

Submission

By



To The

Inland Revenue Department

On

**Reducing Tax Compliance Costs for Small
and Medium-Sized Enterprises – Part One
(Thresholds)**

31 January 2008

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**REDUCING TAX COMPLIANCE COSTS FOR SMALL AND MEDIUM-SIZED
ENTERPRISES - THRESHOLDS
SUBMISSION BY BUSINESS NEW ZEALAND¹
31 JANUARY 2008**

1. INTRODUCTION

1.1 Business New Zealand welcomes the opportunity to comment on the threshold section of the *Reducing Tax Compliance Costs for Small and Medium-Sized Enterprises* discussion document (referred to as 'the document'), released by the Inland Revenue Department (IRD). Overall, we believe the proposed changes in thresholds are a step in the right direction, with further scope for improvement.

2. SUMMARY OF RECOMMENDATIONS

2.1 Business New Zealand makes the following **recommendations** with regard to *Reducing Tax Compliance Costs for Small and medium-Sized Enterprises - Thresholds*, namely that:

- (a) ***The Government should view a lowering of the top marginal personal tax rate as the best way in which to lower overall compliance costs for SMEs (p.3);***

Notwithstanding Business New Zealand's view that this should be the main priority, of the threshold proposals outlined in the document, we recommend that:

- (b) ***Increasing the threshold for paying PAYE deductions once a month from \$100,000 to \$250,000 proceeds (p.5);***
- (c) ***Increasing the threshold for filing FBT returns annually from \$100,000 to \$250,000 proceeds (p.5);***
- (d) ***Increasing the threshold for use-of-money interest safe harbour from \$35,000 to \$50,000 proceeds (p.6);***
- (e) ***The GST threshold be increased from \$40,000 to \$50,000, with further threshold increases welcomed if supported by the majority of submitters (p.7);***
- (f) ***Business New Zealand does not oppose an increase in the threshold for filing GST returns six-monthly from \$250,000 to \$500,000, but we would view this proposal as a lesser priority for change (p.7);***
- (g) ***Business New Zealand does not oppose an increase in the threshold for GST change-in-use adjustments from \$90,000 to \$100,000, however, an exemption solely based on a 5% cap of the total of all supplies made in a 12 month period should be further considered. (p.8);***

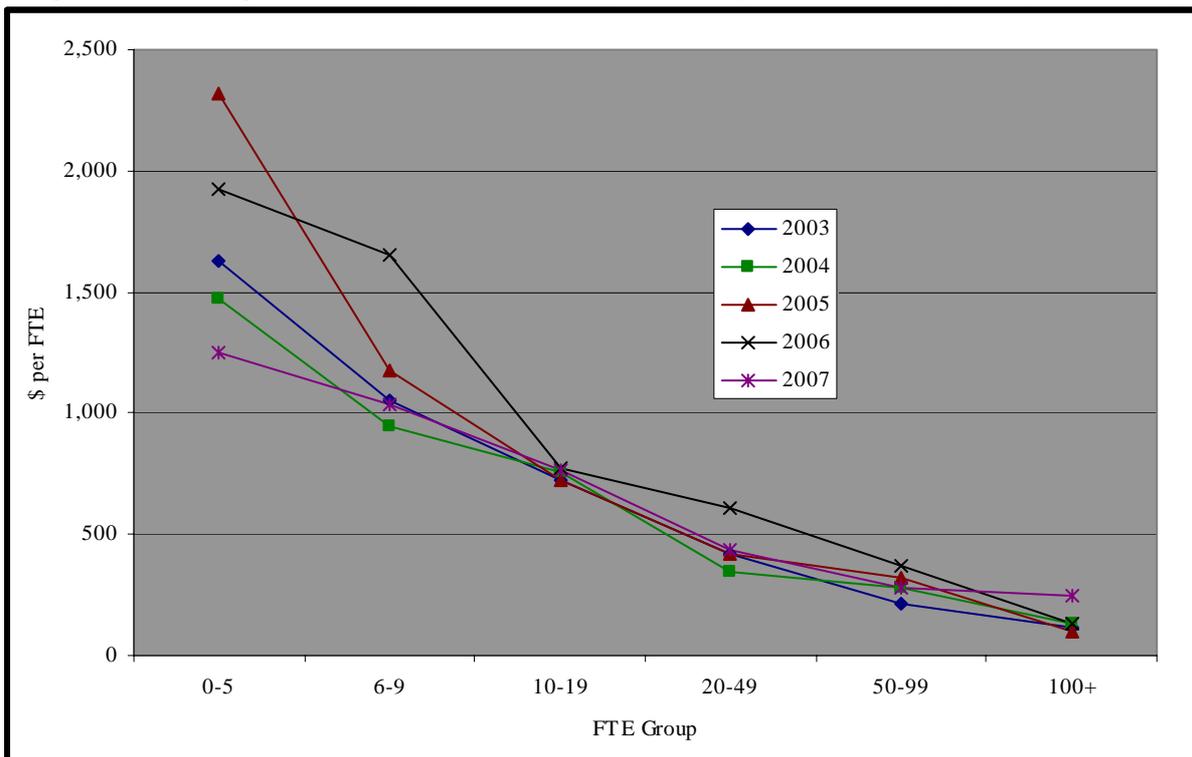
¹ Background information on Business New Zealand is attached in the appendix.

