

Submission

By



To The

Inland Revenue Department

On The

**Tax Penalties, Tax Agents & Disclosures
Discussion Document**

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**TAX PENALTIES, TAX AGENTS AND DISCLOSURES
SUBMISSION BY BUSINESS NEW ZEALAND¹
30 NOVEMBER 2006**

1. INTRODUCTION

1.1 Business New Zealand welcomes the opportunity to comment on the Tax Penalties, Tax Agents and Disclosures Discussion Document (referred to as 'the document'), released by the Inland Revenue Department (IRD). Overall, we believe that the changes outlined in the document represent a positive step forward in reducing compliance costs on businesses, including some changes that are long overdue.

2. SUMMARY OF RECOMMENDATIONS

2.1 Business New Zealand makes the following **recommendations** with regard to the Tax Penalties, Tax Agents and Disclosures Discussion Document, namely that:

- (a) ***IRD investigate whether the proposals outlined for tax agents should have a time clause instigated for those who do not meet the revised criteria (p.4);***
- (b) ***Any future changes to the rules relating to tax agents beyond this review be set at a very high threshold (p.4);***
- (c) ***Those involved in the tax agent industry are actively consulted to ensure a smooth process of change for the proposals outlined (p.4);***
- (d) ***The proposals outlined for refining the scope of the unacceptable tax position shortfall proceed (p.5);***
- (e) ***The notification of late payment clearly stipulates the penalties in both percentage and dollar values the taxpayer will face if they do not pay the penalty by the date prescribed (p.6);***
- (f) ***The proposal regarding the clarification of the late payment penalty legislation to the employer monthly schedule proceed (p.6);***
- (g) ***The proposal regarding removing the shortfall penalty for not taking reasonable care or taking an unacceptable tax position proceed (p.6);***
- (h) ***The proposals regarding shortfall penalties in relation to PAYE proceed (p.7);***
- (i) ***The proposals regarding GST filing proceed, as long as a sufficient time period is provided for those taxpayers who have initially not filed their GST returns and have been given notification from IRD to do so (p.8);***

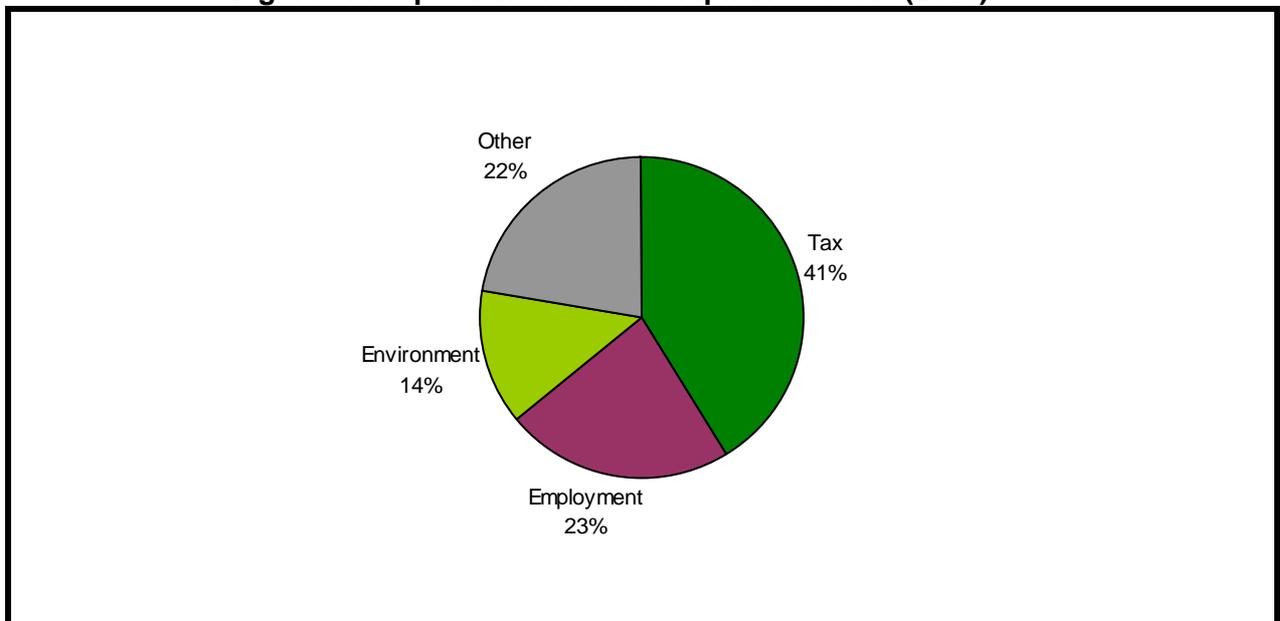
¹ Background information on Business New Zealand is attached in the appendix.

