

Submission

By

Business|NZ

To

Finance & Expenditure Select Committee

On

**Taxation (Annual Rates, Venture Capital
and Miscellaneous Provisions) Bill**

21 May 2004

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**TAXATION (ANNUAL RATES, VENTURE CAPITAL AND MISCELLANEOUS
PROVISIONS) BILL
SUBMISSION BY BUSINESS NEW ZEALAND
21 MAY 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 health 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 The tax system has a critical role to play in attracting investment and fostering a dynamic, productive and innovative economy. High tax rates and complex compliance requirements impose significant costs on the community, including lower investment, output, incomes, and employment as well as distortions in behaviour.
- 1.6 Business New Zealand welcomes the opportunity to comment on the Taxation (Annual Rates, Venture Capital and Miscellaneous Provisions) Bill. Business New Zealand supports many of the measures contained in the Bill, but we have concerns about the provisions confirming tax rates, the penalties applicable to non-resident contractors if double tax relief applies, and changes to the disputes rules. We also note with concern the large number of remedial amendments in this Bill.

2. SUMMARY OF RECOMMENDATIONS

2.1 Business New Zealand recommends that the Taxation (Annual Rates, Venture Capital and Miscellaneous Provisions) Bill should proceed.

2.2 Notwithstanding Business New Zealand's overall recommendation above, we also recommend that:

- (a) Officials should be asked to provide best quantitative estimates on the financial and economic impacts of the changes contained in this Bill.
- (b) The Government should adopt a goal of a lower tax take as a percentage of GDP and lower tax rates overall;
- (c) The Government should as a priority reduce the company tax rate over time to 20%;
- (d) The Bill's provisions on offshore venture capital should proceed, but that the Government should also consider improvements to the tax treatment of domestic-sourced investment, such as through a significant reduction in the company tax rate;
- (e) The Bill's provisions on the deductibility of costs of patent and RMA consents that are not granted or withdrawn should proceed, but that the Government should also reconsider the appropriate tax treatment of those patents and RMA consents that are granted;
- (f) The Bill's provisions on a rebate for early payment of income tax should proceed, but at a more generous 10% after tax;
- (g) The Committee should carefully consider the implications the Bill's provisions on the sale and leaseback of intangible property might have on leases on other assets;
- (h) The Bill's provisions on penalties applicable to non-resident contractors if double tax relief applies should be replaced with a requirement to file information with IRD;
- (i) The Bill's provisions on disputes procedures should proceed but the Committee should also consider further changes to better balance the rights and responsibilities of the IRD and taxpayers; and
- (j) The Government should take more care is taken when amending legislation to ensure that fewer subsequent remedial amendments are required.

2.3 The remainder of this submission is in four parts:

- Part A generally discusses compliance cost issues;
- Part B discusses the Bill's provisions on Annual Rates for 2004/05;

- Part C discusses the remaining provisions in the Bill that Business New Zealand supports; and
- Part D discusses the remaining provisions in the Bill that Business New Zealand has concerns about.

PART A – COMPLIANCE COST ISSUES

3. Compliance Cost Reduction

3.1 Compliance cost reduction rates as among the top priorities for the business community, and this is particularly true for small to medium size enterprises (SMEs). The Government is clearly aware of the priority placed by the business community on reducing the compliance burden. Business New Zealand has welcomed many of its initiatives, although we remain of the view that there is still much room for improvement. For example:

- The Ministerial Panel on Business Compliance Costs produced a most comprehensive report, including 162 recommendations. However, we remain disappointed that a significant proportion of the Panel's recommendations were struck out as being 'outside government policy' and remain untouched. Furthermore, while it is encouraging that the Government is continuing to report on progress towards implementing the Panel's recommendations (at least those with which it agreed), there must also be a focus on the additional compliance costs imposed on businesses since the Panel's report in 2001.
- We have welcomed moves to strengthen the processes for regulatory impact and compliance cost statements, including the requirement that they be publicly disclosed. However, there remain weaknesses with regard to the quality and robustness of too many of these statements (including a lack of quantitative analysis) and there is a need for an independent oversight agency with the resources and authority to critique statements early in the policy development process.
- Some individual Government agencies have been most proactive in working with the business community to find ways to reduce the compliance burden. While this is encouraging, the performance across the whole of government remains patchy. It may come as a surprise to some that we have found IRD to be one of the better agencies at consulting the business community, although it must be said that the IRD is constrained by having to maximise revenue, meaning that many of the most effective ideas for compliance cost reduction are never implemented.
- The Government has established a Small Business Advisory Group to give the SME community a 'voice' in the policy development process. Business New Zealand is supportive of the Group and although it is still early days we understand that it has been making a vigorous contribution and is being listened to.

4. Tax Simplification

4.1 Business New Zealand has welcomed the inclusive and proactive approach the IRD has been taking to develop initiatives to reduce tax compliance costs. This has included consulting Business New Zealand both prior to and

subsequent to recent discussion documents *Making Tax Easier for Small Business and Streamlining the Taxation of Fringe Benefits*.

- 4.2 While the proposals set out in these discussion documents should help, ultimately the most effective methods of tax simplification are those that would either risk the loss of substantial revenue or are deemed to be inconsistent with government policy.
- 4.3 A tax system is more likely to be simple if it meets the 'broad base, low rate' criteria. The challenge for the Government is to maintain a broad tax base and ensure that sufficient revenue is collected to finance its programmes without deadweight costs and compliance costs becoming overly onerous. However, while New Zealand's tax system is 'broad base', it is by no means 'low rate' and, despite recent simplification initiatives, deadweight costs and compliance costs are still too high.
- 4.4 Furthermore, high tax rates provide greater incentives for businesses and individuals to minimise their tax, so requiring greater complexity in the tax system to close 'loopholes' (something of an industry in itself). An example of increased complexity associated with higher taxes was when the 39% top rate of marginal tax was introduced – a seemingly simple decision which nevertheless required 47 pages of legislation and the introduction of the very complicated system of multi-rate FBT.
- 4.5 Higher tax rates also provide added ammunition for sectors advocating special tax treatment to supposedly improve their competitiveness. Special tax treatment for specific sectors not only requires complex rules to discourage abuse (and hence high compliance costs), but it compromises the 'broad base' and so requires the rest of the economy to pay more tax¹. It also encourages other 'worthy causes' to press for their own special tax treatment.
- 4.6 Put simply, a lower overall tax environment would be the most effective way to reduce the compliance burden and make New Zealand businesses more internationally competitive. The following simple question should also be asked across the range of tax compliance issues: is the benefit (i.e., the revenue raised or protected) worth the costs of compliance?

