

Tax Alert

Special update – April 2016



Government announces measures to make tax simpler

On 13 April 2016, as part of the Business Growth Agenda, the Government announced a raft of tax changes which will have an effect on businesses both small and large.

The changes that are likely to impact positively on many taxpayers are in relation to provisional tax and use of money interest regimes. As a result, many businesses will soon fall outside of the use of money interest regime, while small and medium sized businesses will be able to pay provisional tax based on accounting income on a real-time basis (i.e. aligning tax payments with when income is earned).

To ensure more people are meeting their tax obligations, amendments are also being made to how withholding tax applies to contractors. New rules will provide greater flexibility for contractors to have more accurate tax withheld throughout the year. Certain contractors will also be brought within the withholding tax net if they are providing services through a labour-hire firm – these changes are intended to reduce opportunities for contractors to evade tax and child support obligations or inappropriately qualify for benefits.

Other initiatives announced are:

- Removing incremental late payment penalties from GST, provisional tax, income tax and working for families tax credits;
- Removing the requirement for RWT certificates of exemption to be renewed annually;
- Increasing the self-correction threshold for tax errors from \$500 to \$1000;
- Increasing the threshold to allow more taxpayers to pay FBT annually rather than quarterly;
- Simplifying FBT for close companies who provide motor vehicles to shareholder-employees;
- Simplifying the process for businesses claiming deductions for use of motor vehicles and home office space;
- Sharing information about significant tax debts with credit reporting agencies; and
- Sharing information with the Companies Office.

There is a raft of fine detail contained within the 78 page officials' issues paper released, some of which may be refined further before making its way into legislation in August 2016. Most new initiatives will apply from 1 April 2017 (being the 2018 tax year).

Further details on the key changes are outlined below, followed with our thoughts on the proposals.

Provisional tax and use of money interest regimes

- Currently, individual taxpayers with residual income tax ("RIT") of less than \$50,000 are broadly not subject to use of money interest until terminal tax date, unless they have chosen to use the estimation method rather than the standard uplift method in order to calculate their provisional tax. This is more commonly referred to as the "safe harbour" threshold. It is proposed that this threshold be increased to \$60,000 and extended to all taxpayers. This is great news for trusts and companies.
- Use of money interest will be removed for the first two provisional tax instalments for all taxpayers who fall outside of the above safe harbour threshold and who use the standard uplift method to calculate and pay provisional tax. At the final instalment

taxpayers will be able to square up their provisional tax payments with what they expect actual RIT to be. Use of money interest will only apply from the third provisional tax instalment date if there is a shortfall at that point. As the third instalment is after year end it is expected that taxpayers should have an accurate idea of what the RIT for the year will be to allow an accurate payment to be made.

- Consistency requirements will be introduced for related parties and to prevent switching between methods in certain situations.
- Tax pooling can continue to be used.
- A new optional Accounting Income Method ("AIM") for calculating provisional tax is proposed for smaller taxpayers (provisional taxpayers with a turnover of \$5 million or less). This method will use accounting information generated by accounting software for a period as the basis for calculating the tax liability for the period. The idea is that the calculation and payment will be on a real-time basis and become part of running the business - instead of an extra process. This method will allow tax payments to match when income is earned, with the added benefit that if tax has been overpaid during the year the excess can be refunded immediately. At this stage the Government is inviting submissions on the AIM proposals, particularly on software providers' ability to build this capability and the threshold to applying the rules. This new regime will be available from the 2019 income year.

Deloitte comment

There is no doubt that the announcements are positive overall for both businesses of all sizes and individual taxpayers. It is pleasing to see that the Government has taken on board the feedback they have received from businesses that provisional tax is a bugbear for many. High amounts of stress can be caused by needing to accurately forecast annual profits months in advance and being subject to punitive interest charges if they get it wrong. The creation of payment options which remove interest charges from the mix is a great positive step.

There will be some upfront compliance costs for businesses as they get to understand the raft of additional optional rules which they can potentially apply, but with time businesses will likely settle on a provisional tax method which suits their needs. There are also a number of avoidance rules buried in the detail to ensure that taxpayers cannot "game" how the new rules will work. While there will always be some taxpayers who may seek to be "cute" in what they do, we question whether the extent of this risk is worth the additional complexity being proposed.

Deloitte comment (cont)

It is great to see that some of the provisional tax proposals will apply to all taxpayers, large and small. While the compliance burden falls hardest on small businesses, in monetary terms it is large businesses who can really feel the pain of use of money interest being applied when there are unexpected fluctuations in income (for example, the financial arrangement rules can still cause unexpected tax liabilities at year end when there are movements in foreign exchange rates or hedging positions).

The Accounting Income Method is designed to be a “pay-as-you-go” option for provisional tax. While this sounds conceptually appealing, it is likely there will be a higher level of complexity involved in undertaking regular tax calculations than the issues paper lets on. It will be critical here to develop a method where taxpayers are able to essentially “push a button” on their software to get an answer that Inland Revenue will accept, in order for the method to get widespread uptake. A major drawback of this method is that it is only intended to apply to taxpayers with a turnover of \$5 million or less. The turnover measure doesn’t allow high volume / low profit businesses (such as owner-operator supermarkets and petrol stations) to participate. Officials are interested in getting feedback on the threshold chosen and whether this method would also appeal to larger businesses. Note, this new method won’t be available until the 2019 tax year due to the additional complexity which needs to be worked through.

need to pay provisional tax. However, in some cases the Commissioner will still be able to prescribe a rate that must be used where a contractor has been non-compliant; or set a minimum rate (suggested to be 10%) so that it will not be possible to defer or avoid paying tax altogether.

