

# Regulatory Impact Statement

## Design of START – legislative issues

### Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by Inland Revenue.

It provides an analysis of options to address three legislative issues that have arisen in relation to transferring tax types from Inland Revenue's current computer system (FIRST) to Inland Revenue's future computer system (START).

The three issues relate to:

- use-of-money interest (UOMI) and transfers of tax;
- Amending the rules for new and increased assessments by the Commissioner of Inland Revenue by removing the new due date concept; and
- the administration of the grace periods concept (which provides for additional time for payment of a debt before late payment penalties are imposed) throughout the transition of tax types from FIRST to START.

The options considered are intended to simplify the transition from FIRST to START while at the same time ensuring that the integrity of the tax system is preserved. The options were developed in the context of the wider tax policy framework of a clear and coherent broad-base, low-rate tax system.

Legislative change is required before February 2017 because this is when GST is planned to be transitioned from FIRST to START. This feature presented a timing constraint on the amount of consultation and the extent of the analysis that could be undertaken.

Inland Revenue has consulted with the Treasury who are supportive of the recommendations set out in this RIS. Wider consultation was not conducted due to timing constraints (legislative change is required before February 2017 as this is when GST would be transitioned from FIRST to START).

A key gap in the analysis is that Inland Revenue does not hold sufficient data to provide an estimate of the fiscal impact of the options relating to transfers of tax and amending the rules for new and increased assessments.

A key risk is if the transition of GST to START is delayed, then FIRST will operate inconsistently with the new legislation. Conversely, if the new legislation is delayed and GST is transitioned to START before the legislation is enacted, START would not be compliant with the existing legislation as it would be programmed in anticipation of the legislative amendments being passed.

None of the policy options would impose additional costs on businesses, impair private property rights, restrict market competition, reduce the incentives for businesses to innovate and invest, or override fundamental common law principles.

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## **Reader's guide to this RIS**

This RIS covers three different proposals. The RIS begins with generic background and objectives sections. These are followed by a regulatory impact analysis section which provides an overview of each of the problems and their associated options for change. Within the overview tables in this section the following symbols are used:

- ✓✓ - Significant improvement over the status quo
- ✓× - Partial improvement over the status quo
- ×× - No improvement over the status quo

In order to enhance readability, detailed analysis on each of the proposals has been shifted into a set of three appendices, one for each proposal.

Common consultation, conclusion, implementation and review sections follow the regulatory impact analysis section.

## **STATUS QUO AND PROBLEM DEFINITION**

### **Inland Revenue's transformation programme**

1. The Government's objective for the revenue system is for it to be as fair and efficient as possible in raising the revenue required to meet the Government's needs. For taxpayers the tax system should be simple to comply with, making it easy to get it right and difficult to get it wrong. It should serve the needs of all New Zealanders, put customers at the centre and help them from the start, rather than when things go wrong.
2. The shift to digital and greater globalisation has reshaped how businesses and individuals interact and connect, and their expectations of government.
3. Businesses are increasingly using software packages to automate processes and reduce their compliance burden. Businesses have consistently ranked tax as their highest compliance priority, and it often contributes the most to their overall compliance burden. Compliance costs could be reduced by making better use of businesses' everyday processes and systems to meet tax obligations. Enabling businesses to spend less time on tax and more time on running their business will support Government's wider goals of building a more competitive economy and delivering better public services.
4. The ways in which individuals work have changed with different types of employment and working arrangements. The New Zealand workforce has become more casual in nature as permanent employment has become less common, and temporary, casual and contract work has become more prominent. Other trends include part-time and temporary workers increasingly holding multiple jobs, and more self-employment and small businesses. Many of the current tax policies and administrative processes were designed for an era when New Zealand's workforce was more strongly characterised by salary and wage earners in permanent full-time employment arrangements.
5. To protect the Government's ability to collect sufficient revenue to keep providing services, it is important that New Zealand's revenue system keeps pace with change and is as efficient as possible. The fiscal challenges associated with an ageing population and associated demand for high quality healthcare and other services will add impetus to the need for a highly efficient and responsive revenue system. To meet these challenges, Inland Revenue requires a fundamental shift in the way it thinks, designs, and operates.
6. The Government has agreed to change the revenue system through business process and technology change. A digitally-based revenue system, simplified policies, and better use of data and intelligence to better understand customers will simplify how services are delivered and change how customers interact with the revenue system.
7. Having a good overall revenue system means having both good policies and good administration. While the policy framework is fundamentally sound, there is an opportunity to review current policy and legislative settings as levers to help modernise the revenue system and ensure it is responsive to global changes.

8. There is no doubt that Inland Revenue's computer systems (known as FIRST) need replacement to improve resilience and agility. They have reached the end of their life and are not sustainable in the medium to long term. The FIRST systems are aging, extremely complex, very difficult and costly to maintain, and inflexible. Since FIRST was implemented, a number of income-related social policies have been added to the platform. Implementing social policies within a platform designed for tax administration has added layers of complexity and risk to Inland Revenue's business processes and technology infrastructure. This in turn limits the department's ability to respond to government policy priorities.

9. However, Business Transformation (BT) is far more than just updating a computer system. It is a long-term programme to modernise New Zealand's revenue system, and will re-shape the way Inland Revenue works with customers, including improvements to policy and legislative settings and enabling more timely policy changes. A new operating model and new systems will be the catalysts for these changes.

10. As part of BT, FIRST will be replaced with a commercial-off-the-shelf tax and social policy software package from FAST Enterprises, referred to as START.<sup>1</sup> The revenue system will be transitioned to START in the following stages:

- **Stage 1** – GST (early 2017)
- **Stage 2** – income and business taxes
- **Stage 3** – social policy
- **Stage 4** – any remaining taxes and duties

11. While thinking about how to transition the revenue system to START, three problems have been identified which relate to:

- **Use-of-money interest (UOMI) and transfers of tax.** Put simply, taxpayers are able to receive more UOMI from Inland Revenue on overpayments/refunds of tax than they are entitled to in some circumstances. Underpayment UOMI payable to Inland Revenue on underpayments is also reduced in some circumstances. These outcomes adversely impact the integrity and coherence of the current rules and give rise to both efficiency and fairness concerns
- **Amending the rules for new and increased assessments by the Commissioner after the original due date (removal of the new due date concept)** to remove the requirement for setting a new due date for payment to avoid having to customise the configuration of START to create a new due date in such situations.
- **The administration of the grace periods concept throughout the transition of tax types from FIRST to START.** Different tax types will be transitioned to START in different stages. This means that there will be a period in which tax

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<sup>1</sup> START stands for 'Simplified Tax and Revenue Technology' and is the name chosen by Inland Revenue for the GENTAX software provided by FAST Enterprises LLC.

types will be administered from two different systems. This raises an issue with respect to late payment penalty grace periods, as the current rules require the Commissioner to look at the taxpayer's payment history across multiple tax types in determining whether the taxpayer is entitled to a grace period. This would give rise to administrative complexity and cost for Inland Revenue as tax types transition from FIRST to START.

12. Some background and more detail on each of these problems are provided in the appendices at the end of this document.

## **OBJECTIVE**

13. The **main objective** of the options is to simplify the transition from FIRST to START while ensuring the integrity of the tax system is preserved.

14. The transition from FIRST to START is simplified where START is customised as little as possible.

15. The integrity of the tax system is preserved when:

- Taxpayers receive the amount of UOMI they are entitled to, and can continue to legitimately transfer excess tax to mitigate the effects of underpayment UOMI.
- Taxpayers understand how interest and penalties are calculated, their interactions with Inland Revenue are minimised, and revenue collection is improved.
- The Commissioner is able to administer a “grace periods” concept efficiently and accurately in a way that does not present difficulties or complexities for taxpayers.

16. All options are assessed against the following criteria:

- (a) **Fairness and equity:** to support fairness in the tax system, options should, to the extent possible, seek to treat similar taxpayers in similar circumstances in a similar way.
- (b) **Efficiency of compliance and administration:** the compliance cost impacts on taxpayers and the administrative costs to Inland Revenue should be minimised as far as possible.
- (c) **Sustainability of the tax system:** options should collect the revenue required in a transparent and timely manner while not leading to tax driven outcomes.

