Submission

by

BusinessNZ

to the

Policy Advice Division, Inland Revenue Department

on the

"More Time for Business" discussion document

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This submission is presented by Business New Zealand incorporating the regional founder members of the organisation and affiliated organisations. The organisation represents business and employer interests in all matters affecting the business sector.

Members of Business New Zealand

- Apparel & Textile Federation of NZ
- Aviation Industry Assn of NZ Inc
- Baking Industry Research Trust
- Brush Manufacturers Assn of NZ
- Building Service Contractors of NZ
- Bus & Coach Assn NZ Inc
- Canterbury Employers' Chamber of Commerce
- Canterbury Manufacturers Assn
- Casting Technology of NZ Inc
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- Corporation of Insurance Brokers of NZ Inc
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- Employers & Manufacturers Assn (Central)
- Employers & Manufacturers Assn (Northern)
- Federated Farmers of NZ
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- NZ Association of Bakers (Inc)
- NZ Carpet Manufacturers Assn
- NZ Chambers of Commerce & Industry
- NZ Fire Equipment Assn
- NZ Footwear Assn
- NZ Institute of Management
- NZ Meat Industry Assn
- NZ National Flooring Assn Inc
- NZ Nursery & Garden Industry Assn
- NZ Orchards & Vineyards Assn of Employers
- NZ Paint, Ink, Resin & Adhesives Manufacturers Fed
- NZ Painting Contractors Fed
- NZ Post Ltd
- NZ Private Hospitals Assn
- NZ Private Physiotherapists' Assn
- NZ Retail Meat & Allied Trades' Fed Inc
- NZ Seafood Industry Council Ltd
- NZ Society of Master Plumbers
- NZ Stevedoring Employers Assn Inc
- NZ Tanners Assn
- NZ Taxi Federation Inc
- NZ Vegetable & Potato Growers Fed
- Otago-Southland Employers' Assn
- Pharmacy Guild of NZ (Inc)
- Plastics New Zealand
- Printing Industries NZ
- Registered Master Builders' Fed
- Retail Merchants Assn of NZ
- Road Transport Forum NZ
- Textile Care Federation of NZ

More Time for Business: Tax Simplification for Small Business Discussion Document
SUBMISSION BY BUSINESS NEW ZEALAND
14 JUNE 2001

1. INTRODUCTION

1.1 Business New Zealand is the leading national organisation representing the interests of New Zealand's business and employing sectors comprising some 76,000 individual enterprises. Business New Zealand champions policies that would transform and accelerate the growth of high value added goods and services to significantly improve the prosperity of all New Zealanders

1.2 Overall, we believe that the proposals contained in the discussion document *More Time for Business* are an encouraging start and offer a more equitable tax system for small business. It is not at all clear whether the changes proposed will reduce compliance costs for many small businesses but we favour the improvement in equity which will be achieved by these proposals. However, we remain concerned that the proposals on provisional tax do not go far enough to remove several major business concerns. In addition we believe additional work is required on depreciation rates to reduce compliance costs for business. Comments on each of the proposals follow below, in the order they appear in the discussion document.

1.3 We also note that this discussion document does not intend to address the fundamental issue of tax rates and reducing the tax burden on the economy, a tax burden that is high in comparison to our major trading partners. Business New Zealand advocates lower rates of tax (particular corporate tax) and, through its predecessor organisations the Manufacturers and Employers Federations, has made submissions to the Tax Review on this issue. We will not repeat our arguments on tax rates in our submission to this discussion document except to reiterate that it is important for our relatively high tax burden to be reduced.

2. Simplifying Provisional Tax (Chapter Four)

2.1 Currently, small business payers of provisional tax must estimate their tax liability for the upcoming year and would normally pay in three equal payments per year. If underpayments are made, IRD will charge 12.62% on the difference, but for overpayments, IRD will pay only 5.74%.

2.2 The discussion document recognises that income streams often fluctuate and that they can often bear little resemblance to the timing of when provisional tax payments are due. It therefore proposes that businesses with an annual turnover of less than $1.3million would be given the option to nominate a set percentage of revenue (or GST turnover) to be taken aside and paid into a special bank account for the taxpayer, which is in turn paid by the bank to IRD, perhaps monthly. If the percentage ends up being too low (resulting in major under payment), IRD would remove the taxpayer from the system for four years, and the taxpayer would have to revert to using the existing system of three equal payments per year.

