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Reducing SME Compliance Costs  
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SUBMISSION FROM THE  
NEW ZEALAND MANUFACTURERS AND EXPORTERS ASSOCIATION

FOR THE DISCUSSION DOCUMENT

**REDUCING TAX COMPLIANCE COSTS FOR SMALL AND  
MEDIUM-SIZED ENTERPRISES**

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The New Zealand Manufacturers and Exporters Association is pleased to have this opportunity to provide feedback on this submission.

## **BACKGROUND**

The New Zealand Manufacturers and Exporters Association (MEA) represents the interests of manufacturers and exporters throughout New Zealand.

The MEA is New Zealand's only focused, independent voice for manufacturers and exporters. MEA members make over \$2.0 billion in sales and have an export value of around \$1.0 billion. Our organisation can trace its beginning to the early history of New Zealand. As a legacy of the hard work and careful financial management of the past, we have a significant asset base that enables our independence and extends our activity.

The MEA is independent; we do not seek or receive funding from local or central government. We are not associated to any other business group.

The health of the elaborately transformed manufactures, particularly, and exporters generally, acts like the "canary in the coalmine" indicating the long-term prospects for our whole economy. In a similar way the health and development of our smaller companies has a major role to play in the development of the New Zealand economy.

We are happy to discuss this submission with the IRD, Treasury or any other interested party.

If required we are able to speak on this submission at a Select Committee hearing.

## **General Comment**

The issues around compliance cost can be very emotive. In the SME context, almost by definition, the business owner/operator is likely to be resource consumed by the compliance burden. As a result, the opportunity cost of the key business resource being consumed by the compliance load is often considerable, well in excess of what is seen to be the case for larger businesses. Consequently, the impact on growth and success in our economy is directly related to the compliance load. We note that throughout the discussion document the cost to tax revenues are notes. We note further there is no attempt to quantify the tax revenue impact of economic growth. This positive element of reductions in the compliance burden for SMEs creates further opportunity for greater and early reforms.

There needs to be a clear definition of “SME”. We note the Australian small entity of A\$2m, and in the discussion document reference to NZ\$1.3m. The European Union defines SMEs as those with a turnover of €40m! The issues around compliance are really associated with the absence of a “professional” in the business, it is likely that even a 20 person manufacturing business would have a turnover of less than \$3.5m and would likely not even have a full time payroll administrator.

We note the variation of revenue to profit ratios. If a single threshold is chosen, say revenue, it should exclude the bulk of small business. Better to count in too few than count out too many. The more businesses that fall into the SME group the better – if the intent is to reduce the compliance burden.

## **Chapter Two – Thresholds**

Our view on the priority, or value to SMEs, for the issues listed as special submission points in Chapter Two are:

- filing FBT returns annually;
- using the provisional tax use-of-money interest safe harbour using the low-value trading;

- stock valuation rules;
- accounting for financial arrangements;
- filing GST returns six-monthly;
- paying PAYE deductions once a month;
- making GST output tax change-in-use adjustments; and
- registering for GST.

We feel that thresholds have, over time, lost their significance as inflation moves more and more activity to the inclusion side of the threshold. Thresholds, once set, should be subject to regular review and increased in line with the CPI. This would ensure companies, where growth did no more than keep pace with inflation, would not fall out of a particular exclusion.

Regarding the thresholds and accounting for financial transactions for SMEs:

- In our view it is important that the option of cash accounting should be available for all entities.
- Income and expenditure should be accounted for on a straight-line basis.

On the matter of a single threshold, certainly \$1.3m is far too low, this would be typical for a manufacturing business of five or six people, such a business cannot be considered a “large” entity.

In our view, it is unlikely that growth would be constrained to avoid crossing a trigger threshold, indeed the reduction of compliance burden would have the opposite effect.

### **Chapter Three – Simplified Rules for Certain Expenses**

In the normal course of business SMEs do not generally incur significant legal costs. The threshold of \$10k, whilst appropriate, would not be particularly meaningful for most SMEs most of the time.

