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This paper contains advice that has been prepared by the Tax Working Group Secretariat for consideration by the Tax Working Group.

The advice represents the preliminary views of the Secretariat and does not necessarily represent the views of the Group or the Government.

Coversheet: Collection of tax debt

*Background Paper for Session 14 of the Tax Working Group
20 July, 2018*

Purpose of discussion

This background paper is for the Group's information. It:

- Provides an overview of Inland Revenue's position as an administrator of the tax system and as a creditor collecting outstanding debts, including some of the issues that Inland Revenue encounters as a creditor;
- Provides a brief analysis of potential collection tools previously presented to the Group;
- Provides a brief analysis of collection tools administered by other New Zealand government agencies; and
- Explores the current utilisation of taxpayer-provided financial statements and IR10s.

Key points for discussion

- Does the Group agree with the Secretariat's overall judgment that the collection of tax debt can be challenging and that more compliance tools are required to meet these challenges?
- Does the Group agree with the Secretariat that a collection tool that pierces the corporate veil is the most promising opportunity to further improve Inland Revenue's collections capability?
- Is there any further information or advice that the Group would like?

Recommended actions

We recommend that you:

- a note** submitters suggested the Group look at further pursuing policy and operational opportunities that will allow for greater efficiency in crown debt collection.
- b note** there are potential compliance tools available that may increase tax debt recovery and decrease inequities in crown debt collection, including a new compliance tool to pierce the corporate veil.

- c note** the work being done to improve information collection from taxpayers.
- d indicate** what the Group would like to include in the interim report about tax debtors and the options for improving Inland Revenue's compliance capability.

Collection of tax debt

*Background Paper for Session 14
of the Tax Working Group*

20 July 2018

Prepared by the Inland Revenue Department and the New Zealand Treasury

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Executive Summary

This paper outlines some of the issues and challenges in collecting unpaid tax debt in New Zealand and potential solutions to these challenges.

The paper provides a short summary of the types of taxpayers that are likely to owe tax debt. Rather than just imposing punitive sanctions, some of these taxpayers would be better served with tailored assistance and support to help them comply. However, there are other non-compliant taxpayers that would be resistant to this assistance and support and consequently require a much more intensive response.

This paper also looks at Inland Revenue's risk-based Prevent, Assist, Recover and Enforce Model, used to effectively manage New Zealand's tax debtors by segmenting taxpayers based their compliance history. This segmentation helps identify the most effective compliance intervention for particular taxpayers to effectively encourage them to comply.

The paper describes several potential new compliance tools that would help resolve identified gaps in Inland Revenue's range of collection tools. Some of these potential compliance tools are effective in other tax jurisdictions and may be suitable for New Zealand. The paper also describes some ideas and initiatives that may not be suitable due to the current design of New Zealand's tax system.

From the Secretariat's perspective introducing a new collections tool that can pierce the corporate veil (similar to Australia's director penalty notice) and impose personal liability on directors is the most promising opportunity to further improve Inland Revenue's collections capability. Currently, company directors and shareholders are able to incur significant amounts of PAYE and GST debt without placing their personal assets at risk. While a collection tool of this nature should be used in a targeted way, the ability for Inland Revenue to pierce the corporate veil will provide a strong motivation for directors to remain tax compliant.

The paper also discusses the IR10 form used by Inland Revenue to collect detailed financial information from all business taxpayers and the current utilisation of taxpayer-provided financial statements. The paper notes that Inland Revenue's Business Transformation may provide new information channels and analytic capability to better utilise this information.

1. Introduction

1. The Group has asked for information regarding the challenges of collecting tax debt, including an analysis of potential collection tools to further enhance Inland Revenue's (IR) tax debt collection efforts.
2. This paper:
 - Provides an overview of the challenges IR encounters as both an administrator of the tax system and a creditor collecting outstanding tax debts;
 - Provides a brief overview of potential collection tools, including those previously presented to the Group;
 - Provides a brief analysis of collection tools administered by other New Zealand government agencies; and
 - Explores the current utilisation of taxpayer-provided financial statements and IR10s.
3. Submissions made to the Group proposed the Group consider a centralised Government debt collection agency, in order to improve overall better efficiency and minimise inequities between individuals that owe debt to different government agencies.
4. A core component of any modern and well-functioning tax system is the efficient collection of taxes. Alongside the Commissioner of Inland Revenue's (the Commissioner) duties of maintaining the integrity of the tax system¹ and collecting over time the highest net revenue that is practicable within the law², the Commissioner is required to maximise the recovery of outstanding tax from indebted taxpayers. This is until the point where the recovery would be an inefficient use of the Commissioner's resources or where the recovery would place a natural person taxpayer in serious hardship³. The Commissioner's debt collection decisions need to meet all of their statutes, duties and obligations.
5. There is potential merit in exploring new opportunities to more effectively respond to tax indebted taxpayers. These opportunities include:
 - more effective compliance tools, including the ability to pierce the corporate veil in order to respond to directors who are unfairly using their companies to avoid PAYE obligations;
 - broader range of sanctions, focused around mid-range offences where an administrative penalty is insufficient and criminal sanctions are too punitive; and
 - greater information sharing and cooperation between agencies that have common debtors or customers.

