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BusinessNZ
GROWING PROSPERITY AND POTENTIAL

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Expenditure & Finance Committee
Parliament Buildings
Wellington

Dear Committee Members

Re: Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters Bill)

BusinessNZ wishes to submit on certain aspects of the *Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters Bill,* referred to as 'the Bill'). Our primary focus is on the proposed changes to PAYE rules and how these will be most likely to affect the small to medium sized businesses that make up a significant proportion of our membership.

Background
BusinessNZ submitted on the *'Making Tax Simpler – Better Administration of PAYE & GST'* Paper (referred to as 'the Paper') in February 2016, concentrating on those issues with more direct bearing on the day-to-day dealings of business with the tax system. While there were certain recommendations we agreed with, there were others we believed would cause problems, either through increased compliance costs or other unintended consequences.

Therefore, we would like to submit on six aspects of the current Bill.

1. <u>Requiring employers to provide PAYE information to Inland Revenue on a payday basis</u>

The Bill proposes requiring employers to provide Inland Revenue with information about their employees' income and deductions on a payday basis, rather than on the current monthly basis. Specifically, employers over the threshold for mandatory electronic filing, employers using payroll software, and payroll intermediaries will have to provide this information within two working days of payday, while employers below the threshold for mandatory electronic filing not using payroll software and employers exempted by the Commissioner because they are unable to access digital services will have seven working days from payday.

Overall, BusinessNZ has few concerns about those who move to a two working days of payday format. This is simply due to the fact that most of these employers will obviously be using electronic means for payroll purposes so that the requirement to send the correct information through to IRD within two working days should not be too onerous.

However we question the ability of paper-based businesses – mainly SMEs – that fall under the threshold, to provide IRD with the required information within seven working days. There are myriad reasons why many SMEs will find themselves unable to comply including, in no particular order:

- Despite New Zealand Post's best intentions, there can be no guarantee that the relevant information will be delivered to the IRD within the seven day requirement.
- The compliance burden for those businesses under the threshold is relatively larger than for those who have to meet the two-day format.
- For many small businesses it is the owner/employer who manages all payroll matters. Therefore the increased frequency of the new requirements is likely to have negative implications for business planning, not to mention the owner's/employer's ability to take leave etc.
- Problems will be compounded for businesses that pay weekly (or in even shorter timeframes).

In relation to the above, the Regulatory Impact Statement (RIS) regarding the PAYE changes states that *'The Government is committed to making positive changes to reduce the time and costs to employers of meeting their tax obligations, it also seeks more useful and timely PAYE information to improve the administration of social policy and support wider improvements to public services'*. BusinessNZ accepts that in various respects there will be benefits/costs for both business and government arising from the broad Business Transformation programme IRD has undertaken. But as we have previously indicated to IRD, the end outcome should be a clear and measurable net benefit to the business community, otherwise the overall programme would not have our support.

Currently, it is clear the primary benefactor of the proposed payday information changes is not the wider business community but government. One could argue that technological take up could mitigate some problems. However, placing an additional compliance cost on a significant section of the business community begs the question as to what future net tax compliance benefits the business community will receive, ensuring the scheme's broad objectives are achieved. At this stage we are struggling to see what those benefits would be.

Timing of changes

In relation to PAYE information being sent on a payday basis, BusinessNZ also notes the Bill proposes reporting on a payday basis becoming permissible from 1 April 2018 but mandatory from 1 April 2019. While we acknowledge that having a year's grace for SMEs is positive, it still does not hide the fact that this will be a looming compliance cost for many SMEs down the track.

Recommendation: That the proposal to require employers below the mandatory electronic filing threshold to provide PAYE information to the IRD within 7 working days does not proceed until such time as the business

community is aware of the overall net benefits and/or costs of the total Business Transformation programme.

2. <u>Lowering the threshold for mandatory electronic filing of PAYE information</u>

The Bill proposes lowering the threshold for mandatory electronic filing of PAYE information from $100,000 of PAYE and the employer's superannuation contribution tax (ESCT) in the preceding tax year to $50,000, as from 1 April 2019. This was recommended in the IRD's earlier discussion document, about which we outlined significant concerns.

