

Coversheet: Making Tax Simpler: Proposals for modernising the Tax Administration Act - flexibility for dealing with legislative anomalies

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| Advising agencies | <i>Inland Revenue</i> |
| Decision sought | <i>How best to reduce compliance costs and administrative costs by providing earlier certainty to taxpayers and Inland Revenue about the application of tax law when there is a legislative anomaly that results in an inconsistency with policy intent and practice.</i> |
| Proposing Ministers | <i>Minister of Revenue</i> |

Summary: Problem and Proposed Approach

Problem Definition

What problem or opportunity does this proposal seek to address? Why is Government intervention required?

The Commissioner of Inland Revenue (the Commissioner) has limited ability to deal with situations when a provision is not consistent with the intended policy (legislative anomalies). This ties up taxpayer and Commissioner resources in outcomes that are inconsistent with both parties' practice and/or expectations. Taxation laws are public goods provided by the government. Only government action can remedy uncertainty caused by a legislative anomaly.

Proposed Approach

How will Government intervention work to bring about the desired change? How is this the best option?

The proposed approach would enable regulations to be made, or administrative action by way of an exemption issued by the Commissioner to be taken, to address legislative anomalies. The power would be subject to safeguards including consistency with the existing policy and the principles supporting the integrity of the tax system; the outcomes would be optional for taxpayers to apply and would expire in three years.

Section B: Summary Impacts: Benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?

The proposed approach would have no direct impact because it would only enact an empowering provision. The main expected beneficiaries of any regulations or exemptions made under the power would be the full range of taxpayers, including individual taxpayers through to large corporates. The expected benefit would be increased certainty for taxpayers and reduced compliance costs.

Where do the costs fall?

The main costs of the proposal would fall on Inland Revenue in having to administer the system. Some minor costs would fall on taxpayers in having to maintain awareness of any regulations or exemptions made.

What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?

The introduction of the power could raise risks for the rule of law. However, there are various elements of the proposed approach that would mitigate the risks to the rule of law including the limited scope of the power, the procedural safeguards (including parliamentary oversight), and the temporary nature of any modifications or exemptions created under the power.

Identify any significant incompatibility with the Government’s ‘Expectations for the design of regulatory systems’.

There is no significant incompatibility with the Government’s ‘Expectations for the design of regulatory systems’.

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?

Inland Revenue is confident that the evidence supports the policy proposal. Analysis has been undertaken to determine the impact of the current problem, including the length of time taken to remedy anomalies under the current system. Analysis has also been undertaken of comparative regimes overseas, including the recently enacted Australian regime.

To be completed by quality assurers:

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| Quality Assurance Reviewing Agency: |
| Inland Revenue. |
| Quality Assurance Assessment: |
| The Quality Assurance reviewer at Inland Revenue has reviewed the <i>Making Tax Simpler: Proposals for modernising the Tax Administration Act – flexibility for dealing with legislative anomalies</i> Regulatory Impact Analysis and considers that the information and analysis summarised in it meets the quality assurance criteria of the Regulatory Impact Analysis framework. |
| Reviewer Comments and Recommendations: |
| A previous version of this RIA completed on 15 February 2018 was assessed as meeting the quality assurance criteria. This RIA has been updated to reflect changes introduced through a redraft of the proposals. Further detail on this process is included in section 2.5 of this document. This revised version also meets the quality assurance criteria of the Regulatory Impact Analysis framework. |

Impact Statement: Making Tax Simpler: Proposals for modernising the Tax Administration Act - flexibility for dealing with legislative anomalies

Section 1: General information

| Purpose |
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| Inland Revenue is solely responsible for the analysis and advice set out in this Regulatory Impact Assessment, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by or on behalf of Cabinet. |

Key Limitations or Constraints on Analysis

There are two limitations on the analysis because there is some uncertainty about:

- the number of suggested applications of the exemption power that could be proposed by taxpayers, and so the resource impact on Inland Revenue in having to deal with the proposed applications; and
- any possible increase in judicial review applications.

