

Flaws in New Zealand Tax Disputes Process

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Table of contents

1	Introduction.....	6
2	Overview of disputes resolution process.....	7
	2.1. Background and history of disputes resolution process.....	7
	2.2. Previous disputes process.....	8
	2.3. Problems with previous disputes process	8
	2.4. The recommendations of the Organisational Review Committee	9
	2.5. The introduction of Part IVA	10
3	The current disputes resolution process.....	11
	3.1 Overview	11
	3.1.1 Pre-assessment.....	14
	3.2 Notice Of Proposed Adjustment (NOPA)	14
	3.2.1 When a NOPA is issued	14
	3.2.2 When further NOPA will be issued	17
	3.2.3 Contents of a NOPA.....	17
	3.2.4 Where the Commissioner cannot issue a NOPA	18
	3.2.5 Response to NOPA.....	18
	3.3 Notice Of Response (NOR).....	19
	3.3.1 Response period	19
	3.3.2 Content of a NOR.....	19
	3.3.3 Action on receipt of a NOR.....	20
	3.4 Conference	21
	3.5 Statement of Position (SOP) & Disclosure Notice	21
	3.5.1 Disclosure Notice	21
	3.5.2 Content of disclosure notice	22
	3.5.3 Content of SOP.....	22
	3.5.4 Response period	23
	3.5.5 Commissioner may response to the taxpayer's SOP	23
	3.6 Adjudication Unit	24
	3.6.1 Adjudication outcomes.....	25
	3.7 Small claims Jurisdiction of Taxation Review Authority.....	27
4	Perceived benefits.....	27
5	What went wrong	30
	5.1 Unfairness.....	30
	5.1.1 Legislative flaws.....	30
	5.1.2 Lack of a specified timeframe for the Commissioner.....	36

5.1.3	The Commissioner can introduce additional information	38
5.2	Strategy, Time and Costs.....	39
5.2.1	Slow process.....	39
5.2.2	Administration procedure.....	41
5.2.3	The cost of a dispute.....	43
5.2.4	UOMI charges	45
5.3	Follow the policy or follow the spirit of the policy	46
5.3.1	Mandatory v Emendatory	46
5.3.2	“Cards” on the table or under the table.....	49
5.3.3	Compliance model.....	52
5.4	Communications.....	54
6	How can we fix it	55
6.1	Procedural changes.....	55
6.1.1	Simplifying the procedure	55
6.1.2	Simplifying the content	59
6.2	Legislative changes	61
6.2.1	Clear and fair	61
6.2.2	Tight time table	63
6.3	Alternatives - use of mediation.....	64
6.4	Policy changes.....	67
6.4.1	Early settlement.....	67
6.4.2	Cost contribution program.....	71
6.4.3	Abolishing Use of Money Interest (“UOMI”).....	73
6.4.4	Compensation policy	74
6.4.5	External scrutiny.....	74
7	Recommendations	76
7.1	New disputes process	76
7.2	Legislation changes	78
7.3	Independent review process	79
8	Conclusion.....	79

Attestation of Authorship

I hereby declare that this submission is my own work and that, to the best of my knowledge and belief, it contains no material previously published or written by another person (except where explicitly defined in the acknowledgements), nor material which to a substantial extent has been submitted for the award of any other degree or diploma of a university or other institution of higher learning.

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Abstract

The tax disputes process has been a popular topic for some time. Numerous professionals have openly critiqued current tax disputes process since the introduction of the legislative disputes resolution process. Most critics have lacked detailed analysis of the process from both a technical and a practical view. This research report forms part of the Master of Business study at Auckland University of Technology. This report first reviews the historical background of the tax disputes process in New Zealand and this also includes the various amendments introduced after the disputes resolution process was introduced in 1996. The analysis focuses on the pre-assessment phases up to Adjudication review phase (for the purpose of this report, assessment, challenges and penalties are not discussed). The report analyses both the legislative and non-legislative requirements of each phase, step by step, under the Tax Administration Act 1994. The analysis indicates a number of problems and flaws in the current disputes process which is supported by the analysis of case law. The author argues that the current legislative disputes process is complicated, slow, costly and unbalanced. The process has not achieved its initial objective as a fair, quick and efficient resolution. The author recommends significant simplification to the current dispute process and proposes both legislation and policy changes to make the process a more fair, quick and efficient way to resolve tax disputes. The legislation should be changed to reflect the fairness for both disputing parties; a tight timetable should be imposed to the disputing parties equally. Finally, the author suggests some alternative options, such as mediation and arbitration process, to fast track dispute process and minimising associated costs. A cost contribution program such as testing case litigation program and compensation policy will also help to improve the tax disputes process in New Zealand.

1 Introduction

[1] When New Zealand Government released tax disputes discussion document in 2003, Finance Minister Dr. Michael Cullen said at a media conference that no matter how good a tax system is it is inevitable that there will be occasional disputes between taxpayers and the tax administration.¹ The Government considers the environment around how the tax disputes are resolved is critical to maintaining an efficient tax administration.²

[2] The New Zealand tax disputes process is designed to ensure a high level of disclosure between the disputing parties. The purpose of the current disputes process is to improve the accuracy of disputable actions, reduce the likelihood of disputes arising between the Commissioner and taxpayer, and to promote an early and efficient resolution. This purpose is clearly stated under section 89A of the Tax Administration Act 1994 (“TAA”).

[3] The Government has indicated in its *discussion document* that its objective is to ensure an assessment is as correct as practicable and to deal with any disputes fairly, efficiently and quickly.³

[4] The legislative disputes process has been operating for twelve years. Since 1996, the tax disputes process under went significant change to improve its efficiency. Have these changes made the disputes process flawless? Did the Government meet its objectives through the numerous changes? These are the questions need to be answered through this research paper.

[5] A recent tax conference held in October 2007⁴ indicated that a significant amount of tax practitioners think that the current tax disputes process is not the straightforward, cheap, quick and fair process that the government was aiming for.

¹ Media Statement – Tax disputes discussion document released (02 July 2003)

² New Zealand Government (2003) Discussion Document: *Resolving Tax Disputes: A Legislative*, P1

³ Ibid 1

⁴ Inland Revenue’s Accountability to taxpayer – The 2007 Tax Conference, p8

[6] The New Zealand tax disputes process is comprised a numbers of steps. The process itself is a very complicated procedure. After numerous changes, majority taxpayers still see the process as complicated, costly, and unfair and time consuming. It is vital to the New Zealand tax system that the taxpayer believes that a tax dispute will be handled fairly and quickly in order to improve voluntary compliance.

[7] This research paper critic the current tax disputes resolution process and argues that the current process can be simplified by reducing the number of steps in the process. The recommendations focus on reducing the time and cost of the disputes process, and the adoption of a more practical or useful procedure to help disputing parties reach agreement at an earlier stage in a bid to improve disputes process in New Zealand.

2 Overview of disputes resolution process

2.1. Background and history of disputes resolution process

[8] The New Zealand disputes resolution process was first introduced in 1996. The foundation of the rule was the establishment of the Organisational Review Committee (“Review Committee”). In 1993, the New Zealand Government established the Review Committee, chaired by the Right Honourable Sir Ivor Richardson, to review the activities of Inland Revenue (“IR”). Part of the review included the procedures and practices leading to the assessment of tax and the way disputes arising from assessments were resolved. The Review Committee concluded,⁵ among other things, that the then disputes resolution process was deficient and did not adequately support the early identification and prompt resolution of the tax disputes.

⁵ Organisational Review Committee, *Organisational Review of the Inland Revenue Department, Report to the Minister of Revenue from the Organisational Review Committee*, April 1994.

[9] A number of recommendations were included in the Committee's report. As a result of the report, a pre-assessment phase was introduced, which included a set of prescribed steps.

2.2. Previous disputes process

[10] Under the old disputes rules when Inland Revenue was considering a re-assessment, the Commissioner would normally give taxpayer reasons for the proposed adjustment before the re-assessment. If the taxpayer agreed with the proposal, the Commissioner then re-assessed the tax return and issued an assessment.

[11] If the taxpayer did not agree with the proposed adjustment, the Commissioner generally would seek further discussion or meetings with the taxpayer depend on complexity of the case. If the matters were still not solved, an Inland Revenue Officer (other than the investigator) would review the correctness of the proposed adjustment. If the proposed adjustment was correct, an assessment would be issued.

[12] If the taxpayer disagreed with the assessment and wished to challenge it, they were required to lodge an objection with Inland Revenue within two months of the date of the issue of the assessment. The objection had to be in writing.

[13] The Commissioner would then review the objection and decide whether or not the objection was to be allowed. If the objection was disallowed and the taxpayer wished to take the matter further, the taxpayer had two months from the date the objection was disallowed to lodge a case in either the Taxation Review Authority ("TRA") or the High Court.

2.3. Problems with previous disputes process

[14] The Review Committee found numerous issues with the previous disputes process. The Review Committee concluded that the dispute process was deficient

in a number of areas. *Firstly*, communication between Inland Revenue and taxpayer was not open. Often, the taxpayer did not fully understand the full details of facts and arguments of the case. In some cases, the taxpayer did not understand the basis of IR's assessment and therefore found it difficult to object to the assessment. *Secondly*, information was not disclosed to the taxpayer at an early stage, this did not help prompt the resolution of the dispute. Generally, Inland Revenue should disclose all matters to the taxpayer as early as possible to ensure the identification of the issues. In other cases, information was held by only one party. The Review Committee expressed concerns that the process wastes Court resources solving matters arising from "trial by ambush"⁶. *Thirdly*, the length of the process was too long and costly.

2.4. The recommendations of the Organisational Review Committee

[15] The Review Committee's recommendations in the tax disputes process included:⁷

- The introduction of a pre-assessment phase to ensure the correctness of an assessment;
- The post-assessment being subject to standard judicial procedures to provide more effective litigation;
- The introduction of a simple 'fast track', non-precedential procedure for dealing with small claims

[16] The Review Committee concluded that IR should develop a comprehensive approach for major changes in the disputes process. It recommended a pre-assessment phase in which either the Commissioner or the taxpayer could raise a notice of proposed adjustment ("NOPA"). The other party would respond with a notice of response ("NOR"). Both parties should then attend a conference followed by the NOR. If matters are still in dispute, then the Commissioner should issue a disclosure notice. Both parties would then issue

⁶ New Zealand Government (December 1994) Discussion Document: *Resolving Tax Disputes: proposed Procedure*, 221

⁷ Organisational Review Committee, *Organisational Review of the Inland Revenue Department, Report to the Minister of Revenue from the Organisational Review Committee*, April 1994.

statements of position (“SOP”). The evidence exclusion rules would then apply meaning that any facts or issues not discussed in the disclosure notice are barred from being raised in the Court.

[17] The Review Committee also recommended IR to abolish the objection process. Instead, taxpayer can apply to the TRA or the High Court by issuing proceedings to challenge the correctness of an assessment.

[18] The Review Committee further recommended that IR set up a small claims jurisdiction to allow ‘fast-track’, quickly resolve small tax disputes under limited sums of tax.

[19] In addition, the Committee emphasised the need for early and full disclosure of all necessary information to ensure fair and effective resolution of the dispute. As a result of the recommendations, the Government issued a discussion document in December 1994, *Resolving Tax Disputes: proposed procedures*⁸ for public consultation. The document proposed to implement the Review Committee’s recommendations for major changes in the dispute process.

2.5. The introduction of Part IVA

[20] Following from the Review Committee’s report, the Government in 1996 introduced a new Part IVA relating to disputes procedures in the Tax Administration Amendment Act (No 2) 1996. A new part VIIIA relating to challenges was also introduced at same time. Both provisions came into force on 1 October 1996. The introduction of the two new parts in TAA was the implementation of the Review Committee’s idea to promote an “all cards on the table” approach.

⁸ *Resolving Tax Disputes: proposed procedures*, December 1994.

3 The current disputes resolution process

3.1 Overview

[21] The new disputes resolution procedures apply to all assessments issued on or after 1 October 1996. Part IVA applies to all tax disputes and duties administered by IR except of assessments issued pursuant to the Child Support Act 1991 and the Accident Compensation premium assessment (IR no longer the administers of the ACC assessment).

[22] Regardless as to whether a disputes process is initiated by the Commissioner or the taxpayer, the process can be broken down into six phases:

- (a) Pre-assessment (issue of a NOPA and/or NOR);
- (b) Conference;
- (c) Disclosure (issue of disclosure notice/SOP);
- (d) Adjudication Review;
- (e) Assessment;
- (f) Challenge.

For the purpose of this research paper, the Assessment and Challenge phases are not discussed in this report.