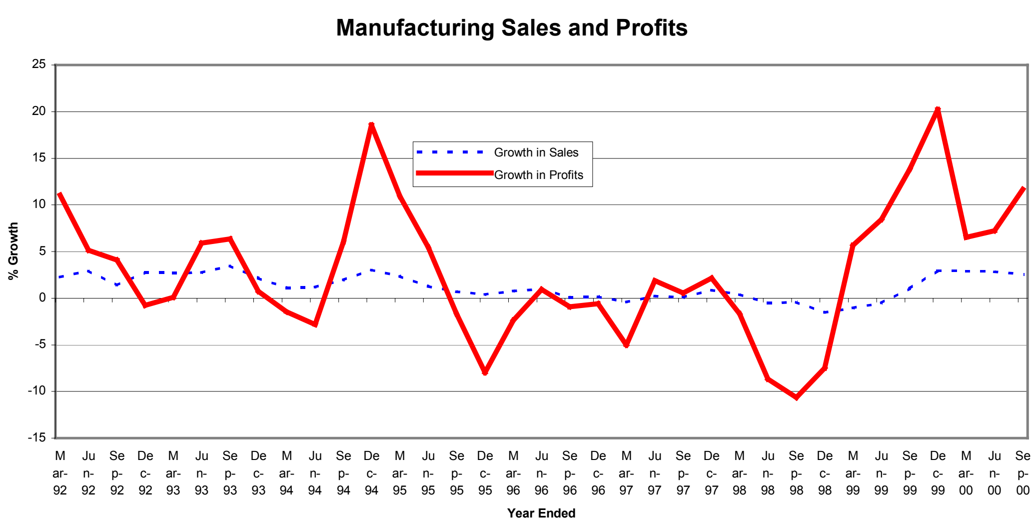
2.3 Another proposal is for businesses to be permitted to pool their provisional tax with other businesses, which would see underpayments being offset by overpayments within the pool. The arrangement would need to be made through an intermediary (probably a financial institution) who would arrange for the businesses to be charged or compensated, as appropriate, for the offset. According to the discussion document, pooling could lead to interest paid to or paid by businesses becoming more favourable than the existing differential rates applied by IRD and would be an option worth considering for some larger businesses that are currently disadvantaged by the relatively high rate charged by IRD for underpayments.

2.4 There is also a proposal that no interest would be charged or paid to tax payers who pay based on the previous year's tax liability plus 5% if their payments during the year meet 90% of their income tax liability for that year.

2.5 Our initial assessment is that, while they are a usefull start, the proposals on provisional tax do not go far enough for the following reasons:

- The proposals do not address the fundamental issue of interest rate differentials between what IRD pays to those companies that overpay and what it charges to those that underpay and they do not address the fundamental concerns that larger enterprises in particular have with Provisional Tax. IRD say that the 12.62% interest charged on underpayments is in line with what banks charge 'unsecured good small businesses'. However, this disadvantages large enterprises that can borrow at much lower rates, particularly those with wildly fluctuating profits due to commodity price variations.

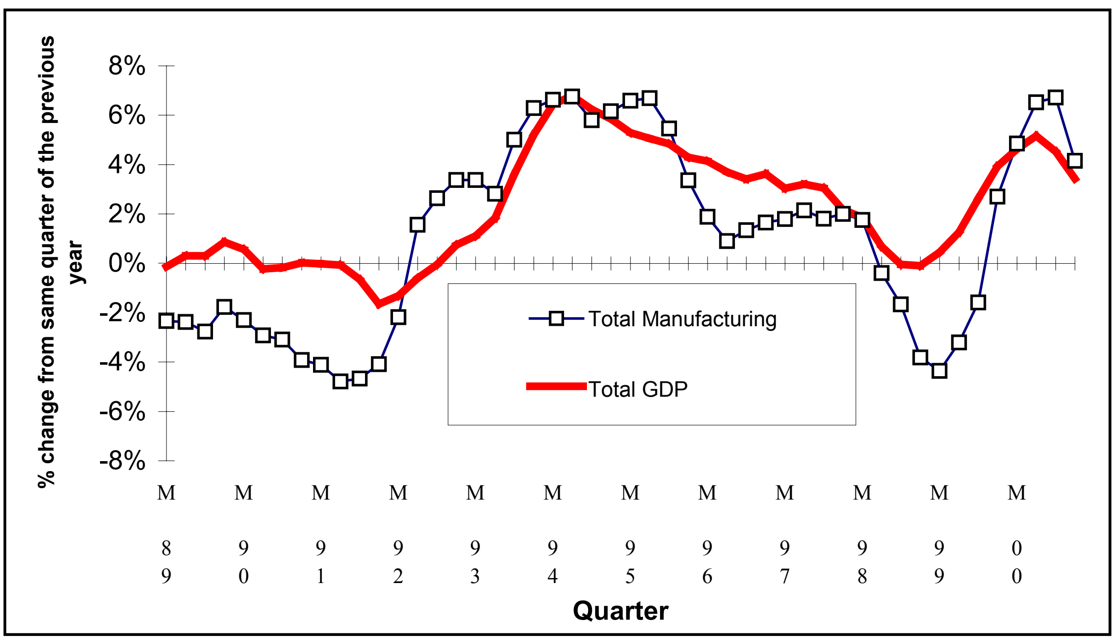
- The proposal to return any company to the existing provisional tax system if it underpays in one year by more than a certain amount seems unduly harsh. We believe that this would be unfair on companies that genuinely make an error in misjudging the amount to pay, as forecasting profits can be difficult, especially when a set percentage of *revenue* has to be calculated for a year's worth of provisional tax payments. A small change in revenue in either direction can have a major impact on levels of profit, as the chart below shows for the manufacturing sector between 1992 and 2000.



