The binding rulings system: legislative issues

An officials' issues paper

July 2009

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

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Chapter 1

OVERVIEW

1.1 Modern tax systems rely on taxpayers assessing their own tax obligations so that tax is collected fairly, efficiently and in a way that minimises the overall cost to the economy. Since the early 1990s, New Zealand has progressively introduced a self-assessment system by using modern administrative practices and by legislating various administrative functions to help taxpayers undertake self-assessment. One such measure is our binding rulings system.

1.2 The binding rulings system was introduced in 1992 following the recommendation of the 1989–90 Tax Simplification Consultative Committee. The recommendation reflected the need for businesses to ensure that the tax consequences of a transaction are clear and, if Inland Revenue has given advice, that the advice will not change. This is particularly important when a business enters a complex tax arrangement.

1.3 The need for certainty is ongoing and is particularly relevant in the current economic climate.

1.4 This issues paper focuses on legislative concerns with the current binding rulings system that are of a clarifying or remedial nature. A number of possible solutions are suggested, aimed at ensuring that the legislation as far as possible supports, or at least does not impede, the timely delivery of binding rulings.

Purpose and background

1.5 In broad terms, a binding ruling will set out how Inland Revenue will apply tax laws to a particular arrangement. Taxpayers are not required to follow the ruling. However, if the taxpayer chooses to follow the ruling, Inland Revenue must apply the tax laws as set out in the ruling.

1.6 There are two principal benefits for taxpayers in obtaining a binding ruling:

- greater certainty about the tax implications of their business decisions; and
- assistance in knowing how to comply with the tax law.

1.7 The current binding rulings system has been reviewed by government from time to time and this has resulted in some minor legislative changes over the years. There is no indication that the system requires a fuller review or overhaul at present. However, several commentators have raised questions relating to the time it takes Inland Revenue to issue a binding ruling. These questions have been about administrative rather than legislative matters, and are currently under discussion between Inland Revenue and representatives of the legal, accounting and business sectors. This paper focuses on certain legislative matters involved in Inland Revenue issuing binding rulings.

1.8 This issues paper has been prepared by officials from the Policy Advice Division of Inland Revenue and from the Treasury, as part of a consultation process. It seeks readers' views on how the law might be changed to achieve this result, and on the workability of the solutions explored here. Submissions will be taken into account when we make formal recommendations to the Government on the final form of the changes, with any amendments included in the next available tax bill.

Summary of suggested options

Scope of binding rulings (Chapter 3)

Replace the current general prohibition on ruling on questions of fact (contained in section 91E(4)(a) of the Tax Administration Act 1994) with a more limited list of factual matters on which the Commissioner cannot rule. They would include:

- A person's intention or purpose – for example, in relation to the acquisition of land. (This would not include the purpose of an arrangement under anti-avoidance legislation.)

- A determination of the value of anything – other than under the transfer pricing provisions, which are specifically excluded from the ambit of section 91E(4)(a).

- What "commercially acceptable practice" is for the purpose of any provision of subpart EW (the financial arrangements rules) that refers to commercially acceptable practice. This exception would clarify the application of section 91E(4)(j) which could consequentially be removed.

An alternative option is to give the Commissioner a discretion not to rule in relation to questions of fact (accompanied by a limitation to the scope of commercially acceptable practice).

Charging for binding rulings (Chapter 4)

Introduce a more flexible fee-waiver provision based on what is fair and reasonable in the circumstances.

Allow only one consultation period or one conference for the provision of, or a request for, additional information.

Reduce the fees for binding rulings supplied to non-residents outside New Zealand by 1/9th if the supply is zero-rated.

Mass-marketed and publicly promoted scheme rulings (Chapter 5)

Allow promoters of arrangements, or those with a similar interest to that of a promoter, to apply for a product ruling for prospective arrangements.

Require promoters to declare the correctness of the information they provide and/or be automatically subject to the promoter penalty in certain cases.

Other matters (Chapter 6)

Clarify the Commissioner's discretion not to rule on matters before the courts by:

- limiting its application to cases involving identical or substantially similar arrangements, facts or issues; or
- basing the exercise of the discretion on factors such as the need for consistency in relation to specific common issues, integrity of the tax system and compliance and administrative cost reduction.

Provide an exception to the prohibition on ruling if the arrangement involves two or more tax types and is the subject of a notice of proposed adjustment.

Clarify that if a ruling is made on two or more tax types, and the ruling fails for one tax type, it will still be binding on the Commissioner for the other type or types.

Remove the requirement to notify the making and withdrawal of public and product rulings in the *Gazette* and require that Inland Revenue publish notification in a suitable format.

Providing rulings and other forms of advice (Chapter 7)

Clarify that if the taxpayer has relied on official advice from Inland Revenue, the "unacceptable tax position" penalty and use-of-money interest cannot apply.

How to make a submission

1.9 Officials invite submissions on the matters raised in this issues paper. Submissions should be made by 28 August 2009 and be addressed to:

Binding rulings review
C/- Deputy Commissioner, Policy
Policy Advice Division
Inland Revenue Department
PO Box 2198
Wellington 6140

Or email policy.webmaster@ird.govt.nz with "Binding rulings review" in the subject line.

