

Impact Summary: Tax pooling to purchase backdated tax

Section 1: General information

Purpose

Inland Revenue is solely responsible for the analysis and advice set out in this Impact Summary, 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 Cabinet.

Key Limitations or Constraints on Analysis

The key constraints on the below analysis is data. As the proposed change would benefit a demographic who currently cannot use backdated tax, it is difficult to fully scope who would use it in these circumstances if they could. There is also a behavioural element to the change that is also difficult to objectively measure. Relatedly, this has limited the scope of consultation and understanding of the scale of impacts as it is difficult to perfectly identify individuals who would specifically benefit from this change.

Evidence of the scale of the issue is largely case-specific and/or anecdotal and we recognise that a number of the parties who have raised it, such as tax poolers, have a vested interest in the change.

In considering the issue, officials primarily considered the status quo as an alternative. Comparing the options, it became apparent that, irrespective of scale, allowing the use of tax pooling to satisfy liabilities that arise from voluntary disclosures for more than income tax and Resident Withholding Tax (RWT) is the right policy outcome. This is because it increases simplicity, coherence and integrity within the tax system

In light of the above constraints, the below analysis has assumed that a voluntary disclosure would be more likely to be made if tax pooling were available more widely to satisfy any tax debt and mitigate Use of Money Interest (UOMI). In addition to the existing tax types covered (income tax and RWT), this means that the tax types covered by this extension are tax paid or payable under the pay as you earn (PAYE) rules, employer superannuation contribution tax (ESCT) rules, retirement savings schemes contributions tax (RSCT) rules, non-resident withholding tax (NRWT) rules, goods and services tax (GST) or fringe benefits tax (FBT).

Responsible Manager (signature and date):

Bary Hollow
Tax Administration
Policy and Regularity Stewardship
Inland Revenue

To be completed by quality assurers:

Quality Assurance Reviewing Agency:

Inland Revenue

Quality Assurance Assessment:

Partially meets

Reviewer Comments and Recommendations:

The Quality Assurance reviewer at Inland Revenue has reviewed the Tax Pooling to purchase backdated tax Impact Summary and considers that the information and analysis summarised in it partially meets the quality criteria of the Regulatory Impact Analysis framework. This is because, as identified in the Key Limitations or Constraints on Analysis section, there is no data to support the current scale of the problem or the impact of the proposed changes if they were enacted. However, the Impact Summary sets out the rationale for why the status quo is an issue and why a regulatory change is preferred, and identifies the main risks and uncertainties.

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

Tax pooling was introduced to assist with uncertainties relating to provisional tax (income tax). It allows provisional tax payments from numerous taxpayers to be grouped into the account of a registered intermediary. By pooling these payments, a taxpayer can offset an underpayment against amounts within the same pool allowing them to reduce their exposure to use of money interest (UOMI).

The coverage of tax pooling was later extended to include historical periods and other tax types, but only in a situation of reassessment of a prior assessment or an increase of a prior obligation. This necessitates that an original assessment has been issued for that tax period or an obligation to pay tax has been quantified because a relevant tax return has already been filed. Taxpayers who have filed and who subsequently wish to make a voluntary disclosure are able to use tax pooling to satisfy the increased tax debt.

However, where there is no existing assessment or quantified obligation the taxpayer would be unable to use tax pooling to satisfy a liability arising from the same voluntary disclosure. There is a limited exception to this rule as certain voluntary disclosures for income tax and resident withholding tax (RWT) may use tax pooling, subject to a Commissioner's discretion measured against specific legislative criteria.

There are several circumstances where a taxpayer may have unintentionally not filed a tax return for a particular tax type and tax period. For example, a small business may be unaware that an employee benefit they provide is subject to fringe benefit tax and so do not provide a return. Where these omissions have been made in good faith, it is disproportionately punitive to not allow taxpayers to use the benefits of tax pooling in these situations should they want to do so.

Allowing the use of tax pooling to satisfy liabilities arising from a voluntary disclosure would therefore encourage voluntary disclosure in these instances. It would result in more consistent outcomes across tax types. Such a change is in line with tax principles and offers the best policy outcome.

Extending the exception to other tax types would take a legislative change to expand existing provisions. These other tax types are tax paid or payable under the PAYE rules, ESCT rules, RSCT rules, NRWT rules, GST or FBT. This change will not impact existing settings for income tax and RWT,

2.2 Who is affected and how?

The demographic whose behaviour would be most impacted by this change are taxpayers who have not filed a return due to an error or oversight (other than for income tax or RWT) and who could or would like to use tax pooling in order to meet the liability. They would be more likely to make a voluntary disclosure under this change than take a risk on the error not being found through audit. This would improve the accuracy of returns and the rate of tax collected. As errors cannot be predicted, equally those who benefit from this change will likely vary considerably between tax years.

The types of business most likely to benefit will be smaller businesses. That is to say, those with employees but not large enough to employ or permanently engage tax advisors. Although not prohibited, larger businesses should be more informed and sophisticated taxpayers and are therefore considerably less likely to meet the requirements of this change.

