# Impact Summary: *Making Tax Simpler* – Improvements to the administration of tax for individuals.

## Section 1: General information

| **Purpose** |
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| Inland Revenue and Treasury are solely responsible for the analysis and advice set out in this Regulatory Impact Assessment (RIA), except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by or on behalf of Cabinet. |
| **Key Limitations or Constraints on Analysis** |
| The proposals were developed as part of the overall business transformation programme that Inland Revenue is currently working through; they build on other changes being made within that programme with a view to improving the overall administration of the New Zealand tax system by reducing compliance and administrative costs as well as looking to simplify the system for taxpayers and give them certainty about their obligations.<br><br>As a result of the extensive public consultation there are few limitations or constraints on the analysis of the final proposals as there was a high level of engagement from stakeholders in the policy development process.<br><br>There were, however, two constraints to the analysis of the financial impacts of the proposal:<br><br>• For those taxpayers who have treated themselves as not being required to file tax returns under current law it has been assumed those individuals do not have other income that should have been separately returned to Inland Revenue. This may include rental income, dividend income or other non-source deducted income. It may be that those taxpayers should have been filing a tax return; and<br>• For those who have used the correct tax code/rate and would therefore not be required to pay any resulting tax liability the analysis has been constrained by the frequency on which Inland Revenue currently receives that tax deduction data. It is currently received on a monthly or twice monthly basis whereas in the future this will be on a payday basis which should enable correct tax rates to be more accurately monitored. This limitation may suggest that tax rates are more or less correct than they actually are if more frequent information was used in the analysis. |
| **Responsible Manager (signature and date):** |

Mike Nutsford
Policy Manager
Policy and Strategy
Inland Revenue
14 March 2018

## Section 2: Problem definition and objectives

### 2.1 What is the policy problem or opportunity?

The current law generally allows those taxpayers who derive only source deducted income (reportable income[1]) not to file a tax return. However, the rules around when a person should file a return are not well understood by taxpayers. In addition, the current "non-filing" regime incentivises taxpayers to actively seek out tax refunds by filing a return and not returning when a debit arises, requiring them to determine if they are in an over-withheld or under-withheld position.

The filing of a tax return can be difficult for individuals; many find it difficult to obtain and retain records relating to their income and the process of filing the return is seen as complex. Although Inland Revenue automatically releases refunds of less than $600 after a personal tax summary has been issued many taxpayers continue to engage intermediaries to determine whether they are due a tax refund.

The more timely information that will shortly be received by Inland Revenue[2] from those who deduct tax at source will allow Inland Revenue to undertake more proactive actions to ensure that the level of withholding during the year is more accurate which should reduce the number and level of tax "square-ups" required at the end of the year.

The changes proposed in this RIA build on this increased provision of information to, for most taxpayers, automatically calculate their year-end square up. This will either automatically send them a refund or a notice to pay under limited situations[3]. These changes will mean that approximately three million taxpayers will have their tax position automatically dealt with and save these people either having to file a return, engage with a tax agent to receive a refund or interact with Inland Revenue to determine their own tax position (either through MyIR[4] or by phone).

The proposals will also simplify the claiming of donation tax credits[5] by moving these into the income tax return process and allowing taxpayers to supply receipts during the year through an on-line portal rather than at the end of the year when receipts may have been misplaced.

The counterfactual to the proposal is to leave the current rules in place and although Inland Revenue could still be more pro-active during the year to reduce any over or under payments there will be no corresponding reduction in compliance costs for taxpayers at the end of the year to determine whether they are due a tax refund or there is a balance to pay. The proposal will decrease these compliance costs and deliver any refunds directly to taxpayers without any cost to them.

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[1] Reportable income is income that has tax deducted at source. This includes income from employment, interest, dividends, Māori Authority distributions and employee share scheme benefits.

[2] Due to changes to information gathering contained in the Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Bill

[3] These will only be issued where the tax liability is over a $20 threshold or where the person has advised their correct tax code or rate but that tax has not been deducted correctly.

[4] MyIR – is Inland Revenue's web based platform.

[5] A tax credit against taxable income is available for donations of $5 or more to approved organisations.

The proposals in this RIA align with the information gathering changes contained in the *Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Bill* and as a consequence to obtain full benefit of the proposals they need to be implemented at the same time, starting 1 April 2019 for the 2018-19 tax year.