- (h) **The low-value trading stock valuation rules threshold be increased from \$5,000 to \$10,000, and proceed no matter what the final outcome of the review as there is no end cost to the taxpayer (p.9); and**
- (i) **The introduction of a single overall threshold for certain tax concessions proceeds, along with the establishment of two parallel schemes (p.9).**

3. BACKGROUND

3.1 Business New Zealand agrees that minimising tax compliance costs is an important matter for all businesses; however research suggests SMEs bear higher relative costs to larger businesses. While the document outlines studies conducted by Colmar Brunton for IRD, Business New Zealand in Association with KPMG have run the Business NZ KPMG Compliance Cost Survey for five years, which clearly shows the relative cost of tax compliance being borne on SMEs (see figure 1). Moves via threshold changes and other initiatives to bring costs down are welcomed, as the aim should be to not only lower, but flatten the tax compliance ‘curve’.

Figure 1: Average Tax Compliance Costs per FTE by Size of Enterprise (2003-2007)



3.2 Unfortunately, like the Business Taxation Review, there is little to guide submitters on exactly how much is deemed to be part of the package to attempt to make trade offs. This makes priorities difficult. However, chapter 2 of the document provides some fiscal costs for the various options, with the combined total of 5 options covered under the thresholds issue coming to \$63 million. The bulk of costs come under changes to GST arrangements, while others have no additional fiscal costs other than the time value of money.

4. OPTIONS OUTLINED

- 4.1 As part of the first submission on the document, IRD have asked for views concerning various thresholds, which are provided as follows.