17. Legislative change is required before February 2017 as this is when GST is planned to be transitioned from FIRST to START. This feature presented a timing constraint on the extent of the analysis and consultation that could be undertaken.

18. It is also noted that we do not have sufficient data to provide an estimate of the fiscal impact of the options relating to transfers of tax and amending the new due date rules for new and increased assessments.

19. There are no social, environmental or cultural impacts associated with the recommended changes.

## **REGULATORY IMPACT ANALYSIS**

20. Officials have developed options to address the above three problems. Each of these problems and the options to resolve them are summarised below. Further detail on these problems and their associated options is contained in the appendices at the end of this document.

### **UOMI and transfers of tax**

21. There are two issues associated with UOMI and transfers of tax:

- *Issue 1:* When an amount transferred to a previous period exceeds the amount owing in that period, UOMI on the excess may start to accrue earlier than if the amount had remained in the original period. This will occur whenever the effective date for the transfer is earlier than the “date interest starts” under the UOMI rules. This is because FIRST incorrectly pays interest from the transfer date, rather than the applicable date under the UOMI rules. Taxpayers aware of this inconsistency are able to make use of it by transferring any overpayment or refund of tax to a prior period before seeking a refund. This is a system and administrative issue as FIRST is incorrectly applying the law. START is able to correctly apply the law with manual administrative processes for staff. Appendix A contains an example that illustrates this issue.
- *Issue 2:* FIRST transfers overpayments of tax at the effective transfer date of a refund, rather than the effective transfer date of an overpayment. Thus where an overpayment has been transferred to satisfy a debt in a previous period, UOMI on that debt will stop accruing earlier than intended because that debt would be treated as having been paid off earlier - that is, at the refund effective transfer date, rather than the overpayment transfer date. Appendix A contains an example that illustrates this issue.

22. These issues arise because FIRST is unable to track the source of a credit (a positive balance for the taxpayer) – for example, what period it arose from and whether it arose from a refund or an overpayment. As a result, FIRST pays UOMI on credits (i.e. refunds or payments) added to a period from the date they are added (rather than the correct date under the UOMI rules), and transfers of overpayments are made at the refund date, rather than the payment date. A further cause of issue 2 is that there is a lack of clarity in the law – basically the law allows a GST overpayment to be transferred at the effective date of a GST refund. The law is clear in relation to transfers of other tax types.

**Options and analysis**

23. Appendix A contains detailed analysis of the options.

24. The status quo does not meet the objective as START would need to be customised in order to apply the status quo (i.e. START would need to be customised to incorrectly apply the law just as FIRST does) and taxpayers would be able to receive more UOMI than they are entitled to. The status quo has the following implications:

- Fairness and equity: Taxpayers with knowledge of the inconsistencies would gain an unfair advantage.
- Efficiency of compliance and administration: Taxpayers would incur compliance costs, and Inland Revenue would incur administration costs resulting from tax being transferred to prior periods that are not in debt or dispute.
- Sustainability of the tax system: Taxpayers would continue to be able to artificially manipulate UOMI calculations.

Options	Analysis against the objective and criteria
<p>Option 1 - Amend the transfer rules to prevent transfers of tax to previous periods that exceed the amount of debt or amount in dispute in that period. Amend the transfer and UOMI rules as they relate to GST to ensure the law achieves the policy intent.</p>	<p>Meets the main objective.</p> <p>Fairness &amp; equity: ✓✓                      Compliance and administration: ✓×                      Sustainability: ✓✓</p> <p>Overall comment: Significant improvement on status quo.</p>
<p>Option 2 – Configure START to correctly apply the current law. Amend the transfer and UOMI rules as they relate to GST to ensure the law achieves the policy intent.</p>	<p>Partially meets the main objective.</p> <p>Fairness &amp; equity: ✓×                      Compliance and administration: ✓×                      Sustainability: ✓×</p> <p>Overall comment: Improvement on status quo.</p>

**Recommendation**

25. Option 1 was recommended over option 2 as it prohibits excess transfers of tax to prior periods which would prevent taxpayers artificially manipulating UOMI calculations in relation to all tax types. Although taxpayers would be prevented from gaming the system with option 2, this would only be in relation to tax types administered by START. Therefore, if option 2 were chosen, taxpayers would continue be able to game the system in relation to some tax types until 2021 when all tax types have been transitioned to START. Although there would be no harm in allowing excess transfers of tax to prior periods once all tax types were administered by START, such a transfer would serve no purpose. It might also be beneficial to limit these transfers in order to prevent mistakes (i.e. the taxpayer might mistype the period they wished to transfer to).



## **Amending the rules for new and increased assessments by the Commissioner (removal of the new due date concept)**

26. If a taxpayer does not file a tax return, or if a taxpayer files an incorrect tax return, the Commissioner may, subject to limits on her powers, make an assessment for the amount of tax that ought to be imposed. When this occurs, a new (and later) due date that is 30 or more days after the notice of assessment date is generally set for the payment of the resulting tax liability. This allows the taxpayer time to pay the increased tax liability.

27. Interest applies from the day after the original due date for the payment of the tax. However, late payment penalties on the increased assessment are imposed on the day after the new due date for the outstanding tax liability if the taxpayer does not pay the tax outstanding plus interest in full by the new due date. These rules result in different due dates in relation to a single tax period which adds complexity.

28. In addition, any excess tax or amount that becomes refundable (this can be for another tax type or period) between the notice of assessment and the new due date is generally refunded to the taxpayer who is then required to repay the relevant amount to the Commissioner shortly afterwards (by the new due date). This increases compliance costs and effort for taxpayers and increases the risk of incurring additional UOMI and late payment penalties if the taxpayer does not pay the relevant amount in time.

29. There are differences in the way Inland Revenue's current FIRST system and the new START system operate. In FIRST a new due date has to be created for each new or increased assessment in order to allow time for the taxpayer to pay the resulting tax before late payment penalties are imposed. START's core functionality operates on a taxable period basis that allows for a period of time for payment before late payment penalties apply without requiring a new due date to be established each time the Commissioner makes an (re-)assessment for a taxable period. This reduces complexity and reflects the fact that the relevant assessment relates to the original due date of the period and would have been due to be paid on the original due date. However, implementing the current legislative framework for setting new due dates for each new or increased assessment in START requires significant customisation and limits the ability to use some of START's core functionalities.

30. During the course of the BT Programme there would be a period of "co-existence" in which some tax and social policy products would be administered in START and others would be administered in FIRST ("the Coexistence Period"). The amendment outlined in option 2 below would only apply to tax types administered in START. This means that during the Coexistence Period taxpayers would be treated differently depending on the tax type that the Commissioner assessed or re-assessed and whether this tax type was administered in FIRST or in START.

### ***Options and analysis***

31. Appendix B contains detailed analysis of the options.

Options	Analysis against the objectives
Option 1 – Maintain the status quo and customise START – a new due date is set for a (re-)assessment 30 days or more after the notice of (re-)assessment and late payment penalties are applied from the day after the new due date.	The status quo does not meet the main objective as it will require significant customisation of START. Fairness & equity: ✓× Compliance and administration: ×× Sustainability: ××
Option 2 – Amend the law so that no new due date is set for new or increased assessment; and late payment penalties are applied 31 days or later after the date of the notice of assessment.	Meets the main objective . Fairness & equity: ✓× Compliance and administration: ✓✓ Sustainability: ✓×  Overall comment: Improvement on status quo.

### ***Recommendation***

32. Officials recommend option 2 because it would avoid heavy customisation of START, minimise compliance costs for some taxpayers and improve revenue collection.

### **The administration of the grace periods concept through the transition of tax types from FIRST to START**

33. During the course of the BT Programme, there will be a period of “co-existence”, in which some tax and social policy products will be administered in START and others will be administered in FIRST (“the Coexistence Period”).

