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This paper contains advice that has been prepared by the Tax Working Group Secretariat for consideration by the Tax Working Group.

The advice represents the preliminary views of the Secretariat and does not necessarily represent the views of the Group or the Government.

Coversheet: **The Future of Work**

*Discussion Paper for Session 6 of the Tax Working Group
April 6, 2018*

Purpose of discussion

This paper outlines some of the issues in relation to the changing nature of work in New Zealand. Predominately it addresses the expected increase in the number of people who will be self-employed.

Key points for discussion

- There are various components to the future of work including:
 - Automation – mainly affecting the less skilled and those who cannot retrain;
 - Loss of tax revenue from labour – requiring replacement funding;
 - Outsourcing to other countries – moving jobs/tasks to low cost jurisdictions;
 - Rise of the Gig economy – more self-employed workers.
- Officials are working on a number of potential ideas to address the increase in the self-employed – increased information reporting to Inland Revenue from payers and platforms, potential extension of withholding taxes and providing third parties opportunity to support compliance.
- Is the Group comfortable with the approach we are taking to changing work patterns?
- Is this something the Group would like to include in its work or is it comfortable with this work being examined through the standard Tax Policy Work Programme?
- Is there any further analysis on this topic that the Group may find useful?

Recommended actions

We recommend that you:

- a **note** the work currently being progressed by officials.
- b **indicate** whether this is something the Group would like to include in its work or whether you are comfortable with the work being progressed as part of the standard tax policy work programme.
- c **indicate** if there is any further analysis you would like on this topic.

The Future of Work: Sustaining the tax system

*Background Paper for session six
of the Tax Working Group*

This paper contains advice that has been prepared by the Tax Working Group Secretariat for consideration by the Tax Working Group.

The advice represents the preliminary views of the Secretariat and does not necessarily represent the views of the Group or the Government.

The Tax Working Group will release its interim report containing its recommendations in September and the views of the Group will be informed by public submissions alongside Secretariat advice.

6 April 2018

Prepared by the Inland Revenue Department and the Treasury

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Executive Summary

This paper outlines some of the issues in relation to the changing nature of work in New Zealand. The purpose of the paper is to outline some of the challenges to the tax system that arise from this change in working arrangements. These challenges are something that officials have been working on for some time. The paper therefore seeks the Group's view on whether you are comfortable with the workstreams currently under way, and if there is anything further you would like to consider or receive further analysis on.

The main challenge identified is that, since the pay-as-you-earn (PAYE) system was introduced in the 1950's, there has been a movement away from employment to self-employment. As the Ministry of Business Innovation and Employment (MBIE) discussed with you recently, this switch is likely to continue in future years. This has been driven by a number of factors, such as changing regulatory requirements and technological developments.

This change in the nature of work presents challenges for the tax system. The self-employed have considerably lower compliance levels than employees, raising fiscal sustainability concerns. The transition to self-employment also raises compliance cost concerns, both for the self-employed and Government. Perhaps most significantly, it raises equity concerns in the different treatment of employees and the self-employed by the tax system.

Inland Revenue has an active work programme to address these challenges. Recent changes include adjustments to the current withholding tax system to address non-compliance by self-employed workers, especially dependent contractors.

Work continues on a number of projects to further address these challenges. This includes consideration of: increased reporting by those who make payments to contractors; expanding the current withholding tax rules; and opportunities to improve compliance through online platforms. These options require balancing improvements in compliance with possible increases in administrative costs and overreach into compliant industries.

This report highlights three further policy responses that we do not recommend, and are not part of Inland Revenues current agenda for addressing future of work challenges. These are: shifting the employer/contractor boundary; increasing the requirements to file tax returns; and changes to GST registration requirements.

Two additional policy challenges are identified in relation to the future of work. The cash economy is a significant issue for compliance and, to date, we have not been able to identify any workable policy solutions in this area without imposing significant compliance costs on customers of the self-employed, particularly private consumers. Finally, there are compliance issues created by the ease with which multinational firms can move specialist employees from country to country.

1. Introduction

1. This paper, along with the attached diagram, outlines some of the issues in relation to the changing nature of work in New Zealand and some of the potential solutions we have been working on to address some of the tax issues arising from these changes.
2. Officials have done a significant amount of work in this area over the last few years and this paper is intended to update the Group on our current thinking and prompt discussion as to whether the Group is comfortable with the work that is being progressed.
3. Inland Revenue has also participated in a research project from Victoria University of Wellington into the income reporting gap of the self-employed, and we will be discussing the findings of that research in a future meeting of the Group¹.
4. The paper discusses:
 - The future of work and the implications for the tax system;
 - The challenges created by the shift in the workforce from employed to self-employed;
 - Changes that the previous government made in this area;
 - Additional policy changes being considered;
 - Policy changes not recommended; and
 - Further policy challenges.
5. In particular, we would like the Group to consider the following:
 - Is the Group comfortable with the approach we are taking to changing work patterns?
 - Is the Group happy with the specific issues that we are working on to progress compliance in this area?
 - Is this something the Group would like to include in its work or is it comfortable with this work being examined through the standard Tax Policy Work Programme?
 - Is there any further analysis on this topic that the Group may find useful?