In addition the timing of the introduction of these new rules is aligned to release three of the business transformation programme which will enable these changes to be implemented at the same time individuals' income tax is brought within the new START[6] computer system. This release is scheduled for April 2019.

## 2.2 Who is affected and how?

The proposals will affect the approximately three million taxpayers who currently only derive reported income. It will enable those taxpayers who are overtaxed for some reason to directly receive their refund without having to engage with Inland Revenue or an intermediary no matter what the level of that refund rather than being restricted to refunds less than $600.

For those who have an underpayment in certain, limited, circumstances they will receive a notification of any debt. However, those taxpayers who have had tax withheld in accordance with the deduction rules will not have to pay any resulting shortfall.

The proposal will reduce taxpayer compliance costs in having to determine their final tax position and obtain any associated refund. It will be paid in full to them automatically notwithstanding the level of that refund.

It will also simplify the claiming of donation tax credits and allow taxpayers to supply receipts during the year instead of having to retain these and claim them at the end of the year. Again this will assist people in claiming tax credits for donations and bring these within the automatic square up process for year-end for most taxpayers.

Officials consider these proposals, in conjunction with the increased levels of proactive actions Inland Revenue will take based on more frequent income information, very beneficial for the affected taxpayers.

## 2.3 Are there any constraints on the scope for decision making?

There have been no constraints on the scope for decision making. The proposals consider in this RIA have been subject to public consultation with some changes being made to the final proposals as a result of that consultation.

These proposals are dependent on the more timely information reporting of payroll and investment income that is included in the *Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Bill* as this provides the platform to enable Inland Revenue to more proactively ensure that taxpayers have the correct rate and tax code

[6] START - Simplified Tax and Revenue Technology – the new information technology platform being introduced by Inland Revenue as part of its business transformation programme.

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| during the year to minimise the amount of any end of year square up. |

# Section 3: Options identification

## 3.1 What options have been considered?

The overarching objective is to minimise the interaction required by individual taxpayers.

This has been assessed against the following criteria:

- Compliance costs – Compliance costs are minimised as far as possible
- Administration costs – Administration costs are minimised as far as possible
- Sustainability – The options should collect the revenue required in a transparent and timely manner while not leading to tax driven outcomes and enable the efficient administration of the social policies administered by Inland Revenue

**Year End Process**

Three options were considered:

- Option 1: The status quo
- Option 2: An improved status quo
- Option 3: An automatic square-up process

***Option 1: status quo***

Taxpayers who derive only source deducted income (reportable income[7]) are not required to file a tax return. At the end of the year those taxpayers who have only reportable income and have a refund owing because of over taxation of under $600 have that refund automatically issued along with a personal tax summary. Those taxpayers who have over $200 of non-reportable income must file either a personal tax summary or a tax return to claim any refund, or square up any liability.

***Option 2: an improved status quo***

Under an improved status quo Inland Revenue would use the information provided by the more timely reporting of payroll and investment income to issue more personal tax summaries to taxpayers where under or over payments were identified. This would require taxpayers to confirm or otherwise complete the personal tax summary (unless any refund arising was less than $600 in which case it would continue to be automatically released along with a personal tax summary). Once that had been done a resulting refund would be issued, alternatively a debt would be issued.

This option has the benefit of a taxpayer turning their mind to their tax position and confirming that position before a refund is issued which can increase the integrity of the system where a taxpayer earns other non-source deducted income. The downside of this is the increased interaction for the majority of taxpayers who only have reportable income. It also has the disadvantage where a taxpayer does not automatically receive a personal tax

[7] Reportable income is income that has tax deducted at source. This includes income from employment, interest, dividends, Māori Authority distributions and employee share scheme benefits.

summary they have to assess whether they need to request one.

***Option 3: automatic square-up process (preferred option)***

This option is based on the premise that for the majority of taxpayers Inland Revenue will hold all the information required to enable it to calculate an end of year tax position for a taxpayer and the step of having a person confirm through the compilation of a personal tax summary is unnecessary.

The advantage of this proposal is that it is much easier for taxpayers to understand, offers a better balance between compliance costs and accuracy than option 2, better utilises the increased information available to Inland Revenue from third parties and reduces the number of taxpayers who will have to provide information to Inland Revenue.