- (j) *The proposals outlined in chapter seven of the document proceed (p.8); and*
- (k) *The proposals regarding voluntary disclosures are formally introduced as soon as possible, preferably via the current Tax Bill before Parliament (p.8).*

3. RESULTS OF THE 2006 BUSINESS NEW ZEALAND KPMG COMPLIANCE COST SURVEY

3.1 Business New Zealand conducts the annual Business NZ/KPMG Compliance Cost Survey² that has now been running for four years. Over that time, the survey consistently shows tax to be the leading compliance cost issue for all business, regardless of size. Figure 1 shows that in 2006, tax made up 41% of the total compliance costs for all business.

Figure 1: Proportion of Total Compliance Costs (2006)



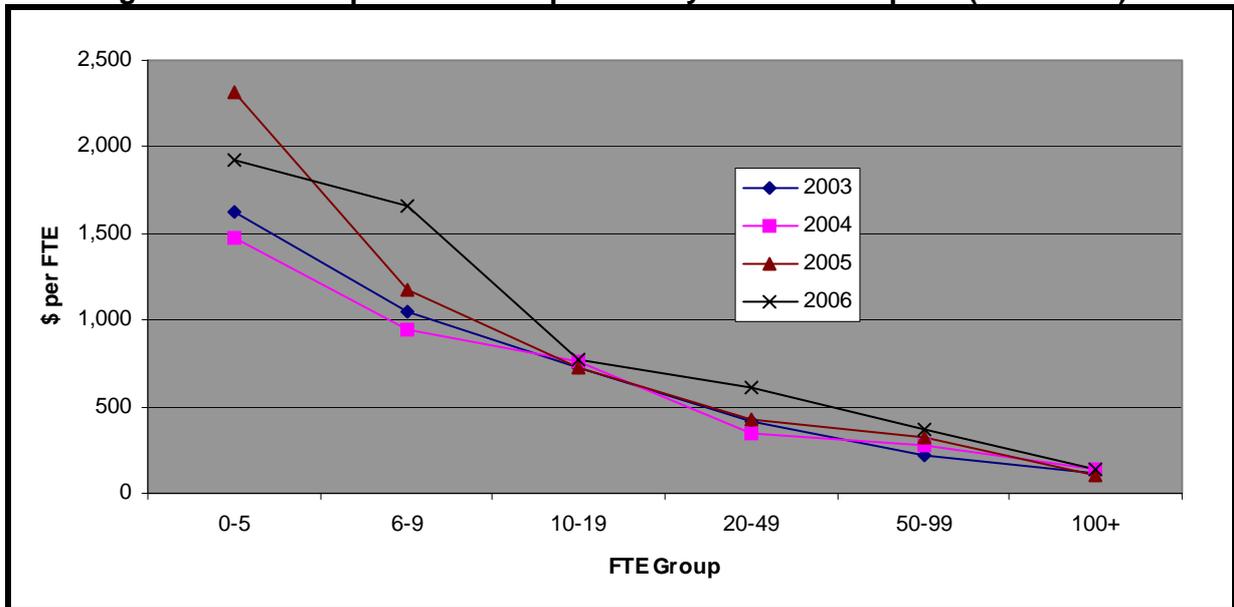
3.2 Figure 2 shows that the cost of compliance falls disproportionately on smaller businesses, compared to larger businesses. With the inclusion of a higher number and proportion of smaller businesses in the survey for 2006, previous estimates of the cost of tax compliance for small businesses may have been under-estimated in previous years. Therefore, proposals by IRD to reduce the compliance load on business has a much greater effect on small businesses, which currently make up the bulk of firms in New Zealand.

