businesses below a certain turnover threshold (\$1.3 million suggested).
- 5.1 Business New Zealand welcomes these moves. Significant changes in terms of broadening the “work-related vehicle” classification, as well as lowering the FBT rate dismantles some of the roadblocks SMEs face when having to deal with FBT on vehicles.
- 5.2 However, the document does see the need for some necessary constraints, including permission of only private travel between home and work, and other incidental travel permitted for private use. Also, work use of the vehicle would need to account for at least 75% of its total use. While we do not object to these constraints, we would disagree with the last constraint proposed, namely a restriction on the value or type of vehicle to ensure inappropriate vehicles (such as sports cars) could not qualify as a restricted private-use vehicle.
- 5.3 One could argue that this last constraint somewhat undoes the loosening of restrictions for businesses to choose the type of work-related vehicle best suited for the needs of their business. Not every business will find a standard van or four door family car sufficient for their business purposes. For instance, a business may be involved in fitting out top end cars in terms of new sound systems, or there may be a travelling Ferrari merchandise stockist who needs to drive the car of the brand he is promoting. In these cases, a top end car is required to convey what the theme of the business is about. In addition, a business may require a certain car to accommodate a particular outfitting for their business, which could require an expensive 4-wheel drive, rather than a standard van. Overall, one needs to apply the reasonableness test, as we doubt many SME businesses would pour significant resources into

buying expensive cars unless there is a real business decision for doing so. We believe the other constraints outlined above would be sufficient to ensure the revised definition of a restricted private use vehicle is met.

- 5.4 We would also like to point out that as the document states that these proposed changes should end up being largely revenue neutral; they should automatically take place regardless of any final priority setting.

Recommendation: That the introduction of a single category of restricted private-use vehicle with FBT rates of 10% of the vehicle's cost price (or 18% of their tax value) proceeds. However, the new definition of a restricted private use vehicle should not include a cap on the value or type of vehicle.

- 5.5 Business New Zealand also supports moves towards removing the requirement to continue monitoring private use during the three-year application period to ensure that actual private use is not 20% or more than the three-month test results. Measuring the private use of a vehicle provided by an employer has always been regarded as a compliance headache, especially since a three-month test period to establish the extent of private use is required at the beginning of the vehicle's use by the employee.

Recommendation: That removing the requirement to continue monitoring private use during the three-year application period to ensure that actual private use is not 20% or more than the three-month test results proceeds.

6. GST INVOICES

- 6.1 The document outlines a series of proposals relating to simplifying GST invoice disclosure requirements, including:

- GST tax invoice content requirements;
- Allowing alternative documentation;
- Broadening the scope of shared tax invoicing; and
- Removing the requirement for IRD approval to issue buyer created tax invoices.

Overall, there is nothing in these proposals that Business New Zealand would oppose. When these proposals are taken on an individual basis may seem to be relatively small, but collectively they have the ability to lower compliance cost obligations for businesses when having to adhere to GST procedures

Recommendation: That the various proposals outlined for GST invoices proceed if supported by the majority of submitters.

7. TAX ADMINISTRATION

Correcting Minor Errors in Subsequent Returns

- 7.1 Business New Zealand supports moves towards allowing taxpayers to rectify minor errors in previous returns by including them in the current tax return. However, we believe the figure of \$500 suggested as a threshold to which this

proposal would apply (either as one error under \$500 or a total error of \$500) is simply too low for a situation whereby the majority of errors are accidental, rather than on purpose. Instead, we would want the threshold where the proposal would apply to increase somewhere within the range of \$2,000-\$5,000.

Recommendation: That the proposal to correct minor tax errors in subsequent returns proceeds, and that the threshold amount is increased somewhere in the range of \$2,000-\$5,000.

Record-Keeping Requirements

- 7.2 The current requirements for businesses to keep their tax records for seven years can often mean additional storage costs, particularly for SMEs, and while the ability to keep their records electronically is available, for many they may simply not have the time or expertise to move to such a system.
- 7.3 Given taxpayers can already apply to IRD to keep records for shorter periods; we support moves to reduce the time period to four years to align it with the time-bar for amending assessments. In addition, we strongly agree that other business record-keeping periods such as the Companies Act (seven years) and Employment Relations Act (six years) should also be reviewed to ensure general alignment of time between the regulations for simplicity purposes. Member feedback on this tells us that because many employers are unsure of the time requirements for various records, they are all typically kept for seven years, so a 'one time period' rule for all would be supported.

