



**INQUIRY INTO
THE POWERS AND OPERATIONS OF THE
INLAND REVENUE DEPARTMENT**

**REPORT OF THE
FINANCE AND EXPENDITURE COMMITTEE**

NEW ZEALAND
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Inquiry into the powers and operations of the Inland Revenue Department

Report of the
Finance and Expenditure Committee

FORTY-FIFTH PARLIAMENT

(HON PETER DUNNE, CHAIRPERSON)

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Inquiry into the powers and operations of the Inland Revenue Department

Summary of recommendations

Following our inquiry we recommend to the Government that:

1. The Tax Administration Act 1994 (TAA) be amended to provide a clear four-year time bar in relation to all taxes except where the Commissioner of Inland Revenue has reasonable grounds to suspect a return to be fraudulent or wilfully misleading.
2. The burden of proof remain with the taxpayer, but that consideration be given to establishing a “test” for the Inland Revenue Department to meet to ensure that only properly calculated and substantiated amended assessments are issued to complying taxpayers.
3. Section 81 of the TAA be amended to allow for access to personal information, but that this provision be linked to requests for information by the individual concerned under privacy principle 6.
4. An electronic footprint be inserted in the Inland Revenue Department’s files to record who accesses individual taxpayers’ details.
5. The Inland Revenue Department review its approach in respect of the care and management provisions in light of recent Court of Appeal decisions, with a view to amending its internal guidelines to make it clear the Commissioner of Inland Revenue can exercise discretion on a case by case basis.
6. The procedures for monitoring the delegation of the powers of the Commissioner of Inland Revenue be reviewed.
7. With respect to the penalties regime:
 - a past record of “good behaviour” be taken into account when deciding whether to impose a penalty
 - the Inland Revenue Department exercise a greater degree of flexibility when applying shortfall penalties
 - shortfall penalties not apply when it is determined that the taxpayer has made an inadvertent error.
8. The Inland Revenue Department develop a systems audit methodology in order to assess whether taxpayers are adopting a reasonable standard of care.
9. The Inland Revenue Department reinforce both publicly and internally that if a taxpayer or adviser has not interpreted legislation a penalty for unacceptable interpretation cannot apply.
10. The Government review the process by which assessments can be challenged, placing particular emphasis on assessing the merits of establishing a time limit on the Commissioner of Inland Revenue when addressing a taxpayer’s Notice of Response.

11. The method by which use of money interest is calculated be reviewed to determine whether changes to the interest rates for overpayments and underpayments to reduce the differential between the rates are appropriate.
12. The Government review the whole area of write-offs and in doing so consider:
 - whether there should be a time limit on the reinstatement of a debt
 - whether, if the present policy is to continue, the term “write-off” should be replaced by wording that more accurately describes the policy (for example “provisional write-off”)
 - whether it is necessary for the write-off provisions to be contained in the Inland Revenue Acts.
13. The Inland Revenue Department issue clear directions to taxpayers as to their options, rights and obligations with respect to repayment arrangements.
14. The ministerial approval thresholds for instalment arrangements and remissions be removed, but that the Commissioner of Inland Revenue be required to provide a regular report to the Minister of Revenue outlining applications for remissions and instalments in excess of \$100,000.
15. The Government review the preferential status of the Inland Revenue Department in liquidations.
16. The Inland Revenue Department re-establish a problem resolution service with experienced personnel who are committed to customer satisfaction outcomes.
17. The Inland Revenue Department ensure that the problem resolution service, once established, is well publicised.
18. The Inland Revenue Department advise all complainants, dissatisfied by the results of an internal inquiry, of their rights to appeal to an external agency.
19. The Government establish a specialist tax adviser position within the Office of the Ombudsman, with appropriate resources, to investigate matters of tax administration by the Inland Revenue Department.
20. The Inland Revenue Department investigate ways to preserve over the counter services in areas where it is closing offices, particularly in isolated areas.
21. The Inland Revenue Department enhance its monitoring of telephone services to ensure greater timeliness and accuracy of responses and that the department identify and remedy any skills deficiencies as a matter of priority.

22. The Inland Revenue Department take steps to enhance the timeliness and quality of its responses to written correspondence, and that the performance standard in the 1999/2000 Purchase Agreement of dealing with all correspondence within eight weeks of receipt be reviewed.
23. The Government consider moving the responsibility for drafting tax legislation back to the Parliamentary Counsel Office.
24. The Government consider whether establishing a board of directors to provide an oversight of the Inland Revenue Department's operation of its powers is desirable.
25. The Inland Revenue Department implement, as a matter of priority, a nationally consistent training programme aimed at improving communication and customer service skills.
26. The Inland Revenue Department consider implementing a programme along similar lines to the Business and Parliament Trust, which would enable staff to build relationships with, and have greater exposure to, the business community.
27. The Inland Revenue Department establish a taxpayers' charter to outline to taxpayers their rights and obligations in respect of the tax system.

Introduction

This inquiry was commenced amid growing public concern over the manner in which the Inland Revenue Department (the department) conducts its operations. It had always been our intention to conduct an inquiry of some nature into the workings of the department during this Parliament as a means of assessing the impact of, and holding the Government accountable for, the new compliance and penalties regime. However, given public perceptions that the department was at times too heavy-handed and inflexible in its dealings with taxpayers we decided that a wider review of the powers and operations of the department was necessary.

We acknowledge that the collection of revenue from often reluctant taxpayers is not an easy task. We also realise that in most cases the department discharges its duties in a fair, ethical and professional manner. However, the evidence we received and heard indicates there are times when the department's approach in its dealings with taxpayers has been less than exemplary. We are concerned that the reasons for the department's occasional lapses in its duty to apply the law in a professional manner be identified and remedied. This is essential to maintain the integrity of and public confidence in the tax system. We consider that this report and our recommendations, if acted upon, will contribute in this regard.

This report makes a number of recommendations to the Government and we note that the Government has announced an intention to undertake a number of reforms in the wake of our inquiry. However, given the wide scope of the inquiry and the relatively short time frame in which it was conducted, we have not been able to investigate fully all the issues which arise from the submissions we have received. Many of these issues raised substantive concerns which we feel warrant a more lengthy period of consideration. While this is the final report of this committee on the inquiry, we agreed that the best approach would be to highlight in this report the areas which we strongly consider need further investigation, and make suggestions for follow-up by the next Finance and Expenditure Committee and the Government.

A number of individual taxpayers took the time to make submissions to us about their dealings and relationships with the department. We make no findings or recommendations in respect of specific cases detailed to us as our terms of reference and factors such as the secrecy provisions in the TAA precluded us from doing so. However, the value of individual submissions in giving us insights into the operations of the department on a number of levels cannot be overstated. The recommendations we make follow the experience of these taxpayers who took the trouble to make full and considered submissions to us. In a number of cases we drew issues relating to specific cases to the attention of the department for comment or follow-up action. Many submitters to the inquiry had genuine and deeply-held grievances with the way they have been treated by the department.

Several made appearances before us at considerable emotional cost. We greatly appreciate their input. Our thanks go to them.

Focus of report: principal issues of concern

We received a large number of submissions on this inquiry and although many submitters detailed to us quite different experiences with the department, several themes emerged from the public hearings. The key points to emerge are as follows:

- The underlying structure of the penalties regime is sound. However, the rates of penalty are excessive in some cases and should be reduced, and there is a need for greater flexibility on the part of the department in its operation of the regime, without unduly compromising fairness and equity to all taxpayers.
- The importance of the perception by taxpayers that the tax law and its administration is fair and appropriate. Improvements are needed in this area.
- More checks and balances on the department's exercise of its powers are required to enhance the integrity of the tax system.
- The first principle of the department's debt management practices should be consistent with the statutory responsibility to collect the highest net revenue *over time*, not collection at any cost.
- The department's debt management practices should include early warning systems and involve more senior personnel who are and can be seen as independent and impartial.
- There is a need for an internal system for the resolution of taxpayer complaints and problems to prevent problems escalating and being brought to the attention of the Ombudsman.
- While we do not find that the department's structure and approach in its dealings with taxpayers is fundamentally flawed, there is a need for a cultural shift in the department to reflect a greater customer oriented ethos. This shift must be driven from the senior management team.

Committee procedure

The membership of the committee, the procedures for beginning this inquiry and hearing evidence, and the terms of reference for our inquiry are set out in Appendix A. A list of submissions received is set out in Appendix B.

During the course of the inquiry, we encountered several issues relating to procedures for committee inquiries in general. We wish to draw these issues to the attention of the House.

Natural justice provisions applied

Several submitters, when describing their experiences with the department made serious allegations against the department and individual officers. Examples of these ranged from general comments about the

professionalism of officers and the manner in which they dealt with the submitters, to serious allegations of misconduct or conflicts of interest. We considered that in order for the inquiry to be requisitely thorough it was necessary for us to receive submissions containing such allegations without requiring that they be removed.

We had an obligation, where a person was named and where an allegation had the potential to seriously damage that person's reputation, to apply the provisions of natural justice. There are set procedures for providing an opportunity for those against whom allegations are made to respond¹. In essence the person concerned is informed of the allegation and given an opportunity to respond. The Commissioner of Inland Revenue (the Commissioner) took the opportunity to respond in writing on behalf of officers of the department who had allegations made against them.

The department was provided with all publicly released submissions and provided written responses to many submissions prior to oral evidence being heard.

Allegation of criminal wrongdoing not pursued

Committees are prohibited from investigating an allegation of crime against a named individual without the express authority of the House. One submitter alleged that an officer of the department altered a document which was subsequently used in Court to commence bankruptcy proceedings against the submitter. It was alleged a letter had been altered to include advice regarding the appeal options available to the submitter. This information, it was alleged, was missing from the original document and would have provided grounds for the submitter to appeal a departmental decision, which may have prevented the subsequent bankruptcy. We subsequently received evidence from the officer concerned who denied all knowledge of the second document. The prohibition on us under Standing Order 206 means that we cannot take this issue any further. However, we understand this matter has been referred to the Police.

Statutory secrecy and select committee powers

We had to consider whether the committee's powers to call for persons, papers and records² could override the statutory secrecy provisions contained in the TAA. This is a broad power derived from section 242 (1) of the Legislature Act 1908. The public interest embodied in these powers is that committees should have the power to call for all information that is relevant to the matter they are considering.

We also had to consider the principles of natural justice in relation to the department's right to respond to allegations made in the submissions. We recognised that it was just as important for the department to counter inaccurate or incorrect information. At issue was the extent to which the

¹ These are contained in Standing Order 226.

² Standing Order 203 provides committees with these powers.

department could disclose information which is covered by the secrecy provisions of the TAA. A further question about the application of the secrecy provisions to the department's employees making submissions in their personal capacity was also a concern for us.

The effect of section 81 (1) of the TAA is to impose a statutory duty on departmental officers to maintain the secrecy of all matters related to the Inland Revenue Acts. The only exceptions to this "fundamental obligation" are communications "for the purpose of carrying into effect" the Inland Revenue Acts. Section 81 (3) specifically prohibits officers from the requirement to produce or divulge anything to a court or tribunal "except where it is necessary to do so for the purpose of carrying into effect" the Inland Revenue Acts. However, the Solicitor-General's advice is that this section can have no relevance to a select committee which is neither a court or a tribunal.

Since 1995 there has been imposed on the department a legislative responsibility to protect the integrity of the tax system (this is contained in section 6 of the TAA). This responsibility specifically includes the rights of taxpayers to have their individual affairs kept confidential. This confidentiality has long been recognised as an important element for the effective working of the tax system.

Against this background we recognised the primary area of potential difficulty was the ability of the department to respond to individual taxpayer complaints and allegations of misconduct.

Advice of the Solicitor-General and the Clerk of the House of Representatives

The advice of both the Solicitor-General and the Clerk of the House of Representatives was that as a principle the secrecy provisions should prevail and that no person can look to the committee to be released from his or her statutory obligations. In effect, the committee has an obligation to obey the law. It is up to the committee to determine a way to reconcile its desire for information with any secrecy provisions that might apply.

The Commissioner is still bound by the duty of non-disclosure in respect of taxpayer confidentiality. We agreed that while we were not strictly bound by the law to observe the secrecy provisions, we still had an obligation to take account of them. However, the Commissioner could obviously comment on matters which had already been placed in the public arena by submitters. The secrecy obligation can only apply to that which is secret.

We concluded it was the responsibility of the Chairperson to guide witnesses away from issues considered irrelevant to the inquiry, being outside our terms of reference, or which could cause difficulties in terms of the secrecy provisions. As a rule of thumb we adopted the principle that the department would be asked to respond to submissions in a way that corrected errors of fact or omission or to requests for information on a general or policy level without revealing taxpayer specific details. In this way we found that we were able to receive responses to the allegations

made in submissions and our requests to the department for information without unduly compromising the secrecy provisions. The option of hearing and receiving evidence in private and secret was always open to us and we availed ourselves of this option during the course of the inquiry.

Adverse findings

This report contains findings with respect to the conduct of the Commissioner and the department which we have identified as being adverse pursuant to Standing Order 245. These findings were forwarded in draft form to the Commissioner to give him an opportunity to make a submission to us on them. The Commissioner made a submission to us on the findings which we took into account before presenting this report.

Term of reference A:

To review the powers of the Commissioner of Inland Revenue to assess and collect income tax pursuant to the Tax Administration Act 1994 and other relevant Acts and to assess whether these powers are justified

Overview of the Commissioner's powers

The primary objective of the department, as contained in section 6A (3) of the TAA, is "to collect over time the highest net revenue that is practicable within the law". In order to do this, the Commissioner has been granted wide powers under the TAA. To enable the Commissioner to carry out his tax administration functions he is able to delegate his powers to officers of the department.

Information-gathering powers

The Commissioner's information-gathering powers include the power to access land and buildings, the power to request information in writing and the power to require a person to give evidence under oath before the Commissioner or to seek an inquiry before a District Court Judge.