34. As information relating to the taxpayer’s tax compliance history and payment activity would reside in two systems, it would be difficult for the Commissioner to look across all applicable tax types to determine whether the taxpayer is entitled to a late payment penalty grace period.

### ***Options and analysis***

35. Appendix C contains detailed analysis of the options.

Options	Analysis against the objectives
Option 1 – Maintain the status quo by manually managing grace periods across FIRST and START	The status quo only partially meets the main objective because it would require significant manual intervention.  Fairness & equity: ✓✓ Compliance and administration: ×× Sustainability: ✓×

Options	Analysis against the objectives
Option 2 – Integrate FIRST and START to deliver customer level grace periods (integration approach)	Does not meet the main objective  As this option does not meet the overarching objective, it does not need to be assessed against the criteria.
Option 3 – Amend the law	Meets the main objective  Fairness & equity: ✓✗ Compliance and administration: ✓✓ Sustainability: ✓✓  This option does not result in an improvement to the status quo with respect to fairness and equity, only partially meeting the criterion, whereas the status quo is fair and equitable. However, this option represents a significant improvement on the status quo with respect to the compliance and administration and sustainability criteria.

### ***Recommendation***

36. Officials recommend option 3 on the basis that it would allow accurate and consistent application of the grace periods concept throughout the coexistence period and it would not give rise to any issues with respect to compliance and administration.

### **CONSULTATION**

37. Inland Revenue officials have consulted with the Treasury who are supportive of the options chosen in this RIS.

38. Wider consultation was not conducted owing to time constraints – legislative change is required before February 2017 because this is when GST will be transitioned from FIRST to START. Officials have commenced limited consultation with CAANZ on the proposals to test their reaction. CAANZ has indicated it supports the grace periods proposal. Officials are still to hear back from them in relation to the other two proposals.

### **CONCLUSIONS AND RECOMMENDATIONS**

#### **UOMI and transfers of tax**

39. Inland Revenue prefers option 1, which is to amend the transfer rules and UOMI rules to limit transfers of tax to prior periods and to ensure the law achieves the policy intent, for the following reasons:

- It would prevent taxpayers from artificially manipulating UOMI calculations in order to obtain a benefit. This would result in a fiscal gain as Inland Revenue would no longer be paying UOMI to taxpayers who are not entitled to it.
- It would address inconsistencies in the legislation and improve clarity.
- It will prevent taxpayers accidentally transferring excessive amounts to prior periods.

**Amending the rules for new and increased assessments by the Commissioner (removal of the new due date concept)**

40. Inland Revenue prefers option 2 for the following reasons:

- It would simplify the design of START in relation to new and increased assessments.
- It would avoid customisation of START to minimise long term costs of the system.
- It would reduce compliance costs for taxpayers who wish to have credits applied to a debt and improve revenue collection.

**The administration of the grace periods concept throughout the transition of tax types from FIRST to START**

41. Inland Revenue prefers option 3 for the following reasons:

- It would allow for an accurate and consistent application of the grace periods concept throughout the Coexistence Period.
- It would not give rise to any system integrity issues.
- It does not require systems to be developed to integrate FIRST and START.

**IMPLEMENTATION**

42. Amendments to the Tax Administration Act 1994 would be required in order to give effect to these proposals. It is proposed that these amendments be included in the Taxation (Provisional Tax, Exchange of Information, and Remedial Matters) Bill, which is expected to be introduced later this year and receive Royal assent by the end of 2016.

43. When introduced to Parliament, commentary would be released explaining the amendments, and further explanation of their effect would be contained in a *Tax Information Bulletin*, which would be released shortly after the bill receives Royal assent.

44. Inland Revenue would administer the proposed changes. The proposals would have minor systems implications for Inland Revenue but may result in some additional

administrative costs, such as costs associated with publications to communicate the changes. There would also be some staff costs associated with the UOMI and transfers of tax proposals, which is examined in further detail below. These costs are expected to be insignificant and would be met as part of Inland Revenue's Business Transformation Programme.

### **UOMI and transfers of tax**

45. It is important to note that these proposals would only apply to START, not to FIRST. This is because FIRST is unable to apply these amendments because of deficiencies in the FIRST system. It is not feasible to incur costs to amend FIRST when all tax types would be transitioned to START within a few years of the enactment of the legislation. In order to ensure compliance with the legislation, preventing transfers of excess tax to prior periods and ensuring transfers of overpayments to cover a debt in a prior period are made at the correct date would be dealt with administratively by Inland Revenue staff for all other tax types until such time as those tax types are transferred to START.

46. This is not expected to impose a significant administrative burden because:

- Taxpayers are unlikely to attempt to transfer excess tax to prior periods once aware it is no longer legal.
- Transfers of overpayments to cover debts in prior periods is relatively uncommon as taxpayers generally pay off their debts before paying upcoming tax liabilities in order to reduce their exposure to penalties and interest.

### **Amending the rules for new and increased assessments by the Commissioner (removal of the new due date concept)**

47. The proposal for new and increased assessments by the Commissioner would only apply to START and not to FIRST due to system constraints in the way FIRST operates. This means that the proposal would apply to assessments and re-assessments of tax types as and when they transition to START. The existing rules would continue to apply for assessments of tax types that have not yet transitioned to START.

### **The administration of the grace periods concept throughout the transition of tax types from FIRST to START**

48. The proposal for the administration of grace periods would require legislative amendment to ensure that the Commissioner is able to only look at compliance history that exists within the system from which the tax type in question (the tax type in respect of which there has been a payment default) is being administered.

49. As this legislative amendment would allow for each system to administer grace periods independently of the other, this proposal is not expected to impose a significant administrative burden. This is because it would remove the need for grace periods to be managed manually across the two systems.

## **Implementation risks**

50. A key implementation risk would arise if the application dates of the legislation do not align with the transition of GST to START. This would have the following implications:

- If the legislation is in force and GST has not transitioned to START, then FIRST would be operating contrary to the law. This risk could be managed administratively for the transfers of tax and new due date proposals – i.e. Inland Revenue would simply limit transfers of tax to prior periods and not assign a new due date to new/increased assessments. The grace periods proposal would be drafted in such a way that a delay in the transition of GST to START would have no impact.
- If the legislation is not in force but GST has transitioned to START, START would be operating contrary to the law as it would be coded in anticipation of the legislative amendments being passed. This could be managed administratively by backing out what START does, but would involve significant manual work and significant costs.

## **MONITORING, EVALUATION AND REVIEW**

51. Inland Revenue will monitor the effectiveness of the proposed changes in the first 12 months of operation. In general, Inland Revenue monitoring, evaluation and review of tax changes takes place under the generic tax policy process (GTPP). The GTPP is a multi-stage policy process that has been used to design tax policy (and subsequently social policy administered by Inland Revenue) in New Zealand since 1995. The final step in the process is the implementation and review stage, which involves post-implementation review of legislation and the identification of remedial issues. Opportunities for external consultation are built into this stage. In practice, any changes identified as necessary following enactment would be added to the tax policy work programme, and proposals would go through the GTPP.

## APPENDIX A – UOMI AND TRANSFERS OF TAX

### Background – status quo

#### *GST periods, refunds and overpayments*

1. GST registered persons<sup>2</sup> must file a GST return and pay any tax owing generally by the 28<sup>th</sup> of the month following the end of their taxable period. Taxable periods are one month, two months or six months.
2. A GST refund arises where GST inputs/expenses exceed GST outputs/sales. Instead of the taxpayer paying the GST output amount and claiming back the GST input amount, these amounts are netted off and the taxpayer receives a refund without making a payment. This is distinct from a GST overpayment – which occurs when the taxpayer pays more than is necessary to satisfy their tax liability.

