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DISPUTES: A REVIEW, JULY 2010

1. INTRODUCTION

- 1.1 The New Zealand Law Society and the New Zealand Institute of Chartered Accountants (the Societies) welcome the opportunity to comment on the *Disputes: A Review – An Officials’ Issues Paper, July 2010* (Issues Paper).
- 1.2 The structure of this submission is as follows:
 - General comments on the Issues Paper (section 2)
 - Submissions on matters raised in the Issues Paper (section 3)
 - Detailed comments in respect of the opt-out (section 4)

We have also provided suggested legislative drafting, in relation to the main issues covered in our submission (see the Appendix to this letter).

2. GENERAL COMMENTS

The need for legislative reform

- 2.1 We are pleased that there is an Issues Paper and that comment is being sought in relation to this very important area of taxation law. However, we are disappointed with the position adopted in the Issues Paper that, for the most part, no legislative change is required. We disagree.
- 2.2 The Societies have been urging reform of the tax disputes resolution and challenge procedures for some years now. From mid-2008 to 2010, the Societies have worked together to develop joint submissions (including the Joint Submission of August

2008), engage with officials (including a great deal of correspondence with the Department), and provide technical assistance to officials. As the professional bodies that act for taxpayers and deal with these procedures, we have serious concerns that the procedures are not working. Practitioners from both Societies report the same concern that the current procedures have led to taxpayer disillusionment with the wider tax system. We are seeing that attitude consistently across taxpayers in all sectors, from larger corporate taxpayers to medium and small businesses, and from individuals and private family entities.

- 2.3 The procedures are also not meeting the purpose for which they were enacted. In our experience, taxpayers are disengaging from a process that prices them out of the ability to seek justice and that delays their access to the courts. This is cementing the view of taxpayers that the system is weighted against them and that there is no point in pursuing disputes. This is undermining the integrity of the tax system.
- 2.4 The Societies urge a rethink of the approach taken in the Issues Paper. It is over a decade since the disputes procedures were enacted and there has been no significant review or reform of the procedures in that time. We are concerned that unless there is legislative reform – ensuring there is an opt-out, timeframes apply to the Commissioner, and to balance the system overall – the integrity of the tax system will continue to be undermined. The ability to progress tax disputes with a minimum of delay and cost will also be lost.
- 2.5 While administrative concessions are well-intentioned, the Societies' recent experience with aspects of our tax system that are left to the Commissioner's administrative discretion has not been positive. We elaborate on this point below, but examples include the Commissioner's approach to referrals to Adjudication and to the non-disclosure rules, as was exemplified in positions taken in recent cases involving the banks. The Societies have previously outlined the need for legislative change; see for example our letter dated 15 September 2009 to officials, which stated that:

“The Societies do not support administrative options as a long-term solution to the issues we have identified. After over a decade of working with the disputes resolution and challenge procedures, the Societies are focused on legislative change to provide long-term solutions to the concerns raised in the Joint Submission [August 2008].”

- 2.6 In many cases completion of the disputes process is not warranted if either or both parties have a fixed view. Accordingly, there is no justification for further delaying legislative reform. We are happy to work with officials to assist with legislative drafting and we have provided some drafting in the Appendix for that purpose.

Incorrect attribution in the Issues Paper

- 2.7 We are disappointed to note there in a number of areas the Issues Paper incorrectly attribute views to the Societies. Examples include:
- (a) The Issues Paper at paragraph 1.9 and paragraph 1.10 states that the Societies consider the legislation surrounding the disputes process is "broadly adequate". That is not correct. The purpose of the Joint Submission and the Societies' subsequent engagement with officials was because we consider the legislation is not adequate and is not achieving the purposes set out in s89A of

the Tax Administration Act 1994 (TAA), and that legislative change is therefore needed. For example, in the Joint Submission the Societies emphasised at paragraph 3.1 that "*[T]he experience of NZICA and Society practitioners after ten years of operation of these procedures is that they have significant deficiencies of their own. ...in a number of respects the current disputes resolution procedures are not operating as was intended and are not meeting the purposes enshrined in section 89A of the TAA*".

- (b) The Issues Paper at paragraph 3.3 and paragraph 3.14 states that the Societies sought an opt-out prior to the conference, and at paragraph 3.15 concludes that a "unilateral opt-out" cannot occur because it would take place prior to the conference, which would undermine the purpose of the disputes procedures. Our position has always been that any opt-out would only be available after the conference. The Joint Submission states that, at minimum, the opt-out should be after a Notice of Proposed Adjustment (NOPA) and Notice of Response (NOR) (paragraph 3.42) but the Joint Submission also emphasised our view at that time that there should be a compulsory conference (paragraph 3.14) and the recommendations work together: with the opt-out following the conference. Our position has been consistently emphasised in subsequent correspondence and in meetings with officials.¹ The opt-out proposal we advocated does not undermine the purpose of the disputes procedures or the place of the conference.

Matters raised by the Societies but not dealt with

- 2.8 We note that matters we have previously raised with officials have not been considered in the Issues Paper or otherwise dealt with. These matters are:
- (a) Section 89M(8) and s89M(9) currently provide the general ability for the Commissioner to add to his Statement of Position (SOP) in response to an SOP from the taxpayer. This right arises separately from s89M(13) and information can be provided without the taxpayer's agreement. In the case of a taxpayer-initiated NOPA, where the taxpayer provides the SOP first, there is no ability for a taxpayer to provide a response to the Commissioner's SOP, without agreement from the Commissioner under s89M(13). We raised this matter with officials, as practitioners had experience of the Commissioner refusing to accept additional information under s89M(13), in circumstances where the Commissioner's SOP in response to the taxpayer's SOP made errors of fact or drew inferences that could easily be proved incorrect. Escalation was required in a number of cases, and more time and cost was spent than was necessary for any correcting information to be accepted by the Commissioner. This is an example of the legislation needing to be more balanced, and needing to provide a matching right to the taxpayer in the context of a taxpayer-initiated NOPA.
- (b) Sections 89O and 89N(1)(ix) provide the ability for the taxpayer and Commissioner to agree for matters proceeding through the disputes procedures to be suspended if there is a test case designation made under s138Q. Given how rarely the Commissioner makes any test case designation, cases of a similar nature are being heard in the courts while disputes continue

¹ See for instance the Societies' correspondence dated 3 October 2008 (see table at page 3), 1 April 2009 (email), 4 June 2009 (page 7 of the table), 15 September 2009 (at paragraph 6.1), 25 September 2009 (at page 1 of the table).

to go through the disputes process. The taxpayer and Commissioner might simply wish to await the judgment of the Court in a substantially similar matter, and this is not necessarily a case for an opt-out. A simple reform would be to provide the ability under s89O and s89N(1)(ix) for it to be agreed that the disputes process be suspended where there is a substantially similar matter before the Courts in the absence of a formal test case designation. The Societies raised this previously with officials.² The test case designation is not required, and the reliance of these provisions on such a designation is the reason these provisions have never been used in the experience of the Societies. Section 89N(3) has no role in this area, as that is currently solely the purview of the Commissioner. Taxpayers need some input into such a process, and there is no need for recourse to the Courts.

- (c) The Societies have provided material but have seen no conclusion from officials on important issues such as settlement guidelines, Model Litigant Guidelines, and access for taxpayers to redacted Adjudication Reports.

3. SUBMISSIONS ON THE ISSUES PAPER

Administering the disputes process

- 3.1 The Commissioner has released Exposure Drafts for consultation (ED 0126 and ED 0127). While Standard Practice Statements are useful to taxpayers and have a place in tax administration, they are not a solution to the problems with the disputes regime. The Commissioner abandons administrative practice at his convenience. An example is the process through to Adjudication, when despite practice statements, in *ANZ National Bank Ltd v C of IR* (2007) 23 NZTC 21,167, the Commissioner determined it was unnecessary to proceed to Adjudication, and in fact (in the High Court case *No.2* (2006) 22 NZTC 19,835) the Commissioner maintained his own unit did not have the necessary technical capability. Just as in the context of the practice statement applicable in *ANZ National*, the Commissioner proposes opt-out guidelines and other guidance that will be administrative rather than legislative, and that apply "where practicable". They need not be followed at the Commissioner's convenience. This changes nothing and leaves the problems unresolved.
- 3.2 The administrative guidelines reflected in the Exposure Drafts are interim solutions pending what is an obvious need for statutory reform. It is not good enough to place reliance on administrative statements. The principal rules need to be encapsulated in legislation. This will minimise ambiguity and provide certainty to taxpayers and the Commissioner.. Carefully drafted legislation that imposes reasonable timeframes on the Commissioner limitations on both the Commissioner and taxpayers, and a unilateral elective opt-out will alleviate the problems with the procedures. A legislated conference phase is also preferred for the same reason, but this can be worked around if the legislated opt-out makes at least one conference meeting compulsory before the opt-out can occur (that in essence would make the conference compulsory, without having necessarily to legislate for the conference itself). These points are considered in detail below.

