

In Confidence

Office of the Minister Revenue

Chair, Cabinet Legislation Committee

EXTENDING THE COMMISSIONER OF INLAND REVENUE'S CARE AND MANAGEMENT ROLE

Proposal

1. This paper seeks the Cabinet Legislation Committee's agreement to introduce a Supplementary Order Paper to the Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Bill. The Supplementary Order Paper re-introduces a proposal to extend the Commissioner of Inland Revenue's care and management role by enabling her to resolve legislative anomalies.
2. The Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Bill has had its first reading and is currently being considered by the Finance and Expenditure Committee.

Policy

3. The proposal provides the Commissioner of Inland Revenue with the ability to temporarily mitigate the effect of legislative anomalies (being circumstances where tax legislation cannot be interpreted in a manner which is consistent with the policy intent) by seeking a modification (through an Order in Council process) or through using an exemption-making power.
4. Cabinet agreed to the original proposal as part of a suite of changes to modernise core components of the Tax Administration Act 1994 (CAB-18-MIN-0103 refers). The original proposal was then included in the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill as introduced. It was removed from the bill at the recommendation of the Finance and Expenditure Committee pending further work on the draft legislation between Inland Revenue and the Legislation Design and Advisory Committee.
5. The revised legislative drafting contained in the attached Supplementary Order Paper, which has been developed with input from the Legislation Design and Advisory Committee, reflects the original policy recommendations agreed to by Cabinet but with minor changes. I propose the following changes as a result of further work between my officials, submitters from the private sector, and the Legislation Design and Advisory Committee:
 - 5.1 Removing the Commissioner's determination-making power. The Order in Council process and ability for the Commissioner to resolve legislative anomalies using an exemption-making power is still proposed.

- 5.2 Making exemptions issued under the proposed power for the Commissioner legislative instruments and disallowable instruments. This means that any changes proposed under the power will be subject to review by the Regulations Review Committee and can be disallowed by the House of Representatives.
 - 5.3 Allowing an Order in Council to modify the application of a tax law for up to four income years before it comes into force. The previous legislative drafting did not specify what period taxpayers could apply a modification for before it came into force.
6. For taxpayers, policy outcomes remain largely unchanged from the original proposal.

Background

7. New Zealand's tax system is very complex, and it undergoes significant change regularly. The nature and volume of the tax law changes mean that unforeseen or unintended outcomes (legislative anomalies) often arise. This is likely to continue to be the case into the future given the increasing complexity of tax law and rapidly evolving business practices.
8. Ideally, any such anomalies would be remedied by an amending Act, given the constitutional importance of tax and the certainty that primary legislation gives to both taxpayers and Inland Revenue. In some cases, this will be both necessary and achievable. However, under the current approach, it takes on average 670 days to remedy a legislative anomaly through primary legislation once it has been identified as needing legislative change. During the time it takes for an anomaly to be remedied, it is possible taxpayers may be required to file different returns spanning multiple periods. This can cause uncertainty and increases compliance costs for taxpayers.
9. The Commissioner is charged with the care and management of the tax system. A key aspect of the care and management of the tax system is applying and explaining the law to taxpayers. Generally, tax law can be interpreted in a way that is consistent with the policy intent. Sometimes when tax law cannot be interpreted consistently with the policy intent, this can tie up Commissioner and taxpayer resources in cases and outcomes that are inconsistent with both parties' practices and outcomes. This situation is also inconsistent with the objective of helping taxpayers to get it right from the start.
10. The Commissioner's care and management role has been interpreted as limited to providing her with administrative flexibility regarding allocating her resources to fulfil her statutory duties. Care and management does not provide flexibility regarding legislative anomalies, being instances when the policy intent is not properly reflected in the legislation.
11. I propose a more flexible approach to dealing with situations when the legislation does not align with the intended policy (that is, there is a legislative anomaly). Specifically, I propose extending the Commissioner's care and management role by providing the ability to have the legislative anomaly resolved using an Order in Council process or allowing the Commissioner to issue exemptions to mitigate the effect of a legislative anomaly. This will reduce taxpayers' compliance costs in dealing with these legislative anomalies.