#### *Use-of-money interest*

3. UOMI is applied to underpayments and overpayments of tax to compensate one party for the use of the other party's money and to encourage taxpayers to pay the correct amount of tax on time. If taxpayers pay too much tax, they receive interest at 1.62% per annum from the Commissioner until the excess is refunded by the Commissioner or applied to another tax liability, whereas if the taxpayer pays too little tax, they must pay the Commissioner interest at 8.27% per annum on the outstanding balance until the balance is paid. Taxpayers do not receive UOMI on prepayments of tax.
4. There are rules in the Tax Administration Act 1994 which determine the date interest starts for the purposes of credit (paid by Inland Revenue to the taxpayer) and debit (paid by the taxpayer to Inland Revenue) UOMI.
5. For underpaid tax, UOMI generally begins on the day after the due date for payment of the tax.
6. For overpaid tax and GST refunds, UOMI generally begins on the latest of:
  - The day after the due date for payment;
  - The day after the payment is made; or
  - The day after the tax return is provided.
7. UOMI stops being charged on underpaid tax on the date that the tax is paid or credited as paid (for example, when the taxpayer transfers tax from a period that is overpaid in order to satisfy the underpayment).

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<sup>2</sup> Taxpayers with an annual turnover from a taxable activity exceeding \$60,000 must register for GST. Taxpayers with a turnover below this threshold or bodies corporate may choose to register.

8. UOMI stops being earned on overpaid tax when it is refunded by the Commissioner or applied to another tax liability.

### ***Transfers of excess tax***

9. Taxpayers are able to transfer excess tax to another tax period or to another tax type or even to other taxpayers. This enables taxpayers to transfer overpaid tax to a period/tax type that has been underpaid, in order to reduce UOMI on that underpaid tax. The transfer rules in the Tax Administration Act 1994 restrict what date a taxpayer may choose to transfer excess tax. Tax may be transferred:

- On any date after the end of the GST return period in which the refund arose (for a GST refund).
- On any date that occurs on or after the date the excess tax is paid (for an overpayment of tax).
- A day after the end of the accounting year in which the amount was deducted (for tax deducted on the taxpayer's behalf – i.e. PAYE and RWT).

10. Put simply, a taxpayer is only able to transfer excess tax once they become entitled to it. GST refunds have an earlier effective transfer date than overpayments because the first of the month is in effect when the GST refund arose for the previous month.

11. The transfer effective date is very important as it affects when UOMI on a prior period underpayment stops being charged. For example, if a taxpayer owed \$200 for the June GST period, and was entitled to a GST refund of \$200 in the July GST period which he wished to transfer to the June period, the effective transfer date for this refund would be 1 August. UOMI on the June underpayment would cease at 1 August, as this is when the July refund is transferred to satisfy the June debt<sup>3</sup>.

### **Problem definition**

12. There are two issues with the current tax rules.

#### ***Issue 1 – excess UOMI on “overpayments”***

13. Taxpayers are able to receive more UOMI from Inland Revenue on “overpayments” than they are entitled to in some circumstances.

#### ***Example***

14. Bob files his 2014 income tax return and is due a refund of \$8,000 arising from tax being withheld at source at incorrect rates. He requests that this refund is transferred to his 2013 taxable period, which has a nil balance. The \$8,000 is transferred as its earliest effective

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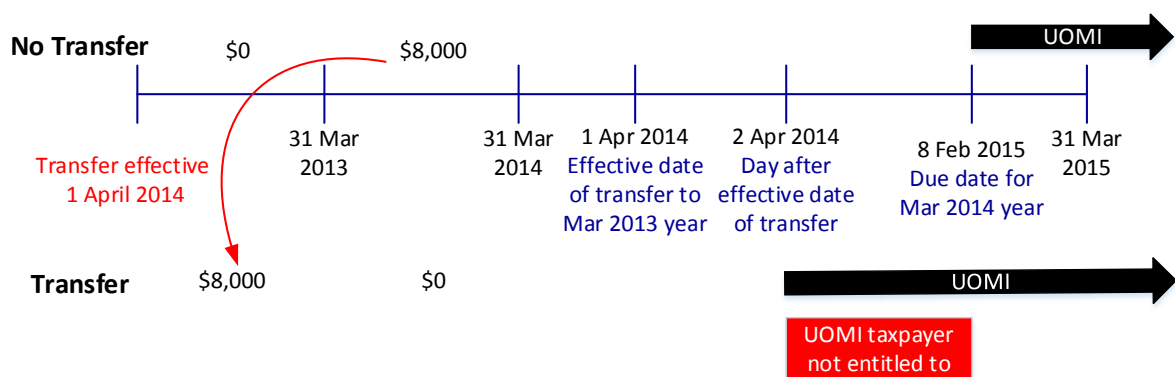
<sup>3</sup> For the purposes of this example assume no penalties or interest accrued on the \$200 debt, so that the \$200 payment fully satisfied it. Transfers are first applied to any interest or late payment penalties that have accrued on the debt, before being applied to the debt.



date of 1 April 2014 (the day after the end of the accounting year in which the amount was deducted – see paragraph 9).

15. FIRST treats this transfer date of 1 April as a payment date and pays UOMI on the \$8,000 balance from 2 April 2014 (the day after the “payment” was made). This is a misapplication of the rules as interest should begin on 8 February 2015 (the day after the due date for payment of tax for the 2014 period).

16. However, as FIRST is unable to track the source of payments, it sees a “payment” being made on 1 April and therefore the only UOMI rule it could apply would be the “day after the payment is made” rule (FIRST couldn’t use the “day after tax return is provided” or “day after due date for payment” rules as it is unable to track that the payment actually comes from a refund in the 2014 taxable period). As a result, Bob is paid almost a year’s worth of interest to which he is not entitled (interest is paid from 2 April 2014 rather than 8 February 2015).



17. Taxpayers aware of this inconsistency are able to make use of it by transferring any overpayment or refund of tax to a prior period before seeking a refund.

**Issue 2 – reduced UOMI on underpayments**

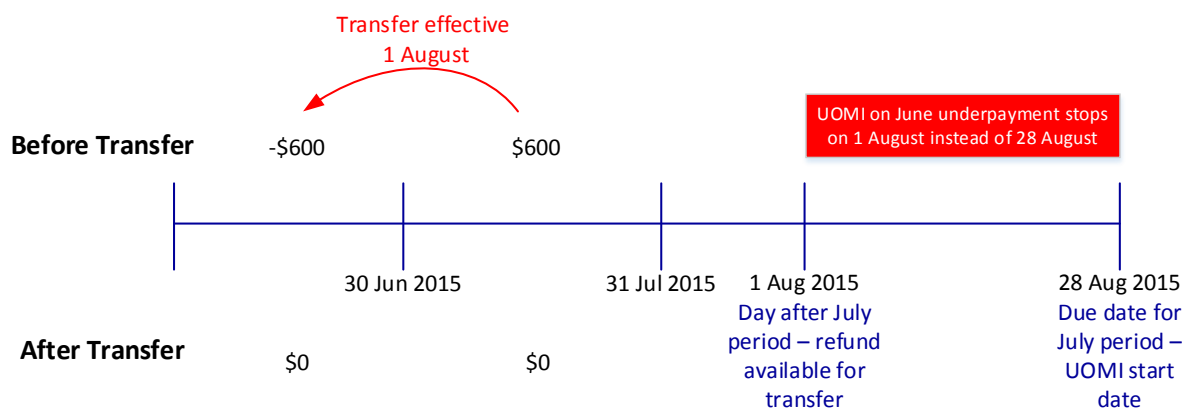
18. Taxpayers are able to reduce the amount of UOMI payable to Inland Revenue on underpayments of GST in some circumstances.

*Example*

19. Vicki has a debt of \$600 for her June GST period. She files her July GST return on 28 August, and mistakenly overpays (also on 28 August) by \$600. Vicki requests that this \$600 overpayment is transferred to the June period. Based on the intended application of the transfer rules, the effective date for this transfer is any date from 28 August.

20. FIRST treats the transfer as having been made on the 1st of August (which is the refund transfer date). As a result, UOMI that Vicki had to pay the IRD on her \$600 June debt ceases on the 1st of August,<sup>4</sup> rather than on the 28th of August (this is the correct date under the UOMI rules).