The power of the Commissioner to access any property is only restricted in the case of private dwellings. Before the Commissioner can enter a private dwelling without the occupier's consent a warrant must be obtained from a judicial officer. We understand that it is very rare for the department to make a formal written demand for access to someone's premises. In most cases the prior agreement of the occupier is obtained.

Assessment powers

The Commissioner is required to assess the taxable income and income tax liability of all taxpayers. If a taxpayer does not file a return, the Commissioner may make an assessment of the amount on which the Commissioner believes tax ought to be imposed and of the amount of such tax. This is known as a default assessment.

If, after an initial assessment is issued, the Commissioner audits a taxpayer and determines that the income as originally returned should be adjusted, the Commissioner has the authority to issue amended assessments. Adjustments can be made at any time with the taxpayer's agreement. However, if agreement is not forthcoming the Commissioner must follow the disputes resolution process.

Generally, the Commissioner may alter an assessment only within four years from the end of the income year in which the taxpayer provided the return. However, if the Commissioner considers that the tax return filed by the taxpayer is fraudulent or wilfully misleading or does not mention income of a particular nature or derived from a particular source, the Commissioner can amend a return at any time.

Powers to impose penalties and grant relief from payment

Under legislation the Commissioner is able to apply penalties for non-payment or under-payment of tax and is also able to remit, write-off and defer payment of tax subject to conditions. We examine the Commissioner's powers and operations in this regard under term of reference B in this report.

Statutory powers generally appropriate

While the Commissioner's powers are extensive, we consider that, by and large, these powers are appropriate for the role the Commissioner is required to undertake. The department is bound to enforce compliance on the part of all taxpayers. Not to do so would seriously damage the integrity of the tax system and undermine the system of voluntary compliance. The extent of the Commissioner's powers is necessary to ensure that reluctant taxpayers meet their obligations. Those powers ensure that taxpayers who willingly pay their tax are not disadvantaged or required to pay a disproportionate share of the tax burden.

The powers of the Commissioner are similar to those conferred upon tax collectors in similar jurisdictions, such as, Australia, Canada, the United Kingdom and the United States. Furthermore, the department's powers are not excessive when compared to other State agencies which operate in revenue collection and enforcement environments.

While the powers of the Commissioner are generally appropriate we do consider that some steps need to be taken with respect to the penalties regime and the Commissioner's powers to enter into arrangements with errant taxpayers. We comment further on these matters later in the report.

We considered various aspects relating to the powers of the Commissioner and make the following comments and recommendations.

Manner in which powers exercised problematic

Many submissions to the inquiry suggest that it is the manner in which the department exercises its powers rather than the extent of those powers which is at issue. The New Zealand Law Society (NZLS) points out that the tax paying community's perception of the way in which the powers are exercised is almost as important as the reality of the extent of those powers. Voluntary compliance is a fundamental feature of the tax system. Taxpayers must believe that the tax system is fair and reasonable and that disputes will be dealt with in a fair and impartial manner.

While we acknowledge that examples of the department misapplying its powers are relatively rare, when they do occur they are a significant issue for the taxpayers involved. During our hearings we heard from a number of taxpayers whose dealings with the department caused them great emotional distress and financial hardship. While fault was not always one-sided, the department in our view sometimes dealt with these taxpayers in a heavy-handed and dictatorial fashion. When the department's officers act

towards taxpayers in such a way it can only serve to undermine the integrity of the tax system.

We note there have been a few recent decisions of the Courts and the Taxation Review Authority (TRA) which demonstrate the misapplication of the department's powers. For example, a very recent decision of the TRA³ contains a number of severe criticisms of the department's performance. Judge Willy refers to a "saga of obfuscation and delay on the part of the Commissioner". He states that the Commissioner failed in his duty to be fair in the exercise of his tax collecting function. Criticisms of the behaviour of the department's personnel were also made in a recent High Court decision⁴. It should be noted that both cases are under appeal.

The most recent report of the department on the health of tax administration⁵, contains survey information that indicates that a relatively high proportion of taxpayers believe that the department targets its enforcement action unfairly on "ordinary people" rather than those who pose the most significant risk to the revenue base. This may be a consequence of perceptions that the department is heavy-handed in the use of its powers in its dealings with smaller taxpayers, especially small businesses. We can understand how this perception has arisen.

It is our view that the recommendations contained in this report and the policy announcements made by the Government in the wake of our inquiry will put in place a set of meaningful checks and balances in the relationship between the department and taxpayers, which should help address the negative perceptions now in place.

Time bar period should be more comprehensive

We share the concerns of the NZLS that the exceptions to the four-year time-bar period are too wide. The time-bar period for the Commissioner to issue an amended assessment is inapplicable if the Commissioner believes that the tax return filed by the taxpayer is fraudulent or misleading or does not mention gross income which is of a particular nature or was derived from a particular source, and in respect of which a tax return is required to be provided.

These limitations can result in a taxpayer having an open-ended and potentially crippling exposure to an unknown tax liability. Additionally, situations can arise where a taxpayer has the onus of proof in relation to an assessment by the department but no longer has the necessary records to successfully dispute that assessment. The TAA imposes a seven-year record retention requirement on most taxpayers. We do not consider that the department should be empowered to issue an amended assessment beyond the period for which the taxpayer is required by the law to retain records, unless the Commissioner suspects fraud or wilfully misleading non-disclosure. The open-ended nature of the Commissioner's power to

³ TRA No. 93/013

⁴ *New Zealand Wool Board v CIR* (1999) 19 NZTC 15,082

⁵ Inland Revenue Health Report, December 1998

issue amended assessments is too wide, especially given the strict nature of the penalties regime.

We recommend to the Government that the TAA be amended to provide a clear four-year time-bar in relation to all taxes except where the Commissioner has reasonable grounds to suspect a return to be fraudulent or wilfully misleading.

Burden of proof

The New Zealand tax system is based on taxpayer self-assessment and voluntary compliance. Since the taxpayer has the primary access to information used in preparing a tax return, the burden of proof falls on the taxpayer. This is consistent with the rationale behind self-assessment and is the practice in both Australia and the United Kingdom.

We received a significant number of submissions calling for the burden of proof to be reversed. Several of these related to disputes with the department over amended assessments and highlighted difficulties in ascertaining from the department the basis on which the assessments had been made. Submitters also pointed to an unwillingness on the part of the department to reassess tax liabilities with the taxpayers concerned.

NZLS and the Institute of Chartered Accountants of New Zealand (ICANZ) also recommend the burden of proof be reversed. NZLS maintains that, given the high level of disclosure which is required of taxpayers under the self-assessment system, the department already has access to considerable taxpayer information. NZLS submits that because of the increased obligations on taxpayers to disclose information to the department, and the increased range of penalties which can apply, the burden of proof should be reversed, except in cases where taxpayers are clearly not complying. NZLS recommends that where a taxpayer has complied with the law, but the department seeks to amend that assessment, the onus should be on the department to prove that liability—at least to a “prima facie” standard. This would greatly assist in achieving a perception of fairness in the tax laws.

ICANZ is of a similar view. It notes the increased obligations on taxpayers and the increased range of penalties and recommends the burden of proof be shifted to the Crown, except as regards the provision of information.

The Committee of Experts on Tax Compliance (the Committee of Experts), however, supports the placement of the onus of proof on taxpayers, except for civil penalties for evasion. The main justification for this is, as noted above, that taxpayers have more information about their tax liabilities and are, therefore, in a better position to assess their own tax liability than the department. This approach is consistent with the taxpayer’s obligation to determine correctly the amount of tax payable which is central to the policy of self-assessment. The Committee of Experts, however, recognises the potential for an undue burden being placed on taxpayers who want to refute an amended assessment.

The Committee of Experts notes that if a taxpayer is able to prove on the balance of probabilities that the department's assessment is excessive by at least a certain amount, the court should be able to reduce the department's assessment by that amount. The Committee of Experts recommends the law be amended to provide expressly for this.

The department submits that any proposal to shift the onus of proof to the Commissioner would need to ensure that risks to the revenue are minimised. In practical terms this would involve implementation of safeguards to ensure the Commissioner had access to information regarding taxpayers' affairs sufficient to sustain the burden of proof. The department argues that to ensure the Commissioner had the necessary information, record-keeping requirements would need to be increased, increased penalties for failure to keep records would be needed, and audit activity would need to increase. These requirements would increase administration costs for the department and compliance costs for the taxpayer.

We note that recent legislative changes have been made to the burden of proof in the United States, shifting the burden from the taxpayer to the Secretary to the Treasury. The shift only applies to individuals and small businesses. Taxpayers must also satisfy a number of conditions to ensure relevant information is provided to the Secretary before the burden of proof is shifted. As the changes are relatively new, there is little information on how the new rules are affecting taxpayers. However, it is probable that satisfying the preconditions will be both costly and unpalatable for taxpayers and will outweigh the benefits from having the burden of proof shifted.

On balance most of us agree the onus of proof should remain with the taxpayer. We are not convinced, however, by the argument that the taxpayer is the only one with all the information available to assess his or her potential tax liability. The department has broad powers to collect information relevant to determining the liability of a taxpayer and has almost unlimited access to records during a taxpayer audit. We have taken account of the many examples given to us by taxpayers who have been confronted with amended assessments of apparently insupportable amounts and the subsequent difficulties encountered in trying to understand the basis for the assessment.

We agree that if the burden of proof is to remain with the taxpayer, there must be a test on the department to ensure that only properly calculated and substantiated assessments are issued to taxpayers who comply with their obligations. This could take the form of a "prima facie" standard as recommended by NZLS or the legislative amendment proposed by the Committee of Experts.

We recommend to the Government that the burden of proof should remain with the taxpayer but that consideration be given to establishing a "test" for the department to meet to ensure that only properly calculated and substantiated amended assessments are issued to complying taxpayers.

Some of us consider that the burden of proof should be placed on the Commissioner. In civil matters where a debt is asserted, it is up to the party making the assertion to prove the debt on the balance of probabilities. Some of us can see no reason why the same burden should not apply to the Commissioner. We agree with the NZLS that the reversed burden of proof on tax matters results in a “guilty until proven innocent” approach and coupled with the harsh penalties regime means that taxpayers can be placed in intolerable positions trying to refute positions taken by the department which may have no substance. We consider that this is a matter worthy of further investigation by the next Finance and Expenditure Committee.

Ability of taxpayers to access their personal files

The secrecy provisions of section 81 of the TAA under which the department must operate make it difficult for taxpayers to get access to information held about them by the department. When the burden of proof rests with the taxpayer, it is doubly difficult for taxpayers to refute tax liability assessments if they cannot access this information.

The Privacy Commissioner submits section 81 of the TAA should be amended to allow individuals access to information held by the department about them. The need for secrecy is not in dispute, but the Privacy Commissioner considers that where this is in conflict with the right of individuals to get information held about themselves, then the provision should go no further than is required to meet the need for secrecy. To highlight this conflict, the Privacy Commissioner provided us with examples of complaints which his office was not able to pursue because the taxpayers concerned were denied access to information held about them by the department. Privacy principle 6 provides for individuals to access personal information held about them. The principle behind this is the recognition of an individual’s entitlement to some degree of personal autonomy. At the very least it allows an individual an opportunity to correct information held about them which might be inaccurate.

In terms of the Privacy Act 1993, section 7 (2) (a) provides that nothing in principle 6 derogates from any provision contained in any Act which imposes a prohibition or restriction on the availability of personal information. Section 81 is such a provision and therefore prevails over the access rights contained in principle 6. For the Privacy Commissioner this means that he is unable to take some complaints any further and they are referred to the Ombudsman to investigate the department’s exercise of its discretion on whether or not to release information for the purpose of carrying into effect the Inland Revenue Acts.

Section 81 does provide for exceptions and it is the view of the Privacy Commissioner that a further exception be added to allow for access to personal information. In recommending this, the Privacy Commissioner suggests that any amendment be worded so that it refers to disclosure of information by the department in response to a request by the individual concerned under privacy principle 6. We agree. A more general exception

might lead to inroads into the obligation of secrecy. The proposed amendment would also ensure the procedural provisions of the Privacy Act 1993, the review provisions involving the Privacy Commissioner and the Complaints Review Tribunal, come into play.

Disclosure, however, should not be absolute. Safeguards would be required to prevent disclosure of information from an informant, or to ensure the information is not being coerced for use by a third party. We think a commonsense approach is required in this situation. The justification that a taxpayer needs to be assured that all his or her details are kept confidential by the department should not apply when it is the taxpayer who is seeking the information.

As a further protection, the Privacy Commissioner recommends that an electronic footprint be incorporated into the department's files. This is done in Australia and acts as a deterrent to unauthorised disclosure. The Australian Tax Office requires the mandatory use by its officers of an electronic technical support system. The purpose of which is, *inter alia*, to manage casework, monitor performance, and to meet the standards of confidentiality which are set out in the Taxpayers' Charter.

We recommend to the Government that section 81 of the TAA be amended to allow for access to personal information but that this provision be linked to requests for information by the individual concerned under privacy principle 6.

We recommend to the Government that an electronic footprint be inserted in the department's files to record who accesses individual taxpayers' details.

Operation of care and management provisions needs assessing

Several submissions raised questions as to the extent of the Commissioner's powers under the "care and management" provisions in section 6A of the TAA. Care and management involves managerial discretion as to the use of statutory powers in a cost effective manner. In 1994 the Organisational Review Committee, chaired by Sir Ivor Richardson, addressed the practicalities of operating the tax system with limited resources and the fundamental importance of voluntary compliance to tax collection. The care and management provisions are the result of recommendations of the Organisational Review Committee. Section 6A (3) of the TAA encapsulates the provisions. It reads:

In collecting the taxes committed to the Commissioner's charge, and notwithstanding anything in the Inland Revenue Acts, it is the duty of the Commissioner to collect over time the highest net revenue that is practicable within the law having regard to—

- (a) the resources available to the Commissioner; and
- (b) the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and
- (c) the compliance costs incurred by taxpayers.