¹ Section 6 Tax Administration Act 1994

² Section 6A Tax Administration Act 1994

³ Section 176 Tax Administration Act 1994

2. Collection issues

6. More than 85% of taxpayers file and pay on time (Inland Revenue Department, 2017) which in turn funds New Zealand's vital public services. A small minority of taxpayers do not comply and seek to minimise their tax obligations. Effectively responding to these non-compliant taxpayers maintains the integrity and public confidence in the tax system.
7. For many compliant taxpayers they want to see the tax system being administered fairly with agreed community standards of behaviour and sanctions for when taxpayers operate outside those community standards. Seeing IR respond to these infractions by subjecting non-compliant taxpayers to appropriate sanctions, bolsters their belief that the tax system is fair and equitable. Trust and fairness in New Zealand's institutions is a key element of New Zealand's social capital.
8. However, in the course of effectively responding to these non-compliant taxpayers there are several issues that the Commissioner encounters that a typical commercial creditor does not. Some issues have potentially effective solutions that could result in fewer tax debtors, while other issues are a consequence of the principles and mechanisms required for an effective and proportionate tax system and changing these in order to resolve the identified issues is not warranted.
9. One of the most significant issues is that the Commissioner is an *involuntary creditor*, which means it is the taxpayer that decides whether the Commissioner effectively becomes an unpaid creditor of their business. The taxpayer is legally required to pay their tax on time and comply with all other obligations imposed them. In practice taxpayers do not generally inform or consult with IR prior to making this decision and usually the first communication about a tax debt is from IR to the taxpayer notifying them of their non-payment.
10. While some commercial entities such as utility and telecommunication providers can also become involuntary creditors, these entities have a far greater flexibility in deciding who becomes a customer and importantly whether they continue to be a customer. IR cannot prevent individuals from entering into business and incurring tax debt and consequently IR must take a longer term view on encouraging taxpayers to comply.

Taxpayer rights

11. Another challenge relates to how tax debts arise under New Zealand's tax system. Most creditors establish a commercial debt when they document the transaction and the amount in an invoice. In contrast, there can be a significant time difference between when a tax liability arises and when the debt is confirmed by IR.

This can be because:

- a tax return is voluntarily submitted sometime after the end of the tax period; or
- in the absence of a return, IR has expended significant effort, firstly in encouraging the taxpayer to comply and file their tax return and then potentially

issuing a default assessment. In some cases, it can be several months or in extreme cases even years before a return is filed.

12. Additionally, the taxpayer is entitled to several safeguards under the Inland Revenue Acts, including:
 - formally disputing the Commissioner's alternative view of their tax assessment. It can be several months or years before a tax dispute is concluded and consequently there may be no funds remaining to resolve the disputed tax liability; or
 - request tax debt relief and review of their financial circumstances consideration for serious financial hardship (including waiting for the taxpayer to provide their financial information to support their request). IR is required to review their circumstances before continuing debt collection activities.
13. These rights and safeguards are an important and highly valued area of New Zealand's tax system and while their removal would likely increase tax debt collection; overall it is unlikely that the integrity of the tax system would be improved by their removal.

Managing tax debtors

14. Another challenge relates to the number of indebted taxpayers IR is required to manage and resolve. While there are a large number of taxpayers that file and pay on time, many do not and it is IR's responsibility to encourage these taxpayers to comply (Inland Revenue Department, 2017).

To give some guidance to the size of tax debt administered by IR, for the fiscal year 30 June 2017:

- outstanding debt: PAYE debt: \$309.7 million, GST debt: \$825.6 million, income tax \$1.5 billion;
 - collected \$7.3 billion of tax debt;
 - closed over 150,000 cases of new debt from 7 February and 7 April terminal tax payment due date; and
 - closed over 85% of debt cases within six months.
15. While it would be optimal for IR to actively case-manage each non-compliant taxpayer, this approach is not practicable given the limited resources available to the Commissioner. IR is required to make a risk assessment of each taxpayer and apply its limited resources to maximise recovery and maintain the integrity of the tax system (Auditor General of New Zealand, 2009).

