Disputes: a review

An officials' issues paper

July 2010

Prepared by the Policy Advice Division of Inland Revenue and the Treasury

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Disputes: a review – an officials' issues paper.
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Chapter 1

INTRODUCTION

1.1 Like all laws, the interpretation and application of tax laws invariably end up in dispute in some cases. Tax systems must allow these disputes to be efficiently resolved and a regular review of the resolution mechanism is therefore necessary.

1.2 The way Inland Revenue conducts its disputes process results from the *Organisational Review of the Inland Revenue Department* (the Richardson Committee).[1] The recommendations of the Richardson Committee were subject to a post-implementation review, the key aspects of which were included in the 2003 Government discussion document, *Resolving tax disputes: a legislative review*.[2] This issues paper follows these previous reviews to focus on some remaining areas of concern for both taxpayers and Inland Revenue.

1.3 This document does not propose major changes to the existing disputes process. Instead, it:

- outlines administrative changes currently being implemented by Inland Revenue that are designed to help the process work more efficiently for all concerned; and
- suggests a limited number of legislative changes to remedy areas that are not working in a way that reflects the policy objectives of the process, or to complement and give effect to the revised administrative practices.

1.4 Unless otherwise stated, all legislative references in this document are to the Tax Administration Act 1994 (the TAA).

Policy objectives of the disputes process

1.5 The policy objectives of the disputes process remain the same as those set out in the 2003 discussion document (p1), which stated that:

> The objective of the legislative disputes process is to ensure that an assessment is as correct as is practicable and to deal with any disputes over tax liability fairly, efficiently and quickly. The disputes process is designed to achieve these objectives by ensuring a high level of disclosure of relevant information and discussion between the parties, which encourages them to place "all cards on the table". The procedures require time and effort to be put into all cases early in the process before an assessment which would alter a position in a taxpayer's return is issued.

[1] *Organisational Review of the Inland Revenue Department, Report to the Minister of Revenue (and on tax policy, also to the Minister of Finance)* from the Organisational Review Committee, April 1994, Chapter 10.
[2] *Resolving tax disputes: a legislative review*, a government discussion document first published in July 2003.

The overall objectives of the process have, therefore, been to improve the quality and timeliness of assessments and reduce the likelihood and grounds for litigation.

Context of this review

1.6 In August 2008 the New Zealand Institute of Chartered Accountants (NZICA) and the New Zealand Law Society sent a joint submission to the Minister of Revenue and the Commissioner of Inland Revenue summarising their members' concerns about the disputes process. While the submission acknowledged that the underlying principles set out by the Richardson Committee were sound, they highlighted the following matters as causing some remaining concern:

- The quality of Inland Revenue disputes documentation is variable, especially notices of proposed adjustment (NOPAs) issued by the Commissioner.
- The conference phase in particular does not encourage full and open communication.
- There is no unilateral right for taxpayers to opt out of the disputes process.
- The evidence exclusion rule, which is designed to prevent "trial by ambush", can result in high compliance and administration costs in an effort to include every conceivable argument and piece of evidence in the statement of position (SOP).
- There is no timeframe within which the Commissioner must issue a SOP, other than within the general time-bar for amending assessments.
- What constitutes an "exceptional circumstance" is too narrowly defined.
- The current mechanisms for dealing with small claims are inadequate, resulting in taxpayers abandoning legitimate disputes.
- The procedure for test cases is inadequate.

1.7 This issues paper examines these concerns and discusses some possible options for resolving them. It also discusses a number of remedial matters that logically fall within the ambit of this review.

Approach to this review

1.8 The disputes process is, and should continue to be, about how the process operates in practice. While some legislative provisions are required for any disputes process, these should simply provide a framework for the administrative process, rather than rules that the administrative process has to shape itself around.

1.9 As noted by the NZICA-NZ Law Society submission, the legislation surrounding the disputes process appears to be broadly adequate. Substantial changes to the legislation have the potential to result in numerous disputes to test the boundaries of the changes, rather than focussing the parties on the substantial issues at hand. We note the current rules have themselves been heavily litigated since their introduction.

1.10 While there may be a small number of inconsistencies between practice and policy, these matters should continue to be tackled through administrative change and guidelines wherever possible, rather than through legislation. The majority of the issues in question can be adequately dealt with through published standard practice statements and internal procedures that will ensure greater clarity and consistency for taxpayers and still meet the over-riding policy objectives of the disputes process.

Summary of suggested options

The main options covered in this paper are:

- Whether taxpayers should have a unilateral right to opt out of the disputes process (Chapter 3).
- Whether the current evidence exclusion rule is working as intended (Chapter 4).
- Whether the Commissioner should be subject to more prescribed timeframes in the disputes process (Chapter 5).
- What the scope of the "disputable decision" definition in relation to certain specific decisions of the Commissioner should be (Chapter 6).
- Whether the "exceptional circumstances" definition is too narrow (Chapter 7).
- Whether the disputes system deals adequately with smaller tax disputes (Chapter 8).
- Whether there should be changes to the way test cases are designated (Chapter 9).

1.11 Simultaneously with the release of this issues paper, Inland Revenue has released revised standard practice statements (SPSs) related to the disputes process for public consultation. The revised SPSs document changes to the current standard practice in the following key areas (which are also discussed in more detail in Chapter 2):

- preparation of the Commissioner's NOPA;
- conduct of a conference;
- conference facilitation; and
- opting out of the disputes resolution process.

1.12 We believe that these revised SPSs will greatly facilitate a swifter and more accessible dispute resolution process and will address many of the concerns raised by NZICA and the NZ Law Society. This paper is prepared on the understanding that the revised SPSs will take effect broadly in the manner set out in Chapter 2.

1.13 The legislative changes suggested in this paper include:

- A limitation of the evidence exclusion rule to the "issues" and "propositions of law" raised by the parties in their SOPs.
- Amendments to the definition of "exceptional circumstances" to include a separate test based on a taxpayer's "intention to dispute", and for the Commissioner's decision on such matters to be "disputable".
- The removal of certain matters from being "disputable decisions".
- The repeal of the small claims jurisdiction of the Taxation Review Authority.
- Amending the test case procedure either to allow for the designation of test cases to be decided by the High Court or for existing court rules to perform a similar function.
- Other remedial matters.

How to make a submission

1.14 Submissions on either or both this paper and the revised SPSs should be made by 20 August 2010 and can be addressed to:

Disputes Project
C/- Deputy Commissioner
Policy Advice Division
Inland Revenue Department
P O Box 2198
Wellington 6140

1.15 Or email: policy.webmaster@ird.govt.nz with "Disputes Project" in the subject line.

1.16 Submissions should include a brief summary of major points and recommendations. They should also indicate whether it would be acceptable for officials from Inland Revenue to contact those making submissions and to discuss their submission, if required.

1.17 Submissions may be the subject of a request under the Official Information Act 1982, which may result in their publication. The withholding of particular submissions on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. Accordingly, those making a submission who feel there is any part of it that should be properly withheld under the Act should indicate this clearly.

Chapter 2

ADMINISTERING THE DISPUTES PROCESS

2.1 The current disputes process involves the following sequence of events:

- A notice of proposed adjustment (NOPA) is issued by either the Commissioner or taxpayer to the other advising that an adjustment is sought to the taxpayer's assessment, the Commissioner's assessment or a disputable decision.
- A notice of response (NOR) is issued by the recipient of a NOPA if they disagree with it.
- A disclosure notice is issued by the Commissioner.
- A statement of position (SOP) is issued by both parties, providing an outline of the issues, facts, evidence and propositions of law with sufficient details to support the position taken.

2.2 There are also two administrative phases in the process – the conference and adjudication phases. If the dispute has not been resolved after the NOR phase, a conference will generally be held to clarify and, if possible, resolve the issues. If the dispute remains unresolved after the SOP phase, the Commissioner will usually refer the dispute to the Adjudication Unit, which is the final process before any amendment to the taxpayer's assessment.

2.3 The full disputes process is set out in the Annex to this paper.

2.4 The efficient resolution of disputes is dependent on how Inland Revenue administers the dispute. Legislation should therefore be sufficiently flexible to allow for a best-practice approach for dealing with this. It is for this reason that the very important steps of the conference phase and the adjudication process are not legislated for.

2.5 Administrative guidelines are a way of effecting good practice; they have the advantage of flexibility, in that they can be relatively easily amended as necessary, while giving taxpayers a degree of certainty about how their dispute will be handled.

2.6 The Commissioner's current SPSs in relation to the disputes process are *SPS 08/01: Disputes Resolution Process Commenced by the Commissioner of Inland Revenue* and *SPS 08/02: Disputes Resolution Process Commenced by a Taxpayer*.[3] The Commissioner has now released the revised SPSs for consultation. This paper is drafted on the assumption that the key changes contained in the revised SPSs will be adopted into practice once the current consultation process is completed. If any of the changes discussed below undergo material change during this consultation process, some of the conclusions in this paper may need to be revised accordingly.

[3] Both SPS are contained in *TIB Volume 20, No. 6, July 2008.*

2.7 The motivation for changes contained in the revised SPSs is to specifically address some of the key concerns raised in the NZICA-NZ Law Society submission outlined in Chapter 1. For the purposes of this paper, the most important changes contemplated by the revised SPSs are in the following areas:

- preparation of the Commissioner's NOPA;
- facilitation of a conference;
- conduct of a conference; and
- providing guidelines on when the Commissioner would be prepared to opt out of the disputes process under section 89N(1)(c)(viii) (the opt-out guidelines).

2.8 The full text of the revised SPSs can be found at the Policy Advice Division website (http://www.taxpolicy.ird.govt.nz). This chapter outlines the content and objectives of the major changes proposed by the revised SPSs.

Preparation of the Commissioner's NOPA

2.9 A common complaint is that Inland Revenue can "burn off" taxpayers (that is, discourage them from proceeding with the dispute) by issuing a long and complicated NOPA for relatively small disputes. Such NOPAs may increase compliance costs because taxpayers feel forced to issue a lengthy NOR in response.

2.10 The revised SPS (for Commissioner-initiated disputes) is intended to improve the process for NOPAs prepared by the Commissioner in the following ways:

- by issuing a NOPA only after a completed investigation;
- by taking a coordinated approach within Inland Revenue to NOPA drafting, to enhance the quality of the NOPA and to ensure that all aspects of it are fully considered before it is issued;
- by the prompt issue of a NOPA when a taxpayer and Inland Revenue reach the stage where they "agree to disagree";
- by ensuring the size of the NOPA is proportionate to the dispute, including guidelines on the maximum NOPA length; and
- by ensuring the NOPA concentrates on the main legal arguments that support the Commissioner's position, with alternative grounds and arguments kept to a minimum.

2.11 It is anticipated that these proposed changes will reduce any "burn-off". The revised SPSs should provide greater certainty and consistency in Inland Revenue's approach to taxpayers and to better ensure that only arguments with a good prospect of success are pursued.

Facilitation and conduct at a conference

2.12 A conference between the taxpayer and Inland Revenue following the issue of a NOR is seen as a vital part of the disputes process. It is a chance for the parties to the dispute to exchange any information that should have been disclosed and resolves differences in their understanding of facts, laws and legal arguments.

2.13 In their joint submission, NZICA and the NZ Law Society considered that the conference should be an independent forum that benefits both parties. The revised SPSs propose that conferences should, at the option of the taxpayer, be attended by a "facilitator". The facilitator will be a senior Inland Revenue officer who has not been involved in the dispute.

2.14 The facilitator would not be authorised to settle a dispute. Instead, they would assist in focussing the parties on the relevant facts and technical issues, explore options and ensure that all information that should have been disclosed is exchanged at the earliest possible opportunity. The facilitator will have the ability to determine that the conference phase is at an end.

2.15 The revised SPSs also set out a basic set of ground rules for the meeting. This includes agreeing to and adhering to, wherever possible, an agenda and timeframe. It also outlines how the facilitator (or, if there is no facilitator, the parties) would manage any meetings and how the conference phase is concluded.

2.16 These proposed operational changes should make the conference more meaningful for the taxpayer. If final resolution is not possible, the approach should better enable the parties to focus on agreed points of difference.

Opt-out guidelines

2.17 The opt-out guidelines apply for disputes initiated by the Commissioner and set out the circumstances in which the Commissioner will agree to a taxpayer's request to opt out of the disputes process. So as not to undermine the "all cards on the table" objective, one prerequisite to the Commissioner agreeing to opt-out is that the taxpayer has participated meaningfully in the conference phase and signed a declaration that all material information has been provided to the Inland Revenue officers directly involved in the dispute. Provided this has taken place, the Commissioner will agree to opt-out when *any one* of the following features is present:

- the "core tax" in dispute is $75,000 or less (except when it is part of a larger dispute);
- the dispute turns on the facts;
- the dispute concerns issues that are about to be considered by the courts; or

- the dispute has facts and issues that are materially similar to a previous dispute between the Commissioner and another taxpayer and that dispute has been decided in favour of the Commissioner by the Adjudication Unit, so that the Commissioner is unlikely to change his view on the relevant matters.

2.18 The Commissioner retains the discretion to agree to opt out in circumstances outside of those described above.

Chapter 3

OPTING OUT OF THE DISPUTES PROCESS

This chapter outlines the arguments for and against a right for taxpayers to unilaterally opt out of the disputes process. It notes that the proposed opt-out guidelines should give a considerably larger number of taxpayers the ability not to follow the full disputes process. While the chapter does not recommend a unilateral opt-out, it considers what legislation for a unilateral opt-out may look like if it were ultimately concluded that this was desirable. Consistently with this conclusion, it recommends removing the existing taxpayer right of unilateral opt-out (which exists for taxpayer-initiated disputes).

3.1 Barring a limited number of exceptions, the full disputes process is intended to be followed so that the various steps can fulfil their role of ensuring disclosure by the parties of the facts and arguments and, therefore, possible resolution of the dispute before it goes to court. Applying the full process generally means that the dispute has been considered by the Adjudication Unit.

3.2 The Richardson Committee also saw the disputes process being complied with in full as an important element in ensuring that any amended assessment was "right first time".

Unilateral opt-out provision

3.3 One of the suggestions raised in the NZICA-NZ Law Society submission is that taxpayers, following the NOPA and the NOR, should have a unilateral right to opt out of the disputes process by electing that the matter go straight to a hearing authority. Some examples of when a right of unilateral opt-out would be justified have been suggested:

- when the claim is "small";
- when the point at issue is the subject of an Inland Revenue dispute that is being litigated with another taxpayer; and
- when the same taxpayer is in more than one dispute in relation to the same issue (for example, when the same position has been adopted across more than one tax period).

3.4 The submission alternatively suggests that taxpayers have a right equal to the Commissioner's right to apply to the Court for an order that the completion of the disputes process is not required.[4]

3.5 The proposals in the submission contained the following arguments:

- Given that the adjudication process is largely for the benefit of the taxpayer, they should not be compelled to participate in it if they don't perceive any benefits from doing so.
- Proceeding straight to a hearing authority may (if the dispute is likely to end up there anyway) result in the dispute being resolved faster, lessening taxpayer exposure to shortfall penalties and use-of-money interest (UOMI) in the event of an unfavourable outcome.

3.6 Given the resource constraints placed on the courts, it could, however, be argued that it is best to keep all disputes out of court that do not logically belong there. While appreciating that there will always be differences of opinion over whether a particular dispute belongs in court, less tax litigation is highly desirable in reducing the time and costs for all parties. Specifically, resolutions that take place outside of traditional litigation (generally referred to as "alternative dispute resolution") tend to have the following advantages in:

- reducing filings;
- encouraging settlement;
- reducing both hearing-related as well as case preparation costs by narrowing the issues that require judicial consideration; and
- developing sustainable solutions that are less likely to be subject to repeated re-litigation.[5]

3.7 These objectives are similar to those established by the Richardson Committee. Given the weight of the arguments, there are two further questions:

- Is it necessary to have a unilateral opt-out?
- Would a unilateral opt-out improve the current system?

