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Binding rulings review
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The Binding Rulings System: Legislative Issues - July 2009 - An Official's Issues Paper

The Society's Taxation Committee (the Committee) welcomes the chance to comment on the IRD issues paper "The binding rulings system: legislative issues" (the issues paper) released in July 2009. The issues paper raises the possibility of several legislative reforms in respect of the binding rulings system.

The Committee is supportive of any steps that might enhance the accessibility of binding rulings delivered on a timely basis, and which might better protect taxpayers who have relied on any Inland Revenue guidance, whether binding or not. This submission reflects that general perspective.

Chapter 3 (Scope of Binding Rulings: Questions of fact, and commercially acceptable practice)

Sections 91E and 91F of the Tax Administration Act (the Act) require or permit the Commissioner to make rulings on "how a taxation law applies" in relation to an arrangement. Sections 91ED and 91FD require the applicant for a private or product ruling to "disclose all relevant facts and documents relating to the arrangement", and sections 91EB and 91FB have the effect of invalidating the binding ruling if (among other things) "the arrangement is materially different from the arrangement identified in the ruling" or there was a "material omission or misrepresentation" in respect of the application for the ruling. The provisions as they currently stand therefore clearly allocate responsibility for factual matters being correct to the applicant.

To the extent that the application of a taxation law turns on questions of fact, the Commissioner is entitled to proceed on the basis of the facts disclosed by the applicant. The Commissioner does not bear the risk of those facts being incorrect. For these reasons, the Committee does not see the justification for the Commissioner to decline to rule on the grounds that the ruling application would require him to determine questions of fact.

In the alternative, if legislative provision is considered necessary, the Committee considers that it should only be in rare situations, as a practical matter, that the Commissioner would be justified in declining to rule on such grounds.

Questions of fact

If there is to be a legislative provision entitling the Commissioner to decline to rule on the grounds that the ruling application would require him to determine questions of fact, such provision should be carefully targeted. The Committee therefore considers a specific list of matters (such as those set out at paragraph 3.15 of the issues paper) on which the Commissioner cannot rule is a better approach, as opposed to granting a discretion to the Commissioner not to rule. The Committee agrees with the need to clarify what is meant by "commercially acceptable practice" in this context, and with the proposed clarification as set out in the third bullet point to paragraph 3.15.

Timeframe for Commissioner to advise as to inability to rule

The Committee is aware of instances in which the Commissioner has considered a ruling application for a lengthy period of time, and then advised of an inability to rule. Applicants in such situations incur significant costs (in terms of fees payable to the Commissioner, costs of external advisors and management time) and suffer significant delay, only to have the Commissioner advise of his inability to rule. This undermines the integrity of the rulings system, and discourages taxpayers from seeking rulings.

There should be a requirement that the Commissioner inform taxpayers, within a fixed period of receiving the ruling application, whether or not he will exercise any available discretion to decline to rule. Alternatively, there should be a provision requiring the Commissioner to waive all fees payable (beyond a sum specified in the Tax Administration (Binding Rulings) Regulations 1999), or that accrue a certain period of time after the application is submitted, in circumstances where the Commissioner subsequently exercises a discretion to decline to rule.

Chapter 4 (Charging for Binding Rulings)

Fee and Time Estimates

Unless the ruling arrangement changes, the Commissioner should retain original fee estimates, and not increase them. For time estimates, unless the taxpayer changes the arrangement should the time estimate be exceeded, fees should reduce. Some more detail about when fees will reduce (for example continual analyst changes) would be helpful here.

Fee waivers and GST reduction for non-residents

The Committee supports the proposals to introduce a flexible fee-waiver provision and to reduce the fees by 1/9th for rulings supplied to non-residents, for the reasons set out in the issues paper.

Only one consultation period would be too inflexible

The Committee does not support the proposal to allow only one consultation period or conference for the provision of, or a request for, additional information, and considers that it would be counter-productive to enact a rigid "one size fits all" rule in respect of consultation between the applicant and the Commissioner.

