

The Small Business Consolidated Reporting Regime

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1. Introduction

- 1.1. The Small Business Consolidated Reporting (“SBCR”) regime simplifies the tax reporting process for small businesses by consolidating and replacing pre-existing obligations into one report filed every second month. Tax is levied on the income information provided in these reports, and replaces the provisional tax obligation of the business.
- 1.2. Where a business has completed all in-year reports, that business will receive an automated income summary from Inland Revenue (inclusive of information reported by third-parties) similar to those currently prepared for individuals. Eligible businesses would be entitled to rely on these reports to satisfy their year-end filing obligations.

2. The case for change

Tax compliance costs

- 2.1. The tax compliance process for businesses in New Zealand rarely differentiates between small and large enterprises. However, small businesses generally have simple tax profiles compared to larger corporates¹. What adjustments are made are often recurring and predictable, such as for depreciation and employee related costs.
- 2.2. Despite the relative simplicity of small businesses for tax purposes, the cost of compliance is disproportionately high². All businesses must prepare multiple filings a quarter³ for various tax types, requiring a significant investment of time⁴.
- 2.3. Further, businesses have recently had their reporting obligations increase in complexity and frequency. Changes made in 2018⁵ to PAYE reporting and Investment Income Reporting (“IIR”) have increased the overall compliance demands on business. Despite these increased reporting requirements, there has not been a corresponding reduction in the compliance burden elsewhere.

For smaller businesses with fewer resources, this compounds already outsized costs. To reduce these costs, these businesses are turning to third-party accounting software intermediaries⁶. These intermediaries centralise accounting and tax functions on one platform, and facilitate the filing of most tax reporting obligations with minimal intervention.

¹ OECD (2015), *Taxation of SMEs in OECD and G20 Countries*, OECD Tax Policy Studies, No. 23, OECD Publishing, Paris, 61-68.

² OECD at n 1, 55, 90.

³ A standard GST registered business employing staff will be required to file at least one GST return and various payday reports for PAYE income, as well as potential fringe benefit tax and investment income reporting.

⁴ Inland Revenue (2018), *2018 study on the time and cost of doing business taxes incurred by NZ small businesses*, Inland Revenue, Wellington, 7.

⁵ Specifically, the payday filing and investment income reporting rules that were introduced in the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2018.

⁶ Inland Revenue at n 4, 12.

- 2.4. Consequently, the quality of accounting information available for most businesses has improved, and can be leveraged to reduce costs⁷⁸. As discussed in section 3, SBCR does so by utilising income and expense figures reported as a by-product of other reporting requirements⁹ to build a proxy of net income for a given business.
- 2.5. To the extent that the proxy is derived from information reported through intermediary that Inland Revenue is satisfied is reliable, then in principle it would be possible to leverage that proxy to automate the year-end reporting of businesses.
- 2.6. If implemented as proposed, the automation enabled by SBCR would effectively limit compliance costs of businesses to their in-year reporting. To the extent that a business has built this reporting into their normal processes, then SBCR would eliminate the majority of costs associated with year-end reporting. Further, as SBCR consolidates existing reporting, costs arising from tracking and satisfying that reporting¹⁰ is also reduced.

Broader policy goal – digital tax administration

- 2.7. While it is generally true that the smaller businesses will have simpler tax profiles, not all businesses considered small will be “simple” for the same reason. In practices, this has meant that simplifying compliance obligations requires simplification of all rules that may apply to a taxpayer.
- 2.8. Historically, this has resulted in the design philosophy that places an over-emphasis on the accuracy of reporting. As discussed in section 4, previous attempts to simplify the compliance process have failed to meet their goal by retaining a high onus on the taxpayer to scrutinise their reporting – limiting the scope of any simplification.
- 2.9. However, in light of the broader adoption of accounting software intermediaries discussed above, there is an opportunity to shift the focus of reporting from the taxpayer to the intermediary. The recent officials’ issue paper “*Tax administration in a digital world*” highlights this opportunity, noting that intermediaries are increasingly offering compliance products that can complement Inland Revenue’s compliance activities¹¹.
- 2.10. SBCR proposes to leverage income records held by intermediaries to provide Inland Revenue with an auditable record of the majority of a business’s net profit or loss. In doing so, the regime seeks to establish sufficient trust in the information that is reported to officials, and therefore enable the automation of a proportion of the compliance process for small business discussed above.
- 2.11. In principle, automation enabled by SBCR would be similar to the automation already in place for individual income tax returns. For that process, returns are generated through PAYE and

