

Submission

By

Business|NZ

To

Inland Revenue Department

On

Options for Dealing with Industry-wide Tax Evasion

1 October 2004

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

OPTIONS FOR DEALING WITH INDUSTRY-WIDE TAX EVASION
SUBMISSION BY BUSINESS NEW ZEALAND
1 OCTOBER 2004

1. INTRODUCTION

- 1.1 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 56-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.
- 1.2 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.
- 1.3 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.
- 1.4 The strength of the economy also determines the ability of a nation to deliver on the social and environmental outcomes desired by all. First class social services and a clean and healthy environment are possible only in prosperous, first world economies.
- 1.5 Business New Zealand welcomes the opportunity to comment on the discussion document *Options for Dealing with Industry-Wide Tax Evasion*. We agree that tax evasion should be reduced. Evaders pay less than their fair share of government revenue and honest taxpayers have to pay more to cover the shortfall. However, while we agree that efforts should be made to fight tax evasion, Business New Zealand is concerned that limited amnesties may not be fair or effective. We consider a better approach would be to address the underlying reasons for tax evasion.

2. BACKGROUND

- 2.1 The vast majority of New Zealand businesses already pay their fair share of tax. In fact, we would argue that they actually pay **more** than their fair share: According to the OECD, New Zealand's tax revenue as a proportion of GDP is now the highest among non-European OECD countries and, unlike most

OECD countries, this proportion has risen since 1999¹. Overall tax revenue has increased by 40% since 1999, with revenue from company tax increasing by 72%².

- 2.2 With each passing year New Zealand's 33% company tax rate is becoming increasingly high compared to other countries that are reducing tax rates to retain and attract investment. For example, since 1997, the OECD average company tax rate has fallen from 37% to 30%³. While the company tax rate is only part of the equation (e.g., it does not take account payroll taxes), the trend is clear and New Zealand's business competitiveness is being eroded.
- 2.3 As well as the company tax rate, it is also relevant (particularly for SME owners), to consider personal income tax rates. In 2000, the top rate of income tax was increased to 39% for income over \$60,000. As well as raising significant additional revenue (and adding to the growing tax burden), the change also increased the complexity of the tax system – for example, necessitating 47 extra pages of tax legislation.
- 2.4 Despite recent welcome initiatives to simplify the tax system, the current system is still too complicated. The Income Tax Act has now grown to over 2,000 pages and each year there are at least two tax bills resulting in significant changes to various tax legislation. The change factor alone makes complying increasingly onerous, particularly for small business owners and the self-employed.
- 2.5 This complexity is added to by various add-ons, such as the use of the tax system for collecting child and family support, student loan repayments, and payment of fines. Meanwhile, the mechanism to facilitate work-based savings through the tax system that was recently proposed by the Savings Product Working Group will only add further to the compliance burden.
- 2.6 While no excuse for tax evasion, the high and growing tax burden and the increasing complexity of the tax system should not be underestimated when considering issues around tax evasion, particularly for those businesses that are otherwise operating lawfully. However, the discussion document largely ignores these issues and instead focuses more narrowly on the current approach to enforcement and penalties.

3. ENFORCEMENT AND PENALTIES

- 3.1 New Zealand currently uses the 'stick' approach for ensuring that businesses and individuals pay their 'fair share' of tax, involving strict enforcement by the IRD and the use of what are very punitive penalties provisions. Although this approach is designed to protect the revenue base, it is likely that it also has unintended consequences.

¹ *Tax Policy: Recent Trends and Reforms in OECD Countries*, Table 1, page 12. OECD, October 2003.

² Various media reports, 29-30 August 2004.

³ KPMG Corporate Tax Rate Survey 2004.