<sup>4</sup> For the purposes of this example assume no penalties or interest accrued on the \$600 debt, so that the \$600 payment fully satisfied it.



### *Scale of the problem*

21. A large number of tax agents manufacture UOMI by transferring any overpayment or refund of tax to a prior period before seeking a refund.

22. Without any legislative change, taxpayers could continue to “game the system” by artificially increasing the amount of UOMI paid to them by Inland Revenue. This practice effectively allows taxpayers who have knowledge of this inconsistency to push the tax burden disproportionately onto other taxpayers. This was not intended. The amount of underpayment UOMI taxpayers must pay to Inland Revenue would also be reduced in some circumstances, although taxpayers are unable to manipulate this.

### **Options and analysis**

23. Two options have been considered for addressing the problem and achieving the main objective. The options are:

- Option 1: Amend the transfer and UOMI rules (Officials’ preferred option).
- Option 2: Configure START to apply the current law.

### *Option 1*

24. Under this option, the following amendments would be made to the UOMI and transfer rules:

- Taxpayers would be prevented from transferring tax to a prior period that exceeds the amount of debt or amount in dispute in that period. This would prevent taxpayers from obtaining credit UOMI on overpayments transferred to prior periods.
- The difference between a GST refund and GST overpayment would be clarified for the purposes of the transfer rules. This would prevent taxpayers from being able to reduce underpayment UOMI by obtaining the GST refund effective transfer date for an overpayment.

- The difference between a GST refund and GST overpayment would be clarified for the purposes of the UOMI rules. This would enhance clarity in the legislation.

25. It is important to note that, unlike START, FIRST is unable to prevent transfers of excess tax to prior periods. By the application date of the above amendments, only GST would have transitioned to START. For all other tax types, these amendments would be manually administered by Inland Revenue staff (see paragraphs 45 and 46 in the main report for further information).

#### *Assessment against objective and criteria – option 1*

- Main objective: This option would meet the main objective for two reasons. First, START would not need to be customised in order to prevent transfers of tax to prior periods that exceed that amount in debt or dispute in that period, as this option is available within START's default settings. Second, taxpayers would only receive the amount of UOMI to which they are entitled and would continue to be able to mitigate the effects of underpayment UOMI by transferring refunds/overpayments to satisfy debts in prior periods.
- Fairness and equity: This option would improve equity as it would prevent taxpayers from obtaining UOMI artificially, therefore preventing taxpayers with knowledge of this from obtaining an unfair advantage over other taxpayers. This option meets this criterion.
- Efficiency of compliance and administration: This option would reduce compliance costs as taxpayers will no longer incur compliance costs associated with moving tax between periods in order to artificially manipulate UOMI. This option would result in a minor and temporary increase in administrative costs arising from Inland Revenue staff having to manually administer these amendments in relation to tax types that have not transitioned to START at the application date of the legislation. This option partially meets this criterion.
- Sustainability of the tax system: This option would improve the sustainability of the tax system as it prevents taxpayers from artificially manipulating UOMI calculations. It also prevents underpayment UOMI from ceasing earlier than it should. This option meets this criterion.

26. Option 1 represents a significant improvement on the status quo.

#### ***Option 2***

27. Under this option START would be configured to correctly apply the current law (i.e. START would be able to track the source of a credit so will know what period a payment came from, and would therefore be able to pay UOMI from the correct date). The law would only be applied correctly for tax types that are administered in START (tax types will be transitioned to START in stages as outlined in paragraph 10 in the main report), and therefore would not fully prevent the problems outlined until all tax types have transitioned to START.

Amendments would also be made to the transfer and UOMI rules in relation to GST (bullet points 2 and 3 of paragraph 24 of Appendix A).

*Assessment against objective and criteria – option 2*

- Main objective: This option partially meets the main objective. START would not need to be customised in order to be able to track the source of a credit as this is part of START’s inherent functionality. Taxpayers would receive more UOMI than they are entitled to on other tax types until those tax types are transitioned to START. Taxpayers could continue to mitigate the effects of underpayment UOMI by transferring refunds/overpayments to satisfy debts in prior periods.
- Fairness and equity: This option would improve equity as it would prevent taxpayers from obtaining credit UOMI artificially, however it only partially meets this criterion as taxpayers would be able to artificially obtain UOMI on tax types until they are transferred to START.
- Efficiency of compliance and administration: This option would reduce compliance costs (albeit delayed because of the timeline for transitioning other tax types to START) as taxpayers would no longer incur compliance costs associated with moving tax between periods in order to artificially manipulate UOMI. This option would only result in very minor administrative costs, such as costs associated with publications to communicate changes. This option partially meets this criterion.
- Sustainability of the tax system: This option would improve the sustainability of the tax system as it prevents (albeit delayed in relation to tax types other than GST) taxpayers from artificially manipulating credit UOMI calculations. This option partially meets this criterion.

28. Option 2 represents an improvement on the status quo.

**Fiscal implications of the options**

<b>Options</b>	<b>Fiscal impact</b>
Option 1 – Prevent transfers of excess tax, amend the UOMI and transfer rules.	This option results in an unquantifiable fiscal gain resulting from: - preventing taxpayers obtaining credit UOMI they are not entitled to; and - ensuring underpayment UOMI taxpayers must pay to Inland Revenue on underpayments is not artificially reduced.
Option 2 - Configure START to apply the current law.	This option also results in an unquantifiable fiscal gain resulting from the above; however it would be slightly delayed given that not all tax types will immediately transition to START.

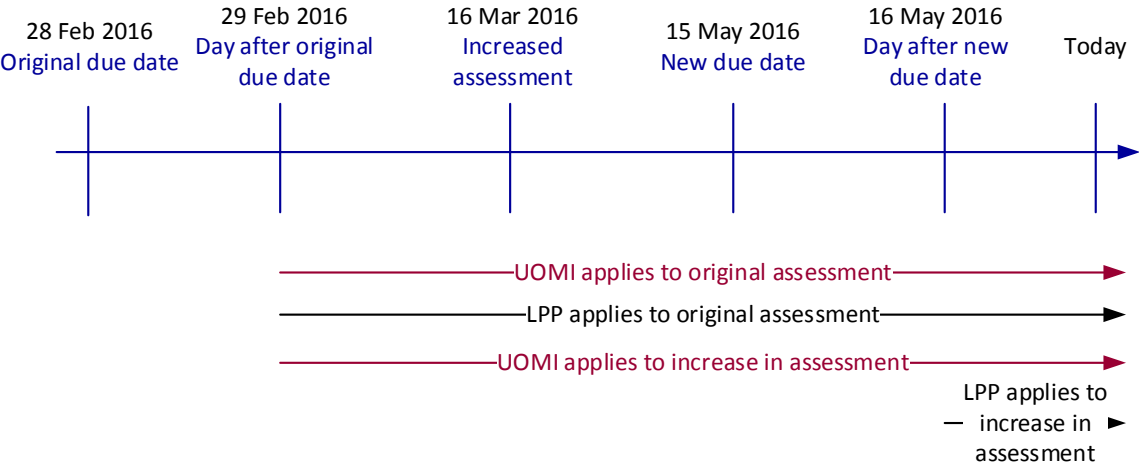
**APPENDIX B –DUE DATES FOR NEW AND INCREASED ASSESSMENTS BY THE COMMISSIONER**

**Background – status quo**

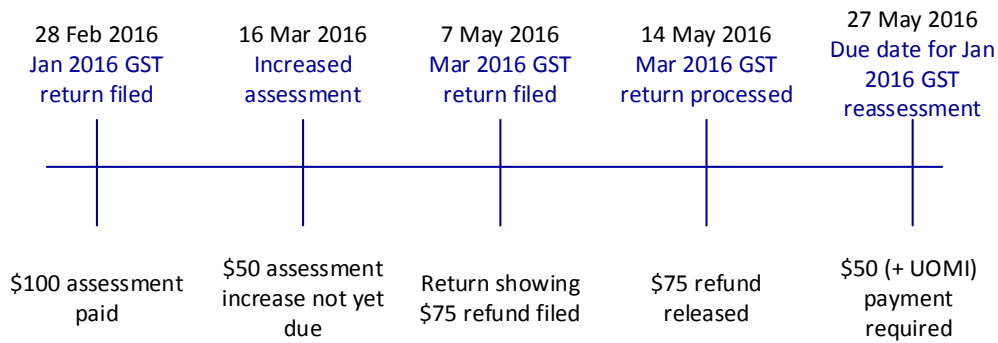
1. The transition from FIRST to START provides opportunities to streamline and improve the way taxpayers and Inland Revenue interact. However, it also presents some challenges due to the different ways FIRST and START operate. One area of opportunity and challenge is the setting of new due dates for new or increased assessments by the Commissioner and the resulting complexities.

