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# How 'tax forgiveness' could help New Zealand's many small businesses weather the financial woes brought on by COVID-19

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Governments worldwide have released emergency stimulus packages to support workers and businesses through the economic crisis COVID-19 has wrought.

These measures include financial support, credit relaxation and tax relief for small businesses and some individuals, but they benefit only some taxpayers.

New Zealand may need to consider more significant changes to the tax system to repay the unprecedented level of borrowing that has funded the pandemic response. Tax cuts, investment incentives, changes to filing deadlines and tax amnesties could all play a significant role in helping to alleviate COVID-19's financial and economic impact.

My research explores whether, under current uncertain economic conditions, introducing a voluntary disclosure program for overseas income could help protect New Zealand's pandemic-impacted businesses — and promote honesty in tax matters at the same time.

New Zealand's tax system is primarily punitive, rather than encouraging tax compliance. If a taxpayer is operating outside the tax system, the consequences of re-entering may be harsh. This encourages even inadvertent offenders to remain outside the system.

Tax amnesties, also known as "tax forgiveness", can help short-term tax collection, recoup lost tax revenue and allow taxpayers to "regularise" their tax compliance.

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### **A low-cost compliance initiative**

New Zealand has strengthened penalties for tax offences considerably during the late 1980s to protect existing voluntary compliance. The introduction of an Overseas Voluntary Disclosure (OVD) mechanism would not only improve compliance but boost future tax revenue. Taxpayers cannot hide from their tax obligations once they have disclosed overseas income.

Since 1990, the number of immigrants has increased in New Zealand. According to the 2018 census, 31% of New Zealand's population are immigrants. One in ten are self-employed without employees, and 5% have employees.

Many of these immigrants own small businesses. As a result of COVID-19, they are dealing with cash-flow stress. They may not be fluent in English or be unaware of their tax obligations and are unintentionally non-compliant. They now face the ramifications and penalty costs of voluntary disclosure.

Of course, some taxpayers are intentionally non-compliant in reporting their offshore income and assets. Whether unintentionally or deliberately non-compliant, many are self-employed and may want to inject their undeclared overseas funds into their local businesses to offset cash-flow stress.

Irrespective of these taxpayers' accidental or deliberate lack of compliance, the Inland Revenue Department (IRD) must support these small businesses through the current crisis.

### **Offshore tax investigations**

New Zealand adopted the Automatic Exchange of Information (AEOI) mechanism, which allows the IRD to obtain information about offshore assets and funds for New Zealand tax residents to verify it is accurately reported for tax purposes. New Zealand completed its first information exchange in 2018.

Since 2019, the IRD has started sending letters to New Zealand resident taxpayers regarding foreign income and tax residence status. They are advised to disclose the foreign-sourced income in their tax returns.

Some taxpayers may falsely assume the IRD is randomly targeting them and may continue to hide their foreign income. For those non-compliant taxpayers, an audit investigation is the first option.

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My research shows that offering voluntary disclosure would substantially reduce administrative costs in cross-checking the millions of lines of additional data received under the AEOI policy.

To administer such a program effectively, the IRD must use the best strategies to encourage voluntary declaration. For example, the opportunity to declare should be offered once only. Enforcement strategies and sanctions for non-compliance should be credible, consistent and clear.

Tougher penalties and interest would apply to those who choose not to take advantage of the program. Research shows a well-administered tax amnesty program facilitates strong engagement.

My research suggests New Zealand should offer a robust voluntary disclosure initiative similar to Australia's 2014 Project Do It. Australian tax administrators gave taxpayers a last chance to correct their offshore tax affairs before audits or litigation.

This allowed intentional and unintentional tax evaders to pay the debt assessed under amnesty conditions without fear of prosecution or compliance penalties. It succeeded in encouraging them to return to the tax system.

Deliberate tax evaders will get the message that if they do not declare offshore assets, severe punishments will be imposed. Voluntary disclosure would also help non-compliant taxpayers protect their businesses from the financial and economic turmoil COVID-19 has caused.