The legislation recognises that it is not possible for the Commissioner, acting with limited resources, to collect every cent of due taxes.

NZLS points out that uncertainty has arisen as to the precise scope of section 6A. The department exercises its discretion at the strategic and policy levels. It is not exercised by individual tax officers in respect of individual taxpayers. The department argues that this is because the duty to collect the highest net revenue operates at the macro level of the tax system and because consistency in the use of discretion is necessary to maintain the integrity of the tax system.

In two recent Court of Appeal judgments there has been specific judicial comment on the department's application of the care and management provisions⁶. These clearly indicate that the discretion in section 6A should be exercised by the department at both the general policy level and at the level of specific tax disputes. By adopting this approach the department would have increased flexibility to settle debts.

We consider that it is important that the status and effect of the care and management provisions be determined. While we note that there are potential dangers from the point of view of consistency of approach in operating discretion on a case by case basis, we agree with ICANZ, NZLS and other submitters that the department's current interpretation of the provisions is too restrictive from both a legal and policy perspective. Consistency can be achieved through the development of guidelines together with a regular review of the exercise of that discretion.

We note that the department acknowledges that changes need to be made to its approach to the settlement of tax issues after assessment.

We recommend that the department review its approach in respect of the care and management provisions in light of recent Court of Appeal decisions, with a view to amending its internal guidelines to make it clear the Commissioner can exercise discretion on a case by case basis. We do not consider, however, that an amendment to the TAA to deal explicitly with the issue is necessary.

Delegation of authority not monitored appropriately

Section 7 of the TAA allows the Commissioner to delegate any or all of his powers to officers of the department and we have concerns that these delegated powers are applied inconsistently. Clearly the delegation of powers is necessary to properly administer the tax system. Most powers are delegated to functions, not to individual officers. NZLS points out that the greatest potential cause of inappropriate exercise of the department's powers is inappropriate delegation. ICANZ suggests that it is not

⁶ *CIR v Auckland Gas Company Limited* (1999) 19 NZTC 15,027 and *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075.

uncommon for officers to exercise delegated powers in a manner inconsistent with the Commissioner's stated policies. Evidence we received from taxpayers supports this assertion. For example, the policies for instalment arrangements are inconsistently applied across offices, with some offices being overly restrictive relative to the department's stated policies.

Having policies applied inconsistently between units or offices of the department creates uncertainty for taxpayers. Furthermore, as a general principle, taxpayers in similar circumstances should be treated the same. We accept that at times it may be appropriate for officers to use their discretion when applying delegated authority. However, when delegated powers are used in a manner inconsistent with stated policies the reasons for such a departure should be recorded and reported to the Commissioner. The Commissioner should then report regularly to the Minister of Revenue (the Minister) and Parliament on the exercise of delegated powers.

We recommend that the Government review the procedures for monitoring the delegation of the powers of the Commissioner.

Term of reference B:

To review the Inland Revenue Department's application of the compliance and penalties regime established under the tax acts, including the process by which and the rate at which use of money interest is set, and also the simultaneous application of late payment penalties

Overview

The compliance and penalties regime has been in place for two years, generally effective for income periods from 1 April 1997. The aim of the compliance and penalties reform was to correct deficiencies in the previous provisions and to tighten the legislative structure of taxpayer obligations and penalties for non-compliance with tax law. The policy objective behind the compliance and penalties regime is to promote voluntary compliance and to encourage all taxpayers to pay their taxes on time.

For the legislation to be fair and equitable to all taxpayers it must be based on the premise that most taxpayers are honest and make a genuine attempt to honour their taxation responsibilities. Taxpayers in similar situations should be treated similarly. The standards that taxpayers are expected to meet, and the penalties applied to them, should recognise the differing circumstances and abilities of individual taxpayers. Sanctions should be consistent with the seriousness of the offence and the culpability of the offender.

There is a delicate balance that must be struck between maximising voluntary compliance and not creating a perception that the regime is being applied too harshly. The public good argument in favour of taxation is jeopardised if compliance can only be achieved under the threat of severe penalties and enforcement action. There is a risk that applying the regime too harshly could in effect be counter-productive in ensuring the compliance of some taxpayers. It is the vast majority of taxpayers who attempt to comply voluntarily who ensure the tax system is efficient and effective.

The cornerstone of New Zealand's tax system is self-assessment. We would like to stress the difference between voluntary compliance and self-assessment. New Zealanders do not pay tax voluntarily, we have a self-assessment system and we pay tax under the threat of penalties if we do not. Under self-assessment, taxpayers determine their own tax liability, notify that in a return to the department and pay the tax. The department's role is to audit those calculations. Self-assessment itself is an example of a trade-off between compliance costs and administration costs. Its basis lies in the fact that taxpayers have more information about their own affairs than the department does. The assumption is the taxpayer is in a much better position than the department to assess their tax liabilities.

The compliance and penalties provisions apply across virtually all tax types. The provisions cover interest, civil penalties, criminal penalties and remissions. The civil penalties are late filing, non-electronic filing, late payment and shortfall penalties. The previous penalty rules consisted

mainly of two types of penalties; additional tax and penal tax. Additional tax was applied to late payments of tax, and the rate varied according to the tax type. Penal tax of up to 300 percent of the deficient tax applied in cases of evasion or fraud, or when the taxpayer failed to account for deduction such as PAYE deductions. It was considered that this regime had its faults and a more comprehensive regime was needed to redress the perceived problems.

The previous Finance and Expenditure Committee stated in the commentary on the Taxpayer Compliance, Penalties, and Disputes Resolution Bill that it was concerned the department might apply the new standards too stringently. The committee voiced a concern that for “ordinary” taxpayers there is a risk that the department may impose penalties in circumstances where the taxpayer’s conduct is not in fact exceptional or in situations where an ordinary taxpayer clearly misunderstands the ramifications of what is or is bound to become, a legally complex piece of legislation. A recent report from the Commissioner to the Minister of Revenue on the health of the tax administration acknowledges the compliance and penalties regime as a pressure point:⁷

A material proportion of business taxpayers are either not aware of the new compliance and penalties regime (CPR) or, of those that are aware, have negative attitudes about its fairness. This represents a pressure point to the department in that the behavioural shift that the change in penalties was designed to effect may not be achieved for those taxpayers who are not aware of the new rules.

A large number of submissions comment that the penalties regime is too harsh or the department is applying the penalties too harshly. NZLS notes that the absence of any discretion given to the department in the application of penalties means that in many situations the department is forced to impose penalties where the circumstances may dictate that it is not in fact the most appropriate course of action. We considered each of the civil penalties in turn and have the following comments and recommendations.

Late filing penalty

The tax system now imposes a penalty onto those taxpayers who file a late tax return. In the case of income tax returns there is a standard penalty of \$50 for late filing. This rises to \$250 if the net income of the entity filing the return exceeds \$100,000, and \$500 if the net income of the entity filing the return exceeds \$1 million. We do not consider that an adjustment to the late filing penalty is required.

Non-electronic filing penalty

Under the 1998 tax simplification legislation, employers are no longer required to file a PAYE reconciliation, but they are required to file a schedule of tax deductions from employees’ wages on a monthly basis.

⁷ Inland Revenue, Health Report, December 1998

Employer monthly schedules are fundamental to the operation of the new simplified tax system, so it is appropriate to impose a penalty if the employer does not file in electronic form. Section 139 of the TAA imposes a penalty on employers who do not file the schedules in a prescribed format. There are exemptions in the Act from filing electronically for some employers. The penalty is the greater of \$250 or \$1 for each person employed at any time during the month to which the employer monthly schedule relates. The penalty will be imposed automatically by FIRST, the department's computer system. We are not recommending any change to the non-electronic filing penalty.

Late payment penalty

The late payment penalty is intended to enforce payment of taxes by the due date. It is designed to support efficient collection of revenue through voluntary compliance.

Under the present rules a late payment penalty of five percent is imposed if the payment of the tax is not made by the due date. After that, incremental penalties of two percent each month are charged on the amount outstanding (excluding interest but including earlier unpaid penalties). Late payment penalties are not charged on amounts outstanding of \$100 or less. Over this threshold the penalties are imposed automatically by FIRST. Section 183B of the TAA provides for 60 percent of the initial late payment penalty to be cancelled if an arrangement is entered into on or before the payment due date.

The Committee of Experts stated in its report that, "The committee endorses the reasons for the late payment penalty, and considers it inappropriate to depart from giving taxpayers incentives to pay their tax on time. However, the penalty should have less of an impact."⁸ A number of submissions held similar views. ICANZ submits that there be no penalty for short term defaults of up to a month, the initial five percent penalty be reduced to two percent and the incremental late payment penalty be reduced from two percent to one percent.

Many submissions comment that the rate of the late payment penalties is excessive. Others claim that the compounding effect of the penalty was too harsh, and that many taxpayers are unaware of the compounding penalty. In their view, the incremental penalty, when considered in conjunction with use of money interest, imposes an effective penalty necessary to ensure compliance.

The department suggests that delaying the imposition of the late payment penalty for 30 days could entice many taxpayers to delay paying by 30 days from the due date. The due date for payment would effectively become the day before the late payment penalty begins. To avoid taxpayers deferring payment in this way, interest for use of money could be charged. The department believes this would ensure that taxpayers had an incentive to pay and enter into instalment arrangements during this 30-

⁸ Report of Committee of Tax Experts on Tax Compliance, 1998.

day period. The department suggests that the risk of deferral could be reduced slightly if the initial late payment penalty is imposed, then remitted if full payment of the outstanding tax and interest is made within 30 days.

Delaying the imposition of late payment penalties might have positive spin-off effects in other areas such as compliance cost reduction, return filing and debt collection. In this way, compliance costs for taxpayers and, possibly, administrative costs of the department could be reduced. It would also represent a more commercial approach to payment of tax. These benefits would have to be balanced against the risk of significant deferral of tax payments. This delay would have no effect on the debt collection process, as the tax would still be outstanding even though the penalty has not been imposed.

We note that the Government considers that an incremental application of the initial late payment penalty has merit and is proposing a policy change along these lines. We welcome this initiative.

The objective of the incremental late payment penalty is to provide a clear, continuing incentive to comply. The department submits that because the late payment penalty is the principal method by which the Government ensures payment of assessed tax it must be a significant penalty. The rate must exceed the borrowing costs faced by taxpayers, otherwise some may decide to defer payment.

Following evidence to our inquiry the Government has announced it is to consider lowering the incremental two percent late payment penalty to one percent per month. We fully endorse this policy change. Reducing the incremental penalty, which in our view is excessive, will increase the fairness and the integrity of the tax system and it will reduce pressure on processes used to mitigate imposition of the incremental penalty such as disputes procedures and remission requests.

Shortfall penalties

Shortfall penalties replaced the penal tax system two years ago. The department must consider whether to impose a shortfall penalty if a taxpayer pays less tax than that which is due and the rate of a shortfall penalty is a percentage of the tax shortfall. The rate of the penalty depends on the category of fault. There are five categories of fault:

Penalty						Percentage of resulting tax shortfall
Lack of reasonable care	...	...	...	...	...	20%
Unacceptable interpretation	...	...	...	...	...	20%
Gross carelessness	...	...	...	...	...	40%
Abusive tax position	...	...	...	...	...	100%
Tax evasion or similar acts	...	...	...	...	...	150%

These penalty rates are non-negotiable and where a default occurs the applicable penalty must be imposed. A taxpayer does, however, have the

right to challenge the decision to impose a shortfall penalty but not the amount of penalty.

Many problems experienced by taxpayers in the area of shortfall penalties occur due to the department's application of the lack of reasonable care and unacceptable interpretation penalties.

Lack of reasonable care

The purpose of the lack of reasonable care penalty is to increase voluntary compliance. The standard is the cornerstone of the penalties regime which requires all taxpayers to act reasonably in the conduct of their tax affairs. The test of reasonable care is whether a taxpayer of ordinary skill and prudence would have foreseen as a reasonable probability or likelihood the prospect that an act (or failure to act) would cause a tax shortfall, having regard to all the circumstances. The Committee of Experts agreed that a tax system, based on self-assessment, requires an effective statutory penalties regime to provide taxpayers with appropriate incentives to comply.

We recognise that in the previous select committee's report on the compliance and penalties regime, the committee was very aware of the problems that could arise due to the application of the lack of reasonable care test. ICANZ notes in its submission that it had sent a memorandum to the department outlining examples of where this test had been applied inappropriately, and where it thought improvements could be made. ICANZ then refers to an internal departmental memorandum published in the Taxation Information Bulletin on 10 June 1998. It explains the reasonable care standard and is the department's operational guideline when applying the standard:

The Standard recognises taxpayers' varying abilities and reflects a balance between the need for returns to be correct and the recognition of the difficulties taxpayers may face in ensuring they are correct.

Reasonable care is not intended to be overly onerous to taxpayers and does not mean perfection. Circumstances that may be taken into account when determining whether a taxpayer has exercised reasonable care include:

- the complexity of the law and the transaction (the need to balance the complexity of the law with the category of taxpayer)
- the materiality of the shortfall (consideration must be given not only to the nature of the shortfall, but also the size of the shortfall in relation to the taxpayer)
- the difficulty and expense of taking the precaution (consider whether the types of controls in place are commensurate with the size and nature of the taxpayer)
- the age, health and background of the taxpayer
- the business's record keeping practices (commensurate with the size and nature of the business and the internal controls).

We are encouraged to note that the department subsequently put into place a number of administrative changes which fully or largely resolved many of the problems which ICANZ had raised regarding the application of the lack of reasonable care standard. However, inconsistencies in the

application of the reasonable care standard continue to occur and this is a concern.