12. As with the original proposal, the Order in Council process would be used where the issue was sensitive or had fiscal implications. The exemption making power would be used where there were negligible fiscal implications and the issue was not sensitive, but it was still important to provide certainty for taxpayers. Exemptions would be for provisions of the Inland Revenue Acts, and would specify an alternative means of complying with the provisions from which taxpayers are being exempted from.
13. Examples of when the discretion could be used include: when a drafting error means that the provision is inconsistent with the intended policy, and when a gap in the legislation is discovered that means there is uncertainty as to whether the legislation is consistent with the policy intent. In these situations, the discretion would provide a temporary bridge to allow taxpayers to adopt an approach that is consistent with the intended policy. This would avoid the Commissioner and taxpayers having to commit resources to the unintended outcomes.
14. Consistent with the original proposal, the power would be subject to the following safeguards:
 - 14.1 Changes made under the power must not be inconsistent with the policy intent. I consider this an appropriate limitation on the power as it ensures that it cannot be used to create new policy settings without going through the full policy process.
 - 14.2 Optional application by taxpayers. Taxpayers are in the best position to determine whether a modification or an exemption provides them with a more favourable outcome than the black-letter law. I note this approach is supported the Legislation Design and Advisory Committee and submitters on the proposal.
 - 14.3 Modifications and exemptions would apply generally for a class of taxpayers or set of circumstances. The power would not be able to modify the application of a tax law for a particular taxpayer, but rather is limited to groups or classes of taxpayers to ensure it is only used to remedy objectively determined legislative anomalies.
 - 14.4 Automatic expiration of changes made using the power after three years. I consider this strikes an appropriate balance between providing taxpayers with certainty and allowing sufficient time for matters to be resolved through amendments to primary legislation.
 - 14.5 Consistency with the existing care and management principles. This means that, in the first instance, the exercise would have regard to the importance of promoting voluntary compliance, and the compliance costs that would otherwise be incurred by taxpayers.
 - 14.6 Before a modification or exemption is made, a public consultation process must be undertaken on the proposed modification or exemption. I recommend that the consultation process can be dispensed with in cases of urgency.

Impact Analysis

15. A Regulatory Impact Analysis was completed for the original proposal. However, as minor changes have been made to the preferred option, a revised version of the original Regulatory Impact Analysis is attached.
16. The internal reviewer at Inland Revenue has reviewed the revised Regulatory Impact Analysis prepared by Inland Revenue and associated supporting material. The reviewer considers that the revised Regulatory Impact Analysis meets the quality assurance requirements.

Compliance

17. The proposed Supplementary Order Paper complies with:
 - 17.1 the principles of the Treaty of Waitangi;
 - 17.2 the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;
 - 17.3 disclosure statement requirements (a draft revised disclosure statement for the Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Bill has been prepared and is attached to this paper);
 - 17.4 principles and guidelines set out in the Privacy Act 1993;
 - 17.5 relevant international standards and obligations; and
 - 17.6 the *Legislation Guidelines* (2018 edition), which are maintained by the Legislation Design and Advisory Committee.

Consultation

18. The proposal has been subject to public and other consultations in accordance with the Generic Tax Policy Process as part of its original introduction to the previous bill.

Relevant government departments and other public bodies

19. The Legislation Design and Advisory Committee (LDAC) have been involved extensively in the revised legislative drafting of the proposal and have seen the proposed legislative drafting. LDAC have provided the following comment:

Clauses 6D and 6E propose to delegate powers to modify the application of the Inland Revenue Acts, which are commonly referred to as Henry VIII provisions. Further, in the case of modification by Order in Council, the modifications can have retrospective effect of up to 4 years. As a consequence, the powers are highly unusual.

We note the policy rationale for these powers stated at paragraphs 7 to 11. LDAC's view is that the proposal seeks to limit the scope of the powers to that which is necessary to achieve their policy objective of addressing remedial issues with Inland Revenue legislation and to

ensure fair outcomes for taxpayers. Key limits are that the modifications and exemptions must be minor and consistent with Parliament's intention (rather than allowing substantive changes to policy). Appropriate safeguards on the exercise of the powers have been included, including ensuring the right person exercises the powers, ensuring the instruments are time limited and optional for taxpayers to apply, and providing clear consultation obligations. Given that the remedial modifications may apply to past income years, it is particularly important that they will be optional for taxpayers to apply.

LDAC notes that there is a risk that, if the powers are overused in practice, they would undermine the rule of law, good legislative design, and stewardship of Inland Revenue's primary legislation. Retrospective effect in particular has the potential to increase complexity in application, undermine the accessibility of the law, and have unintended effects. LDAC considers that the requirement to consider, in each case, whether the power is the most appropriate way of addressing or resolving the issue, and to limit the modification to what is needed to address the issue, limits these risks. LDAC, however, recommends in addition that the use of these powers is closely monitored over time to ensure these risks are managed effectively.

Relevant private sector organisations and public consultation process

20. Since the proposal was removed from the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill, my officials have undertaken further consultation with Chartered Accountants Australia and New Zealand, the New Zealand Law Society, Corporate Taxpayers Group and Russell McVeagh on the revised drafting. The additional consultation resulted in a number of changes outlined in this paper.