⁷ OECD (2017), *Tax Administration 2017: Comparative Information on OECD and Other Advanced and Emerging Economies*, OECD publishing, Paris, 68 – 73.

⁸ Tax Working Group (2019), *Future of Tax: Final Report Volume I – Recommendations*, Tax Working Group, Wellington, 79.

⁹ Specifically, these are GST, PAYE and (where relevant) Investment Income Reporting requirements.

¹⁰ Inland Revenue at n 4, 8.

¹¹ Inland Revenue (2022), *Tax administration in a digital world – an officials’ issues paper to support future tax administration*, Inland Revenue, Wellington, 6.

RWT information received from third-parties throughout the course of the year.

- 2.12. Ultimately, the automation for individuals relies on trust in third-parties to provide complete reporting. While mechanisms exist that require individuals to amend these automated returns where information is missing¹², there is an inherent risk that Inland Revenue may not receive additional information that might otherwise have been reported.
- 2.13. It is acknowledged that the same risk is inherent in this proposal, and the fiscal impacts of this approach are considered in section 5. However, in order to meaningfully automate the compliance process, a degree of manual intervention must be removed through trust in an external source. To that end, SBCR proposes that the potential reduction in reporting accuracy is outweighed by the relative reduction in compliance costs.

3. Solution design – the Small Business Consolidated Reporting Regime

Eligibility

- 3.1. A business would be eligible to opt into SBCR where it meets the following criteria:
 - ▶ The taxpayer is a New Zealand registered business.
 - ▶ The taxpayer is registered for GST, and as an employer with Inland Revenue.
 - ▶ The taxpayer prepares and files its GST, PAYE, IIR and income tax reporting through an approved accounting software intermediary.
 - ▶ In the previous year, the taxpayer did not record adjustments in their statement of taxable income that were greater than 5% of their net profit or loss before tax¹³.
- 3.2. The fourth requirement works as a threshold for whether a business has functionally reported the majority of its taxable profit through other in-year filing requirements. Businesses that make adjustments below the threshold would be considered to have adjustments simple enough to easily audit through an intermediary, and can therefore be safely trusted to have their actual tax profile match closely to the proxy provided.
- 3.3. Businesses will only become ineligible for SBCR if they fail to meet the eligibility criteria for two income years in a row. This recognises that unexpected fluctuations may occur that should not characterise the business as a whole. Businesses would also be eligible to remain in the regime at the discretion of the Commissioner.
- 3.4. The SBCR uses this proportional threshold as more complicated businesses are effectively filtered out without having to exclude high-turnover businesses that have relatively simple tax profiles. As discussed in section 4, turnover thresholds that have been used in previous regimes limits overall impact on compliance costs.

¹² Specifically, sections 22G and 22F of the Tax Administration Act 1994.

¹³ For businesses that were using SBCR in the prior year, this would be the proxy figure provided by Inland Revenue in the automated year-end report.

- 3.5. The Commissioner would be empowered to remove a business from the regime if they were satisfied that a business was using the regime to adopt an intentionally abusive tax position.

Estimated eligible population

- 3.6. An eligible population can be estimated using Inland Revenue's 2018 reporting on the compliance costs of small businesses. Within that report, Inland Revenue defines a small business as an entity with annual turnover up to \$30 million and fewer than 50 employees – being 399,815 entities in 2018¹⁴. Of those businesses, 39% reported using an online accounting system¹⁵.
- 3.7. On the assumption that entities larger than these are likely to have sufficiently large adjustments as to make them ineligible, we can generously assume 156,000 businesses would have been eligible for SBCR in 2018. Assuming reasonable growth in both number of businesses and uptake of online accounting software, the actual number of business eligible in 2022 is likely to be higher¹⁶.