NZLS suggests the need for consistency in the application of the penalties regime to ensure that taxpayers do not have a negative perception of the regime. There is obviously considerable potential for some subjectivity in the application of the penalties regime and NZLS suggested that we review the guidelines that have been developed by the department to achieve consistency. We have listened to many submissions where consistency has been an area of concern and we consider that it would be advantageous for the next Finance and Expenditure Committee in conjunction with the Government's post-implementation review of the compliance and penalties regime to also review the guidelines the department has put in place to guide the department's officers in their application of the regime.

A number of submitters believe that a penalties regime needs to remain in place, but that the existing penalties regime is harsh. Most submitters recognise the need for a penalties regime to act as an incentive for paying taxes. The major area of concern in the penalties regime involves the many cases where penalties are being applied on the average law abiding taxpayer unreasonably. For example, Nigel Smith and Associates provided us with the following case study:

A client had a business of commercial letting of premises. The lessees questioned the lessors on the market value of the rent being charged. The client obtained a market value rental and found that they had been overcharging the client. When this was established the lessor passed a credit note adjusting the rent and GST charged on it. The lessor claimed the adjustment in the same GST return as the lessee adjusted theirs using the credit note. Although no revenue was lost Inland Revenue imposed a 20% lack of reasonable care penalty on the basis that the lessor was on a payments basis and would not accept that the crediting that would have arose constituted a payment.

The solicitor for the department advised us that they were required to impose the penalty as a mistake had occurred and that they had no power otherwise not to do so. On this interpretation every little mistake would be subject to the penalty.

PricewaterhouseCoopers submits that the shortfall penalties regime should be amended to ensure that taxpayers are not penalised for honest or inadvertent mistakes. Unless the department is more willing to accept that taxpayers can make honest errors and is prepared to allow a greater degree of latitude in applying the shortfall penalties regime, the integrity of the tax system will be eroded. Although a small proportion of taxpayers are intentionally non-compliant, and a reasonably tough penalties regime is required to dissuade them from abusing the tax system at the expense of honest taxpayers, most taxpayers try diligently to meet their tax obligations. Many experience difficulty with the complexity and volume of their responsibilities. This sentiment was shared by many other submitters seeking more discretion in the application of the penalties regime.

We have noted the Government's intention to undertake a post-implementation review of the penalties provisions. **When undertaking this we recommend that:**

- a past record of “good behaviour” be taken into account when deciding whether to impose a penalty
- the department exercise a greater degree of flexibility when applying shortfall penalties
- shortfall penalties not apply when it is determined that the taxpayer has made an inadvertent error.

A more consistent, reasonable and flexible application of the lack of reasonable care standard will, in time, be perceived by the taxpaying public as fair and just.

ICANZ suggests that the department develop a systems audit methodology in order to assess whether taxpayers are adopting a reasonable standard of care. Taxpayer confidence in the tax system would be improved if the department’s audit methodology was, in the experience and perception of taxpayers, clearly focussed on whether or not reasonable standard of care systems are in place.

We endorse this idea and recommend the department develop a systems audit methodology to assess whether taxpayers are adopting a reasonable standard of care.

Unacceptable interpretation

The purpose of the unacceptable interpretation shortfall penalty is to ensure that in a self assessment environment taxpayers who take a position which has significant tax consequences take extra care. It ensures that the conclusions they reach on their tax liability are sound. This is required by the reasonable care standard. The distinguishing feature of the acceptable interpretation standard is that it lacks some of the subjective elements, for example, taxpayer effort, when there is a significant amount of tax at stake.

The unacceptable interpretation test only applies to tax shortfalls where, if viewed objectively, that interpretation or application fails to meet the standard of being about as likely as not to be correct. The unacceptable interpretation standard is an objective test involving an analysis of the law to the relevant facts. It is not relevant that a taxpayer believes that the position taken was an acceptable interpretation.

Section 141B (7) of the TAA provides that the matters that must be considered in determining whether the tax position involves an unacceptable interpretation of a tax law include:

- the actual or potential application to the tax position of all the tax laws that are relevant
- decisions of a court or a Taxation Review Authority on the interpretation of tax laws that are relevant (unless the decision was issued up to one month before the taxpayer takes the taxpayer’s tax position).

Other matters which may be considered in particular circumstances are binding rulings and other published departmental statements, legal articles,

statute other than tax law, dictionary meaning and generally accepted accounting practice and commercial practice.

ICANZ submits that the department be required to reinforce internally and publicly the principle that if a taxpayer (or adviser) has not interpreted legislation a penalty for unacceptable interpretation cannot apply. The department has confirmed that where a taxpayer has reasonably relied on an adviser, the taxpayer is considered to have taken reasonable care. In a survey ICANZ did of its members in November 1997, comments were made that to circumvent this arrangement some of the department's staff were, as an alternative, imposing penalties for unacceptable interpretation.

However, we understand that the department has advised that the unacceptable interpretation standard will apply unless the Commissioner is satisfied that the tax adviser did not apply his or her mind to the tax laws or make an interpretation. The tax adviser must demonstrate he or she has not interpreted the tax laws and exercised his or her judgement.

Departmental staff are now taking the view that even where a tax adviser can demonstrate he or she has not interpreted the tax laws or exercised his or her judgement, the tax adviser should have addressed a particular issue and therefore unacceptable interpretation stands. The result of this is that if a tax agent does not address a particular tax law and makes a mistake, unacceptable interpretation applies.

We agree with ICANZ on this matter and understand that the department's policy is that if a taxpayer or adviser has not interpreted legislation, a penalty for unacceptable interpretation cannot apply. **We recommend the department publicise this policy both internally and to the taxpaying public.**

Simultaneous application

Those who fail to comply with the obligations imposed by the Inland Revenue Acts can be subject to the simultaneous imposition of interest and a variety of penalties. If a payment is late, both late payment penalties and interest apply. If at the same time late filing is involved, a late filing penalty can also be applied. In appropriate cases the department considers the imposition of a shortfall penalty. A number of submissions note that it may not be clear to taxpayers that the simultaneous application of penalties applies. The department needs to be more proactive in this area and therefore we expect the department to improve its communication to taxpayers on the issue.

Process for challenging assessments needs review

Currently the TAA provides a challenge process to an assessment or disputable decision made by either the Commissioner or a taxpayer. The legislation provides for a two month response period from the taxpayer to the Commissioner's disputable decision or assessment, or from the taxpayer issuing a Notice of Proposed Adjustment (NOPA) to the Commissioner. However, the two month response period does not apply to the Commissioner in addressing a taxpayer's Notice of Response (NOR).

One submission comments that the legislation provides an open ended time arrangement for the Commissioner to address any disputable decision derived from the Commissioner's own NOPA. The submitter suggests that the Commissioner should be on a limited time frame to respond to the NOR. We consider that this is a matter worth considering. A time limit would provide taxpayers challenging decisions with greater certainty and would provide taxpayers with a protection against potential abuses of the challenge system. A time limit would therefore enhance the integrity of the tax system. **We recommend that the Government review the process by which assessments can be challenged, placing particular emphasis on assessing the merits of establishing a time limit on the Commissioner when addressing a taxpayer's NOR.**

Use of money interest

Operation of policy

The principle behind the use of money interest (UOMI) is to protect the department from being used as a financing or investment option. The payment of interest is a cost to both taxpayer and government for having the use of the other party's money over a period of time. The policy is also aimed at encouraging taxpayers to pay the correct amount of tax on time.

The mechanism for setting interest rates, and the interest rates themselves, are made under Order in Council. The interest rate for overpayments is the 90 day bank bill rate less one percentage point. The interest rate for underpayments is the Reserve Bank base lending rate plus two percentage points. These rates are adjusted when there is an increase or decrease in the Reserve Bank business base lending or 90 day bank bill rates in corresponding amounts to the over/underpayment rates.

For underpayments, the department has adopted the Reserve Bank business base lending rate as its formula because it considers this rate represents the base rate major banks charge good corporate customers. The department notes that for other customers banks generally add a margin of between two and five percentage points. For underpayments, the department considers its formula is appropriate because it recognises that the department is an involuntary lender. The rate applies to all and, although this means it is too high for some and too low for others in some cases, the department believes the rate is below the best available on-demand unsecured bank interest rate.

Extent of differential in rates opposed

The majority of submissions on this issue support the concept of the UOMI policy, but not the continued application of such a wide difference in the rates charged and paid by the department. As at 8 March 1999 UOMI was just over 10 percent for the taxpayer (10.59 percent) if tax has been underpaid and just under four percent to the taxpayer (3.38 percent) if tax has been overpaid.

The department's position, and that of the Committee of Experts, is that without the UOMI provisions, a taxpayer who fully complies may be treated less favourably than a taxpayer who does not. The rates, therefore must recognise that the taxpayer and not the department ultimately chooses whether taxes are underpaid or overpaid. As such the rates must be, on underpayments, close to, but more, than what taxpayers pay for unsecured (short and medium term) borrowing from another source, and on overpayments, close to, but less than what they would receive on short-term deposits of a similar risk.

There is no dispute on the need for differential rates. However, submitters have raised questions about the justification for such a large differential. ICANZ submits the basis of rate setting should be such that the rate charged to taxpayers on underpayments should be no more than the standard bank overdraft rate. ICANZ considers the rate of interest currently charged on underpayments is excessive and significantly higher than the rate at which most taxpayers borrow. Furthermore, ICANZ states the department's rate of interest on overpayments provides the Government with funding at a lower rate than it can borrow and provides a lower return than a taxpayer can achieve if they voluntarily invested (and significantly lower if the taxpayer has borrowed to fund the overpayment). ICANZ notes that it has made a series of submissions to the Ministers of Finance and Revenue on this issue and comments that reasons given for rejecting the Institute's proposals are "specious". ICANZ suggests the UOMI regime does more than "compensate" the Government for not having the use of its money. ICANZ suggests there is a penal element included in the rate which should not be there.

By way of comparison, ICANZ provides the UOMI rates which apply in Australia and the United States, which it suggests are fairer and more appropriate. The difference in the rates in these countries is one percent to 4.5 percent; in New Zealand it is 6.8 percent. ICANZ also notes that base rates adopted in these countries and the uplifts applied attempt to appropriately charge to or return to taxpayers generally for the use of funds without imposing a penal rate.⁹

The UOMI rules have a particular impact on those taxpayers who pay provisional tax. ICANZ submits there be a difference in the imposition of UOMI rates on tax which can be accurately calculated from provisional tax which cannot be calculated accurately. With provisional tax ICANZ notes that interest is charged on the difference between tax actually paid and the actual tax liability. In this situation, ICANZ submits that a penal rate of interest is neither required nor justified. The Committee of Experts notes that if a taxpayer has no reasonable expectation of having to pay interest at the time of making provisional tax payments, an unexpected

⁹ In Australia the rates are related to the Treasury Yield Note (TYN) which is the weighted average of the latest weekly tender for 13 week Treasury Notes. The rates are set at underpayments—TYN plus four percent; and overpayments—TYN. In the United States the rates are related to the Federal Short Term Rate (FSTR). Underpayments are charged at FSTR plus three percent and overpayments at FSTR plus two percent. Higher rates are charged on under/over payments in excess of \$100,000 and \$10,000 respectively.

breach of the interest thresholds should perhaps find relief from UOMI. We agree with the Committee of Experts on this point.

It is the department's position that the UOMI rules have resulted in provisional taxpayers meeting their tax liability on time during the income year. The department does not support a reduction in the interest rate on underpayments of provisional tax. It considers such an action would increase the potential for deferrals because those whose cost of borrowing exceeded the underpayment rate could choose not to pay provisional tax. This could lead to the re-introduction of the under-estimation penalty.

We do not consider the department has responded adequately to the ICANZ proposal that the differential between underpayments and overpayments be narrowed. We accept the UOMI policy and the need for different rates for overpayments and underpayments to protect the department from being used as a financing or investment option and to encourage taxpayers to pay the correct amount of tax on time. We also accept that it may be necessary for the differential to be as wide as it is at present. However, we do not consider the department has made a case for this. At present we consider the spread is perceived to be excessive, unfair and to contain a penal element. While we also acknowledge the need to reduce and minimise both administrative and compliance costs, we do not consider this necessarily justifies the continuation of a policy if it is proved inequitable. **Therefore, we recommend that the method by which UOMI is calculated be reviewed to determine whether changes to the interest rates for overpayments and underpayments to reduce the differential between the two rates are appropriate.**

We agree the UOMI rules for provisional taxpayers should not be changed. The department informs us that the UOMI rules have resulted in the provisional tax payments at the first, second, and third provisional tax dates evening out. We believe this should be encouraged.

Term of reference C:**To review the debt management practices and the adequacy of the powers of the Inland Revenue Department to remit tax liabilities or enter into arrangements for deferring the payment of tax and the department's operation of its powers**

The department has a difficult job to perform when dealing with taxpayers who are in debt to the department. The department differs from other creditors in three important aspects:

- Creditors can generally choose who they deal with. The department must deal with all taxpayers. Often the department's debtors choose to pay trade creditors in preference to the department to ensure that their supply of essential business needs continues.
- Unlike other creditors, the department has no general discretion to compromise on payment of established tax liabilities.
- Some forms of tax debt (such as PAYE and child support) are given preferential status in the statutory priority of distribution following insolvency.

Debts owing to the department arise when the department has issued a default assessment if the taxpayer has failed to file a return, or the department has issued an assessment showing an amount owing and the taxpayer has failed to pay the full amount by the due date.

A large number of submissions indicated to us that the system for informing taxpayers of debts is inadequate. Once a debt has arisen in a taxpayer's account, the taxpayer gets notice of that debt by a variety of ways, by Notice of Assessment, Statement of Account and reminder letters.

If the debt remains unpaid and there is no prospect of immediate payment, the department needs to consider debt management options available to it. Although the department's preference is to recover debt by voluntary payment in full, recovery can also be by way of voluntary time payment (for example, an instalment arrangement), or by compulsory deduction. If a taxpayer is in financial difficulty the department can, in limited circumstances, provide relief from debt by way of write-off, cancellation or remission.