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

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

Chapter 2

THE BINDING RULINGS SYSTEM

2.1 In its review of 1989–90, the Tax Simplification Consultative Committee expressed concern that Inland Revenue could change its opinion without any formal procedure, leaving taxpayers unsure that their actions were based on decisions that would hold. The Committee also considered it unacceptable that taxpayers should be expected to file returns over a number of years with technical issues on those returns remaining unresolved.[1]

2.2 The committee recommended resolving these concerns through a binding rulings regime which, in addition to providing much needed certainty, would have the following advantages:

- a reduction in disputes and litigation;
- increased consistency between Inland Revenue offices;
- increased awareness and knowledge for Inland Revenue staff; and
- improved relations between Inland Revenue and taxpayers.

2.3 The 1994 organisational review, in recommending an impartial adjudication process for Inland Revenue, also stressed the importance of impartiality by Inland Revenue in providing binding rulings.[2] To better achieve this, it recommended a specialist adjudication and rulings unit within Inland Revenue which would provide top-flight technical expertise.[3] (The adjudication and rulings functions are now performed by Inland Revenue's Office of the Chief Tax Counsel.)

2.4 In the same year, the release of a government discussion document, *Binding Rulings on Taxation*, proposed that Inland Revenue be able to issue rulings on the interpretation of tax law which would bind Inland Revenue but not the taxpayer. The discussion document outlined most of the content of the current rulings process, which was enacted with effect from 1 April 1995.

2.5 In 1999, a post-implementation review of the binding rulings regime resulted in a number of legislative refinements, covering matters such as the impact on a ruling of legislative change and the consequences of an assumption included in a binding ruling proving to be incorrect.

[1] *Tax simplification final report of the consultative committee*, 1990, Chapter 3.
[2] *Organisational review of the Inland Revenue Department*, 1994, paragraph 16.1.2.
[3] Ibid paragraph 17.2.

Outline of the current rules

2.6 A binding ruling sets out how Inland Revenue will apply tax laws to a particular arrangement. Taxpayers are not required to follow the ruling but, if they do so, Inland Revenue must apply the tax laws as set out in the ruling.

2.7 Inland Revenue can issue four types of binding ruling:

- ***Public rulings*:** which give an interpretation on how a tax law applies to any type of taxpayer or type of arrangement.
- ***Private rulings*:** which give an interpretation of the tax law as it applies to a specific taxpayer and a particular arrangement (either a one-off or recurring arrangement).
- ***Product rulings*:** which set out Inland Revenue's interpretation of the tax law as it applies to a particular "product", which is an arrangement that is likely to be entered into by a number of people. A product ruling is only issued if:
  - Inland Revenue is satisfied that a private ruling cannot be made because it is not practicable to identify the taxpayers who may enter the arrangement; and
  - the characteristics of the taxpayers who may enter the arrangement would not affect the content of the ruling.
- ***Status rulings*:** which set out Inland Revenue's view of whether an amendment or repeal of a taxation law has changed the way that the law applies in a private or product ruling.

2.8 Inland Revenue can make private or product binding rulings on current and/or completed arrangements and on proposed arrangements that are "seriously contemplated" by the parties involved.

2.9 The legislation sets out the circumstances when Inland Revenue cannot rule – for example, if the application for the ruling would require Inland Revenue to determine questions of fact. It also sets out the circumstances in which Inland Revenue can decline to rule – for example, if the matter on which the ruling is sought is subject to an objection, challenge or appeal.

2.10 Private, product and status rulings are made upon application by the taxpayer. Inland Revenue is required to charge an hourly rate of $155 for considering these rulings as well as an application fee of $310.

2.11 Unlike other types of rulings, taxpayers cannot apply for public rulings. Instead, Inland Revenue issues public rulings on suitable topics, subject to available resources. Taxpayers can nominate issues that they consider should be the subject of a public ruling.

2.12 Public rulings, product rulings and status rulings on public and product rulings are published in the *Gazette*, in Inland Revenue's *Tax Information Bulletin* and on Inland Revenue's website. Private rulings are not published, as they are specific to the taxpayer and the facts of the arrangement.

Disclosure requirements

2.13 Applications for private or product binding rulings must comply with certain disclosure requirements. For private and product rulings, the application must:

- identify the applicant;
- disclose all relevant facts and documents relating to the arrangement for which the ruling is sought;
- state the taxation laws in respect of which the ruling is sought;
- state the propositions of law (if any) which are relevant to the issues raised in the application; and
- provide a draft ruling.[4]

2.14 For product rulings, the application must also explain:

- why it is not practicable to seek a private ruling; and
- why the characteristics of the taxpayers who may enter into the arrangement are not relevant to the content of the ruling.[5]

2.15 Disclosure is required to ensure that Inland Revenue has all of the relevant information on which to make the ruling. It also provides a degree of protection to the applicant by ensuring that Inland Revenue is focused on the relevant issues as set out in the application. If the disclosure requirements are not complied with, the Commissioner can decline to rule.

Consultation

2.16 Before private, product and status rulings are issued, Inland Revenue must consult with the applicant if the content of the proposed ruling differs from that requested.[6] This consultation gives the applicant an opportunity to comment on the interpretation adopted by Inland Revenue before the ruling is issued.

[4] Sections 91ED and 91FD of the Tax Administration Act 1994.
[5] Ibid section 91FD(1)(c).
[6] Ibid sections 91EG, 91FG and 91GE.

