

POLICY AND STRATEGY

Tax policy report: **COVID-19: Update to Inland Revenue's response and next steps**

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|------------------------|--------------------|-----------------------|------------|
| Date: | 5 March 2020 | Priority: | High |
| Security level: | Sensitive - Budget | Report number: | IR2020/123 |

Action sought

| | Action sought | Deadline |
|---------------------|---|-----------------|
| Minister of Finance | Note the contents of this report | 9 March 2020 |
| Minister of Revenue | Direct Inland Revenue to continue preparatory work on the options discussed in this report Refer a copy of this report to the Office of the Prime Minister | 9 March 2020 |

Contact for telephone discussion (if required)

| Name | Position | Telephone |
|-------------|--------------------------|------------------|
| s9(2)(a) | Strategic Policy Advisor | s9(2)(a) |
| | Principal Policy Advisor | |

5 March 2020

Minister of Finance
Minister of Revenue

COVID-19: Update to Inland Revenue's response and next steps

Purpose

1. This report follows our earlier report dated 17 February 2020 (IR2020/088 ref rs) that outlined Inland Revenue's administrative response to the COVID-19 outbreak to assist affected businesses in the forestry, fishing, and tourism and hospitality sectors. Attached to this report is information about the current state, as informed by taxpayers as at 5 March 2020 (see Appendix).
2. Since that earlier report, we consider that the impacts of the COVID-19 outbreak are likely to be longer lasting and New Zealand is likely to experience a period of slower growth for the remainder of 2020. This is based on New Zealand having its third confirmed case, the continued spread of COVID-19 to other countries outside of mainland China, and recent monetary policy responses in the United States and Australia. We are aware that a number of ministerial papers have been prepared for Cabinet with recommendations to soften the impact of the economic situation on businesses and individuals who now find themselves out of a job.
3. Cabinet is currently considering a range of non-tax and tax interventions that could be deployed given the likelihood that the economic downturn caused by the COVID-19 outbreak may be longer and deeper than initially anticipated. This report sets out Inland Revenue's view on the tax measures that we understand are under consideration and sets out the framework we have used to evaluate those measures.
4. Attached to this report are speaking notes to support your discussions with Ministers about potential policy responses to the economic impact of COVID-19.

Consideration of possible Government interventions

5. Inland Revenue officials have been supporting the Treasury in developing a suite of tax measures for discussion at Cabinet. We understand that conversations are focused on issues including:
 - 5.1 A current assessment of the impact that COVID-19 is having on New Zealand's economy;
 - 5.2 The principles that should be considered when making decisions about what interventions should be deployed;
 - 5.3 A suite of non-tax and tax responses;
 - 5.4 Details of potential macroeconomic interventions (including tax); and
 - 5.5 Details of potential microeconomic interventions (including tax).

Framework for responding to the economic impact of COVID-19

6. Our assessment, as at 5 March 2020, is that additional Government intervention is needed to preserve business continuity, but not at the expense of the overall tax system.
7. Policy change, if the Government chooses to intervene, should be:
 - 7.1 Developed within the context of existing policy settings;
 - 7.2 Be sensible, sustainable, and predictable; and
 - 7.3 Should constitute sound tax policy, even if it is a temporary measure and even in the absence of a significant economic event.
8. At an operational level we consider that the framework should be that:
 - 8.1 Unaffected taxpayers continue to pay their taxes on time; and
 - 8.2 Affected taxpayers pay their taxes when they are able to.
9. The administrative tax measures deployed by Inland Revenue on 14 February 2020 support and confirm those principles.

Objectives of the tax interventions to support businesses affected by the COVID-19 outbreak

10. Optimal policy settings should protect and preserve soundly managed businesses. There is a considerable economic cost of otherwise viable businesses failing and this cost should be minimised. These are businesses that are normally profitable but are impacted by COVID-19 in a way that could not be insured against. However, we should not protect and preserve poorly managed businesses (for example, those who have chosen rigid and risky business models, such as operating wholly within narrow markets). Those businesses should bear the cost of those decisions.
11. There are, however, too many value judgements involved in determining whether a business should be allowed to fail, and the tax system lacks the precision to make or implement those judgements.
12. The options discussed in the table on page 6 are, for the most part, not targeted and are assumed to provide cash flow benefits for well-run businesses that are positioned to maximise the full benefit offered by the support. We are working on ensuring that the options are all administratively feasible and can be implemented in the current year (subject to amending law).
13. s9(2)(f)(iv)
14. The options can be considered under three themes:
 - 14.1 **Hardship assistance** – taxpayers may face difficulties in meeting their tax obligations that Inland Revenue can already assist with;
 - 14.2 **Business continuity** – short-term and long-term microeconomic measures that can assist businesses to survive an economic downturn; and
 - 14.3 **Fiscal stimulus** – economy-wide macroeconomic measures to mitigate any contractionary effects at the macroeconomic level.