Operation of the regime – in-year reporting

- 3.8. Where a business has opted into the SBCR, it would no longer be required to file GST, PAYE and IIR separately. Instead, businesses would be required to digitally file one report every two months that consolidates all pre-existing GST, PAYE and IIR reporting requirements. Any payments required to Inland Revenue as a result of the GST, PAYE and IIR components of this report would have their deadlines aligned to the consolidated report.
- 3.9. The consolidated report would derive income and expense information from the underlying reporting types to create a proxy for the taxpayers net taxable income for the period. The report would be required to be generated through an approved accounting software intermediary, and be filed through that intermediary.
- 3.10. The taxpayer may then elect to make adjustments to their proxy figure, such as for depreciation. To do so the taxpayer would be required to make these adjustments through their intermediary, providing the intermediary with a record of the adjustment.
- 3.11. The taxpayer will then pay tax on the proxy income figure less any adjustments made. This tax would be remitted alongside any GST, PAYE and IIR payment obligations due alongside the report. All payments, as well as the report itself, would be due 30 days after the final date for the period covered.

Operation of the regime – end of year automation

- 3.12. Once a taxpayer has completed all reports, Inland Revenue would collate the income information received from the taxpayer and third-party reporting¹⁷, and prepare an automated

¹⁴ Inland Revenue at n 4, 6.

¹⁵ Inland Revenue at n 4, 12.

¹⁶ Inland Revenue's 2021 Annual compliance report (Inland Revenue (2022), *Inland Revenue Annual Report – 2021*, Inland Revenue, Wellington, 75) notes that "as at 30 June 2021, 181,357 small-to-medium-sized enterprises and tax agents used business accounting or payroll software to manage their GST obligations. This compares with 136,936 for the previous year." While not a direct comparison to the estimate population, it does demonstrate growth in the use of intermediaries in New Zealand more generally.

¹⁷ This would include information received by Inland Revenue through the IIR reporting of other taxpayers.

statement of income for the taxpayer.

- 3.13. A copy of this automated statement would be provided to both the taxpayer, and the taxpayers' intermediary. The taxpayer's intermediary would then be required to accept the statement on behalf of the taxpayer. To do so, the intermediary must confirm that:
- ▶ the income information contained in the report (less information provided by external third-parties) matches to the income information that they have provided on behalf of the taxpayer; and
 - ▶ the adjustments that Inland Revenue has recorded match to their records of the adjustments that the taxpayer has engaged the intermediary to assist with.
- 3.14. Once an intermediary has accepted the automated statement, the taxpayer will be considered to have completed their income tax filing obligations for the year. The taxpayer will have their filings finalised on the taxpayers standard reporting date¹⁸.
- 3.15. The taxpayer would have until their standard reporting deadline to file a separate income tax return under normal processes. Doing so would be considered a rejection of the automated assessment, regardless of whether the intermediary had accepted it on the taxpayer's behalf.
- 3.16. In the event that the Commissioner of Inland Revenue later identified that the automated return did not contain all assessable income, any liability will remain with the taxpayer unless inconsistencies were a result of gross carelessness on the part of the intermediary.
- 3.17. To the extent that the taxpayer had intentionally omitted to record income (or make adjustments) through the intermediary for the primary purpose of abusing SBCR to obtain a material advantage, the taxpayer will be considered liable for any applicable penalties and interest.
- 3.18. This threshold is set intentionally high, so as not to capture (and therefore disincentivise) taxpayers who were merely reliant on their intermediary to manage their tax compliance obligations. The fiscal risks associated with this approach are considered in section 5.