3.3 The results clearly show that the day-to-day dealings of businesses with IRD make a significant contribution to compliance costs, and improvement would be welcomed on many fronts. IRD, along with other government departments can often be quick to place penalties on those who do not comply with legislation or regulation. However, they can sometimes be not as quick to

² For more information, visit <http://www.businessnz.org.nz/surveys/504>

improve recognition of those who do regularly comply. Therefore, we are pleased to see IRD making positive steps in this direction.

Figure 2: Tax Compliance Costs per FTE by Size of Enterprise (2003-2006)



3.4 Lastly, there are obvious cases whereby instances of persistent and intentional non-compliance require attending to. Businesses that comply will often have a disadvantage compared to those businesses that intentionally try to avoid required compliance procedures. However, Business New Zealand has always taken the view that the vast majority of businesses do their best to comply with the current regulatory and legislative environment. Therefore, we support moves by IRD that takes a more reasonable approach to tax penalties and associated legislation.

4. TAX AGENTS

4.1 The fact that more than 4,500 tax agents are registered with IRD, representing more than 1.7 million taxpayers, highlights the crucial position tax agents have in New Zealand's administrative tax system. Therefore, it is important that the capability of tax agents meets the services and privileges that the IRD provides with their position. Given the decision by IRD to provide tax agents with greater use of technology and a range of self-service options, we understand the need for the criteria of becoming a tax agent to be re-examined.

4.2 While Business New Zealand generally takes the view of decreasing rather than increasing regulatory requirements, all proposals need to be viewed from the wider perspective of whether the changes will bring about a lower overall regulatory and compliance burden. In the case of the proposals for tax agents, given the full range of proposals put forward in the document, we generally do not oppose the moves regarding the additional requirements for tax agents. However, we would expect IRD to actively consult with tax agents and their representatives over the proposals in case there are any unforeseen issues that require attention.

- 4.3 The document outlines five possible factors that might be taken account when deciding whether to withhold recognition of tax agent status. While the factors appear reasonable, we believe these factors alone would most likely be sufficient without addition. Also, we would support moves that are similar to the conviction of a crime involving dishonesty, in that a time clause is considered on the other factors where relevant. For instance, one could argue that a person who became a undischarged bankrupt say 20 years ago but has lead an exemplary financial position since then should not be harboured with this stigma for the duration of their working life, including applying for tax agent status.

Recommendation: That IRD investigate whether the proposals outlined for tax agents should have a time clause instigated for those who do not meet the revised criteria.

- 4.4 We are pleased to see that there are transitional proposals in the document for reviewing the criteria of a tax agent. We view these as important components when significant regulatory change is made; namely that individual agents currently registered as tax agents will not be required to reapply for their agency status, and that those affected will be given 12 months to provide the information.

- 4.5 Regarding the possibility of future changes to how tax agents are screened, in paragraph 2.14 of the document, it states, *“it is envisaged that the discretion not to grant, or remove tax agent status would be exercised only in a very small number of cases”*. Paragraph 2.31 states that *“Inland Revenue will, however, monitor this situation and may in the future propose more robust measures for screening tax agents should these be seen to be required”*. When these two statements are read in context with each other, Business New Zealand believes that any changes beyond this review regarding the rules for tax agents would have to meet a very high threshold mark given the initial changes were predicated on the fact that any changes would only negatively affect a very small number of tax agents.

Recommendation: That any future changes to the rules relating to tax agents beyond this review be set at a very high threshold.

5. TAX AGENTS AND THE SHORTFALL PENALTY FOR NOT TAKING REASONABLE CARE

- 5.1 Business New Zealand does not oppose the proposals outlined in the document regarding tax agents and the shortfall penalty for not taking reasonable care. However, like the general change outlined for tax agents in section 4 of this submission, we encourage IRD to actively consult with those in the industry to ensure a smooth change in process for those affected.

