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Strengthening the Settings for Inland Revenue's Statutory Role as Tax Collector

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Abstract

Many public officials in New Zealand have statutory functions and powers that are assigned to them by law for which they are granted statutory independence. In a taxation context, the Commissioner of Inland Revenue (the Commissioner) is vested with significant powers under the Tax Administration Act 1994. The Commissioner is free to delegate these powers and is granted statutory independence regarding how these powers are exercised in respect of the tax affairs of individual taxpayers or tax law interpretation. These powers enable Inland Revenue (IR) to assess and collect taxes due to the Crown.

Tax administration is an area that is extraordinarily challenging for IR. There are simply not enough administrative resources to assess and collect every dollar of tax revenue that is due. In addition, the legislation itself is necessarily complex and the meaning of the law is not always clear. A level of administrative discretion is needed to ensure a pragmatic approach can be taken to collecting the highest amount of tax revenue that is practicable. It is important, however, to ensure that the pursuit of tax revenue does not take advantage of administrative flexibility or ambiguity in the legislation by allowing the exercise of statutory functions and powers to be manoeuvred away from the legislator's purposes for said functions and powers.

This thesis establishes a series of expectations that taxpayers have of IR regarding how the independent statutory powers that are vested with the Commissioner should be exercised. With reference to this list of expectations, it then uses a combination of doctrinal and non-doctrinal research methods to conclude that more should be done to strengthen the settings for IR's statutory role as tax collector. The research contends that the statutory settings are not appropriate to support IR in this role and a number of recommendations for legislative change are made. This thesis also makes a number of recommendations as to how IR can revise its internal approach to administering the tax system to reflect its statutory role as tax collector.

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Chapter 1: Contextual Discussion

1.1 Introduction

The purpose of this chapter is to provide a contextual framework for the other chapters included in this submission. My studies were completed under the PhD with Publication model made available through the Department of Commercial Law at the University of Auckland Business School. In total, five papers were prepared that have been integrated into the ensuing chapters. The chapters collectively deal with different facets of the same systemic concern that has arisen in tax administration. This chapter explains the central narrative and outlines how each of these chapters fit within a broader theme.

At its most abstract level, the research is concerned with ensuring that there is the right balance in place between competing priorities in the administration of the tax system here in New Zealand.

The research contends that the current settings for tax administration do not ensure that there are sufficient measures in place to support Inland Revenue's administration of the tax system in a way that reflects its statutory role as tax collector. The Commissioner is personally vested with vast statutory powers under the legislation and is granted statutory independence with regards to how these powers are exercised. With the vesting of statutory powers, there is an expectation that the Commissioner will generally exercise them to uphold the integrity of the tax system and according to Parliament's purposes.

Inland Revenue (IR) is a department of state and the Commissioner is appointed under the legislation as chief executive of this department. There is much to suggest that there are stronger channels of accountability to support the Government's expectations of IR in this regard. With this comes the risk that IR will too often defer to its managerial interest in administering the tax system as a department of State.

The chapters included in this submission are divisible between those chapters that examine selected issues with the current legislative settings and those chapters that examine issues with IR's strategic, regulatory and operational approach to administering the tax system. The aim of the research is to highlight those areas where IR's statutory role as tax collector is not being supported and improvements can be made. Accordingly, the chapters have identified a number of specific action points that are outlined in the summary of findings at the end of this thesis.

In terms of legislative reform, the chapters indicate that the following should happen:

- Rethink the statutory objective for tax system administration and define more precisely the statutory parameters of the Commissioner's adjudicative role.
- A list of independently stated procedural rights should be added to the legislation that sets out what is expected of IR's administration of the tax system.
- Consideration needs to be given to those areas where administrative discretion given to the Commissioner should be curtailed in favour of taxpayer rights.
- The mechanisms that exist to resolve tax disputes be revised.
- Amendments are made that provide that the Commissioner is accountable for the standards set out in administrative law in her administration of the tax system.

Outside of legislative changes, the chapters make a number of recommendations for how IR can revise its approach to administering the tax system. These include:

- The way that performance is assessed and measured at IR needs to be revised to ensure there is better support for IR's statutory role as tax collector.
- A decision-making tool should be developed to assist staff to balance the various elements that need to be considered when determining what administrative action is appropriate in the circumstances.
- Compliance risk management practices can be improved to be more transparent and less divisive as between taxpaying groups.

1.2 Research framework and design

A research framework refers to the epistemological and methodological frame of reference that guides the researcher in the overall organisation of their research and their selection of research tools and methods. Two core paradigms have traditionally guided researchers in the design and conduct of their research, referred to as "positivism" and "interpretivism".[1]

Positivism is described as "being based on an ontology of realism, which views the world as existing independently of our knowledge of it".[2] Positivist researchers adhere to "the belief that

[1] Margaret McKerchar *Design and Conduct of Research in Tax, Law and Accounting* (Thomson Reuters, 2010) at 70.
[2] At 72.

knowledge is created by deductive reasoning".[3] In legal research, is it often associated with doctrinal research (discussed further below). This assumes there is truth in law and seeks to ask what the law is in a particular area.[4] Interpretivism, on the other hand, "provides an understanding of social reality based on the subjective interpretation of the researcher".[5] It is said to be "based on inductive reasoning and does not provide a hard and fast explanation from which causal relationships can be identified and predictions made".[6] In recent years, it has been recognised that the two opposing concepts of positivism and interpretivism are likely to sit on a continuum and that other paradigms sit in between them. "Critical realism" and "pragmatism", as two further examples, are paradigms that reject the positivism approach and are argued to sit on this continuum.[7]

As discussed in the introduction, the chapters included in this submission are divisible between those chapters that examine selected issues with the current legislative settings and those chapters that examine issues with IR's strategic, regulatory and operational approach to administering the tax system.

Three of the chapters prepared use qualitative methodology to consider the current legislative settings. The research framework underpinning this research could be described as "postpositivism".[8] The chapters rely on a combination of doctrinal and non-doctrinal research methods to make conclusions and recommendations based on the broad statutory framework that governs tax administration in New Zealand.

Doctrinal research generally involves the analysis of primary sources of law and other secondary material to determine what the law is in a particular area.[9] The three chapters prepared that consider current legislative settings contain a heavy element of doctrinal research to establish how the law applies. In examining this legislative framework, it is necessary to first consider the relevant jurisprudence because case law has definitely played a key role in shaping the law. The doctrinal research is also built on using non-doctrinal approaches that can be broken down into three further

[3] At 72.
[4] Ian Dobinson and Francis Johns "Qualitative Legal Research" in Mike McConville and Wing Hong Chui (eds) Research Methods for Law (Edinburgh University Press, Edinburgh, 2007) 16 at 19.
[5] See McKerchar, above n 1, at 75.
[6] At 75.
[7] At 70.
[8] At 73.
[9] See Dobinson and Johns, above n 4, at 18.

categories: problem, policy and law reform based research.[10] All four categories of legal research (doctrinal and non-doctrinal) feature at various points in the three chapters. The approach taken in the chapters is normally to first identify what is expected of IR in its statutory role as tax collector. This set of expectations, which is summarised in part three of this chapter, is then used as part of the analytical framework for the research undertaken.

Two of the chapters prepared use qualitative methodology to examine issues with the various operational and administrative decisions made by IR. The research framework underpinning this research closely aligns with the pragmatism paradigm. This is described in the following terms:[11]

> Conceptual research, which could be described as reflecting pragmatism, is characterised by drawing from and "thinking with" the literature to challenge what is taken for granted. It then generates new concepts, or conceptual innovations. While conceptual research adopts a contemplative, deep thinking and creative framework that integrates knowledge and ideas to build now concepts, it does so in a scholarly manner.

It should be noted that the side of tax administration that deals with regulatory strategy and the use of resources by IR necessarily takes on an interdisciplinary character. Many of the conceptual constructs used by IR in its approach to compliance risk management, for example, have their foundations deeply rooted in the economics and social psychology literature. In this respect, the research does not focus on the law only as it is written but takes on a much broader view of the law in a social and political context. A number of regulatory tools and frameworks identified in part five of this chapter are then drawn on as a point of reference in the ensuing chapters to form conclusions through a process of inductive reasoning.

1.3 Expectations of Inland Revenue

Part three of this chapter provides context to the various expectations of IR in its statutory role as tax collector. As discussed earlier in part two of this chapter, these expectations form part of the analytical framework for the research undertaken in each of the chapters included in this submission.

IR is the department of State that is responsible for the administration of the tax system in New Zealand. The person who is appointed as chief executive of IR under the State Sector Act 1988 is designated the Commissioner of IR (the Commissioner). There are considerable statutory functions

[10] At 20.
[11] See McKerchar, above n 1, at 79.

and powers under the Tax Administration Act 1994 (TAA 1994) that are vested in whosoever occupies this position.[12] The Commissioner may also delegate these functions and powers to other officers of IR to enable the performance of duties.[13] As a matter of convention, these powers and functions have always come with the protection of statutory independence as they are exercised in relation to the tax affairs of individual taxpayers.[14]

An important element is that the statutory functions and powers vested with the Commissioner under the TAA 1994 come with certain expectations. These expectations arise from a variety of sources. For example, a body of case law has developed regarding the role of the Commissioner when exercising some of these statutory functions and powers based on an interpretation of the statutory scheme of the TAA 1994. There are constitutional responsibilities that IR must also observe, underscored by legislation such as the Constitution Act 1986 and the Bill of Rights Act 1990. Officers of IR, as with all public officials, are expected to act within the law. This is supported by a requirement that these officers adhere to administrative law principles of natural justice and fairness when exercising statutory functions and powers. These expectations are relevant both for the purposes of determining the tax liability of a particular taxpayer and for determining the tax liability of taxpayers in general. Some of the most important of these expectations are:

- Parliament is responsible for imposing tax liability and IR **is expected** to act in the quantification of that tax liability according to the rules set out by Parliament.[15]
- IR **is expected** to administer the tax system in a fair and impartial manner, and to act consistently between taxpayers to the greatest extent possible.[16]
- IR **is expected** to exercise the various statutory powers or discretions vested in the Commissioner according to Parliament's purposes for that power or discretion.[17]
- IR is appointed under an act of Parliament to assess and collect revenue on behalf of the Crown and the Commissioner is granted statutory independence with respect to certain

[12] All references are to the Tax Administration Act 1994 (TAA 1994) unless stated otherwise.
[13] TAA 1994, s 7.
[14] See Valabh Committee *First Report of the Working Party on the Re-organisation of the Income Tax Act 1976* (Wellington, July 1993). The Commissioner's independence is also protected from Ministerial control with respect to certain matters by s 6B of the TAA 1994.
[15] Constitution Act 1986, s 22. *Reckitt & Colman (NZ) Ltd vs Taxation Board of Review* [1966] NZLR 1,032.
[16] New Zealand Bill of Rights Act 1990, s 27(1). *Reckitt & Colman (NZ) Ltd vs Taxation Board of Review* [1966] NZLR 1,032.
[17] *Gisborne Mills Limited and Others v CIR* (1989) 11 NZTC 6,194, *CIR v Wilson* (1996) 17 NZTC 12,512, *Tannadyce Investments Limited v CIR* (2011) 25 NZTC ¶20-103.

matters. Associated with this, IR **is expected** to be accountable outside of the regular departmental and Ministerial system for the exercise of these independent statutory powers and the proper functioning of the tax system.[18]

While each of these seem of such fundamental importance that they can be considered canons of tax administration, they are described simply as 'expectations' because for various reasons they are not always met. The more relevant question is what systems and processes are in place to ensure each of these expectations are being upheld to the greatest extent possible. The research undertaken in each of the chapters included in this submission arguably supports the view that IR is underperforming with respect to each of the above expectations. The chapters seek to articulate why this is a problem for tax system administration and to make recommendations for change that are designed to ensure that each of these expectations are met.

1.4 The legislative settings

Part four of this chapter describes the legislative settings that govern tax system administration in New Zealand. Many of the issues with supporting IR's statutory role as tax collector that have been identified in the chapters included in the submission are found to have arisen because of problems with the existing legislative settings.

1.4.1 The dual role of the Commissioner and historical background to sections 6 and 6A

A theme that often presents in each of the chapters has to do with the inherent tension between the Commissioner's responsibilities in terms of the expectations listed in the previous section (CIR responsibilities), and the responsibilities that come with the Commissioner's managerial role as the chief executive of a government department (CE responsibilities). It is sometimes argued that the Commissioner is performing a 'dual role' with respect to these separate sets of responsibilities. The CIR responsibilities are largely a product of the statutory functions and powers vested in the position of Commissioner of Inland Revenue under the TAA 1994. The Commissioner is separately accountable to the Minister of Revenue for her CE responsibilities. While some of these responsibilities overlap,[19] the difference is that the Commissioner has a managerial interest in tax system administration that is concerned with the efficient, effective and economical management

[18] New Zealand Bill of Rights Act 1990, s 27(2). See also Valabh Committee, above n 14.
[19] The principal responsibilities of the chief executive of a government department are set out in s 32 of the State Sector Act 1988.

of the activities of IR. This managerial interest belongs to the Commissioner's CE responsibilities. There are various frameworks in place to support accountability for the Commissioner's CE responsibilities in terms of the State Sector Act 1988 and the Public Finance Act 1989. The role of the Commissioner is therefore governed by three pieces of legislation but is assigned to just one person.[20]

It was recognised early on that the potential for conflict existed when the matter was considered by the Valabh Committee in their July 1993 report *First Report of the Working Party on the Re-organisation of the Income Tax Act 1976* ("the Valabh Report").[21] Before this time, there was nothing in the legislation to reconcile these competing sets of responsibilities. The Commissioner was charged simply "with the administration of the Inland Revenue Acts and with such other functions as may from time to time be lawfully conferred on him".[22] It was arguable on an interpretation of the tax legislation that the Commissioner was under an obligation "to assess and collect all taxes that are due regardless of the costs involved".[23] This proved to be an uneasy fit with the pressures placed on chief executives and government departments to be fiscally responsible with public money.

On the back of observations about the dual role of the Commissioner, and some of the inherent stresses between these two positions, came one of the Valabh Committee's key recommendations – that a Review Committee be formed to undertake a comprehensive organisational review of IR.[24] The Richardson Committee picked up the mantle and was formed with a mandate to investigate and make recommendations on the optimal organisation arrangements for administration of the tax system. In April 1994, the Richardson Committee released its report entitled *Organisational Review of the Inland Revenue Department* ("the Richardson Committee Report"),[25] complete with recommendation for a new objective for tax administration.[26] This objective was to be reflected in

[20] The three pieces of legislation being the Tax Administration Act 1994, State Sector Act 1988 and the Public Finance Act 1989.
[21] See Valabh Committee, above n 14.
[22] Inland Revenue Department Act 1974, s 4(1). On one reading of the legislation, the Commissioner's obligation to assess was absolute and, in the words of Richardson P, "there was no scope for weighing and balancing management functions against collection responsibilities in respect of particular taxpayers". See *Brierley Investments Limited v CIR* (1993) 15 NZTC 10,212 at 10,219.
[23] Ivor Richardson and others "Organisational Review of the Inland Revenue Department" (Report by the Organisational Review Committee, 1994) at 49 [Richardson Committee report].
[24] Valabh Committee, above n 14, at 3.
[25] Richardson Committee report, above n 23.
[26] At 47.

new legislation that would also allow the Commissioner to meet her accountabilities to the Minister.[27]

The most significant legislative outcome from this report was the enactment of ss 6 - 6B of the TAA 1994. These sections were enacted on 10 April 1995 in almost identical terms to a draft provision put forward in a recommendation by the Richardson Committee and have remained unchanged ever since. They are regarded as being of such importance by IR that the department's Interpretation Statement on the Care and Management of Taxes Covered by the IR Acts (IS 10/07) contends that these sections provide the 'framework' within which the Commissioner administers the tax system.[28] The expectations of the tax system administrator, which are referred to in part three of this chapter, are also reflected in the statutory wording of s 6.[29]

Both the Valabh Report and the Richardson Committee Report are treated as relevant legislative history by IR and the courts when interpreting ss 6 and 6A.[30] The chapters included in this submission often refer to aspects of the Richardson Committee Report to provide a unique historical perspective on what was envisaged when these sections were originally drafted. In particular, there are some important points worth mentioning that pertain to the Commissioner's competing interests in the administration of the tax system:

- The Richardson Committee view the role of the Commissioner as divided when undertaking the separate responsibilities of **adjudication** and **management**.[31] Adjudication is considered a function of tax administration that applies wherever *the exercise of judgement* is needed in the application of tax legislation to the affairs of individual taxpayers or groups of taxpayers in order to determine liability. Many of the activities of IR have an element of adjudication that is inextricably intertwined, even if adjudication is not primary function of these activities. It should be noted that the Commissioner is granted statutory independence under s 6B with respect to the powers and functions exercised in the course of carrying out her adjudication function and cannot be subject to Ministerial direction or

[27] TAA 1994, s 6A(3).
[28] IR "Care and Management of the taxes covered by the Inland Revenue Acts" Tax Information Bulletin Vol 22, No 10 (November 2010) at [56] (Interpretation Statement IS 10/07).
[29] In particular, the responsibility on Ministers and officials to protect the integrity of the tax system includes the "rights of taxpayers to have their liability determined fairly, impartially, and according to law". TAA 1994, s 6(2)(b).
[30] Interpretation Statement IS 10/07, above n 28, at [22].
[31] Richardson Committee report, above n 23, Appendix D.

control in this regard. Several options for structurally separating the Commissioner's adjudicative function are also considered in the report and are discussed in the chapters.

- Section 6 imposes a responsibility on Ministers and officials to protect the integrity of the tax system. This is specifically defined to include **taxpayer perceptions** of that integrity. It is suggested by the Richardson Committee that taxpayer perceptions are tightly linked to the impartial application of the law and the exercise of IR's coercive and decision-making powers with respect to the affairs of individual taxpayers.[32] Administration of the Commissioner's adjudicative function is regarded to be an important part of upholding taxpayer perceptions of the integrity of the tax system and should be considered a key part of meeting the expectations of the tax system administrator.
- Section 6A charges the Commissioner with the care and management of taxes and provides that the **Commissioner's duty** is to collect over time the highest net revenue that is practicable within the law (having regard to the factors listed in s 6A(3)). Although never incorporated into the legislation, it is noted in the Richardson Committee Report that the primary objective for IR (represented by the Commissioner's duty) applies specifically in meeting accountabilities *to the Minister*.[33]
- The Richardson Committee regarded the integrity of the tax system as not simply being a matter between the Commissioner and the Minister. It is intended to include the interaction between the total tax administration and individual taxpayers.[34]

A major inference to be drawn from the above is that the separate administration of the Commissioner's adjudicative function is vital to ensure that taxpayer perceptions of the integrity of the tax system are upheld. One way this function can be supported is through the general accountability frameworks applicable to organisations in the public sector. After all, the Commissioner in her managerial role as Chief Executive also has an interest in protecting the integrity of the tax system (although this is ultimately tempered by her managerial interests). However, it should not be overlooked that the Commissioner is granted statutory independence from the Minister with respect to the powers and functions exercised in her adjudication role.[35] This suggests that other channels of accountability are also important and need to be maintained.

[32] At 98.
[33] At 52.
[34] At 60.
[35] TAA 1994, s 6B.

1.4.2 Sections 6 and 6A as a legislative framework for tax system administration

The chapters included in this submission evaluate how the legislative framework for tax system administration provided by ss 6 and 6A has been interpreted and applied since its enactment. Over the years, the courts and IR have arrived at some important conclusions regarding the precise scope and nature of each of these sections. To summarise:

- Section 6 does not create any rights or obligations that are enforceable by taxpayers against the Commissioner. The rights and responsibilities affirmed in s 6 are expressed to be of an aspirational nature and IR is expected to use its best endeavours to meet these standards.[36]
- Section 6A grants the Commissioner managerial discretion regarding the use of departmental resources and confirms that she is not under any absolute obligation to bring an assessment. In addition, the Commissioner is authorised under s 6A to settle disputed amounts of tax on a compromise basis.[37] Section 6A does not alter the constitutional framework within which the tax system operates and the Commissioner cannot rely on this section to act inconsistently with the other provisions of the IR Acts.[38]

Neither of these sections, therefore, creates anything in the way of an inalienable statutory standard that either IR or taxpayers must adhere to. The sections instead are there only to shape and guide how tax administration is undertaken. The Commissioner is required to have regard to the values of both of these sections when carrying out her functions or duties.

It is important to acknowledge from the outset that a special relationship also exists between s 6 and s 6A, in that taxpayer perceptions of the integrity of the tax system are often recognised as having an impact on voluntary compliance.[39] **Voluntary compliance** is specifically listed in s 6A(3) as one of the factors that the Commissioner must have regard to when undertaking her duty "to collect over time the highest net revenue that is practicable within the law". A regulatory strategy based on the promotion of voluntary compliance is generally seen as desirable because it

[36] *Russell & Ors v Taxation Review Authority & Anor* (2002) 20 NZTC 17,832 at [71], *CIR v Michael Hill Finance (NZ) Limited* (2016) 27 NZTC ¶22-056 at [31].
[37] *CIR v Auckland Gas Company Limited (*1999) 19 NZTC 15,027, *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075.
[38] *Kemp v CIR* (1999) 19 NZTC 15,110, Interpretation Statement IS 10/07, above n 28, at [59] - [64].
[39] The courts have often paid tribute to the special relationship between the responsibility to protect the integrity of the tax system in s 6 and the importance of voluntary compliance in s 6A(3)(b). See *Westpac Banking Corporation Limited v CIR & Ors; Westpac Banking Corporation Limited v CIR & Ors* (2008) 23 NZTC 21,896 at [51], *Raynel & Anor v CIR* (2004) 21 NZTC 18,583 at [54].

is considered part of the effective, efficient and economical administration of the tax system. This is a significant goal for the Commissioner's managerial interest in tax administration. Taxpayer perceptions of the integrity of the tax system underlie this strategy because these perceptions may affect a taxpayer's motivation to voluntarily comply with their tax obligations. Significantly, this relationship between taxpayer perceptions and voluntary compliance should not be taken to mean that they are one in the same.[40] As already discussed, the Richardson Committee considered that taxpayer perceptions of the integrity of the tax system are acutely related to those areas where the powers or functions exercisable by the Commissioner relate to her adjudicative role. The Commissioner's adjudicative interest is separate from her managerial interest in the administration of the tax system.

Having established that ss 6 and 6A are intended to act as a framework for tax system administration, the question becomes what measures have been implemented at a strategic, regulatory and operational level to ensure that the values espoused in both of these sections are being upheld. There is also a question of whether there are any impediments to giving effect to the values of these sections because of problems that arise with existing legislative settings.[41] Part five of this chapter aims to provide some additional context to the framework for tax administration provided for by ss 6 and 6A. This is achieved by examining the relevant academic literature in this area.

1.5 The regulatory environment

Part five of this chapter introduces the various theoretical considerations, as found in the literature, which can be seen to have increasing influence on tax administration policy and practice. Most of the material presented here is intended to be of general relevance and provide a contextual framework. In contrast, the other chapters included in this submission are specific to New

[40] Writing from a relational perspective, Valerie Braithwaite uses the descriptor 'compliance integrity dilemma' in academic writing to refer to the disconnect between compliance and integrity objectives that occurs when setting performance targets for a revenue authority. It will often be the case that the measures used to assess performance are more closely bound to compliance outcomes. This can come at the expense of integrity in the tax system. See Valerie Braithwaite "Tax System Integrity and Compliance: The Democratic Management of the Tax System" in Valerie Braithwaite (ed) *Taxing Democracy : Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003).

[41] This is relevant as the functions of IR include the provision of policy advice to the Minister, and the responsibility to protect the integrity of the tax system in s 6 in any case extends also to the Minister.

Zealand's experience. The chapters often draw on this contextual information in the body text and the footnotes when making parallels to IR's administration of the tax system.

1.5.1 Taxpayer perceptions of the integrity of the tax system and Wenzel's taxonomy

One reason why it is important to manage taxpayer perceptions is that they share a connection with voluntary compliance. Fairness perceptions are argued to play a vital role in encouraging the general body of taxpayers to comply voluntarily with their obligations. In a tax system where self-assessment is the norm, the importance of voluntary compliance cannot be overstated. The question of how IR should approach the task of administering the tax system to promote voluntary compliance by taxpayers belongs to the domain of regulatory strategy. But taxpayer perceptions of the integrity of the tax system are not just important because of their impact on compliance. This is because the exchange relationship that underpins the payment of taxes is not limited to the goods and services a taxpayer can expect to receive in return for those taxes. It also includes expectations regarding the administration of the tax system by IR. This should be done in a way that is respectful, and protects democratic principles and processes. The capacity for IR and the government to deliver on this objective is referred to in academic writing as integrity.[42] For this reason, taxpayer perceptions of integrity in the tax system are important to manage as a goal in their own right.

As noted by former Commissioner, David Butler, in an address to the Institute of Chartered Accountants 2002 Tax Conference, "a general definition of the word integrity includes honesty, truthfulness, honour, and reliability".[43] A second definition also offered by Butler refers to integrity as "the quality of being whole or united; sound". Less of an effort has been made by IR to understand how taxpayers come to form perceptions about the integrity of the tax system. A contribution made by the chapters included in this submission is that they often refer to a taxonomy adapted by Michael Wenzel from the social psychology literature for thinking about how taxpayers come to form perceptions of fairness. This taxonomy is one of the better understood and researched categorisations in contemporary literature and it helps to place the focus on the "justice and fairness considerations that could play a role in taxpayers' evaluations of the tax system and therefore in

[42] See Valerie Braithwaite "Tax System Integrity and Compliance: The Democratic Management of the Tax System" in Valerie Braithwaite (ed) *Taxing Democracy : Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 271.
[43] David Butler "Protecting the integrity of the New Zealand Tax System" (address to the Institute of Chartered Accountants Tax Conference 2002).

their decision to comply or not comply with tax laws".[44] Regardless of the exact impact of perceptions of fairness on taxpayer compliance,[45] it is suggested that this taxonomy is a useful tool to better understand how to manage taxpayer perceptions of the integrity of the tax system in terms of the responsibility on Ministers and officials under s 6 of the TAA 1994.

Wenzel argues that traditional economic models of tax compliance miss important dimensions of the tax compliance paradigm. His taxonomy draws on a common categorisation made in the literature between three types of justice. An important dimension to Wenzel's framework is that it also relates fairness perceptions to a persons' self-identification with societal groups or society at large.

1.5.1.1 Three areas of justice

Distributive justice

Distributive justice refers to the fairness of outcomes in respect of the exchange or distribution of resources within a group or society. It encompasses and can be analysed in accordance with concepts of horizontal fairness, vertical fairness and exchange fairness. In terms of the tax burden, horizontal fairness is concerned with the idea that people in similar economic circumstances, such as members of a particular income group, should pay a similar amount of tax. Vertical fairness concerns the burden of taxes across income groups and the degree of marginal tax rate progressiveness. Exchange fairness is concerned with the relative balance between the tax burden imposed and the provision of public goods.[46] The exchange or distribution of 'resources' should be understood to include decisions regarding how taxpayer funds should be employed, as well as

[44] See Michael Wenzel "Tax Compliance and the Psychology of Justice: Mapping the Field" in Valerie Braithwaite (ed) *Taxing Democracy: Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 41.

[45] Many empirical studies have examined the influence of fairness perceptions on tax compliance behaviour. Although a majority of the studies find a positive relationship between the two, the findings are not always consistent. Much of the inconsistency can be attributed to the fact that "independent studies often address heterogeneous aspects of fairness perceptions without appropriate delineation of important variables". See Erich Kirchler *The Economic Psychology of Tax Behaviour* (CUP, New York, 2007) at 74. See also Maryann Richardson and Adrian Sawyer "A Taxonomy of the Tax Compliance Literature: Further Findings, Problems and Prospects" (2001) 16 Australian Tax Forum 137, at 183 where it is argued (in a similar review) that "[r]egardless of whether taxpayer perceptions of fairness impact on their compliance behaviour, favourable taxpayer perceptions of the fairness of the tax system are certainly preferable to negative assessments. Accordingly, research into how taxpayer perceptions may be improved is important".

[46] For a review of the relevant empirical studies on these dimensions of fairness, see Eva Hofmann, Erik Hoelzl and Erich Kirchler "Preconditions of Voluntary Tax Compliance: Knowledge and Evaluation of Taxation, Norms, Fairness, and Motivation to Cooperate" (2008) 4 Journal of Psychology 209 at 212. See also Wenzel, above n 44, at 44 and Kirchler, above n 45, at 75.

the burden of taxes imposed. Taxpayers evaluate the exchange fairness of resource allocation not only in terms of the transfer payments or other direct benefits received but also in a broader sense that looks to the Government's revenue use and spending decisions. Relevant to the functioning of enforcement regimes in a tax system is the idea that opportunities to avoid or evade tax can also be viewed as a distributive justice issue given their propensity to affect the actual burden of tax.[47]

Equity theory,[48] as a companion concept to distributive justice, posits that a person will be motivated to attempt to rectify any resulting inequity, where the distribution rules that underlie an exchange relationship are perceived to be unfair. Fairness perceptions arrived at in terms of an evaluation of the elements of gain can be likened to the idea of a psychological tax contract between taxpayers and authorities. However, as reported by Feld and Frey, the contract also involves elements of participation.[49]

Procedural justice

Procedural justice refers to the fairness of process or procedures relating to resource exchange or distribution and connected dealings with authorities. Procedural justice is often argued to have a significant influence on tax compliance behaviour.[50] Gerald Leventhal challenged the validity of equity theory (which is concerned only with distributive outcomes) by arguing that it needs to be subsumed within a wider theoretical framework that also considers the fairness of procedures. He defines procedural fairness as "an individual's perception of the fairness of procedural components of the social system that regulate the allocative process".[51] This is further characterised by six procedural justice rules, which attempt to identify the criteria that a person will use to evaluate

[47] Wenzel, above n 44, at 49.
[48] John Adams "Inequity in Social Exchange" in Leonard Berkowitz (ed) *Advances in experimental and social psychology* (Academic Press, New York, 1965) at 276.
[49] The authors report that "the satisfaction of taxpayers with what they get form the other contract party, that is, the government, mainly influences their tax morale. Taxpayers' reward from that contract must be understood in a broad sense going beyond pure exchanges of goods and services for the payment of a tax price [distributive justice]. In addition to such direct exchange components, the fairness of the procedures leading to particular political outcomes as well as the way the government and the taxpayers treat each other are part of the contractual relationship [procedural justice]." See Lars Feld and Bruno Frey "Tax Compliance as the Result of a Psychological Tax Contract: The Role of Incentives and Responsive Regulation" (2007) 29 Law & Policy 102 at 106.
[50] For a review, see Kirchler, above n 45, at 85. See also Kristina Murphy "Enforcing Tax Compliance: To Punish or Persuade?" (2008) 38 Economic Analysis & Policy 114 at 116.
[51] Gerald Leventhal "What Should Be Done with Equity Theory? New Approaches to the Study of Fairness in Social Relationships" in Kenneth Gregen, Martin Greenberg and Richard Willis (eds) *Social Exchange* (Plenum, New York, 1980) at 35.

whether an allocative procedure is fair.[52] Tom Tyler has also made a significant contribution in this area in his study of a series of interviews undertaken in Chicago from 1984 (known as "the Chicago Study").[53] Respondents in the Chicago Study were asked to share their personal experiences in recent dealings with legal authorities. These were then reviewed from a normative and instrumental perspective. An important finding of the Chicago Study is that people react to their experiences in forming views about perceived justice and the legitimacy of a legal authority which in turn shapes compliance behaviour. The normative perspective contends that people are concerned about both the fairness of outcomes *and* the fairness of procedures, the latter having little to do with the actual outcomes arrived at.[54]

Retributive justice

Retributive justice refers to the fairness of sanctions imposed or the steps taken to respond to non-compliant action or behaviour. Wenzel reports that "[t]he central question of retributive justice is what treatment and degree of sanction the rule-breaker deserves".[55] This will be approached from the perspective of specific sanctions imposed (and whether the punishment is appropriate in the circumstances) and in a wider sense from the perspective of procedures used to investigate non-compliance.[56] Accordingly, there is some degree of overlap between this and the concept of procedural justice discussed above. Key functions that support retributive justice in the tax system include the audit procedures used to detect non-compliance and the penalties regime to impose sanctions on non-compliance. Fairness perceptions will be formed both by taxpayers directly subject to penalties or the audit process and indirectly by taxpayers who evaluate how effective these regimes are in providing restitution for the non-compliance of others.

1.5.1.2 Three analytical levels of justice

[52] These are the consistency rule, the bias-suppression rule, the accuracy rule, the correctability rule, the representativeness rule and the ethicality rule. At 39.
[53] Tom Tyler *Why People Obey the Law* (Princeton University Press, New Jersey, 2006).
[54] At 163. Tyler's assertion has been tested by Kristina Murphy in a tax compliance context in a study that examined taxpayers who were involved in long-standing disputes with the ATO. The results were found to be broadly supportive of Tyler's assertion that perceived procedural justice of a person's experience in dealing with an authority is likely to affect that person's view of the legitimacy of that authority. See Kristina Murphy "Regulating More Effectively: The Relationship between Procedural Justice, Legitimacy, and Tax Non-Compliance" (2005) 32 Journal of Law and Society 562. Others have pointed to the perceived shortcomings of extending the findings of Tyler's study to a tax compliance context. See Mark Burton "Responsive Regulation and the Uncertainty of Tax Law – Time to Reconsider the Commissioner's Model of Cooperative Compliance?" (2007) 5 eJournal of Tax Research 71 at 93.
[55] See Wenzel, above n 44, at 46.
[56] At 58.

Wenzel submits that much of the traditional research on tax compliance has been dominated by individualistic approaches and the analysis needs to be extended by taking account of how taxpayers may define themselves in more inclusive ways.[57] Taxpayers who identify with societal groups or society at large are more inclined to show concern for collective outcomes when forming fairness perceptions.[58] The relationship between taxpayer identification and the three types of justice discussed above is, therefore, a critical part of the wider impact on tax compliance behaviour.

At an *individual* level,[59] taxpayers are most concerned with the outcomes and treatment that they receive in their dealings with the tax system. Outcomes are evaluated in terms of their personal share of benefits relative to the tax burden imposed on them and comparisons to other taxpayers (particularly those taxpayers in the same or similar income group). A taxpayer may choose to take account of their personal attributes in an assessment of whether a treatment is appropriate (individuating principles), or alternatively, may choose to disregard this consideration as a basis for different outcomes and focus instead on the criteria for distribution (deindividuating principles).[60] Procedures and treatment are evaluated in terms of the taxpayer's personal experience in interacting with an authority or the experiences of other close individuals.

At a *group* level,[61] taxpayers are concerned with outcomes, procedures and treatment of a wider group when they feel that they identify with that group. Outcomes will often be evaluated on an intergroup basis rather than by relying on interpersonal comparisons. Again, the assessment may or may not involve a consideration of particular attributes of the group that might be used to argue a certain distribution is justified.

At a *societal* level,[62] the group that taxpayers identify most strongly with is society at large. Taxpayers will want the cumulative treatment and outcomes for all individuals and groups in society to be dealt with in a way that is considered appropriate. This will involve an assessment of

[57] At 44.
[58] At 48.
[59] At 47
[60] At 47. These individuating and deindividuating principles are based on the concepts of microjustice and macrojustice developed by Phillip Brickman et al "Microjustice and Macrojustice" in Melvin Lerner and Sally Lerner (eds) *The Justice Motive in Social Behaviour* (Plenum Press, New York, 1981) at 173.
[61] At 47
[62] At 48

the rules or criteria for fair distribution of outcomes across all recipients in a society and show more regard for deindividuating principles.

Natalie Taylor argues that the outcome of taxpayer identities in terms of how a person defines himself or herself in relation to the tax system and other groups (including the tax authority) has a significant bearing on that taxpayer's attitude towards paying tax.[63] How a taxpayer identifies with each analytical level ultimately plays a part in the fairness perceptions that they form. For instance, a key proposition of procedural justice is that taxpayers will be more willing to accept the decisions of a tax authority as legitimate where the tax authority is perceived to be representative of taxpayers.[64] To extend this line of thinking, it is sometimes argued that legitimacy is more likely to be present where the taxpayer is able to identify with the tax authority and form fairness perceptions of the tax system at the superordinate (societal) level.[65] Similarly, concerns about distributive justice tend to be less pronounced at the superordinate level because distinctions between subgroups are considered less important.[66]

A key point for regulators to take away from the role of taxpayer identity and the influence this has on tax morale and behaviour is that identification with one's society or nation is generally the most conducive to tax compliance.[67] In a later study on the role that taxpayer identities have to play in taxpayers exhibiting favourable tax ethics and attitudes, Wenzel concludes that "social identity, specifically a sense of inclusion, can provide considerable leverage for compliance".[68]

1.5.2 The promotion of voluntary compliance and regulatory perspective

It is well recognised that traditional economic models of the tax compliance theory have dominated regulatory thinking in the compliance landscape. The taxpayer here is depicted as a self-interested, rational decision-maker who will behave in a way to maximise their expected utility. The decision

[63] Natalie Taylor "Understanding Taxpayer Attitudes Through Understanding Taxpayer Identities" in Valerie Braithwaite (ed) *Taxing Democracy : Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 72.
[64] At 76.
[65] See Heather Smith and Tom Tyler "Justice and power: when will justice concerns encourage the advantaged to support policies which redistribute economic resources and the disadvantaged to willingly obey the law?" (1996) 26 European Journal of Social Psychology 171. This, however, was not supported in Natalie Taylor, above n 63, at 85, where it was concluded that "authorities were not perceived as more representative at the superordinate level than at the subgroup level, which may help explain why procedural justice concerns were not stronger at the superordinate level".
[66] This hypothesis was found to be supported by Natalie Taylor, above n 63, at 83.
[67] At 89.
[68] At 45.

of whether or not to evade tax obligations is presented as a function of the penalty for non-compliance and the probability of successfully avoiding detection. The regulatory solution for dealing with non-compliance becomes a strategy that is based on deterrence outcomes (referred to here as the deterrence approach).[69]

The origins of the deterrence approach can be traced back to the theory of utilitarianism and the idea that action taken by an individual will be directed to outcomes that promote the greatest benefit to that individual.[70] This basic utilitarian premise led to the development of a model for optimal allocation of enforcement activity to deter criminal offending by Gary Becker in his seminal article "Crime and Punishment: An Economic Approach".[71] In what is regarded as the *locus classicus* of the deterrence approach in the tax compliance literature, Michael Allingham and Agnar Sandmo later modelled the decision of whether to evade income taxes in their article "Income Tax Evasion: A Theoretical Analysis" using the same basic utilitarian premise.[72] The policy tools identified by the authors to deter would-be evaders of tax include: "the tax rates themselves, the penalty rates and the expenditure on investigation, which determines the probability of being detected".[73]

A question that has been asked of the traditional expected utility theory of tax compliance, espoused by the deterrence approach to regulation, is why are more people not evading their taxes? In what is referred to as the "puzzle of tax compliance",[74] this school of thought challenges the deterrence approach. It reasons that observed levels of compliance are much higher than might be expected given the often-inadequate mechanisms used to deter evasion in many countries.

As early as 1967, in what is generally considered to be a landmark study into the effect of legal sanctions on tax compliance, Richard Schwartz and Sonya Orleans emphasised the predominance of making an appeal to the conscience of the taxpayer rather than relying on the threat of sanctions

[69] Also referred to as command-and-control regulation. See Jenny Job, Andrew Stout and Rachael Smith "Culture Change in Three Taxation Administrations: From Command-and-control to responsive regulation" (2007) 29 Law & Policy 87.
[70] For a discussion on the background of the deterrence approach in tax compliance literature, see Sagit Leviner "An overview: A new era of tax enforcement – from 'big stick' to responsive regulation" (2008) 2 Regulation & Governance 362. See also Kristina Murphy "Enforcing Tax Compliance: To Punish or Persuade?" (2008) 38 Economic Analysis & Policy 114.
[71] Gary Becker "Crime and Punishment: An Economic Approach" (1968) 76 Journal of Political Economy 169.
[72] Michael Allingham and Agnar Sandmo "Income Tax Evasion: A Theoretical Analysis" (1972) Journal of Public Economics 323.
[73] At 338.
[74] See James Alm, Gary McClelland and William Schulze "Why do people pay taxes?" (1992) 48 Journal of Public Economics 21.

as a means to encourage compliance.[75] The findings generally support the "responsible citizen" theory of tax compliance and imply that there must be factors other than just taxpayer self-interest that are relevant to compliance behaviour.[76] Later research has focussed on the social dimension of tax compliance by highlighting the relationship between taxes paid and the provision of public goods. Taxpayers who identify with a group or society are thought to show concern for collective outcomes.[77]

Bruno Frey and Lars Feld portray tax compliance in terms of a psychological tax contract between taxpayers and authorities.[78] This contract is underscored by the exchange relationship and style of interaction that exists between taxpayer and revenue authority, which is argued to shape tax morale and willingness to comply.[79] The concept of 'tax morale' is presented as an intrinsic motivational force that determines an individuals' willingness to pay their taxes and used to explain compliance behaviour.[80] A regulatory strategy based solely on deterrence outcomes will reduce the incentive to evade taxes, but also risks violating the psychological tax contract as this will have the countervailing effect of undermining tax morale.

An alternative regulatory strategy that instead places emphasis on respectful treatment of taxpayers and cooperative procedures is argued to have the potential to bolster tax morale.[81] Deterrence

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[75] Richard Schwartz and Sonya Orleans "On Legal Sanctions" (1967) 34 The University of Chicago Law Review 274 at 299.

[76] For a summary, see Natalie Taylor "Understanding Taxpayer Attitudes Through Understanding Taxpayer Identities" in Valerie Braithwaite (ed) *Taxing Democracy : Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 73. See also Simon James and Clinton Alley "Tax Compliance, Self-assessment, and Tax Administration in New Zealand — Is the Carrot or the Stick More Appropriate to Encourage Compliance?" (1999) 5 NZJTLP 3 at 12.

[77] See Michael Wenzel "Tax Compliance and the Psychology of Justice: Mapping the Field" in Valerie Braithwaite (ed) *Taxing Democracy: Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 43. See also Murphy, above n 70, at 116.

[78] See Bruno Frey and Lars Feld "Deterrence and Morale in Taxation: An Empirical Analysis" (CESifo Working Paper 760, 2002). See also Feld and Frey, above n 53.

[79] See Erich Kirchler *The Economic Psychology of Tax Behaviour* (CUP, New York, 2007) at 189.

[80] At 99.

[81] See Frey and Feld, above n 78, at 7. The analysis is based on "crowding theory", the notion that external interventions in the form of sanctions that arise due to interactions with the tax authority may displace a taxpayers' intrinsic motivation (tax morale) to comply with their tax obligations. This can also be related to the idea of the 'accommodative model' of tax compliance behaviour. For an overview of the differences between the deterrence and accommodative models of tax compliance refer Kristina Murphy "Regulating More Effectively: The Relationship between Procedural Justice, Legitimacy, and Tax Non-compliance" (2005) 32 Journal of Law and Society 562 at 564. The core tenets of procedural justice theory also have some important implications for a style of regulatory approach sometimes referred to as an accommodative style of regulatory approach, which emphasises respect and cooperation in the first instance. It is argued to be more effective at regulating behaviour from the perspective of procedural justice. See Kristina Murphy "Procedural Justice and Tax Compliance" (2003) 38 Australian Journal of Social Issues 379.

mechanisms would still have an important role to play in terms of shaping tax morale in terms of the psychological contract with taxpayers at large. This is because deterring would-be cheats by using appropriate measures also serves to uphold honest taxpayers' perceptions of the overall integrity of the tax system.[82]

A solution to the punishment versus persuasion debate in regulatory compliance was put forward by Ian Ayres and John Braithwaite in their seminal work on responsive regulation.[83] The fundamental premise of responsive regulation is that regulators "should be responsive to the conduct of those they seek to regulate in deciding whether a more or less interventionist response is needed".[84] Responsive regulation principles therefore actively promulgate an approach that is not designed to maximise consistency in terms of response. The concept can be understood as marking an important contrast to regulatory formalism. This is where problems are defined in advance and rules are written to prescribe the appropriate response to each of those problems. Advocates of regulatory formalism will often argue in favour of the approach because of its ability to deliver consistent, transparent and impartial outcomes.[85] Usually, in tax systems, elements of both approaches are evident.

It has been suggested that responsive regulation entails three elements of responsiveness: tactical, meta-strategic and democratic.[86] The tactical element of responsive regulation involves evaluating a taxpayer's motivation and individual circumstances to identify a regulatory technique or style that will best achieve the desired effect. The meta-strategic element refers to the general approach of selecting self-regulatory enforcement strategies that encourage voluntary compliance in the first instance, while maintaining the presence of powerful enforcement options and sanctions that loom in the background for the recalcitrant few. Finally, it is argued that responsive regulation embodies an approach to tax system administration based on democratic principles and engagement with regulatees in an effort to reach a shared understanding of principles and values.

[82] See Feld and Frey, above n 53, at 109.
[83] See Ian Ayres and John Braithwaite *Responsive Regulation: Transcending the Deregulation Debate* (OUP, New York, 1992). For a more recent account of the responsive regulation concept see John Braithwaite "The Essence of Responsive Regulation" (2011) 44 UBC Law Review 475.
[84] See John Braithwaite *Restorative Justice & Responsive Regulation* (OUP, New York, 2002) at 29.
[85] See Valerie Braithwaite "Responsive Regulation and Taxation: Introduction" (2007) 29 Law & Policy 3 at 6.
[86] See Michael Wenzel "The Multiplicity of Taxpayer Identities and Their Implications for Tax Ethics" (2007) 29 Law & Policy 31 at 32.

1.5.3 Implementing responsive regulation principles into tax administration

Although the connection is not often explicitly made, responsive regulation is arguably the dominant theoretical paradigm that has been applied in tax administration in New Zealand since a strategic rethink in 2001 led us to follow the example of the Australian Tax Office. The chapters included in this submission explore in detail New Zealand's experience with this style of regulatory approach. The theoretical frameworks that are discussed below underscore the successful implementation of responsive regulation. This is important because the strategies used by IR to give effect to this style of regulation have an impact on both taxpayer perceptions and voluntary compliance.

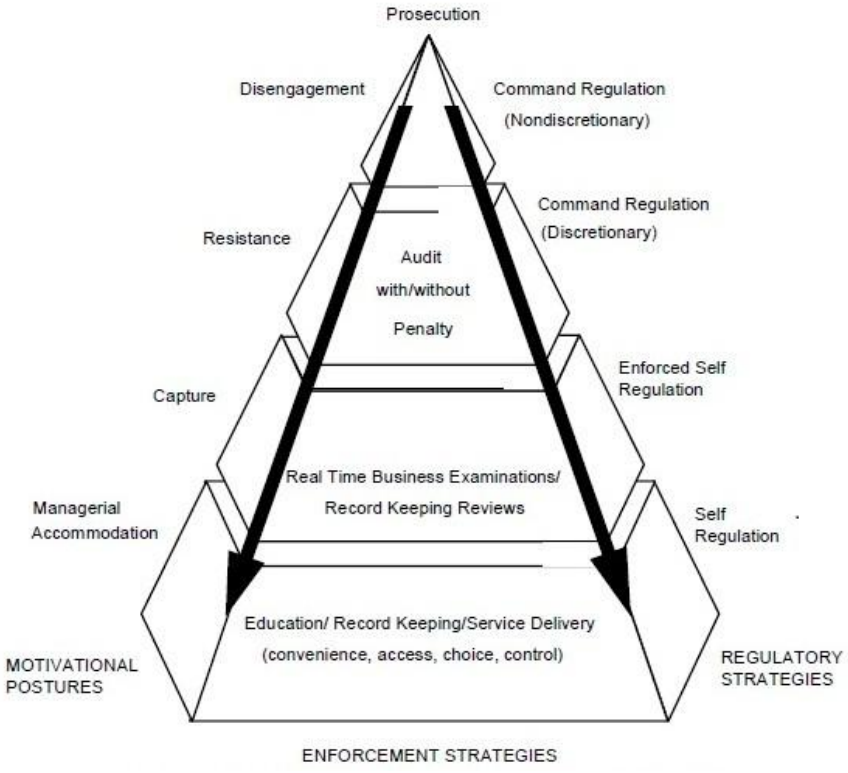
1.5.3.1 The regulatory sanctions pyramid

Ayers and Braithwaite suggest a regulatory sanctions pyramid, where regulatory action at the base of the pyramid will make use of persuasion and self-regulation to achieve compliance at first instance. The level and severity of intervention strategies then escalate in a hierarchy up the pyramid as a means of responding to those who are unwilling to comply. In the realm of tax compliance, the concept of responsive regulation first made the transition from popular academic theory to regulatory compliance tool as a result of the combined work of the Australian Tax Office (the ATO) and its Cash Economy Task Force (CETF) in 1997.[87] The product of this work is embodied in a pyramid referred to as the ATO Compliance Model as illustrated in Figure 1 below.[88]

Figure 1: The ATO Compliance Model

[87] For relevant background to the introduction of the ATO Compliance Model refer Valerie Braithwaite "A New Approach to Tax Compliance" in Valerie Braithwaite (ed) *Taxing Democracy : Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 2. See also Leviner, above n 70, at 369. For a discussion of the ATO's early experiences in adjusting to the programme of responsive regulation refer Jenny Job and David Honaker "Short-term Experience with Responsive Regulation in the Australian Tax Office" in Valerie Braithwaite (ed) *Taxing Democracy : Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 111.

[88] Cash Economy Task Force *Improving Tax Compliance in the Cash Economy* (1998) at 23.



At a regulatory level, the ATO Compliance Model depicted in Figure 1 has been hugely influential in shaping the overarching objectives and principles that govern tax system administration in many jurisdictions around the world. The transition is explained by Valerie Braithwaite:[89]

> Tax administrations have traditionally operated on such a relatively simple presumption. Put simply, tax law will influence the flow of events when sanctions are sufficiently certain and severe to offset the gains of not complying with the law. The Compliance Model does not discount this basic insight, but rather tackles its crudeness. …The Compliance Model, as a generic application of responsive regulation, takes on board the many sources of influence that contribute to compliance, both from the environment of the regulatee and from the toolbox of the regulator.

1.5.3.2 Motivational postures

The left side of the ATO Compliance Model features the motivational posture taken by a taxpayer and is intended to reflect the amount of social distance the individual wishes to place between themselves and a regulatory authority. Motivational postures have been described as "conglomerates of beliefs, attitudes, preferences, interests, and feelings that together communicate the degree to which an individual accepts the agenda of the regulator".[90] A taxpayer at the base of

[89] Valerie Braithwaite "Responsive Regulation and Taxation: Introduction" (2007) 29 Law & Policy 3 at 5.
[90] See Valerie Braithwaite, Kristina Murphy and Monika Reinhart "Taxation Threat, Motivational Postures, and Responsive Regulation (2007) 29 Law & Policy 137 at 138.

the pyramid will be cooperative with authorities and exhibit a high degree of consent to be regulated, whereas a taxpayer at the top of the pyramid will exhibit a high degree of defiance. The concept was originally borrowed by the CETF for use in the ATO Compliance Model based on the work of Valerie Braithwaite regarding motivational postures and trust norms.[91]

Braithwaite identifies five key motivational postures as ranging from commitment, capitulation, resistance, disengagement, and game playing.[92] Commitment and capitulation portray an overall positive relationship characterised by voluntary compliance of tax obligations. Resistance, disengagement and game playing, in contrast, portray postures of defiance where enforced compliance of tax obligations may prove necessary.[93]

There are some parallels between motivational postures and Wenzel's taxonomy discussed earlier. Wenzel confirms the importance of an understanding of taxpayer identities to the sound functioning of the responsive regulation concept in tax administration. He has reported:[94]

> …an understanding of people's identity and their positioning in relation to the regulator and other regulatees facilitates a diagnosis of their motivational postures to which regulators can respond with appropriate measures selected from a suite of regulatory strategies.

Another relevant parallel that has emerged strongly in the realm of responsive regulation is the connection between procedural justice and motivational posturing theory. A tax authority that delivers on procedural justice is more likely to form a relationship that is based on trust and be perceived by taxpayers as legitimate.[95] In order to protect this legitimacy, non-compliance must

[91] Valerie Braithwaite "Responsive Regulation and Taxation: Introduction" (2007) 29 Law & Policy 3 at 20.
[92] See Valerie Braithwaite "Dancing with Tax Authorities: Motivational Postures and Non-compliant Actions" in Valerie Braithwaite (ed) *Taxing Democracy : Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 16. See also Kirchler, above n 49, at 96.
[93] In relation to motivational postures, the Forum on Tax Administration makes the observation that "[i]t is important to realise that an individual taxpayer is capable of adopting any of the attitudes described at different times. It is also possible to adopt all of the attitudes simultaneously in relation to different issues. The attitudes are not fixed characteristics of a person or group, but reflect the interaction between the person or group that impose demands upon them. The value of the model therefore is that it contributes to a deeper understanding of taxpayer behaviour and lays the groundwork for the development of targeted strategies which encourage the motivation to do the right thing and constrain the motivation to resist or evade taxes". See Forum on Tax Administration Compliance Sub-group *Compliance Risk Management: Managing and Improving Tax Compliance* (2004) at 41.
[94] See Michael Wenzel "The Multiplicity of Taxpayer Identities and Their Implications for Tax Ethics" (2007) 29 Law & Policy 31 at 45.
[95] See Valerie Braithwaite, Kristina Murphy and Monika Reinhart "Taxation Threat, Motivational Postures, and Responsive Regulation" (2007) 29 Law & Policy 137 at 142.

be dealt with in a way that works to encourage future compliance and bring about more cooperative motivational postures on the part of the taxpayer. [96]

1.5.3.3 Enforcement strategy and compliance risk management

The right side of the pyramid represents the escalating continuum of regulatory strategies needed to respond to the particular motivational posture assumed by the taxpayer. The centre face of the pyramid illustrates the various enforcement strategies that could be used to ensure taxpayer compliance. In its report, the CETF describes the operation the ATO Compliance Model in the following terms:[97]

> The model advocates a hierarchical approach to compliance improvement which suggests that, in the first instance, ATO strategies are aimed at encouraging voluntary compliance through approaches like education and convenient and efficient service delivery. The ATO will, however, have access to an escalating enforcement regime with a hierarchy of sanctions which will be accessed when there is evidence that measures to encourage voluntary compliance have been unsuccessful in changing compliance behaviour.

It is also worth noting that compliance risk management strategies are often rationalised by regulators in terms of the compliance model as an effective means of deploying resources based on an understanding of taxpayer behaviour.[98] Such an approach allows the revenue authority to tailor their regulatory strategy based on taxpayer groups or arrangements and their relative positioning in relation to the regulatory sanctions pyramid. Resources are directed to those taxpayer groups or arrangements that represent the greatest compliance risk, while a less interventionist approach is adopted in respect of those taxpayer groups or arrangements located at the base of the pyramid (where voluntary compliance is expected). The majority of revenue authorities tend to view compliance risk management as consistent with responsive regulation. In fact, the approach holds

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[96] A significant study in this area examining the effect of procedural justice on motivational postures concluded "[w]hen people feel treated in a procedurally fair manner by the tax authority and procedurally fair decision rules are employed, motivational postures of deference increase whereas motivational postures of defiance decrease". See Martina Hartner et al "Procedural Fairness and Tax Compliance" (2008) 38 Economic Analysis & Policy 137 at 150. A similar conclusion was reached by Kristina Murphy in a study applying the concept of reintegrative shaming theory developed originally as a criminological theory in John Braithwaite *Crime, shame and integration* (CUP, New York, 1989). See Murphy, above n 70, at 128. Likewise, Braithwaite, Murphy and Reinhart, above n 90, at 153 found that future compliance can be encouraged by engaging with taxpayers in appropriate regulatory conversations after a regulator has used its powers of enforcement.

[97] Cash Economy Task Force, above n 88, at 22.

[98] See Forum on Tax Administration Compliance Sub-group *Compliance Risk Management: Managing and Improving Tax Compliance* (2004). Compliance risk management is defined by the OECD in their 2013 report on Cooperative Compliance as "…a systematic process in which efficient and effective choices are made within a broad range of compliance tools. These tools include interventions that are designed to stimulate voluntary compliance and to prevent non-compliance, and that are responsive to the behaviour of taxpayers." See OECD *Cooperative Compliance: A Framework* (OECD Publishing, 2013) at 42.

great appeal for administrators who are able to make better resource allocation decisions given the limited resources at their disposal. Revenue authorities should, however, be mindful not to adopt compliance risk management strategies (to place taxpayers on the compliance pyramid) that are too mechanistic in nature, as such an approach is unlikely to be responsive and may cross over into the realm of regulatory formalism.[99]

1.5.3.4 Making responsive regulation work

A key objective for revenue authorities using a responsive regulatory strategy is to try and encourage the taxpayer into adopting a more cooperative motivational posture. The compliance model supports this by endorsing persuasion and education as the preferred strategies for eliciting compliance where there is no indication that non-compliance is deliberate. The range of sanctioning options available to tax officers will only be brought into play when there is a continued failure to cooperate. This is described as the "novel, and essentially challenging, part of responsive regulation", as it involves "tailoring punishment so that a concession is made for self-regulatory effort".[100] Underpinning this is the democratic element of responsive regulation. Opportunities for dialogue can help address the views of disaffected taxpayers following an encounter with the revenue authority. Regulatory conversations, if held appropriately, can help steer the coping sensibilities of taxpayers responding to the perceived threat of taxation and ensure that greater cooperation is achieved in the future.[101] Participation in democratic processes is also argued to foster a sense of inclusion at the societal level and is seen as essential for the development of a shared understanding of taxation in a regulatory system.[102] Nowhere are these conversations more important than when the rules are indeterminate. As explained by Picciotto:[103]

> [m]uch of the discussion of "compliance" with rules implies an instrumental view of law, in which the aim of the regulator is to induce the regulatee to comply with the requirements of a rule. This assumes that regulator and regulatee both have a relatively clear understanding of what the rules mean, and indeed a shared understanding.

[99] See Judith Freedman "Responsive Regulation, Risk, and Rules: Applying the Theory to Tax Practice" (2011) 44 UBC Law Review 627 at 638.
[100] Valerie Braithwaite "Responsive Regulation and Taxation: Introduction" (2007) 29 Law & Policy 3 at 6.
[101] See Valerie Braithwaite, Kristina Murphy and Monika Reinhart "Taxation Threat, Motivational Postures, and Responsive Regulation (2007) 29 Law & Policy 137.
[102] See Wenzel, above n 86, at 46.
[103] See Sol Picciotto "Constructing Compliance: Game Playing, Tax Law, and the Regulatory State" (2007) 29 Law & Policy 11 at 11.

These democratic processes will often be supported by a taxpayer charter in those jurisdictions using the compliance model. Typically, these taxpayer charters are non-binding and outline a number of rights and service expectations that taxpayers can expect when dealing with the administrator. They also help to set the tone for building a cooperative relationship with the community.

1.5.4 The slippery slope framework

The "slippery slope framework" put forward by Erich Kirchler, Erik Hoezel and Ingrid Wahl (depicted in Figure 2 directly below) is sometimes referred to in the chapters as a useful exploration of the relationship between fairness perceptions according to Wenzel's taxonomy and tax compliance.[104]

Figure 2: The slippery slope framework

[Image redacted]

The starting proposition of the framework is that the "tax climate in a society can vary on a continuum between an antagonistic climate and a synergistic climate".[105] An antagonistic climate is associated with a 'cops and robbers' attitude between taxpayers and authorities, and with minimal voluntary compliance, as it is expected that taxpayers will make decisions about whether or not to evade taxes as rational actors based on the consequences of non-compliance and the perceived risk of detection. In contrast, a synergistic climate is associated with a "service and client" attitude that results in a low social distance between taxpayers and authorities, and with high levels of voluntary compliance.[106] The framework reasons that voluntary compliance and enforced tax compliance

[104] Erich Kirchler, Erik Hoelzl and Ingrid Wahl "Enforced versus voluntary tax compliance: The "slippery slope" framework" (2008) 29 Journal of Economic Psychology 210.
[105] At 211.
[106] See also Kirchler, above n 49, at 203.

can be understood in terms of the dimensions of trust in authorities and the power of authorities.[107] The distinction is an important one for responsive regulation:[108]

> Though for the tax revenue it may seem irrelevant whether taxes were paid voluntarily or not, the differentiation between voluntary and enforced compliance in important with respect to the approach of responsive regulation (citations omitted).

Development of the slippery slope framework as an operational tool for regulators essentially emerged as the product of a study and the integration of extant research. As such, previously tested variables including audit probabilities, fines, tax rates, tax knowledge, attitudes, norms and fairness perceptions are related to the dimensions of trust and power. Fairness perceptions are specifically considered in the context of the justice taxonomy developed by Wenzel. Distributive justice and procedural justice are argued to be antecedents of the trust dimension and retributive justice is thought instead to be connected to the power dimension.[109] Another study by Marius van Kijke and Peter Verboon moderates these findings by exploring the role of trust in authorities (as distinct from trust in the tax office) and the effect of procedural fairness.[110] The study finds that high trust in authorities can serve as a boundary condition to the effects of procedural fairness, which will be more effective at encouraging voluntary compliance among taxpayers with low trust in authorities. It is argued that this is because taxpayers with low trust in authorities pay closer attention and are more likely to scrutinise procedures.

A core premise of the framework is that tax compliance can be achieved in the tax system through some combination of increasing levels of power and trust. An increase in power will engender enforced compliance, whereas an increase in trust will engender voluntary compliance. A later

[107] Trust has been defined as "a general opinion of individuals and social groups that the tax authorities are benevolent and work beneficially for the common good". Power of authorities is defined as "taxpayers' perception of tax authorities' capacity to detect and punish tax crimes". See Ingrid Wahl, Barbara Kastlunger and Erich Kirchler "Trust in Authorities and Power to Enforce Tax Compliance: An Empirical Analysis of the 'Slippery Slope Framework" (2010) 32 Law & Policy 383 at 384.

[108] See Stephan Muehlbacher, Erich Kirchler and Herbert Schwarzenberger "Voluntary versus enforced tax compliance: empirical evidence for the 'slippery slope' framework" (2011) 32 Eur J Law Econ 89 at 95. See also Wahl, Kastlunger and Kirchler, above n 107, at 399, where motivation to comply on a voluntary or enforced basis was operationalised according to the motivational postures of commitment or resistance.

[109] See Kirchler, Hoelzl and Wahl, above n 104, at 219. There is, however, acknowledged to be some degree of overlap to the extent that changes in power can influence trust. For example, where tax authorities are effective in detecting and punishing non-compliance, the trust that honest taxpayers place in the tax system will rise. At 213.

[110] See Marius van Dijke and Peter Verboon "Trust in authorities as a boundary condition to procedural fairness effects on tax compliance" (2010) 31 Journal of Economic Psychology 80 at 88.

study using a large data set on taxpayers from Australia, the United Kingdom and the Czech Republic, collected via online questionnaires confirmed these hypotheses concluding that:[111]

> …trust in tax authorities was the strongest predictor of voluntary tax compliance, whereas power attributed to the authorities predicted enforced tax compliance. Furthermore, enforced compliance was negatively related to trust.

A tax system that promotes voluntary compliance is often seen as the most effective way of encouraging tax compliance. We can relate Wenzel's taxonomy of fairness perceptions with the goal of voluntary compliance by using the slippery slope framework discussed above. As can be seen, there are also many important connections between this goal and responsive regulation as a tool for tax administration. The importance of revenue authorities developing a compliance risk management programme, which promotes fairness and integrity based on trust, is recognised by the Forum on Tax Administration in their 2004 report and approved by the Committee on Fiscal Affairs.[112] A reliance on trust is also argued to be the signature offering of the ATO Compliance Model discussed above. Robert Brenton Whait observes that:[113]

> …the model uniquely and specifically relies on the trust that has developed between the ATO and the taxpayer to achieve voluntary compliance with respect to taxpayers at the second level of the pyramid. Without the model, disengaged and resistive taxpayers would have been met with deterrence action in all cases and compliant taxpayers would be allowed to keep complying.

1.5.5 The OECD's cooperative compliance approach

The latest iteration in regulatory thinking that is championed by the OECD has come in the form of the cooperative compliance model. This approach is seen as consistent with the theory of responsive regulation. New output from the OECD in this area continues to be endorsed by IR.

1.5.5.1 Background

In September 2006, the heads and deputy heads of revenue authorities from 35 economies met in Seoul, Korea, under the auspices of the OECD's Forum on Tax Administration. They participated in discussions on ways to make tax administration more effective and shared their concerns

[111] See Muehlbacher, Kirchler and Schwarzenberger, above n 108, at 95.
[112] See Forum on Tax Administration Compliance Sub-group, above n 98, at 46.
[113] See Robert Brenton Whait "From responsive regulation to dynamic participation: a new model for voluntary tax compliance" (2012) 27 Australian Tax Forum 107 at 111. Whait offers what is referred to as a dual dynamic participation model for the promotion of voluntary tax compliance as an alternative to the ATO Compliance Model. It is relevant that some of the conclusions as to the lack of efficacy of responsive regulation should be viewed narrowly, i.e. as pertaining to the ATO Compliance Model and not the concept of responsive regulation generally.

regarding non-compliance with tax laws in an international context, particularly the promotion of 'unacceptable tax minimisation arrangements'.[114] One of the key work streams to follow on from these discussions was the OECD Tax Intermediaries Study that was formed with a mandate to "improve understanding of the role tax professionals play in tax administration generally and in 'unacceptable tax minimisation arrangements'" and to "identify strategies for strengthening the relationship between tax intermediaries and revenue bodies".[115] The Study Team, however, quickly came to the view that a broader scope was needed to reflect the tripartite relationship between revenue authorities, taxpayers and tax intermediaries. As explained in the OECD published study on the role of tax intermediaries in 2008 (OECD 2008 study):[116]

> the Study Team has come to the firm conclusion that to understand and, more importantly, to influence the behaviour of tax intermediaries, a broader view is needed. Tax intermediaries represent the supply side of aggressive tax planning, but large corporate taxpayers, tax intermediaries' clients, set their own strategies for tax-risk management and determine their own appetites for tax risk. They are the ones who decide whether to adopt particular planning opportunities. Taxpayers represent the demand side of aggressive tax planning.

Large corporate taxpayers, as a taxpayer segment, quickly became the main focus of this study due to time and resourcing constraints.[117] One of the main findings from the Study Team was that there is significant scope to influence the demand side of aggressive tax planning. As a result, many of the recommendations put forward by the Study Team were designed to champion a far more cooperative approach with taxpayers and their advisors as a model for compliance in the large business sector. This concept, which first emerged under the name 'enhanced relationship' in the OECD 2008 study, has several elements critical to its implementation.