Recommendation: That the proposal to lower the record keeping requirements from seven to four years proceeds, along with a general consultation concerning an alignment between the revised tax record keeping time frame, and other regulatory record-keeping requirements.

Reviewing the PAYE Intermediaries' Subsidy

- 7.4 When the proposal for introducing a PAYE intermediaries subsidy was first proposed in 2003, Business New Zealand took the opportunity to provide extensive comments on the matter. Overall, we welcomed the proposal as a useful initiative with potential to make a real difference for SMEs.
- 7.5 Given our support for the regime, it is disappointing to see that the regime has not had the significant uptake by employers that may have been envisioned. The document provides a variety of reasons why this might be the case, but we would like to reiterate that the regime only began in October 2006, and therefore is still somewhat new for the business community to take up, and we would certainly want the scheme retained at this stage to provide sufficient time to increase use.
- 7.6 A specific recommendation we made at that time was that the number of employees covered by the subsidy of payroll agents should be lifted from five

to 10 employees, subject to a cut off of \$100,000 PAYE liability². The document has included increasing the number of employees covered as one of three solutions for change (the other two being extending the subsidy application to other taxes and increasing the rate of subsidy), with an estimated cost of extending the PAYE subsidy to six or seven employees between \$4 to \$8 million a year. However, as pointed out in previous submissions, the cost of extending the threshold from five to 10 employees may not be significantly greater than feared.

7.7 Business New Zealand notes that in 2006 there were around 187,990 private sector employees employed by 80,079 enterprises with 1-5 employees, 126,710 employees employed by 17,560 enterprises with 6-9 employees, 191,730 employees employed by 14,341 enterprises with 10-19 employees, and 220,290 employees employed by 7,470 enterprises with 20-49 employees³. The proportion of enterprises and (therefore employees) that would be eligible for the subsidised payroll service before the \$100,000 PAYE liability takes impact would decrease as the employee group increases.

7.8 Under the proposal to cover the first five employees, the following numbers of enterprises and employees would potentially be covered, assuming 100% of 1-5 employee enterprises, 80% of 6-9 employee enterprises, 50% of 10-19 employee enterprises, and 20% of 20-49 employee enterprises would meet the \$100,000 PAYE liability threshold:

- 1-5 employee group: 80,079 enterprises, 187,990 employees.
- 6-9 employee group: 14,048 enterprises, 70,240 employees.
- 10-19 employee group: 7,171 enterprises, 35,853 employees.
- 20-49 employee group: 1,494 enterprises, 7,470 employees.
- Total: 102,792 enterprises, 301,553 employees.

7.9 Increasing the coverage from five to 10 employees, but retaining the \$100,000 PAYE liability threshold, would not change the number of enterprises eligible but would potentially increase the number of employees covered to:

- 1-5 employee group: 80,079 enterprises, 187,990 employees.
- 6-9 employee group: 14,048 enterprises, 140,480 employees.
- 10-19 employee group: 7,171 enterprises, 71,710 employees.
- 20-49 employee group: 1,494 enterprises, 14,940 employees.
- Total: 102,792 enterprises, 415,120 employees.

7.10 Therefore, we estimate that extending the coverage from five to 10 employees (while retaining the \$100,000 PAYE liability threshold) would therefore add around 27% to the number of employees covered.

² In relation to the \$100,000 PAYE cut off amount, while we agree that a limit of \$100,000 annual PAYE liability for receiving the subsidy seems about right based on the fact that the average size of a business with \$50,000-\$100,000 annual PAYE liability is roughly 15 employees, this should not preclude the cut-off figure also being reviewed on a regular basis, especially given recent wage inflation).

³ *SMEs in New Zealand: Structure & Dynamics*, Ministry of Economic Development, July 2007.