² See for instance Joint Submission at paragraph 3.39, letter dated 15 September 2009 at paragraph 5.11.

3.3 Specific comments on the Exposure Drafts are as follows:

Conference timetable

- (a) Inland Revenue proposes to mark the start of the conference phase by sending a conference facilitation letter to taxpayers within one month of the date of issue of the NOR.³ Timetabling is set by administrative guidelines and the Exposure Drafts indicate that the conference phase ought to be completed within three months.⁴
- (b) The Societies agree in general with the timetable set out in the Exposure Drafts. However, for the reasons outlined below, we reiterate our submission that the conference procedures should be codified in legislation, as should timeframes. There should be a statutory timeframe for commencing and completing the conference phase (which may be extended where the parties agree), with at least one meeting being compulsory if the taxpayer wants to opt-out. Details as to the nature of the meeting (phone, video conference, in person), venue etc can be dealt with by administrative guideline (an appropriate use for a guideline) and the statutory provisions can work quite flexibly. There is no need for that detail to be legislated. Example drafting of a basic legislated conference is provided in the Appendix.
- (c) If the parties wish to continue the conference phase beyond the three-month period, then use of money interest (UOMI) ought to be suspended to encourage participation in a conference. While there are other policy considerations governing UOMI, it is inappropriate to have UOMI continuing to run on the taxpayer's disputed debt beyond this point. Suspending UOMI would encourage engagement during the conference phase and avoid inappropriate time pressure being applied to the taxpayer to resolve issues. There could be a measure that also suspends the time bar in those circumstances. If there are such measures then the termination of the conference should be by way of notice by one party to the other. It would be inappropriate for the Inland Revenue to be able to determine when the conference ends, given the consequences of delaying a taxpayer's access to justice. On the other hand, there does need to be an ability to bring the matter to a head.

Relationship between conference and settlement, and settlement in the disputes process

- (d) As the purpose of a conference may in part be settlement or narrowing of issues, and as settlement can occur at any stage during the disputes process (i.e. even outside the conference), the Exposure Drafts should refer to guidelines which set out how Inland Revenue will approach settlement. In the absence of specific published guidelines on settlement, the Exposure Drafts should set out guidance for taxpayers in relation to settlement in the context of the disputes regime.

³ ED 0126 paragraph 234; ED0127 paragraph 166.

⁴ ED 0126 paragraph 41; ED 0127 paragraph 173.

Role of the Facilitator

- (e) The Exposure Drafts state that optional conference facilitation will be offered to all taxpayers. The facilitator will be a senior Inland Revenue official with sufficient technical knowledge who is independent of the dispute in question. The role of the facilitator is to promote and encourage structured discussion between the parties. The facilitator will not have any decision-making powers, except for determining when the conference phase has come to an end (see below). In particular, it is not the role of the facilitator to undertake settlement of the dispute.⁵
- (f) Although the Societies broadly agree with the option of an independent Inland Revenue facilitator, we consider the Exposure Drafts should clarify that the facilitator must not be from the same office or have otherwise been involved in giving advice on the dispute or the subject matter of the dispute. For example, if the issue arose in Napier and the Legal and Technical Services department of the Inland Revenue in Wellington had given advice, then the facilitator should not be drawn from either of those offices.
- (g) In our view, the taxpayer should also have the option to pay for an independent non-Inland Revenue facilitator.
- (h) We also consider that the facilitator should be given broader authority to direct the parties towards addressing and resolving the core issues in dispute. We see no reason why the facilitator could not, with the agreement of the parties, play a more active role in mediating a settlement.
- (i) The Exposure Drafts state that the facilitator will be responsible for clarifying the agreed end date of a facilitated conference, and will have the power to bring the conference phase to an end if s/he considers that both parties have exchanged all materially relevant information and have fully discussed the tax technical issues but may not have been able to resolve the dispute.⁶ Vesting such a power in the facilitator involves the exercise of a discretion that is potentially subject to dispute or judicial review. In addition, given the consequences of delay for taxpayers (in circumstances where UOMI continues to be calculated on unpaid tax), it is inappropriate that the timing of the end of a conference is controlled solely by the Inland Revenue. We recommend that legislation should provide that either the taxpayer or Inland Revenue can determine that the conference phase is over, by notice to the other party.

Opt-out following the commencement of the Conference

- (j) While we are appreciative of some guidance from the Commissioner in relation to s89N(1)(c)(viii), the Societies reiterate that administrative guidelines (which can be abandoned at the Commissioner's convenience) will not solve the problems with the procedures. Statutory change is required. In our view, taxpayers should decide how best to apply their resources (the disputes regime or Court) and the decision should not require the agreement of the Commissioner, especially in circumstances where the purpose for which the disputes procedures were enacted has been met via the

⁵ ED 0126 paragraph 232-233; ED 0127 paragraph 164-165.

⁶ ED 0126 paragraph 252-254; ED 0127 paragraph 184-186.

NOPA/NOR and conference processes. A unilateral elective opt-out should be available in the legislation. This will also ensure that the Commissioner is on notice when he issues his NOPA that the taxpayer may well elect to opt-out after the conference and that the arguments in the NOPA should be well-reasoned and based on factual information. We expand on this submission later.

- (k) The Exposure Drafts state that a taxpayer may request to opt-out of the remainder of the disputes process pursuant to s89N(1)(c)(viii). However, the Commissioner will not agree to an opt-out request unless there has been a conference and the Commissioner must first be satisfied that the taxpayer has “*participated meaningfully*” during the conference phase. The taxpayer must also have signed a declaration that all material information has been provided to the Commissioner.⁷
- (l) The requirement that the taxpayer has “participated meaningfully” in the disputes resolution process is a vague standard and risks locking taxpayers into an administrative process that is not achieving anything. We note that there is no sanction on Inland Revenue officials who do not engage in what the taxpayer considers to be meaningful participation during the conference phase.
- (m) We do not agree with the suggestion that the taxpayer must first sign a declaration that all material information has been provided to the Commissioner. The standard of “materiality” is particularly difficult to quantify. We note also that the Commissioner has the ability to require information at all stages of an investigation/dispute and retains that ability until litigation commences.
- (n) As discussed further below, we suggest that the Commissioner could consider whether he needs to issue a final catch-all s17 notice if he determines that insufficient information has been provided. The Commissioner will need to consider the necessity for such a request, meet the requirements of s17, and act in a manner that is sensible and proportionate to the dispute. Issuing s17 requests as a matter of course would be inappropriate. Prior to issuing a NOPA the Commissioner should have obtained all information necessary in any event, as the Exposure Draft specifically provides that a NOPA follows the completion of an audit, and is not to be issued in the course of an audit. A s17 notice should therefore not be required. A preferred alternative is the Commissioner considering the issue of a s17 notice as the s17 notice requirements are reasonably well-established and understood, and are supported by appropriate sanctions. This protects the Commissioner and does not impose ill-defined requirements on taxpayers.
- (o) Taxpayers have two weeks from the end of the conference phase to request to opt-out of the disputes process.⁸ A two-week timeframe is too restrictive. A compressed timeframe means that the decision may not be well-reasoned. The ability of the taxpayer to take legal advice is also hindered under such a tight timeframe. We suggest a one-month timeframe. Further, the Exposure Draft should require Inland Revenue officials to notify the taxpayer of their

⁷ ED 0126 paragraph 261.