5. Regulatory Impact and Compliance Cost Statement

- 5.1 This Bill contains a Regulatory Impact and Business Compliance Cost Statement. All legislation must include such a statement to show that compliance cost implications have been considered by officials and Ministers in the policy development and approval process.
- 5.2 While supporting the good intentions behind requiring such statements to be published, Business New Zealand has expressed concern that they have often lacked analysis and can appear to be written as an afterthought, justifying or defending a particular decision that has usually already been made.

¹ The McLeod Taxation Review found that the pre-1984 tax system was extremely costly in that the incentives regime required income and company tax rates to be significantly higher in order to maintain any given revenue level than if there were no incentives.

- 5.3 In particular, we have seen very little quantitative analysis in any of the regulatory impact and compliance cost statements attached to legislation we have submitted on. Not only is there a lack of information on the degree to which compliance costs are expected to rise or fall for individuals and businesses, but there is also a lack of analysis of the wider economic impacts.
- 5.4 These comments also apply to the Statement accompanying this Bill. Apart from comments that various changes in the Bill will reduce, have no impact, or increase compliance costs, there has been no attempt to quantify the impacts. It is therefore difficult for submitters to assess the financial and economic impact on compliance costs either individually or in aggregate. There is also no indication of how compliance costs would be affected in either the short or longer term.
- 5.5 *Recommendation: Business New Zealand recommends that officials should be asked to provide best quantitative estimates on the financial and economic impacts of the changes contained in this Bill.*
- 5.6 More fundamentally, we consider that our experience with regulatory impact and compliance cost statements has strengthened the argument for a Regulatory Responsibility Act. Such an Act, with an independent agency overseeing the process, would improve the analysis of compliance costs, and encourage Ministers and MPs to take the statements more seriously.

6. Business New Zealand – KPMG Compliance Cost Survey

- 6.1 In July 2003 Business New Zealand, in conjunction with KPMG, undertook the first of what will be an annual survey of business compliance cost trends and perceptions (see www.businessnz.org.nz for a copy of the 2003 report). 760 businesses responded to the survey from the very largest to the very smallest across the country and with a wide spread of industries represented. The annual nature of this survey will mean that we will be able to track trends over time, so enabling us to better assess the impacts of policy and legislative changes. Preparations are underway for the 2004 survey.
- 6.2 We intend the survey to assist both business and government in the measurement of compliance costs and inform the debate on compliance cost implications of policy and legislative decisions.
- 6.3 Please refer to Annex 1 for a summary of the 2003 survey results as they relate to tax.

PART B – ANNUAL RATES

7. Income tax rates for 2004/05

- 7.1 The Bill confirms the annual income tax rates that will apply for the 2004/05 year – these are the same as those that applied for the 2003/04 year.
- 7.2 Business New Zealand continues to submit that the status quo on tax rates is unsatisfactory. Maintaining tax rates at their existing levels is catching an ever increasing number of individuals in 'high income' tax brackets, is damaging to business' international competitiveness, and is making New Zealand less attractive as an investment destination.
- 7.3 Business New Zealand's position on tax is to advocate for a lower tax take as a percentage of GDP and lower tax rates overall. Our priority is the reduction of the company tax rate to 20% by 2010.

Lower Tax Take and Lower Tax Rates Overall

- 7.4 The Government's spending target is for core Crown expenses plus New Zealand Superannuation Fund (NZSF) contributions to average around 35% of GDP. According to the 2004 Budget Policy Statement, core Crown expenses *plus* NZSF contributions has risen from an actual 31.5% for 2000/01 to 33.3% in 2002/03 before tracking downwards to 32.5% in 2007/08².
- 7.5 In light of this forecast, the only explanation for the Government setting a target of 35% is to give it room to significantly increase core spending in out-years, and the Minister of Finance has confirmed this suspicion by hinting that the Government intends to substantially increase spending in the upcoming Budget. There is no credible evidence that high levels of core government spending would promote the sustained economic growth rates of 4% needed to lift New Zealand's OECD ranking. Business New Zealand therefore submits that core Crown expenses as a percent of GDP should be targeted to fall below 30% by 2005 by ensuring that spending grows at a rate slower than that of GDP. This does not mean a reduction in nominal spending levels.
- 7.6 The Government's revenue target is for tax-to-GDP to remain at 'around current levels' (i.e., 33% if using core Crown revenue, or 43% if using total Crown revenue). According to the 2004 Budget Policy Statement, tax-to-GDP is forecast to increase over the period, despite no change in tax rates being signalled. Again, we consider this target to be set too high and should be reduced. In the light of large surpluses that are forecast (even when taking account of NZSF contributions), Business New Zealand submits that there is ample scope for tax rates to be reduced.
- 7.7 *Recommendation: Business New Zealand recommends that the Government should adopt a goal of a lower tax take as a percentage of GDP and lower tax rates overall.*

² These forecasts of course do not take into account the inevitable further spending increases that seem certain to be announced in future budgets.