Level of suggestions

Taxpayers would be able to suggest instances when the proposed power could be used. There is some uncertainty about the number of suggested applications that might be submitted by taxpayers, so there is some uncertainty about the resources Inland Revenue would need to process them. There is only a small risk that there would be a significant number of suggestions because there is evidence of the number of legislative anomalies that are discovered each year and the number suitable for the remedial power is likely to be a subset of those issues.¹

Inland Revenue received 140 referrals from all sources for remedial amendments between October 2015 and October 2017. Only a small subset of those referrals is likely to be appropriate for the proposed option. Furthermore, under the similar Australian provision only 22 applications were received in the first six months. Of those only two were considered appropriate for the remedial power. It is acknowledged that although the Australian provision is similar to the preferred option discussed below, the differences in the tax systems might lead to a different number of suggestions being made. Overall, the evidence suggests that the proposed option is unlikely to require a significant amount of resource for Inland Revenue to manage the process, and the analysis proceeds on that basis.

Increase in judicial review applications

There is some uncertainty about the impact of any possible judicial review of the use, or failure to use, the proposed power. However, Inland Revenue considers the risk to be small because the application of any exemption is optional so taxpayers are unlikely to judicially review the application of the exemption power and the courts have been reluctant to allow judicial review challenges that are seen as collateral attacks on a tax assessment.² Inland Revenue considers the risk is so small that it will not have any meaningful impact on the analysis.

¹ The number of remedial referrals is contained in an internal database.

² *Tannadyce Investments Limited v Commissioner of Inland Revenue* [2011] NZSC 158.

Responsible Manager (signature and date):

Chris Gillion
Policy Manager
Policy and Strategy
Inland Revenue

24 January 2019

Section 2: Problem definition and objectives

2.1 What is the context within which action is proposed?

Taxation laws are public goods provided by the government. Only government action can remedy uncertainty caused by a legislative anomaly. If the government does not remedy the anomaly, then the taxpayer bears the risk of being found not to have complied with the law, or they must bear the unintended costs.

New Zealand's tax system is very complex, and it undergoes significant change regularly. The nature and volume of the tax law changes mean that unforeseen or unintended outcomes (legislative anomalies) arise often. This is likely to continue to be the case into the future given the increasing complexity of tax law and rapidly evolving business practices.

Ideally, any such anomalies would be remedied by an amending Act, given the constitutional importance of tax and the certainty that primary legislation gives to both taxpayers and Inland Revenue. In some cases this will be both necessary and achievable.

However, under the current approach, it takes on average 670 days to remedy a legislative anomaly through primary legislation once it has been identified as needing legislative change. During that time, taxpayers are required to file different returns in different periods. For example, GST returns often need to be filed every two months and income tax returns every year. Taxpayers, therefore, might need to file several returns in the period during which an anomaly is being remedied.

It is noted that similar problems arise in Inland Revenue's non-tax functions (such as the administration of social policies). Clarifying that the care and management provision applies to the Commissioner's non-tax functions is intended to be progressed as part of the Making Tax Simpler project to modernise the administration of social policy.

2.2 What regulatory system, or systems, are already in place?

The elements of the current regulatory system that are relevant for dealing with legislative anomalies are set out below:

- In some situations, a purposive approach to interpreting the relevant legislation will mean that an anomaly that may arise on the plain reading of the relevant provision does not arise. However, sometimes the legislation cannot be interpreted in a way that is consistent with the policy intent.
- Some anomalies can be remedied quickly through the legislative process if their discovery aligns with an existing bill. However, this does not often happen and so the average time to remedy a remedial issue is approximately 670 days.
- The Commissioner also has some administrative flexibility under the existing care and management provision. The current provision does not allow the Commissioner to administratively remedy legislative anomalies.³ Instead, the flexibility allows the

³ Interpretation statement "Care and management of the taxes covered by the Inland Revenue Acts – section 6A(2) and (3) of the Tax Administration Act 1994", Tax Information Bulletin Vol 22, No 10 (November 2010).

Commissioner to decide not to allocate her resources to investigate situations when there is a known anomaly. This does not provide certainty for a taxpayer when Inland Revenue becomes aware of an issue because the Commissioner does not have a general power to suspend the application of the law. As it is only an administrative undertaking by the Commissioner, it provides limited protection for taxpayers who rely on it and so do not comply with the law. In those circumstances, the Commissioner would continue to have a duty to apply the law, even when it would produce outcomes that are not consistent with the purpose or object of the law.