Risk management is an essential tool for revenue authorities to identify and prioritise risk and make resource allocation decisions. For risk management to be effective, revenue authorities need to be able to make use of information that is current, relevant and reliable. A theme observed by these Forum on Tax Administration (FTA) countries dealing with aggressive tax schemes was that there was often a lag between when the relevant scheme was entered into and when a revenue authority

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[114] See OECD *Final Seoul Declaration* (Third meeting of the OECD Forum on Tax Administration, 14-15 September 2006).
[115] See OECD *Study into the Role of Tax Intermediaries* (OECD Publishing, 2008) at 7 [OECD 2008 study].
[116] At 5.
[117] It was, however, acknowledged by the Study Team that high net-worth individuals also present a risk in relation to aggressive tax planning and that investment banks pose their own unique set of issues. These two groups representing important stakeholders in the tax system were the subject of later studies. See OECD *Building Transparent Tax Compliance by Banks* (OECD Publishing, 2009) and OECD *Engaging with High Net Worth Individuals on Tax Compliance* (OECD Publishing, 2009).

was made aware of the scheme's existence. Normally, this was brought to their attention on the basis of information submitted with tax returns and from information obtained using statutory powers. The risk was that by this time, any operational or legislative response might be ineffective, as the scheme may have already evolved into some further iteration.[118] The 'enhanced relationship' describes an administrative approach that attempts to overcome these difficulties by urging parties to move beyond a basic obligation-based relationship. Part of this entails information which is, instead of being provided late, provided in real time and on a voluntary basis. As explained in the OECD 2008 study:[119]

> [r]isk management should guide the way revenue bodies deploy resources with the overarching objective of encouraging voluntary compliance. Information is key to effective risk management and resource allocation. Therefore, the more transparent taxpayers (and their advisers) are in their communications and dealings, disclosing significant risks in a timely manner, the better informed revenue bodies will be. Better information should lead to more effective risk assessment and more appropriate resource allocation, and early disclosure may also facilitate more timely responses, including remedial legislation.

For revenue authorities, the enhanced relationship is founded on the twin expectations of taxpayers for 'disclosure' and 'transparency'. In return, the OECD 2008 study identifies five attributes that revenue authorities need to demonstrate when dealing with *all* taxpayers.[120] These are an understanding based on: commercial awareness; impartiality; proportionality; openness through disclosure and transparency; and responsiveness.[121]

The 'enhanced relationship' was later rebranded as 'cooperative compliance' in a follow-up publication in 2013 (OECD 2013 study).[122] The essential planks underpinning the relationship remain the same: the five attributes to be demonstrated by revenue authorities just mentioned, and the twin expectations of taxpayers for disclosure and transparency. What did change in the five years between the 2008 and 2013 studies is that there were developments in the compliance risk management strategies in use by revenue authorities, and the OECD had come to appreciate the

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[118] OECD 2008 Study, above n 115, at 10.
[119] At 40.
[120] The study team accepted the point that these should be seen "as fundamental attributes that underpin all the revenue body's actions" although observed that "revenue bodies will be able to apply at least some if not all of these attributes more comprehensively when dealing with a taxpayer who provides a high level of disclosure and transparency". At 34.
[121] For an explanation of each of these terms, see OECD 2008 study at 33.
[122] OECD *Co-operative Compliance: A Framework* (OECD Publishing, 2013) [OECD 2013 study] at 16. For further background refer Eelco van der Enden and Katarzyna Bronzeeska "The Concept of Cooperative Compliance" 68 Bulletin for International Taxation 567.

importance of the Tax Control Framework (TCF) as a tool for managing the disclosure and transparency expectations of taxpayers. These two factors became a significant focus of the new report and are now central to the concept of cooperative compliance. In addition, the rebrand was seen as needed to respond to concerns that the relationship could breach the principle of equality before the law, given the preferential treatment available to large corporate taxpayers under these arrangements.[123]

1.5.5.2 Cooperative compliance within a broader regulatory framework

No precise definition of cooperative compliance is offered in the OECD 2013 study, and exact cooperative compliance models will vary per jurisdiction. Based on a survey of common features the study concludes that the approach can best be characterised as "transparency in exchange for certainty".[124] The taxpayer is expected to have in place sufficient systems of internal control (i.e. a TCF) that allow a revenue authority to (a) place reliance on the accuracy of information submitted as part of the tax return process; and (b) have confidence that any transactions or positions that are uncertain in terms of compliance with the law are disclosed. This is referred to in the report as 'justified trust' and is argued to validate the benefits that accrue to taxpayers who choose to engage with revenue authorities under a cooperative compliance model. According to the OECD 2013 study:[125]

> [t]he existence of an effective TCF, coupled with a taxpayer's explicit willingness to meet the requirements of disclosure and transparency that go beyond their statutory obligations, provide an objective and rational basis for different treatment.

The OECD in their report acknowledge that the cooperative compliance concept can be placed within a wider compliance risk management framework and is, in fact, consistent with a regulatory approach founded on the principles of responsive regulation:[126]

> Compliance or non-compliance with tax rules is the outcome of an ongoing interaction between government, revenue bodies and taxpayers. Compliance management has to take these different

[123] The OECD accepted that the term 'enhanced relationship' may give rise to misunderstandings although they remain confident that the principles on which the relationship is based remain sound. In their report, the OECD explicitly state that "it is important to state at the outset what cooperative compliance is not intended to achieve: it should not result in a different or more favourable tax outcome for the taxpayer. On the contrary, cooperative compliance has been developed by revenue bodies as a more effective means of achieving tax compliance". At 45.
[124] At 29.
[125] At 47. Further guidance intended to help businesses design and operate their TCFs and for revenue authorities to tailor their risk management strategies was subsequently released in 2016. See OECD *Co-operative Tax Compliance: Building Better Tax Control Frameworks* (OECD Publishing, 2016).
[126] At 42.

> factors into account. This implies that revenue bodies should not only focus on taxpayers but also on what revenue bodies do themselves and how they perform. That performance is itself a driver of taxpayer behaviour.
>
> In the past revenue bodies used the command-and-control approach. Since the end of the last century revenue bodies have shifted the focus to risk management and take action only if there is a real risk to address. The approach could be summarised as co-operation if possible and enforcement if necessary. This is consistent with what academics have been saying since the beginning of 1990s and it is also consistent with the theory of responsive regulation, which is central to the tax compliance strategy of revenue bodies and which has been discussed in earlier FTA reports. The introduction of the co-operative compliance approaches by revenue bodies fits into this new strategy.

Consistent with the 2011 edition of the OECD guidelines for Multinational Enterprises, taxpayers operating under the cooperative compliance model are expected to comply with "both the letter and spirit of the tax laws and regulations of the countries in which they operate".[127] Taxpayers who were consulted during the course of the OECD 2013 study shared their concerns that this reference "implies an identifiable, separately assessable body of interpretation, beyond the words of the statute or other legislative history".[128] The OECD 2013 study recognised that legitimate differences of opinion can exist and that this is not inconsistent with the cooperative compliance concept, nor should it entail taxpayers agreeing to accept what in the view of the revenue authority is legally owing where the parties cannot agree. Instead, what is important is that both parties are willing to resolve the dispute. If disclosure and transparency under the cooperative compliance model are to be effective in bringing uncertain tax positions to the fore, taxpayers must be able to have confidence that mechanisms exist to ensure disputes are resolved in a fast and effective manner.

1.6 Contribution to Research

Part six of this chapter provides a brief description of each of the chapters prepared and explains how each of them contributes to the broader theme. The aim of the research is to highlight those areas where IR's statutory role as tax collector is not being supported and improvements can be made. The chapters included in this submission are broadly divisible between those chapters that examine issues with existing legislative settings (chapters two, three and four) and those chapters that examine issues that have arisen because of administrative practices (chapters five and six).

[127] See OECD *OECD Guidelines for Multinational Enterprises: 2011 Edition* (OECD Publishing, 2011) at 60.
[128] OECD 2013 Study, above n 122, at 49.

1.6.1 Problems with existing legislative settings

1.6.1.1 Chapter 2: The Commissioner's assessment function and discretionary adherence to the law

The chapter examines those statutory powers and discretions that are used by the Commissioner to undertake her assessment function and considers the impact that ss 6 and 6A have had on their exercise. A broad view of the Commissioner's assessment function is taken, which includes not only the power to bring an assessment but also the discretion to later amend an assessment or to enter into settlements with taxpayers regarding disputed amounts.

Expectations of the Commissioner, in terms of her assessment function, are established by examining what the courts have said about the role of the Commissioner when bringing an assessment, or when exercising administrative discretions. It is suggested that the various case law decisions discussed help shed some light on what was envisaged by the Richardson Committee when they refer to the adjudicative role of the Commissioner.

Before s 6A was enacted, it was arguable on an interpretation of the legislation that the obligation to bring an assessment was absolute and that no discretion existed. The issue that has arisen with the current legislative settings is that s 6A has since introduced an additional layer of discretion in terms of how the Commissioner undertakes her assessment function. This has given the Commissioner greater flexibility to pursue her managerial interests. This is because the additional discretion has not been tempered in the legislation with a meaningful requirement to consider her adjudicative responsibilities, or much by the way of guidance as to what her adjudicative role entails.

As it stands, the Commissioner's adjudicative responsibility is only partially reflected in the statutory wording of s 6, and it is best represented by the right for taxpayers to have their liability determined fairly, impartially and according to the law. This is only one of a number of factors in s 6 that will be weighed when the Commissioner carries out her functions or duties. There has been no subsequent separation of the Commissioner's adjudicative role in the legislation, despite this being originally recommended by the Richardson Committee. This creates a significant imbalance between taxpayers and IR regarding the adjudicative responsibilities of the Commissioner being given force in terms of how the Commissioner undertakes her assessment function. Section 6 does not establish any fundamental rights that a taxpayer may assert against

the Commissioner. IR, on the other hand, can point to whatever factors in s 6 or s 6A justify it being able to pursue its managerial interest in the discretionary exercise of its powers and functions.

The chapter argues that a result of the Commissioner being left to pursue her managerial interests is often that an assessment is left to stand at variance with the law. This contravenes the expectation that the Commissioner's role is to act in the quantification of tax liability according to the rules set out by Parliament. An important caveat is that the present-day realities and challenges of tax administration demand an element of flexibility. In this respect, it might be entirely appropriate that an assessment is left to stand at variance with the law. However, managerial discretion should not come without any meaningful obligation to factor in the adjudicative interests of the Commissioner in coming to a decision. This is the result under current legislative settings.

1.6.1.2 Chapter 3: The Commissioner's assessment function and the narrow pathways for judicial oversight of administrative action

The chapter considers the Commissioner's accountability before a Court or tribunal in relation to her responsibility under s 6 to protect the rights of taxpayers' to have their liability determined fairly, impartially and according to the law. In the course of carrying out of the Commissioner's assessment function, this responsibility, and accountability for this responsibility, is core to the various expectations that taxpayers have of the tax system administrator.

The chapter contends that the expectation that the Commissioner will act in the quantification of tax liability according the rules set out by Parliament is not supported in existing legislative settings. The broad framework of ss 6 and 6A, and its interaction with other various provisions of the TAA 1994, allows the Commissioner to exercise discretion in carrying out her assessment function. This discretion also allows the Commissioner to pursue her managerial interests with the result that an assessment is sometimes left to stand at variance with the law. Given that this is permitted under the current legislative framework, the courts will generally not use their supervisory jurisdiction to second guess the statutory powers of decision made by the Commissioner in carrying out her assessment function. Accountability for determining liability in accordance with the law is therefore only supported where the Commissioner does decide to bring an assessment against a taxpayer, in which case it can be challenged by a taxpayer and brought before a court or tribunal.

The chapter next considers what accountability exists for the responsibility to determine a taxpayer's liability fairly and impartially. These duties affirm administrative law principles of natural justice and fairness. The decisions examined in this chapter reveal a perhaps unexpected outcome with respect to this responsibility.

While the courts have always expressed mixed views about their ability to interfere with the Commissioner's assessment function, those judges who have called for some binding requirement of natural justice and fairness have normally found themselves in the minority. The majority instead prefer the view that the Commissioner must be allowed to enforce the law according to her own honest judgement when bringing an assessment. In this respect, correctness in the quantification of the assessment in terms of the substantive taxing provisions of the legislation is the only standard that the Commissioner must adhere to. The courts, therefore, will not bind the Commissioner to another standard even if this would be supportable in an administrative law challenge in another context. Challenges to an assessment based on estoppel, legitimate expectation and consistency grounds have all been considered and have generally been rejected by the Courts over the years.

The chapter finds that recent decisions have also meant that there is an impediment to the courts invalidating an assessment after the fact on the basis that it was not made in adherence to some binding requirement of administrative law. Where an assessment is involved, there are statutory restrictions on taxpayers using judicial review procedures to challenge these decisions made by the Commissioner. A Supreme Court decision has recently held that these statutory restrictions are far more comprehensive in scope than previously thought. Judicial review remains an option only where the taxpayer cannot practically invoke the statutory challenge procedures in Part 8A of the TAA 1994. The problem arises because another recent decision has held that the powers of a hearing authority under the statutory challenge procedures are generally limited in scope to considering whether an assessment has been correctly quantified in accordance with the law. The result is that taxpayers may be denied access to a judicial forum for the purposes of ensuring that the Commissioner is accountable for fair and impartial administration.

1.6.1.3 Chapter 4: The Commissioner's approach to taxpayer amendment requests

The chapter examines the Commissioner's approach to taxpayer amendment requests and her use of the statutory discretion in s 113 of the TAA 1994 to, at any time, amend an assessment to ensure

its correctness. Taxpayer amendment requests are a particular area where the adjudicative aspect to the Commissioner's role is not being given appropriate representation in the decision-making process. It is argued that IR's latest standard practice statement in this area, on how the Commissioner will use s 113, contravenes an expectation that the statutory discretion will be exercised in accordance with Parliament's purposes for that discretion.

Case law has established that s 113 is the primary amendment power following utilisation of the disputes process, and has a broader role to play in correcting undisputed errors or allowing amendments at the Commissioner's or taxpayer's initiative. How the Commissioner uses this statutory discretion is therefore central to how the Commissioner undertakes her broader assessment function. The discretion also has a role to play in supporting the self-assessment scheme that underpins the legislation.

Early case law decisions on the Commissioner's discretion to accept a late notice of objection emphasise the importance of the Commissioner considering the merits of a taxpayer's position before coming to a decision on how to exercise this discretion. This is argued to be important from the perspective of the adjudicative component to the Commissioner's role. While it is not decisive, considering the merits of a taxpayer's position is clearly established as a factor in case law that should carry considerable weight. More recent decisions discussed in the chapter specifically involve the Commissioner's refusal to accept a taxpayer's amendment request. These also confirm that considering the merits of a taxpayer's position is of great importance in the area of taxpayer amendment requests.

It is therefore open for taxpayers to scrutinise very carefully the reasons provided by IR for declining an amendment request where the merits of the taxpayer's position are not given due consideration.

After discussing the relevant case law, the chapter turns to consider IR's most recent standard practice statement on how the Commissioner will exercise her s 113 discretion in response to a taxpayer amendment request. Broadly speaking, the statement sets out the circumstances where IR regards that it would be justified in not allocating the resources needed to properly consider the merits of the taxpayer's position. This would allow the Commissioner to prioritise her managerial interests in the administration of the tax system over the adjudicative aspects of her role.

The chapter makes the case that the circumstances provided in the statement, as to when the Commissioner will not give due consideration to the merits of a taxpayer's amendment request, do not satisfy Parliament's purposes for the exercise of the s 113 discretion. It is, therefore, also a dereliction of the Commissioner's adjudicative responsibility to undertake her assessment function in a way that upholds the rights of taxpayers to have their liability determined in accordance with the law.

1.6.2 Problems with administrative practices

1.6.2.1 Chapter 5: The strategic and regulatory settings for supporting tax system integrity and taxpayer perceptions.

The chapter examines IR's management of the integrity of the tax system and taxpayer perceptions at a strategic and regulatory level. The broad statutory framework for tax administration that was established by ss 6 and 6A was enacted in 1995. Despite this, it took some time before the regulatory changes needed internally at IR, to support the values espoused in those sections, would begin to take place. A key development was the strategic rethink that IR undertook in 2001. The chapter first provides some important historical context behind these changes. The chapter then outlines some of the key initiatives introduced in 2001 and tracks their later development.

It is relevant to note that the strategic reorientation in 2001 came only after a breakdown in the relationship between taxpayers and IR, which led a Parliamentary inquiry to conclude in 1999 that significant changes were needed. This is an example of an accountability measure that is normally accompanied by an extraordinary amount of public interest and is used only in the most extreme of circumstances. These developments lend credibility to the assertion that integrity measures and taxpayer perceptions are important and need to be separately considered and managed in their own right.

The changes that took place in 2001 saw IR introduce a business plan founded on some of the fundamentals of responsive regulation. In line with this approach, IR first introduced its compliance model into tax administration and established a new taxpayer charter. Other changes saw IR release its first-ever *Statement of Intent* that sought to extend its output-contracting model to include specific outcomes (which included an intermediate outcome to protect the integrity of the tax system). IR also gave some thought to policies, procedures and controls used internally to protect tax system integrity and established its Escalation Policy for technical issues.

Based on the principles of responsive regulation, the regulatory strategy that has been pursued since 2001 is fundamentally one that is concerned with compliance outcomes. The appeal for regulators of this strategy is that it allows an administrator to adopt a risk management perspective in the deployment of limited resources with the promise of administrative cost savings and greater efficiency. What it overlooks, however, is that integrity measures and taxpayer perceptions are things that should be managed in their own right, not because of any real or perceived connection to compliance outcomes (including voluntary compliance). This follows from the statutory responsibility in s 6 to protect the integrity of the tax system that applies to all Ministers and officials. It also follows from the adjudicative responsibilities of the Commissioner that reflect her statutory role as tax collector in terms of the TAA 1994.

After a critical examination of the initiatives that were introduced with the strategic reorientation that took place in 2001, the chapter argues that there are flaws in how IR supports tax system integrity and taxpayer perceptions at a strategic and regulatory level. There has been an insufficient separation of the Commissioner's adjudicative responsibilities in tax administration from her managerial interests at this level. As a result, expectations of the Commissioner regarding her adjudicative responsibilities and accountability for these responsibilities are at risk of being undermined.

1.6.2.2 Chapter 6: Inland Revenue's management of key stakeholder relationships

The chapter examines IR's efforts to build community partnerships with respect to three key stakeholder groups in the tax system. The aim is to identify whether any improvements could be made to the management of these relationships in order to support IR in its responsibility to protect tax system integrity and uphold taxpayer perceptions. The three stakeholder groups that are examined are tax agents, large enterprises and industry bodies (those where industry members are likely to operate in the cash economy).

Building community partnerships and managing the expectations of key stakeholder groups in the tax system is an important part of implementing a regulatory strategy that is founded on the principles of responsive regulation. Because of the relationship between taxpayer perceptions and compliance behaviour, it will often be the case that the measures used to promote responsive regulation are consistent with a strategy of managing taxpayer perceptions. But this will not always be the case, and IR should be aware of limitations in the approach.

The chapter identifies two limitations in IR's compliance model where regulatory strategy is argued to overlook elements of taxpayer perceptions of the integrity of the tax system. The chapter then uses the compliance model and these limitations as a conceptual tool for identifying areas in IR's administration of the tax system where improvements can be made with respect to the management of these three key stakeholder relationships. Some areas where the compliance model has been applied appropriately and led to positive outcomes in line with IR's strategic direction are also discussed.

A key observation made in this chapter is that the s 6 responsibility to protect the integrity of the tax system is given greater regard by IR in terms of its relevance to the exercise of specific statutory powers or discretions and more generally in policy development. In contrast, it has not been meaningfully integrated into strategic thinking or regulatory strategy. The chapter concludes with a summary of suggested improvements for IR's approach to managing stakeholder relationships.

Chapter 2: The Commissioner's assessment function and discretionary adherence to the law

2.1 Introduction

It is sometimes said that the Commissioner occupies a dual role when undertaking her assessment function. These two roles are governed by three pieces of legislation but are assigned to just one person.

Under the TAA 1994,[1] the Commissioner is given statutory independence and is charged with the collection of taxes due to the crown. The Commissioner is vested with vast powers and discretions in order to perform this function. Over the years, the courts have sometimes drawn inferences about the role of the Commissioner when bringing or amending an assessment and when exercising administrative discretions based on the statutory scheme of the TAA 1994. A considerable body of law has since developed in this area that underscores the Commissioner's adjudicative responsibilities in terms of this Act.

The Commissioner is also the Chief Executive of IR and must observe the accountability frameworks and associated responsibilities for chief executives in terms of the State Sector Act 1988 and the Public Finance Act 1989. Among other things, the Commissioner is answerable for the "efficient and economical delivery of goods or services provided by the department…".[2] Clearly, IR does not have the resources to consider each taxpayer's individual tax affairs separately. A degree of managerial discretion therefore needs to be exercised by the Commissioner when deciding how to prioritise resources in order to meet this objective.

Recognising that the potential for conflict between these two roles existed, the Richardson Committee in 1994 recommended the introduction of a care and management rule similar to that found in the United Kingdom. This was subsequently enactment by Parliament and was inserted into s 6A of the TAA 1994. Before any such legislative fix, it was arguable on an interpretation of the tax legislation that the Commissioner was under an obligation "to assess and collect all taxes that are due regardless of the costs involved".[3] This proved to be an uneasy fit with the pressures

[1] All references in this chapter are to TAA 1994 unless stated otherwise.
[2] State Sector Act 1988, s 32.
[3] Ivor Richardson and others "Organisational Review of the Inland Revenue Department" (Report by the Organisational Review Committee, 1994) at 49.

placed on chief executives and government departments to be fiscally responsible with public money and arguably defies common sense.[4] The enactment of s 6A has since removed this ambiguity. This section now provides that the duty of the Commissioner is "to collect over time the highest net revenue *that is practicable* within the law".

The enactment of s 6A was accompanied by the enactment of s 6 of the TAA 1994. Section 6 imposes a responsibility on every Minister and every officer having responsibilities under the legislation in relation to the collection of taxes and other functions to "at all times use their best endeavours to protect the integrity of the tax system".[5] The section goes on to list a number of rights and responsibilities belonging to both taxpayers and those administering the law that are within the meaning of "the integrity of the tax system". The only right that taxpayers have in relation to an assessment brought by the Commissioner that is specified in s 6 is "to have their liability determined fairly, impartially, and according to the law".[6] This is an important right for taxpayers and the best articulation of the Commissioner's adjudicative role in terms of the TAA 1994. However, the statutory responsibility of 'tax collectors' in s 6 to protect the integrity of the tax system only provides context to the decision-making framework within which the Commissioner administers the tax system. Section 6 does not, of itself, create any enforceable standards against which the Commissioner may be held accountable, nor does it provide any guidance as to what weight should be given to the Commissioner's adjudicative role versus her managerial interests.

When bringing an assessment against a taxpayer, the Commissioner is required to exercise judgement and there must be a genuine attempt to ascertain the taxable income of the taxpayer.[7] The problem is that the Commissioner's assessment function is broader than just an obligation to enforce the law when bringing an assessment. The enactment of s 6A has meant that the Commissioner is, generally speaking, no longer under any obligation to bring an assessment. The primary responsibility for furnishing an assessment has instead shifted to the taxpayer and the Commissioner's power to amend an assessment is couched in discretionary terms.[8] When deciding

[4] It makes little sense, for example, to institute an action that costs $10,000 to assess $1,000 worth of taxes.
[5] TAA 1994, s 6(1).
[6] TAA 1994, s 6(2)(b).
[7] *CIR v Canterbury Frozen Meat* (1994) 16 NZTC 11,150 at 11,158.
[8] TAA 1994, s 113. See also *Lawton v CIR* (2003) 21 NZTC 18,042 at [12] – [25] where the Court of Appeal confirmed the power to amend assessments was discretionary and "cannot be elevated to the point of a statutory duty".

on whether or not to exercise this discretion, the Commissioner must have regard to the broad decision making framework provided for under ss 6 and 6A. She may come to the decision not to allocate resources to alter an assessment. This could be the result of IR refusing to accept a taxpayer amendment request, or choosing to abandon a dispute it would otherwise have to pursue through the statutory disputes regime.[9] The Commissioner is likewise empowered under s 6A to enter into settlement agreements with taxpayers on disputed tax positions. In all of these scenarios, the Commissioner is using her 'power' in s 6A such that an assessment may legitimately be left at variance with the correct position under the legislation.

While these scenarios are not necessarily unfavourable for the taxpayer, the fact remains that the Commissioner holds all the cards when deciding how to undertake her assessment function.

In light of this, taxpayers would be right to question whether the right settings are in place for managing the competing interests and responsibilities of the Commissioner in her distinct roles as Commissioner of IR and as Chief Executive. This chapter argues that the enactment of ss 6 and 6A has not resolved this tension with regards to the Commissioner's assessment function. Instead, it has fixed only the incompatibility between these two sets of responsibilities. More to the point, it has only achieved this by subjugating the Commissioner's adjudicative responsibilities to her managerial interests. A case is made that there needs to be greater recognition of the Commissioner's adjudicative role under the legislation, as well as a strengthening of taxpayer rights. Without this, there can be no meaningful 'responsibility' for the Commissioner's adjudicative role in terms of the TAA 1994.

The remainder of this chapter is structured as follows:

Part two outlines what the courts have said about the role of the Commissioner when undertaking her assessment function in terms of the statutory scheme of the TAA 1994. **Part three** considers the significance of ss 6 and 6A as a framework for decision-making in tax administration and how these sections relate to the separate adjudicative and managerial responsibilities of the Commissioner. **Part four** explains why s 6 is not effective as a protection for taxpayers and argues that the parameters of the Commissioner's adjudicative role need to be better articulated in the legislation. **Part five** describes the tension between the Commissioner's power in s 6A to settle a disputed tax liability with taxpayers on a compromise basis and the adjudicative role of the

[9] TAA 1994, pt 4A.

Commissioner in undertaking her assessment function. **Part six** examines the Commissioner's power in s 6A to exercise managerial discretion regarding the allocation of resources and identifies a number of areas where this is leading to unsatisfactory outcomes in terms of the Commissioner's adjudicative responsibilities.

The chapter concludes with some thoughts on why legislative change is needed to ensure that the Commissioner's adjudicative role is given due consideration in tax administration.

2.2 Role of the Commissioner in terms of statutory scheme

2.2.1 Role of the Commissioner when bringing or amending an assessment

The TAA 1994 confers on the Commissioner independent statutory powers to enable the performance of duties. The most important of these powers for the purpose of the present discussion is the power to bring an assessment; but the Commissioner also acts in the collection of taxes and is provided with a number of administrative discretions to allow some flexibility in administering the law. Because the statutory powers and discretions conferred under the TAA 1994 vest in the Commissioner personally, the courts have at various times formed inferences about the role of the Commissioner based on the statutory scheme of the TAA 1994. Accordingly, it is useful to examine what the courts have said about what is expected of the Commissioner when she exercises her statutory powers and discretions.

It is important to remember the constitutional principle that Parliament alone has the power to levy tax and that it is the legislation itself that imposes the charge to tax according to the rules set out by Parliament. The Commissioner's assessment function is instead concerned with quantification of the amount due. This basic proposition was put forward by Sir Ivor Richardson (acting for the respondent) and was endorsed in the Court of Appeal in *Reckitt & Colman (New Zealand) Limited v Taxation Board of Review.* Per McCarthy J:[10]

> I agree with Mr Richardson that the general scheme of the Acts is as follows. Liability is imposed by the charging sections. …The Commissioner acts in the quantification of the amount due, but it is the Act itself which imposes, independently, the obligation to pay. The assessment and objection procedures are merely machinery for quantifying; they do not cast liability.

[10] *Reckitt & Colman (NZ) Ltd vs Taxation Board of Review* [1966] NZLR 1,032 at 1,045.

Sir Ivor Richardson would later himself become a justice of the Court of Appeal and has been influential in the development of the law in this area:[11] a major theme from his contribution being that an assessment made by the Commissioner is an imperative duty under the statutory scheme. The Commissioner is unable to self-impose any limitations (whether by contract or estoppel) on the obligation to enforce the law. He expressed this sentiment in the majority decision of *CIR v Lemmington Holdings Limited:*[12]

> We are satisfied that in making an assessment under this statutory scheme the Commissioner is not exercising an enjoinable power or right in the sense contemplated under the *Judicature Amendment Act*. When he is discharging his statutory assessing function under sec. 19 and the associated provisions *he is performing a duty imposed on him in imperative and unconditional terms.*

Richardson J went on to comment about the distinction between a challenge to the correctness of an assessment and the legitimacy or validity of process adopted in making an assessment (the latter perhaps being susceptible to challenge on administrative law grounds).

This distinction would surface again in in *CIR v Canterbury Frozen Meat* where Richardson J elaborated further on this point.[13] In that case, the taxpayer made a payment of $2.25 million under an agreement for the variation and partial surrender by another company (Borthwicks) of its rights under a long-term supply contract. IR took the view that the treatment of that payment was assessable income in the hands of Borthwicks and an assessment was made. Borthwicks, however, objected to this assessment (which was disallowed) and the issue was the subject of separate proceedings. IR then sought to protect itself against an impending time bar by raising a purported assessment against the taxpayer so that it could attempt to deny the taxpayer a deduction for the payment in the event that it lost the proceedings against Borthwicks. Richardson J's comments in this case are again grounded on the statutory language:[14]

> In making an assessment the Commissioner is required to exercise judgment. He or she is not entitled to act arbitrarily or in disregard of the law or facts known to the Commissioner. There must be a genuine attempt to ascertain the taxable income of a taxpayer even if carried out cursorily or perfunctorily (citations omitted).

[11] See Geoffrey Clews "The Richardson Years: An Overview of Case Law Affecting the Commissioner's Statutory Powers" (2002) 8 NZJTLP 224.
[12] *CIR v Lemmington Holdings Limited* (1982) 5 NZTC 61,268 at 61,273 (emphasis added).
[13] *CIR v Canterbury Frozen Meat* (1994) 16 NZTC 11,150.
[14] At 11,158.

On the facts, it was found that the taxpayer had established an arguable case that the purported assessment (being provisional or conditional) made by the Commissioner did not "have the character of an assessment within the meaning of that term in the act".[15]

While the judgment of Richardson J in *Canterbury Frozen Meat* affirms a duty to apply the law according to the Commissioner's honest judgement, other decisions such as *Miller and O'Neil v CIR* have taken the logical step of confirming that the Commissioner is, in fact, under a statutory obligation to change her mind concerning an interpretation of a tax law, if she comes to the conclusion that a former approach is incorrect.[16]

The courts are generally reluctant to interfere with the Commissioner's obligation to enforce the law, which they view as a product of the statutory scheme. Notably, the significance that the courts have traditionally attached to the statutory scheme in this respect has continued to hold even after the enactment of ss 6 and 6A and the move to self-assessment in New Zealand. One example of this is the decision of *Westpac Banking Corporation v CIR*, where the Court of Appeal upheld the prevailing view that the Commissioner is required to apply the law when making an assessment and that the Commissioner (outside of the binding rulings regime) "cannot estop himself from enforcing the law".[17] What *has* changed since ss 6 and 6A were first enacted is the significant increase in the number and importance of administrative discretions vested with the Commissioner, particularly those that were introduced in support of substantial taxpayer self-assessment.[18] The Commissioner's discretion in s 113 of the TAA 1994 to amend an assessment has also become far more prominent in terms of the wider management of the Commissioner's assessment function by IR in this self-assessment environment.

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[15] At 11,158. Contrast *CIR v New Zealand Wool Board* (1999) 19 NZTC 15,476 where it was found that the purported reassessment was made with the requisite statutory exercise of judgement. The Court of Appeal held that "[t]he statute requires a genuine attempt to ascertain the assessable income of the taxpayer. That obvious obligation cannot be elevated into a requirement that the Commissioner not assess unless and until fully informed of the taxpayer's affairs. …The statute requires the exercise of judgment but it does not set a high threshold as to the material on which that judgment is based. The Commissioner must do the best he or she can on the information in his or her possession and so, as it is put in the *Canterbury Frozen Meat Co Ltd* case, it is only where the Commissioner acts arbitrarily — without any foundation for the assessment — or in disregard of the law or facts known to the Commissioner, that the purported assessment will be set aside on that ground". At [49].

[16] *Miller and O'Neil v CIR* (1993) 15 NZTC 10,187.

[17] *Westpac Banking Corporation v CIR* (2009) 24 NZTC 23,340 at [84]. See also *CIR v Michael Hill Finance (NZ) Limited* (2016) 27 NZTC ¶22-056.

[18] See Shelley Griffiths "Revenue Authority Discretions and the Rule of Law in New Zealand" in Chris Evans, Judith Freedman and Richard Krever (eds) The Delicate Balance – Tax, Discretion and the Rule of Law (IBFD, Amsterdam, 2011) at 155.

2.2.2 Role of the Commissioner when exercising administrative discretions

Case law has established that the Commissioner is held to an "Olympian" standard of impartiality and consistency in the administration of the tax system.[19] This is not to say that the Commissioner cannot differentiate between cases and make decisions regarding the affairs of individual taxpayers, where express provision for the discretion to do so has been made in the legislation. Administrative discretions permit a degree of flexibility in the administration of the tax system and are an important part of making self-assessment work in New Zealand.[20] It is also basic to the nature of a discretion that has been delegated to public authorities that the rights of taxpayers to pursue legal remedies will accordingly be limited. In the words one commentator:[21]

> Where a discretion is delegated to the authorities in respect of specific matters, it follows that affected taxpayers lack a comprehensive right of appeal to the courts. The decisions in question would otherwise not be discretions, in the sense of representing independent and binding judgements of the tax authorities, but rather normal items of law or fact on which the courts would pronounce under general appeals procedures.

Given the significant degree of flexibility that these administrative discretions have afforded the Commissioner in terms of her administration of the tax system, taxpayers will be interested in what responsibilities accompany the exercise of these discretions. Briefly therefore, this chapter will discuss some of the decisions that deal with how the Commissioner must exercise the various statutory discretions vested with her.

Consistent with the theme that the Commissioner is required to exercise judgment when bringing an assessment is the idea that the Commissioner must not fetter her discretion.

In *Gisborne Mills Limited and Others v CIR*, it was held that the Commissioner is under a statutory responsibility to undertake a reasoned exercise of discretions or powers of decision, requiring the Commissioner "to weigh the particular circumstances which existed".[22] The case is authority for

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[19] This is a reference to the much cited passage of Turner J in *Reckitt & Colman (NZ) Ltd vs Taxation Board of Review* [1966] NZLR 1,032. Turner J provides that "[w]here there is no express provision for discretion, however, and none can be properly implied from the tenor of the statute, the Commissioner can have none; he must with Olympian impartiality hold the scales between taxpayer and Crown giving to no one any latitude not given to others. Omne capax movet urna nomen". At 1,042.

[20] Usually, the exercise of a statutory power of discretion is made in adherence to stated policy to ensure that the proper degree of consistency is maintained between taxpayers.

[21] Dominic de Cogan "Tax, Discretion and the Rule of Law" in Chris Evans, Judith Freedman and Richard Krever (eds) The Delicate Balance – Tax, Discretion and the Rule of Law (IBFD, Amsterdam, 2011) at 9.

[22] *Gisborne Mills Limited and Others v CIR* (1989) 11 NZTC 6,194.

the proposition that rigid adherence to policy will not always satisfy Parliament's requirements for the exercise of a discretion that has been delegated to the Commissioner.

Richardson P, in the Court of Appeal decision of *CIR v Wilson*, expanded on this decision and provided that:[23]

> As in the case of any authority entrusted with statutory powers of decision, the Commissioner's statutory powers must be exercised in accordance with explicit or implicit statutory criteria and to serve the purposes of the legislation.

The *Wilson* decision above (and the later decision of *Lawton v CIR*)[24] involved the discretionary relaxing of time limits which would allow the Commissioner to accept a late notice of objection. Richardson P in the *Wilson* decision kept true to form and again embarked on a contextual analysis of the discretion in terms of the statutory scheme before quashing the Commissioner's refusal to accept a late objection, and redirecting the Commissioner to consider the merits of the taxpayer's request. Glazebrook J, in the decision of *Lawton*, later affirmed this judgment and added that:[25]

> …it is important in a system which relies on voluntary compliance for the Commissioner to be seen to be operating fairly, and this will in many circumstances mean that the merits of a taxpayer's position will be a material factor to be weighed.

Both the *Wilson* and *Lawton* judgments involve judicial review of decisions made by the Commissioner in a legislative setting that did not include ss 6 and 6A. The more recent High Court decision of *Arai Korp Limited v CIR* dealt with the very similar issue of the Commissioner's refusal to exercise her discretion in s 113 of the TAA 1994 to amend an assessment in respect of the taxpayer's amendment request. The decision confirms that, while the merits of a taxpayer's request is still a relevant consideration, the matters that the Commissioner might properly have regard to when exercising a statutory power of discretion have since been widened to encompass the responsibilities set out in ss 6 and 6A of the TAA 1994.[26] As a direct consequence of this, there is more scope for refusing a taxpayer's amendment request for reasons other than the merits of the taxpayer's position.[27]

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[23] *CIR v Wilson* (1996) 17 NZTC 12,512.
[24] *Lawton v CIR* (2003) 21 NZTC 18,042
[25] At [29].
[26] *Arai Korp Limited v CIR* (2013) 26 NZTC ¶21-014
[27] See IR "SPS 16/01 Requests to Amend Assessments" Tax Information Bulletin Vol 28 No 4 at 12.

In the section that follows, this chapter considers how ss 6 and 6A have broadened the criteria that the Commissioner will have regard to in her administration of the tax system.

2.3 Tax system administration and sections 6 and 6A

2.3.1 A framework for decision-making

Sections 6 and 6A together are described by IR in Interpretation Statement IS 10/07 as "a 'legislative package' to provide the framework within which the Commissioner administers the tax system".[28]

According to Interpretation Statement IS 10/07, s 6A(2) is seen as the provision authorising the use of managerial discretion and s 6A(3) is intended to provide legislative guidance as to its exercise. The considerations listed in ss 6 and 6A(3) will be considered by the Commissioner whenever she exercises her s 6A powers, but they are also of much more fundamental application. These sections also underpin and inform all aspects of IR's approach to its tax assessment and collection function. This 'framework' has as much to do with the strategic orientation of IR as it does with the specific exercise of statutory powers and discretions vested in the Commissioner.

The Courts have been quick to recognise and comment on the significance of this framework to the role of the Commissioner and her exercise of statutory powers. Perhaps nowhere is this clearer than in the judgment of the Supreme Court decision of *Westpac Banking Corporation Limited v CIR & Ors; ANZ National Bank Limited & Ors v CIR.*[29] This case turned on an interpretation of s 81, which imposes a statutory duty on IR officers to maintain secrecy, in the context of discovery proceedings. Simply put, the Commissioner wished to rely on information held in relation to the business affairs of other taxpayers (i.e. other large banks) in defending proceedings brought by Westpac and ANZ National respectively. The Supreme Court noted that there are "important new provisions in the Tax Administration Act against which s 81 must now be read".[30] Per McGarth J.[31]

[28] IR "Care and Management of the taxes covered by the Inland Revenue Acts" Tax Information Bulletin Vol 22, No 10 (November 2010) at [56] (Interpretation Statement IS 10/07).
[29] *Westpac Banking Corporation Limited v CIR & Ors; Westpac Banking Corporation Limited v CIR & Ors* (2008) 23 NZTC 21,896 at [32]. See also the minority judgement of Elias CJ and McGrath J in the Supreme Court decision of *Tannadyce Investments Limited v CIR* (2011) 25 NZTC ¶20-103 at [32].
[30] At [32]
[31] At [52].

> The central position of s 6 and 6A in the legislative scheme provides contextual support for an interpretation of the Tax Administration Act that requires the Commissioner to have regard to the importance of both values.

This conclusion is consistent with the comments of Richardson P in *CIR v Wilson* noted earlier regarding the exercise of statutory powers of decision, where it was held that "the Commissioner's powers must be exercised in accordance with explicit or implicit statutory criteria and serve the purposes of the legislation".[32] Other decisions explicitly or implicitly confirm the central influence that these sections now have in the context of the Commissioner's discretion to amend assessments,[33] enter into settlement agreements[34] and to remit outstanding tax debt.[35]

Although the Commissioner is required under the legislation to have regard to each of the factors listed in s 6A(3), as well as s 6, when deciding between alternative courses of action, the sections do not stipulate the weight to be given to each factor.[36] The task is therefore little different from what the Courts have held is required of the Commissioner in the exercise of administrative discretions generally, namely, to weigh and balance the particular circumstances in accordance with the relevant statutory criteria when coming to a decision. The enactment of these sections may well have altered the statutory framework and widened the criteria that the Commissioner must have regard to, but, as with other statutory powers of decision, the decision belongs to the Commissioner alone. It is argued that this is what is intended by the words "taxes committed to the Commissioner's charge" in section 6A(3).[37]

The courts have often paid tribute to the special relationship between the responsibility to protect the integrity of the tax system in s 6 and the importance of voluntary compliance in s 6A(3)(b).[38] One concern regarding judicial commentary on the ss 6 and 6A decision-making framework is that

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[32] See discussion supra at 2.2.
[33] *Arai Korp Limited v CIR* (2013) 26 NZTC ¶21-014
[34] *CIR v Auckland Gas Company Limited (*1999) 19 NZTC 15,027, *Accent Management Ltd & Ors v CIR (No 2)* (2007)23 NZTC 21,336.
[35] *Raynel & Anor v CIR* (2004) 21 NZTC 18583, *Clarke v CIR; Money v CIR* (2005) 22 NZTC 19,165.
[36] Per Interpretation Statement IS 10/07, in relation to s 6A "[t]he word 'and' after the first two factors indicates that the Commissioner must have regard to all of the factors when evaluating the possible courses of action". See Interpretation Statement IS 10/07, above n 28, at [112] – [113].
[37] See Interpretation Statement IS 10/07, above n 28, at [99] – [101] citing a passage from the Valabh Committee report that enacting a care and management provision "…would have to be presented and implemented with due care. It would be important to emphasise that the taxes are committed to the Commissioner's charge. Taxpayers may try to take advantage of the apparently increased discretion". See Valabh Committee *First Report of the Working Party on the Re-organisation of the Income Tax Act 1976* (Wellington, July 1993) at 8.
[38] See *Westpac Banking Corporation Limited v CIR & Ors; Westpac Banking Corporation Limited v CIR & Ors* (2008) 23 NZTC 21,896 at [51], *Raynel & Anor v CIR* (2004) 21 NZTC 18,583 at [54].

it has the potential to do great damage to the priority given to each of these factors by the Commissioner when coming to a decision of how to exercise a statutory power of decision. The weight of judicial commentary on ss 6 and 6A tends to approach the concepts of tax system integrity and voluntary compliance from the perspective of *retributive justice*,[39] often in the context of denying a taxpayer access to judicial review proceedings or expressing support for a decision made by the Commissioner in the exercise of a statutory power.[40] There are far fewer examples of judgments being similarly rationalised in terms of ss 6 and 6A even when, for example, a judicial review decision has been made in favour of the taxpayer and the decision made by the Commissioner is subject to reconsideration.

Because of the way that subsequent decision making in tax administration is in turn influenced by these judgments, the emphasis on retributive justice concerns when applying the ss 6 and 6A decision-making framework becomes negatively reinforcing.[41] This is not helped by the fact that the Commissioner is only required to weigh the particular circumstances that exist, and there is no accountability for the weight that is given to each of the factors in ss 6 and 6A. This is somewhat perverse for s 6, a section that purports to affirm the rights of taxpayers and the responsibilities of IR. It means that the Commissioner can simply point to whichever of the factors listed in this section best suits the purposes of the department, and arguably find some vindication for her decision in case law.

In the next section, we will discuss the origins of ss 6 and 6A which can be traced to the final report of the Richardson Committee produced to the Minister of Revenue in April 1994. An important view held by the Richardson Committee is that the Commissioner has separate and distinct responsibilities of adjudication and management in her administration of the tax system. The

[39] Retributive justice refers to the fairness of sanctions imposed or steps taken to respond to non-compliant action or behaviour. See Michael Wenzel "Tax Compliance and the Psychology of Justice: Mapping the Field" in Valerie Braithwaite (ed) *Taxing Democracy: Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 46.

[40] Typical of this are the comments of Randerson J in *Raynel & Anor v CIR* (2004) 21 NZTC 18583 where he observed that "[t]axpayers who comply with the requirements of the Inland Revenue Acts are entitled to expect that appropriate and (where necessary) firm action is taken against taxpayers who shirk their obligations. If not, complying taxpayers will justifiably perceive there is a lack of integrity in the system and an unfair burden is cast on those who conscientiously comply with their obligations". At [54].

[41] As an example, the Commissioner's standard practice statement that set out the circumstances where IR will accept a taxpayer amendment request appears to be overly preoccupied with the culpability of the taxpayer for not having self-assessed correctly in the first place. See IR "SPS 16/01 Requests to Amend Assessments" Tax Information Bulletin Vol 28 No 4 at 12. The statement is at pains to ignore the broader role that the Commissioner's discretion in s 113 of the TAA 1994 has to play in promoting self-assessment that has been emphasised in decisions such as *Westpac Securities NZ Limited v CIR* (2014) 26 NZTC ¶21-118.

enactment of s 6A has since fixed any incompatibility between these sets of responsibilities, but it has not ameliorated the tension between them. In areas where the exercise of a statutory power has the potential to impact the final quantification of an individual taxpayer's liability there needs to be a careful balancing of adjudicative and managerial interests. This will often play out as a weighing up of the factors set out in ss 6 and 6A.

2.3.2 The separate responsibilities of adjudication and management

2.3.2.1 Section 6A and the Commissioner's duty

Prior to the introduction of s 6A, the Commissioner was charged "with the administration of the IR Acts and with such other functions as may from time to time be lawfully conferred on him".[42] On one reading of the legislation the Commissioner's obligation to assess was absolute and, in the words of Richardson P, "there was no scope for weighing and balancing management functions against collection responsibilities in respect of particular taxpayers".[43] This was considered to be an unrealistic objective and not commensurate with the appropriation requirements and systems of financial accountability that were put in place for chief executives and government departments under the State Sector Act 1988 and Public Finance Act 1989.

The Valabh Committee supported the legislative recognition of managerial discretion as to the exercise of the Commissioner's statutory powers and recommended that a provision be introduced along the same lines as that found in the United Kingdom.[44] Section 1(1) of the Taxes Management Act 1970 (UK) provided that:

> Income tax, corporation tax and capital gains tax shall be **under the care and management** of the Commissioners of Inland Revenue…

The House of Lords in the United Kingdom interpreted this provision as conferring on the Commissioners a broad managerial discretion. These observations were summed up by Lord Diplock in *R v IRC, ex parte National Federation of the Self-Employed and Small Business Ltd* (the Fleet Street Casuals case) where he held:[45]

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[42] Inland Revenue Department Act 1974, s 4(1).
[43] *Brierley Investments Limited v CIR* (1993) 15 NZTC 10,212 at 10,219.
[44] Valabh Committee *First Report of the Working Party on the Re-organisation of the Income Tax Act 1976* (Wellington, July 1993) at 5.
[45] *R v IRC, ex parte National Federation of the Self-Employed and Small Business Ltd* [1982] AC 617 (HL) at 636 (the Fleet Street Casuals case).

> …the [Board of IR] are charged by statute with the care, management and collection on behalf of the Crown of income tax, corporation tax and capital gains tax. In the exercise of these functions the board have a wide managerial discretion as to the best means of obtaining for the national exchequer from the taxes committed to their charge, the highest net return that is practicable having regard to the staff available to them and the cost of collection.

In New Zealand, the matter was picked up again a year later by the Richardson Committee, which ultimately recommended the enactment of ss 6 and 6A. These comments by Lord Diplock would later find form in s 6A(3) and the legislative duty imposed on the Commissioner.[46] That said, although s 6A(2) and s 6A(3) were modelled on the United Kingdom provision, there was always a clear expectation owing to the different administrative contexts that the two sections would operate differently in at least some respects.[47]

In addition to providing the Commissioner with legislative authorisation for the use of managerial discretion, it was anticipated by the Richardson Committee that s 6A would entitle the Commissioner to enter into compromise agreements with taxpayers (both in the course of litigation and in the area of debt management).[48] The Committee, however, went further than this in their formulation of s 6A. They also took the opportunity to revise the legislative objective of tax administration and to incorporate a number of additional elements. Section 6A(3) is, in all material respects, identical to the Richardson Committee's recommended objective for tax administration with regards to IR's tax assessment and collection function.[49] Most notably, the revised legislative objective promulgates an enforcement strategy based on the promotion of voluntary compliance. The report makes the observation that this fundamental strategy is "considered to be the most efficient and effective basis for tax collection, and underpins all aspects of tax collection in New Zealand".[50]

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[46] Young J in *Fairbrother v CIR* (2000) 19 NZTC 15,548 would later suggest that this similarity is not a coincidence and "…s 6A must be regarded as a statutory ratification of the approach adopted by the House of Lords in [the Fleet Street Casuals case]". At [26].

[47] The Richardson Committee considered that it would be undesirable for IR to be bound by any view it may have expressed to taxpayers outside of the binding rulings process. See Ivor Richardson and others "Organisational Review of the Inland Revenue Department" (Report by the Organisational Review Committee, 1994), Appendix D at [38] [Richardson Committee report]. This is contrary to a line of English decisions decided under the corresponding UK provision. See *Re Preston* [1985] 1 AC 835 (HL), *R v Board of Inland Revenue, ex parte MFK Underwriting Agencies Ltd* [1990] 1 WLR 1545 (QB) and *R v Commissioners of Inland Revenue, ex parte Unilever Plc* (1999) 68 TC 205 (CA).

[48] Richardson Committee report, Appendix D at [48].

[49] This was considered to be distinct from IR's role in providing policy advice to Ministers, social policy and information supply functions. At 48.

[50] At 49. For a framework that considers the variables that are important to the promotion of voluntary compliance in a tax system, see Erich Kirchler, Erik Hoelzl and Ingrid Wahl "Enforced versus voluntary tax compliance: The

Several passages in the report note that the primary objective of IR will apply in meeting accountabilities *specifically to the Minister*. It is acknowledged elsewhere in the report that IR has responsibilities not only to the Government/Minister, but also to Parliament and to taxpayers. A clear inference emerges that this legislative objective relates to the Commissioner meeting her responsibilities as Chief Executive of IR in terms of the State Sector Act 1988 and Public Finance Act 1989; perhaps in particular the responsibility for "the efficient, effective, and economical management of the activities of the Department".[51]

2.3.2.2 Section 6 and the responsibility to protect the integrity of the tax system

To accompany the care and management rule in s 6A, the Richardson Committee recommended the companion concept of tax system integrity in s 6. This section now imposes an obligation on every Minister and every officer having responsibilities under the TAA 1994 (or any other Act) in relation to the collection of taxes and other such functions to at all times use their best endeavours to protect the integrity of the tax system. This is emblematic of IR's wider accountability to Parliament and taxpayers for administration of the tax system, and was no doubt introduced (together with the Commissioner's statutory independence with respect to certain matters under s 6B) to provide some degree of assurance that fair and impartial administration of the law will be maintained. According to the Richardson Committee:[52]

> The integrity of the tax system is not simply a matter between the CE/Commissioner and the Minister. It also includes the interaction between the total tax administration and individual taxpayers.

The extension of the s 6 responsibility "to every Minister and every officer of any government agency having responsibilities under this Act or any other Act" is also significant in this context. As with the many statutory powers under the TAA 1994 that first vest with the Commissioner personally and then must be delegated,[53] the duty in s 6A(3) is also personal to the Commissioner. Evidentially, it is related to the Commissioner's role as Chief Executive in meeting accountabilities to the Minister. The s 6 responsibility to protect the integrity of the tax system belongs instead to

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"slippery slope" framework" (2008) 29 Journal of Economic Psychology 210. See also Maryann Richardson and Adrian Sawyer "A Taxonomy of the Tax Compliance Literature: Further Findings, Problems and Prospects" (2001) 16 Australian Tax Forum 137 at 204.

[51] This is how the section read at the time. See s 32 of the State Sector Act 1988 (replaced, on 1 July 2014, by s 64 of the Public Finance Amendment Act 2013 (2013 No 50)). The language used in this section is also mirrored in the Richardson Committee Report when it suggests that "the operation of the tax system, and its effective, efficient and economical administration are critically dependent on a strategy of voluntary compliance". Richardson Committee report, Appendix D at [21].

[52] See Richardson Committee report, above n 47, at 60.

[53] TAA 1994, s 7.

all persons making decisions involving the affairs of individual taxpayers, whether or not these decisions relate to the Commissioner's managerial role as Chief Executive. Probably this was done in an effort to encompass IR's wider responsibility to Parliament and taxpayers. This responsibility extends also beyond the Commissioner's lines of delegation and belongs equally to (for example) the Solicitor-General and the Minister of Revenue.

The responsibility in s 6 to protect the integrity of the tax system bears a close relationship to the adjudicative role of the Commissioner in terms of the TAA 1994. The Richardson Committee viewed the role of the Commissioner as divided when undertaking the separate responsibilities of adjudication and management (these were considered to be distinct). Adjudication is defined in the report as "*the exercise of judgment in the application of tax legislation* to the affairs of individual taxpayers or groups/classes of taxpayers *in order to determine liability*".[54] The adjudicative interest of the Commissioner is concerned with the impartial application of the law to taxpayer's affairs, and with ensuring that quantification of tax liability is in accordance with the law.[55] Many of the activities undertaken by IR have an element of adjudication inextricably intertwined with management of the tax system.

Earlier it was discussed how the decisions in case law have dealt with the role of the Commissioner when she exercises her various statutory powers.[56] Some of these decisions undoubtedly weighed on the Richardson Committee when they originally formulated ss 6 and 6A, and therefore shed some light on what may have been envisaged by the Committee in terms of the Commissioner's adjudicative interests under the legislation.

The Richardson Committee were of the opinion that the structural separation of the Commissioner's adjudicative role from the Commissioner's managerial role as Chief Executive was both desirable and necessary from the perspective of tax system integrity. Of particular concern for the Committee, and for which the Committee considers structural separation to be appropriate, are those intersections:[57]

> …where there is *both a high concentration of the adjudicative component and a close proximity to the final quantification of an individual taxpayer's liability*. Particular attention should also be paid

[54] See Richardson Committee report, above n 47, Appendix D at [63].
[55] Appendix D at [22]-[24]
[56] See discussion supra at 2.0.
[57] Appendix D at [66].

> to areas which have a high potential for contention or are performed in an adversarial context. Special structural focus for this intersection will address these concerns.

The Richardson Committee recommended establishing an adjudication function as a separate business unit, distinct from audit and investigation, to act in the final quantification of liability for taxpayers prior to the issue of an assessment (the final adjudication function). The Committee describes the role of the adjudication function as being "to provide a specific and strong focus on the correct and impartial application of the tax law to the affairs of individual taxpayers".[58] This business unit will also be responsible for making binding rulings and operate within the same agency as the rest of the department, ultimately reporting to the Commissioner.[59] Some of the Committee's key recommendations in the context of the revised statutory disputes resolution process in pt 4A of the TAA 1994 were made with this relationship in mind.

It is well worth mentioning that the Richardson Committee thought it important in their report to go further than just implementing the recommendations that were ultimately made. They argued that the separate roles of adjudication and management should be given appropriate statutory recognition, and that a redrafting of responsibilities should take place so that the title of Commissioner is reserved exclusively for her adjudication role in all relevant provisions under the legislation. It was recognised, however, that this change would likely prove difficult, and that there were barriers to its immediate implementation. The Committee noted:[60]

> …much further detailed evaluation and testing are required to arrive at a definition of the precise scope and boundaries of the adjudication functions suitable for long-term legislative expression. The intertwining of elements of adjudication and management which has developed over decades cannot be unravelled overnight. Defining the ultimate boundaries identifying high level adjudication as the subject of special focus is a process that will benefit from detailed analysis and testing together with operational experience of the proposed structure.

What this means is that the allocation of adjudicative responsibilities to a separate business unit was only ever intended to be the first step in a wider project that would seek to articulate the

[58] At 114.
[59] The Disputes Review Unit (previously the Adjudication Unit) was formed by IR in line with the Richardson Committee's recommendation as an important administrative step in the disputes resolution process to serve this final adjudication function. It is part of the Office of the Chief Tax Counsel and based in Wellington – see IR Tax Information Bulletin "Adjudication Unit – its Role in the Dispute Resolution Process" Vol 19 No 10 at 9. For a review of the Disputes Review Unit, see Sarah Miles "The Price We Pay for a Specialised Society: Do Tax Disputes Require Greater Judicial Specialisation?" (2015) 46 VUWLR 361 at 375.
[60] See Richardson Committee report, above n 47, at 57.

statutory parameters of the Commissioner's adjudicative role under the legislation. In the end, this exercise was never completed.

2.3.2.3 A single overriding objective for tax system administration

The adjudicative and managerial aspects of the Commissioner's role were regarded by the Richardson Committee as having "a significant, mutually reinforcing contribution" to make to a single revenue-orientated objective.[61] That single revenue-orientated objective is the duty of the Commissioner that has now been given legislative expression by s 6A(3) as described above.[62]

Each of the respective roles of the Commissioner were perceived by the Committee to have an interest in voluntary compliance and the integrity of the tax system. The managerial interest of her role as Chief Executive was argued, in part, to derive from an appreciation that more cost-effective compliance can be achieved if taxpayers consider the integrity of the tax system is being upheld. This is because more taxpayers will be inclined to voluntarily comply with their tax obligations, which lowers the cost of collection. The adjudicative interest of the Commissioner was instead thought to belong to a narrower subset of the Commissioner's total managerial interests in the integrity of the tax system, and is concerned with the impartial application of tax law to a taxpayer's affairs.[63]

There is a strong argument to be made that this conclusion reached by the Committee (i.e. that the Commissioner's managerial and adjudicative interests function together in the fulfilment of a single objective) was short-sighted.[64] While the Commissioner's newfound powers of care and management in s 6A may have fixed any incompatibility between these sets of responsibilities, it has not resolved the tension between them. There are still intersections in IR's administration of the tax system where statutory powers of decision exercisable by the Commissioner bear a close proximity to the quantification of a taxpayer's ultimate tax liability for which safeguards may not be in place to support the Commissioner's adjudicative interests. One example that is discussed in this chapter is IR's consideration of taxpayer amendment requests.[65] Another is the decision of

[61] Appendix D at [89].
[62] See discussion supra at 3.2.1.
[63] Appendix D at [22] – [24].
[64] In fairness to the Richardson Committee, the comment was made in the context of considering whether an organisational split was appropriate to protect the Commissioner's high level adjudicative functions.
[65] See discussion infra at 6.0.

whether or not to enter into settlement agreements with taxpayers.[66] Even the statutory disputes regime that was recommended by the Richardson Committee with safeguards in mind is often accused of not meeting its objectives in this regard. A frequent criticism of the disputes regime is that the IR investigator acts as both 'player' and 'referee' for the vast majority of the process and this can sometimes lead to perceptions of bias on the part of IR investigators.[67] That this might be a problem for the adjudicative aspects of the Commissioner's role was highlighted in the High Court decision of *McIlraith v CIR* where it was held that:[68]

> The statutory role of [the Commissioner] is a dual role of investigator on the one hand, and prosecutor and adjudicator on the other. This is envisaged by the various IR Acts. The Commissioner is required in terms of those Acts to collect over time the highest net revenue (TAA s 6A(3)). The defendant is given both extensive investigatory powers at s 16–19 of the TAA, and then the power to adjudicate on the taxpayer's liability by amending the taxpayer's assessments (s 113 of the TAA).
>
> *There is a natural and inevitable tension between the two roles* of prosecutor and investigator, which in a judicial context would be unacceptable but which in the context of the New Zealand IR Acts, *is specifically contemplated and permitted*.

The question that needs to be asked from a policy standpoint is obviously not whether it is permitted, but rather whether it *should* be permitted and to what extent. A separate objective for the Commissioner's adjudicative responsibilities could provide IR and the judiciary with a greater sense of how to strike an appropriate balance between managerial and adjudicative interests. Perhaps the Richardson Committee thought that these issues would be addressed at the same time as the proposed rewrite of the tax legislation to reflect the separate functions of adjudication and management. As this did not occur, the single revenue-orientated objective in s 6A(3) is perhaps given more prominence in terms of tax system administration than was ever intended.

The section that follows describes how s 6 enacted in its current form is inadequate as a protection for taxpayers in terms of what they can expect of the Commissioner in her adjudicative role. Legislative reform that instigates a greater level of protection is one way to address the inherent tension between the Commissioner's managerial and adjudicative interests.

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[66] See discussion infra at 5.2.

[67] See also Taxation Committee of The New Zealand Law Society and National Tax Committee of the New Zealand Institute of Chartered Accountants "Joint Submission: The Disputes Resolution Procedures in PartIVA of the Tax Administration Act 1994 and The Challenge Procedures in Part VIIIA of the Tax Administration Act 1994" (Wellington, August 2008) at 6.

[68] *Mcllraith v CIR* (2007) 23 NZTC 21,456 at [77] – [78] (emphasis added).

2.4 Section 6 and protection for taxpayers

For the purposes of the Commissioner's assessment function, it is important that channels of accountability exist for how statutory powers and discretions are exercised in respect of individual taxpayers and at the time they are exercised. As one commentator has noted, it is at this point that the "rhetoric of accountability" must have real meaning for the taxpayer. Processes and standards must exist to ensure that IR is answerable and responsive in fact.[69] Taxpayers who were hoping that the responsibility in s 6 to protect the integrity of the tax system will lead to some form of statutory balancing of taxpayer rights against the Commissioner's powers in s 6A have been left disappointed. At best, it may be said that the section is a codification of the rights that already exist under the statutory processes and in administrative law. The reality though is that s 6 is largely a redundant provision. It is often referred to by IR to lend support to whatever course of action that the department would have in all probability decided to pursue anyway. It has, arguably, no meaningful influence over the way that tax system administration is approached in New Zealand.

In the High Court decision of *Russell & Ors v Taxation Review Authority & Anor*, it was argued by the Commissioner that any failure to meet the standards laid down by s 6 "could lead to a complaint to the Commissioner, or if necessary the Ombudsman… but could not be the foundation of an independent High Court action against the Commissioner for breach". [70] This was accepted by O'Regan J who considered there "is nothing in the statutory wording" of s 6 to suggest that the legislature had an intention to create "rights and obligations akin to those created by the New Zealand Bill of Rights Act".[71]

More recently, the Court of Appeal in *CIR v Michael Hill Finance (NZ) Limited* read down the responsibility in s 6 quite significantly where it was held that:[72]

> …even though the Commissioner is subject to strict standards of conduct because she is exercising highly coercive powers for the purpose of collecting revenue, her responsibility under s 6(1) to protect the integrity of the tax system is not of an absolute nature. The Commissioner is required instead to use her "best endeavours". The aspirational nature of this standard reflects Parliament's recognition of the limitations imposed upon the Commissioner by various factors including the availability of

[69] Denham Martin "Inland Revenue's Accountability to Taxpayers" (2009)14 NZJTLP 9 at 12.
[70] *Russell & Ors v Taxation Review Authority & Anor* (2002) 20 NZTC 17,832 at [46].
[71] At [47]. This view was later upheld by the Court of Appeal. See *Russell & Ors v Taxation Review Authority & ABC* (2003) 21 NZTC 18,255 at [36]. See also *Tannadyce Investments Limited v CIR* (2009) 24 NZTC 23,036 at [63].
[72] *CIR v Michael Hill Finance (NZ) Limited* (2016) 27 NZTC ¶22-056 at [31].

> resources, the prospect of revising an interpretation of relevant statutory provisions, and the inevitability of differing views within the IRD about the interpretation of those provisions…

Section 6(2) sets out a non-exhaustive list of factors that are included within the meaning of "the integrity of the tax system". The only right specified in s 6 that taxpayers have in relation to an assessment made by the Commissioner is for that taxpayer "to have their liability determined fairly, impartially, and according to the law".[73] According to the Court of Appeal decision in *Michael Hill*:[74]

> *[a] taxpayer's only right on an assessment is to have its liability 'determined fairly, impartially and according to law'* (s 6(2)(b)); the Commissioner's correlative duty must be limited to the same three elements when determining liability to tax. The first two duties of fairness and impartiality affirm administrative law principles of natural justice; the third duty refers to legal or substantive correctness.

It is important to understand that a taxpayer's right to have their assessment determined 'according to the law' will only apply when an assessment is actually brought by the Commissioner. There are no guarantees that this right extends to all decision-making that occurs within the wider ambit of the Commissioner's assessment function. The introduction of s 6A into a legislative scheme that relies on taxpayer self-assessment means that the Commissioner cannot be compelled to exercise her discretion to amend an assessment. Moreover, the Commissioner may at her discretion decide to enter into a settlement agreement with taxpayers regarding an amount of tax in dispute. If either of these situations is applicable, the ultimate assessment may legitimately be left to stand at an amount that is at variance with the correct position under the legislation. In other words, the duty of the Commissioner to ensure legal or substantive correctness is undermined by other managerial discretions she exercises. Furthermore, it is the Commissioner who holds all the cards when deciding how to exercise her powers in s 6A. These points are discussed further in parts five and six of this chapter.

A separate issue relates to the duties of 'fairness' and 'impartiality' when the Commissioner has in fact brought an assessment. The trend of cases suggests an erosion of accountability before the judiciary for these duties. The courts will seldom entertain taxpayer challenges to an assessment brought through the procedure in pt 8A of the TAA 1994 for reasons other than the correctness of the assessment.[75] Separately, the courts have placed restrictions on judicial review proceedings as

[73] TAA 1994, s 6(2)(b).
[74] *CIR v Michael Hill Finance (NZ) Limited* (2016) 27 NZTC ¶22-056 at [27].
[75] In *Michael Hill Finance (NZ) Limited* the Court of Appeal held that "correctness may not be the sole consideration when the Commissioner exercises her administrative powers within the TAA at large. But that factor does not

an avenue for examining decisions made by the Commissioner.[76] These issues are beyond the scope of the present chapter.

These observations in respect of the rights of taxpayers expressed in s 6 should give us pause for thought. The Commissioner's adjudicative responsibilities in terms of the TAA 1994 should weigh on all aspects of the Commissioner's broader assessment function. But if the Commissioner's adjudicative role is best represented in s 6 by the right of taxpayers "to have their liability determined fairly, impartially, and according to the law", then a very real concern would be that the Commissioner's managerial interests, supported by s 6A (which applies "notwithstanding anything in the IR Acts"), has subjugated these Commissioner's adjudicative interests. The responsibility to protect the integrity of the tax system in s 6 is, after all, only a 'best endeavours' standard. Even within the context of the ss 6 and 6A decision-making framework discussed earlier, the Commissioner's adjudication role is only partially represented by the factors listed in s 6 and the Commissioner simply might not give any weight to these factors. While this subjugation may be appropriate in a number of situations, it cannot be appropriate in all circumstances. Such a crude codification of the Commissioner's adjudicative role, with the result that taxpayers are given no enforceable rights and all the power is left in the hands of the Commissioner, does little to preserve the integrity of the tax system.

