

Committee Secretariat
Finance and Expenditure Committee
Parliament Buildings
Wellington

4 September 2019

Taxation (Kiwisaver, Student Loans, and Remedial Matters) Bill

Dear Ma'am,

Tax Management NZ appreciates the opportunity to comment on the Taxation (Kiwisaver, Student Loans, and Remedial Matters) Bill.

Our submission relates to the following proposed amendments in the Bill:

1. Eliminating the requirement to estimate the final instalment date for provisional tax.
2. Clarifying the 'lesser of' calculation of interest for standard uplift taxpayers.
3. Clarifying the application of late payment penalties applicable from the final provisional tax instalment date.
4. Removing the ability for taxpayers to choose the provisional tax instalment to which a particular payment is applied.
5. Clarifying the way in which provisional tax is truncated to whole dollars.
6. Non-standard provisional tax instalments.

We are also making a submission on a gap in the legislation that is not addressed in the commentary of this Bill.

It is our view that all but amendment 4 are positive for taxpayers.

However, we believe IRD needs to provide greater clarification relating to amendment 3 as the commentary is not clear what happens for taxpayers in situations where the amount due at final instalment is less than uplift and a third of actual.

It is also our view that amendment 5 be applied from an earlier date.

Thank you for the opportunity to make this submission.

Yours sincerely,

Tax Management NZ

1. Eliminating the requirement to estimate at the final instalment date for provisional tax

Clauses 110 and 125(4)

Summary of proposed amendment

These changes will allow provisional taxpayers who use the standard method to pay provisional tax to pay an amount lower than the uplift instalment on the final instalment date without having to switch to the estimation method.

Taxpayers who switch to the estimation method at any time during the year will not be able to use the interest concession rules in s120KBB Tax Administration Act 1994. They will fall under s120KB of the Act and potentially be subject to IRD interest from the date of their first provisional tax instalment if they do.

Submission

We support this amendment.

Comment

Many of our clients are already lowering their final instalment payment when their RIT for the year is going to be lower than forecast, without filing an estimate after the second instalment.

Removing the legislative requirement for them to do so by including a new formula in sRC10 Income Tax Act 2007 that deals specifically with the final instalment in these situations makes sense.

2. Clarifying the ‘lesser of’ calculation of interest for standard uplift taxpayers

Clauses 109(2) and (3)

Summary of proposed amendment

This confirms that IRD interest and late payment penalties for provisional taxpayers using the standard method will be calculated using the lower of the 105 percent or 110 percent uplift amounts for instalment dates prior to the date the taxpayer files their return for the previous year.

Submission

We support this amendment.

Comment

There is no mention of this anywhere in the current legislation, and it was only when we sought clarification from IRD’s policy team that we were made aware of this.

This amendment clarifies for taxpayers what IRD is doing operationally.

3. Clarifying the application of late payment penalties applicable from the final provisional tax instalment date

Clauses 124 and 130

Summary of proposed amendment

This change will align the legislation with Inland Revenue's systems to ensure that late payment penalties are only calculated on the lesser of the standard uplift amount or a third of the year's RIT at the final provisional tax instalment date for the year, rather than on the total outstanding tax liability at that date.

Submission

We seek further clarification from IRD.

Comment

While we understand IRD does not want taxpayers unfairly penalised at the final instalment, we would like to know how and/or if IRD would apply late payment penalties in a situation where a taxpayer pays the standard uplift amount due at their first and second instalments, but whose RIT for the year turns out to be lower than forecast.

We are concerned about an unintended consequence of a taxpayer in this situation incurring a late payment penalty that does not correspond with the amount due to settle the liability for the year.

4. Removing the ability for taxpayers to choose the provisional tax instalment to which a particular payment is applied

Clause 126

Summary of proposed amendment

The ability for taxpayers to allocate their provisional tax payment to an instalment of their choosing will be removed and the Commissioner of IRD will be required to allocate payments to the oldest outstanding provisional tax instalment.

Submission

We do not support this amendment.

Comment

IRD fails to illustrate in the commentary the impact this will have on a taxpayer in terms of incurring further interest and late payment penalties at future instalment dates.

It is our view that taxpayers will be worse off if IRD applies payments to late payment penalties and core tax of the oldest debt first. Please refer to **Example 1**.

Example 1

A taxpayer forgets to pay their uplift instalment of \$54,755 on 28 Aug 2018 (P1). They instead pay \$109,510 on 15 Jan 2019 (this being two-thirds of their uplifted RIT from the previous year).

On 7 May 2019 (P3), the taxpayer pays the uplift amount of \$54,755 because they feel this is the final balance to settle the liability for the year. They later confirm the RIT for the year is \$164,265.

Currently, if they asked IRD to apply the entire 15 Jan 2018 payment to P2 (as per s120L Tax Administration Act 1994), the taxpayer will only be liable for the LPP for the missed P1 payment, plus 140 days of IRD interest*. This works out to be:

- LPP: \$2759.65
- Interest: \$1809.26

However, under IRD's proposed change, the commissioner would allocate a portion of the \$109,510 paid at P2 to the LPP and core tax owing for P1.