⁸ ED 0126 paragraph 266.

right to opt-out of the disputes process rather than leaving taxpayers to figure this out on their own.

- (p) In respect of the guidelines in the Exposure Drafts relating to s89N(1)(c)(viii), in the course of previous consultation the Societies agreed with officials that opt-outs would be broadly available under s89N(1)(c)(viii), except in defined cases such as mass-marketed schemes or fraud. That agreement is not reflected in the guidelines, which allow opt-outs only in narrow circumstances.
- (q) There are also quite obvious problems with the opt-out guidelines. For example, the Commissioner will agree to an opt-out if the matter is similar to something heard at Adjudication. As taxpayers have no access to Adjudication decisions it will not be possible for a taxpayer to apply within two weeks on such a ground. The Exposure Draft deals with this, with the suggestion that the taxpayer simply applies to opt-out blindly, and then Inland Revenue confirms. The same issue arises with tax cases before the Courts (for instance, the same problem arises in respect of Taxation Review Authority cases, as there is no public access to such material). This is simply not practicable. Taxpayers who think they may be eligible to opt-out on these grounds will not know of their eligibility and may not apply, or alternatively, every taxpayer seeking an opt-out will apply (just in case) and Inland Revenue will be clogged with requests. Redacted Adjudication reports need to be published to avoid these problems arising.
- (r) Another flaw in the administrative opt-out rules is in the ability to opt-out when the dispute turns on issues of fact only. Whether an issue is one of fact, law, or mixed, is often a fraught question and we anticipate there will be endless debate on this point.
- (s) If the Exposure Drafts took the position that opt-outs will be available generally, apart from defined exclusions, that would be a workable option.

Taxpayer opt-out following receipt of Commissioner's NOR

- (t) In respect of paragraph 158 of ED 0127, the ability to file proceedings brings an end to the disputes process (this ability may arise under s138B(3)) and we agree that this is an opt-out and should be treated as such. For clarity we suggest a legislative amendment to the disputes procedures, to make it clear that when proceedings are filed under this provision no further documents are required to be filed under the disputes process.
- (u) Sanctions should be imposed on the Commissioner where timeframes are not met. Unless timeframes are imposed on the Commissioner in the legislation or there is an amendment that allows the taxpayer to force the Commissioner to issue a disclosure notice and SOP, there can be no amendment or repeal of s138B(3). At present, after the Commissioner has filed his NOR in a taxpayer-initiated dispute, there is no legislative provision requiring any further action on his part. There are no timeframes to meet and there is no obligation to issue the taxpayer with an amended assessment if the Commissioner disagrees with the taxpayer's proposed adjustment. Section 138B(3), in its current form, is the taxpayer's only resolve in these circumstances. Removing or repealing this section would leave the taxpayer

with no alternative at all. The removal or amendment of s138B(3) is objectionable.

Timetable for issuing Disclosure Notice

- (v) The Exposure Drafts set out administrative timeframes for the issue of a disclosure notice by the Commissioner:
 - (i) In those cases where the dispute has been initiated by the Commissioner, the disclosure notice will be issued (together with a SOP) within three months of:⁹
 - (A) the end of the conference phase; or
 - (B) the date when the Commissioner declines the taxpayer's opt-out request.
 - (ii) In those cases where the dispute has been commenced by the taxpayer, a disclosure notice will be issued within one month after the end of the conference phase.¹⁰

The Commissioner can, however, extend the three-month timeframe in disputes initiated by the Commissioner, for example, when the dispute is complex, involves an important issue of precedent, or the Litigation Management Unit or external advisors are involved in advising on the Commissioner's SOP.¹¹

- (w) All timeframes should be set out in legislation. The timeframes should be reasonable, and allow a Court to extend those timeframes on application. (An example of how that could be drafted is in the Appendix). If Inland Revenue fails to meet the statutory timeframe for issuing a disclosure notice, and in the absence of a Court order to the contrary, Inland Revenue should be deemed to have accepted the taxpayer's position, or alternatively UOMI should be suspended.
- (x) The Societies oppose the ability of the Commissioner to extend the timeframe for issuing a disclosure notice. Setting out reasonable timeframes in the legislation, with a safety net that allows the Commissioner to apply to the Court for an extension, provides a balance with taxpayers' obligations; it is also a fair way of managing the time allowed for the Commissioner to prepare and issue the disclosure notice and SOP. (An example of how that could be drafted is in the Appendix). The approach of the Exposure Drafts in proposing administrative timeframes without sanctions for failure to comply, and the ability to extend them at the Commissioner's convenience, brings into question the Commissioner's commitment to making the disputes process effective in practice. The Exposure Drafts should provide that where administrative timeframes are not met, the Commissioner will exercise discretion when considering the imposition of UOMI.

⁹ ED 0126 paragraph 309.

¹⁰ ED 0127 paragraph 209.

¹¹ ED 0126 paragraph 313.

Adjudication

- (y) If the parties have not agreed on all the issues at the end of the conference phase, and there has not been an opt-out of the disputes process, the dispute will be sent to the Adjudication Unit for review (unless one of the specified exceptions applies). If the dispute is to be referred to the Adjudication Unit, the Commissioner will write to the taxpayer seeking concurrence on materials to be sent to the Adjudication Unit. The taxpayer will have no more than 10 working days to respond. Materials relevant to the dispute will be sent to the Adjudication Unit once the taxpayer has concurred or, if the taxpayer does not respond, 10 working days after the date of issue of the Commissioner's letter.
- (z) The 10 working days in which the taxpayer has to respond to the Commissioner's referral letter is too restrictive in light of what the taxpayer is expected to do within that time. Timeframes should be as standard as possible, but should not be less than a month.
- (aa) Redacted Adjudication reports should be published. The Exposure Drafts suggest that the Commissioner will agree to the taxpayer's opt-out request if the dispute concerns facts and issues similar to those already considered by the Adjudication Unit or Office of the Chief Tax Counsel.¹² That is unworkable without redacted reports. The publication of redacted Adjudication reports should be a mandatory requirement. An alternative would be a self-explanatory summary of the adjudication decision and the subject matter of the dispute.

Limitation to grounds of assessment and grounds of challenge

- (bb) Following an opt-out, the Commissioner will issue an amended assessment. The Exposure Draft notes that the evidence exclusion rule does not apply and the Commissioner is not bound by the facts, evidence and propositions of law stated in the NOPA and NOR.¹³ Even though the evidence exclusion rules do not apply, the Commissioner's administrative practice is that grounds of assessment that have not been referred to in the NOPA and NOR will not be relied upon if they have not been notified or sufficiently discussed during the conference phase.
- (cc) For reasons stated below, a statutory limitation on the grounds of assessment for both the Commissioner and taxpayer is vital. The Exposure Drafts and the approach of officials should not add to the problems with the regime. If the taxpayer's opt-out request has been agreed to, the grounds of assessment should be included in the Notice of Assessment. We further discuss this point below, and have drafted new sections 89LB(4) – (8) in the Appendix to show how this could be achieved.

Opting out of the disputes process

- 3.4 Legislative amendments should be enacted to provide a unilateral elective opt-out to taxpayers after the NOPA, NOR and conference. We disagree with the view in the Issues Paper that a statutory elective opt-out is not a vastly superior process.

¹² ED 0126 paragraphs 279-281 and 289-297.

¹³ ED 0126 paragraphs 282 to 283.

Taxpayers should not have to rely on the party they are in a dispute with agreeing to them doing something to progress the dispute. The rationale in the Issues Paper for not legislating for a unilateral elective opt-out does not withstand scrutiny. Legislative drafting for this has been provided in the Appendix.