Commentators have questioned whether there is a place for a new legislative setting, one that clearly sets out what is expected of IR's administration of the tax system with reference to a statutory list of independently stated rights to provide a new standard for intervention from the courts.[77] In view of the importance of the Commissioner's adjudicative function to the proper

displace its primacy within the process of challenging her determination of a taxpayer's liability". At [42]. See also *Dandelion Investments Ltd v CIR* (1996) 17 NZTC 12,689. This case establishes the principle that the powers of a hearing authority under s 138P of the TAA 1994 contemplate a right of hearing de novo. The High Court held that a hearing authority "can hear the taxpayer's case without examining in detail the process which led to the Commissioner's assessment. In reaching its own decision as to the appropriate assessment to be made the Authority can cure any defects that might have existed in the Commissioner's assessment". At 12,694.

[76] *Tannadyce Investments Limited v CIR* (2011) 25 NZTC ¶20-103. The Supreme Court in this decision by majority judgement held that judicial review should only be made available for the "extremely rare" situation of where "the taxpayer cannot practically invoke the relevant statutory procedure". At [61].

[77] See Denham Martin "Inland Revenue's Accountability to Taxpayers" (2008) 14 NZJTLP 9 and Geoffrey Clews "Remedies Against the CIR Considered Through a Constitutional Lens" (2014) 72 Taxation Today 13. Currently, s 15B of the TAA 1994 sets out in concise terms the obligations of a taxpayer under the IR Acts. Adrian Sawyer, who individually made a public submission to the Taxpayer Compliance, Penalties and Disputes Resolution Bill 1996 recommending a statutory balancing of obligations with rights for taxpayers, argues that the decision by the government at the time not to enact any form of legislative protection for taxpayer's rights appears to have been ill-conceived. He notes that "[w]hat this failure to legislate fails to recognize is that tax compliance, fundamental to a

functioning of the tax system, this does not seem like an unreasonable proposition. Moreover, it would seem that this is entirely consistent with the exercise originally proposed by the Richardson Committee of rewriting the tax legislation in order to give the Commissioner's adjudicative role appropriate legislative recognition.[78]

2.5 The power to enter into compromise agreements

2.5.1 Initial reluctance to embrace these new powers

The Richardson Committee envisaged that s 6A would entitle the Commissioner to enter into settlement agreements with taxpayers regarding the assessment of tax liability. At first there was a great deal of reluctance on the part of IR to recognise these powers. What emerged were the first signs of the cracks between the Commissioner's new powers of care and management in s 6A and the Commissioner's adjudicative responsibility to determine a taxpayer's liability fairly, impartially and according to the law.

In 1999, a parliamentary inquiry was formed (the FEC Committee inquiry) and was tasked with conducting an inquiry into the powers and operations of IR.[79] The FEC Committee received several submissions that called into question the extent of the Commissioner's powers in s 6A. As noted in the FEC Committee's final report:[80]

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

In light of two Court of Appeal judgments, the FEC Committee recommended that IR review its approach in respect of s 6A. Both the decisions of *CIR v Auckland Gas Company Limited*[81] and

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self-assessment system, is a two-way process necessitating rights and obligations for both the Commissioner and taxpayers to be clearly stated. The rights preferably should be stated in legislative form or at least in an administratively-binding charter of taxpayers' rights". See Adrian Sawyer "A Comparison of New Zealand Taxpayers' Rights with Selected Civil Law and Common Law Countries– Have New Zealand Taxpayers Been 'Short-Changed'?" (1999) 32 Vanderbilt Journal of Transnational Law 1345 at 1378 (footnotes omitted).

[78] See Richardson Committee report, above n 47, at 57.

[79] Finance and Expenditure Committee *Inquiry into the powers and operations of the Inland Revenue Department* (Parliamentary paper 1.3, October 1999).

[80] At 9.

[81] *CIR v Auckland Gas Company Limited (*1999) 19 NZTC 15,027. According to the the judgement of Richardson P "[t]he right to challenge assessments for tax is central to the functioning of the tax system in our society. So, too, are the principles underlying ss 6 and 6A which are designed to protect the integrity of the tax system in an environment where the Commissioner is required to operate within limited resources in the care and management of all the functions committed to the Commissioner's charge". At 15,034.

Chatham Islands Enterprise Trusts v CIR[82] are clear that "the discretion in section 6A should be exercised by the department at both general policy level and at the level of specific tax disputes".[83] It was advised that the department should amend its internal guidelines to reflect that the Commissioner can exercise her discretion on a case-by-case basis and regularly review the exercise of this discretion against these operational policies.

IR's only formal policy on settlements at the time did not permit agreements to be reached in the course of a tax investigation on anything other than a principled basis.[84] Generally speaking, this meant that any final agreement had to be reached in accordance with the law and could not simply 'split the difference'. However, where the issue at hand involved a quantum of tax that may vary according to the facts (such as where questions of valuation or apportionment are concerned) then the department could agree to resolve the dispute. According to the statement:[85]

> [t]he Commissioner has a duty to assess the tax properly payable within the terms of the statutory framework, and in carrying out that duty the Commissioner must be completely impartial. All assessments arising from final agreements must conform to the relevant Inland Revenue Act.

IR released two draft Standard Practice Statements in 1999 in response to the two Court of Appeal decisions discussed above. Here, the department accepted for the first time that it can settle on a compromise basis for tax amounts in dispute under s 6A without strict adherence to the IR Acts.[86] Through the combination of these two statements, IR sought to differentiate between finalising an agreement in tax investigations up to the time of assessment (which must be settled on a principled basis) and settlement of disputed tax litigation post assessment (which may be settled on a compromise basis). The justification provided by IR for this difference of treatment appears to have come from a fixation on the judgment of Richardson P in *Auckland Gas Company Limited* where he held that "…*for litigation purposes* there is no cause to read the legislation as placing any

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[82] *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075.
[83] Finance and Expenditure Committee, above n 79, at 9. See also Mike Lennard "Peace In Our Time" (2008) 4 Taxation Today 29.
[84] Only recently has this official policy been replaced. The updated standard practice statement now clarifies that the prerogative to reach an agreement on a principled basis in the course of a tax investigation does not apply to settlements involving the use of the Commissioner's powers under s 6A. See IR "SPS 15/01: Finalising Agreements in Tax Investigations" Tax Information Bulletin Vol 27 No 9 at 24.
[85] IR "Finalising agreements in tax investigations SPS INV-350" Tax Information Bulletin Vol 10, No 8 (August 1998) at 4.
[86] See Kirsty Maclaren and Mark Keating "The Settlement of Tax Disputes: The Commissioner is Able but not Willing" 15 NZJTLP 323 at 328.

substantial or undue inhibition on his or her powers in this regard".[87] The department's statements, however, were never finalised.

In 2005, IR released its first draft statement on the interpretation of ss 6 and 6A of the TAA 1994. The draft statement shed more light on IR's earlier reluctance to entertain settlement decisions on a compromise basis before an assessment has been issued and litigation commenced. While now accepting it is possible that the Commissioner may employ her powers to determine the appropriate stage at which to enter into a settlement agreement, the precise legal mechanism intended to give effect to this (and, in particular, whether an assessment need be issued on that basis) was not clear. More to the point, the department's effort to distinguish the Commissioner's assessment function from settlement decisions made pursuant to s 6A is entirely understandable given the strong themes from case law that the Commissioner is under an absolute obligation to enforce the law when bringing an assessment.[88] The draft statement, however, came to the conclusion that the practical implementation of settlement agreements would require an assessment to be raised and that this conclusion is implicit in decisions made at the Court of Appeal.[89]

An updated draft of the interpretation statement was released in 2008 and much of the discussion on whether the Commissioner is entitled under s 6A to enter into settlement agreements on a compromise basis with taxpayers was removed in view of clear support from New Zealand case law that this practice is authorised. It was not until nearly 15 years after ss 6 and 6A were originally enacted that the matter was finally settled and interpretation statement 'Care and Management of the Taxes Covered by the IR Acts' – Section 6A(2) and (3) of the Tax Administration Act 1994' (Interpretation Statement IS 10/07) was finalised.[90] The finalised interpretation statement confirms that the Commissioner can enter into compromise agreements in respect of both the litigation process and in the area of debt management under s 6A.[91]

[87] *CIR v Auckland Gas Company Limited (*1999) 19 NZTC 15,027 at 15,034 (emphasis added).
[88] See discussion supra at 2.1.
[89] *Attorney-General v Steelfort Engineering Company Limited* (1999) 1 NZCC 55-055.
[90] IR "Care and Management of the taxes covered by the Inland Revenue Acts" Tax Information Bulletin Vol 22, No 10 (November 2010) at 17 (Interpretation Statement IS 10/07). See also Mike Lennard "Peace In Our Time: Part 2" (2008) 5 Taxation Today 16.
[91] At [151].

2.5.2 Exercising the power to enter into a settlement agreement

As noted in Interpretation Statement IS 10/07, the issue of whether the power to settle litigation on a compromise basis by way of an amended assessment is given legal effect by s 6A or on some other basis still remains a point of uncertainty.[92]

The Court of Appeal decision in *Accent Management Ltd & Ors v CIR (No 2)* dealt with settlements and relied on s 89C(d) as "authority for the Commissioner to issue an assessment which reflects an agreement with the taxpayer rather than the Commissioner's own view of the correct tax position".[93] This interpretation is somewhat strained in this context as the section (belonging to pt 4A dealing with disputes resolution) provides only that the Commissioner is not obliged to issue a notice of proposed adjustment (NOPA) when making an assessment if "the assessment reflects an agreement reached between the Commissioner and the taxpayer…". There is nothing to suggest that the type of agreement envisaged by s 89C(d) should necessarily depart from a principled basis for tax settlements reached in accordance with the department's official policy.[94] Some commentators have also noted the inconsistency between the ability to settle on a compromise basis and the Commissioner's power under s 113 to "amend an assessment as the Commissioner thinks necessary in order to ensure *its correctness*…" (emphasis added).[95]

Irrespective of the precise legal mechanism for doing so, the authority is clear that the Commissioner may enter into a settlement and that the position reached on settlement may be at variance with the Commissioner's own view of the correct position under the law. Once IR has issued an assessment to reflect a settlement agreement, this will generally be the final word on the quantification of tax liability in respect of that individual.[96] What probably matters more is how IR will approach the task.

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[92] At [152].
[93] *Accent Management Ltd & Ors v CIR (No 2)* (2007)23 NZTC 21,336 at [16].
[94] IR "SPS 15/01: Finalising Agreements in Tax Investigations" Tax Information Bulletin Vol 27 No 9 at 24. See Andrew Beck "Compromises with the Commissioner" (2007) 3 NZ Tax Planning Reports 1 where the author notes it seems inconsistent with the underlying premise of the assessment provisions of the TAA 1994 for s 89C(d) to permit the type of adjustment argued for by the Court of appeal. See also Kirsty Maclaren and Mark Keating, above n 86, at 343 where the authors argue s 89C(d) "simply authorises the Commissioner to raise an assessment without completing the disputes procedure, and does not appear to be a separate power of assessment".
[95] See Mike Lennard "Care and Management of Taxes" (2011) 38 Taxation Today 3 at 7 and Kirsty Maclaren and Mark Keating, above n 86, at 343.
[96] See Interpretation Statement IS 10/07, above n 90, at [161].

The Commissioner has recently made public operational guidelines (the settlement guidelines) prepared for internal purposes on the approach IR will take to s 6A settlement decisions that occur prior to filing of a challenge in the Taxation Review Authority or the High Court.[97] Settlement of cases in litigation must instead be jointly approved by Crown Law and IR in accordance with the protocols developed between the Solicitor-General and the Commissioner (dated July 2009).[98] The release of the settlement guidelines is a significant plus from the perspective of transparency from the tax system administrator. Prior to its release, the only indication that taxpayers had in terms of how IR would exercise its power to enter into settlement agreements on a compromise basis came in the form of a non-exhaustive list of factors that the Commissioner might have regard to provided in Interpretation Statement IS 10/07.[99]

The settlement guidelines confirm that the Commissioner's powers in s 6A allow for the settlement of tax disputes, and provide guidance for how to balance the competing principles that must be taken into account when deciding whether to enter into a settlement. In line with the Commissioner's adjudicative responsibilities, the settlement guidelines acknowledge that IR "is under an on-going obligation to apply the law" and that "[t]he starting point is that, where the facts are clear and the law is settled, the Commissioner must apply the law correctly".[100] However, the settlement guidelines also state that "[e]ven when the position is clear, however, there may still be a basis for accepting an outcome which does not fully reflect the strict legal position".[101] Compromise settlement agreements are necessarily made on a basis that does not correspond to the Commissioner's view of the correct tax position. Therefore they reflect a compromise of the Commissioner's adjudicative responsibility in favour of managerial concerns that direct the Commissioner to consider other relevant factors, such as litigation risk.

The settlement guidelines provide a framework of seven factors that are required to be considered before coming to a settlement decision. The factors are listed in order of importance with those that are thought to be more relevant to the decision listed first. The seven factors are: (1) IR's Resources; (2) Likelihood of Success in the Dispute; (3) Promoting Voluntary Compliance; (4)

[97] Available at <https://www.ird.govt.nz/technical-tax/commissioners-statements/operational-guidelines-s6-settlements.html> (accessed 7 December 2016).
[98] The protocol is available at <http://www.ird.govt.nz/technical-tax/general-articles/ga-ir-clo-protocols-agreement.html> (accessed 17 June 2016).
[99] See Interpretation Statement IS 10/07, above n 90, at [157].
[100] At [5], [53].
[101] At [5].

The Integrity of the Tax System; (5) Precedential Value of the Dispute; (6) Quantum of Tax in Dispute; and (7) The Taxpayer's Capacity to Pay. The inclusion and explanation of each of the factors in the settlement guidelines provide a reasonably well-balanced framework for considering whether the decision to enter into a settlement agreement is justified in the circumstances. It does this by first taking the position that a taxpayer's liability should be determined under the substantive taxing provisions by default, and then by discussing the circumstances where a departure from IR's view of the correct position is appropriate. The settlement guidelines recognise that while each of these factors must be considered, they also do not detract from the centrality of ss 6 and 6A:[102]

> …the overriding obligation is to ensure that any settlement decision is consistent with collecting the highest net revenue over time, protecting the tax system's integrity and promoting voluntary compliance by taxpayers. The decision to settle a dispute or not must be consistent with those objectives. This means that factors specific to the settlement proposal not discussed in the Guidelines may still be relevant to the process.

The settlement guidelines serve to illustrate how a separate objective for the Commissioner's adjudicative responsibilities under the legislation could contribute to a better understanding of this important aspect of the Commissioner's role. Without a separately defined objective it is difficult to put in place a strategy to manage the competing interests of adjudication and management. For example, while a settlement may obviously be reached on core tax, it may instead be that an agreement reached in respect of shortfall penalties and use of money interest may be more consistent with the Commissioner's adjudicative responsibilities. The other concern is that, without a separately defined objective, there is no specific delineation of what elements of s 6 are important to consider. Inclusion of taxpayer perceptions of the integrity of the tax system in s 6 has particular significance for the Commissioner's managerial responsibilities as promoting public confidence in the tax system is conducive to promoting voluntary compliance by taxpayers. Naturally, much of the discussion regarding the integrity of the tax system in the settlement guidelines is as a result concerned with aspects of the Commissioner's managerial interest in the integrity of the tax system. Having a separate objective for the Commissioner's adjudicative role would ensure that important elements of this responsibility are not overlooked, and that they are incorporated into the decision making process.

[102] At [53].

2.6 Managerial discretion and resource allocation decisions

Section 6A(2) charges the Commissioner "with the care and management of the taxes covered by the IR Acts and with such other functions as may be conferred on the Commissioner".

Interpretation Statement IS 10/07 explains what the Commissioner considers is meant by the 'care' of taxes: [103]

> …the Commissioner is charged with the "care" of the taxes. This means the Commissioner is responsible for promoting the integrity and effective functioning of the tax system. To discharge this responsibility, the Commissioner must seek to foster the tax system's capacity to function effectively in light of economic, commercial, technological and other changes.

Likewise, the interpretation statement explains what in the Commissioner's view is meant by the 'management' of taxes: [104]

> …the Commissioner is charged with the "management" of the taxes. This means he is responsible for making managerial decisions in the interests of bringing about the efficient and effective administration of the tax system. The "management" responsibility recognises that the Commissioner makes decisions about the allocation and management of his limited resources. This involves the Commissioner exercising judgement as to the resources he allocates, over time, across the various parts of Inland Revenue and to dealing with particular taxpayers. The "management" responsibility also recognises that the Commissioner often exercises judgement as to how he carries out his functions.

As well as authorising the Commissioner to enter into settlement agreements on a compromise basis with individual taxpayers, s 6A(2) is recognised as legislative authority for providing the Commissioner with managerial discretion regarding the allocation and management of the limited resources supplied to the department. This is implicit in the Commissioner's management responsibility.

The recognition that the Commissioner must be able to make sensible decisions in light of competing demands for limited resources is central to Interpretation Statement IS 10/07's main contention that "section 6A(2) and (3) may authorise the Commissioner to act inconsistently with the rest of the IR Acts only to the extent that they otherwise require him to collect the full amount of tax".[105] It is argued by IR that the words "within the law" in s 6A(3) support a view that

[103] At [8].
[104] At [9]. The judgement exercised by the Commissioner may apply to resource allocation decisions both at a strategic level (e.g. the design of case selection procedures for taxpayer audit) and at the level of the individual taxpayer (e.g. deciding whether to accept a taxpayer's amendment request under s 113).
[105] At [11]. For a critique of the conclusion reached in this statement refer Mike Lennard, above n 95, at 5.

"parliament intended to legally constrain the Commissioner's ability to maximise the net revenue collected" and that the Commissioner must "act consistently with the specific constraints and obligations imposed on him by other provisions".[106]

In support of this interpretation, IR seeks to rely on the High Court decision of *Kemp v CIR.*[107] That case involved the Commissioner entering into a number of arrangements with taxpayers to settle outstanding tax liabilities without regard to the requirements of s 414A(5) of the Income Tax Act 1976. This section provided amounts in excess of $50,000 shall not be remitted without prior approval of the Minister. The Commissioner sought to resile from the arrangements when it later became apparent that the requirements of that section had not been met, and the taxpayers applied for judicial review of this decision. Noting that the arrangements in question were entered into before the enactment of s 6A, the Court felt it did not need to express an opinion on whether a power to enter into settlements exists. Instead, the judgment delivered by Robertson J held that:[108]

> …even if a general power to enter into settlements with taxpayers exists, it would not override the specific requirements laid down by Parliament for the exercise of powers of remission in Part XVI of the IT Act. If this were the case, it would be possible for the Commissioner to avoid the limitations on his discretionary power merely by omitting to take one of the steps specified in sections such as s 414A and then claiming recourse to a general power. To allow such an unbridled discretion can not have been the intention of Parliament. I agree with the Commissioner that this would allow through a "back door" that which does not meet the explicit statutory requirements.

In terms of s 6A, IR's contention that the Commissioner can only depart from the requirements of specific provisions where he would otherwise be obligated to collect taxes due regardless of the costs or resources involved forms the basis of what the department views as being some quite important boundary conditions to the exercise of managerial discretion. It is argued that s 6A does not authorise the Commissioner to:[109]

- disregard the requirements for the lawful exercise of powers and discretions conferred by other provisions;
- alter taxpayers' obligations and entitlements;
- issue extra-statutory concessions;
- administratively remedy legislative errors and other deficiencies; or
- interpret provisions other than in accordance with statutory interpretation principles contained in the Interpretation Act 1999 and court decisions.

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[106] At [63].
[107] *Kemp v CIR* (1999) 19 NZTC 15,110
[108] At 15,117.
[109] Interpretation Statement IS 10/07, above n 90, at [65].

In the technical adherence to these limitations, a fine distinction is sometimes drawn between the correct tax position under the legislation and the tax that is ultimately payable as the result of a decision by the Commissioner not to allocate resources to challenge a taxpayer's self-assessment, or even enforce payment of an outstanding tax liability. So, although the Commissioner cannot direct a taxpayer to assess themselves other than in accordance with the substantial taxing provisions set out in the legislation, the Commissioner may make a decision (quite often an overt decision) not to allocate any resources to determining the correct tax position.

One example of this is the decisions made by IR about exactly which periods to investigate. Following the Supreme Court decision of *Penny and Hooper v CIR*,[110] IR announced what in substance amounted to a tax amnesty for those taxpayers who operated similar remuneration structures to the taxpayers involved in that case (provided that a voluntary disclosure was made in respect of the arrangement).[111] The concession for those who elected to pursue this option was that disclosure was only required for the last two years in which a tax position was taken. The decision not to reassess taxpayers for the last four years (i.e. to the extent of the time bar) was stated as being made as a way to promote voluntary disclosure, and to achieve a change in practice. The decision was also stated as being expressly made pursuant to s 6A.

Another example relates to taxpayer amendment requests. If a taxpayer believes there is an error in their assessment but they are outside the four-month period for commencing the statutory disputes process, they are left with no other option than to make a formal request to the Commissioner to exercise her discretion in s 113 to amend the assessment. Where the amendment request results in additional tax payable, and therefore amounts to a voluntary disclosure, the Commissioner has stated that she will always devote resources to considering the request.[112] Taxpayers instead who make an amendment request that is taxpayer favourable can expect to come under considerably more scrutiny before the Commissioner agrees to exercise this discretion. If the requested amendment is anything other than a clear and obvious error, the Commissioner may

[110] *Penny and Hooper v CIR* [2011] NZSC 95, (2011) 25 NZTC ¶20-073.

[111] The case concerned two taxpayers who practiced as orthopaedic surgeons and effectively restructured their practices so that associated entities taxed at the lower company tax rate derived what was in substance personal services income earned by the individuals. After the Court found that the facts in this case amounted to a tax avoidance arrangement, IR published Revenue Alert RA 11/02 advising the taxpaying community of the factors it considers may feature in similar arrangements where tax avoidance is a concern. See IR "Diverting personal services income by structuring revenue earning activities through an associated entity such as a trading trust or a company: the circumstances when Inland Revenue will consider this arrangement is tax avoidance" Revenue Alert RA 11/02 <http://www.ird.govt.nz/technical-tax/revenue-alerts/revenue-alert-ra1102.html>

[112] IR "SPS 16/01 Requests to Amend Assessments" Tax Information Bulletin Vol 28 No 4 at 12 at [47].

well decide (using her managerial discretion) not to allocate the resources needed to determine whether a correct assessment will result from the requested amendment.[113]

2.7 Conclusion

This chapter has revealed some interesting insights into what ss 6 and 6A have come to mean for the Commissioner's assessment function since their enactment.

Section 6A provides the Commissioner with the power to enter into settlement agreements with taxpayers on a compromise basis. In doing so, it permits the Commissioner to depart from her view of the correct tax position under the legislation. Less explicit but by no means less potent is the power in s 6A to exercise managerial discretion and to make a decision not to allocate resources to investigating or disputing a tax position. This effectively allows the Commissioner to walk away from bringing an assessment (or reassessment) citing 'resource constraints'.

Despite the apparent boundary conditions to the exercise of managerial discretion, IR has displayed a willingness to offer what was essentially a de facto tax amnesty for taxpayers in reliance on s 6A. This is one example of the power of managerial discretion and its clear and direct effect on the correctness of an assessment. Taxpayers have also become hugely reliant on the Commissioner's willingness to exercise her discretion under s 113 in circumstances where the statutory periods for initiating a dispute have expired. While the very purpose of this discretion is to ensure that an assessment, which has already been made, can later be amended to ensure its correctness, the Commissioner may choose instead to prioritise managerial concerns and decline to apply the resources needed to exercise this discretion.

While these outcomes may seem entirely appropriate in view of the present-day realities and challenges of tax system administration, what is concerning is that they come unencumbered with any meaningful obligation to factor in the adjudicative interests of the Commissioner in coming to a decision. To ensure managerial discretion is being used appropriately, there is a need to understand when IR is aware of probable non-compliance but chooses not to act because it wants to achieve a particular result or purpose. Equally, there is a need to understand when IR uses its enforcement activity to achieve a particular compliance outcome that is not supported in the law.

[113] At [37] – [57].

With regards to the power to enter into settlement agreements, the Commissioner will necessarily exercise judgement and determine her own view of the correct application of the law before agreeing to settle. What is missing is guidance for when a departure from the Commissioner's responsibility to determine a taxpayer's liability in accordance with the law is appropriate in the circumstances. In these circumstances, it may be the case that the adjudicative component of any decision is simply ignored and managerial concerns around the allocation of resources are given priority. This is a result of the absence of any enforceable standards for the Commissioner to adhere to, and the fact that the Commissioner's adjudicative role is only partially represented by the factors listed in s 6. Within the context of the Commissioner's wider assessment function and the ss 6 and 6A decision-making framework, there is no guarantee that a taxpayer's right "to have their liability determined fairly, impartially, and according to the law" will be given much weight. This is a matter left solely to the discretion of IR.

It is worth reiterating that the Richardson Committee originally felt that more needed to be done in terms of giving the Commissioner's adjudicative role appropriate legislative recognition. Even at the time, this was perceived as being a difficult exercise given the intertwining elements of adjudication and management in terms the Commissioner's role. But just because it would have been a difficult exercise doesn't mean that it shouldn't have been followed through with. The adjudicative responsibilities of the Commissioner are an important component of the responsibility to protect the integrity of the tax system. The integrity of the tax system is a matter that taxpayers are entitled to expect that IR is accountable for outside of the regular departmental and Ministerial system. Perhaps an error made by the Richardson Committee was to assume that the Commissioner in her managerial role as Chief Executive would be similarly vested in the s 6 responsibility to protect the integrity of the tax system.

To ensure that the Commissioner is held accountable for the adjudicative aspects of her role, there is a strong case to be made that this function should be given appropriate legislative recognition. Ideally, this would be accompanied by the statutory set of fundamental taxpayer rights that provide a channel of accountability before a Court or tribunal. Together, these changes would facilitate a reorientation of the structure and operations of IR in order to meet the new requirements of the legislation. Future research could look to articulate more precisely the statutory parameters of the Commissioner's adjudicative role and identify what rights are needed to ensure accountability in this area. There is also room to consider whether IR's

Performance Measurement Framework could be revised to make better use of integrity measures that support the Commissioner's adjudicative role.

If we continue along this current path and its subjugation of adjudicative responsibilities, a bias towards managerial interests (for which there are meaningful channels of accountability to the Minister) could be allowed to develop. This is all the more possible when one considers that the duty of the Commissioner in s 6A(3) represents the overriding objective for the Commissioner's assessment function and is expressed in terms of a single revenue-orientated objective. To quote from the often cited judgment of Turner J in *Reckitt & Colman*,[114] how can we be sure that the Commissioner will "…with Olympian impartiality hold the scales between taxpayer and Crown giving to no one any latitude not given to others"? Without separate specification of the Commissioner's adjudicative function in the legislation, there can be no such assurances.

[114] *Reckitt & Colman (NZ) Ltd vs Taxation Board of Review* [1966] NZLR 1,032 at 1,042.

Chapter 3: The Commissioner's assessment function and the narrow pathways for judicial oversight of administrative action

3.1 Introduction

Taxes are debts due to the Crown that have been levied with the consent of Parliament.[1] A person's tax liability is determined by the substantive taxing provisions of the legislation passed by Parliament. When assessing and collecting taxes that are due, the Commissioner acts as a statutory agent of the Crown.[2] The role of the Commissioner is to act in the quantification of the amount due and her assessment function is merely the machinery used in this process.[3] The Commissioner is also a public sector official. As such, she must adhere to the administrative law principles applicable to all public officials when undertaking to assess and collect taxes due.

These requirements of the Commissioner in this regard are reflected in the legislation. Section 6 of the Tax Administration Act 1994 (TAA 1994) imposes a responsibility on every Minister and every officer having responsibilities under the legislation in relation to the collection of taxes and other functions to "at all times use their best endeavours to protect the integrity of the tax system".[4] The section goes on to list a number of rights and responsibilities belonging to both taxpayers and those administering the law that are within the meaning of "the integrity of the tax system".[5] The most important of these rights and responsibilities for the purposes of the Commissioner's assessment function is the right under s 6(2)(b) for a taxpayer "to have their liability determined fairly, impartially, and according to law".[6]

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[1] The power to levy tax belongs to Parliament alone. See s 22 of the Constitution Act 1986.
[2] *Cates v CIR* (1982) 5 NZTC 61,237.
[3] *Reckitt & Colman (NZ) Ltd vs Taxation Board of Review* [1966] NZLR 1,032. This chapter regards any decision made by the Commissioner that is intimately associated with the final quantification of tax payable by a taxpayer as part of the Commissioner's broader assessment function.
[4] All references in this chapter are to the Tax Administration Act 1994 (TAA 1994) unless stated otherwise.
[5] These include (i) the rights of taxpayers to have their liability determined fairly, impartially, and according to law; (ii) the rights of taxpayers to have their individual affairs kept confidential and treated with no greater or lesser favour than the tax affairs of other taxpayers; (iii) the responsibilities of taxpayers to comply with the law; (iv) the responsibilities of those administering the law to maintain the confidentiality of the affairs of taxpayers; and (v) the responsibilities of those administering the law to do so fairly, impartially, and according to the law.
[6] *CIR v Michael Hill Finance (NZ) Limited* (2016) 27 NZTC ¶22-056. According to the Court of Appeal decision, "[a] taxpayer's only right on an assessment is to have its liability 'determined fairly, impartially and according to law' (s 6(2)(b)); the Commissioner's correlative duty must be limited to the same three elements when determining liability to tax. The first two duties of fairness and impartiality affirm administrative law principles of natural justice; the third duty refers to legal or substantive correctness". At [27].

This chapter explores whether there is sufficient accountability in place through a Court or tribunal system so that taxpayers can have confidence that the Commissioner will adhere to this standard.

Complicating the matter is that the Commissioner is no longer under any absolute obligation to bring an assessment. Since the enactment of s 6A of the TAA 1994 in 1995,[7] the duty of the Commissioner has been to "collect over time the highest net revenue *that is practicable* within the law…".[8] This section authorises the Commissioner to exercise managerial discretion when deciding on how to allocate and manage the limited resources of IR. The Commissioner cannot be compelled to use her discretion under the legislation to amend an assessment,[9] even if it is revealed that there are manifest errors in that assessment.[10] Additionally, the courts have established that s 6A empowers the Commissioner to reach a settlement agreement with taxpayers regarding an amount of tax liability.[11] Any subsequent assessment that is brought by the Commissioner to give effect to the terms of a settlement agreement can be fixed at an amount that is at variance with the Commissioner's own view of the correct application of the law.

A taxpayer's right to have their assessment determined 'according to the law' will therefore only apply when an assessment is actually brought by the Commissioner.[12] This right does not extend to all decision-making that occurs within the wider ambit of the Commissioner's assessment function. It is left to the Commissioner's determination to decide how her powers in s 6A are exercised. The principal concern of the courts is to ensure that those powers are lawfully exercised and the choice to prioritise her managerial interests is one that the Commissioner is specifically empowered to make. The result is that the requirement to determine a taxpayer's liability 'in accordance with the law' only applies when the Commissioner brings an assessment, and this is often left to the Commissioner's discretion.

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[7] Tax Administration Amendment Act 1995 (1995 No 24), s 4.
[8] TAA 1994, s 6A(3).
[9] TAA 1994, s 113.
[10] *Arai Korp Limited v CIR* (2013) 26 NZTC ¶21-014, *Charter Holdings Limited v CIR* (2016) 27 NZTC ¶22-075.
[11] *CIR v Auckland Gas Company Limited (*1999) 19 NZTC 15,027, *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075.
[12] The reference to the rights of taxpayers to have their liability determined 'according to the law' is used here to reflect the role of the Commissioner when undertaking her assessment function. It is a constitutional principle that Parliament alone has the power to levy tax. Statutes impose the charge to tax according to the wishes of Parliament. The Commissioner's assessment function is concerned with quantification of the amount due. See *Reckitt & Colman (NZ) Ltd vs Taxation Board of Review* [1966] NZLR 1,032 at 1,045. The Commissioner's corresponding responsibility in s 6(2)(f) of the TAA 1994 to administer the law 'according to the law' should possibly be construed in broader terms and include the duty to act in accordance with the principles of administrative law. See *New Zealand Fishing Industry Association Inc v Minister of Agriculture and Fisheries* [1988] 1 NZLR 544 at 552.

That the Commissioner can put weight on managerial concerns has created an imbalance between taxpayers and IR. Taxpayers are not afforded the same discretion as the Commissioner under the statutory scheme. They must make an assessment that correctly determines the amount of tax payable if required to do so. Additional penalties and interest may be imposed under the legislation on a taxpayer when they fail in their obligation to correctly self-assess. While the Commissioner is not subject to penalties or interest for a failure to bring a correct assessment, there is instead an expectation that the Commissioner comply with administrative law principles when undertaking her duties.[13] This is represented in s 6(2)(b) by the rights of taxpayers to have their liability determined 'fairly' and 'impartially'.

This chapter identifies a trend in the case law that suggests an erosion of accountability for these duties. Based largely on the statutory scheme of the tax legislation, the courts have proven extremely reluctant to interfere with the Commissioner's duty to enforce the law when bringing an assessment. These decisions emphasise that it is the *correctness* of an assessment that is the paramount standard. Cases where the taxpayer has sought to bind the Commissioner and her assessment function to the standards normally expected of public officials in administrative law have not gained much traction in New Zealand jurisprudence. Interestingly, these decisions have continued to hold even after the enactment of s 6A clarified that the Commissioner is not under any absolute obligation to bring an assessment.

More recently, the courts have placed restrictions on judicial review proceedings as an avenue for examining decisions made by the Commissioner. Taxpayers are required instead to air their grievances using the statutory challenge procedures provided for under pt 8A of the TAA 1994. However, there are serious questions over whether these procedures provide an adequate enough avenue to ensure that IR is answerable for the processes used in arriving at an assessment.

From the decisions examined in this chapter, it is difficult to escape the conclusion that there is a significant question as to whether the Commissioner is truly accountable for her exercise of fair and impartial administration.

The structure of this chapter is as follows:

[13] Bill Birch *Legislating for self-assessment of tax liability* (Treasurer and Minister of Finance, Discussion Document, August 1998) at [3.11].

Part two describes what is meant by the supervisory jurisdiction of the courts and identifies areas where this is relevant to statutory powers exercisable by the Commissioner. It is confirmed that the Commissioner can exercise various statutory powers in a way that leaves an assessment at variance with the correct position under the law, and that the courts will not interfere with these decisions. This is a product of the statutory text that currently allows the Commissioner to prioritise her managerial interests over the expectation that an assessment is correctly quantified in accordance with the law.

Part three examines some aspects of how the courts have traditionally approached the availability of administrative law challenges in tax cases. Based on an interpretation of the statutory scheme of the tax legislation, case law reveals that the courts are reluctant to constrain or place conditions on the exercise of the Commissioner's assessment function. This is because the courts perceive that any interference risks negating an expectation that the Commissioner must be allowed to use her best judgement to enforce the law when bringing an assessment.

Part four examines what recent decisions have meant for the availability of judicial review in circumstances where an assessment has been brought by the Commissioner. The courts have always been circumspect about the availability of these separate proceedings. This is because there is a statutory challenge procedure already provided for in pt 8A of the TAA 1994, and the legislation places restrictions on matters that may be raised outside of this process. Following a decision from the Supreme Court in 2011, the door has now all but been shut on judicial review proceedings.

Part five seeks to determine if there is anything lost in accountability terms where administrative challenges are brought instead through the statutory challenge procedures. A recent decision from the Court of Appeal suggests a hearing authority may only regard the correctness of an assessment as having any importance in challenge proceedings. This is to the detriment of matters that could have otherwise been raised in judicial review.

The trend observed in these decisions has had the effect of seriously undermining the rights of taxpayers to have their liability determined fairly, impartially and according to the law. This chapter concludes with some thoughts on the problem that this represents for the proper functioning of the tax system here in New Zealand.

3.2 Accountability for the exercise of statutory powers

3.2.1 The availability and scope of judicial review

Judicial review provides the means by which the courts exercise control of administrative action. This is sometimes referred to as part of the courts' supervisory jurisdiction. Under s 4 of the Judicature Amendment Act 1994, the High Court may examine the decisions of IR in relation to the exercise (including the proposed or purported exercise or the refusal to exercise) of a statutory power on an application for review. It is outside the scope of this chapter to examine in any level of detail the grounds of review that can be brought in an administrative challenge. In broad terms, these grounds adhere to three distinct heads that are neither exhaustive nor mutually exclusive. These were summarised by Lord Diplock in *Council of Civil Service Unions v Minister for the Civil Service* as (a) illegality; (b) irrationality and (c) procedural impropriety.[14] Sir Robin Cooke in *New Zealand Fishing Industry Association Inc v Minister of Agriculture and Fisheries* states simply that the substantive principles of administrative law require that a decision maker must act "in accordance with the law, fairly and reasonably".[15]

In a taxation context, the scope for using judicial review as an avenue for challenging decisions made by the Commissioner is limited by the statutory scheme of the TAA 1994. Due to the custom-built challenge procedure in pt 8A of the TAA 1994, the legislation places restrictions on the availability of separate proceedings where the decision concerned is a 'disputable decision' as defined. Sections 109 and 114 of the TAA 1994 provide:

> **109 Disputable decisions deemed correct except in proceedings**
>
> Except in objection proceedings under Part 8 or a challenge under Part 8A,—
>
> (a) no disputable decision may be disputed in a court or in any proceedings *on any ground whatsoever*; and
> (b) every disputable decision and, where relevant, all of its particulars *are deemed to be, and are to be taken as being, correct in all respects*.

[14] *Council of Civil Service Unions and others v Minister for the Civil Service* [1985] 1 AC 374 (HL) at 410. The ground of review of 'irrationality' is replaced by a more generic heading of 'unreasonableness' in Phillip Joseph *Constitutional and Administrative Law in New Zealand* (4th ed, Brookers Ltd, Wellington, 2014) at ch 23 – 25. This is because irrationality is seen as synonymous with *Wednesbury* principles of judicial review, whereas developments in case law have meant that the grounds of review have widened since the time that case was decided. At 997.

[15] *New Zealand Fishing Industry Association Inc v Minister of Agriculture and Fisheries* [1988] 1 NZLR 544 at 552. In this case, Cooke P notes that "[t]he threefold duty merges rather than being discrete". At 552. Cooke P has been instrumental to the development of administrative law in New Zealand. For a review of his immense contribution in this area, see Dean Knight "Simple, Fair, and Discretionary Administrative Law" (2008) 39 VUWLR 99.

114 Validity of assessments

An assessment made by the Commissioner is not invalidated—

(a) through a failure to comply with a provision of this Act or another Inland Revenue Act; or
(b) because the assessment is made wholly or partially in compliance with—
(i) a direction or recommendation made by an authorised officer on matters relating to the assessment:
(ii) a current policy or practice approved by the Commissioner that is applicable to matters relating to the assessment.

The definition of disputable decision is found in s 3 of the TAA 1994 and includes an assessment.[16] An assessment may be challenged either by the taxpayer or the Commissioner by commencing proceedings in a hearing authority (either the Taxation Review Authority or the High Court) after complying with all mandatory steps in the statutory disputes resolution procedure. Given the legislative restriction on separate proceedings, the courts are understandably reluctant to entertain judicial review proceedings where an assessment is concerned. There have however always been exceptions where the courts accept that judicial review should remain available. That said, recent developments in case law indicate that the circumstances in which the courts will allow these separate proceedings are far more restrictive than previously thought. This is discussed further in part four of this chapter.

Not all decisions made by the Commissioner are disputable decisions. A particular category that is excluded from the definition of disputable decision relates to those decisions that cannot be challenged through the statutory challenge procedures. Section 138E of the TAA 1994 confirms that no right of challenge exists with respect to decisions made under s 113 of the TAA 1994 (relevant to taxpayer amendment requests)[17] and s 89C of the TAA 1994 (arguably, of relevance to settlement decisions on the basis of *Accent Management*).[18] Any decision made by the

[16] TAA 1994, s 3. Disputable decision is defined to include an assessment and a decision of the Commissioner under a tax law, except for a decision (i) to decline to issue a binding ruling; or (ii) that cannot be the subject of an objection; or (iii) that cannot be challenged; or (iv) to issue a notice of proposed adjustment, a disclosure notice or statement of position, or a challenge notice under the mandatory (pre-litigation) disputes resolution regime in pt 4A of the TAA 1994.
[17] *Charter Holdings Limited v CIR* (2016) 27 NZTC ¶22-075.
[18] *Accent Management Ltd & Ors v CIR (No 2)* (2007) 23 NZTC 21,336. The Court of appeal decision dealt with settlement decisions and relied on s 89C(d) of the TAA 1994 as "authority for the Commissioner to issue an assessment which reflects an agreement with the taxpayer rather than the Commissioner's own view of the correct tax position". At [16]. Whether this conclusion can be reached based on the wording and purpose of s 89C(d) however has been questioned by a number of commentators. See Andrew Beck "Compromises with the Commissioner" (2007) 3 NZ Tax Planning Reports 1 where the author notes it seems inconsistent with the underlying premise of the assessment provisions of the TAA 1994 for s 89C(d) to permit the type of adjustment

Commissioner under either of these sections may well therefore become the subject of judicial review.

Where judicial review does remain an option, case law has confirmed that the courts will seldom second guess actions taken by the Commissioner. Typical of this are the comments of Randerson J in the High Court decision of *Raynel & Anor v CIR*.[19] This case involved a judicial review of the Commissioner's decision to reject repayment offers by taxpayers in relation to the recovery of tax liability outstanding. Per Randerson J:[20]

> …I wish to say a word about the availability of judicial review in cases such as this. Given the broad managerial responsibilities given to the Commissioner and officials of the Inland Revenue Department, *this court will be slow to interfere with the proper exercise of their statutory duties and discretions* in relation to the recovery of outstanding taxation revenue. Decisions in this field essentially involve the exercise of judgment within the statutory framework and this court will not lightly interfere with decisions of that kind.
>
> It is important to emphasise the proper function of judicial review. It is to ensure, in a broad sense, that statutory powers and duties are exercised in accordance with law. In the present context, the grounds for review will generally be very limited. If the decision-maker has called to attention all mandatory considerations and has not made any material errors of law, then this court will be unlikely to intervene unless the decision can be shown to be such that no reasonable decision-maker could have made it. It must be emphasised that *this court does not, on judicial review, simply substitute its own view for that of the decision-maker* and proper weight will be given to the experience, knowledge, and judgment of the departmental officer or officers concerned.

The focus of judicial review is normally the manner in which a decision is made and not the merits of the decision. Even in circumstances where the processes followed by the decision-maker are found to be flawed and do not uphold Parliament's purposes for the statutory power of decision, there is no guarantee of relief. This is left to the discretion of the courts. The most common form of remedy is an order that sets aside the decision and an order referring the matter back to the Commissioner for reconsideration. Reconsideration need not result in a different outcome.

The fact that judicial review is principally concerned with the lawfulness of decisions made by the Commissioner exposes a more serious accountability concern. This arises from the statutory articulation of the responsibilities and duties of the Commissioner in ss 6 and 6A of the TAA

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argued for by the Court of appeal. See also Kirsty Maclaren and Mark Keating "The Settlement of Tax Disputes: The Commissioner is Able but not Willing" 15 NZJTLP 323 at 343 where the authors argue s 89C(d) "simply authorises the Commissioner to raise an assessment without completing the disputes procedure, and does not appear to be a separate power of assessment".

[19] *Raynel & Anor v CIR* (2004) 21 NZTC 18583 at [73].

[20] At [56].

1994.[21] As discussed in the introduction, s 6(2)(b) provides for the rights of taxpayers "to have their liability determined fairly, impartially, and according to law". However, in reliance on her managerial discretion in s 6A, the Commissioner may legitimately choose to prioritise her managerial interests over the rights of taxpayers expressed in s 6. This is a product of the legislative text, and in particular the wording of s 6A which applies "notwithstanding anything in the IR Acts". In contrast, s 6 does not create any enforceable standards against which the Commissioner may be held accountable,[22] nor does it provide any guidance as to what weight should be given to each of the factors listed. Furthermore, the responsibility in s 6 to protect the integrity of the tax system is stated to be only a "best endeavours" obligation. It cannot be elevated to the point of a statutory requirement.

While this result may seem unfair in many respects it is nevertheless an outcome that is specifically contemplated by the legislation. Moreover, it is not without foundation. Common sense suggests that a degree of managerial discretion is needed to cope with the present-day realities and challenges of tax system administration. However, without judicial oversight of the use of managerial discretion, it may be there is an inherent and inevitable bias for IR to use its managerial discretion to meet its compliance objectives. The risk is that this may come at the expense of tax system integrity.

3.2.2 Judicial review and managerial decisions

The Commissioner is empowered to make decisions regarding the allocation and management of the limited resources supplied to the department using her managerial discretion under s 6A of the TAA 1994. This is implicit in the Commissioner's care and management responsibility. In Interpretation Statement IS 10/07, IR claims that this power "may authorise the Commissioner to act inconsistently with the rest of the IR Acts only to the extent that they otherwise require him to collect the full amount of tax".[23] It is argued that the words "within the law" in s 6A(3) support a view that "parliament intended to legally constrain the Commissioner's ability to maximise the net

[21] IR argues that these sections function together as "a 'legislative package' to provide the framework within which the Commissioner administers the tax system". See IR "Care and Management of the taxes covered by the Inland Revenue Acts" Tax Information Bulletin Vol 22, No 10 (November 2010) at [56] (Interpretation Statement IS 10/07).

[22] *Russell & Ors v Taxation Review Authority & Anor* (2002) 20 NZTC 17,832 at [46] – [47], *Review Authority & ABC* (2003) 21 NZTC 18,255 at [36], *Tannadyce Investments Limited v CIR* (2009) 24 NZTC 23,036 at [63], *CIR v Michael Hill Finance (NZ) Limited* (2016) 27 NZTC ¶22-056 at [31].

[23] Interpretation Statement IS 10/07, above n 21, at [11]. For a critique of the conclusion reached in this statement refer Mike Lennard "Care and Management of Taxes" (2011) 38 Taxation Today 3 at 5.

revenue collected" and that the Commissioner must "act consistently with the specific constraints and obligations imposed on him by other provisions".[24]

These broad contentions help form the basis of what the department views as being some quite important boundary conditions to the exercise of managerial discretion. It is argued that s 6A does not authorise the Commissioner to:[25]

- § disregard the requirements for the lawful exercise of powers and discretions conferred by other provisions;
- § alter taxpayers' obligations and entitlements;
- § issue extra-statutory concessions;
- § administratively remedy legislative errors and other deficiencies; or
- § interpret provisions other than in accordance with statutory interpretation principles contained in the Interpretation Act 1999 and court decisions.

In the context of the supervisory jurisdiction of the courts, these so-called boundary conditions to the exercise of managerial discretion can actually become a strength. It seems unlikely that resource allocation decisions made by the Commissioner using her managerial discretion in s 6A, without invoking another statutory provision, would ever become the subject of judicial review proceedings.[26] By claiming as the Commissioner does in Interpretation Statement IS 10/07 that the managerial discretion in s 6A does not confer on the Commissioner any general dispensing or suspending power, it is difficult for a court to review the Commissioner's decisions. In contrast, if the Commissioner were instead entitled (using her powers of care and management) to lawfully alter a taxpayer's obligations and entitlements under the legislation, then it may well be that these decisions would be reviewable through a process of implicating some other statutory provision.[27]

Support for such a view can be found in the comments of Richardson J in *Brierley Investments Limited*.[28] The facts of this case involved a decision by the Commissioner to conduct an

[24] At [63].
[25] At [65].
[26] Noting also that s 6A of the TAA 1994 is not itself listed in s 138E of the TAA 1994 as being a matter "left to the discretion, judgment, opinion, approval, consent, or determination of the Commissioner". It may therefore be defined as a disputable decision that must in any case be challenged through the procedure in pt 8A of the TAA 1994.
[27] See Phillip Joseph *Constitutional and Administrative Law in New Zealand* (4th ed, Brookers Ltd, Wellington, 2014) at 1211.
[28] *Brierley Investments Limited v CIR* (1993) 15 NZTC 10,212.

investigation into the taxpayer's affairs on a basis that did not correspond with certain formulas for calculating deductions that had been accepted and used in the past. Richardson J held that:[29]

> Whether or not the Commissioner can be held bound if such an understanding is established depends on the statutory regime under which the Commissioner is acting. As we have seen the Commissioner does not have a general dispensing or suspending power. *Any failure on the Commissioner's part to assess or to pursue recovery in a particular case is simply that, a failure to act. It makes no difference that it may arise from resource constraints.* It is not a waiver of liability. It confers no rights on taxpayers. Certainly there is nothing in the New Zealand legislation to justify the conclusion that the Commissioner may elect not to assess taxpayers or may elect to charge them with less tax than throughout the assessment and re-assessment period the Commissioner considers due.

This case was decided before the enactment of s 6A. As discussed in the next section of this chapter, the courts have continued to hold to a view that it would be inappropriate to interfere with the Commissioner's assessment function even after the enactment of s 6A confirmed she is no longer under any obligation to assess. The issue is that there is sometimes a fine line between exercising a general dispensing or suspending power, and relying on managerial discretion to achieve the same result because of 'a failure to act'. At least, with the former, there is a stronger case that it should fall within the supervisory jurisdiction of the courts.

3.3 Administrative law and the Commissioenr's assessment function

3.3.1 The Court of Appeal in *Lemmington Holdings*

In a landmark decision, the scope for using judicial review to examine an assessment made by the Commissioner was considered by the Court of Appeal in *CIR v Lemmington Holdings Limited*.[30]

Lemmington Holdings acted as agent to a group of investors and promoted a plan that allowed the investors to claim the benefit of certain export incentives. The Commissioner initially approved the plan and subsequently issued special tax code certificates to the investors reflecting this approval. Later, after an investigation, the Commissioner came to the conclusion that the arrangement was not effective for tax purposes. The Commissioner then advised the Lemmington Holdings of the decision to withdraw his approval of the plan and the special tax code certificates that had been issued. In response, Lemmington Holdings commenced judicial review proceedings against the Commissioner. It was claimed that these decisions were based or irrelevant reasons

[29] At 10,216. Arguably now the Commissioner does have a general dispensing or suspending power by virtue of the power in s 6A to enter into compromise agreements, although this in itself is unlikely to be enough to alter a finding that enforceable rights do not accrue to the taxpayer as a result of a "failure to act".
[30] *CIR v Lemmington Holdings Limited* (1982) 5 NZTC 61,268 at 61,272.

and were arbitrary and unlawful. The decision of the High Court was appealed by the Commissioner.

The majority decision of the Court of Appeal (delivered by Richardson J) placed special importance on the statutory scheme of the tax legislation in coming to a decision. His honour held that the Judicature Amendment Act 1972 could not be invoked as a prior restraint to bind the Commissioner's assessment function, as the act of an assessment is an imperative statutory duty under the scheme (and therefore not amenable to judicial restraint). This was likened to the proposition that "estoppel cannot be raised against the operation of a statute imposing a duty of a positive kind".[31] In summary, his honour stated that:[32]

> We are satisfied that in making an assessment under this statutory scheme the Commissioner is not exercising an enjoinable power or right in the sense contemplated under the *Judicature Amendment Act*. When he is discharging his statutory assessing function under sec. 19 and the associated provisions *he is performing a duty imposed on him in imperative and unconditional terms.*

Cooke J, in the minority, did not agree that the mandatory nature of the Commissioner's assessment function should necessarily prevent the court from intervening. Per Cooke J:[33]

> [I]n my opinion, it is at least reasonably arguable that the court may in its discretion grant relief against a proposed exercise of the assessment function if the taxpayer can show that the Commissioner proposes to act either on a fundamentally wrong legal basis or contrary to some binding requirement of natural justice and fairness…

The difference between the majority and the minority in this instance exposes the conflict between the Commissioner's assessment function and accountability for the requirement to adhere to the principles of administrative law. Because the Commissioner's assessment function was mandatory in terms of the statutory scheme, the majority were of the opinion that judicial review was not permitted.[34] They did recognise, however, that there was "a distinction between challenging the

[31] Citing with approval the decision of *Maritime Electric Co Ltd v General Dairies Limited* [1937] AC 610. See *CIR v Lemmington Holdings Limited* (1982) 5 NZTC 61,268 at 61,275.
[32] At 61,273 (emphasis added).
[33] At 61,278.
[34] Interestingly, the enactment of s 6A and the codification of self-assessment have since changed the mandatory nature of the Commissioner's duty to bring an assessment. However, the courts have continued to hold to a view that the judiciary should not interfere with the bringing of an assessment by the Commissioner. See discussion infra at 3.2.

correctness of an assessment and impugning the legitimacy or validity of the process adopted in making a purported assessment".[35] In this regard, the majority held:[36]

> The legitimacy of the process by which a purported assessment was arrived at or a proposed assessment is to be made may perhaps be susceptible to challenge in other proceedings on traditional administrative law grounds.

Despite this acknowledgement, it is asserted that the significance that the majority in *Lemmington Holdings* attached to the statutory scheme of the tax legislation would hinder the development of administrative law in a number of later decisions. This is discussed below in the context of legitimate expectation and consistency challenges.

3.3.2 Legitimate expectation

A legitimate expectation in administrative law is said to trigger the requirements of natural justice or fairness.[37] New Zealand has seen a number of cases that have sought to bind the Commissioner's assessment function on the grounds of legitimate expectation. These cases are a clear example of the conflict between what is expected of the Commissioner in administrative law terms and what is expected of the Commissioner's assessment function in terms of the statutory scheme. Despite numerous challenges, it is difficult to point to even one claim based on legitimate expectation that has succeeded in New Zealand in a taxation context.[38]

In the High Court decision of *Brierley Investments Limited v CIR*, the taxpayer (BIL) sought judicial review of the Commissioner's decision to undertake a broad investigation of its affairs.[39] BIL argued that it had a legitimate expectation regarding its use of certain formulae to calculate appropriate deductions of interest and expenses and its classification of certain share disposals as income or capital because it relied on representations that such treatment would be accorded. The Court sought to apply the majority decision in *Lemmington Holdings* to arrive at the conclusion that investigative decisions made by the Commissioner in the course of her duties were amenable to judicial review. According to that decision:[40]

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[35] At 61,273.
[36] At 61,273.
[37] See Joseph, above n 14, at 1029.
[38] *Chatfield & Co Limited v CIR (No 2)* (2016) 27 NZTC ¶22-072 at [17].
[39] *Brierley Investments Limited v CIR* (1993) 15 NZTC 10,075.
[40] At 10,077.

> In general terms, the Commissioner is under a mandatory statutory obligation to collect income tax. …it follows that income tax assessments made by the Commissioner are not open to judicial review under the Judicature Amendment Act (No 2) 1972, relating as it does merely to powers. The assessment itself is to be challenged by the statutory objection and hearing procedure. However, there is a distinction between ultimate assessment and aspects of process involved. In the course of reaching an assessment, the Commissioner commonly exercises various discretions. An example is a decision to use sec 16 and 17 to require information; conceded as possibly amenable to review. (While the label "discretion" commonly is used, some such decisions perhaps are better described as the making of judgments.) Such ancillary discretionary or judgmental decisions are amenable to judicial review. Indeed, it may be that the whole process of assessment is subject to judicial review under accepted administrative law principles relating to excess or abuse of power. As a major aspect, in at least the former "discretionary" case, the Commissioner in the assessment process must be amenable to review based on "unfairness" in its administrative law sense; including within that term the defeat of legitimate expectations. The Commissioner can have no unique immunity from consequences of acting outside powers or unlawfully.

The taxpayer lost and subsequently appealed the decision. The Court of Appeal in *Brierley Investments Limited v CIR* was divided on the issue of whether the taxpayer's substantive legitimate expectation claim should be dismissed.[41] In dismissing the claim, Richardson J expanded on his view that challenges such as these are inherently restricted by the statutory scheme. His honour observed that the audit function was "central to the assessment and re-assessment regime" and that "the Act itself contemplates that subject only to the time limit the Commissioner will revisit and re-assess so as to ensure the correctness of assessments".[42] In summary of his findings, Richardson J concluded that:[43]

> In short, where, as here, the Act calls for the Commissioner to exercise judgment in quantifying the statutory liability for taxation with very narrow and limited powers to provide relief from that liability and where, as here, the Act provides for assessment within a 4-year limitation period irrespective of whether and how the assessments have already been made, there can be no estoppel or waiver since it is envisaged that any statutory power of the Commissioner may be re-exercised from time to time up to the 4-year limit so as to ensure the correctness of the assessment.

Casey J, on the other hand, saw no essential distinction between the New Zealand Commissioner's responsibility to "administer" the tax system and the obligations imposed on the United Kingdom

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[41] *Brierley Investments Limited v CIR* (1993) 15 NZTC 10,212.

[42] At 10,216. In further support of this point, Richardson J held that "[t]he Commissioner cannot contract out of the responsibilities imposed by the Act. He cannot tie his hand. He cannot create no go areas for himself. To confine in advance the scope of any future investigation would be to derogate from the generality and breadth of the Commissioner's powers conferred in aid of the statutory functions". At 10,216.

[43] At 10,217. While earlier case law had focussed on the imperative nature of the Commissioner's statutory duty to assess, these comments are significant as they indicate that judicial analysis of what aspects of the statutory scheme are significant has perhaps later shifted. This is important as the obligation to assess no longer rests with the Commissioner and taxpayer self-assessment has become the norm since this case was decided, however the Commissioner's discretion to at any time amend an assessment "to ensure its correctness" has remained a persistent feature of the legislative scheme. See s 113 of the TAA 1994.

Commissioners for the "care and management" of the collection of taxes. In reliance on a line of English cases,[44] Casey J was disposed to accept that the Courts may intervene by way of judicial review in the process leading up to an assessment where the Commissioner proposes to act inconsistently with a taxpayer's legitimate expectation and an appropriate case has been stated.[45]

The Court of Appeal decision of *CIR v New Zealand Wool Board* would later affirm the above judgment of Richardson J.[46] This decision provides that "any scope for invoking legitimate expectation is necessarily limited by the scheme and purpose of the income tax legislation" and that "legitimate expectation cannot frustrate an honest appraisal by the Commissioner of the income tax liability of the taxpayer by means of an assessment of that liability".[47] Crucially, this case was decided in relation to transactions entered into prior to 10 April 1995 (being the date that ss 6 and 6A of the TAA 1994 came into force). Much has been made since of what effect the enactment of specific care and management powers in s 6A has had on the availability of legitimate expectation, and whether New Zealand should follow an approach that is consonant with the United Kingdom.[48]

An opportunity for the Court of Appeal to consider legitimate expectation under the new legislative setting came in the decision of *CIR v Ti Toki Cabarets (1989) Limited & Ors*.[49] The facts of this case involve a married couple (Mr and Mrs H) that traded as property developers buying and selling real estate. After separating in 1993, the couple agreed to settle matrimonial property claims whereby Mrs H would transfer to Mr H her shareholding and interests in a group of companies in return for Mrs H receiving ownership of some of the properties belonging to the group. The terms of the settlement were negotiated in reliance on a policy statement prepared by IR that dealt with GST and matrimonial property settlements. The Commissioner later assessed the companies in the

[44] *Re Preston* [1985] 1 AC 835 (HL), *R v Board of Inland Revenue, ex parte MFK Underwriting Agencies Ltd* [1990] 1 WLR 1545 (QB), *R v Commissioners of Inland Revenue, ex parte Unilever Plc* (1999) 68 TC 205 (CA). Typical of this approach are the comments of Lord Templeman in *Preston*, where he held that "[t]he court can only intervene by judicial review to direct the Commissioners to abstain from performing their statutory duties or from exercising their statutory powers if the court is satisfied that 'the unfairness' of which the applicant complains renders the insistence by the commissioners on performing their duties or exercising their powers an abuse of power by the commissioners". At 864.

[45] At 10,225. The third judgment of McKay J preferred not to consider "whether the New Zealand legislation contains special features which prevent the Commissioner from being bound by the creation of legitimate expectation", deciding instead to leave that question open until a case stated would be determinative. At 10,230.

[46] This judgment itself delivered by Richardson P. See *CIR v New Zealand Wool Board* (1999) 19 NZTC 15,476.

[47] At [62]

[48] See Paul Quirke "Estopping the Commissioner: New Possibilities for Legitimate Expectation in New Zealand Tax Law" (2004) 10 NZJTLP 11 and Nicola Williams "The Scope for Invoking Legitimate Expectation in the New Zealand Tax Context" (2005) 11 NZJTLP 92.

[49] *CIR v Ti Toki Cabarets (1989) Limited & Ors* (2000) 19 NZTC 15,874.

group for GST on the transfer of the properties and the taxpayers challenged. They argued this was a breach of legitimate expectation as the assessment was inconsistent with the position reached under the stated policy.

The High Court refused to grant the Commissioner's application for orders to stay or dismiss the review proceedings and the Commissioner appealed. The Commissioner in his submissions sought to rely on *New Zealand Wool Board* and argued that the new provisions of ss 6 and 6A "do not warrant departure from the previous New Zealand position in favour of the English position set out in *Preston*, whereby notions of legitimate expectation and estoppel are said to be relevant to the assessment function".[50] The Court of Appeal did not rule out a challenge based on estoppel or legitimate expectation, preferring instead to stress that the statutory challenge procedures be given priority for contesting decisions that go to the very correctness of an assessment.[51] Per Gault J:[52]

> The decision which is sought to be reviewed is the ruling of the Commissioner that the TIB does not apply to supply by the companies. That was a substantive decision and an essential plank in the reasoning underpinning the assessment. It can be, and must be, contested in the challenge proceedings and essentially on the same ground — perhaps estoppel which in the circumstances is denial of a legitimate expectation in another guise.

Although appearing to leave the door open to these sorts of administrative challenges, the Court of Appeal decision in *Westpac Banking Corporation v CIR* has clarified that the enactment of ss 6 and 6A was not intended to interfere with the Commissioner's statutory assessment function.[53] The Court regarded as still applicable under the legislative scheme the prevailing view prior to the enactment of ss 6 and 6A that "the Commissioner was required to apply the law and was thus unable by contract or the creation of an estoppel (or a legitimate expectation for that matter) to preclude resort to the statutory processes". [54]

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[50] At [31]. See also *R v IR Commrs; ex parte Preston* [1985] AC 835.
[51] At [40].
[52] At [42].
[53] *Westpac Banking Corporation v CIR* (2009) 24 NZTC 23,340.
[54] At [55], [84]. The Court's reasoning here it seems was influenced by the enactment of the binding rulings regime at the same time as the enactment of ss 6 and 6A of the TAA 1994. It was held that the existence of the binding rulings regime creates a clear implication that this is the only basis by which IR can be bound by the views it expresses about the application of the tax law. Several commentators have criticised the Court's reasoning given that the process of having IR agree to issue a ruling is necessarily a complex, costly and time-consuming exercise, suited only to a small number of high value transactions (in the case of a private ruling). See Paul Quirke, above n 48, at 28 and Shelley Griffiths "Revenue Authority Discretions and the Rule of Law in New Zealand" in Chris Evans, Judith Freedman and Richard Krever (eds) The Delicate Balance – Tax, Discretion and the Rule of Law (IBFD, Amsterdam, 2011) at 160.

The above decisions indicate that the courts are reluctant to bind the Commissioner to accepted standards of administrative law in terms of the act of bringing an assessment. In an extension to this trend, the recent Court of Appeal decision in *Chatfield & Co Limited v CIR* blurs the line in the distinction traditionally made by the courts when considering an administrative challenge between the assessment itself and the process employed in bringing an assessment.[55]

The *Chatfield* case involved the Commissioner's decision to issue an information request notice under s 17 of the TAA 1994 to a tax agent (Chatfield) to provide information on the tax affairs of 15 Korean taxpayers carrying on business in New Zealand. This was done in order to meet its exchange of information obligations to the Korean National Tax Service under a double tax agreement. Chatfield argued that the s 17 notice issued was in contravention to an operational statement released by IR (OS 13/02).[56] Among other things, para [73] of OS 13/02 deals with requests for certain information from tax agents and provides that:

> These requests will only be made in limited circumstances and only where it is considered the transactions or arrangements are likely to involve tax avoidance or evasion, or other offences leading to prosecution for offences. Before making such requests to tax agents, investigators must first take all reasonable steps to obtain the necessary or relevant information from the taxpayer(s) or other third parties.

Chatfield claimed that OS 13/02 gave rise to a legitimate expectation that the investigators at IR will take all reasonable steps to obtain the information from the Korean taxpayers themselves or other third parties before issuing a s 17 notice to the relevant tax agent. It was also pleaded that the Commissioner failed to appropriately take into consideration the terms and operational procedure outlined in OS 13/02 before issuing the notice. The Court of Appeal rejected these claims. In arriving at this conclusion, the Court placed significant weight on the Court of Appeal decision of *Dandelion Investments Limited v CIR*.[57] This case rejected taxpayer claims of legitimate expectation in the context of a policy statement issued by IR on how the Commissioner will apply the anti-avoidance provisions of the TAA 1994. Applying an earlier decision of the Privy Council,[58] it was held in *Dandelion* that statements of policy could not frustrate the

[55] *Chatfield & Co Limited v CIR* (2017) 28 NZTC ¶23-015. See discussion supra at 3.1.
[56] IR "Operational Statement OS 13/01: The CIR's Search Powers" Tax Information Bulletin Vol 25, No 8 (September 2013) at 18.
[57] *Dandelion Investments Limited v CIR* (2003) 21 NZTC 18,010.
[58] *O'Neil & Ors v CIR* (2001) 20 NZTC 17,051.

Commissioner's statutory duty to reassess the taxpayer in any case where the anti-avoidance provisions apply. According to the Court of Appeal in *Dandelion*:[59]

> In the end this ground fails for the reasons articulated by the Privy Council, reflecting as they do earlier observations of this Court as to the limited scope for application of the principle of legitimate expectation to confine the Commissioner in the exercise of statutory duties in relation to assessment functions… The Commissioner cannot act in a manner incompatible with statutory powers which must be exercised to a specified end.

The Court of Appeal in *Chatfield* relied on the above passage to conclude that "[t]he same underlying rationale must apply equally to the exercise of her statutory powers".[60] This was to include the power to issue s 17 notices. Importantly, the previous decisions on legitimate expectation were reached based on an interpretation of the Commissioner's duty to bring an assessment in the context of the statutory scheme of the tax legislation. This represents a specific exception in a taxation context to the standards normally expected of public officials in administrative law. Whether it is correct to extend the protection afforded by the statutory scheme to all corners of the Commissioner's assessment function (i.e. beyond the act of bringing an assessment) is less clear. In this instance, the Court of Appeal viewed the legitimate expectation claim as an impairment on the Commissioner's power to demand information. Without concluding that the decision is wrong, it should be noted that OS 13/02 does not appear to restrict the breadth of the s 17 power. Rather, it pertains to the process that will be followed before a notice is issued. The judgment fails to adequately deal with this distinction.

