

1 October 2003

'MAKING TAX EASIER FOR SMALL BUSINESSES' – TAX SIMPLIFICATION DISCUSSION DOCUMENT

TIANZ has reproduced this material which was produced by Business New Zealand for use by organizations affiliated to Business New Zealand.

On 17 September the Government released a discussion document on tax simplification, 'Making Tax Easier for Small Businesses'. Copies of the full document may be downloaded from the IRD website at www.taxpolicy.ird.govt.nz. Submissions are due by 31 October 2003.

The following is a summary of the steps proposed by central government, some advantages and disadvantages. There are also some questions we would like you to consider. Please take some time to send your responses to these questions to TIANZ Policy Manager David Barnes at email: david.barnes@tianz.org.nz

1. Covering Part of Cost of Payroll Agent for First 5 Employees

The Government proposes to cover part of the costs that small employers incur when they use a payroll agent to take over their PAYE and other government-imposed payroll obligations (e.g., child support, student loan repayments etc). The subsidy would apply to as many as five employees per business.

The Government would contract with payroll agents and pay the subsidy directly to those agents – payroll agents would largely be paid by the Government to help small employers with their PAYE and other obligations.

Government departments would interact directly with an employer's payroll agent rather than the employer, thus freeing the employer to spend more time on the business while giving the employer access to specialist payroll resources. It is possible that over time scheme could be extended to cover other compliance cost areas such as Statistics NZ surveys, ACC etc. Payroll agents could eventually become 'one-stop compliance shops'.

The scheme would be voluntary – small employers could still choose whether to use a payroll agent or do the work themselves.

The scheme would be open to those employers with less than \$100,000 annual PAYE liability – around 93% of employers. For 71% of employers, the cost of using payroll

agents would be free (i.e., they have 5 or fewer employees). The remaining 22% would benefit by having part of the cost of using payroll agents covered.

The cost to the Government of providing the subsidy will depend on the uptake of the scheme by employers, the frequency their employees are paid, the composition of employers, and the amount per employee that a payroll agent is paid. The Government's best estimate of the cost is around \$40 million, but there is a high degree of uncertainty, with a possible range of between \$5 million-\$80 million.

Benefits of the proposal include:

- Increased accuracy of pay and PAYE calculations;
- Reduced risk of PAYE payment default;
- Small employers would have more time for running and growing their businesses;
- Reduced bias against those with child support and student loan obligations; and
- More efficient communication, including greater uptake of electronic communications.

Risks of the proposal:

- Government subsidy might not be passed on through lower or no fees for small employers – IRD would seek to address this through contracts with agents;
- Businesses using a payroll agent would lose the financial benefit of keeping PAYE deductions until they are paid to IRD;
- Subsidy might distort the market by encouraging the use of agents over alternatives, such as payroll software;
- Individual employers may feel 'locked into' using a payroll agent; and
- Payroll agent could still default on a significant tax payment.

Questions

1. *Would this proposal benefit significantly small employers?*
2. *What are the costs for small businesses using tax agents?*
3. *Would small employers feel locked into using as payroll agent?*
4. *Would the costs incurred in the event of the number of employees increasing beyond the level of government subsidy discourage small businesses from expanding?*

2. Paying Provisional Tax and GST on the Same Date

At present provisional tax is paid in three large installments and most pay GST every two or six months. The Government's research has indicated that many small businesses would prefer to pay provisional tax more frequently, to help with their budgeting, and relatively few wanted to reduce their GST filing frequency. Around 79% of all businesses (and 87% of small businesses) supported a single payment date for all taxes.

The Government has suggested aligning the payment dates of GST and provisional tax to the 28th day of the month payments are due, as follows:

- Businesses that pay GST every two months would pay provisional tax every two months.
- Businesses that pay GST every six months would pay provisional tax every six months.
- Businesses that pay GST monthly would pay provisional tax every two months.
- Businesses and individuals that are not registered for GST and earn over \$1.3 million a year would pay provisional tax every two months.
- Other businesses and individuals that are not registered for GST would pay provisional tax every six months.

This would result in many businesses making more frequent but smaller provisional tax payments.

Benefits of the proposal:

- More frequent and smaller payments of provisional tax would make payments easier to budget for – especially for smaller businesses that have less than perfect accounting systems and tight cash flows.
- There would be fewer payment dates to remember.

Risks of the proposal:

- Many businesses, including large businesses, would pay provisional tax more frequently – this means they would have use of money for business purposes for shorter periods and there might be higher compliance costs for some.
- It could create complications for those businesses that prepare their own GST returns but hire an accountant to do their provisional tax returns.
- Change would require a considerable communications effort.