¹ The date of this briefing is yet to be finalised as the research paper is still being finalised.

2. The changing nature of work

2.1 The driving forces of change

6. Change is coming to our work places. The rapid advance of digital technology is driving successive waves of automation of work. As noted in the recent Ministry of Business, Innovation and Employment (MBIE) presentation to the Group, the OECD estimates that approximately 35% of New Zealand jobs are at risk of automation over the next two decades, with 9% at high risk.
7. Technology is also driving a change in work practices. Online platforms have opened up a new front in the casualization of work, allowing for real-time matching of labour supply and demand. This is leading to a new type of freelance worker in the ‘gig economy’. As also noted by MBIE, while the share of self-employed workers in New Zealand has been relatively steady at 15 – 20% over the past 10 years, there are expectations we will follow overseas trends – in the UK, the share of the workforce that is self-employed has grown by a quarter since 2001.²
8. Globalisation is a third force driving change, especially in a small open market like New Zealand. In less than 20 years, over 1 billion people have been added to the ‘global market economy’.³
9. Finally, demographic shifts are changing the workplace. Our population is aging, and older people are become an increasingly large part of the work force. The share of New Zealand’s labour force aged over 65 is set to increase by 50% over the next 20 years.

2.2 The implications for the wellbeing of New Zealanders

10. The economic impact of these trends on New Zealanders is uncertain. The labour market could see a contraction in supply driven by the aging population, but also a contraction in demand driven by automation of work. New skills will become increasingly important as people learn to complement rather than compete with machines.
11. The gig economy offers both businesses and workers the benefits of greater flexibility, potentially boosting productivity - but it comes at the cost of greater job insecurity, raising significant fairness and equity concerns.
12. Globalisation is creating new markets for export, and new opportunities for innovation through global supply chains. However, it also opens New Zealand workers and businesses to increased competition, potentially putting pressure on wages and profits, leading again to fairness and equity concerns.

²<https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/articles/trendsinselfemploymentintheuk/2018-02-07>

³ https://www.oxfordmartin.ox.ac.uk/downloads/academic/technology-globalisation-future-of-work_Mar2015.pdf

2.3 The implications for the tax system

13. These trends, and their impacts on businesses and workers, are a significant challenge for Government. Fiscal challenges from demographic changes are acute and there are likely to be pressures on many areas of government policy. However, the impact on the tax system is expected to be more limited, most notably, challenges to the sustainability of the tax system, and the use of tax policy to respond to broader policy issues.
14. Our assessment of the trends has identified the rise of the self-employed contractor as the most likely and significant challenge to the sustainability and integrity of the tax system. This is examined further in the following section.
15. We consider tax policy is likely to play a more limited role in the areas of automation, aging or globalisation. However, in saying this, it is nevertheless important that the tax system is capable of responding to them. For example, changes to the contractor/employee interface have been suggested as means to better protect struggling workers in the gig economy. This is also examined further in this report.

3. The rise of the contractor, and the challenges for the tax system

3.1 The rise of the contractor

16. In 1958, when New Zealand's pay-as-you-earn (PAYE) system was introduced, workers were in two groups. The majority were employees who had tax deducted at source, but were still permitted to deduct expenses incurred in earning that income. The other group was those people who were in business.
17. Historically, employees tended to have steady incomes and, more importantly, all their tax obligations were dealt with by their employer. Their employer made PAYE deductions, accounted for Accident Compensation Corporation (ACC) contributions (from 1974) and, being employees, Goods and Services Tax (GST) did not apply when it was introduced. The only tax obligation left to the individual was to file their tax return at the end of the year, which was mainly to allow them to claim any deductions against their employment income, take advantage of a number of low income earner rebates, or claim credits for their donations.
18. Since that time, the regulatory environment for employers has changed. It is much more onerous for businesses to have employees as well as being less cost effective for specific short-term projects. Businesses want a flexible workforce who can be hired on an as-needed basis, and the need for specialist skills for specific projects lends itself to a more flexible workforce rather than an employee/employer relationship.
19. Hiring employees creates overheads, compliance costs, labour law obligations (in terms of ability to terminate surplus employees without significant costs), Kiwisaver obligations and, historically, health and safety requirements for firms. These would not arise if independent contractors were hired instead⁴.
20. In addition to this regulatory pressure creating a bias towards engaging contractors, the workers themselves may enjoy the relative freedom that being a contractor can provide. It is now relatively simple for these people to set up and run their own business. Previously, to run your own business, there were large barriers to entry. You had to set up a company, engage a lawyer, find work (usually by advertising in the Yellow pages or newspapers), and engage an accountant to deal with your accounts and tax affairs.
21. Today, setting up a company can be done within minutes on-line. Work can be found through advertising with online platforms such as Freelancer⁵, or through contracting through a labour hire firm. In addition, many aspects of running your own business have been simplified. Cloud accounting packages make keeping your