20% Company Tax Rate

- 7.8 Business New Zealand's view is that the company tax rate should be reduced as a priority. We submit that a steady reduction in the company tax rate to around 20% in the medium term would be beneficial for international competitiveness and business investment, while not impacting detrimentally on the Government's overall fiscal position.
- 7.9 Maintaining New Zealand's international competitiveness is behind Business New Zealand's calls for a lower company tax rate. As KPMG's annual Corporate Tax Rate Survey has observed, 'the global trend of decreased tax rates persists', continuing a trend where the average rate of corporate tax for OECD countries has fallen from 37.5% in 1996 to 30.0% in 2004³.
- 7.10 While it is true that New Zealand does not have the high additional payroll taxes that are a feature of many OECD countries, the headline rate of company tax is nevertheless an important consideration for investors. In this respect, New Zealand fares poorly. Whereas a 33% company tax rate was highly competitive in 1988, the advantage has been steadily eroded over time, so much so that by 2003 New Zealand's company tax rate is higher not only than almost all Asia-Pacific countries (including Australia), but also the averages for the OECD and even the EU. The international trends are clearly working against New Zealand retaining a 33% company tax rate.
- 7.11 The Government should also be very careful about comparing New Zealand's overall tax burden with the OECD average or individual European countries. Our major trading partners and competitors for investment are mainly in the Asia-Pacific region. These countries generally have significantly lower tax rates and tax burdens than New Zealand.
- 7.12 Business New Zealand is confident that reducing the rate of company tax should not result in significant revenue loss to the Government, due to three main factors:
- A lower corporate tax rate should have positive dynamic impacts, such as stimulating business activity and encouraging investment, which should in turn result in increased taxable income and therefore higher tax revenue. Meanwhile, increases in employment resulting from increased activity should also reduce calls on government expenditure through lower transfer payments.
 - The operation of imputation credits means that in many circumstances company tax is effectively a withholding tax. Reducing the company tax rate should therefore increase the revenue collected from personal income tax, with the only leakage being for those situations where imputation credits are not being utilised (e.g., non-resident shareholders, state owned enterprises, managed investment funds, etc).

³ KPMG Corporate Tax Rate Survey, January 2004.

- Reducing New Zealand's company tax rate to be more competitive with other Asia-Pacific countries should help reverse the existing disincentive for firms to declare taxable profit overseas, and so result in substantially more taxable income being declared in New Zealand.

7.13 These positive factors in combination should more than offset any short-term revenue loss from a lower company tax rate.

7.14 *Recommendation: Business New Zealand recommends that the Government should as a priority reduce the company tax rate over time to 20%.*

PART C – REMAINING PROVISIONS IN THE BILL THAT BUSINESS NEW ZEALAND SUPPORTS

8. Venture capital

- 8.1 The Bill removes a tax barrier to unlisted New Zealand companies gaining access to offshore venture capital. The main change is to provide an exemption from income tax for certain non-residents that sell shares in certain New Zealand companies. Non-residents will be eligible for the exemption if they are resident in a country with which New Zealand has a double tax agreement and would be eligible for a credit in their home jurisdiction for the tax paid in New Zealand.
- 8.2 These changes are designed to align New Zealand's tax treatment with that of the foreign investor's home jurisdiction, the idea being to minimise New Zealand tax as an impediment to investment decision-making.
- 8.3 Although Business New Zealand supports the proposed amendments on venture capital, we note that their focus is on offshore venture capital. While improving the treatment of offshore venture capital is very important, there is also actual and potential local investment that, in the absence of adequately competitive tax treatment, could drift offshore to more attractive destinations or be invested in areas of the economy with more favourable tax treatment (such as owner occupied housing).
- 8.4 Business New Zealand submits that a reduction in the headline rate of company tax would greatly assist in encouraging domestically sourced venture capital (not to mention other forms of business investment) and would also have the effect of making New Zealand a more internationally competitive and attractive investment destination.
- 8.5 *Recommendation: Business New Zealand recommends that the Bill's provisions on offshore venture capital should proceed, but that the Government should also consider improvements to the tax treatment of domestic-sourced investment, such as through a significant reduction in the company tax rate.*

9. Costs associated with patent and RMA consents that are not granted or are withdrawn

- 9.1 The Bill proposes that these costs are to be made deductible. At present, they cannot be claimed under the general deductibility rules because they are regarded as a capital expense (yet cannot be depreciated because there is no depreciable asset). This change will address some 'black-hole' expenditure, an issue that was identified as a priority for action by the Private Sector Liaison Group on Research and Development in its report last year to the Minister of Finance.
- 9.2 Business New Zealand supports these amendments, but we would also welcome a change in thinking away from the capitalisation of patent and RMA

consents when they are granted. For example, even when granted many patents will not eventuate into earning opportunities, yet they can only be depreciated over their perceived life. We consider this treatment to be a barrier to innovation and to research and development in particular.

- 9.3 *Recommendation: Business New Zealand recommends that the Bill's provisions on the deductibility of costs of patent and RMA consents that are not granted or withdrawn should proceed, but that the Government should also reconsider the appropriate tax treatment of those patents and RMA consents that are granted.*

10. Horticultural plants

- 10.1 The Bill will enable the Commissioner for Inland Revenue to determine different amortisation rates for different plants, reflecting their estimated useful lives – rather than the current single rate applied to all plants and trees. Business New Zealand supports the intent of the new rules to provide greater certainty for the treatment of replacement plants.

11. Rebate for early payment of income tax

- 11.1 The Bill introduces a 6.7% rebate of tax to encourage individuals who begin receiving income from self-employment or partnerships to pay tax voluntarily before they are legally obliged to pay provisional tax.
- 11.2 This proposal was floated in the Government's discussion document last year *Making Tax Easier for Small Business* in response to concerns that many small businesses find it tough when they begin paying provisional tax as they often discover they have income tax for the prior year and provisional tax for the current year due at once.
- 11.3 Business New Zealand supported the rebate proposal in its submission to the discussion document, as it would provide some relief to those struggling with their cash flow at a critical time of the business' life. However, we also recommended that the discount should be a more generous 10% *after tax* (rather than 6.7%, which is effectively 10% *before tax*).
- 11.4 *Recommendation: Business New Zealand recommends that the Bill's provisions on a rebate for early payment of income tax should proceed, but at a more generous 10% after tax.*
- 11.5 Although Business New Zealand supports the rebate proposal, it is in no way sufficient for addressing tax simplification for small businesses and there were a number of other proposals that were discussed in *Making Tax Easier for Small Business* where the Government has yet to make decisions upon (e.g., around payment dates and frequencies). We look forward to Government announcements on further tax simplification initiatives.