The disadvantage to this option is that some taxpayers who do not currently interact with the tax system (on the assumption that their reported income has been accurately withheld from) may now have to interact. In the majority this will be receiving a refund where previously they may not have claimed one but the interaction may cause taxpayers some concern.

**Flow-on effects**

In addition to these overriding options, a number of other flow-on effects of the year-end process were considered under two headings:

- Who has to “square-up” at year end ?; and
- How should donation tax credits be dealt with in the future?

***Who has to square-up at year end?***

Three options were canvassed in respect of who should have to square up at year end:

- Option 1: The status quo – taxpayers are required to obtain a personal tax summary where they have more than $200 of reportable income taxed at the incorrect rate and have to square up any tax shortfall. Those who have a refund of greater than $600 are required to confirm a personal tax summary and automatic refunds for those less than $600;
- Option 2: A monetary threshold – taxpayers who have tax to pay or a refund under a certain level would not receive notification for payment or a refund; or
- Option 3: The notification model – taxpayers who have advised the payers of their reportable income their correct tax code or rate and the payers are correctly using that code but have still ended up with a shortfall should not have to square up any shortfall as they have met their obligations in respect of their tax affairs. Any refunds arising would be automatically refunded.

***How should donation tax credits be dealt with under the new proposal?***

Donation tax credits are currently claimed annually using a specific form issued by Inland Revenue. There were a number of options considered to improve this process given the proposed changes to the way the end of year square up was undertaken.

Three options were considered:

- Option 1: The status quo with taxpayers either supplying receipts during the year or saving their receipts until the end of the year and then filing a rebate claim form at the end of the tax year to claim the credit;
- Option 2: Remove the need for a separate rebate claim form and have taxpayers complete the claim as part of an end of year square up process either through filing a tax return or a personal tax summary; and
- Option 3: Allow taxpayers to submit their donation receipts to Inland Revenue during the year which could then form part of their year-end square-up process through either an automatic square-up or tax return process.

## 3.2 Which of these options is the proposed approach?

**Year End Process**

Officials consider that option 3, an automatic square-up process for taxpayers who only derive reportable income, is the preferred option. Essentially these proposals will result in only those taxpayers who derive more than $200 of non-reportable income[8], are a non-resident, have tax losses, are subject to the financial arrangement regime or pay provisional tax will need to file a tax return or personal tax summary.

It provides taxpayers with a large reduction in compliance costs while not adversely affecting those taxpayers who are using the correct tax codes and rates and who do not currently interact with Inland Revenue (as option 2 might have, depending on the level of the tax to pay threshold).

Option 3 also better utilises the more timely information provided to Inland Revenue by third parties in respect of reportable income than the other options. Although all options would allow Inland Revenue to closely monitor and correct any tax code or rate issues which should result in a more accurate tax position for taxpayers, option 3 uses those pro-active actions more fully for taxpayers.

In the majority of cases option 3 will ensure that taxpayers receive a refund automatically and not receive a bill where they have ensured that their rate and tax code are correct. This has the benefit of no interaction with Inland Revenue for those taxpayers where option 1 required an interaction prior to the issue of a refund (except for those less than $600). It also provides taxpayers with the certainty that unless they earn non-reportable income they don’t need to consider if they need to file a return or personal tax summary as it will all be completed for them automatically.

**Who has to square-up any underpayments?**

[8] Non-reportable income will include amounts not subject to tax at source this would include contracting income or other income not subject to withholding taxes.

The status quo did not ultimately fit with the objective of attempting to minimise the interaction required by taxpayers and, in fact, may have had the opposite effect and was discarded.

After consultation it was decided that a combination of the latter two options provided the best outcome for taxpayers and Inland Revenue. Two monetary thresholds will apply, one for refunds paid by cheque where only refunds above $5 will be issued by cheque (there is no threshold for electronic payments) and the other for debts less than $20 which will not be assessed/collected from taxpayers. The $5 limit recognises the cost of processing a manual payment. The $20 limit reflects the approximate cost of collection of the small balance. Any credits not refunded under that threshold may be carried forward to future periods any debits under the threshold will be extinguished, rather than being carried forward.