- We are concerned that once a percentage amount is nominated it would not be able to be changed during the year if the taxpayer finds that trading conditions have changed (such as winning a significant contract). This inflexibility could become very costly.

- We are also concerned that some sectors, such as manufacturing, could be particularly disadvantaged by this proposal. While some service industries with predictable revenue flows that translate easily into certain levels of profit may find this system to be of benefit, those in more volatile industries would find it more difficult. The chart below shows that manufacturing is somewhat more volatile than general economic activity as measured by GDP. The primary sector also exhibits a high degree of volatility and payers of provisional tax in that sector might also face similar difficulties.

Manufacturing GDP and Total GDP (1989-2000)



2.6 The Department rules out options for simplified part-year calculations on what appear to be quite flimsy reasons since it would be easy to focus audits on companies with significant variations between each of the three provisional tax payments. Larger companies have noted that the option of quarterly returns has already been successfully introduced in Australia and would like to see a similar option here.

2.7 We have the following recommendations that we believe would improve the proposals on provisional tax:

(a) Firms using the withholding tax on business income or paying provisional tax with GST approaches should be able to adjust the percentage of revenue/sales (up or down) during the year if it is found that the original level nominated is no longer appropriate.

(b) The decision on whether to remove a company from the withholding tax on business income or paying provisional tax with GST approaches should be based on tax outcomes over a two year period to recognise the fluctuations that can occur in income on an annual basis

(c) Rather than expulsion from the withholding system, IRD should use a progressive penalty structure, with a low penalty applying to those that underpay in any year, with subsequent and consistent underpayment resulting in escalating penalties.

(d) Different penalty interest rates for underpayment should apply according to company size, to take account of the fact that large companies can access cheaper funds.

(e) We support the introduction of an option for small businesses to pay provisional tax based on simplified part-year calculations, while large businesses are very supportive of options for quarterly tax returns.

3. Reducing PAYE Obligations (Chapter Five)

3.1 We believe that permitting employers to use a recognised payroll firm to calculate and pay PAYE has merit, as it would reduce their exposure to penalties and interest and should enable them to get on with running their businesses.

3.2 We recognise though that it would be up to the employer to ensure that the information it provides to the payroll firm is correct. Payroll also firms charge for their services, so there would be costs for businesses in using such firms, although these might be outweighed by not having to spend as much time and energy on complying with PAYE administrative requirements.

3.3 Greater use of experts within payroll firms might also help businesses cope better with some of the more complex PAYE issues, such as student loan repayments and liable parent contributions.

4. Reducing End-of-Year Tax Adjustments (Chapter Six)

4.1 We support the specific proposals in the discussion document regarding trading stock and depreciation. In particular we believe the threshold for immediate deductibility for goods purchased from the same supplier should be increased to $1,000.

5. Building on the Tax Simplification Reforms for Wage and Salary Earners (Chapter Seven)

5.1 We support the proposals in the discussion document to extend scope of non-filing and simplifying family assistance for wage and salary earners.

6. Simplifying Other Areas of Tax (Chapter Eight)

6.1 We support the proposals in the discussion document relating to simplifying non-resident contractors' withholding tax (NRCWT), resident withholding tax, and imputation credit accounts.

7. Role of Information Technology (Chapter Nine)

7.1 We are supportive of the proposals in the discussion document for IRD to make better use of information technology and the internet in improving taxpayer services. However, those taxpayers (particularly small businesses) that are not 'wired' should continue to have traditional avenues of communication open for them to use.