These proposals will suit some but not others. Clearly, what would suit small businesses might not suit larger ones. Your views on the tradeoffs involved would be appreciated.

Questions

5. *Should provisional tax be paid along with GST? If not, how could the proposal be improved to make it more attractive?*
6. *Is the 28th of the month an appropriate date for payment of GST and provisional tax?*
7. *Would those paying GST six-monthly or not registered for GST face problems paying provisional tax twice a year instead of three times per year?*
8. *Would six-monthly GST filers that file on dates other than October or April prefer filing dates for provisional tax to be aligned with balance date for income tax?*

Basing Provisional Tax Payments on GST Turnover

Many small businesses, especially those with seasonal income, have a problem where three large provisional tax payments do not always match their income flow. These businesses can be liable for large charges of use of money interest if they underestimate the tax due.

One solution would be for these businesses to base their provisional tax payments on a percentage of their GST turnover – this would be possible if payment dates for provisional tax and GST were aligned (as discussed above).

There are two options for basing provisional tax on GST turnover:

- A simple percentage of GST turnover; or
- A percentage of GST turnover plus other forms of income (not subject to GST) – a more complex but more accurate procedure.

The Government proposes that this would be voluntary and that those who choose not to base their provisional tax on GST would still be able to choose between using the ‘standard’ and ‘estimation’ methods.

Businesses that based their provisional tax on GST would not be charged use-of-money interest if they had underpaid and would not be paid use-of-money interest if they overpaid.

This proposal would be limited to those businesses with annual turnover of less than \$1.3 million. It would also be limited to businesses in which the same entity paid both income tax and GST.

Benefits of the proposal:

- Tax payments made during the year would be more closely aligned with when a business earned the income, which could also reduce its end-of-year tax liability.
- Provide greater certainty for taxpayers with seasonal income and could reduce the need for businesses to re-estimate their provisional tax liability and reduce borrowing costs to finance tax payments.
- Better reflect a business’s cash flow – e.g., tax would reduce during a period of downturn without need to make re-estimation (and vice versa).

Risks of the proposal:

- If the ratio selected were incorrect the business would still end up overpaying or underpaying tax.
- Possibility of abuse through deferring tax rather than improving accuracy.
- In some cases, this method could make the calculation of provisional tax more complicated.

Questions

9. *Would this proposal provide a good balance between ensuring taxpayers who have seasonal income can qualify and preventing abuse of the system?*

10. *Are the sanctions for non-payment of provisional tax an effective deterrent to abuse?*
11. *Would it be possible to link GST and provisional tax for those entities that are GST registered but another entity pays provisional tax?*
12. *Would the additional compliance costs in basing the calculation of GST-adjusted sales outweigh the increased accuracy of provisional tax payments from undertaking income adjustments?*

4 Discount for Self-Employed People Who Pay Provisional Tax in Their First Year of Business

Self employed people do not have to pay provisional tax in their first year of business, instead paying tax on their first year's income in their second year of business, when they are also paying tax for that second year – this can be a real strain for new small businesses.

The Government is proposing an incentive for self-employed people to make voluntary payments of tax at any point during their first year of business. The incentive would be a discount of 6.7% for each dollar of tax paid in the first year, with the discount calculated when the business's end-of-year tax bill is prepared. It could be claimed in a year chosen by the business.

Research has indicated that many small businesses would have taken up this option if it had been available when they started.

Benefits of the proposal:

- People would be encouraged to pay tax earlier, thus relieving them of a double payment later.

Risks of the proposal:

- Each payment of tax in the difficult first year of business could create problems for businesses that need the cash in that first year.

Questions:

13. *Would a 6.7% discount (net of tax) be effective in encouraging small businesses to pay provisional tax in their first year of business?*
14. *Should other measures to encourage payment in the first year be considered?*

5. Electronic Tools to Answer Questions on Employment and Residence Status

IRD suggests that it could provide on-line tools to clarify employment and residence status, which it believes would reduce compliance costs for employers. However, there are also risks in that the determination could be used for non-tax purposes (e.g.,

employment issues) so the questions would need to be framed very carefully and that if there is any doubt the response should advise the employer to consult expert advice.

Question:

15. *Would you support the availability of on-line tools to clarify employment and residence status?*

Email your comments to David Barnes at TIANZ by 10 October 2003 by email:
davidb@tianz.org.nz