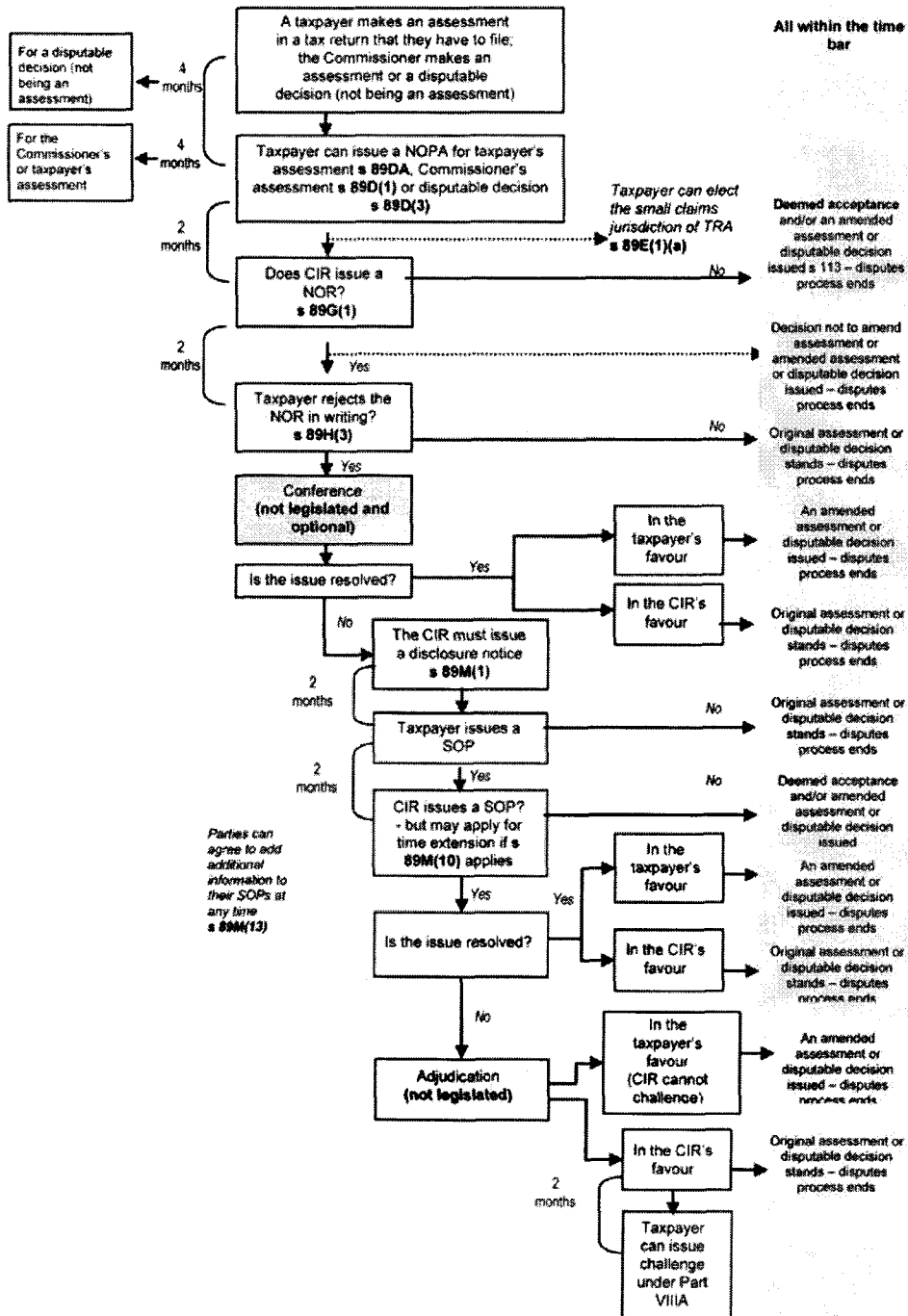
The following flow chart explains the full disputes process commenced by the Commissioner:⁹

⁹ SPS 05/03

All within the time bar



Disputes resolution process commenced by a taxpayer



3.1.1 Pre-assessment

[23] Tax disputes normally arise as a result of the Commissioner auditing a taxpayer's tax affairs. In general, an audit occurs after a taxpayer has filed a tax return, and a notice of assessment has been issued based on the taxpayer's self-assessment. After investigation officer started an investigation, dispute may arise when the taxpayer disagrees with the proposed adjustment raised by the Commissioner. The Commissioner will initiate the disputes process by issuing a NOPA. In situation where taxpayer initiates the dispute, the dispute will arise after the Commissioner has issued an assessment or made a disputable decision.

[24] The brief steps involved with pre-assessment phase are as follows:

- (a) The Commissioner issues a NOPA;
- (b) Taxpayer accepts the NOPA (end of disputes) or issues a NOR;
- (c) The Commissioner accepts the NOR (end of disputes) or rejects;
- (d) Conference;
- (e) The Commissioner issues a disclosure notice and a statement of position ("SOP");
- (f) Taxpayer issues a SOP;
- (g) If the dispute is not resolved, the matter is referred to Adjudication Unit for review;

An assessment may be issued to reflect the Adjudication review, if it agrees with the Commissioner's position.

3.2 Notice Of Proposed Adjustment (NOPA)

3.2.1 When a NOPA is issued

[25] Section 89B and 89C of TAA mainly deal with the NOPA. Under section 89B the Commissioner may issue a NOPA when:¹⁰

- (i) the Commissioner wishes to issue a taxpayer with an assessment or determination which differs from the amount or basis declared in the taxpayer's tax return; or

¹⁰ TIB, Vol 8, No.3, p3

- (ii) the Commissioner wishes to issue a taxpayer with an assessment based on new information and, in either case, the taxpayer does not agree with that assessment or proposed assessment.

The Commissioner may issue a NOPA in relation to more than one tax period, issue or tax type.¹¹ The Commissioner can issue more than one NOPA in relation to a tax return or an assessment.¹² Tax Information Bulletin (TIB)¹³ states that in any large or complex audits, the Commissioner may issue more than one NOPA. When an audit involves multiple periods and time bar is pending for some period(s), the Commissioner may issue a separate NOPA for each period to ensure that the assessment is issued before the period becomes time barred.

[26] Section 89B(1) states the Commissioner “may” issue NOPA, but in the writer’s view, it is the Commissioner’s mandatory duty to issue NOPA if the Commissioner considers a proposed adjustment or re-assessment and the pre-conditions set out in s 89C are not fulfilled. The reason being is because section 89C states the situations where the Commissioner is allowed to issue assessment without first issued a NOPA. Therefore, if the situation does not meet the criteria for exceptional circumstance under s 89C, the Commissioner has no choice but to issue NOPA before issuing an assessment.

[27] In circumstances, where the Commissioner fails to issue a NOPA before issuing an assessment, the taxpayer can request a judicial review of the Commissioner’s action. Section 114 of TAA provides that no assessment is invalid because any of the provisions of TAA or any other Act have not been complied with. The right to challenge an assessment is subject under Part VIIIA of TAA. In the writer’s view, the purpose of s 114 is to differentiate the validity of an assessment from the right to challenge or dispute a decision. In

¹¹ Section 89B(2) and (3) of TAA

¹² Section 89B(1) of TAA

¹³ TIB, Vol 8, No.3, p11

Canterbury,¹⁴ the Court of Appeal concluded that in practice there were only two grounds upon which an assessment could be invalid. This was that either the Commissioner did not follow the proper process in arriving the reassessment or no assessment was actually made. In the writer's view, the invalidity argument is 'limited ground' for challenging an assessment. When the Commissioner fails to follow the process of issuing a NOPA before issuing an assessment, the Court may find the Commissioner in abuse of his statutory power. Therefore the Court can, and more likely will, declare the assessment is invalid. In a situation where the Commissioner has wrongly or rightly considered exceptional circumstances under s 89C, the Court will not consider the Commissioner to be abusing his power, resulting in a valid assessment regardless of the correctness of the decision.

[28] The taxpayer on the other hand can issue a NOPA if the Commissioner issues a notice of assessment and has not previously issued a NOPA.¹⁵ This situation also applies when the Commissioner is obligated to issue NOPA under section 89C but has not done so.

[29] When the assessment is a default assessment, the taxpayer may only dispute the default assessment by issuing a NOPA.¹⁶ There is an argument that if the taxpayer files a return after the default assessment was issued, the tax return can be treated as NOPA. Justice Baragwanath in *Singh*¹⁷ held that the return filed by the taxpayer could be a NOPA. In the writer's view, a tax return filed by the taxpayer can not be treated as NOPA, as the return does not meet the requirement under section 89F and is not in the pre-scribed form. Details of the contents of a NOPA will be discussed later in this paper.

¹⁴ *CIR v Canterbury Frozen Meat Co Ltd* [1994] 2 NZLR 681, Para 41 & Para 43

¹⁵ Section 89D of TAA

¹⁶ TIB, Vol 8, No. 3, (Aug. 1996)

¹⁷ *Singh v CIR* (2002) 20 NZTC 17,811

[30] Taxpayer may also issue a NOPA within two months of furnishing the tax return if the Commissioner has not issued a notice of assessment (a recent amendment extended the period to four months).

3.2.2 When further NOPA will be issued

[31] The Commissioner stated in a TIB¹⁸ that a new NOPA will only be required for issues that weren't covered in a previous NOPA. Examples were also given in the TIB. In general, if the Commissioner issued a NOPA and considered an issue under a certain category (e.g. disallow the motor vehicle deduction due to private usage of the motor vehicle), and after the NOPA was issued, the Commissioner changed his view on the issue, but considered the issue was still in line with the category (e.g. still disallow the motor vehicle deduction but consider the reason being capital expenditure), there will be no new NOPA issued.

3.2.3 Contents of a NOPA

[32] A NOPA indicates the commencement of the disputes process. It intends to explain the legal position of an issue in relation to a proposed adjustment. Therefore a NOPA should be in writing and contain following:¹⁹

- Sufficient detail of matters to identify the issues including the nature, and amount with supporting calculations;
- The key facts;
- Legal issues;
- The tax laws upon which the proposed adjustments are based;
- A statement of how the law applies to the facts

If the taxpayer initiates the disputes process, the NOPA has to be in the prescribed form (IR777).

[33] The legislation requires the NOPA to contain a “concise” statement of the key facts and laws in sufficient details. The Commissioner indicated²⁰ that the

¹⁸ TIB, Vol 8, No. 3, (Aug. 1996), p13

¹⁹ Section 89F of TAA

Commissioner's practice is to issue a NOPA as brief as practicable with greater detail being provided in the SOP.

3.2.4 Where the Commissioner cannot issue a NOPA

- [34] The Commissioner can not issue a NOPA if the proposed adjustment is already the subject of a challenge.²¹ Further, the Commissioner is precluded from issuing a NOPA when the time bar has expired under section 108, 108A or 108B of TAA.²²

3.2.5 Response to NOPA

- [35] The recipient of a NOPA has three options in response:

- (a) Do nothing, therefore be "deemed" to accept the NOP;
- (b) Accept the NOPA in full or part;
- (c) Reject the NOPA by issuing a Notice of Response (NOR)

- [36] It is important to note that if the taxpayer accepts the NOPA issued by the Commissioner, then the taxpayer may not challenge it in the future.²³ The Commissioner can also accept a NOPA under section 89J.

- [37] Deemed acceptance will arise when the recipient of a NOPA does not response to the NOPA within the two-month response period and there are no exceptional circumstances as defined under s 89K(3). Under s 89H(1), a disputant is deemed to accept the NOPA with section 89I applying, if the disputes fails to reject the adjustment(s) proposed in a NOPA. The same applies to the Commissioner,²⁴ if the Commissioner does not reject adjustments proposed by a taxpayer in the notice within response period, section 89J applies. The Commissioner must issue a subsequent notice of assessment to reflect the adjustments proposed in the taxpayer's NOPA.

²⁰ Standard Practice Statements – *Disputes Resolution Process Commenced by the Commissioner of Inland Revenue* –SPS 05/03, TIB Vol 17, No. 3 (April 2005), p36

²¹ Section 89B(4) of TAA

²² Section 89B(4)(b) of TAA

²³ Section 89I(1) of TAA

²⁴ Section 89H(2) of TAA

3.3 Notice Of Response (NOR)

3.3.1 Response period

[38] In order to reject a NOPA, the recipient must within two months of the date of issue of the NOPA notify the issuer by issuing a NOR.²⁵

[39] Where multiple NOPAs are issued, a single NOR can be issued to reject all NOPAs. The single NOR must be issued within the two-month response period from the date of issue of the first NOPA. Where several NOPAs were issued, each NOPA must be responded to within the response period.

3.3.2 Content of a NOR

[40] Section 89G(2) requires the NOR to contain:

- (a) The facts or legal arguments in the NOPA that are considered as wrong; and
- (b) Why; and
- (c) Facts and legal arguments that are relied upon;
- (d) How the legal arguments apply to the facts; and
- (e) The quantitative adjustments to the NOPA.

[41] In *Standard Practice Statement- Disputes Resolution Process Commenced by the Commissioner of Inland Revenue* (SPS -05/03), it states that if the Commissioner is aware of deficiencies in the content of NOR, that the taxpayer or tax agent will be notified of the deficiencies as soon as practicable.²⁶ If the NOR is received by the Commissioner before the end of the response period, the taxpayer will have opportunity to rectify the deficiencies. If a NOR is invalid under s 89G(2) and the response period has expired, and the taxpayer has no exceptional circumstance under s 89K, the taxpayer is deemed to accept the NOPA in accordance with section 89H(1).

²⁵ Section 89G(1) of TAA

²⁶ TIB Vol 17, No. 3 (April 2005), p43

3.3.3 Action on receipt of a NOR

[42] The recipient of a NOR can:

- (a) Reject NOR in part or full in writing, the issues will progress to the conference stage;
- (b) Accept the NOR in full (end of the dispute process);
- (c) Be deemed to accept the NOR.

[43] If the taxpayer does not reject the NOR within two-month response period, under section 89H(3), the taxpayer is deemed to accept the NOR issued by the Commissioner. The contents of the NOR are to be treated the same as a NOPA. Therefore the taxpayer who is deemed to accept the NOR can not challenge the matters in the future.

[44] It is important to know that if the taxpayer accepts part of a NOR, that they must reject the rest in writing within the response period. The acceptance also has to be in writing.

[45] In summary, if the taxpayer does not agree with the Commissioner's NOR, the taxpayer has to reject the NOR in writing. There is no requirement for the content of the rejection. A letter of rejection should be sufficient.

[46] On the other hand, s 89H(3) does not apply to the Commissioner. In fact, there is no time limit for the Commissioner to either reject the taxpayer's NOR or issue an assessment to reflect the matters proposed in the taxpayer's NOR. However the Commissioner states in SPS-05/03 that the Commissioner will take reasonable efforts to advise taxpayer or taxpayer's agent within one month of the receipt of the NOR whether the NOR is being considered, accepted or rejected in full or part.²⁷

²⁷ TIB Vol 17, No. 3 (April 2005), p43

3.4 Conference

[47] The conference phase is not a legislative requirement under Part IVA of the TAA. In fact, it is an administrative procedure cared by the Commissioner. The Commissioner is not required to include the conference stage in the disputes process.

[48] Inland Revenue states the purpose of the conference is to:²⁸

- (a) Identify and clarify the facts or issues in dispute;
- (b) Facilitate resolution of any disputed facts and issues; and
- (c) State the facts and define the issues in a clear and concise manner for consideration by the Adjudication Unit.

[49] The Commissioner stated²⁹ that the timeframe to initiate a conference usually is within one month after receipt of the taxpayer's NOR. The time suggested for the conference phase is an average of three months depending upon the complexity of the case.

[50] The Commissioner's guideline for the conference is to keep it as flexible as possible. This means that the conference can be just a phone call or a face to face meeting. Any discussion during the conference should be recorded or documented, especially any agreement made during the conference.

3.5 Statement of Position (SOP) & Disclosure Notice

3.5.1 Disclosure Notice

[51] The disclosure notice is the only part of the administrative phase contained in the legislation. This process is designed to allow both disputing parties to put their "cards on the table" by detailing their respective positions in writing. The parties are bound by their disclosure in Court proceedings.

²⁸ TIB Vol 8, No. 3 (Aug 1996), p14

²⁹ TIB Vol 17, No. 3 (April 2005), p43

[52] Under section 89M(1) the Commissioner can issue a disclosure notice at any time of issuing NOPA or any later time. The Commissioner may not issue a disclosure notice if the Commissioner has already issued a notice of disputable decision that was included in the NOPA.³⁰

3.5.2 Content of disclosure notice

[53] Section 89M(3) imposes two requirements on the Commissioner when he issues a disclosure notice. The Commissioner must:

- (a) Provide the disputant with the Commissioner's statement of position (SOP);
- (b) Include in the disclosure notice-
 - i. A reference to section 138G; and
 - ii. A statement as to the effect of the evidence exclusion rule

[54] The effect of s 138G is that only the facts, evidence, issues and laws disclosed in the SOP may be raised in the challenge stage. This means any issues or evidence that did not disclose in the disclosure notice may not be introduced in the Court, hence evidence exclusion rules apply.