Chapter 3

SCOPE OF BINDING RULINGS

Current scope

3.1 The 1994 discussion document which outlined the design of the binding rulings regime made recommendations on the ambit of the regime in the form of a number of specific exclusions and a number of circumstances in which the Commissioner would have the discretion not to rule. The ambit of the current rules is based on those recommendations, although in most cases expressed largely in the form of specific exclusions which prohibit the Commissioner from issuing a ruling, rather than in the form of a statutory discretion.

3.2 The specific exclusions as they affect the process for private rulings are contained in section 91E(4) of the Tax Administration Act 1994, and apply if:

- the application for the ruling would require the Commissioner to determine questions of fact;
- the person to whom the ruling is to apply is not seriously contemplating the arrangement for which the ruling is sought;
- the application is frivolous or vexatious;
- the matter on which the ruling is sought concerns a duty or levy that is due and payable or is being/should be dealt with under the competent authority provisions of a double tax agreement;
- a private ruling already exists in relation to the relevant arrangement and person that covers the timeframe in question;
- an assessment has been made for the relevant arrangement, person and timeframe;
- Inland Revenue is auditing or investigating how the taxation law applies to the relevant arrangement, person and timeframe;
- the application relates to an arrangement that is the subject of a notice of proposed adjustment;
- the Commissioner's opinion is that insufficient information has been provided following a request for further information;
- the Commissioner's opinion is that it would be unreasonable to make a ruling in view of the resources available;
- the application for the ruling would require the Commissioner to form an opinion on generally accepted accounting practice or commercially acceptable practice.

3.3 Similar exclusions apply to the process for obtaining a product ruling.

Question of fact

3.4 One of the key exclusions, section 91E(4)(a), applies when the application for the ruling would require the Commissioner to determine questions of fact. This exclusion is the predominant focus of this chapter. The discussion document, *Binding Rulings on Taxation*, explained the rationale for the exclusion in the following terms:

> A rulings system is intended to provide certainty on the Commissioner's view of the law. There are established common law principles as to what constitutes a "question of fact", although the application of these principles can be difficult in practice. Determining whether an application gives rise to a question of fact will depend on the particular circumstances of each case. Nevertheless, the discretion is important because the Commissioner cannot be expected to give rulings on whether facts supplied by taxpayers are correct.[7]

3.5 Determining what constitutes a "question of fact" as opposed to a question of law is notoriously difficult. This chapter suggests how this boundary could be clarified in the binding rulings context so that certainty over whether a ruling can be provided is improved for both taxpayers and Inland Revenue.

The problem

3.6 An underlying principle of the binding rulings legislation is that the Commissioner should not have to determine whether facts provided by an applicant for a ruling are correct. This is because the Commissioner's role is to rule on the application of the law to the facts in the arrangement outlined by the applicant. This legislative intent is supported by the fact that the rulings legislation applies to prospective transactions.

3.7 That said, on a more literal interpretation, section 91E(4)(a) could be argued to prohibit a ruling being made when doing so would expressly or implicitly require particular facts to be found to exist. In that case, the Commissioner may be unable to rule on fact-dependent issues such as the application of section BG 1 or other anti-avoidance provisions. This limitation could also apply to a consideration of the capital/revenue boundary or whether the taxpayer was carrying on a business.

3.8 Such an interpretation would be inconsistent with the understanding and application of the binding rulings provisions by taxpayers, tax practitioners and officials. It would also be inconsistent with the policy intent of binding rulings, which was clearly to allow determinations about tax avoidance to be made.

[7] Paragraph 6.11.

3.9 To remove the scope for such interpretations clarification of the circumstances in which a ruling application would require the Commissioner to determine questions of fact would therefore seem to be warranted.

3.10 We note, incidentally, that, in a similar way to the intended policy in New Zealand, the Australian legislation allows private rulings to be given on the basis of assumptions for which the relevant information has not been provided to the Commissioner provided those assumptions are brought to the attention of the applicant.[8] Rulings can also be made on an ultimate conclusion of fact that relates to a tax law – for example, on whether an activity is a hobby or business.[9]

Generally accepted accounting practice/commercially acceptable practice

3.11 The last exception in section 91E(4) – paragraph (j) – provides that a ruling may not be made if the application for the ruling would require the Commissioner to "form an opinion as to a generally accepted accounting practice or to form an opinion as to a commercially acceptable practice".

3.12 The reason for the exclusion for generally accepted accounting practice is self-evident in that opinions on accounting practices are likely to fall outside the Commissioner's specific sphere of expertise in administering the taxation laws.

3.13 The exclusion for commercially acceptable practice was provided for the same reason. However, its scope is unclear. We consider that its application was intended to be, and should be, limited to those provisions in the tax legislation such as the financial arrangements rules in which it is explicitly used. Without this limitation paragraph (j) could possibly be interpreted to mean that any matter concerning commercially acceptable practice, including the application of section BG 1, which we have noted turns on questions of fact, could not be ruled on. This would be inconsistent with the policy noted above that rulings on section BG 1 ought to be able to be made.

Possible solutions

3.14 Possible legislative solutions for dealing with the uncertainties around questions of fact and commercially acceptable practice are:

- to list specifically the questions of fact on which the Commissioner cannot rule; or
- to give the Commissioner a discretion not to rule in relation to questions of fact (accompanied with a limitation to the scope of commercially acceptable practice).

[8] Schedule 1, section 357-110 of the Taxation Administration Act 1953.
[9] PS LA 2003/3, Precedential ATO view, at paragraph 26.