- 7.11 Furthermore, there is also likely to be a relatively high fixed cost element to setting up and running payroll but a low marginal cost of processing extra employees. Therefore the fees may not be much higher for 10 employees as they would be for five. As for the payroll agent, the costs of dealing with IRD are also likely to be much the same for 10 as opposed to five employees.
- 7.12 The Business New Zealand – KPMG Compliance Cost Survey has consistently found that businesses in the 6-9 and the 10-19 full-time equivalent groups reported high compliance costs, suggesting that enterprises of those sizes need assistance as well as those with 0-5 employees. We suspect that the additional cost of moving from a limit of five employees to a limit of 10 would be closer to the \$4 million estimate than the \$8 million estimate as stated in the document, and it would certainly not be substantial compared to the benefit that would be gained by extending the proposal fully to enterprises with 6-9 employees and further for those with 10-19 employees.
- 7.13 Therefore, Business New Zealand would reiterate our main recommendation outlined in 2003 via increasing the number of employees covered, which we view as the top priority of the three proposed to improve the system.

Recommendation: That the number of employees covered by the subsidy of payroll agents should be lifted from five to ten employees, subject to a cut off of \$100,000 PAYE liability.

8. INFORMATION SHARING

- 8.1 Chapter 7 of the document that is dedicated to the issue of information sharing is of prime importance to Business New Zealand in terms of reducing compliance costs on SMEs. Specific comments received from the five years Business NZ –KPMG Compliance Cost Survey has been running, as well as day-to-day anecdotal evidence, consistently poses questions as to why background information provided once needs to be provided again to Government departments.
- 8.2 Therefore, Business NZ strongly endorses one of the key elements outlined in the document for *“greater information sharing between Government agencies to prevent repeat information requests, brought about by improving compatibility between IT systems”*.
- 8.3 Business New Zealand supports both the recent current information sharing initiatives, as well as those being planned at present that are outlined in chapter seven of the document. Of the future plans, we see merit in developing a Standard Business Reporting System, which would mean a businesses’ financial data would be posted once and then drawn down as required by Government agencies. Also, enabling businesses to provide commonly sought data only once with all agencies advised of this information would be a welcome step. Making the business.govt.nz portal the sole entry point for businesses seeking to interact with Government deserves further exploration, although we would expect this process to be well tested and notified amongst the business community before proceeding.

- 8.4 Lastly, the document raises the issue of any concerns regarding a centralised data system and information, particularly pertaining to tax, that should not be shared or remain confidential. We agree with the view expressed in the document regarding existing privacy legislation that *“it is critical that any system intended to maximise the efficiency of government transactions with taxpayers does not compromise these rights”*. Headlines over recent times about employees within IRD selling information to the general public would not allay these fears, and the establishment of a centralised database could have the potential to provide further opportunities for criminal activities.
- 8.5 Overall though, we believe the advantages of the establishment of a centralised data base outweigh potential security and privacy concerns. However, we would want to ensure that there are sufficient checks and balances with parts of a database only being available to those sections of agencies that would require that data, along with constant auditing and reporting of what is being extracted and for what purpose. We would also expect any Government employees or outside hackers found to be extracting information for illegal purposes to feel the full arm of the law to discourage similar behaviour by others.
- 8.6 Lastly, if all businesses are to be part of a generic Government database, it may be useful to provide businesses with ‘in or out’ options for those elements of information which may be highly sensitive. One would expect that if security of information is retained and the success of the centralised database means lower compliance costs, businesses would be more willing to provide particular data in the system as time goes on.

Recommendation: That the information sharing initiatives outlined in the document proceed, with necessary steps taken to ensure privacy and security of information that is of a sensitive nature for businesses.

9. OTHER MATTERS

Use-of-Money Interest

- 9.1 Chapter 8 of the document briefly mentions a review of the use-of-money interest rate-setting methodology will take place in 2008. Business New Zealand has long held the view that a review in this area has been overdue, and we welcome consultation on this as soon as possible.

APPENDIX

10. About Business New Zealand

- 10.1 Encompassing four regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 70-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.
- 10.2 In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.
- 10.3 Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per capita per year would be required to achieve this goal in the medium term.