

Executive summary

This report highlights two proposals to reduce tax compliance costs for small business taxpayers who have substantially active business income¹. Typically a small business is categorised by the number of people it employs. This discussion paper does not measure a small business by the number of employees it has, but rather by its levels of turnover.

The first proposal targets business activity that is operating on a very small turnover scale which we have termed the "Micro Business Taxation" proposal. The second proposal captures those small businesses whose turnover is up to \$1.2m which we have termed the "Small Business Taxation" proposal.

Each of the two proposals is discussed in more detail below:

Micro Business Taxation

We propose a very simplified basis of taxation for micro business taxpayers who are:

- Unregistered for GST
- Have no employees and have a turnover of less than \$60,000 at the time of opting to use this model
- Running a small business or in the process of business start up
- Those people earning periodic cash receipts from "under the table" income

The tax paid will substitute for income and fringe benefit taxes (if applicable). More specifically:

- A final income tax rate of 15 percent will be paid on business turnover
- Tax payments made monthly or at any time
- No filing of returns
- The micro tax of 15% includes a component for Accident Compensation levies
- Income for the purposes of social policy commitments (child support, student loans and working for families tax credits) is 50% of gross income
- The income will be transferred to the taxpayer's summary of earnings and no further income tax on this business income will be payable
- A transitional rule for people who earn cash "under the table" will give a 12 month window for people to enter the tax system without further repercussion for past year's earnings from undeclared income from these sources provided all tax is correctly accounted for going forward

Small Business Taxation

This proposal is a much simplified taxation model for small businesses with:

- Turnover less than \$1.2m
- Designed for more established businesses but could also be used for start ups if desired
- Income tax will be calculated on a cash basis on the GST return, as an adjustment to the GST result²
- Like GST, income tax will be paid every two months: there will be no year end adjustments, no provisional tax and no fringe benefit tax

More specifically:

- Small business that trades through a company or partnership will be taxed analogously to a sole trader by taxing the entity based on the personal marginal tax rate structure
- Transactions, such as dividends and salaries, between the business entity and its owners are eliminated, as is the need to maintain an imputation credit account
- Income tax and GST will be calculated and paid two monthly on a simplified cash basis
- No balance date and square up issues
- Trading stock (except for livestock) purchases are deducted on a cash basis – no need for stock takes for tax purposes
- No provisional tax, no fringe benefit tax and no entertainment tax
- Simplified rules for depreciation

Inland Revenue and the Accident Compensation Corporation systems will also have to be able to support the resultant processes. Concurrently and independently work is being undertaken by the Ministry of Economic Development which, among other things, is considering removing the statutory need for financial statements for smaller entities.

The micro and small business taxation models are discussed further below. As the objective is to reduce business compliance costs we need to know what businesses and others think. The more information we can provide policy makers about what you want, the better the outcomes are likely to be.

¹ The proposals are not designed for investment income or passive activities.

² This can be achieved because in many ways income tax and GST are calculated on very similar concepts, they just use different labels. That is, in a GST context we use the terms output tax and input credits and, in an income tax context, we call these things income and expenses. GST is paid on output tax less input credits, and income tax is paid on income less expenses.