Recommendation: That those involved in the tax agent industry are actively consulted to ensure a smooth process of change for the proposals outlined.

6. REFINING THE SCOPE OF THE UNACCEPTABLE TAX POSITION SHORTFALL PENALTY

6.1 While the IRD state that the aim of the shortfall penalty is to encourage taxpayers to get their tax position corrected in terms of the law, we are pleased to see that IRD have recognised that the structure of the current legislation has caused an adverse effect on taxpayer behaviour by making them less inclined to disclose errors to IRD. Therefore, we support the proposals by IRD to:

- (a) Remove GST and withholding type tax from the scope of the unacceptable tax position penalty (thus only relating to income tax); and
- (b) Increase the thresholds for the assessment of the unacceptable tax position shortfall penalty (\$50,000 and 1% of the taxpayers total tax figure for the relevant return period, compared with \$20,000 and the lesser of \$250,000 and 1% of the taxpayers total tax figure for the relevant return period as it currently stands).

As stated in the document, proposals will remove many cases from the scope of the penalty, which in previous cases have often been overly harsh towards the taxpayer.

Recommendation: That the proposals outlined for refining the scope of the unacceptable tax position shortfall proceed.

7. IMPROVING RECOGNITION OF GOOD COMPLIANCE

7.1 We note that four proposals have been put forward by IRD in terms of improving recognition of good compliance:

- (a) IRD will notify a taxpayer the first time their payment is late rather than imposing an immediate late payment penalty;
- (b) The late payment penalty legislation relating to the employer monthly schedule will be clarified;
- (c) The shortfall penalty for not taking reasonable care or taking an unacceptable tax position will not be imposed when a tax shortfall is voluntarily disclosed; and
- (d) A new graduated penalty to replace the current shortfall penalty in relation to PAYE will apply when an employer has filed an employer monthly schedule but not paid the PAYE.

7.2 Business New Zealand congratulates the IRD for making these proposals. As paragraph 5.6 of the document rightly points out, it is probably inappropriate that taxpayers who are usually compliant but have inadvertently missed a payment should have late payment penalties imposed on them, especially when the penalty seems disproportionately high compared with the severity of the breach.

- 7.3 The first proposal from IRD notifies taxpayers the first time their payment is late, rather than the current situation of automatically applying a late penalty. We view this change as the sort of pragmatic and good-willed adjustment that recognises that the majority of taxpayers try to comply to the best of their ability. In most cases where procedures are not followed, taxpayers generally try to rectify the situation.
- 7.4 If a late penalty is imposed due to non-payment after the notification is sent, the document states that the penalty will be 1% the day after the initial due date and 4% six days later. While the document outlines what the notification will explain, we believe it is important that the notice clearly outlines the cost of the penalty to the taxpayer both in percentage and dollar value.

Recommendation: That the notification of late payment clearly stipulates the penalties in both percentage and dollar values the taxpayer will face if they do not pay the penalty by the date prescribed.

- 7.5 Business New Zealand supports the second proposal involving clarification of the late payment penalty legislation to the employer monthly schedule, to reflect the current practice of warning employers when a schedule is filed late, and imposing penalties on subsequent cases.

Recommendation: That the proposal regarding the clarification of the late payment penalty legislation to the employer monthly schedule proceed.

- 7.6 The third proposal involves shortfall reductions for voluntary disclosures. Given that shortfall penalties are reduced by 75% if the disclosure is made before the taxpayer is notified of a pending tax audit or investigation, and by 40% if the disclosure is made between the notification of an audit and before the audit or investigation begins, there is still a penalty imposed even when complying voluntarily with their tax obligations.
- 7.7 Business New Zealand supports the move whereby shortfall penalties payable when tax shortfalls are voluntarily disclosed before taxpayers are notified of pending tax audits or investigations will not be imposed. We also view two years as a fair time period for most taxpayers in which they are given the opportunity to voluntarily notify IRD of any tax shortfalls. However, in some circumstances two years may still not be sufficient, so we support the move to continue the 75% reduction for those who voluntarily disclose outside the two-year window of opportunity.