12. Resident withholding tax on use-of-money-interest

- 12.1 The Commissioner's obligation to deduct resident withholding tax (RWT) from use-of-money-interest (UOMI) in respect of overpaid tax is being removed. Although deducting RWT from UOMI is consistent with the wish to treat UOMI as if it is interest received from a bank, it has proved overly complex to apply.
- 12.2 The amendment is intended to reduce compliance costs for taxpayers and administration costs for IRD. Business New Zealand therefore supports the amendment.

13. Incorporated societies

- 13.1 The Bill will allow incorporated societies to carry forward tax losses and offset income and losses of companies in the same group. They will also be allowed (for a limited period) to offset income and losses against those of its commonly owned incorporated societies. The change will close a gap in the existing law by ensuring that incorporated societies that are treated as companies for tax purposes can avail themselves of the same rules applying to other corporate entities. Business New Zealand therefore supports the amendment.

14. Information matching

- 14.1 The Bill will extend existing data exchanges between IRD and the Ministry of Social Development to include student allowance recipients to ensure that overpayments of student allowances are identified. Business New Zealand supports this amendment.

15. Self-assessment of GST

- 15.1 Amendments are being made to confirm that GST is a self-assessed tax. This will provide a more consistent legislative framework and allow taxpayers' obligations to be provided for more clearly and directly. Business New Zealand therefore supports the amendment.

16. Tax shortfalls – loss-attributing qualifying companies

- 16.1 To the extent an adjustment reduces a net loss of a loss attributing qualifying company (LAQC), any penalties will be charged to the shareholder, not the company. If the shareholder has not claimed a deduction for the attributed loss, no penalty will be charged. We understand that the recently passed offset mechanism has proved to be clumsy from both a taxpayer and IRD perspective and that this amendment provides a better mechanism for providing relief from the double incidence of penalties if an LAQC and its shareholders are each penalised for what is virtually the same shortfall. Business New Zealand therefore supports the amendment although we question the need to hit shareholders who may be acting in good faith.

PART D - REMAINING PROVISIONS IN THE BILL THAT BUSINESS NEW ZEALAND HAS CONCERNS ABOUT

17. Sale and leaseback of intangible property

- 17.1 The Bill includes provisions that will ensure that taxpayers entering into transactions involving sale and leaseback of intangibles (e.g., trademarks) do not get deductions for the lease payments, which IRD considers to be 'in substance repayments of loan principal'.
- 17.2 These amendments are designed to protect the tax base and will apply from 1 April 2004. Although the Government says it has identified only one such transaction before now, it is clearly worried about the potential for them to spread – so it is nipping them in the bud.
- 17.3 Business New Zealand considers it important to recognise that the changes in this area are likely to affect more than just sale and leaseback of intangibles as the rules around 'finance leases' are also being amended to ensure that such transactions are included. Clearly businesses will need to apply added care when considering leases of all other assets, from now on (although arrangements entered into prior to 1 April will not be affected). This will have compliance cost implications.
- 17.4 *Recommendation: Business New Zealand recommends that the Committee should carefully consider the implications the Bill's provisions on the sale and leaseback of intangible property might have on leases on other assets.*

18. Penalties applicable to non-resident contractor if double tax relief applies

- 18.1 The Bill will impose a penalty of \$250 per employer monthly schedule if an employer fails to make a required deduction from the withholding payment to a non-resident contractor.
- 18.2 New Zealand employers are currently required to withhold non-resident contractors' withholding tax from contract payments to non-resident contractors. This is regardless of whether the non-resident qualifies for total tax relief under a double taxation agreement. If the contractor qualifies for double tax relief, the contractor will be refunded the tax paid when a tax return is filed at the end of the year. Currently, failure by the employer to withhold the tax will result in a shortfall penalty becoming payable.
- 18.3 The change will reduce a payer's exposure to shortfall penalties. However, any penalty seems contradictory to double tax agreements that relieve a non-resident from all liability to pay tax – in those instances it can be argued that failure to deduct is not a failure at all.
- 18.4 Business New Zealand supports the intention of reducing exposure to shortfall penalties, but the change does not go far enough – there should not be any penalty at all for this 'offence' when there is no apparent harm to the tax base.

We submit that an alternative approach of filing the information with IRD should be considered.

- 18.5 *Recommendation: Business New Zealand recommends that the Bill's provisions on penalties applicable to non-resident contractors if double tax relief applies should be replaced with a requirement to file information with IRD.*

19. Dispute rules – disputes resolution process

19.1 The main objective of the disputes process is to have legislation and administrative practices that encourage disputes to be dealt with fairly, efficiently and quickly before they get to court. However, many features of the rules have been subject to criticism in that they have been regarded to be complex in themselves, costly and have created their own disputes.

19.2 The proposals would appear to be a mixed bag. There are some improvements, but the proposals do not tackle some of the big issues. For example:

- The ability of taxpayers to get a tax assessment to reflect the correct amount of tax they should pay has not been resolved – IRD will assess a taxpayer for deficient tax, yet not allow a taxpayer an adjustment in his/her favour, even when it is consequential on the adjustment made by IRD.
- IRD has the ability to reopen an assessment up to four years after the year in which a return is furnished, yet taxpayers only get four months to do so unless they can satisfy IRD that they are entitled to an adjustment when there is a clear entitlement.
- The statute bar is to be extended – a major change in IRD's favour. This will allow the Commissioner to amend when he believes there has been a material overstatement of deductions. Taxpayers should be able to expect that after a certain period of time, unless they have been fraudulent, that their assessment becomes final.
- Currently, if a ruling or decision goes in an individual taxpayer's favour, only those that have an interest in the issue through the disputes process will qualify for the benefit of the decision. However, if a decision goes in IRD's favour, IRD can apply the decision retrospectively against all taxpayers.