[55] The Commissioner may not issue a disclosure notice in respect of a NOPA issued by the taxpayer, if the Commissioner has issued a notice of disputable decision that has taken accounts of the adjustments proposed in the taxpayer's NOPA.³¹

3.5.3 Content of SOP

[56] Section 89M(4) provides the requirements for the content of the Commissioner's SOP. Section 89M(6) contains the requirement for the content of the taxpayer's SOP. In summary, both SOPs require the disputants to:

- (a) Give an outline of the facts on which the disputants intend to rely; and
- (b) Give an outline of the evidence on which the disputants intend to rely; and

³⁰ Section 89M(2) of TAA

³¹ Section 89M(2) of TAA

- (c) Give an outline of the issues that the disputants considers will arise; and
- (d) Specify the propositions of law on which the disputants intend to rely.

[57] The content of a SOP for both the Commissioner and the taxpayer is equivalent to the NOPA. The level of disclosure in a SOP is higher and more detailed due to the “evidence exclusion rule”.

3.5.4 Response period

[58] If the Commissioner issues a disclosure notice to a taxpayer, the taxpayer must respond to the Commissioner’s disclosure notice within two-months of the date of issue of the disclosure notice.³²

[59] If the taxpayer does not issue a disclosure notice within the response period, the taxpayer is deemed to have accepted the Commissioner’s NOPA or SOP, and can not challenge the issues in the Court.³³

[60] Under section 89M(11), a taxpayer may apply to the High Court for extension of time to respond to the Commissioner’s SOP. Such application has to be made before the expiry of the response period and the issues in dispute have not been previously discussed between the parties.

3.5.5 Commissioner may response to the taxpayer’s SOP

[61] The Commissioner has the right to provide additional information in response to the taxpayer’s SOP within the two-month response period.³⁴ Under section 89M(9), the additional information provided by the Commissioner forms part of the Commissioner’s SOP.

[62] Unlike the Commissioner, the taxpayer has no such rights to reply to the additional information. Under section 89M(13), the taxpayer may add additional

³² Section 89M(5) of TAA

³³ Section 89M(7) of TAA

³⁴ Section 89M(8)(a) of TAA

information to the SOP if this is agreed to by both parties. If this is the case, the additional information will also form part of taxpayer's SOP.³⁵

[63] The Commissioner can also apply for extension of the time to respond to the taxpayer's SOP if the application is made before the expiry of the response period and the Commissioner considers it is unreasonable to reply to the taxpayer's SOP within the response period, due to complexity of the issues raised in the SOP.³⁶

3.6 Adjudication Unit

[64] The next phase is Adjudication. Like the conference stage, Adjudication is an administrative process. There is no legislative reference for the Adjudication phase. It is administrated by the Adjudication Unit. The Adjudication Unit is an independent unit in Inland Revenue's National office and is separate from the audit function.

[65] The role of the Adjudication Unit is to take a fresh look at tax disputes in an impartial and independent manner.³⁷

[66] An Inland Revenue officer will prepare a cover sheet and note all documents that need to be sent to the Adjudication Unit, such as³⁸

- NOPA
- NOR
- Taxpayer's rejection of the Commissioner's NOR
- Conference notes
- The Commissioner's SOP
- Taxpayer's SOP
- Any additional information

³⁵ Section 89M(14) of TAA

³⁶ Section 89 M(10) of TAA

³⁷ TIB Vol 17 No.3 (April 2005)

³⁸ TIB Vol 17 No.3 (April 2005)

- Material evidence

[67] Inland Revenue action officer will then attach the cover sheet to the documents with contact details of both parties and send to the taxpayer before the submissions and evidence send to the Adjudication Unit. A letter will be issued to the taxpayer at the same time asking whether they would like any other material to be sent to the Adjudication Unit. Taxpayer will have 10 working days to reply to the letter.³⁹

[68] Details of any agreed adjustment(s) should also be sent to Adjudication Unit, so they can be included in the final decision. Any new information provided after the disclosure notice stage should also be noted.

[69] The Adjudicator will only consider the issues and material submitted by the Commissioner and the taxpayer. However, the Adjudication Unit may consider that additional material is required and will seek further information.

[70] The Adjudicator will not reconsider those issues that have been agreed upon.

3.6.1 Adjudication outcomes

[71] In a situation where the adjudicator considers that all the proposed adjustments are correct, he or she will issue a letter and adjudication report detailing the decision and reasons for the decision.

[72] Inland Revenue action officer will carry out the recommendations of Adjudication Unit and follow up on necessary procedures, such as issuing a notice of assessment to the taxpayer.

³⁹ TIB Vol 17 No.3 (April 2005), para 206

[73] If the dispute was initiated by the Commissioner, the taxpayer is able to challenge the adjudication decision in the TRA or High Court. If the adjustments were initiated by the taxpayer, the Commissioner can not challenge the adjudicator's decision.

[74] In a situation where the adjudicator disagrees with the Commissioner's proposed adjustment, the original assessment stands. The Adjudication Unit will issue a final determination notice. The Commissioner cannot challenge the decision. The dispute will be at an end.

[75] If in a case where the time bar is closed and taxpayer has not agreed to waive it. In this case, the Adjudication Unit will not consider the dispute and the file will be sent back to the initial IRD action officer. The Commissioner will then decide whether or not to re-open the time bar in order to amend the assessment or make re-assessment under other provision of the TAA, so the taxpayer can then challenge the assessment in Court. However, the Commissioner's decision whether or to amend the assessment is not certain in the New Zealand disputes process, because such action is not a legislative requirement. In circumstance, where the Commissioner fails to make such decision, the taxpayer has no conclusion of the disputes process and can not continue the process in Court, because the taxpayer has no assessment to challenge in Court. In practice, taxpayer most likely will want an answer from the Commissioner. Taxpayer is powerless to enforce such action when the Commissioner fails to do so. In the writer's opinion, this is one of the flaws in the disputes process.

[76] In summary, the adjudicator will issue a notice of determination if he or she agrees with part or all of the Commissioner's proposed adjustments. The taxpayer has two months from the date of issue of the notice of assessment, disputable decision or final determination to file challenge proceedings in the TRA or High Court.

3.7 Small claims Jurisdiction of Taxation Review Authority

[77] A taxpayer may elect to have the tax dispute heard in the small claims jurisdiction of the Taxation Review Authority (“TRA”).⁴⁰ Such election can be made where a NOPA or NOR is issued either by the Commissioner or the taxpayer.

[78] The small claims jurisdiction was originally limited to tax disputes of up to \$15,000. Section 98(1) Taxation Act 2004⁴¹ amended s 89 E and replaced \$15,000 with \$30,000. This amendment applies to disputes that are commenced under Part IVA of the TAA on or after 1 April 2005. Given the rising costs, in the author’s view, the threshold can be lifted to a higher standard in order to reduce dispute related costs and achieve more effective resolution.

[79] Any decision made by the TRA under the small claims jurisdiction will be the final decision. The disputing parties can not challenge it in the future. Also the decision of the case can not be used as precedent.

4 Perceived benefits

[80] The current disputes resolution process was based on the recommendations made by the Review Committee in 1993. Before Part IVA was introduced in 1996, the government issued a discussion document.⁴² In that paper, it clearly indicated that the aim was to introduce a legislative disputes process designed to make the dispute resolution procedures faster, fairer and more efficient.⁴³

[81] Inland Revenue’s Corporate plan indicated that the vision of tax administration was to ensure taxpayers respected the tax administration by

⁴⁰ Section 89E of TAA

⁴¹ Taxation (Venture Capital and Miscellaneous Provisions) Act 2004

⁴² Resolving Tax Disputes: Proposed Procedures 1994

⁴³ Ibid, p1

believing it to be fair, helpful and efficient with the legislation being well understood by taxpayer and is presented in the simplest manner possible.⁴⁴

[82] The perceived benefits of the current disputes resolution procedure, in the author's view, can be summarized as follows:

- (a) ***Fairness*** – a high level of disclosure and early disclosure to improve the identification of the matters;
- (b) ***Efficiency*** – a shortened process, as the previous process could take an unacceptably long time;
- (c) ***Effectiveness*** - the introduction of a pre-assessment phase helping both disputing parties focus on relevant facts and issues. There will be no mismatch of facts and issues between the parties.

[83] The introduction of a new legislated dispute process has made some positive improvements. The replacement of the objection procedure with the challenge procedure; the introduction of small claims jurisdiction and pre-assessment phases made the disputes process more efficient and effective. The New Zealand Government also hoped that the introduction of the legislative disputes process would reduce the number of disputed cases.

[84] The Government's perception is that the legislative review of the new disputes resolution process worked very well and the objectives set in 1996 have been met. Is this the right perception? Or are there rooms for further improvement?

[85] As part of the recommendations made by the Review Committee, it was recommended that the process be reviewed two years after the implementation of the legislative process. In July 2003, seven years after the disputes resolution was introduced, the Government issued a discussion document –*Resolving Tax*

⁴⁴ Review Committee report 1994, p 3

Disputes: A Legislative Review, and proposed amendments to the disputes process.

[86] The Government indicated⁴⁵ that the objectives of the current disputes process were to improve the quality and timeliness of Inland Revenue's assessments and to reduce the likelihood for subsequent litigation. The 2003 discussion document declared that the current process appeared, to a significant extent, to be meeting its objectives because disputes from audits and litigation cases were both decreased.⁴⁶

[87] The legislative review was based on theory that the current disputes resolution process was working and that the review was to focus on the miscellaneous issues or certain things only. The scope of the legislative review was narrow.

[88] As the result of the review, a number of amendments were passed in 2004.⁴⁷ The amendments came into effect on 1 April 2005.

[89] The amendments restate the requirements for both the Commissioner's and the disputant's NOPA and NOR, emphasizing that the NOPA or NOR are a "concise statement" with only key facts, issues and laws. Further more, a disputant's NOPA must include copies of "significantly relevant" documents to the issues. The expectation is that the "significantly relevant" documents will assist the Commissioner to resolve disputes at an early stage.

[90] The amendments also requested the Commissioner to complete and consider the disputant's SOP before issuing an amended assessment, except in specified circumstances. The Bill seemed to prevent the Commissioner from

⁴⁵ Media Statement – Tax disputes discussion document released (02 July 2003)

⁴⁶ Resolving Tax Disputes: A Legislative Review(July 2003), Chapter 1, p2, p.a. 1.7,

⁴⁷ Taxation (Venture Capital and Miscellaneous) Act 2004

exercising his discretion shortcut the disputes resolution process, and hence to improve the fairness of the process.

[91] The amendments also restrict the Commissioner's power to issue a re-assessment at the end of disputes process as the Commissioner's power is subject to a four-year statute bar. The Government believed such a restriction on the Commissioner's power will ensure the timely and fairness of the disputes resolution process.

5 What went wrong

[92] So what went wrong and what are the problems with the current disputes resolution process?

5.1 *Unfairness*

[93] One of the big problems with current disputes resolution process, in the writer's view, is the unfairness between the taxpayer and the Commissioner. The current disputes legislation imposes restrictions on taxpayers, such as specified respond period and criteria for an extension of that respond period. On the other hand, same restrictions are not equally applicable to the Commissioner. In addition, the Commissioner as a party to the dispute, has certain powers to verify the validity of taxpayer's disputes document. In some circumstances this 'special power' can strip taxpayer's rights to continue with the disputes process. In the writer's view, the unfairness is one of the reasons why we still have so many judicial review cases in New Zealand even after the new legislative disputes process was introduced and amended.

5.1.1 Legislative flaws

[94] *Firstly*, the legislation is not clear in some areas. For example, it is not clear whether or not the Commissioner can change legal grounds after issues of NOPA. In fact the legislation is silent on this issue. There is no legislative

authority granted to the Commissioner to introduce totally new grounds in the SOP stage. On the other hand, there is no legislation that restricts the Commissioner's right to change legal grounds at SOP stage, and the Commissioner has done so in the past. Under s 89M(8), the Commissioner is allowed to introduce additional information as long as the information falling within the categories of facts, evidence, issues and proposition of laws which is in response to the issues raised in the taxpayer's SOP. In the writer's view, under section 89M(8), the Commissioner is limited to introduce additional information only if there are new issues raised in the taxpayer's SOP. Such section does not and should not give the Commissioner a remedy to get out of the legal grounds stated in NOPA and introduce new grounds.

[95] The reality is that the Commissioner in the past has changed his mind about the legal basis at SOP stage and left the taxpayer with two months to respond. The sad thing is that the Court interpreted the legislation and decided that the Commissioner does have the power to change the legal grounds argued mainly due to the lack of restrictions in the current legislation.

[96] For example, in *Zentrum*,⁴⁸ the Commissioner issued a NOPA against the disputant on the basis of tax avoidance. The disputant issued a NOR rejecting the Commissioner's NOPA. A second NOPA was issued by the Commissioner which was replied to by a second NOR. The Commissioner issued an assessment before the disputant filed its second NOR. No disclosure notice was issued. The assessment was issued on the basis of the general anti-avoidance provision (s BG 1⁴⁹).

[97] The disputant filed a challenge to the assessment in the Taxation Review Authority. The Commissioner defended on the basis of tax avoidance. The TRA held that there was no tax avoidance. The Commissioner appealed to the High Court.

⁴⁸ *CIR v Zentrum Holdings Limited & Anor* (2006) 22 NZTC 19,912

⁴⁹ Income Tax Act 1994

[98] In preparing for the appeal, the Commissioner formed the view that, as well as being a tax avoidance arrangement, the transactions were shams and gave notice that he wished to raise the additional argument of sham on appeal. The disputant brought an interlocutory application for an order limiting the Commissioner to the grounds raised in the TRA. The High Court held that the Commissioner was not allowed to raise the new argument of sham on appeal due to the *Farnsworth*⁵⁰ principle, but granted the appeal because it considered that the *Farnsworth* principle was developed under the old objections process not the legislative disputes process. (Under the *Farnsworth* principle the Commissioner may not rely on a ground of assessment not originally advanced. The Court held that the Commissioner was limited to rely on the grounds on which he based his assessment by the scheme of the legislation governing objections).

[99] In the Court of Appeal, the Court held that the new ground of assessment did not increase the amount assessed and that the time bar in section 108 of the TAA was not applicable and did not prevent the new ground being raised on appeal. The appeal was allowed.