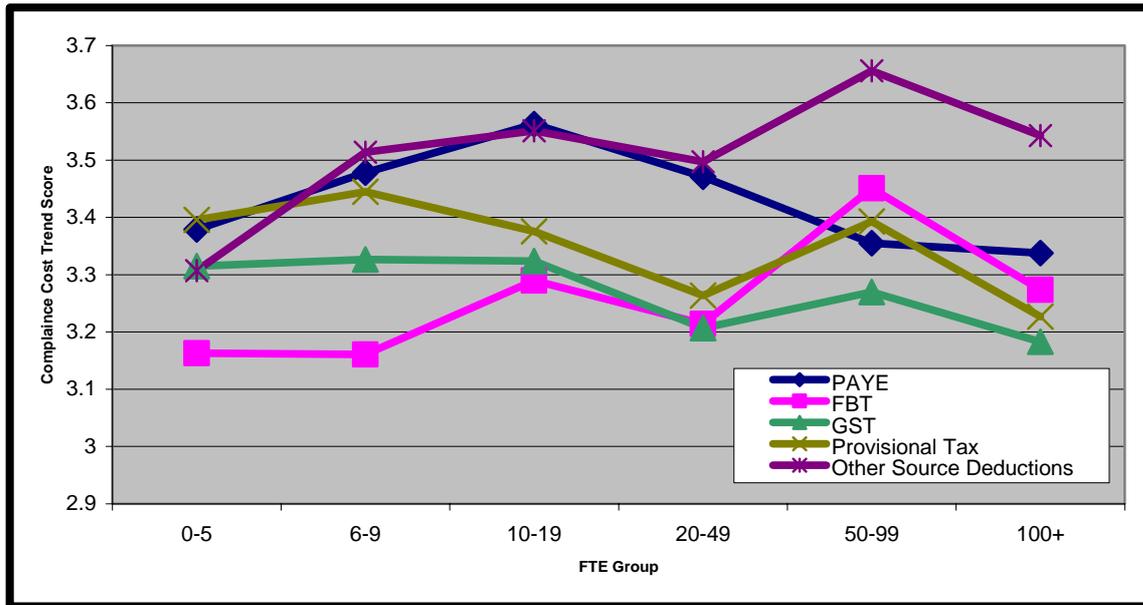
Business New Zealand's Primary Priority

- 4.2 While Business New Zealand general supports the various proposals outlined in the document, we believe the single best proposal to reduce tax compliance costs for SMEs is to flatten the personal tax rate. Currently, there are various tax rates around the 30% mark, including the corporate tax rate (soon to become 30%), the savings vehicle rate (30%), and the trust rate (33%). The top personal tax rate that most small businesses will find they are on experiences a sizeable discrepancy from the other rates, and therefore creates substantial costs and distortions, including incentives to restructure, ongoing administration issues and complexity.
- 4.3 Business New Zealand believes a decrease in the top personal tax rate from 39% to a level at or near 30%, which would make it more in line with the company tax rate and trust tax rate would alleviate many of the compliance and administrative issues that SMEs have to deal with on a regular basis.

Recommendation: That the Government should view a lowering of the top marginal personal tax rate as the best way in which to lower overall compliance costs for SMEs.

- 4.4 Figure 2 shows the tax compliance cost trends scores recorded from the compliance cost survey in 2007 for the various sizes of enterprises. Essentially, the higher the score, the higher businesses perceived there to be an increase in compliance issues associated with a particular tax issue. A value between 3.0 and 3.499 was considered to be a *modest increase*, while a *large increase* was any value between 3.5 and 3.999. As the figure shows, PAYE, provisional tax and 'other source deductions' were typically perceived as increasing the most for SMEs in 2007, with GST and FBT showing more modest increases.
- 4.5 While a similar pattern has been evident in previous survey results, a positive aspect has been a move downwards in the level of increases perceived for each tax issue, which indicates previous initiatives IRD have introduced may now be starting to filter through in terms of reducing compliance issues for SMEs. Certainly, further moves towards reducing tax compliance costs are encouraged.

Figure 2: Tax Compliance Cost Trend Scores by Size of Enterprise (2007)



4.6 Given the specific group of tax issues that SMEs tend to view as showing more significant compliance cost increases, priority given to any proposed threshold changes should mirror these findings.

Paying PAYE Deductions Once a Month

4.7 Currently, employers can pay deduction from PAYE and SSCWT once a month instead of the standard two times a month if the total amount deducted for PAYE and SSCWT for all their employees was less than \$100,000.

4.8 The Government has proposed increasing the threshold to \$250,000, which would mean an additional 24,000 employers could file once-monthly, equating to 96% of all employers.

4.9 Specific views expressed by SME respondents during the five years the Business NZ KPMG Compliance Cost Survey has been running have expressed PAYE compliance as very time consuming and expensive. A number of respondents 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. One respondent commented that he “would like to pay PAYE once per month only” as it is more work to pay it twice monthly and harder on the business financially.

4.10 We are also pleased to see that the Government will ensure that employers that are above the current threshold but below a new threshold could still file twice-monthly if that better suited their business systems. This ensures there is still flexibility if this threshold is changed that does adversely affect those businesses who wish to remain with the status quo.

4.11 In addition, it is worth pointing out that while extending reporting periods results in less forms, some businesses, especially those that don't accrue correctly (which may include many 'micro' businesses) may find that deferring relatively large outgoings actually creates a bigger problem.