19.3 Business New Zealand is concerned that the proposals on the disputes process do not go far enough. There remains a fundamental 'guilty until proven innocent' burden of proof on the taxpayer to prove they are innocent of unpaid tax assessed by the IRD. We understand that the 'fear factor' of the IRD means that many small businesses are reluctant to use the disputes process despite having sufficient evidence to prove their case. Many agree to settle rather than fight an assessment since it is the cheaper option.

19.4 Although Business New Zealand supports most of the Bill's changes to the disputes process, we submit that the Committee should further improve them to better balance the rights and responsibilities of the IRD and taxpayers so that the processes are fair, equitable and efficient for all involved.

19.5 *Recommendation: Business New Zealand recommends that the Bill's provisions on disputes procedures should proceed but the Committee should also consider further changes to better balance the rights and responsibilities of the IRD and taxpayers.*

20. Minor Remedial Amendments

20.1 There are a large number of remedial amendments contained in the bill, many of them minor and very technical. Business New Zealand does not wish to comment on these amendments other than make a general comment that the large number of remedial changes calls into question the quality of legislation and whether too many changes are pushed through the system too quickly. Hurried law is not good law.

20.2 Considering the importance of tax legislation for businesses and indeed all New Zealanders it is critical that flaws do not slip through the process. It is also worth observing that while taxpayers who misinterpret tax legislation can be (and often are) penalised for their mistakes, taxpayers are unable to gain redress from Parliament for mistakes it makes in considering tax legislation.

20.3 *Recommendation: Business New Zealand recommends that the Government should take more care is taken when amending legislation to ensure that fewer subsequent remedial amendments are required.*

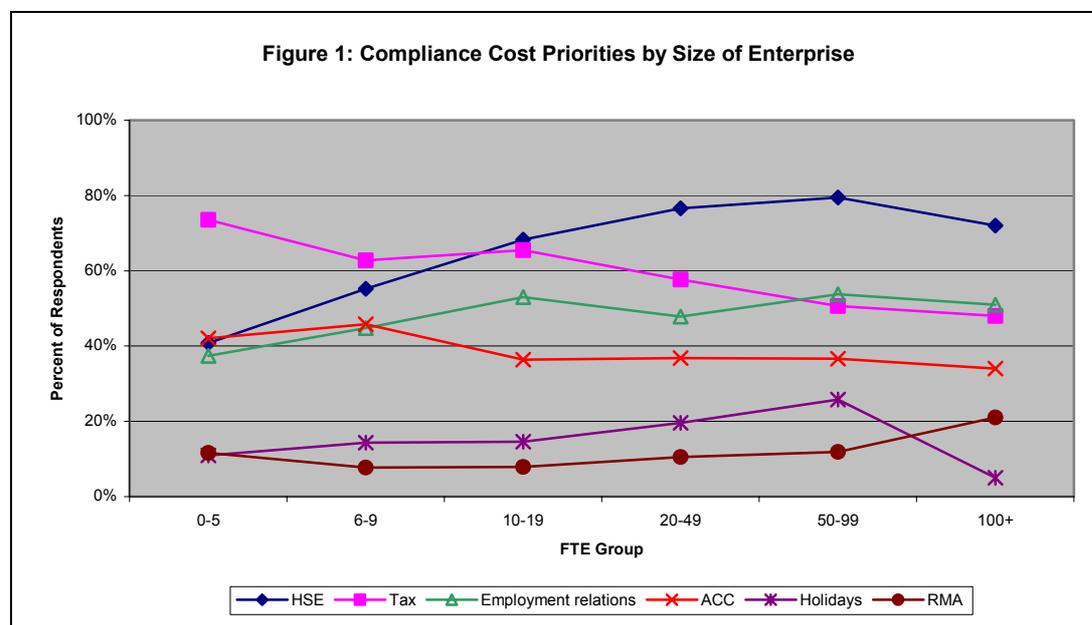
ANNEX 1 – SUMMARY OF BUSINESS NEW ZEALAND – KPMG COMPLIANCE COST SURVEY 2003

Compliance Cost Priorities

Tax compliance costs have traditionally been a high priority for businesses, but the Business New Zealand – KPMG Compliance Cost Survey found that employment related compliance costs are also very significant⁴. 35.5% of respondents listed tax as the highest priority for action, well ahead of health and safety in employment (HSE) on 22.8%. However, after adding respondents' top three priorities HSE (64.9%) overtook tax (60.8%) with employment relations (47.6%) and ACC (38.7%) also prominent.

The lower relative priority for tax compliance could be due to recent tax simplification initiatives having a positive influence on the business community's perceptions around tax compliance. However, employment-related compliance costs have also increased their relative priority, with many respondents having to wrestle with the implications of the HSE Amendment Act, which took effect in May 2003.

The survey found that the smaller the enterprise the more likely they were to list tax as one of their top three priorities. This is not surprising considering that whereas micro businesses can avoid many of the formal employment-related compliance requirements there is virtually no escaping the tax compliance burden regardless of size. Figure 1 below illustrates the change in relative priorities for HSE, tax, employment relations, ACC, holidays, and RMA according to the size of enterprise.



Service industries (particularly finance and business services, trade and hospitality, and transport, storage and communications) were more likely to identify tax as one of their top three priorities, while the primary industry was least likely to. Interestingly, tax compliance costs seemed to be of higher priority for those regions

⁴ Employment-related compliance costs refer to those associated with HSE, employment relations, ACC, and holidays.