Is unilateral opt-out necessary?

3.8 Taxpayers have, since 2005, had the option to seek the opt-out agreement provided for in section 89N(1)(c)(viii). As discussed in the previous chapter, it is anticipated that the administration of this opt-out would be greatly assisted by the proposed new opt-out guidelines.

[4] The Commissioner's ability to apply for such an order is contained in section 89N(3).
[5] Ministry of Justice website: http://www.justice.govt.nz/publications/global-publications/a/alternative-dispute-resolution-general-civil-cases/6-adr-and-the-courts-system/?searchterm=reducing%20court.

3.9 These guidelines (set out in the revised SPS for Commissioner-initiated disputes) will provide taxpayers with a degree of certainty on whether their dispute will be required to go through the full disputes process. The proposed $75,000 core tax threshold means that for many taxpayers the opt-out process will in effect be available. As we have noted, the other criteria, such as the issue being one of fact, similar cases being in front of the courts and the Commissioner's discretion to agree to opt-out in other cases, will make the opt-out process more broadly available.

3.10 Under the terms of the opt-out guidelines, it is therefore likely that there will be a considerable number of disputes that proceed directly to a hearing authority following a conference. This will result in a much less compelling case for a unilateral opt-out.

Would a unilateral opt-out be an improvement to the current system?

3.11 Given the increase in the number of disputes that are likely to be eligible for bilateral opt-out, the question is whether a unilateral opt-out would be an improvement to the process for the remainder of tax disputes.

3.12 The role of the Adjudication Unit becomes more prominent in larger disputes: taxpayers are likely to be more willing to bear the costs in the event of the Adjudication Unit finding in their favour, and both parties are likely to welcome the opportunity of a review being undertaken by technically skilled staff not previously involved in the dispute.

3.13 The contents of the revised SPSs regarding the preparation of disputes documents and conduct at the conference phase are designed to ensure that disputes are focussed and, where possible, resolved during the administrative phases of the process – rather than resorting to the courts. The adjudication process is a further step in the process at which resolution can occur.

Legislating for the opt-out

3.14 Granting taxpayers a unilateral opt-out right raises the question of where in the disputes process the opt-out right should be available. The NZICA-NZ Law Society submission appears to suggest that for small claims, the right should exist at any stage and for all other cases, the right should exist after the exchange of the NOPA and NOR (presumably irrespective of whether the dispute is taxpayer- or Commissioner-initiated).

3.15 Even if the right applied after the exchange of the NOPA and NOR, there are further matters to consider. Irrespective of the size or complexity of the dispute, the conference is an important forum for the exploration of arguments, exchange of information and discussion of options on how to proceed with the dispute. Any opt-out right that existed immediately after the rejection of a NOR would allow the taxpayer to circumvent the conference phase, which could detract from the objective of avoiding court, and the related costs, where possible.

3.16 A potential way around this would be to legislate for a conference phase (a proposal supported by the joint submission) and then allow for a unilateral opt-out right after the conference phase.

3.17 If the conference were legislated for, the purposes of the conference and the procedures that it entails would also need to be included. These purposes would differ from case to case. Some may be used predominantly for exchange of legal arguments and information, while others may explore settlement options. Legislating for desired outcomes during this phase could, unless carefully drafted, result in further litigation about the respective requirements.

3.18 It is anticipated that the facilitation of conferences (as detailed in the revised SPSs) will assist in the conference being a venue for constructive dialogue. Legislating for desired outcomes may detract from any improvements that could result from this process.

3.19 The other difficulties in legislating for a conference relate to the logistical differences between disputes. In particular:

- The "conference" is often more akin to a series of discussions, rather than a single session.
- The discussion can take place across a range of timeframes and forums (for example, face-to-face, telephone or video-conference).
- Any meetings that do take place can be formal or informal in nature.

3.20 If legislation were nevertheless considered desirable, this might be achievable by keeping the legislation limited to:

- a requirement that the parties "meet" (in any forum) at least once (for body corporate taxpayers, the person attending would have to be authorised to commit the taxpayer to a course of action); and
- the taxpayer signing a statement to the effect that all information relevant to the dispute had been provided.

3.21 This would allow a significant degree of flexibility in terms of available forums and discussion points, and would provide the Commissioner with some comfort that all information needed to contest any subsequent court challenge was available.

Conclusion

3.22 We consider that the current process (which will be supplemented by the revised SPSs) should be departed from only if the alternative offers a substantial improvement. Although we see merits in taxpayers having a unilateral opt-out right, it does not seem to represent a vastly superior process for the majority of disputes. This conclusion is further supported by our view that a unilateral opt-out right would need to be accompanied by legislating for the conference phase. Given the desire to keep legislative change to a minimum (to maintain administrative flexibility and reduce the cost of disputes about the process), legislating for something that can be capably dealt with through administrative measures appears counter-productive.

3.23 Although every disputant clearly has a right to their "day in court", this has to be balanced against the policy objective of reducing unnecessary tax litigation. The bilateral opt-out provisions appear to provide the best balance between these two, occasionally competing, ideas.

3.24 As a result, we believe that legislation to provide for a unilateral opt-out for Commissioner-initiated disputes is unnecessary.

Court order not to complete the disputes process

3.25 The NZICA-NZ Law Society submission also suggests including a matching taxpayer ability to the Commissioner's ability under section 89N(3) to apply to the High Court for an order that completion of the disputes process is not required.[6] The Commissioner's view on this provision is set out in SPS 08/01 and reiterated in the revised SPSs.

3.26 Section 89N(3) is used in practice as either a revenue-protection provision, which prevents taxpayers from unduly delaying the process when they know that the time-bar may work in their favour, or as a cost-saving mechanism when there are numerous substantially similar disputes that are not suitable for test case treatment.

3.27 Given the administrative constraints that the Commissioner places on the ability to truncate the process under section 89N(3), we do not consider that a matching taxpayer right is warranted. In addition, taxpayers are free to approach the Commissioner with a proposal that completion of the disputes process is not required. The Commissioner has the ability to treat such a proposal as an opt-out request and may use the residual discretion outlined in the opt-out guidelines to agree to the request if none of the main opt-out criteria are met.

[6] Section 89M(3) also allows the Commissioner to apply for an order to allow more time to complete the disputes process. However, such an application is not directly relevant for these purposes.

3.28 Further, the opt-out guidelines cater for disputes where the issue is already being considered by the courts. As a result, we anticipate that the use of section 89N(3) to truncate the process will become rarer.

3.29 As a final point, we note that section 89M(11) currently provides taxpayers with the capacity to apply to the High Court for more time to respond to the Commissioner's SOP. Because SOPs are generally the most detailed documents produced by the parties, it is important that this provision is retained to give taxpayers the opportunity to respond to new propositions put forward by the Commissioner at the SOP stage. Likewise, it is important that sections 89M(13) and (14) are retained, so that additional information can be added to SOPs, with the agreement of the other party.

Section 138B(3)

3.30 As a result of the conclusion that a unilateral opt-out right for the taxpayer is not desirable, we believe that section 138B(3) should be repealed or amended. In circumstances when the dispute has been initiated by the taxpayer, this section effectively provides taxpayers with a unilateral opt-out immediately following receipt of the Commissioner's NOR. The existence of section 138B(3) produces a discrepancy between disputes that are taxpayer-initiated and those that are Commissioner-initiated. It is because of this section that the opt-out guidelines have not been reproduced in the revised SPS for taxpayer-initiated disputes – there is little point having guidelines when the taxpayer can circumvent them through the challenge provisions.

3.31 A taxpayer-initiated NOPA must be issued within four months of the date on which the original self-assessment is received by Inland Revenue.[7] In practice, taxpayer-initiated NOPAs tend to occur when a taxpayer is aware of potential ambiguity in the law: they will self-assess on a conservative basis and then immediately propose an adjustment to that assessment.

3.32 Although this practice has the advantage of bringing potential legislative anomalies to the attention of Inland Revenue, its result (being a unilateral opt-out right for taxpayers) is inconsistent with our view regarding unilateral opt-out measures more generally. Following our suggested amendment to section 138B(3), it is anticipated that the bilateral opt-out procedures set out in the opt-out guidelines will be incorporated into the revised SPS for taxpayer-initiated disputes, so that they will apply irrespective of which party produced the NOPA.

[7] Section 89DA. The four-month response period is the general timeframe. For R&D tax credits, the response period is two years (see section 89AB(3)(b).

Chapter 4

EVIDENCE EXCLUSION RULE

Summary of suggested changes

This chapter suggests the following amendments to the evidence exclusion rule:

- that it applies only to the "issues" and "propositions of law" elements of the relevant party's SOP;
- that when one party is required to produce a SOP both parties are required to do so. The evidence exclusion rule will then attach to these SOPs; and
- that there be no formal evidence exclusion rule in place for disputes if the taxpayer and the Commissioner agree to opt out of the disputes process under section 89N(1)(c)(viii).

It also suggests that the Taxation Review Authority Regulations be updated to refer to the District Court Rules 2009.

4.1 The evidence exclusion rule (EER), contained in section 138G, applies following the issue of a disclosure notice[8] and limits the Commissioner and the taxpayer to the facts, evidence, issues and propositions of law that are disclosed in their respective SOPs.

Policy

4.2 By largely limiting the parties to the material in their SOP, the EER serves as the central pillar to the "all cards on the table" approach advocated by the Richardson Committee. In the words of the NZICA-NZ Law Society submission, its purpose is to "encourage open and full communication".

4.3 The EER aims to ensure that the SOP contains all of the best arguments for each party and therefore eliminates the possibility of "trial by ambush". It also helps to make sure that all relevant information is brought forward at the SOP stage (at the latest) to increase the possibility that the Commissioner's assessment will be correct.

[8] Section 89M of the TAA.

Current problems with the EER

4.4 The main problem with the EER stems from what is sometimes described as the "kitchen sink" approach to preparing a SOP, whereby all facts, evidence, issues and propositions are included. There are two possible motivations for this:

- to avoid the risk of the matter being prevented from being raised in a hearing authority; and[9]
- to provide all relevant information that the parties consider will be persuasive or helpful to the Adjudication Unit (which, as an independent function of Inland Revenue, will not have previously been exposed to the issues being disputed).

4.5 The result of this all-inclusive approach is lengthy documentation and, if the dispute does reach a hearing authority, potential duplication between the preparation of the SOP, court documents and discovery process.[10] This can increase reluctance to proceed with a legitimate dispute.

4.6 The NZICA-NZ Law Society submission suggests that the scope of the EER be relaxed, so that the parties are limited to the "propositions of law" set out in their respective SOPs, rather than also being limited to the facts and evidence. The submission argues that this will provide the necessary certainty on the legal issues at stake, while going some way towards preventing the "kitchen sink approach" to SOP preparation.

4.7 The current legislation also arguably provides the potential in taxpayer-initiated disputes for the EER to apply to the taxpayer only. This possibility comes about because section 89N(2) provides that the Commissioner can issue an amended assessment after the taxpayer's SOP has been considered; there is no requirement for the Commissioner to also produce a SOP. The counter-argument is that the Commissioner is effectively required to issue a SOP because, without doing so, section 138G would prevent any arguments being able to be raised in a hearing authority. The matter requires clarification.

Role of disputes documents

4.8 In considering whether the EER should be amended, the respective roles of the NOPA and the SOP should be taken into account.

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[9] *Joint Submission: The Dispute Resolution Procedures in Part IVA of the TAA 1994 and The Challenge Procedures in Part VIIIA of the TAA 1994*, by NZLS and NZICA, para. 3.16.

[10] Note the distinction between dispute documents – documents which are legislatively required under the Disputes and Challenge procedures of the TAA – eg, NOPA, NOR, SOP, disclosure notice – and court documents, which are required to be filed within the hearing authority – eg, Notice of Claim, Notice of Defence.

The role of a NOPA

4.9 The NOPA is the first step towards the identification of the issues in a dispute. The purpose of the NOPA is to ensure that the party receiving the notice is aware of the arguments on which the other party is relying. It is intended to foster open and frank discussion early in the resolution process and advance the "all cards on the table" objective.[11]

4.10 Irrespective of whether it is issued by the Commissioner or the taxpayer, a NOPA must identify the proposed adjustment, provide a concise statement of the key facts and the law (in sufficient detail to inform the other party of the grounds for the proposed adjustments) and state how the law applies to the facts. A taxpayer's NOPA must also provide copies of significantly relevant documents.[12]

4.11 The NOPA is not intended to be an investigative tool (for Commissioner-initiated disputes), as ideally the investigation of the taxpayer's affairs would have been concluded by this point and any proposed adjustments should already have facts and evidence to support them. If further information is considered necessary, but is not forthcoming, the Commissioner will be able to exercise the powers under sections 16 and 17 to gather it. In this respect, the NOPA is a document that reflects the outcome of a concluded investigation.

The role of the SOP

4.12 The SOP forms the basis upon which the issues will be argued if the case proceeds to court. It is generally the last card on the table before the challenge procedures, and its main role is to inform the other party of the legal and factual arguments that the party is relying on so that any "trial by ambush" is effectively eliminated from future litigation.

4.13 The SOP must, with sufficient detail to inform the other party, give an outline of the facts, evidence, issues and propositions of law relied upon.[13] A well-drafted SOP provides the other party with an adequate base from which to draft either a reply SOP or a notice of claim in the hearing authority. A SOP that contains at least an outline of all relevant information is also important for the effective operation of the Adjudication Unit.

4.14 Concerns about possible duplication of the NOPA and SOP are, in our view, not overly problematic when looking at the disputes process as a whole. Given that the NOPA and the SOP are extremely likely to focus on the same points, some degree of duplication is inevitable (some issues may have been resolved in the intervening period).

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[11] *Resolving tax disputes: a legislative review. A government discussion document.* July 2003 para. 2.14-2.16.
[12] Section 89F, TAA.
[13] Section 89M.

4.15 If the NOPA is completed as outlined, the pressure for the SOP to be a heavily detailed document will be reduced. If not all of the contents of the SOP are subject to the EER, as suggested by the NZICA-NZ Law Society submission, there will be less temptation to include every available shred of information. These factors should in turn result in the SOP being the "outline" document contemplated by the TAA.

Possible solutions

4.16 We therefore agree that the EER should be relaxed, subject to:

- the Commissioner having all relevant information available so that any assessment is as accurate as possible; and
- if a challenge does arise from that assessment, any court proceedings operating on a "no surprises" basis to the fullest extent possible.

4.17 If the EER is to be relaxed, it is questionable whether an "evidence exclusion rule" is an appropriate label for such a rule. Any new label used will need to be consistent with its role in the overall disputes process. One possibility is simply to change the label to "exclusion rule".

4.18 The NZICA-NZ Law Society submission suggested relaxing the EER so that it was limited to the "propositions of law" contained in the SOP, allowing for new issues, facts and evidence to be adduced at the challenge stage. The submission also suggested, especially if no SOP is involved, binding the Commissioner to the "grounds of assessment".

"Proposition of law" EER

4.19 A "proposition of law" can be regarded as the legal basis for the technical position taken by the party. It will contain references to the relevant statutory provisions, and judicial and other authorities that may assist in the interpretation of them (including, where appropriate, overseas court decisions, legislative history analysis, and reference to legal principles and cases outside of the taxation area). It may also include a statement on the application of law that has not previously been considered by the courts.

4.20 Certainty as to the propositions of law is important to the efficient operation of the disputes process. If propositions of law are not finalised during the dispute phases, legal issues may be poorly defined until the commencement of proceedings in court. Such an outcome would be directly contrary to the objectives of the Richardson Committee, which sought full and early disclosure of relevant matters.