2.3 What are the objectives sought in relation to the identified problem?

The primary objective of this change is to improve the rate of voluntary disclosures and thereby increase the accuracy of tax returns and tax collected. This is linked to a secondary consideration of improving fairness within the tax system by not being overly punitive on errors related to different tax types.

The other key objective of this work is to protect and enhance the integrity of the tax system.

These objectives are similar in their focus and they have been given equal weighting with regard to considering this proposal.

Section 3: Options identification

3.1 What options have been considered?

There are concerns that the current rules could be disincentivising voluntary disclosures where the disclosure does not relate to a tax type that can currently use tax pooling to satisfy the liability. Instead, taxpayers may be choosing to risk the error not being caught in an audit rather than disclose it and face the additional cost of UOMI.

Two key options were considered in addressing this issue:

- Status quo
- Enabling the use of tax pooling to purchase backdated tax to satisfy a liability arising from a voluntary disclosure for tax types other than income tax and RWT where a return has not previously been returned.

Other options were considered but were not progressed due to limitations such as not being able to fully address the identified issue of inconsistent treatment between tax types or of reducing system integrity. These options were to reduce penalties associated with liabilities arising from voluntary disclosures or increasing education and compliance activities to reduce errors. Similarly, initial thought was given to the removal of tax pooling as an option however this was not progressed. Tax pooling emerged in response to the inherent inaccuracy that is a feature of the provisional tax regime so its cessation would remove flexibility and increase the punitive aspect of the regime. This is inconsistent with intended policy outcomes.

These options were considered in light of the degree to which they address the issues of incentivising voluntary disclosure, fairness, enhancing the integrity of the tax system and associated administrative and compliance costs.

Under the status quo, where a taxpayer finds they have made an error – for example, not realising an employee benefit is subject to Fringe Benefit Tax (FBT) and therefore not providing a return – they are obliged to make a voluntary disclosure to the Commissioner of Inland Revenue so their tax liability can be adjusted to account for the FBT liability. As this represents an underpayment, the FBT would attract UOMI and thereby increase the amount the taxpayer is obliged to pay to Inland Revenue. The taxpayer is not able to use tax pooling to reduce their exposure to UOMI in this instance.

Where the error relates to RWT or income tax and a voluntary disclosure is made, the taxpayer is able to purchase backdated tax from a tax pool. Purchasing backdated tax reduces the amount of UOMI they are subject to as purchased funds are credited from the day they are added to the pool rather than the day they are purchased.

Alternatively, a taxpayer may choose to not make a voluntary declaration in the hope that the error is not discovered through audit and their tax liability therefore does not increase.

Under the proposal to enable the use of tax pooling to satisfy tax liabilities arising from voluntary disclosures where the taxpayer has not previously filed a return, the taxpayer would be able to use tax pooling, and thereby mitigate their exposure to UOMI, for voluntary declarations related to tax types other than RWT and income tax. This is expected to increase the number and amounts of voluntary disclosures.

We recognise that there is a risk that this proposal could be seen as encouraging non-filing of returns. The option to alter the status quo therefore includes measures to ensure the integrity of the tax system is not undermined through the wilful non-filing of returns. These measures are the requirement for the taxpayer to make the disclosure before Inland Revenue has engaged with them (or their agent) regarding that tax type, and for the disclosure to have been made in a reasonable timeframe of the error being discovered. A penalty is also proposed where the Commissioner is satisfied that the debt has arisen through the taxpayer choosing not to comply with their tax obligations

This option would require legislative change to both the Income Tax Act 2007 and Tax Administration Act 1994 to enable taxpayers to use tax pooling for a voluntary disclosure where the taxpayer has not previously filed an original return. (i.e., the voluntary disclosure is not for a reassessment or amending a prior obligation). The Income Tax Act change is to allow for the use of tax pooling to satisfy a tax liability that has arisen from a voluntary disclosure where there is no original return. The Tax Administration Act change is to enable the use of shortfall penalties where the Commissioner is satisfied that the debt has arisen through the taxpayer choosing not to comply with their tax obligations. Such changes would represent the expansion of existing provisions rather than the creation of new ones.

Further options to achieve the intended outcome of increasing voluntary disclosures were considered and ruled out. Primary amongst these was consideration of reducing the penalties and interest that could be applied for liabilities arising from voluntary disclosure. This was ultimately rejected as there are integrity concerns to providing additional 'discounts' or exceptions to existing interest and penalty rules related to voluntary disclosures. These concerns include the risk of incentivising intentional omissions followed by disclosures in order to achieve a reduced tax liability. As the underpinning penalty framework is considered sound, focus has been placed on reducing inconsistent outcomes between tax types which are the subject of voluntary disclosures.

Similarly, an approach focussed on education and enforcement was considered. Although important, such an approach would only go so far in reducing instances of voluntary disclosures as it is not possible to mitigate all potential for error or misunderstanding. Ensuring that taxpayers are supported to do the right thing when such an error is discovered is one of the reasons that voluntary disclosures are a feature of the tax system. Accepting this, an approach solely focused on education and enforcement would not address the identified issue of inconsistent outcomes between tax types which are the subject of voluntary disclosures.