The government caucus and other parties represented in Parliament

21. Caucus, coalition and support party consultation will be undertaken on this Supplementary Order Paper prior to its proposed release.

Binding on the Crown

22. A number, but not all, of the Inland Revenue Acts currently bind the Crown. This Supplementary Order Paper does not alter the status quo in this respect – the amendments will follow the position of the principal Acts.

Creating new agencies or amending law relating to existing agencies

23. The Supplementary Order Paper will not create a new agency.
24. The Supplementary Order Paper will not amend the existing coverage of the Ombudsman Act 1975, the Official Information Act 1982, or the Local Government Official Information and Meetings Act 1987.

Allocation of decision-making powers

25. The Supplementary Order Paper does not involve the allocation of decision-making powers between the executive, the courts, and tribunals.

Associated regulations

26. No regulations are required to bring the proposed legislation into operation.

Other instruments

27. The Supplementary Order Paper does include provisions empowering the making of legislative instruments that are deemed to be legislative instruments and disallowable instruments. This is because the proposal relies on the ability for the Commissioner to seek (via an Order in Council process on the recommendation of the Minister of Revenue) modifications or issue exemptions relating to provisions of the Inland Revenue Acts.
28. As the proposal relies on the ability to make modifications to the application of, or exempt taxpayers from, provisions of the Inland Revenue Acts, I consider it appropriate that Parliament has the ability to disallow modifications or exemptions made under the powers proposed.

Definition of Minister/department

29. The Supplementary Order Paper does not contain a definition of Minister, department, or chief executive.

Parliamentary stages

30. I propose the Supplementary Order Paper should be released as soon as possible following Cabinet approval and before the 6th of March 2019, which is the date that my officials provide a briefing to the Finance and Expenditure Committee on the Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Bill.
31. Releasing the Supplementary Order Paper before the 6th of March will allow the Finance and Expenditure Committee to consider the Supplementary Order Paper as part of the Bill. It will also allow the Committee to call for public submissions if they choose to.
32. The provisions that extend the Commissioner of Inland Revenue's care and management role are proposed to come into force on the date the Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Bill receives Royal assent.

Financial Implications

33. The proposed amendment will have no fiscal impact. Any fiscal impact of regulations or exemptions made under the empowering provision will need to be considered at the time, but are expected to be minor.

Legislative Implications

34. Implementing these proposals requires changes to the Tax Administration Act 1994.
35. If approved, I propose including the legislative changes resulting from these recommendations in a Supplementary Order Paper to the Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Bill.

Human Rights

36. There are no human rights implications associated with the proposed amendment.

Proactive Release

37. I propose to proactively release this Cabinet paper, and associated minutes in whole within 30 working days of Cabinet making final decisions.

Recommendations

The Minister of Revenue recommends that the Cabinet Legislation Committee:

1. **note** that Cabinet previously agreed to a proposal to enable new processes to allow exemptions to be issued to address legislative anomalies, either by way of an Order in Council, a determination or an administrative power of the Commissioner (recommendation 14 in DEV-18-MIN-0019 refers);
2. **agree** to rescind the decision referred to in paragraph 1; and instead replace it with agreement to a proposal to enable new processes to allow the Commissioner of Inland Revenue to address legislative anomalies by way of an Order in Council on the recommendation of the Minister of Revenue, or through the use of an exemption-making power;
3. **agree** that exemptions issued by the Commissioner under the proposed power should be legislative instruments and disallowable instruments to ensure that these are subject to review by the Regulations Review Committee and can be disallowed by the House of Representatives;
4. **agree** that modifications made by an Order in Council can, depending on the circumstances, apply to taxpayers for a period including up to the most four recently completed income years from when the modification comes into force;
5. **note** that the attached Supplementary Order Paper is proposed to be released and considered by the Finance and Expenditure Committee as part of the Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Bill;
6. **note** that the Supplementary Order Paper makes substantive amendments to the Tax Administration Act 1994;
7. **approve** the Supplementary Order Paper for release, subject to the final approval of the government caucus and sufficient support in the House of Representatives;

8. **delegate** the Minister of Revenue authority to make minor amendments of a technical nature to the measures recommended in this paper without further reference to Cabinet;
9. **agree** that the Supplementary Order Paper should be released as soon as practicable following Cabinet agreement, and at the latest before the 6th of March 2019;
10. **note** that this Cabinet paper, and the associated Cabinet minute will be released on Inland Revenue's website.

Authorised for lodgement

Hon Stuart Nash
Minister of Revenue