Possible advantages

4.21 Removing the existing strict requirements to include facts, evidence and issues in the SOP, and having the EER limited to propositions of law appears to have a number of advantages:

- It continues the current practice of both parties being aware of the legal arguments proposed by the other.
- It should provide the Adjudication Unit with all the information required to analyse the respective legal arguments.
- It should take some of the pressure away from including every fact and piece of evidence in the SOP.
- Propositions of law, as a term, is already included in the legislation and is a requirement for the contents of a SOP. Any legislative change to limit the EER in this way would therefore be minimised.

"Grounds of assessment" EER

4.22 The NZICA-NZ Law Society submission suggests that the Commissioner should be bound by his "grounds of assessment", particularly when no SOP has been issued. A rule based on grounds of assessment has one major advantage, in that there is almost always an assessment in a substantive dispute. Because the challenge is generally to the assessment, there is no possibility of the rule not applying to the Commissioner.

4.23 However, we do not favour a "grounds of assessment" rule for the following reasons:

- The assessment is generally issued after the SOP. Therefore, there would be no finality to the SOP.
- The Commissioner's assessment quantifies the tax liability but does not contain detailed analysis. This would necessarily change. If there is a SOP, this could be a simple cross-reference or reproduction of the SOP. However, when there is no SOP, (such as opt-out disputes), this rule would effectively still require the Commissioner to produce a document similar to a SOP with the attendant documentary detail.
- To provide parity, so that the Commissioner was not the only party bound, an additional reply would be required of the taxpayer. Placing further documentary requirements on the taxpayer would be an unnecessary additional compliance cost.

"Issues" EER

4.24 We see "issues", in the context of the SOP as akin to "legal issues to be resolved between the parties". This is supported in some respect by the fact that sections 89M(4) and (6) both refer to issues that the party "considers will arise". This can be contrasted with the facts, evidence and propositions of law "on which the [party] intends to rely". In other words, the issues arise and the remaining elements are relied upon to demonstrate a particular view. If this is the case, then "issues" is effectively the umbrella term and propositions of law, facts and evidence are put forward by the parties in an attempt to make a decision-maker resolve the issues in their favour.

4.25 On this basis, it makes sense to consider the possibility that the issues should be set, so that the parties can go about constructing their propositions of law and gathering their facts and evidence. Such an approach has many of the advantages of a "propositions of law" approach (discussed above) while recognising that propositions of law are only ever determined in the context of the wider legal issues.

Possible solution

4.26 On balance, we consider that the best approach may be to have the EER apply to "issues" and "propositions of law". We prefer this for the following reasons:

- Simply having an "issues" EER could lead to concerns around exactly how broadly "issues" is defined. A dispute may only have one over-arching issue. Although there are arguably benefits in having this issue set, it may be so broad as to effectively provide no limitation at all.
- Having a "propositions of law" EER would effectively limit the issues because a new issue would be unlikely to be introduced unless propositions of law could be raised to support it.
- Requiring the parties to clearly state what they consider to be the relevant issues, and the propositions of law that would support the resolution of those issues in their favour, would create an appropriate level of certainty – especially when coupled with the requirement to provide an outline of facts and evidence in the SOP.

4.27 We do note, however, that any amendment to the EER within the existing legislative framework would not cater for truncated disputes.

"Trial by ambush" and factual certainty

4.28 To relax the EER, both parties would need assurance that they could not be "ambushed" at a court hearing by previously undisclosed material. Correspondingly, the parties would also need to be confident that they fully understood the factual events relied upon by the other (even if there are disagreements over the relevant facts).

Trial by ambush

4.29 The risk of trial by ambush is reduced in the modern litigation environment. Lord Donaldson of Lymington MR in *Mercer v Chief Constable of the Lancashire Constabulary* stated:[14]

> Over the last quarter of a century there has been a sea-change in legislation and judicial attitudes towards the conduct of litigation, taking the form of increased positive case management by the judiciary and the adoption of procedures designed (a) to identify the real issues in dispute (b) to enable each party to assess the relative strengths and weaknesses of his own and his opponent's case at the earliest possible moment and well before any trial. Not only does this tend to make for shorter trials and save costs, even more importantly it facilitates and encourages settlements.

4.30 New Zealand commentators have expressed the view that the above passage is equally true in New Zealand. Discovery and the advent of the case management system[15] has encouraged an environment where the Court is no longer accepting of trial by ambush,[16] and the traditional adversarial approach to litigation whereby parties "keep their cards close to their chest".[17]

District Courts Rules and judicial settlement conferences

4.31 Under section 16 of the Taxation Review Authorities Act 1994, the TRA has a wide discretion to determine its own proceedings. The District Courts Rules in effect act as a guide to reduce any uncertainty about TRA proceedings.[18] To this end, Regulation 4 of the Taxation Review Authorities Regulations 1998 states:

> To the extent that they are not inconsistent with these regulations, or the provisions of the Taxation Review Authorities Act 1994, or the Tax Administration Act 1994, the District Courts Rules 1992 apply to the commencement, interlocutory steps, and conduct of proceedings in the Authority as if those proceedings were civil proceedings in the District Court.

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[14] [1991] 2 All ER 504, 508-509 (CA).
[15] The system whereby judiciary officers allocate proceedings to different tracks according to their needs and complexity, and ensures they keep moving through regular checks and conferences.
[16] see *Donovan v Graham* (22/5/90, Eichelbaum CJ, HC Auckland, CP1980/89).
[17] Andrew Beck, *Civil Procedure in NZ*, para 1.13.
[18] Section 16(1).

4.32 New District Court Rules came into effect 1 November 2009. One feature of the new rules is that they provide for "settlement conferences" between the parties before a hearing.

4.33 A judicial settlement conference must be convened by a judge and held in chambers. The purpose of the conference is to give the parties to the proceedings an opportunity to negotiate a settlement of the claim or any issue.[19] The inclusion of the conference is another opportunity to make sure parties have the same understanding of the facts and should prevent any trial by ambush before a hearing. It is worth noting that a party can still apply for discovery if there is a serious possibility of information having been withheld or trial by ambush.

4.34 Under section 16 of the Taxation Review Authorities Act and Regulation 4, the TRA has the discretion to adopt these settlement conferences into its proceedings. However, greater certainty on the application of the rules may be desirable.

4.35 Because of the improved systems that settlement conferences introduce, and to make it easier for disputants (who will not then have to deal with the "old" rules) we suggest that the Taxation Review Authorities Regulations be amended to apply the 2009 District Court Rules and that the settlement conferences be incorporated for tax challenges.[20]

4.36 One question that does arise, however, is whether the documentation required by the disputes process and the new District Court Rules overlap. Our view is that this is not likely because if adequate exchanges between the parties have occurred under the disputes process, the court documents will simply become more manageable in nature.

4.37 To this end, we also suggest an amendment to Regulation 8 of the Taxation Review Authorities Regulations to relax the requirement that notices of claim have to effectively duplicate the SOPs of both parties. Provided the relevant information (NOPA, NOR and SOPs) were attached to the notice of claim, that would be sufficient. In practice, this is often what occurs and appears to cause little difficulty.

Factual certainty

4.38 Factual certainty is essential to an efficient disputes process and, as previously noted, it is important that any relaxation of the EER does not undermine this. Whatever change is made towards relaxing the EER, there would still be a requirement that a SOP contain an outline of the facts and evidence "on which the [party] intends to rely".[21] If an important fact or piece of evidence is not included in this outline and the party then seeks to rely on it, they run the risk of the hearing authority refusing to accept it.

[19] Clause 2.47.2 District Court Rules 2009.
[20] Reg. 4, TRA Regulations.
[21] Section 89M(6).

4.39 Factual certainty could be achieved in the following ways:

- There is a natural incentive for taxpayers and the Commissioner to put their best case forward as early as possible in the dispute process because of the costs (including UOMI) of doing otherwise. If the Commissioner suspects the taxpayer has not disclosed all the relevant information, the Commissioner can rely on the information-gathering statutory powers under sections 16 and 17, or the hearing authority's powers in relation to discovery and interrogatories, to obtain as much factual certainty as possible.
- The Commissioner will also have the ability to achieve greater factual certainty during the conference phase, particularly if there is an opt-out under section 89N(1)(c)(viii), as an agreement will be signed at the end of the conference stating that all material facts have been disclosed.
- As discussed above, the District Court Rules 2009 also provide for a settlement conference to take place between the parties. Assuming that this element of the new rules is applied to proceedings in the TRA, this conference will also afford the parties with an opportunity to ensure that all the key facts are available and issues discussed in requisite detail. The prospect of material factual information being withheld from a statement of claim, when a settlement conference is imminent, is minimal.

EER applying to both parties

4.40 We agree with the NZICA-NZ Law Society submission that, where the EER applies, it should apply to both parties. There are two possible solutions to ensuring this is achieved:

- make it clear that the Commissioner must, to continue a taxpayer-initiated dispute, issue a SOP in response to the taxpayer's SOP; or
- provide that the Commissioner always issues the first SOP, even in taxpayer-initiated disputes.

Commissioner issues a SOP

4.41 This proposal would require an amendment to section 89N(2)(b) (concerning the process for taxpayer-initiated NOPAs) to the effect that the Commissioner cannot amend an assessment until the later of:

- the Commissioner has considered a statement of position issued by the disputant; or
- the Commissioner has issued a statement of position.

4.42 This would mean that if one party has to produce a SOP, so would the other. Each party to a dispute would then have a SOP to which the EER could apply.

Commissioner always issues the first SOP

4.43 An amendment could be made to section 89M(3). This section currently states that the Commissioner's disclosure notice does not need to be accompanied by a SOP if the NOPA was issued by the taxpayer. If this requirement were removed, the Commissioner would always have to issue a SOP at the same time as the disclosure notice. The taxpayer would then have the usual response period to reply with their SOP.

4.44 This proposal has the advantage of aligning all disputes from the conference phase onwards. Irrespective of who initiated the dispute, the onus would always be on the Commissioner to produce a disclosure notice and SOP. In the event that the taxpayer's SOP raised novel material or arguments not previously discussed between the parties, the Commissioner would still be able to respond to these through the addendum SOP provisions in section 89M(8). On the other hand, this approach presupposes that the Commissioner will have completed the investigation well in advance of the SOP having to be issued. For taxpayer-initiated NOPAs this is not always the case and the approach may not therefore provide an adequate basis from which the Commissioner can prepare an appropriate SOP.

4.45 We welcome submissions on the possible approaches.

EER and opt-out under section 89N(1)(c)(viii)

4.46 When the taxpayer and the Commissioner agree to opt-out of the disputes process under section 89N(1)(c)(viii), the EER (in either its current or proposed form) will not apply, as no SOP will have been issued. Therefore, in theory, nothing limits the issues, propositions of law, facts or evidence put forward by either the taxpayer or the Commissioner. The question is whether or not this should be seen as a problem for either party to such a dispute.

4.47 The natural incentive to end the dispute as soon as possible will still exist under an opt-out scenario. Also, because of the requirement set out in the opt-out guidelines that all material information has been provided by the taxpayer, the conference is likely to be an adequate disclosure tool in an opt-out case.

4.48 Factual certainty does not necessarily provide certainty as to the issues and propositions of law. However, when a conference is undertaken before an opt-out, there is less potential for disputes to reach a hearing stage without the issues and propositions of law being sufficiently well defined. This is because, if the parties have all the information relevant to the dispute (a pre-requisite of being eligible for opt-out), they should be in a position to anticipate the legal arguments of the other party with some degree of accuracy.

4.49 The following further factors appear to weigh in favour of there being no EER (or equivalent) applicable to opt-out disputes:

- If novel arguments are raised in the court documents, the other party will still have some time to consider these before filing their documents or the judicial settlement conference begins (as applicable).
- Although it is not correct to say that all disputes of $75,000 or under (a suggested criterion for an opt-out) are "simple", we do not anticipate that the most complex of cases will be eligible for the opt-out.

Chapter 5

TIMEFRAMES

This chapter focuses on whether the issuing of a disclosure notice and SOP by the Commissioner should be subject to a statutory timeframe.

Although it concludes that administrative guidelines are sufficient at the current time, it also discusses what form any future legislation on this issue might take.

Finally, the chapter suggests some minor amendments to the Taxation Review Authority Regulations to align timeframes between the TRA and the High Court.

5.1 The Commissioner generally has four years from the end of the tax year in which the return was filed to undertake any investigation of a taxpayer's affairs and complete the disputes process to the point where an amended assessment can be issued.

5.2 Concerns have been raised that this timeframe should incorporate appropriate intermediate deadlines that the Commissioner must meet – particularly relating to the Commissioner's disclosure notice and associated SOP, for which there are no statutory timelines.

Arguments for imposing timeframes

5.3 The arguments for imposing specific timeframes on the Commissioner include the following:

- Excessive delays undermine the integrity of the tax system and go against the aims of the Richardson Committee. In this sense, the non-financial aspects of a tax dispute are also important. Disputes with Inland Revenue can have a negative effect on the particular taxpayer (for example, a business may not take on additional employees until it is certain of its financial position) as well as an emotional impact on the people concerned.
- The Commissioner is subject to some time limits, but not all. The "playing field" should be level: if timeframes apply to taxpayers at each step then they should equally apply to the Commissioner.
- UOMI continues to run through the course of a dispute, irrespective of which party is primarily responsible for any delay. The lack of timeframes on the Commissioner provides an incentive to delay the process. In other words, delay is effectively a means by which taxpayers can be "burnt off" by the continued accumulation of UOMI.

Arguments for not having timeframes for the Commissioner's SOP

5.4 One of the main recommendations of the Richardson Committee was that disputes should have every opportunity to be resolved before reaching the courts. It is therefore important that any timeframes placed on the various steps of the process for each party do not hinder this objective and, instead, encourage resolution. Key to this is the conference phase of the process, which could be compromised by adherence to statutory timeframes.

5.5 Other considerations are:

- Strict timeframes around the issue of a disclosure notice and a SOP may encourage Inland Revenue staff to front-load the dispute, by including material in the NOPA which should otherwise have been placed in the SOP. This would lessen the possibility of a speedy resolution of the dispute, and the costs (including UOMI) would be largely unchanged.
- Disputes that take the longest are generally more complex and can have the highest potential revenue impact. Single statutory timeframes would need to take into account these cases and, as a result, may cause unnecessary delays in smaller disputes.
- Because the statutory marker (the issue of a NOR) is followed by the administrative conference phase, there are dangers in applying a strict timeframe on the issuing of a SOP. For example, if the Commissioner were to have a set number of months to produce a SOP, the taxpayer could be motivated to ensure that the conference phase was a protracted one. This is because the longer the conference phase lasted, the less time the Commissioner would have to draft the SOP.

Possible solutions

5.6 Fixing the perceived problem again comes down to whether the system could be improved more meaningfully by administrative change or legislative amendment. Several options are discussed below.

Administrative options

5.7 As we noted earlier, administrative solutions have the advantage of providing a degree of certainty to taxpayers, while allowing the Commissioner to deal with the process in a way that ensures maximum flexibility to address difficult circumstances.

5.8 The revised SPSs state that the period between the receipt of a taxpayer's NOR and the issue of the Commissioner's SOP will be, on average, approximately seven months, subject to the facts and the complexity of the dispute. The seven month period is broken down as follows:

- one month to consider the taxpayer's NOR and initiate the conference phase;
- three months for the conference phase itself;
- three months following the conclusion of the conference to prepare a disclosure notice and SOP.

5.9 If meeting the recommended timeframe is not possible (for example, if the facts or law are complex, the dispute could be precedential or Crown Law involvement is necessary), approval must be obtained from a senior manager and the taxpayer must be advised of the new estimated date for the issue of the SOP.