Interaction with the provisional tax regime

- 3.19. As the SBCR models in-year tax payments, it supplants a business's provisional tax obligations. Instead of paying provisional tax one year in advance, payments will be tied directly to cashflow in the current year.
- 3.20. Where a pre-existing business opts into the regime, that business will have a transitional year for its first year. For that year, they will still be required to pay provisional tax under their previous method to the extent that any instalments were still due for the transitional year. However, when providing their consolidated reports to Inland Revenue, the tax rate applied on the reported income will be 0%.

¹⁸ For example, 7 July for a non-tax agency listed 31 March standard balance date taxpayer.

3.21. If at year end there is a shortfall between tax paid through SBCR and the tax liability as determined by the taxpayer's year end filing, use of money interest ("UOMI") would only apply from the due date of the final consolidated report (i.e., 30 April for 31 March balance date). Taxpayers would be eligible to use tax pooling to mitigate any UOMI exposure.

4. Differentiation from and assessment against existing solutions

4.1. As noted in section 2, there have been previous attempts to reduce the complexity of tax compliance for smaller businesses. For the purposes of assessing SBCR, it is important to understand what these solutions have relied upon, where their limitations lie, and where SBCR differentiates itself.

Accounting Information Method ("AIM") for Provisional Tax

4.2. AIM places a significant reliance on regularly reviewed accounting information. Under AIM, a taxpayer is required to provide regular "statements of activity" which are in essence miniature financial statements.

4.3. As a result, taxpayers are effectively required to bring their year-end accounting processes forward and prepare year-end reconciliations every two months. While this will generally ensure that provisional tax paid is closer to the actual obligation for the period, for many this represents an outsized hassle over the simplicity of the standard uplift method.

4.4. Contrasted with the standard uplift method, AIM also had to contend with changes to safe-harbour rules (minimising the exposure of most businesses to use of money interest) and the benefits that tax pooling provides.

4.5. For many businesses AIM does not represent a material reduction in cost over other methods, especially when considering the relative complexity of complying with the method.

4.6. SBCR differentiates itself from AIM in four key ways:

- ▶ The underlying information SBCR is reliant upon is the reporting already required by the taxpayer (GST, PAYE, IIR), and not their accounting information.
- ▶ Adjustments that are made in-period are optional, and may instead be completed at year-end.
- ▶ Adjustments that are made in-period do not need to be substantiated through accounting information that has been adjusted – trust is placed in the authenticity of the information held by the intermediary.
- ▶ Where a taxpayer has opted to make in-period adjustments, and has no adjustments to make at year-end, that taxpayer will have met all income tax compliance obligations for that year.

4.7. SBCR identifies that in order to incentivise change it must compete on reducing the overall complexity of compliance, rather than on the direct costs involved in calculating and paying

provisional tax. To that end, SBCR leverages the limitations of AIM to design a less complex regime.

GST Ratio Method (“GRM”) for Provisional Tax

- 4.8. GRM reduces compliance costs through better tying provisional tax payments to cashflow. GRM acknowledges that, for many smaller taxpayers, taxable income and income reported for GST purposes will often closely align. Therefore, GRM uses GST as a proxy for taxable income received in-period, and levies provisional tax on it.
- 4.9. However, GRM has tight eligibility requirements. A taxpayer cannot have more than \$150,000 of residual income tax for the prior year. While this will be suitable for many small businesses, it locks more medium enterprises out of the scheme.
- 4.10. Additionally, as businesses grow, they may find themselves ejected from the scheme. Businesses that no longer meet the eligibility criteria in-year must instead use the estimate method for provisional tax for the remainder of that year. As the estimate method does not carry the same risk mitigation benefits of the standard uplift method (discussed above) many businesses close to the cut-off point may view GRM as high-risk low-reward relative to the standard uplift method.
- 4.11. Lastly, businesses must have a RIT of greater than \$5,000. Practically, this means that businesses that experience a loss in a given year become ineligible. This further excludes businesses that may have unsteady cashflow, or who are actively investing in their underlying income earning activity.
- 4.12. To that end, SBCR offers a much wider eligibility requirement – with the aim of incentivising businesses to see the method as a long-term option for tax compliance. As detailed in section 3, SBCR removes the narrow focus on RIT in favour of a broader ratio test.
- 4.13. Aside from the eligibility requirements, GRM is limited to GST reporting as the basis for its proxy. Since the introduction of GRM the information reporting requirements of businesses have increased; now including much more regular and detailed reporting of employee costs (PAYE reporting) and investment income.
- 4.14. While these costs have always been present, GRM attempts to factor for them through its ratio mechanism. While functional, it is less than ideal where that income information could theoretically be included. As a result, GRM may expose taxpayers to UOMI where changes in these underlying costs year-to-year de-synchronise the taxpayer’s GRM ratio from actual residual income tax.
- 4.15. SBCR has been designed to include most regular reporting into the basis of its proxy. As discussed in section 3 above, the SBCR report consolidates GST, PAYE and IIR reporting into one filing. In principle, the net of these figures will better proxy the businesses actual RIT – ensuring that tax paid through SBCR better limits the over or underpayment of tax in-year.