2.3 What is the policy problem or opportunity?

The existing approach to resolving legislative anomalies in tax law can create uncertainties and is costly for taxpayers and Inland Revenue.

The process creates uncertainties because when the legislation does not align with the intended policy, then taxpayers are unsure how to apply the law. To a limited extent this uncertainty can be resolved by binding rulings and other forms of advice. However, such advice can only clarify the meaning of the legislation and cannot resolve issues when the legislation cannot be interpreted consistently with the intended policy. Taxpayers either have to comply with the legislation as interpreted either by themselves or the Commissioner, so incurring unintended costs or compliance requirements; or comply with the intended policy and risk being penalised for not complying with the law. The uncertainty makes it harder for taxpayers to organise their affairs, invest or plan for the future.

The uncertainty can also undermine the integrity of the tax system, by encouraging taxpayers to ignore the relevant tax law and comply with the policy. It can also be seen to undermine the rule of law when there is uncertainty about whether the law is intended to be complied with.

The rule of law has been described as an elusive constitutional principle that includes at its heart the requirement that all persons (including the State) should be bound by the laws publicly made.⁴ This has been developed further to suggest that the law should be clear, predictable, accessible and not made arbitrarily.

When the only avenue to resolve the issue is through legislative amendment, then there can be a substantial period of uncertainty. This can create compliance costs for taxpayers by requiring them to seek advice either from an external advisor or Inland Revenue as to the correct approach to the relevant provision in the interim period. This also increases the administrative costs for Inland Revenue in dealing with the issue.

⁴ Ross Carter et al *Subordinate Legislation in New Zealand* (LexisNexis, Wellington, 2013) 26.

2.4 Are there any constraints on the scope for decision making?

There were no particular constraints on the scope of options considered.

The options tie in with the broader work that is being undertaken to modernise the Tax Administration Act 1994. Specifically, the work on updating the type of advice provided by Inland Revenue deals with situations when the legislation can be interpreted in a way that aligns with the policy intent. The work on advice is aimed at better communicating the Commissioner's position to taxpayers through different forms of advice tailored to the needs of different taxpayers. The current issue deals with situations when the legislation cannot be interpreted consistently with the policy intent.

2.5 What do stakeholders think?

The problem affects all taxpayers and there are various stakeholders that have an interest.

Significant consultation has been undertaken which has resulted in four options being developed. The consultation process is set out below.

The policy proposal was originally included in the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill. During their consideration of the Bill, the Finance and Expenditure Committee recommended that the proposal be removed from the Bill pending further engagement between Inland Revenue and the Legislation Design and Advisory Committee. This resulted in a substantial change to the legislative drafting and minor changes to the originally preferred policy proposal. Stakeholders who have been consulted on the revised legislative drafting are still broadly supportive of the proposal.

Problem identification

Taxpayers highlighted the lack of speed and certainty in rectifying legislative anomalies in the *Tax Administration for the 21st century* conference in June 2014. The conference's purpose was to explore options for making tax easier (by reducing both compliance and administration costs) and increasing voluntary compliance balanced against core tax policy objectives such as raising revenue, and ensuring fairness and efficiency.

First discussion document proposed options

In response to the identified problem (and other problems), the Government released a discussion document *Making Tax Simpler: Towards a new Tax Administration Act* in 2015 which suggested two possible options:

- extend the Commissioner's current discretionary or determination-making powers that attach to specific provisions (referred to as "option 3" in this RIA); or
- a clarification to the care and management provision to deal with some legislative anomalies (referred to as "option 4" in this RIA).

The consultation included an online forum and presentations to submitters.

The proposal to clarify the care and management provision was based on some criteria set out in *R v Inland Revenue Commissioners; Ex parte Wilkinson* [2005] UKHL 30, which discussed the scope of the Commissioners' discretionary powers under the similarly worded United Kingdom care and management power. The option would allow the Commissioner to use her discretion in relation to:

- minor legislative anomalies;
- transitory legislative anomalies;
- cases when the relevant legislation has failed to adequately deal with the particular situation because a statutory rule is difficult to formulate;
- a long-standing established practice of both the Commissioner and taxpayers;
- cases of unfairness at the margins.