Taxpayer-initiated disputes

5.10 There is little difference in theory between the way a taxpayer-initiated dispute is conducted and one that is initiated by the Commissioner. For taxpayer-initiated disputes, the Commissioner must issue a NOR within two months of receipt of a NOPA. The taxpayer then has a further two months to reject the NOR. If the Commissioner's NOR is rejected and the Commissioner wishes to continue with the dispute, the conference phase will begin. The revised SPS suggests an average four-month conference period for taxpayer-initiated disputes (one month following the receipt of a taxpayer's rejection of the Commissioner's NOR to set up the conference and three months for the conference itself). Again, this is subject to the facts and complexity of the dispute.

Will administrative practices change?

5.11 Under the suggested change, it is anticipated that there will be fewer exceptions to the administrative guidelines being met because:

- any amendment to soften the application of the EER (discussed in the previous chapter) will go some way to relieving pressure on the production of the SOP; and
- the publication of the revised SPSs will create clearer, more detailed guidance for Inland Revenue staff**,** which should result in more emphasis being placed on meeting the recommended deadlines. The Commissioner expects any decision to extend the deadline would be more than just a "rubber stamping" of an investigator's decision to extend time.

Legislative amendment

5.12 In Chapter 3 we raised the possibility of legislating for the conference, and concluded that it was not desirable at this stage. Not legislating for timeframes would, from a practical perspective, be more consistent with this view.

5.13 While legislation would reduce flexibility in the administration of a dispute, on the positive side, taxpayers would know that their dispute would not be left to sit indefinitely. The Commissioner would know that documents have to be produced by a certain date (with consequences for not doing so) and would be able to allocate resources in a manner that progresses all disputes within a consistent timeframe.

5.14 Although our preference is for an administrative approach, the following discussion looks at how legislated timeframes may work, should that option be preferred.

The legislative option

5.15 Any statutory timeframe would need to be flexible enough to cater for both very complex disputes and disputes where the statutory time-bar is likely to be a serious consideration.

5.16 Bearing in mind that timeframes would also need to allow time for both the conference and the drafting of the SOP, the most feasible legislative option would appear to be to codify the current administrative timeframes for these phases. As mentioned above, Inland Revenue currently anticipates that a total of seven months is needed between the receipt of a taxpayer's NOR and the issue of the Commissioner's SOP.

5.17 While we have noted that a statutory timeframe could provide an incentive for taxpayers to lengthen the conference phase, seven months (including the conference phase) is a reasonable length of time for the Commissioner to ascertain the cooperativeness or otherwise of a particular taxpayer.

5.18 Another possible risk with a single legislated timeframe is that relatively simple disputes could be delayed until the end of the seven-month period. If the conference is shortened or is seen as unnecessary, this statutory timeframe effectively allows the Commissioner up to seven months to draft the SOP, which is unduly long. This risk needs to be factored against the certainty that a back-stop date for this part for the process would provide for taxpayers.

Extending the deadline

5.19 There will always be disputes where a lengthy conference phase is necessary and in the best interests of all parties. Imposing a strict timeframe on these disputes could result in the Commissioner being forced to abridge a constructive conference in order to allow time to draft a SOP. This could mean that settlement negotiations (with the potential to end the dispute) could be abandoned in favour of an option that would add both time and costs to the dispute.

5.20 To ensure that a legislative approach retained some administrative flexibility for the most complex cases, one option could be to use the seven-month timeframe and give the Commissioner the ability to extend this, perhaps by a maximum of two months. A two-month period is based on an assumption that the majority of documentation should be complete or nearing completion within the original seven months. Any extension should therefore be of a sufficient time to allow completion of these documents without causing unnecessary further delay.

5.21 In the event that this further period was needed, the Commissioner would, before the seven-month deadline, advise the taxpayer of:

- the decision to extend the deadline;
- the reasons for doing so; and
- the revised deadline.

5.22 Internal guidelines may need to be drafted to ensure that the "easy" option of extending for two months is not used as a default. Any decision to extend the deadline should still ensure that the disclosure notice and SOP are issued at the earliest opportunity.

Taxpayer-initiated disputes

5.23 For taxpayer-initiated disputes, there is currently no obligation on the Commissioner to produce a SOP at the same time as the disclosure notice. As a result, if a time limit is to be set for the issue of the disclosure notice, it may not need to factor in time for drafting the Commissioner's SOP.

5.24 However, factored against this consideration is that, generally speaking, taxpayer-initiated disputes are received with little warning. Although the Commissioner has a statutory requirement to respond to a taxpayer's NOPA (by way of NOR) within two months, it can be difficult to undertake an entire investigation within this timeframe. Any statutory timeframe for the conference may therefore need to take into account the fact that the initial investigation may not be complete at the time the Commissioner's NOR is issued.

Use-of-money interest

5.25 The NZICA-NZ Law Society submission argues that the possible imposition of UOMI (in the event that increased tax is payable following the outcome of the dispute) can be a major factor in the overall cost of a tax dispute. The submission considers that there should be scope to suspend UOMI when inaction by the Commissioner has caused a delay in a dispute.

5.26 The timeframes set out in the revised SPSs have been set because they are considered to be reasonable for completing the relevant steps in the process, without sacrificing thoroughness or quality. More rigid adherence to these timeframes in future should result in fewer delays in the process.

5.27 We do not favour a legislative suspension of UOMI for the delays in the process that do nevertheless arise. UOMI is a "no fault" concept, designed to be administratively workable by ensuring that exceptions are kept to a minimum. Practically speaking, any provision that suspended UOMI would need to relate back to a particular statutory "event" – for example, the taxpayer's NOR. If UOMI were to be suspended within the administrative timeframe for the issue of a SOP, this would effectively penalise the Commissioner even if the length of the conference phase or complexity of the dispute provided an acceptable rationale for the administrative timeframe not being adhered to.

5.28 We note, in any event, that it is the Commissioner's practice to exercise a degree of discretion when quantifying UOMI. Generally, where an undue delay in the process is attributable to Inland Revenue, an appropriate remission of UOMI will be made to reflect this.

5.29 The imposition of a statutory deadline on the Commissioner for issuing a SOP would mean that no consideration would need to be given to the suspension of UOMI. This is because the likely consequence of any failure to meet a statutory timeframe would be that the Commissioner was deemed to accept the position set out in the taxpayer's NOR.

Other minor regulatory amendments

5.30 We have identified the following issues concerning timeframes in the Taxation Review Authorities Regulations where changes could be made:

- amending Regulation 11 to reduce the time that the Commissioner has to file a Notice of Defence from 40 working days to 25 working days. This would align the filing requirement in the TRA with that of the High Court; and
- amending Regulation 28 to require the TRA to set a date for a directions hearing within 35 working days of the filing of the notice of claim (at present, this date has to be at least 90 days after filing or another date agreed by the parties). The directions hearing in the TRA was introduced prior to the "track" system for cases being introduced in the High Court. However, it seems appropriate to bring the timing requirements for tax cases in line with those for case management conferences of "standard track" cases in the High Court. In any event, there does not appear to be great justification for having timing discrepancies between the TRA and the High Court, given that both can be the hearing authority of first instance for tax cases.

Chapter 6

DISPUTABLE DECISIONS

This chapter proposes amending the TAA to clarify that the Commissioner's decision whether or not to agree to a taxpayer's opt-out request (and certain other matters) are not "disputable decisions". It also suggests making the exceptional circumstances discretion a disputable one.

6.1 A disputable decision should be one that has a direct bearing on the quantum of tax payable by a taxpayer. An assessment is the most obvious example of this, but other decisions made by the Commissioner have a potentially similar effect. These decisions should be afforded a relatively simple and clear appeal right, such as the challenge proceedings set out in Part VIIIA.

6.2 By contrast, administrative decisions made by the Commissioner should – as with every government agency – be subject to administrative review applications. No special system is required in the tax legislation to achieve this.

6.3 The courts have determined that a taxpayer can use the challenge procedures set out in Part VIIIA to challenge any decision of the Commissioner that is "disputable". The definition of "disputable decision" covers an assessment and any other decision made by the Commissioner under a tax law, except for decisions specifically excluded by the definition. If a decision made by the Commissioner is excluded from the "disputable decision" definition, the only option available to a taxpayer is to have the decision reviewed through a judicial review application.[22]

6.4 The specific examples raised in this chapter relate to the list of exceptions to the "disputable decision" definition contained in section 138E.[23] However, this review also provides an opportunity to look at the definition more generally. We would be particularly interested in any submissions on whether the current definition imposes undue compliance costs by effectively requiring taxpayers to issue a NOPA in response to a decision made by the Commissioner that does not itself make an amended assessment imminent.

[22] *Westpac Banking Corporation v CIR* (2008) 23 NZTC at para. 30-31.
[23] One exception from the "disputable decision" definition is decisions that cannot be challenged under Part VIIIA. Section 138E contains the relevant list.

Opting out of the disputes process

6.5 As mentioned in previous chapters, we anticipate that agreements under section 89N(1)(c)(viii) to opt out of the disputes process will become more common in future.

6.6 Under the current drafting of section 138E, a decision of the Commissioner to enter into an opt-out agreement is "disputable". By their very nature, opt-out agreements are consensual and freely entered into by the parties. We therefore do not consider that the best interests of the disputes process are served by providing taxpayers with the ability to challenge this decision.

6.7 If the Commissioner does not agree to enter into an opt-out agreement, the remaining steps of the disputes process will follow and, generally (assuming neither party accepts the position of the other in the interim), lead to an assessment. That assessment can be challenged by the taxpayer in the normal way, so the taxpayer does not "lose" as a result of the Commissioner's procedural decision regarding the opt-out.

6.8 As a result, we propose an amendment to section 138E to clarify that the Commissioner's decision whether or not to enter into an opt-out agreement under section 89N(1)(c)(viii) is not "disputable".

Validity of NOPA and SOP

6.9 Section 138E(1)(e) lists the decisions that cannot be challenged if the decision "is left to the discretion, judgment, opinion, approval, consent or determination of the Commissioner". This wording is consistent with the policy intent that discretionary administrative matters should not generally be subject to the challenge provisions.

NOPA

6.10 Under section 89B, the Commissioner may issue one or more NOPAs in respect of a tax return or assessment. The use of the word "may" is permissive; the Commissioner is not compelled to issue a NOPA (other than possibly under the care and management provisions). The fact that the Commissioner "may" issue a NOPA suggests that this is a matter that is "left to the discretion, judgment [or] opinion" of the Commissioner.

6.11 However, the decision to issue a NOPA is not listed as one of the exceptions to the use of the challenge proceedings under section 138E. The result is that the issuing of a NOPA by the Commissioner is arguably a "disputable decision". This means that, in theory, a taxpayer could issue a NOPA in response to the Commissioner's NOPA. Such an outcome is clearly procedurally circular and in substance contrary to the scheme and purpose of the disputes process. The disputes process is designed so that taxpayers do have a right of response to the Commissioner's NOPA, through their NOR.

SOP

6.12 Section 89M(3) states that the Commissioner must, unless the dispute is taxpayer-initiated, provide the taxpayer with a SOP at the same time as the disclosure notice is issued.

6.13 Section 89M is one of the provisions listed in section 138E(1)(e), meaning that discretionary decisions made under it are not "disputable". However, the use of "must" in section 89M(3) effectively compels the Commissioner to provide the disputant with a SOP. Therefore, issuing a SOP is arguably not discretionary. The result is that the taxpayer can, in theory, respond with a NOPA.

6.14 As with the previous issue, an ability to respond to a SOP with a NOPA is circular and unintentional. The disputes process already provides an avenue for taxpayers to respond to the Commissioner's SOP.

6.15 We therefore consider that section 138E should be amended to clarify both of these issues.

Definition of "disputable decision"

6.16 An overlap has been identified in the definition of "disputable decision". Subparagraph (iv) of the definition provides that a decision is not a "disputable decision" if it "is left to the Commissioner's discretion under sections 89K, 89L, 89M(8) and (10) and 89N(3)". However, decisions left to the Commissioner's discretion under sections 89K and 89M are also excluded from being "disputable" by the operation of section 138E.

6.17 The definition of "disputable decision" and section 138E should be amended so that all discretionary-type matters are listed in one place (section 138E) rather than in the definition itself.

Exceptional circumstances

6.18 The Commissioner has the ability under section 89K to determine whether to allow a taxpayer to provide documents out of time. Late submissions will be allowed if the Commissioner is satisfied that the lateness is as a result of "exceptional circumstances". This decision is not a "disputable decision". Given the policy rationale for a decision to be "disputable", and the implications for the taxpayer if the "exceptional circumstances" test is not satisfied, we consider that a decision by the Commissioner that the test has not been satisfied should be disputable. Proposed amendments to the definition of "exceptional circumstances" generally, and its relationship with the disputable decision definition, are discussed in more detail in the following chapter.

Chapter 7

EXCEPTIONAL CIRCUMSTANCES

This chapter suggests that the definition of "exceptional circumstances" be amended so that taxpayers who have demonstrated an "intention to dispute" can also submit documents after the response period. It also suggests that decisions should continue to be made by the Commissioner and those decisions should be "disputable".

7.1 The consequences of not meeting a statutory timeframe set out in the disputes process are serious: the defaulting party is deemed to accept the position adopted by the other. As a result, a taxpayer who fails to issue a NOPA, respond in time to the Commissioner's NOPA, disclosure notice, SOP or assessment within the statutory timeframe will generally be liable for the tax, penalties and interest sought by the Commissioner. Similarly, if Inland Revenue fails to respond to a taxpayer NOPA in time, the Commissioner will be deemed to accept the revised tax position proposed. If this deemed acceptance occurs, the dispute is at an end.

7.2 The exception to this rule is if "exceptional circumstances" apply. The exceptional circumstances rules are ameliorating provisions that blunt the otherwise harsh effects of statutory timeframes. If exceptional circumstances exist, a notice issued by the taxpayer or Commissioner that is issued out of time will be treated for the purposes of the TAA as if it had been given within the applicable response period.[24]

7.3 The idea of an exceptional circumstances test will always give rise to an inherent tension. Although statutory timeframes are considered essential to ensure that the disputes process is navigated in a timely and efficient manner, there will be situations when a late response is justified and the party to the dispute should not be unduly penalised for failing to meet a deadline. However, ameliorating provisions should not be so weak as to allow a taxpayer with any excuse to issue notices out of time. To do so would give rise to ongoing uncertainty about the tax position and additional administrative and other costs. The key is therefore in finding a system that best accommodates the two competing objectives.

[24] Section 89K.

Current law

7.4 For taxpayers, the tests for exceptional circumstances are set out in sections 89K(3) and 138D(2). Section 89K(3) applies to the "dispute documents" – that is, the NOPA, NOR and SOP. Section 138D(2) applies to a challenge in a hearing authority to a disputable decision.

7.5 Under section 89K, the Commissioner has a discretion to accept late documents if an event beyond the taxpayer's control provides them with a "reasonable justification" for not meeting the deadline.

7.6 For acts or omissions of agents of disputants, an exceptional circumstance exists only if it results from an event outside the control of the agent, and its effect could not have been avoided by compliance with accepted standards of business organisation and professional conduct.

7.7 In both cases, the Commissioner also has a discretion to accept documents if the lateness is minimal. The Commissioner interprets this discretion as meaning he will generally accept documents that are only one to two days late and if the other factors relevant to the exercise of the discretion under section 89K(1) are satisfied.[25]

7.8 The tests in section 138D are broadly similar to those in section 89K. A key difference, however, is who makes the decision on whether exceptional circumstances exist. Under section 89K, the decision is made by the Commissioner whereas, under section 138D, the decision is made by the hearing authority. Most case law on exceptional circumstances focuses on section 138D, with an acknowledgement that the existence of exceptional circumstances should be applied consistently wherever it is used in the TAA.[26]

7.9 Because it is always the taxpayer that issues challenge proceedings, the exceptional circumstances test that applies to the Commissioner applies only to "dispute documents", and is only relevant if the Commissioner is late in filing a NOR (this being the only timeframe for the Commissioner's documents).