In addition, there is an overriding assumption the correct tax code/rate has been used on reportable income. In that case no square-up will be required no matter what the level of the liability. Further, even where an incorrect rate has been used, a square-up will only be required if the incorrect rate was applied to more than $200 of income. Officials consider this combination of the two options provides the best outcome for taxpayers who only derive reportable income, in that, as long as they have ensured that the correct rate or code has been supplied to the payer they have discharged their obligation to ensure their tax position is correct.

**How should donation tax credits be dealt with under the new proposal?**

Because donation tax credits could be claimed by a taxpayers who follow differing year-end square up processes it is necessary to have multiple options for taxpayers to use. In addition, there may be a number of options that taxpayers want to enable them to claim their tax rebates. Some maybe comfortable with saving their receipts and claiming these at the end of the year as they already do, others may want to supply receipts when they get them and those who are still required to file a tax return because they have other non-reportable income may want the convenience of claiming their rebate as part of that tax return process.

Ultimately officials' preference is to proceed with all these options as each option has merits for taxpayers dependent on their year-end square up process but also allowing flexibility for taxpayers as to the best way for them to claim their donation tax credits.

The proposal is that taxpayers have three ways to claim their donation rebate:

1. They can continue with the current process of filing a separate rebate claim form and either save the receipts until the end of the year or provide these during the year. They could do this whether or not they are required to file a tax return or are part of the automatic square-up process; or

2. For those who are required to file a tax return because of non-reportable income they can choose to include the donation tax credit claim on their tax return for the year supplying the receipts at that time; or

3. A taxpayer could upload their donation receipts to Inland Revenue during the year and these could be automatically refunded at the end of the year (or potentially prepopulated on their tax return should they be required to file one).

Officials consider this reduces taxpayer compliance costs and also provides taxpayers with flexibility for the particular system that they are comfortable with to make their donation tax credit claim.

The preferred options are not incompatible with the Government's "Expectations for the design of regulatory systems".

# Section 4: Impact Analysis (Proposed approach)

## 4.1 Summary table of costs and benefits

| **Affected parties** *(identify)* | **Comment**: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks | **Impact** *$m present value, for monetised impacts; high, medium or low for non-monetised impacts* |
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| Additional costs of proposed approach, compared to taking no action[9] | | |
| Regulated parties | Monetary costs for non-filing taxpayers who will be required to pay tax | Up to $50m[10] in tax to pay. This is not a forecast, but rather a static analysis of unpaid sums larger than $20 in the 2016 tax year. The $50m does not take account of the amounts that would not have to be paid (because they were withheld in accordance with the rules) suggesting that the total will be lower than $50m. Inland Revenue is not able to quantify what proportion of the $50 million would not be payable. |
| Regulators | Administrative costs for Inland Revenue of dealing with customer enquiries or contacts, these are likely to be transitional as people get used to the new rules. | These will be accommodated within the Business Transformation programme funding allocated to Inland Revenue. |
| Wider government | Reduction in Government revenue through issuing refunds which are not currently issued. | $150m[11] |

[9] Business transformation has committed to deliver additional Crown revenue of $2,880m - $6,175 million (including inflation) by 2023/24 as a result of improved voluntary compliance and better use of information and analytics to identify and address non-compliance. The Government has already accounted for the lower end of this range in its fiscal forecasts. These numbers took into account the broad direction of policy intent, as signalled through the Government's discussion document, *Making Tax Simpler: A Government Green Paper on Tax Administration* (including early thinking on individuals' income tax returns), in addition to the further changes that will be delivered as part of Business Transformation.

[10] The data is based on a sample of taxpayers and has been scaled up to population estimates. This data only looks at non-filing individuals earning employment income which is reported on Employee Monthly Schedules, and calculates their likely refund or tax to pay by comparing the actual tax withheld on this income with the amount of tax that should have been withheld.

[11] Inland Revenue will be taking proactive action during the year to reduce the number and size of end-of-year discrepancies by moving people to better tax rates and codes so that they only pay what they need to during the year. Accordingly, total year-end refunds issued and total year-end tax to pay will not reflect this static analysis of the quantum of unclaimed refunds or amounts of tax to pay, as year end refunds/amounts to pay will reduce over time.