8. Inland Revenue's Administrative Improvements (Chapter Ten)

8.1 We support the proposals in the discussion document regarding the advisory service for small businesses, electronic filing of PAYE accounts, telephone service, and forms and notices. However, with regard to PAYE filing, electronic filing should continue to be optional as some employers may not be capable of using electronic means.

9. Other Tax Issues

9.1 Some manufacturers have recently expressed concern about the regime that applies to the depreciation of equipment for businesses working multiple shifts. We believe there are significant compliance issues which need to be addressed an a serious lack of information for the business sector on the depreciation options available.

9.2 There have been complaints from business that they are unable to depreciate their equipment more quickly when multiple shifts are being worked at their plant. However, it has also been pointed out that the economic life approach adopted in the early 1990's means that businesses may apply to IRD for a determination allowing their equipment could be depreciated at a higher rate. Few businesses seem to be aware of the opportunity to apply for a faster depreciation rate.

9.3 We are also concerned that the application process seems very bureaucratic since each firm that works beyond the standard hours must apply individually with evidence that their equipment is wearing out more quickly. With more firms working multiple shifts or longer shifts to improve capacity utilisation, it seems timely to see if the application process could be simplified. For example, it would seem possible for businesses to use a standard adjustment formula when their factory is used more than the standard 35 hours per week. Businesses would only then need to apply for an assessment if they were not happy with the standard formula.

9.4 A survey done of manufacturers (with more than 20 staff) in 1994 by the Australian Manufacturing Council showed that at that stage New Zealand manufacturing plants were operating on average 10 hours more per week than their Australian counterparts. In 1997 the Ministry of Commerce updated the survey, but the question on hours was deleted, so we do not have a more up-to-date number. Feedback from companies, however would suggest that the average hours worked has increase significantly since 1994.

9.5 We have the following recommendations on depreciation:

(a) IRD should work with the business sector to ensure that firms are alerted to the ability to depreciate their plant at a higher rate if it is being heavily used.

(b) A standard adjustment factor should be adopted based on the additional hours worked above the base of 35 hours to replace the existing application procedures.

10. Conclusion

10.1 Business New Zealand is broadly supportive of much of what is proposed within the discussion document. We believe that while some of the measures proposed will do little to reduce compliance costs, they will introduce a greater degree of equity into the tax system, particularly for business provisional tax payments. We believe further changes are however still required to make it easier for taxpayers to concentrate on their core activities of doing business.

10.2 Most of the proposals are to be applauded, but we have some significant concerns about the application of provisional tax, particularly the fundamental issue of the large interest rate differential that IRD applies for over payments versus underpayments. While the proposals would probably be most beneficial to those businesses with easily predictable revenue streams, they do not appear to address the issues faced by those taxpayers with volatile and unpredictable incomes and those where small changes in revenue result in large impacts on profitability.

10.3 Although this issue is not directly under the ambit of the discussion document, we are also concerned about the lack of knowledge in the business sector that enterprises may in fact depreciate their plant at a higher rate if it is being heavily utilised. We also believe that the application process for getting approval to use the higher rate is currently a significant compliance cost and a barrier to its use by the small business sector.

11. Recommendations

11.1 Business New Zealand recommends that:

Provisional Tax

(a) Firms using the withholding tax on business income or paying provisional tax with GST approaches should be able to adjust the percentage of revenue/sales (up or down) during the year if it is found that the original level nominated is no longer appropriate.

(b) The decision on whether to remove a company from the withholding tax on business income or paying provisional tax with GST approaches should be based on tax outcomes over a two year period to recognise the fluctuations that can occur in income on an annual basis

(c) Rather than expulsion from the withholding system, IRD should use a progressive penalty structure, with a low penalty applying to those that underpay in any year, with subsequent and consistent underpayment resulting in escalating penalties.

(d) Different penalty interest rates for underpayment should apply according to company size, to take account of the fact that large companies can access cheaper funds.

(e) We support the introduction of an option for small businesses to pay provisional tax based on simplified part-year calculations, while large businesses are very supportive of options for quarterly tax returns.

Depreciation

(f) IRD should work with the business sector to ensure that firms are alerted to the availability to depreciate their plant at a higher rate if it is being heavily used.

(g) A standard adjustment factor should be adopted based on the additional hours worked above the base of 35 hours to replace the existing application procedures.

(h) The threshold for immediate deductibility for goods purchased from the same supplier should be increased to $1,000.