Submission

By

BusinessNZ

to the

Inland Revenue Department

on

Public Issues Document for Future Company Income Tax Returns – An Issues Paper

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PUBLIC ISSUES DOCUMENT FOR FUTURE COMPANY INCOME TAX RETURNS
SUBMISSION BY BUSINESS NEW ZEALAND[1]
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1. INTRODUCTION

1.1 Business New Zealand welcomes the opportunity to comment on the *Public Issues Document for Future Company Income Tax Returns Issues Paper* (referred to as 'the Paper'). Overall, Business New Zealand agrees with the main thrust of what is being proposed, and we provide the following comments to ensure it has the best chance of success amongst the business community.

2. SUMMARY OF RECOMMENDATIONS

2.1 Business New Zealand makes the following **recommendations** with regard to the Paper, namely that:

(a) ***A differential reporting approach include four categories (p.3);***

(b) ***The criteria for selecting the four categories as outlined in chapter 4 of the Paper are accepted (p.4);***

(c) ***The turnover threshold for micro size enterprises increases to $50,000 if the June Tax Bill is passed in its current form (p.4);***

(d) ***IRD (and SNZ) establish a comprehensive education campaign to provide large companies with significant warning of increased reporting requirements (p.5);***

(e) ***Business New Zealand does not object to mandatory electronic filing of all companies by the start of the 2010/2011 tax year (p.6); and***

(f) ***Loss of the time bar, where information in the new return is of low quality, is considered only if IRD has provided a clear and concise indication of what is expected of companies in regard to the new return. (p.6).***

2.2 While the Paper asks a series of specific questions regarding the proposals outlined, we would like to take the opportunity to provide broader comments as outlined below.

3. IRD CONSULTATION

3.1 First, Business New Zealand would like to congratulate IRD on the high level of consultation that has already taken place regarding this issue. This is something we have come to expect from the Department. As should be the case with any significant policy change, the main players most likely to be affected should be consulted first, followed by a consultation document outlining proposals. The main findings should then shape any further policy decisions before moving to a proper regulatory decision. We are optimistic

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

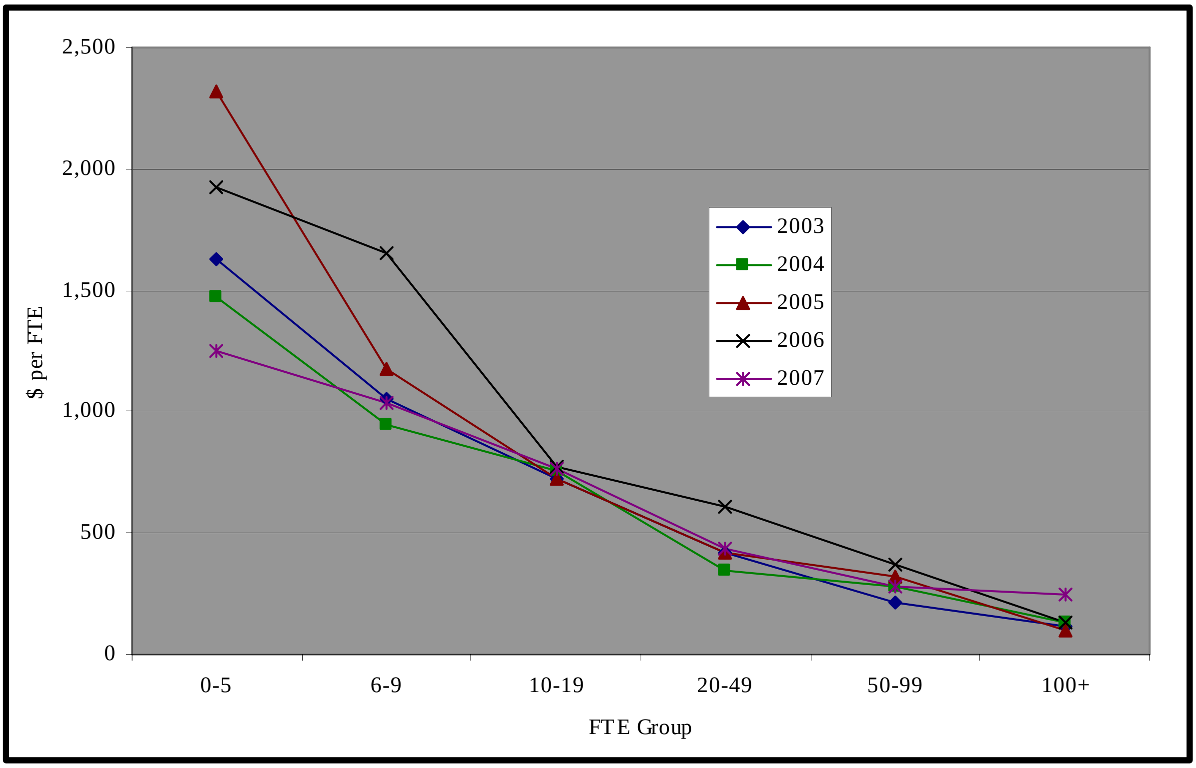
that the main views expressed by submitters will shape the policy framework further to ensure that the end goal of lowering compliance on enterprises is satisfactorily achieved.

