



**Tax Working Group Information Release**

**Release Document**

**February 2019**

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*The advice represents the preliminary views of the Independent Advisor and does not necessarily represent the views of the whole Group or the Government.*

*Some papers contain draft suggested text for the Final Report. This text does not constitute the considered views of the Group. Please see the Final Report for the agreed position of the Group.*

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- [3] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions;
- [4] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice.

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## Small value disputes

The Group is considering whether or not there should be some form of truncated or reduced set of rules for either disputes of low value or those involving small businesses. The concern is that the complexity of the rules involve disproportionate expense to small taxpayers with the effect that they pay the tax rather than dispute it. (burn off)<sup>1</sup>

Inland Revenue has noted that there is similar burnoff at their end with small value disputes.

**In my view the best option is to get the Tax Advocate service up and running and then seek advice from them as to potential improvements. Officials agree that this approach merits consideration.**

However if the Group does wish to go further I have some possible suggestions which mostly involve minor tweaks to the existing processes and law. I do, however, return to the Group's advice in the interim report of the importance of *deep and significant technical capability across ... investigation staff*.

I have focused on the situations where taxpayer burnoff is suboptimal. That is either where the Department's application of the law is actually wrong or it situations where the law is unclear.<sup>2</sup>

### **Inland Revenue is wrong**

The cases where Inland Revenue is incorrect in pursuing disputes tend to involve one or all of the following factors:

- Complex law;
- Inexperienced, junior or poorly supported investigators;
- Inadequate or incomplete responses from taxpayers to initial inquiries.<sup>3</sup>

### ***Complex law***

It is no longer difficult for some of the more complex pieces of legislation such as the financial arrangements, land sales, associated person, foreign investment fund and double tax agreements to apply to relatively low level economic activity.<sup>4</sup>

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<sup>1</sup> From reading the 2008 NZICA/NZLS paper I note that these are the same concerns of the 1994 Richardson Committee which lead to the introduction of the current rules.

<sup>2</sup> I have not considered situations where the taxpayer is legally wrong, doesn't like the outcome but would pursue it if they had more resources.

<sup>3</sup> These factors can often be addressed at the conference stage when a senior technical person within the department reviews the case and acts as a facilitator potentially with a view to settling the case. However at that stage both the Department and the taxpayer have expended significant resource.

<sup>4</sup> That is owing a foreign holiday house, small scale property development or receiving a foreign pension.

With a few exceptions, broadly these rules apply to all transactions large and small, often with quite significant tax effects as to whether the rules apply or not. The reason for relatively uniform application is to not create boundaries between large and small transactions or taxpayers.

In my view this will be the key aspect where Inland Revenue incorrectly takes cases. However it will be exacerbated by the next two factors.

### ***Inexperienced, junior or poorly supported investigators***

In such cases an investigator won't understand that what might intuitively seem like the wrong result is in fact technically correct. Examples could include:

- If the FIF rules applied; a foreign pension shouldn't be returned or
- Interest income was netted off within a financial arrangement calculation.

Although all of this can equally work the other way and cases are not taken where they should be.

The Group has already addressed this in its interim report with its recommendation that:

*Inland Revenue must continue to invest in deep and significant technical capability across its investigation staff.*

Perhaps the Group could stress this again in the final report as a mechanism of ensuring cases are not taken incorrectly as well as ensuring that all correct cases are taken.

### ***Inadequate or incomplete responses from taxpayers to initial inquiries***

In such cases taxpayers or their agents, potentially out of fear of the Department, may choose to bluster rather than directly address an investigator's queries. Such behaviour in turn can make an investigator think the taxpayer or agent is hiding something and then look to escalate the dispute.

To the extent that the taxpayer, or agent, is right that the tax paid is correct but they are not confident of the technical arguments, the Group's recommendation for a Tax Advocate to assist small taxpayers resolve disputes will be helpful here. Also the suggestions discussed below could also be useful in this situation.

### **Grey areas**

There are also situations which are highly fact based such as capital/revenue, permanent place of abode, or anything involving intention where none of the above apply; it is just

simply that the Department and the taxpayer have different views on how the law applies to the facts.<sup>5</sup>

In those cases, particularly if they involve precedent Inland Revenue will be better resourced than the taxpayer to conduct the dispute. Having the taxpayer concede due to lack of resources may not give the right outcome from a public policy perspective.

### **Possible tweaks to the existing processes**

While the Tax Advocate service will better level the respective resources there are also other options that could be considered:

- 1) Expansion of the threshold<sup>6</sup> for a Commissioner issued Notice of Proposed Adjustment.<sup>7</sup> Currently it is \$5,000 of tax at stake. This could be raised to \$10,000. A simpler document from the Commissioner could help taxpayers better understand what the issue was and provide an additional incentive for the Department to be succinct.
- 2) Extension of the response period by the taxpayer once the NOPA has been received. Currently it is two months. While it would seem counterintuitive to allow small disputes longer to respond than large disputes; to the extent these are taxpayers (and agents) who are not experienced with the process extra time would give them a better chance of producing their facts and discussion of the law in a compelling way. This could be in conjunction with using the Tax Advocate service.
- 3) Extending the threshold for allowing taxpayers to truncate the dispute and go to Court. One of cases for Commissioner agreement is that the tax at stake is \$75,000<sup>8</sup>. This could be increased further to say \$100,00 or \$150,000 without any loss of credibility in the process.

However, in my view, these options are second order compared to the Tax Advocate and well trained investigation staff. My recommendation is that the Group focus on those two aspects in its final report for the timely resolution of small value disputes.

**Andrea Black**

19 October 2018

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<sup>5</sup> Where the Department's position is considered to be contrary to the underlying policy; representations can be made to Policy officials and the Revenue Minister for a law change. This occurred with the debt capitalisation issue in 2014.

<sup>6</sup> Paragraph 79 <https://www.ird.govt.nz/resources/4/4/4490832d-e2fe-4ad3-a4b5-0ad965fe97b7/sps-16-05-disputes-resolution-commenced-commissioner.pdf> This is an administrative threshold only. That is it is not in the law but something the Department has agreed to do.

<sup>7</sup> A notice of proposed adjustment is the first document of the formal dispute process. There can, however, be extensive communication and discussions before this document is issued.

<sup>8</sup> Paragraph 167 <https://www.ird.govt.nz/resources/4/4/4490832d-e2fe-4ad3-a4b5-0ad965fe97b7/sps-16-05-disputes-resolution-commenced-commissioner.pdf>