- 3.5 Seeking a declaration from taxpayers that all "material" information has been provided should not be proceeded with. There is no obvious sanction and the "materiality" standard is ill-defined and likely to cause confusion and debate. As a NOPA is not going to be issued before completion of an audit (during the course of which the Commissioner can exercise his information gathering powers), the Commissioner should seek and obtain all information before the disputes process is activated. In the ordinary course nothing further will be needed, as the Commissioner would have used those powers appropriately before entering the disputes procedures. In circumstances when this has not been possible prior to the conference, the Commissioner still has the ability to seek information until such time as litigation commences.
- 3.6 If a unilateral elective opt-out is not legislated, at minimum the legislation should provide that a taxpayer is able to seek a Court order that the disputes procedures are not required to be completed, similar to the process currently only available to the Commissioner under s89N(3). There is no substantive basis for not providing such a right for taxpayers. This would appropriately balance the system and provide a Court-controlled check on the Commissioner's administration. This is appropriate in an adversarial system that relies on a party to a dispute exercising discretion favourably when it is sought from the other party to the dispute. We note the Exposure Drafts (for example ED 0126 at paragraph 260) state that the Inland Revenue officers directly involved in the dispute would be responsible for exercising this discretion, which is even more of a cause for concern. In previous consultations with officials, including in reports issued by officials, there has been support for such a legislative change.
- 3.7 In terms of s138B(3), unless legislative timeframes apply to the Commissioner throughout the disputes process, s138B(3) should remain in its current form, or even more problems will arise. This is because after filing a NOR to a taxpayer-initiated dispute, the Commissioner need do nothing further at all as there are no statutory timeframes on Inland Revenue, and no obligation to issue an amended assessment in circumstances when the Commissioner disagrees with the taxpayer's proposed adjustment. There is no incentive for the Commissioner to do anything at all. In the event of inaction by the Commissioner, the taxpayer can do absolutely nothing about it, as, absent s138B(3), to file a challenge requires an amended assessment to be issued (s138B(2)(b)). It is objectionable to remove or amend s138B(3) as this condemns taxpayers to no rights at all.
- 3.8 We note that if legislative timeframes applying to the Commissioner were to be enacted (which we support), then there may well be no need for s138B(3) as in that event there would be a statutory obligation on the Commissioner to act after filing a NOR. This area has not been adequately addressed in the Issues Paper.

Evidence exclusion rule

- 3.9 The Societies agree with the conclusions (which are consistent with the Joint Submission) that:
- (a) the evidence exclusion rule should be relaxed to be an exclusion rule applying to propositions of law, and, if necessary, legal issues (although we comment that the Commissioner needs to specify what statutory provisions he is relying upon);
 - (b) the Notice of Claim requirements should be amended so that it is clear that attaching the NOPA, NOR and/or SOP will sufficiently set out the basis for claim;
 - (c) an amendment to s89N(2)(b) (which in essence requires an SOP from the Commissioner on every occasion) is desirable. The proposed rule in paragraph 4.41 of the Issues Paper would work, but must be accompanied by an amendment to s89M(8) and s89M(9) as we have noted above.
- 3.10 A legislated limitation on the Commissioner to the grounds of assessment, and equivalent rule applying to limit taxpayers to their legal grounds for dispute, is absolutely vital in an opt-out (be it unilateral or bilateral) when there is potentially no SOP. To suggest that no rule be applicable will cause additional problems. This issue should be resolved through legislation now. The Issues Paper should not take the approach of avoiding legislative change when it is so necessary. Suggested drafting for such a rule has been provided in the Appendix.

Timeframes

- 3.11 Legislative timeframes are necessary if balance is to be restored to the system. Using the Standard Practice Statement as a guideline for the current response timeframes from Inland Revenue does not reflect the real position. It is difficult to have confidence in administrative guidelines and the Commissioner's commitment to comply with them in future, when they have not been complied with to date. It also sends a signal that officials are not serious about changes to provide a fairer system for taxpayers. With a system that imposes commitments on the taxpayer, yet does not hold Inland Revenue to those same standards, combined with the imposition of UOMI and harsh sanction for error or failure, it is little wonder taxpayers disengage from the process. Effectively taxpayers remain priced out of pursuing valid disputes. Unless change is made to reform this aspect of the disputes rules, taxpayer confidence in the system will continue to decline and with it their perception of the integrity of the tax system. This is also affecting the development of tax precedent, which is also undermining the integrity of the system.
- 3.12 Reasonable legislative timeframes can be imposed on Inland Revenue that should be sufficient for the majority of disputes (be they taxpayer or Commissioner-initiated), combined with the ability to seek enlargement of those timeframes by Court order. It is hard to see the objection to this, particularly since it restores balance to the process. The Commissioner could then, as an administrative measure, set targets within those legislative timeframes for officials to meet, and measure performance. These timeframes can be imposed without undue risk to the conference phase, and simply start when that phase ends. We have provided drafting in the Appendix to show how this could be achieved.

- 3.13 There should be sanctions for failing to meet such timeframes. There are two possible alternatives. First, that the Commissioner should be deemed to accept the taxpayer's position. This would mirror the taxpayer's sanction, and would provide the necessary balance to the system. The alternative is suspending UOMI, to ensure that one of the harshest consequences of the Commissioner's failure is alleviated and an incentive is provided for the Commissioner to meet the timeframe. In respect of paragraph 5.28 of the Issues Paper, not one of our practitioners could point to an occasion when Inland Revenue officials have exercised discretion when quantifying UOMI. At best, officials' exercise of discretion occurs on extremely rare occasions. This does not justify a position of no change in this area.
- 3.14 We generally support proposals to amend the Taxation Review Authority's Regulations. Further changes to the management of tax matters before the Courts to reduce a double-up of cost could be considered, such as discouragement of discovery, given that the Commissioner has information-gathering powers that he will have already utilised before a NOPA or NOR is issued by the Inland Revenue.
- 3.15 The summary to this part of the Issues Paper refers to potential "future legislation". There should be no delay to legislative reform. The disputes procedures have been in place for over a decade, and this is a clear and obvious problem that should be remedied by legislation without delay.

Disputable decisions

- 3.16 Without a legislated unilateral elective opt-out for taxpayers, or the ability for taxpayers to seek a Court order (similar to s89N(3)) that the disputes process does not need to be completed, a decision by the Commissioner not to agree to a bilateral opt-out under s89N(1)(c)(viii) should be able to be reviewed by the Court via an originating application. During consultation officials consistently supported amendments to provide taxpayers with the right to apply to the Court under a provision mirroring s89N(3), so it is a surprise to see that position was not taken in the Issues Paper. There is no justification provided in the Issues Paper for the change of view.
- 3.17 We do not object to the issue of a NOPA or the issue of a SOP not being a "disputable decision". Nor do we object to the co-ordination of the definitions of "disputable decision". We are not aware of any of these issues being in practical terms a serious problem, unlike the other issues we have raised. We urge officials to focus legislative reform on alleviating real problems with the procedures as opposed to focusing on minor technical issues such as these.
- 3.18 A matter we do wish to raise is the increasing use of Notices of Disputable Decision by Inland Revenue. This is concerning, as it suggests that Inland Revenue is using this as a way of avoiding the need to issue a NOPA and, instead, forcing taxpayers to issue NOPAs.

Exceptional circumstances

- 3.19 The "exceptional circumstances" definition should be amended, to ensure that a change in tax law is a circumstance beyond the control of the taxpayer as well as the Commissioner, and the proposal of an alternate basis for the acceptance of late notices where there is evidence of an intention to dispute, where an error has been made, and where the time delay is not significant in the circumstances.

- 3.20 Further, taxpayers should be able to make an application to the Commissioner first, on either of the above bases. However, the decision of the Commissioner on either basis should be able to be reviewed by the Court via an originating application. To insist that this decision is a disputable decision results in a NOPA, NOR and conference. This is more cost, and more time, and the likelihood of a change in approach by the Commissioner seems to be very low. Upon reflection, to make this a disputable decision is not workable and will add cost and time into the process to get the matter before the Court.
- 3.21 Timeframes in the disputes procedures will need to be suspended while the Commissioner makes a decision on either basis. Therefore, it is critical for the Commissioner to be subject to a firm timeframe to make such a decision, and if he fails to do so within that timeframe UOMI should be suspended, and the taxpayer should have recourse to the Court for that decision to be made. Otherwise the taxpayer will be subject to ongoing delay, while UOMI is being imposed, exacerbating a current problem.