- 4.12 Regarding the discussion on seasonal employers, while we do see some justification for at least further exploration into the notion of allowing such industry members to be able to use a once-monthly payment at certain times of the year, we agree that this may cause greater rather than less complexity overall. In addition, the fact that 91% of the horticultural sector would be covered under the new threshold should meet the needs of most.
- 4.13 Regarding other issues discussed, we agree that using employee count to determine once-monthly or twice-monthly payments should not be introduced, while the PAYE intermediary's subsidy should also increase from \$100,000 to \$250,000 for alignment purposes.
- 4.14 Overall, Business New Zealand supports the threshold change for paying PAYE and SSCWT deductions from \$100,000 to \$250,000, and given the cost to taxpayers will be a relatively small cost of \$8 million, the compliance cost saving overall should lead to a net economic benefit for the country.

Recommendation: That increasing the threshold for paying PAYE deductions once a month from \$100,000 to \$250,000 proceeds.

Filing FBT Returns Annually

- 4.15 The document outlines the proposal to increase the threshold for tax payers allowed to submit an annual rather than quarterly FBT from \$100,000 where to \$250,000. This proposal was also outlined in the Business Tax Review discussion document, where it was generally supported by various submitters.
- 4.16 At that time, Business New Zealand stated that given the proposal was not expected to change aggregate tax collections in any fiscal year, just the time value of money to the value of approximately \$4 million a year, this proposal should go ahead.
- 4.17 Although FBT tends to be lesser of a priority for SMEs when examining figure 2 above, there are still groups of SME employers who struggle with the administrative issues associated with FBT, and would welcome a significant fall from having to file four times a year down to once (estimating at affecting 3,000 employers).
- 4.18 However, like PAYE deductions, there may be some businesses who like regulatory of paying FBT quarterly due to familiarity of process or even record keeping discipline. Those who fall within the threshold for filing FBT returns annually should still have the option of filing quarterly if requested.
- 4.19 Overall, Business New Zealand believes the increase in the threshold is a step in the right direction.

Recommendation: That increasing the threshold for filing FBT returns annually from \$100,000 to \$250,000 proceeds.

Provisional Tax Use-of-Money Interest Safe Harbour

- 4.20 Under the standard uplift method for calculating provisional tax, the Government proposes lifting the amount in which no use-of-money interest is payable if their residual income tax is less than a certain amount, currently \$35,000. The proposed increase would take that value to \$50,000, meaning 243,000 (or 97% of all individual provisional taxpayers) rather than 238,000 (or 95%) could potentially rely on the use-of-money interest safe harbour threshold.
- 4.21 Business New Zealand agrees that estimating residual income tax can be difficult, and can often become a substantive compliance cost for SMEs, not to mention the penalty cost due to incorrect forecasting. Our view is that the vast majority of employers do their best to ensure the accuracy of their estimations, and incorrect projections should not automatically incur a sometimes hefty penalty.
- 4.22 This option has no additional expense cost for taxpayers, as it would simply lower those who would otherwise have to pay penalties on inaccurate financial information. Therefore, we cannot see any reason why this should not proceed.

Recommendation: That increasing the threshold for use-of-money interest safe harbour from \$35,000 to \$50,000 proceeds.

GST Registration

- 4.23 The document outlines the proposal for increasing the registration threshold for GST from \$40,000 to \$50,000, which they estimate would allow around 24,000 taxpayers to exit the GST base if they wish to do so. The last change was in 2000, which had previously been \$30,000. At \$40,000, the threshold in New Zealand is low by international standards, especially since Australia recently increased their threshold to AUS\$75,000.
- 4.24 Unlike the proposals outlined above, there are potential disadvantages to consider when looking to increase the registration threshold for GST, which the document notes. These include a substantial reduction in the GST base to the cost of around \$15 million per year, which may lead to a need to increase taxes in other areas. Also, there may be increased compliance implications for various businesses involving determining the supplies that did or did not give rise to input tax deductibility.
- 4.25 Regarding the loss of tax revenue, Business New Zealand regards this as of only a minor concern. Current and projected records show healthy surpluses for the Government, which would probably mean spending in other areas would not need to be sacrificed. Furthermore, the \$15 million is probably projected on the fact that every business that could now de-register would do so. There may be cases where businesses may not choose to de-register, given the relationship with other businesses in terms of supply that are registered as outlined above. Not having to deal with compliance issues relating to GST issues would also free up various businesses to spend time

growing their operations, which in turn has the potential to bring in increased tax revenue for the Government. Therefore, a figure of \$15 million would represent the maximum, rather than probable loss.