The discretion would only be exercised consistently with policy intent, and not allow for a policy-making ability. The exercise of the discretion would be time-limited and could not exceed three years. After this time, if the issue was on-going, an amendment to the primary legislation would be required. Consultation prior to the exercise of the discretion would be required, and any exercise of the discretion would be published to ensure transparency. The discretion would also be exercised only by Inland Revenue officers with an appropriate level of expertise.

Submissions on the care and management proposal suggested various safeguards

Submissions were generally supportive of the proposal to clarify the care and management provision. They commented that it should be a positive step for taxpayers and ensure the Commissioner had the ability to direct her resources where they were most needed. It was also noted that the proposal needed to be supported by a change in mind-set within Inland Revenue to support use of the care and management provision.

Submissions suggested:

- Any enhanced administrative flexibility should only be exercised in favour of the taxpayer, and the amendment should expressly state this rule to avoid any doubt.
- Any care and management power should be guided by a set of principles – including those in sections 6 and 6A of the Tax Administration Act.
- There needed to be a principle which establishes whether the policy is clear enough such that the Commissioner could depart from the ordinary meaning of the words – for example, “persons reading the relevant legislation would in most cases agree what the policy intent of the legislation is”.
- A balancing of a collection of factors was suggested, including: cost to the taxpayer; cost to the Commissioner; a ceiling of an amount of tax at issue if the legislation is applied as written (compared to if the Commissioner has the flexibility to take another approach); and perhaps a time period.

Submissions reflected in proposed safeguards and options

The submissions were taken into account in developing a refined proposal that was consulted on in a subsequent Government discussion document, *Proposals for modernising the Tax Administration Act* (December 2016). The consultation included an online forum and

workshops with submitters. The revised proposal retained the listed criteria and set out the relevant safeguards that would apply, including that it would be optional for taxpayers.

The submissions on the specific criteria and safeguards suggested:

- While there was support for each of the listed criteria for when the discretion could be exercised, there was some uncertainty about the scope of the criteria.
- There were differing views on whether the exercise of the discretion should be limited to taxpayer-friendly situations or whether it should be optional for taxpayers to apply.
- The discretion should be applied consistently and only in appropriate circumstances, but that these safeguards should not impede the exercise of the discretion in an effective manner.
- Guidance was needed to ensure taxpayers had a clear understanding of how the provision would apply.
- The power should not be exercised if it would not be in the public interest to do so.
- The exercise or non-exercise of the discretion should be a reviewable decision.
- There should be some flexibility around the requirement to consult as whilst consultation might be beneficial in some cases, in many cases it would result in significant delay of the effective exercise of the discretion.
- The requirement to publish the exercise of the discretion should be subject to a public interest requirement.

Submitters proposed other options

A concern was raised that not all taxpayers would have access to decisions made by the Commissioner under an extended care and management power, which would result in a body of private law. Some submitters suggested exploring further the option of granting the Commissioner a regulation-making power in the form of disallowable legislative instruments like those proposed in Australia.

Alternatively, it was suggested that the Commissioner should be allowed to anticipate legislative changes by issuing interpretation statements that then apply as binding interpretations.

Submitters, and the Legislation Design and Advisory Committee, supported having a range of options by which the discretion could be exercised (a “tool box approach”). This approach is similar to the suite of powers available to the Financial Markets Authority under the Financial Markets Authority Act 2011 and Financial Markets Conduct Act 2013.

The Crown Law Office was concerned about the implications for the rule of law of the proposed extension to the Commissioner’s care and management power, but noted that those concerns were, to a limited extent, addressed by the specific safeguards. The Crown Law Office considered that it would be preferable if the power could be exercised only by Order in Council.

These concerns and comments led to the development of the proposal referred to as “option 5” in this RIA.

Workshop with submitters

Following the submissions on the discussion document, and the comments above, Inland Revenue organised a workshop with submitters (including Crown Law) on the various proposals. The discussion focused on option 5.