3.3.3 Duty of consistency

The importance of the due and impartial administration of tax statutes was made abundantly clear in the judgment of Turner J in *Reckitt & Colman (NZ) Ltd vs Taxation Board of Review.*[61] According to that decision:[62]

> It is of the highest public importance that in the administration of such statutes every taxpayer shall be treated exactly alike, no concession being made to one to which another is not equally entitled. This is not to say that in cases where the statute has so expressly provided the Commissioner has not a discretion to differentiate between cases -- but this is in my opinion only to be done when provision for it is expressly, or it may be impliedly, made in the legislation. Where there is no express provision for discretion, however, and none can be properly implied from the tenor of the statute, the

[59] *Dandelion Investments Limited v CIR* (2003) 21 NZTC 18,010 at [75].
[60] *Chatfield & Co Limited v CIR* (2017) 28 NZTC ¶23-015 at [16].
[61] *Reckitt & Colman (NZ) Ltd vs Taxation Board of Review* [1966] NZLR 1,032.
[62] At 1,042.

> Commissioner can have none; he must with Olympian impartiality hold the scales between taxpayer and Crown giving to no one any latitude not given to others. Omne capax movet urna nomen.

Despite these comments, successfully mounting a consistency challenge in the courts against an assessment brought by the Commissioner is something that is hard fought.[63]

Decisions such as *Miller and O'Neil v CIR* have confirmed that the Commissioner is entitled to change her mind concerning an interpretation of the tax law if she comes to the conclusion that the former approach was incorrect.[64] Taking it even further, the decision suggests that the Commissioner is in fact "under a statutory obligation to do so".[65] This is seen as consistent with the duty implied by the statutory scheme that the Commissioner must apply the law according to her own honest judgement.

In the context of settlement decisions, the Court of Appeal in *Accent Management Ltd & Ors v CIR* were asked to consider a consistency challenge brought by taxpayers.[66] The taxpayers were part of a group of investors that challenged the Commissioner's assessments and lost at trial. The taxpayers then sought to argue that the Commissioner was required to assess them at an amount that was consistent with the assessment of other investors in the same scheme that had settled with the Commissioner before the trial had begun. The taxpayers bid was rejected by the Court.[67]

Separately, there have been a number of instances where consistency challenges have been rejected in judicial review proceedings in part because of the presumed validity of assessments provided under ss 109 and 114.[68]

In the recent decision of *Michael Hill Finance (NZ) Limited v CIR*,[69] the Court of Appeal rejected that the Commissioner was under a duty of consistency regarding the treatment or interpretation of tax legislation as between taxpayers when undertaking her assessment function. After reviewing

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[63] In the context of administrative law, Joseph reports that "a failure to act consistently may overlap the grounds of *Wednesbury* unreasonableness, error of law for misinterpretation of relevant criteria, taking into account irrelevant considerations, substantive unfairness, legitimate expectation or acting beyond a decision-maker's delegated powers". See Joseph, above n 14, at 956.
[64] *Miller and O'Neil v CIR* (1993) 15 NZTC 10,187.
[65] At 10,203.
[66] *Accent Management Ltd & Ors v CIR (No 2)* (2007) 23 NZTC 21,366.
[67] The Court held that the terms of a settlement agreement are given effect by an amended assessment. However, the power to enter into a settlement is somewhat unique in the context of the Commissioner's assessment function. The Court acknowledged "the Commissioner is entitled to settle cases commercially" and there is "no reason why the settlements and amended assessments need to reflect the Commissioner's view of the correct tax position". At [20].
[68] Such as the decision of *Westpac Banking Corporation v CIR* (2009) 24 NZTC 23,340. See discussion infra at 4.1.
[69] *Michael Hill Finance (NZ) Limited v CIR* (2015) 27 NZTC ¶22-036.

the English authorities, the Court in *Michael Hill* confirmed that any duty of consistency is restricted to the treatment of the same taxpayer:[70]

> Only Lord Denning MR and Scarman LJ in HTV recognised a duty of consistency but limited expressly to the treatment of *the same taxpayer*, which is an essential component of the obligation to act fairly under English law. That limited duty of fairness is subsumed within the estoppel type of ground because it is an element of the requirement for consistency of conduct towards the particular taxpayer. *Simunovich* was decided on an analogous principle without reference to the English authorities. None of the authorities suggest an obligation of consistency in the treatment of the same taxpayer might possibly extend to consistency of treatment as between taxpayers.

The Court of Appeal decision of *Simunovich Fisheries Limited v CIR* (referred to in the above judgment) is a rare win for the taxpayer in what might be seen as an exception to the trend. The court in this case held that the Commissioner must act consistently across periods in respect of the same asset and the same taxpayer.[71] The taxpayer in that case had purchased a fishing vessel in 1995 and at first treated the transaction as a purchase of secondhand goods for GST purposes. After an enquiry by department officials, the purchase was instead treated as a taxable supply and a refund was issued on that basis. Upon subsequent sale of the vessel in 1997, the taxpayer treated the transaction as zero rated for GST purposes. In doing so, the taxpayer had placed reliance on the vessel's earlier classification as a taxable supply at the time of purchase. The Commissioner issued a NOPA proposing to treat the sale as attracting GST on the basis that the purchase was in fact the supply of a secondhand good. It is relevant to the decision that the Commissioner did not propose to reopen or alter the earlier 1995 assessment. Per Richardson P:[72]

> It would be inconsistent to have the same asset of the same taxpayer taxed on sale as having a different character from its characterisation in respect of its purchase. For the Commissioner to disregard a basic inconsistency of that kind would undermine the integrity of the tax system which he has the duty under s 6 of the 1994 Act to use his best endeavours to protect.

Richardson P noted that this was an unusual case as under the particular sections concerned "the question of liability for output tax is linked to the circumstances under which the vessel was acquired and to the GST tax characterisation at that time".[73] As an aside, the outcome of this decision is somewhat ironic. Richardson P was of course instrumental in the earlier decisions discussed in this chapter that sought to insulate the Commissioner's assessment function from the

[70] At [69].
[71] *Simunovich Fisheries Limited v CIR* (2002) 20 NZTC 17,456.
[72] At [50].
[73] At [57].

sorts of challenges that might be expected in administrative law. When faced with a clear injustice on the facts of this case, Richardson P would allow the taxpayer's appeal (noting the assessment made by the Commissioner faced a procedural difficulty) but without explicit reference to any particular principle in administrative law. The court was therefore prepared to bind the Commissioner in her duty to bring an assessment in this instance even though GST is subject to a periodic assessment process and there was no suggestion that the Commissioner's assessment on sale of the vessel was incorrect.

The majority of the above decisions illustrate that the Commissioner's obligation to enforce the law when bringing an assessment generally also acts as a form of protection for the Commissioner's assessment function. The statutory scheme of the tax legislation has meant that the courts will not bind the Commissioner to the standards normally expected of public officials in administrative law. It does not follow that the courts cannot invalidate an assessment after it has been made by the Commissioner if it is found to have breached administrative law principles. This is considered further in parts four and five of this chapter.

3.3.4 Assessments that are provisional or conditional

One area where the courts have always been prepared to recognise that an assessment can be invalidated is where that assessment is not of a kind contemplated under the legislation.

In the Court of Appeal decision of *CIR v Canterbury Frozen Meat*,[74] Richardson J elaborated further on what is expected of the Commissioner whenever an assessment is made. In that case, the taxpayer made a payment of $2.25 million under an agreement for the variation and partial surrender by another company (Borthwicks) of its rights under a long-term supply contract. IR took the view that the treatment of that payment was assessable income in the hands of Borthwicks and an assessment was made. Borthwicks, however, objected to this assessment (which was disallowed) and the issue was the subject of separate proceedings. IR then sought to protect itself against an impending time bar by raising a purported assessment against the taxpayer so that it could attempt to deny the taxpayer a deduction for the payment in the event that it lost the

[74] *CIR v Canterbury Frozen Meat* (1994) 16 NZTC 11,150.

proceedings against Borthwicks. Richardson J's comments in this case are again grounded on an interpretation of the statutory scheme:[75]

> An assessment is the quantification by the Commissioner of the statutorily imposed liability of the particular taxpayer to tax for the year in question. The making of an assessment including an amended assessment requires the exercise of judgment on the part of the Commissioner in quantifying that liability on the information then in the Commissioner's possession. It involves the "ascertainment" of the taxable income and of the resulting tax liability…

On the facts, it was found that the taxpayer had established an arguable case that the purported assessment (being provisional or conditional) made by the Commissioner did not "have the character of an assessment within the meaning of that term in the act".[76] Because there was no assessment in terms of the act, the legislative restrictions on separate proceedings did not apply and judicial review was available.[77]

The approach that has traditionally been taken by the courts regarding the availability of judicial review proceedings has recently been overruled by the Supreme Court's decision in *Tannadyce Investments Limited v CIR*.[78] That case, which is discussed in part four of this chapter, has held that s 109 of the TAA 1994 was designed "to emphasise the comprehensive nature of the embargo on bringing proceedings outside the statutory framework".[79] This includes "the ground that what the Commissioner claimed to be a decision or assessment was not a decision or assessment at all".[80] As a result, taxpayers who wish to invalidate an assessment on the ground that it is provisional or conditional must do so in the course of the statutory challenge procedures.[81] In this context, the courts have specifically recognised that a hearing authority may invoke its power to *cancel* an assessment if this ground is used to challenge an assessment. However, the courts appear to be more restricted in their view as to the availability of a wider

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[75] At 11,158.
[76] At 11,158. Contrast *CIR v New Zealand Wool Board* (1999) 19 NZTC 15,476 where it was found that the Commissioner's reassessment was made with the requisite statutory exercise of judgement. The Court of Appeal held that "[t]he statute requires a genuine attempt to ascertain the assessable income of the taxpayer. That obvious obligation cannot be elevated into a requirement that the Commissioner not assess unless and until fully informed of the taxpayer's affairs. …The statute requires the exercise of judgment but it does not set a high threshold as to the material on which that judgment is based. The Commissioner must do the best he or she can on the information in his or her possession and so, as it is put in the *Canterbury Frozen Meat Co Ltd* case, it is only where the Commissioner acts arbitrarily — without any foundation for the assessment — or in disregard of the law or facts known to the Commissioner, that the purported assessment will be set aside on that ground". At [49].
[77] Previously, these legislative restrictions were found in ss 26 – 27 of the Income Tax Act 1976.
[78] *Tannadyce Investments Limited v CIR* (2011) 25 NZTC ¶20-103.
[79] At [54].
[80] At [54].
[81] *Michael Hill Finance (NZ) Limited v CIR* (2015) 27 NZTC ¶22-036 at [83].

administrative law challenge to invalidate an assessment in challenge proceedings. This is discussed in part five of this chapter.

3.4 The current state of play regarding judicial review

3.4.1 The Court of Appeal decision in *Westpac Banking*

Historically, the approach of the courts has been to emphasise that the statutory challenge procedures will normally provide superior remedies and should be preferred, while at the same time, recognising that there are sometimes "exceptional circumstances" where judicial review should be permitted.[82] The courts regarded it as an abuse of process for the taxpayer to commence judicial review proceedings where the statutory procedures are available unless the taxpayer could point to exceptional circumstances justifying this course.[83] In the decision of *Westpac Banking Corporation v CIR*,[84] the Court of Appeal captured the essence of this approach in their judgment based on already established principles in case law. The test of exceptional circumstances has now been upended following the Supreme Court decision of *Tannadyce Investments Limited v CIR*.[85]

First, this chapter examines what the Court of Appeal in *Westpac* said of the circumstances where a court will be justified in using judicial review proceedings to declare invalid an assessment made by the Commissioner. Next, this chapter discusses the far more restrictive approach taken in *Tannadyce* to the availability of judicial review. The comparison is expected to contribute to the discussion by helping to determine what has been lost in accountability terms and whether judicial oversight of the Commissioner's assessment function has been impaired.

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[82] *New Zealand Wool Board v CIR* (1997) 18 NZTC 13,113 at 13116.
[83] *CIR v Abattis Properties Limited* (2002) 20 NZTC 17,805.
[84] *Westpac Banking Corporation v CIR* (2009) 24 NZTC 23,340.
[85] *Tannadyce Investments Limited v CIR* (2011) 25 NZTC ¶20-103. It is worth noting that, while the majority judgment overrode much of the previous case law on when judicial review will be available by taking a much more restrictive approach, the minority judgment was also critical of the approach taken by the Court of Appeal in *Westpac*. In the view of the minority, the Court of Appeal did not address the line of authority from decisions made by the Court of Appeal and Privy Council under previous legislation where there had been no significant change in the statutory scheme or the relevant provisions. They also considered that the Court of Appeal was overly influenced by decisions made in the High Court of Australia, but did not deal with important differences in the statutory context between the two jurisdictions. According to the minority judgment, "[t]he better guide to [the] meaning and effect [of ss 109 and 114] is that given by the Court of Appeal and Privy Council in applying the provisions in the 1976 Act which are not materially different. That approach, reflecting principles applied generally in New Zealand for over 25 years, was developed by interpreting the legislation in a way which did not impair the courts' ability to hold public officials to account, particularly where there were allegations going to the legitimacy of the process, but preferred the statutory route of appeal where that was more appropriate". At [29] – [31].

The facts of *Westpac* are as follows. The taxpayer (Westpac) was one of a number of banks engaged in litigation with IR over whether certain structured finance transactions known as 'repo deals' amounted to tax avoidance under the legislation. The Commissioner issued amended assessments on the basis that tax avoidance was present. In the case of another similar transaction (not subject to litigation), Westpac took the precaution of obtaining a binding ruling regarding the tax treatment. The ruling confirmed that no tax avoidance existed, provided that the transaction meets the stringent conditions laid down in the rulings. In addition to challenging the correctness of the amended assessments, Westpac also sought to challenge the validity of the amended assessments by way of judicial review on administrative law grounds. The Commissioner applied to the High Court to strike out the challenge to the validity of the amended assessments and this was granted by the High Court. Westpac appealed this decision.

A number of specific contentions were put forward by Westpac that included (a) the amended assessments were not an honest appraisal or a genuine exercise of judgement; (b) there was an alleged inconsistency between the legal approach underpinning the assessments and the binding ruling previously issued; (c) that IR was guilty of conscious maladministration; and (d) there was a breach of legitimate expectation as the other repo deals were entered into on the basis that the legal approach taken in the binding ruling would continue to apply.[86] These specific contentions were all seen by the Court as being products of a broader primary complaint. To put it simply, Westpac alleged that there was an unacceptable and unresolved (or unacceptably resolved) inconsistency in the approach taken by the separate business units of IR responsible for issuing the binding ruling and amending the assessment. IR has in place an 'escalation process' designed to sort out inconsistencies between the business units within the department with regard to an interpretation or application of the law.[87] Westpac's complaint was that IR subverted its own escalation process when it issued the amended assessments, and it was aware that doing this would lead to a contemporaneous inconsistency in how the law was being applied.

Before dealing with these allegations, the Court of Appeal first set out its approach to judicial review of tax assessments based on ss 109 and 114 and the relevant case authorities. The Court

[86] *Westpac Banking Corporation v CIR* (2009) 24 NZTC 23,340 at [67].
[87] IR's Escalation Policy for technical issues was recently made publicly available on IR's website. Available at <http://www.ird.govt.nz/technical-tax/commissioners-statements/escalation-policy-technical-issues.html> (accessed 30 March 2017) [Escalation Policy].

accepted that judicial review is available "where what purports to be an assessment is not an assessment".[88] Associated with this, the Court also accepted that judicial review is available "in exceptional cases and thus may be available in cases of conscious maladministration…".[89] Despite the de facto validity provided for assessments under s 114, the Court reasoned in these circumstances that any resulting assessment is not of a kind that the legislature had contemplated when enacting ss 109 and 114. According to the judgment delivered by William Young P:[90]

> …in such cases (ie no genuine assessment or conscious maladministration) what is challenged is either not an assessment, or at the least, not the sort of assessment which the legislature had in mind in enacting those sections. On this basis we see the availability of judicial review as depending on the claimant establishing exceptional circumstances of a kind which results in the amended assessment falling outside the scope of s 109 and 114 and thereby not engaging those sections.

The Court of Appeal found, in the circumstances, that there was no arguable basis that the amended assessments were not an honest appraisal or a genuine exercise of judgement. Likewise, the argument that the amended assessments had breached Westpac's legitimate expectation was seen as inconsistent with the statutory scheme and the existence of the binding rulings regime.[91] Only the alleged inconsistency, and contention that IR was guilty of conscious maladministration, were considered for exceptional circumstances on the basis pleaded. On these points, the Court was of the view that the allegation of conscious maladministration did not relate directly to the issuing of the amended assessment. This was because the escalation process and its resolution were thought to be only casually connected to the assessments and it would therefore be inconsistent with the policy underlying ss 109 and 114 to allow a challenge to the validity of these assessments on the basis that there are exceptional circumstances. According to the Court of Appeal:[92]

> To allow taxpayer litigants to trawl through processes which were antecedent to the issuing of an assessment (and the preassessment disputes procedure) with a view to identifying and then relying on perceived departures from internal department procedures is inconsistent with the orderly and efficient resolution of tax disputes. Such breaches could hardly be regarded as exceptional (in the sense of being rare) and to allow them to invalidate later assessments would leave very little scope for s 109 and 114. …in a situation in which the officer issuing an assessment believes that it is well founded on the facts and law, and that there is no legal impediment to it being issued, we take the view that an advertent departure is not conscious maladministration and in any event is not an exceptional circumstance in the relevant sense of excluding the operation of s 109 and 114. This is

[88] At [59].
[89] At [59].
[90] At [59] – [60].
[91] See discussion supra at 3.2.
[92] At [94].

> all the more so where, as here, the alleged departure from department procedures is entirely collateral to the accuracy or otherwise of the assessment.

This is a good illustration of the principle that the Courts are reluctant to entertain collateral attacks to the correctness of an assessment. But it is not always the case that a challenge to the validity of an assessment is necessarily an attempt by the taxpayer to use judicial review to frustrate assessments honestly reached by the Commissioner. Often the taxpayer will have a legitimate grievance to air. Even in circumstances where the allegations are not found to be 'exceptional' and supporting a case for judicial review, it is not to say that the allegations are without merit. The approach in *Westpac* to allow judicial review in exceptional circumstances meant that these separate proceedings were at the very least available to act as an accountability measure and ensure IR was answerable when it stepped over the line. This separate judicial forum for ensuring accountability was all but put to an end following the Supreme Court decision of *Tannadyce*.

3.4.2 The Supreme Court decision of *Tannadyce Investments Limited*

In *Tannadyce Investments Limited v CIR*,[93] the Supreme Court was asked to consider the circumstances in which a taxpayer may use judicial review to challenge assessments made by the Commissioner, and whether the lower court's decision to strike out the taxpayer's application for judicial review was correct. Both the majority (Blanchard, Tipping and Gault JJ) and minority (Elias CJ and McGrath J) were in agreement that the taxpayer had failed to prove its case. However, they differed regarding the circumstances in which judicial review should be available where a disputable decision could instead have been pursued through the statutory challenge procedures.

The minority judgment of Elias CJ and McGrath J preferred to take an expansive view of the availability of judicial review, concluding that "the investigation and assessment of liability to tax is an area of public administration which can give rise to circumstances where judicial review is not excluded by ss 109 and 114".[94] They begin by emphasising the constitutional importance of judicial review:[95]

> Our constitutional arrangements recognise that the Parliament of New Zealand is the supreme law maker and has "full power to make laws". The courts of higher jurisdiction, however, have constitutional responsibility for upholding the values which constitute the rule of law. A central aspect

[93] *Tannadyce Investments Limited v CIR* (2011) 25 NZTC ¶20-103.
[94] At [32].
[95] At [3] – [5] (citations omitted).

> of that role is to ensure that when public officials exercise the powers conferred on them by Parliament, they act within them. Judicial review is the common law means by which the courts hold such officials to account. It provides the public with assurance that public officials are acting within the law in exercising their powers, and are accountable if they depart from doing so. Statutes limiting recourse to judicial review to challenge statutory decisions accordingly raise issues of constitutional concern…
>
> Legislation which does not on its terms prohibit judicial review, but restricts its availability, can nevertheless interfere with full supervision by the courts of the conformity of activities of government with the rule of law. The courts are reluctant to read legislation in a manner that impairs their ability to hold public officials to account in this way.

After an analysis of the legislative history of ss 109 and 114 and the relevant case law,[96] Elias CJ and McGrath J then turned their minds to the central role that ss 6 and 6A now play within the statutory scheme of the tax legislation. They argue that "[t]hese important provisions are part of the wider context of the Tax Administration Act in which ss 109 and 114 are to be interpreted".[97] Based on a reading of ss 6 and 6A in the context of the wider statutory scheme, the minority held that a proper interpretation of ss 109 and 114 should not restrict the courts supervisory jurisdiction. According to the minority judgment:[98]

> In proposing that these provisions form part of the core responsibilities of the Commissioner and officers of the Inland Revenue Department, the concern of the [Richardson] Committee was that independent judgment should be exercised in all decisions involving the tax affairs of individual taxpayers. While independence from political influence was part of this imperative, the Committee also saw the integrity of the tax system as concerned with "the interaction between the total tax administration and individual taxpayers".
>
> In this context, *defective administration* in the exercise of what can be highly intrusive statutory powers *can give rise to departures from the statutory purposes of such significance that resulting assessments, or other decisions affecting taxpayers, should be invalidated.* That may be the case if fresh appellate determination of the correct tax liability is not adequate to uphold Parliament's requirements in tax administration. It follows that at times, when allegations are made of such

[96] In their analysis, the minority in *Tannadyce* cite a passage from *CIR v Ti Toki Cabarets (1989) Limited & Ors* (2000) 19 NZTC 15,874. In this decision, the Court of Appeal noted that the authorities decided under the equivalent provisions in the 1976 Act to draw a distinction between the correctness of an assessment and the legitimacy of the process employed. This distinction contemplates that "judicial review cannot frustrate the honest discharge by the Commissioner of his statutory duty to assess, *yet can be invoked to address procedural error, defects resulting in ultra vires, unlawfulness and such matters as bad faith, abuse of power and errors of law going to the legitimacy of the process* rather than to the correctness of the decision…" (emphasis added). At [40]. The minority in *Tannadyce* noted that no reference to this passage was made in the Court of Appeal decision of *Westpac*. The minority were also critical that the *Westpac* decision did not adequately address the line of authority under the 1976 legislation where there had been no significant change in the provisions. At [27] – [29]. All of this suggests that the minority in *Tannadyce* were prepared to take a broader view as to when judicial review should be available to invalidate an assessment than the limited circumstances contended for in the *Westpac* decision.

[97] At [33].

[98] At [34] – [35]. See Ivor Richardson and others "Organisational Review of the Inland Revenue Department" (Report by the Organisational Review Committee, 1994) [Richardson Committee report].

> situations, judicial review will be available, where proper grounds are made out, as the better means of providing the necessary judicial scrutiny of departmental actions.

The majority judgment of Blanchard, Tipping and Gault JJ held that the statutory language of s 109, and in particular the words "on any ground whatsoever", supports a far more restrictive approach than that contended for by the minority. The majority found that this "must have been designed to emphasise the comprehensive nature of the embargo on bringing proceedings outside the statutory framework".[99] This meant that there is no reason, on the premise of presumed parliamentary purpose, to read down the clear and unequivocal statutory language. Accordingly, judicial review should only be made available for the "extremely rare" type of situation of where "the taxpayer cannot practically invoke the relevant statutory procedure".[100] In response to the views of Elias CJ and McGrath J, the majority judgment concluded:[101]

> There is no disadvantage, constitutional or otherwise, in giving effect to what Parliament has enacted and every reason for doing so. Allowing for an unwritten "exceptional circumstances" or "proper grounds" escape from s 109 would not be consistent with the purpose which Parliament was trying to achieve in what it enacted. In these circumstances it is not appropriate to apply any presumption that Parliament's purpose, when enacting s 109, was to preserve judicial review.
>
> It may be that in a different statutory context words such as those contained in s 109 should be construed as not precluding judicial review. But, in the present context, it is not necessary, for the reasons already given, to adopt that view. Indeed, the best construction of s 109 in its particular statutory context is that it precludes judicial review, save where the statutory procedures could never be invoked.

In view of the clear disagreement between the minority and the majority in *Tannadyce* regarding when judicial review should be available in this particular statutory setting, and the fact that the judgment of the majority has changed our understanding of when these separate proceedings are available, the decision should have been a strong catalyst for public debate as to whether accountability from the Commissioner is best served through recourse to the statutory challenge procedures. This is a debate that has yet to properly take place.

The value of having a judicial forum to review statutory powers exercisable by the Commissioner is vital for ensuring that the Commissioner is accountable for her actions to individual taxpayers. This includes the act of bringing an assessment. It is principally through an independent and impartial review by the judiciary of the administrative processes used by IR that meaningful

[99] At [54].
[100] At [61].
[101] At [72] – [73].

precedent is allowed to develop regarding what standards and behaviours are expected of the Commissioner.[102]

In leaving the door open to judicial review, the minority in *Tannadyce* held that an important consideration for the courts is whether the overall effect of allowing a taxpayer access to this forum will uphold that taxpayer's right in s 6 to have their liability "determined fairly, impartially, and according to the law".[103] The majority in *Tannadyce* instead shut the door on judicial review, depriving taxpayers and their advisors of this means of redress. This is against a background where the test of exceptional circumstances previously applied by the courts had already set a high threshold for intervention from the courts in this context.

3.5 The statutory challenge procedures and administratrive challenges

3.5.1 Scope of the statutory challenge procedures and powers of a hearing authority

This chapter now seeks to establish what scope taxpayers have for challenging an assessment within the statutory challenge procedures for reasons other than the correctness of the assessment. It is only by doing this that a more pressing question can be answered; has an important avenue for ensuring accountability from IR been lost by determining that practically any challenge in relation to an assessment must be dealt with in the statutory procedures?

It should first be noted that the statutory challenge procedures in pt 8A can only be invoked by taxpayers after first completing all of the relevant steps in the mandatory (pre-litigation) disputes resolution regime in pt 4A of the TAA 1994.[104] This chapter is concerned mainly with the statutory challenge procedures, although it needs to be recognised that the disputes resolution procedures can at times feel like a very real barrier to justice for taxpayers.[105] For one, the consequences for failing to adhere to this mandatory process can also be severe. They include deemed acceptance of the other party's position and restrictions on the matters that can be raised in challenge proceedings. At the same time, the process is frequently criticised as being overly lengthy and

[102] See Denham Martin "Inland Revenue's Accountability to Taxpayers" (2009)14 NZJTLP 9 at 32.
[103] *Tannadyce Investments Limited v CIR* (2011) 25 NZTC ¶20-103 at [38].
[104] TAA 1994, ss 138B, 138H.
[105] See Alison Pavlovich "The Tax Disputes Process and Taxpayer Rights: Are the Inconsistencies Proportional?" (2016) 22 NZJTLP 70. The author argues that the prohibition in s 109 from challenging a decision until the disputes process is completed is an infringement on a taxpayer's right to access justice found in s 27(3) of the Bill of Rights Act 1990.

complex. It is argued that many taxpayers are effectively "burned off" and capitulate to IR's view without necessarily agreeing with that position.[106]

The disputes resolution procedure must normally be followed to its conclusion before an assessment is issued by the Commissioner.[107] This represents a change from the old objection regime that was in place for disputes previously. In the decision of *CIR v Abattis Properties Limited*,[108] the Court of Appeal noted that there are important differences between the old and new regimes. Per Glazebrook J:[109]

> …under the old regime, assessments were issued before the formal objection process began. Under the new regime assessments are issued after a formal disputes resolution process, including in most cases (although not in this) adjudication. This means necessarily that many issues as to the validity of an assessment may not be able to be dealt with in the course of the new disputes resolution process, except in an anticipatory sense, as no assessment will have been made.
>
> Issues as to process and validity can, however, still be dealt with under any challenge proceeding in court and, as the Privy Council has said, should be, save in exceptional cases. In our view it amounts to an abuse of process to commence judicial review proceedings unless the taxpayer can point to exceptional circumstances justifying that course

The second observation of the Court in the above passage reflects what before the Supreme Court's decision in *Tannadyce Investments Limited v CIR* was a settled understanding, i.e. that the Courts will only exercise their discretion to allow judicial review in exceptional cases.[110] It was never to discount the statutory challenge procedures from being primary vehicle for considering challenges to the validity of an assessment,[111] which is generally the route preferred by the Courts. Moreover, there are certain well recognised grounds for challenging the validity of an assessment through the statutory procedures. These include whether the assessment is made within time bar,[112] and

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[106] For example, in a joint submission from the Taxation Committee of the New Zealand Law Society (NZLS) and the National Tax Committee of the New Zealand Institute of Chartered Accountants (NZICA) to an officials' issues paper in 2010 it was argued by the Societies that "[t]he procedures are also not meeting the purpose for which they were enacted. In our experience, taxpayers are disengaging from a process that prices them out of the ability to seek justice and that delays their access to the courts. This is cementing the view of taxpayers that the system is weighted against them and that there is no point in pursuing disputes. This is undermining the integrity of the tax system". See New Zealand Law Society and New Zealand Institute of Chartered Accountants "Submission to the Disputes Project on Disputes: A Review – An Officials' Issues Paper" at [2.2] – [2.3].

[107] See s 89C of the TAA 1994 for exceptions.

[108] *CIR v Abattis Properties Limited* (2002) 20 NZTC 17,805. The decision of *BNZ Finance Ltd v Holland and Anor* (1996) 17 NZTC 12,658 also confirms that a taxpayer need not wait until an assessment is made by the Commissioner before issuing judicial review proceedings.

[109] At [23] – [24].

[110] See discussion supra at 4.2.

[111] *Golden Bay Cement Company Ltd v CIR* (1996) 17 NZTC 12,580.

[112] Once the statutory time bar period of four years has expired the Commissioner may not amend an assessment so as to increase the amount assessed unless the Commissioner is of the opinion that a tax return is fraudulent or

whether the assessment involves an honest exercise of judgement by the Commissioner.[113] With that said, the parameters for successfully invalidating an assessment through the statutory challenge procedures on the basis of administrative law principles are very narrow.

The powers of a hearing authority on hearing a challenge under pt 8A of the TAA 1994 are determined by s 138P. This section provides:

138P Powers of hearing authority

(1) On hearing a challenge, a hearing authority may—

> (a) confirm or cancel or vary an assessment, or reduce the amount of an assessment, or increase the amount of an assessment to the extent to which the Commissioner was able to make an assessment of an increased amount at the time the Commissioner made the assessment to which the challenge relates; or
> (b) make an assessment which the Commissioner was able to make at the time the Commissioner made the assessment to which the challenge relates, or direct the Commissioner to make such an assessment.
> …

Case law indicates that these powers "contemplate a right of hearing de novo on the merits with the hearing authority determining the correct tax liability and making assessment accordingly."[114] This principle was enunciated in the High Court decision of *Dandelion Investments Ltd v CIR*, where it was held that:[115]

> …the [hearing authority] can hear the taxpayer's case without examining in detail the process which led to the Commissioner's assessment. In reaching its own decision as to the appropriate assessment to be made the Authority can cure any defects that might have existed in the Commissioner's assessment. A challenge to process is effected, therefore, not by attacking the method by which the Commissioner reached his decision, but by calling the evidence necessary to enable the Taxation Review Authority to make the correct decision.

This principle was later applied again in a Court of Appeal decision concerning the same taxpayer. In *Dandelion Investments Limited v CIR* the Court had to decide whether the Taxation Review Authority had exceeded the scope of its statutory powers when it undertook an examination into the processes employed by IR leading up to a decision to disallow the taxpayer's objection.[116] The

wilfully misleading, or that the tax return omits income of a particular nature or from a particular source. The section allows taxpayers to achieve can achieve a level of finality with their assessments. See s 108 of the TAA 1994.
[113] An assessment that is tentative or provisional or subject to adjustment or conditional has been held not to be a genuine assessment in terms of the statutory scheme. See discussion supra at 3.4.
[114] *Tannadyce Investments Limited v CIR* (2011) 25 NZTC ¶20-103 at [25].
[115] *Dandelion Investments Ltd v CIR* (1996) 17 NZTC 12,689 at 12,694.
[116] *Dandelion Investments Limited v CIR* (2003) 21 NZTC 18,010.

Court of Appeal held that "the Authority's role remained one which was concerned with the correctness of the assessment" and that this "*did not extend to conducting what was effectively a broad based judicial review* of the process leading up to the Commissioner's assessment…".[117] This was reinforced again later in the same judgment where the Court of Appeal held:[118]

> To the extent that the appellant in this case used the objection procedure to challenge whether the actions of the Commissioner constituted a valid assessment made within time, the Authority's process was of a kind contemplated by these authorities. But the Authority's wider process challenge to what took place after the act of assessment was not. In accepting that jurisdiction questions could be raised in the statutory process the [previous] decisions of this Court …did not, and were never intended to, invite fishing expeditions into the internal processes of the Department seeking administrative law grounds on which to mount objections to substantive assessments. That is what transpired in the present case.

The approach taken by the Court of Appeal in this decision has the potential to allow the Commissioner to escape accountability for instances of bad administration. This is because the Court has held that this is not to detract from the focus of the hearing authority, which is (generally speaking) the correctness of the resulting assessment. Lengthy inquiries into the alleged behaviour or conduct of IR will not be entertained. Importantly, this case was decided in an environment where the courts were prepared to allow the taxpayer access to judicial review proceedings where exceptional circumstances permitted. This all changed following the Supreme Court decision of *Tannadyce* discussed in part four of this chapter. It is likely that Elias CJ and McGrath J in the minority judgment of *Tannadyce* had in mind the need to preserve accountability (via the separate avenue of judicial review) when, in respect of the statutory challenge procedures, they argued that "[s]uch an appeal right is a prime instance of a right of appeal which will usually, but not always, provide all that procedural fairness requires".[119] As discussed, the majority in *Tannadyce* instead took a far more restrictive approach.

In light of the Supreme Court's decision in *Tannadyce,* and the fact that it has overturned so much of the earlier case law on these issues, there has been a need to revisit the scope of the statutory challenge procedures to determine whether these should provide more headroom for the exercise of supervisory jurisdiction by the courts. An opportunity for doing so under the existing legislative

[117] At 18,031.
[118] At 18,032. It is relevant to the decision that much of the TRA's examination into the processes used by IR took place after the act of assessment. The decision can therefore be distinguished on this ground.
[119] *Tannadyce Investments Limited v CIR* (2011) 25 NZTC ¶20-103 at [37].

provisions came in the recent Court of Appeal decision of *Michael Hill Finance (NZ) Limited v CIR*.[120]

3.5.2 The Court of Appeal decision of *Michael Hill Finance (NZ) Limited*

In the lower court decision of *Michael Hill Finance (NZ) Limited v CIR*,[121] the High Court refused to strike out a consistency challenge to a tax assessment made by the Commissioner that was brought by the taxpayer (Michael Hill) under the statutory challenge procedure. In arriving at this conclusion, the High Court considered it arguable that the decision of *Tannadyce* does not place any restrictions on the sorts of administrative law challenges that may be brought within the statutory procedures. The consistency challenge was later struck out by the Court of Appeal. This chapter first discusses the decision of the High Court before next considering the Court of Appeal decision.

The decision concerned the transfer of intellectual property and franchising operations and the establishment of an Australian Limited Partnership (ALP) that was used by Michael Hill to create an asymmetric tax treatment during the years in question. Michael Hill applied for a binding ruling but this was provided only in relation to the black letter law. This is because the Commissioner was of the view that the general anti-avoidance provision in s BG 1 would apply to the arrangement. Michael Hill therefore self-assessed on the basis that s BG 1 applied and initiated the disputes procedures in respect of its own self-assessment. Later, Michael Hill sought to bring proceedings against the Commissioner challenging both the correctness of the assessment and an alleged inconsistency. At the heart of the consistency challenge is that the Commissioner, whether explicitly (by providing a binding ruling or by forming a view that s BG 1 has no application), or tacitly (by making a decision not to investigate these structures), has been inconsistent by taking the view that s BG 1 does not apply to the structures used by other taxpayers that were, for all material purposes, identical to the one used by Michael Hill.

In the High Court decision, Mr Heron for the Commissioner sought to argue (based on the Court of Appeal's approach to the availability of judicial review in the *Westpac* decision)[122] that the ability for a taxpayer to raise administrative law grounds in the statutory challenge procedures is limited to those circumstances where what purports to be an assessment is not an assessment, or in

[120] *CIR v Michael Hill Finance (NZ) Limited* (2016) 27 NZTC ¶22-056.
[121] *Michael Hill Finance (NZ) Limited v CIR* (2015) 27 NZTC ¶22-036.
[122] *Westpac Banking Corporation v CIR* (2009) 24 NZTC 23,340 at [59]. See discussion supra at 4.1.

exceptional cases such as where there has been conscious maladministration.[123] This was not accepted by the Court. In the judgment delivered by Toogood J, it was held that "[t]he test in *Westpac* is not grounded in the threshold for review itself, but in the existence of review outside the statutory challenge procedure" and that "[t]he test does not appear to be appropriate for determining whether an invalidity challenge is properly brought within Part 8A".[124] Based on comments made by the majority in the Supreme Court decision of *Tannadyce*,[125] Toogood J considered it arguable that there are no limitations on the types of administrative law challenges that may be brought within the statutory challenge procedures.[126] Furthermore, from a standpoint that the *Tannadyce* decision has changed our understanding of when judicial review is available, Toogood J would not accept that an assessment cannot be invalidated if the Commissioner's assessment can be proved to be correct. Per Toogood J:[127]

> The Supreme Court in *Tannadyce* appears to have adopted a similar approach to that taken by the England and Wales Court of Appeal in suggesting that the correctness of the Commissioner's view in law may not preclude a taxpayer from bringing a validity challenge. The Supreme Court acknowledged that, in practice, the validity challenge would normally be determined first, and then the Court may go on to consider substantive correctness, insofar as that is necessary or appropriate.

Earlier in the judgment, Toogood J seized upon the views expressed by the minority in *Tannadyce* as an indication of when it might be appropriate for a court to invalidate an assessment brought by the Commissioner. These expressions of opinion (referred to earlier in this chapter) were regarded as persuasive but not binding and on the Court and bear repeating:[128]

> In this context, *defective administration* in the exercise of what can be highly intrusive statutory powers *can give rise to departures from the statutory purposes of such significance that resulting assessments, or other decisions affecting taxpayers, should be invalidated*. That may be the case if fresh appellate determination of the correct tax liability is not adequate to uphold Parliament's requirements in tax administration. It follows that at times, when allegations are made of such situations, judicial review will be available, where proper grounds are made out, as the better means of providing the necessary judicial scrutiny of departmental actions.

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[123] *Michael Hill Finance (NZ) Limited v CIR* (2015) 27 NZTC ¶22-036 at [55] – [56].
[124] At [59].
[125] In coming to the conclusion that the words "on any ground whatsoever" in s 109 were comprehensively designed to restrict proceedings outside of the statutory framework, the majority in *Tannadyce* also conceded that Parliament must have contemplated that disputable decisions may be challenged under the statutory procedures *on any ground whatsoever*. A footnote to this passage reads that "[a] hearing authority may address issues otherwise apt to be raised on judicial review…". See *Tannadyce Investments Limited v CIR* (2011) 25 NZTC ¶20-103 at [54].
[126] *Michael Hill Finance (NZ) Limited v CIR* (2015) 27 NZTC ¶22-036 at [66].
[127] At [78] (footnotes omitted).
[128] At [35].

The Commissioner appealed the decision of the High Court and Michael Hill's cause of action based on the ground of inconsistency was struck out at the Court of Appeal. It is unfortunate that, in their efforts to strike out the inconsistency challenge, the reasoning applied by the Court of Appeal was also perhaps too dismissive of Toogood J's findings regarding when a challenge to the validity of an assessment may be brought through the statutory challenge procedures. The Court of Appeal seems to have taken a different interpretation to the High Court on the decision of *Tannadyce*. In particular, the Court of Appeal seems to have taken the main assertion by the majority in that decision, that the statutory language does not permit an 'exceptional circumstances' or 'proper grounds' test when considering whether judicial review is available, as also rejecting the broad approach contended for by the minority as to when it might be appropriate for an assessment to be invalidated by the court.[129]

In support of its view, the Court of Appeal in *Michael Hill* sought to rely on what the courts have said about how the powers of a hearing authority contemplate a right of hearing de novo, and how this is generally curative of any defects in the process leading up to an assessment.[130] In reliance on this interpretation, the Court of Appeal specifically rejected authorities put forward by Ms Fitzgerald (for Michael Hill) as relevant only to judicial review proceedings, and not in the process of determining a challenge. According to the Court of Appeal judgment delivered by Harrison J:[131]

> The older authorities cited by Ms Fitzgerald do not assist Michael Hill. They were addressing the possible displacement of the correctness criterion within the context of the availability of judicial review beyond the challenge process. *Tannadyce* has since settled that issue. We accept that correctness may not be the sole consideration when the Commissioner exercises her administrative powers within the TAA at large. But that factor does not displace its primacy within the process of challenging her determination of a taxpayer's liability.

Later, in the same judgment, the Court of Appeal found further support for these views in its discussion of the remedies sought by the taxpayer. The Court referred to a line of decisions regarding the role of the Commissioner when bringing an assessment in terms of the statutory

[129] *CIR v Michael Hill Finance (NZ) Limited* (2016) 27 NZTC ¶22-056 at [35] – [37].
[130] To the extent that the Court of Appeal in their judgment sought to also attribute these views to the decision in *Tannadyce*, only the minority seem to have expressed this view. The Court of Appeal also sought to attribute to the decision of *Tannadyce* the observation that "challenges should only be separated only in rare cases", presumably referring to a separation between procedural and substantive grounds. All that was said by the majority is that there is "no potential for separation of matters of legality from matters of correctness", which in the context is more likely a reference to separation between proceedings where both the statutory challenge procedures and judicial review are used to challenge the same issues. At [38] – [41].
[131] At [42].

scheme, before inferring that "[i]n performing her duty to collect revenue the Commissioner must determine a taxpayer's liability fairly, impartially, and according to law".[132] In their view, the remedies sought by Michael Hill from the hearing authority run counter to its consistency challenge, as the hearing authority must be bound by the same obligations as the Commissioner. Per Harrison J:[133]

> The hearing authority must be bound by the same statutory obligation on an appeal: its power to cancel, vary or reduce is limited to the degree, if any, necessary to rectify the incorrectness of the Commissioner's assessment. The s 138P power is not a true discretion in the orthodox sense. It is, rather, an obligation to act upon satisfaction of a statutory precondition that the Commissioner's determination of liability to tax was incorrect.
>
> …the Supreme Court's recognition in *Tannadyce* of the taxpayer's right to rely on administrative law grounds within the challenge process does not transform the essential nature of that process into an application for judicial review. The majority construed s 109 as giving the hearing authority the same if not wider powers as the High Court on judicial review and with correspondingly wider remedies. There was no suggestion that a hearing authority is exercising a supervisory power on a pt 8A appeal where the inquiry is primarily into the correctness, lawfulness or validity of the decision.

The Court of Appeal was only prepared to accept that a hearing authority may use its power in s 139P to *cancel* an assessment in circumstances where "the Commissioner's assessment was not an assessment at all or the Commissioner acted outside or abused her powers in making the assessment".[134]

3.5.3 Is the Court of Appeal decision in *Michael Hill* an accurate reflection of *Tannadyce*?

Contrary to the findings reached by the Court of Appeal in *Michael Hill*, there is actually very little in the majority judgment of *Tannadyce* to support the views expressed in the Court of Appeal decision. The majority in *Tannadyce* did not attempt to define the sorts of grounds that a taxpayer may raise in the statutory challenge procedures. The majority also acknowledge that the presumption of the courts when interpreting legislation is that Parliament's purpose would not have

[132] At [80].
[133] At [81] – [82] (footnotes omitted).
[134] At [83]. The Court of Appeal indicated that these were "the extreme examples cited in *Tannadyce*", but without a specific reference to where it was referred to in that judgment. It seems to be an acknowledgement of some of the more orthodox grounds for invalidating an assessment already accepted by the courts as being able to be brought within the statutory challenge procedures. See *CIR v Canterbury Frozen Meat Company Limited* (1994) 16 NZTC 11,150, *Golden Bay Cement Company Ltd v CIR* (1996) 17 NZTC 12,580.

been to impair the courts' ability to hold public officials to account.[135] This is reflected in the following extract:[136]

> We have already referred to the Court's strong inclination to read sections like s 109 in a way that preserves the availability of judicial review to deal, at least, with matters of vitiation which render the decision involved no decision in law at all. But that is not the right way to approach s 109 in its particular statutory context. By insisting that the statutory disputes and challenge processes be followed, as s 109 does, Parliament has not deprived taxpayers of *the ability to have all their concerns about tax assessments* determined by the High Court. The legislative policy evident in s 109 is not at odds with the right of citizens to have matters of legality determined by the High Court. There is therefore no reason to read down, on the premise of presumed parliamentary purpose, the clear and unequivocal words of s 109 *and, in particular, its use of the words "on any ground whatsoever*".

In coming to their decision, the majority in *Tannadyce* were therefore clear on the importance of judicial review as the conventional means of testing the legality of decisions and that, were it not for s 109, the Commissioner's statutory power to make an assessment would otherwise be a statutory power of decision that is amenable to judicial review.[137] The restrictive approach to the availability of judicial review was said to be "a product of the text and purpose of s 109 in its particular statutory setting" and "does not diminish the general importance of and availability of judicial review for examining the legality of conduct and decisions that fall within its compass".[138] Elsewhere, the majority were also clear that the statutory challenge procedures offer taxpayers broader rights and remedies than are available on judicial review, and in exactly the same forum.[139] The majority refuted points raised by the minority concerning constitutional concerns that come with restrictions on judicial review.[140] In the view of the majority, "[t]here is *no disadvantage*, constitutional or otherwise, in giving effect to what Parliament has intended…".[141]

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[135] The majority in *Tannadyce* cited the Court of Appeal decision of *Bulk Gas Users Group v Attorney-General* [1983] NZLR 129 (CA) as support for the view that "judges should be slow to conclude that a statutory provision ousting or limiting access to the courts was intended to preclude applications to the High Court for judicial review alleging unlawfulness of any kind." At [56]. The concern that any interpretation of the legislation does not impair the courts' ability to hold public officials to account was also mirrored in the minority judgment where they added "particularly where there were allegations going to the legitimacy of process". At [3]–[5], [29]–[30]. These views are also supported by ss 6 and 27 of the Bill of Rights Act 1990.

[136] At [67].

[137] At [56].

[138] At [60].

[139] This is because the statutory challenge procedures have a built-in right for taxpayers to take the matter to the High Court. At [71]-[72].

[140] The minority argued that the courts "…have constitutional responsibility for upholding the values which constitute the rule of law. A central aspect of that role is to ensure that when public officials exercise the powers conferred on them by Parliament, they act within them. Judicial review is the common law means by which the courts hold such officials to account. It provides the public with assurance that public officials are acting within the law in exercising their powers, and are accountable if they depart from doing so". At [3] (footnotes omitted).

[141] At [72].

A reasonable inference from the above comments is that the majority in *Tannadyce* must have reasoned that any type of challenge (including those otherwise apt to be raised in judicial review) is capable of being brought through the statutory challenge procedures.[142] Provided the taxpayer has done so, the taxpayer should not be disadvantaged because of the forum in which they have brought proceedings. This is accomplished by empowering the hearing authority to first consider any administrative law challenge brought through the statutory procedure, and allowing the hearing authority to treat this as conclusive of the matter. It is supported in the majority judgment where it was held:[143]

> A hearing authority, whether it be a Taxation Review Authority or the High Court, has all the usual powers to deal with preliminary issues ahead of and separately from other matters of challenge. For example, if there is a proper basis for doing so, a hearing authority can deal as a discrete threshold point with a question which, if answered in a particular way, would be conclusive of the whole challenge.

The majority in *Tannadyce* must therefore have contemplated that a hearing authority would retain a discretion to decline to consider the merits of an assessment if there were grounds for invalidating the assessment that would succeed on an application for judicial review. Equally, the majority must have contemplated that a hearing authority would retain a discretion to consider the merits of an assessment if it considered this would be curative of any defects in the process leading up to the Commissioner's assessment. The proper approach would depend on the circumstances of each case.

The reasoning employed by the Court of Appeal in *Michael Hill* when it came to its decision to strike out the administrative challenge brought by the taxpayer seems to be a serious departure from these principles. Insofar as the decision held that a hearing authority is not empowered to cancel or invalidate an otherwise correct assessment, the decision has realised the constitutional concerns of the minority in *Tannadyce*. A key aspect of judicial review, and a reflection of the courts constitutional responsibility "for upholding the values which constitute the rule of law", is that it ensures that "public officials are acting within the law in exercising their powers, and are accountable if they depart from doing so".[144] The approach taken by the Court of Appeal in *Michael Hill* would suggest there is in fact a significant impairment on the supervisory

[142] *Michael Hill Finance (NZ) Limited v CIR* (2015) 27 NZTC ¶22-036 at [66].
[143] *Tannadyce Investments Limited v CIR* (2011) 25 NZTC ¶20-103 at [51].
[144] At [3].

jurisdiction of the courts for ensuring that the Commissioner accountable for her power to bring an assessment.

3.6 Conclusion

The supervisory jurisdiction of the courts is concerned with the lawfulness of statutory powers exercisable by public officials. A court is therefore unlikely to intervene with the exercise of statutory powers by the Commissioner in reliance on s 6A. This is because the Commissioner may prioritise her managerial interest in administering the tax system over the expectation that an assessment is correctly quantified in accordance with the law. This is an outcome that is contemplated and permitted under the legislation. No statutory standard exists that can compel the Commissioner to exercise her wider statutory powers to ensure an assessment is in accordance with the law. There is a case to be made for a strengthening of taxpayer rights to ensure that managerial discretion is not used as a means to trump the proper exercise of statutory powers vested in the Commissioner in the way intended by Parliament. For taxpayer rights to be effective, they would need to provide a clear standard for intervention from the courts to ensure judicial oversight.

The decisions examined in this chapter that deal with the extent to which the Commissioner may be held accountable to the standards expected in administrative law also point to a need for legislative reform. Collectively, the decisions suggest that accountability from the Commissioner in this area has not simply remained stagnant, but has actually gone backwards since the enactment of s 6A. Ironically, the enactment of the compliance and penalties regime and disputes resolution procedures to encourage self-assessment have meant that the consequences for taxpayers getting it wrong have only intensified over the same period.

The courts have interpreted the statutory scheme of the tax legislation as affording a degree of protection to the Commissioner's assessment function against administrative challenges. The Commissioner cannot be prevented from bringing an assessment based on her own view of how the law applies. This will be the case even where it would be in the interests of natural justice and fairness to bind the Commissioner in this regard.

Much of the case law in this area was decided under legislation where the Commissioner was arguably acting under an imperative duty to assess and collect all taxes that are due. However, the reluctance on the part of the courts to interfere with the Commissioner's assessment function has

not been tempered following the enactment of s 6A and any impact that this might have had on the statutory scheme. This is despite the fact that s 6A clarifies that the Commissioner cannot be compelled to exercise her wider statutory powers to ensure that an assessment is made according to the law. While the Commissioner is not obliged to bring an assessment, the Commissioner is still acting in the quantification of the amount due whenever an assessment is brought. She will do this in accordance with her own view of the applicable law and facts (settlement agreements aside). The process of quantifying an assessment is of course central to the role of the Commissioner in terms of the statutory scheme of the tax legislation. Because of this, it would have to be exceptional for the courts to tie the Commissioner's hands before an assessment is even made.

It does not follow from the above that the courts cannot invalidate an assessment by the Commissioner if it is found to have been made in breach of administrative law principles. To ensure that the Commissioner is accountable for adhering to Parliament's purposes for the exercise of her assessment function, it is important that the courts retain some degree of judicial oversight. A significant step backwards in this regard are the legislative restrictions placed on judicial review.

Historically, the courts have always been reluctant to use their discretion and allow taxpayers access to judicial review proceedings to challenge an assessment brought by the Commissioner. This was on the basis that the statutory challenge procedures are intended as the vehicle for this, and the legislation itself places restrictions on matters that may be raised outside of this process. All the same, the approach taken by the courts has previously always been to recognise that there will sometimes be exceptional circumstances where judicial review should remain an available option. This changed following the Supreme Court decision of *Tannadyce*, which has placed severe restrictions on the availability of these separate proceedings.

That the loss of this judicial forum could have the potential to seriously undermine accountability for the standards set in administrative law whenever an assessment is brought by the Commissioner was made abundantly clear by the Court of Appeal decision of *Michael Hill*. The Court of Appeal was not prepared to accept that there may even be a threshold question of whether exceptional circumstances or something similar could occasion a hearing authority to examine a deciding point that otherwise would have been apt to raise in judicial review. This chapter makes the case that the approach taken by the Court of Appeal is not an accurate reflection of the majority judgment in *Tannadyce*. It is arguable that the decision of *Tannadyce* should have prompted a rethink from the courts as to what are the appropriate parameters for invalidating an assessment that has been

challenged using the statutory challenge procedures. Instead, the Court of Appeal in *Michael Hill* viewed only the standard of correctness as having any relevance.

Whether or not the Court of Appeal got it right in *Michael Hill*, the issue now is that the current approach does nothing for ensuring that the Commissioner is held to account for administrative law principles in the process of bringing an assessment. Neither judicial review nor the statutory challenge procedures are offering taxpayers any means of redress.

This is not a minor or a trite matter. Meaningful accountability through a Court or tribunal system is vital for the proper functioning of the tax system. This is because it is principally through a judicial forum that meaningful precedent will be allowed to develop regarding what accountability standards and behaviours are expected of IR. It is also of constitutional importance that the courts retain some power of supervisory jurisdiction to ensure public officials act within the law when exercising their statutory powers. Such a glaring exception with regard to the Commissioner's power to bring an assessment demands nothing less than an urgent rethink of legislative settings currently in place to provide some assurance to taxpayers that the Commissioner is not outside the reach of the law.

Chapter 4: The Commissioner's approach to taxpayer amendment requests

4.1 Introduction

The Commissioner's statutory discretion to at any time amend an assessment in s 113 of the Tax Administration Act 1994 (TAA 1994)[1] has been a feature of the tax legislation in New Zealand since the Land and Income Tax Act 1916. Despite minor amendments to the wording of this provision over time, the essence of the provision has always been the same.[2] This power allows the Commissioner to "at any time" make amendments to an assessment "as the Commissioner thinks necessary to ensure its correctness".[3]

Often described by taxpayers and their advisors as the 'last chance saloon', the discretion is an important one for taxpayers who seek to amend their tax position and who are outside the statutory time limits for initiating a dispute to an assessment. Taxpayers in this situation will have to send an amendment request to the Commissioner and rely on her agreeing to exercise her discretion under s 113. The advantage of doing so in circumstances where the amendment proposed will result in additional tax to pay is that the taxpayer may benefit from a reduction in shortfall penalties (provided that a full voluntary disclosure is made in accordance with the legislative provisions).[4] Taxpayers instead who make an amendment request that is taxpayer favourable can expect to come under considerably more scrutiny before the Commissioner agrees to exercise her discretion.

The research in this chapter is concerned with whether the decision-making process used by the Commissioner to determine how she will respond to taxpayer amendment requests is a fair reflection of the role that s 113 should play in terms of the broad statutory scheme of the TAA 1994.

Over the years, there have been several important developments that have had an impact on the significance of s 113 to the Commissioner's administration of the tax system.

The first of these is the advent of self-assessment. This has changed the role of s 113 from being a mechanism to ensure that the Commissioner's assessment function is being undertaken correctly,

[1] All references in this chapter are to the Tax Administration Act 1994 (TAA 1994) unless stated otherwise.
[2] *Westpac Securities NZ Limited v CIR* (2014) 26 NZTC ¶21-118 at [58].
[3] TAA 1994, s 113(1).
[4] TAA 1994, ss 141G, 141 J. See also IR Tax Information Bulletin "SPS 09/02: Voluntary Disclosures" Vol 21 No 5 at 13.

to a mechanism that can assist taxpayers with their obligation to correctly determine the amount of tax payable. It is critical that any exercise of the s 113 discretion reflects the importance attached to self-assessment under the statutory scheme. This chapter discusses some of the various case authorities on this point.

Another important development has been the enactment of ss 6 and 6A. These sections were intended to establish the broad statutory framework within which the Commissioner must approach the task of administering the tax system. As IR has identified in its most recent standard practice statement on the topic,[5] there is a need for the department to consider and weigh up each of the factors listed in ss 6 and 6A when deciding whether to accept a taxpayers request to amend their assessment. Section 6A also brought with it an express authorisation for the Commissioner to exercise a degree of managerial discretion regarding the limited resources appropriated to the department. Now that the legislation recognises that the Commissioner has a managerial interest in her administration of the tax system, this has arguably broadened the criteria that she will have regard to when coming to a decision on how the s 113 discretion should be exercised.

It is equally relevant though that s 113 is a statutory power that is designed to permit the Commissioner to amend an assessment to ensure its *correctness*. The wording used in s 113 emphasises the importance of this standard. However, there must be some instances where the Commissioner's managerial concerns take priority over the importance of ensuring that each and every assessment is correctly quantified in accordance with the substantive taxing provisions. This tension is inherent in every exercise of the s 113 discretion. Taxpayers rely on the grace of the Commissioner to strike an appropriate balance between these competing priorities when coming to a decision.

The point that is sometimes overlooked is that the Commissioner is widely accountable to Parliament and taxpayers alike for the way in which her statutory powers are exercised. Associated with this, the courts have over the years set out what can be expected of the Commissioner when exercising her statutory powers based on a reading of their place within the broader statutory scheme. In other words, s 113 is a statutory power that is vested with the Commissioner for a reason. It is there to serve the purposes of the legislation and the tax system as a whole. Taxpayers are entitled to question whether the Commissioner is doing enough to exercise the requisite degree

[5] IR "SPS 16/01 Requests to Amend Assessments" Tax Information Bulletin Vol 28 No 4 at 12 (SPS 16/01).

of judgement in her assessment of taxpayer amendment requests to ensure these are not being passed over without good reason.

This chapter argues that the way in which the Commissioner in her latest standard practice statement has said that she will approach taxpayer amendment requests is an inappropriate reflection of what the case decisions have said regarding how s 113 should be exercised. It should not lightly be overlooked that *both* taxpayers under s 15B and the Commissioner under s 6(2)(b) of the TAA 1994 have a responsibility to correctly determine the amount of tax payable. Neither of these sections is served by making a decision not to allocate the resources needed to properly consider the merits of a taxpayer amendment request. Sadly, this is where many taxpayers end up under the approach taken by the Commissioner. The reasons provided by the Commissioner for declining an amendment request where the merits of the taxpayer's position are not given due consideration deserve to be scrutinised very carefully.

After a review of the relevant case law, this chapter argues that the Commissioner's standard practice statement is a poor reflection of what the courts have held is expected of the Commissioner when exercising her discretion in s 113. Nowhere in the statement does IR attempt to describe how this discretion will be used to support self-assessment in line with the broader statutory scheme of the TAA 1994. On the contrary, the statement is at pains to emphasise instead that a taxpayer's various neglects and failure to correctly self-assess in the first instance should count against their amendment request. Such an approach unduly detracts from the Commissioner's own responsibility regarding the exercise of the discretion in s 113.

This structure of this chapter is as follows:

Part two outlines the views of the Richardson Committee regarding the separate adjudicative and managerial interests of the Commissioner in her administration of the tax system. **Part three** describes the transition to self-assessment in New Zealand as explains how this has transformed the statutory scheme of the TAA 1994. **Part four** considers what self-assessment has come to mean for an exercise of the s 113 discretion by the Commissioner in light of relevant case law in this area. **Part five** examines two early decisions that involved the Commissioner's discretion to accept a late notice of objection received after the statutory time limit and that emphasise the importance of considering the merits of a taxpayer's position. **Part six** examines two recent decisions that involved the Commissioner's refusal to accept a taxpayer's amendment request,

despite the fact that there were manifest errors in each of the assessments. **Part seven** reviews IR's most recent standard practice statement on how the Commissioner will exercise her s 113 discretion in response to a taxpayer amendment request.

The chapter concludes with some thoughts on how IR should amend its approach to ensure that a taxpayer's right to have their liability determined in accordance with the law is given fair representation in the decision making process.

4.2 The adjudicative component to the Commissioner's role

In a self-assessment environment, the primary responsibility for bringing an assessment belongs with the taxpayer. The Commissioner retains a residual power in s 113 of the TAA 1994 to at any time amend an assessment. However, the decision of whether or not to accept an amendment request from a taxpayer is left to the Commissioner's discretion.[6] Relevant to this decision, the Commissioner is entitled under s 6A to exercise managerial discretion when deciding on how to allocate and manage the limited resources of IR. Resource constraints may well therefore have a bearing on how the Commissioner approaches the task of considering taxpayer amendment requests.

It was the Richardson Committee in 1994 who first recommended that the legislation be amended to recognise a power of managerial discretion,[7] and s 6A was subsequently inserted into the legislation on 10 April 1995.[8] Since the enactment of s 6A, the duty of the Commissioner has been to "collect over time the highest net revenue *that is practicable* within the law…".[9]

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[6] TAA 1994, s 113. See also *Lawton v CIR* (2003) 21 NZTC 18,042 where the Court of Appeal confirmed the power to amend assessments was discretionary and "cannot be elevated to the point of a statutory duty". At [12] – [25]. See also Geoffrey Clews "Remedies Against the CIR Considered Through a Constitutional Lens" (2014) 72 Taxation Today 13.

[7] Ivor Richardson and others "Organisational Review of the Inland Revenue Department" (Report by the Organisational Review Committee, 1994) [Richardson Committee report].

[8] Section 4 of the Tax Administration Amendment Act 1995 (1995 No 24).

[9] TAA 1994, s 6A(3). Prior to the introduction of s 6A, the Commissioner was charged "with the administration of the Inland Revenue Acts and with such other functions as may from time to time be lawfully conferred on him". On one reading of the legislation the Commissioner's obligation to assess was absolute and (in the words of Richardson J) "there was no scope for weighing and balancing management functions against collection responsibilities in respect of particular taxpayers…". See *Brierley Investments Limited v CIR* (1993) 15 NZTC 10,212 at 10,219. This was considered to be an unrealistic objective and fits uncomfortably with the appropriation requirements and systems of financial accountability that were put in place for chief executives and government departments under the State Sector Act 1988 and Public Finance Act 1989.

The Richardson Committee also recommended the enactment of s 6 of the TAA 1994. This section imposes a responsibility on every Minister and every officer having responsibilities under the legislation in relation to the collection of taxes and other functions to "at all times use their best endeavours to protect the integrity of the tax system". The section goes on to list a number of rights and responsibilities belonging to both taxpayers and those administering the law that are within the meaning of "the integrity of the tax system".

Sections 6 and 6A together are described by IR in Interpretation Statement IS 10/07 as "a 'legislative package' to provide the framework within which the Commissioner administers the tax system".[10] These sections are therefore pivotal to how the Commissioner will approach the task of responding to taxpayer amendment requests. Different elements of these sections also regularly feature in judicial commentary from the various decisions in case law that are discussed in this chapter. For these reasons, it is worthwhile determining what was originally envisaged by the Richardson Committee when they recommended the enactment of ss 6 and 6A.

The Richardson Committee made their views known in their final report released in April 1994 entitled *Organisational Review of Inland Review Department* ("the Richardson Committee Report").[11] This is also often regarded as relevant legislative history when interpreting ss 6 and 6A.[12] A significant theme in the Richardson Committee Report was the emphasis that the Committee placed on the separate and competing roles of the Commissioner. The Committee regarded the Commissioner as having distinct responsibilities of adjudication and management in her administration of the tax system.

The Commissioner's managerial responsibilities are related to her role as Chief Executive of IR. The power of managerial discretion in s 6A enables the Commissioner to meet her various accountabilities to the Minister of Revenue in terms of the requirements and expectations on chief executives and government departments to be fiscally responsible with public money. This accountability is well supported in the context of the performance management and reporting

[10] IR "Care and Management of the taxes covered by the Inland Revenue Acts" Tax Information Bulletin Vol 22, No 10 (November 2010) at [56] (Interpretation Statement IS 10/07).
[11] Richardson Committee report, above n 7.
[12] For a summary, refer to comments in IR "Care and Management of the taxes covered by the Inland Revenue Acts" Tax Information Bulletin Vol 22, No 10 (November 2010) at [22] (Interpretation Statement 10/07).

requirements applicable to public sector organisations under the State Sector Act 1988 and Public Finance Act 1989.

The adjudicative responsibility of the Commissioner on the other hand is a product of the statutory scheme of the TAA 1994 and the independent statutory powers that are vested in the position of the Commissioner. It reflects the courts' view about the role of the Commissioner when undertaking her assessment function, and the requirement to comply with the administrative law principles of natural justice and fairness. In terms of the legislation, it is only partially represented in the s 6 responsibility on Ministers and officials to protect the integrity of the tax system. It is represented by the right under s 6(2)(b) for a taxpayer "to have their liability determined fairly, impartially, and according to law".

Adjudication is defined in the Richardson Committee report as "*the exercise of judgment in the application of tax legislation* to the affairs of individual taxpayers or groups/classes of taxpayers *in order to determine liability*".[13] Many of the activities undertaken by IR will have an element of adjudication inextricably intertwined. The Richardson Committee were of the opinion that the structural separation of the Commissioner's adjudicative role from the Commissioner's managerial role was both desirable and necessary from the perspective of tax system integrity. Of particular concern for the Committee, and for which the Committee considers structural separation to be appropriate, are those intersections:[14]

> …where there is *both a high concentration of the adjudicative component and a close proximity to the final quantification of an individual taxpayer's liability*. Particular attention should also be paid to areas which have a high potential for contention or are performed in an adversarial context. Special structural focus for this intersection will address these concerns.

With this in mind, the Richardson Committee recommended establishing an adjudication function as a separate business unit, distinct from audit and investigation, to act in the final quantification of liability for taxpayers prior to the issue of an assessment (the final adjudication function). The Committee describes the role of the adjudication function as being "to provide a specific and strong focus on the correct and impartial application of the tax law to the affairs of individual taxpayers".[15] This business unit will also be responsible for making binding rulings and operate within the same

[13] Richardson Committee report, above n 7, Appendix D at [63].
[14] Appendix D at [66].
[15] At 114.

agency as the rest of the department, ultimately reporting to the Commissioner.[16] Some of the Committee's key recommendations in the context of the revised statutory disputes resolution process in pt 4A of the TAA 1994 were made with this relationship in mind.

The problem is that there are still some intersections in IR's administration of the tax system where statutory powers of decision exercisable by the Commissioner bear a close proximity to the final quantification of a taxpayer's ultimate tax liability and for which there remain insufficient safeguards to support Commissioner's adjudicative interests. Taxpayer amendment requests is one area where there is no specific or strong focus on structurally separating the Commissioner's adjudication function.[17] Certainly, there is a high concentration of the adjudicative component of the Commissioner's role to the exercise of s 113. It bears a close proximity to the final quantification of tax liability for a taxpayer and there is a need for the Commissioner to exercise judgement as an assessment can only be amended under s 113 "to ensure its correctness".