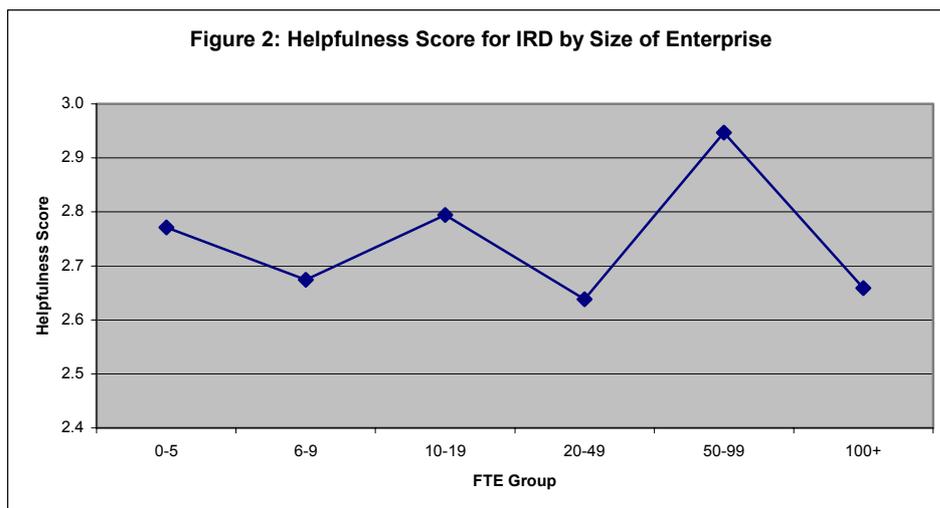
dominated by large metropolitan areas (i.e., Northland/Auckland, Wellington, and Canterbury).

Helpfulness of Government Agencies

IRD was the government agency with which respondents identified as having the most contact over the previous 12 months (89.6%), well ahead of ACC (67.5%), local authority (62.4%), and WINZ (60.4%). This very high level of contact for the IRD was remarkably consistent across enterprise size, industry, and region.

The survey also asked about perceived helpfulness of government agencies. The Companies Office was perceived to be by far the most helpful of agencies and the Environmental Risk Management Authority by far the least helpful agency. The remaining agencies listed were very closely grouped together, with IRD ranking 8th out of 12 agencies for perceived helpfulness.

Unlike some agencies, IRD had fairly consistent helpfulness scores regardless of enterprise size, although enterprises in the 0-5, 10-19 and 50-99 FTE groups were rather more likely to find IRD helpful than the 6-9, 20-49, and 100+ FTE groups. Figure 2 below shows how IRD's 'helpfulness score' fluctuated by FTE group⁵.



Respondents in the primary industry were most likely to have perceived IRD to be helpful while those in the transport, storage and communications industry were least likely. Of the regions, respondents from the Upper South Island were most likely to have perceived the IRD to be helpful, while Wellington respondents were least likely.

Compliance Cost Trends

Respondents were asked to indicate the degree to which they had perceived compliance costs to have increased or decreased over the preceding 12 months. In most areas (the exceptions being the employment-related compliance cost areas

⁵ The 'helpfulness score' was the sum of the weighted scores of each of the columns showing the number of respondents who considered the government agency to be 'very helpful', 'helpful', 'unhelpful', or 'very unhelpful'. Each column's percentage was weighted by a value, with the maximum possible score being 4 ('very helpful') and the minimum possible score being 1 ('very unhelpful').

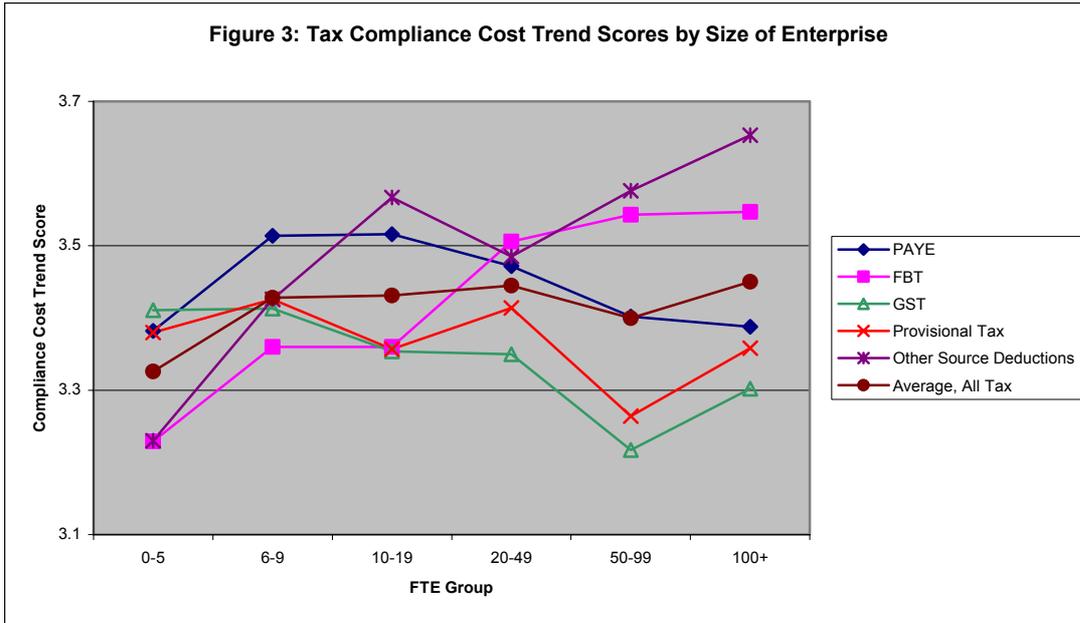
where most respondents picked large or modest rises) the majority of respondents picked 'no change'.

Table 1 below shows that the tax-related areas were those most likely to have respondents recording falls in compliance costs (ranging from 1.4% of respondents for Provisional Tax to 3.5% for Fringe Benefit Tax). This is likely to be a reflection of tax simplification initiatives beginning to bear some fruit, albeit in a limited manner. Less encouragingly, however, the tax-related areas also had a relatively higher proportion of respondents recording modest rises in compliance costs – not as high as for the employment-related areas, but considerably higher than areas such as border control, RMA, hazardous substances etc.