7.10 Section 89L, which applies to the Commissioner, focuses on whether circumstances beyond the control of Inland Revenue provide a reasonable justification for lateness. An exceptional circumstance also includes a change in tax law made during the response period. To be eligible to issue a NOR after the response period, the Commissioner must apply to the High Court, within the two-month response period, for an order that exceptional circumstances exist.

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[25] *SPS 08/01: Disputes resolution process commenced by the Commissioner of Inland Revenue*, para 201. See also further examples of the exercise of this discretion in *Tax Information Bulletin*, Volume 8, No. 3, 1996, Questions and Answers.

[26] *Treasury Technology Holdings Ltd v CIR* (1998) 18 NZTC 13,752; *Milburn NZ Ltd v CIR* (1998) 18 NZTC 14,005; *Fuji Xerox NZ Ltd v CIR* (2001) 17,470 (CA); *Hollis v CIR* (2005) 22 NZTC 19,570; and *Balich v CIR* (2007) 23 NZTC 21,230.

7.11 There have been numerous cases that involve an application to the hearing authority under section 138D. The Court of Appeal, in *CIR v Fuji Xerox New Zealand Ltd* outlined the approach it considered should be taken in considering when exceptional circumstances exist:[27]

- Identification – The hearing authority must identify the events or circumstances relied on by the disputant and ascertain whether they were beyond the disputant's, or their agent's, control.
- Evaluation – For the events that are beyond the control of the taxpayer, or their agent, the hearing authority must then evaluate whether those events provide a reasonable justification for not commencing the challenge proceedings within the response period.
- Discretion – If the events do provide a reasonable justification, the hearing authority retains a residual discretion not to allow the challenge to commence.

Problems with the current rules

7.12 The NZICA-NZ Law Society submission considers that:

- The existing exceptional circumstances test is too strict, and the test that applies to agents is even stricter. This may result in genuine disputes being unable to be advanced because the taxpayer cannot convince the Commissioner to exercise his discretion (under section 89K) in their favour.
- The Commissioner can apply to the High Court if exceptional circumstances are considered to exist, whereas the decision on whether the taxpayer has exceptional circumstances is made by the Commissioner. Associated with this is that any decision of the Commissioner is not "disputable", meaning that taxpayers must have the decision judicially reviewed to have any chance of it being overturned.
- There is a disparity between the tests that apply to the Commissioner and the taxpayer. The Commissioner has an additional "exceptional circumstance" if there is a change in tax law during the response period.[28]

7.13 This chapter considers these concerns in turn. However, as a starting point, we note that we do not believe that the tests that apply to the Commissioner and the taxpayer should be in perfect symmetry. The Commissioner is a statutory office, with the wider responsibility for revenue collection through the efficient operation of the tax system. This role makes it appropriate that any possible failure to meet statutory requirements be considered by a court. For the taxpayer, the concern is instead for the right mechanism being in place so that there can be an objective consideration of the issue.

[27] (2002) 20 NZTC 17,470.
[28] Section 89L(3)(b).

Intention to dispute

7.14 The NZICA-NZ Law Society submission argues that the discretion to accept late documents should be extended to circumstances when there is evidence of an intention to dispute, or when an error has been made and the time delay is not significant in the circumstances. This idea has merit because taxpayers with a genuine grievance should not generally be precluded from pursuing the matter.

7.15 The idea of a test based on an intention to dispute has its genesis in case law. The principal case in New Zealand is *Gisborne Mills Ltd v CIR*.[29] Although *Gisborne Mills* was decided before the introduction of the current disputes process, it nevertheless provides support for the proposition that continual assertion of a contrary position is sufficient to maintain a dispute.

7.16 The taxpayers in *Gisborne Mills* were members of a consortium of exporters. The Commissioner assessed on the basis that a particular tax incentive was no longer available. Another exporter successfully pursued a challenge to the ruling to the High Court. Despite the other exporter receiving a favourable decision from the Court, the Commissioner refused to retrospectively amend the taxpayer's assessments because they had not made a formal challenge. The taxpayers sought to have that decision of the Commissioner judicially reviewed.

7.17 The High Court (Robertson J) upheld the taxpayer's application and referred the decision back to the Commissioner. An important part of the Court's reasoning was that the taxpayers:

- had "consistently asserted that they were entitled to the export incentive…". This was "in marked distinction to a person who, never having contemplated seeking a benefit under the taxing legislation, endeavours to take advantage of a matter when they become aware of a decision affecting another taxpayer"; and
- had "in an informal way been involved in the [previous case] and were, throughout the period, objectors in fact, if not in law".

Possible test

7.18 Although "intention to dispute" is a difficult concept to articulate in legislation, there are merits in having a test that provides some leeway to a taxpayer who misses a deadline but who nevertheless has demonstrated that they have an unresolved grievance. This test could co-exist with the current exceptional circumstances test, so that late documents could be accepted either when there was a clear intention to dispute before the end of the response period, or when exceptional circumstances existed.

[29] (1989) 13 TRNZ 405.

7.19 While an intention test is inherently subjective, it could be interpreted by reference to objective criteria set out in the legislation. Any list of possible indicators should not be exhaustive, because it is impossible to anticipate the number of circumstances that may apply to individual taxpayers.

7.20 The central tenet of any test should be that the taxpayer demonstrates they have, before the deadline, clearly communicated an intention to formally dispute the matter on certain grounds and have not subsequently modified that position.

7.21 To support this general proposition it may be helpful to consider the following further factors:

- The taxpayer has responded to any Inland Revenue correspondence (whether by phone or in writing) and has attended scheduled meetings regarding the dispute and consistently asserted their contrary position regarding the substantive issues.
- The taxpayer has complied with other parts of the disputes process and their overall tax obligations (for example, if the late document in question is the taxpayer's SOP, the fact that they have filed a timely NOR should count in their favour).
- The taxpayer has corresponded with other relevant parties regarding the dispute – for example, the Minister of Revenue, the Ombudsman or Inland Revenue's Complaints Management Service.

7.22 An application would not be accepted if the degree of lateness was unjustified in the circumstances, or it was considered to be designed to defeat the application of the time period or to frustrate the disputes process itself. An example might be a taxpayer who contacts the Commissioner close to a deadline to confirm they intend to dispute, but then does nothing further for some considerable time, effectively rendering the timeframe meaningless. To counter such risk, new rules may be needed to extend the Commissioner's statutory time-bar if the Commissioner cannot complete the disputes process as a result of delay that is clearly attributable to a taxpayer's actions.

7.23 In addition, a taxpayer who sought to retrospectively take advantage of a favourable court decision for another taxpayer would not have an intention to dispute if they had not previously kept their own dispute "live". This approach is consistent with the Court's view in *Gisborne Mills*.

7.24 We consider that taxpayers who engage tax agents should still be able to use the "intention to dispute" test. It may even be that the Commissioner will view the engagement of a tax agent specifically to manage the dispute as evidence in determining whether there was actually the requisite intention to dispute. This would also ensure that taxpayers are not unduly prejudiced by seeking the assistance of tax agents.

7.25 We have considered whether an "intention to dispute" test should contain a final date after which documents would not be accepted and the Commissioner's tax position would be deemed to be accepted. The problem with this approach is that there is a risk this date could become the default date for all filings.

7.26 As a result, we consider that this is a matter best left to the discretion of the Commissioner, possibly subject to a requirement that the progress of the dispute is not unduly delayed. Taxpayers will still have the two-month response period in which to prepare their documents and will still be able to have their circumstances considered under the "exceptional circumstances" test in the event of situations genuinely beyond their control (such as sudden illness or a natural disaster affecting the taxpayer's locality). We therefore suggest that the combined test should be a matter that the Commissioner considers upon application from a taxpayer. If this suggestion is adopted, administrative guidelines as to the application of the test may be needed.

Agents and the current exceptional circumstances test

7.27 We believe that the current exceptional circumstances test for agents works well. Although it imposes a higher standard on tax agents, it is not usual for the law to "expect more" from people who are acting in a professional capacity in a highly skilled environment. The recent TRA decision in *Case Z25* shows that agents should be able to rely on the exceptional circumstances test in appropriate situations.[30]

How should "exceptional circumstances" decisions be made?

7.28 The NZICA-NZ Law Society submission considers that taxpayers should have a general ability to apply to the Court for an extension of time (as the Commissioner has under section 89N(3)).

7.29 We do not agree that a hearing authority should be the first port of call for taxpayers who claim exceptional circumstances (or an intention to dispute). There will always be cases when there is obviously an exceptional circumstance that has prevented the timely production of the relevant document. There is no need to involve the courts in these cases; a decision to accept late documents can be made more cheaply and easily by the Commissioner. Similarly, when the taxpayer clearly has an intention to dispute, the suggested indicators would mean that the Commissioner was in a good position to make the necessary decision.

[30] Taxation Review Authority NZTRA No 022/09 Dec No 5/2010, Hearing: 21 January 2010; Decision: 11 February 2010.

7.30 The question therefore is whether the taxpayer should be able to appeal an exercise of the Commissioner's discretion. Under current law, an exceptional circumstance decision is not a "disputable decision". The only option for a taxpayer who disagrees with the Commissioner's decision on the existence of an exceptional circumstance is therefore to have that decision judicially reviewed.

7.31 The Court of Appeal has confirmed that the established principles of judicial review in tax cases (being, essentially, dishonesty or deliberate maladministration) should not be widened, and that the use of judicial review in other than extreme cases is an abuse of process.[31] As a result, judicial review places a very high burden of proof on to a taxpayer who is looking to have a decision reviewed by the Court, and is also likely to involve considerable expense (both for the taxpayer and the Commissioner seeking to defend the decision).

7.32 As discussed in the previous chapter, disputable decisions for tax purposes should generally be decisions that relate to matters that directly impact on the tax liability.

7.33 In our view, judicial review is too cumbersome a tool to deal with what should be a fairly simple administrative matter that would normally be made by the Commissioner in the first instance. The preferable approach is to allow instead for the consideration of exceptional circumstances to be a disputable decision.

7.34 Making the Commissioner's decision on exceptional circumstances "disputable" has a number of advantages:

- It is analogous to a "typical" disputable decision in that it directly impacts on the quantum of tax payable by the taxpayer. Deemed acceptance of the Commissioner's decision results in all tax, interest and penalties becoming payable immediately.
- The provisions by which disputable decisions are challenged in a hearing authority are well understood by the Commissioner and taxpayers (and their agents).
- The general jurisdiction of the TRA is well-equipped to deal with challenges of this kind.

7.35 Making an exceptional circumstances decision disputable may involve the following consequential changes:

- A rule to confirm that, if the matter was decided in favour of the taxpayer (so that the dispute continued), it would then fall back into the relevant stage of the disputes process for that process on the substantive issue to continue.

[31] *Westpac Banking Corporation v CIR* (2009) 24 NZTC (23,340).

- A suspension of the time-bar (and any relevant intermediate disputes process timeframes) for the period between when the Commissioner's decision is made and resolution of the matter by the courts.

Change in the law

7.36 Section 89L(3)(b) clarifies that a change in tax law is a circumstance beyond the control of the Commissioner. This section is phrased as being "for the avoidance of doubt" and was introduced to provide for circumstances when the Commissioner is confronted with a new law but there is insufficient time to consider its application to the dispute in question.

7.37 As the Commissioner is an officer of the executive branch of government, a change in law is undoubtedly beyond the control of the Commissioner, which explains the fact that it is phrased as only being for the avoidance of doubt.

7.38 There is equally little doubt that a change in tax law (however affected) would also be a circumstance beyond the control of a taxpayer. Therefore, we consider there is scope for the provision to be removed or be extended so that it also applies to the taxpayer.

Chapter 8

DEALING WITH SMALL CLAIMS

This chapter suggests that:

- the administrative opt-out process, as governed by the new opt-out guidelines, should effectively deal with all small claims;
- the existing small claims jurisdiction of the TRA should be repealed; and
- it is not necessary to introduce a specialist tribunal for "very small" tax disputes.

8.1 The fact that, in recent years, fewer tax cases reached the courts is consistent with the Richardson Committee's aim of increasing the number of tax disputes that are resolved before the parties have to resort to the courts. On the other hand, anecdotal evidence suggests that taxpayers are unwilling to pursue small claims against the Commissioner because they find the disputes process too onerous. This occurs when the costs of the disputes process outweigh the amount of tax at stake and the taxpayer therefore concedes or settles the dispute.

8.2 The result of imposing the full disputes process on relatively small claims may be that some legitimate disputes are not being aired. This is likely to have repercussions for the integrity of the tax system, because the affected taxpayers may come to have less faith in its overall fairness.

8.3 This chapter looks at options for improving the small claims processes, including a review of the existing small claims jurisdiction of the TRA and the role of the bilateral opt-out process.

The small claims jurisdiction

8.4 To provide an avenue for small claims to be dealt with quickly and efficiently, the small claims jurisdiction of the TRA was established in 1996. This was supplemented by the release, in 1998, of standard practice statement INV-140, which sets out the Commissioner's criteria for fast-tracking "small, simple disputes" to resolution.

8.5 Section 89E allows a taxpayer to elect for the dispute to be heard in the TRA acting in its small claims jurisdiction where the proposed adjustment is $30,000 or less. This election can be made in the taxpayer's NOPA (for a taxpayer-initiated dispute) or their NOR (for a Commissioner-initiated dispute).[32] If the taxpayer makes this election, it is irrevocable.[33]

8.6 The election effectively circumvents the remainder of the disputes process through an exception to completing the full process, under section 89N, which applies when an election is made.

8.7 There is no separate set of rules that govern proceedings in the TRA when it is acting in its small claims jurisdiction. Taxpayers have the right to represent themselves in the general jurisdiction of the TRA, and this remains true for the small claims jurisdiction.

Perceived problems with the small claims jurisdiction

8.8 In addition to the $30,000 threshold, there are other limitations on the small claims jurisdiction. It can only hear disputes when:[34]

- the facts are clear and not in dispute; and
- there is no significant legal issue, or there are no other taxpayers that may be affected by the result.

8.9 These other limitations are fairly substantial in practice. There are very few tax cases involving no disputed facts. Often cases will turn on fact patterns, or the parties' interpretation of factual matters. Equally, for cases when the facts are genuinely clear, it is often at least arguable that there is a "significant" legal issue at stake. Regarding the application to other taxpayers, the Commissioner certainly has the ability to argue that the fact pattern present in a particular case could be repeated across, for example, an industry group. Such an argument may result in the small claims jurisdiction being unavailable to a disputant even where the tax effect is small and the facts clear.

[32] In the circumstances set out in section 138O(1) of the TAA, the Commissioner may challenge the taxpayer's election and apply to the TRA to have the proceedings transferred to either the general jurisdiction of the TAA or the High Court. Similarly, under section 138O(2), the TRA itself can require the proceedings to be transferred to its general jurisdiction.
[33] Section 89E(2).
[34] Section 13B, Taxation Review Authorities Act 1994.

8.10 Another perceived disadvantage of electing the small claims jurisdiction (from both parties' perspective) is that any decision of the TRA acting in its small claims capacity is final – that is, there is no right of appeal to the High Court.[35] There is no appeal right from the TRA acting in its general jurisdiction if the amount of tax involved is less than $2,000 or the amount of the net loss is less than $4,000.[36] However, by electing to have the case heard by the small claims jurisdiction, a taxpayer is effectively extending this general prohibition on appeals for any tax amounts between $2,000 and $30,000.

