KPMG

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Issue 1

Investment income reporting in an IT world

Snapshot

Making Tax Simpler – investment income information proposes changes to the amount and frequency of information relating to NZ dividends, interest, Maori Authority income and PIE income. Inland Revenue will receive investment income, tax and recipients' details monthly from most payers. It will use this information to help recipients to better comply with their tax and social policy obligations and minimise end of year refunds and payments.

This new system relies on correct IRD numbers. Therefore, if an IRD number is not provided, a 45% non-declaration rate is proposed in most cases. The proposals do not otherwise affect what is taxable.

The discussion document acknowledges the proposals will create one-off costs for payers. It expects that payers will already have the information required. This, and proposed reductions in end of year reporting to investors, are assumed to help offset some of the additional costs. Based on our experience, there may be significant costs in upgrading, particularly if an investment income payer is operating legacy tax withholding systems. There may however be opportunities to rationalise reporting requirements. These should be taken.

The investment income information changes will have practical impacts for both recipients and payers

Investment income recipients will need to provide the correct details, including their IRD number, or be over taxed

For investment income payers, there will be costs in upgrading tax reporting systems (but there may be opportunities to rationalise reporting requirements)

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What are the proposals?

Currently, Inland Revenue is provided summary information of tax deducted from investment income. After year-end, it receives further information about the recipients. Payers of investment income (e.g. banks and PIEs) must also provide information to the recipients of that income.

Tracking and matching the information is not easy for Inland Revenue or recipients. Moreover, getting the investor details after year-end means that recipients of social policy assistance (and/or student loan borrowers and child support payers) may have additional obligations due to under or overpayments during the year.

Inland Revenue is therefore proposing that more detail be provided more frequently – i.e. each month or as payments are made. Inland Revenue will store this information in each recipient's tax account.

Inland Revenue will:

- Use this information to pre-populate tax returns. Recipients will have all of this information in one place and it will be easier to confirm their taxable income and tax liability.
- Compare it with other information from employers' PAYE returns to confirm whether the right withholding tax or PIE rate is being used (and if the incorrect rate is being used, it will advise payers to adjust).
- Adjust *Working for Families* entitlements or student loan and child support obligations, during the year, to minimise end of year refunds and/or payments.

Payers of investment income should note the following:

- The taxpayer specific information to be reported to Inland Revenue would include the customer's name, IRD number, address, and date of birth (if known), in addition to taxable income, exempt income, tax paid and tax credits.
- Joint investments would need to be separately reported.
- Investor details would need to be provided for Approved Issuer Levy ("AIL") recipients and those with exemption certificates.
- A non-declaration rate of 45% would apply to most types of investment income (e.g. RWT on interest and PIE income) if an IRD number is not provided.
- Payers will have access to a searchable exemption certificate database to determine whether an investor is eligible for a 0% rate.
- The need to provide year-end certificates to investors will be removed if the investor has provided their IRD number.

Further issues of detail arise, and feedback is requested on these, including:

- How often should a PIE report investor details and if a 45% non-declaration rate is applied should that be a final tax rate to encourage compliance?
- Will reporting AIL recipients' details help with confirming eligibility to use AIL?
- How should investment income from joint investments be allocated?
- How long is required to implement the proposals and should there be a period of time where payers can file manually, or should payers (particularly larger ones) be required to file electronically?
- Should investor information be provided on a cumulative (i.e. year-to-date) or period (e.g. monthly) basis?
- What thresholds should apply for self-correcting errors? (A percentage and dollar threshold is proposed in the discussion document.)

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Who's impacted?

Both recipients and payers of withholding income will be affected. The affected investment income ranges from NZ dividends and interest to PIE income and Maori Authority distributions. This will therefore impact hundreds of thousands of New Zealand savers and investors and potentially every NZ company, interest payer and collective investment vehicle.

Recipients will need to supply their IRD number so that tax is not over deducted. The objective is to provide better real-time tax and social policy delivery. We expect they will have two main concerns.

- How "smart" is Inland Revenue's system? Will it be able to process the information in a way which accurately predicts their circumstances and taxable income to be able to adjust tax payments and social policy obligations in real-time?
- What control will they have over the information provided to Inland Revenue and its correctness? It is a truism that "garbage in" means "garbage out". Real-time tax and social policy adjustments based on incorrect information will impact more immediately. While the design of the new rules is aimed at encouraging investors to provide accurate information (e.g. their IRD numbers), there may be challenges for payers in keeping clients' details up to date.

Payers will have systems and customer concerns to manage. Existing withholding systems are designed for existing rules. Even if the information is already held by the payer, current systems may not be able to simply pick up and communicate that data to Inland Revenue. Some legacy withholding systems may already be creaking under the strain of the current rules. Client concerns may arise over the accuracy of information in payers' systems as this will impact tax and social policy entitlements or payments in real-time.

Our view

Today's technology makes it inevitable that customers and users expect access to information in real-time. Inland Revenue is no different. It expects there will be efficiency gains for it, its "customers", and the broader integrity of the tax system by moving to more frequent collection of investment income information. This is also consistent with the other Business Transformation proposals, as well as the Government's greater focus on digital delivery of public services.

For investment income payers (similar to employers and business being asked to shoulder the burden of the PAYE and GST changes announced earlier), the key issue will be the impact on their systems and processes. While the discussion document acknowledges a transitional cost, the impact will vary widely by the type and size of payer.

For smaller payers, with non-electronic systems, the cost will be mainly in meeting the new electronic filing requirements. For large interest payers, thought should be given to how best this change can be delivered within their existing reporting systems. For example, much of the proposed information is already reported to investors in annual RWT certificates. Can those systems be used to report information monthly to Inland Revenue instead? If so, Inland Revenue should be encouraged to design its system to facilitate this. Inland Revenue can then make interest and RWT information available to recipients.

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For non-bank financial institutions, the proposals may not reduce compliance costs, if they have investor reporting requirements, for example, under the Financial Markets Conduct Act 2013.

For PIEs, incorporating a new 45% non-declaration rate into their tax systems may impose significant costs, based on our previous experience with implementing tax rate changes.

For recipients, the proposals mean there may be a trade-off between reducing the need to claim a refund, or pay tax, at year-end and needing to consider whether real-time tax and social policy adjustments are accurate. Simple and efficient means of correcting errors will be required.

While we support the objective of improving the delivery of tax and social policy outcomes, it should not automatically be assumed that the transitional costs can simply be absorbed by investment income payers, or will be offset due to removal of year-end reporting. The issues are more complex.

There are also a number of issues which are unclear:

- Payers may also be recipients of investment income. It is not clear what will be required for those "investors" to claim exemption certificates under the new rules. There could also be duplication of reporting.
- For some, their taxable income will not align with cash-flows. For example, those investors subject to the financial arrangement rules. While Inland Revenue will be able to make adjustments during the year for reported interest flows, this may not be the full picture.
- How investment income reporting will interact with financial institutions' automatic exchange of information and FATCA obligations. There is a real risk of duplication of information reporting and, therefore, processes and systems, unless there is rationalisation of the requirements.

Finally, with some irony, we note that Government will be one of the most affected, as it is the largest payer of AIL. It does not appear to be exempt from these proposals.

For further information

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