Dealing with Small Claims

Background and Issues

- 3.22 In general, we agree with the Issues Paper that the current process for handling small tax disputes is not working. As one of the Supreme Court Judges noted in a recent speech:¹⁴

“In the five years from 1993 to 1998, the Taxation Review Authority issued an average of 48.4 substantive determinations per year, whereas in the last five completed years this figure has plummeted to 9.6, a drop of over 80 per cent. Equivalent figures are not available for substantive High Court determinations over the past five years. Despite this, given the way the annual number of High Court determinations has closely mirrored those of the Taxation Review Authority, it is reasonable to assume that a corresponding decline has occurred in relation to High Court determinations.”

- 3.23 Sir William Young made his comment in the context of noting that judicial involvement was currently more about process than substance. He then went on to say that the implications for the New Zealand tax system were as follows:¹⁵

“I see grounds for concern in the limited number of cases that are determined substantively by the courts. It means that taxation disputes are being largely resolved within the Inland Revenue Department. Because internal departmental opinions are necessarily backwards looking and controlled by the existing patterns of judicial decisions, there is little scope for judicial development of the law - the sort of fresh look exemplified by the Supreme Court judgment in the Trinity case. Associated with all of this is the possibility that some (and perhaps many) taxpayers are burnt off by the costs of the process and by the risks of litigation. The resulting practical unavailability of departmental opinions may be unhealthy in a society that subscribes to the rule of law.”

¹⁴ Refer *Tax Disputes in New Zealand* A paper delivered by Sir William Young at the 2009 Conference of Australasian Tax Teachers Association at paragraph 42 on page 15.

¹⁵ Ibid paragraph 45.

- 3.24 Sir William Young's concern about burn-off is reflected in the number of cases that are heard by the Taxation Review Authority (TRA), as the tax court of first instance. Prior to the changes from the Organisational Review, the TRA carried the largest judicial tax workload. However, following the changes introduced by the Organisational Review, the High Court has assumed that mantle and there are a greater number of cases being heard in the High Court, than are considered by the TRA as the court of first instance. This is demonstrated by the number of cases reported in *New Zealand Tax Cases*, as these are a close reflection of the number of cases heard by the various courts.¹⁶

| Year | TRA | District Court | High Court | Court of Appeal | Supreme Court |
|--------------|------------|-----------------------|-------------------|------------------------|----------------------|
| 2006 | 10 | 3 | 37 | 15 | 4 |
| 2007 | 13 | 0 | 57 | 16 | 7 |
| 2008 | 13 | 1 | 41 | 9 | 7 |
| 2009 | 19 | 1 | 54 | 23 | 5 |
| Total | 55 | 5 | 189 | 63 | 23 |

- 3.25 In addition, in 1996 there were four judges who had warrants to hear tax disputes in the TRA. Currently this has been reduced to one judge who spends approximately a quarter of his time in the TRA, with the balance being allocated to ACC appeals, other specialist tribunals and general district court matters. So it would be fair to say that following the change made by the Organisational Review, the TRA has atrophied.

- 3.26 Undoubtedly, part of the decrease in the number of disputes in the TRA may be ascribed to a number of different factors:

- (a) The pre-assessment dispute process could have improved the accuracy of the assessment process.
- (b) The ability of the Commissioner to settle cases on a commercial basis.¹⁷
- (c) Litigation risks associated with use of money interest and penalties that might deter challenge procedures.
- (d) The cost and uncertainty of taking a dispute through the dispute process.

- 3.27 However, since the recommendations of the Organisational Review were implemented, the number of disputes heard at the High Court and courts above that level have increased, rather than decreased. Therefore, the most likely reason for the

¹⁶ As Commerce Clearing House advise that they report all tax cases heard by those courts.

¹⁷ Although steps in this direction have usually only occurred after the Courts have shaped the Commissioner's views of the extent of these powers (see for example *Auckland Gas v CIR* (1999) 19 NZTC 15,027).

dramatic decrease at the TRA level is that the cost of taking a dispute through the process outweighs the tax at stake.

- 3.28 As the Organisational Review noted, for a sample period of six months in 1991, the median amount of tax in dispute was \$4,863 for objections and \$20,115 for cases filed.¹⁸ In their view, two-thirds of tax disputes in 1991 were for amounts under \$10,000. If those figures were inflation adjusted to 2010, the median amount would equate to \$7,252 and the cases filed would equate to \$29,997.¹⁹ Two thirds of disputes would be for less than \$14,913. The reality is that under the current system, it would be uneconomic to take a dispute for any of those amounts. In our view, those disputes do not disappear, they are left to fester, as was suggested by the Organisational Review, where it said:

“The Review Committee has been told that many taxpayers, once aware of both the costs and delays of objections aimed at recovering the disputed tax, decide to drop the dispute. The resulting perception, of paying too much tax by default, may lead to disgruntled taxpayers who undoubtedly tell other people and who may not be willing compliers in the future.”

- 3.29 The Organisational Review’s recommendation was that “In relation to small claims, involving amounts under \$10,000, a fast track non-precedential process for dealing with these types of claims should be available.”
- 3.30 The Organisational Review considered that this new process should come within the purview of the Taxation Review Authority, which was done. However, under the rules that apply to the small claims jurisdiction, a dispute could only be considered if:
- (a) The facts are clear and not in dispute; and
 - (b) There is no significant legal issue, or
 - (c) There are no other taxpayers that may be affected by the result.

If the facts are clear and undisputed and there is no significant legal issue, one could well ask what there is to dispute. Under these criteria, it seems the small claims jurisdiction is confined to small taxpayers who have clearly misunderstood the law – a forum for sidelining those who are ignorant of the relevant law rather than a forum for resolving real disputes. This somewhat cynical restriction of the jurisdiction to cases where neither the facts nor the law are seriously in dispute could well explain why so few taxpayers have availed themselves of it.

- 3.31 The effects of those limitations are that the small claims jurisdiction can almost never be used. As one TRA remarked, in those cases when the jurisdiction has been used, it probably should not have been.
- 3.32 So the issue is not that there is no demand for the resolution of small tax disputes, but rather that the current process for the resolution of small disputes can almost never be used and even if it can be used, the cost of doing so results in a pyrrhic outcome in many cases.

¹⁸ Refer *Organisational Review of the Inland Revenue Department* April 1994 at page 66.

¹⁹ Based on a calculation using the Reserve Bank of New Zealand Online Inflation Calculator.

What needs to be changed – Small Claims in general

- 3.33 The Issues Paper states that the current procedure for disputes is not working, especially as it applies to small claims. We agree with this. However, we disagree with the Issues Paper on the type of reform needed. Under the proposed opt-out guidelines, the Commissioner will agree to an opt-out of the disputes process when a meaningful conference has taken place and the tax in dispute is less than \$75,000.
- 3.34 The opt-out is a step that will reduce costs in small disputes but, as noted above, the right to opt-out of the disputes process should be a legislative right, rather than the administrative opt-out process proposed in the Issues Paper. In this aspect we share the view of Sir William Young that where the disputes regime is partly legislated and partly administrative, this will lead to further litigation.²⁰

“A related problem is the new disputes resolution process has always only been partially implemented by legislation. The Organisational Review Committee envisaged that the audit investigation and final quantification of liability should, as far as practicable, be clearly separated.

This, however, is only currently provided for at the adjudication step in the process, which is not legislatively required. While the courts do not hold the Commissioner to administrative procedures laid down in the relevant policy statements, inconsistency between policy statements and the Commissioner's actions has proved to be a common trigger for litigation.”

- 3.35 We would go further than that. It is not only those cases when the Commissioner feels particularly aggrieved by the taxpayer's conduct that he will pursue a course of action contrary to previously promulgated administrative guidelines – this also arises in circumstances where the Solicitor-General, as the person responsible for the Crown's litigation, may choose a course of action contrary to the Commissioner's position. In either of those circumstances, a taxpayer (and their advisors) will have no certainty that an administrative statement made by the Commissioner will be followed.
- 3.36 The New Zealand tax system is based on taxpayers making a self-assessment of their own income tax liability, which presumes that they know what the law is and what procedural steps are involved, if they want to challenge a decision of the Commissioner. Where the rules are only provided by administrative guidelines, that certainty (or the rule of law as Sir William Young describes it) is removed.
- 3.37 This is aggravated by the significant penalties and punishing interest rates that are applied to taxpayers if they are mistaken. The penalties are premised on there being taxpayer certainty and if taxpayers do something that is contrary to the law, then they deserve to be punished since other taxpayers have voluntarily complied. This scenario does not factor in administrative discretions that allow officials to change the rules and the processes applying to disputes. Examples of this include:
- (a) *ANZ National Bank Ltd v C of IR* (2007) 23 NZTC 21,167, where ANZ sought to have its case heard by the Adjudication Unit. The Court of Appeal

²⁰ Supra paragraph 40.

held that the Commissioner cannot be forced to enter into the non-statutory administrative procedures involving Adjudication.