[100] So what about the scheme and purpose of the disputes resolution process? Richardson J in *Challenge*⁵¹ developed an approach known as the “scheme and purpose” approach that is the application of sections should base on an interpretation of all relevant or specific provisions. So the Court consideration has to be consistent with the scheme and purpose of the Act. The conclusion therefore should be based on the underlying policy of the provisions. What happened to the government’s intention of “all cards on the table”, the fairness and early resolution? Should all of these have been taken into consideration by the Court in *Zentrum*?

⁵⁰ *CIR v Farnsworth* [1984] 1 NZLR 428 CA

⁵¹ *CIR v Challenge Corporation Ltd* [1986] 2 NZLR 513

[101] On the other hand, in other judicial review cases, the Commissioner was refused such rights to change the legal basis. Judge Willy in *TRA Case W18*⁵² held:

...I do not accept the Commissioner's submission that s 89M(8) allows the Commissioner to change the legal basis upon which he has made his disputable decision. To take that view, particularly where a disclosure notice has been issued, is to confer on the Commissioner an indulgence which is not available to the taxpayer...

[102] The inconsistent debates and conclusions amongst different Courts have further confused the New Zealand taxpayers. Although under the doctrine of precedent, the Court is obligated to follow the decision from a higher Court. In that sense it seems that the issue has been 'solved' following *Zentrum's* Court of Appeal decision, but the outcome was not inline with the parliament's intention for the legislative dispute resolution process. Furthermore, numerous judicial review cases indicated the issue is not a one-off case, and these are good reasons for the public to seek clarity in the legislations.

[103] If the Commissioner is allowed to introduce new grounds in the SOP it means that the Commissioner is entitled to materially alter the legal basis of his argument after the taxpayer has committed themselves to a response to the Commissioner's argument. This action breaches the purpose of the legislation which is designed to promote the fairness and full disclosure between the parties.

[104] Surely, it is not Parliament's intention to allow the Commissioner to have such indulgences and to be able to change his mind after commencing the disputes resolution process. This contradicts the Government's disputes process objectives of fairness and full disclosure. If Parliament's intention was as clear as it says so, why not amend the legislations to reflect the intention? In the writer's view, if Parliament has no intention to grant the Commissioner such indulgence, the legislation should make it clear in order to avoid any confusion.

⁵² TRA Case W18 (2003) 21 NZTC 11,175

[105] *Secondly*, the legislation does not make the NOPA and NOR binding documents for the disputing parties involved, it lacked certainty for both parties. The problem arising from unbinding clause is that it gives the parties an opportunity to change their mind about key argument during any stage of the disputes process. For example, either party can withdraw a NOPA after it is issued regardless of whether the NOPA is replied to or not. In some cases, the withdrawal happened at the SOP stage, and quite often requiring the other party to re-start the dispute again by withdrawing the first NOPA and issuing a new NOPA. If both parties are committed to its arguments why not make NOPA and NOR binding documents to fulfill the gap? This would allow the judicial review cases, such as *Zentrum* to be avoided.

[106] The Commissioner stated in the latest exposure draft⁵³ that a NOPA or NOR is not conclusive, in other words a NOPA or NOR is not binding. As discussed before, a NOPA is a legal document, and indicates the commencement of the disputes process, in the writer's view, the legislation should make the NOPA and NOR binding legal documents to ensure that the disputes action is not made lightly. Such a clause can also ensure that the disputes action is necessary and reasonable, and is not a result of personality disputes between the taxpayer and IR investigator. If the legislation makes all legal documents binding to the disputes party, it would limit unnecessary dispute cases and both dispute parties would pay more attention to the documents issued by them. Arguably, New Zealand would not then have judicial review case like *Zentrum*.

[107] *Thirdly*, in the writer's view, another legislative flaw is that the current legislations lacks of clarity about who can do what. For example, the legislation is not clear about who has the power to determine the validity of the disputes documents. As I am writing this report, a recent High Court judicial review case agreed with my view. In *Zahirul Alam and Parul Begum v CIR*,⁵⁴ Honour Woodhouse J raised the question as to whether the Commissioner had the power

⁵³ Exposure Draft – Disputes resolution process commenced by the Commissioner of Inland Revenue (ED0099)

⁵⁴ *Zahirul Alam and Parul Begum v CIR* (CIV 2007-470-267), 17 June 2008, HC

to assess the validity of a NOR. Although s 89G set out the requirement of a NOR, it failed to state who in fact had the right to determine the validity of the NOR. There is no provision in the TAA giving the Commissioner the power to determine the validity of a NOR, but the Commissioner always had done so. Same issues also apply to the validity of a NOPA. Furthermore, if the Commissioner cannot determine the validity of the NOR, who can? Why has the Commissioner in the past made such decisions? Are those decisions subject to judicial review?

[108] In the writer's view, it is not fair to the parties of the disputes that the Commissioner has the power to determine the validity of any dispute document under s 89G, because the Commissioner is a party to the dispute. Under any civil disputes, none of the disputing party should be granted additional powers to overcome the other party. This has in fact opened a door to the Commissioner to interpret s 89G in a manner to his advance.⁵⁵

[109] As to this date, it is not clear who has the power to determine the validity of a NOR, and who has the power to reject or accept a NOR. The validity of a NOR is a vital decision during the disputes process. In some cases it will decide whether a disputes case is at the end, or whether the taxpayer has further rights to continue with the dispute. It is an important part of disputes process. Therefore the legislation should be crystal clear about the issue and both disputing parties should not have to guess what to do or seek Court interpretation for further clarity.

[110] In the writer's view, the Commissioner is more likely to appeal the decision in *Alam and Begum* and fight for the power that he has enjoyed in the past. Until further legislation changes, the New Zealand taxpayer is still puzzled about who has what power.

⁵⁵ In *Alam and Begum v CIR*, the Court indicated that s89 G is not to be interpreted in the manner advanced for the Commissioner. Para 28

5.1.2 Lack of a specified timeframe for the Commissioner

[111] The current disputes process lacks specified timeframes for the Commissioner while it has strict time frames for the taxpayer. For example, after the taxpayer's NOR, there is no time limit for the Commissioner to issue a disclosure notice or SOP. The taxpayer has to rely on the Commissioner's guideline for an indication of the expected timeframe for the Commissioner. Further, the Commissioner's guideline on the timeframe is not clear. In SPS 05/03, the Commissioner described the timeframe to issue a SOP is an "administrative practice" and indicated the normal practice is to negotiate a time line with the taxpayer.⁵⁶ So what happens if the Commissioner does not negotiate a timeframe with the taxpayer? In addition the Commissioner is not bound by his own guide line. This means that if the Commissioner does not meet the guide line, there is nothing the taxpayer can do but to "negotiate" with the Commissioner. If the Commissioner does not "negotiate" a timeframe with the taxpayer for any reasons, the taxpayer has no other options but to wait for the Commissioner's action.

[112] On the other hand, once the Commissioner issues a disclosure notice and SOP, the taxpayer only has two months to respond and issue a SOP. Otherwise they will be deemed to have accepted the Commissioner's SOP. In the writer's view, it is difficult to figure out the Parliament's intention on this timeframe issue, as the law is unbalanced with no good reason for such unbalanced legislation.

[113] The effect of this issue can constrain the taxpayer's right to take the dispute case to Adjudication Unit, the time bar constrain is an example of this. It is also a waiting game where the taxpayer cannot do anything until the Commissioner issues a SOP. Furthermore, as soon as the Commissioner issues a SOP, it is expected that the taxpayer has to respond straight away. Is this fair?

⁵⁶ TIB Vol 17, No. 3 (April 2005), SPS 05/03, para 178

[114] The unfairness, in the writer's view, is that one of the disputes parties (the Commissioner) is in control of the process. How often do we see this kind of situation in a civil disputes case? If the disputants go to the Court for a decision, who decides when to produce the documents and what to produce? The Court. Have we ever seen one of the disputes parties decide when to submit evidence? So why is the tax disputes procedure so different from any other disputes process? Furthermore, if one of the disputes parties requires six months to prepare a legal document, common sense dictates that we would expect the other disputing party to require the same length of the time to respond. Why in the tax disputes system, the Commissioner can take as long as he wants to prepare the SOP, while the taxpayer only has two months to respond? Is this fair?

[115] *Secondly*, in the current disputes process if a taxpayer requires an extension to respond to the Commissioner's SOP, the taxpayer can apply to the High Court for an extension only if the issues raised in the Commissioner's SOP were not previously discussed by the parties. In the contra, the Commissioner can apply to the High Court for extension if he or she thinks the case is complicated and requires more time to complete the SOP. There is no need for the Commissioner to meet the additional issues requirement. Sadly, the taxpayer does not have the same right, regardless of the complexity of the case.

[116] The taxpayer and the Commissioner deal with same case. If the Commissioner considers the complexity of the case is an issue, the same would apply to the taxpayer. If the taxpayer is capable of replying the Commissioner's SOP within a two-month period, the Commissioner should also be capable. Arguably the Commissioner has more resources than the taxpayer, so why the Commissioner have such an advantage over the taxpayer? Is this fair?

[117] *Thirdly*, the timeframe for the Adjudication review phase is not clear. The timeframe for the Commissioner to forward the case to the Adjudication Unit is not clear. There is no timeframe restriction on the Commissioner to complete

such action. Taxpayer is advised by experienced tax practitioner to ask the Commissioner for a timeframe. Even the Commissioner gives a timeframe; it is not guaranteed that the Adjudication review phase will be completed within that timeframe. Again the taxpayer has no remedy to progress further but to passively wait. Fair process? The Adjudication review is also very important to the taxpayer because this is the only independent review before the Court, in the writer's view, the Commissioner should be forced to complete the Adjudication review before litigation proceedings.

[118] When the case is forwarded to the Adjudication Unit for a decision, the timeframe for the adjudicator to determine the outcome of a case is not clear. Again, the reason is that this is not a legislative requirement. The Commissioner stated in the TIB,⁵⁷ in 1996 that the Adjudication Unit would attempt to determine a case within four to six weeks in a normal case. In 2002, the Commissioner indicated⁵⁸ that a taxpayer should expect the outcome from Adjudication Unit in about five months for a simple case (with a simple case not being defied). There was no further specification from the Commissioner. Another waiting game.

5.1.3 The Commissioner can introduce additional information

[119] Under s 89M(8), the Commissioner can introduce additional information within two months of the date of issue of the taxpayer's SOP. Such rights do not apply to the taxpayer. The additional information introduced by the Commissioner is also deemed to form part of the Commissioner's SOP. However, the taxpayer can only introduce additional information if the Commissioner agrees.

[120] Arguably the Commissioner has an advantage over the taxpayer to introduce additional information to form part of his argument. In the writer's view, this is another example of that the current legislation being unbalanced between the disputing parties. Why is the Commissioner allowed such an

⁵⁷ TIB Vol 8, No. 3 (August 1996), p20

⁵⁸ TIB Vol 4, No. 2 (February 2002), p10

indulgence? To me, the weight between the tax disputes parties is not balanced. In fact, it seems the weight is always on the Commissioner's side.

5.2 *Strategy, Time and Costs*

5.2.1 *Slow process*

[121] The current disputes process is very slow, and is incurred by the steps that both disputants are required to follow. Inland Revenue indicated in SPS INV-170 in 2002 that a simple disputes case takes approximately 16 months to go through all phases before the litigation stage.⁵⁹ However, the replacement of INV-170, SPS-05/03 and SPS-05/04, has no indication of the length of the pre-litigation process. The Commissioner in SPS 05/03 instead indicated a timeframe for each step of disputes process, which is hard to compare with the previous timeframe for the overall process due to lack of a specified timeframe between the steps. People who have experiences with tax disputes can tell you how slow the process was and still is.

[122] Often the disputes process follows an Inland Revenue tax audit. The length of an audit also varies depending upon the nature of the case. A taxpayer who is in the disputes stage would have spent a great length of time dealing with the audit. If you count from the date the tax audit starts to end of the tax disputes, the overall process is extremely long.

[123] There is no statistical research available to indicate whether or not the current process is significantly quicker than the previous process. The overall impression of the current disputes process is that it is still too long and slow; of course this is the taxpayer and tax agent's view. This impression mainly contributes to the Commissioner's discretionary power to issue SOP or response to the taxpayer's NOR without specified response period. The taxpayer has no other remedy but to wait for the Commissioner's action, which in most of cases is

⁵⁹ TIB Vol 14 No. 2 (February 2002), Standard Practice Statement SPS INV-170: *Timeliness in Resolving Tax Disputes*, p10

hard to predict. It all depends on the individual investigator's approach and the process of different branches.

[124] More complex cases can take years to complete or remain unresolved for years. Quite often this kind of case does not complete pre-litigation disputes process within the four-year time bar period.

[125] In the writer's view, the slow process of current disputes resolution is due to three main reasons. *Firstly*, the number of steps required to complete the pre-litigation disputes process is too long. Too many steps are involved. Most of these steps are a legislative requirement. Both parties can not move forward without completing the full process. More steps equal more costs, with the majority of taxpayer relying on professional help to comply with each step. The number of steps significantly contributes to the high costs and the slow process, which is the major problem with current disputes system. *Secondly*, there is lack of a specified response period for the Commissioner to continue the disputes process to the next stage. As discussed before, for example, there is no response period for the Commissioner to issue a notice of disclosure and SOP. A lack of timeframe for the Commissioner leaves the taxpayer powerless to move the disputes process forward, unless the Commissioner is willing to speed up the process. *Thirdly*, there is a lack of guidelines for the administration phases. For example, there is no timeframe set for the Commissioner to call for a conference and there is no time limit for the Commissioner to complete the conference stage; and there is no requirement for the Commissioner to forward the disputes case to the Adjudication Unit. It is not clear whether or not the Commissioner will forward the case to the adjudication stage. It is not clear how long this will take the Commissioner and how long the taxpayer has to wait.

[126] The problem here is the speed of the disputes process is half defined by the legislation and half controlled by the Commissioner. Compare this with New Zealand Court proceedings, where the Court controls the speed.

[127] The timeframe problem is not a new issue. This has been identified by a number of practitioners since 1996. An official report in 2004⁶⁰ also indicated the problem. However the submission for the change during the course of legislative review process was rejected by the Government.

5.2.2 Administration procedure

[128] *Firstly*, the conference phase is not a legislative required step. In other words, it is not a compulsory step to follow. In the writer's view, the conference phase is no more than a formal meeting; there is nothing special about the conference. As what requires for all disputes situation, meetings are required to be well documented. There is no special requirement for the conference. If the disputes parties really want to put "all cards on the table", they don't have to wait for the conference stage to do so. Communication can happen at any stage of the disputes process, preferably at early stage of the dispute to help with an early resolution of the disputes.

[129] Because there is no legislative requirement surrounding the conference, the Commissioner again manages the conference under the administration procedure. The Commissioner therefore can do things his way. Furthermore, the Commissioner is not required under the law to either initiate or complete this step. So what is the point to have conference phase in the process? Formal or informal meetings can happen at any stage of the process, and should be able to be initiated by either party.