15. The table on page 6 summarises the potential tax policy responses outlined under this framework. We recommend that you discuss the content of the table with officials.
16. Separate to policy responses targeted at mitigating negative economic impacts, Inland Revenue has also commenced working on information sharing. This could lead to legislative changes that will allow for better data flows between Government agencies, improving the efficiency of responding to this event and other significant economic shocks.

Tax policy responses that are not recommended

17. Officials are aware of some policy responses that consider removing or deferring the obligation of businesses to deduct PAYE and/or pay GST. Wages that are withheld are required to be held on trust under current law, which means that these PAYE funds cannot be used as working capital. Removing an obligation to pay GST will provide more benefit to unaffected taxpayers and no benefit to exporters or taxpayers getting refunds.
18. Inland Revenue and the Treasury strongly recommend that these sorts of measures are not implemented. Aside from the above arguments, these are likely to create significant administrative issues as such changes will be complex to deliver within tight timeframes. We also anticipate that integrity and enforcement issues would arise with such measures in both the short-term as well as after the economic impact of COVID-19 has ended.
19. Officials consider the concerns raised by business taxpayers regarding their payment obligations are better managed using existing tools and discretions allowed to Inland Revenue under the Tax Administration Act 1994 and the tax payment services provided by the tax pooling companies.
20. There are a number of changes that can be made to the provisional tax settings, such as not requiring provisional tax payments throughout the year and not charging the use of money interest that would normally apply. However, officials strongly recommend against changing provisional tax dates. These dates drive a number of key internal processes (such as use of money interest and tax liability assessments). Inland Revenue considers that changing the dates has the risk of creating unintended consequences and could impair our ability to effectively and efficiently manage tax collection of business income tax.

Considering tax policy changes under uncertainty

21. Determining appropriate policy responses is significantly constrained by uncertainty and incomplete information in a number of areas. This includes how deeply the COVID-19 outbreak will impact the economy, how long that impact will last for, and the efficacy of policy responses in mitigating any negative impacts. Data that might otherwise be useful for evaluating economic impacts is often subject to a lag.
22. The framework described earlier, and the options described in the table, should be considered in the context of this uncertainty. Officials' policy recommendations may change over time in accordance with new and/or unexpected developments resulting from COVID-19.

When should tax policy changes be made?

23. Inland Revenue has already undertaken a significant amount of preparatory work on tax measures that would soften the economic impact of the COVID-19 outbreak on businesses and households. Ministers should direct officials to continue to

develop these measures so that the Government is well prepared to implement any tax options if Cabinet decides that they should be implemented. The deployment considerations for each option is included in the table.

24. There are several indicators that may signal the need for the Government to respond to the current COVID-19 outbreak using temporary or permanent changes to current tax policy settings. These include health indicators such as announcements by the Ministry of Health concerning the severity of the outbreak, and economic indicators such as domestic or global market disruptions and significant revisions downward of growth forecasts. These sorts of indicators may act as a trigger to progress one or more of the tax responses outlined in this report.
25. Tax policy changes that are recommended now include:
 - 25.1 A law change to allow Inland Revenue to share information with key agencies to support and improve policy and operational responses; and
 - 25.2 A change in the setting of the underlying interest rate formula to reduce the interest charge on underpayments of tax (use of money in the estate).

s9(2)(f)(iv)

Impact on the tax policy work programme

30. The Minister of Finance has stated that the Government's response to COVID-19 is a top priority. We have allocated resources to develop the options set out in the table on page 6. We note that this work will have an impact on longer-term priorities on the tax policy work programme. We are not anticipating any problems with delivering the Government's earlier announcements on feasibility expenditure, loss continuity, and measures for Budget 2020.

Consultation

31. The Treasury was consulted as part of the preparation of this report. The Ministry for Business, Innovation and Employment have been informed of this report.

Next steps

32. Inland Revenue is continuing to work with other agencies to support the Government's response to the COVID-19 outbreak.
33. A copy of this report has been sent to the Minister of Finance and a copy should be referred to the Office of the Prime Minister.
34. We have provided relevant speaking notes for discussion with Ministers on tax responses and will continue to update you and your offices as events develop.