⁴ The exception to this is health and safety requirements which have been extended to independent contractors working for a firm.

⁵ Freelancer is a marketplace that matches buyers and sellers of services around the world. It offers all types of work such as web design through to accounting services (www.freelancer.com)

finances in order easier and provisional tax options such as the accounting income method (AIM)⁶ make completing tax obligations a lot easier.

3.2 Challenges for the tax system

22. A shift towards a self-employed workforce presents significant challenges. Compliance rates risk falling, which puts pressure on the overall system, including administration. There are also pressing challenges of equity and fairness arising from the self-employed who either knowingly or unwittingly fail to comply.

3.2.1 Compliance – the system and scale

23. The fairness and equity concerns of lower compliance are discussed below. However, at a system level, it is important to note that self-employed taxpayers have significantly lower compliance rates than the employed. As a higher share of the workforce transitions into self-employment, this lower compliance put downwards pressure on overall compliance rates in the tax system creating pressures on the sustainability of the tax system.
24. This issue of lower tax compliance by the self-employed has been measured in a number of overseas studies. Those studies suggest that the income gap⁷ between what the self-employed should be reporting for tax purposes and what they do report can range from 16% in Canada to 42% in Greece. As noted above, Inland Revenue has participated in a study by Victoria University of Wellington on the income gap of the self-employed in New Zealand. The results of that research will be discussed with the Group at a future meeting.

3.2.2 Increased administration costs

25. From an administrative viewpoint it is more efficient to have larger organisations deduct and pay tax to Inland Revenue. This reduces the number of taxpayers Inland Revenue need to engage with, and ultimately audit. Also, the larger the organisation, the higher the competency and level of trust in the processes.

3.2.3 Fairness and equity concerns

26. Fairness and equity concerns come under two broad headings:
- High compliance costs make it difficult for some self-employed to comply;
 - The fact that payments to contractors do not generally have tax deducted at source makes it easier for the self-employed not to comply (and the relative freedom to report your own income and claim deductions can result in income suppression or inflation of expenses).

⁶ AIM is a new provisional tax method for small to medium enterprises with turnover under \$5m. It applies from the 2018-19 income year.

⁷ The “income gap” is the difference between what a taxpayer should have reported as income to tax authorities and what they actually reported.

Higher compliance costs

27. Although completing tax obligations is much easier for a business today than historically, business tax obligations continue to be much more complex than those of an employee. Today an employee, generally, doesn't file a tax return - simplified by the fact that there are very few expenses that can be claimed against employment income⁸. Their Kiwisaver and ACC obligations are taken care of by their employer along with some social obligations such as student loan or child support payments.
28. A person who is self-employed has, in the main, to account for their own taxes⁹ as well as Kiwisaver, ACC and their social obligations. Because they are likely be making taxable supplies, they may be required to register and account for GST¹⁰. In addition, compliance costs tend to be comparatively greater at the smaller end of the market, as large enterprises generally have the systems in place to more efficiently deal with tax compliance
29. For those self-employed in a position that is akin to an employee role, often termed a dependent contractor, the contrast in tax obligations is outlined below:

| Obligation | Employee | Dependent Contractor |
|-------------------|-------------------------|---|
| Income Tax | Dealt with by employer | Subject to provisional tax to the extent not covered by withholding tax ¹¹ |
| GST | N/A | Required to account for GST if providing over \$60k of taxable supplies |
| Tax Return | Generally not required | Must file an annual tax return |
| Deductions | Generally not permitted | Permitted deductions incurred in earning income |
| KiwiSaver | Dealt with by employer | Own obligation |
| ACC Levies | Dealt with by employer | Own obligation |
| Child Support | Dealt with by employer | Own obligation |
| Student Loans | Dealt with by employer | Own obligation |

30. This can result in a situation where two people sitting across from each other, essentially doing the same role, can end up with very different tax obligations. This raises the horizontal equity concerns between employees and the self-employed.
31. Increased compliance requirements for the self-employed can lead to inadvertent non-compliance. These people can perhaps best be described as “struggling

⁸ Income protection insurance and the cost incurred completing a personal tax summary or tax return are the exceptions.

