KPMG

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Regular commentary from our experts on topical tax issues

Issue 2

Business tax proposals announced

Snapshot

The Government has announced the next phase of Inland Revenue's Business Transformation changes, this time aimed at business taxation.

The business tax proposals being consulted on include:

- Changes to the use of money interest and penalties rules.
- A new accounting-based method to calculate and pay provisional tax.
- Changes to the tax regime for contractors and extending these rules to labour-hire firms.
- Allowing Inland Revenue to report tax debt to credit rating agencies and to share information with the Companies Office about serious offences.

Submissions on the issues paper are due by 30 May.

There is something for everyone in the suite of business tax proposals

While the changes are broadly positive, the package is ultimately designed to support Inland Revenue's Business Transformation agenda

Therefore, there may be costs to business from adopting some of the proposals

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What are the proposals?

Changes to the use of money interest and penalties rules

- The threshold for use of money interest to apply will increase from $50,000 of residual income tax to $60,000 and be extended to non-individuals.
- Use of money interest will apply only from the third instalment of provisional tax for all taxpayers who pay on the uplift basis.
- The 1% monthly incremental late payment penalty for income tax, provisional tax, GST, and family assistance liabilities will be removed.

New income tax calculation and payment basis for SMEs

An Accounting Income Method ("AIM") for calculating and paying provisional tax will be introduced from 1 April 2018.

- Businesses with an annual turnover of $5 million or less that use accounting software that meets basic specifications will be able to use the AIM.
- Provisional tax will be based on accounting results (e.g. generated for GST purposes), with appropriate tax adjustments.
- AIM payment dates will be aligned with GST. Supporting information will need to be provided with each payment.
- If there is a loss for a period, the business has the option of having tax refunded or the loss carried forward.
- There will be no use of money interest and no terminal tax liability.

Payments for shareholder employees

A closely-held company will be able to pay provisional tax on salary and wages paid to shareholder employees, as their agent.

- This will remove shareholder employees from the provisional tax rules, but they would still need to return the income.
- The payments would form part of the company's provisional tax but would need to be separated out at year-end.
- The employee would receive a tax credit for any provisional tax paid, on their behalf, by the company.

Changes to the contractors withholding rules

Contractors that are currently subject to withholding will be able to elect and change their withholding tax rate.

- This will replace the current requirement to request a special rate from Inland Revenue.
- A minimum rate of 10% for resident contractors and 15% for non-residents will apply.
- Contractors will only need a payer's consent to change if they have changed their withholding rate twice in the same income year.
- If name, IRD number and tax code information is not provided, a non-declaration rate of 45% (similar to PAYE) will apply.

The withholding rules will also be extended to contractors engaged by labour-hire firms, including those operating through companies.

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Contractors not currently subject to withholding will be able to opt into voluntary withholding agreements.

Sharing of tax information

Inland Revenue will be able to disclose income tax, GST, and employers' unpaid PAYE, social assistance and KiwiSaver debt to credit rating agencies.

- Disclosure will be allowed only if the debt is significant, not in dispute, reasonable efforts have been made to collect it, the taxpayer is not in serious hardship, and has been personally notified of the intention to disclose the debt and has not paid it within 30 days.
- "Significant debt" will be based on either a percentage of a taxpayer's gross income or assets, or a dollar amount, such as $150,000.
- Inland Revenue will disclose the amount (within a dollar range), the tax type(s), age of the debt and the debtor's identity details.

Inland Revenue will also be able to provide information to the Companies Office if:

- There is a reasonable suspicion that a serious offence has, is being or will be committed; and
- Inland Revenue considers that disclosure will prevent, detect or provide evidence of a serious offence; and
- Inland Revenue is satisfied the information is available, practicable to communicate, and communication is in the public interest.

The offences in relation to which information will be shared with the Companies Office include:

- Serious breaches of a director's duty to act in good faith and in the best interests of the company.
- Authorising or making false statements.
- Breaches of prohibitions on managing a company (including in a Court Order and by the Financial Markets Authority).
- A director of a failed company managing or being a director of a phoenix company.

Tax "simplification" for SMEs

The issues paper also proposes:

- Allowing an income tax "private expenditure" adjustment for motor vehicles available to one or two shareholder employees, instead of requiring FBT returns and payments.
- Increasing the threshold for self-correction of errors from $500 to $1,000 of tax.
- Using standard value deductions rather than requiring apportionment of actual costs for motor vehicles and premises used privately.
- Removing the annual renewal requirement for RWT exemption certificates.
- Allowing more employers to file FBT annually by raising the PAYE threshold from $0.5m to $1m.
- Making the deductibility of accrued employee remuneration paid within 63 days of year-end optional.