8.11 Perhaps as a result of these factors, there have been only six disputes taken to the small claims jurisdiction since its establishment in 1996. Comments from Judge Barber also suggest that, even on the few occasions the small claims jurisdiction has been used, it is not necessarily the best forum for those disputes.[37]

INV-140

8.12 The former administrative "fast-track" procedure, set out in standard practice statement INV-140, is also of limited value. This is because it effectively replicates the small claims jurisdiction requirements of the facts being undisputed and the case not involving any significant legal issues. It also operates on a lower monetary threshold ($15,000) and introduces an additional requirement that the issue is non-recurrent for the particular taxpayer. It is anticipated that the revised SPSs will supersede INV-140.

What is a small claim?

8.13 There is no "one size fits all" model for determining what constitutes a small claim. For a small business owner, a tax dispute of $10,000 could have a material impact on the business while, for a large enterprise, a dispute of over $100,000 may not necessary be of major consequence in terms of the balance sheet or shareholder value. Equally, a large enterprise may consider it worthwhile pursuing a tax dispute for a relatively small sum because of the precedential value the outcome may have for it in subsequent tax periods.

8.14 That said, there needs to be effective procedures in place to identify disputes that do not justify application of the entire disputes process. Given that small disputes are proportionately more likely to affect SMEs (who bear a relatively higher proportion of tax compliance costs), these costs should, wherever possible, be kept to a minimum.

[35] Section 26A(2), Taxation Review Authority Act 1994.
[36] Section 26A(1).
[37] Judge Barber *Observations from the bench*, New Zealand Institute of Chartered Accountants, 2007 Conference, page 3.

Possible solutions

Administrative opt-out

8.15 Under the proposed opt-out guidelines, the Commissioner will agree to opt-out of the disputes process when a meaningful conference has taken place and the tax in dispute is less than $75,000. Implementation of these guidelines will result in small claim disputants effectively having a "fast track" to the TRA.

8.16 Implementation of the opt-out guidelines is likely to result in fewer taxpayer elections to use the small claims jurisdiction of the TRA. As a result, there is a strong case for removing the small claims jurisdiction altogether. This would be achieved by removing a taxpayer's ability to elect to use this jurisdiction, and repealing the appropriate provisions of the Taxation Review Authority Act and Taxation Review Authorities Regulations.

8.17 The opt-out route may be preferable to the small claims jurisdiction, both because taxpayers will retain their appeal rights and because a facilitated conference should be a valuable forum for ensuring that all information and arguments are exchanged and explored.

Removing the existing restrictions

8.18 Another possible approach to improving the process for small claims would be to amend the rules that stipulate when a taxpayer can elect to use the small claims jurisdiction of the TRA. In particular to:

- increase the financial limit to $75,000; and
- allow the small claims jurisdiction to decide factual disputes.

8.19 The lack of appeal rights would still make the election to the small claims jurisdiction more of a "gamble" for taxpayers. However, if appeals were allowed, the jurisdiction would hardly differ from the general TRA jurisdiction.

8.20 As we have noted, implementation of the opt-out guidelines should result in most disputes of under $75,000 being fast-tracked in any event. Taxpayers whose dispute is less than $75,000 will know from the outset that they will be eligible for fast-track treatment following a meaningful conference.

Making the small claims jurisdiction compulsory

8.21 The idea of bolstering these changes by making the small claims jurisdiction compulsory for disputes under a certain amount is not favoured. Compulsion would create genuine access to justice issues, assuming the restriction on appeals from the small claims jurisdiction remained. The full disputes process, or the process under an agreed opt-out, contains the most appropriate number of checks and balances to ensure that disputes are, as much as possible, resolved before they get to court. Given the uniqueness of each tax dispute, it is important to recognise that there are taxpayers whose disputes may be "small" (however that is defined) that nevertheless wish to go through the full disputes process.

Very small claims

8.22 The NZICA-NZ Law Society submission suggested that an area of particular concern is those disputes that are "very small". Again, this term requires some definition, but for these purposes, we will assume that they are tax disputes where the tax at issue is $5,000 or under, which is the threshold used in Australia.

8.23 Currently, Inland Revenue has a strong emphasis on settling very small claims without the need for litigation. Although "settle" does not always equate to "compromise" (particularly in respect of core tax at stake), an approach based on care and management principles will continue to be taken for very small claims to ensure that the escalation of the dispute is proportionate to the amount at stake.[38]

8.24 We consider that the new administrative opt-out process and care and management principles should effectively deal with very small claims. We are not therefore recommending any legislative change in this area. Nevertheless, what follows is a discussion of the possible options for very small claims, including the establishment of a separate tribunal for very small cases, should specific legislated approaches be considered desirable.

Using the Disputes Tribunal

8.25 New Zealand already has a Disputes Tribunal for disputes where the amount is (generally) $15,000 or less. These disputes are resolved relatively quickly, with minimal cost and formality.

[38] Section 6A(3).

8.26 Although the system has intuitive appeal for also dealing with tax disputes, we think it is unsuitable for the following reasons, all of which are inter-related:

- The jurisdiction of the Disputes Tribunal is predominantly related to quasi-contractual or damage to property disputes. By contrast, tax disputes generally hinge on statutory interpretation, (irrespective of whether the dispute is on a novel point or one where the application of existing case law is necessary).
- The individuals who oversee Disputes Tribunal hearings are all well-trained in matters pertinent to the Disputes Tribunal, are respected members of their local communities and have valuable mediation and fact-finding skills. However, they are not judges and it is a lot to expect for members of the community to be well-versed in the intricacies of tax law and how it should apply to a particular set of facts.
- Tax law is not a discipline that easily lends itself to "rough justice". Even small tax disputes can, because of the complexity of legislation and case law, involve fine, lengthy and sometimes precedential legal arguments. The Disputes Tribunal, where disputes are habitually resolved in less than two hours and lawyers do not represent either party, is not an appropriate forum for this type of legal argument.

8.27 On the other hand, the Disputes Tribunal can be an effective forum for resolving factual matters. In theory, if a tax dispute was for a small amount and turned only on its facts (when both parties agree that the outcome will be settled if certain factual findings are made), the Disputes Tribunal would be a good place to have these disputes resolved quickly and efficiently. However, any advantage of moving such disputes to the Disputes Tribunal would be outweighed by the inconvenience of different tax disputes going to different authorities, depending on their nature. In addition, as purely factual disputes are now part of the opt-out guidelines, they should be able to be heard by the TRA without undue delay.

A specialist tribunal for very small claims

8.28 One option suggested in the NZICA-NZ Law Society submission is establishing a separate tribunal or authority for the hearing of very small tax claims. Such tribunals (or divisions of the main authorities) appear in various guises in Australia, Canada and the United Kingdom.

8.29 These countries allow for appeals to be made from decisions of the relevant hearing authority, although appeals from informal procedure cases in Canada are restricted to errors of law and matters akin to breaches of natural justice.

Australia

8.30 Australia has a tribunal known as the Small Taxation Claims Tribunal (STCT). This Tribunal, which is a branch of the Administrative Appeals Tribunal, hears tax disputes when the amount of tax in dispute is less than A$5,000. If a taxpayer wishes to challenge a decision of the Australian Tax Office, they complete an application form (available from the STCT website) that requires them to provide their personal details, the amount of tax in dispute, a copy of the decision they are disputing and their reasons for disagreeing with the decision. In sending in the application form, there is a non-refundable filing fee, currently set at A$68 (which can be waived in the case of hardship). On receipt of this application form, the ATO must provide the STCT (and the taxpayer) with all documents that it has used to arrive at its decision.

8.31 Any hearing by the STCT is preceded by a conference between the taxpayer and the ATO that is facilitated by a Tribunal Member or Conference Registrar. If this conference is unsuccessful in resolving the dispute, the matter will be heard by the STCT by way of a public, but informal, hearing.

United Kingdom

8.32 The United Kingdom and Canada both have broadly comparable fast-track procedures to take small claims to a relatively informal hearing body.

8.33 In the United Kingdom, the recently established Tax Chamber of the First-tier Tribunal will generally be the initial forum for all tax disputes. These disputes are divided into categories, depending on their level of complexity. The simplest cases are decided "on the papers" without any hearing. In such cases, taxpayers and Her Majesty's Revenue & Customs produce the documentary evidence they believe supports their interpretation of events and the law. This is considered by the Tribunal and the parties are advised of the outcome. Where a hearing is requested by the taxpayer, or a "paper" classification is otherwise inappropriate, the case will be heard under the "basic" category. This provides for an informal hearing before the Tribunal where evidence is presented and witnesses called by the parties. The Tribunal aims to inform the parties of its decision at the conclusion of the hearing.[39] There is no filing fee.

[39] There are actually four classifications of case in the First-tier Tribunal. In addition to "paper" and "basic", a case can also be heard in the first instance as a "standard" or "complex" case, depending on its complexity or value. These latter two classifications are not discussed here because they are less likely to be used for very small disputes.

Canada

8.34 In Canada (assuming the taxpayer's original objection has been rejected by the Canadian Tax Authority), a taxpayer can elect to have their appeal against an assessment heard by the Tax Court of Canada's "informal procedure". The informal procedure is only available if the disputed federal tax is not more than C$12,000, the disputed loss is no more than C$24,000 or interest is the only matter in dispute. An informal hearing does not have to follow legal or technical rules of evidence and the decision of the Court has no precedential value. The filing fee for using the informal procedure is C$100, which is less than the fees payable for using the "general procedure".

Application to New Zealand

8.35 An obvious difference between the countries mentioned above and New Zealand is that the taxpayer is appealing against a decision of the relevant tax authority. In other words, these jurisdictions operate on a fundamentally different structure, whereby the revenue authority issues an amended assessment and a dispute ensues from that. By contrast, in New Zealand, the bulk of the dispute takes place before the assessment being issued. The policy rationale for this difference is well documented.

8.36 Although it could be argued that for very small claims, the dispute could be more easily dispensed with by an independent body, the approach to issuing a NOPA (as outlined in the revised SPSs) should greatly assist taxpayers by ensuring that impartial decisions are taken earlier in the process than previously. This approach should therefore result in better choices being made around abandoning disputes with either a low prospect of success or when the costs of pursuing marginal cases are likely to outweigh the benefits of taking them through the disputes process.

8.37 The revised SPSs, in relation to the guidelines on NOPA size, should also ensure that the documents that are produced by the Commissioner in very small claims are concise, so that responding to them does not place an undue compliance cost on the taxpayer concerned.

8.38 Another key disadvantage in adding another disputes tribunal layer into the New Zealand system is the associated costs. The benefits of having a separate, informal disputes forum for very small claims do not appear to outweigh the costs associated with the establishment and ongoing administration of such a body. Given that claims of up to $75,000 are likely to be fast-tracked to the TRA in any event, taxpayers can take some comfort from the fact that compliance costs should be minimised in all "smaller" disputes.

8.39 The TRA also has a good deal of flexibility in its ability to set its own processes. It is a commission of enquiry, rather than governed by strict court rules, and taxpayers can represent themselves. This flexibility provided to the TRA should continue to ensure that very small claims that do make it to hearing are dealt with efficiently.

Filing fees

8.40 In the interests of access to justice for small claims, the current TRA filing fee of $400 may be considered disproportionately large. However, given the amount of time that taxpayers will generally spend on the dispute, coupled with the cost of any professional advice in reaching the hearing stage (even if the opt-out is used), we do not consider the fee to be prohibitive. In any case, Regulation 10A of the Taxation Review Authorities Regulations allows the taxpayer to apply to the Registrar to have the filing fee waived in cases of hardship.

Chapter 9

TEST CASES

This chapter looks at the procedures surrounding test cases. It concludes that the Australian approach of having a separate test-case panel and taxpayer-funding for test cases is not desirable in New Zealand. Instead, it discusses the options of either test-case designation (that is, the dispute that is to be the test case) and the identity of the "affected" parties being determined by the High Court, or relying on existing court rules to perform the same function as the test-case provisions.

9.1 Occasionally, a number of taxpayers will have disputes with Inland Revenue that revolve around similar arrangements or transactions.

9.2 If the circumstances of the individual taxpayers are materially identical, it makes sense to have one case (referred to in this chapter as the "test case") that is taken through the disputes process, with the outcome of that dispute being determinative for other taxpayers in the same situation (referred to in this chapter as the "affected cases").

9.3 By having one case determine the outcome of others, all parties will have swifter resolution of the dispute. In addition, costs may be lower – as all affected cases can (in theory) contribute to the costs of the test case and the Commissioner will need to prepare just one case. The burden on the courts associated with hearing near-identical cases will be similarly relieved. However, current legislation and administrative practices fall short of fully achieving these objectives.

Reasons for a test-case procedure

9.4 Before discussing solutions to these problems, we note that there are two main reasons justifying the existence of a formal test-case procedure:

- the benefit and cost savings of having a number of disputes decided more quickly than would be the case if each dispute were to run its own individual course; and
- test cases are arguably a good way of clarifying any uncertainty in the existing legislation (for example, it might be important to take a dispute that features a particular pattern of facts through the court system so that Inland Revenue and a particular industry group get a clear understanding of how the legislation applies).

9.5 The first reason is undeniable. Access to more timely and cost-effective justice is universally recognised as a desirable outcome of any judicial process. The objectives are of equal importance to each other, since there seems little point in having swift justice if it is prohibitively expensive – while a low cost solution that results in lengthy delay appears equally unattractive.

9.6 The idea that test cases provide legal clarity appears to be at least partially based on the notions that the law is static and the relationship between the disputing parties is effectively equal. The reality of the New Zealand parliamentary system is that, if the Government of the day believes that a decision of the courts does not reflect good policy (or the policy intent behind the provisions in question), it has the capacity to sponsor a legislative amendment so that the law reflects the position it is seeking to determine. The clarification of a legislative provision by the courts will therefore provide certainty in respect of law in force at the time relevant for the particular dispute, but will not always provide the parties with lasting clarity on legal implications of the arrangement in question. We therefore consider that the first objective is the more relevant one in considering possible changes to the test-case process.

Current test-case rules

9.7 Section 138Q gives the Commissioner the power to designate a challenge as a test case if he "considers that determination of the challenge is likely to be determinative of all or a substantial number of the issues involved in one or more other challenges". Designated test cases are always heard in the High Court.

9.8 Once a case has been designated as a test case, the Commissioner may stay proceedings for other cases that are considered to be subject to the outcome of the test case. This stay can only be issued if the other case has not itself been determined by a hearing authority (that is, it is in a pre-court phase of the disputes process).[40] A disputant has the right to challenge this stay.[41] Factors that the courts will consider relevant in considering the taxpayer's challenge are:[42]

- A taxpayer should not lightly have access to the courts denied, even for a time.
- The closer the similarity in facts between the test case and the subject case, the more likely it is that the stay will be granted.
- The more cases riding on the test case, the more likely it is that the stay will be granted.

[40] Sections 138R(1) – (2).
[41] Section 138R(3).
[42] See *Bage Investments Ltd v CIR* (1999) 19 NZTC 15,531; *CIR v T* 11/6/03, Williams J, HC Auckland, CIV 2003-404-3355; and *B v CIR; CIR v Multiple taxpayers* [2004] 2 NZLR 86 (para 36).

- The more tax involved, the less likely it is that the stay will be granted.
- The longer the period between the events leading to the tax dispute and the likely resolution of that dispute if the case is "parked", the less likely it is that the stay will be granted.
- The more devastating the consequences of the unwanted stay on the taxpayer, the less likely it is that the stay will be granted.

9.9 However, when there is agreement that the test case will cover all of the material issues at stake, there must be very strong reasons for the Commissioner's stay to be set aside.[43] When a stay applies, relevant statutory time limits are frozen.[44]

9.10 Section 89O provides that a taxpayer and the Commissioner may agree to suspend proceedings subject to the resolution of a test case. This agreement is different from the stay issued unilaterally by the Commissioner under section 138R (see preceding paragraphs), in that this agreement can occur at any stage during the disputes process, whereas the stay generally only applies to cases when an amended assessment has already been issued. When a suspension of proceedings is agreed under section 89O, it applies until either the test case is resolved or the particular taxpayer's dispute is otherwise resolved.[45] The Commissioner may issue an amended assessment to the "suspended" taxpayer that is consistent with the outcome of the test case.[46]

9.11 Neither the Commissioner nor an affected taxpayer (either suspended or stayed) are bound by the outcome of the test case, meaning that any amended assessment issued by the Commissioner in accordance with the outcome of the test case can itself be challenged.