While we have no issue with continuing to base the threshold on the value of PAYE and ESCT deductions, we noted in our submission on the discussion document that the ability to make a judgement call on whether a reduction in the threshold by half should proceed was clouded by the fact there was no indication whether the actual number of businesses required to file electronically would change to any great degree.

At the time, the discussion document stated that 60 percent of businesses not required to file their ESCT electronically do so anyway. Therefore, those between $50,000 and $100,000 might already constitute the vast bulk of that 60 percent. If so, then it would appear that what is proposed has already largely been achieved and therefore in reality, very little would change.

With the lack of guidance as to whether a drop from $100,000 to $50,000 would make any material difference, we believed it would be more beneficial if any decision on the future PAYE threshold was not made until submitters had a better understanding of likely significant changes to PAYE processes. These could then be taken into account when examining a revised threshold.

Subsequently, pages 28 and 29 of the RIS outlined the number of employers caught by both a $50,000 and $100,000 per year of PAYE and ESCT threshold, helping to provide some guidance. The following tables in the RIS outlining the four options considered, and the effect of each on the set criteria, provide valuable insights into the best overall options not only from a government perspective but also for the business community. Therefore, it is interesting to note that the proposal to lower the threshold to $50,000 is not what Inland Revenue officials recommended as the primary option going forward. Instead, IRD clearly recommended option two, namely that the PAYE threshold should be set at $100,000.

Running through the various benefits and impacts of the four options examined in the RIS, it is clear that option two provides the best overall benefit to the business community - a key factor given one the primary aims of the Business Transformation programme is to reduce tax compliance costs for businesses. In comparison, option three that recommended reducing the threshold to $50,000 has a greater benefit to government than the business community. The RIS also notes that option 3 will have *"one off costs and cash flow impact"* that *"may adversely impact on small* *employers"*. Therefore, BusinessNZ recommends that the advice of officials is accepted and the PAYE threshold remains at $100,000.

Recommendation: That the threshold for mandatory electronic filing of PAYE information remains at $100,000.

3. <u>Information about new and departing employees</u>

The Bill proposes that employers be required to provide IRD with information about new and departing employees no later than the next return of payday information. To help ensure identity is correctly assigned, the Bill proposes requiring employers to obtain date of birth information from new employees and pass it on to the Department.

As BusinessNZ pointed out in its submission on the IRD paper when this proposal was first outlined, the primary reason for requiring an employee's date of birth may, at first glance, appear to be compelling, providing, as it does, evidence not only for PAYE purposes but in relation to child support and KiwiSaver contributions as well.

In principle, BusinessNZ believes some employee information should remain private, although there will be a number of factors to consider when determining what is private and what is not. From our own perspective, we would be concerned if employee information shared with the employer could potentially damage the employment relationship and/or put the employer into any type of difficult or risky position.

While BusinessNZ understands employers have the right to ask for an employee's date of birth for tax purposes, this does not make the task any easier for those with staff who are very protective of their age. It would obviously put many in a difficult position and would not enhance the working relationship. Therefore, although we support the provision of the employee's date of birth, we do not support a requirement for it to be provided to the IRD via the employer.

Consequently we are pleased to see the statement in Schedule 4 of the proposed Bill (row 6 of table 2), that in regards to information about new employees, the requirement is *'The date of birth of the employee, if supplied to the employer'*. As stated above, there may be a variety of reasons why employees do not want to provide their date of birth to the employer, so BusinessNZ supports legislation that does not make it a mandatory employer undertaking to ascertain employees' birth dates.

Recommendation: That row 6 in table 2 (information about new employees) of schedule 4 of the Bill proceeds with the words 'The date of birth of the employee, if supplied to the employer'.

4. Abolition of the payroll subsidy

As a background, BusinessNZ does not support subsidies or tax credit schemes in New Zealand. For instance, we do not support R&D tax credits, given much of the spending purported to be for R&D purposes in reality ends up being spent under a different guise. In essence, such schemes could essentially be 'gamed' to maximise the tax credits available to the enterprise. Likewise with subsidies, we would question why these are made available and whether they don't end up becoming a crux for those in the business community receiving them.