Because of the broad decision-making framework represented by ss 6 and 6A, the Commissioner can (and does) rely on her managerial discretion to simply refuse to apply the resources needed to properly consider a taxpayer amendment request. This is evident from the Commissioner's standard practice statement and the case law decisions discussed in this chapter. Moreover, the supervisory jurisdiction of the courts to examine statutory powers of decision exercisable by the Commissioner is concerned mainly with ensuring that those decisions are lawfully made. The choice to prioritise her managerial interests is one that the Commissioner is specifically empowered to make in reliance on her managerial discretion in s 6A, and her statutory duty in s 6A(3) that applies "notwithstanding anything in the IR Acts". Section 6, on the other hand, is of itself absent of any enforceable standards for the Commissioner to adhere to.[18] The result is that the responsibility to determine a taxpayer's liability 'in accordance with the law' only applies when the Commissioner brings an assessment, and this is largely left to the Commissioner's discretion.

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[16] The Disputes Review Unit (previously the Adjudication Unit) was formed by IR in line with the Richardson Committee's recommendation as an important administrative step in the disputes resolution process to serve this final adjudication function. It is part of the Office of the Chief Tax Counsel and based in Wellington – see IR Tax Information Bulletin "Adjudication Unit – its Role in the Dispute Resolution Process" Vol 19 No 10 at 9.

[17] Generally, the decision of whether or not to exercise the discretion in s 113 is made by a senior IR officer working in tandem with Legal and Technical Services (LTS). This is a business unit that sits within the Service Delivery Group and who provide technical and legal support to IR staff.

[18] *Russell & Ors v Taxation Review Authority & Anor* (2002) 20 NZTC 17,832 at [46] – [47], *Review Authority & ABC* (2003) 21 NZTC 18,255 at [36], *Tannadyce Investments Limited v CIR* (2009) 24 NZTC 23,036 at [63], *CIR v Michael Hill Finance (NZ) Limited* (2016) 27 NZTC ¶22-056 at [31].

Although the Commissioner is empowered to prioritise her managerial interests over adjudicative concerns, it should not be forgotten that both ss 113 and 6A are statutory powers that have been vested with the Commissioner for a reason. They are there to serve the purposes of the legislation. The question this chapter seeks to answer is whether the Commissioner is doing enough to exercise the requisite degree of judgement in her assessment of taxpayer amendment requests to ensure that they are not being passed over without good reason.

4.3 The transition to taxpayer self-assessment in New Zealand

In this section, this chapter outlines a number of important reforms that were implemented in order to help facilitate the transition to self-assessment. An awareness of these reforms and how they fit within the broader statutory scheme of the TAA 1994 is critical to understanding how an exercise of the s 113 discretion will best serve the purposes of the legislation.

A number of regimes were enacted to support the practice of self-assessment before even the codification of self-assessment took place in 2001.[19] The binding rulings regime was enacted in 1995 to help taxpayers to achieve certainty on the Commissioner's view of the tax treatment of their transactions. In 1996, new statutory procedures for bringing a dispute and a new compliance and penalties regime were also enacted.

The new compliance and penalties legislation was inserted into pt 9 of the TAA 1994 on 26 July 1996. It was designed to support voluntary compliance by clarifying the standards and obligations expected of taxpayers when they self-assess their tax liability. Its purposes are set out in s 139 and include:

> (a) to encourage taxpayers to comply voluntarily with their tax obligations and to co-operate with the department; and
> (b) to ensure that penalties for breaches of tax obligations are imposed impartially and consistently; and
> (c) to sanction non-compliance with tax obligations effectively and at a level that is proportionate to the seriousness of the breach.

It was accompanied by s 15B of the TAA 1994 that sets out a taxpayer's tax obligations. These include:

> (aa) if required under a tax law, make an assessment:

[19] The process of formally legislating for self-assessment did not occur until 2001 with the passing of the Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001.

(a) unless the taxpayer is a non-filing taxpayer, correctly determine the amount of tax payable by the taxpayer under the tax laws:
(b) deduct or withhold the correct amounts of tax from payments or receipts of the taxpayer when required to do so by the tax laws:
(c) pay tax on time:
…

What might already be evident from the purpose provision of the compliance and penalties legislation is that the sanctions provided for under pt 9 of the TAA 1994 were enacted by Parliament to deal with a failure to meet any of the obligations provided for in s 15B.[20] This is important because the Commissioner in her standard practice statement has sought to rely on a taxpayer's failure to meet their obligations under s 15B as a factor that counts against the taxpayer when deciding on whether to accept a taxpayer's amendment request. In other words, the taxpayer (or the Commissioner) has already made an assessment but the taxpayer is now requesting an amendment because new information has arisen or an error has been discovered. Where the amendment is taxpayer favourable, the Commissioner will sometimes reject the taxpayer's request on the basis that the taxpayer has failed to meet their obligations to correctly self-assess in the first instance. But Parliament intended for the compliance and penalties regime to apply to a breach of s 15B. For the Commissioner to read s 15B in the way that she has is to ignore how Parliament intended for the statutory scheme to deal with a taxpayer's breach of their obligations. Moreover, there is no reason to read the obligation on taxpayers in s 15B(a) to correctly determine the amount of tax payable as applying only the first time an assessment is brought.

For completeness, it is worth noting that s 15B(aa) above was only later inserted as part of the process of codifying taxpayer self-assessment. In this regard, other structural amendments were also made to TAA 1994 to support the respective obligations of the taxpayer and the Commissioner. Section 92 of the TAA 1994 was replaced on 24 October 2001 to reflect the codification of self-assessment. This section now provides that:

A taxpayer who is required to furnish a return of income for a tax year must make an assessment of the taxpayer's taxable income and income tax liability and, if applicable for the tax year, the net loss, terminal tax or refund due.

[20] See also Bill Birch and Wyatt Creech *Legislating for self-assessment of tax liability* (Minister of Finance and Minister of Revenue, Government discussion document, April 1995).

Taxpayers are therefore largely responsible for carrying out the assessment function previously carried out by the Commissioner. What constitutes an assessment by the Commissioner for tax purposes is a matter that has over the years been refined through the Courts. It requires (1) a consideration of the facts relating to the taxpayer's financial affairs; (2) the interpretation and application of the law to those facts; (3) the determination of the amount of tax owing by the taxpayer; and (4) an intention that the determination of the amount owing is final.[21] Although it is not explicitly stated, taxpayers are now generally responsible for meeting each of these requirements when they make a self-assessment of their own tax liability. This is said to be inherent in the taxpayer's tax obligations set out in s 15B.

Another important regime that will have a bearing on whether the Commissioner accepts a taxpayer's amendment request is the statutory disputes regime. The statutory process for resolving disputes was inserted in pt 4A of the TAA 1994 on 1 October 1996. The regime appears to be somewhat unique internationally in that it prescribes a number of procedural steps that must normally be followed before an assessment by the Commissioner can even be issued.[22]

The purposes of the disputes procedures are set out in s 89A as follows:

> (a) improve the accuracy of disputable decisions made by the Commissioner under certain of the IR Acts; and
> (b) reduce the likelihood of disputes arising between the Commissioner and taxpayers by encouraging open and full communication—
> (i) to the Commissioner, of all information necessary for making accurate disputable decisions; and
> (ii) to the taxpayers, of the basis for disputable decisions to be made by the Commissioner; and
> (c) promote the early identification of the basis for any dispute concerning a disputable decision; and
> (d) promote the prompt and efficient resolution of any dispute concerning a disputable decision by requiring the issues and evidence to be considered by the Commissioner and a disputant before the disputant commences proceedings.

In line with this purpose provision, the disputes procedures have led to a number of positive outcomes for resolving disputes in New Zealand. In particular, the procedures assist in helping

[21] At [3.4]. See also summary by Fisher J in *Golden Bay Cement Company Limited v CIR (No 1)* (1995) 17 NZTC 12,253.
[22] See Mark Keating and Mike Lennard New Zealand branch report in Cahiers de droit fiscal international *The practical protection of taxpayers' fundamental rights* (International Fiscal Association, volume 100B, 2015) at 573. For more information on the process that will be followed refer to SPS 11/05 and SPS 11/06 in IR Tax Information Bulletin Vol 23 No 9. See s 89C of the TAA 1994 for when the Commissioner is not required to follow the disputes process.

both parties to be fully informed of each other's respective positions. On the other hand, it has also been heavily criticised by taxpayers and their advisors for being overly long and complex. The consequences for failing to adhere to this mandatory process for a taxpayer can also be severe. They include deemed acceptance of the Commissioner's position and restrictions on the matters that can be raised in challenge proceedings.

Generally, a taxpayer will have only a four-month period that starts on the date that the Commissioner receives that taxpayer's self-assessment within which to commence the disputes process.[23] If a taxpayer misses this narrow window then they will have to send an amendment request to the Commissioner. They then have to rely on the Commissioner agreeing to exercise her discretion under s 113 of the TAA 1994 to make any change to the assessment. If the Commissioner considers that the taxpayer should have brought the matter to her attention using the disputes resolution process, this will weigh significantly against a decision to accept the taxpayer's amendment request.

Part of the justification for these regimes that support taxpayer self-assessment is that they ensure consistency of outcomes. A government discussion document on legislating for self-assessment explains that these reforms intended to level the playing field, as a taxpayer is not bound by the same administrative law principles that bind IR:[24]

> One difference between assessment by the Commissioner and assessment by the taxpayer is that the Commissioner must comply with the administrative law principles of natural justice and fairness. Those principles aim to ensure consistency of treatment between taxpayers. The penalties legislation, the disputes resolution process and the binding rulings system are all intended to ensure that these outcomes are achieved when taxpayers assess their own tax liability.

The compliance and penalties regime and disputes resolution procedures have certainly both raised the stakes for taxpayers and their advisors in terms of how important it is to accurately determine tax liability on self-assessment. Failure to do so may attract a fiscal cost in terms of penalties and interest being imposed. Moreover, a delay of only four months from the date that the Commissioner receives that taxpayer's self-assessment will have meant that the taxpayer has lost the opportunity to use the statutory disputes resolution process to challenge their self-assessment.

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[23] TAA 1994, s 89DA(1).

[24] Bill Birch *Legislating for self-assessment of tax liability* (Treasurer and Minister of Finance, Discussion Document, August 1998) at [3.11].

Given that the above consequences already apply when a taxpayer has failed in their obligation to correctly self-assess, it is really important that the decision-making process used by the Commissioner to determine how she will respond to taxpayer amendment requests is seen to be operating fairly.

4.4 The new role of section 113 in supporting self-assessment

To support substantial self-assessment by taxpayers, there has been a significant increase in the number and importance of administrative discretions vested with the Commissioner.[25] The power in s 113 to amend an assessment has also become far more prominent in terms of ensuring that the self-assessment scheme works in New Zealand. For these reasons, it is relevant to consider what the courts have held can be expected of the Commissioner when exercising her powers.

4.4.1 Role of the Commissioner when exercising administrative discretions

This chapter first examines what the Courts have inferred about the role of the Commissioner when exercising administrative discretions generally. Administrative discretions permit a degree of flexibility in the administration of the tax system and are an important part of making self-assessment work in New Zealand.[26] It is also basic to the nature of a discretion that has been delegated to tax authorities that the rights of taxpayers to pursue legal remedies will accordingly be limited. In the words one commentator:[27]

> Where a discretion is delegated to the authorities in respect of specific matters, it follows that affected taxpayers lack a comprehensive right of appeal to the courts. The decisions in question would otherwise not be discretions, in the sense of representing independent and binding judgements of the tax authorities, but rather normal items of law or fact on which the courts would pronounce under general appeals procedures.

This does not mean that these discretions are entirely outside the domain of the courts. Under s 4 of the Judicature Amendment Act 1994, the High Court is empowered to examine the decisions of IR in relation to the exercise (including the proposed or purported exercise or the refusal to exercise) of a statutory power on an application for review. This is sometimes referred to as the

[25] See Shelley Griffiths "Revenue Authority Discretions and the Rule of Law in New Zealand" in Chris Evans, Judith Freedman and Richard Krever (eds) The Delicate Balance – Tax, Discretion and the Rule of Law (IBFD, Amsterdam, 2011) at 155.

[26] Usually, the exercise of a statutory power of discretion is made in adherence to stated policy to ensure that the proper degree of consistency is maintained between taxpayers.

[27] Dominic de Cogan "Tax, Discretion and the Rule of Law" in Chris Evans, Judith Freedman and Richard Krever (eds) The Delicate Balance – Tax, Discretion and the Rule of Law (IBFD, Amsterdam, 2011) at 9.

court's supervisory jurisdiction whereby the courts oversee that the exercise of powers vested with public bodies is lawful. However, taxpayer challenges in judicial review proceedings are normally advanced against the processes followed by a decision maker and not against the decision itself. This is because the court will not simply substitute its own view for that of the Commissioner.[28] The most common form of remedy on judicial review is an order that sets aside the decision, together with an order requiring that the matter be reconsidered. There are no guarantees that reconsideration will necessarily result in a different outcome.

Given the significant degree of flexibility that these administrative discretions have afforded the Commissioner in terms of her administration of the tax system, taxpayers will be interested in what responsibilities the courts have said accompany the exercise of these discretions. Briefly therefore, this chapter discusses some of the decisions that deal with how the Commissioner must exercise the various statutory discretions vested with her.

In *Gisborne Mills Limited and Others v CIR* it was held that the Commissioner is under a statutory responsibility to undertake a reasoned exercise of discretions, which requires the Commissioner "to weigh the particular circumstances which existed".[29] The case is authority for the proposition that rigid adherence to a stated policy will not always satisfy Parliament's requirements for the exercise of a discretion that has been delegated to the Commissioner.

Richardson P, in the Court of Appeal decision of *CIR v Wilson*, expanded on this decision and provided that:[30]

> As in the case of any authority entrusted with statutory powers of decision, the Commissioner's statutory powers must be exercised in accordance with explicit or implicit statutory criteria and to serve the purposes of the legislation.

The *Wilson* decision above involved the discretionary relaxing of time limits which would allow the Commissioner to accept a late notice of objection. Richardson P in the *Wilson* decision embarked on a contextual analysis of the discretion in terms of the statutory scheme before quashing the Commissioner's refusal to accept a late objection. The issue in that case was that the Commissioner had failed to properly consider the merits of the taxpayer's request. In particular,

[28] *Raynel & Anor v CIR* (2004) 21 NZTC 18583 at [73].
[29] *Gisborne Mills Limited and Others v CIR* (1989) 11 NZTC 6,194.
[30] *CIR v Wilson* (1996) 17 NZTC 12,512.

the Commissioner's discretion to allow a late discretion was held to be important to a tax system "which attaches so much significance to voluntary compliance by all taxpayers" and "which, to maintain goodwill, has to be seen to be operating fairly".[31]

The *Wilson* decision was applied in the later decision of *Lawton v CIR*.[32] This case also involved the Commissioner's discretion to accept a late notice of objection. The *Lawton* decision again emphasised the importance of considering the merits of the taxpayer's position. Likewise, this decision also recognised the importance of considering the merits of a taxpayer's position in a system that relies on voluntary compliance by taxpayers. According to the judgment delivered by Glazebrook J:[33]

> …it is important in a system which relies on voluntary compliance for the Commissioner to be seen to be operating fairly, and this will in many circumstances mean that the merits of a taxpayer's position will be a material factor to be weighed.

The amount of reliance that the tax system places on voluntary compliance is only magnified in an environment characterised by self-assessment. It is also now specifically incorporated into IR's management of the tax system by virtue of s 6A.

Both the *Wilson* and *Lawton* judgments involved judicial review of decisions made by the Commissioner in a legislative setting that did not include ss 6 and 6A. As they were decided before legislative recognition of the Commissioner's managerial interests in the administration of the tax system, they are argued to be a good indication of what is important for the purposes of the Commissioner's adjudicative role. A feature of these decisions is that they both emphasise the importance of considering the merits of a taxpayer's position. Part five of this chapter revisits these cases and makes the point that this consideration is, from the perspective of the Commissioner's adjudicative role, fundamental to the exercise of certain discretions connected to the final quantification of a taxpayer's liability.

More recent decisions have confirmed that, while the merits of a taxpayer's position is still relevant to the exercise of the s 113 discretion, the matters that the Commissioner might have regard to when exercising her statutory powers have been widened to encompass the

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[31] At 12,520.
[32] *Lawton v CIR* (2003) 21 NZTC 18,042.
[33] At [29].

responsibilities set out in ss 6 and 6A of the TAA 1994. As a direct consequence of this, there is, in the view of the Commissioner, more scope for refusing a taxpayer's amendment request for reasons other than the merits of the taxpayer's position.[34] This chapter examines how the more recent case authorities have dealt with the importance of considering the merits of a taxpayer's position in part six of this chapter.

4.4.2 Case decisions on the scope and purpose of section 113

As discussed in the introduction, the statutory discretion in s 113 of the TAA 1994 to amend an assessment "to ensure its correctness" has been around for quite some time (close to a century). Despite some minor amendments to its wording, the essence of the provision has always been the same.[35] Section 113 of the TAA 1994 reads as follows:

> **113 Commissioner may at any time amend assessments**
>
> (1) Subject to sections 89N and 113D, the Commissioner may from time to time, and at any time, amend an assessment as the Commissioner thinks necessary in order to ensure its correctness, notwithstanding that tax already assessed may have been paid.
> (2) If any such amendment has the effect of imposing any fresh liability or increasing any existing liability, notice of it shall be given by the Commissioner to the taxpayer affected.

Recent decisions in the High Court have confirmed in no uncertain terms that, subject to the one stipulation that a correct assessment must result from the requested amendment, the discretion is not fettered in any way. In the High Court decision of *Arai Korp Limited v CIR*, s 113 is described in the following terms:[36]

> The discretion is not constrained in any way. It is not expressed to be subject to the prior exercise of the disputes procedure or the challenges procedure. It does not call for an inquiry into why any assessment is incorrect. It is not necessary to identify who has made the error that has resulted in an assessment being incorrect. It does not distinguish between consequential errors and genuine errors. The focus is on the correctness of an assessment, not on the errors which lead to an assessment being incorrect. The section can be considered to be a "backstop" provision.

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[34] See IR "SPS 16/01 Requests to Amend Assessments" Tax Information Bulletin Vol 28 No 4 at 12.
[35] This was confirmed in the judgment of Clifford J in *Westpac Securities NZ Limited v CIR* (2014) 26 NZTC ¶21-118 where it was held that the discretion has "developed from a power to make all 'alterations in or additions to' an assessment that he 'thinks necessary in order to ensure the correctness' of the assessment to a power to 'amend an assessment as the Commissioner thinks necessary in order to ensure its correctness'. The essence of the provision has however remained the same - the Commissioner is able to amend an assessment 'to ensure its correctness' — and to that extent previous authority on the interpretation of s 23 [of the Income Tax Act 1976] remains applicable". At [58].
[36] *Arai Korp Limited v CIR* (2013) 26 NZTC ¶21-014 at [34].

Moreover, the decision in *Westpac Securities NZ Limited v CIR* has confirmed that the discretion (as a matter of law) is more flexible than IR previously considered.[37] It will permit an assessment to be amended even if, left unchanged, it would still be correct under the legislation. Following this decision, IR was forced to abandon its previous view that the Commissioner cannot exercise her discretion to agree to an amendment request where there has been no genuine error.[38] The decision also suggests that s 113 has a broader role to play in a self-assessment environment. Per Clifford J:[39]

> …s 113 is the primary amendment power available following utilisation of the disputes process, and also plays a broader role in the self-assessment scheme enabling the Commissioner to correct undisputed errors, or make amendments at the Commissioner or taxpayer's initiative outside of the narrow time period in which the disputes resolution procedures are available.

Section 113 has shifted on self-assessment from being a mechanism to ensure that the Commissioner's assessment function is being undertaken correctly, to a mechanism that can assist taxpayers in their obligation under s 15B of the TAA 1994 to correctly determine the amount of tax payable.[40] This is consistent with the transference of responsibility from the Commissioner to the taxpayer that occurred with self-assessment.[41] The taxpayer is now expected to perform each of the steps previously required to be undertaken by the Commissioner to constitute an assessment.

Another important point in *Westpac Securities* is that Clifford J responds to the Commissioner's duty under s 6A(3) of the TAA 1994 "to collect the highest net revenue that is practicable within the law" by suggesting that "it may nevertheless be the case that allowing a taxpayer to amend their self-assessment is more consistent with the policy underpinnings of the legislation".[42] One interpretation of this is that the judge was prepared to read down the Commissioner's managerial interests and her duty in s 6A when it comes to the exercise of her discretion in s 113. The decision

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[37] *Westpac Securities NZ Limited v CIR* (2014) 26 NZTC ¶21-118.

[38] IR in their previous statement on the exercise of this discretion held to a concept of "regretted choice". This is explained in the following terms– "[w]here taxpayers request the Commissioner to change assessments from one valid option to another, there is no genuine error to correct. This is a matter of regretted choice, such as where taxpayers choose one of several legitimate options for the calculation of a tax liability and later request that option be changed". See IR "SPS 07/03 Requests to Amend Assessments" Tax Information Bulletin Vol 19 No 5 at [30].

[39] *Westpac Securities NZ Limited v CIR* (2014) 26 NZTC ¶21-118 at [52].

[40] See Graham Tubb – Group Tax Counsel, IR "Requests to amend assessments: Section 113" (Paper presented to Chartered Accountants Australia and New Zealand Tax Conference, Auckland, November 2015) at 12.

[41] See discussion infra at 3.0.

[42] *Westpac Securities NZ Limited v CIR* (2014) 26 NZTC ¶21-118 at [62].

instead recognises the central importance of a power like s 113 discretion when it comes to the Commissioner's adjudicative responsibilities under the legislation.

This finding is reinforced by the Court of Appeal decision in *Charter Holdings Limited v CIR*.[43] In that case, s 113 was said to fit comfortably with the responsibility to protect the integrity of the tax system in s 6. Per Cooper J:[44]

> Section 113 allows the Commissioner to amend an assessment at any stage when she thinks it necessary to ensure its correctness. The power given is remedial in nature and sits comfortably with the obligation conferred on functionaries under the TAA "at all times to use their best endeavours to protect the integrity of the tax system". Relevantly, s 6(2) of the TAA states that, without limiting its meaning, the expression "the integrity of the tax system" includes taxpayer perceptions of that integrity, and the rights of taxpayers to have their liability determined "fairly, impartially, and according to law". Amendment of an assessment so as to ensure its correctness is therefore clearly in accordance with protecting the integrity of the tax system.

The Commissioner's adjudicative responsibility described in part two of this chapter is best represented in s 6 by the responsibility to protect the rights of taxpayers to have their tax liability determined fairly, impartially, and according to the law. The Court of Appeal in *Charter Holdings* has therefore recognised in their judgment that there is a strong adjudicative component to how the Commissioner exercises her discretion in s 113. The decision of whether or not to amend an assessment bears a close proximity to the final quantification of tax liability for a taxpayer. In part seven, this chapter examines IR's most recent standard practice statement on how the Commissioner will exercise her s 113 discretion in response to a taxpayer amendment request. Far from embracing the possibilities that s 113 has to offer for supporting voluntary compliance in a self-assessment environment, it would seem that IR has been slow to embrace its potential.

4.5 Early decisions on the merits of the taxpayer's position

This section deals with the most important factor that must be weighed from the perspective of the Commissioner's adjudicative responsibilities under the legislation. This is the need to consider the merits of the taxpayer's position when coming to a decision on whether or not to accept a taxpayer's amendment request.

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[43] *Charter Holdings Limited v CIR* (2016) 27 NZTC ¶22-075
[44] At [52].

Both of the *Wilson* and *Lawton* decisions discussed earlier involved the Commissioner's discretion to accept a late notice of objection received after the statutory time limit. While decided before the enactment of ss 6 and 6A and in a slightly different context to the Commissioner's discretion to amend an assessment in s 113, both of these decisions deal with the importance of considering the merits of a taxpayer's positon when coming to a decision. These cases both also confirm that the Commissioner is not under a statutory duty to exercise her power of reassessment. This is essentially left to the Commissioner to determine. However, the Commissioner is still under a duty to weigh the relevant circumstances before coming to a decision.

CIR v Wilson

In the *Wilson* decision, the taxpayer sought to deduct losses incurred on the sale of listed shares in his income tax return for 1988. IR subsequently added back the net loss on the sale of shares. This was in line with a position IR had previously taken on the deductibility of share losses that was since tested in court and held to be incorrect.[45] Although the taxpayer in relevant correspondence with IR continued to assert that they were entitled to these losses, no written objection was made to the notice of assessment received from IR within the required timeframe. Instead, a request was made in writing to IR that the assessment be re-opened. This was treated as a late objection and was refused. The taxpayer sought judicial review of the Commissioner's decision not to accept the late objection.

In court, the taxpayer argued that the Commissioner's discretion to accept a late notice "must be exercised so as to recognise the paramount consideration that there should be an accurate assessment and failure to do so is an abuse of the statutory power".[46] This was not accepted by Richardson P who held that other factors, such as the statutory imposition of time limits, may also be relevant to the decision.[47] That said, unless there are good reasons to discount the merits of the taxpayer's proposed objection, it will be a material factor that still needs to be weighed in coming to a decision. According to Richardson P:[48]

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[45] *CIR v Inglis* (1992) 14 NZTC 9,180.
[46] *CIR v Wilson* (1996) 17 NZTC 12,512 at 12,520.
[47] According to Richardson P "[t]he imposition of time limits is a central feature of tax administration in New Zealand, as in other jurisdictions. It is part of the scheme and policy of the legislation. Without time constraints, administrative chaos and uncertainty would ensue. …The setting of time limits and other constraints throughout the legislation recognises that the correctness and the quantification of tax liability is not an absolute value". At 12,518.
[48] At 12,220.

> …the purpose of a discretionary relaxing of time limits is to allow consideration of a challenge to the adjustment on the ground that the income tax liability has been overstated. That is particularly important in a system which attaches so much significance to voluntary compliance by all taxpayers with the IR Acts and which, to maintain goodwill, has to be seen to be operating fairly. In some circumstances the inadequacy of the explanation for lateness may make it unnecessary to consider the apparent strength of the proposed objection. In many circumstances, however, *it will be a material factor to be weighed*.

The Court of Appeal ultimately held that this was not a case where "the explanation for late objecting and the ensuing delay and other relevant factors in that area of the case pointed so strongly against accepting the late objection that the apparent merits did not matter".[49] It was also found on the facts that the merits of the proposed objection were not properly considered. Accordingly, the Commissioner was directed by the Court of Appeal to reconsider the taxpayer's application for late objection.

This decision implies that the threshold is set relatively high in terms of when the merits of the taxpayer's position can be dismissed without being given proper consideration. Only where the explanation for lateness is inadequate does the decision indicate that this factor need not be considered. The fact that the taxpayer had never abandoned his claim and the fact that IR and the taxpayer's agent had each also contributed to the delay were accepted by the Court of Appeal as supporting the taxpayer's explanation.

Lawton v CIR

The same issues were dealt with by the Court of Appeal in the *Lawton* decision in what was a substantially similar judgment.

That case involved a share trader and it was agreed by the parties that the share trading activities were on revenue account for the entire period relevant to the decision. A number of the taxpayer's income tax returns were filed on the basis that profits or losses relating to the sale of shares and associated interest costs were all on capital account. It was not until the taxpayer was prompted to have a discussion with his accountant because of the publicity around other court decisions that the error came to light. The taxpayer sent a request to IR to reissue the corresponding assessments to correct what was argued to be an oversight. This request was treated as a late objection and was refused by IR without adequate thought given to the merits of the taxpayer's objection. The

[49] At 12,521.

question was whether the Commissioner's failure to consider the merits of the taxpayer's position was justified in the circumstances. The Court of Appeal held:[50]

> We do not consider this to be a case where examination of the merits was not required. The explanation for lateness in this case was that Mr Lawton had not realised that the transactions were on revenue account. In such a case, unless this explanation was palpably untrue or quite unjustified, it would be rare for the explanation to be deemed so inadequate that the merits need not be examined. It would be difficult in any event to assess whether that explanation was adequate or reasonable without considering the merits at all.

The Commissioner was again in this case directed to reconsider the application for late objection.

This case provides some good context for what the courts will consider as being a valid explanation for lateness in a situation where the taxpayer seeks to have their own self-assessment amended. The taxpayer had made a simple oversight as he had not realised that the transactions were on revenue account. Despite being outside the statutory timeframes for challenging the assessment, this did not excuse the Commissioner from a requirement to consider the merits of the taxpayer's positon. The decision indicates that the circumstances where the Commissioner would be justified in coming to a decision without an examination of the merits of the taxpayer's position are really quite extraordinary – it would only be where the explanation "was palpably untrue or quite unjustified".

These cases are a good indication of the importance that the courts have traditionally attached to weighing up the merits of the taxpayer's position. While this is not necessarily the decisive factor, it is critical that the Commissioner gives this due consideration in coming to a decision (or otherwise has very good reasons for not doing so).

4.6 Recent decisions on Commissioner's approach to taxpayer amendment requests

The Commissioner's discretion to accept a late notice of objection (which was the subject of the cases examined in the previous section) has since been replaced by strict statutory procedures that apply in relation to the dispute resolution and challenge regimes. Most relevant now are the statutory time limits that apply for bringing a dispute. In addition, ss 6 and 6A of the TAA 1994

[50] *Lawton v CIR* (2003) 21 NZTC 18,042 at 18,050.

have been added to the statutory scheme. In this new context, there have been a number of recent decisions that deal with the Commissioner's approach to taxpayer amendment requests.

As discussed earlier, the High Court decision of *Westpac Securities* involved the Commissioner declining to exercise her discretion on the basis that she considered s 113 could not be invoked to amend an assessment from one legally valid option under the legislation to another. The decision has since confirmed that this is possible. Moreover, allowing the taxpayer to amend their self-assessment may even be "more consistent with the policy underpinnings of the legislation".[51] While *Westpac Securities* was mainly relevant to the scope of the s 113 discretion, it also confirmed that the Commissioner may well have regard to factors other than the merits of the taxpayer's position. These will include available resources and whether the taxpayer is making an amendment request as a way of circumventing the statutory disputes process.[52]

Below we discuss two other recent decisions that have shed some light on how this discretion should be exercised and what factors should influence the decision. These decisions stand apart from *Westpac Securities* and are important to discuss because they each involve the Commissioner declining to exercise her discretion in s 113 despite there being manifest errors in the assessments.

Arai Korp Limited v CIR

The first of these is the High Court decision of *Arai Korp*.[53] The taxpayer in this case was a property development company that had been in neglect of its obligations to file income tax returns from 2002 – 2007. An investigation by the Commissioner resulted in default assessments being issued against the taxpayer under s 106 of the TAA 1994 for the 2004 and 2005 income years where income should have been returned on the sale of several units in a subdivision.

The taxpayer wrote to the Commissioner requesting that they be allowed to complete fresh returns in place of the default assessments and that a late challenge to the Taxation Review Authority be granted. This was treated as a taxpayer amendment request and was declined. Significant to the taxpayer's request was the assertion that the default assessments issued by the Commissioner made no allowance for the costs of purchasing the land or interest payable on a loan in relation to the subdivision. The Commissioner, in her statement of defence, *accepted* that no allowance had been

[51] *Westpac Securities NZ Limited v CIR* (2014) 26 NZTC ¶21-118 at [62].
[52] At [67].
[53] *Arai Korp Limited v CIR* (2013) 26 NZTC ¶21-014.

made for either of these two items. It was argued for the taxpayer that these errors were "self-evident" and that "a reasonable and fair minded decision maker, concerned with the integrity of the tax system, would have exercised the discretion, and allowed tax to be assessed on the correct position".[54] However, the Court did not agree.

The IR officer responsible for considering the request had simply stated that there had already been a full investigation into the taxpayer's affairs and that "the Commissioner was confident that the default assessments were correct".[55] Wylie J for the High Court agreed that no consideration had been given to the merits of the taxpayer's arguments, and that in his opinion, the IR officer "should have done so".[56] This however was not to prove fatal, as the judge was prepared to find that other relevant factors supported the Commissioner's decision to decline to exercise her s 113 discretion. On the matter of correctness of the default assessments, Wylie J found that:[57]

> I am not, however, persuaded that [the Inland Revenue officer's] failure to address these issues is fatal to his decision. While the correctness of the default assessments was in my view a relevant factor, it was not the paramount consideration on the facts of this case.

The fact that resource considerations were taken into account (as the earlier investigation would have to be reopened) was also accepted as being a relevant factor. It is clear that the Commissioner is empowered to take into account available resources when deciding on how to exercise her discretion. This is specifically allowed under s 6A(3) of the TAA 1994. Also weighing strongly against the taxpayer was the fact that the statutory disputes and challenge procedures (although clearly available) were not used by the taxpayer to challenge the default assessments within the timeframes permitted. Wylie J was inclined to agree with submissions for the Commissioner:[58]

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[54] At [29].
[55] At [38].
[56] At [48].
[57] Citing with approval the decision of *CIR v Wilson* (1996) 17 NZTC 12,512. At [50].
[58] At [68]. The risk with these sorts of judicial insights into what falls within IR's responsibility to protect the integrity of the tax system is that it can easily be taken out of context. Frankly, the Commissioner can point to whichever of the factors listed in s 6(2) justifies an intended course of action and can probably find some vindication in case law for how she has decided to exercise her statutory powers. Meanwhile, a taxpayer cannot assert that their tax affairs were treated with greater or lesser favour than the affairs of other taxpayers in terms of (for example) the resources used and efforts of IR to bring an assessment. This was confirmed in the recent decision of *CIR v Michael Hill Finance (NZ) Limited* (2016) 27 NZTC ¶22-056. The problem is that s 6 does not confer on the taxpayer any rights that are enforceable against the Commissioner. Moreover, the section does not prescribe the weight to be given to each of the factors listed in s 6(2). This has led to an imbalance in terms of how s 6 has come to be applied, and perhaps an over-fixation by IR on retributive fairness concerns to the exclusion of other kinds of fairness. See Michael Wenzel "Tax Compliance and the Psychology of Justice: Mapping the Field" in Valerie Braithwaite (ed) *Taxing Democracy: Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 46.

> I agree with Mr Ebersohn [for the Commissioner] that Arai Korp is doing no more than trying to bypass the disputes process, and the challenge procedure, in circumstances where there is no proper explanation for its failure to avail itself of those processes in the first place. If it were to be allowed to do so, this would undermine the statutory scheme. Arai Korp would be being treated more favourably than other taxpayers. Section 6(2)(c) of the Act requires the Commissioner to protect the right of a taxpayer to have his or her tax affairs treated with no greater or lesser favour than the tax affairs of other taxpayers. A taxpayer who has sat on his or her hands and done nothing, is not entitled to expect preferential treatment.

The approach taken by Wylie J in *Arai Korp* represents a shift in the importance placed on considering the merits of the taxpayer's position that was seen in the *Wilson* and *Lawton* decisions. These earlier decisions recognise that correctness and the quantification of tax liability is not an absolute value in tax administration, but it should weigh in the decision unless there are very good reasons for not doing this. In the *Arai Korp* decision, Wylie J reached the conclusion that the IR officer should have considered the merits of the taxpayer's arguments, but that his failure to do so did not prove fatal to his decision not to accept the taxpayer's amendment request. But can it really be said with certainty that the same decision would have been reached had the merits of the taxpayer's position been properly considered?

In this instance, the decision has allowed the Commissioner to overlook her adjudicative responsibility to exercise judgement by pointing instead to limited resources and the failure of the taxpayer to invoke the statutory processes.

The problem with this decision is that it reads down the broader role that s 113 has to play in a self-assessment environment. When the Commissioner issued the taxpayer with default assessments, she was performing a statutory duty that required the exercise of judgement. If the merits of the taxpayer's amendment request were properly considered, then it would have been evident that there were manifest errors in those assessments and that the Commissioner had failed to quantify the amount properly in accordance with the substantive taxing provisions. This was not simply a case of a contestable tax position that the taxpayer had failed to bring Commissioner's attention via the statutory disputes processes. There is another aspect to this decision, one that relates to what can be expected of the Commissioner with regards to the various statutory powers vested with her. By disregarding the significance that should be attached to the merits of the taxpayer's position, the judge has downplayed the emphasis that should be placed on the Commissioner's adjudicative responsibilities.

The Commissioner has since sought to apply the above comments by Wylie J rather broadly in her standard practice statement on how taxpayer amendment requests will be dealt with.[59] This is done without referring to any of the particulars of the decision. It is for example highly relevant to the *Arai Korp* decision that the taxpayer had neglected to file its own income tax returns and, as a result, the Commissioner was prompted to issue default assessments under s 106 of the TAA 1994. These assessments were issued only after a full investigation into the taxpayer's affairs. The taxpayer was also advised by IR of its right to dispute the default assessments using the statutory processes at the same time the assessment was issued. This is very different from a taxpayer who makes a request to the Commissioner to have their own self-assessment amended in the ordinary course of things. Nevertheless, the standard practice statement makes no attempt to differentiate between these two sets of circumstances.

Charter Holdings Limited v CIR

A second decision that also involved the Commissioner refusing to exercise her discretion in s 113, despite manifest errors in the assessment, is the Court of Appeal decision of *Charter Holdings*.[60]

The taxpayer (Charter Holdings) was engaged over the relevant years first as a swimming pool equipment retailer and distributor and later as a management consultancy business. The company had a poor track record in terms of filing its returns, many of which were filed substantially after the relevant due dates.[61] There was also a particular issue with the 2004 tax return. The company at this time was in receivership and the relevant correspondence was sent to the receivers, with the taxpayer unaware that the tax return had not been filed. Despite a number of other issues, really the principal error made by the taxpayer seems to have come down to the simple matter of how the relevant tax return forms were filled out. The taxpayer neglected to add together losses incurred in all previous years and therefore did not record an aggregate figure of losses as the "amount brought forward" item in the tax return. Assessments were automatically generated by IR on the basis of the information provided in the returns as filed and no independent verification had taken place.

[59] See IR "SPS 16/01 Requests to Amend Assessments" Tax Information Bulletin Vol 28 No 4 at 12 (SPS 16/01) at [41] – [43]. See discussion infra at 6.0.
[60] *Charter Holdings Limited v CIR* (2016) 27 NZTC ¶22-075.
[61] The tax returns for the 2002 and 2003 income years were not filed until 6 September 2006 (although they were due 7 July 2002 and 7 July 2003 respectively). The outstanding returns for the 2005 to 2012 income years were not filed until 5 March 2013.

The error surfaced when the Commissioner sent the taxpayer assessments for amounts of tax to pay for the 2006 – 2012 years. When completing returns for these years, the taxpayer had inserted an amount for losses claimed in that year to match the amount of income declared for that year. This was done under the mistaken belief that the Commissioner had accepted the losses incurred by the company in previous years (or in any event, that IR maintained a record of these losses). After the taxpayer made contact to try and resolve the issue, IR advised that the 2004 return had to be filed before any consideration of loss utilisation could take place. Once this was done, the department advised the taxpayer that their request to amend the assessments to reflect the loss utilisation had been declined as no information had been provided to substantiate the claim. IR also indicated that financial statements were required. The taxpayer duly forwarded this information and again requested that the aggregate losses be applied to subsequent years' trading. This request was once again refused.[62] At some point during all this back and forth with Inland Revenue, the statutory time period for the taxpayer to initiate the dispute procedure within had expired.

Much of the judgment in the Court of Appeal decision was concerned with a jurisdictional matter, as the High Court had erroneously taken the Supreme Court decision in *Tannadyce Investments Ltd v CIR* to mean that the taxpayer could not pursue the issues raised on an application for review.[63] On that point, the Court of Appeal noted:[64]

> …it is inappropriate to postulate a rule that relief cannot be granted because the statutory disputes and challenge procedures have not been followed. Often that fact will be an important consideration and may persuade the Court that relief should not be granted. But to reason as the High Court did is to elevate to a substantive rule a consideration that could only be relevant to the question whether relief should be granted in the court's discretion.

In line with the *Wilson* and *Lawton* decisions, the Court of Appeal then reaffirmed the importance of considering the merits of a taxpayer's amendment request. Per Cooper J:[65]

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[62] A small but interesting fact in this case is that the investigating accountant, who the taxpayer was largely dealing with in respect of the amendment request, had in fact recommended that the application be accepted. However, the delegated authority to exercise the s 113 discretion reposed in Legal Technical Services (LTS), another business unit within IR. The recommendation by the investigating accountant to accept the application was ultimately rejected by a Team Leader in LTS, who was concerned about the resources that IR would need to devote to verifying the correct position. In her reasons for rejecting the application, the Team Leader wrote "[t]he Commissioner cannot be compelled to investigate the claims that the assessment of the previous tax returns are in error and the assessments should be amended". At [23] – [29].

[63] *Tannadyce Investments Limited v CIR* (2011) 25 NZTC ¶20-103.

[64] *Charter Holdings Limited v CIR* (2016) 27 NZTC ¶22-075 at [59].

[65] At [62].

> The importance of considering the merits in deciding whether or not to exercise the s 113 power is, we think, inherent in the evident purpose of s 113: the section constitutes a conferral of power exercisable outside the statutory disputes and challenge procedures by which the Commissioner may make adjustments necessary to ensure the correctness of assessments.

The Court of Appeal concluded that the High Court did not deal with the merits of the application for review and proceeded to consider the process followed by the Commissioner in coming to her decision not to exercise her s 113 discretion. They found that the Commissioner had based her decision on material mistakes of fact, and concluded that these factual errors must have had an influence on her decision.[66] This was found to properly constitute a ground of review and the matter was referred back to the Commissioner for reconsideration.

It is reassuring to see the Court of Appeal renew the emphasis that has traditionally been placed on considering the merits of the taxpayer's position in coming to a decision on how s 113 should be exercised. Cooper J even suggests it is "inherent in the evident purpose of s 113" that the merits of the taxpayer's position is an important consideration when coming to a decision about how to exercise this discretion. This supports that there is a strong connection between the Commissioner's adjudicative responsibility and s 113 in terms of the statutory scheme. The Commissioner's responsibility to uphold a taxpayer's right to have their liability determined according to the law should therefore not be lightly dismissed. This is realignment in the direction of the earlier *Wilson* and *Lawton* decisions.

4.7 The Commissioner's approach to taxpayer amendment requests

4.7.1 Standard Practice Statement (SPS 16/01)

IR has issued a revised standard practice statement "SPS 16/01: Requests to amend assessments" (SPS 16/01) to describe how the Commissioner will approach the task of responding to taxpayer amendment requests.[67] This replaces a previous statement issued in 2007 and was updated to reflect some of the various court decisions already discussed in this chapter. Also in light of these decisions, this chapter now turns to consider whether this statement is a fair reflection of what the courts have said is important to an exercise of the s 113 discretion.

The statement sets out a process that the Commissioner will use to consider amendment requests. This process is broken down into the following four phases: **Phase one** is the initial examination

[66] At [75].
[67] IR "SPS 16/01 Requests to Amend Assessments" Tax Information Bulletin Vol 28 No 4 at 12 (SPS 16/01).

of the request; **Phase two** is a consideration of whether to apply resources to consider the request further; **Phase three** is a consideration of whether a correct assessment will result from the amendment requested; and **Phase four** is the final consideration of whether there are any other reasons for why the Commissioner should not amend the assessment.

A theme throughout SPS 16/01 is just how much emphasis that IR purports to place on the obligations of taxpayers to correctly determine their tax liability and meet their other tax obligations under the legislation in the first instance. This is a far cry from embracing the role that s 113 has to play in a broader self-assessment scheme by correcting undisputed errors or allowing the taxpayer to amend their assessment outside of the strict timeframes provided for under the disputes resolution procedures.

At phase one, on initial examination, the Commissioner will consider the "apparent merits" of all amendment requests. According to SPS 16/01, "[t]he aim of this phase is to act as a 'filter' for these clearly correct/incorrect requests" and "to either decline the request or progress the request directly to phase four, and to do so with the minimum use of the Commissioner's resources".[68] At first blush, the approach of filtering out those clearly correct/incorrect requests would suggest that those manifest errors found in the *Arai Korp* and *Charter Holdings* decisions would have been remedied. This however belies the reality that IR needs to be satisfied on the information provided that an adjustment is needed, and this in itself is often a subjective consideration. IR is often (and understandably) extremely circumspect with the information it receives. There therefore remains a substantial risk that the merits of a taxpayer's amendment request is not given due consideration at this stage.

Phase four considers only whether there are any residual factors that point away from the exercise of the discretion. Normally, this will be because the integrity of the tax system could in some way be undermined should the Commissioner agree to the taxpayer's amendment request. While these circumstances are expected to be relatively rare, SPS 16/01 cites as possible examples taxpayer amendment requests that are part of a tax avoidance arrangement, and taxpayer amendment requests where the assessment is already correct under the legislation.

Phase two of SPS 16/01 is concerned with whether the Commissioner will apply resources to consider the request further. If the Commissioner decides not to do so then she will decline the

[68] At [35].

request and will not even consider whether a correct assessment will result from the amendment requested (this only takes place at phase three). Phase two is therefore an important step from the perspective of the Commissioner striking a balance between her adjudicative and managerial responsibilities. The Commissioner has limited resources and is entitled (using her express managerial discretion under s 6A) to make sensible resource allocation decisions. We should always be mindful, however, that when the Commissioner makes the decision not to exercise her discretion in s 113 in these circumstances, she has consciously decided not to exercise judgement regarding how the tax law applies to determine the amount of tax liability owed by an individual taxpayer.

To the extent that the Commissioner seeks to rely on her managerial discretion regarding the application of limited resources to achieve this result, taxpayers will be interested in whether the Commissioner's adjudicative responsibility is given fair consideration in the decision-making process. If the Commissioner has declined to progress an amendment request to phase three then the only opportunity to consider the merits of that request will have come at phase one. Because phase one is only designed to act as a filter for those clearly correct/incorrect requests, there is a strong argument that the consideration given to the merits of the taxpayer's position at this stage is probably insufficient. There is a significant difference between the effort spent on verification and technical correctness of issues versus the effort spent on verification of facts. The question then becomes whether it is fair in the circumstances for the Commissioner at phase two to decline to allocate resources to considering the amendment request further.

It stands out that the Commissioner's practice is to always apply resources to considering a s 113 request that amounts to a voluntary disclosure (i.e. an amendment request that results in further tax to pay).[69] Immediately, it is difficult to see how such selective use of resources is justified. The Commissioner's adjudicative interest in ensuring that a taxpayer's liability is correctly quantified in accordance with the law should not be at all concerned with whether more or less tax is payable following a reassessment. There is nothing in s 6A that would seem to justify the difference of approach.[70] Nor does it seem tenable to argue that this difference of approach is justified in terms

[69] At [47].

[70] Under s 6A(3) of the TAA 1994 it is the Commissioner's duty to "collect over time the highest net revenue that is practicable within the law…". According to IR's interpretation statement IS 10/07, the term 'net revenue' refers to actual revenue less administration (collection) costs. The administrative costs that go into considering a voluntary disclosure will sometimes outweigh the amount of additional tax that will be imposed, together with any penalties that are applied. Nevertheless, the Commissioner has indicated that she will always devote resources to considering

of serving the purposes of the legislation. In this regard, it bears repeating the observations of Clifford J in *Westpac Securities* where he held:[71]

> Whilst the Commissioner is obliged to collect the highest net revenue that is practicable in accordance with the law, it may nevertheless be the case that allowing a taxpayer to amend their self-assessment is more consistent with the policy underpinnings of the legislation.

At phase two, SPS 16/01 attempts to justify the inherent discrimination between voluntary disclosures and taxpayer favourable amendment requests through a process of implicating the culpability of the taxpayer and their failure to correctly self-assess into the decision-making process. The result is a hard-nosed approach that does little to promote voluntary compliance in New Zealand, let alone uphold taxpayer perceptions of the integrity of the tax system. In taking this stance, the Commissioner may also be guilty of selective interpretation of s 113 within the statutory scheme. Nowhere in SPS 16/01 does it discuss relevant case law on the broad role that s 113 has to play in supporting self-assessment. On the contrary, the statement is at pains to emphasise the taxpayer's obligations to self-assess correctly, or alternatively, a requirement that the taxpayer pursue the matter through the statutory procedures.[72]

4.7.2 Factors counting against a taxpayer's amendment reuest

We examine in turn a number of the factors listed in SPS 16/01 that the Commissioner has stated she may examine at phase two when considering whether or not to apply the resources needed to consider a taxpayer's amendment request in any detail.

The taxpayer's compliance history

SPS 16/01 confirms that the Commissioner's responsibilities under ss 6 and 6A of the TAA 1994 will have an important influence on whether the Commissioner chooses to exercise her discretion. However, the entire introductory discussion on the s 6 responsibility to protect the integrity of the

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a voluntary disclosure. It could be argued that this is justified in the interests of tas system integrity over the longer term on the basis that the words "over time" require a balancing of the short and long term implications of a proposed course of action. However, one would have thought that both voluntary disclosures and taxpayer favourable amendment request would need to be treated equally in terms of resource utilisation to promote voluntary compliance in a self-assessment environment. See IR "Care and Management of the taxes covered by the Inland Revenue Acts" Tax Information Bulletin Vol 22, No 10 (November 2010) (Interpretation Statement 10/07) at [104], [108] – [109].

[71] *Westpac Securities NZ Limited v CIR* (2014) 26 NZTC ¶21-118 at [62].

[72] A taxpayer has only a four-month period in which to issue a NOPA in respect of their own tax return. In practice, it is not very often that an error or oversight made in the tax return will come to the taxpayer's attention within this period.

tax system is concerned with prioritising "the responsibilities of taxpayers to comply with the law".[73] SPS 16/01 then lists some of the various responsibilities set out in s 15B of the TAA 1994, before noting:[74]

> Given this, the Commissioner may consider a taxpayer's compliance history when deciding whether to apply s 113 to an amendment request. Although not decisive, a particularly poor compliance history may support the Commissioner declining to make the requested amendment where, in her opinion, making such an amendment would not promote other taxpayers' perceptions of the integrity of the tax system or voluntary compliance…

This position is problematic for a number of reasons. It is a selective use of s 6 that downplays quite significantly the Commissioner's adjudicative interest in ensuring that taxpayers are correctly assessed in accordance with the law. The Commissioner can point to whatever of the factors in s 6 arguably justifies her decision. As far as the Commissioner's contention that other taxpayers' perceptions of the integrity of the tax system are relevant to the decision, this seems to be little more than the Commissioner substituting her own views for those of other taxpayers. It is difficult to see how other taxpayers in normal circumstances will even become aware of the Commissioner's decision. Even if they were to find out about it, it is difficult to believe they would somehow perceive that a decision to amend an assessment to reflect a correct position in terms of the law is somehow unfair. Additionally, a focus on the taxpayer's compliance history ignores the fact that culpability is sometimes also present on the part of IR.

The whole focus on the taxpayer's failure to comply with their own tax obligations under the legislation is a poor reflection of the role of s 113 within the statutory scheme. It must be remembered that parliament enacted the compliance and penalties regime to deal with a failure on the part of the taxpayer to meet any of the obligations provided for in s 15B. The fact that the Commissioner would then take it upon herself to refer to a taxpayer's compliance history as a justification for deciding not to exercise the s 113 discretion is unfairly punitive for the taxpayer in a manner that is not contemplated by Parliament. It is also a serious dereliction of the Commissioner's own adjudicative responsibilities.

Primacy of the disputes resolution process

[73] TAA 1994, s 6(2)(d).
[74] SPS 16/01, above n 67, at [24].

Applying the principle in *Tannadyce*,[75] SPS 16/01 begins by postulating that "[r]equesting an amendment under s 113 cannot be used as an alternative means of considering the merits of the assessment by circumventing the statutory disputes procedure".[76] Following the Court of Appeal decision of *Charter Holdings*,[77] we now know that this application of the suggested *Tannadyce* principle is simply incorrect. SPS 16/01 then proceeds to argue that it would be inappropriate to use s 113 in circumstances where there are disputed or unclear facts or interpretations of law that "should properly be considered using the disputes resolution process".[78] Likewise, the Commissioner will consider it relevant to the decision if a taxpayer was aware that the statutory disputes procedure was available to them, but they did not take any steps to adhere to the relevant timeframes or to engage with this process.[79] According to SPS 16/01:[80]

> To accede to a taxpayer's amendment request in these circumstances would potentially mean treating that taxpayer more advantageously than others who, in line with the statutory scheme of the TAA, use the disputes resolution regime to seek amendment to assessments. Section 6(2)(c) of the TAA requires that the Commissioner protect the rights of taxpayers to have their tax affairs treated with no greater or lesser favour than the tax affairs of other taxpayers. As Wylie J observed in *Arai Korp*, a taxpayer who has sat on their hands and done nothing is not entitled to expect preferential treatment (citations omitted).

The disputes resolution regime plays an important role in supporting self-assessment by ensuring that parties are fully informed of the facts, propositions of law and interpretations upon which their respective positions are based.[81] When these intentions are being frustrated by the taxpayer through use of the s 113 procedure then the Commissioner is quite justified in taking this into account when coming to a decision. However, the position taken in SPS 16/01 has taken the decision of *Arai Korp* out of context and ignores the broader role of s 113 has to play in supporting self-assessment.[82]

It is also inappropriate to argue that it is inconsistent with the statutory scheme for taxpayers to use the s 113 mechanism just because the matter might instead have been dealt with using the statutory disputes resolution process. Both the *Westpac Securities* and *Arai Korp* decisions confirm that the

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[75] *Tannadyce Investments Lmited v CIR* (2011) 25 NZTC ¶20-103.
[76] SPS 16/01, above n 67, at [41].
[77] *Charter Holdings Limited v CIR* (2016) 27 NZTC ¶22-075.
[78] SPS 16/01, above n 67, at [41].
[79] At [42].
[80] At [43].
[81] See Bill Birch *Legislating for self-assessment of tax liability* (Treasurer and Minister of Finance, Discussion Document, August 1998) at [3.23].
[82] See discussion supra at 6.0.

discretion is to be treated as a backstop provision that does not rely on the disputes procedure first being invoked. Moreover, the taxpayer's failure to pursue this through the statutory processes has already meant that they have forfeited the right to challenge the assessment. It is difficult to see why the taxpayer should be further disadvantaged when making an amendment request if the Commissioner could be persuaded to agree with the taxpayer's position. This may well mean that the Commissioner will have to turn her mind to the relevant facts and propositions of law, but does not mean the Commissioner would be compelled to accept any less complete information to support the amendment than would be forthcoming under the disputes resolution procedure.

The approach taken in SPS 16/01 at phase one is to try and draw a line between obvious errors for which s 113 is available and matters that are appropriate to bring through the disputes resolution procedures. The risk with this is that even the most remotely novel of amendment requests are passed over without much thought given to the correct application of the law.

Whether there has been a delay in making the request

SPS 16/01 suggests that when there has been a delay in making the request (either from when the original position was first taken or when the taxpayer became aware of the issue) that this may count against the taxpayer when it comes to determining how the discretion is exercised.[83] It may be that this is a hiccup from the earlier *Wilson* and *Lawton* decisions where, in the context of the Commissioner's discretion to accept a late notice of challenge, the delay and the explanation for lateness are of obvious relevance.

In terms of the legislation, there are no specific time limits within s 113 itself that would prevent the Commissioner from amending an assessment. However, there are time limits that apply to amending an assessment to increase the amount payable and refunding overpaid amounts of tax. Section 108(1) of the TAA 1994 prevents the Commissioner from amending an assessment to increase the amount after 4 years have passed from the end of the tax year in which the taxpayer has furnished their tax return. This is subject to one significant exception. Section 108(2) provides that the Commissioner may at any time amend the assessment to increase the amount if she is of the opinion that a tax return provided by the taxpayer is fraudulent or wilfully misleading, or that the tax return does not mention income which is of a particular nature or derived from a particular

[83] SPS 16/01, above n 67, at [52].

source. Case law confirms that the Commissioner does not however have a statutory duty to assess omitted income.[84]

As mentioned above, the Commissioner has stated that she will always devote resources to considering a taxpayer's voluntary disclosure that results in additional tax payable.[85] Likewise, once aware of omitted income or a fraudulent or misleading return, IR may end up devoting considerable resources in the course of an audit or investigation. In these circumstances, the exception in s 108(2) will apply and no time limit will operate to prevent the Commissioner from amending an assessment to increase the amount payable.

The time limits for refunds of overpaid tax are intended to strike an appropriate balance between achieving finality and ensuring that the correct amount of tax has been paid.[86] They operate to provide certainty and to protect the Government's fiscal position against a significant but otherwise unquantifiable revenue risk. Refunds of overpaid tax (other than GST) are also generally aligned to the four-year period in s 108, although there are a limited number of exceptions set out in Subpart RM of the Income Tax Act 2007.

Quite sensibly, the Commissioner's practice in SPS 16/01 is not to apply resources to considering an amendment request where she is unable to refund an amount of tax because the period under consideration is time barred.[87] Outside of this, it is difficult to see why SPS 16/01 will take the position that a taxpayer's delay in making a request is such an important factor in circumstances where time limits for refunds of overpaid tax are already operative. Likewise, it is difficult to see how the difference in approach between taxpayer favourable and taxpayer unfavourable amendment requests is justified given the number of years that the Commissioner can normally go back relying on the exception in s 108(2).

SPS 16/01 suggests that where a substantial amount of time has passed "it may be difficult for the Commissioner to ascertain and/or verify the facts".[88] If it is the adequacy of the material supporting the amendment that is the underlying concern then the statement should just say so. This would be preferable to trying to use the delay as a factor that counts against the taxpayer through some

[84] *Lawton v CIR* (2003) 21 NZTC 18,042.
[85] At [47].
[86] See Graham Tubb and Campbell Rose "Dealing with errors – Taxpayer and Commissioner perspectives" (Paper presented to Chartered Accountants Australia and New Zealand Tax Conference, Auckland, November 2014).
[87] SPS 16/01, above n 67, at [35], [79]-[84].
[88] At [53].

process of trying to implicate the taxpayer's own culpability. Moreover, it is accepted that the onus is primarily on the taxpayer to put the facts before the Commissioner. It should be added that this factor in and of itself has not found much favour with the courts and is often tempered with other considerations. These will include whether the amount involved is material and whether the Commissioner can prove that she has somehow been prejudiced by the delay.[89]

4.8 Conclusion

There is a difficult balance that needs to be struck by the Commissioner between her managerial and adjudicative interests in administering the tax system. It is true that the Commissioner, like the Chief Executive of any other government department, needs to exercise a degree of managerial discretion and make sensible decisions regarding where to apply departmental resources. But the Commissioner is also vested with a considerable number of independent statutory powers under the TAA 1994. These come with the expectation that they will be exercised in a way that serves the purposes of the legislation and therefore the tax system as a whole.

This chapter makes the case that the discretion in s 113 is an important one from the perspective of the adjudicative component to the Commissioner's role. It has also become critical for helping to promote voluntary compliance by taxpayers in a statutory scheme that is characterised by self-assessment. Taxpayers often find themselves in the situation where the only avenue for amending their tax position is to write to the Commissioner and request that she exercise her power to amend the assessment. In this regard, the courts have confirmed that the residual power in s 113 stands outside of the statutory disputes and challenge regimes. It can be considered a backstop provision for the Commissioner to ensure the correctness of an assessment.

The case law in this area has also emphasised how important it is for the Commissioner to consider the merits of the taxpayer's position before coming to a decision on whether or not to accept an amendment request. This is inherent in the purpose of s 113. There have however always been exceptions to this rule. Early decisions regarding the Commissioner's discretion to accept a late notice of objection for example emphasised that the statutory imposition of time limits were a valid consideration. The taxpayer was expected to have an adequate explanation for not adhering to these. But the game has changed. Section 113 is not itself expressed to be subject to any specific

[89] *Lawton v CIR* (2003) 21 NZTC 18,042 at [63]-[64] and *Charter Holdings Limited v CIR* (2016) 27 NZTC ¶22-075 at [75].

statutory time limits. Moreover, we know that this power has an important role to play in supporting self-assessment by helping taxpayers to comply with their obligation to correctly determine the amount of tax payable.

The Commissioner's standard practice statement SPS 16/01 sets out how she will respond to taxpayer amendment requests.

Phase one of SPS 16/01 is meant to act as a filter for those clearly correct/incorrect requests. But the relevant decisions in this area suggest that the Commissioner for various reasons will sometimes take the position that the s 113 power should not be exercised despite there being manifest errors in the assessment. Taxpayers are entitled to be sceptical regarding whether the merits of the taxpayer's position will be given due consideration at this stage.

Much of phase two of SPS 16/01 is concerned with setting out the circumstances where the Commissioner will be justified in not applying the resources needed to properly consider whether a correct assessment will result from the requested amendment. The amount of emphasis that the statement places on a taxpayer's various neglects and failures as being relevant to the decision is argued to be unduly punitive in a manner that is not contemplated by parliament. The consequences for failing to pursue a matter through the statutory disputes process or to correctly self-assess in the first instance are prescribed elsewhere in the legislation. It also detracts from the Commissioner's own responsibility to exercise her s 113 power in a way that ensures the correctness of an assessment. This responsibility cannot be met without at the very least considering the merits of the taxpayer's position.

This chapter is not suggesting that there will never be circumstances where the merits of the taxpayer's position need not be considered. But the way in which the Commissioner has stated in SPS 16/01 that she will approach the determination of whether to apply resources to considering an amendment request is a dereliction of responsibility.

Case law confirms that rigid adherence to a stated policy will not always satisfy Parliament's purposes for the exercise of statutory powers. But even if SPS 16/01 is not rigorously applied, it would be naïve to think that the tenor of the statement would not at the very least influence the approach that is taken by IR personnel to dealing with an amendment request. Most of the discussion on self-assessment in the standard practice statement deals with the obligations of the

taxpayer to correctly self-assess. Nowhere in the statement does IR attempt to describe how s 113 will be used to support self-assessment in line with the broader statutory scheme of the TAA 1994.

SPS 16/01 should be rewritten to ensure it places an appropriate amount of emphasis on what can be expected of the Commissioner when exercising this discretion.

The current approach of trying to implicate the relative culpability of the taxpayer into the decision-making process is a poor reflection of the statutory scheme. Moreover, it detracts from what the courts have held to be the scope and purpose of s 113. The standard practice statement needs to deal with the case law on this issue and perhaps even supplement this with specific examples on how the discretion will be exercised to support self-assessment.

There is also a need to revise the circumstances where the Commissioner is justified in not allocating the resources needed to properly consider an amendment request. The statement needs to recognise that a taxpayers right in s 6(2)(b) to have their liability determined according to the law is an important one for tax administration. It should only be in exceptional cases that this right be dismissed without due consideration first being given to the merits of the taxpayer's amendment request. There is a need to be far more specific about the sorts of circumstances where the Commissioner considers this appropriate so that there can be an open debate on the issue.

It stands out that the Commissioner's practice is to always apply resources to considering a request that amounts to a voluntary disclosure. To promote voluntary compliance by taxpayers, the self-assessment scheme has to be seen to be operating fairly. Part of this means that the Commissioner's adjudicative responsibility to uphold a taxpayer's right to have their liability determined in accordance with the law should apply equally to both voluntary disclosures and taxpayer favourable amendment requests. This highlights the importance of ensuring that taxpayer amendment requests are properly resourced.

It should be noted that the key focus of this chapter has been on why the approach taken in SPS 16/01 is perhaps inappropriate because of the statutory scheme of the TAA 1994. Future research could look to develop a regulatory tool that can be used to assist IR staff more generally in striking a balance between the various elements of ss 6 and 6A. From a legislative standpoint, there is also room to consider whether s 113 should be amended to better facilitate self-assessment and provide taxpayers with the right in appropriate circumstances to reopen past returns (i.e. without having to rely on the Commissioner's discretion).

Finally, it should be added that the Richardson Committee did not recommend the enactment of s 6A by Parliament lightly. They discuss in their final report the need for taxpayers to be assured that their rights are being protected, and that resources are being applied appropriately by the tax administrator to this end. What is clear from SPS 16/01 is that IR needs to rethink how it applies resources to considering taxpayer amendment requests. Only by doing this can we ensure that taxpayer perceptions of the integrity of the tax system are not being diminished.

Chapter 5: The strategic and regulatory settings for supporting tax system integrity and taxpayer perceptions.

5.1 Introduction

Having a strategy in place to manage taxpayer perceptions of the integrity of the tax system is important for tax administration. For one, it has long been recognised that taxpayers' evaluations of the tax system will influence their compliance decisions.[1] The importance of voluntary compliance cannot be overstated in a tax system that is predicated on self-assessment such as the one here in New Zealand. A tax system that is perceived as being fair is more conducive to voluntary compliance by taxpayers. But the perceptions a taxpayer will form are just one of many variables that are thought to have an impact on an individual's decision to comply or not comply with tax laws. There are in fact a multitude of variables that influence compliance behaviour, and it can be difficult to determine what is the precise nature of the relationship between taxpayer perceptions and compliance outcomes.

Quite apart from an important connection to voluntary compliance, the need to have in place a strategy to manage taxpayer perceptions of the integrity of the tax system is an important exercise in its own right. Taxes play an essential role in society. It falls to Parliament to determine how much tax each of us pays. IR is the public service department charged with overseeing the administration of the tax system and its role is to act in the quantification and collection of the amount due. The Commissioner is vested with vast administrative powers under the legislation to enable IR to perform this function. Taxpayers therefore expect (and are entitled to expect) that IR will at all times conduct itself and operate in a way to ensure that the integrity of the tax system is being protected.

Parliament has also been mindful of the need for IR to conform to the standards and behaviours that a taxpayer could reasonably expect of the department. Adopting the recommendations of the Richardson Committee,[2] on 10 April 1995 it enacted s 6 of the Tax Administration Act 1994 (TAA

[1] This chapter will at times make use the justice taxonomy adapted by Michael Wenzel from social psychology literature for thinking about how taxpayers come to form fairness perceptions. See discussion at part 5.1 in chapter 1 of this thesis.

[2] Ivor Richardson and others "Organisational Review of the Inland Revenue Department" (Report by the Organisational Review Committee, 1994), Appendix D at [38] [Richardson Committee report].