Setting goalposts for success

- 4.16. When considering SBCR against these two regimes we must consider the common policy objective of all three – reducing the overall compliance cost on businesses. Where a business

can see a practical reduction in costs by adopting a given regime, it is logical to assume that it will do so. As explored above, both AIM and GRM do not provide a net reduction in costs to businesses in practice, leading to low adoption rates.

- 4.17. Therefore, SBCR could be assessed as successful based on the number of businesses that opt into the regime. This would be weighed against any tax-base leakage brought about by automation. Consideration of the potential fiscal costs involved are considered in section 5.

5. Assessment against judging criteria

Impact on the New Zealand economy

- 5.1. The primary impact of SBCR on the New Zealand economy is through a net increase in the productivity of businesses. Compliance costs reduce businesses overall available capital, and therefore reduce their ability to invest.
- 5.2. Flowing on from this, the regime has been designed to facilitate product innovation by accounting software intermediaries. Eligible businesses could, in theory, automate all adjustments in-year where intermediaries offer sufficiently sophisticated tools. To that extent, intermediaries are incentivised to develop an end-to-end compliance offering, growing these businesses specifically.

Social and environmental acceptability

- 5.3. As the cost reductions of the regime do not come from a reduced tax rate, there is no significant impact on social equity. While a fringe group of businesses will receive an unintentional tax benefit from joining the regime, these businesses are likely to be small and disproportionately impacted by compliance costs. On balance, these businesses are unlikely to be viewed as receiving a socially unacceptable benefit.
- 5.4. The regime does not have a measurable environmental impact.

Political and public acceptability

- 5.5. SBCR is an adjustment to the tax compliance process, and not to the tax base. Historically, similar changes have received near unanimous support¹⁹. Furthermore, the two provisional tax regimes that SBCR shares “DNA” with (being GRM and AIM) were implemented by successive Labour and National Governments. Prima facie, political and public opposition should be minimal, to the extent fiscal impacts are minimal as well.
- 5.6. When assessing the fiscal impact of the SBCR regime, there are two factors to consider:
- ▶ As noted above, the regime does not offer businesses a reduced tax rate. In principle, businesses will still remit income tax as they would have under the status quo. As such,

¹⁹ While ultimately voting against the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act at third reading, Andrew Bayley (Revenue spokesperson for the National Party) spoke positively of the initiatives for individual income tax automation in that debate – *New Zealand Parliament, Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill – Third Reading*.

there is no direct fiscal impact.

- ▶ As noted throughout this paper, the regime does represent an increased risk that the accuracy of reporting will decrease, with a flow-on impact to the quantum of income that tax is levied upon. Therefore, there is an indirect fiscal impact.