4. DISCUSSION POINTS

4.1 Business New Zealand agrees that minimising tax compliance costs is an important matter for all businesses; however research suggests SMEs bear higher costs relative to larger businesses. Business New Zealand in association with KPMG has run the Business NZ/KPMG Compliance Cost Survey for five years, which clearly shows the relative cost of tax compliance being borne by SMEs (see figure 1).

4.2 If we take the average value for each FTE group over the five years the survey has been running, the 12:1 ratio for costs comparing the 0-5 and 100+ FTE groups is the largest of any of the four main compliance cost areas. Therefore, moves towards reducing the compliance costs associated with form filling 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)



Tailoring to Business Size

4.3 We agree with paragraph 3.2 of the Paper that in regard to filling in forms for tax specific and financial statement information, *"one size does not fit all"*, and that rationalisation of such forms is required to ensure future forms are versatile enough to take into account the size of the enterprise.

4.4 One of the specific questions asked in the paper involves whether the four categories are suitable, or whether they should be condensed down into two or three categories instead. While one could argue at the margins whether there should be 'one more or one less' in terms of categories, we believe it would be preferable to keep the existing framework of four categories for the following reasons.

4.5 There is little in the way of formal worldwide definitions for what are considered 'small', 'medium' and 'large' enterprises. However, New Zealand's business demographics also tend to lend themselves to including a 'micro' category.

4.6 The inclusion of a 'micro' category is fully justified from Business NZ's point of view for two primary reasons. First, if we were to view this from an FTE viewpoint, 86.8% of enterprises employ 5 or fewer people, while over 73% of those are self employed. Obviously, this represents a significant number of businesses. Second, as discussed above, figure 1 shows that the costs per FTE worker are considerably higher for small businesses based on FTE workers.

4.7 The graph on page 8 of the Paper clearly shows the greatest gains in terms of requiring less information are for 'micro' enterprises, which experience a 57% drop in the number of numerical data elements. This is followed by small enterprises, which will experience a 21% fall. Although one could argue that the smaller number of categories would mean less confusion about what businesses would exactly have to comply with, we would assume that the amalgamation of groups would see a lift in data requirements, which would no doubt come at the expense of the 'micro' group.

Recommendation: That a differential reporting approach include four categories.

Using Financial Criteria for Category Setting

4.8 The criteria used for the four categories as outlined in section 4.1 of the Paper focus on existing financial criteria via other Acts. There is no one measure to accurately categorise enterprises, although financial criteria and numbers of FTE workers are generally the leading indicators.

4.9 For instance, in the Ministry for Economic Development's (MED), annual report into *SMEs in New Zealand: Structure and Dynamics* publication, SMEs are defined as enterprises with 19 or fewer employees, so the breakdown is based on FTE workers. The same is done via the Business NZ KPMG Compliance Cost Survey as the preferred way in which to show the relative cost differences between businesses, where there are certainly differences in the costs of tax compliance by size of enterprise, with quite significant differences for the 0-5, 6-9 and 10-19 FTE group.

4.10 However, with any measure, there are advantages and disadvantages. Obviously, applying FTE workers as a measure for business size in relation to company income tax filing would obviously not be the best option, as there are companies with very low staff numbers, but with significant turnover and assets. Therefore, we agree with the recommended rationale, based on existing financial definitions as the best way forward.

Recommendation: That the criteria for selecting the four categories as outlined in chapter 4 of the Paper are accepted.

4.11 Regarding the question whether providing less information results in tangible benefits for smaller businesses, a consistent message we receive from our smaller members in particular concerns the amount of form filling that eats into their day-to-day activities. We would assume that a 57% reduction in the numerical data elements required of them for financial and tax filing would provide a tangible benefit for many. As well as the actual compliance costs, another cost which is often just as relevant but hard to measure is the 'psychic' cost associated with administrative requirements, which can be as simple as not being able to sleep at night because a business owner is concerned about whether they have filled in their forms correctly. A significant reduction in reporting requirements would hopefully ease any other costs that are not strictly time or monetary related.

4.12 On another note, we see that the turnover threshold for micro sized enterprises is based on the compulsory GST registration threshold of $40,000. Given the June Tax Bill seeks to increase that threshold to $50,000 by 1 April if passed, we assume there would be an associated adjustment for the micro enterprise criteria in the paper.