[130] In practice, most taxpayers and tax practitioners find that the conference is not much help, and often delays the process. If the conference is not part of requirement in the process, once the disputing party receives a NOR, he or she

⁶⁰ Inland Revenue and Treasury, Taxation (Annual Rate, Venture Capital and Miscellaneous Provisions) Bill, (Wellington August 2004). Official's Report to the Finance and Expenditure Committee on Submissions on the Bill, Disputes Resolution, Issue: Lack of Time-Frames on the Commissioner

can then decide whether or not to continue with the dispute instead of waiting for the conference to happen then move to the next step.

[131] In the writer's view, to have a step that is not compulsory does not achieve anything and adds no value to the process. If the conference is not important enough to become a legislated compulsory step, it should be taken away from the disputes process, and the parties should be left to have meetings when they want and wherever they want.

[132] The second administration procedure that should be abolished is Adjudication review phase. Like the conference phase, the Adjudication review phase is an administrative procedure of the disputes process. There is no legislative reference for this stage. Again the step is managed by the Commissioner.

[133] The problem with Adjudication Unit is that it is still part of Inland Revenue. Although it appears impartial and independent from the IR audit unit, it is still managed by IR. How impartial and independent is this when a 'disputant' is also the 'referee'?

[134] Master Thomson in *Tagasoft*⁶¹ also recognized this weakness in the disputes process. His Honour observed:

...[it] was that the adjudication process created under Part IV of the Tax Administration Act appears to suffer from a procedural weakness, because the adjudicator appointed is an employee of the [Commissioner]. He is for that reason not seen as a completely independent adjudicator.

[135] The second problem with the Adjudication review is that because there is no legislative reference for this step, it is not clear whether or when the Commissioner will take the case to the Adjudication Unit. In the past the Commissioner adopted the strategy not taking cases to the Adjudication Unit.

⁶¹ *Tagasoft v CIR* (2000) 19 NZTC 15,869 (HC)

Therefore there is a high possibility that the taxpayer can be precluded from this phase and constrained from further challenge due to the expiring of the response period. For example, after the taxpayer rejects the Commissioner's NOR, there is no requirement for the Commissioner to take the case to Adjudication Unit. While the taxpayer assumes the Commissioner is doing so, they wait and in the meantime, the two-month response period expires, and taxpayer finds out the Commissioner did not forward the case. This will be at the taxpayer's expenses. This is another example of the Commissioner being in control of the process.

[136] In the writer's view, the Adjudication review phase was a positive outcome of the development of the current disputes process. But the experience and history shows that this step is not good enough to accelerate the disputes process, the step is not far enough to reduce unnecessary waiting times and to simplify the process. Six months waiting time is too long. The taxpayer is more likely to face time bar issues during the waiting period, not to mention the cost involved. In the writer's view, the Adjudication review step is an important part of the dispute process. Taxpayers generally want to wait for the only independent review before going to Court proceedings. Unfortunately, the policy to complete the process is not clear and enforceable. Therefore it has lost the purpose of being a step in the disputes process.

5.2.3 The cost of a dispute

[137] There has been some confusion or misunderstanding amount taxpayers that the bulk of the costs of tax dispute only stems from the SOP stage. This impression came from SPS 05/03, in which the Commissioner indicated that a NOPA or NOR only requires a concise statement of issues. Therefore the nature of the NOPA or NOR is to provide background information for the discussion and that the bulk of the work should be done at the SOP stage due to the evidence exclusion rule. Instead, a taxpayer who disputes with the Commissioner finds that by end of the NOR (assuming the Commissioner initiated the dispute), they are exhausted by responding to the Commissioner's NOPA because of the length and

detail contained in the Commissioner's NOPA. Most taxpayers find that the costs associated with the response to a NOPA are high, simply because in order to reject the Commissioner's NOPA the disputant has to reject every single issue raised by the Commissioner's NOPA otherwise the disputant is deemed to accept the Commissioner's position in the NOPA.

[138] Further the Commissioner also has the power to determine whether the NOPA is valid or not, and the Commissioner has done so in the past. Not only does the Commissioner expects the taxpayer's NOR to be lengthy and as detailed as his NOPA, but also does the Commissioner have the right to decide the validity of the NOR. Again a "player" is also a "referee". Most taxpayers find that by the NOR stage, they had already incurred significant legal and professional costs. In the writer's view, the amount of information and costs involved at the NOPA and NOR stages are too high and this is contradicts the disputes process of being a timely way to resolve the dispute.

[139] The recent case *Alam and Begum v CIR*⁶² is an indication of that how the Court expects the Commissioner to determine a NOR. The Court clearly indicated that s 89G is not to be interpreted in the manner advanced for by the Commissioner.⁶³ Not that the writer is an advocator of a short NOR as the one in this case, but the writer certainly welcomes such recognition by the Courts in promoting a timely and efficient disputes process. Length does not equal quality. The Commissioner's narrow reading and interpretation of the legislation does not truly promote an effective and efficient disputes process. In the writer's view, Parliament's intention for the disputes resolution process was never to let the Commissioner interpret the law to his advantage. Hopefully cases like *Alam and Begum* will help the New Zealand disputes resolution process move forward and ensure that all disputes process are in line with its original intention.

⁶² *Alam and Begum v CIR* HC TAU CIV 2007, 470

⁶³ *Ibid*, Para 28.

[140] Everybody knows how costly the litigation process can be. The same applies to the tax disputes process, as it requires professional services to complete certain phases. Generally, the taxpayer requires quite bit of spare cash to deal with the dispute. In addition, how many people ever think about the emotional costs of a tax disputes? Although it is hard to put down a tangible dollar amount for the emotions involved, people who have had the misfortune to deal with a tax dispute will have better feeling about the impact on the individuals, the family and the business. What about the opportunity cost? The time and effort involved in a tax dispute could be used to grow the business. What about the Commissioner's action to bring a test case? The taxpayer still has to bear the cost for such a decision. The Commissioner's measurement of compliance costs does not include these costs. Arguably the real cost for the taxpayer in dealing with a tax dispute are a lot higher than what a dollar amount can measure. Possibly it can never be measured by a dollar amount.

5.2.4 UOMI charges

[141] In the IR's report, the Commissioner considered that the current disputes resolution process worked well. One of the reasons disclosed by the Commissioner was that the number of disputes cases has been reduced.⁶⁴ The writer has not made same conclusion from the observation of the process. Without statistical research, which in the writer's view is impossible to conduct (because under the secrecy provision a taxpayer's details cannot be disclosed unless the disputant goes to the High Court or higher Court), the true reasons for the reduced number of disputes cases is unknown. No doubt the introduction of the current disputes resolution process has had some positive outcomes, but there is a high possibility that the taxpayer's decision not to continue with the disputes process is due to the costs and the length of process. Not every taxpayer has deep pocket to fight for their principles.

⁶⁴ Resolving Tax Disputes: *A Legislative Review* (July 2003), Chapter 1, p2, Para. 1.7,

[142] Regardless of the outcome of a disputes case, the monetary pressure on the taxpayer is huge. For example, the use of money interest (UOMI) charged by IR is calculated on a daily basis at a near market rate. In some cases, the UOMI charged can be greater than the tax liability in dispute if a case takes few years to complete. Therefore it is more logical for the taxpayer to cut the loss, discontinue with the dispute and move on. This is not taking into account the imposition of tax shortfall penalties and late payment penalties. Arguably the tax disputes process costs the taxpayer daily.

[143] On the other hand, when the Commissioner pays the taxpayer for the interest compensation and the rate is lower than what he charges to the taxpayer. This is, below the market rate and therefore a loss of interest to the taxpayer. The money could have been better invested elsewhere. Therefore the taxpayer is in a loose-loose position. The writer is not surprised that one of the main reasons for taxpayer not continuing or going through the process is due to the financial pressure, given the majority business in New Zealand are small to medium sized business.

5.3 *Follow the policy or follow the spirit of the policy*

5.3.1 *Mandatory v Emendatory*

[144] Discussed early was that some of the disputes process steps are not mandatory under the legislation, such as the conference and Adjudication review, as there is no legislative reference. Therefore there is no consequence or penalty if the party (more likely the Commissioner) fails to complete the process.

[145] This is not a myth. In fact the Commissioner in the past has failed to complete emendatory part of the procedure. In *PLM Software*⁶⁵, the Commissioner only completed the mandatory step by issuing a NOPA. The taxpayer rejected the Commissioner's NOPA with a NOR. There were no further steps completed by the Commissioner before he issued a notice of assessment. In

⁶⁵ *PLM Software Ltd v CIR* (2001) 20 NZTC 17,336 (HC)

other cases, the Commissioner has issued a NOPA one day and issued an assessment the next day. Although the new amendments limit the Commissioner's power to issue assessment before completing the disputes process, the amendments do not fully close the gaps in current disputes process.

[146] The Commissioner agreed that the procedures were only followed to the extent of the mandatory steps, but unfortunately this does not make the assessment invalid.⁶⁶ Heron J in *PLM Software* held that

‘...it is far from clear that failure to follow the Part IVA procedures to the letter is fatal to the Commissioner's assessment.’

[147] There is no guarantee that the Commissioner will complete all administrative procedures. Therefore some practitioners recommended that the taxpayer seeks written confirmation from the Commissioner that a certain procedure will be completed by the Commissioner within a set timeframe.

[148] In the past the Commissioner has adopted a strategy to bypass the administrative process. This has meant that the Commissioner has issued assessments without “completing” the administrative procedure and forwarding the case to the Adjudication Unit.

[149] Under the current tax disputes process, the taxpayer is not certain if and when the Commissioner will complete the administration procedure.

[150] Yes, the Commissioner's action of amending assessments can be subject to a judicial review and there is a possibility the Court may invalidate the assessment if it is found that the Commissioner abused his power. But how many taxpayers can afford the time and costs of another Court case while the first disputes case remains unresolved?

⁶⁶ Under s 114 of TAA

[151] Furthermore, a judicial review is not available to everybody. Case law indicates that the taxpayer first has to prove that the Commissioner has abused his power. Secondly, the taxpayer has to prove that he or she suffered from the Commissioner's unfair action. The standard is so high that it is not recommended as a place for complaint. Baragwanath J stated in *Duncan v CIR*⁶⁷ that the taxpayer 'has to establish the real prospect of loss resulting from abuse of power which is required to secure judicial review...' In the writer's view, the Commissioner has to act in an 'unusual way' and in an 'exceptional circumstances' before the taxpayer can take the case to the Court. So why there are so many judicial review cases since the new legislative disputes process came into force? The growing number of judicial review cases may indicate people are still not happy with the process and that there are flaws in the current process and certainly there is room for improvement.

[152] By the end of the day, the Commissioner can exercise his discretion power to amend the assessment to 'ensure' the correctness of the assessment under s 113 of the TAA, so a win-win situation for the Commissioner.

[153] Furthermore, it seems waste of time and costly for both parties to prepare a SOP and go through the process without completing the last step; can make it worse, there are no consequences for the Commissioner not to complete the administration phase. The argument being that both parties can still take the case to the Court within the response period if they wish to do so.

[154] Under the current legislation, the Commissioner is only required to complete the legislative phase. Therefore in theory, the Commissioner does nothing wrong by not completing the administration procedures. But, does the Commissioner's strategy to only complete the mandatory procedures meet the purpose requirement under s 89A? Does the Commissioner's strategy have a likelihood of reducing disputes?

⁶⁷ *Duncan v CIR* (2004) 21 NZTC 18,735 para 113

[155] The purpose provision under s 89A indicates that the Parliament's intention towards the disputes resolution process is that the interpretation of the legislation should be read in line with the purpose provision. Surely it is not the Parliament's intention to enable the Commissioner to "cherry-pick" parts of the procedure. In the writer's opinion, the answer is a 'no' for all. Therefore can the Government claim that the new disputes resolution process has met the disputes objectives and dealt with disputes fairly?

5.3.2 "Cards" on the table or under the table

[156] As this report is being written, the Commissioner has just issued two new standard practice statements (SPS 08/01) *Disputes resolution process commenced by the Commissioner of Inland Revenue* and (SPS 08/02) *Disputes resolution process commenced by the taxpayer*.⁶⁸ Both statements apply to disputes commenced on or after 10 June 2008.

[157] The Commissioner states in SPS 08/01 that the disputes resolution process is designed to encourage an "all cards on the table" approach with resolution of issues without the need for litigation.⁶⁹ Has the Commissioner adopted such approach in the past since the legislative process was introduced in 1996?

[158] In *CIR v Fuji Xerox*,⁷⁰ the Commissioner has sent all correspondence to the taxpayer's agent, KPMG, in relation to the audit (including both income tax and GST). There was a considerable amount of correspondence between Inland Revenue and KPMG. A final audit letter was addressed to KPMG indicating that Notices of Assessment would be issued in due course but without saying whom the notices would be issued and when they would be issued. However, KPMG was not the nominated tax agent for GST purposes in the IR system. Therefore the GST assessment was sent to the taxpayer's address. There was no copy sent to the KPMG. At no time or any reason did the chief accountant at *Fuji Xerox*

⁶⁸ TIB Vol.20, No. 6 (July 2008)

⁶⁹ Para 8, page 2.

⁷⁰ *CIR v Fuji Xerox New Zealand Ltd* (2002) 20 NZTC 17,470

would expect the correspondence in relation to the audit to be sent to him. As a result there was no discussion between him and KPMG.

[159] However, when the tax agent concerned about not receiving the assessment, a personal from KPMG contacted IRD and queried. The answer was that the assessment should have been issued but no details were provided as to when and where the assessment was sent. By the time the tax agent finally discovered the assessment, the response period was expired.

[160] This paper will not discuss whether *Fuji Xerox* has met the test of exceptional circumstance for filing a late challenge, as the Court has detailed analysis and discussion on that point. Rather the paper is more interested to discuss whether the Commissioner's action met the "all cards on table" approach. If the Commissioner had been communicating with taxpayer's agent throughout the audit. All correspondence was sent to the tax agent (except the first letter which a copy was sent to the taxpayer). Why was the notice of the assessment sent to the taxpayer without notifying the tax agent? Furthermore, why was the final audit letter which indicated the Commissioner would be issuing a re-assessment sent to the tax agent; while in fact the real assessment was sent to the taxpayer, who arguably has no idea that the Commissioner would issuing such an assessment? It is clear, that the chief accountant in *Fuji Xerox* was not familiar with the tax dispute rules, and obviously he was not aware the consequences of ignoring the statement. Despite this the taxpayer paid full amount of the tax liability.