- 3.2 Most importantly for the vast majority of taxpayers, the penalty provisions are too punitive against those who make innocent mistakes and as a result they generate a climate of fear and result in high compliance costs. Moreover, it is also likely that the penalty provisions discourage evaders from complying – once they are outside the tax system, the penalty provisions ensure that there are dire consequences if they were to want to come back inside.
- 3.3 The discussion document is effectively suggesting that a ‘carrot’ approach (i.e., an amnesty) is also needed for evaders in certain industries. Business New Zealand is pleased that the Government has acknowledged that the current regime discourages voluntary compliance for those outside the tax system. However, we are not convinced that an amnesty approach would either be fair for the vast majority of those who do pay their fair share or would even succeed in achieving a higher degree of voluntary compliance from those that currently do not.
- 3.4 The Government acknowledges that its proposals would raise concerns with those who do voluntarily comply. This is an equity issue the importance of which should not be underestimated. We received strong feedback from both businesses and individuals concerned about fairness and equity, with the majority instinctively negative about the proposal, particularly when they see IRD imposing punitive penalties on honest taxpayers making innocent mistakes.
- 3.5 On the issue of effectiveness, the discussion document notes that overseas experience with amnesties has been mixed, with a number of risks associated with them. An important point is that amnesties are likely to be more effective when they are used sparingly and for a special purpose, for example implementing significant changes to the tax system that would disadvantage taxpayers. We also agree that the credibility of an amnesty would rely upon enhanced detection and enforcement efforts to build an expectation that evaders will actually be caught.
- 3.6 With overseas experience on amnesties mixed at best, a fairer and more effective approach would be for IRD to accept that honest taxpayers should not be punished for making innocent mistakes, but ensure that those who deliberately evade feel the full force of the law. The pyramid diagram within Figure 1 on page 7 of the discussion document suggests that IRD agrees that it should concentrate its enforcement efforts on those who have consciously decided to evade paying their fair share of tax, while making it easier for those that do voluntarily comply.
- 3.7 Business New Zealand strongly supports this model, but we are aware that a perception remains that IRD is still going after those that make innocent mistakes. Therefore, we feel that more could be done to transform the model into reality by providing greater leniency to honest taxpayers and discretion to IRD officials on the action taken against taxpayers. This would help address some of the fairness issues around providing amnesties for tax evaders.

4. ANSWERS TO CONSULTATION QUESTIONS

- 4.1 The following comments provide brief answers to the consultation questions on page 14. Although the questions on the design of an amnesty regime are important, we do not feel sufficiently able to comment on the questions of detail.

- 4.2 Would it be acceptable to offer limited amnesties to tax evaders?

Not unless there were a satisfactory addressing of the issue of fairness for honest taxpayers and reasonable certainty that an amnesty would be effective in increasing voluntary compliance. Neither would appear to be a given at present. Such amnesties would need to be offered in special circumstances only.

- 4.3 Would limited amnesties help evaders to begin complying with the tax laws?

Judging on international experience the case does not appear to be strong.

- 4.4 Would it be fair to offer amnesties, even limited ones, as a last chance for tax evaders to get their tax affairs in order?

Probably not, but a possible exception may be if an amnesty were offered as part of implementation of a significant change in the tax system that would disadvantage taxpayers. It would need to be open to all taxpayers, not just those in certain 'problem' industries.

- 4.5 Are there other options instead that would deal with industries or areas of the economy where there is ingrained evasion?

Overall, we believe that the Government should make greater efforts to reduce the overall tax burden (including lower tax rates), simplify the tax system, and take a less punitive approach to taxpayers who make honest mistakes (as opposed to deliberate evaders who should feel the full force of the law).

Policy makers need better information about the scale of the problem. The oft-quoted figure of the 'black economy' being around 10-12% of GDP seems implausibly high.

With regard to specific industries or areas of the economy, we are aware that the IRD has been working constructively with several industry groups on improving compliance with tax requirements. This should be extended to other 'problem' industries in the first instance, with positive incentives for the 'clean' operators that are compliant and better efforts at detecting and catching those that are not.

We also see some scope for a public education campaign to raise awareness about the economic and societal costs of 'cash jobs' and the wider issue of tax evasion. It may be that the effectiveness of such a campaign would be facilitated by steps to lower tax rates, thereby directly addressing the public concern that the Government's tax take is high and has continued to grow.

5. CONCLUSION AND RECOMMENDATIONS

- 5.1 Business New Zealand welcomes the Government's willingness to consider ways to increase voluntary compliance with the tax system. However, we are not convinced that offering limited amnesties to those in certain problem industries would be either the fairest or most effective way to increase voluntary compliance.
- 5.2 Business New Zealand recommends that the Government should do more to reduce the tax burden (including lower tax rates), simplify the tax system, and make it less punitive for honest taxpayers – while ensuring that deliberate evaders are detected and feel the full force of the law. Before considering amnesties, more information is needed about the scale of the problem and IRD should work more closely with 'problem' industries to improve the level of voluntary compliance. If amnesties are to be considered, they should be used sparingly and in conjunction with the implementation of significant changes to the tax system that would disadvantage taxpayers.