⁹ Those subject to the scheduler payments regime may have withholding tax deducted to partially offset their income tax liability.

¹⁰ Compulsory registration will occur where the person is providing over \$60,000 of taxable supplies in any 12 month period (or the expectation of doing so).

¹¹ The threshold for payment of provisional tax is where a taxpayers residual income tax (RIT) is greater than \$2,500. RIT is the remaining tax payable after tax credits such as PAYE and withholding taxes have been applied to a taxpayers liability.

workers”, often not possessing the necessary skills to enable them to comply. A classic example of workers would be pizza delivery drivers, who are generally young, inexperienced and for which being a contractor may be their first job.

32. Although this group may be non-compliant, it is mainly because they are not aware of their compliance obligations, and find themselves in a contractor role which would have traditionally been an employee role.

Decreased compliance

33. Quite apart from the struggling workers, removing workers from the employee relationship to one of self-employed has a decreased compliance story. New Zealand has a very high voluntary compliance rate for taxpayers. However, this is in part driven by the fact that the majority of New Zealand taxpayers have tax deducted at source. The movement to more contractual relationships removes that safeguard of employer deductions and increases the ability for taxpayers to be non-compliant.
34. Non-compliance could be in the form of suppressing income or inflating expenses by claiming predominately private expenditure as business expenses. The ability for the self-employed to manipulate their income is much greater than for an employee because of three factors:
- Employers provide information to Inland Revenue on their employees’ earnings and tax deductions monthly or twice monthly¹² (ie, there is third-party information reporting);
 - Employers deduct and pay to Inland Revenue the tax owing on their employees’ earnings (along with social obligations) on a monthly or twice monthly basis (ie, there is withholding); and
 - The self-employed can claim deductions against their income, giving them the ability to blur the line between private and business expenditure. Personal deductions are much more limited for employees.

¹² There is currently a proposal being considered by Parliament to have this information provided to Inland Revenue on a payday basis.

4. Policy responses to the self-employment challenge

4.1 Recent work

35. The previous Government recently introduced a number of changes to assist in maintaining compliance of the self-employed and, in particular, dependent contractors where Inland Revenue had encountered some compliance issues.

36. The previous Government:

- Added labour-hire firms to the schedular payment rules, which require labour hire firms to deduct withholding tax at 20% or a rate chosen by the worker;
- Removed the company exemption from withholding tax for those companies working through labour hire firms;
- Allowed contractors to choose a rate of withholding tax down to a minimum of 10%; and
- Allowed contractors to, with the agreement of the payer, have voluntary withholding tax deducted from payments – potentially removing the contractor from provisional tax obligations.

37. Combined, these rules make the withholding tax system more bespoke for contractors in allowing them some flexibility on the level of withholding that is taken from their payments and it also addressed some non-compliance in the labour-hire firm area.