When in 2003 the Government first put forward the idea of a payroll subsidy, BusinessNZ supported the move, particularly given that as soon as a small business employs its first person its contact with IRD, and its compliance costs skyrocket. In light of this, encouraging the use of payroll agents would probably be the most effective way to address the issue. However, we also pointed out at the time that although we supported the proposal, the fact that it was considered necessary was something of an indictment of how complicated the tax system had become. Also, we pointed out that the cost of the proposal should not preclude other tax simplification initiatives from being progressed, since that was the better way to reduce tax compliance costs overall.

If we fast forward to 2008 when the scheme was reviewed, BusinessNZ recommended the number of employees covered by the subsidy of payroll agents be lifted from five to ten employees, subject to a cut off of $100,000 PAYE liability. This was preferred to the other two options of extending the subsidy application to other taxes and increasing the rate of subsidy. Despite our recommendation, the proposal was not taken up. Instead, the payroll subsidy threshold was lifted from $100,000 a year of PAYE and ESCT to $500,000 a year. In our view, while this meant 98% of employers at the time were eligible for the payroll subsidy, it did not properly target those employers who required it most, namely small-sized businesses with up to 10 staff.

From BusinessNZ's perspective, there are two issues at play. First, we do not believe the payroll subsidy should be something that lasts in perpetuity. If we simply look at technological advancement say between 2003 when the subsidy was first introduced and today, the situation now is very different. This kind of change will only continue, and with ongoing advancement in terms of sophisticated options to assist businesses with their tax obligations, one could rightly argue that in the near future a payroll subsidy will not be required.

However, as stated above regarding the provision of PAYE information on a payday basis, BusinessNZ is concerned that at present there is little in the proposed changes that materially benefits New Zealand businesses in relation to tax compliance cost reduction. While future announcements may assist in reducing the tax compliance burden the business community faces, for now the current Bill simply provides some businesses, at best, with marginal to indifferent benefits. On the other hand, many SMEs will have additional responsibilities in terms of their tax obligations. Whether future benefits will more than cover the additional compliance costs placed on small businesses remains to be seen.

Therefore, at a practical level we question the timing of the payroll subsidy removal. Instead, BusinessNZ believes the possible removal of the subsidy would be better examined once all significant tax compliance changes have been passed and the business community has had some time to understand and comply with the new settings. Given the timeframes discussed in the Bill, we believe any steps to remove the payroll subsidy should only be taken after a period of 2-5 years.

Recommendation: That any steps towards the removal of the payroll subsidy are not taken until 1 April 2019 at the earliest, or until such time as the major tax changes through the Business Transformation programme have bedded down.

5. Taxation of employee share schemes: exempt share schemes

While we believe that modernisation of the exempt share scheme regime is a step in the right direction, the removal of the employers ability to claim a tax deduction for the cost of purchasing and providing shares means that this regime is not actually concessionary. From our perspective, we want to ensure that the changes enhance, not reduce, the use of employee share schemes given such schemes play a key role in attracting and retaining the best talent, boosting productivity and ensuring staff retention.

Therefore, BusinessNZ does not support the removal of the employers ability to take deductions, and in particular does not support this change in law being made effective from the date of introduction of the Bill.

Recommendation: That the removal of the employers ability to take deductions in relation to exempt share schemes does not proceed.

6. Frequency of investment income information

While BusinessNZ broadly appreciates the intent of the proposed changes to investment income information, we have concerns around proposals for more frequent and comprehensive collection of investment income information. Specifically, we are unsure as to whether Inland Revenue have considered the potential wide range of taxpayers that will be made to provide information on a monthly basis to Inland Revenue.

Our understanding of the proposed legislation is that it will not only capture large financial institutions, but also many individual taxpayers and SMEs. Therefore, we would question whether the frequency of information is worth the additional compliance costs placed on these groups. Instead, BusinessNZ would want to see better targeting of these proposals, so as to ensure individuals and SMEs are not burdened with regular and increased compliance costs.

Recommendation: That the proposals around regular provision of investment income information are better targeted towards those receiving an amount of investment income above a minimum threshold level.

Thank you for the opportunity to submit.

Kind regards,

Kirk Hope
Chief Executive
BusinessNZ