Some submissions were approving of the department's general approach; for example, Denham Martin and Associates states:

Our clear impression is that in this area the Commissioner and his staff have adopted a fair and compassionate approach to applying penalties and assisting taxpayers with their outstanding tax obligations. The cases where this has not been done would be the exception rather than the rule.

This sentiment was shared by others who acknowledge that the department has a difficult job to perform, but many submissions also suggest that significant improvements could be made to the department's debt management practices. Following our examination of the department's debt

management practices we make the following comments and recommendations.

Department needs to take action on outstanding debt more quickly

PricewaterhouseCoopers states the debt recovery division within the department should become involved in collecting outstanding tax at an earlier stage than at present. Under current policies and procedures, situations are often beyond retrieval before they reach debt recovery. In many cases the first contact with a taxpayer in relation to unpaid taxes is several months after the due date has passed, at which time the department issues a statement recording the unpaid tax together with accrued penalties. Many taxpayers who get themselves into this situation are unaware of the effect of penalties, and by the time they are made aware of it, substantial penalties have accrued, plus interest.

Many other submissions state that a contributing factor in the accumulation of debt is that the department is too slow in identifying and following up on debt. PricewaterhouseCoopers suggests that the department should adopt practices common to trading banks and institute prompt follow-up procedures for overdue debts. Arguably the department should have more sophisticated follow-up procedures than banks as the imposition of late payment penalties and UOMI will generate a higher debt and can result in what are initially relatively small debts escalating into amounts which are beyond the ability of taxpayers to ever pay back. When debt is recognised early there is a better chance of recovering the debt (from the department's perspective), and the debt will be more manageable (from the taxpayer's perspective); therefore, a 'win-win' situation is achieved. We concur with this analysis.

We understand the department is working on ways to identify outstanding debt earlier and that it is working towards utilising its call centres to make outbound calls to taxpayers in arrears. We welcome these initiatives.

Refocusing of debt and return management strategy

The department accepts the validity of the above concerns and is refocusing its debt management resources on two broad priority areas:

- Debt which has risen to a significant level (over \$10,000) irrespective of age.
- PAYE and GST. This debt tends to be newer debt and has significant potential to escalate.

This approach recognises the need to balance the use of resources across both new and old debt. Performance standards in the departmental forecast report focus on the department collecting new debt as quickly as possible.

ICANZ submits that the experience of its members suggests that there are cases where a defaulting taxpayer is "put to the wall". ICANZ has no problem with a firm and fair approach being adopted towards debt collection, but is concerned with the lack of commercialism that sometimes

is displayed by debt collection personnel, probably as a result of “punishing” operational guidelines set down for them.

In order to improve the department’s debt collection philosophy ICANZ suggested that the department must ensure that:

- the department’s systems immediately identify situations where a taxpayer is “in arrears”
- if the amount of the arrears is significant, the department is promptly in direct contact with the defaulting taxpayer, with a view to alerting them and seeing whether there is a situation calling for departmental help and assistance (or indeed, fast track recovery action)
- in all cases, if immediately the debt is say three weeks in arrears, contact be made with the taxpayer to alert them to the situation, and (where appropriate) to formally invite them to come and discuss the situation (including any required instalment arrangements)
- in the case of continuing default, thereafter continue to follow-up routinely on the default with the taxpayer, and be prepared to take appropriate action (which need not necessarily be recovery action).

ICANZ also suggests that the department consider passing the debt on to be dealt with by another body, perhaps a separate arm of Government to deal with unaddressed debts.

At the moment no personal contact by the department’s debt collecting staff is made until the debt is several months overdue. By this time, if the taxpayer has serious financial problems there will be a further two to three months of unpaid taxes (PAYE and GST, etc.) along with mounting late payment penalties and interest charges. This kind of debt compounding over a few months for a small business can be devastating.

Accordingly, ICANZ believes that if such an approach were to be introduced and the approach was accompanied by a positive, focussed, friendly but firm cash flow management approach on the part of the department’s debt management staff, there would be considerable advantages for taxpayers, the perception of the department in the minds of taxpayers, and the community at large, in particular:

- debt problems would be identified promptly, and consequentially managed better
- the penalty and interest exposure of defaulting taxpayers could be minimised
- if a suitable debt management arrangement was not concluded within a (say) six month period, then the troublesome debt not in dispute could pass out of the hands of the departmental officers (who otherwise would be considered “the bad guys”) onto another Government department for debt collection.

We consider that the ideas raised have merit and should be closely investigated by the department. The next Finance and Expenditure Committee should consider following up with the department what action has been taken in this regard. However, we do see a problem in passing

the debt on to another body, in that this would just transport the problem somewhere else, rather than resolve it.

Write-offs

A write-off is an accounting concept whereby a debt is written off the books of a creditor. The debt still exists but no action is being taken to collect it. The debt can be reinstated if the taxpayer's position improves. The write-off provisions are not contained in legislation. They are an administrative practice adopted by the department in line with the Public Finance Act 1989. UOMI and penalties continue to accrue. Debts that can be written-off can generally be reinstated at anytime (except in cases of bankruptcy or liquidations).

Many submitters were concerned that the term "write-off" is not fully explained. Many taxpayers believe their debt has been permanently wiped and they are often subsequently unprepared in cases where the debt collection is reinitiated. Another submitter raised the problem of its demotivating effect on taxpayers. If a taxpayer knows the debt will be reinstated once he or she is in a better financial position, the incentive to find work is removed. In this situation a "lose-lose" outcome is the result because not only is the department failing to maximise net revenue over time by not collecting money to pay the debt, but the taxpayer is not working to pay tax in the interim.

We recommend that the Government review the whole area of write-offs and in doing so consider:

- **whether there should be a time limit on reinstatement of a debt**
- **whether, if the present policy is to continue, the term "write-off" should be replaced by wording that more accurately describes the policy (for example "provisional write-off")**
- **whether it is necessary for the write-off provisions to be contained in the Inland Revenue Acts.**

Cancellation of penalties

Penalties may be cancelled subject to the successful completion of a specified action such as an instalment arrangement. If the action is successfully completed the remaining debt is cancelled.

The purpose of the penalty cancellation provisions is to encourage taxpayers to enter into repayment arrangements at an early stage and to make repayment of debt by instalments more rapid. ICANZ, in its submission, included the department's practice statement about the application of the cancellation provision:

Provided taxpayers *fully* comply with an approved arrangement entered into before the due date, Inland Revenue will cancel 60% of the initial late payment penalty and all the subsequent late payment penalties. This cancellation does not however extend to use of money interest, which will still be charged (emphasis added).

However, section 183B (2) of the TAA states in relation to the cancellation provision:

(b) the taxpayer complies with the taxpayer's obligations under the arrangement.

The word "fully" does not appear in the legislation. The department's explanation of the inclusion of the word "fully" in the practice is:

By fully we mean the taxpayer has to see an agreed arrangement through to the end—they cannot bail out part way through and still expect to get cancellation of the penalties under section 183B.

However, as stated, the taxpayer can vary the arrangement by mutual agreement and still stay within the ambit of section 183B.

The ability to vary the arrangement by mutual agreement is not widely known. The use of the word "fully" is inconsistent with this position. Obviously, if a repayment arrangement can be varied once agreed to, the original arrangement does not have to be fully complied with to attract cancellation. We consider that partial failure to comply with an arrangement should not result in a disproportionate penalty.

We consider that it is important that the department be very clear as to the rights of the taxpayer under repayment arrangements. **We recommend the department issue clear directions to taxpayers as to their options, rights and obligations with respect to repayment arrangements.**

Instalment arrangements

Under section 177 of the TAA the Commissioner can provide relief by way of granting an instalment arrangement when a taxpayer is in financial difficulties. The provision is restricted to income tax and fringe benefit tax, but we understand that under the care and management provisions instalment arrangements have been entered into for other types of taxes. While we consider that it is appropriate for instalment arrangements to be available for all tax types, the current legislative framework does not establish clearly that the Commissioner is empowered to do this. This can lead to inconsistent treatment for taxpayers seeking an instalment arrangement for tax types other than income tax and fringe benefit tax. We note that following these concerns being raised during our inquiry the Government intends to clarify this situation.

The department generally limits instalment arrangements to periods of less than 12 months (commonly six months). We consider the restriction may lead to unrealistic instalment arrangements if taxpayers are required to pay debt within rigid time frames rather than within the taxpayer's financial budget. The factors that may determine whether an instalment arrangement is an acceptable course of action for the department include:

- is the repayment proposal realistic?
- can the taxpayer meet future tax liabilities?
- has the taxpayer previously had and adhered to an instalment arrangement?

- has the taxpayer filed all required returns or are there any current default assessments?
- has the taxpayer been granted other relief in the past?

In practice a complicated calculation must be done to ensure that the department receives the best possible return from the action taken, thereby maximising the "Net Present Value" (NPV). This value will be maximised if the debt can be repaid over as shorter period as possible. However, we consider that rigidly imposing time limits for instalment arrangements of six or 12 months, as some local offices have been doing, is far too inflexible and is not consistent with the Commissioner's duty to maximise revenue collected over time.

Many submitters wrote or told us of the frustration at not being kept fully informed of what was required of them, and of the department's tardiness in communicating with taxpayers who were asking for help or were asking for clarification regarding their tax affairs. One submitter told us he had desired to enter into an arrangement and offered payment of \$600 per month to help clear some of the debt as the department was threatening bankruptcy. This offer was refused.

The department agrees with many of the sentiments expressed by those who made submissions. The department acknowledges that some local offices have been seeking to impose time limits on instalment arrangements. National Office has recently sent out a memorandum to all staff which emphasises that there is no time limit for instalment arrangements.

The department adopts a policy that instalment arrangements will not generally be entered into if a taxpayer can pay the debt using other sources or means. This satisfies the principle that immediate recovery of the full amount of the debt is the optimum outcome in terms of NPV. Lengthy instalment arrangements are unlikely to maximise the NPV of any recovery, so a number of factors need to be taken into account when long-term instalment arrangements are being considered. Following legitimate concerns raised in submissions to this inquiry, a standard practice statement on instalment arrangements is being produced that is intended to improve consistency across departmental offices. This will be completed following both internal and external consultation. We are pleased the department is taking steps to enhance a consistency of approach. We expect the department to be more flexible in its approach to instalment arrangements, and make its intentions clear to the taxpaying public.

Serious and financial hardship provisions require review

The Commissioner has discretion to remit income tax or fringe benefit tax if a taxpayer is in financial difficulties or to remit income tax if satisfied that serious hardship exists. The NPV calculation applies to these provisions. In practice the department uses the financial hardship provision for taxpayers in a continuing business who are in genuine financial difficulties and do not have the ability to pay arrears, but do have the ability to account for future taxation requirements.

Many submitters believe the department is reluctant to grant remission for serious and financial hardship, and that it is unclear as to when the provisions are granted and under what circumstances. The hardship provisions are very limited at the moment, and applying them across all tax types was suggested in many submissions. Submitters argue the hardship provisions should be used more widely to avoid bankruptcy in many situations where there is a realistic option of the business being able to pay its current and future tax obligations if relief is granted.

The department instigated a review of the hardship provisions in October 1998, having had concerns about possible deficiencies in the provisions for some time. There are philosophical reasons why remission should be agreed to only rarely. These are based on fairness and the perception remitting for some taxpayers gives to other taxpayers who have paid their tax. It also erodes the ethos that all taxpayers have an obligation to pay their tax. Effectively a delicate balance must be reached between remitting tax for those taxpayers in serious and financial hardship and the impression this gives the compliant taxpayer.

The policy reason behind not applying these provisions to all tax types is that certain tax types such as PAYE are deemed held in trust by the taxpayer¹⁰. It is the taxpayer's duty to withhold these taxes on trust and then forward them on to the department. They are not meant to be spent in the general course of every day business.

The department has acknowledged that the current application of the hardship provisions and the write-off rules can lead to inconsistency and there is some lack of clarity with their application. It is not clear when a write-off is granted rather than serious or financial hardship. These problems would be partially removed if the hardship provisions applied to all tax types. We note and welcome the Government's intention to extend the provisions in this manner. However, we consider some clear statements as to when the provisions will apply are also needed.

PricewaterhouseCoopers in its submission included material contained in an April 1994 Report to the Minister of Revenue. The report specifically stated:

To ensure the proper and consistent use of managerial responsibility in these areas, the tax administration will be required to refine or develop internal guidelines for the exercise of care and management in the administration of the Inland Revenue Acts. The guidelines should be consistent with the objective of maximising net revenue over time according to the law and give guidance to staff on the proper procedures and consideration to take into account as they apply tax law.

The report went on to suggest that the application of these guidelines should be subject to an independent and periodic audit by the Office of the Controller and Auditor-General. The results of the audit should then be published in a report to Parliament. We believe this is a very good suggestion which may solve many of the problems raised by submitters, expressing their concern at the consistency of the provisions' application.

¹⁰ See section 167 (1) of TAA.

The department points out that there are a number of problem areas in the current hardship provisions. These include whether the current tests are appropriate. The department is to review the provisions as part of the post-implementation review of the compliance and penalties regime. We consider the next Finance and Expenditure Committee should thoroughly assess the outcome of that review.

Ministerial approval threshold in cases of serious or financial hardship

Under the TAA, ministerial approval must be obtained if the amount subject to an instalment arrangement or remission exceeds \$50,000. In practice, however, the Commissioner told us the department had generally not been requesting ministerial approval for instalment arrangements of over \$50,000. This kind of disregard for the law could severely damage the integrity of the tax system, if taxpayers perceive that the department can summarily disregard its statutory obligations. If in practice the approval thresholds are inappropriate or overly cumbersome, then the law should be changed, not merely ignored.

