

FLEXIBLE TAX FOR BUSINESS

DISCUSSION DOCUMENT

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Labour's Flexible Tax for Business proposal is designed to give businesses more flexibility and control over when they pay their tax.

It has three parts:

1. An entirely flexible voluntary withholding tax, to let businesses meet their tax obligations at a rate of their choosing and on their own timetable, rather than the current rigid system of provisional tax.
2. Raise the threshold for businesses to pay provisional tax from \$2500 to \$5000.
3. Remove late payment penalties on provisional tax.

Current problem

Provisional tax is a significant burden for many small businesses. It requires them to forecast their earnings for the next year and pay tax in instalments that may not reflect their actual earnings. This can lead to significant tax bills at the end of the year, especially for seasonal businesses, causing substantial cashflow problems.

How Flexible Tax for Business helps

1. Voluntary Withholding Tax option

Flexible Tax for Business establishes a new option of a voluntary withholding tax for firms, including sole traders. This is paid regularly, similar to PAYE. Businesses can adjust their withholding tax rate depending on their revenue stream, to make sure they don't have large provisional tax liabilities during the income year or a massive terminal tax liability at the end of the tax year. This puts them in control and means they can align their tax payments to their cash flow.

The tax paid will be a credit against their final tax for the end of the year. With the thresholds for provisional tax also being raised, many businesses using the option should be able to manage their payments so they can avoid the provisional tax regime entirely.

This means businesses have a lower risk of unexpected tax payments and can reinvest in their business and employees with more certainty.

All businesses will be able to use the new system, but small to medium sized enterprises will be the most likely to take it up.

2. Lifting thresholds for provisional tax

Labour believes the current threshold at which businesses enter the provisional tax and Use of Money Interest (UOMI) regimes are too low. We propose it be lifted to the following amounts.



	Existing Threshold	New threshold subject to fiscal costs
Prov tax- individuals	\$2,500	\$5,000
Prov tax- corporates	\$2,500	\$5,000
UOMI - individuals	\$50,000	\$60,000
UOMI - corporates	\$2,500	\$5,000

This would cost the Crown around \$10 million a year.

3. Removing late payment penalties for provisional tax

Taxpayers who fail to pay minimum amounts of provisional tax are currently subject both to late payment penalties and also to punishing UOMI interest rates of 9.21%.

This is a needless double punishment for small business. Labour proposes to scrap provisional tax late payment penalties. Late payers will still be subject to the UOMI regime.

This will cost the Crown around \$5 million a year.



How can businesses pay their Voluntary Withholding Tax?

Businesses will be able to pay IRD directly through their online banking, including via automatic payments. Also, and by mutual agreement, businesses can have their bank or client deduct voluntary withholding tax payments on their behalf, forwarding them to IRD in much the same way as PAYE.

What if a business underpays or overpays?

If a business over pays, it can get a refund of credits at any time or wait until the end of year and get a refund when the tax return is filed. If it discovers a likely overpayment during the year, it can also reduce its rate of voluntary withholding tax in order to avoid overpaying across the full year.

If a business underpays, it can correct this in its terminal tax payment, just as it does now. There are no penalties for underpaying the voluntary withholding tax.

Can the system be gamed?

Some businesses may try to “game” the system by paying all their voluntary withholding tax payments at the very end of the tax year. To prevent this, the proposal doesn’t allow businesses to increase their rate of voluntary tax payments during the final three months of the financial year.

How much tax deferral will there be?

The voluntary withholding tax is not expected to result in any deferral of tax payments to the government

It is estimated that lifting the thresholds would defer by one financial year the time when the government recognises about \$300 million of tax revenue for accounting purposes.

This would be a one-off cost to the Crown of up to \$8 million in foregone interest if there was a 100% takeup of the scheme.

What happens next?

Labour has already consulted with major players in the financial services sector, including banks and accounting companies such as MYOB and Xero.

The proposal has been developed in conjunction with tax advisors OliverShaw.

Labour will now consult with small businesses across the country to refine the proposal.



which we plan to implement as soon as possible after Labour becomes government.

Examples

Seasonal Business

Beachside cafes are usually very busy in the summer, but quiet the rest of the year.

Currently, café owners have to pay provisional tax three times throughout the course of the year, including the quiet times when they have very little cashflow. That means guessing how much they will need to put aside. If they get it wrong, they could face a big bill at the end of the financial year.

If they chose to use Flexible Tax for Business, the café owners could choose to pay as tax a proportion of revenue throughout the year (based possibly on the expected overall profit margin).

Since revenue is low in winter, tax payments would be low over these months. In summer as business picks up revenue will increase, as will tax payments.

If the cafe finds that it has difficulty meeting bills out of low revenue over winter, it could decide to set a low withholding rate over the first part of the year and increase the rate over the busy summer months. The owner knows their business best, and they should be the ones deciding when they pay their tax, based on their cash flow. This takes the worry away and puts the control in their hands.

Sub-Contractor

Some telecommunications workers used to be employed by a company but now work as sole-trading sub-contractors.

Previously, PAYE meant when they got their weekly pay cheque, they knew all their tax obligations had been met. Now, as sub-contractors, when the money comes in their obligations are just starting.

If they choose to use Flexible Tax for Business, they can pay a chosen percentage of each payment they get from their clients to cover their taxes. Or, by mutual agreement, they can have their client businesses withhold the tax payments on their behalf. It means they get the same peace of mind they had previously with PAYE.

Feedback

Over the next three months, Labour will be consulting with the business community about ways in which our proposal can be improved ahead of the 2017 election. We welcome your feedback.

If you'd like to get in touch about making a submission, please send an email to flexibletax@labour.org.nz.