4.2 What is next?

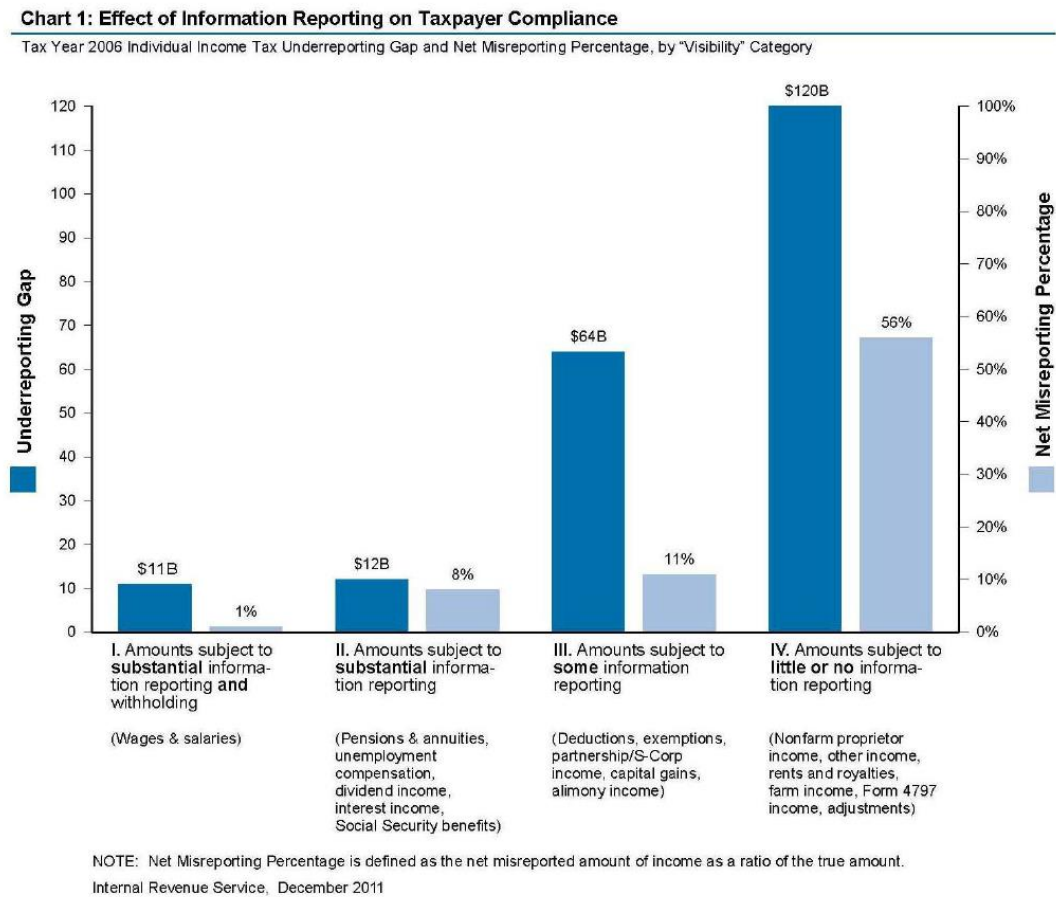
38. As previously mentioned, there is a predicted move to proportionately more self-employed in our labour force in the coming years. The question for revenue authorities is how this should be addressed to ensure that compliance rates are maintained.

39. In the main, the issue is one of continued compliance. Officials accept that the ability of the self-employed to claim expenses against income (whereas employees cannot) raises questions as to whether that policy setting is correct from a horizontal equity perspective. However, it is the ability to not comply that is the main issue for revenue authorities. We are currently looking at a number of tools to address these issues outlined below.

4.2.1 Increasing reporting

40. International studies have indicated that, when taxpayers know that the revenue authority is receiving information on payments received, compliance automatically increases. The “fear factor” that the revenue authority has been told about the income earned is a natural incentive for taxpayers to comply.

41. This is illustrated in the following chart from the United States Internal Revenue Service on the effect of information reporting. Misreporting rates fall from 56% where little or no information is reported to the tax authority, to 8% when substantial amounts are reported. They fall further to 1% when there is also withholding.



42. The issue with increasing reporting is the compliance costs for the payer, which to some degree can be minimised through the application of the information requirements. For example, providing information about payments made to dependent contractors could be extremely compliance cost intensive as they will need to identify those who meet the "dependent contractor" requirements, split that information out from the remaining accounts payable information, and supply it to Inland Revenue.
43. Alternatively, payers could provide Inland Revenue with a download of their entire accounts payable system by creditor and Inland Revenue could extract that information for use in matching income to taxpayers. This results in the compliance cost being converted to an administration cost. This option would have an extremely low cost for payers.
44. However, it would be counterproductive to demand increased reporting if it were inordinately costly for Inland Revenue to make use of that information to improve compliance further. If taxpayers see that, although Inland Revenue is receiving

information on payments, nothing is followed up, compliance is unlikely to improve. Both costs to employers and the administration cost to Inland Revenue of any new withholding schemes need to be balanced.

4.2.2 Extending withholding

45. The high rates of compliance among employees can be attributed to the inability of employees to manipulate their income sources. For those who derive only source deducted income, the benefits of PAYE and other direct deductions mean that not only are the compliance costs for taxpayers lowered overall¹³ the compliance levels are increased.
46. Withholding taxes do impose some compliance costs on the payers of that income, but in the majority of cases these are persons who are best placed to bear those compliance costs - especially those who are large employers.
47. However, there can be substantial compliance costs with any extension of withholding taxes depending on who is included in any extension.
48. To date, extensions of withholding taxes have been limited to specific industries, which are reasonably defined and where there are the biggest concerns about non-compliance. The recent extension of withholding to those working through labour hire firms is a step towards a more general application of withholding to a variety of industries. For instance, as long as the payer can be well defined (being a labour hire firm), the labour hire changes could apply to businesses supplying manual labour for construction projects or those in predominately white-collar roles rather than one particular industry.
49. The removal of the company exemption for those contractors working for a labour hire firm is also a step towards piercing the corporate veil in situations where the company is essentially a look through and the owner predominately does the work.
50. In addition, the recent change to allow voluntary withholding with the agreement of the payer could be extended to remove the requirement that the payer agree. However, there is a compliance issue with this for those smaller taxpayers, who may not have systems in place to correctly capture and deduct withholding taxes¹⁴.
51. A global withholding tax on every payment made by a business payer is inherently simple to apply by a payer including both capital and revenue expenditure. Every single payment made by them could be subject to withholding, although the rates may differ. However, for industries where there the voluntary compliance rates are

¹³ This is a net reduction in compliance costs. For some taxpayers compliance costs will increase (usually the payer) but overall they should decrease.