Compliance Model and Right from the Start

16. The purpose of IR's Compliance model⁴ is to help better understand the drivers and behaviours of taxpayers in order for IR to develop effective strategic and operational

⁴ Launched in March 2015.

responses to these (such as targeted information, compliance tools and activities) (Inland Revenue Department, 2015).

17. At the core of the model are the three factors that form taxpayer behaviour:
 - capability – a taxpayer’s knowledge and understanding of the tax rules, to assist them meeting their tax obligations;
 - motivation – a taxpayer’s willingness to comply, including social norms and personal beliefs; and
 - opportunity – the ease for the taxpayer to comply or not to comply.
18. Importantly, the Compliance model places a strong emphasis on IR understanding the taxpayer’s perspective of the tax system rather than a focus on tax enforcement. Unlike the earlier ‘*compliance pyramid model*’, the new compliance model better recognises that most taxpayers are voluntarily compliant and that they are more likely to remain compliant if they are given the right tools and assistance.
19. Underpinning the compliance model is an OECD tax administration concept of *Right from the Start*. This model identifies that the most effective way of addressing tax compliance risks is by proactively influencing taxpayer behaviour up front, through early interventions. This involves providing easy-to-follow advice and proactively fixing simple mistakes or errors before the tax return is finalised. Taking this supportive and proactive approach (rather than reactive once an issue has been discovered) will reduce opportunities for taxpayers to become non-compliant (OECD, 2012).
20. The development of any tax compliance tool needs to effectively grow a taxpayer’s capability, reduce their motivation to non-comply and reduce their opportunity to non-comply.

3. Types of non-compliant taxpayers

21. Almost all of IR's tax indebted taxpayers can be classified into three broad groups – 1) *disorganised*, 2) *can't pay* and 3) *won't pay*. Placing taxpayers into these three groups helps understand their drivers and behaviours and easily pair an appropriate response to effectively encourage them to comply.
22. Along with these groups, it is important to remember that there are conscious and unconscious dimensions of non-compliance. A taxpayer's compliance may be the result of conscious decisions about non-compliance, or less conscious considerations. In some cases the taxpayer may have little awareness that their motivations will lead them to being non-compliant.
 - 1) *Disorganised*:

Are confused or disengaged taxpayers that are close to being voluntarily compliant, but have a general apathy towards improving their tax compliance or feel discouraged to try and comply. They may have a poor understanding of their tax requirements and/or have underdeveloped business processes. Their business (or the business owner) may have reached the point where they need the services of a bookkeeper or tax accountant. Sometimes these taxpayers routinely file and pay late, but a reminder from IR is enough to reverse their non-compliance.
23. An appropriate response is to provide support, education and assistance to increase the taxpayer's capability and knowledge and make it as easy as possible for the taxpayer to comply. These taxpayers are not looking to actively avoid their tax obligations, in so much as they need to apply more effort and prioritise their tax obligations⁵. A simpler tax administration system will allow these taxpayers to view their compliance obligations as less burdensome.
 - 2) *Can't pay*:

Are taxpayers that are not in a financial position to pay their tax obligations. These taxpayers want to pay their tax, but they do not have the funds to do so. It is likely that these taxpayers are operating a business that has experienced a temporary shock (such as a new competitor or poor harvest), or is permanently failing and is unlikely to financially recover. It is possible the business owner has several other creditors who may not be aware of the full extent of the business's insolvency.
24. An appropriate response is for IR to actively manage the situation early on and have a clear conversation with the business owner about their business as a going concern⁶. These interventions are likely to reduce the risk to IR and also the risk to the business's other creditors, by encouraging them to restructure part of their

⁵ Typical interventions include easy payment options (including direct debiting), service-driven measures such as filing and payment due date reminders and outbound calling campaigns.

⁶ Typical interventions include directly contacting the taxpayer and enquiring about their non-compliance, offering payment arrangements (instalment arrangement), considering waiving some or all of the tax debt due to the taxpayer's particular circumstances.

business, explore new lending opportunities or conduct an ordinary wind-up of their business. In extreme cases, IR would petition the courts to place the taxpayer into bankruptcy or liquidation.

25. Imposing financial penalties on these taxpayers is unlikely to encourage them to comply because they cannot afford to pay the original tax debt. In some circumstances, IR is likely the only creditor with the resources to place the taxpayer into bankruptcy or liquidation.