Table 1: Compliance Cost Trends over the Preceding 12 Months

Compliance Cost Area	Percent of respondents commenting	Large Rise (5)	Modest Rise (4)	No Change (3)	Modest Fall (2)	Large Fall (1)	Cost Trend Score
Tax – PAYE	98.9%	5.6%	37.0%	54.4%	2.9%	0.1%	3.450
Tax – FBT	96.1%	8.5%	28.5%	59.5%	3.0%	0.5%	3.414
Tax – GST	98.8%	5.3%	27.2%	64.6%	2.9%	0.0%	3.349
Tax – Prov Tax	95.4%	6.2%	26.1%	66.3%	1.4%	0.0%	3.372
Tax – Other deductions	96.3%	7.5%	35.4%	54.8%	2.2%	0.1%	3.480
<i>Average, all Tax</i>	<i>97.1%</i>	<i>6.6%</i>	<i>30.8%</i>	<i>59.9%</i>	<i>2.5%</i>	<i>0.1%</i>	<i>3.413</i>
ACC	97.4%	16.2%	46.6%	35.8%	1.4%	0.0%	3.777
HSE	96.2%	43.2%	40.1%	16.7%	0.0%	0.0%	4.264
Employment relations	96.4%	25.5%	47.2%	26.6%	0.5%	0.1%	3.974
Holidays	97.8%	11.0%	41.0%	47.4%	0.5%	0.0%	3.625
Statistics NZ surveys	96.1%	3.8%	24.4%	70.4%	1.4%	0.0%	3.307
Local government	95.5%	7.4%	27.1%	64.5%	0.8%	0.1%	3.410
RMA	90.0%	7.9%	15.6%	76.0%	0.4%	0.0%	3.310
Hazardous substances	92.9%	8.5%	17.6%	73.4%	0.6%	0.0%	3.340
Transport sector	92.0%	5.6%	21.3%	72.4%	0.6%	0.1%	3.317
Consumer issues	91.6%	7.5%	26.4%	65.5%	0.6%	0.0%	3.409
Companies & securities	94.3%	5.2%	19.9%	71.4%	3.2%	0.3%	3.265
Border control	89.6%	4.0%	15.3%	79.7%	0.9%	0.1%	3.221
Other compliance costs	92.9%	12.3%	41.1%	46.3%	0.3%	0.0%	3.655

Trends in overall tax-related compliance costs were perceived to be of a fairly similar magnitude regardless of enterprise size, but this overall stability masked some significant fluctuations for specific areas of tax, as can be seen in Figure 3 below. For example, perceptions that costs were increasing for FBT and 'other source deductions' started off at low levels among the smallest respondents but consistently worsened as enterprises grew in size. The opposite trend was generally true for PAYE, GST and Provisional Tax.

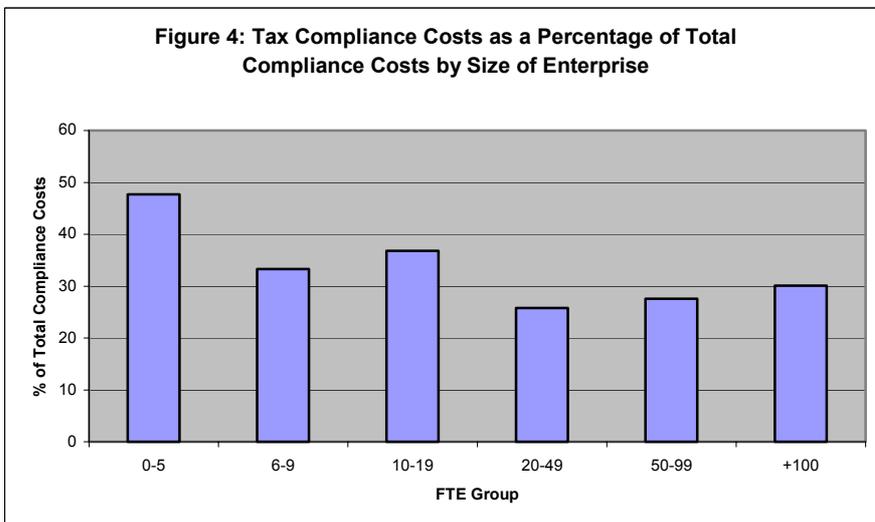


Overall trends in tax-related compliance costs were also fairly similar across industries, although PAYE and other source deductions were of greater concern to the primary industry and FBT to the manufacturing industry. The South Island and Wellington tended to have somewhat lower perceptions of increases in tax compliance costs than those in the rest of the North Island.

Estimating Total Compliance Costs

Respondents were asked to estimate the compliance costs they incurred over the previous 12 months across tax, employment, environmental, and other compliance costs.

Tax compliance costs made up 30.1% of total costs, followed closely by employment compliance costs at 29.4% and environmental compliance costs at 24.5%. As Figure 4 shows below, tax-related compliance costs were particularly significant for smaller businesses (i.e., 0-19 FTEs), and made up almost half (47.7%) of total compliance costs for the 0-5 FTE group.



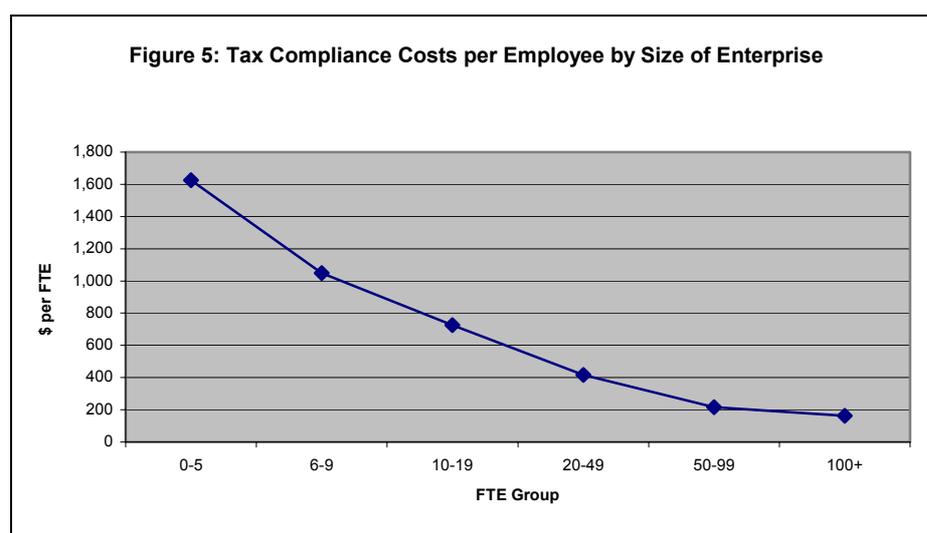
The average respondent spent 315.6 hours per year within the enterprise on tax compliance, less than the amount of time spent on employment compliance (549.7). However, 83.3% of respondents paid for external advice on tax matters, a much higher proportion than any of the other compliance cost areas.