¹⁴ In larger organisations that use sophisticated accounting systems the deduction of withholding tax is relatively simply within their accounts payable systems as part of the vendor set up. For smaller organisations with less comprehensive software the interaction between the accounts payable and payroll systems may be more manual in nature and create relatively higher compliance costs as well as introduces a higher risk of error.

good this could be seen as an overreach, as it would impose compliance costs on those industries for no discernible revenue increase.

52. As mentioned above, a withholding tax that applies to a subset of, say, “dependent contractors” could be more compliance intensive as it relies on applying a definition of who is and therefore who is not within the regime. An objective test may be easier to apply (say, based on hours worked over a period of time). However, the application of that definition in a business context may be made by people within an organisation who are not equipped to apply that test.
53. Both Australia and the United Kingdom have a definition of dependent contractor and we continue to work through whether that might be an option for New Zealand. However, to date, our understanding is the definitional issues are problematic and this option may not be an effective solution.
54. Similarly, an ill-defined group of contractors such as “IT professionals” can leave room for the restructuring of contracts to move outside that definition – for example, is a project manager who happens to deliver an IT project an IT professional?
55. Any expansion of withholding tax on a more general basis needs to find a comfortable position between increased compliance costs (which inevitably there will be in some form) and appropriate targeting.
56. One area where withholding taxes could be applied well with lower compliance costs are clearly defined industries where non-compliance is identified - for example, courier drivers. Targeted withholding taxes can also be deployed in specific industries where “struggling workers” are being used. Again these are generally clearly defined industries and roles - for example fast food delivery people.

4.2.3 Making better use of platforms

57. Technology platforms have been integrated into our modern society. From ride-sharing to house-sharing platforms, names such as *Uber* and *Airbnb* have become engrained in everyday life. These platforms provide revenue authorities with a potential opportunity to reduce any non-compliance within these predominately business-to-consumer markets.
58. One area where platforms could assist in compliance in the cash economy is a platform such as *MyCare*, which is essentially a marketplace for domestic workers and matches caregivers with those requiring care. As part of its service, *MyCare* deals with the caregiver’s tax obligations by deducting tax from payments received and paying this through to Inland Revenue. *MyCare* is a New Zealand organisation that is facilitating tax compliance through its platform, which results in lower compliance costs for the caregivers.

59. Currently the law may not be the best fit for a *MyCare* model. However, if platforms such as this become a good way to increase compliance, consideration should be given to it being supported by the legislation (with appropriate protection against business failure for the caregivers).
60. Other platforms provide further opportunities to increase compliance with lower compliance costs than other businesses. Essentially, platforms such as *Uber* or *Airbnb* could be seen as an “employer” of a large number of workers on which a standardised provision of information or the extension of withholding tax could be easily applied.
61. Platforms do give revenue authorities an ability to increase the provision of information and/or the extension of withholding. However, the larger platforms are generally run from offshore and there may be a compliance issue with those non-resident platform providers complying with New Zealand tax legislation - although non-compliance has not been apparent with the recent introduction of GST to remote services.

4.3 Policy responses we do not recommend

4.3.1 *Shifting the employee-contractor boundary*

62. The tax system places different compliance obligations on employees and the self-employed raising equity and fairness concerns – see 3.2.3 *Fairness and equity concerns* above. This has led to suggestions of shifting the boundary between employees and contractors.
63. There is settled case law on the employee-contractor boundary, although the application of that boundary can be problematic for a number of reasons. There is limited policing of this boundary by Inland Revenue because it is costly to do so and the revenue consequences of doing so are generally small in comparison.
64. The distinction between a contractor and employee can be a fine one. No matter where that boundary sits, applying it must be done on a case-by-case basis, which has a high cost of enforcement. Moving it now would create greater uncertainty, at least in the short term. In addition, the ability to move to either side of the boundary can be controlled by the terms of a contract and thus, when the boundary is changed or challenged, it can be moved through a renegotiation of a contract in which the contractor may have very little ability to negotiate.
65. As long as taxpayers are fully compliant, the distinction between a contractor and employee is moot because, from a revenue viewpoint, the only differences are the timing of the tax payments (the self-employed usually pay less frequently) and the treatment of expenses. For those dependent contractors who may be close to the employee boundary the quantum of expenses claimed are likely to be at the lower end of the scale and may be immaterial overall.
66. There may questions as to whether you could deem certain people to be employees in legislation and remove the need for the courts to determine the

employee/contractor boundary. Again, definitional issues that could be changed by contractual conditions are likely to make this particularly difficult to apply in practice. So, although this could be a theoretical solution to the issues of low compliance, GST and deducting expenses, in practice, we believe it may be difficult to apply, and some of the other solutions we have been working on may be better placed to address these issues.