3) *Won't pay:*

Are risk-takers, adversarial or criminal taxpayers that have the funds to pay their tax debts, but just chose not to. These taxpayers will challenge any attempts to resolve the tax debt, and often be intentionally evasive and deceitful. These taxpayers may file inaccurate tax returns, not pass on employees PAYE deductions or seek refunds they are not entitled to. These taxpayers require greater effort and resource to effectively respond to and resolve⁷.

26. It is important to effectively address the behaviour of this group, because their success will undermine the fairness and integrity of the tax system, as well as taxpayers' perception of the fairness and integrity of the tax system. Viewed from a Living Standards Framework, this can lead to a decrease in social capital. Non-payment of tax can also lead to economic distortions. For example, if suppliers of goods and services do not pay their tax, they effectively have a competitive advantage over suppliers who do pay their tax.
27. An appropriate response to these taxpayers is deterrence through increased visibility of their commercial activities, civil penalties and in severe cases, criminal prosecutions that may result in a custodial sentence⁸.
28. It is critical that IR does not mistake *confused* or *can't pay* taxpayers for *won't pay* and criminal taxpayers, as this misidentification will result in IR imposing sanctions that are not proportionate to the taxpayers true intent and behaviour.

The Prevent, Assist, Recover and Enforce (PARE) model - Inland Revenue's approach to managing tax indebted taxpayers

29. The PARE model is IR's approach to managing tax debtors (Appendix one)⁹. This model recognises that a standardised debt management approach across all tax indebted taxpayers will not always deliver an optimal outcome. The PARE model segments taxpayers based on their tax compliance history and helps identify the most effective interventions to improve the taxpayer's compliance (Inland Revenue Department, 2010).

⁷ Typical interventions include: In some cases, a garnishee notice (known as a deduction notice) may be used to require a third party to transfer taxpayer-owned funds directly to IR (i.e. employers or banks).

⁸ Typical legal interventions include initiating insolvency proceedings, taking securities over property in lieu of significant Pay-As-You-Earn arrears, prosecuting deliberate attempts by taxpayers to evade their tax liabilities.

⁹ Developed by IR and supported by the International Debt Management Committee.

30. Previously successful tax debt collection strategies have avoided a one-size-fits-all approach and have encompassed a mix of traditional tax debt enforcement as well as other measures. Applying a differentiated or risk-based approach will avoid low risk businesses being over-penalised. Advanced risk analytics in combination with behavioural insights can support the segmentation of non-compliant taxpayers (OECD, 2012).
31. Recently, IR was recognised for its customer-centric approach to managing debt when it was awarded the ‘Improving public value through Business Transformation’ category at the 2016 Deloitte IPANZ Public Sector Excellence awards.

4. Potential new collections tools and measures

32. On the 20 April 2018, the Group discussed a range of potential tax debt collection tools and measures, that if implemented could improve the effectiveness of IR's tax debt collections. These are further explored below. These items are divided into three broad categories:
- 1) piercing the corporate veil and attributing liability to other individuals;
 - 2) increased criminal enforcement and criminal offences; and
 - 3) other potential items.

Piercing the corporate veil and attributing liability to others

33. A growing issue is directors and shareholders using company structures to incur significant Pay-As-You-Earn (PAYE) and other tax arrears. These directors are conscious that the two important concepts of New Zealand company law (*corporate veil* and *limited liability*) will very likely ensure the debt stays ring-fenced in the company and prevent any recovery against their personal assets.
34. While the legal concept of the corporate veil and limited liability allows for appropriate risk-taking for shareholders (by enabling shareholders to operate a business without risking their personal assets), some individuals are taking advantage of these concepts to circumvent their tax obligations.
35. A potential response to this behaviour is to "look through" the corporate veil. While "looking through" the corporate veil should not be taken lightly, we consider that there are some good reasons to deem a company director and/or shareholder to be personally liable for a company's unpaid PAYE debt in certain situations.
36. One submitter to the Group highlighted that other OECD jurisdictions (including Australia, United Kingdom, and Canada) have the ability for direct recourse against directors of companies who default on their employee tax deductions and that New Zealand too needs a similar compliance measure to address inequities within the tax system, as well as return greater revenue to the Government.
37. The Secretariat agrees with the submitter and believes this is one of the most significant limitations in IR's compliance regime. Given the impact this measure can have on directors, it would need to be used in a targeted way, and ensure directors are given the opportunity to resolve the company debt, before Inland Revenue imposes personal liability on them.
38. As noted above, for nearly 25 years non-compliant directors in Australia have been subject to the *Director Penalty Notice* regime (DPN). The purpose of the DPN regime is to enhance the accountability of directors' of companies that fail to pass on employee deduction payments to the ATO by looking through the corporate veil and making the directors' personally liable for these arrears.
39. The DPN achieves this by introducing a 'director penalty' of equal amount of the company's unpaid Pay-As-You-Go (PAYG) withholding tax liabilities or

Superannuation Guarantee Charge and making the director personally liable for the director penalty¹⁰.