- 4.26 While the Business NZ KPMG Compliance Cost survey show GST as a tax issue further down the priority listing compared with other issues, it has still shown an overall increase in compliance for all SME groups by FTE size. Therefore, changes to ease the compliance cost load for SMEs in this area are welcome.
- 4.27 Overall, Business New Zealand supports increasing the GST registration threshold from \$40,000 to \$50,000, and we would not be adverse to even higher threshold increases if that is the general sentiment by submitters in the taxation consulting industry.

Recommendation: That the GST threshold be increased from \$40,000 to \$50,000, with further threshold increases welcomed if supported by the majority of submitters.

GST Six-Monthly Return Filing

- 4.28 Given businesses that have a turnover of less than \$250,000 may elect to file returns every six months, the document proposes doubling that threshold to \$500,000, which would capture an additional 58,000 taxpayers having the option of filing six-monthly.
- 4.29 However, it is interesting to note that while 400,000 taxpayers are eligible to file GST every six months with the current threshold value, only one-third do so, primarily because of other benefits such as earlier input tax credit entitlement, easier cash-flow management and use of the GST-ratio method for calculating provisional tax.
- 4.30 The cost of doubling the threshold is estimated in the document to cost the taxpayer around \$12 million per year. However, it does not say whether this figure is based on all 58,000 converting over to a six-monthly regime, or just one-third as is evident with existing taxpayers eligible for the six-month option.
- 4.31 While Business New Zealand does not oppose increasing the threshold from \$250,000 to \$500,000, we view this as a lesser priority compared with the other proposals outlined. Also, given the fact that two-thirds of existing eligible taxpayers have not taken up the option for various reasons may mean this option does not provide the level of compliance cost reduction that other initiatives could.

Recommendation: Business New Zealand does not oppose an increase in the threshold for filing GST returns six-monthly from \$250,000 to \$500,000, but we would view this proposal as a lesser priority for change.

GST Change-in-Use Adjustments

- 4.32 The document examines the possibility of changes to one of the thresholds concerning assets (goods or services) acquired or produced by a GST-registered person that are used for making exempt supplies so that no output tax adjustment needs to be made. An exemption is available if the total value of exempt supplies over a 12 month period does not exceed the lesser of \$90,000, or 5% of the total of all supplies made (taxable and exempt) in the 12-month period.
- 4.33 The document proposes an increase in the monetary threshold from \$90,000 to \$100,000, at an estimated cost to the taxpayer of around \$24 million a year.
- 4.34 Like the changes to filing GST returns six-monthly, we would view this as one of the lesser priorities for change. A better approach for making GST output tax change-in-use adjustments more compliant cost light may instead be to remove the monetary threshold altogether, so that it is just based on not exceeding 5% of the total of all supplies made in a 12 month period. Obviously, we would not be in a position to know the additional cost of this amendment, but we believe it would be worth exploring in an attempt to provide bolder initiatives to reduce compliance costs for SMEs.

Recommendation: Business New Zealand does not oppose an increase in the threshold for GST change-in-use adjustments from \$90,000 to \$100,000, however, an exemption solely based on a 5% cap of the total of all supplies made in a 12 month period should be further considered.

Accounting Basis for GST

- 4.35 Although the document states that any changes to the thresholds regarding the way in which a person accounts for GST (via a payments, invoice or hybrid basis) is not considered under this document, we would like to endorse moves outlined to review GST accounting bases at a later date. We would hope that such a review takes place sooner rather than later, especially since the \$1.3 million threshold for the payments basis has not changed since October 2000 (when it was raised from \$1 million).

Low-value Trading Stock Valuation Rules

- 4.36 As the document points out, there are various small businesses that do not sell stock as their primary activity, e.g. plumbers and electricians who normally carry out a service activity with a small amount of stock on hand to avoid additional trips to pick up parts. Therefore, the financial rules regarding valuing stock on hand at each balance date in order to calculate the cost of sales for the year for tax purposes should not really apply to such businesses.
- 4.37 The current exemption of having to calculate its stock value at year-end for businesses with turnover of \$1.3 million or less per year that reasonably estimates their closing stock worth less than \$5,000 is useful, and Business New Zealand would support an increase in the stock threshold figure to

\$10,000. This would ensure additional businesses would not have to comply with the record-keeping requirements, without any cost to the taxpayer.