4.3.2 Increasing filing requirements

67. Currently most taxpayers who earn only source deducted income (and who do not have social policy obligations) do not have to engage with the tax system. They are not required to file a tax return unless they earn over \$200 of income taxed at the incorrect tax rate.
68. Recent proposals by the Government involve a modification to that rule for taxpayers who only earn income that the Commissioner has been notified of, and where tax has been deducted at source. They will continue to not have to engage with Inland Revenue, but will be deemed to accept the assessment of tax within a certain time period - at which time a refund or a notice to pay will be issued. This will only be in certain limited circumstances¹⁵.
69. A counter argument could be that a reduction of tax return filing requirements has reduced compliance overall. Taxpayers who have other income that is not subject to tax at source may be less inclined to return that income, as there is no “obligation” to sign a return. Historically, filing a tax return required taxpayers to sign on the dotted line that they had made a true and correct disclosure of their income.
70. By continuing with a non-filing regime, there is an argument that overall the tax “literacy” of the general public is reduced. In a situation where a person’s circumstances change and they start earning income that is not subject to source deduction, they are more likely to find themselves in the group of “struggling workers”, not having knowledge of their obligations and consequently failing to comply.
71. Rather than going back to a framework where everyone should turn their minds to their tax position each year, we believe that the better way to confront non-compliance is to make the system as automatic as possible for all taxpayers.
72. The more that information can be obtained and prepopulated to individuals’ MyIR¹⁶ accounts or to a tax return, the more it will prompt individuals to return income from those sources, or to specifically tell Inland Revenue that they don’t earn income from those sources.

¹⁵ If a taxpayer has notified the payer of the source deducted income of the correct tax rate and tax has been deducted at that rate then notwithstanding an amount may be owing it will not generally be payable.

¹⁶ MyIR is the web platform that allows taxpayers to interact with Inland Revenue systems and file returns or personal tax summaries on-line.

73. The bulk of taxpayers have simple tax positions and we consider this approach is preferable to moving back to an increased filing regime. Most self-employed people are required to filing a tax return, and will continue to need to do so. This is predominantly due to the fact that, although withholding taxes can reduce the year-end tax square-up required by those in self-employment, they will not eliminate it for most people. The reason for this is the rate of withholding can be a blunt instrument and not factor in a person's marginal rates and the level of expenses correctly.

4.3.3 *Changing registration requirements for GST*

74. GST is New Zealand's comprehensive value added tax. It is world renowned for being a simple and highly efficient tax. Value added taxes, by their nature, tax on the value added through the chain of supplies that ultimately results in the sale to the end consumer.
75. The value-add nature of the tax provides a safeguard to the compliance issues that arise with retail sales taxes and there is a chain of invoicing throughout the process that results in the final sale to the consumer. This reduces the concerns around fraud often found in retail sales taxes.
76. There are few exemptions from our GST system. As noted in the table in paragraph 29 above there are significant differences in the tax obligations of an employee versus someone who is self-employed. One of those areas is in GST.
77. The definition of taxable activity in our GST legislation specifically excludes any engagement, occupation or employment under a contract of service, which removes employees from the GST net. In the main, this has been done for compliance reasons - to avoid having every employee register and return GST on their income. It also minimises leakage from GST claims for expenditure by the employee.
78. However, a person undertaking similar work under a contract for services is not excluded from the taxable activity definition, so will be required to register for GST if they exceed the registration threshold.
79. For a dependent contractor who is similar to an employee and who has very few expenses eligible for an input tax credit, GST compliance can be seen as a something that has very little benefit. In the majority of cases the payer will be registered for GST and will be able to claim that GST paid back from the Government. The GST process in that case could be seen as a compliance burden.
80. From the tax authority's viewpoint, GST in this scenario could also be seen as problematic. It is likely that the person claiming the input credit for the GST paid to the dependent contractor is on a more frequent filing basis than the contractor themselves, so there is a timing mismatch where the GST paid is refunded to the payer but not paid to the revenue authority until a later date. This can also create a collection issue for the revenue authority where the contractor ends up defaulting.