Legislated criteria for when not to rule

3.15 The first option would involve an amendment listing the specific questions of fact on which the Commissioner may not rule. These specific questions of fact would include:

- A person's intention or purpose – for example, in relation to the acquisition of land. (This would not include the purpose of an arrangement under anti-avoidance legislation.)
- A determination of the value of anything – other than under the transfer pricing provisions, which are specifically excluded from the ambit of section 91E(4)(a).
- What commercially acceptable practice is for the purpose of any provision of subpart EW (the financial arrangements rules) that refers to commercially acceptable practice. This exception would in effect clarify the application of section 91E(4)(j), which could consequentially be removed.

3.16 The intention or purpose of the taxpayer (as opposed to the intention or purpose of the arrangement) may be difficult to determine based on the facts provided by the applicant without incurring significant further administration costs and, for the applicant, compliance costs, including fees. Exclusion therefore seems warranted. The value of anything or what is commercially acceptable practice would be excluded because the Commissioner has limited expertise in these matters.

3.17 Specifically listing the matters on which the Commissioner may not rule will ensure that rulings can be issued for significant matters, such as whether an arrangement involves tax avoidance and the determination of the capital/revenue boundary. As is currently the case, the Commissioner, in making a binding ruling, would accept the facts as provided by the applicant. If the arrangement is entered into based on the binding ruling, the arrangement may be audited at a later stage. If there are any material differences between the facts in the ruling and the actual arrangement, the ruling would not apply.

3.18 This approach is also consistent with taxpayers self-assessing their tax liability, as broad legislative provisions in a tax system based on self-assessment may not provide taxpayers with adequate certainty.

3.19 On balance, this is the option officials prefer. We would welcome submissions on any other matters that should be included in the suggested list.

3.20 If the preferred option were adopted, a further amendment would be made to clarify that rulings will be based entirely on the facts advised to the Commissioner by the applicant and that, where any such facts are stated in the ruling, the Commissioner will not be treated as accepting those facts. This would further assist in addressing the seeming underlying difficulty with a ruling determining questions of fact.

3.21 A regulation-making power could also be introduced to allow for expansion of the matters to be excluded from being able to be ruled on. This flexibility would deal with any matters that may arise resulting from the changing business environment.

Commissioner discretion

3.22 An alternative option would allow the Commissioner not to rule if the application for the ruling would, in the Commissioner's opinion, require the determination of questions of fact. Paragraph (j) would simply be amended by limiting the formation of an opinion on commercially acceptable practice to the provisions in the tax legislation that used that term.

3.23 This approach assumes the Commissioner is best placed to determine what can and cannot be ruled on as the Commissioner is able to take into account all relevant factors. The approach is also consistent with the observation of the 1994 discussion document on binding rulings that "if the operation of the rulings regime indicated that taxpayers were requesting rulings for the purposes of tax avoidance, the regime would have to be amended to guard against such abuse, perhaps by introduction of an additional discretion to decline to rule".[10]

3.24 On the other hand, a discretion in relation to questions of fact could lead to uncertainty and may require guidelines on when the discretion would be likely to be exercised. A concern is that views on the application of the guidelines might differ and further "grey areas" would develop.

[10] Paragraph 6.29.

Summary of suggested options

Replace the current general prohibition on ruling on questions of fact (contained in section 91E(4)(a)) with a more limited list of factual matters on which the Commissioner cannot rule. They would include:

- A person's intention or purpose – for example, in relation to the acquisition of land. (This would not include the purpose of an arrangement under anti-avoidance legislation.)

- A determination of the value of anything – other than under the transfer pricing provisions, which are specifically excluded from the ambit of section 91E(4)(a).

- What commercially acceptable practice is for the purpose of any provision of subpart EW (the financial arrangements rules) that refers to commercially acceptable practice. This exception would clarify the application of section 91E(4)(j), which could consequentially be removed.

An alternative option is to give the Commissioner a discretion not to rule in relation to questions of fact (accompanied by a limitation to the scope of commercially acceptable practice).

Chapter 4

CHARGING FOR BINDING RULINGS

4.1 Private, product and status binding rulings all incur fees that are based on recovering the cost of providing the ruling. The fees include an application fee of $310 which covers the costs of receiving and reviewing the ruling application and a fee of $155 per hour spent by Inland Revenue considering the application. This includes time spent consulting with the applicant. Any costs incurred by Inland Revenue in consulting with external professionals to obtain independent advice are also passed on to the applicant.

4.2 Upon receipt of a binding ruling application, Inland Revenue estimates the time it will take to produce the ruling, and therefore the cost, and advises applicants accordingly. If the estimate proves to be too low, Inland Revenue re-estimates the cost and advises applicants before continuing work on the ruling.

4.3 The rationale for charging fees is that the applicant receives the benefit of certainty about how Inland Revenue will apply the tax laws in relation to their situation. If no fee were charged, taxpayers in general would effectively fund the benefit received by the applicant.

4.4 Charging a fee also ensures that applications for straightforward, everyday transactions, are limited and tend instead to relate to more complex transactions. If Inland Revenue received large volumes of applications for simple transactions, resources would need to be diverted from other areas of Inland Revenue to process them.

4.5 Binding rulings may also provide a second opinion or an additional degree of comfort to advice provided by tax professionals. In that context, assuming the rulings system is operationally effective, charging fees is regarded as justifiable.