[161] Did the Commissioner do any thing wrong in *Fuji Xerox*? On the face it, no. There is nothing wrong with the Commissioner sending a 'notice' to the tax agent for information and issuing the assessment to the taxpayer without notification or sending a copy to the tax agent. Regardless of which way you look at, the Commissioner certainly 'communicated' well with either the KPMG or taxpayer. The writer can't comment on the Commissioner's internal processes or

policy. Is it reasonable for the Commissioner to act in such a way? The writer agrees with O'Regan J's comment in the High Court, where he held that the Commissioner's action to send a notice to the tax agent and then sending an assessment to the taxpayer was out of the ordinary action. Such comment was later rejected by Court of Appeal. In the writer's view, an ordinary person in this situation will also send a copy of the notice of assessment to the tax agent as he did throughout the investigations. There was no reason not to send the last piece of correspondence to the tax agent which was arguably the most important correspondence in the challenge action. In the writer's view, IR would know the importance of the assessment and the time limit to dispute the assessment. For IR to send every single piece of correspondence to the tax agent but the last and most important one is not an acceptable action. If this was not an intentional action of the Commissioner, why did the Commissioner not accept the late NOR?

[162] This approach was not that I would call it "all cards on table" approach. It seems that the strategy adopted by the Commissioner in this case was to pick the cards that he wanted to put on the table, and the table that he wanted it to be on. The issue here is that the Commissioner had more than one card in his hand. The strategy was to show the card only if he thought it would work for him. In an event like *Fuji Xerox*, where there is more than one table to play with, the Commissioner can also choose which table to put cards on.

[163] Was *Fuji Xerox* a one-off event? Five years after the *Fuji Xerox* case, did the Commissioner improve his "cards on the table" approach? The recent case of *Amaltal Fishing Co Ltd v CIR*⁷¹ indicated nothing had been changed. In that case the taxpayer's solicitor was dealing with IRD in relation to the tax dispute. The in-house accountant received all copies of the correspondence between IR and its solicitor. A letter dated 20 April 2006 was sent to the taxpayer's solicitor advising that a notice of assessment would be issued shortly and also notified that the assessments would be sent directly to the taxpayer.

⁷¹ *Amaltal Fishing Co Ltd v CIR* (2007) 23 NZTC 21,639

[164] A copy of the letter was sent to the in-house accountant and the external accountant. The assessment was issued to the taxpayer and the in-house accountant was not aware of that until the external accountant contacted the in-house accountant. This was due to an IR investigator telephoning the external accountant in relation to the assessment. Again the in-house accountant neglected to act until the response period had expired.

[165] It is unbelievable that the facts and circumstances in these two cases are similar and the Commissioner won both cases. These cases are great examples of showing how hard it is to prove that exceptional circumstances exist under the current legislation. In the writer's opinion, the taxpayers in both cases failed to file challenge proceedings within the response period due to the in-house accountants lacking the knowledge and experiences in the tax disputes process. Understandably, as they are not trained to deal with such events, both taxpayers had taken reasonable steps to employ professionals to deal with their dispute. The strategy adopted by the Commissioner in sending notification to the taxpayer was arguably only in the hope that the taxpayer would not respond within the required response period due to their lack of knowledge. Therefore the Commissioner could win the battle without further challenge, which happened in both cases.

[166] It was not a fair game, and certainly was not a one-off event.

5.3.3 Compliance model

[167] The Commissioner of Inland Revenue introduced the "Compliance Model"⁷² to the New Zealand tax system in 2004. The model was developed by the Australia Tax Office ("ATO") and adopted by New Zealand Inland Revenue Department. The compliance Model is in the form of pyramid and divides taxpayers into four categories according to their tax compliance behaviour.

⁷² Inland Revenue Annual Report 2004

[168] According to the compliance model, the majority taxpayers are “willing to do the right thing” category which sets them at the bottom of the triangle. The Commissioner indicated in the annual report that the majority of taxpayers willingly meet their obligations and Inland Revenue try to make it as easy as possible for them to do so.⁷³ The Commissioner can use the model to ‘tailor’ services, hence only use his power on those people who are at the top of triangle and choose not to comply with the law.

[169] In writer’s view, the compliance model should also be used as a measurement of all tax policies. For example, the disputes resolution procedure should be designed to distinguish taxpayers from the different categories. Further, the disputes process should encourage taxpayers at the top of the pyramid to move forward, and more importantly, move toward the bottom of the triangle. The current disputes process does not have the flexibility to reflect the compliance model; the policy does not meet the ‘needs’ of the New Zealand taxpayer. It seems that the current policy is a one-fits-all sizes process.

[170] It is not clear whether the Commissioner treats all disputants, including genuine tax disputants as ‘none compliant’ or whether there is policy to distinguish them taxpayers who do comply but have an honest disagreement with the Commissioner.

[171] It is common knowledge, that the perception of the reasonableness of the Commissioner when conducting tax disputes will affect the taxpayer’s future compliance attitudes towards voluntary compliance.

[172] It seems that the Commissioner forgets that the tax law and legal issues are complicated and in some cases there is no clear cut answer on the issue. There is no easy answer to it, the legislation is not always that clear and does not cover every single circumstance happens in the real world. The interpretation of

⁷³ Inland Revenue Annual Report 2006, p26

legislation can vary widely between the Commissioner and the taxpayer. This is why we have a Court system to make decisions when it comes to disputes.

[173] In the writer's view, the introduction of the compliance model was a positive movement by the Commissioner. It has helped the taxpayer understand the importance of the compliance model, and where they are setting amount others. But sadly, the current disputes process does nothing to compliment the compliance model. Experience shows that the Commissioner treats all tax disputants as non compliant. Most disputants consider that they themselves are willing to do the right things, but genuinely disagree with the Commissioner, only to find out that they are portrayed as non-compliant.

[174] To be able to implement the compliance model, the current disputes resolution process should set up options for those taxpayers who are willing to comply and help them better understand the disputes issues and take to options to help settle the dispute at an early stage. Such options will increase future compliance. Such options should also be a 'give-and-take' approach. Both parties will have to meet in the middle and share costs in order to reach an early settlement. Recommend remedies, such as an early settlement policy and cost contribution policy, will be discussed later in this paper.

5.4 *Communications*

[175] We all know that communications are a vital part of disputes process. The disputing parties should communicate throughout the entire process, as often as they can and as clear as they can. It is vital that the both disputants are fully understood the issues and tax positions in dispute. The paper has discussed the lack of communication and the miscommunication between the Commissioner and the disputers. Furthermore, in other cases taxpayers are not happy that the Commissioner has kept silent about problems and issues found about their tax agent during the disputes process.

[176] Like any other profession, tax agent or advisor can be controversial. In some cases, which are not uncommon, tax agents or advisors are not competent to deal with the disputes process. In other cases the tax agent may take a tax position due to their self interest. Most taxpayers are not trained or sophisticated enough to know what their tax agent is really doing, because they rely on the tax agent's knowledge and experience. If the Commissioner is aware of such a situation, in the writer's view, the Commissioner is obligated to communicate with the taxpayer to ensure that they are aware of all prevailing circumstances. Experience shows that such messages are not communicated to the taxpayer.

[177] Knowing that the tax agent has made a mistake or has a conflict of interest and is not communicating with the taxpayer is not a way to promote an effective disputes process. If the Commissioner pin points the mistake or incorrect tax position made by the tax agent as early as possible, logically the taxpayer will take reasonable steps to accept the mistake and move on, rather than drag on until at the end of process only to find that there is no way out. When the taxpayers wish to continue with the disputes process, they genuinely believe that they are right in some way and there is option for them to turn things around. Reasonable person will not waste money to fight for their own mistake knowingly that there is no way out.

[178] The issue here is not just communication, but full communication, and also the best way to communicate. In a disputes situation, both parties should focus on full communication not selective communications to a certain party.

6 How can we fix it

6.1 *Procedural changes*

6.1.1 Simplifying the procedure

[179] We all know that the litigation process is long, slow and costly. When the Government introduced the legislative disputes process in 1996, one of its purposes was to make the disputes process faster, and more efficient avoiding the

costly litigation procedure. Over a decade of experience shows that the current disputes process is as slow as litigation, not to mention the cost.

[180] Clearly there is a need to change current disputes process. One solution is to simplify the process and reduce the number of steps in the pre-litigation process. Recommend changes are as follows.

[181] Firstly, *Abolish the administration phases* – conference, adjudication review. The administration phases of current disputes process have numerous problems; they lack regulation, guidelines and a timeframe to complete the process. It seems these steps are part of the process but are only used to advance the Commissioner's position. Taxpayers feel powerless to challenge such actions. If a step is not important for the Government to introduce the legislation, in the author's view, it is not worth to put in the process for the parties to follow. The administration phases are pointless, because if one of the disputes party fails to complete, then there are no consequences for missing the step. The lack of regulation has left gaps for disputing parties to use them to their own advantage. These phases do not achieve a fair and effective outcome in the disputes resolutions process.

[182] In practice, the conference achieves very little during the disputes process. The conference, in the writer's view is no more than a formal meeting; its purpose is no more than facilitation of the communication between the parties. If both parties said everything they want to say during the NOPA and NOR period, what is the purpose to have the conference just for the sake of having one? Without the conference phase, the process will be shorter and more efficient. Without the conference phase, there will be no more waiting games to play.

[183] The Adjudication Unit has done a great job and 'acting' independently from the Audit Unit. Because the Adjudication Unit is still under the management of Inland Revenue, it can not be truly impartial during the process.

Other issues such as a lack of the timeframe to reach its decision also delay the disputes process. This lack of guideline on a timeframe leaves the taxpayer with endless waiting and contributes to the long process. As with the conference phase, there is no guarantee that the Commissioner will forward the case to the Adjudication Unit for review. The problem being the lack of regulation.

[184] In some cases, the Adjudication Unit can not solve the problems, for example, there are issues that can only be solved in Court. Under the current process, regardless of the issues or complexity of the case, it has to go to the Adjudication for review. As a result, the Adjudication Unit does not service the purpose of resolving the dispute. This is the opposite of the early resolution objective.

[185] The alternative to the Adjudication Unit, in the writer's view, will be the use of a third party mediator, where an independent opinion can be obtained to fast track the dispute. Details will be discussed later.

[186] Secondly, *Abandonment of the disclosure stage*. The disclosure stage and the issue of the SOP, in the writer's view, is a repeat of the NOPA and NOR. The exchange of SOPs is unnecessary repetition which adds no value to the process but to make the whole process painfully long and costly. If the disputes parties have made clear statements in their NOPA and NOR, what is the value in issuing a statement of position repeating something that other party already knew about it? If the disputing parties can not reach agreement after the issuing of the NOPA and NOR, along with numerous meetings, what is the chance of settling the dispute after the issuing of the SOP? Therefore the exchange of SOPs isn't going to achieve anything except to make the process longer and costly.

[187] The current requirements for the SOP are too detailed and long, the taxpayer has a huge financial burden from preparing the SOP. The initial intention of the current disputes process was to avoid costly litigation. Why then

does current process of pre-litigation require the same details as litigation? If both parties decide to go for litigation, there are opportunities for the parties to issue statements. Why have these requirements in pre-litigation stage? Isn't this requirement a gone too far?

[188] The writer can't see the value to have a disclosure process. History shows that the Commissioner is not obligated to issue a disclosure notice.⁷⁴ Some people may argue that the issue of a disclosure notice is subject to the evidence exclusion rule, thereby limiting the Commissioner's arguments to the issues raised in the SOP. But history showed this is not a case. In *Zentrum*, the Commissioner issued a SOP but not the disclosure notice, and the Court decided that the evidence exclusion rule did not apply; hence the Commissioner was allowed to change the legal basis of his argument. What a time waste of time for the taxpayer in that case!

[189] To have a step in the disputes process but a lack of rules to police the process is no more than time wasting.

[190] The evidence exclusion rule should also be abandoned as the disclosure notice is no longer required. Instead, the exclusion rule should apply to NOPA and NOR, to make both NOPA and NOR a binding documents. Therefore, both of the disputing parties should restrict their arguments within the issues and laws stated in their NOPA and NOR. This will prevent the parties from 'changing' mind between the disputes process and the challenge proceeding.

[191] Abandoning the SOP can also solve the problem of a lack of specified timeframe for the Commissioner to complete the SOP. Without the SOP, both parties can focus on whether to seek early resolution of the dispute or whether to go straight to litigation.

⁷⁴ *CIR v Zentrum Holdings Limited & Anor* (2006) 22 NZTC 19,912

6.1.2 Simplifying the content

[192] No doubt the NOPA and NOR stages play an important role in the current disputes process and should be retained. The NOPA and NOR allow the disputing parties to understand the arguments and issues they are disputing. Although the legislative review of the current disputes process has made some changes to the content of the NOPA and NOR. The reality is that it is still too long and too complicated for most taxpayers and their tax agents to complete. In the writer's view, the NOPA and NOR should be no more than an exchange of information about what is in dispute and the reasons for the different arguments along with supporting documents. With the current requirement for supporting documents, the NOPA and NOR should be straight forward and in a prescribed form.

[193] The current legislative requirement of the contents for NOPA and NOR is too long and too complicated. In the writer's view, if the objective of the disputes process is to seek an early resolution and to avoid costly litigation, then the initial disputes documents, such as the NOPA and NOR, should not be in a legal format, because the disputing parties are not in the litigation stage. When the disputing parties do go through the proceedings, both parties will have opportunity to produce such legal documents in the following Court process. There is no need to have such a requirement at this early stage of the dispute.

[194] In the writer's view the Review Committee went too far on the requirements of the NOPA and NOR. May be the initial idea was to avoid litigation as much as possible with the end result showing the requirements of the NOPA and NOR are as just costly as litigation.

[195] Compared with other jurisdictions in the OECD, the initial requirements of the dispute documents in New Zealand is far too long and complicated. For example, in Australia, the taxpayer is only required to file an "Objection form"⁷⁵

⁷⁵ www.ato.gov.au

to initiate a dispute. In the objection form, the taxpayer is only required to briefly state '*the decision objecting to*'. For example, 'objecting the Commissioner's decision on disallowing car expenses of \$2,000'. This gives both disputing parties a clear view on what is in dispute. Compare this with New Zealand's NOPA that has no such requirement but lots of legal terms such as when the tax position was taken; what was the assessment and when the assessment was issued. The New Zealand NOPA takes disputing parties straight to the facts of the dispute without an overview of the dispute. By the end of day, the disputing parties do not want to know when a company was incorporated, just to state that the car expenses are in dispute is more practical than stating when the tax position was taken by the taxpayer.

[196] In cases where more than one issue is in dispute, there can be degree of confusion if the items in dispute are not clearly stated. This is because if the responding party do miss on any issues in their NOR, they are deemed to accept the issues proposed in NOPA. In the writer's view, this is a big hidden issue, our NOPA and NOR requirements have lots of hidden pitfalls. If you miss one, that is the end of the story. Fair or not?