- (b) *CIR v Zentrum Holdings* (2006) 22 NZTC 19,912, where the taxpayers sought to prevent the Commissioner from raising new arguments on appeal. The Court of Appeal held that as the Commissioner had not issued a disclosure notice, the Commissioner was not precluded under s138G from raising new grounds on which to assess the taxpayer. This is totally contrary to the tenor of the Organisational Review, which had as a focal point the need for each party's argument to be "on the table" throughout the process. The point of having a NOPA/NOR, Conference, SOPs and Adjudication was to make sure that both parties were aware of the other party's arguments before they went to court. *Zentrum* reflects that the Commissioner's actions were inconsistent with the Organisational Review, because of an administrative discretion given to the Commissioner.

- 3.38 As noted by Sir William Young above, the lack of consistency between the policy statements and the Commissioner's actions has proved to be common trigger for litigation. As a consequence of that, there have been a large number of procedural cases. Sir William Young cited²¹ an article by Mark Keating²² which reviewed the number and type of reported tax cases over the period 2005 – 2008:

“From 2005 to the present, there was a total of 121 reported cases on procedural issues in the High Court, Court of Appeal and Supreme Court, while over that same period there were only 27 purely substantive cases. Over that same period, the Taxation Review Authority (TRA) has determined 23 procedural cases compared with 29 substantive cases.”

- 3.39 The fact that there is such a high percentage of procedural cases nine years after the introduction of the legislation is an indictment of the potpourri of legislative and administrative rules. It also strongly supports the view that where amendments are required, then they should be in legislation so that taxpayers have certainty.
- 3.40 We agree that for small claims involving larger sums of money and where the right of appeal is important, the changes that will allow a taxpayer to opt-out of the rest of the disputes process will save taxpayers some cost and time. Provided these rights are enacted in legislation, this will be a step that reduces costs and will assist to speed up the process if a dispute cannot be resolved at the conference level.
- 3.41 In addition, we suggest that the process could reduce the amount of formal documentation required. We understand from discussions with officials that there are procedural steps they would accept as constituting the basis of the Commissioner's case (in the event of an opt-out), so we do not need to make further submissions on this point.

Micro tax cases

- 3.42 The Issues Paper makes reference to “very small claims”, which we have referred to as micro tax cases. The Issues Paper considers that by making administrative opt-out available this would suffice, and it proposes the abolition of the Small Claims jurisdiction with nothing further to replace it. This is not adequate. As the

²¹ Idem paragraph 30.

²² Refer *New Zealand's Tax Dispute Procedure – Time for a Change* (2008) 14 NZJTL 425, 428.

Organisational Review envisaged, there needs to be a fast-track non-precedential process to deal with micro tax disputes. This is considered in more detail below.

- 3.43 As already noted, the Small Claims jurisdiction of the TRA has been singularly unsuccessful, having heard six cases in 14 years in an area where statistically the greatest number of cases arise. As the Issues Paper notes, New Zealand is alone amongst other common law jurisdictions in not having an appropriate forum to deal with small tax disputes.
- 3.44 Australia has the Small Taxation Claims Tribunal that commences with the completion of a form that fits on two sheets of A4 paper and payment of \$68. The taxpayer specifies the decision of the Australian Taxation Office that they are unhappy with and pays a fee of \$68. There is a pre-trial conference and most of the disputes are resolved at those conferences, with the person who will hear the trial (if it progresses) running the conference. The Small Taxation Claims Tribunal can hear tax disputes when the amount of the tax in dispute is less than \$5,000.
- 3.45 The United Kingdom has recently introduced the Tax Chamber of the first-tier Tribunal. There is no filing fee, and this forum can be used to commence all proceedings. The disputes are divided into different categories depending on the complexity of the dispute. To commence a dispute, the taxpayer completes a form which includes a tax reference number from Her Majesty's Revenue and Customs (HMRC), any reference number to the decision that HMRC have provided, the reasons why the taxpayer considers the decision is wrong, the result a taxpayer believes should occur, and any additional information such as letters from HMRC. The Tax Chamber has four levels of "hearings" – it can be done on the papers, a basic level where both parties present their case, then standard or complex if the cases warrant this.
- 3.46 Similarly in Canada, there is an "informal procedure" that is available where disputed tax is not more than \$12,000 or the disputed loss is not greater than \$24,000. An informal hearing does not have to follow legal or technical rules of evidence and the decision of the Court has no precedential value. The filing fee for this "informal procedure" is \$100.
- 3.47 Compare this to New Zealand where currently a taxpayer must pay a filing fee of \$400 and has to provide either a NOPA or a NOR (to which they will be bound) that:
- (a) specifies the adjustment or adjustments proposed to be made in the assessment; and
 - (b) provides a concise statement of the key facts and the law in sufficient detail to inform the Commissioner of the grounds for the disputant's proposed adjustment or adjustments; and
 - (c) states how the law applies to the facts; and
 - (d) includes copies of the documents of which the disputant is aware at the time that the notice is issued, that are significantly relevant to the issues arising between the Commissioner and the disputant.
- 3.48 This is the same process that is used to commence the most complex tax disputes. Accordingly, a taxpayer that wants to question a simple tax error of \$10,000 must

meet the same procedural standards as a taxpayer that commences a proceeding in the High Court and is litigating a tax issue worth millions.

- 3.49 The taxpayer that wants to challenge a minor tax matter is automatically put at a disadvantage because most (if not all) taxpayers would find it very difficult to comply with these requirements and would be forced to hire a tax advisor to advance the matter. These procedural requirements make no concession to the size of the dispute or complexity of the issue.
- 3.50 If the taxpayer was brave enough to complete a NOPA or NOR without external advice and got it wrong, then the Commissioner may issue a default assessment and challenge the validity of the taxpayer's documentation in court.²³ The effect is that if the taxpayer gets the detailed procedure wrong, then the Commissioner's assessment stands and the taxpayer's dispute is lost without any consideration of the substantive issue.
- 3.51 In micro tax disputes there is an imbalance of power and knowledge. Inland Revenue has a staff of 6,500 people, many of whom have decades of tax experience and there is a division within Inland Revenue that is dedicated to litigation of tax disputes. A taxpayer may only run into a tax dispute once or twice in a lifetime, whereas Inland Revenue officials deal with these matters on a daily basis and there is sufficient experience within Inland Revenue to ensure that specialist advice is at hand at no cost. Taxpayers are expected to be able to specify the relevant sections, quote the relevant law, decide what the relevant facts are and decide what evidence they have available. If they decide to hire professional advice, the costs mount up very quickly due to the current legal and procedural requirements, and the dispute becomes uneconomic to pursue.
- 3.52 It is important that New Zealand has a specialised process to deal with small disputes:
- (a) New Zealand is a country in which 89% of businesses have five or fewer staff, and most of those businesses will have tax disputes involving relatively small amounts. There are therefore a large number of tax disputes for relatively small amounts.
 - (b) Even where a business is not small, it may still wish to challenge an Inland Revenue decision in relation to a small amount. So the complexity of dispute resolution procedures affects all taxpayers, not just small enterprises.
 - (c) If the disputes process is made too complicated or uneconomic for taxpayers to challenge for small amounts, taxpayers will not have an economically feasible option to challenge decisions and there will not be any check on Inland Revenue administration or processes.
- 3.53 An appropriate forum for micro disputes is necessary as a basic right to justice. This was reflected in the principles set out by the Organisational Review, which noted that two-thirds of all tax disputes were for amounts less than \$10,000. It is also reflected in all other common law countries which make specific provision to find a speedy low-cost system of resolving tax disputes that do not put procedural and cost barriers in place, preventing access to justice.

²³ Refer to the Court of Appeal's decision in *CIR v Alam and Begum* (2009) 24 NZTC 23,564.