Recommendation: That the low-value trading stock valuation rules threshold be increased from \$5,000 to \$10,000, and proceed no matter what the final outcome of the review as there is no end cost to the taxpayer.

Introduction of a Single Threshold for Certain Concessions

- 4.38 The document proposes the notion of a single threshold for concessions associated with being classified as a small business, such as that used in Australia. While PAYE & SSCWT deductions, along with number of employers would not be viable as threshold choices, turnover may instead provide a better measure of the size of the business (although not without issues itself such as problems relating to profit ratios as evidenced with the petrol station versus a self-employed professional service firm).
- 4.39 In Australia, turnover of less than \$2 million means a business is eligible for a variety of concessions, which a business can choose whether to apply or not. However, as pointed out, if a similar regime was introduced in New Zealand, the ability to choose to apply or not apply each concession would quickly erode the simplification benefits, while the incentive to remain under the single threshold would be stronger so as to prevent the increased compliance cost issues once the threshold has been breached.
- 4.40 Business New Zealand supports the flexible approach outlined in the document to rectify these concerns via the establishment of two parallel schemes. This would involve one where taxpayers that satisfy the single threshold would be eligible for all the concessions available under that rule, while taxpayers that failed to satisfy the standardised threshold would still be eligible to access individual concessions if they satisfied the relevant individual thresholds.
- 4.41 Lastly, while a figure of \$1.3 million is discussed as an example for the single threshold limit, we would hope that given the AUS\$2 million currently in place in Australia, a similar figure is arrived at in New Zealand for not only compliance but competitive purposes.

Recommendation: That the introduction of a single overall threshold for certain tax concessions proceeds, along with the establishment of two parallel schemes.

5. PULLING IT ALL TOGETHER – KEY THRESHOLD PRIORITIES

- 5.1 Table 3 below shows the ranking Business New Zealand puts to the various proposals outlined for thresholds in the document. Our primary priority is an immediate reduction in the top personal tax rate. The remaining proposals are ranked in order, along with proposals that should take place regardless of the outcomes of the review.

Table 3: Business New Zealand’s Summary Ranking of Threshold Proposals

Priority	Proposal	Estimated Maximum Cost per Year
Highest Priority	Lowering of the top personal tax rate	
Secondary Priorities	Threshold for PAYE filing once a month increased from \$100k to \$250k	\$8 million per year
	Threshold for filing FBT returns annually increased from \$100,000 to \$250,000	\$4 million per year
	Threshold for GST registration increased from \$40,000 to \$50,000	\$15 million per year
	Consideration of a single threshold for concessions	
Lower Priorities	Threshold for filing GST returns six-monthly increased from \$250,000 to \$500,000	\$12 million per year
	Monetary threshold for GST change-in-use adjustments increased from \$90,000 to \$100,000	\$24 million per year
Should Automatically Take Place Regardless	Threshold for low-value trading stock valuation rules increased from \$5,000 to \$10,000	\$0
	Threshold for use-of-money interest safe harbour increased from \$35,000 to \$50,000	\$0

5.2 Collectively, the threshold proposals outlined in the document that have been costed would involve a maximum of around \$63 million for the taxpayer. Given findings of the annual Business NZ KPMG Compliance Cost survey show that tax compliance on average was \$11,592 per business, and at last count 126,127 businesses employ at least one staff member², total tax compliance cost would come to roughly \$1.5 billion for businesses employing staff. If only 10% of that cost was due to some of the threshold issues discussed in the document that would still equate to \$150 million. Therefore, we would expect a net economic gain for the country, especially once the economic gains are considered in a dynamic, rather than static sense.

5.3 Overall, Business New Zealand believes that despite our preferred answer via significant personal tax rate changes towards a flatter, broad based structure, the threshold changes proposed generally provide ways in which further reductions on compliance costs can occur for an increased proportion of SMEs.

² Business Demography Statistics, SNZ, 2006

APPENDIX

6. About Business New Zealand

- 6.1 Encompassing four regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 70-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.
- 6.2 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.
- 6.3 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.