Perceived problems with the test-case procedure

9.12 The existing test-case procedure appears to be causing some difficulties for both taxpayers and the Commissioner.

Taxpayers

9.13 The NZICA-NZ Law Society submission raises the following concerns with the operation of the current test-case legislation:

- The test-case designation is entirely in the hands of the Commissioner.
- The Commissioner can take too long to determine whether a case should be treated as a test case.

[43] *CIR v Erris Promotions; Wilson & Black Associates Ltd v CIR; CIR v West Coast Developments Ltd* [2003] 1 NZLR 506, para 30.
[44] Section 138R(7).
[45] Section 89O(3).
[46] Section 89O(4).

- The procedure is seldom used and there is little guidance on how it would be used.
- Some cases that are of potential precedential value do not appear before the courts because of "burn-off".

The Commissioner

9.14 From the Commissioner's perspective, the following difficulties arise:

- Taxpayers are often reluctant to have their case designated as a test case and will judicially review their selection.
- Taxpayers are not bound by the test-case decision, thereby reducing the effectiveness of the procedure (in terms of time and cost savings to both parties).
- If a designated test case is settled, further delay is caused while the remaining parties have to go through the test-case process again under a new designated case. Alternatively, delay will simply arise by reason of the time taken to settle.

Possible solutions

Test-case panel

9.15 In Australia there is a test-case litigation program[me] that applies to tax cases. To quote from the ATO website:

> Under the test case litigation program[me], the ATO provides financial assistance to taxpayers whose litigation is likely to be important to the administration of Australia's revenue and superannuation systems. The aim of the program[me] is to develop legal precedent – that is, legal decisions that provide guiding principles on how specific provisions we administer should be applied more broadly.
>
> We are guided in the decision to fund such cases by the criteria contained in this guide and by a test case litigation panel. The panel includes members of the accounting and legal professions, to ensure that we fund issues of importance to the community.

9.16 Their criteria for funding are:

- there is uncertainty or contention about how the law operates;
- the issue is of significance to a substantial section of the public or a particular industry; and
- it is in the public interest for the case to be litigated.

9.17 Taxpayers or an industry group generally apply for funding through a formal application process.

9.18 The programme is available to taxpayers:

- that have a case that has commenced or is about to commence;
- that have a potential case that is not yet fully developed; or
- where there is a potential issue, but no live case at present. These cases are generally identified by associations that represent industry groups. The ATO, sometimes with the assistance of the relevant association, will attempt to identify a suitable case to test the issue and that taxpayer will then apply for test case funding.

9.19 For these taxpayer-initiated cases, the programme generally also covers appeals (by either party) to the Full Federal Court (but not the High Court). The ATO can also initiate test cases when it has identified an issue it feels needs clarification. ATO-initiated cases receive public funding without the need for the taxpayer to submit an application.

9.20 Public funding may also be available to taxpayers when the ATO loses in the original hearing authority and appeals against that decision. This funding may be available irrespective of whether the original hearing was part of the programme and is available for ATO appeals up to the High Court level.

9.21 The test case panel is an advisory body only. The chair of the panel is the ATO's Chief Tax Counsel, who makes the final decision on whether funding is offered. The current panel comprises six people, four of whom are external. The panel meets four or five times a year where applications are generally considered.

9.22 Funding of test cases is generally formalised through the taxpayer and the ATO entering into a test case funding deed. This deed can cover funding for solicitors' fees, counsels' fees and disbursements up to a level that allows the taxpayer to match, but not exceed, the number and seniority of the counsel instructed by the ATO.

Should the Australian approach apply in New Zealand?

9.23 There are a number of reasons for favouring the introduction of a similar programme in New Zealand:

- It would promote clarity of law in complex areas. The early recognition of complex issues would allow both taxpayers and Inland Revenue some certainty on how the law applies – even in law that is relatively recently enacted.

- Taxpayer funding is more likely to result in taxpayers volunteering to either be the test case or be bound by the outcome.
- Provided the Commissioner invariably followed the recommendation of a test case panel, the process would arguably be more transparent and acceptable to taxpayers.[47]

9.24 Countered against these arguments are the following major disadvantages:

- If the purpose of a test-case process is to aid cost reduction and timeliness rather than development of the law, there is more limited justification for funding some taxpayers and not others.
- New Zealand is a small jurisdiction with a limited pool of independent persons qualified to sit on a panel. This is especially problematic for cases that involve a large number of prominent taxpayers.
- There would be a fiscal cost associated with taxpayer funding of all or a substantial part of the costs of both parties to a protracted piece of litigation. There are policy concerns around the circumstances in which government funds should be diverted to assisting tax disputes.
- There appear to be no major advantages over a court making the decisions, which may have substantial experience in test-case designation (discussed below). To introduce a separate body would appear to be an unnecessary duplication of resources.
- The panel would need to be established through legislation. As a statutory body, its decisions would be subject to judicial review. Although we consider that the judicial review of the decisions of an independent panel would be rarer than the review of decisions by the Commissioner, this is by no means guaranteed. Therefore, in practical terms, the situation may not be materially advanced from the current position of these decisions being made by the Commissioner.

9.25 On balance, we consider that the disadvantages for having a taxpayer-funded test-case programme outweigh the advantages.

Test-case matters decided by the courts

9.26 One of the major stumbling blocks of the current system appears to be that the test-case designation is made unilaterally by the Commissioner. Another possible way of tackling the issue of test-case designation and application may therefore be to replace the Commissioner's power and instead have the matter determined directly by the courts.

[47] In this respect it is worth noting that the ATO has, on occasion, declined to follow a funding recommendation by its Panel, see *Review of Tax Office Management of Part IVC litigation*, The Inspector General of Taxation, 28 April 2006, para 6.103.

9.27 Any such system should first allow the parties to reach decisions of their own accord. As a result, the affected taxpayers and the Commissioner should be afforded the opportunity to agree to a particular taxpayer dispute being a test case for a wider set of affected cases (irrespective of what stage in the disputes process these various taxpayers were currently in). To be consistent with the policy of expeditious resolution of disputes, there would need to be timeframes that governed the reaching of this agreement.

9.28 Failure to reach an agreement by the set deadline would enable an application to be made to the Court for test-case designation. As test cases are required to be heard by the High Court (and it seems sensible that this should continue), that Court would be the most appropriate forum for the application.

9.29 To avoid the parties filing simultaneous applications at the earliest possible opportunity, the Commissioner could be given a certain timeframe within which to file the relevant application. If the Commissioner failed to file within the allotted timeframe, the filing right would pass to the taxpayers concerned.

9.30 The original application (regardless of who it was ultimately filed by) would cover:

- the taxpayer or taxpayers to be designated as the test case; and
- the identity of the affected taxpayers.

9.31 The responding party could object to the application by one or both of the following methods:

- arguing that the cases are inappropriate for test-case designation at all (this would need to be based on a notion that no one case, or set of cases, would be determinative of any other of the cases contained in the original application); and/or
- arguing that the wrong taxpayer had been nominated as the test case and/or the list of affected taxpayers was incorrect (in that it named too many or too few taxpayers).

9.32 The High Court would then determine all matters under contention (that is, would designate a test case and the specific affected cases). Given that any such proceedings would not be determinative of the substantive proceedings, there may be a strong argument that the parties' costs for the High Court and any subsequent appeals should lie where they fall.

9.33 Under this approach, the affected cases would be suspended and determined by the outcome of the test case.

9.34 The advantages of such an approach would be that:

- The parties have the ability to discuss test-case designation to see if a mutually agreeable position can be found.
- If there is disagreement, both parties have the opportunity to articulate their views on how, or if, the test scenario should apply to the circumstances.
- The decision on test-case designation is made by an independent party.
- High Court judges have experience in this type of process. Rule 10.12 of the High Court Rules 2008 allows a judge to consolidate proceedings if there are various cases that share common characteristics. Also, Rule 4.24 allows for representative action proceedings.[48] In practice, the effect of either of these provisions may be largely identical to test-case designation. If the rules for test-case designation were to effectively mirror one or both of these rules, the process should be familiar to the Court and therefore adopted with a minimum of disruption.

9.35 The disadvantages of such a system are:

- There will invariably be disputes when there is disagreement on test-case designation and the scope of the affected cases. In such instances, there will be another delay to the substantive proceedings while the test-case designation is decided by the courts. Countered against this is the fact that current test-case designations made unilaterally by the Commissioner are frequently subject to judicial review in any event.
- The system requires that all relevant taxpayers agree amongst themselves who the test-case taxpayer/s should be and who will be bound by the decision.
- Such a system potentially places an additional burden on the court system, and there will be delays in every case while a hearing time before the High Court is obtained and then the Judge's decision is released.
- Decisions of the High Court on test-case designation would themselves be subject to appeal and hence further delay. Although it is possible to make a decision of the Court on this issue final, there are always access to justice concerns with such an approach.

[48] *McGechan on Procedure*, Rule 2.24 synopsis.

Remove the test-case provisions

9.36 As mentioned previously, the High Court (High Court Rule 10.12 and 4.24) and the corresponding rules in the District Court (Rule 3.72.1 and 3.33.5), of which the TRA forms a part, have the ability to either consolidate two or more proceedings if the Court sees that there is a suitable number of similarities between them or allow one or more persons to sue or be sued on behalf of all persons with the same interest in the subject matter (known as "representative action").

9.37 The courts have these powers and there is some established judicial guidance on when it is appropriate to use them.[49] Also, either party can apply for an order under either of these rules by way of interlocutory application.[50]

9.38 One possibility is therefore to dispense with a separate statutory test-case procedure and leave it to the appropriate court to determine the circumstances in which consolidation of proceedings, representative action or the hearing of multiple cases simultaneously, would be appropriate.

9.39 Leaving matters entirely to the courts would appear to have the following advantages:

- There would be no "additional" dispute between the parties; the substantive case for each taxpayer would appear before the court.
- The TRA already has the ability to refer cases to the High Court, if appropriate.[51] Similarly, the Commissioner has the right to apply to the High Court to have any challenge proceedings transferred to the High Court if he thinks that Court is a more appropriate forum for the dispute.[52] The net result (of proceedings going straight to the High Court and then being either consolidated by the Court or heard as a representative action) would be the same test-case designation but without the need for the introduction of new rules.
- The parties to a consolidated hearing or a representative action are bound by the substantive decision of the hearing authority.

[49] See for example *Medlab Hamilton Ltd v Waikato District Health Board* (2007) 18 PRNZ 517, *Callplus Ltd v Telecom New Zealand Ltd* (2000) 15 PRNZ 14 in respect of consolidation and *Houghton v Saunders* [2009] NZCCLR 13; (2008) 19 PRNZ 173 in respect of representative action.
[50] *McGechan on Procedure*, High Court Rules, paragraph 10.12.02.
[51] Section 24, Taxation Review Authority Act 1994.
[52] Section 138N(2).

9.40 The major disadvantage of this system would appear to be that a dispute must have reached the court hearing stage of the process before it can be consolidated. In practice, disputes with numerous taxpayers do not follow neat time-lines. The complexity of some cases compared with others, the ability to file documents at any time during a statutory time period, resource constraints and information imbalance all contribute to some disputes progressing through the disputes resolution process faster than others. It is therefore not uncommon for some taxpayers who are potentially test cases or affected cases to be at vastly different stages of the process. Having no way of grouping these taxpayers before they all reach the point where proceedings are before a hearing authority may result in undue delay in getting the substantive issues resolved.

9.41 Countered against this is the fact that the Commissioner has a wide discretion in relation to opting out of the disputes process (as discussed in earlier chapters). If the parties were in general agreement that either consolidation or representative action was appropriate, the Commissioner could agree to fast-track the relevant disputes to the challenge stage so the relevant hearing could begin at the earliest possible time. However, this scenario depends on two factors:

- that all parties agree to be part of the consolidated or representative action proceedings. If there were no such agreement, the relevant party would not agree to opt out of the disputes process, effectively forcing the Commissioner to either take the case (or cases) that had already reached the hearing authority on its own, or apply for a court order under section 89N(3) to truncate the disputes process in respect of the "later" taxpayer/s; and
- that the courts will be willing to adjourn the "first" challenge to allow the remaining disputes time to "catch up". Again, this may also depend in some measure on the cooperation of the individual taxpayer.

9.42 Because of the uncertainty in leaving test-case decisions to the existing court rules, our initial preference would be to have a formal test-case procedure that would pre-empt all of the disputes reaching the filing stage. Although this could be achieved by administrative guidelines, we believe this is an instance where clear statutory language is preferable.

Status quo

9.43 One option is to maintain the status quo. Given that test cases do not arise frequently, there may be an argument for simply maintaining the current system, despite its perceived flaws. This would be particularly attractive if significant improvements could be identified through remedial changes to the current rules. Although retaining the current system (or a variant of it) remains an option, the current review provides an ideal time to focus on this issue and, if possible, introduce a system that is more agreeable to both Inland Revenue and taxpayers.

Chapter 10

OTHER ISSUES

This chapter discusses some other possible amendments to the TAA that, although relatively minor, logically fit within the scope of this review. They are a review of the use of the word "challenge" in the TAA and amendments to the rules related to the:

- exceptions to when a Commissioner must issue a NOPA (in particular, section 89C(db)); and
- financial relief rules (sections 177C(5) and (6)).

Use of "challenge"

10.1 There are numerous places in the TAA and the Income Tax Act 2007 in which the word "challenge" is used.[53] In the TAA, this terminology can generally be traced to wholesale changes that implemented the current disputes process. These amendments were necessary to ensure that the legislation was clear as to whether the "old" objection procedure or the "new" challenge procedure would apply to the assessment in question.

10.2 The term "challenge" in the TAA has a particular meaning that relates only to challenges under Part VIIIA. It may not, however, be sufficiently clear that a taxpayer who disagrees with an assessment by the Commissioner made under specific sections should first go through the disputes process in Part IVA. Only if the matter is unresolved after going through the standard disputes process should the assessment be challenged in a hearing authority.

10.3 Although the relevant provisions in Part VIIIA attempt to ensure that a dispute has first been through the dispute process, there is concern that sections 138B and 138C are not particularly clear.

10.4 This issue is compounded by later amendments that confer on taxpayers the right to "dispute or challenge… under Parts IVA and VIIIA".[54]

10.5 We suggest a review of both Acts to ensure that appropriate terminology is used so that the disputes process is used in all appropriate circumstances. If necessary, this may include amendments to Part VIIIA to clarify this intent.

[53] See, for example, section 44(3), TAA and section DB 3, Income Tax Act 2007.
[54] This language is found in Part V (Determinations). See, for example, section 91AAB(5).

Section 89C(db)

10.6 Section 89C effectively allows the Commissioner to bypass the entire disputes process in certain limited circumstances. When these circumstances exist, the Commissioner may simply issue an assessment to the taxpayer.

10.7 The exception contained in section 89C(db) is where:

> The assessment is made in relation to a matter for which the material facts and relevant law are identical to those for an assessment of the taxpayer for another period that is at the time the subject of court proceedings.

10.8 The intention behind section 89C(db) is that the Commissioner and the taxpayer do not need to go through the disputes process for every tax period in which a particular dispute is relevant. For example, a taxpayer adopts a particular income tax treatment of a series of annual transactions that occurred in each of the 2007, 2008 and 2009 income years and court proceedings are underway in respect of the 2007 transactions. Rather than having to complete the entire disputes process for the 2008 and 2009 periods, the Commissioner can simply issue an assessment for those periods that is consistent with the one issued for 2007. The later two periods can then be governed by the outcome of the court proceedings. Such an approach saves the compliance costs associated with unnecessary duplication.