- 3.54 The Societies have met with Judge Barber, who is the only remaining TRA judge. In his view the TRA is established as a Court of Inquiry, so he is free to adopt whatever process is necessary to achieve a just outcome. Judge Barber is of the view that an appropriate way to deal with all small disputes would be for the parties to first have a mediated hearing. He left open two ways in which micro disputes could be progressed:
- (a) One alternative is to have specialist tax mediators who have detailed tax experience. This would give the parties a reality check by an independent third party. If the matter was not resolved at that level then there could be a further hearing before a suitably experienced tax arbitrator who would make a final decision.
 - (b) The other alternative is to have a mediation run by the TRA, which would not be disqualified from hearing the case if it were not resolved at mediation.
- 3.55 In both situations, the parties would be required to provide a summary of their arguments (as is done in a settlement conference) and the mediators would have inquisitorial powers to obtain the information necessary to make a decision.
- 3.56 This form of micro dispute resolution should be available for tax in dispute up to \$50,000 (with the mediator having powers to impose UOMI and shortfall penalties as appropriate). As envisaged by the Organisational Review, we would see the decisions as being non-precedential and taxpayers would be able to opt for this form of dispute resolution without having to proceed through the NOPA/NOR or conference phase. If the taxpayer had to proceed through the NOPA/NOR and conference phase, then any savings that may have existed would be lost.
- 3.57 We also believe that there is no principled justification for restricting criteria for this jurisdiction to those disputes which involve no dispute as to the facts and/or the law, and especially by the double restriction which, as already noted, restricts the jurisdiction to simple cases of taxpayer ignorance. A non-precedential low-value dispute resolution process will by definition have no appreciable impact, adverse or otherwise, on tax law or the revenue base, so there is no practical reason for either restriction. On the other hand, a jurisdiction where genuine tax disputes as to the facts or the law can be resolved relatively cheaply and easily will have positive impacts on the perceived integrity of the tax system for those taxpayers who avail themselves of it and, win or lose, have their day in court.

Test cases

- 3.58 We are pleased to note the comments at paragraph 9.43 of the Issues Paper which suggest a willingness to consider reform in this area, and an acceptance that the status quo is not working properly.
- 3.59 However, we note that the proposals in the Joint Submission in relation to test cases – for a test case panel and for a Government funding programme – are two separate proposals. The Issues Paper seems to consider the two proposals as inextricably linked, which is incorrect. They are separate proposals.
- 3.60 In respect of a test case panel, we do not agree with the stance taken in the Issues Paper (paragraph 9.24) that a test case panel is not desirable. The rationale provided for this is convincing. New Zealand is a small community, but it is quite possible to

appoint members to a wide range of advisory committees (the Tax Working Group being the latest) and advisory panels such as the GST Advisory Panel and the Rewrite Advisory Panel. None of those bodies required legislation and if there was a fear of legislation (as the Issues Paper suggests), the Commissioner could make an administrative undertaking that he will follow the advice of the test case panel. Where conflicts of interest arise in respect of other panels, the members of those panels or committees declare the conflicts and the conflicts are dealt with. That is quite manageable. Further, there are obvious advantages in a panel rather than a court making a test case decision, in terms of cost, timing and access. Finally, there is no duplication of resources, as the practical reality is that currently there is a complete paralysis of decision-making on test cases. As an example, one practitioner wrote to the Director, Litigation Management and waited over 13 months for a decision in respect of s89O; the decision, when it finally came, was not in favour of a test case designation in respect of a remarkably similar case before the Courts. Clearly, by the time 13 months had passed, the cost advantages had completely disappeared for that taxpayer. The fact is that a resource is needed, and the panel would be best practice, and a low-cost solution.

- 3.61 There are obvious advantages in terms of efficiency (not having cases on the same issues appear before the courts), cost, and clarification of the law from test case procedures. We note the comments made at paragraph 9.6 of the Issues Paper regarding clarification of the law; however, legislation to overturn court decisions is not as commonplace as suggested, and legal clarity especially in a complex area such as taxation is an advantage of a well-functioning test case procedure. Unfortunately, currently the test cases procedures are not operating well, nor are the disputes procedures, and tax law is suffering as a consequence. Our experience over a decade of working with these procedures indicates quite clearly that reform in this area is needed.
- 3.62 We suggest that a fresh approach is needed in respect of test case procedures. First, there needs to be an amendment to s89O so that a formal test case designation under s138Q is not required in respect of matters that are proceeding through the disputes process, where a similar matter is being heard in court. This could be in the form of legislation providing for an agreement between the parties to suspend the disputes process (and amending s89O accordingly), although the best solution is for parties in the disputes context as well to be able to access the test case panel. Secondly, there needs to be a test case panel for cases before the Courts. The new approach would be for both taxpayers and the Commissioner to be able to consider if a case should be designated a test case and to apply to the panel for a decision, in a similar process as that adopted by the Rewrite Advisory Committee. If taxpayers had input into the test case decision and the decision-maker was seen to be independent of the Commissioner (who is the counter-party in a dispute), there would be a greater degree of confidence in the test case procedures. Some minor amendments could be considered to s138Q, for instance to note that the designation can be made after application from taxpayers or interested bodies. Thirdly, the advantages of the Australian system could be replicated. In particular, industry groups should also be able to make submissions and nominate a test case. This would ensure that the procedures promote efficient clarification of legal issues.
- 3.63 If a test case panel is not proceeded with, then we would support the ability for both the Commissioner and the taxpayer to apply to the Court for a test case designation to be made. A decision-maker other than the Commissioner (who is after all one of the parties to the dispute) is needed to generate greater confidence in the test case

procedures. Whether such a determination by the High Court is a final decision can be considered. However, scrapping test case procedures altogether and relying on the Court procedures is not the best way to solve this problem. A test case panel is the best solution, for reasons of cost, timing, ease of access and because the involvement of decision-makers other than the Commissioner will promote confidence in the test case procedures.

- 3.64 On our other proposal in this area, test case funding, we can only reiterate that this is an inexpensive process, not a lot of funding is needed, and left-over funding can be rolled over annually. As can be seen from the Australian system, it enables test cases with a high precedential value to be determined swiftly and efficiently (for example *FCT v McNeil* [2007] ATC 4223). We do not agree that the disadvantages outweigh the advantages in this context (per paragraph 9.25 of the Issues Paper). Diverting funding to clarify tax issues and create precedent affecting a large number of taxpayers in the New Zealand community is an efficient and sensible use of resources. Any policy issues and ensuring there is community support for such a programme can be dealt with when considering the criteria for funding, which could be set administratively. Finally, as stated above, we do not agree that that clarification of the law is not a goal of test cases, and reiterate that while occasionally there is legislation to clarify Parliamentary intention after a judgment is issued by the Courts, that is hardly commonplace. We support a test case funding programme and believe its establishment would also promote confidence in the tax system.

Other issues

- 3.65 Regarding the amendments proposed to clarify the use of the word "challenge" in the Tax Administration Act 1994, officials should focus on legislative change to alleviate the problems with the procedures, rather than focusing on remedial matters such as this.
- 3.66 Regarding amendments to s89C(db), these should make it clear that where a taxpayer has a number of years in dispute on the same issue, the application of the disputes process to the taxpayer can be curtailed.
- 3.67 The Societies have no issue with the suggested amendments to s89C in the context of s177C.

4. DETAILED COMMENTS IN RESPECT OF THE OPT-OUT

- 4.1 We disagree with the position taken by the Issues Paper that a unilateral opt-out is not desirable. The Issues Paper focuses on three main reasons for the position that a unilateral elective opt-out for taxpayers is not desirable.²⁴ The rationale provided for the position in the Issues Paper does not withstand scrutiny.
- 4.2 The first reason the Issues Paper provides for the position that a unilateral opt-out is not desirable, is that it would increase filings in Court, and this should be avoided (paragraph 3.6, paragraph 3.23). Nowhere in the Richardson Committee report does it state that an objective of the disputes procedures was to reduce access to the

²⁴ There is a fourth reason given, but as stated above, the fourth reason in the Issues Paper (ie that the opt-out would be available prior to a conference being held) is wrong and misstates the Societies' consistent submission to officials.