Recommended action

We recommend that you:

- (a) **note** the contents of this report;

Noted

Noted

- (b) **note** that Cabinet is considering tax options for responding to the economic impact of COVID-19 and that we have provided relevant speaking notes attached to this report;

Noted

- (c) **direct** officials to continue preparatory work to support the possible implementation of the options discussed in this report, including the recommended changes to allow information sharing and changing the use of money interest formula;

Directed/Not directed

- (d) **refer** a copy of this report to the Office of the Prime Minister for their information.

Referred/Not referred

s9(2)(a)



Principal Policy Advisor
Policy and Strategy

Hon Grant Robertson

Minister of Finance

/ /2020

Hon Stuart Nash

Minister of Revenue

/ /2020

Table: Tax policy responses to the economic shock created by COVID-19

| Theme | Description | Objective | Temporary/Permanent | Deployed |
|----------------------------|---|---|---|---|
| Hardship | Remission of late payment and late filing penalties | Provide taxpayers who cannot pay with relief to allow them to manage debt. | Permanent | Yes, from 14 February 2020. |
| Hardship | Instalment arrangements | Provides taxpayers with a tool to manage payment of tax debts, including giving Inland Revenue the ability to remove interest charges. | Permanent | Yes, from 14 February 2020. |
| Hardship | Remission of interest on tax debts in emergency situations | Allows Inland Revenue to remit interest charges when there is an emergency event that physically prevents taxpayers from meeting their tax obligations | Temporary | Not deployed as the current state does not meet the statutory criteria for this relief. |
| Business continuity | Loss carry-back Allow companies to carry back a loss and get the value of the loss carry back refunded | The effect would be the same as allowing a cash-out of losses to the extent of income earned in the prior three years. This is safer than providing a general cash out of losses, as the company must have a record of paying tax earlier. This option is intended to help with cash flow for companies that are generally profitable but are temporarily in loss due to a period of economic weakness. It is expected that small-to-medium scale businesses would benefit from this proposal rather than large corporates due to limitations on refunding tax that had been transferred to shareholders through imputation. Would target small-to-medium scale businesses over large corporates. | Permanent | To be developed. Would require legislation to implement. |
| Business continuity | Grant or subsidy to cover employee sick leave costs | Provide businesses with cash to compensate for the effect of sick leave taken by employees. RISK: Fraud. | Would be a temporary measure | To be developed. Would require legislation to implement. |
| Business continuity | Reduce the rate of use of money interest (UOMI) | Reduces the carrying cost of tax debt and reduces the financial penalty associated with under-estimating provisional tax liabilities. RISK: May be issues with returning to normal rates. | Would be temporary measure, pending the outcome of further work on the underlying UOMI formula We do not recommend a zero rate unless an emergency event | We recommend legislative reform on the underlying use of money interest formula. |

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| Business continuity | Temporarily set the provisional tax uplift to zero, rather than the usual 5% that applies under normal conditions | Recognises that businesses are unlikely to experience income growth during the period of the economic shock. Benefits would potentially be realised for businesses by the time P1 payments were due. | Would be a temporary measure | Sensitive - Budget Would require legislation to implement. Copies a similar tax policy change for businesses as in response to the Global Financial Crisis. |
| Business continuity | Provisional tax changes for Budget 2020 | Bring forward provisional tax changes planned for Budget 2020 that could assist with cash flow issues that businesses are currently facing. | Permanent | Would require legislation. Policy is well developed. |
| Business continuity | Allow businesses earning under \$60,000 to not have to pay provisional tax throughout the year but still get the UOMI concession | Businesses currently earning under \$60,000 are currently not exposed to UOMI until their terminal tax date as long as provisional tax is paid through the year. This measure would benefit small businesses as it provides a significant cash flow benefit to them. Late payment penalties would be waived. | Would be a temporary measure | Would require legislation. |
| s9(2)(f)(iv) | | | | |
| Fiscal stimulus | Provide businesses with depreciation deductions for buildings | Reduce the tax cost with investing in industrial, commercial, and multi-storied residential complexes. Objective to raise business-confidence by removing a source of black-hole expenditure. | Permanent | Would require legislation. Policy is well developed. |

35. This theme targets taxpayers who struggle to meet their tax obligations as a result of COVID-19. This includes remission of late payment/filing penalties and facilitating instalment arrangements. These measures relieve some of the short-term cash flow issues that taxpayers may be currently facing.
36. These options are already available under current tax settings. They are immediately accessible by taxpayers and do not require any sort of policy development.
37. Taxpayers will seek this type of support individually, so these measures are incorporated into the framework at a microeconomic level and are the most targeted of the options considered in this report.