3.2 Which of these options is the proposed approach?

The proposed approach is to enable taxpayers to use tax pooling for a voluntary disclosure where the taxpayer has not previously filed an original return, as it will support an increase in voluntary disclosures. It will do so by ensuring that voluntary disclosures are treated equally with regard to their ability to utilise tax pooling to mitigate UOMI and thereby achieve greater consistency of outcomes across tax types.

Overall, it will improve simplicity and consistency within the tax system compared to the status quo whilst upholding system integrity.

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Additional costs of proposed approach, compared to taking no action		
The Crown	Improved compliance would reduce the UOMI the department collects.	Low – as the outcome is linked to behavioural changes it is hard to measure but, as the demographic is small, these changes are also anticipated to be small.
Inland Revenue	More voluntary disclosures, potentially an increase in the need to verify these disclosures meet the criteria, and processing of penalties where they are found to not meet criteria. These represent an increase in administrative costs.	Low – this proposal represents an extension of existing settings and so changes should be straight-forward and small. Similarly, the demographic incentivised to make voluntary disclosures under this change is small, meaning the increase in contacts with Inland Revenue should be equally small.
Total Monetised Cost	As noted, as costs and benefits are intrinsically linked to behavioural change it is difficult to put a value on them. Overall, the costs are likely to be low.	Low
Non-monetised costs		Low
Expected benefits of proposed approach, compared to taking no action		
Taxpayers	Assuming full compliance irrespective of the change, this proposal would reduce costs to the taxpayers by mitigating UOMI.	Low – tax pooling enables the mitigation of UOMI, but the tax liability would not be impacted by this change. Due to links with behavioural changes, this is hard to measure.
Taxpayers	Voluntary disclosures are incentivised therefore it is easier and less punitive to do the right thing.	Medium – although as a behavioural factor this is difficult to fully gauge.
Tax poolers	By increasing the potential number of taxpayers able to use tax pooling, this would increase the income of tax poolers.	Low - as a small demographic increase, the income increase would also be small.
The Crown	Improved compliance rates will increase the amount of tax collected.	Low – as the outcome is linked to behavioural changes it is hard to

		measure but, as the demographic is small, these changes are also anticipated to be small.
The Crown	Penalties from voluntary disclosures that have not met the necessary criteria to use tax pooling in these instances would increase the amounts collected by the Inland Revenue and therefore the Crown.	Low - as a small demographic of an already small demographic increase, the income increase would be equally small.
Total Monetised Benefit		As noted, as costs and benefits are intrinsically linked to behavioural change it is difficult to put a value on them. Overall, the costs are likely to be low.
Non-monetised benefits		Medium

4.2 What other impacts is this approach likely to have?

Inherent in this change is that, by increasing voluntary disclosures that are influenced by the ability to use tax pooling, the use of tax pooling is also likely to increase. This is not inherently either negative or positive, however it may be worth noting that the funds available via tax pooling are finite (i.e., funds that can be purchased are only available up to the total amount that has been deposited with the pool). Increasing the ability to use tax pooling could mean that tax pool funds are not always able to meet demand.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?

This is a discrete issue and, as noted above, due to the nature of those likely to benefit from it, it is difficult to effectively target consultation.

In addition to internal stakeholders within Inland Revenue, entities consulted were:

- Tax pooling intermediaries;
- PricewaterhouseCoopers;
- Chartered Accountants Australia and New Zealand; and
- Corporate Taxpayers Group.

Stakeholders were supportive of the problem analysis and the proposed approach. Although several of the entities listed above are tax poolers, that support for the change was universal amongst those consulted. This supports the view that the proposed option is a positive change that will benefit taxpayers and the wider tax system. Overall, all are satisfied that the proposed change will realise the intended benefits and is adequately balanced against the risk of exploitation and potential fiscal impacts.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?

A legislative change is required to give effect to this change.

Once legislated, a number of focussed system changes would be required. These involve the extension of existing settings, and implementation risks are therefore minimal.

Inland Revenue would be responsible for the ongoing operation and enforcement of changes.

The option is proposed to come into effect from 1 April 2022.

Section 7: Monitoring, evaluation and review

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

The primary indication of whether the intended outcome is achieved is if we see an increase in voluntary disclosures related to these tax types.

Data is available around those who use tax pooling to satisfy tax liabilities arising from voluntary disclosures currently and so uptake can be monitored.

Given who is intended to benefit from this change (i.e. individuals who make an error in good faith), there should not be 'regulars' who use this legislation. Inland Revenue collects data on who is making voluntary disclosures and what they entail and so would be able to review if patterns of repeat non-filing followed by disclosure emerge.

7.2 When and how will the new arrangements be reviewed?

There is no specific plan to review this legislation. However, Inland Revenue is in regular and ongoing engagement with the wider tax advisory community and it is likely that members will be a proactive and effective source of feedback on the operation of the change.

Additionally, in light of the monitoring outlined above, the changes will be reviewed where voluntary disclosures under the new legislation increase significantly, a number of taxpayers are found to use the legislation repeatedly or, conversely, where the legislation does not appear to be used at all.