Courts. Limiting access to justice would be an extraordinary objective, and it simply is not the objective of the procedures. The Richardson Committee report focuses on early resolution of disputes. Where a NOPA and NOR have been exchanged, legal and factual arguments explored, information sought and provided, and a conference phase undertaken to explore resolution (with the conference improved by changes being instituted by the Commissioner), the policy objective of the disputes resolution procedures – early resolution – has been met. However, in some cases early resolution will be sought and considered by the parties, but not achieved. In our view, the suggestion in the Issues Paper that Adjudication is a process where resolution can occur (paragraph 3.13) and that this is a reason for forcing taxpayers through the process, is quite misleading. Resolution as proposed by the Richardson Committee was the focus of the conference. The Adjudication process determines the outcome of the dispute. It is not a resolution function. Some taxpayers may choose to proceed to Adjudication, but to force all taxpayers to do so is a cause of current disillusionment with the procedures.

- 4.3 Delaying access to the Courts in such circumstances is not a sensible rationale, and doing so does not support the objective of the procedures (that objective has already been met). Delaying access to justice confirms the current view that the system is weighted against taxpayers, and it will continue the demise of tax precedent. This undermines the integrity of the tax system.
- 4.4 The second reason that the Issues Paper provides for the position that a unilateral opt-out is not desirable, is that administrative changes relating to s89N(1)(c)(viii) mean that a unilateral opt-out is not necessary (see paragraph 3.10 for example). In circumstances where there is a discernible lack of engagement and confidence in the procedures and where access to justice is being curtailed, it is not credible to suggest that an administrative fix controlled by the Commissioner will be enough. It is a right of taxpayers to access the Courts and it serves no purpose (other than increased cost and time) to delay that right. Curtailing the right of taxpayers to access the Courts has led to disillusionment with the tax system. The Commissioner continuing to control a taxpayer's access to the Courts by way of an administrative process will not alleviate that problem. The Societies are supportive of some guidance from the Commissioner about s89N(1)(c)(viii), but this does not alleviate the problems identified.
- 4.5 There are a number of concerns with the nature of administrative opt-out that is proposed by the Commissioner. Those concerns were raised previously in the Societies' letter dated 4 June 2009. A number of the reasons for the Commissioner agreeing to an opt-out under s89N(1)(c)(viii) are vague, ill-defined and can be themselves the subject of debate or, in the case of one (where a matter has been heard before Adjudication), completely unworkable since taxpayers have no access to Adjudication reports and will be completely unaware of what has been heard in Adjudication. We believe the Commissioner's proposed administrative opt-out will result in more, rather than fewer, problems. The Commissioner has also left open the potential of not agreeing, including where the issues are believed to be "complex" (paragraph 4.49 of the Issues Paper). It is also an unfortunate reality that Inland Revenue officials do not always feel bound by administrative pronouncements. For these reasons we do not agree with paragraph 3.9 or paragraph 3.11 of the Issues Paper, which suggest that it is "likely" that a "considerable number" of disputes will be the subject of an administrative opt-out. The basic point is that access to justice should not be controlled by the Commissioner, particularly

where the objective of the disputes procedures has been met. It makes no sense to continue with the current problems.

- 4.6 The third reason that the Issues Paper provides for the position that a unilateral opt-out is not desirable, is that it would require a legislated conference (see paragraph 3.16 and following). That is not necessarily correct. The legislation could simply require that an elective unilateral opt-out is only possible after at least one meeting is held between the Commissioner and the taxpayer. Administrative guidelines could then outline the manner and process that such a meeting should follow. We have provided suggested drafting in the Appendix, setting out how to legislate for a conference and the unilateral elective opt-out, and how the two could be linked (this drafting was provided earlier to officials, on 30 March 2009). The drafting is straightforward. The detail suggested in paragraph 3.19 of the Issues Paper (regarding length and method of conference meeting etc) is simply not required in legislation and could be dealt with by way of administrative guidelines. We would be happy to engage with officials to discuss and develop the drafting further, or to adapt it, and the opt-out, for a conference that is not legislated.
- 4.7 On examination, the rationale provided by the Issues Paper for the position that a unilateral and elective opt-out is not desirable does not have substance. We urge a rethink of this area, and submit that legislating for an elective unilateral opt-out for taxpayers after NOPA, NOR and conference would alleviate one of the most prevalent problems with the disputes procedures, while still ensuring the policy objectives of the procedures are met. Legislative drafting has been provided in the Appendix and we would be happy to work with officials to develop that further.
- 4.8 The Societies remain willing to consult with officials in this important area. Please feel free to contact us if you would like to discuss any aspect of our submission with us - Julie Smith, New Zealand Law Society on (04) 4632967 or Craig Macalister, New Zealand Institute of Chartered Accountants on (04) 474 7860.

Yours sincerely



Jonathan Temm
President
New Zealand Law Society



Geoff Nightingale
Chair, National Tax Committee
New Zealand Institute of Chartered Accountants

APPENDIX: DRAFTING

The attached drafting (amendments in mark up) covers the following issues:

- (a) Response Periods:
 - (i) timeframes are inserted for the Commissioner in s3(1) (paragraph (a) is a timeframe for the conference (one month from Notice of Response), paragraph (b) is a timeframe in which the taxpayer must elect to opt-out under the unilateral opt-out if they are going to do so (2 months from conference end), paragraph (c)(vi) is a timeframe for the disclosure notice (3 months from conference end));
 - (ii) a timeframe is also inserted in new s89LB(3) for the issue of an assessment after an opt-out under the unilateral opt-out;
 - (iii) those timeframes can be extended by Court order (s89L);
 - (iv) note that a timeframe would also be needed for a decision by the Commissioner as to whether there are exceptional circumstances (this is as per the Societies' submission and is for discussion with officials).
- (b) Sanctions if timeframes are not met:
 - (i) if the conference timeframe is not met the Commissioner cannot issue an assessment (s89C(2) (with some exceptions)), or, in respect of a taxpayer initiated Notice of Proposed Adjustment, the Commissioner is deemed to accept the taxpayer's position (s89H(2));
 - (ii) if the Commissioner fails to meet the timeframe for a disclosure notice or a statement of position the Commissioner is deemed to accept the taxpayer's position (s89M(2), s89M(7));
 - (iii) if the taxpayer does not opt-out within the response period the sanction is they must proceed through the disputes process (absent any other provision in s89N applying to curtail that process);
- (c) Legislated conference (s89LA) including:
 - (i) The general purpose of a conference, and providing that at least one meeting is required (s89C(2));
 - (ii) How a conference ends (important for the "response period" changes above), which consistently provides that at least one meeting is required (s89LA(4));
 - (iii) How a conference extends (s89LA(3));
 - (iv) Providing for an extension of the statutory time bar when conference is occurring if it is extended, but note that this needs to be accompanied by changes to UOMI (s89LA(5)) and link to the unilateral elective opt-out (s89LB(2)) – *note that while a legislated conference is considered preferable and can be very easily achieved the Societies can work with officials to adapt this drafting for a conference which is not legislated;*

- (d) Unilateral elective opt-out (s89LB and s89N(1)(x)), including requirement that an election cannot occur unless a conference has been held and all information requests issued prior to the conference have been met (s89LB(2));
- (e) Limitation of the Commissioner to specified of grounds of assessment if an opt-out occurs (be that under s89LB or s89N(1)(c)(viii)) (s89LB(4)) and ability to expand those grounds with Court order (sections 89LB(6)-(8));
- (f) Limitation of taxpayer to grounds in Notice or Statement of Claim if an opt-out occurs (be that under s89LB or s89N(1)(c)(viii)) (s89LB(5));
- (g) Amendments to s89O (test cases) (note that drafting for the test case panel has not been provided, and is for discussion with officials), and sections 89M(8) and (9) affecting taxpayer initiated disputes (which appear as s89M(9) and (10) in the attached) per the comments at paragraph 2.6 of the Societies' letter, and miscellaneous amendments such as those to s138B to ensure that if an assessment is issued in accordance with s89C(db) by the Commissioner in the absence of a NOPA, the taxpayer need not issue a NOPA to be able to challenge such an assessment.