1994).[3] This section requires that every Minister and every officer having responsibilities in relation to the collection of taxes and other such functions "are at all times to use their best endeavours to protect the integrity of the tax system". This includes taxpayer perceptions of that integrity. The section goes on to list a number of rights and responsibilities shared between taxpayers and those administering the law that are within the meaning of "the integrity of the tax system".[4] Taxpayer perceptions of the integrity of the tax system are closely bound to these rights and responsibilities.[5]

The responsibility on Ministers and officials to protect the integrity of the tax system in s 6 of the TAA 1994 is however not of an absolute nature.[6] Instead, it is an aspirational standard requiring only that IR use its "best endeavours". This is intended to reflect Parliament's recognition of the present-day limitations and challenges faced by the tax system administrator. A failure by IR to meet any of the standards in s 6 therefore does not constitute a ground for intervention from the courts against the Commissioner for the breach.[7]

Although s 6 does not create any rights enforceable against IR, this does not diminish the need to have in place a plan to protect tax system integrity. It should be remembered that s 6 extends to *every* Minister and every officer of any government agency having responsibilities in relation to the collection of taxes and other such functions. The responsibility is so broad that it extends beyond the Commissioner's own lines of delegation. This is significant, because while the Commissioner herself is subject to the responsibility in s 6, she is also under a specific duty under s 6A of the TAA 1994 "to collect over time the highest net revenue that is practicable within the law". The statutory duty of the Commissioner, herself, is therefore largely concerned with

[3] All references in this chapter are to the Tax Administration Act 1994 (TAA 1994) unless stated otherwise.
[4] These include (i) the rights of taxpayers to have their liability determined fairly, impartially, and according to law; (ii) the rights of taxpayers to have their individual affairs kept confidential and treated with no greater or lesser favour than the tax affairs of other taxpayers; (iii) the responsibilities of taxpayers to comply with the law; (iv) the responsibilities of those administering the law to maintain the confidentiality of the affairs of taxpayers; and (v) the responsibilities of those administering the law to do so fairly, impartially, and according to the law.
[5] Richardson Committee report, above n 2.
[6] *CIR v Michael Hill Finance (NZ) Limited* (2016) 27 NZTC ¶22-056 at [31].
[7] *Russell & Ors v Taxation Review Authority & Anor* (2002) 20 NZTC 17,832. In this High Court decision, it was argued by the Commissioner that any failure to meet the standards laid down by s 6 "could lead to a complaint to the Commissioner, or if necessary the Ombudsman… but could not be the foundation of an independent High Court action against the Commissioner for breach". This was accepted by O'Regan J who considered there "is nothing in the statutory wording" of s 6 to suggest that the legislature had an intention to create "rights and obligations akin to those created by the New Zealand Bill of Rights Act". At [46] – [47]. This view was later upheld by the Court of Appeal. See *Russell & Ors v Taxation Review Authority & ABC* (2003) 21 NZTC 18,255 at [36]. See also *Tannadyce Investments Limited v CIR* (2009) 24 NZTC 23,036 at [63].

promoting compliance. Wherever possible, s 6A promulgates a strategy based on the promotion of voluntary compliance. This is because voluntary compliance is considered to be the most efficient and effective bases for tax collection in New Zealand.

The promotion of voluntary compliance and the responsibility to protect the integrity of the tax system are often considered to be consistent objectives. It would be a mistake, however, to see them as the same. Measures and strategies used to promote compliance may come at an unseen cost to integrity if the right settings are not in place. For there to be meaningful management of taxpayer perceptions of the integrity of the tax system, the responsibility in s 6 needs to be incorporated into strategic and regulatory thinking. Without this, IR may tend too readily towards its compliance objectives. The risk with this is that the steps taken by IR to uphold the integrity of the tax system are too often only those steps that are also consistent with the attainment of measurable compliance outcomes. The consequences can be pervasive, with the potential to influence anything from operational decisions (such as which taxpayer groups to audit) to the items that end up on the Government's tax policy work programme. Separate strategic management of the responsibility in s 6 is therefore essential if we want to facilitate the development of those areas and functions that are important to protecting the integrity of the tax system.

The research in this chapter is concerned with IR's management of its responsibility to protect the integrity of the tax system, and taxpayer perceptions of that integrity, at a strategic and regulatory level.

Several key developments that have shaped the way tax administration is approached here in New Zealand are relevant to the responsibility referred to in s 6. The most significant of these is IR's 2001 business plan that marked the transition to a regulatory strategy founded on the principles of responsive regulation. In support of this new approach, IR established its taxpayer charter and introduced a compliance model to guide tax system administration. Both of these were identified in the business plan as being critical tools underpinning the strategic direction. Leveraging off of the business plan, IR subsequently released its first-ever *Statement of Intent* (SOI 2002-03) that sought to extend its output-contracting model to include specific outcomes. Separately, IR revised some of its internal processes and established its Escalation Policy in 2001. This is a mechanism for upholding the values of s 6 by ensuring consistency in how the law is administered and applied across the department.

This chapter is divided into two halves.

The first half (parts two – three of this chapter) outlines a number of key developments in tax system administration that provide context for the issues discussed in this chapter.

Part two looks at the views of the Richardson Committee who first recommended the enactment of the responsibility to protect the integrity of the tax system in s 6. **Part three** discusses the 1999 Parliamentary inquiry into the powers and operations of IR. This inquiry was a significant prompt that led IR to rethink its approach in 2001. An overview of the initiatives introduced with IR's 2001 business plan is then provided.

The second half (parts four – seven of this chapter) examines certain key initiatives that were put into place to support the strategic reorientation of IR. The aim of this is to determine the extent to which these initiatives have taken into account the responsibility in s 6. While these initiatives have changed over time, they are all still in use by IR today.

Part four provides an overview of IR's former and current compliance models and identifies two areas where these may conflict with taxpayer perceptions of the integrity of the tax system. **Part five** identifies limitations in the taxpayer charter and complaints management service that may lead to taxpayer perceptions not being appropriately managed. **Part six** argues that IR's performance measurement and outcome framework has not done enough to incorporate the responsibility to protect the integrity of the tax system. **Part seven** examines whether IR's escalation process and other related policies are being given enough support to ensure that the responsibility to protect the integrity of the tax system is managed at organisational level.

The strategic rethink that took place in 2001 was a turning point for tax administration in New Zealand. In the fifteen years since its release, there has not been anything else to come out of IR quite like it. The question is whether it was also a missed opportunity to incorporate IR's responsibility to protect the integrity of the tax system and manage taxpayer perceptions at a strategic and regulatory level. The conclusion reached in this chapter is that it was.

5.2 Richardson Committee and section 6 of the TAA 1994

5.2.1 Relationship between voluntary compliance and the integrity of the tax system

As discussed in the introduction, there is a relationship between taxpayers' perceptions of the integrity of the tax system and the objective of voluntary compliance.

Section 6 of the TAA 1994 imposes a responsibility on Ministers and officials to protect the integrity of the tax system. This includes, *inter alia*, taxpayer perceptions of that integrity. Section 6A stipulates that the duty of the Commissioner is to "collect over time the highest net revenue that is practicable within the law…" while having regard to a number of factors. These factors include the importance of promoting compliance, and the section promulgates a strategy based on promoting voluntary compliance in particular.

Sections 6 and 6A are based on a draft provision put forward in a recommendation by the Richardson Committee in 1994. The Richardson Committee was formed with a mandate to investigate and make recommendations on the optimal organisation arrangements for administration of the tax system. Part two of this chapter focuses on identifying what the Committee considered was important to the responsibility to protect the integrity of the tax system (i.e. distinct from any compliance-based objectives). The Committee made their views known in their final report released in April 1994 entitled *Organisational Review of Inland Review Department* ("the Richardson Committee Report").[8] This is also regarded as relevant legislative history when interpreting ss 6 and 6A.[9]

The importance of taxpayer perceptions to the goal of voluntary compliance is emphasised throughout the Richardson Committee report and was central to many of the Committee's recommendations. According to the Committee:[10]

> A key component of obtaining the highest net revenue, by supporting voluntary compliance, rests on taxpayer perceptions of the integrity of the tax system. Perceptions about integrity are tightly linked to the impartial application of the law and the exercise of the administration's coercive powers and decision making powers with respect to the affairs of individual taxpayers.

[8] Richardson Committee report, above n 2.
[9] For a summary, refer to comments in IR "Care and Management of the taxes covered by the Inland Revenue Acts" Tax Information Bulletin Vol 22, No 10 (November 2010) at [22] (Interpretation Statement 10/07).
[10] Richardson Committee report, above n 2, at 98.

A significant theme in the Richardson Committee Report was the emphasis that the Committee placed on the separate and competing roles of the Commissioner. The Committee regarded the Commissioner as having distinct responsibilities of adjudication and management in her administration of the tax system.

The Commissioner's managerial responsibilities are related to her role as Chief Executive of IR. The power of managerial discretion in s 6A enables the Commissioner to meet her various accountabilities to the Minister of Revenue in terms of the requirements and expectations on chief executives and government departments to be fiscally responsible with public money. This accountability is well supported in the context of the performance management and reporting requirements applicable to public sector organisations under the State Sector Act 1988 and Public Finance Act 1989.

The adjudicative responsibility of the Commissioner on the other hand is a product of the statutory scheme of the TAA 1994 and the independent statutory powers that are vested in the position of Commissioner. Adjudication is defined in the Richardson Committee report as "*the exercise of judgment in the application of tax legislation* to the affairs of individual taxpayers or groups/classes of taxpayers *in order to determine liability*".[11] This responsibility should also encompass what the courts have held is required of the Commissioner when exercising the various statutory powers vested with her in the carrying out of her assessment function.

In terms of the legislation, the Commissioner's adjudicative role is only partially represented in the s 6 responsibility on Ministers and officials to protect the integrity of the tax system. It is best represented by the right under s 6(2)(b) for a taxpayer "to have their liability determined fairly, impartially, and according to law".

The Richardson Committee perceived that each of the respective roles of the Commissioner (i.e. the adjudicative and managerial roles) have an interest in both voluntary compliance and the integrity of the tax system. The managerial interest of the Commissioner was argued to derive, in part, from an appreciation that more cost-effective compliance can be achieved if taxpayers consider the integrity of the tax system is being upheld. This is because taxpayers will be more inclined to voluntarily comply with their tax obligations, which lowers the cost of collection. The

[11] Appendix D at [63].

adjudicative interest of the Commissioner was instead thought to belong to a narrower subset of the Commissioner's total managerial interests in the integrity of the tax system, and is concerned with the impartial application of tax law to a taxpayer's affairs.[12]

It is important to appreciate what these views on the adjudicative role of the Commissioner mean for the responsibility to protect the integrity of the tax system. Taxpayer perceptions of integrity are acutely sensitive to the successful undertaking of this adjudicative function by the Commissioner. This was also an area where the Richardson Committee considered that taxpayer perceptions of fairness in the tax system will have a significant impact on voluntary compliance. But the need to have in place a strategy to manage the responsibility in s 6 should not be regarded as having originated from compliance-related concerns. According to the Committee:[13]

> Even in a hypothetical situation where a strategy of voluntary compliance was not pursued, the integrity of the tax system would be of vital interest to both the Commissioner and Chief Executive functions in order to protect the constitutional rights of taxpayers as individuals.

The above passage lends support to a view that in order to uphold the integrity of the tax system, the responsibility in s 6, and the Commissioner's adjudicative role in particular, needs separate management at a strategic and regulatory level. As discussed in the introduction, this is especially important given that s 6 does not provide for any enforceable rights that taxpayers can use to ensure that the integrity of the tax system is being upheld.

The Commissioner is vested with vast powers under the legislation. She is also granted statutory independence with regard to how these powers are exercised at the level of individual taxpayers.[14] With this independence comes an expectation that the Commissioner will serve Parliament's purposes for the exercise of these legislative powers. Parliament enacted s 6A as a way of providing the Commissioner with the managerial discretion needed to enable a pragmatic approach to tax system administration. The expectation that came with this is that the resources managed by IR would also be applied to ensure that the integrity of the tax system is being protected. The questions that therefore need to be considered are (1) what is important to the Commissioner's adjudicative interest in the integrity of the tax system; and (2) how do we protect

[12] Appendix D at [22] – [24].
[13] Appendix D at [23].
[14] TAA 1994, s 6B.

the Commissioner's adjudicative function against intrusion from the compliance-based objective represented by the duty of the Commissioner in s 6A?

5.2.2 Supporting the Commissioner's adjudicative function

The Richardson Committee were of the opinion that the structural separation of the Commissioner's adjudicative role from the Commissioner's managerial role as Chief Executive was both desirable and necessary from the perspective of tax system integrity. Of particular concern for the Committee, and for which the Committee considers structural separation to be appropriate, are those intersections:[15]

> …where there is *both a high concentration of the adjudicative component and a close proximity to the final quantification of an individual taxpayer's liability*. Particular attention should also be paid to areas which have a high potential for contention or are performed in an adversarial context. Special structural focus for this intersection will address these concerns.

The Richardson Committee recommended establishing an adjudication function as a separate business unit, distinct from audit and investigation, to act in the final quantification of liability for taxpayers prior to the issue of an assessment (the final adjudication function). The Committee describes the role of the adjudication function as being "to provide a specific and strong focus on the correct and impartial application of the tax law to the affairs of individual taxpayers".[16] This business unit will also be responsible for making binding rulings and operate within the same agency as the rest of the department, ultimately reporting to the Commissioner.[17]

Some of the Committee's key recommendations in the context of the revised statutory disputes resolution process in pt 4A of the TAA 1994 were made with this relationship in mind. Given the inherently adversarial nature of tax disputes, the Committee considered that "the way disputes are resolved is critical to taxpayer perceptions of fairness, and has wider impacts for the tax administration".[18] Apart from these changes recommended by the Richardson Committee, IR have made relatively few structural or organisational changes of their own volition to support the Commissioner's adjudicative interests. What is interesting about this is that the Richardson

[15] Richardson Committee report, above n 2, Appendix D at [66].
[16] At 114.
[17] The Disputes Review Unit (previously the Adjudication Unit) was formed by IR in line with the Richardson Committee's recommendation as an important administrative step in the disputes resolution process to serve this final adjudication function. It is part of the Office of the Chief Tax Counsel and based in Wellington – see IR Tax Information Bulletin "Adjudication Unit – its Role in the Dispute Resolution Process" Vol 19 No 10 at 9.
[18] At 65 (emphasis added).

Committee considered that many of the activities undertaken by IR have an element of adjudication inextricably intertwined. While structural separation may not be possible for all of these activities, the second half of this chapter argues that a better separation could have been achieved by more effectively integrating the Commissioner's adjudicative responsibility at a strategic and regulatory level.

The Richardson Committee also recommended in their report that the separate roles of adjudication and management should be given appropriate statutory recognition, and that a redrafting of responsibilities should take place so that the title of Commissioner is reserved exclusively for her adjudication role in all relevant provisions under the legislation. It was recognised, however, that this change would likely prove difficult, and that there were barriers to its immediate implementation. The Committee noted:[19]

> …much further detailed evaluation and testing are required to arrive at a definition of the precise scope and boundaries of the adjudication functions suitable for long-term legislative expression. The intertwining of elements of adjudication and management which has developed over decades cannot be unravelled overnight. Defining the ultimate boundaries identifying high level adjudication as the subject of special focus is a process that will benefit from detailed analysis and testing together with operational experience of the proposed structure.

This indicates that the allocation of adjudicative responsibilities to a separate business unit was only ever intended to be the first step in a wider project that would seek to articulate the statutory parameters of the Commissioner's adjudicative role under the legislation. In the end, this exercise was never completed.

As a final point, the separation of high-level adjudicative functions into a different organisation as a further option was also considered but ultimately rejected by the Richardson Committee. This was on the basis that the adjudicative and managerial aspects of the Commissioner's role were regarded as having "a significant, mutually reinforcing contribution" to make to a single revenue-orientated objective.[20] Presumably, this conclusion was reached because the Committee recognised that there is a relationship between taxpayer perceptions of the integrity of the tax system and a taxpayer's motivation to voluntarily comply with their tax obligations. It should not diminish the need to separately manage the responsibility to protect the integrity of the tax system

[19] Richardson Committee report, above n 2, at 57.
[20] Appendix D at [89].

at strategic and regulatory levels. This is because integrity and compliance are not always consistent objectives, and at times they will conflict.

5.2.3 Implications for the management of the responsibility in section 6

According to the Richardson Committee, the reason that legislative recognition of the Commissioner's adjudicative role was considered so important is that it would assist in the structural separation of this function and facilitate consideration of further structural development in the future.[21] Without a separate articulation of the Commissioner's adjudicative role in the legislation, we are left only with the single revenue-orientated objective for tax system administration expressed in terms of the Commissioner's duty in s 6A. The problem that this represents is that this legislative objective may end up having too much influence over the strategic direction pursued by IR. The Richardson Committee itself stated:[22]

> The key to an objective is that it provides sufficient high-level direction for strategies to be developed, and resources to be applied. In addition, it should assist the Government to monitor the tax administration's performance in terms of how well the objective is being achieved. It should also provide a strong incentive for the tax administration to research the benefits of its strategies and resource allocation.

In arriving at the objective for tax system administration in s 6A(3), the Richardson Committee put forward a number of additional recommendations for how to ensure its implementation would be successful.

It was noted by the Richardson Committee that the output targets used by IR to measure performance at the time did not adequately make use of macro-level measures. The Committee perceived the need for the department to develop and maintain a set of macro performance 'indicators' to help achieve the following proposed objectives:[23]

- the macro indicators should assist the Minister and/or IR management in making strategic decisions in relation to tax; and
- the macro indicators should enable an overall assessment to be made of how well IR is meeting its overall objective in s 6A(3).

[21] At 58.
[22] At 51.
[23] Use of the word 'indicator' was intended to recognise "that there will not be the same degree of accuracy that is associated with the word 'measure'". See Appendix C at 16.

Among the macro indicators suggested in the report (ultimately to form part of a critical management tool to assist in strategic decision making) were taxpayer perceptions as a measure of voluntary compliance. This was to be carried out using regular independent surveys of key taxpayer groups in an effort highlight views and trends on influential matters.[24] It was envisaged by the Committee that many of the strategic indicators suggested would contribute to a "health report" to assess the health of tax administration. This would be prepared for the Minister of Revenue as part of the Department's on-going strategic planning cycle and the Government's budget planning process.[25]

To ensure that taxpayer perceptions of integrity are not diminished in an environment where statutory recognition has been given to the Commissioner's managerial discretion in s 6A, it was considered important that adequate internal guidelines are developed by the department for both resource allocation decisions generally and for the specific entitlement to enter into compromise agreements. It was recommended that an independent and periodic audit by the Office of the Controller and Auditor General take place to ensure that internal procedures and guidelines were being followed.[26] Separate consideration was also given for how best to support the management of high-level adjudicative functions within the wider department. In addition to the proposed "health report" discussed above, the Committee were of the view that these issues would most appropriately be addressed by adequate specification and monitoring of outputs (including

[24] Appendix C at 17. IR currently incorporates the results of a number of externally run customer surveys into its performance measures. This chapter expresses concerns over whether the measures selected actively cover those areas that are most important to taxpayer perceptions of the integrity of the tax system and the adjudicative function of the Commissioner in particular. See discussion infra at 6.0.

[25] Appendix D at [42] – [47]. Only four of these 'health reports' were ever prepared by IR and none have been completed since 1999. Reportedly, they were replaced by reports against the department's Customer Charter although these have also since been discontinued. See Controller and Auditor-General *Inland Revenue Department: Performance of Taxpayer Audit* (Wellington, 2003) at 65.

[26] Appendix D at [48] – [51]. The guidelines that were ultimately prepared by IR in these areas have an involved history. In 1998, IR's formal policy on settlements did not recognise that s 6A permitted the Commissioner to reach a settlement agreement in the course of a tax investigation on a compromise basis. See IR "Finalising agreements in tax investigations SPS INV-350" Tax Information Bulletin Vol 10, No 8 (August 1998). Only recently has this official policy been replaced. The updated standard practice statement now clarifies that the prerogative to reach an agreement on a principled basis in the course of a tax investigation does not apply to settlements involving the use of the Commissioner's powers under s 6A. See IR "SPS 15/01: Finalising Agreements in Tax Investigations" Tax Information Bulletin Vol 27 No 9 at 24. Several draft statements were also released with respect to the interpretation of ss 6 and 6A in general terms, although nothing was finalised until 2010. See IR "Care and Management of the taxes covered by the Inland Revenue Acts" Tax Information Bulletin Vol 22, No 10 (November 2010) (Interpretation Statement IS 10/07). Neither of these statements makes provision for external review by the Office of the Controller and Auditor General as originally recommended.

associated performance measures) and scrutiny of the estimates by a Parliamentary select committee.[27]

All of this indicates that those areas that are important to taxpayer perceptions of the integrity of the tax system are expected to be incorporated into planning at a strategic and regulatory level. Separate legislative expression of the Commissioner's adjudicative role as recommended by the Richardson Committee would have also contributed to a better understanding from IR of what strategies could be developed and how resources could be applied to manage this very important function. These issues could have been addressed at the same time as the recommended rewrite of the of the tax legislation to reflect the separate functions of adjudication and management. Ultimately, this proposed rewrite never ended up taking place.

The situation that New Zealand has under the current legislative framework is susceptible to what has been referred to by Valerie Braithwaite in academic writing as the 'compliance integrity dilemma'. If compliance is seen as what is expected of taxpayers in their participation in the tax system, then integrity is what taxpayers are entitled to expect in return. Writing from a relational perspective, Braithwaite makes some observations on just how easy it is to lose sight of integrity when compliance is the main objective. She notes:[28]

> Improvements in compliance are among the major yardsticks used by tax authorities and their governments to assess their performance. Commonly, compliance gains are considered against compliance costs, which refer to the financial and opportunity costs of compliance borne by taxpayers and tax officers. But there also may be a cost to the integrity of the tax system. Compliance gains may mean integrity loss, at least in the view of the public.

The broad objectives of tax administration recommended by the Richardson Committee and enunciated by each of the factors listed in ss 6 and 6A were ultimately enacted in 1995. Despite this, any significant strategic or regulatory shift from IR to give effect to these objectives was still some years off. Essentially, it took a breakdown in the relationship between taxpayers and IR and a Parliamentary inquiry to force a rethink of regulatory approach. These developments are discussed in the next section and highlight the importance of having in place a strategy to deal with integrity concerns.

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[27] Appendix D at [87]. There is little to suggest that this has been achieved in any adequate way. See discussion infra at 6.0.

[28] Valerie Braithwaite "Tax System Integrity and Compliance: The Democratic Management of the Tax System" in Valerie Braithwaite (ed) *Taxing Democracy : Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 282.

5.3 Transition to a new regulatory approach

5.3.1 The 1999 Parliamentary inquiry

Valerie Braithwaite's views on the compliance integrity dilemma and the democratic management of the tax system offer a keen insight into New Zealand's own experience in the late 1990's. She writes:[29]

> At the organisational coalface, as performance targets are being set for a workforce, compliance is more tightly bound to the tax authority's short-term interests than integrity. Integrity comes into focus when there is time to stand back and consider long-term interest. Integrity also increases in salience, relative to compliance, when a tax office's accountability is called into question, or when legitimacy is called into play to deal with change or failure in the system.

Certainly, the inquiry into the powers and operations of IR that was formed in 1999 by Parliament's finance and expenditure committee (the FEC committee) seems to fit this description.[30] This was a time when the relationship between IR and the taxpaying community had reached an all-time low. Taxpayers and their advisors were still coming to grips with the compliance and penalties legislation and dispute resolution procedures introduced some years earlier to support the move to taxpayer self-assessment.[31] Problems with the debt and hardship rules (some of which dated back to the 1930s) were rife and IR found itself the subject of extensive media criticism following a spate of taxpayer suicides that lead to assertions of aggressive and callous behaviour.[32] There was a strong public perception that IR was heavy-handed and inflexible when dealing with individual taxpayers. The growing concern led parliament to conclude that the review was needed.

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[29] At 276.

[30] Finance and Expenditure Committee *Inquiry into the powers and operations of the Inland Revenue Department* (Parliamentary paper 1.3, October 1999).

[31] Apparently foreshadowing these issues is an article by Simon James and Clinton Alley on the implementation of self-assessment in New Zealand. The authors argue that the move to a self-assessment system brings with it the risk that "a revenue service might resort too readily to a penalty driven compliance policy" and that "the temptation to rely on a harsher enforcement regime" may ultimately be a threat to voluntary compliance. Instead, they contend that a regulatory approach that is more cooperative with a view to assisting taxpayers to comply "must be the best way forward for tax administration in New Zealand". See Simon James and Clinton Alley "Tax Compliance, Self-assessment, and Tax Administration in New Zealand — Is the Carrot or the Stick More Appropriate to Encourage Compliance?" (1999) 5 NZJTLP 3 at 14.

[32] See John Shewan "Protecting the Integrity of the Tax Act: The Practitioner's Perspective" (paper presented at ICANZ tax conference, Wellington, October 2002) at 7. According to a government discussion document released in 2001 the debt and hardship rules as they existed then "were designed for asset rich but cash flow poor taxpayers of the Depression era, and were not reviewed as part of the introduction of the current compliance and penalties legislation". See Policy Advice Division *Taxpayer compliance, standards and penalties: a review* (government discussion document, August 2001) at 19.

Over the course of the inquiry, many taxpayers came forward to share their experiences in dealing with IR. At the forefront of their concerns was a belief that the department unfairly targets ordinary people with its enforcement activities and needs to improve its service to taxpayers. It was also around this time that the academics were beginning to take a real interest in the effect of procedural fairness on taxpayer compliance, a fact that was not lost on the FEC committee.[33]

A significant focus of the FEC committee was on the way in which IR exercised its powers, rather than just the statutory powers themselves. The FEC Committee considered that the scope of statutory powers vested in the Commissioner was generally appropriate to ensure that taxpayers comply with their obligations under the legislation. It was instead the *manner in which those powers were being exercised* that was described as 'problematic'. The FEC Committee's report condemned IR for a culture that placed undue emphasis on enforcement, concluding that "the pendulum has swung too far towards the use of sanctions and threat to enforce compliance".[34]

The whole experience for the department was undoubtedly a salutary reminder of its wider accountability to parliament and taxpayers for the integrity of the tax system. As one commentator has put it:[35]

> The lesson to be learned from the parliamentary inquiry is that society will not tolerate bureaucratic behaviour that is inconsistent with reasonable standards of fairness and even-handedness. It is incumbent on the IRD to be sufficiently au-fait with the views of the community it serves to ensure that concerns are identified and dealt with prior to them boiling over to the point where political intervention is necessary.

The FEC Committee made a total of twenty-seven recommendations that in their view would "put in place a set of meaningful checks and balances in the relationship between the department and taxpayers" and "help address the negative perceptions now in place".[36]

In addition to some of the specific recommendations to improve service delivery for taxpayers (which the author takes as a given), the following recommendations were put to IR as part of a design to support an attitudinal shift within the department:

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[33] The FEC endorse a submission from the New Zealand Law Society (NZLS) who point out that "the tax paying community's perception of the way in which the powers are exercised is almost as important as the reality of the extent of those powers. Voluntary compliance is a fundamental feature of the tax system. Taxpayers must believe that the tax system is fair and reasonable and that disputes will be dealt with in a fair and impartial matter". See Finance and Expenditure Committee, above n 30, at 6.
[34] At 28.
[35] John Shewan, above n 32, at 8.
[36] Finance and Expenditure Committee, above n 30, at 7.

1. Implementation of a programme within IR that is designed to enable staff to build relationships with the business community and better understand the pressures that businesses face;
2. The establishment of a taxpayer charter designed to outline to taxpayers their rights and obligations in respect of the tax system; and
3. Re-establishing a problem resolution service to provide an avenue for dealing with taxpayer concerns, ensuring this is well publicised and making taxpayers aware of their rights of appeal to external agencies (e.g. the Office of the Ombudsman).

The above-listed recommendations, along with the other recommendations of the FEC Committee, were therefore part of an effort to facilitate a concerted change in IR that is geared towards a better management of its responsibility to protect the integrity of the tax system. This includes the management of taxpayer perceptions in particular. According to the FEC committee:[37]

> …we consider that more is required for perceptions of the fairness of the tax system to improve markedly. Our recommendations, if acted on will, in our view, greatly contribute towards this.
>
> In addition to legislative and policy changes, we consider a shift in culture is necessary.

Shortly after the parliamentary inquiry, IR responded with a change in regulatory tact and began to follow the example of its Australian counterpart by adopting responsive regulation practices into its administration of the tax system.

5.3.2 Inland Revenue's strategic reorientation in 2001

The way forward and strategic direction

The department in 2001 outlined its new vision for the future in the strategic document entitled "The Way Forward 2001 onwards" (the 2001 business plan).[38] When introduced, it was designed as a five-year business plan that sets out the long-term goals of IR and outlines major strategic areas and initiatives that the department plans to implement over that period. It signals a move away from a command-and-control approach to regulation and a commitment by the department to adopt a more responsive approach to tax administration. It also specifically recognised the need to take

[37] At 31.
[38] IR *Inland Revenue Business Plan: The Way Forward 2001 Onwards* (2001) [2001 business plan]. See Jenny Job, Andrew Stout and Rachael Smith "Culture Change in Three Taxation Administrations: From Command-and-control to responsive regulation" (2007) 29 Law & Policy 87 at 89. See also Mark Burton and Justin Dabner "The Limits of the Responsive Regulation Model: What Really Defines the Relationship between the New Zealand Inland Revenue and Tax Practitioners" (2009) 15 NZJTLP 111 at 113.

into account taxpayer perceptions towards tax administration. According to the 2001 business plan:[39]

> Negative publicity over the last few years has weakened taxpayer perceptions of the fairness and integrity of the tax administration. Our approach to administering the tax law is dependent on taxpayers paying the correct amount of tax of their own accord. It is therefore crucial that we continue to work closely with the community to redress these perception issues…

The 2001 business plan recognised that tax administration is just one component of a tax system that has an overall objective that comprises: sufficiency of revenue for the government, efficiency and fairness.[40] It identified four key principles of tax administration to guide the department's new approach.[41] In addition, the 2001 business plan identified four strategic areas that collectively form strands of the new strategic direction. These were to provide a framework for the specific initiatives that IR planned to implement over the coming years. The four strategic areas were:

1. To streamline and simplify tax processes;
2. To create an environment which promotes compliance;
3. To enhance administration of IR's social policy businesses; and
4. To enhance the people capability of IR.

The strategic direction has been revised a number of times over the years and some modifications to these strategic areas have been made. One area that has remained constant has been IR's priority to create an environment that promotes compliance. This strategic area is supported by the compliance model as discussed below. The strategic areas act as a guide to the specific initiatives and areas of focus that are selected by IR to achieve the objectives of its various business plans. There is also a clear link between IR's strategic direction and the selection of performance measures.[42]

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[39] At 28.

[40] At 4. This part of the report made use of analysis in the Richardson Committee report that led to the legislative expression of the object of tax system administration in s 6A(3).

[41] These four principles are (1) IR administers tax, social policy and loan regimes on behalf of all New Zealanders, for the good of all New Zealanders; (2) IR administers the tax and social policy regimes within the laws made by Parliament; (3) IR will work with New Zealanders to make it simpler and easier to meet obligations of their own accord – aimed at reducing costs both for the community (compliance costs) and IR (administration costs); and (4) New Zealanders are a diverse group, with varying tax service needs, that require a range of responses. Principle four is especially pertinent to the adoption of responsive regulatory practices. It emphasises the need to move away from a 'one size fits all' approach to instead tailoring interactions with taxpayers and being responsive to their individual circumstances. At 32.

[42] The outcome measures selected in particular have a role to play in this regard. See discussion infra at 6.0.

A concern with the above strategic direction is the lost opportunity to provide within the plan a separate focus for the Commissioner's adjudicative role when these strategic areas were first selected. This was obviously considered important by the Richardson Committee as far as taxpayer perceptions of the integrity of the tax system are concerned. The repercussions of this decision can be felt in the absence of any significant policy development or organisational shift to fully support the adjudicative component of the Commissioner's role. A case for this is made in the second half of this chapter.

The strategic direction is underpinned by two factors that were identified as being critical if IR was to achieve success with its new approach. These were (a) implementation of the taxpayer compliance model, and (b) meeting the values set out in the taxpayer charter. Fundamentally, these initiatives were each borrowed from the Australian Tax Office (ATO) and are designed to give effect to the principles of responsive regulation.

The principles of responsive regulation

The premise of responsive regulation is that regulators "should be responsive to the conduct of those they seek to regulate in deciding whether a more or less interventionist response is needed" (citations omitted).[43] The approach was first put forward in 1992 by Ian Ayers and John Braithwaite as a proposed middle ground between alternative schools of thought on what regulatory model is the most effective.[44]

Ayers and Braithwaite suggest a regulatory sanctions pyramid where regulatory action at the base of the pyramid will make use of persuasion and self-regulation to achieve compliance at first instance. The level and severity of intervention strategies will then escalate in a hierarchy up the regulatory sanctions pyramid as a means of responding to those who are unwilling to comply.

In the realm of tax compliance, the concept of responsive regulation first made the transition from popular academic theory to regulatory compliance tool as a result of the combined work of the

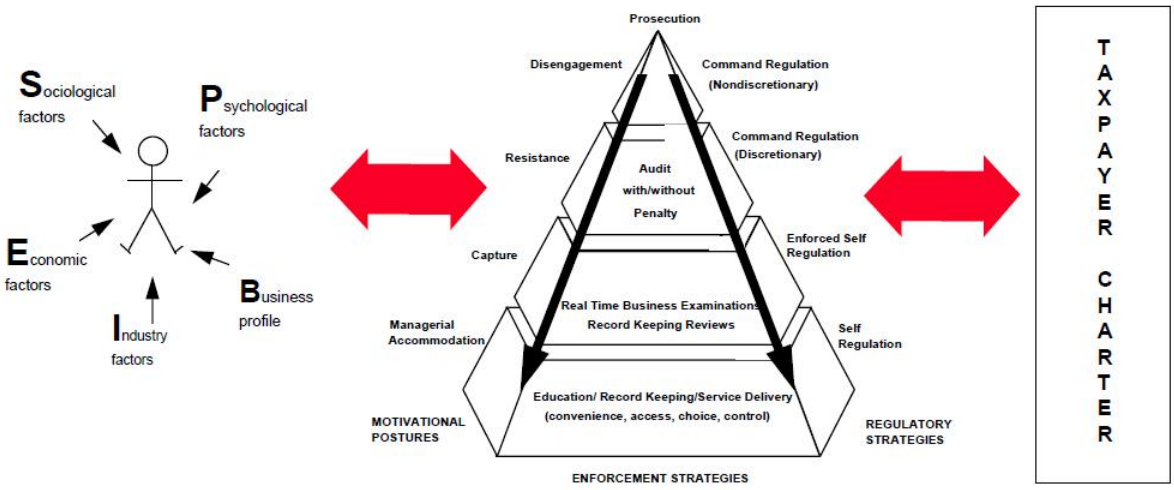
[43] John Braithwaite *Restorative Justice & Responsive Regulation* (OUP, New York, 2002) at 29.
[44] Ian Ayres and John Braithwaite *Responsive Regulation: Transcending the Deregulation Debate* (OUP, New York, 1992). For a more recent account of the responsive regulation concept see John Braithwaite "The Essence of Responsive Regulation" (2011) 44 UBC Law Review 475. The two different schools of thought on what drives compliance behaviour and therefore what regulatory strategy is the most effective can broadly be referred to as the deterrence and accommodative models of compliance. For an overview see Kristina Murphy "Regulating More Effectively: The Relationship between Procedural Justice, Legitimacy, and Tax Non-compliance" (2005) 32 Journal of Law and Society 562 at 564.

Australian Tax Office (the ATO) and its Cash Economy Task Force in 1997.[45] At a regulatory level, the ATO Compliance Model has been hugely influential in shaping the overarching objectives and principles that govern tax system administration. The transition is explained by Valerie Braithwaite:[46]

> Tax administrations have traditionally operated on such a relatively simple presumption. Put simply, tax law will influence the flow of events when sanctions are sufficiently certain and severe to offset the gains of not complying with the law. The Compliance Model does not discount this basic insight, but rather tackles its crudeness. …The Compliance Model, as a generic application of responsive regulation, takes on board the many sources of influence that contribute to compliance, both from the environment of the regulatee and from the toolbox of the regulator.

The product of this work is embodied in a pyramid referred to as the ATO Compliance Model as illustrated in Figure 1 below.[47] This figure is also intended to demonstrate the interaction between the compliance model, the various factors impacting on a taxpayer and the Taxpayer's Charter.

Figure 1: The ATO Compliance Model



[45] For relevant background to the introduction of the ATO Compliance Model see Valerie Braithwaite "A New Approach to Tax Compliance" in Valerie Braithwaite (ed) *Taxing Democracy : Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 2. See also Sagit Leviner "An overview: A new era of tax enforcement – from 'big stick' to responsive regulation" (2008) 2 Regulation & Governance 362 at 369. For a discussion of the ATO's early experiences in adjusting to the programme of responsive regulation, see Jenny Job and David Honaker "Short-term Experience with Responsive Regulation in the Australian Tax Office" in Valerie Braithwaite (ed) *Taxing Democracy : Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 111.

[46] Valerie Braithwaite "Responsive Regulation and Taxation: Introduction" (2007) 29 Law & Policy 3 at 5.

[47] Cash Economy Task Force *Improving Tax Compliance in the Cash Economy* (1998) at 56.

The left side of the ATO Compliance Model features the motivational posture taken by a taxpayer and is intended to reflect the amount of social distance the individual wishes to place between themselves and a regulatory authority. Motivational postures have been described as "conglomerates of beliefs, attitudes, preferences, interests, and feelings that together communicate the degree to which an individual accepts the agenda of the regulator".[48] A taxpayer at the base of the pyramid will be cooperative with authorities and exhibit a high degree of consent to be regulated, whereas a taxpayer at the top of the pyramid will exhibit a high degree of defiance. The concept was originally borrowed by the Cash Economy Task Force for use in the ATO Compliance Model based on the work of Valerie Braithwaite regarding motivational postures and trust norms.[49]

Braithwaite identifies five key motivational postures as ranging from commitment, capitulation, resistance, disengagement, and game playing.[50] Commitment and capitulation portray an overall positive relationship characterised by voluntary compliance of tax obligations. Resistance, disengagement and game playing, in contrast, portray postures of defiance where enforced compliance of tax obligations may prove necessary.[51]

A feature of both the Australian and New Zealand versions of the compliance model is the connection between motivational postures (or attitudes to compliance) and the various factors that influence taxpayer decisions and behaviour.[52] These include Business, Industry, Sociological,

[48] Valerie Braithwaite, Kristina Murphy and Monika Reinhart "Taxation Threat, Motivational Postures, and Responsive Regulation (2007) 29 Law & Policy 137 at 138.
[49] Valerie Braithwaite "Responsive Regulation and Taxation: Introduction" (2007) 29 Law & Policy 3 at 20.
[50] See Valerie Braithwaite "Dancing with Tax Authorities: Motivational Postures and Non-compliant Actions" in Valerie Braithwaite (ed) *Taxing Democracy : Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 16. See also Erich Kirchler *The Economic Psychology of Tax Behaviour* (CUP, New York, 2007) at 202 at 96.
[51] In relation to motivational postures, the Forum on Tax Administration makes the observation that "[i]t is important to realise that an individual taxpayer is capable of adopting any of the attitudes described at different times. It is also possible to adopt all of the attitudes simultaneously in relation to different issues. The attitudes are not fixed characteristics of a person or group, but reflect the interaction between the person or group that impose demands upon them. The value of the model therefore is that it contributes to a deeper understanding of taxpayer behaviour and lays the groundwork for the development of targeted strategies which encourage the motivation to do the right thing and constrain the motivation to resist or evade taxes". See Forum on Tax Administration Compliance Sub-group *Compliance Risk Management: Managing and Improving Tax Compliance* (2004) at 41.
[52] The ATO Compliance Model developed by the Cash Economy Task Force actually takes it one step further than the NZ model and acknowledges the link between the compliance model and the taxpayer's charter. The Cash Economy Task Force reports that a "strong contention of the compliance model is that the behaviour of the ATO can influence the compliance behaviour of the community. That is, if the ATO takes steps to give the community confidence in the professionalism and integrity of its operations compliance should improve. This notion corresponds with much of the intention of the Taxpayers' Charter." See Cash Economy Task Force, above n 47, at 58.

Economic and Psychological factors (collectively the 'BISEP' tool) which combine to influence the particular motivational posture taken up by the taxpayer.[53]

The Taxpayers' Charter is described by the Cash Economy Task Force as "a key tool in building a better relationship between the ATO and the community and giving the community confidence in the ATO's operations".[54] It is intended to govern the way in which the revenue authority interacts with taxpayers. According to the 1998 report of the Cash Economy Task Force:[55]

> The Charter is intended to bring together the legal rights that the law provides for taxpayers as well as the components of a fair approach to tax administration. This will help ensure everyone understands their rights and the fair approach as well their legitimate expectations of standards of service and how they can complain if they are not satisfied.

Regulatory strategies are expected to conform to both the compliance model and the Taxpayers' Charter. This is based on the contention that the behaviour of the ATO has an influence on the compliance behaviour of taxpayers. Because taxpayers have confidence in the professionalism and integrity of ATO staff, compliance by taxpayers is expected to improve. Ultimately, therefore, the ATO Compliance Model is principally concerned with compliance outcomes. In this respect, it was recognised that due regard also needs to be given to the importance of taxpayer perceptions in order to achieve voluntary compliance. This is emphasised in the 1998 report:[56]

> In order to influence community attitudes and perceptions regarding the taxation system, an hierarchical enforcement strategy such as the one proposed by the compliance model requires change from within the ATO. This includes ATO staff acting with integrity so that community perceptions of the ATO can be changed. If the ATO is able to foster perceptions of fairness, both procedural and distributive, trust in the institution, and agreement with its mission it may increase the likelihood that citizens will want to cooperate with the ATO and therefore voluntarily comply with their obligations.

The main takeaway is that steps need to be taken and procedures need to be in place to ensure that officials are committed to integrity measures that are designed to manage taxpayer perceptions and to improve taxpayer compliance under this approach.

Other related developments

The second half of this chapter looks to New Zealand's experience with its adoption of the compliance model and a taxpayer charter to support the new strategic approach. In addition to

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[53] Forum on Tax Administration Compliance Sub-group *Compliance Risk Management: Managing and Improving Tax Compliance* (2004) at 38.
[54] Cash Economy Task Force, above n 47, at 25.
[55] At 26.
[56] At 57.

these initiatives, there were several other significant developments that also took place around the same time. Leveraging off of the business plan, IR released its first-ever *Statement of Intent* (SOI 2002-03) that sought to build on its output-contracting model.[57] These are strategic documents prepared by IR in accordance with the Public Finance Act 1989 that describe the department's strategic intentions and explains how the department will manage its functions and operations. Separately, IR established its Escalation process in 2001 as a mechanism for ensuring consistency in how the law is administered and applied across the department. This is one of a number of policies, procedures and controls that are used at organisational level to protect the integrity of the tax system and manage taxpayer perceptions of that integrity.

This chapter examines each of these in the parts that follow.

5.4 The compliance model

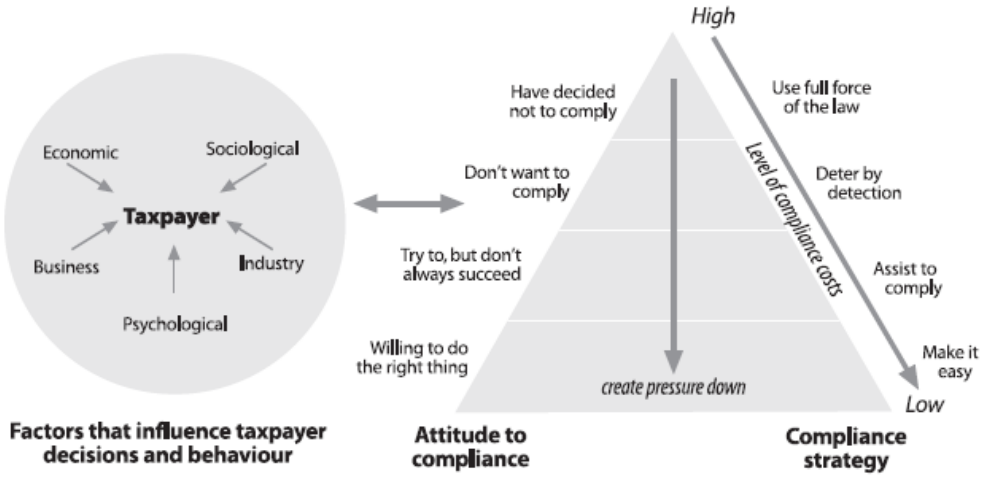
5.4.1 Inland Revenue's former compliance model

Part four of this chapter examines in detail IR's former and current compliance models. IR has used these models over the years to support the approach taken in terms of its strategic direction. This chapter argues that there are two limitations observable in both of these models where strategic pursuits might conflict with the responsibility to protect the integrity of the tax system.

IR's former compliance model (in figure 2) first debuted in the department's 2001 business plan and has for many years since its introduction been a pervasive feature of IR annual reports, strategic documents and other output.[58] The compliance model was based in large part on the version used by the Australian Tax Office and makes use of the work of the Cash Economy Task Force discussed above. It has been described as an important part of the way in which the Commissioner will meet her s 6A duty to promote voluntary compliance by taxpayers and provides a framework for IR to think about how to appropriately tailor its interactions with taxpayers.

Figure 2: Inland Revenue's (former) compliance model

[57] IR *Our Statement of Intent: Including our Departmental Forecast Report for 1 July 2002 – 30 June 2003*.
[58] At 35. Source: Inland Revenue and licensed by Inland Revenue for re-use under the Creative Commons Attribution 3.0 New Zealand Licence. Crown copyright ©. The views, opinions, findings, and conclusions expressed in this thesis do not necessarily reflect the views of Inland Revenue. Inland Revenue has made every effort to ensure that the information contained in the Inland Revenue documents referred to in the thesis is reliable, but does not guarantee its accuracy or completeness and does not accept any liability for any errors."



A paper presented to the annual Institute of Chartered Accountants of New Zealand in 2004, that was co-authored by the now Commissioner, Naomi Ferguson, describes its intended application:[59]

> This model illustrates that we can influence taxpayers' behaviour by the way we respond. Our focus is to distinguish between different groups and tailor our response accordingly, rather than taking a 'one size fits all' approach. By taking a responsive rather than punitive approach with our taxpayers we can encourage future compliance, and effectively move taxpayers 'down' the triangle. This allows us to take a risk-based approach to the management of compliance activity.

The BISEP tool to the left of the pyramid (discussed earlier in this chapter)[60] offers a framework for IR to help understand taxpayer behaviour and attitudes to compliance. It then allows IR to develop the most appropriate response based on this understanding and an analysis of the reasons for the particular attitude or behaviour identified.[61] Tony Morris and Michele Lonsdale of IR, in an article discussing the specific initiatives implemented to give effect to the compliance model, describe the significance of taxpayer attitudes to this compliance strategy in the following terms:[62]

> To determine the most appropriate response for the customer, we look at the factors that may be influencing the attitude of the customer toward compliance. Once we have an understanding of the factors influencing his or her attitude, it allows us to develop a compliance strategy that is more appropriate and effective for that customer. Our response needs to encourage the customer's attitude to move down the pyramid. This will result in improved voluntary compliance.

[59] Naomi Ferguson and Spyros Papageorgiou "Tax Administration" (paper presented at ICANZ tax conference, Wellington, October 2004) at 3.
[60] See discussion supra at 3.2.
[61] Tony Morris and Michele Lonsdale "Translating the Compliance Model into Practical Reality" (2004) The IRS Research Bulletin: Proceedings of the 2004 IRS Research Conference 57 at 60.
[62] At 63.

At an operational level there are reports to suggest that the integration of the model has not always been as successful.[63]

For one, it is not always clear to frontline staff how to apply the model to different business situations. Part of this is that there will always be a tension between being responsive on the one hand and the need for consistent decision-making across taxpayer groups on the other. But it is not clear why the compliance model has not featured more prominently in standard practice statements or similar output to justify or rationalise how the Commissioner will exercise her statutory powers to deal with particular matters. This is surprising, given that the essence of the compliance model is to as far as possible tailor a response based on the individual circumstances of the taxpayer. Developing the capability of staff so that the compliance model is embedded in day-to-day operations is also a challenge. The lack of legislative backing, and the lack of budgetary support, have both been cited as being barriers to the successful uptake of the compliance model within IR.[64]

As a guide to strategic thinking, however, the compliance model has had a significantly positive influence on the tax system administration in New Zealand.

Across all services and tax types, the emphasis has been on improving systems and processes and providing assistance to make it easier for taxpayers to comply with their tax obligations. An important part of implementing the model relies on building relationships with the taxpaying community. This has led to many successful initiatives that allow for targeted intervention, particularly for those taxpayers operating in the cash economy. The Office of the Auditor-General has also shown a tendency to make use of the compliance model when undertaking performance audits of IR, and many positive recommendations have been made as a result of this.[65]

In areas where the statutory framework has led to outcomes that are inconsistent with a responsive approach, the compliance model can validate an argument for introducing more flexibility into the tax system. This is an important tool for both managing taxpayer perceptions and promoting

[63] Job, Stout and Smith "Culture Change in Three Taxation Administrations: From Command-and-control to responsive regulation", above n 38, at 93.
[64] At 93.
[65] Controller and Auditor-General *Inland Revenue Department: Performance of Taxpayer Audit* (Wellington, 2003) at [3.3] – [3.9], Controller and Auditor-General *Inland Revenue Department: Managing tax debt* (Wellington, 2009) at [2.3] – [2.7], Controller and Auditor-General *Inland Revenue Department: Making it easy to comply* (Wellington, 2011) at [1.4], Controller and Auditor-General *Inland Revenue Department: Effectiveness of the Industry Partnership programme* (Wellington, 2008) at [2.28].

voluntary compliance. This is because a legislative regime that fails to recognise and give credit for when a taxpayer is trying to comply with their tax obligations is liable to attract considerable criticism.

A good example of the compliance model being used to inform policy development is the amendments that were made to the compliance and penalties regime in 2007. These legislative reforms were made to ensure that the compliance and penalties regime is "better targeted to encourage voluntary compliance" and to provide for the relaxation of penalties "when taxpayers have genuinely and consistently tried to do the right thing".[66] This led to the introduction of a number of new measures that allow IR to respond more effectively to non-compliance.[67] Significant improvements have also been made in the area of the collection and management of taxpayer debt.[68] Legislative amendments have since introduced the ability for taxpayers to request to have some or all of the tax debt written-off on grounds of serious hardship, and to apply for more flexible repayment options.[69]

5.4.2 Limitations of the compliance model

For all the good that the compliance model has done for the New Zealand tax system, it is not without its limitations. There are two particular areas where the integrity of the tax system could be compromised under IR's compliance model given its predilection for compliance outcomes. These are that (a) the compliance model is customer centric and therefore pays little attention to the fairness perceptions that other taxpayers form in relation to a particular compliance strategy; and (b) the compliance model critically assumes the law is determinate.

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[66] Policy Advice Division *Tax penalties, tax agents and disclosures* (government discussion document, October 2006) at [1.3]. See also Burton and Dabner, above n 38, at 125.

[67] For example, a mandatory notification requirement is now in place before a late payment penalty is imposed for the first time when a taxpayer inadvertently misses a tax payment (s 139B of the TAA 1994). There is also now a 100 per cent reduction in certain penalties for voluntary disclosures of tax shortfalls (ss 141G, 141J of the TAA 1994).

[68] This was a real sticking point for taxpayers during the FEC Committee inquiry in 1999. It was noted by the FEC Committee that "[m]any submissions claim that the department takes a heavy handed approach to debt collection, and pursues debt rigorously and without tact". The Committee recognised the importance of early communication with taxpayers regarding outstanding debt; particularly as the imposition of late payment penalties and use of money interest can quickly escalate the debt beyond a point that is manageable for the taxpayer (or indeed recoverable for the department). See Finance and Expenditure Committee, above n 30, at 18. IR now report on using the PARE model for managing debt with a focus on early intervention with its four phases (prevent, assist, recover and enforce) essentially being an application of the compliance model. See IR *Annual Report 2010* at 31.

[69] TAA 1994, s 177. See also Morris and Lonsdale, above n 61, at 64.

An understanding of these limitations can help to facilitate a better implementation of regulatory strategy by IR. It is principally by being aware of these limitations that IR can take steps to address them.

The compliance model is customer centric

The compliance model is generally focussed on promoting better compliance outcomes from the perspective of the individual taxpayer or taxpayer group under consideration. However, when implementing a regulatory strategy, it is important to also be aware of how an approach taken with an individual taxpayer or taxpayer group might have an influence on the compliance behaviour of taxpayers at large.[70] If compliant taxpayers perceive that non-compliant taxpayers are not being appropriately sanctioned for their behaviour, this might affect their own willingness to comply. At the same time, a key objective for revenue authorities using the compliance model is to try and encourage the taxpayer to be more compliant in the future. The perceived fairness of the sanctions imposed from the point of view of a non-compliant taxpayer is a key part of this. It is a difficult balance, but it is only by being aware of the limitations of the compliance model that IR can implement an effective strategy to manage the perceptions of all taxpayers within the tax system.

For similar reasons, there is also a need to think very carefully before pursuing an administrative strategy or legislative reform that is likely to be divisive as between societal groups.[71] This should be a particular concern for New Zealand. At the time of the 1999 Parliamentary inquiry,[72] there was already a strong perception that IR unfairly targets ordinary people with its enforcement function while being a light touch on large enterprises. This perception is beginning to emerge

[70] This is particularly true from the perspective of retributive justice. Wenzel reports that "[t]he central question of retributive justice is what treatment and degree of sanction the rule-breaker deserves". Key functions that support retributive justice in the tax system include the audit procedures used to detect non-compliance and the penalties regime used to impose sanctions on non-compliance. Fairness perceptions will be formed both from the point of view of the rule-breaker directly and indirectly by taxpayers who evaluate how effective these regimes are in providing restitution for the non-compliance of others. See Wenzel, above n 1, at 46.

[71] Another important dimension to Wenzel's framework is that it also relates fairness perceptions to a persons' self-identification either as an individual, with a particular societal group or with society at large. While much of the traditional research on tax compliance has been dominated by individualistic approaches, Wenzel submits that the analysis needs to be extended by taking account of how taxpayers may define themselves in more inclusive ways. Taxpayers that identify with societal groups, or society at large, are more inclined to show concern for collective outcomes when forming fairness perceptions. The relationship between taxpayer identification and the three types of justice identified by Wenzel is, therefore, a critical part of the wider impact on tax compliance behaviour. See Wenzel, above n 1, at 44.

[72] See discussion supra at 3.1.

again quite strongly with the growing international attention being given to the tax practices used by some large enterprises (referred to as base erosion and profit shifting or 'BEPS').[73]

This limitation in the compliance model has the potential to represent a significant concern for tax administration in the area of compliance risk management. Compliance risk management strategies are often rationalised by regulators in terms of the compliance model as an effective means of deploying resources based on an understanding of taxpayer behaviour.[74] Such an approach allows the revenue authority to tailor their regulatory strategy based on taxpayer groups or arrangements and their relative positioning on the regulatory sanctions pyramid. Resources are directed to those taxpayer groups or arrangements that represent the greatest risk to compliance, while a less interventionist approach is adopted in respect of those taxpayer groups or arrangements located at the base of the pyramid (i.e. where voluntary compliance is expected).

While the majority of revenue authorities tend to view compliance risk management as being consistent with responsive regulation, it is not always clear precisely how the compliance model is meant to interact with a risk management strategy.[75] Despite the promise of gains in efficiency and administrative cost savings that come with a risk based approach to the compliance model, it may be there is an accompanying threat to the integrity of the tax system if it leads to certain types of obligation being consistently left unenforced.[76] This is supported by Burton and Dabner where they report:[77]

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[73] Mounting BEPS concerns, along with rising disquiet about inequality, recently led 88% of chief executives in a recent 'Mood of the Boardroom' survey undertaken by the New Zealand Herald to conclude "there is now a general mistrust across society that the rich don't pay their fair share". See "Mood of the Boardroom: Foreign firms not paying fair share" The New Zealand Herald (28 September 2016).

[74] See Forum on Tax Administration Compliance Sub-group *Compliance Risk Management: Managing and Improving Tax Compliance* (2004). Compliance risk management is defined by the OECD in their 2013 report on Cooperative Compliance as "…a systematic process in which efficient and effective choices are made within a broad range of compliance tools. These tools include interventions that are designed to stimulate voluntary compliance and to prevent non-compliance, and that are responsive to the behaviour of taxpayers." See OECD *Cooperative Compliance: A Framework* (OECD Publishing, 2013) at 42.

[75] See Chris Ohms, Karin Oleson and Natalie Khin-Carter "Taxpayer Compliance Models: A Literature Review and Critique" 21 NZJTLP 427 at 445. Transparency and accountability concerns that stem from uncertainty regarding how the compliance model is meant to operate within a broader compliance risk management framework is much more so the case with IR's new compliance model recently implemented by the department. See discussion infra at 4.3.

[76] Taxpayers may justifiably come to perceive that there is a lack of retributive justice in the tax system if certain taxpayers are not being appropriately sanctioned for their non-compliance. Taxpayers may also perceive there to be a lack of distributive justice as obligations left unenforced can alter the actual burden of tax.

[77] Mark Burton and Justin Dabner "The Partnership Model of the Relationship between Tax Administrators and Tax Practitioners: Drivers, Challenges and Prospects" (2008) 11 Journal of Australian Taxation 108 at 120.

> …this narrative of risk management cannot, of itself, sustain legitimacy. This is because the flexible administration which it embodies threatens to undermine public confidence in the integrity of the tax system. The adoption of risk management as a tax administration tool therefore means that the general public must also assume a risk management outlook in overseeing the administration of its tax system. The incorporation of risk management within the discourse of tax administration can therefore be expected to prompt public demands for enhanced transparency and accountability as the general public seeks to manage *its* risk in the form of threats to tax system integrity.

To provide some context to where this is relevant, an example of a risk management strategy leading to outcomes that are inconsistent with taxpayer perceptions of integrity in the tax system relates to IR's selection of cases to assign to its debt officers for enforcement. A review by the Auditor-General in 2009 noted that IR:[78]

> needs to review how it assesses risk when selecting debt cases for further enforcement action. This is in order to enforce all kinds of tax obligations and to maintain public confidence that non-compliance is effectively deterred for all types of taxpayer.

While there is an obvious temptation to assign only high value debt where the chance of recovery is better, there is still a risk that this will cause taxpayers to perceive that there is a lack of fairness in the tax system. It was recommended by the Auditor-General that IR's risk-based system for case selections be reviewed to ensure that all types of debt are effectively targeted, as doing otherwise "can lead to a perception of unequal treatment and jeopardise public confidence in, and compliance with, the tax system".[79]

The compliance model assumes that the law is determinate

The second issue relates to one of the critical foundations on which the compliance model is built, that the law is determinate. This implies an instrumental view of the law and assumes that both taxpayer and IR have a shared understanding of what the rules mean. Based on this assumption, the aim of IR is to try and induce the taxpayer to comply with the requirements of the law.[80] However, the reality is that the meaning of the law will not always be clear. Parties often fail to reach a shared understanding of the laws meaning.

Those who attempt to define compliance according to a single set of principles will often make use of concepts such as the 'spirit' of the legislation to encompass both the written legislation and the

[78] Controller and Auditor-General *Inland Revenue Department: Managing tax debt* (Wellington, 2009) at 19.
[79] At 19.
[80] See Sol Picciotto "Constructing Compliance: Game Playing, Tax Law, and the Regulatory State" (2007) 29 Law & Policy 11 at 11.

intended impact of the law. As an example, James and Alley offer the following definition of compliance:[81]

> …the willingness of individuals and other taxable entities to act in accordance within the spirit as well as the letter of tax law and administration, without the application of enforcement activity.

A consequence of this sort of approach is that it can constrict the focus of regulation to a dualistic paradigm of compliance and non-compliance. Burton and Dabner take an alternative approach and challenge the view that there need necessarily be a common understanding of taxation law. They argue that the relationship between taxpayers and the tax administrator is at risk of being undermined where a tax administrator fails to acknowledge that there may be more than one interpretation of the law. They also refer to this as creating a power of interpretive discretion:[82]

> The failure to appreciate that there is not necessarily a 'correct' view of the taxation laws challenges the partnership model. Moreover, it also exposes a weakness in the theory supporting voluntary compliance and responsive regulation. When the theory speaks of encouraging taxpayers to voluntarily comply to pay the 'correct' amount of tax, what it means is that the tax administrator is seeking to achieve voluntary compliance with its interpretation of the taxation laws, or at least the interpretation of the taxation laws which it is prepared to accept. Rather than the tax administrator merely being the neutral, disempowered oracle for the legislative voice, it exercises power in wielding its interpretative discretion.

The authors therefore contend that appropriate compliance behaviour essentially falls to be defined by the tax system administrator who wields its 'interpretive discretion' and pursues an enforcement strategy based on its own interpretation of the legislation. In this context, there is a risk that IR may sometimes wield its interpretive discretion to pursue its compliance objectives in those areas where the law may not be determinate. This risk was also identified by Burton who reports:[83]

> In the context of indeterminate law, it is reasonable to expect that the Commissioner will at least occasionally interpret his managerial obligation in such a way that he will 'play for the grey' in seeking to maximise the revenue, rather than conceding that legal indeterminacy means that interpretive discretion should be exercised in favour of the taxpayer.

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[81] Simon James and Clinton Alley "Tax Compliance, Self-assessment, and Tax Administration in New Zealand — Is the Carrot or the Stick More Appropriate to Encourage Compliance?" (1999) 5 NZJTLP 3 at 10 . This definition was cited by Valerie Braithwaite in her work on motivational postures. See Valerie Braithwaite "Dancing with Tax Authorities: Motivational Postures and Non-compliant Actions" in Valerie Braithwaite (ed) *Taxing Democracy : Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 19.

[82] Burton and Dabner, above n 77, at 128.

[83] Mark Burton "Responsive Regulation and the Uncertainty of Tax Law – Time to Reconsider the Commissioner's Model of Cooperative Compliance?" (2007) 5 eJournal of Tax Research 71 at 93.

This limitation of the compliance model is perhaps not that surprising when one considers that the model was born out of work done by the Australian Tax Office on how to combat evasion in the cash economy. What amounts to non-compliance in this context can readily be identified, and 'voluntary compliance' for a taxpayer can be understood to mean accurately reporting income and expenses and then paying the taxes that are due. When applied to other taxpayer groups, non-compliance may not be so easy to identify.

Large corporates, for instance, routinely report on all income and expenses when determining tax payable under the legislation. In these terms, this taxpayer group is highly compliant. Large corporates also operate in complex business and regulatory environments and will often incorporate a degree of active tax planning to minimise tax payable. In contrast, a revenue authority will tend to take a more conservative view of the law and be influenced by a need to protect the tax base.[84] In this space, the law is often uncertain. Legitimate differences will arise as to what is the correct tax outcome in terms of the legislation. The difficulty with the compliance model is that compliance is inevitably framed in terms of how the tax administrator views that the law applies to any given situation. A taxpayer who is unfortunate enough to have taken a different position risks being labelled by the compliance model as 'uncooperative' and faces an escalation of enforcement actions. The conclusion that the principles of the compliance model can be undermined in circumstances where the law is indeterminate is shared by many commentators and is underpinned by rule of law concerns.[85]

Indeterminacy in the law is not necessarily problematic if there are proper procedures in place for resolving disputes that operate alongside the compliance model at reasonable cost to the taxpayer. While it is outside the scope of the present chapter to consider this issue, it is worth noting that the mandatory (pre-litigation) disputes resolution regime in pt 4A of the TAA 1994 is often seen by taxpayers and their advisors as creating some significant impediments to challenging the view of

[84] See Burton, above n 83, at 85. See also John Braithwaite "Large Business and the Compliance Model" in Valerie Braithwaite (ed) *Taxing Democracy: Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 178 – 179. Braithwaite suggests that, for large businesses, the objective of compliance must take on a purposive approach to questions of interpretation and this will mean compliance with the purposes of the law. Interestingly, Braithwaite notes that "while the pattern of individual compliance is broadly pyramidal, the pattern of large corporate compliance is egg-shaped, with most taxpayers playing for the grey…" and concedes that "[i]t is hard to make compliance strategies work when compliance behaviour is egg-shaped". The chapter goes on to consider methods for moving more taxpayers away from playing for the grey in the middle of the egg down into the base.

[85] See Mike Lennard "Peace in Our Time" (2008) Taxation Today 29 at 31 and Burton, above n 83, at 82. In an effort to remedy perceived deficiencies in the compliance model, Ohms, Oleson and Khin-Carter contribute to this discussion by suggesting an alternative compliance model premised on the concept of legal obligation space (LOS). See Ohms, Oleson and Khin-Carter, above n 75, at 458.

IR in Court.[86] It is argued that many taxpayers are effectively "burned off" and capitulate to IR's view without necessarily agreeing with that position.[87]

When recommending the enactment of s 6 of the TAA 1994, the Richardson Committee originally placed a lot of emphasis on the relationship between taxpayer perceptions and the correct and impartial application of the law to the affairs of individual taxpayers. The disputes resolution procedures were singled out as an area in particular where taxpayer perceptions of integrity in the tax system are likely to be acutely sensitive.[88] It seems extraordinary that taxpayer concerns that the dispute resolution procedures are not working as intended still continue to endure more than 20 years after the regime was introduced.

The compliance model and its core assumption that the law is determinate may have inadvertently contributed to this problem by taking the focus away from the Commissioner's adjudicative responsibilities in terms of the tax system administration. The result is that the systems and procedures introduced to support the compliance model are actually well advanced. There have been some significant improvements in areas such as taxpayer audit and service delivery in this regard. In contrast, the systems and procedures needed to support the Commissioner's adjudicative function have been left underdeveloped. The problem is that a responsive regulatory strategy requires trust to exist between taxpayers and the regulator. Given that procedural fairness concerns can be particularly acute in an adversarial context, it may be that a failure to address this issue has diminished IR's legitimacy in the eyes of the public.[89] This would in fact undermine the whole point of the compliance model.

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[86] See Alison Pavlovich "The Tax Disputes Process and Taxpayer Rights: Are the Inconsistencies Proportional?" (2016) 22 NZJTLP 70. The author argues that the prohibition in s 109 from challenging a decision until the disputes process is completed is an infringement on a taxpayer's right to access justice per s 27(3) of the Bill of Rights Act 1990.

[87] In a joint submission from the Taxation Committee of the New Zealand Law Society (NZLS) and the National Tax Committee of the New Zealand Institute of Chartered Accountants (NZICA) to an officials' issues paper in 2010 it was argued by the Societies that "[t]he procedures are also not meeting the purpose for which they were enacted. In our experience, taxpayers are disengaging from a process that prices them out of the ability to seek justice and that delays their access to the courts. This is cementing the view of taxpayers that the system is weighted against them and that there is no point in pursuing disputes. This is undermining the integrity of the tax system". See New Zealand Law Society and New Zealand Institute of Chartered Accountants "Submission to the Disputes Project on Disputes: A Review – An Officials' Issues Paper" at [2.2] – [2.3].

[88] See discussion supra at 2.2.

[89] See Melinda Jone and Andrew Maples "Mediation as an Alternative Option in New Zealand's Tax Disputes Resolution Procedures" (2012)18 NZJTLP 412 at 420. The author reviews the importance of fairness perceptions specifically in the context of the tax disputes resolution procedures.

5.4.3 Inland Revenue's transition to a new compliance model

IR went live with a new compliance model in March 2015.

In IR's *Statement of Intent 2014 – 18*, the department indicated that the revamp was so that its compliance model "assesses a more comprehensive range of factors influencing customer behaviour".[90] Complete with circular design and three moving wheels, the model is depicted in figure 3 below.