40. Once a director penalty notice is issued, the directors have 21 days to resolve the unpaid debts, or risk recovery and enforcement action against the director penalty. The directors can either pay the penalty amount (therefore pay the original outstanding amount), settle the amount with the ATO, or place the company into voluntary liquidation (invalidating the penalty).
41. Where the return for the unpaid amount is filed with the ATO more than three months after the due date, a 'lockdown DPN' is issued, where the penalty can only be remitted by payment – voluntarily liquidation does not invalidate the director penalty. Importantly, the director has a defence to the penalty where they did not participate in the management of the company during the arrears period.
42. The DPN regime provides a strong motivation for directors to be tax compliant with its PAYG and social policy obligations. The employer is considered to be holding these funds 'on trust' for their employees and it's expected that these funds are held aside and paid to the ATO (Australian Tax Office, 2011).
43. In practice, the potential imposition of personal liability has resulted in encouraging directors to place their insolvent companies into voluntarily liquidation sooner rather than risk personal liability for company PAYG arrears.
44. In the absence of a compliance tool like a DPN, many directors would likely continue to trade and potentially incur further tax arrears, while the ATO or another creditor petition the courts to place the company into liquidation. Such a delay can often increase losses for all creditors.
45. However, a downside to DPNs is that some directors may feel that the risk of losing of some or all of their personal assets may be too much and consequently are less likely to pursue directorship roles. This would need to be weighed up against the potential benefits of looking through the corporate veil in limited circumstances, which include revenue integrity benefits for the tax system, and potentially reductions in risk for other creditors of the business.
46. Another potential response is the *Trust Fund Recovery Penalty*. This United States of America (USA) based regime operates in a similar way to Australian's director penalty notice, but the penalty can be imposed on any person in the business that is responsible for collecting and paying these funds and wilfully fails to collect or pay them¹¹ (United States of America, Internal Revenue Service, 2018).
47. To help determine liability, the Internal Revenue Service conducts taxpayer interviews to accurately determine who was ultimately responsible for the non-

¹⁰ If the company pays the underlying liability, or the director personally pays the director penalty, then the payment offsets both items, to avoid paying more than what was originally owed.

¹¹ These persons include directors, company officers, persons with payroll-related responsibilities and any persons that have control and authority over directing company disbursements.

payment and whether they were aware that these funds should have been paid to the IRS¹². Taxpayers can appeal to the courts if they disagree with the outcome (United States of America, Internal Revenue Service, 2018).

48. The trust fund recovery penalty is applied more broadly than Australia's DPN but requires additional administrative resources to accurately determine the party in the company who is ultimately accountable for the non-payment.
49. Increasing the ability for the *Commissioner of Inland Revenue* to 'look through' to directors and shareholders for the non-payment of PAYE and GST has been a continued area of focus for IR officials. If IR was to have this capability, then it is likely certain safeguards and thresholds would be required to ensure the power is appropriately exercised. These could include:
 - the inclusion of certain types of tax debt (i.e. deducted or withheld from employees and customers), and excluding other types such as unpaid income tax;
 - owing a minimum amount of qualified tax debt;
 - a 'notice' rule, similar to Australia's director penalty notice;
 - provide the director/company a time-bound opportunity to correct the non-compliance before enforcing the debt; and
 - provide broad discretion to IR for the timing and use of this measure, including consideration of the taxpayer's previous tax compliance behaviour, the taxpayer's personal circumstances and what stage the debt recovery process is at.
50. IR's Business Transformation (BT) programme is providing new opportunities for IR to effectively administer new compliance measures and as BT progresses, IR officials will be mindful of the potential opportunity to design and administer a director liability regime.

Criminal enforcement and criminal offences

51. While there are existing criminal offences (with custodial sanctions), these are focused more on addressing a taxpayer's willingness to evade their tax obligations, by under-declaring or non-filing their tax returns, rather than the non-payment of tax debt only. The main exception to this is the prosecution of employers that fail to pass on their employees PAYE deductions, as this can be treated as a form of evasion.
52. One option the Group discussed was increasing the *criminal penalties for failing to file a tax return*. These are currently imposed in three ways; 1) as an absolute liability with fine up to \$12,000, 2) a knowledge offence with fine up to \$50,000, or 3) an evasion offence with fine up to \$50,000 and/or imprisonment for up to 5 years.
53. Increasing the criminal penalty is likely to enhance its general deterrence effect and consequently may reduce non-compliance. However the number of taxpayers that

¹² Applying these funds to other debts is considered an indication of wilfulness.

ultimately receive a criminal conviction is low, due to the level of litigation resources required and the judiciary's views on imposing a custodial sentence for an unfiled tax return. Any changes in this area would need to align with the Government's overall criminal justice strategy.