Fee waiver

4.6 Currently, Inland Revenue may in exceptional circumstances, at the Commissioner's discretion, waive in whole or in part any fee payable by an applicant. This provision, Regulation 6 of the Tax Administration (Binding Rulings) Regulations 1999, is similar to other provisions that allow Inland Revenue to waive fees – for example, for financial arrangement determinations and depreciation determinations.

The problem

4.7 There is a concern that the current waiver provision does not provide sufficient direction over the circumstances in which binding rulings fees should be waived.

4.8 Inland Revenue staff involved in considering rulings applications will have different skill and experience levels but there is a risk that waiving fees for different levels could be too frequent an occurrence to be treated as an "exceptional circumstance". However, a lower level of expertise will frequently result in more time being spent on a ruling application and application of the fee waiver may be justified in these cases.

4.9 Another problem arises when a significant amount of time is spent researching an issue and the research is, or will be, relevant to a number of different rulings. In some cases it would be inequitable to charge all of the time to the first ruling that considers the issue. In other instances this may be perfectly reasonable.

Possible solutions

4.10 We suggest that the waiver provision in the Tax Administration (Binding Rulings) Regulations 1999 be amended so that it takes into account what is fair and reasonable in the circumstances.

4.11 On the issue of differing skill and experience levels, we considered whether, as often happens in private firms, differential rates should be applied according to the relative skill and experience levels (as reflected in the job description) of the staff. On balance, we concluded that this would add more complexity to the system than is worthwhile as the rates would need to be benchmarked and regularly reviewed. However, what is fair and reasonable in the circumstances could have regard to the skill and experience levels of staff handling rulings applications.

4.12 If the binding rulings waiver provision is amended, consideration should be given to amending similar provisions in the financial arrangement determination and depreciation determination regulations.

Closing ruling applications and consultation

4.13 Before private, product and status rulings are issued, Inland Revenue must consult with the applicant if the content of the proposed ruling differs from that requested.

4.14 This consultation gives the applicant an opportunity to comment on the interpretation adopted by Inland Revenue before the ruling is issued. It also allows further information to be obtained about the implications of the ruling.

The problem

4.15 Despite its benefits, consultation is one of the factors that contributes to the delay in issuing binding rulings. Providing additional information, and/or possible changes to the arrangement itself to "make it fit" the requested ruling, can add significantly to the time taken. This is particularly so if Inland Revenue has indicated that a negative ruling may be given. In this event the applicant may often choose to amend the arrangement to obtain a favourable ruling.

Possible solution

4.16 The Australian Tax Office (the ATO) treats any revision of an arrangement or the submission of additional information, even if at the request of the ATO, as a fresh application for a ruling.[11] This approach may increase the incentive for applicants to provide all of the relevant information to the tax authority in the first instance.

4.17 The approach is more difficult to justify in New Zealand where rulings are charged for. Delays in issuing rulings may be reduced if the legislation specified a requirement for just one consultation period or one conference, and for any further information to be provided or requested during or at that consultation period or conference. We are interested in submissions on the workability of this approach.

4.18 While the opportunity for the applicant to provide additional information would be limited if this suggestion were implemented, we note that in cases where the arrangement already exists at the time of application, there is little opportunity to change the nature of the arrangement. If the application is for a proposed arrangement, the arrangement needs to be seriously contemplated. To meet this condition, it could be argued that only limited opportunity for changes to the arrangement could be contemplated.

GST and binding ruling fees

4.19 Under Regulation 7 of the Tax Administration (Binding Rulings) Regulations 1995 the fees charged for binding rulings are inclusive of any goods and services tax.

[11] Schedule 1, section 359–65 of the Taxation Administration Act 1953.

The problem

4.20 The fees assume a GST rate of 12.5% and do not take into account the fact that binding rulings issued to non-residents outside New Zealand may be zero-rated under the Goods and Services Tax Act 1985. Therefore, any binding ruling issued to a New Zealand resident is in effect cheaper than if that same ruling were supplied to a non-resident. This is because the New Zealand resident, if registered for GST, can generally claim an input tax credit for the GST cost of acquiring the binding ruling. The non-resident, on the other hand, is unlikely to meet the requirements for registration or input tax credit entitlement.

Possible solution

4.21 We recommend amending the Tax Administration (Binding Rulings) Regulations 1995 to allow fees for binding rulings supplied to overseas non-residents to be reduced by 1/9th if the supply is zero-rated. This would bring the regulations in line with existing GST policy.

Summary of suggested options

Introduce a more flexible fee-waiver provision based on what is fair and reasonable in the circumstances.

Allow only one consultation period or one conference for the provision of, or a request for, additional information.

Provide that the fees for binding rulings supplied to non-residents outside New Zealand are reduced by 1/9th if the supply is zero-rated.

Chapter 5

MASS-MARKETED AND PUBLICLY PROMOTED SCHEME RULINGS

5.1 A product ruling sets out Inland Revenue's interpretation of how the tax law applies to an arrangement that is likely to be entered into with a number of people on identical terms. The product ruling is intended to be available when a private ruling cannot be made because it is not practicable to identify all the taxpayers that may enter into the arrangement.

The problem

5.2 One of the conditions when applying for a product ruling is that the applicant must intend to be a party to the proposed arrangement (section 91FC(1A)). This means that the promoter of an arrangement may not be able to apply for a product ruling. This position followed a legislative clarification in 1999 intended, among other things, to ensure that rulings applications were limited to "seriously contemplated" arrangements.