Deductions for entertainment expenses cause no end of discussion and debate. Having the option of adopting standard allowable deductions would be helpful. The threshold should be meaningful and index linked at around the same level; \$10k per annum. This would quickly be consumed by dinner for 30 customers through the year, and a staff Christmas function.

#### **Chapter Four – Fringe Benefit Tax**

Here again the cut off or \$1.3m is used, that is far too low to sustain the examples cited. Were that threshold around \$5m then the three vehicle scenario would work for most manufacturing businesses. In that case the option of 10% across all vehicles would be meaningful and help reduce the compliance cost, but again, a good definition of SME is required to count in as many companies as possible.

#### **Chapter Five – GST Invoices**

The reaction to these proposed changes was underwhelming. These activities form part of the “business as usual” process of invoicing and collections. The changes proposed were not seen as that helpful in reducing compliance cost.

#### **Chapter Six – Tax Administration**

It seems the general practice is to correct errors when they are uncovered, typically when tax agents complete returns. A threshold might be helpful but meaningless at the \$500 level, it should be at least ten times that amount, but we wonder what practical difference it will make.

There was no really strong interest in using the **GST ratio** method to calculate provisional tax. However, expanding the **GST ratio** method to cover shareholder employees, partners in partnerships, and beneficiaries of trusts, had more support.

There were strong comments on the **reduction of the time** that records must be retained. The cost of storage generally has a linear relationship to the duration, half the time-half the storage costs. Three years was seen as a reasonable length of time particularly when considered in the SME context. Other legislation could be updated to bring the period into line for SMEs.

Withholding **tax exemption certificates** are seen as an unnecessary burden on buyers. If a “tax invoice” is submitted by the seller, tax issues should reside with the seller. The buyer should have no part in the tax issues of the seller. Often these transactions are between SMEs and really mess everyone around for little gain to anyone. Frustration levels and costs would certainly fall if exemption could be assumed given GST registration.

The current **PAYE subsidy**, in our experience, has not seen a high adoption rate, thus it is not effective. The IRD will have a better idea of the general uptake, but we did not detect strong involvement or interest. The lack of interest should not be seen as an indication that costs are lower than the subsidy offered, it is more likely to be insufficient to change embedded practice where the real costs are lost to the general flow of events.

We have a view that a **PAYE subsidy** could be useful for SMEs, however it needs to have a more attractive subsidy, cope with all tax issues, cover as many employees as possible, and be well promoted to SMEs.

## **Chapter Seven – Information Sharing**

Information sharing should be a priority of Government. When one agency asks for the same information very soon after a similar enquiry from another government agency, the level of frustration grows. This does not have to happen often, when it does happen it demonstrates one hand does not know what the other is doing and credibility suffers. It is not generally a significant compliance burden but it is a frustration.

All information should be shared across common data base structures. It is access to that information that should be restricted across dimensions of “need to know”, “level of authority”, “level of experience”, that is, if I am employed by Government and I can’t get access to the information on the Government data base, I should not have the authority to ask the citizen or tax payer. Once the access rules and security requirements have been put in place any lack of compliance to those rules and requirements should result in dismissal of those concerned, and those in the associated management path up to the Chief Executive - no exceptions.

### **Concluding Comments**

The compliance burden has two aspects: the cost and the frustration – both impact the opportunity cost to the business. For SMEs this is greatest as it is generally the principals who must also drive the business who deal with compliance. Consequently productivity suffers.

The recognition of the differential impact on SMEs is the principle reason to focus on the compliance cost for SMEs. New Zealand has a large number of SMEs and so a more productive SME landscape, the more revenues should grow so there are positives, not just losses to revenue as the rules are simplified.

Any simplification fails if the rules where the simplification applies are such to exclude the vast majority of New Zealand’s businesses, it should be possible to include in the SME definition 90% to 97% of the businesses in New Zealand. If this was achieved and the simplifications were effective, it would be highly positive for our economy, and as a result have the potential to increase taxation revenues.

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Manufacturers and Exporters Association