Many submissions express concern over the need for ministerial approval to remit, refund or enter into instalment arrangements for amounts exceeding \$50,000. The Minister's role is designed to provide an assurance that the Commissioner is appropriately applying the hardship provisions in the most significant cases. However, there are a number of disadvantages with the requirement to get ministerial approval:

- The process can be time consuming, causing considerably more stress to the taxpayer.
- Delays often affect the taxpayer's economic circumstances and may act to reduce revenue collection.
- It impacts on the separation of the Commissioner's statutory role of day to day tax administration from the Minister's role of political oversight.

We are of the view that ministerial discretion should be removed. We consider that removing the threshold would be beneficial for a number of reasons. Primarily it would reduce the amount of stress on the taxpayer waiting to hear whether their application has been agreed to. It will result in administrative cost savings for the department and reduce compliance costs on taxpayers due to the faster processing times. **We recommend that the ministerial approval thresholds for instalment arrangements and remissions be removed, but that the Commissioner be required to provide a regular report to the Minister outlining applications for remissions and instalments in excess of \$100,000.**

Bankruptcy proceedings

A large number of the submissions we received were from people who had been forced into bankruptcy by the department. Of these, a significant proportion were self-employed or sole contractors. The department states

that legal proceedings are initiated as an action of last resort and only after careful consideration of all aspects of a case.

Many submissions claim that the department takes a heavy handed approach to debt collection, and pursues debt rigorously and without tact. Some submissions allege that the department uses standover tactics in the form of intimidation and threats to obtain payments. While we make no findings in respect of individual cases, we are concerned at the pattern they reveal.

In the period 1 July 1998 to 30 June 1999, the department referred 1000 individuals for bankruptcy and 995 companies for liquidation. In 44 percent of those cases the proceedings referred have subsequently been withdrawn mainly because the debt was paid in full or arrangements were made to pay the debt over time.

The department considers bankruptcy and liquidation as a last resort. Several submitters claim the department instigates or threatens bankruptcy proceedings too readily. Submitters are of the view that the department is not prepared to consider alternative strategies or options. Many bankruptcy proceedings could be avoided if the department became actively involved in taxpayers' affairs sooner rather than later, to halt the growth of debt. By the time the department does get involved the debt is so large the department has no other choice but to bankrupt.

As stated earlier, the department is to take steps to be more proactive in identifying new debt more quickly. It will focus some of the debt collection follow-up from the call centres and use the benefit of the technology to more actively pursue debt. We welcome this initiative and hope this action will be a factor in lowering the number of department initiated bankruptcies. We consider this matter should be kept under review by the next Finance and Expenditure Committee.

Department's statutory preference in liquidation proceedings should be reviewed

The department has statutory preference in liquidations. The statutory preference is governed by section 312 of the Companies Act 1993 and the preferences are set out in the Seventh Schedule of the Act. The tendency is to pay out the department's tax preference, including interest and penalties, which appear not to have a statutory preferential status, dispose of any remaining assets (frequently there are none) and wind up the company. Remaining unsecured creditors are advised that there is no dividend and no fighting fund with which to litigate to recover bad debts or pursue delinquent directors.

Research on liquidations in the Wellington region was submitted to us by Ian Caddis and Jane Laking. The statutory preference of the department was identified as a major contributing factor to the dismal result of only two cents in the dollar being paid out to unsecured creditors. This has a significant flow on effect. The researchers conclude that the department loses more revenue than it collects in the liquidation process and this has a domino effect on other creditors who often fail as a consequence. Further,

it is not clear whether the statutory preference extends to the collection of penalties and interest as well as the core tax debt. We consider that these arguments are valid and **we recommend that the Government review the preferential status of the department in liquidations.**

Tax amnesty

Tax amnesties are commonly used when there is a major change proposed to a tax regime. Research indicates that a tax amnesty is most successful when changes are proposed to the method of detection or to the size of the penalties. PricewaterhouseCoopers submits the Government should promulgate a tax amnesty in which taxpayers with undeclared tax issues can pay off tax due from previous years without any penalties or interest being imposed. PricewaterhouseCoopers believes there are thousands of taxpayers living in fear of the consequences of not having declared income for tax purposes but who would like to bring their affairs up-to-date. People in this situation, however, feel unable financially and unwilling emotionally to approach the department for fear of significant penalties being imposed.

An amnesty was last held in New Zealand in 1988. The reason for this was to encourage people to come forward if they had failed to meet their tax obligations but also because the department had increased both its checks on tax evasion and the penalties for this offence. The amnesty ran for a two month period. Taxpayers who came forward at that time were still charged with a late penalty payment. This was done for reasons of fairness. If penalties had not been charged, non-compliers would have had the advantage of the use of that money and would have paid less tax than those who complied. Just over 16 000 taxpayers responded with an additional \$26.6 million of revenue being assessed. The majority (80 percent) of respondents were non-business taxpayers disclosing additional income from interest and dividend tax. This has since been addressed through withholding taxes.

Arguments put forward to support a tax amnesty note the potential receipt of tens of millions of additional dollars for the revenue. Aspects of the black economy may also be brought into the regulated taxation regime by allowing people to come forward without fear of prosecution and penalties. An amnesty could provide a mechanism to draw attention to the implications of not complying with the taxation Acts, it could stimulate voluntary compliance, and recover tax which might otherwise never be paid to the department. PricewaterhouseCoopers submits that a tax amnesty be held under which people would pay core tax owing but not penalties or interest. Such an action, in the submitter's view, would go some way to restoring faith in the integrity of the tax system.

There are several drawbacks to providing a tax amnesty, however. PricewaterhouseCoopers acknowledges that if an amnesty was introduced, it would need to be handled with due regard to all those taxpayers who have and continue to comply with their tax obligations. For this reason, PricewaterhouseCoopers does not recommend that any core tax amounts be

remitted. The 1988 amnesty attempted to find a balance between complying and non-complying taxpayers by charging a late payment penalty. The need to achieve a balance of this sort is a key disadvantage with holding a tax amnesty. A further consideration is whether the changes in the tax regime are significant enough or provide a sufficient incentive for non-compliant taxpayers to come forward. One further disadvantage of tax amnesties is that if they become a reasonably frequent occurrence non-compliers might be discouraged from coming forward in anticipation of another tax amnesty at a later time.

We find the arguments for and against a tax amnesty both have merit. We have no doubt that there are many taxpayers with a strong desire to regularise their tax situation and make a fresh start with the department but are afraid to do so because of the effect of compounding penalties. There needs to be due consideration, however, given to those taxpayers who do comply with their tax obligations. We do not believe it is appropriate for us to make a recommendation as to whether a tax amnesty is desirable at this time. This is a matter for the Government to consider.

Term of reference D:

To examine the feasibility and desirability of establishing a tax ombudsman to investigate taxpayer complaints

Complaint mechanisms within the department

We received overwhelming support from submitters for the establishment of a separate tax ombudsman to investigate taxpayer complaints. We feel this is more a reflection of the general frustration amongst some taxpayers with the lack of redress available to them from within the department. We consider the call to establish a tax ombudsman is a direct consequence of the disestablishment by the department of its Problem Resolution Service in 1996.

The Problem Resolution Service was established to resolve problems that could not be resolved through the department's standard procedures (that is, with the officer concerned or with the officer's manager). A dedicated Problem Resolution Officer was established in each district office to assist with cases where long delays had occurred or where taxpayers considered a decision to be incomplete or unfair. The Service was disbanded in 1996 after the Organisational Review which introduced segmentation into the department. The effect of this was to group all the information about a particular taxpayer within one managerial group. It was considered sufficient for the manager to act as the point of contact for any taxpayer complaints. Many submitters, however, feel this arrangement lacks transparency and independence.

Queries, complaints and disputes about technical tax matters are resolved under the disputes resolution procedures as set out in the TAA. This includes referral to the department's Adjudication Unit, which is an independent unit within the department set up to assess the merits of a case against a taxpayer before legal proceedings are initiated. From the evidence we received, there is general support for this practice and confidence in the neutrality and independence of the Unit. Ultimately taxpayer complaints of a technical nature are determined by the Taxation Review Authority or other courts. Complaints that may amount to a serious breach of the department's Code of Conduct are dealt with by the Internal Audit section of the department's National Office.

There are very few options, however, for a taxpayer who has a relatively "low level" complaint such as poor communication or the lack of timely responses from the department when dealing with a tax dispute. If the dispute cannot be resolved at the officer/manager level the other options available to the taxpayer are an approach to the Commissioner directly, to a local Member of Parliament, the Minister, or the Ombudsman.

Current role of the Ombudsman in tax matters

While there is no dedicated tax ombudsman in New Zealand, taxpayers can and do make complaints to the Office of the Ombudsman regarding any administrative action or decision made by the department. A specific

unit within the Office of the Ombudsman deals with complaints of this nature. The Ombudsman, however, cannot make determinative or binding decisions following an investigation of a complaint. The department, therefore, like any other government department is not obliged to follow the Ombudsman's recommendation. However, the department notes that it "accepts most recommendations".

The Ombudsman advised us that the number of general inquiries received relating to the department's administration of the tax laws has increased significantly over the past three years.¹¹ The major areas of complaint are:

- refusal of access to information requested by taxpayers
- failure to communicate adequately the reasons for a decision
- failure to respond to a taxpayer's communication within a reasonable time
- failure to take account of all relevant matters when exercising a statutory decision
- applying a narrow interpretation of statutory provisions.

Options for enhancing the Ombudsman function

PricewaterhouseCoopers submits there is no need for a separate tax ombudsman to be established provided the resources of the existing Office of the Ombudsman are strengthened by establishing a specialist tax team to review decisions made by the Commissioner as they relate to the department's administration of the TAA. PricewaterhouseCoopers is surprised that this expertise is not currently available within the Office of the Ombudsman given that tax issues represent the second highest number of complaints against government agencies. ICANZ submits that a tax ombudsman, whether separate from the existing Office of the Ombudsman or not, must have the requisite skills and experience, and have the unqualified support of the Commissioner who has in place a "fast track priority facility" to deal with tax ombudsman cases.

In 1995 in Australia a specialist tax ombudsman position was established within the Commonwealth Ombudsman Office. The establishment of this position was seen as a key mechanism in balancing the rights and responsibilities of the Australian Tax Office (ATO) and of the taxpayers. Publicity about and accessibility to the tax ombudsman are considered key performance objectives of the ATO. Areas of tax administration investigation undertaken by the tax ombudsman include debt recovery actions, decisions to bankrupt, conduct of audits, provision of advice, method of handling inquiries, remission of penalties, handling of correspondence, and delays in decision making. We note these areas in particular were all raised by submitters as problem areas with the department.

The Chief New Zealand Ombudsman, Sir Brian Elwood, submits there is no point in establishing a parallel office to his unless the powers of the tax

¹¹ In 1996/97 there were 80 complaints, in 1997/98 this rose to 119, and in the 1998/99 year the total number of IRD-related complaints was 189.

ombudsman are radically different from those which apply to the existing Ombudsman.

Sir Brian also submits that the investigation of complaints about the administration of the tax laws of New Zealand currently rests with the Ombudsmen as part of their general jurisdiction. The Ombudsmen undertake a review function and have the necessary statutory powers to enable them to do so. Sir Brian's view is that, given this background, there is no need to establish a separate and stand-alone Tax Ombudsman Office. If a specialist tax position was established along the lines of the Australian example, Sir Brian submits that additional resources would be required to undertake investigations. He suggests that the cost of additional specialist resources to deal with tax administration investigations would be less than the cost of establishing a stand-alone Tax Ombudsman Office.

We agree and note the majority of submitters on this issue are seeking a means of redress for administrative actions on the part of the department. There was no support for a separate tax ombudsman to investigate technical tax issues which, we agree, are best left for the courts to determine.

On a related issue, Sir Brian submits that the department has a statutory obligation to advise taxpayers of their right to seek redress from the Ombudsman. He suggests the department be required to inform a complainant, dissatisfied with the results of an internal inquiry, that they are able to lodge a complaint with an external review agency, such as the Ombudsman or the Taxation Review Authority. Sir Brian also suggests the Commissioner operate an internal complaints system headed by a complaints review officer who reports directly to the Commissioner. The Ombudsman further recommends section 81 of the TAA be reviewed so that taxpayers' access to information held about them by the department is improved. We deal with this issue elsewhere in this report.

Need for effective departmental complaints service

We conclude that the establishment of a separate Tax Ombudsman is not necessary. We do not think the cost of such an establishment (estimated at approximately \$1 million) is warranted, especially as we do not recommend that a tax ombudsman exercise determinative powers in respect to technical tax matters. We agree that the current powers of the Office of the Ombudsman are sufficient to investigate complaints of tax administration.

We believe there is a public perception that a fundamental imbalance exists between the powers of the department and the taxpayer. Recent changes in the tax laws have imposed on taxpayers significant compliance obligations, the department has at its disposal extensive investigatory powers which are less well supervised than those of the Police, and the burden of the "onus of proof" all combine to produce an impression that it is impossible and perhaps foolhardy to "take on" the department. The issue for us, therefore, is the need to ensure the tax system provides a ready and inexpensive avenue through which taxpayers can find redress.

There should not be a need for taxpayers to engage professional help to sort out unacceptable administrative performance which has already been the subject of meaningful resolution attempts by the taxpayer.

We also consider the segmentation of the department has failed to achieve the desired outcomes in respect of problem resolution. Before initiating an investigation into a complaint, the Ombudsman must be satisfied that genuine efforts have been made to resolve the dispute through the department's dispute resolution procedures. In the case of tax administration issues, we do not consider the current procedures of officer/manager resolution followed by an approach to the Commissioner or a Member of Parliament represent such an effort. We believe that a greater onus on the department to provide an avenue for problem and complaint resolution is required.

We recommend a problem resolution service, similar to that established in 1989, be reinstated. We recommend the department commit adequate resources to this service in terms of experienced personnel and personnel committed to "win-win" outcomes. We believe that if such a service is set up many taxpayer issues will be resolved at an early stage at the least personal and financial cost to taxpayers concerned. If this is done, we feel that recourse to the Office of the Ombudsman will be limited to the more serious cases of alleged mistreatment. We also consider that such a service, if properly resourced and well publicised, will be seen as a significant step by the department to improving equity in the tax system.