Figure 3: Inland Revenue's (current) compliance model

[90] IR *Statement of Intent 2014 – 18* at 19. Source: Inland Revenue and licensed by Inland Revenue for re-use under the Creative Commons Attribution 3.0 New Zealand Licence. Crown copyright ©. The views, opinions, findings, and conclusions expressed in this thesis do not necessarily reflect the views of Inland Revenue. Inland Revenue has made every effort to ensure that the information contained in the Inland Revenue documents referred to in the thesis is reliable, but does not guarantee its accuracy or completeness and does not accept any liability for any errors.

A government discussion document (the third in a series released as part of IR's business transformation project) describes each of the components of the model:[91]

> The new compliance model is made up of moveable wheels that show how Inland Revenue should be flexible and adaptive. At the centre of the new compliance model is the customer and what forms their behaviour. The middle wheel shows the five key principles of the new compliance model. The outer wheel shows the seven activities Inland Revenue uses to build compliance.

The new compliance model is an adaptation of the behavioural change wheel (BCW), a model that has been developed by University College London Centre for Behaviour Change. The BCW is described as "a synthesis of 19 frameworks of behavioural change found in the research literature"[92] and is used as a guide for designing and evaluating behaviour change interventions. The key similarity between the BCW and IR's new compliance model is the wheel centred around the customer that sits at the inner hub (known as the behaviour wheel). When talking about compliance behaviour, it is intended to move the focus away from just 'attitude to compliance' to instead encompass a combination of capability, opportunity and motivation. Known also as the COM-B model (standing for 'capability', 'opportunity', 'motivation' – 'behaviour') it was proposed as a new framework for understanding behaviour.[93]

While there are many elements in common between IR's old and new compliance models, such as the need to understand the customer and the need to be responsive and not adopt a 'one size fits all' approach, arguably the major expansion to the model is the consideration of factors reflected in the behaviour wheel. According to IR's *Annual Report 2015* each of the three factors that form customer behaviour are described in the following terms:[94]

> **Capability** is how well customers can meet their obligations and access their entitlements. It includes their knowledge of rules that apply to them, their access to tools and assistance, and their ability to understand.
>
> **Motivation** is about the factors that create the willingness to comply and then actually follow through and do it. Motivation includes both social and personal norms.
>
> **Opportunity** is about how easy it is for a customer to comply or not to comply with their obligations or access their entitlements.

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[91] Policy and Strategy *Making Tax Simpler :Towards a New Tax Administration Act* (government discussion document, November 2015) at 70.
[92] Susan Michie, Lou Atkins and Robert West *The Behaviour Change Wheel: A Guide to Designing Interventions* (Silverback Publishing, Great Britian, 2014) at 11.
[93] For background on the origins of the COM-B system see Susam Michie, Maartje van Stralen and Robert West "The behaviour change wheel: A new method for characterising and designing behaviour change interventions" (2011) Implementation Science 6:42.
[94] IR *Annual Report 2015* at 16.

Apart from the behaviour wheel that makes use of the COM-B model described above, IR has adapted the remainder of the BCW for its own purposes. The customer sits at the centre of compliance thinking.[95] The second wheel of IR's compliance model makes use of five key principles that are intended to act as a guide both for direct customer interactions and more broadly at a strategic level (the principles wheel). Based on discussions with IR, the author understands that three of the five principles – being 'understand and involve the customer and stakeholders', 'build compliance right from the start' and 'made it easy to comply and difficult not to' – have been taken from an information note prepared by the SME Compliance Sub-group of the Forum on Tax Administration in January of 2012.[96] The remaining two principles – 'influence norms' and 'provide certainty' – have been carried over from "IR for the future - 2011 onwards",[97] IR's primary document outlining strategy, and other strategic output produced by the department.

The outer layer of the compliance model (the activities wheel) represents the range of activities IR could undertake to facilitate compliance and support whatever principle applies in the situation. Given that these various activities have the potential to run across the quite separate responsibilities of different business groups within IR, it would immediately suggest that a high level of internal collaboration is needed to apply the model successfully. The need for concerted input will naturally limit the usefulness of the model as a thinking tool for the front line staff that deal directly with the customer. Arguably, it was much clearer to staff how to apply the former compliance model at an operational level.[98]

Apart from brief mentions in IR's *Annual Report 2015* and the latest *Statement of Intent 2016 – 20*, there has been little released outside of IR regarding the transition to the new compliance model, or how it will work in practice. This is in fact a deliberate decision, with officials at IR believing taxpayers and their advisors have little interest in the internal strategic and policy tools used by the department. While this may be true, there are still good reasons to be transparent. This is

[95] Staff were given swappable stickers to place on the centre of the model depending on what customer group they are dealing with – individuals, microbusiness / self-employed, SME enterprises, high-wealth individuals, significant enterprises or not-for-profits.
[96] Forum on Tax Administration SME Compliance Sub-group *Right from the Start: Influencing the Compliance Environment for Small and Medium Enterprises* (2012).
[97] IR "IR for the future - 2011 onwards" (March 2011) <https://www.ird.govt.nz/aboutir/reports/business-plan/irftf-2011/>
[98] See Jenny Job, Andrew Stout and Rachael Smith "Culture Change in Three Taxation Administrations: From Command-and-control to responsive regulation" (2007) 29 Law & Policy 87.

particularly so when it comes to how the model will incorporate risk management practices and deal with decisions on the application of limited resources.[99] The compliance model, with its comprehensive COM-B system for understanding taxpayer behaviour and flexible use of strategies and interventions, promises to be the height of 'responsive' as far as items in the regulatory toolbox are concerned. Whether it can live up to this promise will come down to how successfully it can be applied in practice.

The fact that the former triangular compliance model was in such widespread use by tax system administrators around the world has meant that the effect of regulatory enforcement activity on the end goal of voluntary compliance was well understood and learnings could be shared. It has also served as an important accountability measure in New Zealand, referenced by both academics and the Office of the Auditor-General when recommending changes to the tax system or to tax system administration. The design of the new model would appear to be something of a leap in the dark as there is little academic analysis in tax compliance literature to support its merits. Moreover, as it is an *adaptation* of the BCW, IR's version of the BCW and the addition of the principles wheel in particular (replacing nine intervention functions on the BCW) would appear to be untested in terms of behaviour change literature as well.[100] While IR should be applauded for its forward-thinking in this area, it must now fall to them to demonstrate the value of their new compliance model to tax administration.

In any case, it is not clear that the revamp has overcome either of the two limitations of the former compliance model referred to in the previous section – the new design is overtly customer centric (more so even than the former design) and there remains a risk that behaviour at the centre of the model is defined in terms of IR's view of the law, even when that law may be ambiguous and open to interpretation. As discussed, the new model may also not be providing clear enough outcomes for operational staff at IR who deal with individual taxpayers. If it cannot be understood by taxpayers, there is an additional risk of obfuscating regulatory strategy against the norm of providing more transparency in the public sector. IR needs to think carefully about how the new

[99] For the public to have confidence in the integrity of the tax system, it is critical that IR is transparent and accountable for how it deploys its limited administrative resources. These decisions need to make sense to taxpayers within the context of a broader risk management strategy. See discussion infra at 4.2.

[100] The nine intervention functions on the behaviour change wheel were carefully selected after a systematic evaluation of existing frameworks against the three criteria of comprehensiveness, coherence and a clear link to an overarching model of behaviour. It is unclear what effect that IR's substitution of its five principles of compliance will have on the overall usefulness of the design. See Michie, Stralen and West, above n 93.

compliance model is being applied in practice and consider disclosing this information. This is important so that taxpayers can understand how IR will determine whether its implementation of the new model has been a success.

5.5 Taxpayer charter and complaints management service

Part five of this chapter looks at how the taxpayer charter and complaints management service, both launched by IR in March 2001,[101] supports the shift in regulatory approach that came with the department's 2001 business plan. This chapter then makes the case that these initiatives, particularly in recent years, do not go far enough in terms of their management of tax system integrity.

The charter is made up of five sections as follows:[102]

How we will work with you

We will be easy to deal with, prompt, courteous and professional.
We will follow through on what we say we will do.
We will be responsive to individual, cultural and special needs.
The person you are dealing with will give you their name.
We will value your feedback and use it to improve our services.

Reliable advice and information

We will provide you with reliable and correct advice and information about your entitlements and obligations.
We will assist you to get in touch with the right people for your needs.
We will be well-trained and competent.
We will keep looking for better ways to provide you with advice and information.

Confidentiality

We will treat all information about you as private and confidential, and keep it secure. We will only use or disclose it in accordance with the law.

Consistency and equity

We will apply the law consistently so everyone receives their entitlements and pays the right amount.

[101] This was done in line with the recommendations made by the FEC Committee in the course of the 1999 Parliamentary inquiry. Prior to this, the department had in place a Statement of Principles issued in 1986 and subsequently to this a Customer Charter. The FEC Committee considered that these did not go far enough. For further background see Adrian Sawyer "A Comparison of New Zealand Taxpayers' Rights with Selected Civil Law and Common Law Countries- Have New Zealand Taxpayers Been 'Short-Changed'?" (1999) 32 Vanderbilt Journal of Transnational Law 1345 at 1373.

[102] The charter was revised and a new version was published on 1 July 2008 to better reflect IR's tax and social policy functions, although the changes made were only minor. See IR *Annual Report 2008* at 10.

> We will take your particular circumstances into account as far as the law allows.

Your right to question us

> We will make it easy for you to question the information, advice and service we give you. We will inform you about options available if you disagree with us, and we will work with you to reach an outcome quickly and simply.

The complaints management service was seen to augment the charter by providing feedback on the effectiveness of the services that IR provides. By doing this, it reinforces the service commitments made in the first four sections of the charter. The implementation of the complaints management service is a significant plus from a procedural fairness standpoint. Judging by the reduction in the number of official complaints made to the Office of the Ombudsman shortly after their introduction, it would seem that both the taxpayer charter and complaints management service have had an immediate and positive effect on taxpayer perceptions of fairness in the tax system. According to the Report of the Ombudsman for the year ended 30 June 2003:[103]

> There has been a significant reduction this year in the number of complaints received against the Inland Revenue Department (the IRD). This is pleasing. The reduction may reflect the effect of the IRD service charter and the continuing beneficial operation of the IRD Complaints Management Service. The IRD continues to show a helpful and positive response to approaches from us and a willingness to review existing policies and practices where circumstances require. During the year a number of complaints have been resolved to the benefit of the complainants.

Reporting on complaints and ministerial enquiries used to be a regular feature in IR's annual reports, but this practice was discontinued after the year ended 30 June 2013. In response to an official information act request, IR confirmed that the reason for its discontinuance was because it did not relate to any of the department's external performance measures.

The taxpayer charter has been described by IR as their "new contract with the community".[104] It sets out the type of working relationship that IR wants to have with taxpayers. This is important, because developing a cooperative relationship with taxpayers is a significant part of implementing responsive regulation successfully. The Cash Economy Task Force recognised that building community partnerships is integral to making the compliance model work effectively and facilitates a move away from a command-and-control style of regulatory approach.[105] The challenge, as put

[103] Report of the Ombudsman for the year ended 30 June 2003 (presented to the House of Representatives pursuant to s 29 of the Ombudsmen Act 1975) at 19.
[104] David Butler "Protecting the integrity of the New Zealand Tax System" (address to the Institute of Chartered Accountants Tax Conference 2002).
[105] Cash Economy Task Force, above n 47, at 25.

by IR, "is to move the public perception of Inland Revenue to the point where the community feels assured and positive about its proven ability and competence".[106] IR's contention is that public perceptions will improve if the department acts in accordance with the values set out in its taxpayer charter in its administration of the tax system. This is described in IR's *Statement of Intent* (SOI 2002-03) as meeting public expectations of service:[107]

> Public perception of Inland Revenue and the legislation we administer affects our ability to achieve our outcomes. We know people are more likely to voluntarily comply with their obligations if they accept, and have confidence in, the need for the law and the way it is administered.
>
> Public perceptions will continue to improve if we continue to meet public expectations. We consider the Charter to be a major expression of the way in which we intend to meet public expectations regarding the type of customer service they will receive from us.

A revenue authority that is seen by taxpayers to abide by its taxpayer charter is therefore able to increase its trust and legitimacy from the perspective of procedural justice.[108] The charter also plays a decisive role in promoting a 'synergistic tax climate'. This is argued by academics to be conducive to voluntary compliance under a model of tax compliance known as the slippery slope framework.[109]

Initially, at least, a great deal of emphasis was placed on reporting back on charter commitments as well as the specific initiatives that were being implemented to support the charter. This commentary (termed the 'charter report') was a regular feature of IR's annual reports from the year ended 30 June 2002 – 30 June 2007. Since this time, the regular reporting on charter commitments has been discontinued. IR confirmed that this was done to reduce duplication as much of the information that was reported under 'charter commitments' until 2007 can be found elsewhere in the report. In particular, the charter report was thought to duplicate information reported in the

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[106] IR *Our Statement of Intent: Including our Departmental Forecast Report for 1 July 2002 – 30 June 2003* at 33.
[107] At 37.
[108] See John Bevacqua "Redressing the imbalance – challenging the effectiveness of the Australian taxpayers' charter" (2013) 28 Australian Tax Forum 377.
[109] This conclusion is reached by Sue Yong and Alvin Cheng in a study published 10 years after the New Zealand taxpayer charter was first implemented. The authors focus on three particular directives in the charter and evaluate these in terms of IR's audit function. The authors conclude that "…the Charter has brought about some positive changes in the interactions between Inland Revenue and taxpayers. Although Inland Revenue has adopted a more humane approach to their dealings with taxpayers, more can and should be done to create a synergistic tax climate conducive to increased voluntary compliance." See Sue Yong and Alvin Cheng "The Inland Revenue's Taxpayer Charter and the Small Business Community" (2011) 17 NZJTLP 245 at 265. For background on the slippery slope framework, see Kirchler, above n 50, at 202.

Statement of Service Performance.[110] Notwithstanding, there is a risk without the charter report (or something equivalent in its place) that there will be a loss in transparency and accountability for the commitments made by IR in its charter. It also increases the risk that regulatory strategies are developed without regard to the principles of the charter. The taxpayer charter has itself not featured in annual reports since the year ended 30 June 2013. Rather, it is available to download as form IR614 on IR's website.

Another significant criticism of the charter is that it appears to be directed mainly at meeting the service standard expectations of taxpayers. In terms of the compliance model this is of obvious importance, because it promotes voluntary compliance at the base of the compliance pyramid and represents the strategy of making it easy to comply. What it overlooks though is that a charter that is bound too closely to improving public perceptions through meeting service expectations may not be comprehensive enough in terms of its coverage to manage tax system integrity. An alternative that is well worth considering would be to clearly set out what is expected of IR's administration of the tax system. This should be done with reference to a list of independently stated procedural rights that are affirmed by the taxpayer charter. Ideally, a charter along these lines would coincide with the exercise originally proposed by the Richardson Committee of rewriting the tax legislation in order to give the Commissioner's adjudicative role appropriate legislative recognition.[111] The desired outcome would be to provide a new standard for intervention from the courts and enable meaningful precedent to develop regarding what accountability standards and behaviours can be expected of IR.[112]

[110] The Statement of Service Performance is itself also no longer prepared. The requirement for a department in s 45 of the Public Finance Act 1989 to include a Statement of Service Performance in its annual report was replaced on 1 July 2014. See ss 82 – 84 of the Public Finance Amendment Act 2013.

[111] Richardson Committee report, above n 2, at 57.

[112] This view is shared by a number of other commentators. See Denham Martin "Inland Revenue's Accountability to Taxpayers" (2008) 14 NZJTLP 9 and Geoffrey Clews "Remedies Against the CIR Considered Through a Constitutional Lens" (2014) 72 Taxation Today 13. Currently, s 15B of the TAA 1994 sets out in concise terms the obligations of a taxpayer under the IR Acts. Adrian Sawyer, who individually made a public submission to the Taxpayer Compliance, Penalties and Disputes Resolution Bill 1996 recommending a statutory balancing of obligations with rights for taxpayers, argues that the decision by the government at the time not to enact any form of legislative protection for taxpayer's rights appears to have been ill-conceived. He notes that "[w]hat this failure to legislate fails to recognize is that tax compliance, fundamental to a self-assessment system, is a two-way process necessitating rights and obligations for both the Commissioner and taxpayers to be clearly stated. The rights preferably should be stated in legislative form or at least in an administratively-binding charter of taxpayers' rights" (footnotes omitted). See Adrian Sawyer, above n 101, at 1378.

5.6 Performance measurement and outcomes for Inland Revenue

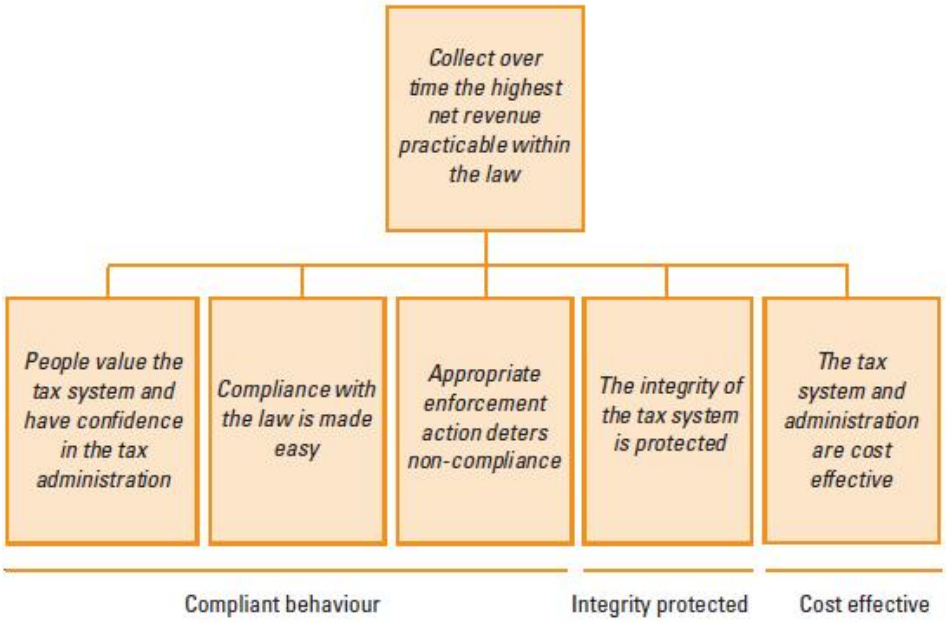
Part six of this chapter looks at how the framework used by IR to measure its performance has over the years developed without proper regard to the responsibility in s 6 to protect the integrity of the tax system.

The release of IR's first-ever *Statement of Intent* (SOI 2002-03) took place around the same time as the release of the 2001 business plan.[113] SOI 2002-03 reiterated the central importance of the compliance model and taxpayer charter for achieving organisational goals. Preparing this document also prompted IR to think about the main outcomes it is working to achieve and the nature of the relationship between these outcomes and the four strategic areas identified in IR's 2001 business plan.[114]

Quite naturally, one of the two primary taxation outcomes that IR landed on was the Commissioner's duty in s 6A(3) of the TAA 1994 "to collect over time the highest net revenue that is practicable within the law". The second primary outcome was not the responsibility to protect the integrity of the tax system in s 6, as might be expected. This was instead categorised as an intermediate outcome and seen as subordinate to the s 6A(3) objective (depicted in figure 4 below).[115]

Figure 4: Intermediate Tax Administration Outcomes (SOI 2002-03)

[113] IR *Our Statement of Intent: Including our Departmental Forecast Report for 1 July 2002 – 30 June 2003*.
[114] See discussion supra at 3.2.
[115] IR, above n 113, at 17.



This illustrates that the responsibility to protect the integrity of the tax system has been linked from the outset to a compliance-based objective, rather than being pursued as a separate objective in its own right. This is consistent with the Commissioner's duty in s 6A of the TAA 1994 and the view of the Richardson Committee that this duty represents a single revenue-orientated objective for tax system administration. With that said, the process of separating out the Commissioner's adjudicative responsibilities in terms of the legislation (also recommended by the Richardson Committee) was never undertaken. The way in which targets are set and performance measured could in fact have been very different had this separation taken place.

The approach taken by IR suggests that improvements in compliance and revenue collection are treated as the overriding touchstones for how performance is measured. But an agenda that is based on compliance outcomes is inherently results driven and can suffer from short-term thinking. Often the performance measures selected come at the expense of integrity measures that might in fact promote better compliance in the longer term, but are more difficult to measure (and therefore validate). It also overlooks the fact that protecting the integrity of the tax system is an objective that should be pursued by IR in its own right and not because of its impact on compliance.[116]

Since publishing SOI 2002-03, IR has redefined its outcomes a number of times. The responsibility to protect the integrity of the tax system was removed as an outcome altogether as part of strategic

[116] These are exactly the problems that Valerie Braithwaite is referring to when, in academic writing, she uses the descriptor 'compliance integrity dilemma'. See Braithwaite, above n 28.

planning that went into IR's *Statement of Intent* (SOI 2005-08).[117] IR's performance measurement framework is now the main way in which the department is held accountable to Parliament for the decisions it makes with limited resources to fulfil its functions under the legislation. The importance of accountability cannot be overstated. It is interesting, therefore, to note that the responsibility to protect the integrity of the tax system has become increasingly disassociated from IR's performance reporting and strategic output over the years. The consequence of this has been a fixation on compliance measures, and a lack of consideration given to how separate integrity measures could be utilised to contribute to impact indicators and outcomes.

IR's latest *Statement of Intent* (SOI 2016 – 20) is perhaps a step in the right direction. It indicates that IR's responsibility to protect the integrity of the tax system, while not part of the performance measurement framework, underpins the framework. Presently, it is only supported by two integrity measures.[118] This is a far cry from the sorts of accountability measures envisaged by the Richardson Committee when they first recommended the enactment of managerial discretion for the Commissioner.[119] It also gives insufficient recognition to the Commissioner's adjudicative role that the Richardson Committee considered shared a special connection to taxpayer perceptions of tax system integrity.[120] If IR were to develop additional and more comprehensive integrity measures in the future then this will go a long way to ensuring that its responsibility in s 6 is being managed appropriately at a strategic and regulatory level.

It is worth noting that the performance measurement framework, to a limited extent, does incorporate taxpayer perceptions into some of the output targets and impact indicators used to assess performance. These performance measures are reviewed each year and tend to change over time. To support a number of appropriations, particularly in the areas of investigations and services to inform the public about entitlements and meeting obligations, the performance measures often

[117] IR *Statement of Intent 2005 – 08* at 23.
[118] IR *Statement of Intent 2016 – 20* at 35. These include (a) the percentage of customers who have trust and confidence in IR based on a composite measure derived from IR's Customer Satisfaction and Perceptions survey; and (b) IR's Public Sector Reputation index (RepZ) score from the annual Colmar Brunton report on public-sector reputation.
[119] Such as a periodic independent audit of the exercise of s 6A by the Office of the Controller and Auditor General and the proposed health report to be prepared annually for the Minister of Revenue. Many of these measures have either been discontinued or were never picked up.
[120] For example, it would seem sensible to test taxpayer perceptions of the disputes resolution procedures as a specific performance measure because of its proximity to what the Richardson Committee considered was important to the adjudicative component of the Commissioner's role.

draw from the results of externally run customer surveys.[121] The surveys however are mainly used to assess whether service standard expectations of IR are being met. This is to the exclusion of what really matters to taxpayers in terms of the integrity of the tax system. There is merit in the idea that IR should work more closely with the professional tax community to develop surveys that align with taxpayer expectations in this area.

As an example, CAANZ and Tax Management New Zealand (TMNZ) regularly commission Colmar Brunton to survey the New Zealand members of CAANZ on matters relating to satisfaction with IR service. The results of these annual surveys reveal some consistent and alarming trends in the area of tax disputes.[122] The surveys confirm that the vast majority of members who have been involved in the disputes process say that the matter is closed before a case is filed in court. However, when asked what the main reason was that prompted the taxpayer to agree to settle, the overwhelming year-on-year response has been that the time commitment and cost to continuing the dispute is too great.[123] Another trend reported by members is that IR would only fairly consider the taxpayer's position in less than half of the cases where the taxpayer fully or partially decided to settle the dispute. Despite assurances in 2010 from the Minister of Revenue that legislative solutions will be reconsidered (in approximately two years' time) if significant taxpayer concerns remain,[124] there have been no new developments on this front.

One way to address these issues is a rethink regarding how the performance measurement framework could be better employed to support the Commissioner's adjudicative role under the legislation. As it stands, there has been a failure to in any adequate way separate out those activities undertaken by IR that can properly be said to belong to the Commissioner's adjudicative role. The absence of separate and meaningful measures to support this adjudication function undermines the ability to monitor how well IR is performing in relation to its responsibility to protect the integrity of the tax system. A consequence is that integrity may only be pursued as a goal when it makes sense in the context of other compliance-related initiatives.

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[121] These include IR's Customer Satisfaction and Perceptions (quarterly survey), the small and medium enterprises (annual survey), the large enterprises (bi-annual survey) and the tax agents' perceptions of audit (bi-annual survey).
[122] Available at >http://www.nzica.com/Technical/Tax/Tax-articles-and-media.aspx< (accessed 27 October 2016). See also Lindsay Ng and Chris Cunniffe "Inland Revenue Service – are you satisfied?" (February 2013) The Chartered Accountants Journal 78.
[123] These results are corroborated even by IR's own evaluation of the disputes process commissioned in 2012. See Gail Kelly "IR's view of your satisfaction" 28 February 2013 <http://www.nzica.com /News/Archive/2013/March/IRs-view-of-your-satisfaction.aspx> (accessed 27 October 2016).
[124] Taxation (Tax Administration and Remedial Matters) Bill (Commentary on the Bill) at 18.

It is worth reiterating the Richardson Committee considered that the responsibility in s 6 to protect the integrity of the tax system represents a line of accountability that IR owes to the Minister, Parliament and taxpayers collectively. Several passages in the Richardson Committee report note that the Commissioner's duty in 6A(3) applies instead in meeting accountabilities specifically to the Minister. The inference emerges that this legislative objective relates to the Commissioner meeting her responsibilities as the chief executive of a government department under the State Sector Act, and perhaps, in particular, the responsibility for (as it was then) "the efficient, effective, and economical management of the activities of the Department".[125] Section 6, in contrast, was introduced in an effort to secure IR's wider responsibilities to the tax system.[126] This is reinforced by the Commissioner's statutory independence with respect to certain matters under s 6B, and the fact that s 6 is a responsibility that belongs to all Ministers and officials.[127]

If outputs, impacts and outcomes are not better defined in a way that supports integrity measures at an organisational level then it is difficult to see how IR will ever be able to manage its responsibility in s 6 in any meaningful way. This is an area where more work is needed.

5.7 Policies, procedures and controls used to protect integrity

Part seven of this chapter examines IR's use of policies, procedures and controls that apply throughout the organisation. These are a useful way for IR to manage its responsibility its responsibility to protect the integrity of the tax system.

One clear example is IR's code of conduct that sets out expected standards of behaviour. This is regularly reviewed to ensure it remains fit for purpose. The code of conduct is brought to the attention of all staff when they begin working for IR. Among other things, this ensures that they are all aware of their responsibility under s 6 to protect the integrity of the tax system.[128] Other

[125] State Sector Act 1988, s 32 (replaced, on 1 July 2014, by s 64 of the Public Finance Amendment Act 2013 (2013 No 50)). The language used in this section is mirrored in the Richardson Committee report when it suggests that "the operation of the tax system, and its effective, efficient and economical administration are critically dependent on a strategy of voluntary compliance". Richardson Committee report, above n 2, Appendix D at [21].
[126] The Richardson Committee point out that "[t]he integrity of the tax system is not simply a matter between the CE/Commissioner and the Minister. It also includes the interaction between the total tax administration and individual taxpayers". See Richardson Committee report, above n 2, at 60.
[127] This contrasts with the Commissioner's duty in s 6A(3) of the TAA 1994. This duty is instead specific to the Commissioner.
[128] The document makes staff aware of some of the more serious breaches of integrity, such as accessing information relating to friends, family or acquaintances or breaching the strict secrecy obligations imposed on staff under s 81 of the TAA 1994.

policies, procedures and controls used by IR are far more specific in their description of the measures used to help protect the integrity of the tax system. They include the Standard Practice Statements that IR regularly uses to communicate how the Commissioner will normally exercise a statutory discretion or deal with a particular matter. They also include the internal policies used by IR to document certain processes and make it clear who is responsible or accountable for various decisions.

Given the broad range of internal processes which IR has in place that could be regarded as being integrity measures, it is difficult to comment on each of them individually. One of the best examples is IR's Escalation Policy for technical issues. This is discussed in some detail below. Before moving to this, it is appropriate to first comment on some aspects of IR's use of policies, procedures and controls more generally. This is because there do appear to be a number of common elements that are limiting how effective these can be as administrative tools for protecting the integrity of the tax system.

One limiting factor is that these policies, procedures and controls are not being supported effectively by the performance measurement framework used by IR to assess performance. Earlier, this chapter made the same observation with regards to the adjudicative role of the Commissioner.[129] There is no reason why important elements of the Commissioner's adjudicative role should not be built into the performance measurement framework. Similarly, many of the policies, procedures and controls used by IR to safeguard tax system integrity could be supported by performance measures. This would ensure that IR's compliance objectives do not compromise tax system integrity. The ideal solution would be to work with taxpayers to develop a number of impact measures (or additional integrity measures) in areas that are important to tax system integrity, and incorporate these into the framework.

As an example, IR has recently published its 12 page internal approach to managing changes or perceived changes of interpretation or practice (dated 21 November 2016).[130] This policy is an important one for tax system integrity as it deals not only with a change in position from a published public statement or taxpayer specific advice, but also where taxpayers *perceive* that there have been changes to the technical interpretation or practice of administering tax legislation. By doing so,

[129] See discussion supra at 6.0.
[130] This policy is available at <http://www.ird.govt.nz/technical-tax/commissioners-statements/escalation-policy-technical-issues.html> (accessed 30 March 2017).

the policy is mindful of the need to manage taxpayer perceptions of the integrity of the tax system. Key to its effective implementation is that any potential change or perceived change situation is identified early and that steps are then taken to make ensure the process is followed. Having in place suitable performance metrics that are externally communicated and reported to would provide an assurance to taxpayers that IR is accountable for overseeing that this process is working as intended.

Another limiting factor is that IR does not appear to have a suitable strategy for balancing the various elements of ss 6 and 6A when coming to a decision. While the two sections are not necessarily inconsistent,[131] there is a balance that needs to be struck between sometimes competing considerations when coming to a decision. Academic literature suggests that the perceptions a taxpayer will form about tax system integrity can be categorised in different ways.[132] Nevertheless, no clear attempt has made by IR to develop a strategy to differentiate between these. There is a place for a strategic tool that could be used to assist in decision-making and provide guidance to staff for how to weigh up and consider the various elements of ss 6 and 6A.[133]

Escalation Policy for Technical Issues

IR's Escalation Policy for technical issues was recently updated and has been made publicly available on IR's website.[134]

The Escalation Policy recognises that different people within IR will at times form different views on the interpretation or application of the legislation. It is accepted that inconsistent positions are sometimes inevitable in an organisation as large as IR. However, IR staff are not permitted to knowingly adopt a different interpretation or application of the tax law where this is contrary to an existing interpretation or position applied by the Commissioner.[135] Instead, the Escalation Policy

[131] See IR "Care and Management of the taxes covered by the Inland Revenue Acts" Tax Information Bulletin Vol 22, No 10 (November 2010) at [146].
[132] See Wenzel, above n 1.
[133] A useful exploration of the relationship between Wenzel's taxonomy and voluntary tax compliance (versus enforced tax compliance) is provided by Erich Kirchler, Erik Hoelzl and Ingrid Wahl "Enforced versus voluntary tax compliance: The "slippery slope" framework" (2008) 29 Journal of Economic Psychology 210. See also Kirchler, above n 50, at 202. This could be a useful starting point for IR to develop a tool that can differentiate between the various perceptions that a taxpayer might form and establish the relationship between these perceptions and voluntary compliance.
[134] Available at <http://www.ird.govt.nz/technical-tax/commissioners-statements/escalation-policy-technical-issues.html> (accessed 30 March 2017) [Escalation Policy].
[135] There are some exceptions to this rule, such as with Taxpayer Rulings or the Disputes Review Unit. See [43] – [49].

sets out a process that must be followed where staff find that they disagree with the Commissioner's existing interpretation or position on an issue.[136]

The Escalations & Advising Unit (E&A) is part of the Office of the Chief Tax Council (OCTC) and plays a key role in supporting the escalation process. IR created the Office of the Chief Tax Council (OCTC) following an internal restructure in 2006.[137] This business group was established with the intention that the responsibility for all technical and legal decision-making that occurs at IR is brought into a single office.[138]

Matters are generally referred to E&A for resolution only after they have been cleared for escalation by Service Delivery or Legal Technical Services, and the matter has been tested in a wider forum.[139] Once referred to E&A, this will trigger an internal consultation process that culminates in a final view being reached and a consistent interpretation being applied across all of IR. The process will also identify whether E&A's interpretation of the law is likely to present any legislative, operational or other issues that require further consideration.[140]

The Escalation Policy was originally established in a memorandum from the Commissioner to all IR staff on 23 November 2001. According to this memorandum:[141]

> Under paragraph 6(2)(f) of the Tax Administration Act 1994, it is the obligation of all Inland Revenue officers to administer the law "according to law". However, section 6 of that Act also imposes other obligations upon us as well, and these are not always easy to balance in an environment where we must routinely determine and apply interpretations of the law.
>
> In particular, our over-riding obligation to protect the integrity of the tax system in subsection 6(1) also includes having regard to taxpayer perceptions of that integrity [paragraph 6(2)(a)], the right of taxpayers to have their liabilities determined "fairly" and "impartially" [paragraph 6(2)(b)], and to

[136] This includes any interpretation or position set out in externally published material but it also includes legal or technical opinions prepared by IR staff that are only internally available or even an established practice applied by IR. At [2] – [5].
[137] See Mark Keating *Tax Disputes in New Zealand — A Practical Guide* (CCH New Zealand, Auckland, 2012) at 238.
[138] In addition to E&A, the OCTC has a number of independent units that are involved in adjudicating on disputes, issuing binding rulings, and producing technical output on the Commissioner's view of the law. Many of these functions were previously performed by the Adjudications & Rulings group that had been established in 1995 following a recommendation made by the Richardson Committee. See discussion supra at 2.2.
[139] The Escalation Policy designates that the Tax Intelligence Group is the forum for this purpose. See Escalation Policy, above n 134, at [52] – [64].
[140] At [73] – [75].
[141] Memorandum from David Butler (Commissioner) to IR staff regarding Technical Issues – Consistency and Escalation Process (23 November 2001) (Obtained under Official Information Act 1982 request to Government and Executive Services, IR).

> have their individual affairs "treated with no greater or lesser favour than the tax affairs of other taxpayers" [paragraph 6(2)(c)].
>
> These paragraphs in combination mean that it is important that the Department – to the greatest extent possible – does not apply the law inconsistently as between taxpayers, as this can give rise to negative perceptions of the fairness and impartiality of the tax system and can advantage, or disadvantage, some taxpayers over others.

As all staff essentially obtain the power to undertake their duties through a process of delegation from the Commissioner,[142] the memorandum states that it is indefensible for the holder of that office, through these delegates, to routinely and knowingly apply different interpretations of the law. Having a process in place so that different views on the interpretation of the law can be brought together is therefore a critical part of how IR meets its responsibility in s 6 to protect the integrity of the tax system. What is not clear from the Escalation Policy is whether any measures are being taken by IR to ensure that this process is being adhered to. These are important, as the Escalation Policy is simply an administrative process. It is open to the Commissioner to depart from the process or even to conclude that it is not needed in a particular case.

The decision in *Westpac Banking Corporation v CIR* confirms that any failure on the part of IR to comply with its own Escalation Policy will not normally invalidate an assessment made. According to that decision:[143]

> Given the size of the Inland Revenue Department, it is inevitable that there will be inconsistencies of interpretation and application. We do not see how it could be credibly argued that an assessment is invalid merely because some such inconsistency can be identified. In this case the complaint is that such an inconsistency was identified prior to the amended assessment but then not resolved appropriately. But for reasons already indicated, the "flaws" in the escalation process (if any) and any associated failure to comply with a provision of the Tax Administration Act (including s 6) would not usually invalidate an amended assessment.

Because it is generally in the interests of tax system integrity to adhere to the Escalation Policy, one would expect IR to have mechanisms in place to ensure that it's being implemented effectively. Transparency is also key to accountability in this situation. The Escalation Policy should be rewritten to describe how IR staff are accountable for a failure to adhere to the process. External communication of this would help to assure taxpayers of the integrity of this process.

The Escalation Policy states that any escalation of a matter will not lead to any adverse inferences being drawn due to its impact on performance targets for outputs in individual cases. However, it

[142] TAA 1994, s 7.
[143] *Westpac Banking Corporation v CIR* (2009) 24 NZTC 23,340 at [80].

is not clear that this in itself is enough to motivate IR staff to exercise independent judgement and engage in meaningful debate with taxpayers over the correctness of an existing interpretation or position.[144] In situations where there may be two different and legitimate interpretations of the law, it is probably easier for IR staff to side with an existing position or interpretation already taken by the Commissioner. The problem is that the merits of the taxpayer's arguments might not have been properly considered at the time this existing position or interpretation was reached. Another consequence is that taxpayers sometimes find themselves in the situation where they are unaware they are dealing with IR staff that are already bound by an existing policy or interpretation, because it has not been externally communicated.[145]

It is also crucial that there is a mechanism built into the process to monitor the number of instances where an inconsistency should have been identified by IR staff in the course of their research into an issue, but for whatever reason was overlooked. While it is "inevitable" that inconsistencies will occasionally arise, every effort should be made to reduce these occurrences. This monitoring mechanism should ensure that an assessment is made of each of the inconsistencies identified. It can then be established what went wrong and what can be done to avoid a similar occurrence happening in the future.

If the Commissioner decides not to apply the Escalation Policy in a particular case, then there should be clear reasons for not doing so. Ideally, these reasons would be communicated to taxpayers as part of this process.

5.8 Conclusion

Both ss 6 and 6A have been in force since 10 April 1995. The Richardson Committee, who recommended the enactment of these provisions, recognised the special connection between the Commissioner's adjudicative role and the responsibility to protect the integrity of the tax system. However, the Richardson Committee also were of the view that "both the high-level adjudicative and the other functions of tax administration have a significant, mutually reinforcing contribution

[144] Based on annual survey information collected by Colmar Brunton, taxpayers involved in a dispute with IR regularly report that the department would only fairly consider the taxpayer's position in less than half of the cases where the taxpayer fully or partially decided to settle the dispute. This is an alarming trend, and suggests that the Escalation Policy is not managing taxpayer perceptions quite as effectively as it perhaps should be. See Colmar Brunton survey results, above n 122.
[145] See Mark Keating, above n 137, at 242.

to make to [a single revenue-orientated] objective".[146] This conclusion was reached in recognition of the fact that taxpayer perceptions of the integrity of the tax system "are crucial to maintaining voluntary compliance", and therefore IR will seek to manage taxpayer perceptions because of the Commissioner's duty in s 6A(3).[147] In the years immediately following the enactment of these provisions, taxpayer perceptions of the integrity of the tax system had actually deteriorated to the point that the Government felt it necessary to intervene. This is evidence that clear pathways of accountability are needed to support the responsibility in s 6.

Since the release of IR's 2001 business plan, the department has pursued a new strategic direction based largely on the principles of responsive regulation. The department introduced its compliance model and taxpayer charter. It also revised the way its performance is measured and began to include outcome measures and impact indicators to supplement its output-contracting model. These have been steps in the right direction for managing taxpayer perceptions through the provision of improved service delivery. What might have been overlooked is that taxpayer perceptions of integrity are about more than just service delivery. The Richardson Committee in fact considered that taxpayer perceptions of integrity are closely bound to "the impartial application of the law and the exercise of the administration's coercive powers and decision-making powers with respect to the affairs of individual taxpayers".[148]

Much of the appeal behind a responsive regulatory strategy is that it allows an administrator to adopt a risk management perspective in the deployment of limited resources, with the promise of administrative cost savings and greater efficiency. A concern with this is that any administrative action making sense for the sake of maximising the collection of revenue will be pursued, but these actions may come at an unseen cost of undermining tax system integrity. Measures used to monitor the integrity of the tax system are often difficult to define, and the precise relationship between these measures and voluntary compliance even more so. The problem is sometimes one of a revenue authority's performance targets and compliance objectives being more tightly bound to short-term interests at the expense of a longer-term outlook.[149] Taxpayer perceptions of tax system

[146] Richardson Committee report, above n 2, Appendix D at [89].
[147] At 58. The Courts too have paid mind to the special relationship between the integrity of the tax system and the importance of voluntary compliance listed in s 6A(3)(b) in a number of decisions. See, for example, *Westpac Banking Corporation Limited v CIR & Ors; Westpac Banking Corporation Limited v CIR & Ors* (2008) 23 NZTC 21,896 at [51] and *Raynel & Anor v CIR* (2004) 21 NZTC 18,583 at [54].
[148] Richardson Committee report, above n 2, at 98.
[149] See Braithwaite, above n 28, at 276 and Burton and Dabner, above n 77, at 120.

integrity are also just one of a number of variables explored in the tax compliance literature as having an influence on the compliance behaviour of taxpayers (and therefore voluntary compliance).[150] It is easy to see how integrity could fall to the wayside when compliance is the ultimate goal.

The examination undertaken in this chapter of the initiatives that have been in place since the 2001 business plan suggests that there has never really been an adequate focus from IR on what needs to be done to uphold the integrity of the tax system. Neither the taxpayer charter with its focus on service performance (to the exclusion of a rights focus) nor IR's current performance measurement framework (with its near lack of integrity measures) should provide any assurance to taxpayers that IR's responsibility to protect the integrity of the tax system is being upheld. This chapter argues that the internal processes designed by IR as integrity measures, such as the Escalation Policy for Technical Issues, will only be effective if they are supported by clear accountability measures and incorporated into the wider performance measurement framework. The compliance model also argued to overlook elements of the s 6 responsibility in key areas. First, the compliance model is customer-centric and therefore disregards the responsibility to manage the perceptions of all taxpayers in the tax system. Second, it gives insufficient weight to the fact that the meaning of tax legislation is not always clear. This allows IR to wield its 'interpretive discretion' and select an enforcement strategy that is based on its own interpretation of the law.

The revamp of IR's compliance model in March 2015 has only led to fresh concerns regarding a lack of transparency (or lack of consideration) as to how this model is intended to fit within a wider regulatory strategy. Its release was not accompanied by a fundamental rethink of strategic direction or a revised business plan. It is difficult to see how it provides a clear direction for the frontline staff that deal with individual taxpayers as to what action is appropriate to take in the circumstances. With the former compliance model, there were clearer links between regulatory strategy, voluntary compliance and the efficient management of administrative resources. These links have been extensively canvassed in tax compliance literature, and are supported by the learnings of revenue authorities in other jurisdictions using similar models. If IR cannot demonstrate that its new compliance model is an effective regulatory tool that supports accountability for the management

[150] See Kirchler, above n 50.

of administrative resources then it may be better to revert back to the previous model, even in spite of its limitations.

The conclusion reached in this chapter is that the responsibility in s 6 to protect the integrity of the tax system is not being given proper or separate strategic consideration. There is room for a far more concerted effort from IR to manage this responsibility at a strategic or regulatory level. It is unlikely that the Richardson Committee would have intended for the responsibility in s 6 to become such a sedentary object of tax administration.

Chapter 6: Inland Revenue's management of key stakeholder relationships

6.1 Introduction

The responsibility of Ministers and officials to use their best endeavours to protect the tax system's integrity is given legislative expression by s 6 of the Tax Administration Act 1994 (TAA 1994).[1] Integrity of the tax system is defined to include taxpayer perceptions of that integrity. The section also lists a number of rights and responsibilities belonging to both taxpayers and those administering the law.[2] Section 6 is to be read alongside s 6A, which grants the Commissioner the express managerial discretion she needs to make sensible decisions regarding the allocation of resources of the department in the collection of taxes. Section 6A(3) stipulates that the duty of the Commissioner is to "collect over time the highest net revenue that is practicable within the law" while having regard to a number of factors, which include the importance of promoting compliance. Importantly, the section also promulgates a strategy based on promoting voluntary compliance.[3]

The responsibility to protect the integrity of the tax system belongs to every Minister and every officer having responsibilities under the legislation in relation to the collection of taxes and other such functions. The standard is one of "best endeavours". As explained by the Court of Appeal in *CIR v Michael Hill Finance (NZ) Limited*:[4]

> …even though the Commissioner is subject to strict standards of conduct because she is exercising highly coercive powers for the purpose of collecting revenue, her responsibility under s 6(1) to protect the integrity of the tax system is not of an absolute nature. The Commissioner is required instead to use her 'best endeavours'. The aspirational nature of this standard reflects Parliament's recognition of the limitations imposed upon the Commissioner by various factors…

A perverse result of this standard being of an "aspirational nature" is that there is little that can be done to compel IR to observe this section. It is not unreasonable to conclude that this best endeavours responsibility would have to influence tax system administration at both a strategic and

[1] All references in this chapter are to the Tax Administration Act 1994 (TAA 1994) unless stated otherwise.
[2] These include (i) the rights of taxpayers to have their liability determined fairly, impartially, and according to law; (ii) the rights of taxpayers to have their individual affairs kept confidential and treated with no greater or lesser favour than the tax affairs of other taxpayers; (iii) the responsibilities of taxpayers to comply with the law; (iv) the responsibilities of those administering the law to maintain the confidentiality of the affairs of taxpayers; and (v) the responsibilities of those administering the law to do so fairly, impartially, and according to the law.
[3] Other factors include the resources available to the Commissioner and the compliance costs incurred by taxpayers.
[4] *CIR v Michael Hill Finance (NZ) Limited* (2016) 27 NZTC ¶22-056 at [31].

regulatory level for it to hold any real meaning for taxpayers. In line with such a conclusion, this chapter seeks to assess how IR performs in its management of this responsibility.

While New Zealand, along with many other democracies, has systems in place to oversee the activities of IR, such as the Office of the Ombudsman and annual performance reviews before the Finance and Expenditure Committee, accountability under these avenues is determined after any problems have already occurred.[5] The author hopes that by instead focusing on what IR *can* control, in terms of its strategic planning and regulatory approach, this review might lead to some positive outcomes for taxpayers and shape IR's management of its s 6 responsibility into the future.

This chapter examines IR's management of its s 6 responsibility in the context of its efforts to build community partnerships with respect to three key stakeholder groups:

- *industry bodies* (those where industry members operate in the cash economy),
- *tax agents* and
- *large enterprises.*

It has been stated by former Commissioner David Butler that at "an individual level achieving high levels of integrity is about the strength of our stakeholder and customer relationships".[6] The need to build community partnerships with stakeholders in the tax system was also recognised by the Cash Economy Task Force (CETF) in Australia as a component part of the compliance model.[7] This was intended to help revenue authorities move away from a command-and-control style of regulation towards an approach based on the principles of responsive regulation. In order to be responsive, it is incumbent upon the regulator to form collaborative relationships with key groups of stakeholders in the tax system. These groups may then assist (i) in the process of identifying areas of non-compliance, and (ii) cooperative taxpayers in complying with their tax obligations.

IR's 2001 business plan brought to the fore a strategy for meeting the various statutory objectives and responsibilities expected of the tax system administrator, as prescribed in ss 6 and 6A.[8] The compliance model was introduced as a strategic tool that embodies an approach based on the

[5] See Valerie Braithwaite "Responsive Regulation and Taxation: Introduction" (2007) 29 Law & Policy 3 at 4.
[6] David Butler "Protecting the integrity of the New Zealand Tax System" (address to the Institute of Chartered Accountants Tax Conference 2002).
[7] Cash Economy Task Force *Improving Tax Compliance in the Cash Economy* (1998) at 25. The New Zealand compliance model was based in large part on the version used by the Australian Tax Office (ATO). This was the result of the combined work of the ATO and its Cash Economy Task Force in 1997. See discussion infra at 2.1.
[8] IR *Inland Revenue Business Plan: The Way Forward 2001 Onwards* (2001) [2001 business plan].

principles of responsive regulation. While voluntary compliance and protecting the integrity of the tax system are often consistent objectives for tax administration, this will not always be the case.[9] There is a risk that the strategic direction that has been pursued since this time has sometimes been overly focussed on compliance outcomes, at the expense of integrity.

The previous chapter in this thesis identified two limitations of the compliance model that are argued to overlook important elements of IR's responsibility to protect the integrity of the tax system in s 6:

1. that the compliance model is customer centric and therefore pays little mind to the perceptions of integrity in the tax system that other taxpayers will form in relation to a particular compliance strategy;[10] and
2. that the compliance model critically assumes the law is determinate.

Examples of how these limitations may have interfered with IR's efforts to build community partnerships with key stakeholder groups are identified throughout the analysis in this chapter. At other times, this chapter makes use of the compliance model to showcase examples of what is working well, or to highlight areas where more can be done in line with the compliance model to promote both voluntary compliance and tax system integrity.

Although the compliance model has been updated recently, the analysis in this chapter makes use of the former compliance model because of its clear links to regulatory strategy.[11] It would be fair to think of the new compliance model as more of a planning tool than a regulatory tool. This is because the release of the new compliance model does not appear to have been accompanied by a fundamental rethink in strategic or regulatory approach. There is nothing in the new compliance model to indicate that IR intended to abandon the fundamentals of responsive regulation by

[9] Writing from a relational perspective, Valerie Braithwaite uses the descriptor 'compliance integrity dilemma' in academic writing to refer to the disconnect between compliance and integrity objectives that occurs when setting performance targets for a revenue authority. It will often be the case that the measures used to assess performance are more closely bound to compliance outcomes. This can come at the expense of integrity in the tax system. See Valerie Braithwaite "Tax System Integrity and Compliance: The Democratic Management of the Tax System" in Valerie Braithwaite (ed) *Taxing Democracy : Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003).

[10] This chapter makes use of a justice taxonomy adapted by Michael Wenzel from the social psychology literature concerning how taxpayers come to form fairness perceptions. See discussion at part 5.1 in chapter 1 of this thesis.

[11] The department went live with a new compliance model in March 2015. In a separate chapter, the author has criticised the revised model because of its lack of clear links to regulatory strategy. This contrasts with the compliance model referred to in this chapter that is in widespread use by revenue authorities in other jurisdictions. IR has not released much externally in the way of guidance as to how its new model will be applied in practice, and how this will lead to better outcomes in tax administration.

adopting a new model. The two limitations identified in the old model and discussed in this chapter are in any event equally applicable to the new model.

The structure of this chapter is as follows:

Part two discusses how IR has formed relationships with industry bodies and used compliance risk management strategies to address problems in the cash economy. This has probably been the best practical application of the compliance model, and it is a great example of putting the theory to work in practice. Measures introduced in 2007, that permit the Commissioner to declare a limited scope business amnesty, are also examined. The power to declare a tax amnesty is an interesting illustration of how an approach based purely on the compliance model may fall short of managing taxpayer perceptions of integrity in the tax system.

Part three considers aspects of IR's relationship with large enterprises. It picks up on some interesting perception issues at play, particularly in the context of the recent political and media interest in the tax affairs of multinational enterprises. One issue identified is that corporate tax governance is an underdeveloped area of tax administration in New Zealand and there is room for improvement.

Part four explores concerns expressed by tax professionals in relation to their perceptions of tax system integrity. Tax agents are not only a very important stakeholder in their own right, but they also represent the views of a great many number of taxpayers in the system. Their perspective on the statutory procedures for resolving disputes and how IR exercises its coercive powers with a view to upholding the law is therefore of great interest.

In terms of regulatory strategy, the analysis in this chapter supports a view that the responsibility in s 6 to protect the integrity of the tax system has not permeated into strategic thinking and strategic output from IR as much as it perhaps should have. By examining IR's management of key stakeholder relationships, this chapter has been able to identify some of the consequences that this lack of integration has had in operational terms. These consequences might have been avoided if the link between strategic-level thinking and the responsibility in s 6 to protect tax system integrity were better established.

This chapter concludes with a summary of those areas identified where IR could strengthen its approach to managing its responsibility to protect the integrity of the tax system. In summary, the following areas are identified:

§ IR should do more to follow the approach taken in other jurisdictions to promote good corporate tax governance practices in large enterprise taxpayers.
§ IR should work to develop a regulatory tool, which operates alongside the compliance model, that can assist staff in striking an appropriate balance between the various elements of ss 6 and 6A. This will be of use to the Commissioner in the exercise of specific statutory powers, such as the power to declare a business tax amnesty.
§ IR should take a far more active approach to media management. This will also involve a rethink of the kind of information that should be released to address public concern regarding the integrity of the tax system.
§ IR should take care not to use its powers of enforcement to secure compliance with a threshold that is not supported by the law.
§ IR should work with taxpayers, and their advisors, to develop procedures that resolve tax disputes to the satisfaction of both parties.

6.2 Community partnerships with industry bodies

6.2.1 The Industry Partnership programme and the hidden economy

In what was a flagship project for the compliance model, IR introduced its Industry Partnership programme which operated from February 2002 to November 2006 and involved relationships with around 20 specific industries.[12]

Tony Morris and Michele Lonsdale of IR report that the high level activities being carried out as part of the Industry Partnership programme fall within three major categories: relationship management, leverage and audit activities.[13] Dedicated teams were established both nationally and within local areas to maintain a relationship with selected industries as part of the project. The programme was designed to target specific industry groups where industry participants were known

[12] Controller and Auditor-General *Inland Revenue Department: Effectiveness of the Industry Partnership programme* (Wellington, 2008) at [1.8] – [1.11].
[13] Tony Morris and Michele Lonsdale "Translating the Compliance Model into Practical Reality" (2004) The IRS Research Bulletin: Proceedings of the 2004 IRS Research Conference 57 at 67.

contributors to evasion in the cash economy.[14] The strategy was to provide tailored services by establishing relationships with organisations in the industry and by understanding industry needs. Teams gathered intelligence on the specific industry and help design targeted intervention strategies by identifying specific issues that affect compliance behaviour. This was very much intended to be an application of the compliance model, with an emphasis on providing information, advice, education and support to assist taxpayers to comply. This was of course also supplemented by appropriate enforcement action in the case of non-compliance.[15] Leverage activities range from general (e.g. promoting awareness of compliance issues to a large group of taxpayers) to targeted (e.g. personal and direct contact with taxpayers regarding a specific issue/risk). These were used with the aim of coaxing taxpayers into becoming more compliant and changing taxpayer behaviour. Audit activities were carefully selected to ensure the most appropriate enforcement action was taken. This was done only after a consideration of the taxpayer's attitude to compliance and other factors influencing compliance behaviour.

There were four objectives of the programme: (1) to increase levels of voluntary compliance within selected industries; (2) to increase IR's presence in the community; (3) to improve the community's perception of IR as a professional organisation; and (4) to direct audit resources toward the highest risk cases within selected industries.[16] A performance audit of the programme conducted by the Controller and Auditor General confirmed that the programme was generally successful in meeting its high-level objectives. It was also said to be "in keeping with [IR's] compliance model and strategic direction".[17] The one exception was that the programme had limited success in directing audit resources towards the highest risk cases. This was because cases were selected from IR's existing information on taxpayers and no specific measures were used to identify people already outside the tax system. Key recommendations of the Office of the Auditor-General (OAG) report were to:[18]

(a) *record and reflect the lessons learned* from the Industry Partnership programme *in specific operational guidance and support resources for staff focusing on the hidden economy*; and

[14] The 'hidden economy' is used to describe transactions that are outside the tax system. The 'cash economy' is used to describe these same transactions when they are in cash.
[15] See Naomi Ferguson and Spyros Papageorgiou "Tax Administration" (paper presented at ICANZ tax conference, Wellington, October 2004) at 9.
[16] Controller and Auditor-General, above n 41, at [1.7].
[17] At 6.
[18] At 8 (emphasis added).

(b) identify, as part of reporting on the results of a specific programme or initiative that may be affected by a range of variables, those factors contributing to the results that are not attributable solely to the programme or initiative.

The OAG report therefore provides at least some validation that the compliance model can achieve success when it comes to improving voluntary compliance for certain operators in the hidden economy.[19]

A new operating structure took effect in November 2006, and the Industry Partnership programme became part of the Customer Insight Group who, it was intended, was to be active in promoting industry partnerships and retain essentially the same *modus operandi*.[20] According to the OAG report:[21]

> The crucial feature of the programme (the relationship-based approach) and an important lesson learned (the need for more attention on people outside the tax system) have been reflected in the design of the Customer Insight Group.

When the Government announced as part of budget 2010 that IR would receive a funding boost of approximately $120m for audit and compliance activity in the areas of debt compliance, property speculation, and the hidden economy, the Customer Insight Group had already been restructured. IR report that its functions and staff were relocated in two other business groups and permanent staff positions were created with "a focus on compliance risks, including those in the hidden economy, a need identified by the programme".[22] The hidden economy has remained a strong focus in IR's annual reports and compliance focus documents. Industries such as hospitality, agriculture and horticulture, construction, inbound tourism and the scrap metal trade have each

[19] There are some important qualifications to this conclusion. First, as noted in the OAG report, while voluntary compliance within the selected industries was accepted to have increased within the life of the industry partnerships programme, it was not possible to attribute these changes solely to this initiative. This is consistent with the second key recommendation of the OAG report that better reporting be used to identify factors contributing to results as part of other specific initiatives that may be affected by a range of variables. Second, it was noted that the high-level objectives set by IR did not have definite targets and a positive trend was therefore the only measure that could be used to identify whether voluntary compliance increased in a selected industry. See Controller and Auditor-General, above n 41, at 45. Sawyer and Tan report that there "is a growing argument that Inland Revenue's current approach to gaining voluntary compliance through partnerships with trade associations in industries in which cash jobs are common is not achieving *the level of success* desired". See Adrian Sawyer and Lin Mei Tan "Limited Scope Amnesties: Are They the Answer?" 10 NZJTLP 202 at 207 (emphasis added). Clearly more work is required to understand *the extent* that strategies such as these are successful in improving voluntary compliance in light of other relevant factors, such as how resource intensive the programme has been and compliance costs for business.
[20] At [1.16].
[21] At [2.38].
[22] Controller and Auditor-General *Performance audits form 2008: Follow-up report* (Wellington, 2010) at 23.

been singled out as particular areas of concern. There are ample examples being reported of how IR continues to form collaborative relationships with industry partners, although there is perhaps now more of an emphasis on intelligence gathering and risk management practices.[23]

While it is not entirely clear from outside the organisation, it would be reasonable to assume that IR took on board the recommendation of the OAG report to integrate lessons learned from the Industry Partnerships programme into their work on the hidden economy.

6.2.2 Limited scope business amnesties

An interesting application of the compliance model is that it helped lead to the enactment of s 226B of the TAA 1994. This section provides the Commissioner with a limited power to declare an amnesty in relation to a group of persons belonging to a specific industry.

Affected persons eligible to benefit from the amnesty, and who have given notice under the section, will only have to pay tax on previously undisclosed income for two years (including the current filing year and the year before that) in relation to income from the affected business. The Commissioner is then prevented from investigating or assessing the person (in terms of that affected business) in relation to other previous income years. This is provided that the Commissioner has not already given notice of the investigation to the affected person before receiving notice from the person. Similarly, the Commissioner must not bring a prosecution action for an act or omission of the person before or in giving the notice if this person has provided information relating to this act or omission. Again, this is provided that the Commissioner has not already given notice of an investigation before receiving notice from the affected person. The affected person's income tax liability for the two years that are assessed will include use-of-money-interest and shortfall penalties (after any relevant reductions for voluntary disclosure or previous good behaviour) as applicable.

[23] Examples include establishing an anonymous information service "so that industry can play its part by supplying us with information about people who are cheating the system and undermining successful businesses" and publishing industry benchmarks (gross profit ratio, stock turnover per annum, etc.) based on information supplied from Statistics New Zealand. According to IR, "introducing benchmarks makes it clear to small businesses what we expect of them. We'll be reviewing those outside industry standards and taking action where needed". See IR *Compliance focus 2011-12* at 10. It would be a mistake in terms of the compliance model for regulators to assume that taxpayers who sit outside of the industry benchmark standards necessarily need to be targeted with a more intensive intervention strategy to ensure compliance (if indeed they are even non-compliant). This is an area where care needs to be taken.

Following the amnesty period, audit activity in the affected industry will be stepped up in an effort to identify those taxpayers who continue to be non-compliant. Those detected in this process will then face the full force of penalties and other sanctions provided under the legislation.[24]

The power to declare a business group amnesty in s 226B has been operative since 19 December 2007, although the Commissioner has not exercised this power even once since this time.[25] One possible reason for this is a good illustration of one of the limitations in IR's compliance model referred to earlier. This is that the model is customer centric. Declaring an amnesty makes a lot of sense from the perspective of promoting voluntary compliance within the particular taxpayer group that is eligible to benefit from the amnesty. But it might not be seen as being fair by other taxpayers in the system.

According to a government discussion document released in 2004, the statutory power to declare a business tax amnesty was introduced to deal with the problem of industry-wide tax evasion.[26] When evasion has become entrenched in an industry, there are many reasons why a person might have evaded their tax obligations. It may in fact be built into the business practices of the whole industry. For those that want to come forward and begin complying with the law it can be extremely difficult to do so. This act of honesty will be met with significant unpaid back taxes that are often compounded by penalties and interest. As tax is a cost of business, these people will also be put at a commercial disadvantage if they come forward (and their competitors choose not to). *Using the compliance model as a rationalisation for the proposals*, the discussion document describes the issue:[27]

> Tax law *does not attempt to distinguish between different motivations* for evading tax. In the statutory scheme, evasion is evasion and it is unacceptable, whatever the reason behind it, which is reflected in the severe sanctions provided in the law.
>
> Even so, evasion may require a wider range of responses, *depending upon the underlying attitudes of the evaders*, as shown in [the compliance model]. Traditional enforcement measures may not be effective against certain types of evasion, particularly when it is built into business practices across a whole industry.

[24] See IR "Tax Compliance Initiatives – Limited Amnesties" Tax Information Bulletin Vol 20, No 3 (April 2008) at 72.
[25] Noting that a sort of amnesty occurred after the Supreme Court decision of *Penny and Hooper v CIR* [2011] NZSC 95, (2011) 25 NZTC ¶20-073. See discussion infra at 5.2.
[26] Policy Advice Division *Options for dealing with industry-wide tax evasion* (government discussion document, August 2004).
[27] At [2.2] – [2.3] (emphasis added).

Before exercising the discretion in s 226B, the Commissioner is required to be satisfied that declaring the amnesty is consistent with protection of the integrity of the tax system.[28] While the business scope amnesty reforms might have made a lot of sense in terms of the compliance model, and can have a profound effect in terms of promoting voluntary compliance within the affected industry, this wider mandate requires the Commissioner to have regard to the perceptions of *all* taxpayers within the tax system. In particular, an important component of the perceptions that taxpayers will form from the perspective of *retributive justice* relates to how other taxpayers in the system are punished for their non-compliance. While the government discussion document was quick to recognise that "unfairness to honest taxpayers is a concern",[29] it seems likely that the Government might have misjudged just how strongly the public would react in the event an amnesty ever be declared.[30] The lesson here is that the compliance model should not be relied upon in isolation. The regulator will also need to find a way to balance the interests of taxpayers in general with the interests of taxpayers who are the subject of a particular compliance strategy.

6.3 Relationship with large enterprises

6.3.1 Regulation of large enterprises and corporate tax governance

It is often pointed out that large enterprises in New Zealand account for half the annual revenue that IR collects from companies, despite making up just 0.1% of registered entities.[31] In addition to this contribution to the corporate income tax take, these taxpayers also contribute to the tax system by supporting other activities that bolster government revenue (e.g. employment and consumer spending) and through the collection of taxes for the government (PAYE, GST and other withholding taxes). Most large enterprise taxpayers will have an in-house tax function to manage their compliance obligations and will also, at times, seek the assistance of external advisors. Frequently, their operations will span across more than one jurisdiction. Given that they also

[28] TAA 1994, s 226B(1)(a).
[29] Policy Advice Division, above n 55, at [3.4] – [3.5].
[30] In relation to the announcement on 17 August 2004 that the Government was considering introducing the amnesty provisions, Sawyer and Tan report that the "Government within days of the announcement is somewhat on the back foot given the immediate and frequently emotional reaction to the proposal. It has been at pains to emphasise that the proposal is not about simply letting tax evaders off the hook. Rather …it is about improving the incentive to come forward for those who are willing to begin complying with the law, allowing IR to focus more resources on those who continue to evade tax. Furthermore, IR is concerned about the general public perception on the fairness of the proposals in relation to all taxpayers, including tax evaders that take advantage of an amnesty". See Sawyer and Tan, above n 48, at 203.
[31] Defined as having an annual turnover of more than $100 million. See IR *Compliance Focus* 2009 – 2010 and IR *Compliance Focus* 2010 – 2011.

operate in complex business and regulatory environments, their tax responsibilities are often highly complex.

Large enterprises are well represented in their discussions with IR. The Corporate Taxpayers Group (CTG) works with IR and Treasury officials on both tax policy and operational matters. It is described by IR as one of the three most active tax special interest groups in New Zealand.[32] The group operates on a subscription basis and is comprised of around 38 major corporate organisations. It has a focus on achieving the right corporate tax policy outcomes for New Zealand, and evaluates reform proposals against a number of principles that it believes a good tax system should be built around. These are:

1. High certainty and low business risk.
2. Low compliance costs.
3. International competitiveness with our major trading partners and competitors, especially Australia.

For IR's part, it manages the important relationship with large enterprises on several fronts. IR publishes a quarterly newsletter, *Large Enterprises Update*, which aims to keep taxpayers informed about key risk areas, new initiatives and legislative changes. It also allocates senior personnel known as Compliance Managers to the larger taxpayers within this customer segment. These Compliance Managers look after technical issues, maintain the working relationship and manage the annual risk review process. Large Enterprise taxpayers will also have an Account Manager to look after day-to-day tax matters. To provide certainty on transactions or issues, IR will provide advice or give information in accordance with its technical assistance matrix.[33] An external research agency is contracted by IR to conduct a bi-annual survey of large enterprises. This survey covers aspects of relationship management, audit, correction of errors, voluntary compliance, tax minimisation and the taxation environment. In addition, IR meets regularly with senior managers and CEOs of large enterprise clients to discuss issues.

[32] According to Corporate Taxpayers Group promotional material.
[33] IR *Compliance Focus 2009 – 2010* at 18. Note that the only way to achieve *legal* certainty in advance of a specific transaction is by through a binding ruling. See pt 5A of the TAA 1994. Other forms of advice (such as informal indicative views) only provide *practical* assurance to taxpayers of IR's view as to the application of the law, but the department cannot be bound by this. More recently, the department has begun to supplement its binding rulings by offering factual reviews where the tax position relies on a critical factual condition or assumption (value, market rates, generally accepted accounting practices, etc.) being satisfied. See IR *Large Enterprises Update* (August 2013) at 2.