This means at P2 the taxpayer will have a shortfall of \$2759.65. This equates to LPP and interest at P2 of:

- LPP: \$139.08
- Interest: \$72.93

As the \$54,755 payment made at P3 is required to cover the LPP and core tax owing for P2, they will have a shortfall of \$2898.72 at this date. Therefore, they will have LPP and interest for P3 of:

- LPP: \$146.08
- Interest: This continues to accrue on the final balance remaining to settle the liability for the year (plus the LPP from above) until the taxpayer pays this off.

So, rather than only having LPP and interest at P1, the taxpayer is also now liable for this at P2 and P3.

**The IRD interest rate in this example is 8.22 percent.*

IRD acknowledges compounding interest and late payment penalties do not lead to greater taxpayer compliance. It's why they removed the monthly incremental one percent late payment penalty on income tax. This amendment runs counter to this.

We believe the late payment penalties and interest for the missed instalment is punishment enough for the non-compliance. So too is not being able to use the safe harbour concession (applicable for taxpayers with RIT of less than \$60,000) in s120KE (1) and (2)(a) Tax Administration Act 1994 due to not paying the uplift instalment on time or in full, therefore being subject to IRD interest from the final instalment date on the remaining balance to settle the liability for the year.

This amendment means the taxpayer is being punished multiple times as they are exposed to compounding interest and late payment penalties.

5. Clarifying the way in which provisional tax is truncated to whole dollars

Clause 110

Summary of proposed amendment

The proposed amendment would confirm that where Inland Revenue systems truncate provisional tax amounts to whole numbers, payment of those whole dollar amounts rather than the amount including cents will be considered to meet the requirements to take advantage of concessionary regimes such as the safe harbour.

Submission

We support this amendment – but believe it should apply retrospectively to the 2017-18 income year.

Comment

We have heard stories from clients about taxpayers being prevented from using the safe harbour provision because they did not pay the cents (or rounded the instalment amount payable down).

That meant they were subject to interest from the final provisional tax instalment on the remaining balance required to settle the liability for the year.

In one instance, a taxpayer underpaid their standard uplift instalment by 30 cents and received a \$2400 IRD interest bill.

We believe that cost is disproportionate to the error made and welcome any change that ensures taxpayers are not unfairly punished or prevented from using the safe harbour interest concession.

However, we do not agree the amendment should apply from the 2019-20 income year. We believe it should be applied retrospectively from the 2017-18 income year as this aligns with when the current safe harbour interest concession rules came into effect.

6. Non-standard provisional tax instalments

Clause 129

Summary of proposed amendment

This proposed amendment alters s139B (6)(bb) Tax Administration Act 1994 to account for taxpayers who have a non-standard number of instalments of provisional tax.

Submission

We support this amendment.

Comment

This is a minor change that addresses a drafting error that was missed when the provisional tax rules were re-written a couple of years ago.

Other matters

Clarifying the amount on which interest and late payment penalties are applied when a third of actual is lower than uplift instalment at the second instalment

We are seeking clarification on this issue because the legislation and IRD's system do not align.

For taxpayers using the standard uplift method, s120KBB (3)(b) Tax Administration Act 1994 says if an instalment is underpaid, interest is charged on the lesser of:

- The standard uplift instalment amount, minus the amount paid in relation to that instalment; or
- The RIT for the year, multiplied by one and divided by the number of instalment dates for the year, minus the amount paid in relation to that instalment.

The wording in this section implies that each instalment is treated separately.

Moreover, s139C (1D) of Act defines the amount of unpaid tax on which late payment penalties are charged at the first and second instalment as the amount given by s120KBB (3)(b).

However, IRD's system is ignoring this.

It is still coded to use the formula found in sRC10 (2) Income Tax Act 2007 to calculate the amount due at an instalment. It also replaces the term 'residual income tax' as defined in subsection (3) of the Act with the actual RIT for the year if this figure turns out to be lower.

As a result, there is an issue arising in situations where a taxpayer:

- Files the previous year's return – which has a significantly higher RIT than the return from two years ago which they used as the basis to calculate their first instalment – between their first and second instalment dates; and
- A third of the current year RIT turns out to be lower than the uplift amount due at the second instalment.

That's because IRD is calculating the amount payable at the second instalment based on the lesser of:

- The actual RIT for the year, multiplied by two and divided by three, minus the 110 percent uplift amount at the first instalment; or
- The previous year's RIT uplifted by 105 percent, multiplied by two and divided by three, minus the 110 percent uplift amount at the first instalment.

While we agree with IRD allowing the taxpayer to retain the ability to use the 110 percent uplift amount at their first instalment if it is lower than the 105 percent uplift calculation or a third of the actual RIT, we believe what IRD is doing operationally to calculate the amount payable at the second instalment is not consistent with s120KBB (3)(b).

If this is a system error, IRD needs to notify taxpayers who have paid their second instalment of provisional tax based on the amount given by s120KBB (3)(b) and remit any interest and late payment penalties incurred as this is causing great angst.

However, if this is a legislative error – and IRD's intention is to charge interest and late payment penalties on the instalment amount determined by sRC10 (2) – then the wording of the legislation needs to reflect this.

If IRD plans to amend the legislation to match what its system is doing and chooses to apply this amendment from the 2017-18 tax year onwards to align with the introduction of the interest concession rules, we ask that a provision be put in place so taxpayers who paid their provisional tax based on the current wording of s120KBB (3)(b) are not punished retrospectively.