[197] The next section in Australia's objection form is to state the '*reasons for objection*'. This section requires facts, arguments and information to support the argument of the case, this also include any legislation, public rulings or cases laws. The content of the requirement is similar to New Zealand NOPA, but the format is more flexible. The requirement of the reasons for the objection is designed to support the dispute argument; it makes no difference to the validity of the objection. Compare with New Zealand disputes process, the validity of NOPA and NOR plays important role and on the other hand coursed so much problems. In New Zealand disputes process, addition to the disputes argument, both parties also have to determine the validity of the disputes document, again it makes the process painfully long and costly. I can not see the importance of the validity of the NOPA or NOR. Dispute party is entitled to explain their point of

view and how they interpret the tax laws. How they deliver their view should not affect their rights to disputes. It seems the current New Zealand disputes process is more focus on the format of the document rather than the reasons of the arguments.

[198] In the author's view, the content of NOPA and NOR should be no more than few pages long for average cases. The NOPA and NOR should be completed in a pre-scribed form to maintain consistency. Disputing parties only should be required to state the decisions in disputes with reasons and provide supporting documents. There is no need to determine the validity of the document. Once both parties are satisfied about the issues raised in the NOPA or NOR, both parties should be bound to the issues and arguments raised in the documents only, without being able to change or withdraw their arguments after the NOPA or NOR is issued.

6.2 *Legislative changes*

6.2.1 Clear and fair

[199] It is accepted that legislation can never cover all situations in disputes process. One thing that should be certain are that the legislative requirements should apply equally to both parties not just one of the parties.

[200] The problem with a lack of a specific timeframe for the Commissioner has been long identified as the fundamental flaw in the disputes process. Practitioners have made numerous submissions in the past crying for these legislative changes. Unfortunately this has been omitted by the Government.

[201] In writer's view, if the Commissioner is allowed to introduce new issues that form part of the SOP, so should the taxpayer. If the Commissioner can apply for an extension of time due to the complexity of the case, so should the taxpayer. There should be no difference between the taxpayer and the Commissioner as they are both parties to the disputes.

[202] Until the legislation is changed to ensure equality, there will be no fairness in the New Zealand disputes process. The objective of fairness can never be achieved until the changes happen. The quicker the Government amends the current legislation, the better the disputes process will be.

[203] In order to promote future compliance, the taxpayer has to be treated fairly. The current disputes legislation has numerous flaws and in some case, it lacks of clarity. For example, the legislation is not clear who has power to do what. Past judicial review cases indicate that the Commissioner has interpreted legislation to his advantage and that the taxpayer seldom has the same power.

[204] There is need for the current legislation to be amended to give more clarity to reduce the likelihood of judicial review proceedings. For example, the legislation should make the NOPA and NOR binding documents, therefore preventing either party changing their mind about the legal basis used. This prevents disputing parties wasting their time responding to something that is not usable later on in the process. Currently, it seems that the taxpayer can waste lots time and incurs large costs to go through the whole disputes process, then only to find out that the Commissioner can change the legal basis of his arguments at the last minute before the Court proceedings.

[205] Furthermore, the legislation should avoid granting any power to either of the disputing parties. In writer's view, a decision should only be made by an independent third party such as the Court or tribunals during the disputes process. This will eliminate the issue of one of the disputing parties acting as the "player" as well as "referee" and will help ensure the ultimate fairness of the disputes process.

[206] Arguably the Commissioner has an obligation to make proposals to the Government if he finds that the tax law is complex and unclear during a tax

dispute. Under the TAA, this obligation on the Commissioner helps maintain the integrity of the tax system.

6.2.2 Tight time table

[207] One of the fundamental flaws in the current disputes process is that the legislation lacks a specified timeframe for the Commissioner. The legislation imposes strict deadlines on the taxpayer, but not to the Commissioner. In the writer's opinion, the whole disputes process should be subject to a tight time table and this should apply equally to both disputing parties regardless.

[208] A specified tight time table means under the current dispute process means that a case will reach to challenge stage within approximately eight months. This is based on a dispute being started by issuing of a NOPA and it being responded by a NOR within two months period; a conference being completed within two months of the issuing of a NOR; the Commissioner issuing of a disclosure notice and a SOP within two months after the conference stage, followed by the taxpayer's SOP.

[209] If the pre-litigation process reduces by half the number of current steps, arguably the length of time will be reduced by half. The argument is valid only if a tight time table policy is followed. Otherwise the same problems will appear regardless of the numbers of steps involved in the process.

[210] In the past decade, numerous changes have been made to the civil proceedings in the Court. This has had a significant impact on the length and cost of litigation in New Zealand. There is no reason why the pre-litigation tax disputes procedure should not be changed to meet the current environment. When the Review Committee first introduced the legislative disputes process, its aim was to avoid costly litigation. Arguably the purpose has not been achieved because the current disputes process is as long as the litigation process and is possibly even more costly than litigation due to the requirements of the legal documents

and the steps to follow. Furthermore, the Court introduced a case management system, where the parties can track status of a case and the evidential requirements. Equally, the disputes process should have a similar system to make sure the process is continually moving forward and complying with the time table.

6.3 *Alternatives - use of mediation*

[211] In order to achieve an effective and efficient way to solve tax dispute, an alternative procedure should be established to provide a sufficiently neutral procedure without requiring the taxpayer to go through the Court process. Overseas experience shows substantive justice can be achieved through an alternative procedure. The alternative is mediation.

[212] In general, the mediation procedure can be designed to assist the negotiation between the taxpayer and the Commissioner by helping both parties understand their own goals. The mediator is a neutral third party and who should have no authority or power to impose a decision on either party. The role of the mediator is to facilitate, promote communication and negotiation with aim to resolve the tax disputes in a fair and impartial manner. The mediator should not impose a solution on the dispute. Instead it should let both parties follow their way to the settlement.

[213] The use of mediation option is not new in overseas and other jurisdictions have proved a great success. Australia has mediation system. In the USA, the taxpayer can request the use of mediation process with tax disputes less than \$1 million dollars. The testing period started in November 1998 and the process was so successful that now taxpayers who have a tax dispute of more than \$1 million can apply to the access mediation. By end of 1999, the USA government declared an 87% success rate with \$3 billion worth of tax disputes resolved.⁷⁶

⁷⁶ The CPA Journal, June 2000, p56

[214] Because the mediator does not have authority to settle the dispute or make any decisions, the taxpayer has nothing to lose and everything to gain. If the mediation procedure does not work. The taxpayer can still continue with litigation option. The mediation process gives both parties a second chance to reconsider the dispute with an aim to resolve the issue before litigation.

[215] The ideal mediation system works as follows:

[216] ***Selection of Mediator:*** Ideally mediation works in a similar way to the Adjudication Unit, but with the panel selected from external parties only or a combination of Inland Revenue National office independent from the audit unit and external personnel. The writer would prefer to have external parties only to have true independent from Inland Revenue.

[217] ***Participants:*** The purpose of mediation is to promote resolution of the dispute. Therefore the personnel who attend the mediation should be persons who have the authority to make decisions on the spot in order to achieve efficiency. For example, if a tax agent attends the mediation meeting on behalf of the taxpayer, he or she should have full authority from the taxpayer to make a final decision. The same applies to the Commissioner, if an officer attends the meeting, the officer should be at an appropriate level in order to make settlement decision. Otherwise, there will be waiting time with mediation staff having to go back and discuss matters with those that can make a decision.

[218] ***Time and Cost:*** The ideal mediation process should be brief and concise with the duration not being more than two working days. If matters can not be resolved within that period, the parties then have to decide whether or not to go for civil proceedings. The cost of mediation should reflect the length of the process and be a relatively a low cost process. In the writer's circumstances, the mediator can set a fixed fee for a simple or standard case. The costs of mediation

should be shared by both the Commissioner and taxpayer or loser pays if applicable.

[219] However, the mediation system is designed to help solve simple disputes such as allowable deductions; depreciations etc. and give both disputing parties an opportunity to resolve the issues before litigation. Complex tax issues, such as tax avoidance, or other arguments that requires a Court decision are not suitable for mediation; hence the parties should seek a Court decision to resolve the issue.

[220] The mediator should be subject to the approval of both the taxpayer and the Commissioner. A registration system can also be established to maintain a list of mediators by geographic area. The ideal mediator should have knowledge in both taxation and taxpayer's industry. It is also preferred that the mediator should have some mediation experiences.

[221] Other options such as arbitration can also be used as a preferable option to litigation. Arbitration is commonly used for commercial disputes. It is closer in style to the litigation process. The process is meant to be shorter and quicker than a court case and is suitable for parties seeking quick resolution. An arbitration award is strictly binding with limited possibilities for appeal.

[222] The tax arbitration system can be established in the New Zealand disputes system with retired or semi-retired judges elected as Arbitrators. Although the Arbitration system does not automatically replace the litigation system, it should be made available for people who seek quick and early resolutions. It is important to understand that the difference between mediation and arbitration is that arbitration is binding but mediation is not.

6.4 *Policy changes*

6.4.1 *Early settlement*

[223] Although the New Zealand Government declared one of its objectives when introduce current disputes resolution process was to seek an early resolution to the tax dispute, but the current legislation and policy does not reflect of that. There is no policy in place to encourage a taxpayer who honestly disagrees with the Commissioner to seek an early settlement of the dispute even though while such an approach has been successfully used overseas.

[224] Under the Tax Administration Act,⁷⁷ the Commissioner's role is to maintain the integrity of the tax system and the collecting tax making the best use of resources. The Commissioner also has the obligation to administer the taxation system in an effective and efficient way. Under the current disputes process, regardless the amount of tax liability in dispute, both the Commissioner and taxpayer are required to complete the disputes process. There is no consideration for the cost or benefit of the disputes action. There is no such approach for either party to meet in the middle, negotiate the dispute in order to minimize the cost and seek an early settlement. Arguably the Commissioner has the equal obligation to minimize the taxpayer's compliance costs under the TAA. The current disputes process does not reflect such obligations.

[225] In the writer's view, the legislation should introduce a settlement policy to promote an early resolution of the dispute. Hence both the Commissioner and taxpayer can move on as quickly as possible. In the past, the Commissioner had argued that he has no such power to do so under the TAA and is required to continue with the dispute.

[226] The settlement policy has been successfully used overseas. For example, in U.S.A., a similar informal settlement is in place. The US government declared

⁷⁷ Section 6 of TAA

that approximately 88% of the cases were settled at an informal settlement stage.⁷⁸

[227] In Australia, the ATO has a similar policy. The recommendation of early settlement has its support from the Court, in *Grofam Pty Ltd*.⁷⁹ The Full Federal Court urged the dispute parties to consider a commercial settlement and recommended that further discussion between the parties would result in a sensible adjustment of the matters. The Court went on to say that ‘... we realize that the Commissioner is mindful of the important public duty under the administration Act. Nevertheless, if this were a commercial dispute, there would be much to be said for the view that a further attempt at settlement should be made, perhaps with the aid of an appropriate mediator...’.

[228] In fact, our own Court had a similar view. In *Auckland Gas Co. Ltd*,⁸⁰ the Court of Appeal considered the Commissioner’s power to enter into a settlement and concluded that the Commissioner can enter into settlements with a taxpayer. The view was also shared by the Court in *Attorney-General v Steelfort Engineering Company Limited*.⁸¹ To date, the Commissioner is still reluctant to adopt such a policy. The reason is unknown.

[229] The writer cannot see why the tax dispute is any different from other commercial dispute. It is a common practice in civil and commercial disputes for both parties to seek settlement outside the Court due to the length and costs involved and the New Zealand Court supports such a movement. It is also more practical and economical for the parties to settle outside of the Court. If the tax dispute is no different to any other commercial dispute, such approach should be an adopted by the Commissioner.

⁷⁸ Arbitration Journal, June 1993, p38

⁷⁹ *Grofam Pty Ltd v FCT* (1997) 36 ATR 493, 512

⁸⁰ *Auckland Gas Co. Ltd v CIR* [1999] 2 NZLR 409, para 217

⁸¹ *Attorney-General v Steelfort Engineering Company Limited* (1999) 1 NZCC 61,030

[230] In the writer's previous discussion, it was identified that the Commissioner had set up the compliance model to demonstrate the behaviour of taxpayers, but the current disputes process does not reflect the different treatment of the majority taxpayers who generally comply with tax laws and have a disagreement with the Commissioner. In the writer's view, the disputes process policy should reflect the compliance model developed by Inland Revenue and promote further compliance by seeking an early settlement. This would enable the Commissioner to best use his resources to enforce the law by focusing on those people at the top of the pyramid and chose not to comply. The Commissioner has the obligation to make best use the resources available to collect tax under s 6A of TAA.

[231] It is common practice amongst solicitors to adopt the 80/20 rules when considering litigation action. That is if the case has an 80 per cent of chance of wining, a decision will be made to take the case, otherwise it will be recommended that the client opt for an out of Court settlement or drop the case. This is a widely used technique applied to various disputes. The Commissioner can also adopt such an approach in order to seek early settlement. If 80 per cent of tax in dispute has been solved why chase the other 20 per cent? The policy should be in line with the amount of tax involved. If the disputed issues do not have a significant impact on others and are unlikely to be on going issues, in the author's view, the Commissioner should seek education rather than disputing the action. IR seldom shows any willingness to soften the approach to recognise that we all make honest mistakes. This is the time to call for a soft approach, as the Commissioner said in the compliance model, use force only on those people who are not willing to comply and adopt the 80/20 principle to settle tax disputes as early as possible.

[232] The settlement approach should ideally happen before the assessment or amended assessment is issued. Often this occurs at the end of an audit. The settlement policy is appropriate in situations where for example the litigations

costs are likely to exceed the benefits gained from winning due to the uncertainty and unclearness of tax laws and the taxpayer has a reasonable argument, and the probability of winning the dispute has 50/50 chance to win. Other circumstances where settlement is more likely to achieve further compliance from a cost-effective way should also adopt an early settlement policy.

[233] A settlement is not appropriate where the dispute is subject to escalation has public interest, or the dispute is in contrast to the well documented policy. The settlement policy should not be imposed if the action involves inconsistency in the treatment of taxpayers.

[234] Furthermore, a guideline or standard practice statement should be issued by the Commissioner to ensure the best practice of his delegated officers and to ensure that the settlement is a fair and reasonable outcome.

[235] The settlement policy should aim to reach an early resolution. Therefore it is not a policy designed to enable the Commissioner to seek full acceptance of the disputes from the taxpayer. The settlement policy seeks to have a 'give' and 'take' principle, designed to promoting both parties seeking an early resolution. The settlement process should be fully documented to avoid complications.