38. Although it is expected that there will be some degree of recovery from an economic downturn (i.e. people may expect the economy to return to more "normal" and predictable settings), some businesses may not survive the downturn due to cash flow issues and therefore will not be in a position to continue after the economic impacts of COVID-19 have ended. This could lead to a permanent reduction in economic activity in the long term. To mitigate this long-term economic contraction, officials have considered business continuity measures.
39. Short-term continuity measures include assisting businesses with paid sick leave (such as through a subsidy administered using payday filing), temporarily reducing the use of money interest (UOMI) rate on underpayments of tax, and changing some of the settings for provisional tax relating to uplift rates and UOMI concessions. Each of these would require legislation to implement.
40. Long-term continuity measures include allowing companies to carry back a loss and permanently changing the formula that calculates UOMI. These would be sustained changes to the tax system that officials recommend as ideal policy decisions rather than as a reaction to economically significant events. Regardless, they would also assist businesses with cash flow and so would help businesses throughout the COVID-19 outbreak.

41. The last theme, fiscal stimulus, is the broadest with respect to application. Consequently, these measures are likely to be the most fiscally significant, though we do not provide costings in this report.

42. s9(2)(f)(iv)
43. Allowing deductions for building depreciation is a form of stimulus with respect to businesses. It is likely to affect fewer people compared to measures like personal tax cuts and cash payments. Reintroducing building depreciation also has a less direct effect on cash held by people/businesses. However, it does have a fiscal impact with regard to reducing tax liabilities, and it will also contribute positively to business confidence.

Appendix: Current state

44. In our earlier report (IR2020/088 refers), we outlined a package of administrative responses that Inland Revenue deployed on 14 February 2020 to support taxpayers affected by the COVID-19 outbreak. The deployed measures included:
 - 44.1 Remission of late payment and late filing penalties; and
 - 44.2 Offering instalment arrangements for taxpayers with cash flow problems to help manage tax debts.
45. Inland Revenue notes that these measures have been tried and tested in previous responses to economic shocks caused by natural disasters and viral outbreaks (for example, the Canterbury earthquakes in 2010, the Kaikoura earthquake in 2016, and the Hawke's Bay gastro outbreak in 2016).
46. We are aware that the tax pooling companies have also responded and are assisting business taxpayers to manage their tax debt obligations by offering competitive interest rates for taxpayers needing to use their services to meet provisional tax payments. For example, Tax Management New Zealand is charging taxpayers in the forestry sector 3.95% for their services. The current rate of interest charged by Inland Revenue for underpayments of tax is 8.35%.

Enquiries from customers

47. We have been regularly updating your office and using the Status Report to inform you about the key themes emerging from taxpayer contacts with Inland Revenue related to COVID-19. We expect that the number of customer contacts will increase rapidly following New Zealand's first confirmed case on 28 February 2020. As of the morning of 5 March, there have been three confirmed cases.
48. Customer enquiries have covered a range of issues. For individuals, half of the enquiries have related to income tax. Other issues of concern include child support liabilities and Working for Families entitlements. For businesses, Inland Revenue is managing an increase in contacts to request instalment arrangements or the remission of penalties. A number of small businesses are advising that they have ceased trading.
49. The economic impact of COVID-19 appear to be being felt more strongly in particular regions, such as Northland and Gisborne. There are also strong signals that the Chatham Islands are experiencing a major economic downturn.

Cross-agency policy development

50. Inland Revenue officials are meeting with the Treasury daily to assist with preparing policy advice for the economic impact of COVID-19. We also have a presence at the Economic Advisory Group that is monitoring and responding to the economic impacts of COVID-19. Officials have upcoming meetings with the Ministry of Business, Innovation and Employment as well as the Ministry for Primary Industries.
51. Inland Revenue officials are currently working with the Treasury on their own advice as well as creating briefing material for Cabinet discussions. Speaking notes are attached to this report in relation to the tax elements of any all-of-Government responses.
52. Officials have also begun investigating the legal provisions for information sharing and we may propose legislative amendments to enhance our ability to give and receive data from other agencies. This will improve the efficiency with which we can respond to COVID-19 as well as other future events.

Proactively Released

Proactively Released