During the workshop, submitters suggested:

- The proposal should adopt a principle-based approach. This would allow the discretion to be used when the legislation did not align with the intended policy without being limited by any specific criteria.
- There should be a tool-box of options by which legislative anomalies could be dealt with, including Orders in Council, Commissioner-made determinations, and administrative action.
- Any exercise of the discretion should be optional for taxpayers to apply.

Summary

The consultation comments were taken into account in developing the options discussed below.

Section 3: Options identification

3.1 What options are available to address the problem?

There are five options considered in this analysis:

- **Option 1:** Address legislative anomalies using existing processes (status quo).
- **Option 2:** Increase resources to address legislative anomalies using existing processes. Increasing the resources directed at remedying legislative anomalies would involve redirecting existing resources or increasing the resources directed to law development. This option does not require legislation and could be used in conjunction with any of the other options.
- **Option 3:** Provide for more discretionary provisions in legislation. This option would extend the Commissioner's current discretionary or determination-making powers that attach to specific provisions. It would provide the Commissioner with increased administrative flexibility to deal with legislative anomalies in specific situations.
- **Option 4:** Administrative flexibility in limited circumstances. This option would extend the Commissioner's care and management provision to provide some more administrative flexibility in limited circumstances.
- **Option 5:** Regulations and exemptions⁵ to temporarily remedy anomalies (preferred option). This option would provide a power to make regulations or take administrative action by issuing an exemption to remedy a legislative anomaly.

⁵ The exemption-making power would enable the Commissioner to exempt taxpayers from provisions of the Inland Revenue Acts. If necessary, an exemption may come with terms and conditions (including specifying an alternative means of compliance) that must be met for taxpayers to apply it.

3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The overarching objective is to reduce compliance costs and administrative costs by providing earlier certainty to taxpayers and Inland Revenue about the application of tax law when there is a legislative anomaly that results in an inconsistency with policy intent and practice.

The options have been assessed against the objective and the following criteria:

- **Sustainability:** The options should support the rule of law and maintain the integrity of the tax system.
- **Compliance costs:** Compliance costs for taxpayers should be minimised as far as practicable.
- **Administrative costs:** Administrative costs for Inland Revenue should be minimised as far as practicable.

The objective of the proposal is to balance the compliance cost and administrative cost reduction criteria against the sustainability criterion. This would be achieved through the limitations included in the options considered.

Overlaps between criteria

There is likely to be an overlap between reductions in compliance costs for taxpayers and reductions in administrative costs for Inland Revenue, in that a reduction in the former is likely to cause a reduction in the later under the relevant options. This is because the simpler the option for taxpayers the less likely they will need advice from Inland Revenue.

3.3 What other options have been ruled out of scope, or not considered, and why?

Some submitters suggested that one option could be to re-interpret the current care and management provision, so as to provide the Commissioner with greater administrative flexibility without the need for a legislative amendment. The preferred option suggests retaining the current care and management provision but supplementing it with further flexibility in certain circumstances. As a result, the proposal does not prevent a broader interpretation being taken of the scope of the current provision.

However, it is considered that while the current provision does provide the Commissioner with flexibility about the allocation of her resources, it does not provide her with the flexibility to administratively remedy legislative anomalies. Further, it is considered that the scope of any such power, and the safeguards that would apply, should be specified in the legislation to protect the integrity of the tax system and the rule of law. As a result, the option of re-interpreting the current provision was ruled out because it would risk the integrity of the tax system and the rule of law.