81. A potential option could be to remove those contractors from the GST system entirely in order to remove this compliance issue and address the administrative issues around timing and collection. As noted, our GST system is predicated on the wide application of GST and there is a question whether such an “exemption” would compromise the integrity of the system.
82. Another option (if it is seen to be integral to keep those transactions within the GST system) is, for those contractors we have termed “struggling”, to create some kind of reverse charge mechanism. A reverse charge would require the person making the payment to the struggling worker to return the output tax on those supplies at the same time as the input tax is claimed. This could effectively remove those who have difficulty complying from the GST regime. This option would slightly increase the compliance costs of the business making the payments but they are most likely in the best place to deal with those costs.
83. On balance officials see more complications with these options than the current GST treatment. Although it may reduce the compliance costs and issues for dependent contractor, it could introduce a number of other boundary issues in terms of business-to-business transactions compared to business-to-consumer transactions. The latter would be subject to GST whereas the former would not. Determining which was which could end up increasing compliance costs.

5. Further policy challenges

5.1 The cash economy

84. To date, the discussion centred around the self-employed relates to business-to-business transactions, which does not pick up the cash economy. This is mainly due to the fact that work is mostly generated from businesses rather than through final consumer transactions¹⁷.
85. There is no apparent policy answer to the question of the cash economy without imposing significant compliance costs, and raising potentially more non-compliance issues on the consumer market. The possible solutions identified above in the business-to-business market (requiring withholding tax or the provision of information on a compulsory basis) would have significant downsides in the consumer market.
86. We have also considered the application of a mechanism that could account for taxes in the business and consumer market but only on a voluntary basis¹⁸. This would involve a banking intermediary deducting and paying tax to Inland Revenue as income payments are received by the self-employed. This would capture some of the cash economy to the extent that funds were banked, but is unlikely to be a complete solution.
87. Officials' view is that to tackle compliance challenges the cash economy, public perceptions will need to change.

5.3 Mobility of labour

88. The mobility of labour across international borders has always created compliance issues for business and consequential compliance costs. New Zealand also has the complex non-resident contractors tax¹⁹ (NRCT) which is reasonably unique in internationally.
89. Increasingly, multi-national firms rely on the movement of highly skilled professionals between countries for short or medium term assignments. This presents practical compliance issues for both the company sending the person and the company employing the person. To a large extent these issues arise where a person transitions tax residency between countries during the assignments. The ultimate aim is to ensure these people are taxed on their New Zealand sourced income unless a double tax agreement (DTA) provides otherwise.

¹⁷ The exception to this is the reference to Freelancer noted above where work through that particular platform could be business-to-consumer transactions.

¹⁸ The reason why this was not explored on a compulsory basis is because of the compliance costs on the final consumer.

¹⁹ NRCT applies when a non-resident contractor is providing contract services in New Zealand generally where they are personally present for more than 92 days in a year working for any person (i.e., not just the payer considering the test).

90. Further, from an employer viewpoint, often the overseas employer of the person is required to register and pay PAYE in relation to that person notwithstanding they may not have systems set up to do this. Practically, in cases where this occurs, the domestic subsidiary will account for those liabilities although this may not strictly fit within current legislation.
91. One of the main issues with all of these rules and situations is that the current structure can create uncertainty for taxpayers and their workers. The rules can also have retrospective effect, which can have sanction implications notwithstanding the rules can require a measure of hindsight.
92. A modern tax system should make it easy for taxpayers to comply and have rules that provide certainty to taxpayers and the revenue authority. Above all, it should make compliance easy and the current cross border rules have compliance issues which can at times seem unfair, particularly when contracts run over their expected timeframes.
93. Inland Revenue is currently undertaking work in relation to these complex issues. In particular, work is being done around the definition of residency to improve certainty for employers and taxpayers.

6. Conclusion

6.1 Summary of analysis

94. Whilst the changing nature of working patterns and the cross border flow of employees creates a number of challenges for tax authorities we believe the workstreams we are currently working on and the framework which those are based on should address the challenges imposed by this changing environment.
95. Although it may be possible to simply impose a withholding tax on every payment made by every business in New Zealand, the overreach that could occur may cause other negative issues and not correctly balance the compliance and administrative costs of dealing with the changing nature of work.
96. The key to any changes in this area is compromise between compliance and administration costs, and that is a main focus of our continuing work.

6.2 Questions for the Group

- Is the Group comfortable with the approach we are taking to changing work patterns?
- Is the Group happy with the specific issues that we are working on to progress compliance in this area?
- Is this something the Group would like to include in its work or is it comfortable with this work being examined through the standard Tax Policy Work Programme?
- Is there any further analysis on this topic that the Group may find useful?

Appendix A: Future of work: Sustaining the tax system

A3 sheet as attached.