

9 May 2016

Public Consultation
Inland Revenue
PO Box 2198
Wellington

By email: public.consultation@ird.govt.nz

QWB00085: The period for which a private or product ruling applies

1 Introduction

1.1 The New Zealand Law Society (Law Society) welcomes the opportunity to comment on Exposure Draft *Question we've been asked QWB 00085 – The period for which a private or product ruling applies* (draft). The Law Society considers that some aspects of the draft undermine the policy of the binding rulings regime in Part 5A of the Tax Administration Act 1994 (TAA) and also appear to be contrary to relevant statutory provisions. It is recommended that the draft is either withdrawn or significantly reconsidered.

2 Comments

Overview

- 2.1 The draft states that where an arrangement has a term or expected life of more than three years, the Commissioner will generally rule for a period of three years from the date of issue of the draft or final ruling.¹ The Law Society submits a binding ruling ought to apply to the whole of an arrangement, regardless of its duration. This accords with the underlying policy of the binding rulings regime and the relevant provisions to give effect to the requirements for certainty of tax treatment for “an arrangement”.
- 2.2 The binding rulings regime is a significant contributing feature to the effective operation of the New Zealand tax system. It is the only mechanism by which a taxpayer can obtain certainty in relation to the Commissioner’s application of the tax law to that taxpayer’s arrangements.
- 2.3 Obtaining a binding ruling is however an expensive and sometimes protracted process. Setting a maximum of three years for an arrangement that has an expected life of more than three years seems arbitrary, and unreasonable from a cost and administrative point of view. Substantial time and cost may be involved in applying for the original ruling, and it would be burdensome to repeat those compliance costs seeking a re-issue of the ruling. In addition, the individuals who worked on the application for the original ruling (both within Inland Revenue and the taxpayer) may have moved on and new staff will lack the background knowledge supporting the original ruling. In some instances, the taxpayer’s new employees may not even be aware of the need to apply for a re-issue of the ruling. This could lead to unfairness if the tax treatment that was agreed in the original ruling is no longer afforded to the taxpayer because the original ruling has expired while the arrangement continues to apply.

¹ Paragraph 3(b)

- 2.4 Taxpayers often place great value on binding rulings and, within the statutorily prescribed limits, taxpayers should be entitled to the benefit of a binding ruling when entering into significant and often complex arrangements. Limiting the duration for which a ruling obtained under that process will apply risks undermining the efficacy of that regime.
- 2.5 An arbitrary three-year time limit on the period for which rulings will be provided both undermines the certainty for which the rulings regime was enacted and may also be contrary to the provisions governing that regime. The Law Society considers that the Commissioner should not adopt the time limits for the period of issue of binding rulings as set out in the draft.

Arrangements

- 2.6 The draft explains the Commissioner's proposed practice of limiting the length of the term of a private or product ruling to a lesser period.² The draft states:³

"the legislation does not specify what that period should be. This is left to the discretion of the Commissioner."

- 2.7 Such an approach is arguably contrary to the purpose of the binding rulings regime. That purpose is explained in section 91A of the TAA as:

"to provide taxpayers with certainty about the way the Commissioner will apply taxation laws".

- 2.8 There appears to be no justification for imposing an arbitrary limit on the duration of any ruling to a period less than the duration of the arrangement. Doing so would expose taxpayers to uncertainty regarding the Commissioner's interpretation and application of the tax law to the remainder of that arrangement.
- 2.9 It is incorrect to state that the duration of the ruling is "left to the discretion of the Commissioner". As outlined below, the duration of the ruling should properly be determined by the duration of the arrangement to which it applies.
- 2.10 Under Part 5A, a ruling (whether a private or product ruling) is required to be made with regard to how a tax law applies (or would apply) **to an arrangement**: see sections 91E and 91F. Consistent with its usual meaning under the taxation Acts, the term "arrangement" extends to "*a contract, agreement, plan, or understanding whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect*".⁴
- 2.11 An "arrangement" is therefore defined widely and includes:

- All steps and transactions by which it is carried into effect;
- Unilateral arrangements;
- Two or more documents or transactions together if they constitute a single "agreement, contract, plan or understanding";
- Steps or transactions carried out or brought into effect outside of New Zealand.

There is also an extended definition of "arrangement" for private and product rulings which includes facts which the Commissioner considers material or relevant as background or context to the ruling.

- 2.12 That definition equally embraces a "proposed" arrangement. This interpretation is reinforced by the wording of section 91E(5) and the limitation contained in section 91E(4)(b). The former provision

² Paragraph 3(b) and 3(g)

³ Paragraph 2

⁴ See s 3(1) Tax Administration Act 1994

precludes the Commissioner from making a private ruling (before the dates which are specified in the section) on an arrangement if it was entered into before the date the application for the ruling was received. However, the latter provides that matters which are being “seriously contemplated” can also be the subject of a binding ruling.

- 2.13 The language of sections 91E and 91F contemplate that a binding ruling applies to the **entire term** of the arrangement. These sections specifically state that the ruling shall apply “**to an arrangement**”, i.e. the whole of that arrangement, including its temporal element, and therefore presumably to its full term. This interpretation calls into question the view expressed in the draft that it is possible to provide a ruling limited to just three years of the arrangement. As set out above, the definition of “arrangement” includes “all steps and transactions by which it is carried into effect”. The words “includes all steps ... and carried into effect” denotes that an arrangement continues until all steps have been completed.
- 2.14 It is therefore submitted that the duration of the ruling is not, as a matter of law, “left to the discretion of the Commissioner”. Rather, the appropriate duration of the ruling is properly determined by the term of the arrangement ruled upon. Accordingly, there is no statutory power to limit the length of the term of the ruling to a period shorter than the actual term of the arrangement (as is proposed by paragraphs 3(b), (d), (e) and (f) of the draft). Any such shorter period would not apply to “the arrangement” but only to part of the arrangement, which is not provided for under the applicable sections.
- 2.15 The draft justifies the shorter period on the basis that:⁵

“a period of three years is a reasonable balance between the relevant matters set out above, particularly the desire to provide certainty to applicants and the risk of the Commissioner’s interpretation changing over time”.