- 5.7. When assessing the indirect fiscal impact, it is important to examine how accuracy may decrease. At its core, SBCR simplifies compliance by reducing the number of mandatory adjustments that a business must make to its year-end reporting.
- 5.8. Businesses that choose not to make downward adjustments represent a fiscal saving. Businesses may choose to do so as they view the relative savings of claiming deductions (i.e., depreciation on a small number of assets) as lower than the costs incurred in calculating and reporting that deduction. In effect, businesses are empowered to make a cost decision that is either neutral to status quo, or actively beneficial from a fiscal perspective.
- 5.9. Alternatively, there will be some businesses that do not make upward adjustments, representing a fiscal cost. Businesses will either do so because they are merely reliant on their intermediary to perform their tax function, or wilfully abuse SBCR to obtain a tax advantage.
- 5.10. The former group represents a relatively small fiscal cost. Businesses in this category are likely neglecting minor upwards adjustments, such as for the non-deductible proportion of entertainment expenditure. Costs associated with this group could be mitigated through direct incentives granted to intermediaries to develop automation of these adjustments. As similar automation is required under AIM, many intermediaries may already have much of the infrastructure in place.
- 5.11. The latter group represents a potentially larger fiscal impact, though the exact impact is difficult to measure. As New Zealand is a self-assessment jurisdiction, taxpayers that wish to adopt abusive tax positions are able to do so. The extent to which SBCR incentivises additional abusive behaviour must be measured against its in-built disincentives.
- 5.12. Ultimately, a business is not eligible unless it utilises an intermediary. While the taxpayer may adopt an abusive position, their records would be much more easily auditable. To the extent that the Commissioner suspected abusive behaviour, SBCR better enables identification of abuse. This operates as a strong disincentive, and helps lock-out taxpayers already participating in the hidden economy²⁰.
- 5.13. On balance, it is likely that the net fiscal impact of SBCR is likely to be low. Even if SBCR represents a net cost it would be a relatively low cost compared to the reduction in compliance costs experienced by taxpayers. Therefore, public acceptability is likely to be high.

Simplicity of the tax system

- 5.14. The SBCR does not represent a change to the underlying rules for assessing income, and therefore does not impact complexity in that respect. However, for businesses that opt into

²⁰ Tax Working Group (2018), *Hidden Economy: Background paper for session 14 of the Tax Working Group*, Tax Working Group, Wellington, 8 – 13.

the regime, the initial adoption represents a minor increase in complexity as new processes are adapted to. Given that this complexity is optional, the overall impact on the simplicity of the tax system is low.

Compliance costs and complexity for taxpayers

5.15. As discussed in the body of this paper, the primary advantage of SBCR is in reducing the compliance costs experienced by taxpayers. For eligible businesses, the regime is expected to significantly reduce compliance costs on an on-going basis. Please refer to section 2 for specific discussion on this point.

Administrative complexity for Inland Revenue

5.16. Implementation of SBCR would require significant investment in Inland Revenue's capabilities, and in further investment in the business transformation project. This represents a significant short-term increase in administrative complexity and operating costs.

5.17. However, as discussed in section 2, SBCR is designed to assist with the challenges officials have identified with the future of tax administration. Specifically, SBCR provides the following benefits to Inland Revenue:

- ▶ Eligible businesses are specifically those with regular and easily auditable reporting. Officials will ultimately improve the quality of information available to them as more taxpayers are incentivised to use intermediaries, reducing the long-term costs involved with investigation²¹ and policy development.
- ▶ SBCR provides a framework with which officials can design further rules for simplifying the reporting process. Where future rules are designed in such a way that less subjective judgement is required, automation on the part of the intermediary is more feasible. Importantly, shifting the design thinking in this way²² means that future improvements need not be locked behind policy, but can be driven by third-parties.

5.18. SBCR should be viewed as an investment in future-proofing the tax compliance process. While costly, it represents potential long-term cost reduction for the Government, as well as businesses.

²¹ Joel Slemrod & Shlomo Yitzhaki (2002), *Chapter 22: Tax Avoidance, Evasion and Administration*, Handbook of Public Economics, Volume 3, Elsevier, 1447-1448.

²² Inland Revenue, at n 4, 23 – 24.