2. The new due date is required to be set 30 or more days after the date of the notice of the assessment. Administrative practice is to set the new due date 60 days after the assessment. Interest starts on the day after the original due date for the payment of the tax. Late payment penalties, however, are imposed on the day after the new due date for the outstanding tax liability if the taxpayer does not pay the tax outstanding plus interest in full by the new due date. These new due date rules result in different due dates in relation to a single tax period which adds complexity to the calculation of interest and penalties.

3. The following diagram shows the differing dates for the calculation of UOMI and penalties for a January 2016 GST return that is not paid and is then reassessed on 16 March 2016.



4. The following diagram shows how a refund can be released even when the taxpayer has been assessed for a period that has passed its original due date for payment and will be required to pay the assessed amount shortly, and is already incurring UOMI.



## Problem definition

5. Implementing the current legislative framework for setting new due dates in START would require significant customisation and would limit the ability to use some of START's core functionalities. START has the ability to automatically apply any excess tax or credit that becomes refundable to satisfy a debit amount in the system. This limits underpayment UOMI charged to a taxpayer and also reduces the interaction they are required to have with Inland Revenue.

6. START does this by looking at taxable periods that have passed their due date and whether there is any outstanding amount in relation to these previous periods. However, this period based approach means that the system does not distinguish between a debt (an amount that has passed its due date for payment) and a debit (an amount that relates to a taxable period that has passed its original due date, but that itself is not yet due to be paid).

7. Although this system configuration can be suppressed, it would mean significant customisation and manual processing. This would also impact other desirable features of START, such as real-time balancing of taxpayer accounts which provides transparency for taxpayers of what they are required to pay at any time.

## Options and analysis

8. The status quo and an option for change have been considered for addressing the problem and achieving the main objective. The options are:

- Option 1: Maintain the status quo by customising START to allow the setting of a new due date for new and increased assessments (status quo).
- Option 2: Amend the law so that no new due date is set for a new or increased assessment by the Commissioner for taxable periods that have passed their original due date for payment, but allow time for payment of the assessed amount before late payment penalties are applied (officials' preferred option)

### *Option 1*

9. This option would involve implementing the existing new due date rules for new and amended assessments in START and customising START to the extent needed to allow for

different due dates (original and new due date(s)) to be created and managed within a single tax period.

#### *Assessment against objective and criteria*

- Main objective: This option would not meet the main objective as it would require significant customisation of START to an extent that it would limit the use of some of the core functionalities of START. Manually managing transfers and the application of credits against liabilities within START would be required. Owing to the significant complexity involved in manually managing transactions there is potential for error.
- Fairness and equity: Taxpayers have time to pay a tax liability resulting from a new or increased assessment before late payment penalties are applied. Taxpayers who have a refund available in START in the relevant timeframe will have this refunded to them then be required to make a separate payment on the due date. Taxpayers who are aware of this can ask for the refund to be transferred to meet their liability which may result in lower UOMI than if they have the amount refunded then repaid. This only partially meets the criteria.
- Efficiency of compliance and administration: Under this option any excess tax or other credit that becomes refundable to the taxpayer in the period between the notice of assessment and the new due date for payment will continue to be refunded to the taxpayer, despite the fact that the taxpayer will be required to make payment of the tax resulting from the notice of assessment to Inland Revenue shortly after receiving this refund (i.e. by the new due date). Manual managing of some transfers and the application of credits in payment of tax and other liabilities would be required, which gives rise to increased resourcing and administrative costs to Inland Revenue. This does not meet the criteria.
- Sustainability of the tax system: Due dates and the calculation of interest and penalties for new and increased assessments will continue to be complex. Taxpayers are at a higher risk of incurring penalties and increased interest because overpayments of tax are refunded to the taxpayer unless the taxpayer requests otherwise even where a payment is due shortly after the refund. This does not meet the criteria.

#### ***Option 2***

10. This option would involve a legislative change that the Commissioner would not set a new due date for new or increased assessments. However, the current way interest is calculated would be retained and the date for applying late payment penalties would also be unchanged as they would be imposed 31 or more days after the (re-)assessment.

11. During a Coexistence Period some tax types and social policy products will be administered in START and others in FIRST. In relation to this option this means that during the Coexistence Period taxpayers would be treated differently depending on the tax type that the Commissioner has assessed or re-assessed. For tax types that are administered in START no new due date would be set and refunds or credits becoming available would be applied to the tax liability from the assessment date. Relevant assessments of tax types that are

administered in FIRST would receive a new due date for payment. Credits and refunds that become available between the assessment date and the new due date would not be applied to offset the new or increased tax liability unless the taxpayer requests otherwise but would be refunded to the taxpayer.

*Assessment against objective and criteria*

- Main objective: This option would meet the objective as it would avoid customisation and minimise complexity of START and allow Inland Revenue to leverage the inherent system functionality.
- Fairness and equity: Taxpayers who have no refund available in START in the relevant timeframe will continue to have time to pay tax resulting from a new or increased assessment before late payment penalties are applied. These taxpayers will have the same financial outcome as under the status quo. However, taxpayers who have a refund available in START in the relevant timeframe will have this applied to satisfy their tax liability automatically when it becomes available. This means that these taxpayers would effectively “pay” earlier than is required under status quo; however, this may reduce their UOMI liability. Any further excess credits available would be refunded to the taxpayer. This is an improvement on the status quo.
- Efficiency of compliance and administration: Compliance costs are reduced for taxpayers whose refunds are applied to satisfy the tax liability arising from a new or increased assessment, instead of receiving a refund and having a payment obligation shortly after. This option would enable Inland Revenue to take advantage of START’s core functionalities in relation to automatic handling of transfers and application of credits to satisfy liabilities within the system and does not require any additional resources and accordingly does not give rise to the efficiency concerns raised in respect of option one. This is a significant improvement on the status quo.
- Sustainability of the tax system: Due dates, interest and penalty calculations within a tax period that had a new or increased assessment would be simplified and easier to follow for taxpayers. Revenue collection will be improved. This is an improvement on the status quo.

12. This option represents an improvement on the status quo.

**Fiscal implications of the options**

Options	Fiscal impact
Option 1 – Maintain the status quo	None
Option 2 – Amend the law	A small unquantifiable fiscal loss of UOMI due to automatic application of credit or refund to tax liability is largely offset by an earlier resolution of the tax obligation.



## APPENDIX C – ADMINISTRATION OF THE GRACE PERIODS CONCEPT

### Background – status quo

#### *Late payment penalty grace periods*

1. The current legislative framework for penalties sets out that a late payment penalty will be imposed if a taxpayer does not pay on time.<sup>5</sup> However, where the taxpayer has punctually paid all taxes due in the two years prior to the default in question, the Commissioner must first issue a notice to the taxpayer specifying a further date for the unpaid tax, before a late payment penalty can be imposed. This gives the taxpayer a grace period in which to pay the amount owing before the imposition of late payment penalties.<sup>6</sup>
2. The application of the late payment penalty grace period is determined on the basis of the taxpayer's previous compliance in terms of the payment of tax across all relevant tax types (such as GST, income tax and PAYE deductions).<sup>7</sup>
3. The transition from FIRST to START will be done on a tax-type by tax-type basis, with GST being transferred to START in early 2017 and income tax, FBT and PAYE being transferred in 2018. This raises an issue with respect to the late payment penalty grace period, as the current legislative framework for the application of the penalty requires the Commissioner to consider the taxpayer's compliance history across all applicable tax types.