Section 4: Impact Analysis

Marginal impact: How does each of the options identified at section 3.1 compare with the counterfactual, under each of the criteria set out in section 3.2?

| | No action Option 1 | Option 2 (Providing greater resources) | Option 3 (Enact more discretionary provisions) | Option 4 (Administrative flexibility in limited circumstances) | Option 5 (, Regulations, and admin action) (Preferred option) |
|---|-----------------------|--|---|--|--|
| Criterion (Sustainability) | 0 | 0 Although remedying all issues through legislative amendment would seem to support this criterion, the lengthy legislative process would mean taxpayers would be required to follow either the policy or the law for a substantial time. This would harm the integrity of the tax system and the rule of law. | + This option would support the integrity of the tax system and the rule of law, but it would be difficult to predict any issues so the problem is likely to still arise in many cases. As a result, in most cases taxpayers would be required to follow either the policy or the law, harming the integrity of the tax system and the rule of law. | - This option would support sustainability by remedying anomalies quicker. However, it would be at the discretion of the Commissioner and it would not be subject to Parliamentary oversight. | + This option would remedy the anomalies and would be subject to parliamentary scrutiny, thereby supporting the rule of law. This option would mean taxpayers could choose the best option so supporting the integrity of the tax system. |
| Criterion (Compliance costs) | 0 | + It would reduce taxpayers' compliance costs because more attention would be paid to problematic issues but it would still take time to resolve, so taxpayers would incur costs working out what to do in the interim. | 0 – It would only be effective when the problem could be anticipated so taxpayers would still likely have significant compliance costs in most cases. Relying on discretions would involve moving away from the efficiency objective of self-assessment, and so would incur further compliance costs for taxpayers than the status quo. | + The speed by which the issues could be resolved would reduce taxpayers' compliance costs. However, the remedy would not provide legal certainty so taxpayers might still need to seek advice as to the consequences. | + Anomalies could be resolved quickly, and this would reduce taxpayers' compliance costs. However, taxpayers would incur some costs associated with understanding the process and choosing whether to apply the remedy or the black letter of the law. |
| Criterion (Administrative costs) | 0 | - Devoting more resources to the policy development process would divert resources from elsewhere, or require more funding. | - Additional administrative costs in determining on a case-by-case basis whether the issue is within a discretionary power. | + The ease of remedying anomalies would reduce administrative costs but there would be risks of challenges to the use of the discretion. | + This option would reduce administration costs by quickly remedying anomalies. However, there would be some increased costs for Inland Revenue in deciding whether the discretion should be exercised. |
| Overall assessment | | 0 | 0 | + | ++ |

See below for more detailed analysis

Key:

- ++** much better than doing nothing/the status quo
- +** better than doing nothing/the status quo
- 0** about the same as doing nothing/the status quo
- worse than doing nothing/the status quo
- much worse than doing nothing/the status quo

Further analysis:

Option 2 (Increase resources)

Sustainability

This option would seem to support the integrity of the tax system and the rule of law as it reflects the constitutional importance of tax and the certainty that primary legislation gives to both taxpayers and Inland Revenue. However, under the current approach it takes on average 670 days to remedy a legislative anomaly through primary legislation once it has been identified as needing legislative change. It is not clear that increasing the policy resources would substantially reduce this time period, as it is mainly driven by the legislative process. The time period involves the lead-in time to get a remedial item added to a bill (including the relevant reporting requirements) and the passage of the bill through the House.

As a result, it is likely that even with more policy resources it might still take a similar time to resolve the relevant legislative anomalies. The substantial time taken by the legislative process would mean taxpayers either comply with the legislation as interpreted, so incurring unintended costs or compliance requirements; or comply with the intended policy and risk being penalised for not complying with the law. This would result in no change from the status quo for the integrity of the tax system and the rule of law. The uncertainty makes it harder for taxpayers to organise their affairs, invest or plan for the future.

Compliance costs

Under this option there would be some reduction in taxpayers' compliance costs because more attention would be paid to problematic issues, and so taxpayers could be better informed about the correct approach. However, the Commissioner could only provide administrative guidance prior to the legislation being enacted and so taxpayers would not have any certainty about the outcome in that period. Taxpayers would still need to decide during the time taken to remedy the problem whether they would follow the existing law or the policy. Often this would require taxpayers to consult a professional advisor or Inland Revenue to work out what to do in the interim. In some circumstances, taxpayers and Inland Revenue might still end up in disputes that are inconsistent with both parties' expectations. This would impose compliance costs on taxpayers.

Administrative costs

Increasing resources, or directing existing resources towards fixing anomalies, both come with an opportunity cost for Inland Revenue for other functions those resources could have been directed towards. As a result, this option would increase administrative costs for Inland Revenue.