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Who should take note?

A number of the business tax proposals will impact businesses of all shapes and sizes. The changes to use of money interest (a common bugbear for all business) and penalties are size "agnostic".

The SME sector is clearly the main target for the new AIM method. (A number of the tax simplification proposals are also aimed at small and micro businesses.) This is a "carrot" to encourage more SMEs to adopt accounting software. Increased electronic uptake will support Inland Revenue's Business Transformation agenda, which is heavily electronic systems and processes driven. It will also provide more, and earlier, information to Inland Revenue.

Non-residents should take note of the proposed changes to the contractors' rules. The ability to self-assess withholding rates will be welcome for contractors. It will be a quicker process than requesting a special tax rate. By contrast, businesses engaging contractors will need to ensure their systems and processes are flexible enough to accommodate different withholding rates and changes to those rates.

Our initial thoughts

The Prime Minister's speech releasing the issues paper highlighted the Government's thinking on business tax:

- Perfect accuracy can sometimes be costly in a way that doesn't seem justified.
- Provisional tax is hard to get right and expensive to get wrong.
- Some penalties are seen as punitive and discourage compliance.

These are welcome, pragmatic, positions. In our experience, Inland Revenue has not always been keen to embrace the practical, at the expense of accuracy. Further, use of money interest is seen as revenue to be protected rather than an excessive cost of not forecasting your tax perfectly.

The business tax proposals are broadly positive.

Use of money interest

The increase in the $50,000 use of money threshold and its extension to non-individual taxpayers is welcome. This will take a number of micro businesses outside of the interest rules altogether.

The key change for business will be the use of money "safe harbour" for the first two instalments if provisional tax is paid on an uplift basis (i.e. based on last year's liability plus 5% or two years ago plus 10%). This is a significant acknowledgement of the difficulty of getting those instalments right.

Reasonable estimates of the total liability will still be required for the third instalment. It also means that a business expecting reduced income for the first two instalments will run a use of money interest risk if it pays provisional tax on a lower estimate to manage its cash-flow. The benefit of using tax pooling to mitigate interest exposure will also need to be considered. So there is a bit for business to think about.

AIM

For SMEs, particularly those with variable or seasonal income, the AIM is worth a closer look. This method uses accounting information to calculate the income tax liability for the same period that GST is calculated. This will split the income year into multiple periods equal to a business's GST filing frequency.

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Tax adjustments will still need to be made for each of these periods and possibly at year-end. (We expect accounting software providers to automate some of these.) To make this process simpler, some tax rule changes will be required to align accounting and tax profit.

The AIM will put pressure on accounting information and processes as the frequency of filing will mean that the accounting system will be more heavily relied upon. The old adage, "garbage in, garbage out", applies here.

Tax payments will also be more frequent under the AIM. This will have a cash-flow impact.

The upside? Businesses will have an earlier line of sight of their tax position and better accounting information.

Contractors

The proposed changes to the contractors' withholding rules have a dual role. They will allow "self-management" while bringing more taxpayers into the withholding system and providing Inland Revenue with earlier information for their audit and enforcement activity.

Withholding systems minimise the ability and opportunity to not pay tax. Inland Revenue's audit activity is finding non-compliance by contractors.

The tightening and widening of the rules is the response. This will in part be offset by the ability to self-assess the withholding tax rate.

For contractors, the changes will impact their cash-flow. This is particularly important for affected company contractors. Inland Revenue will move ahead in the creditors queue as a result of the changes. This may reduce the risk that income tax debt causes business solvency problems. However, for creditors advancing funds on the basis of available cash-flow, there will be reduced cash-flow to support the borrowing (if a minimum of 10% of each contract receipt must be paid to Inland Revenue).

For businesses using contractors, there will be system impacts. There is limited ability to decline a change of withholding rate. There may be multiple rates to apply if different contractors are hired. This will encourage automation of the withholding system.

The increased tax collection will therefore come at a compliance cost for business. However, the obvious cash-flow benefit to Government suggests that these changes are likely to be a first, not a, final step. More, not fewer, contractors are likely to be in the withholding tax net in future.

Information sharing

The sharing of information with credit rating agencies and the Companies Office will no doubt give some cause for concern. Secrecy has traditionally been a real point of difference for Inland Revenue. Restrictions on information sharing are gradually being chipped away.

The Business Transformation consultation on the Tax Administration framework (see taxmail and KPMG's submission) has asked the question more generally. We believe it is better that this general consideration of what is, and isn't, appropriate for Inland Revenue to share should precede further specific changes to the current rules.

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However, in anticipation of the potential privacy concerns and issues, there are clearly defined criteria for exchange of information, which need to be considered for their appropriateness.

For further information

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