Recommendation: That the turnover threshold for micro size enterprises increases to $50,000 if the June Tax Bill is passed in its current form.

A Step towards Rationalising Information across Government

4.13 Business NZ strongly agrees with the views stated in 6.1 of the Paper that businesses should be able to view government as a whole, rather than as different agencies to whom they often have to provide the same information on repeated occasions. Links between departments to reduce information requirements are strongly welcomed, especially the links between IRD and Statistics New Zealand (SNZ), which are probably the two departments that "ask the most" across all businesses.

4.14 We note the trade-off between SNZ eliminating the requirement for the majority of businesses to supply the same annual financial statement information within two years of implementing the new return, and the requirement that large and complex businesses would most likely be required to provide more detailed information. On balance, we believe that the sizeable potential benefit for many enterprises that often do not have the capability and/or resources to compile information for government purposes would outweigh the additional requirements for large businesses, who in all likelihood would be able to cope better with the additional requirements.

4.15 Having said that, we would expect IRD and SNZ to work together to establish an effective communications programme to inform large companies well in advance of the additional requirements expected of them. This would not mean a simple leaflet handed out at the time the information is requested. Instead, this would involve a multi-faceted campaign, including significant advanced warning, as well as working through business organisations who can also convey the message to their members via newsletters, magazines, emails etc. Personal contact by IRD/SNZ to some of the major companies regarding this would also be beneficial.

Recommendation: That IRD (and SNZ) establish a comprehensive education campaign to provide large companies with significant warning of increased reporting requirements.

Electronic Filing

4.16 The paper states that 75% of companies file their income tax returns electronically, and propose mandating electronic filing for all companies from the 2010-2011 tax year. This would be consistent with the Companies Office, which require the majority of company information to be provided electronically from 1 July 2008.

4.17 Business New Zealand has traditionally taken the view that individual businesses are in the best position to decide what is right in terms of processes within their enterprise. Therefore, we usually side on the position of choice for an enterprise to accept a change, or remain within the status quo. However, for this issue we would not object to a mandatory switch to electronic filing for all enterprises, given the considerable benefits available to businesses. However, we would also want the following criteria to be met:

- All the real time support options as outlined in paragraph 7.4 of the paper are carried out, and done in consultation with individual businesses and business organisations when draft options are put together;

- Related forms that are part of filing are also available in an electronic format, so there is complete coverage for business filing; and

- If for any reason the original tax year of implementation (2010-2011) may not be feasible, it is pushed out to ensure minimal problems arising from not being fully prepared.

4.18 Of the remaining concerns raised in the paper by those not filing electronically, we would assume IRD would find a suitable solution regarding reviews, sign-offs and record keeping via electronic means. Also, by 2010-2011, we would assume almost all businesses would have the technological means to access the Internet to file electronically.

4.19 In addition, to avoid complications, the transition period should apply for all companies. We take this view because while electronic filing would benefit all businesses, the proposed regime would tend to benefit smaller businesses more, and that is where the greatest collective gains could be made.

Recommendation: Business New Zealand does not object to mandatory electronic filing of all companies by the start of the 2010/2011 tax year.

Time Bar

4.20 A further policy issue that is of significance amongst many businesses involves that of the time bar, which is the statutory protection that taxpayers get from being reassessed more than four years after the year in which they filed their tax return.

4.21 Business New Zealand takes the view that the new return as outlined in the Paper should satisfy the time bar provisions. We would want legislation to explicitly state that in filing the new return this would be the case.

4.22 Concerning the option where a company might lose the use of the time bar where the information provided in the new return was of low quality, we would only support this if IRD provided clear and concise communication as to what was to be expected regarding information from the new return. Taxpayers currently have the option of filing statements to ensure that they have made full disclosure for time bar purposes. If IRD is to recapture taxpayers to file electronically (and thereby benefit from the timely capture of data at the taxpayer's expense), Business New Zealand believes it would be inappropriate for IRD to apply the time bar rules in a narrow or aggressive manner.

Recommendation: That loss of the time bar, where information in the new return is of low quality, is considered only if IRD has provided a clear and concise indication of what is expected of companies in regard to the new return.

APPENDIX

5. Background Information on Business New Zealand

5.1 Business New Zealand is New Zealand's largest business advocacy organisation.

5.2 Through its four founding member organisations – EMA Northern, EMA Central, Canterbury Employers' Chamber of Commerce and the Otago-Southland Employers' Association – and 69 affiliated trade and industry associations, Business NZ represents 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.

5.3 In addition to advocacy on behalf of enterprise, Business NZ contributes to Governmental and tripartite working parties and international bodies including the International Labour Organisation, the International Organisation of Employers and the Business and Industry Advisory Council to the Organisation for Economic Cooperation and Development.