Overall assessment

Increasing resources to policy development to fix more anomalies would result in some compliance gains for taxpayers while maintaining the sustainability under the status quo. However, the option would increase administrative costs for Inland Revenue.

Option 3 (Provide for more discretionary provisions)

Sustainability

Enacting the discretionary provisions as part of the primary legislation would support the integrity of the tax system and the rule of law. However, if an issue can be foreseen then they are currently addressed in the primary legislation. This might be through a specific discretion or by allowing determinations to be made on the relevant issue. As a result, it is

considered that the current problem is unlikely to be one that can be foreseen. Taxpayers, therefore, would still be required to follow either the policy or the law in most cases, so harming the integrity of the tax system and the rule of law.

Compliance costs

Given that the problem really relates to those situations when it is not possible to anticipate the likely issue, adopting this option is unlikely to reduce compliance costs for taxpayers compared with the status quo. In addition, relying on Commissioner discretions would mean that taxpayers would not have certainty from the legislation and would need to consider when the Commissioner would exercise her discretion. There may also be compliance costs in applying to the Commissioner to exercise her discretion or make a determination and the approach could in any case be inconsistent with a tax system based on self-assessment.

Administrative costs

This option would impose additional administrative costs on the Commissioner because she would be required to consider whether to exercise a particular discretion in a situation. The consideration of the use of the discretion would require resources. The amount of resources would depend on the number of discretionary provisions and the number of possible situations when the discretion could apply. As a result, the more discretionary provisions included in the Revenue Acts to deal with anticipated anomalies, the more resources the Commissioner would potentially have to commit to the various issues.

Overall assessment

This option would meet the criteria for the issues that could be identified in advance. However, Inland Revenue considers that the majority of anomalies could not be foreseen, and this option would not satisfy the criteria for those issues.

Option 4 (Administrative flexibility in limited circumstances)

Sustainability

Option 4 would reduce sustainability because it would be subject to challenge and would raise rule of law concerns that the Commissioner was not bound to the published law. The proposed safeguards would limit the concerns to some extent. Specifically:

- The limited criteria, and the requirement that any exercise of the discretion must be consistent with existing policy, would mean that the scope of the discretion is very limited;
- The requirement to consult on any exercise of the discretion would reduce the risk of challenge because concerns could be dealt with before any exercise of the discretion; and
- The time limitation would mean any exemptions would only be temporary, which would reduce rule of law concerns.

Compliance costs

This option would allow anomalies to be remedied quickly. This would reduce compliance costs for taxpayers by providing them guidance on the intended policy outcome. However, as the remedy would not be legislative and would only be administrative, it would not provide legal certainty for taxpayers. This would mean that taxpayers might still need to seek advice as to the likelihood of the remedy being overturned. There would also be a small increase in compliance costs in having to become familiar with the new process, and having to keep up-to-date with any exercise of the discretion. Taxpayers would also have to monitor any challenges to the exercise of the discretion.

Administrative costs

The ease of remedying anomalies would reduce administrative costs for Inland Revenue in having to provide less advice about the anomaly, and having less disputes about outcomes that were not intended. However, there would be some increase in administrative costs in having to set-up and administer the new process. This would include providing guidance to taxpayers about how the new process would work, although this is expected to taper over time. There might also be additional costs from any challenges to the exercise of the administrative power. Even so, it would be optional for taxpayers to apply, and so the risk would be small.

Overall assessment

This option would reduce compliance and administrative costs but could undermine the sustainability of the tax system. The lack of any parliamentary oversight of the process might raise rule of law issues.

Option 5 (Regulations, and administrative action)

Sustainability

Using Orders in Council or disallowable exemptions to remedy anomalies would support the sustainability of the process of remedying the anomalies by enabling parliamentary oversight of the process. Parliamentary oversight would be provided by the disallowance process and the oversight of the Regulations Review Committee. In many cases, the issue would still need to be resolved through the normal legislative process, with the new process providing a temporary bridge until that could occur.

This option would support the rule of law by enabling Parliament to disallow any remedies that were considered to be the proper domain of Parliament. The temporary nature of the remedies and the fact that they do not override the primary law also support the sustainability of the system.