5.3 In contrast, in Australia, product binding rulings can only be applied for by the promoter of a scheme or by persons involved as principals carrying out the arrangement. Participants or investors in the scheme cannot apply for a product ruling.[12]

5.4 There are advantages to investors, promoters and Inland Revenue in issuing binding rulings on schemes. Prospective investors could make their investment decision in full knowledge of the tax effects of the arrangement which would also assist investors voluntarily complying with their tax obligations. The promoter of the scheme could use the binding ruling to market the scheme as a means of demonstrating that the scheme is sound from a tax perspective. For Inland Revenue, the advantage is that it becomes aware of the arrangement at an early stage and administrative costs in auditing the scheme will be reduced or eliminated.

5.5 Encouraging (or at least not discouraging) promoters of schemes to apply for product rulings could result in these applications becoming standard practice. If this occurred, arrangements that were not supported by a product ruling would start to become the exception and be seen as more risky than those with Inland Revenue clearance. This could help in securing a tax-compliant environment.

[12] PR 2007/71 The Product Rulings System, at paragraphs 55 and 56.

Possible solution

5.6 We consider that the requirement for the applicant to be a party to the scheme should contain an exception for promoters. This would apply either when the applicant who is not a party to the scheme is a promoter of the scheme or is another person with a similar interest to that of a promoter. This could be achieved either within the existing product ruling legislation or by creating a further special category of ruling.

5.7 Consistent with the objectives of providing certainty in investment planning and maintaining tax compliance, ruling applications by promoters and similar persons would be limited to prospective arrangements. As with all rulings on prospective arrangements, the arrangement would have to be seriously contemplated.

5.8 A concern that would have to be addressed in designing this type of ruling is the possible incentive for promoters of arrangements to omit relevant information or misrepresent the arrangement to obtain a favourable binding ruling. This incentive could be provided by the applicant not being a party to, and therefore not having a financial interest in, the arrangement.

5.9 One option for dealing with this concern would be to require the promoter of the scheme to make a declaration that the material provided in the application is correct. Another option could apply in cases where the arrangement, once begun, gives rise to an abusive tax position shortfall penalty for the investors. In that case, if the applicant for the ruling had omitted or provided false information, the promoter penalty could be automatically applied. Submissions on these alternatives are welcome.

Clarification of the "seriously contemplated" requirement

5.10 The Commissioner may not make a product ruling if the person to whom the ruling applies is not "seriously contemplating" the arrangement at the time the ruling is applied for (section 91F(4)(b)). If, as suggested in this chapter, persons that are not party to the arrangement are able to apply for a product ruling, the ruling may be given before any prospective investors are aware of its existence. In that case the "seriously contemplated" requirement would not be met.

5.11 We consider that the requirement should remain as it serves to appropriately limit the number of rulings applications made to Inland Revenue. However, we consider that the legislation should be amended to remove the requirement that the person to whom the ruling is to apply is seriously contemplating the arrangement and replace it with a requirement that the applicant is seriously contemplating that the arrangement will be proceeded with.

Summary of suggested options

Allow promoters of arrangements, or those with a similar interest to a promoter, to apply for a product ruling for prospective arrangements.

Require promoters to declare the correctness of the information they provide or be automatically subject to the promoter penalty in certain cases.

Chapter 6

OTHER MATTERS

Ability to rule when the matter is subject to a case before the courts

6.1 Under section 91E(3)(b), the Commissioner "may decline to make a private ruling if the matter on which the ruling is sought is subject to an objection, challenge or appeal, whether in relation to the applicant or to any other person".

6.2 The 1994 discussion document explained the policy rationale for the discretion in the following terms:

> In the Government's view, a discretion not to rule for questions before the courts should be available in New Zealand. The purpose of a binding rulings system is to provide a timely decision as to how the Commissioner will interpret the legislation, but in cases where a court decision on a question of law is pending it would be inappropriate for the Commissioner to provide a ruling on the issue. Inland Revenue will notify the applicant that the issue is before the court and what Inland Revenue's position is.[13]

The problem

6.3 The purpose of the discretion to decline to rule was not outlined in detail at the time of introduction but application of the discretion would seem to have these advantages:

- It helps ensure that the application of the law by the Commissioner is consistent across taxpayers in similar circumstances.
- It ensures that taxpayers cannot take undue advantage of a lack of clarity in the law that is in the process of being addressed by the courts.
- It reduces administrative and compliance costs.

6.4 Section 91E(3)(b) is expressed in general terms and the scope of the provision, particularly the term "matter" is unclear. The provision does not allow for an unduly narrow interpretation such as requiring an identical transaction and the same or associated taxpayer. At the other extreme, it would be inappropriate to apply it to all instances where an issue arises that is commonly determined in a transaction – for example, the application of section BG 1 – as that would allow the Commissioner to turn down any ruling application on that issue. (We noted earlier that it was clearly intended that the Commissioner be able to rule on section BG 1.)

[13] Paragraph 6.15.

6.5 Such broad discretions do not fit well in a tax system based on self-assessment as taxpayers may be uncertain about how the Commissioner will exercise the discretion and may feel unable to confidently enter into legitimate business arrangements.

6.6 Even though section 91E(3)(b) is expressed in discretionary terms, we consider that greater clarity needs to be provided to guide taxpayers on when the discretion might be exercised. Otherwise, a taxpayer could apply for a binding ruling on an issue, unaware that the same "matter" is being considered by the courts, and Inland Revenue could decline to rule. This could result in significant costs to the taxpayer in not obtaining the certainty needed and in making the unsuccessful ruling application. In cases when the decision to decline to rule is made part-way through the rulings process – for example, because a new matter is before the courts – similar costs could arise.