54. Alternatively, an infringement notice measure could be more appropriate. Infringement offences are a subset of criminal offences that do not result in criminal convictions (New Zealand Legislation Design and Advisory Committee, 2018). Given the taxpayer has already incurred a monetary penalty without success, it is likely a non-monetary penalty would be required as a sanction because it is more likely to alter the taxpayer's behaviour.
55. Another option discussed by the Group was to *amend the criminal tax evasion offence for unpaid GST* and narrow the scope of acceptable behaviour to largely mirror the PAYE evasion rules¹³.
56. At a high level, the culpability threshold for unpaid PAYE is where the employer makes a PAYE deduction and they are aware that the funds should have been held aside and on-paid to IR, but instead they have applied the funds to something else (such as paying other creditors). Whereas, GST evasion has a higher threshold where the Commissioner needs to demonstrate that the taxpayer had the intention to evade the GST tax, instead of just demonstrating that the GST funds were collected and were not paid to IR. PAYE funds are well regarded as trust funds, whereas GST funds less so due to the differences between PAYE and GST (such as the mixing GST debits and credits).
57. Another idea that the Group discussed was Australia's *Departure Prohibition Order* (DPO) which can prohibit a taxpayer from leaving Australia until their tax liability is resolved (Australian Tax Office, 2011).
58. Because of the restrictions a DPO can place on a taxpayer's freedom of movement, there are very strict requirements on when the ATO can apply for a DPO from the courts. In practice, DPOs are only issued where there is a significant tax debt and the taxpayer is likely to leave Australia without resolving their unpaid tax liabilities.
59. In New Zealand, IR can apply to the New Zealand courts for arrest warrants¹⁴ (preventing individuals from leaving New Zealand) for tax evasion, student loan debtors and unpaid child support. A new tool like a DPO would likely be considered only where IR has attempted all other compliance measures. Significant consideration and analysis is required before a similar measure for tax debt could be considered for New Zealand, due to the considerable impact it has on affected taxpayers.
60. Importantly, the administration of a DPO would require the on-going cooperation with other government agencies such as NZ Customs. IR's BT programme is

¹³ Section 143B (d) of the Tax Administration Act 1994: knowingly does not make a deduction or withholding of tax required to be made by a tax law.

¹⁴ Where the taxpayer owes significant amounts of unpaid student loan and child support obligations.

providing new opportunities for IR to work together with other government agencies, towards shared outcomes.

Other potential ideas

61. As well, the Group discussed other ideas to improve tax debt collection, in addition to the ideas discussed above.
62. One idea presented was imposing a *withholding obligation on debit current accounts balances*. This in an effort to encourage directors of companies to retain funds in the company, leading to more company funds being available to be paid towards their tax obligations. One issue with this idea is that if the non-compliant taxpayer has chosen not to pay their tax liabilities, as well as deciding to distribute much-needed company funds to other creditors and shareholders, it is difficult to conceive that the director would change their compliance behaviour based on another tax obligation.
63. There is inherent unfairness if a withholding obligation was imposed on tax-compliant companies. The withholding tax funds would be paid to IR, included in the annual income tax square up and ultimately be refunded back to the taxpayer. This action would result in additional compliance costs (cost of filing returns and time value of money of paid withholding tax funds) for tax-compliant taxpayers, as well as administrative costs to IR, all while potentially delivering limited success against non-compliant taxpayers.
64. Another idea presented related to addressing issues with trusts with are non-compliant.
65. Currently, trustees are personally liable for tax arrears incurred by the trust. However, if the trustee is a company (corporate trustee), the trustee (in the form of the director) can place another layer of protection to their personal liability (limited by the corporate veil). The director of the company becomes the governing mind of the trust. As noted above, there are potential compliance tools that are designed to look through the corporate veil and impose personal liability on individuals, with similar treatment towards corporate trustees. Any future policy measures could give consideration to corporate trustees; ensuring corporate trustees are treated in the same way as stand-alone companies.
66. Recently, at Meeting 12 of the Group, the Group discussed a submission that raised an idea of New Zealand potentially creating a *single, centralised Crown debt collection agency*. The submitter argued that this centralised agency that would gain greater efficiencies and achieve more equitable outcomes across all crown debtors. The Group came to a provisional conclusion that work should continue to advance a joint agency.
67. Officials note that the idea of a centralised crown debt collection agency has been previously considered and viewed as having significant challenges. Combining fragmented agency systems, collection powers and operational policies would be

challenging. It is worth acknowledging that some crown debt is recovered differently, because the underlying reasons for incurring the debt are different (i.e. tax debt vs. court fines).