[236] A 'without prejudice' rule should also form part of the settlement policy. This means any statements made during the settlement process cannot be considered as an admission of liability and cannot be used as evidence. This is to prevent either party from using such statements in Court as evidence in the event that negotiations breakdown.

[237] A settlement agreement between the parties should be final, meaning that if settlement agreement is reached neither party can take further action to challenge the assessment, the matter is considered at the end.

[238] The focus of a settlement should be on the early resolution of the tax disputes from the beginning. The focus should motivate the disputing parties to work toward resolution rather than waiting.

6.4.2 Cost contribution program

[239] One of the Commissioner's obligations under section 6A of TAA is to minimize taxpayer's compliance cost. We all know that litigation is a very expensive process especially for many ordinary 'family' taxpayers. Litigation in most of these cases is beyond the taxpayer's capable resources after a long dispute. Often the Commissioner takes litigation action against a taxpayer for the purpose of establishing a precedent. The Court has indicated concerns in these so called 'test cases' and the unnecessary legal costs borne by the taxpayer who was involved in the case.

[240] In *Case Y1*,⁸² Barber DCJ observed:

"... it is concerning the people such as this fairly typical family of taxpayers, have been used as a test case for significant tax questions when a relatively small sum of tax is in issue and they must have incurred substantial professional fees....it would be the fair thing for the IRD to make a significant contribution to their legal and accounting fees flowing from this litigation even though the IRD succeeds in this case...."

[241] There is no such policy in place to reflect the Court's concerns. However, taxpayers in Australia can apply to ATO's 'test case litigation program' for legal funding.⁸³ Under the Australia Test Case Litigation Program, the Australia Taxation Office will provide financial assistance to taxpayers involved in litigation that is regarded as important to the administration of the revenue system. The purpose of the program is to develop legal precedents and to provide guiding principles on how the law should be applied. The program is not limited to any specific type of case or taxpayer. Any taxpayer who meets the criteria can

⁸² Case Y1 (2007) 23 NZTC 13,001, 13,005

⁸³ www.ato.gov.au

apply. Since the start of the program in 1995, the ATO declared that the program provided greater certainty to the taxpayer and considered to be successful.⁸⁴

[242] Here is how the program works; taxpayer can apply for funding by completing an application form with a submission. In the submission, the taxpayer needs to provide the details of the case, show how the issue is related to the tax laws that need further clarifications and how it significantly affects other taxpayer. The submission will then be forwarded to the Test Case Litigation Panel for consideration. Taxpayer can ask for a review of the decision if the funding is declined.

[243] In the writer's view, the program certainly gives taxpayers an opportunity to seek financial support for a test case. This is one way to reduce dispute costs. In the writer's opinion, the Australia program also has its limitations. For example, the funding is only limited to legal costs, other non-legal costs still have to be met by the taxpayer, furthermore, the ATO only pays the counsel fees and solicitor fess at a certain rate, this usually less than the market rate. If the taxpayer wants to employ a top solicitor, he or she may have to pay for the difference. This does not take into account the cost of the paper work and procedures requirement. Also the taxpayer may have to wait for at least three months before getting a decision from the panel. The process itself can be painfully long and will most likely require the taxpayer to pay for professional services.

[244] The U.S.A. has a similar program where the taxpayer can request the American Inland Revenue Service to contribute to the litigation costs.

[245] The writer suggests that the New Zealand disputes resolution process should introduces a similar cost sharing policy, where the Commission will bear part or all of the cost for disputes case that can provide a legal precedent.

⁸⁴ [www.ato.gov.au/test case litigation program](http://www.ato.gov.au/test%20case%20litigation%20program), p1

Furthermore, the program can be introduced to cover alternative options, such as share half of the cost of mediation. A policy can also be introduced to share the cost of using professions services if the case is a 'test case'.

[246] If a disputes case is to be used as test case to seek the Court's interpretation of the law, in the writer's view, the Commissioner has the obligation under the TAA to reduce the taxpayer's compliance costs and this can be achieved by sharing the disputes costs.

6.4.3 Abolishing Use of Money Interest ("UOMI")

[247] One of the associated costs with a tax disputes is the UOMI, the interest charged is calculated on a daily basis. Therefore each day is costing the taxpayer. Arguably the UOMI charged is one way to make a profit for Inland Revenue Department; the writer will not be surprised if UOMI is used as a profit making mechanism for the department. No doubt this can be used as a strategy to make the disputes process more costly for the taxpayer, hence to pressure the taxpayer not to continue with the process.

[248] The Commissioner, in the writer's view, should adopt a policy to wave the UOMI and late payment penalties charged during the disputes process as a way to promote fair process. Such a policy would reduce a significant financial burden from the taxpayer who is involved with a tax dispute and bring the focus back on the tax disputes. Theory has been well established that tax compliance is related to the public's perception of the fairness of the tax system and perceived treatment received by the taxpayer. A policy to wave UOMI will certainly promote fairness in the process.

[249] The writer is confident such a policy would be welcomed by the majority of the public if not all. It is a great opportunity to show the Commissioner's diligence to reducing compliance costs and the promotion of a fair and reasonable tax disputes process.

6.4.4 Compensation policy

[250] A taxpayer who has suffered financial loss or emotional damages due to unfairness and mistreatment during the tax disputes process should be allowed to seek compensation from the Commissioner. Like any other public body, Inland Revenue should also be subject to such damage claims.

[251] For example, the Crown is subject to the compensation if it breaches its duties. Recently two private compensation actions against the Serious Fraud Office indicated that individual who suffered damages during the process were prepared to sue on the grounds of tort. There should be no difference to Inland Revenue. Like any body else if the Commissioner makes a mistake during the tax disputes process, he should compensate the taxpayer who has been treated unfairly and has suffered a financial loss.

[252] Caution is required though; as such compensation should not be used as another way to dispute the tax issues. Actions that are subject to compensation should be only extreme cases, such as assault, malicious prosecution, defamation and knowingly hiding true information from the taxpayer. The policy should not be used to gain any personal advantage or revenge.

[253] In Australia, the taxpayer can apply for compensation from the revenue authority for bad administration. A similar policy also exists in the United Kingdom. In the writer's view, the New Zealand Revenue dispute process should also introduce such a policy to give reasonable compensation to the taxpayer who has in fact suffered from unfair treatment during the process.

6.4.5 External scrutiny

[254] One of the biggest concerns from taxpayers and practitioners is the consistency of Inland Revenue's policy. For many years, practitioners suggested the establishment of external panels to monitor the quality and consistency of the implement of the disputes process. Unfortunately this was ignored by the

Government. The public needs to be satisfied that each disputes case is considered on its merits and not according to the individual personality of the investigator. It is one way to achieve fairness in the disputes system.

[255] In the writer's view, the full disputes process should be subject to external scrutiny in order to ensure the accountability and transparency of the process. This includes the settlement agreement and mediation process.

[256] A corporate registration system should be established to record the outcome of all disputes cases and cases that reached early settlements while retaining the confidentiality of individual taxpayers.

[257] A Quality Review Committee should also be established and consist of independent experts. The Quality Review Committee should bi-annually randomly review the quality of the interpretative decisions in disputed cases in order to maintain the consistency of the process and to ensure that the Commissioner has followed standard practice statements or guidelines issued by him. The quality review should also include a review of any settlement agreements.

[258] The ideal Quality Review Committee should be selected from technical experts from different business industries, such as a community representative with similar experiences or officers from Audit general or law society.

[259] The Quality Review Committee's review should focus on the issues in dispute, and determine whether the decision is appropriate and in accordance with the standard practice statements and guidelines. Other issues such as the documentation of the process, like whether the decision is appropriately authorized should also be reviewed.

[260] An annual report should be prepared by the Committee and be made available to publish for the interest the public. Furthermore, like the Review Committee, the Quality Review Committee should also have the freedom to make recommendations or submission to the Government for future improvement.

[261] In the writer's view, a regular external scrutiny will improve the transparency and accountability of the Commissioner's decisions during the disputes process; hence promoting the future compliance of the taxpayer. The quality review system will also enhance voluntary compliance and public confidence in the integrity and efficiency of Inland Revenue's performance.

[262] Similar systems are also in place overseas. For example, in Australia, a Technical Quality Review (TQR) process was established to review settlements in tax disputes. The TQR was designed to ensure all that officers involved complied with the Code developed by the Australia Taxation Office.⁸⁵ Law Administration Practice Statement PS LA 2001/11, a similar version of New Zealand Standard Practice Statement, details the process of the TQR.

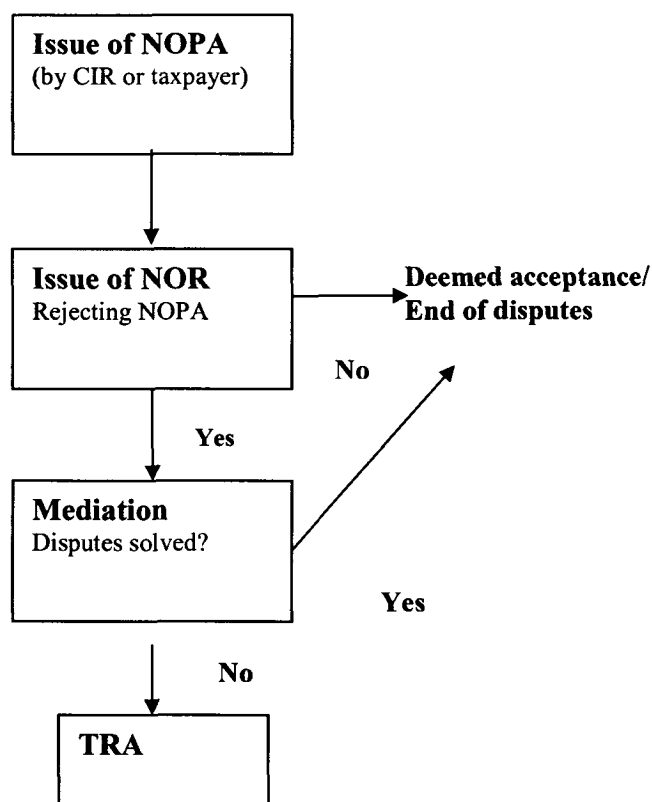
7 Recommendations

7.1 *New disputes process*

[263] To ensure the disputes process is simple and easy to follow, one of the remedies recommended by the writer is to simplify process by reducing the number of steps involved in the process. The new proposed pre-assessment disputes process can be divided into following phases:

- (1) Issuing of NOPA;
- (2) Response by the issuing of a NOR
- (3) Mediation
- (4) Tax Review Authority

⁸⁵ www.ato.gov.au



[264] The focus of the NOPA and NOR should be limited to the exchange of information between the disputing parties in order to gain a better understand each other's position. The exchange of the NOPA and NOR may also give the parties the opportunity to narrow the dispute and should therefore be retained.

[265] The content of the NOPA and NOR should also be simplified. The NOPA and NOR should be in a prescribed form containing only the relevant information, such as the issues in disputes, relevant laws and supporting documents. Both disputing parties should be bound by the issues and laws disclosed in the NOPA and NOR.

[266] Under the proposed disputes procedure, all administrative phases are abolished to reduce the number of the procedures involved. Instead a mediation

process is introduced to give both parties an opportunity to re-think their position and achieve an early resolution. An independent party's involvement should help the disputing parties achieve their own objectives. The process should be brief and concise and should only last for no more than two working days. Disputes that can not be solved at this stage should evoke the challenge procedures.

[267] Under a tight time table, the new disputes process should only take four to five months to complete. The proposed new disputes procedures have fewer steps to follow and only include the steps that are crucial to solve the problem. The writer sincerely believes such a proposal will better achieve an early resolution objective.

7.2 *Legislation changes*

[268] Future legislation changes should focus on fairness and clarity. *Firstly* the legislation should make all steps in the disputes process mandatory. Penalties should be imposed if either party refuses to complete the process. The requirements should equally apply to both parties without any exceptions.

[269] Further the legislation should clearly identify the powers and obligations of both disputing parties during the process. None of the disputing parties should have the power to make any decisions during the disputes process. If an independent party is not appointed to make a decision, a remedy should be in place that to appoints the Court to make such decisions.

[270] *Secondly*, a tight timetable should be set and applicable to both of the disputing parties regardless who initiated the dispute. The law should not grant any special powers to either of the parties during the disputes procedure, thereby reducing the potential for judicial review action against the Commissioner.

[271] If Parliament considered that in exceptional circumstance the disputing party may be entitled to an extension of time to respond, such consideration

should apply equally to both disputing parties without any other additional conditions.

[272] *Thirdly*, the validity of the documents should not affect the disputing parties' rights to continue with the disputes procedure. Parliament cannot expect all NOPAs and NORs to be of the same quality and standard. As these documents are prepared by different people. Each person has their own writing style. As long as disputes issues are included, the validity of the document should not be an issue. The validity of the document should not affect the disputant's right to dispute. If in circumstance where the validity of the document has a crucial impact on the disputes process, the legislation should appoint an independent third party, such as Court to make a decision. Neither of the disputing parties should be allowed to make such a decision. This would avoid the 'player' acting as 'referee'.

7.3 *Independent review process*

[273] An independent Quality Review Committee should be established to monitor the disputes process. A regular review of the process would identify problems during the implementation of the legislative process. The independent and external review will also increase the transparency and satisfaction of the tax disputes process.

[274] The Government should seek regular reports and recommendations from the Quality Review Committee for future improvements to the process.

8 Conclusion

[275] This report began by reviewing the history and background of current legislative disputes process. It considered that the current disputes process was a great improvement from old objection process, but did not work as well as it was said. Next, the report analyzed both the legislative and non legislative

requirements of the current disputes process with the writer indicating a number of problems and flaws in the disputes process. In the writer's view, the major problems of the current disputes process are that the process is too long, costly and that the legislative requirements of the process were not equally applicable to both disputing parties hence contributing to the unfairness of the process.

[276] In making recommendations, the author first suggests that the procedures be simplified by reduction in the number of steps involved. It is recommended that all administration phases to be abolished, as they have not achieved their purpose in the process. Furthermore, the contents of related documents, such as the NOPA and NOR, should be kept to a minimal level in order to move the process forward. The current legislation also needs to reflect fairness between the disputing parties. The legislation requires changes to be made in order to provide more clarification on certain issues.

[277] Finally, the writer suggests that the alternative opinions should be made available to the taxpayer who seeks a quick and less costly option to the litigation proceedings in order to achieve an efficient and effective resolution to the disputes. Regular external scrutiny is also recommended to help achieve consistency and promote a fairer process.

[278] In summary, the current disputes resolution process has made significant improvements when compare to the old objection system. But the process has not fully achieved the Government's objective of promoting a fair, effective and efficient disputes resolution process. The current process clearly has room for improvement, and the changes should be prompt and in depth.

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