For revenue authorities, the trend in recent years has tended towards forging more co-operative relationships with this taxpayer segment. The OECD have begun to champion a concept known as the 'co-operative compliance' approach, where both parties are expected to move beyond the basic obligation-based relationship.[34] In support of this, in June 2009, IR released its first compliance focus document in an effort to be open and transparent about risk areas they will be targeting.[35] The document notes:[36]

> In line with international trends, we are reviewing our relationship with large enterprises, particularly around complex and large tax issues. A key objective is to develop and foster relationships based on two-way transparency and early disclosure of tax issues. This approach is intended to result in mutual benefits. Overseas experience shows that two-way transparency and disclosure results in more certainty upfront and much less investigations activity. We will be actively exploring how we can achieve cooperative compliance with large enterprises through enhanced relationships.

A key part of making co-operative compliance strategies work relies on the taxpayer being able to demonstrate that they have good corporate governance systems in place that support transparency and disclosure. Corporate tax governance has always been part of the discussions between IR and large enterprises. The message is that the boards and CEOs of large businesses need to consider tax risk management as part of their corporate governance, and exercise independent judgement with respect to the tax advice put before them by in-house tax personnel or by external advisors.[37] IR has also suggested that senior management should concern itself with the following issues in particular:[38]

- Having a broad understanding, at least from a financial and business perspective, of the major tax issues that come up in the business's normal ongoing operations.
- Establishing reporting procedures for identifying risks so that IR can have confidence that corporate processes are promoting tax compliance.
- Considering, at least from a financial and business perspective, the tax implications of major transactions, business structure and strategies.
- Overseeing the overall amounts of different taxes the business pays.

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[34] OECD *Co-operative Compliance: A Framework* (OECD Publishing, 2013) [OECD 2013 study] at 16. For further background, see Eelco van der Enden and Katarzyna Bronzeeska "The Concept of Cooperative Compliance" 68 Bulletin for International Taxation 567.

[35] This is in line with the principles listed in the OECD published study on the role of tax intermediaries in 2008. The study identifies five attributes that revenue authorities need to demonstrate when dealing with all taxpayers. These are: understanding based on commercial awareness; impartiality; proportionality; openness through disclosure and transparency; and responsiveness. See OECD *Study into the Role of Tax Intermediaries* (OECD Publishing, 2008) at 5 [OECD 2008 study].

[36] IR *Compliance Focus 2009 – 2010* at 18.

[37] Tony Morris "Inland Revenue's view of corporate governance" (2010) 89 Chartered Accountants Journal 10 at 10.

[38] IR *Compliance Focus 2010 – 2011* at 25.

§ Knowing their business's relationship with IR. How does it scrutinise its tax affairs? Where does it stand on tax compliance and tax planning?

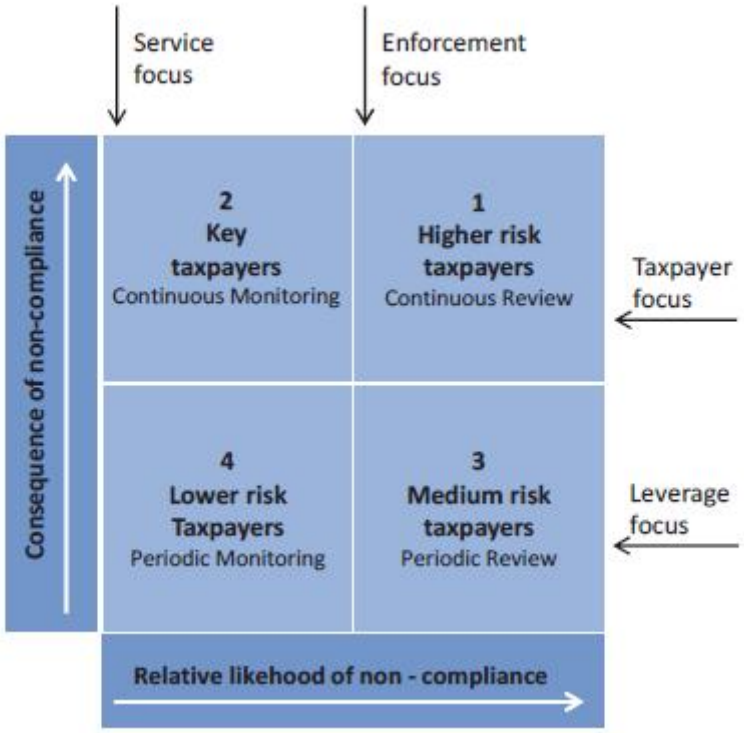
IR regularly includes corporate governance as a behavioural criterion as part of its ongoing risk assessment of large enterprises.[39] Despite this, a focus on corporate tax governance is not a prominent feature in terms of the administrative approach here in New Zealand when compared with other jurisdictions.

Non-resident owned groups of companies operating in New Zealand were recently asked to complete an international questionnaire as part of IR's annual risk assessment process. The questionnaires have been designed to gather information and evaluate tax risks from international dealings, especially those involving associated persons. The questionnaire for the 2014 income year attracted a 100% response rate across 292 foreign owned groups. A question was asked whether the group has a tax governance policy or framework documented specifically for New Zealand. Only 48% of taxpayers responded 'yes' to having some form of tax governance policy in place for New Zealand. The question was omitted from the international questionnaire for the 2015 income year.

The ATO by comparison has published a comprehensive tax risk management review guide (available on its website).[40] The guide was developed primarily for large corporations, tax consolidated groups and foreign multi-nationals operating in Australia. It was designed to assist taxpayers to: (1) develop their own tax governance and internal control framework; (2) test the robustness and design of internal control frameworks against ATO benchmarks; and (3) understand how to demonstrate the operating effectiveness of key internal controls to stakeholders. The approach is augmented by the risk-differentiation framework (RDF) that was designed by the ATO to support its version of the compliance model (see Figure 2 below).[41]

Figure 2: ATO Risk Differentiation Framework

[39] See IR *Corporates Contact* (December 2006) at 1.
[40] Available at <www.ato.gov.au/business/large-business/in-detail/key-products-and-resources/tax-risk-management-and-governance-review-guide> (accessed 21 September 2016).
[41] See OECD *Co-operative Compliance: A Framework* (OECD Publishing, 2013) [OECD 2013 study] at 25.



The compliance strategy adopted by the ATO under the RDF will depend on the risk categorisation of the taxpayer under consideration. The relative likelihood of non-compliance is based on the ATO's estimation of whether the taxpayer will have a tax position that they will disagree with, or whether the taxpayer may have misreported their tax obligations. The relative consequence of non-compliance is based on a series of factors, such as the absolute dollar value of non-compliance and impact on community confidence. Taxpayers that demonstrate good internal risk management and governance frameworks will be categorised as being at a lesser likelihood of non-compliance. These taxpayers are therefore at a reduced risk of being subject to the ATO's formal channels for gathering information, and can expect less intrusive forms of review.[42]

Stronger links should be developed here in New Zealand between the risk assessment procedures used by IR and the corporate tax governance of large enterprises so that this important self-regulatory process is not left underdeveloped. There is a case to be made in terms of the compliance

[42] More recently, the ATO has begun to implement another similar approach that it refers to as key taxpayer engagement (KTE). This is described as follows: "The KTE is a tailored engagement approach where services and assurance checks are based upon the risk profile of the client. Improved compliance behaviour and greater co-operation will result in enhanced services and a streamlined approach to assurance. Less compliant behaviour and less cooperation will lead to reduced services and greater assurance checks". See < https://www.ato.gov.au/business/large-business/compliance-and-governance/key-taxpayer-engagement/>.

model for introducing more in the way of formal testing procedures for corporate governance processes, supplemented by something like the RDF.[43] If there is not more done to encourage self-management of tax risks, it becomes a question of who really sets the risk agenda for large enterprise taxpayers? These taxpayers may simply respond to the specific areas of concern for IR, made widely known to taxpayers in compliance focus documents and through conversations with the department. It is then quite possible that certain unique or business-specific tax risks are not being picked up and dealt with by large enterprise taxpayers or their advisors. These are the same risks that are more likely to fly under IR's radar.[44]

6.3.2 Secrecy requirements and public perceptions of large enterprises

An important part of the dynamic when it comes to managing the relationship with large enterprises is recognising that the New Zealand public will form perceptions about the integrity of the tax system based on what they see happening in this area.

When the Government formed a Parliamentary inquiry (amid growing public concern) to look at the powers and operations of IR in 1999,[45] the Winebox Inquiry weighed heavily on the minds of ordinary taxpayers. The genesis of this inquiry lay in repeated claims from the Hon Winston Peters that some of New Zealand's largest companies were engaged in criminal tax planning activities, and that IR and the Serious Fraud Office had acted unlawfully or were seriously incompetent when dealing with the relevant transactions.[46] The Government was eventually forced to bow to public pressure and established a Commission to look into these matters in September 1994. It took the Commission almost three years (until August 1997) to complete its report. This report concluded that there was no fraud or incompetence, although the controversy would continue to play out for some years further in the Courts through various actions brought by Mr Peters.[47]

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[43] Noting that IR does currently include behavioural criteria in its overall risk rating for large enterprises based on their perception of a corporate group's attitude in a number of areas including governance and tax strategy.

[44] One option for strengthening self-regulatory processes that is discussed in this chapter is to reinitiate and extend IR's (formal) co-operative compliance programme to all suitable taxpayers who are willing to commit to good governance processes. See discussion infra at 4.3.

[45] Finance and Expenditure Committee *Inquiry into the powers and operations of the Inland Revenue Department* (Parliamentary paper 1.3, October 1999).

[46] The original documents at the centre of the allegations were tabled before Parliament by Mr. Peters in a wine box on 16 March 1994. The Government at the time set up an independent commission to investigate these allegations known as the Commission of Inquiry into Certain Matters Relating to Taxation. Colloquially, it became known to the public as the Winebox Inquiry.

[47] See Lydia Tsen, Jagdeep Singh-Ladhar and Howard Davey "The Winebox Inquiry Twenty Years On" (2016) 22 NZJTLP 172 at 186. Collectively, these are referred to as the *Peters v Davison* decisions.

Many of the transactions and practices at issue took place in the mid-to-late 1980s, a period of rapid deregulation and unprecedented economic reforms in the New Zealand economy. This provided new opportunities for aggressive tax planning. The environment has since changed, and it is most unlikely that a board of directors would ever agree to enter into a transaction or arrangement on similar terms today.[48] Nevertheless, it likely that the Winebox saga (coupled with the high degree of media and public interest) has had a lasting impact on the New Zealand psyche.[49] IR was quick to acknowledge this. Shortly after the Winebox Inquiry released its report in August 1997, the Commissioner made the following comments in the department's newsletter:[50]

> There is no denying that public attitudes towards the integrity of the tax system and the fairness of the department have suffered during the course of the [Winebox] hearings… The perception that customers hold concerns us all because, if it is negative, it can harm voluntary compliance and make it more difficult for us to achieve our overall objective of maximising revenue.

It is unfortunate for IR that, at the same time as the Winebox saga, the media were also frequently reporting on stories of IR heavy-handedness when dealing with individual taxpayers. Survey information gathered by IR in their 1998 Health Report indicated that "a relatively high proportion of taxpayers believe that the department targets its enforcement action unfairly on 'ordinary people' rather than those who pose the most significant risk to the revenue base".[51] A perception that IR unfairly targets ordinary people with its enforcement function, while being a light touch on large enterprises, can be extremely damaging for the integrity of the tax system. In terms of Wenzel's taxonomy,[52] it is liable to create divisiveness among taxpayer groups who will no longer identify and form fairness perceptions at a *societal* level (the most conducive to voluntary compliance in the tax system).

Since this time, IR has come to be much more mindful of the role that the media has to play in influencing taxpayer perceptions of the integrity of the tax system. The Committee of Tax Experts

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[48] According to Tsen, Singh-Ladhar and Davey, an independent commission set up today and tasked with investigating these same arrangements may even come to a different conclusion. At 205.

[49] See John Shewan "Protecting the Integrity of the Tax Act: The Practitioner's Perspective" (paper presented at ICANZ tax conference, Wellington, October 2002). John notes that the "Commission's findings that there was no evidence of any lawful conduct or impropriety on the part of [IR] did not bring any closure to the issues. Even had no further Court action occurred it is unlikely that the huge damage to the integrity of the tax system, resulting from four years of almost daily television news headlines dealing with assertions against [IR] and certain companies mentioned in the Winebox, could ever be adequately repaired". At 5.

[50] IR *Revenews* (September 1997) as cited in *Tax Compliance* (Report to the Treasurer and Minister of Inland Revenue by a Committee of Experts on Tax Compliance, December 1998) at 217.

[51] Finance and Expenditure Committee *Inquiry into the powers and operations of the Inland Revenue Department* (Parliamentary paper 1.3, October 1999).

[52] See Wenzel, above n 27.

on Tax Compliance too recognised the importance of the media in this regard. In their December 1998 report to the Treasurer and Minister of Revenue,[53] they made two specific recommendations that were geared towards helping IR manage taxpayer perceptions. The first recommendation was around the use of attitude-forming media campaigns. While noting that some work was already being done to encourage taxpayers to file returns and pay tax on the relevant due dates, the Committee "had in mind deeper campaigns designed to encourage overall taxpayer compliance and engender a sense of responsibility and duty when it comes to paying taxes".[54] The second recommendation was that the secrecy requirements in s 81 be amended to clarify that the Commissioner may, in certain circumstances, disclose information regarding a taxpayer's affairs for the purpose of responding publicly to complaints circulating in the media. According to the committee:[55]

> If the Commissioner cannot respond publicly in cases where the taxpayer goes to the media with complaints about the department, the public perception of what occurred in the particular case may not necessarily be correct. … Highly publicised complaints about the department which are not in fact correct can adversely impact upon the integrity of the tax system, because public perceptions play an important role in maintaining the integrity of the tax system. To allow unfounded allegations to go without response could adversely affect taxpayers' perceptions about the tax system, and thereby undermine the system's integrity.

Despite this second recommendation, the secrecy rule was not immediately changed. Because of this secrecy provision, setting the record straight is something that IR continued to struggle with for a number of years. In an address to the Institute of Chartered Accountants Tax Conference in 2002, former Commissioner David Butler stated:[56]

> A taxpayer's perception of integrity will be most strongly influenced by their personal experience and perhaps their understanding of the experiences of close family and friends. Clearly other factors, particularly media reporting also influence taxpayer perception. … this and many other influencing factors are largely beyond Inland Revenue's control. For instance, Inland Revenue cannot make comments to the media about a particular taxpayer's affairs even where that taxpayer goes to the media to make some form of a "public complaint".

IR was eventually given a much broader discretion to disclose information in these sorts of circumstances when s 81(1B) was inserted into the TAA 1994 on 29 August 2011. The new

[53] See Committee of Experts on Tax Compliance, above n 79.
[54] At [16.32] – [16.36].
[55] At [16.38] – [16.39].
[56] David Butler "Protecting the integrity of the New Zealand Tax System" (address to the Institute of Chartered Accountants Tax Conference 2002).

provision is an exception to the general secrecy requirement in s 81(1), and permits communication of a matter "for the purpose of executing or performing a duty of the Commissioner, or for the purpose of supporting the execution or performance of such a duty". This is provided that the Commissioner considers that "such communication is reasonable with regard to the relevant purpose". The Commissioner must also have regard to the following factors listed in 81(1B)(b)(i) to (v):[57]

> (i) the Commissioner's obligation at all times to use best endeavours to protect the integrity of the tax system; and
> (ii) the importance of promoting compliance by taxpayers, especially voluntary compliance; and
> (iii) any personal or commercial impact of the communication; and
> (iv) the resources available to the Commissioner; and
> (v) the public availability of the information.

"Duty of the Commissioner" is defined in s 81(8)(b). It will include both powers and functions of the Commissioner, as well as anything done within the law to:

> (i) administer the tax system:
> (ii) implement the tax system:
> (iii) improve, research, or reform the tax system.

Hence, this new exception to the secrecy requirement provides a broad discretion to communicate information relating to the Commissioner's duties (as defined). The section imports many of the factors already set out in ss 6 and 6A, and the Commissioner must give explicit consideration to each of these factors before this discretion is exercised. As confirmed in the government discussion document that first proposed these changes, ss 6 and 6A "are the fundamental guiding principles that are the basis for Inland Revenue's administration of the tax system".[58] Another quite important change is that the previous requirement in s 81(4)(j) to seek ministerial approval before disclosing information that is statistical or general in nature, and that does not reveal the identity of individual taxpayers, was removed from 2 June 2016.[59] The Commissioner can now release this information, subject to a consideration of the same factors in 81(1B)(b)(i) to (v) listed above.

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[57] For an analysis of how each of these factors will be taken into account, see IR "SPS 11/07: Application of the Discretion in Section 81(1B) of the Tax Administration Act 1994 – The Secrecy Provisions" (2012) 24 Tax Information Bulletin 3 [SPS 11/07].
[58] Policy Advice Division *Making tax easier* (government discussion document, June 2010) at [9.14].
[59] Taxation (Transformation: First Phase Simplification and Other Measures) Act 2016, s 122(3).

These new powers of information disclosure have relevance in the current political climate and environment for large enterprises. The corporate tax base has come under intense international scrutiny in recent years as politicians and the media speak out against the various strategies used by multinational corporations to avoid paying taxes. The base erosion and profit shifting (BEPS) initiative to come out of the OECD is said to represent "a bold move by policy makers to restore confidence in the system" and the "trust of ordinary people in the fairness of their tax systems".[60]

New Zealand is not immune to these issues. The Government has already implemented a number of reforms to support BEPS initiatives and continues to watch the OECD developments quite closely.[61] With all the attention that this issue has received internationally, it is only natural that the New Zealand media would pick up the debate and question whether corporate taxpayers in New Zealand are paying their fair share. Much like the Winebox fiasco, media coverage of the BEPS issue has engendered a general sense of mistrust among ordinary people of multinationals and their tax compliance behaviours.[62] Against this backdrop, there is a sentiment shared by some large enterprise taxpayers that IR should be doing more to address the wave of misinformation being propagated by the media. There is particular concern that the media sometimes compares accounting profit with taxes paid, or total revenue with taxes paid. Both of these measures are argued to be misleading. These large enterprise taxpayers believe it is IR that is often best placed to address perception issues held by the public. This might be done by educating the public on the methods and procedures used by IR to place scrutiny on large enterprises, or by producing information to confirm whether, for the most part, these taxpayers are compliant.

Given the recent amendments to the secrecy provision in s 81(4)(j) (discussed above), which give the Commissioner more room to release general or statistical information, it appears that more can probably be done in this space. The Commissioner may also exercise her power in s 81(1B) to comment on the tax affairs of some of the specific corporate taxpayers being discussed in the media,

[60] OECD *Co-operative Tax Compliance: Building Better Tax Control Frameworks* (OECD Publishing, 2016) at 12 [OECD 2016 guidance].
[61] See Cabinet Paper "Base Erosion and Profit Shifting (BEPS) – Update on the New Zealand Work Programme" (May 2016).
[62] The BEPS issue, along with rising disquiet about inequality, led 88% of chief executives in a recent 'Mood of the Boardroom' survey undertaken by the New Zealand Herald to conclude "there is now a general mistrust across society that the rich don't pay their fair share". See "Mood of the Boardroom: Foreign firms not paying fair share" The New Zealand Herald (28 September 2016).

if a weighing of the relevant circumstances permits disclosure.[63] Consent to the disclosure by the taxpayer in question will carry significant weight in this regard.[64]

IR is generally good at responding to media enquiries when it itself is the subject of criticism.[65] However, it would make sense that a "best endeavours" approach to managing taxpayer perceptions must entail IR (who holds information not generally available to the public) taking ownership for how the large enterprises narrative is told. A review of IR's media releases for the last five years suggests that this function is used mainly as a way to warn taxpayers of the consequences of non-compliance.[66] There is room for a more proactive approach to dealing with the media and addressing any perception issues that are at play.

6.3.3 Cooperative compliance pilot programme and tax transparency

In 2011/12, IR trialled a formal co-operative compliance programme (by invitation only) with a handful of New Zealand's large enterprise clients.[67] The terms of arrangement between IR and the taxpayer is set out in a Cooperative Compliance Agreement (CCA) that is signed between the parties.[68] This is an administrative instrument that is recorded in a written agreement but is not binding on either party. In response to a questionnaire on enhanced relationship programmes operating in member jurisdictions of the International Fiscal Association (IFA), the New Zealand branch provide an overview of the CCA programme:[69]

> The arrangement may apply to all of the principal tax types. While the content of such arrangements may vary, they generally require the taxpayer to commit to certain governance processes in respect of tax matters, to proactively disclose material tax issues to IR and to make available senior personnel to facilitate the resolution of issues arising under the arrangement. For its part, IR generally commits to provide prompt advice and to resource the prompt resolution of material issues, to disclose to the taxpayer any relevant emerging issues or risks, and to similarly make available senior personnel to facilitate the resolution of issues arising under the arrangement. Other provisions that may be included in a Cooperative Compliance Arrangement are the pre-filing review by IR of the taxpayer's tax

[63] TAA 1994, s 81(1B). Arguably, disclosure could support the execution or performance of the Commissioner's duties as defined, particularly given the importance of addressing any misconceptions by taxpayers that might affect their perceptions of tax system integrity.
[64] SPS 11/07, above n 86, at [27].
[65] See "Tax audits of large companies plummet" The New Zealand Herald (3 October2016) where IR defends its new approach to managing the tax audits of large enterprises.
[66] Normally, this is used to report on taxpayer prosecutions or IR winning in court, and to warn about other areas of non-compliance. See < http://www.ird.govt.nz/aboutir/media-centre/media-releases/> (accessed 4 October 2016).
[67] IR *Large Enterprises Update* (February 2010) at 2.
[68] As with many other initiatives in tax administration adopted in New Zealand, the idea behind the CCA originated from developments in Australia where a pre-filing scheme, represented by an Annual Compliance Arrangement with the Australian Tax Office, was introduced in 2008. See Enden and Bronzeeska, above n 63, at 569.
[69] International Fiscal Association *IFA Initiative on the Enhanced Relationship: Key Issues Report* (Version 3.3, 31 August 2012) at 12, 93.

returns, the maintenance of an issues register that records issues raised between the parties and a process (and time-frames) for resolving those issues.

Large enterprise taxpayers who enter into a CCA with IR anticipate that the key benefits will come in the form of increased certainty, reduced compliance costs and prompt resolution of issues. There are no statutory concessions for entering into a CCA. The absence of any reduction in penalties or interest in particular have been key sticking points, and have contributed to a perception that there is a lack of any material benefit for taxpayers. Specific concessions were never open for negotiation as IR's position is that they do not want to be seen as providing preferential treatment to large businesses. An issue with this is that there are already considerable resources dedicated by IR to maintaining a good working relationship with large enterprise taxpayers. Without firm commitments from IR to provide additional benefits under the arrangement, there may be little incremental advantage for taxpayers to be gained from entering into a CCA.

Taxpayers that enter into a CCA are expected to commit to effective tax governance processes.[70] Early versions of the CCA indicate that IR was intending to develop a Large Enterprise booklet, and that this would include key corporate governance guidelines. Large enterprises operating under a CCA would be required to produce a tax governance letter that acts as confirmation from either the CEO or CFO that the taxpayer meets or intends to meet these guidelines. These guidelines were never completed. However, IR does continue to endorse output from the OECD in this area. The department recently communicated its approval for the OECD guidance released in 2016 on designing and operating Tax Control Frameworks (TCFs) and reiterated its support for the OECD's Principles of Corporate Governance and Guidelines for Multinational Enterprises.[71]

The author understands that IR is currently revisiting its CCAs and looking to expand the programme. The trend for cooperative compliance programmes in other jurisdictions has been to only allow those taxpayers who are considered sufficiently low risk to join the programme and benefit from its advantages.[72] The relationship is based on the concept of 'justified trust'. This means that taxpayers must be able to demonstrate that they can self-manage tax risks and deliver on disclosure and transparency expectations under the arrangement before being allowed to participate. More clarity around IR's design expectations for taxpayer TCFs is first required. IR

[70] This was identified in the New Zealand branch response to the IFA questionnaire as a key prerequisite for admittance into the pilot CCA programme. At 95.
[71] IR *Large Enterprises Update* (August 2016).
[72] International Fiscal Association, above n 98, at 7.

should also look to find ways to extend the benefits of a CCA to smaller taxpayers, possibly in the context of its wider business transformation initiative.[73] The OECD 2013 study notes that revenue authorities should look to develop approaches that work on a one-to-many basis, rather than on a one-to-one basis. This will help address the mainstream perception issues that might otherwise arise. Intermediaries may also play an important role in this regard.[74] As discussed in the OECD 2013 study:[75]

> Managing perceptions is one of the more significant challenges that have to be addressed. It is all too easy for an external (media) and internal perception to arise that companies in this programme are being treated more favourably than either their peers or smaller enterprises. The current economic and social climate has also given rise to much greater public and media scrutiny and mistrust of large businesses and that has extended to the way they manage their tax obligations.

The other big development that is starting to emerge internationally is the push for greater tax transparency and public disclosure of information from large enterprise taxpayers. Tax transparency codes are normally voluntary in nature and go hand-in-hand with the cooperative compliance concept. IR has recently endorsed the Business and Industry Advisory Committee (BIAC) Statement of Tax Principles for International Businesses, and recommends that boards of directors adopt these principles in their reporting practices.[76] The alternative is to take a rules-based response, similar to the Tax Transparency Code (TTC) developed in Australia that was presented in the Board of Taxation's final report released in February 2016.[77] Something along these lines would probably do more to address public expectations around disclosure. This is because the TTC was designed having regard to the information requirements of interested users, such as social justice groups, the media, analysts and shareholders, as well as the public at large.

Irrespective of whether a principle-based or rules-based approach is taken, the compliance model implies there should be recognition of the self-regulatory effort made by taxpayers that comes with

[73] Because they are fewer in number, it is much easier to establish cooperative relationships with large corporates and high net-worth individuals. Nevertheless, it is important when dealing with ordinary businesses and individual taxpayers that the relationship does not become too compliance driven. A consistent compliance goal to maximise revenue as efficiently as possible across the two different administrative contexts that exist for large enterprise and ordinary taxpayers could lead to a more responsive approach being taken when dealing with large enterprise taxpayers. This may come at an unseen cost to the tax office in the form of a perceived loss of institutional integrity. See Valerie Braithwaite "Tax System Integrity and Compliance: The Democratic Management of the Tax System" in Valerie Braithwaite (ed) *Taxing Democracy : Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 282.
[74] See OECD 2013 Study, above n 70, at 47.
[75] At 103.
[76] IR *Large Enterprises Update* (August 2016) at 2 and OECD 2016 guidance, above n 89, at 31.
[77] The Board of Taxation *A Tax Transparency Code* (A Report to the Treasurer, February 2016).

adopting a voluntary tax transparency code. This needs to be taken into account by IR when deciding on how best to manage the relationship. This approach, and more guidance for businesses around TCFs, should help to facilitate greater self-management of tax risks by taxpayers and promote voluntary compliance.

6.4 Relationship with the tax profession

6.4.1 Enhanced services and regulation of the tax profession

Tax professionals play a crucial role in the tax system by helping their clients to navigate the complexities of tax law and comply with their obligations. They are also frequently seen by regulators as being the 'supply side' of aggressive tax planning. A balanced approach is needed to help tax agents in their role, while at the same time, discouraging tax agents from promoting any inappropriate tax planning arrangements to their clients.

There are approximately 5,900 registered tax agents that help manage the tax affairs of nearly 2.7 million clients.[78] Under the legislation, a tax agent is any person (including a company or trust) that prepares income tax returns for 10 or more taxpayers and meets the other requirements of the legislation.[79] A broader view of the profession would also include the lawyers and advisors who represent taxpayers on various tax matters, employees of tax agents and relevant industry groups such as Chartered Accountants Australia and New Zealand (CAANZ). IR recognises just how important a good working relationship with this sector of the tax community is for it to meet its own objectives and promote voluntary compliance within the tax system. In a memorandum of understanding that was signed between IR and the New Zealand Institute of Chartered Accountants (NZICA) – the forerunner of CAANZ – in 2007, the parties note:[80]

> New Zealand's tax system is based on voluntary compliance. Taxpayers are required to self-assess their own tax obligations. Tax agents and advisors play a pivotal role in assisting taxpayer compliance and advising and educating taxpayers on our tax laws.

IR has put in a significant effort over the years to tailor the services it delivers to tax agents and to better assist them in their role. All tax agents are paired with an Agent Account Manager, who

[78] Based on figures provided in Policy and Strategy *Making Tax Simpler: Proposals for Modernising the Tax Administration Act* (government discussion document, December 2016) at 65.
[79] TAA 1994, s 34B.
[80] The memorandum of understanding is dated 7 December 2007 and is available at <http://www.nzica.com/Technical/Tax/Tax-submissions/Tax-policy-and-other-submissions/Tax-policy-and-other-submissions-archive.aspx>. The aim of the memorandum is stated as being to "establish the principles that form the basis of the relationship between both organisations".

serves as a primary point of contact with the department. The online service platform 'myIR' provides a range of self-service options that tax agents can use to help manage the tax affairs of their clients,[81] and a dedicated telephone service is made available to tax agents for any queries or concerns. IR also publishes a monthly newsletter, *AGENTS answers*, that keeps tax agents informed of any emerging operational and technical issues. Tax agents who operate under an extension of time (EOT) agreement with IR can benefit from a concession under the legislation where the time allowed for filing client's returns is extended until the 31 March following the end of the tax year.[82]

Given the enhanced services made available to tax agents, and the increasingly important role that tax agents have come to play in the tax system as a whole, some consideration has been given to how to regulate this sector. A government discussion document released in October 2006 discussed options for reform to the rules applying to tax agents. The discussion document notes:[83]

> As Inland Revenue continues to provide tax agents with a greater range of self-service options and greater online access, the ability to place a high level of trust in tax agents assumes much greater importance.

IR has reported that around 60% of tax agents are members of professional bodies or associations.[84] It can be expected that these members are being regulated to a degree by the profession. Those tax agents who are New Zealand members of CAANZ, for example, are bound to apply the NZICA code of ethics. The code of ethics is based on a number of principles that capture the professional and ethical expectations of members, and includes the principle of integrity.[85] However, not all tax agents are members of professional organisations. Moreover, it was previously the case that there was no ability to refuse to register as a tax agent a person that met the limited criteria of the legislation. A person would have to be registered even if (for example) they were in serious neglect of their own tax affairs or those of their clients, or if there is a real risk that the person would engage in dishonest practices (perhaps because of a previous conviction involving dishonesty).

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[81] The services offered are expected to expand significantly in the context of IR's business transformation initiative.
[82] TAA 1994, s 37(5). For taxpayers with a non-standard balance date this date doesn't change.
[83] Policy and Strategy *Tax Penalties, tax agents and disclosures* (government discussion document, October 2006) at [2.9].
[84] Policy and Strategy, above 94, at 65.
[85] According to the code of ethics, 'integrity' is defined as the "obligation on all members to be straight forward and honest in all professional and business relationships" and also "implies fair dealing and truthfulness". See NZICA "Code of Ethics" (July 2013) <http://www.nzica.com/Technical/Ethical-and-professional/Standards-and-guidance.aspx> effective from 1 January 2014.

New legislation was enacted on 19 December 2007 to provide IR with the power to "withhold recognition of, or remove, a person as a tax agent when the action is necessary to protect the integrity of the tax system".[86] Compliance focus documents, released by IR after these reforms, suggest that an early area of focus had been on tax agents' personal compliance with their own tax obligations, based on a belief that "the compliance behaviour and attitude towards their own personal tax affairs generally reflects the advice they give to clients".[87] Since 26 March 2003, it has also been the case that a civil penalty may be imposed on agents who promote certain tax arrangements that are found to involve an abusive tax position, and where certain other criteria are met.[88]

The amendments described above are necessary to help regulate the profession. This will ensure those few 'bad apples' are not in a position to have an adverse influence on the compliance behaviour of a greater number of ordinary taxpayers.

6.4.2 The existence of 'interpretive discretion'

The responsibility to protect the integrity of the tax system has been described by former Commissioner, David Butler, as a shared responsibility with the profession:[89]

> Although not specifically referred to in the tax law, it is my view that the tax profession does have an important role to play in improving the integrity of our tax system. As I mentioned earlier, the definition of integrity within [s 6 of the Tax Administration Act 1994] includes 'the responsibilities of taxpayers to comply with the law.'

While it may be convenient for IR to view this as a shared responsibility, this conclusion is marred by the fact that the two parties will not always see eye-to-eye when it comes to what compliance with the law entails.

When taxpayers take advantage of the products and advice offered by their advisors, and in doing so escape the intended impact of the law, the issue is sometimes referred to as the problem of

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[86] TAA 1994, s 34B. See IR "The Definition of 'Tax Agent'" Tax Information Bulletin Vol 20, No 3 (April 2008) at 65.
[87] IR *Compliance focus 2009-10* at 27.
[88] TAA 1994, ss 141EB and 141EC. The author understands these sections are rarely used and were last applied in the year ended 30 June 2011. Notwithstanding this, a concern for the profession is that IR may sometimes threaten to apply these provisions more widely than originally intended by the legislator. See Lindsay Ng "Promoter penalties – tax agents beware!" (October 2010) The Chartered Accountants Journal 56 and "IRD whacks dodge scheme promoters" Sunday Star Times (26 February 2012).
[89] David Butler "Protecting the integrity of the New Zealand Tax System" (address to the Institute of Chartered Accountants Tax Conference 2002).

creative compliance. This is seen as representing a particular attitude to the law based on the belief that the given arrangement is still perfectly legal. In her work on motivational postures, Valerie Braithwaite specifically includes the category of 'game playing'. This was designed to reflect an attitude that the law "is seen as something to be moulded to suit one's purposes rather than as something to be respected as defining the limits of acceptable activity".[90] Whether creative compliance amounts to tax avoidance can only be confirmed when a matter is won or lost in court.[91] In this respect, a defining feature of the New Zealand environment is the strength of the general anti-avoidance rule (GAAR). This is coupled with a relatively high strike rate from IR in the courts. This means the New Zealand authorities have a powerful tool for tackling creative compliance that separates us from comparable jurisdictions who sometimes struggle with enforcement.[92]

Even absent concerns about creative compliance, it may still be the case that the two parties come to a different view of how the legislation applies to a given situation.

Earlier, this chapter discussed the limitation in IR's compliance model that it is built around the assumption that the law is determinate. This was argued to create a power of 'interpretive discretion'.[93] If one wanted any evidence that this interpretive discretion indeed exists and is a powerful tool for IR, they need only look to the Revenue Alert issued following the Supreme Court decision of *Penny and Hooper v CIR*.[94]

The case concerned two taxpayers who practiced as orthopaedic surgeons. The taxpayers restructured their practices so that associated entities (taxed at the lower company tax rate) derived amounts that would have otherwise been personal services income earned directly by the individuals. The result of this was that the salaries derived by the taxpayers during the years in question were fixed at levels that were 'artificially low'. At the time, it was a commonplace

[90] Valerie Braithwaite "Dancing with Tax Authorities: Motivational Postures and Non-compliant Actions" in Valerie Braithwaite (ed) *Taxing Democracy : Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at19.
[91] See Doreen McBarnet "When Compliance is not the Solution but the Problem: From Changes in Law to Changes in Attitude" in Valerie Braithwaite (ed) *Taxing Democracy : Understanding Tax Avoidance and Evasion* (Ashgate Publishing, Burlington (VT), 2003) at 232.
[92] At 233.
[93] See discussion supra at 2.2.
[94] *Penny and Hooper v CIR* [2011] NZSC 95, (2011) 25 NZTC ¶20-073. As explained on IR's website, a Revenue Alert "provides information about a significant and/or emerging tax planning issue that is of concern to" IR and "outlines the Commissioner's current view on how the law should be applied". It will identify (a) the issue (which may be a scheme, arrangement, or particular transaction) which IR believes may be contrary to the law or is inconsistent with policy; (b) the common features of the issue; (c) IR's current view; and (d) IR's current approach. See <http://www.ird.govt.nz/technical-tax/revenue-alerts/> (accessed 6 September 2016).

arrangement for professionals to use company structures to avoid high income tax. They did so in reliance on the views of their accountants and advisors who considered such structures to be legitimate in the eyes of the law. The tax profession was left in a state of uncertainty following the Court's decision that the facts in *Penny and Hooper* amounted to a tax avoidance arrangement. Confusion remained over how the concept of a commercially realistic salary should be applied in practice, as essentially no guidance was offered by the courts as to how this might be arrived at. In the wake of this uncertainty, IR published Revenue Alert RA 11/02 in August 2011.[95] This advised the taxpaying community of the factors that IR considers may feature in similar arrangements where tax avoidance is a concern. RA 11/02 also stated:

> Given our focus on the more artificial arrangements, and the resources available to us, we are more likely to examine arrangements where the total remuneration and profit distributions received by the individual service provider *is less than 80%* of the total distributions received by the controller, his/her family and associated entities.

Termed the '80 per cent rule', it was argued by some advisors that this "could well have the effect of requiring much more than a market salary to be paid", and that this "completely ignores the court, and has the practical effect of virtually ignoring the taxpayer's legitimate choice of business structuring".[96] Shortly after, in November 2011, the Commissioner announced that the department would offer what in substance amounted to a "tax amnesty" for taxpayers who operated similar structures, and who made a voluntary disclosure in respect of the arrangement.[97] IR made it well known that it would step up its audit activity in this area following expiration of the concession on 31 March 2013. Taxpayers who chose not to come forward under the amnesty, therefore, did so in the knowledge of the risk and exposure to shortfall penalties and use-of-money interest. With little else to go on in certain terms of what an appropriate level of remuneration would look like, and a looming amnesty deadline, it was entirely foreseeable that advisors would come to see the 80 per cent rule as representing a safe harbour threshold for remuneration arrangements, even if none was

[95] IR "Diverting personal services income by structuring revenue earning activities through an associated entity such as a trading trust or a company: the circumstances when Inland Revenue will consider this arrangement is tax avoidance" Revenue Alert RA 11/02 <http://www.ird.govt.nz/technical-tax/revenue-alerts/revenue-alert-ra1102.html>.

[96] The comments were made by Ernst & Young partner Joanna Doolan. See "Taxman accused of exploiting court's ruling" *The New Zealand Herald* (26 September 2011).

[97] The concession for those who elected to pursue this option was that disclosure was only required for the last two years in which a tax position was taken. The decision not to reassess taxpayers for the last four years (i.e. to the extent of the time bar) was stated as being made as a way to promote voluntary disclosure and to achieve a change in practice. It was expressly made pursuant to s 6A of the TAA 1994. The author understands that more than 300 voluntary disclosures were received by IR, whereas IR's intelligence-based selection procedures identified about 3,000 taxpayers potentially affected by the Supreme Court decision.

intended.[98] More worrying were the concerns expressed by practitioners about the use of 'bullying tactics' by IR to achieve compliance with the 80 per cent threshold.[99]

The existence of interpretive discretion, and the right to decide which taxpayers and arrangements to investigate or bring enforcement action against, brings into sharp focus the statutory process for resolving disputes in New Zealand. One would think that a 'partnership' would entail fair and impartial measures being put in place that can be used to resolve any items of disagreement to the satisfaction of both parties. Instead, there is some strong disagreement between IR and the profession over how effective the statutory disputes resolution procedures are in resolving these disputes. This is discussed next.

6.4.3 Disputes resolution procedures and disagreement with the profession

New Zealand is somewhat unique internationally in that since 1996 it has operated a statutory dispute resolution procedure that must be followed before an assessment is even issued.[100] The consequences for failing to adhere to this mandatory process can be severe. They include deemed acceptance of the other parties position, and restrictions on the matters that can be raised in challenge proceedings. However, for taxpayers, the procedures can also sometimes exacerbate the problem of interpretive discretion.

The concept was first introduced as part of the report of the Richardson Committee in 1994.[101] The Richardson Committee recognised the central importance of tax disputes resolution to the integrity of the tax system, observing that "the way disputes are resolved is critical to taxpayer perceptions of fairness, and has wider implications for the tax administration".[102] At the time of the Richardson Committee review, New Zealand was operating a traditional 'objection model' that the Committee

[98] See Grant Sidnam "What is a commercially realistic salary?" (2013) 5 NZ Tax Planning Reports 1.
[99] These views were solicited in a series of interviews conducted between November 2011 and January 2012. See Richard Bracefield and others "Perspectives and Implications of the Supreme Court Ruling in Penny: Evidence of an Expectations Gap?" (2013) 19 NZJTLP 51. The authors suggest that this "is of significant concern for the practitioners wishing to build a strong working relationship with the Commissioner". At 65. To IR's credit, the author understands that in March 2013, the department started advising practitioners that it was prepared to accept voluntary disclosures that detailed the relevant factors of a particular case but did not propose any actual adjustment or detail any error. Taxpayers who came forward under the amnesty and took advantage of this could maintain their position but also gain the protection from the concession in relation to shortfall penalties and the number of years IR would review.
[100] See Mark Keating and Mike Lennard New Zealand branch report in Cahiers de droit fiscal international *The practical protection of taxpayers' fundamental rights* (International Fiscal Association, volume 100B, 2015) at 573.
[101] Ivor Richardson and others "Organisational Review of the Inland Revenue Department" (Report by the Organisational Review Committee, 1994) [Richardson Committee report].
[102] At 65.

considered was deficient in a number of areas.[103] The Richardson Committee made four recommendations to help form the basis of a new approach:[104]

1. A revised tax disputes resolution process should be introduced with a revised approach to the pre-assessment.
2. Legislative changes should be made to introduce "all cards on the table" and appropriate evidence exclusion provisions, to remove the legal requirement for a taxpayer to lodge an objection with the Commissioner and to provide for taxpayer initiated litigation to be subject to standard judicial timetabling.
3. A review of the operation of the new procedures for disputes resolution should be carried out two years after all the elements of the proposals are in place.
4. A simple, "fast track", non-precedential procedure for dealing with small claims should be introduced as part of the jurisdiction of the Taxation Review Authority.[105]

The statutory process for resolving disputes was inserted in pt 4A of the TAA 1994 on 1 October 1996. The regime provides for a number of procedural steps that must normally be followed before an assessment is issued. The disputes process begins when a notice of proposed adjustment (NOPA) is issued by either the Commissioner or taxpayer advising the other party that an adjustment is sought. A notice of response (NOR) is then issued by the recipient of a NOPA if they disagree with this adjustment. Both parties will then each exchange a statement of position (SOP) detailing their respective positions on matters relating to the facts of the dispute, evidence, propositions of law and the issues that each party considers will arise. In addition to the legislative framework, the regime is supported by two important administrative phases. The first is voluntary participation in a conference to identify and, if possible, resolve any of the facts and issues relating to the dispute.[106] The second comes at the very end of the process, where disputes that remain

[103] For a review of the perceived deficiencies in the previous regime, see Mark Keating *Tax Disputes in New Zealand: A Practical Guide* (CCH New Zealand Limited, Auckland, 2012) at ¶102.
[104] Richardson Committee report, above n 130, at 71.
[105] The right for a taxpayer to elect to have their dispute heard in the small claims jurisdiction of the Taxation Review Authority was removed from 29 August 2011 by the Taxation (Tax Administration and Remedial Matters) Act 2011. Apparently this process was used less than 10 times since it was established in 1996 before the decision was made to remove it. In its absence, IR has since amended the criteria it will consider before agreeing to exercise its discretion in s 89N(1)(c)(viii) of the TAA 1994 to truncate the disputes process. This now includes circumstances where the core tax in dispute is under $75,000. See SPS 11/05 and SPS 11/06 in IR Tax Information Bulletin Vol 23 No 9 at 34, 70.
[106] This step was administratively prescribed in line with the Richardson Committee's description of the pre-assessment activities that should take place before an assessment is issued. See Richardson Committee report, above n 130, at 68.

unresolved are generally referred to the Disputes Review Unit (previously the Adjudication Unit) for final consideration before an assessment is issued.[107]

The post-implementation review of the legislative framework, recommended by the Richardson Committee, did not occur until July 2003 when a government discussion document was released for consultation. The government discussion document refers to the policy objective of the statutory regime:[108]

> 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 cases early in the process before an assessment which would alter a position in a taxpayer's return is issued.
>
> The overall objectives of the process have, therefore, been to improve the quality and timeliness of assessments and to reduce the likelihood and grounds for subsequent litigation.

The government discussion document went on to conclude that "the current process would appear to a significant extent to be meeting its objectives *because* the number of audited cases that are disputed is decreasing and the cases that are being litigated are also decreasing".[109] This was a rather ill-considered conclusion to make on the efficacy of the disputes regime and did not hold much water with the profession. A number of commentators have instead attributed this trend to taxpayers effectively being 'burned off' given the costs and complexity involved in pursuing a tax dispute through the statutory procedures.[110]

Dissatisfaction with the regime prompted the Taxation Committee of the New Zealand Law Society (NZLS) and the National Tax Committee of NZICA (the Societies) to work together on a rare joint

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[107] The Disputes Review Unit was formed in line with a recommendation from the Richardson Committee that a separate delivery and management stream, distinct from audit and investigation, should exist to act in the final quantification of liability for taxpayers prior to the issue of an assessment (the final adjudication function). See Richardson Committee report, above n 130, at 57. The Disputes Review Unit is part of the Office of the Chief Tax Counsel based in Wellington and is responsible for this final adjudication function. See IR Tax Information Bulletin "Adjudication Unit – its Role in the Dispute Resolution Process" Vol 19 No 10 at 9. Because it is simply an administrative process, there is no requirement that adjudication take place before an assessment is issued. See *Sweetline Distributors Limited & Ors v CIR* (2004) 21 NZTC 18,608.

[108] Policy Advice Division *Resolving tax disputes: a legislative review* (government discussion document, July 2003) at [1.3] – [1.4].

[109] At [1.7].

[110] Mark Keating observes that "many critics doubt whether this decline is due to the efficient working of the procedure". See Mark Keating "New Zealand's Tax Disputes Procedure" (2008) 14 NZJTLP 425 at 426. Based on his own analysis of a number of reported cases from 2005 - 2008, Keating reports that the number of reported tax cases on procedural issues has risen drastically under the current procedures. At 428.

submission to the Minister of Revenue in August 2008.[111] The submission contends that the problems identified by the Richardson Committee in the old 'objection model' were still present in the current system, and that the amendments made following the Government's post-implementation review of the regime had not cured the deficiencies.[112] The submission also comments on some specific issues that had emerged and makes a number of proposals for reform. In July of 2010, IR released an officials' issues paper in response to the concerns expressed in the joint submission.[113] The issues paper concluded that the matters raised in the joint submission should be dealt with through changes to the administrative framework and guidelines wherever possible, and rejected the assertion that anything more than minor changes to the legislation were needed. The Societies have since expressed their disappointment with this conclusion and have reiterated their view in a further joint submission (made in response to the issues paper) that legislative reform is needed. They also made the following comments:[114]

> As the professional bodies that act for taxpayers and deal with these procedures, we have serious concerns that the procedures are not working. Practitioners from both Societies report the same concern that the current procedures have led to taxpayer disillusionment with the wider tax system. We are seeing that attitude consistently across taxpayers in all sectors, from larger corporate taxpayers to medium and small businesses, and from individuals and private family entities.
>
> The procedures are also not meeting the purpose for which they were enacted. In our experience, taxpayers are disengaging from a process that prices them out of the ability to seek justice and that delays their access to the courts. This is cementing the view of taxpayers that the system is weighted against them and that there is no point in pursuing disputes. This is undermining the integrity of the tax system.

Few of the legislative changes recommended by the Societies were ultimately picked up and incorporated into the legislation.[115] It is outside the scope of this chapter to comment on the many and well-considered proposals that were advanced in the joint submission. The two most significant legislative changes that were sought by the Societies, but that were discounted by officials, were:[116]

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[111] Taxation Committee of The New Zealand Law Society and National Tax Committee of the New Zealand Institute of Chartered Accountants "Joint Submission: The Disputes Resolution Procedures in PartIVA of the Tax Administration Act 1994 and The Challenge Procedures in Part VIIIA of the Tax Administration Act 1994" (Wellington, August 2008).
[112] At [2.1].
[113] Policy Advice Division *Disputes: a review* (Officials' issuers paper, July 2010).
[114] New Zealand Law Society and New Zealand Institute of Chartered Accountants "Submission to the Disputes Project on Disputes: A Review – An Officials' Issues Paper" at [2.2] – [2.3].
[115] See Keating, above n 132, at ¶105.
[116] Taxation (Tax Administration and Remedial Matters) Bill (Commentary on the Bill) at 17.

- § that taxpayers should have a unilateral right to opt out of the disputes process;[117] and
- § that the Commissioner should be subject to more legislated timeframes.

When these matters were once again raised in submissions to the Taxation (Tax Administration and Remedial Matters) Bill, officials from IR insisted that the administrative changes and revisions would be sufficient to allay taxpayer concerns. According to the officials' report to the Finance and Expenditure Select Committee:[118]

> Officials understand the concerns giving rise to these submissions – that taxpayers are being "burnt off" by an overly long and elaborate disputes process. However, officials disagree with submitters that legislation is the best way of addressing these concerns.

This position sits in stark contrast to the views expressed by the Societies in their response to the issues paper:[119]

> The administrative guidelines reflected in the Exposure Drafts are interim solutions pending what is an obvious need for statutory reform. It is not good enough to place reliance on administrative statements. The principal rules need to be encapsulated in legislation. This will minimise ambiguity and provide certainty to taxpayers and the Commissioner. Carefully drafted legislation that imposes reasonable timeframes on the Commissioner limitations (sic) on both the Commissioner and taxpayers, and a unilateral elective opt-out will alleviate the problems with the procedures.

One commentator, who was involved in lobbying for change on behalf of the Societies, was left with the strong impression that IR "is very conscious that it presides over a tax administration which is weighted in its favour. It is reluctant to see that change".[120] Meanwhile, practitioner concerns around the efficacy of the disputes procedures continue to persist. CAANZ and Tax Management New Zealand (TMNZ) regularly commission Colmar Brunton to survey the New Zealand members of CAANZ on matters relating to satisfaction with IR service. The results of these annual surveys reveal some consistent and alarming trends in the area of tax disputes.[121] The surveys confirm that the vast majority of members who have been involved in the disputes process

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[117] Alison Pavlovich, in a recent article, argues that the prohibition from challenging a decision until the disputes process is completed in s 109 of the TAA 1994 is an infringement on a taxpayer's right to access justice per s 27(3) of the Bill of Rights Act 1990. See Alison Pavlovich "The Tax Disputes Process and Taxpayer Rights: Are the Inconsistencies Proportional?" (2016) 22 NZJTLP 70. This is good evidence to suggest that legislative change is needed in this area to help protect the integrity of the tax system.

[118] Taxation (Tax Administration and Remedial Matters) Bill (Officials' Report to the Finance and Expenditure Select Committee on Submissions on the Bill) at 40.

[119] New Zealand Law Society and New Zealand Institute of Chartered Accountants, above n 143, at [3.2].

[120] Geoffrey Clews "Remedies Against the CIR Considered through a Constitutional Lens" (2014) Taxation Today 13 at 14.

[121] Available at >http://www.nzica.com/Technical/Tax/Tax-articles-and-media.aspx< (accessed 27 October 2016). See also Lindsay Ng and Chris Cunniffe "Inland Revenue Service – are you satisfied?" (February 2013) The Chartered Accountants Journal 78.

say that the matter is closed before a case is filed in court. However, when asked what the main reason was that prompted the taxpayer to agree to settle, the overwhelming year-on-year response has been that the time commitment and cost to continuing the dispute is too great.[122] Another trend from the surveys is members reporting year-on-year that IR will only consider fairly the taxpayer's position in less than half of the cases where the taxpayer fully or partially decided to settle the dispute. Despite assurances in 2010 from the Minister of Revenue that legislative solutions will be reconsidered (in approximately two years time) if significant taxpayer concerns remain,[123] there have been no new developments on this front.

Taxpayers have been left in the position of having to rely on IR agreeing to administrative or managerial changes to improve the integrity of a regime that it wields considerable control over. The Richardson Committee were clear that the way in which disputes are resolved is critical to IR delivering on its responsibility to protect the integrity of the tax system. Far from taking a "best endeavours" approach and making improvements to this process, it is difficult to think of examples where IR has done anything more than the bare minimum. Even some of the more positive changes made over the years, such as conference facilitation introduced in 2009, have only come after continued lobbying from taxpayers and as a concession to legislative reform.

A criticism often made is that the IR investigator acts as both 'player' and 'referee' for the vast majority of the process. It bears repeating that the Richardson Committee originally envisaged that a separate strategic business unit would manage the adjudication function. The role of this adjudication function is described as being "to provide a specific and strong focus on the correct and impartial application of the tax law to the affairs of individual taxpayers".[124] The Office of the Chief Tax Counsel (OCTC), who performs this role, only has the opportunity to weigh in at the very end of this process when the matter is referred to the Disputes Review Unit.[125] It is difficult to see why the OCTC could not or would not exercise more independent oversight over this process, or be more involved in its facilitation. This could include, for instance, being responsible for the

[122] These results are corroborated even by IR's own evaluation of the disputes process commissioned in 2012. See Gail Kelly "IR's view of your satisfaction" 28 February 2013 <http://www.nzica.com /News/Archive/2013/March/IRs-view-of-your-satisfaction.aspx> (accessed 27 October 2016).
[123] Taxation (Tax Administration and Remedial Matters) Bill (Commentary on the Bill) at 18.
[124] Richardson Committee report, above n 130, at 114.
[125] While matters are normally referred to the Disputes Review Unit for consideration, this is simply an administrative practice and can sometimes be overridden at the discretion of the Commissioner. See *ANZ National Bank Limited & Ors v CIR (No 2)* (2006) 22 NZTC 19,835. Note also that OCTC staff will sometimes be involved in conference facilitation, although their role is limited to encouraging structured discussion between the parties and they are not responsible for making any decisions.

internal review of documents prepared early on in the process, and how various procedural discretions are exercised.[126]

Over its twenty year history, the disputes resolution procedures has been dogged by allegations of bad administration. There are many examples often complained of by the profession as to how IR will use the regime to place procedural hurdles in the way of a taxpayer seeking to achieve resolution of a dispute, rather than approaching the dispute in the spirit of the procedures.[127] Although some positive improvements have been made to the disputes procedures over the years, it is still far from a level playing field. Too often, it is treated as an inherently adversarial process.

6.5 Conclusion

The analysis in this chapter suggests that IR's management of key relationships with stakeholders in the tax system may fall short of the "best endeavours" standard in s 6.

Since 2001, IR has pursued a regulatory strategy based on the principles of responsive regulation. The adoption of the compliance model was intended to underpin this new strategic direction. This chapter began by identifying two limitations that are present in IR's compliance model that are argued to be incompatible with s 6. It then examined aspects of IR's management of key stakeholder relationships with a view to highlighting areas where improvements can be made. These are broadly divisible into three areas and are outlined below.

This chapter has also discussed some areas where the compliance model is being applied appropriately to understand stakeholder needs and tailor interactions. The Industry Partnerships programme was endorsed by the Office of the Auditor-General as generally being a success and meeting its objectives. This programme represents some important learnings in terms of putting the principles of responsive regulation to work in practice. Significant enhancements have also been made in terms of the services offered to large enterprise taxpayers and tax agents. These have had the positive effect of promoting voluntary compliance in the tax system by making it easier for taxpayers to comply. However, improvements such as these should be taken as a given because they are normally consistent with IR's own compliance objectives. Clearly, there is a need also to be mindful of the limitations of the compliance model when pursuing a regulatory strategy. This

[126] For example, whether late actions under s 89K are deemed to occur within the response period or whether to agree to a taxpayers opt out request under s 89N(1)(c)(viii) of the TAA 1994. See also SPS 11/05 and SPS 11/06 in IR Tax Information Bulletin Vol 23 No 9 at 33-35, 70-72.
[127] See Denham Martin "Inland Revenue's Accountability to Taxpayers" (2008) 14 NZJTLP 9 at 18 – 25.

is important; the responsibility in s 6 to protect the integrity of the tax system should not be overlooked.

As a general observation, there appears to be a disconnect between regulatory strategy and the exercise of certain statutory powers and discretions. It is not clear why the compliance model has not featured more prominently in standard practice statements or similar output as a means of rationalising how the Commissioner will exercise her powers to deal with particular matters. This is surprising, given that the essence of the compliance model is to, as far as possible, tailor a response based on the individual circumstances of the taxpayer in question. In contrast, the responsibility on Ministers and officials to protect the integrity of the tax system does tend to feature quite regularly in this decision making.[128] While this is positive for tax system administration, there is room for a regulatory tool to assist IR staff in striking an appropriate balance between the various elements of ss 6 and 6A.[129] This can then be used to support the principles of the compliance model by providing clear links between the responsibilities listed in these sections and regulatory strategy.

Area one: improvements consistent with the compliance model

The first area relates to improvements that are already consistent with the compliance model and the principles of responsive regulation. This chapter has identified that more can be done by IR to facilitate better self-management of tax risks by large enterprises. IR has failed to keep pace with international developments and OECD thinking with regards to communicating its own expectations for corporate tax governance. More work is also needed to find ways to incorporate testing of TCFs into risk assessment procedures so that a concession is made for self-regulatory effort, possibly in the context of a formal cooperative compliance programme that is offered widely

[128] It has also become common for legislative reform in respect of a new or existing administrative power to include an express requirement to consider the integrity of the tax system. While not a comprehensive summary, this chapter has discussed three examples of this: (1) exceptions to the secrecy provision in s 81(1B); (2) the power to declare a limited scope business tax amnesty in s 226B; and (3) designating persons as tax agents in terms of s 34B. IR often refers to the responsibility to protect the integrity of the tax system in standard practice statements or operational guidelines, even where the provisions involved do not contain an express direction to do this in the legislation.

[129] A useful exploration of the relationship between the various categories of fairness perceptions a taxpayer will form about integrity in the tax system and voluntary tax compliance is made under the slippery slope framework. See Erich Kirchler, Erik Hoelzl and Ingrid Wahl "Enforced versus voluntary tax compliance: The "slippery slope" framework" (2008) 29 Journal of Economic Psychology 210. See also Erich Kirchler *The Economic Psychology of Tax Behaviour* (CUP, New York, 2007) at 202. This could be a useful starting point for IR to develop a tool that can delineate between the various categories of perceptions that a taxpayer might form, and establish the relationship between these perceptions and voluntary compliance.

to taxpayers. There are a number of quick wins to be had if IR can find ways to leverage off of OECD output on these issues, or the existing work of other jurisdictions.

Area two: compliance model narrows strategic thinking to customer/group

The second area where improvements can be made relates to the limitation in the compliance model that it is customer centric. This tends to narrow thinking to the individual taxpayer or taxpayer group in question, to the exclusion of perceptions that will be formed by the general body of taxpayers in the tax system. A clear example of this is the policy thinking that went into the limited power to declare a business tax amnesty contained in s 226B. The policy objective behind this section is to bring non-compliant taxpayers back into the system by offering them a realistic opportunity to change their compliance behaviour going forward. Despite this being a textbook application of the compliance model, it has yet to be exercised even once. The most likely reason for this is that IR perceives that any exercise of this statutory power will be met with backlash from the taxpaying public. This conflict of principles is a good illustration of the need for a regulatory tool to balance the perceptions of taxpayers in general with the interests of the taxpayers that might be the subject of a particular compliance strategy. This would assist in policy development and operational decisions regarding the exercise of specific statutory powers or discretions.

This limitation in the compliance model is also relevant to how large enterprise taxpayers are being viewed by the taxpaying public. The political landscape in New Zealand has been rocked over the years by reports in the media that point to a disparity between what large enterprise taxpayers can get away with and how IR will use its enforcement function against small businesses and individual taxpayers. These reports have contributed to a divide between ordinary people and those at the 'big end of town'. The most recent manifestation of this has come in the form of growing international concern about the use of BEPS practices by multinational corporations to avoid paying taxes. This chapter argues that a "best endeavours" should entail a far more active approach to media management than the IR is undertaking currently. This is particularly so given that the department is in a privileged position because of the information it holds. It could also be used help address any mainstream perception issues that are at play.

Area three: compliance model assumes the law is determinate

The third area where improvements can be made relates to the assumption made by the compliance model that the law is determinate. The tax profession is quite vocal in areas where this assumption

has undermined the trust that exists between IR and taxpayers. This damage to the relationship can itself lead to outcomes that are inconsistent with a regulatory strategy based on the principles of responsive regulation.

This chapter has discussed the '80 per cent rule' in the context of *Penny and Hooper* type remuneration arrangements as an example of how IR will sometimes use its 'interpretive discretion' to define what it considers to be acceptable compliance behaviour. IR has then used its enforcement function in a way to secure compliance with that definition. This is something that might have looked like a sensible use of administrative resources on paper, but has had the effect of taking the focus away from the substantive features of remuneration arrangements that need to be present before tax avoidance can be alleged. While there is nothing wrong with using an administrative safe harbour to promote certainty, IR should take care to ensure staff do not treat taxpayers in breach of the safe harbour as necessarily in breach of the law.

The statutory disputes resolution procedures are also argued to exacerbate the problem of interpretive discretion. Members of the tax profession are regularly employed by their clients to help navigate the procedural complexities of this regime. Tax practitioners involved in this process are almost uniform in their belief that disputes procedures are not working as intended. Taxpayers are effectively being "burned off" by a regime that is too time consuming and needlessly complex. If IR is failing to deliver on taxpayer perceptions of integrity in this area, this can seriously undermine the legitimacy of the regulator and present a significant issue from the perspective of voluntary compliance. Every dispute that is won by IR on procedural grounds or is abandoned for reasons other than the substantive merits of the case risks further damage to this legitimacy. By disregarding practitioner concerns in this area, IR also risks undermining the democratic principles that fundamentally underpin the successful implementation of a responsive regulation strategy. The chapter has suggested that the Office of the Chief Tax Council should be more involved in the process. There is also a strong case that IR should collaborate with taxpayers to make legislative changes and develop procedures that work to the satisfaction of both parties.

7.1 Summary of findings

The research undertaken and conclusions reached in each of the chapters included in this submission point to a need to strengthen the settings for IR's statutory role as tax collector. The successful undertaking of this role is critical to delivering on expectations of IR in its administration of the tax system. It is underscored by both (i) the democratic principles and processes that guide the country and (ii) the tax legislation itself, in s 6 of the TAA 1994, which imposes a responsibility on Ministers and officials to protect the integrity of the tax system. This legislative provision has now been part of the framework of the tax administration for over 20 years. Despite this, there is an argument to be made that IR is not proactive enough in taking the steps needed to uphold the integrity of the tax system. This has largely been the result of its strong predilection for achieving compliance outcomes.

The above contention suggests that the steps needed in order to strengthen the settings for IR's statutory role as tax collector cannot come from administrative changes alone. It needs to be accompanied by a rethink of the current legislative settings. In terms of specific actions, the chapters indicate that, at a minimum, the following should happen:

- The way in which ss 6 and 6A function together to resolve the tension between the Commissioner's CIR and CE responsibilities is to give priority to her managerial (CE) interests. This is supported by a single revenue-orientated objective for tax system administration. Future reform should look to articulate more precisely the statutory parameters of the Commissioner's adjudicative role and make this distinction clear in the legislation. Consideration could also be given to whether the Commissioner's CIR responsibilities should sit within a Departmental Agency.
- A list of independently-stated procedural rights should be added to the legislation that set out exactly what is expected of IR's administration of the tax system. The desired outcome would be to provide a new standard for intervention from the courts and enable meaningful precedent to develop regarding what accountability standards and behaviours can be expected of IR.
- In line with the above exercise, consideration should also be given to those areas where the often wide-ranging administrative discretion provided to the Commissioner needs to be curtailed in favour of taxpayer rights. An example of this is whether s 113 of the TAA 1994

should be amended to better facilitate self-assessment and provide taxpayers with the right in appropriate circumstances to reopen past returns (i.e. without having to rely on the Commissioner's discretion).

- § Mechanisms should exist to resolve disputed tax positions that work to the satisfaction of both parties. This would ensure that the integrity of the tax system is being upheld. The current view of taxpayers and their advisors of the disputes resolution procedures in pt 4A of the TAA 1994 suggests that reform is needed in this area.
- § Accountability for the administrative law principles that public officials are expected to adhere to in the exercise of a statutory power needs to be restored in the context of the Commissioner's assessment function. Amendments to the tax legislation could either provide that the act of bringing an assessment is amenable to judicial review, or expand the scope of a hearing authority's powers under the statutory challenge procedures to make room for this sort of inquiry.

Outside of changes to the legislative framework, the chapters make a number of recommendations as to how IR can revise its strategic, regulatory and operational approach to administering the tax system. At a high level, more thought should be given as to how IR's statutory role as tax collector (and the expectations that come with that) could be better integrated into a broader regulatory strategy. While significant revisions were made to IR's strategic direction in 2001, there is much to suggest that this was also a missed opportunity to incorporate the responsibility to protect the integrity of the tax system and manage taxpayer perceptions at a strategic and regulatory level. This lack of integration has resulted in a number of flow-on effects that have been identified in the chapters and should be addressed as part of a broader review. Although not a complete list, any future work in this area should include a consideration of the following in particular:

- § Changes to the way in which performance is assessed and measured at IR to ensure there is better support for IR's statutory role as tax collector. The aim would be to achieve better outcomes through the general accountability frameworks applicable to organisations in the public sector.
- § There is a need for a decision-making tool to assist IR staff in balancing the various elements of ss 6 and 6A when exercising administrative powers or discretions. Ideally, this would need to provide clear outcomes regarding how to balance the interests of taxpayers

in general with the interests of taxpayers who are the subject of a particular compliance strategy.

- As a starting point, the chapters suggest that Wenzel's taxonomy is useful when thinking about how taxpayers come to form perceptions about the integrity of the tax system. The chapters also suggest that the slippery slope framework is useful when thinking about what actions could be taken by IR to promote voluntary compliance by taxpayers.
- Associated with this, future research could look to determine how IR can extend the benefits of the cooperative compliance regulatory concept beyond the large enterprise spectrum. This could be accompanied by measures for testing taxpayer perceptions to get a gauge of what compliance strategies are acceptable to the taxpaying public. This would be important, for example, if there is a risk that a particular taxpaying group could be viewed as being given preferential treatment.
- There is room for IR to be more transparent in its approach to administering the tax system and its approach to compliance risk management. This could extend to taking a more active approach to media management where there are misconceptions held by the taxpaying public that might adversely affect their perceptions of integrity in the tax system. The public release of internal documents that has recently been seen from IR is a positive development on this front.

IR is probably better placed now than it will be in the future to consider the above issues given the scope of its current business transformation initiative. That having been said, the need to strengthen the settings for IR's statutory role as tax collector has yet to be included on the agenda for reform. Now is the time to revisit some of the tax administration fundamentals and engage in serious debate about and then action these issues.

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