68. Although the idea has theoretical merit, officials believe the way forward is to develop better information sharing opportunities between government agencies and together develop a more consistent approach where agencies share common debtors or customers. These opportunities could achieve the stated efficiencies without the need for establishing an independent government agency. This cooperation could include developing shared strategies, for example between IR and the Ministry of Social Development.
69. The tax policy work programme has a number of prioritised projects and any additional compliance measures will be considered in line with those priorities. There are several items on the work programme that are seeking to improve taxpayer compliance. This includes developing an optimal tax regime to maximise compliance by addressing corporate fraud and evasion, and looking at policy options to address the underreporting of income and therefore under taxation of self-employed taxpayers.

Other government agency collection tools

70. Several other New Zealand government agencies have their own collection tools. In some cases, these tools are made possible due to their unique regulatory responsibilities (i.e. NZ Customs and goods moving across the border) or because of associated powers.
71. Under certain circumstances, NZ Customs can detain and seize the goods of indebted excise taxpayers, where the importer has incurred significant duties and excise arrears operating on a deferred payment scheme. These goods are either released once the outstanding duties have been resolved or they are sold to offset the outstanding debts. This collection tool is best applied to regular importers/exporters, which represent a relatively small number of active businesses¹⁵.
72. The Ministry of Justice has several options for collecting outstanding court fines, as well as civil debts. This includes bailiffs seizing property, issuing garnishee notices to third parties, sharing the debts with NZ credit reporters, overseas travel restrictions, wheel clamp motor vehicles and suspending driver licences (where the fines relate to traffic offences) (New Zealand Ministry of Justice, 2018). Additionally, where it's found that the taxpayer has the ability to pay, but all other enforcement options have been unsuccessful, a court judge can order the debtor to complete up to 200 hours of community work (New Zealand Ministry of Justice, 2018).

¹⁵ By value, New Zealand's top 100 exporters contributed 71% of the total exports, with top 100 importers contributing 48% of imports – 2011 NZ Stats.

73. One of the roles held by the NZ Police is administrating the *Proceeds of Crime (PoC) regime*. NZ Police's assets recovery units, in cooperation with courts, can restrain a person's assets where they're suspected to have engaged in 'significant criminal activities'¹⁶, determined using only the civil standard of proof (i.e. balance of probabilities) and no prior court conviction is required. The PoC regime is not constrained by the concepts of *limited liability* or the *corporate veil*.
74. The intention of the PoC regime is to disrupt, deter, and derail crime, especially in the areas of organised crime and methamphetamine offending (McKenzie, 2015). The introduction of a non-conviction based civil forfeiture regime for assets and profit forfeiture orders was a defining departure from previous legislation (McKenzie, 2015). NZ Police undertake a whole-of-government approach, including close cooperation with other agencies such as NZ Customs, the Serious Fraud Office and IR.

¹⁶ Criminal Proceeds (Recovery) Act 2009, section 6 - activity engaged in by a person that if proceeded against as a criminal offence, would amount to offending:

- One or more offences punishable by a maximum term of imprisonment of five years or more; or
- From which property, proceeds or benefits of a value of \$30,000 or more have directly or indirectly been acquired or derived.