Possible solution

6.7 Officials suggest that the ambit of section 91E(3)(b) be clarified by having regard to more explicit factors that would narrow the application of the discretion. These factors would be based on the need for consistency in relation to specific common issues, integrity of the tax system and reduced compliance and administrative costs. Our suggestion is to refer to:

- an identical or substantially similar arrangement; and/or
- an arrangement that concerns the same, or substantially similar, facts and issues.

6.8 This approach to the application of the discretion could preclude rulings being given for taxpayers involved in the same arrangement as that being considered by the courts (for example, as parties to a mass-marketed scheme) and taxpayers involved in a different arrangement with substantially similar characteristics to that being considered by the courts.

6.9 A key advantage of this approach is that it would remove any suggestion that the discretion can be applied when the similarity arises purely from a commonly considered tax issue such as the application of section BG 1.

6.10 An alternative option would be to base the exercise of the discretion on the objectives we have outlined – the need for consistency in relation to specific common issues, integrity of the tax system and compliance and administrative cost reduction.

6.11 Both of these options will raise issues of interpretation and we seek comments on this concern.

Declining to rule when the arrangement is the subject of a dispute

6.12 Under section 91E(4)(ga), the Commissioner may not make a private ruling if the application relates to an arrangement that is the subject of a notice of proposed adjustment (NOPA). This criterion was added in 1999 to clarify the policy intent that there should be no overlap between the existing disputes resolution process and the binding rulings regime. This is necessary to ensure that certainty for the taxpayer about the Commissioner's position is maintained.

6.13 If a NOPA relates to only one aspect of the arrangement, the Commissioner cannot rule on other aspects which may not be related to the issue being disputed. For example, consider an arrangement which has both income tax consequences and GST consequences. Even if the NOPA relates only to the GST aspects of the ruling, a taxpayer cannot obtain a ruling in relation to the income tax aspects of the arrangement.

Possible solution

6.14 Officials suggest that the section be amended to allow the Commissioner to make a binding ruling if the arrangement is the subject of a NOPA but the application for the ruling relates to a different tax type from that in the NOPA.

6.15 For example, if the NOPA relates to GST aspects of the arrangement only, the Commissioner would be able to make a binding ruling in relation to the income tax consequences of the arrangement. However, if the NOPA relates to the tax treatment of an income stream under the arrangement, a binding ruling would not be able to be made if the ruling application concerns an expenditure stream under the arrangement as in this case the issues may overlap.

6.16 While we suggest that rulings should be able to be made if the matter involves a different tax type to that in the NOPA, there may be circumstances in which an issue concerning GST affects an income tax issue – for example, an issue involving a common definition such as that for a group of companies. A further qualification on the ability to rule would therefore be necessary to ensure that the matter in dispute, and that for which the ruling was sought, were sufficiently separate.

A ruling which fails in part

6.17 A similar question arises over whether a binding ruling application that fails in part should continue to apply in relation to the other part. For example, if a ruling relates to both GST and income tax and the GST part is taxpayer-negative should the income tax aspects of the binding ruling continue to apply?

Possible solution

6.18 Consistent with the previous issue, if the binding ruling is made for two or more tax types, the part or parts of the ruling which do not fail, and that concern separate tax types, should be treated as binding on the Commissioner. This would again be subject to the qualification of the different parts of the ruling being sufficiently separate.

Publication of notification of binding rulings in the *Gazette*

6.19 The binding rulings legislation requires Inland Revenue to notify the making and withdrawal of public and product rulings in the *Gazette*. Public and product binding rulings are also published in full in Inland Revenue's *Tax Information Bulletin* (TIB). The TIB is available on Inland Revenue's website and a paper copy can be requested. The question is whether Inland Revenue should continue to be required to notify taxpayers in the *Gazette*.

Possible solution

6.20 Given that these types of rulings are publicly available, and the only information published in the *Gazette* is notification that the ruling is being made or withdrawn, we consider that the requirement to publish in the *Gazette* should be removed.

6.21 However, to ensure that information on public and private rulings remains publicly available, we suggest the legislation be amended to require Inland Revenue to notify the making or withdrawal of such rulings in a suitable format.

Self-assessment

6.22 Under section 91E(4)(f), the Commissioner may not make a private ruling if an assessment has been made relating to the person, the arrangement, and a period or a tax year to which the proposed ruling would apply, unless the application is received by the Commissioner before the date an assessment is made.

6.23 As noted earlier, taxpayers are required to self-assess their tax liability. A recent "Question we have been asked" (QWBA) raised the issue of whether section 91E(4)(f) applies in cases when the taxpayer self-assesses before a private ruling application has been received by Inland Revenue.[14] It concluded that the section does apply and a binding ruling may not be made.

[14] QB 08/01 *Tax Information Bulletin* Volume 20, No. 5, June 2008.

6.24 The QWBA notes that:

> 2. The rationale behind section 91E(4)(f) is that if a transaction has been the subject of an assessment, then any dispute over the correct tax treatment of that transaction should be resolved under the tax disputes resolution procedures (Inland Revenue Department, Binding Rulings on Taxation: A Discussion Document on the Proposed Regime, June 1994).

6.25 As the rulings regime was introduced before self-assessment was legislated, the question has been raised whether the rulings regime ought to apply to allow the Commissioner to rule when the taxpayer had self-assessed.