### Problem definition

4. As information relating to the taxpayer's tax compliance history and payment activity will reside in two systems, it will be difficult for the Commissioner to look across all applicable tax types to determine whether the taxpayer is entitled to a grace period. Without significant manual intervention, or an integration of FIRST and START, Inland Revenue will not be able to administer the current grace period rule.

#### *Scale of the problem*

5. The manual intervention necessary to look across both systems to see all applicable tax types would require significant resources on the part of Inland Revenue.
6. By way of illustration, the number of customers who could have been eligible for a late payment penalty grace period in respect of the due date of 20 November 2015 was 603,867. If this were to occur during the Coexistence Period (with the status quo retained), this would require 603,867 manual interventions to correctly administer the grace periods rules.

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<sup>5</sup> A financial penalty for late payment of tax is automatically imposed at 1% on the initial date the tax was due to be paid, at 4% seven days later, and at 1% each month after that.

<sup>6</sup> If the taxpayer does not make payment within that notified further period, the late payment penalty is imposed as usual from the day after the original due date.

<sup>7</sup> The late payment penalty grace period applies to all tax types except the following: child support, student loan scheme, tax credits (formerly known as rebates), certain types of provisional tax, KiwiSaver voluntary employer contributions and complying fund debt referred to Inland Revenue from the Financial Markets Authority.

## Options and analysis

7. Two options for change and the status quo have been considered for addressing the problem and achieving the stated objectives. The options are:

- Option 1: Maintain the status quo by manually managing grace periods across FIRST and START (status quo)
- Option 2: Integrate FIRST and START to deliver customer level grace periods (integration approach).
- Option 3: Amend the law (officials' preferred option).

8. Within the third option, there are two “sub-options” with respect to the way in which the selected legislative amendment makes provision for the consideration of payment behaviour history. The two “sub-options” are outlined below, as part of the analysis of the third option.

### *Option 1*

9. This option would involve continuing to apply the existing grace period rules until all tax types have been transitioned and the implementation of START is complete. As the current rules require a taxpayer's compliance history across all tax types to be considered, this option would require Inland Revenue to manually manage customer-level grace periods across FIRST and START.

### *Assessment against objective and criteria*

- Main objective: This option partially meets the objective because, while it does not require any additional configuration to the START system and will not present difficulties or complexities for taxpayers, it would require significant manual intervention.
- Fairness and equity: Retaining the current grace period regime throughout the Coexistence Period maintains equity among taxpayers as, in all cases, the applicability of a grace period will be determined on the basis of the taxpayer's compliance across all tax types, irrespective of whether the tax type in question is being administered through FIRST or START. This option meets this criterion.
- Efficiency of compliance and administration: This option does not meet this objective in that manually managing grace periods across the two systems would give rise to increased resourcing and administrative costs to Inland Revenue. In addition, it is considered that this option poses a risk to the integrity of Inland Revenue's administration of the tax system due to the significant complexity of and difficulties inherent in manually managing grace periods across two systems, and the risks associated with this. Manually managing grace periods across two systems gives rise to significant potential for error, which could also inadvertently result in different treatment among taxpayers.

- Sustainability of the tax system: This option preserves the application of the current grace periods rules and therefore will not give rise to any difficulties for taxpayers or to the potential for tax-driven outcomes. There is, however, the potential for this option to give rise to an integrity risk for Inland Revenue, in that manually managing grace periods across two systems will generate significant potential for error. This option partially meets this criterion.

### ***Option 2***

10. The Integration Approach involves continuing to apply the existing grace period rules and integrating FIRST and START to the extent needed to identify all late payments and determine the appropriate application of grace periods.

11. Integrating FIRST and START for the purpose of managing grace periods would require real-time interfaces in FIRST and START to enable the real-time transfer of information, which would require new code to be written. The new code and real-time interfaces developed for this purpose would only be used for the duration of the Coexistence Period. As this option requires START to be reconfigured, this option does not meet this objective.

#### *Assessment against criteria*

12. As this option does not meet the overarching objective, it is not a viable option and accordingly does not need to be assessed against the criteria.

13. This option would not lead to any improvement on the status quo.

### ***Option 3***

14. This option involves amending the legislation to allow grace periods to be managed independently in each of the two systems.

15. The proposed legislative amendment would mean that when a taxpayer defaults on a payment, the Commissioner would only look at information regarding the taxpayer's previous behaviour that is contained in the system (FIRST or START) from which the tax type in question is being administered when determining whether the taxpayer is entitled to a grace period.

16. The previous behaviour information that is contained in START will be dependent on the form in which compliance history is brought across to START. The two options for the way in which taxpayer compliance history is brought across to START are outlined below.

#### *(a) Customer level indicator*

17. The first option with respect to the transfer of compliance history to START is to bring across an indicator that would show when the taxpayer is next entitled to a grace period, based

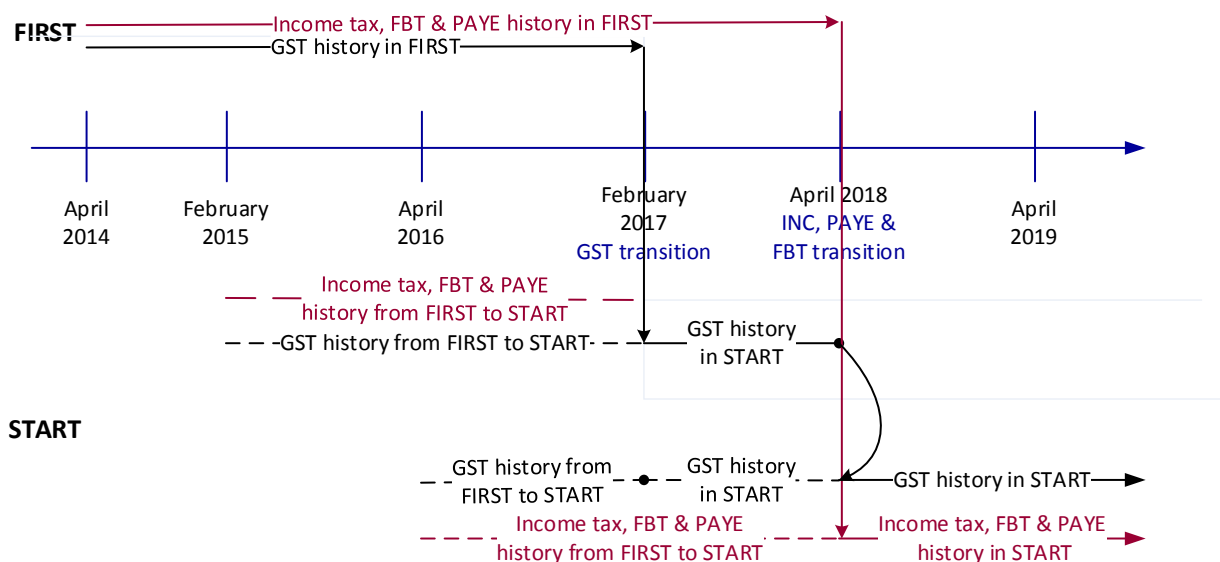
on the date that they last paid late. The indicator would encompass the taxpayer's payment history from February 2015 (two years before GST is brought across to START) to February 2017 in respect of income tax, GST, FBT and PAYE.

18. Although the taxpayer's payment history across all these tax types will inform the indicator date (the date at which the taxpayer will next be entitled to a grace period) it will not be possible to identify the tax type in respect of which the default has occurred.

19. During Stage 1 of START, this indicator would be used to determine whether the taxpayer is entitled to a grace period when they default on a GST payment (where the GST period in issue is a period after the date on which GST was transferred to START). Where the taxpayer defaults on a payment in respect of a tax type that is still being administered through FIRST, the compliance history that exists in FIRST at that time will be used to determine whether the taxpayer is entitled to a grace period.