We consider the Office of the Ombudsman should be augmented by the establishment of a tax specialist with appropriate resources as in the Australian practice.

We recommend:

- **the department re-establish a problem resolution service with experienced personnel committed to customer satisfaction outcomes**
- **the department ensure that the problem resolution service, once established, is well publicised**
- **the department advise all complainants, dissatisfied by the results of an internal inquiry, of their rights to appeal to an external agency**
- **the Government establish a specialist tax adviser position within the Office of the Ombudsman with appropriate resources to investigate matters of tax administration by the department. We consider establishing a separate tax ombudsman's office is not desirable.**

Term of reference E:

To review whether the structure, operation and culture of the Inland Revenue Department, and its understanding of the law, have affected the department's application of the compliance and penalties regimes and the service it provides to taxpayers and their agents

Structure

Overview of structure

The current organisational structure was put in place as a consequence of the 1994 Organisational Review of the Inland Revenue Department.

The department is structured on the basis of four business units:

- *Policy Advice*—responsible for development of tax policy.
- *Adjudication and Rulings*—undertakes the final quantification of taxpayer liability in disputed cases and provides rulings.
- *Operations*—responsible for providing the bulk of services to taxpayers and their agents.
- *Strategic Services*—provides specialist management advice to the Chief Executive and senior managers.

The Operations business unit has the most interactions with taxpayers and is responsible for providing the bulk of services to taxpayers. The provision of services to taxpayers and their agents is managed by means of a ‘‘hub and spoke’’ model of field delivery. There are three office types:

- *Service Centres*—large metropolitan hubs responsible for managing the other offices within their area with a range of centralised technical and support functions.
- *Branch Offices*—smaller offices, located in non-metropolitan areas providing all functions, such as services, debt and return management and audit.
- *Customer Service Offices*—relatively small offices which largely provide service functions centred on the operation of a public counter.

Current changes and restructuring

The department is in the process of implementing major structural changes as a result of the Government's decision to implement tax simplification initiatives for salary and wage earners. Implementation of the tax simplification programme and the introduction of call centres have substantial implications for the future structure of the department.

The change process markedly alters the manner of service delivery. The call centres will respond to the majority of taxpayers' queries. The immediate result of this will be the removal of the majority of advisory staff from the branch offices.

Call centres and electronic filing are new delivery mechanisms which will significantly change the nature of interactions with customers and the skill

needs of the organisation. The changes currently affect the Operations business group. Staffing reductions of around 700 full-time positions will result and 11 of the current permanent sites will close. Most telephone calls will be centralised into five call centres.

The department is to close the nine customer service offices and its two smallest branch offices (located in Greymouth and Alexandra). Office closures are timed for March 2000. While we are generally supportive of the broad direction of the simplification programme and the restructuring, the office closures will substantially reduce the capability of the department to provide face-to-face services to taxpayers. A taxpayer facing difficulty with their tax affairs will often be able to resolve problems more easily dealing with an officer in person. Disputes and problems can thus be resolved before they escalate. Not having access to a face-to-face service may cause frustration and annoyance among taxpayers and impact on the perceived fairness and integrity of the tax system. We consider the effect of the loss of face-to-face services should be closely monitored by the next Finance and Expenditure Committee and **recommend that the department investigate ways to preserve over the counter services in areas where it is closing offices, particularly in isolated areas.**

Initiatives such as the establishment of mobile offices and the creation of a network of agencies should be considered.

Quality of telephone services

Given that the vast majority of taxpayer contacts with the department in future will be over the telephone, it is imperative that the department provides outstanding service in this area. The department has performance targets of answering:

- 80 percent of calls within 20 seconds at the Business Call Centre
- 70 percent of calls within 30 seconds at the Personal Call Centres.

We note that these targets are broadly in line with international benchmarks for call centres. We have been sharply critical of the quality of the department's telephone services in the past. The department has responded to criticism of its service by devoting more staff to answering calls and has sought to minimise the need for people to contact the department by simplifying requirements and improving statements.

We note that around 13 percent of all calls to the call centres are currently being abandoned. This rate of call abandonment is too high. We understand that the call centres have only been in operation since April 1999 and difficulties can be expected while the system is bedded in. However, we would expect to see significant reductions in abandonment rates in the very near future. This is a matter which should be closely monitored by the next Finance and Expenditure Committee.

The quality of the department's telephone services is dependent not only on the timeliness with which calls are answered, but also on whether queries are being dealt with to taxpayers' satisfaction. ICANZ submits that its members complain they cannot get access to knowledgeable staff and

that they are left waiting on the telephone for up to 30 minutes. Several other submissions lend support to this claim, as do the personal experiences of members of the committee. This is unacceptable. Clearly it is crucial that frontline staff have the knowledge and skills necessary to provide taxpayers with prompt and accurate service. The consequences for taxpayers when they are misinformed can potentially be dire. **We recommend the department enhance its monitoring of telephone services to ensure greater timeliness and accuracy of responses and that the department identify and remedy any skills deficiencies as a matter of priority.**

We understand that the Business Call Centre has been primarily staffed by employees with no background in tax matters who have been trained in the various tax questions most likely to be received. According to the State Services Commission, staff received a month's full-time training prior to the call centre going on-line. In hindsight this appears to have been inadequate. However, as staff members spend time in the job we expect deficiencies in knowledge to be overcome, as long as staff can be retained and training is ongoing. This is a further matter which should be monitored and reported on by the next Finance and Expenditure Committee. In particular we suggest the committee should consider whether the call centres are retaining sufficiently skilled staff and should assess whether staff are being adequately trained.

Responses to written correspondence require improvement

A very large number of submissions complain about the department's poor performance in the manner in which it deals with correspondence. Numerous examples were given where the department has not responded to correspondence, has been tardy in its response or has provided an unsatisfactory response. We note that the department accepts many of these criticisms. Delays in replying to correspondence are particularly unacceptable when taxpayers are in arrears and are accumulating penalties. The department needs to take particular care to deal with such cases expeditiously. This is another aspect of the department's operations which should be closely monitored by the next Finance and Expenditure Committee. **We recommend that the department take steps to enhance the timeliness and quality of its responses to written correspondence, and that the performance standard in the 1999/2000 Purchase Agreement of dealing with all correspondence within eight weeks of receipt be reviewed.**

Internal provision of drafting services inappropriate

The Policy Advice division of the department contains a legislative drafting unit which, under an Order in Council made in 1994, has responsibility for the drafting of tax legislation. The department is the only Government department which is responsible for drafting its own legislation. We considered whether this is appropriate. We understand that the department was given responsibility for drafting tax bills in 1994 in

order to speed up the process and to overcome some managerial deficiencies within the Parliamentary Counsel Office. We understand that these have now been resolved.

We consider that there are a number of reasons why it is undesirable to allow the department to draft its own legislation. Primarily we are concerned that allowing the department to both initiate and draft its own legislation allows tax legislation to progress without the scrutiny of an agency set aside from policy considerations. Issues of importance in the wider public policy context can potentially go unraised as a consequence. Furthermore, the Parliamentary Counsel Office and the Chief Parliamentary Counsel set drafting standards. The department is not bound by those standards. We do not consider it desirable that drafting standards and style for tax legislation differ from all other forms of legislation. Additionally, there is an efficiency argument in favour of having a single drafting agency. Having an agency competing for drafters splits the already small talent pool. We are concerned that this will lead to the more talented drafters being attracted to the department's drafting unit if it is able to offer more attractive employment packages. This could have potentially serious implications for the overall quality of legislative drafting.

We consider that the arguments for moving the responsibility for drafting tax legislation back to the Parliamentary Counsel Office have merit and are worthy of further consideration. **We recommend that the Government consider moving the responsibility for drafting tax legislation back to the Parliamentary Counsel Office.**

Desirability of a board of directors should be considered

We consider that an improvement in the accountability arrangements for the department is necessary. Given the wide powers of the Commissioner and the degree to which authority is delegated, we believe that a specialist body, in the form of a board of directors, to review the performance of the department and to review the Commissioner's performance in discharging his or her statutory responsibilities may be desirable. This board could be modelled on the Board of Directors of the Reserve Bank of New Zealand, in that it would have a general oversight function, but would not be involved in the day to day operations of the department. We do not envisage such a board as a limitation on the statutory powers presently conferred upon the Commissioner.

Any board should be staffed by those with expertise in areas such as the management of large service organisations, customer service, tax law and information technology. Functions of the board could include providing independent reports to the Minister of Revenue on the health of the tax system, the stewardship of the department, the operation of the penalties regime and the strategic direction of the department.

Any such board should not have access to specific taxpayer information and should have no involvement in specific matters relating to the interpretation and enforcement of tax laws, tax legislation or day to day operational decisions.

We recommend that the Government consider whether establishing a board of directors to provide an oversight of the department's operation of its powers is desirable.

Culture

The culture of any organisation stems from its leaders. Some submissions to us suggest that the department's senior management team, including the Commissioner, have engendered a culture of punishment and fear which impacts upon both staff and in turn taxpayers. Irrespective of the extent to which this is true, we believe that there must be a cultural shift within the department, and that shift *must* come from the top.

We acknowledge that the department has a compliance and enforcement function which often requires it to take firm steps to ensure taxpayers are meeting their obligations. However, from the evidence we heard, we consider that the department's culture is one which sometimes emphasises enforcement at the expense of providing a courteous and professional service to taxpayers. The fact that taxpayers have obligations which must be met does not excuse the manner in which some taxpayers have been treated by the department.

We do not consider that the department needs to use the threat of sanction as a means to encourage compliance to the extent that it currently does. The vast majority of taxpayers will willingly comply with their obligations, as long as they are treated civilly and are made aware of their responsibilities. We do not question that the law will at times need to be firmly enforced. However, we believe that the pendulum has swung too far towards the use of sanctions and threats to enforce compliance. Taxpayer satisfaction must become paramount for the department.

Having said that, we do not wish to denigrate the department's employees. We believe, however, that the level of communication between National Office and the coalface needs improvement. The Public Service Association spoke to us of a culture of "punishment and fear" in the department and of management imperatives which stress efficiency and speed over quality of service. It believes such an approach can lead to undue pressure being placed on staff to meet unrealistic or inappropriate performance targets, which in turn can lead to a breakdown in the department's relationships with taxpayers.

What we consider is required is an attitudinal shift. This shift needs to come from senior management and involve a restatement of values focussing on the needs of the department's customers.

We consider that it is imperative that the Commissioner strongly re-emphasise to staff the importance of the values and behaviours that contribute to a strong organisational culture. There are currently seven Organisational Commitments which were developed in 1996 and are included in the department's Code of Conduct for staff. They are:

- *Recognising and meeting customer needs.* Providing an effective customer service by pursuing excellence and being fair, efficient and responsive to the diverse needs of customers, and constantly looking for better ways of doing things.
- *Highly ethical behaviour.* Maintaining the highest standards of trust, confidentiality and integrity in work and relationships with others.
- *Positive work environment.* Encouraging open communication and cooperation, making use of the widest range of skills, experience and diversity and providing opportunities for development.
- *Encouraging voluntary compliance.* Seeking to make compliance easier and less costly while being fair and firm with non-compliers.
- *Recognising the importance of cooperation.* Working together to improve job satisfaction and achieve better results.
- *Treaty of Waitangi obligations.* Seeking to meet treaty obligations and providing opportunities for staff to further develop their understanding of Māori and their working relationships with Māori.
- *Exercising good judgement.* Exercising good judgement while promptly correcting any mistakes and learning from them.

We understand that these commitments form the base on which core competencies for staff are built.

We consider the commitments themselves, if adhered to, are appropriate to the work the department has to undertake. Clearly, however, the evidence we heard points towards instances where these commitments were not being followed, and an example not being set by senior management. Our attention was drawn to inappropriate cartoons in the department's internal practice documents. While we accept the Commissioner's statement that no one in the current senior management team was aware of the cartoons until recently, their very existence indicates the commitments are not being reinforced adequately. While this specific issue has been addressed, it is the Commissioner's duty to ensure that all staff are made aware of the commitments and to take action where it is demonstrated that they are not being followed. We expect this duty to be carried out.

Affecting cultural change in an organisation the size of the department is not a task which should be taken on lightly. However, we consider such a change is necessary to complement the proposed changes in policy and legislation outlined in this report and to maintain the integrity of the tax system. We understand that improvements in staff training will be made to assist in improving the culture. Training will focus on communication skills and customer service training as well as courses in negotiation techniques for debt management staff. We welcome these initiatives.

We recommend that the department implement, as a matter of priority, a nationally consistent training programme aimed at improving communication and customer service skills.

The department is also reviewing the form of its system-generated correspondence to improve, to an acceptable professional standard, its content and tone. Many submissions noted the heavy-handed tone of much

of this type of correspondence from the department and we are encouraged that the department has pledged to act to remedy this.

Staff require greater interaction with business community

We consider that the department's relationships with small taxpayers often break down because the department does not understand sufficiently the pressures facing small businesses in meeting their tax obligations. We consider this could be remedied in part by the department initiating a programme whereby officers of the department in areas such as debt management and operations get given the opportunity to interact more frequently with the business community and small business in particular. This would enable them to get a feel for the pressures businesses work under and help to improve the working relationship between the department and business. **We recommend the department consider implementing a programme along similar lines to the Business and Parliament Trust, which would enable staff to build relationships with and have greater exposure to the business community.**

Understanding of law

Tax legislation is extremely complex. The practice of tax law is considered one of the most intellectually demanding areas in large corporate law firms. We consider that improving the department's understanding of the law is primarily a human resource issue. The department needs to attract and retain skilled tax professionals. The department's work programme for 1999/2000 includes the implementation of new remuneration structures to ensure pay levels are appropriate to the market in those areas in particular where technically skilled staff are required to be recruited and retained.