10.9 However, the problem with the current wording of section 89C(db) is that there is no "corresponding" provision that relates to the actions to be taken by the taxpayer in the dispute. This means that, in the example above, even though the Commissioner can issue an amended assessment without having to go through the disputes process, a taxpayer cannot challenge that assessment without issuing a NOPA. If the taxpayer issues a NOPA then the Commissioner must issue a NOR before the taxpayer can then challenge at a hearing authority through the challenge provisions. (We note that if the proposed amendments to prevent a unilateral taxpayer opt-out at this stage were to be adopted, this problem could be further exacerbated.)

10.10 The requirement for a taxpayer to issue a NOPA in these circumstances clearly goes against the objective of section 89C(db), which is to provide a fast-track directly to a hearing authority for disputes that are essentially identical to those ones already being heard. Having all of the disputes at the hearing authority also provides the hearing authority with the opportunity to consolidate the proceedings if it considers such an approach desirable. A consequential amendment may also be necessary to section 138B to ensure that a disputant is immediately entitled to challenge the Commissioner's assessment in these circumstances.

Suggested change

10.11 We suggest amending the TAA to clarify that a taxpayer does not have to issue a NOPA for an assessment made under section 89C(db) and can instead directly move to the challenge proceedings relating to that assessment.

Sections 177C(5) and (6)

10.12 This issue appears to be a simple oversight created by a mismatch between the TAA and the Income Tax Act 2007. It can be summarised as follows:

- Section 177C(5) and (6) requires tax losses to be extinguished at the same time as outstanding tax is written off.
- A "net loss", as defined in section YA of the Income Tax Act, factors in losses removed under section 177C(5).
- An "assessment" as defined in section 3 of the TAA includes a determination of a "net loss" for the purposes of the Income Tax Act.
- Section 89C required a NOPA to be issued whenever the Commissioner is proposing to amend an assessment.

10.13 The result is that, under the current rules and unless a contrary position is agreed with the taxpayer, a NOPA is required to be issued by the Commissioner when tax losses are extinguished, even though the "main" decision – to write-off the tax debts – is not "disputable" by operation of section 138E. It seems illogical for there to be a situation where the Commissioner makes a non-disputable decision that is generally favourable to a taxpayer (that is, to write off the overall tax debt), but a mandatory side effect of that decision (to also extinguish tax losses) has to be subject to the disputes process.

Suggested change

10.14 We suggest amending section 89C to clarify that the Commissioner does not need to issue a NOPA in circumstances where the Commissioner has made a decision to write-off tax debt under section 177C. Such an amendment would clarify that write-off decisions are not intended to be subject to the dispute process and would also capture any extinguishment of tax losses under sections 177C(5) and (6).

Annex

THE DISPUTES RESOLUTION PROCESS

The disputes process was introduced in 1996 in response to the recommendations of the Richardson Committee.[55]

The objection procedures at that time were perceived to be deficient, in that they did not adequately support the early identification and prompt resolution of issues leading to tax disputes. The Richardson Review recommended that a comprehensive approach to tax disputes be developed with the following objectives:

- every practical effort be made to ensure that assessments are correct before they are issued;
- any dispute be identified at the earliest practical time;
- communication between the taxpayer and Inland Revenue be direct and open to ensure that all information relevant to the dispute is available as soon as possible; and
- appropriate independent advice within Inland Revenue be provided at the earliest practical time.

In response, a pre-assessment phase was introduced, comprising a set of prescribed steps to facilitate the "all cards on the table" approach to tax dispute resolution.

This annex describes in detail the legislative steps that make up the disputes resolution process.

How does a dispute arise?

A dispute may arise when a taxpayer and Inland Revenue have not reached agreement on a tax position taken in a taxpayer's self-assessment, and often follows an audit of the taxpayer. If no agreement has been reached on some or all of the issues identified, Inland Revenue will begin the disputes process by issuing a notice of proposed adjustment (NOPA).

Alternatively, a taxpayer may dispute his or her own assessment or disputable decision made by the Commissioner by issuing a NOPA.

[55] *Organisational Review of the Inland Revenue Department, Report to the Minister of Revenue (and on tax policy, also to the Minister of Finance)* from the Organisational Review Committee, April 1994.

The time-bar

The TAA imposes time limits for increasing assessments. If a taxpayer has furnished a return and made an assessment, the Commissioner may not amend the assessment to increase the amount assessed if four years have passed from the end of the income year in which the taxpayer provided the return.[56] The Commissioner is prevented from refunding amounts of overpaid income tax after four years from the end of the year in which the original assessment was made.[57] The Commissioner cannot refund amounts of overpaid GST after four years from the end of the taxable period in which tax was assessed.[58]

The time-bar does not apply if the Commissioner is of the opinion that a return is fraudulent, wilfully misleading or does not mention gross income which is of a particular nature or was derived from a particular source.[59]

The disputes process

Once a dispute has begun, the issuing of a correct assessment is intended to be achieved through a series of steps prescribed in Part IVA.

Once an assessment is issued, the challenge process, involving litigation in the courts, as set out in the TAA begins.

The main legislative elements of the pre-assessment phase of the disputes resolution process are:

- Notice of Proposed Adjustment (NOPA);
- Notice of Response (NOR); and
- Disclosure notice and Statement of Position (SOP).

There are also two important administrative phases in the process – the conference and adjudication phases.

The current application of all these elements is explained in more detail below.

The Notice of Proposed Adjustment

The NOPA is the first formal step in the disputes process.

[56] See section 108 and for GST assessments, section 108A.
[57] See section RM, Income Tax Act 2007.
[58] See section 45, GST Act 1985.
[59] See section 108(2).

The content of a NOPA is prescribed. It must contain sufficient detail to reasonably inform the recipient of:[60]

- the adjustments or adjustments proposed to be made to the assessment;
- the tax laws on which the adjustments are based;
- a statement of the facts giving rise to the adjustments; and
- a statement of how the law applies to the facts.

The purpose of the NOPA is to ensure that the party receiving the notice is aware of the arguments on which the other party is relying. Reducing these points to writing emphasises the need to review the positions of Inland Revenue or the taxpayer and is intended to foster open and frank discussion early in the resolution process in terms of the "all cards on the table" objective. Providing adequate information also ensures that the NOPA can be responded to fully.

The taxpayer may dispute his or her own assessment by issuing a NOPA within two months after the date of the notice of assessment.

Acceptance of Notice of Proposed Adjustment

If the adjustment is accepted in writing, or the adjustment is deemed to have been accepted, because either Inland Revenue or the taxpayer has not responded in time, the disputes process ends and an amended assessment is issued or the assessment stands.[61] No further challenge may be made to that adjustment.[62]

A late response by a taxpayer is deemed to have been received within the response period if exceptional circumstances apply. Exceptional circumstances are discussed in detail in Chapter 7 of this document.

The Notice of Response

If the taxpayer or Inland Revenue disagrees with one or more of the proposed adjustment in a NOPA, the taxpayer must notify the other party by issuing a NOR within two months of the date of issue of the NOPA.[63] The NOR is the vehicle used by the recipient of the NOPA to formally reply to the proposed adjustment.

[60] See section 89F.
[61] See sections 89H and also 89J.
[62] See section 89I.
[63] Section 89AB defines "response period". For these purposes, this is two months from the date of issue of the originating document.

The content of the NOR must:[64]

- specify the facts or legal arguments in the NOPA that the recipient considers to be in error and why they are in error;
- specify the facts and tax laws that are relied on by the recipient and how the law applies to the facts; and
- state the adjustments to a figure referred to in the NOPA as a result of the above factors.

Small claims election

A taxpayer may indicate in his or her NOPA or NOR (in a dispute initiated by the Commissioner) that he or she wishes to be heard before the small claims jurisdiction of the Taxation Review Authority (TRA).[65] The TRA's jurisdiction includes the determination of small claims where the facts are clear and not in dispute, the tax to pay or tax effect is below $30,000 and no significant legal issues or precedent are involved. The taxpayer is bound by the decision of the TRA.

Conference

Conferences between the Commissioner and the taxpayer were administratively prescribed following a recommendation by the Richardson Committee.

The purpose of the conference, of which there may be more than one, is to facilitate the resolution of any disputed facts and issues that have been raised in the NOPA and NOR.

Disclosure notice

If the dispute is not resolved because the NOR is not accepted, the Commissioner may issue a disclosure notice. For disputes initiated by the Commissioner, the disclosure notice must be accompanied by a SOP. The disclosure notice is an important document because it triggers the application of the evidence exclusion rule. The evidence exclusion rule is discussed in detail in Chapter 4.

[64] See section 89G(2).
[65] See section 89E.

The Statement of Position

Each party's SOP must:[66]

- give an outline of the facts on which the party intends to rely;
- give an outline of the evidence on which the party intends to rely;
- give an outline of the issues that the party considers will arise; and
- specify the propositions of law on which the party intends to rely.

Statement of Position in Commissioner-initiated disputes

If the Commissioner initiates the dispute, then the Commissioner must issue a SOP at the same time that a disclosure notice is issued.[67] The taxpayer must file his or her own SOP within two months of the disclosure notice.[68] The taxpayer may apply to the High Court for further time to issue the SOP provided that the taxpayer applies within two months and it is unreasonable to reply because the issues in dispute had not previously been discussed.[69]

If the taxpayer fails to respond to the Commissioner's SOP and the taxpayer has not applied to the High Court for more time in which to reply, the taxpayer will be considered to have accepted the proposed adjustment as detailed in the Commissioner's SOP or NOPA.[70]

The Commissioner has a right of reply to the taxpayer's SOP[71] but must exercise this right within two months of the date of issue of the taxpayer's SOP. Any additional information in the reply then becomes part of the Commissioner's SOP.[72]

The Commissioner may apply to the High Court for an extension of time to reply to the taxpayer's SOP.[73] The extension may be granted if the Commissioner applies before the expiry of the two-month period in which to respond to the taxpayer's SOP and it is unreasonable to reply within the period owing to the number, complexity or novelty of the matters raised in the taxpayer's SOP.[74]

The need to apply to the High Court may arise when the taxpayer's SOP refers to facts, issues, evidence or propositions of law that have not previously been disclosed and it is necessary for the Commissioner to obtain and consider these matters.

[66] See sections 89M(4) and 89M(6).
[67] See section 89M(3).
[68] See section 89M(5).
[69] See section 89M(11).
[70] See section 89M(7) TAA.
[71] See section 89M(8) TAA.
[72] See section 89M(9) TAA.
[73] See section 89M(10) TAA.
[74] Ibid.

Statement of Position when the taxpayer initiates the dispute

If the taxpayer has initiated the dispute, the taxpayer may issue a statement of position within two months of the date that the Commissioner issues a disclosure notice.[75] It is standard practice for the Commissioner to issue a SOP in reply – generally within three months of receipt of the taxpayer's SOP.

The taxpayer does not have a right to reply to the Commissioner's SOP. However, the Commissioner and the taxpayer may agree to additional information being added, at any time, to their SOPs.[76]

Adjudication

A dispute that is not resolved by the end of the SOP phase is generally referred to the Inland Revenue's Adjudication Unit. The function of this Unit is to consider the dispute impartially and independently of the audit function. The Adjudication Unit makes the assessment decision on behalf of the Commissioner. As a result, if the Unit finds in favour of the taxpayer, the dispute will conclude. On the other hand, if the Unit finds that an adjustment is necessary, an assessment consistent with that finding will be issued.

Assessment

An assessment as amended by the Commissioner is issued after completion of the disputes process, or the original assessment stands.

Post-assessment challenge

A taxpayer is entitled to challenge an assessment by beginning proceedings in a court within the two-month response period.[77]

[75] See section 89M(5) TAA.
[76] See sections 89M(13) and 89M(14) TAA.
[77] See section 138B(1).

Figure 2: Process for a dispute initiated by the Commissioner of Inland Revenue

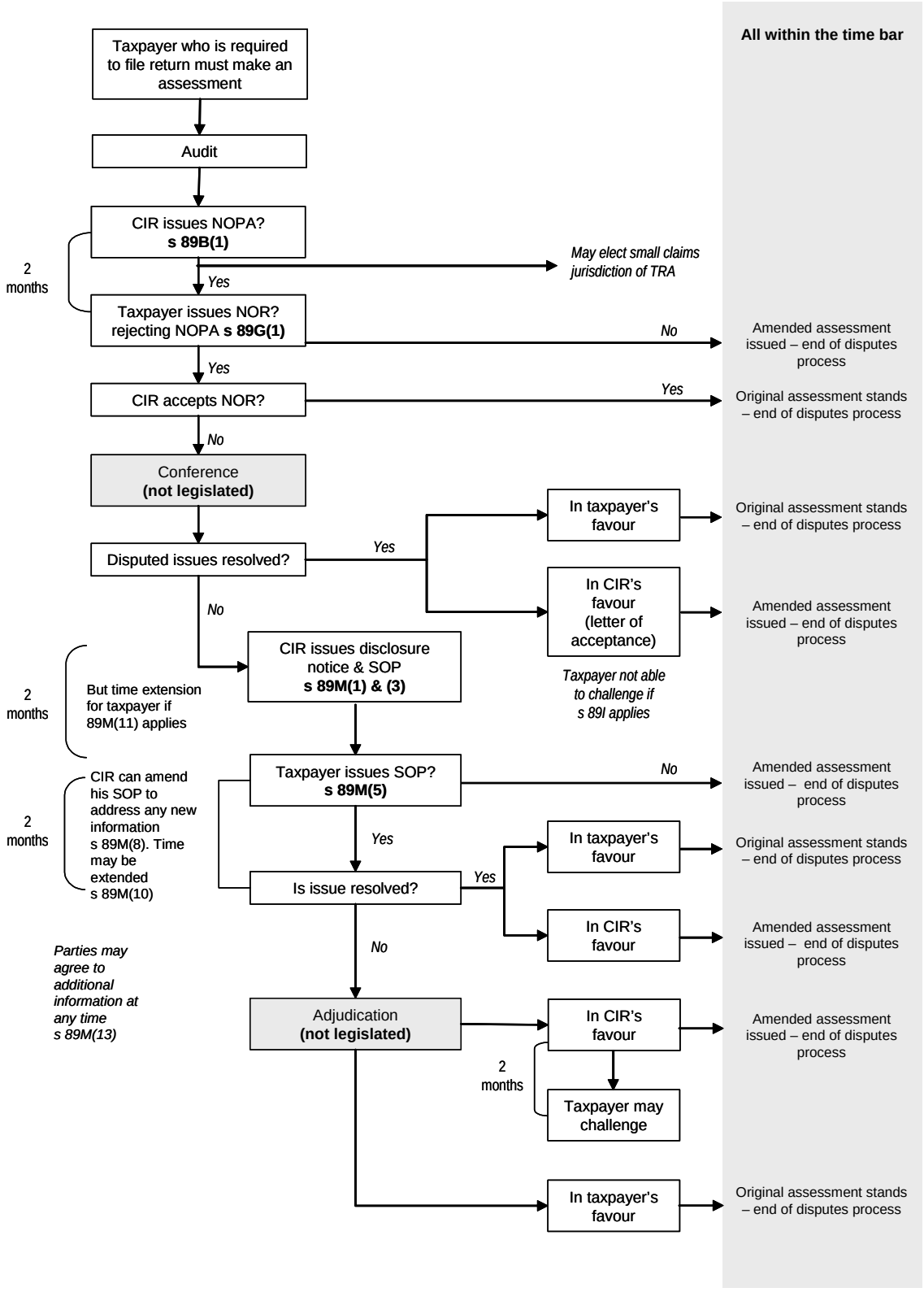

Figure 3: Process for a dispute initiated by a taxpayer