- 2.16 This “balance” is unnecessary as there is no basis in law for the Commissioner to give a private or product ruling for a term less than the actual duration of the arrangement.
- 2.17 The draft relies on section 91EH(1)(d) for Private Rulings and s 91FB(1)(b) for Product Rulings, which provide that a ruling will apply for a prescribed period. However, those administrative rules merely give effect to the substantive powers to make rulings with respect to “an arrangement”. It appears that those provisions alone do not authorise the Commissioner to make a ruling with respect to only part of the duration of an arrangement.
- 2.18 As arrangements may exist for varying lengths of time, those provisions allow the Commissioner to tailor the duration of the ruling to that of each arrangement – it does not allow the Commissioner to issue a ruling for a fixed period that is less than the duration of that arrangement. The provisions are merely mechanical in nature and the Law Society submits it would be wrong to interpret them as creating a separate discretion over the duration of a ruling.
- 2.19 Implicit in the draft is the desire to preserve the right to change the Commissioner’s interpretation of the law part-way through the duration of an arrangement. Such a change is obviously to the detriment of the taxpayer, who may have entered into the arrangement based on the interpretation contained in the original binding ruling. To change interpretation in this way after three years would result in the Commissioner applying different and inconsistent interpretations to the same “arrangement”, contrary to sections 91D and 91E.

⁵ At para 3(b)

2.20 The Law Society’s interpretation is also supported by two further provisions within the rulings regime:

- Section 91DE(4A) and s 91EI(3) provide the Commissioner may withdraw a ruling – but only with respect to arrangements entered into after the ruling was withdrawn. By contrast, for arrangements entered into before the ruling is withdrawn, “the ruling continues to apply”, as provided by s 91DC(4A)(b) and s 91EI(3)(b). Those provisions recognise that taxpayers may have entered into an arrangement in reliance on the certainty provided by the former ruling. Accordingly, both provisions ensure that certainty will continue to apply to existing arrangements even if the Commissioner’s interpretation of the law subsequently changes. To do otherwise would undermine the efficacy of the binding rulings regime.
- Section 91G provides that a ruling will cease to apply if the applicable tax law is repealed or amended. Obviously if the underlying statutory provisions are changed, the ruling is invalidated. Accordingly, the concern about balancing certainty against “the risk of the Commissioner’s interpretation changing over time” cannot be justified if that change results from legislative reform. Any “change in interpretation” would therefore arise only from subsequent case law. However, Parliament has chosen not to provide the Commissioner with a right to withdraw a ruling on that basis. Accordingly, the draft should not be used to indirectly introduce such a power into the binding rulings regime.

Relevant factors to be taken into account

2.21 Paragraph 2 of the draft sets out the relevant factors that the Commissioner will take into account when deciding on the appropriate period for the ruling.

2.22 One factor is the need for “consistency and fairness as between different ruling applicants”. This is not a valid factor to take into account when considering the duration of a ruling. Each arrangement will differ in duration, and it is therefore unnecessary to apply a uniform timeframe to ensure “fairness” to other taxpayers. There appears to be nothing in the statute which permits the Commissioner to exercise her powers in this manner. Rather, the duration of the ruling ought to be determined solely by the duration of each taxpayer’s underlying arrangement, which preserves consistency for all taxpayers given that the framework of the Act already provides for changes in the law (on a prospective basis).

Timeframes

2.23 Notwithstanding the submissions above, the Law Society comments on the timeframes provided in paragraph 3 of the draft (which set out the Commissioner’s proposed practice in determining the period for which a ruling shall apply).

Paragraph 3(a)

2.24 Where an arrangement is expected to last less than three years, the Commissioner will issue a ruling for a period that is the exact term or expected life of the arrangement. Where there is uncertainty regarding the date of implementation or the length of the term of the arrangement, the period may be extended. The length of time for which the ruling will be extended should be clarified. In particular, it would be helpful to know the maximum time limit for which the ruling may be extended. It would also be helpful to know whether a new application has to be made for the extension of time or whether the longer duration will be given at the time of the original application.

Paragraph 3(b)

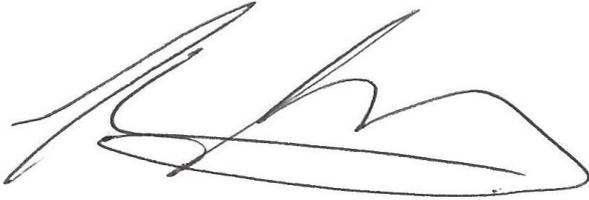
2.25 Where an arrangement is expected to last more than three years, the draft provides that the Commissioner will “generally” rule for a period of three years (from the date of issue of the draft or final ruling). The draft does include some allowance for periods of longer than three years (for example, a fixed life of three years and six months: paragraph 3(d)) however, it is unclear when the

Commissioner will agree to the extended period or what considerations will be taken into account in coming to that decision.

3 Conclusion

- 3.1 This submission was prepared with the assistance of the Law Society's Tax Law Committee. If you wish to discuss this further, please do not hesitate to contact the committee convenor Neil Russ, through the committee secretary Jo Holland (04 463 2967 / jo.holland@lawsociety.org.nz).

Yours faithfully

A handwritten signature in black ink, appearing to be 'Kathryn Beck', written in a cursive style.

Kathryn Beck
President