6.26 The QWBA also notes that:

> 21. The rulings regime exists primarily for prospective transactions to enable taxpayers to obtain certainty, and thus comply with their tax obligations. When a taxpayer has already filed their return and made an assessment, the disputes resolution process is available to the taxpayer, should the Service Delivery Group disagree with the assessment. There was a clear legislative policy that the disputes resolution process would be available to ensure that disputes were resolved in these situations, and that the rulings regime would generally be available for situations that were contemplated or occurred before assessment.

6.27 Taxpayers who self-assess their tax liabilities have an obligation to determine the correct tax position in relation to an arrangement before taking it and, as the QWBA notes, the disputes process is available to the taxpayer should the taxpayer or the Commissioner seek to change that position. The conclusion reached in the QWBA is consistent with self-assessment and the clear separation between the disputes resolution process and the binding rulings regime. We consider that the policy in these areas remains sound and that no change to the legislation is warranted.

Summary of suggested options

Clarify the Commissioner's discretion not to rule on matters before the courts by:

- limiting its application to cases involving identical or substantially similar arrangements, facts or issues; or
- basing the exercise of the discretion on factors such as the need for consistency in relation to specific common issues, integrity of the tax system and compliance and administrative cost reduction.

Provide an exception to the prohibition on ruling when the arrangement involves two or more tax types and is the subject of a notice of proposed adjustment.

Clarify that if a ruling is made on two or more tax types, and the ruling fails for one tax type, it will still be binding on the Commissioner for the other type or types.

Remove the requirement to notify the making and withdrawal of public and product rulings in the *Gazette* and require that Inland Revenue publish notification in a suitable format.

Chapter 7

PROVIDING RULINGS AND OTHER FORMS OF ADVICE

7.1 A binding ruling application typically requires that Inland Revenue give thorough consideration to the variety of tax issues pertinent to the arrangement. Particularly in the case of an application for a private binding ruling, the Commissioner must rule on all the issues raised in the application unless one of the specific statutory exceptions applies.

7.2 At times this need for comprehensiveness may be at odds with the commercial needs of taxpayers – that is, taxpayers may require a quicker response than Inland Revenue's decision-making process allows. However, as the decision as outlined in the ruling is binding on Inland Revenue, all matters need to be fully considered to ensure the response is robust and the revenue base is not adversely affected.

7.3 As outlined in chapter one, Inland Revenue is working with the affected sectors to improve the timeliness of the rulings process. However, given the need for Inland Revenue to manage its resources and to protect the revenue base, it cannot provide binding advice in response to all requests. For more general queries, a response may be provided in other formats such as guides or booklets for those completing tax returns.

7.4 In whatever format the Commissioner provides advice, taxpayers should be able to rely on that advice.

7.5 Concerns have been expressed regarding the possible imposition of penalties and interest when taxpayers have relied on advice provided by Inland Revenue other than in the form of a binding ruling.

Unacceptable tax position penalties and use-of-money interest

7.6 A shortfall penalty for taking an unacceptable tax position can be imposed when a taxpayer's tax position fails to meet the standard of being "about as likely as not to be correct". The penalty applies when the tax position involves a significant amount of tax.

7.7 Use-of-money interest imposed on a taxpayer is charged when tax is underpaid and compensates the Crown for not having the use of its money.

7.8 It is possible that an unacceptable tax position penalty and/or use-of-money interest may apply if the taxpayer has underpaid their tax, even if this is as a result of having relied on advice provided by Inland Revenue.

7.9 Under the legislation the Commissioner's ability to remit use-of-money interest is very limited, applying only if the remission would be consistent with the Commissioner's duty to collect the highest net revenue over time as practicable within the law (section 183D of the Tax Administration Act). The Commissioner's practice, as set out in *SPS 05/10 Remission of penalties and interest*, is that interest will be remitted in limited circumstances such as when an Inland Revenue officer has given incorrect advice to the taxpayer, and that advice has directly resulted in the non-compliance. However, this is not the only situation when interest may be remitted. The Commissioner will consider each case on its own merits.

7.10 One of the aims of the tax system is to encourage voluntary compliance and, although it may seem to be stating the obvious, a critical means of achieving this is by taxpayers following the advice provided by Inland Revenue. Officials therefore recommend that the legislation be clarified to ensure that, if the taxpayer has relied on the advice of Inland Revenue, the unacceptable tax position penalty cannot apply. While the current provisions allow use-of-money interest to be remitted, we also consider that the legislation should specifically allow for the remission of use-of-money interest if the taxpayer has relied on the advice of Inland Revenue. The taxpayer would remain liable to pay the underlying tax in either case.

7.11 The advice relied on would need to be provided by Inland Revenue as the official position of the Commissioner or in specific advice to taxpayers. In the first instance it should be clear that the advice was applicable to the taxpayer in the circumstances, and in the second instance it should be clear that all relevant facts were provided by the taxpayer and the advice provided by an appropriately authorised person in Inland Revenue. The advice to be taken into account would generally need to be written although oral advice of a standard nature in relation to a common issue (which in limited cases may include advice provided by a call centre) could also be considered.

7.12 The Commissioner would retain the discretion to determine whether the taxpayer had relied on Inland Revenue's advice.

Summary of suggested option

Clarify that if the taxpayer has relied on official advice from Inland Revenue the unacceptable tax position penalty and use-of-money interest cannot apply.