Table 2 shows tax compliance costs by size of enterprise. Unsurprisingly, total hours spent (and the external costs) within the enterprise grew with the number of full time equivalents (FTEs). However, when adjusting for FTEs, the cost per FTE fell substantially from \$1,625 for the 0-5 FTE group to \$216 for the 50-99 FTE group and \$162 for 100+ FTE group. This trend is set out very clearly in Figure 5 below.

Table 2 also shows tax compliance costs as a percent of turnover. Costs were very high even for enterprises with 10-19 FTEs. In our opinion, this shows that it is not just enterprises with 0-5 FTEs that need assistance.

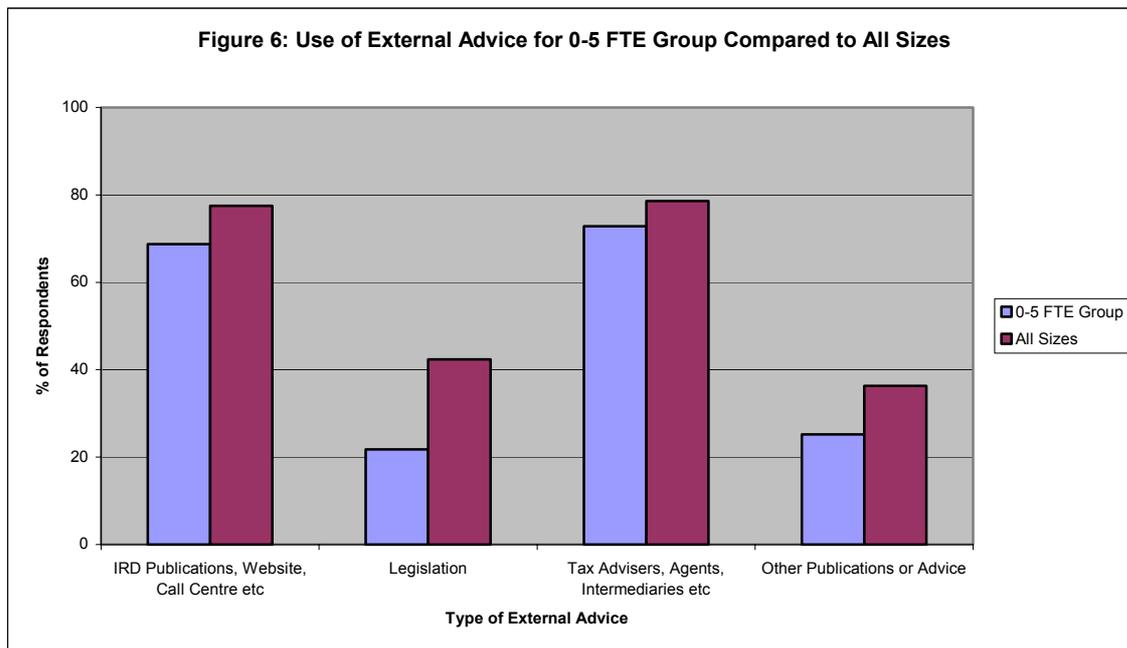
Table 2: Tax Compliance Costs by FTE Group

	0-5	6-9	10-19	20-49	50-99	100+	All Sizes
Mean annual hours spent within enterprise on Tax	114.6	152.5	211.6	203.3	245.4	1196.3	315.9
Average internal cost	\$2,183	\$2,903	\$4,029	\$3,870	\$4,672	\$22,777	\$6,015
% of respondents that used external advice	76.4%	91.3%	83.3%	84.3%	81.6%	85.9%	83.3%
Average external cost	\$3,885	\$5,095	\$6,695	\$10,485	\$12,230	\$39,108	\$11,836
Average total cost	\$5,152	\$7,555	\$9,608	\$12,710	\$14,653	\$56,359	\$15,881
Average total cost by FTE	\$1,625	\$1,049	\$725	\$417	\$216	\$162	\$245
Average total cost as % of turnover	0.54%	0.35%	0.40%	0.17%	0.10%	0.19%	0.20%
Tax as a % of total compliance costs	47.7%	33.3%	36.8%	25.8%	27.6%	30.1%	30.1%



The survey also asked respondents to select the sources of external tax information accessed over the preceding 12 months. Uptake of external advice was at consistent levels across all size groups, with the exception of the 0-5 FTE group which recorded particularly low use of legislation and 'other advice'. This disparity is shown in Figure 6 below. Overall, it appears that micro businesses have either less need or less willingness to seek advice, are less able to do so, or are less aware of

the opportunities that there are for the use of external information and advice on tax compliance requirements.



Suggestions for Improvement

Finally, the survey asked respondents to provide comments. This provided an opportunity for respondents to make suggestions on, among other things, how to improve the tax system to reduce the compliance burden. Not surprisingly, many of the comments were directed at tax issues and the IRD.

There were many calls from respondents for lower tax and flatter rates. This issue has relevance for tax simplification, as a move to more uniform tax rates would reduce the need for complicated legislation needed to close loopholes. The 47 pages of legislation needed to implement the 39-cent top marginal tax rate is an example of the reverse.

There were many comments expressing frustration at FBT, with calls for it to be simplified, clarified, and abolished altogether. The complexity of multi-rate FBT was cited on numerous occasions.

A number of respondents commented on payment dates and frequencies, with many suggesting that dates should be aligned – although opinion appeared to be divided on frequency of payment. Other themes included support for more transactions to be able to be made ‘on-line’ and there were familiar complaints about employers’ perceived role as ‘unpaid tax collectors’.