- Where a contractor does not select a rate, it is proposed that a default rate of 20% will apply, and if a contractor does not provide an IRD number, a non-declaration flat rate of 45% will apply.
- The withholding tax rules will be extended to specifically cover all contractors operating through labour-hire firms. A labour hire arrangement is one where a firm arranges for workers to do work for clients and the labour-hire firm receives payment from the client and pays the worker themselves.

Deloitte comment

The changes around withholding taxes may not be popular with some parties, however the issues paper does highlight some examples of how the current rules have been abused and used by individuals to obtain social assistance they are not entitled to or to make lower child support payments than they should. Most people can probably appreciate the greater good of getting contractors back in the tax base and paying their fair share.

There may be some detail to be worked through to determine exactly what a “labour-hire arrangement” is as currently this appears to be quite a wide definition. The example in the issues paper suggests as an example that an IT company which is in the business of providing staff to assist other businesses with their projects will be subject to this rule. The devil will be in the legislative detail with regard to defining who will be subject to the labour-hire withholding tax rules, but this could potentially be a significant change for some businesses.

Withholding tax proposals

The Government is looking at modernising the withholding tax rules to make it easy for people to comply and self-manage their obligations. To this end it is proposed:

- Contractors will be allowed to select their own withholding tax rate without the need to make an application to Inland Revenue for a special tax code to alter a rate from the rate specified in the schedule for that industry. A contractor could therefore select a higher rate, so that the withholding is more closely matched to their final tax liability and eliminate the

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Sharing of information

- Some businesses with cash-flow issues are paying other creditors ahead of paying Inland Revenue because failing to pay the other creditors will affect their credit rating. It is proposed that Inland Revenue will be able to share information about outstanding tax debt in serious cases to credit reporting agencies, as currently this information is subject to secrecy rules and not permitted to be disclosed. If this proceeds, businesses providing credit will be able to make more informed commercial decisions and obtain a more comprehensive picture about a business' total debt position before deciding whether to provide credit. Submissions are invited on the criteria for reporting and the level of information to be disclosed.
- It is also proposed that Inland Revenue will be able to share certain information with the Companies office to improve the Registrar of Companies' ability to enforce serious offences under the Companies Act so that it can hold non-compliant business and directors responsible for breaching their corporate responsibilities.

Deloitte comment

These proposals to share information with credit agencies and the Companies Office are a significant change in the current secrecy rules that operate. Removing secrecy rules and improving transparency in serious cases is sensible provided the criteria for disclosure is clear. This will no doubt be welcomed by businesses that deal with debt ridden businesses, non-compliant companies and directors in ignorance.

Other proposals

- Currently when a tax payment is made late, an initial 1% penalty can be applied, followed by another 4% one-off penalty seven days after. Thereafter a monthly incremental penalty of 1% is imposed until payment. Use of money interest will also accrue. It is proposed to remove the incremental monthly penalty as it is considered that while late payment penalties usually do encourage taxpayers to pay on time, there is a point at which penalties and interest overwhelm small and medium businesses and cease to be effective or simply cannot be repaid using expected cash flow.
- The threshold for self-correcting errors in a subsequent income tax, FBT or GST return will be increased from \$500 to \$1,000 of tax. This is a welcome move which likely catches up with what happens in practice anyway.
- Currently taxpayers must adjust their tax calculations for any accruals of employment income (for example holiday pay accruals, bonuses etc.) which are not paid out by the end of the 63rd day after balance date. This typically involves a taxpayer undertaking additional compliance work to determine the deductible component. The Government proposes that taxpayers will be able to choose to simply add back the full accrual and not bother with the additional compliance of determining any deductible amount.



- Calculations for dual use of vehicles and home office are to be simplified. The current rule allowing taxpayers to deduct a fixed amount per kilometre travelled for business purposes based on mileage rates published by Inland Revenue will be extended so that it can apply regardless of kilometres travelled. For home office calculations, an optional single rate would be available for taxpayers to use for multiplying by the square metres of the business use area. The single rate would not cover rates, rental costs or mortgage interest as there is too much variability, so actual costs would still need to be used for those items in this calculation. However, officials recommend that a deduction of rent, interest and rates relating to home office use will only be able to be claimed where there is a separately identifiable part of the house which is primarily used for business purposes. Although this is normally calculated on this basis, it is not currently a strict requirement.
- Close companies that provide shareholder-employees with a motor vehicle for private use are generally required to pay FBT on that benefit, whereas sole traders and partners of partnerships simply apportion the expenditure between private and business use with the private element being non-deductible. It is proposed to allow close companies to opt out of paying FBT and apply the same apportionment rules (making it clear that the private non-deductible element is not a dividend for tax purposes).

Deloitte comment

Overall these initiatives should all be viewed positively by business, albeit they are largely tinkering at the margins. Inland Revenue has taken some time to consider the balance between tidying up areas of non-compliance while providing real pragmatic solutions to reducing compliance for business.

What will be interesting to see is whether this is just the beginning of a bigger programme of making tax simpler for businesses. One would hope so. The whole transformation of Inland Revenue's computer systems is a once in a generation opportunity to sort out rough edges which impact both sides of the tax net.

Submissions on these proposals close on 30 May 2016. For more information about these proposals please contact your usual Deloitte Tax Advisor.



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