For many arrangements seeking a ruling raises complex issues. Often there are several discrete issues which are best considered separately. In addition, it is often the case that on a complex ruling application, consultation proceeds in phases. There is initial consultation to assist the Commissioner by providing further background to the arrangement and its commercial objectives. Later in the process there may be consultation concerning the interpretation of the taxation laws on which the ruling is sought. Finally, once the Commissioner provides a draft ruling, there may be

consultation on that draft, including any proposed conditions. It would be impractical for these separate phases of consultation to be compressed into one consultation period.

The Committee agrees with the expressed concern that there are delays in the rulings process. However, it is unlikely that delays in the rulings process are due to unreasonable consultation with applicants for two reasons.

First, as the issues paper notes, the Commissioner charges for his time spent on applications so applicants do not generally engage the Commissioner on fruitless inquiries. Also, it is in an applicant's interest for the process to proceed to a conclusion as soon as reasonably possible. Generally the most significant delays in the process are because of constraints on Inland Revenue's resourcing, not consultation with applicants on an application or a proposed ruling.

Second, section 91EG of the Act (section 91FG for product rulings) which requires the Commissioner to consult with an applicant if a proposed ruling is different to the ruling sought, contains the qualifier that the opportunity for consultation be “reasonable”. If it were the case that applicants were using the rulings process in a manner that was unnecessarily lengthy, the Commissioner would not be obliged to consult further.

Sections 91EG and 91FG contain an appropriate balance between the need for flexibility, the need to ration the Commissioner's resources by preventing excessive consultation, and/or use of the rulings system for tax planning (ie, making repetitive changes to a proposed arrangement in response to indications from the Commissioner that he is not prepared to rule as requested). If necessary, the Commissioner could issue an interpretation statement or standard practice statement indicating the circumstances in which consultation will go beyond what is reasonable. A draft statement to this effect was released some years ago, but not finalised.

Chapter 5 (Mass-marketed and Publicly Promoted Scheme Rulings)

Applications by promoters and corresponding safeguards for persons participating in the arrangement

The Committee recognises the benefits in permitting promoters of arrangements to apply for product rulings, but at the same time sees the need for caution in respect of this proposal, for the reasons outlined at paragraphs 5.8 and 5.9 of the issues paper. There is a risk that unsophisticated investors might take false comfort from the existence of a product ruling and may not appreciate that the product ruling could cease to apply as a result of, for example:

- legislative amendment to any of the tax laws on which the ruling has been given;
- any material non-disclosure or misrepresentation by the applicant in seeking the ruling;
- any material difference between the arrangement description in the ruling and the arrangement as entered into; or
- any non-compliance with a condition in the ruling, however immaterial that non-compliance may be.

As a minimum, promoters should automatically be subject to the promoter penalty if they have provided false information and, as a result, the abusive tax position penalty applies to persons who participate in the arrangement.

Further to this, the promoter, when providing a copy of the ruling to any intending participants in the arrangement, should include with the ruling a statement that warns of the circumstances in which the ruling may be invalid, and that the validity of the ruling depends on the accuracy and completeness of disclosure made by the applicant (ie promoter) to the Commissioner. It should also

recommend that intending participants seek independent tax advice concerning the ability to rely on the ruling, and the application of the tax laws to the arrangement.

To avoid doubt, these safeguards should be provided only in cases where the applicant is not also a party to the arrangement to which the ruling relates. The Committee does not consider these measures to be necessary in the case of product rulings as presently provided, where the applicant is also a party to the arrangement.

The Committee notes the officials' suggestion to include a requirement that the applicant is "seriously contemplating that the arrangement will be proceeded with". The cost of applying for a ruling makes the prospect of spurious applications unlikely, and therefore the requirement is unnecessary.

Chapter 6 (Other Matters)

Declining to rule when the arrangement is the subject of a dispute (section 91E(4)(ga))

For the reasons set out in the issues paper, the Committee supports the proposals to provide exceptions to the prohibition on ruling when the arrangement involves two or more tax types and is the subject of a notice of proposed adjustment, and that a ruling made in respect of more than one tax type can still be binding on the Commissioner in respect of some tax types, even though it does not apply in respect of other tax types.