5. The IR10 – the standardised provision of information to IR

Background

75. The IR10 is a prescribed form used by IR to collect detailed financial information from all customers that have business activity. The form is filed with the annual income tax return and must be provided by an individual, partnership, club/society, trust or company if they have schedular payments, net rents, self-employed net income, income from trading activities or other income. There are 59 questions which are split into profit and loss questions, balance sheet questions, and questions relating to other financial information.
76. The last redesign of the form took place in 2013 although a second change was effectively made in the removal of the obligation of small New Zealand companies to prepare general purpose financial statements. For those entities the minimum reporting requirements are now reconcilable with the information in the IR10.
77. Over 700,000 IR10s are filed each year (290,000 by companies, 192,000 by individuals, 119,000 by partnerships and 115,000 by trusts). The Upper Hutt Processing centre (UHPC) also manually completes around 20 to 30,000 IR10s per year from financial accounts.
78. In theory, 100% of businesses should have IR10 information available (either by filing IR10s themselves or filing financial accounts and having the data input into an IR10 by UHPC). However, in practice that is not the case. Around 94% of companies with business income have IR10 data available. The equivalent figure is 92% for partnerships and 80% for trusts. The proportion for individuals is hard to estimate because of the range of income they receive.
79. Few large corporate organisations file an IR10 and this means that of those 94% of companies that file an IR10 that represents only ~49% of company tax liability. Most significant enterprises (SE) who have a turnover of over \$80 million (soon to reduce to \$30 million) are part of the basic compliance package (BCP) process and are required to supply to IR a copy of the financial statements for each company in the group, consolidated financial statements, a group structure chart and tax calculations for each member of the group. This is supplied separately from the tax return process (notwithstanding that same information may have been supplied with the returns).
80. The BCP information is generally provided in pdf form and is manually reviewed by IRs SE staff with 12 financial metrics being entered into a BCP database. This information is separate and generally not comparable with the information from IR10s thus there is an information gap between the SME and SE populations. There is a question as to how useful such a comparison would be although it would be beneficial to have a wider database of information relating to the wider SE population.

Business Transformation

81. As you will be aware IR is completing its BT programme which will update its aging information technology platform. BT gives IR the opportunity to modernise the way in which it collects information and the way that taxpayers interact with IR as a whole.
82. Part of the BT programme is the review of our analytics capability and the channels through which IR receives that information with a view to using technology more to reduce both the compliance costs of providing information to IR and the administrative costs of analysing that information by IR.
83. BT also gives us the opportunity to gather information from third parties more to prepopulate tax information for customers over time as the work continues and more information is received from payers. The programme will also allow the information collection to be more agile and change as our requirements change over time.
84. The BT programme is part way through its completion and the next release will see income tax brought into the new technology platform in 2019. Alongside that process a programme of modernising analytics is being run to determine the best way to integrate advanced analytics within the transformed environment.
85. As that work is ongoing it is, at this point, too early in the process to outline what the information requirements for taxpayers will be for the future and how that information will be used in an analytics tool to improve interactions with taxpayers. The first aim of BT is to successfully migrate and simplify the current tax types and information to the new platform with any improvement to the types of information to be driven by the analytics programme after BT is complete.

Improvements

86. As part of the review of effective tax rates that officials have undertaken and been previously presented to the Group, some improvements to the current information collecting process have been identified and we have previously done some more general work on future information needs.
87. In the previous work that officials have undertaken in this area we have also canvassed more direct information flows from taxpayers and specifically large taxpayers. An example of where this type of more real time flow has been implemented already is those taxpayers that are using the accounting income method (AIM).
88. Taxpayers using AIM must provide a statement of activity with each AIM payment that details the year to date accounts information for the taxpayer. This information is based on the IR10 information with some additional fields to deal with tax adjustments. This allows more targeted interventions sooner rather than later where issues are identified.

89. In the SE segment we have also explored the ability for IR to receive a trial balance from SE taxpayers at the end of each year. The challenge to that is the ability for IR to collate that bespoke information into a standardised format for comparative analytics.
90. Any progress of these potential improvements will be re-evaluated once BT and the analytics framework, strategy and the programme overall have been progressed.

6. Conclusion

91. The collection of tax debt is complex and multidimensional. There are several drivers for a taxpayer to incur tax debt and IR needs effective compliance tools and measures to effectively respond to each of these drivers.
92. It is important to recognise that IR is different from commercial entities and those differences extend to IR's management of its debtors. Because IR is the responsible agency for all taxpayers, compliant as well as non-compliant, IR needs to take a long-term strategy on helping today's non-compliant taxpayer transition into tomorrow's long term compliant taxpayer. New Zealand's social capital is strengthened by increasing the integrity of the tax system.
93. There are areas that need improvements and there are several potential collection tools that could effectively respond to these identified areas that would further improve tax debt collection and overall voluntarily compliance. In particular, the Secretariat believes IR needs the ability to deem directors personally liable for a company's unpaid PAYE and GST. This capability will significantly limit the director's ability to incur significant tax debt without placing their personal assets at risk.
94. In terms of the information gathering undertaken by IR, as BT develops, the information that IR requires from taxpayers will change and this will be dependent on the way in which analytics develops within BT.
95. In summary, there are a number of work streams being pursued which officials consider will result in more effective, efficient and better targeted collections in the future.

Glossary

Business Transformation: IR's transformation programme.

BCP: Basic Compliance Package.

PAYG: Australia's Pay As You Earn employee deductions.

UHPC: Upper Hutt Processing Centre.

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