20. It should be noted that the indicator will be a "snapshot" of the taxpayer's compliance history from February 2015 to February 2017. Information relating to the taxpayer's compliance regarding income tax, PAYE and FBT after February 2017 will not be able to be taken into account in determining whether the taxpayer is entitled to a grace period when they default on a GST payment after this date. As time passes, there will accordingly be a "compliance history relevance tail-off" in terms of the indicator for the purposes of determining whether the taxpayer will be entitled to a grace period for products remaining in FIRST in respect of defaults in payments of GST.

21. The intention is that a new "compliance indicator" will be brought across when income tax is transitioned to START. Assuming that income tax is transitioned to START in April 2018 (noting that this is only a proposed date), this second indicator would encompass the taxpayer's payment history from April 2016 (two years before income tax is brought across to START) to April 2018 in respect of income tax, FBT and PAYE. The second indicator would "top up" the relevant compliance history encompassed by the first indicator from February 2019 (the end date of the indicator brought across with GST) to April 2020 (two years from the date on which the second compliance indicator is brought across). As GST will have been operated from START from February 2017, the information that is brought across by the second indicator will not encompass GST. The information relating to the taxpayer's compliance with respect to GST payments will be required to "supplement" the information on the second indicator. This is illustrated on the diagram below.



22. Compliance information with respect to periods that occur after the tax type in question has transitioned to START will only exist in START and will not be visible in FIRST.

*(b) Individual tax type compliance history*

23. The second option with respect to the transfer of compliance history to START is to only bring across compliance history that relates to the specific tax type that is being transferred. For stage one, only the customer's compliance history that relates to GST would be transferred across to START. This option would mean that, if a taxpayer misses a payment date, the Commissioner would only look at the taxpayer's previous behaviour regarding payments made in respect of the tax type in question, and any other tax types administered from the same system, when determining whether or not to impose a penalty.

24. During stage 1 of the implementation of START, this would mean that the timeliness of a taxpayer's GST payments would be considered in isolation from all other tax types. As the Business Transformation Programme continues and more tax types are moved from FIRST to START, a more holistic view of the timeliness of a taxpayer's payment history would once again be considered when deciding whether to apply a late payment penalty.

25. Compliance information with respect to periods that occur after the tax type in question has transitioned to START will only exist in START and will not be visible in FIRST.

*Required legislative amendments*

26. Irrespective of which of the compliance history options is selected, the third option will require legislative amendment to ensure that the Commissioner is able to only look at the compliance history that exists within the system from which the tax type in question (the tax type in respect of which there has been a payment default) is being administered.

### *Assessment against objective and criteria*

- Main objective: This option will not require any additional configuration to START, irrespective of which of the compliance history options is selected. This option therefore meets the objective.
- Fairness and equity: This option raises an issue with respect to horizontal equity in that, during the period in which different tax types are administered out of different systems, some taxpayers will be able to benefit from a grace period to which they would previously not have been entitled. The way in which this could arise is illustrated by the following hypothetical examples:<sup>8</sup>
  - (i) The date is 31 August 2017. Taxpayer 1 is a small business owner who fails to pay their GST liability by the 28 August 2017 due date. They were two weeks late in paying their PAYE liability by the 20 June 2017 due date. As the PAYE period in which they defaulted occurred after GST and the compliance history indicator was transferred to START, this will not be able to be considered in determining whether Taxpayer 1 will be entitled to a grace period in respect of their late payment of GST for the period ended 28 June 2017. Taxpayer 1 will accordingly be entitled to a grace period to which they would not, under the current system, have been entitled.
  - (ii) The date is 31 August 2017. Taxpayer 2 is a small business owner who fails to pay their PAYE liability by the 20 August 2017 due date. They were also two weeks late in paying their GST liability by the 28 June 2017 due date. As the GST period in which they defaulted occurred after GST was transferred to START, this will not be able to be considered by FIRST in determining whether Taxpayer 2 should be entitled to a grace period in respect of their late payment of PAYE for the period ended 20 August 2017. Taxpayer 2 will accordingly be entitled to a grace period to which they would not, under the current system, have been entitled.
  - (iii) The date is 30 June 2017. Taxpayer 3 is a small business owner who fails to pay their PAYE liability (of one period) by the 20 June 2017 due date. They were two weeks late in paying last year's income tax liability, due 7 April 2016. A late payment penalty will automatically be imposed, as PAYE and income tax will still be being administered within the FIRST system. Taxpayer 3 will not be entitled to a grace period, as they were late in paying the income tax they owed last year. Viewed against the previous two examples, this scenario illustrates how, under option 3, taxpayers' entitlements to a grace period will to some extent be dependent on the tax type in respect of which they have made a late payment and the system through which this tax type is being administered.

It should be noted that option (b) with respect to the way in which compliance history is brought across to START gives rise to a slightly greater issue with respect to horizontal

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<sup>8</sup> It is assumed, for the purpose of these scenarios, that the taxpayer has not defaulted on any payments other than those stated in the examples.

equity (in that the number of scenarios in which a taxpayer could be afforded a grace period to which they would, under the current system, have previously not been entitled is greater). This is illustrated by a comparison of the two compliance history options in the following example:

- (iv) The date is 28 June 2017. Taxpayer 4 fails to pay their GST payment due on 28 June 2017. They previously defaulted on their income tax payment due on 7 April 2016. If option (a), the compliance history indicator, is selected as the way in which compliance history should be transferred to START, Taxpayer 4 will not be entitled to a grace period, as information relating to their payment history in respect of all tax types (including income tax) from February 2015 to February 2017 will have been transferred to START. If option (b), the individual tax type compliance history, is selected as the way in which compliance history should be transferred to START, Taxpayer 4 will be entitled to a grace period, as only historical information concerning their payment behaviour with respect to GST will be brought across to START.

In light of this, it is considered that the preferred option with respect to the way in which compliance history is transitioned to START is option (a), the customer-level indicator.

It is noted, however, that the legislative amendment option with the customer-level indicator does not result in an improvement to the status quo with respect to the fairness and equity criterion. The fact that some taxpayers will be able to benefit from a grace period to which they would not otherwise have been entitled means that this option only partially meets the fairness and equity criterion. The status quo meets this criterion.

- Efficiency of compliance and administration: As this option will enable grace periods to be managed independently in each system, it will not give rise to any compliance or administration issues. This option represents a significant improvement on the status quo, as it will not require any manual management and will therefore not require any additional resources.
- Sustainability of the tax system: This option will not give rise to any difficulties for taxpayers or to the potential for tax-driven outcomes. This option represents a significant improvement on the status quo as it does not give rise to the potential for error as a result of manual intervention.

27. Overall, this option would represent an improvement on the status quo.

**Fiscal implications of the options**

<b>Options</b>	<b>Fiscal impact</b>
Option 1 – Status quo	This option does not result in any fiscal impact as it maintains the current grace periods legislative provisions.
Option 2 – Integration Approach	This option does not result in any fiscal impact as it maintains the current grace periods legislative provisions.
Option 3 – Officials’ preferred option	<p>This option results in a fiscal loss in that it gives rise to instances where a taxpayer could be granted a grace period to which they would not, under the current rules, have been entitled. A fiscal loss will be incurred in each year of the Coexistence Period, as follows:</p> <ul style="list-style-type: none"> <li>• June 2015 – June 2016: \$0.1 million</li> <li>• June 2016 – June 2017: \$1.5 million</li> <li>• June 2017 – June 2018: \$1.3 million</li> <li>• June 2018 – June 2019: \$0.1 million</li> <li>• June 2019 – June 2020: \$0.1 million</li> </ul> <p>The fiscal loss detailed above has been calculated on the basis of option (a), the customer-level indicator, being selected as the way in which compliance history is brought across to START. Option (b), the individual tax type compliance history option, would result in a slightly higher fiscal cost due to it resulting in a greater number of instances in which a taxpayer could be afforded a grace period to which they would not have been entitled.</p>