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| Other parties | | |
| **Total Monetised Cost** | | $200m |
| **Non-monetised costs** | Negative impact on business models of agents or intermediaries who currently file personal tax summaries for customers | |

| Expected benefits of proposed approach, compared to taking no action | | |
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| Regulated parties | Monetary benefits for current non-filing taxpayers who will automatically receive refunds<br>Cost saving for taxpayers who currently prepare and file personal tax summaries | $150m |
| Regulators | Reduced administrative costs for Inland Revenue over time | These will be accommodated within the Business Transformation programme funding allocated to Inland Revenue. |
| Wider government | Increase in Government revenue through collecting amounts of tax which are not currently collected | Up to $50m |
| Other parties | | |
| **Total Monetised Benefit** | | $200m |
| **Non-monetised benefits** | The macroeconomic impacts of the flow-on effects from private individuals consuming, investing and/or saving their refunds and, conversely, the private economic activity forgone by individuals who have more tax to pay have not been quantified. | |

| 4.2 What other impacts is this approach likely to have? |
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| The associated simplification of the year-end system and perceived fairness to those who are over taxed during the year should have a positive benefit on the way taxpayers view Inland Revenue and the tax system as whole.<br><br>It also provides a clear tangible benefit to taxpayers from the business transformation programme.<br><br>The automatic year-end square-up of most taxpayer tax affairs may mean a significant number of clients will no longer need to use an intermediary to file a tax return or personal tax summary on their behalf. |

## Section 5: Stakeholder views

| 5.1 What do stakeholders think about the problem and the proposed solution? |
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| The proposals and preferred options outlined in this RIA were subject to public consultation in the discussion document *Making Tax Simpler – Better Administration of Individuals' Income Tax* released by the Minister of Revenue in June 2017. There was also an online forum for the public to make comment on the proposals and a survey was undertaken to gain insights to the final proposals.<br><br>The submissions on the options were evenly split between supporting the preferred option and proposing a variation on the preferred option which would require individuals to confirm their tax position before an assessment was finalised and a refund issued. This latter approach had been previously ruled out by the Government.<br><br>A further approach was proposed by two submitters and this was incorporated into the final proposals. This approach was to eliminate a year-end square up for underpayments where the taxpayer had met all their obligations to advise payers of reported income their correct tax code or rate.<br><br>The other proposals were supported by submitters, including those relating to small balance square-up amounts and claims for donation tax credits.<br><br>None of the proposals specifically affect iwi and although they had an opportunity to submit on the proposals through the public consultation process it was not considered necessary to separately consult on the proposals with them. |

# Section 6: Implementation and operation

| 6.1 How will the new arrangements be given effect? |
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| The proposed changes are expected to be included in a tax bill to be introduced in early 2018 with application from 1 April 2019 for the 2018-19 income year as this is when the associated changes to the provision of information by payers of reportable income will become mandatory. This date will allow Inland Revenue to commence its proactive actions to ensure that taxpayers are using the correct tax rates and codes and suggest alternatives when that is not the case.<br><br>The first returns that will be subject to the new year-end square-up process will be for the tax year ended 31 March 2019.<br><br>Inland Revenue will have responsibility for the implementation and ongoing operation and enforcement of the proposals and will have a communications programme for educating taxpayers of these changes at the time they are implemented. Inland Revenue has extensive experience in implementing, operating and enforcement of these types of changes. |

# Section 7: Monitoring, evaluation and review

### 7.1 How will the impact of the new arrangements be monitored?

As part of the implementation and operation, Inland Revenue will be continuously monitoring the effectiveness of the proposals. This is a normal part of the work Inland Revenue does in respect of the tax system to ensure that the rules and processes are fit for purpose.

Monitoring and enforcement can only be effective once Inland Revenue is receiving the additional and more timely information from payers of reportable income as it is only at this time that Inland Revenue can increase its proactive actions to ensure taxpayers are using the correct tax code and rates.

### 7.2 When and how will the new arrangements be reviewed?

As part of the ongoing monitoring and evaluation, Inland Revenue will be constantly reviewing the outcomes of the proposals with a view to assessing the effectiveness of the changes.

As with all aspects of the tax system Inland Revenue is constantly reviewing the outcomes to identify any issues that may need remediation. Inland Revenue also has a number of channels for taxpayers and the public in general to raise any specific concerns with the tax system and it has appropriate pathways to address those concerns.