Recommendation: That the proposal regarding removing the shortfall penalty for not taking reasonable care or taking an unacceptable tax position proceed.

- 7.8 Regarding late payment of PAYE, comments to the Compliance Cost Survey regarding PAYE compliance shows that it is very time consuming and expensive. A number of respondents have commented that their costs are high due to the requirement to pay PAYE deductions to IRD twice monthly, even though they do not consider themselves to be large businesses.

- 7.9 Given the compliance headache many employers experience with PAYE, it goes without saying that the level of frustration is increased when they receive penalties if they fail to pay IRD on time, which in almost all cases is probably due to oversight rather than any type of intent not to comply.
- 7.10 Therefore, regarding the fourth issue in the document involving situations where an employer files the schedule but does not pay the PAYE, we agree that the current regime provides a lack of opportunity for taxpayers to correct non-compliance, and that there is certainly a perception that the current rules are too harsh.
- 7.11 Business New Zealand supports moves to see new rules whereby shortfall penalties for evasion will not be imposed if the employer files the employer monthly schedule but does not pay the PAYE. Instead, the IRD will contact the employer to establish the reason for the non-payment and offer to liaise with the employer to establish or enhance their systems to ensure future compliance. Again, this is a simple and very effective solution to a problem that IRD have recognised, and that should improve the relationship between IRD and businesses.
- 7.12 We also agree that if the employer does not make a payment or enter into an instalment arrangement after 30 days and after contact by IRD has been made to the business on this matter, a shortfall penalty of 20% of the unpaid PAYE will be imposed, which will reduce to 10% if the payment is made within a further 30 days. This continues to provide an incentive for employers to comply, and we agree that the level of the penalties should be given a cap so they will not exceed in total any penalty that could be charged under the current rules.

Recommendation: That the proposals regarding shortfall penalties in relation to PAYE proceed.

8. IMPROVING GST FILING

- 8.1 While Business New Zealand is supportive of the bulk of proposals in the document, we are disappointed about the decision to reduce the number of default assessments being sent by introducing a late filing penalty of \$250. However, we must also acknowledge that along with other proposals discussed, IRD must again initially issue a warning notification with a specified time period in which to correct any error in process. In addition, we support the clean-state approach proposed whereby if a taxpayer files GST returns on time for at least 12 months after the initial error, the process starts again with a warning notice being sent, rather than another fine taking place.
- 8.2 Overall, we are not generally supportive of fines as they are often paid in most circumstances by those businesses who do not intend to intentionally ignore compliance procedures in any way but have made a genuine error in process. However, we accept a quid pro quo approach of what appears to be aligning the processes of notification, followed by some form of fine. Our only stipulation would be that the time period in which a taxpayer is able to

file their GST returns after initially failing to do so is sufficient so as to be able to realistically avoid the penalty fee being imposed on them.

Recommendation: That the proposals regarding GST filing proceed, as long as a sufficient time period is provided for those taxpayers who have initially not filed their GST returns, and have been given notification from IRD to do so.

9. OTHER CHANGES TO THE PENALTIES RULES

9.1 Overall, Business New Zealand does not oppose the remaining proposals outlined in chapter seven of the document. All proposals represent further enhancements to the administrative tax system in New Zealand.

Recommendation: That the proposals outlined in chapter seven of the document proceed.

10. APPLICATION DATES

10.1 Business New Zealand does have one concern in relation to the lead-in times for the enactments of many of these proposals, which at this stage is planned towards the end of 2007. We note that KPMG³ have also pointed out that this creates a perverse incentive to hold off making a voluntary disclosure until the legislation is enacted. Therefore, we would strongly support moves that would see at least the change to voluntary disclosures be introduced as soon as possible, given there would be little if any opposition from interested groups to the proposals outlined. The most obvious way in which this could be done is the Tax Bill currently before parliament.

Recommendation: The proposals regarding voluntary disclosures be formally introduced as soon as possible, preferably via the current Tax Bill before Parliament.

³ KPMG Taxmail – Issue 1, 17 October 2006.

APPENDIX

11. About Business New Zealand

- 11.1 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 63-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.
- 11.2 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.
- 11.3 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.