Commissioner's discretion not to rule where matter on which ruling sought is subject to challenge (sections 91E(3)(b) and 91F(3)(b))

The Committee supports the proposal to limit the Commissioner's discretion under section 91E(3)(b) of the Act not to rule, by limiting its application to cases involving identical or substantially similar arrangements, facts or issues. However, the Committee considers that this formulation is broader than is appropriate. Section 91E(3)(b) should be confined to situations in which the challenge proceedings concern the same arrangement and the particular tax laws on which the ruling is sought.

The Committee accepts that if an arrangement is the subject of challenge proceedings in respect of certain tax laws, the Commissioner should not be required to rule on the application of those tax laws to that arrangement (in respect of later income years, for example). Such an application would be a waste of resources. Nor does it seem realistic that a taxpayer would seek a ruling in those circumstances, given that the Commissioner's stance on the issue in question should be obvious from the fact there is a dispute about the arrangement that is the subject of a challenge. That will generally follow from section 91E(4)(ga) (although it is unclear whether an equivalent provision would then be necessary in respect of product rulings); a rule in respect of challenge proceedings would not be necessary.

The Committee does not accept that there can be a justification for the Commissioner to decline to rule where a different taxpayer, in respect of a separate arrangement (albeit one substantially similar to an arrangement the subject of challenge proceedings) seeks a ruling. As a matter of principle, taxpayers should be entitled (upon paying the prescribed fees) to have the benefit, in binding form, of the Commissioner's view of the law. That the Commissioner's view may be the subject of a challenge in the Courts in relation to another arrangement or a different taxpayer, does not prevent the Commissioner from having a view and applying it in the context of the binding rulings process.

The only justification the Committee can envisage for suspending the Commissioner's rulings function in relation to an arrangement substantially similar to one that is the subject of challenge

proceedings, is that the Commissioner might have a different view of the law in each of the rulings and challenge proceedings forums. That possibility is alluded to in the first two bullet points of paragraph 6.3 of the issues paper.

The Commissioner should have a consistent view of the law, which should be applied in the context of the rulings process and litigation. If the Commissioner considers, for example, that section BG 1 applies to a particular arrangement, the Commissioner should assert that stance in challenge proceedings and in responding to ruling applications. If the Commissioner is ultimately unsuccessful in the challenge proceedings following appeals then the Commissioner's view will necessarily change in response to the Court's ruling. But (contrary to paragraph 6.3 of the issues paper), there is no inconsistency other than that which inevitably arises when the Commissioner changes his interpretation in response to new case law. Provided the Commissioner has a consistent view of the law at a given time, there is no scope for taxpayers to take advantage of the Commissioner by seeking a ruling on a point the Commissioner is also litigating.

Chapter 7 (Providing rulings and other forms of advice)

No use of money interest or "unacceptable tax position" penalties if taxpayers rely on IRD

For the reasons set out in the issues paper, the Committee supports the proposal to clarify that taxpayers who rely on IRD advice will not be subject to use of money interest or a penalty for taking an unacceptable tax position.

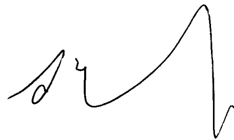
The proposal should extend to reliance on non-taxpayer specific advice in certain circumstances

The Committee also recommends that the proposal be extended, at least in certain circumstances, to taxpayers who satisfy only the "first instance" outlined in paragraph 7.11 of the issues paper, namely that it is clear that the advice was applicable to the taxpayer in the circumstances. It should not be necessary that the taxpayer provided facts to IRD and that a formal response was provided by IRD.

Paragraphs 7.1 to 7.4 of the issues paper describe the way that IRD provides guidance to taxpayers in a number of forms that taxpayers should be able to rely on, such as guides or booklets. A taxpayer who relied on those forms of guidance would not satisfy the two stage test suggested in paragraph 7.11 because they would not have provided facts to IRD, nor received advice. However, the Committee considers that it is equally unfair to penalise taxpayers who rely on published IRD guidance when taking a tax position. The Committee endorses the statement at paragraph 7.4 that "In whatever format the Commissioner provides advice, taxpayers should be able to rely on that advice".

If you have any queries regarding this submission please contact Diana Brown, Committee Secretary, phone 04 463 2967 or email diana.brown@lawsociety.org.nz. We would be happy to discuss the points raised in this submission at any stage.

Yours sincerely



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