The majority of us have no comment to make as to whether the department acted competently with respect to seeking prosecutions on "winebox" transactions. This issue has been comprehensively examined in the courts and the Commission of Inquiry into Certain Matters Relating to Taxation. We note that the Commissioner is seeking the advice of the Solicitor-General with respect to prosecuting those involved in certain winebox transactions following the recent High Court ruling overturning findings of the Commission of Inquiry. We consider this is an appropriate step to take.

Taxpayers' charter

Many submissions raised the idea of establishing a charter of taxpayers' rights. Currently the department has a customer charter which sets out very simply what a taxpayer's rights and obligations are when dealing with the department. We do not believe that this customer charter goes far enough. Very few people are aware of its existence, and a taxpayers' charter should be widely advertised so all taxpayers are aware of what is expected of them and the department when being audited.

A more comprehensive taxpayers' charter could be based on the following which is drawn from charters in other tax jurisdictions:

This Charter deals with your rights and obligations and the level of service you will receive in your dealings with the Inland Revenue Department. While you are obliged to co-operate with the audit process, these rights are designed to protect you from unreasonable demands, to minimise disruption of your business or personal life during the audit, and to protect you from arbitrary actions.

1. Co-operation and Professionalism
 - 1.1 We will be client focussed and co-operative.
 - 1.2 We will act ethically and with honesty and integrity.
 - 1.3 We will treat you in a professional, objective and fair manner.
2. Assistance
 - 2.1 We will help you understand our processes and practices regarding tax collection.
 - 2.2 We will provide you with information concerning your taxation obligations.
 - 2.3 We will explain our decisions under the tax laws and will advise you of the identity of, and enable you to directly contact, the decision maker.
3. Privacy & Confidentiality
 - 3.1 We respect your privacy and will treat all information collected or received as private and confidential.
 - 3.2 This information will be kept secure and will only be used or disclosed in accordance with the law.
4. Service Orientation
 - 4.1 We will treat you with courtesy and respect.
 - 4.2 We will provide competent, timely and consistent service.
 - 4.3 We will respond promptly to your letters and telephone calls.
5. Investigations
 - 5.1 Where practicable we will give you reasonable notice of our intention to conduct an investigation.
 - 5.2 We will arrange a suitable time and place for an interview and allow you time to prepare your records.
 - 5.3 We will explain the audit process and will advise you of the scope and nature of our enquiries.
 - 5.4 We will give you an indication of how long the audit should take.
 - 5.5 On completion of the audit we will formally notify you of the result.
6. Right to instalment arrangement

You can request to enter into an instalment arrangement if you;
Have filed your returns and paid tax on time for the past five years; and
Have not entered into an instalment arrangement before.
7. Objection, Review and Appeal
 - 7.1 We will explain your rights and the process to you.
 - 7.2 We will ensure that your objections are dealt with by an independent officer and without bias.
 - 7.3 If your objection is partially or fully disallowed we will provide you with a formal statement of reasons.
 - 7.4 If you are dissatisfied with the outcome of an objection you have the right to lodge an appeal.
8. Your obligations
 - 8.1 We are committed to treating your complaints seriously and will endeavour to resolve them quickly and efficiently.
 - 8.2 If you believe your rights as detailed in this Charter have not been adequately met please contact the Complaints Centre.

A further issue is whether there should be a time limit on taxpayer audits. Some submissions suggested that the department has all the power when conducting an audit. This power imbalance causes unnecessary and unwanted stress. There are many obligations imposed on the taxpayer, but the perception is that the department has few, if any, obligations imposed on it. Many of the suggestions contained in the taxpayers' charter help to redress this concern through a commitment to responding to correspondence and phone conversations in a timely manner. Including a time limit on taxpayer audits would go one step further in imposing an obligation on the department to raise its efficiency standards and complete audits as quickly as possible. For this to work the taxpayer would in turn have to ensure all documents were provided as quickly as possible.

We believe a taxpayers' charter similar to one outlined above would be advantageous in New Zealand. We would expect it to be widely publicised to ensure that all New Zealanders were aware of its content.

We recommend that the department establish a taxpayers' charter to outline to taxpayers their rights and obligations in respect of the tax system.

Conclusion

We are pleased to see that in the wake of our inquiry the Government has announced proposals to make a number of policy and administrative changes to enhance the fairness and clarity of the tax system. It is also pleasing to see steps being taken to simplify the tax system for small businesses. This should reduce compliance costs and make it easier for businesses to meet their obligations. However, we consider that more is required for perceptions of the fairness of the tax system to improve markedly. Our recommendations, if acted on will, in our view, greatly contribute towards this.

In addition to legislative and policy changes, we consider a shift in culture is necessary. We note that an effort has begun. However, more is required to ensure that the focus of the department is on achieving the highest standards of service possible to taxpayers.

We consider that the next Finance and Expenditure Committee has a significant role to play in continuing to examine the powers and operations of the department. Primarily, we suggest the next committee should:

- closely examine the outcome of the post-implementation review of the compliance and penalties regime
- review the effectiveness of the department's new organisational structure to assess whether service to taxpayers has been improved
- assess the adequacy of the Government's response to the recommendations in this report.

Appendix A

Terms of reference

The Finance and Expenditure Committee resolved to conduct an inquiry into the powers and operations of the Inland Revenue Department on 3 March 1999, with the following terms of reference:

- (a) To review the powers of the Commissioner of Inland Revenue to assess and collect income tax pursuant to the Tax Administration Act 1994 and other relevant Acts and to assess whether these powers are justified.
- (b) To review the Inland Revenue Department's application of the compliance and penalties regime established under the tax Acts, including the process by which and the rate at which use of money interest is set, and also the simultaneous application of compounding late penalty payments.
- (c) To review the debt management practices and the adequacy of the powers of the Inland Revenue Department to remit tax liabilities or enter into arrangements for deferring the payment of tax and the department's operation of its powers.
- (d) To examine the feasibility and desirability of establishing a tax ombudsman to investigate taxpayer complaints.
- (e) To review whether the structure, operation and culture of the Inland Revenue Department, and its understanding of the law, have affected the department's application of the compliance and penalties regimes and the service it provides to taxpayers and their agents.

Approach to inquiry

We invited certain organisations to make submissions on the inquiry. We also called for public submissions with a closing date of 30 April 1999. Hearing evidence took 52 hours, including over 12 hours from the department. We spent a further nine hours in consideration. We received 188 public submissions on the inquiry from the organisations and individuals listed in Appendix B. We heard 53 submissions in public.

Committee members

Hon Peter Dunne (Chairperson)
Belinda Vernon (Deputy
Chairperson)
Mrs Jenny Bloxham
Hon Dr Michael Cullen
Ruth Dyson
Hon Peter Gresham

Rodney Hide
Alec Neill
Rt Hon Winston Peters
Mark Peck
Ian Revell
John Wright

Committee staff

Nick Aldous
Ainslie Rayner
Louise Sparrer

Appendix B

List of Inland Revenue Department submissions

- IRD/INQ/1–14 (initial briefing material provided to committee)
- Inland Revenue Department responses to committee requests for information dated 15 June 1999, 23 June 1999, 7 July 1999, 12 July 1999, 20 July 1999, 11 August 1999, 31 August 1999, 3 September 1999, 7 September 1999, 17 September 1999 and 5 October 1999.
- Inland Revenue Department responses to issues raised in specific submissions dated 31 May 1999, 8 June 1999, 14 June 1999, 15 June 1999, 23 June 1999 and 30 June 1999.
- Final submission from the Inland Revenue Department dated August 1999.
- Response under natural justice provisions from Commissioner of Inland Revenue, dated 17 September 1999, to allegations made in submissions.
- Submission from Commissioner of Inland Revenue, dated 5 October 1999, on draft adverse findings.

In addition to the above, the department provided the committee with approximately 37,000 pages of documents requested by the committee. The index to these documents is IRD/INQ/5.

List of public submissions

1W	C McKnight
2W	Elgin Ross Limited
3W	T Higham
4W	W Deeming
5W	E R Harrison
6W	Denco Audio Ltd
7W	M Bailey
8W	B Silvester
9W	S Johnson
10W	A McIntosh
11W 11WA	R Engel
12W	P Cornelius
13W	L Middlemiss
14W	B Steel
15W	Taranaki Farmers
16W	ADALEC Products Ltd
17W 17WA	Barry I Rusden
18W	John McNeil
19W	Trevor Phillips
20W	Phil Bowering
21W	Ralph L Martin
22W	Mr K A Donoghue
23W	IG & JM Newman Partnership
24W	A Flavell
25W	DFL Money
26	Ron Peek
27W	Mountain Beech Apiaries
28W	B R Hansen

29W	P M Wright
30W	Peter Jones Chartered Accountants
31	J McNeil
32W	W F & PD Pearson
33W	Independent Business Foundation
34W	Accounting Action
35W	J P Coutts
36W	P Maskery
37W	J A Sheat & W C Sheat
38 38A—38E	B M Grierson
39	R Denby
40	Leep Consulting
41W	S Wilson
42W	W R Faulkner
43W	Berry & Walker
44W	Harley Cooke Real Estate
45	B Sutherland
46W	Sea Air and Land Communications Ltd
47W	Colbert Cooper Ltd Chartered Accountants
48W	British Pensioners Association (NZ) Inc
49W	David Deck Public Accountant
50	P Williams
51W	D Kindley
52W	I Horn
53W	Objective Communications
54W	D Harry
55W	G Kent
56W	S Leonard-Taylor
57W	L M Leighton
58W	M Yurjevich
59 59A	G Cosgrove
60W	B G Mullane
61W	A D Reveley
62W	C J Peterson
63W	J Kingsbury
64	Te Huinga O Te Whanau (Peoples Project) Inc.
65W	T & P Robinson Te Karaka Bakery Store
66W	A H S Bridgman
67W	Mr H N Healey
68W	Mr SPJ Smith
69W	A Calcott
70W	A Sutherland
71W	C R Middleton
72W	Federated Farmers of New Zealand (Inc)
73W	R Tattershaw
74W	S Schurgers
75W	F G Respinger
76W	E W G Taylor
77W	M R Allen
78 78A	Montgomerie & Associates
79	Design Association New Zealand Inc.
80	Managing Director ACE Payroll Plus NZ
81 81A—81C	Engineering Contractors (New Zealand) Limited
82 82A	Nigel Smith & Associates Ltd
83W	SBT Business Centre
84	Wgton/Hutt Valley Branch Cactus & Succulent Society of N Z (Inc)
85	R I Monks

86	P W Drysdale
87W	R Thompson
88	McNally Farm Systems Ltd
89W	State Services Commission
90W	G Hills & G Stenhouse
91	M V Hay
92W	B J Douglas
93W	D Hare
94	Sea-Right Investments Ltd.
95W	J Saunders
96W	P D Milne
97W	B K Knowles
98W 98WA	Horwath Wellington Chartered Accountant
99 99A—99B	G R Somerville
100W	Schnauer & Co
101	NZ Public Service Association
102W	T Cox
103 103A—103B	P D Ramsay
104W	P A Burgess
105W	T Angelo
106W	B Williams
107W	Fitzherbert Rowe Lawyers
108W	Marshall Associates Ltd
109W	B K Knowles
110W	S Gallagher
111 111A—111F	M J Scott
112	R & P T Broughton
113	Luke Cunningham & Clere Barristers & Solicitors
114	National Council of Women
115W	Darryl Ward
116 116A	Auckland Regional Chamber of Commerce
117	C G Duff
118	R Smith
119W	F D Bailey
120	D Henderson
121 121A—121C	Institute of Chartered Accountants of NZ
122W	H P Hanna & Co Chartered Accountants
123W	Baycorp Holdings Limited
124W	J C Berry
125 125A	H Speirs
126W	T P Patterson
127	Harts Gauld Ltd Chartered Accountants
128W	Neil Allan Signs (1984)
129W	A L Stevens
130W	C Munn
131 131A—131B	D Powell Chartered Accountant
132W	Y E Smith
133	Ebbett Automation Ltd
134W 131A-131B	Kahu Heartland Farm
135W	M H Anderson
136W	J N Barker
137W	G D R Sword
138W	Richards Woodhouse Chartered Accountant
139W	M Smith
140W	R J F Witten
141W	McCallum Petterson Forensic
142	R Wilson
143W	B S Palliser Hill Lee & Scott

144W	M H White
145	S E McLeod
146W	Castle/Brown, Barristers and Solicitors
147W	A W Taylor
148 148A—148B	Retail Merchants Association of NZ Inc.
149W	D Glew
150W	R & J Clark
151W	P A Verry & Associates
152 152A—152C	T P Brady NZ Taxpayer Rights Movement
153	Robert Cooper Chartered Accountants
154 154A	Libertarianz
155W 155WA-155WB	R Cullen
156 156A	PricewaterhouseCoopers
157W 157WA	P Graham
158	Denham Martin & Associates
159W	Grant Turnpenny
160–160A	M Webley
161W	J Watson
162W—162WA	R D Harder
163W	G Liston
164	Newlandia Industries Limited
165W	L M Wright
166W	Business Professional Services Ltd
167 167A	K F M Ritchie
168W	B Milne
169W	C J Tweed
170W	R E Andrew
171W	A Phillips
172W	G C Novak
173W	S L Jasper
174 174A	T Norriss
175 175A—	
175B	Privacy Commissioner
176	G Howden & R Voice
177W	Flyger and Associates Chartered Accountants
178W	N S Shepherd
179W	I Gaskin
180W	G J Smith
181W	S Dewing
182W	F Spence
183W	M Duncan
184 184A	I Caddis/J Laking
185W	D M Parsons
186W	J & T Pearce
187–187A	Chief Ombudsman
188–188A	NZ Law Society

In addition to the above submissions the committee received a number of submissions in private and secret. The committee also received and considered numerous items of correspondence after the closing date for submissions.