The optionality of the remedies would mean taxpayers could choose the best option so supporting self-assessment and the integrity of the tax system.

Compliance costs

This option would reduce compliance costs for taxpayers by providing them with faster remedies for legislative anomalies. As noted previously, this would overcome a specific issue raised by taxpayers. It would reduce the need for taxpayers to seek advice either from professional advisors or Inland Revenue on the operation of the relevant provision (when it seems to be inconsistent with the intended policy). It reduces the risks for taxpayers of getting it wrong, and so encourages investment and planning for the future.

The option would increase compliance costs for taxpayers to a limited extent. There would be a small increase in compliance costs in having to become familiar with the new process, and having to keep up-to-date with any exercise of the discretion. It would increase the overall complexity of the tax system. This option would be more complicated than Option 4 given the two possible remedies. However, the use of regulations and disallowable exemptions under Option 5 would make it easier to keep track of any remedies, so reducing the increased compliance costs to some extent. Some compliance costs may be incurred by taxpayers in having to submit on the draft remedies during the process. Finally, taxpayers would need to determine whether any remedy would be favourable for them in their own circumstances, which would increase compliance costs for them. Inland Revenue considers the reduction in compliance costs from providing certainty for taxpayers more quickly under this option would significantly outweigh the increased compliance costs.

Administrative costs

The option would reduce the overall administrative costs for Inland Revenue. Providing greater certainty for taxpayers more quickly would reduce the need for them to contact Inland Revenue seeking advice and would prevent disputes arising when the legislation does not align with the policy. This would reduce the resources Inland Revenue needed to commit to such issues.

As previously noted, the average time taken to remedy an anomaly spans several return periods so providing certainty to taxpayers sooner could reduce the resources Inland Revenue needs to assist to amend previous tax positions.

There will be an increase in administrative costs for Inland Revenue in establishing the process and processing any suggested applications of the power from Inland Revenue staff or taxpayers. The Australian experience would suggest there would not be a large number of applications so this cost is not expected to be large.

When the anomaly needed to be fixed subsequently through the normal legislative process, the costs incurred in providing a temporary solution could be seen as a duplication, but many of the subsequent elements of the process would not need to be repeated. For example, if the problem had been identified and a remedy consulted on before the making of a regulation, then it may not need to be repeated to the full extent when the permanent legislative amendment is being subsequently proposed.

Overall assessment

Inland Revenue prefers this option. It would support the sustainability of the tax system by incorporating Parliamentary oversight through the disallowance process and the Regulations Review Committee. The option would also reduce compliance and administrative costs. As a result, this option best meets the stated criteria.

Section 5: Conclusions

5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?

Inland Revenue prefers option 5 for the following reasons:

- It provides a process by which legislative anomalies could be quickly dealt with, while supporting the integrity of the tax system and the rule of law.
- It would reduce taxpayers' compliance costs in dealing with legislative anomalies, while aligning with the self-assessment system.
- It would reduce the administrative costs for Inland Revenue in dealing with anomalies. Although there would be some increased costs in identifying and providing a remedy for the relevant issues, the current number of remedial issues and the Australian experience with their similar provision, suggest these costs would be relatively small.
- It is the option most favoured by submitters because it has sufficiently broad scope, it is optional for taxpayers to apply, and because it has appropriate safeguards in place.

5.2 Summary table of costs and benefits of the preferred approach

| Affected parties (identify) | Comment: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks | Impact \$m present value, for monetised impacts; high, medium or low for non-monetised impacts | Evidence certainty (High, medium or low) |
|--------------------------------|--|---|---|
|--------------------------------|--|---|---|

Additional costs of proposed approach, compared to taking no action

| Additional costs of proposed approach, compared to taking no action | | | |
|---|---|-----|------|
| Regulated parties (taxpayers) | Cost of gaining an initial understanding of how the new process would operate. | Low | High |
| | Cost of being involved in consultation process for any new regulations or exemptions. | Low | High |
| | Cost of choosing whether to apply the remedy or the black letter of the law. | Low | High |

| | | | |
|--------------------------------|--|-----|--------|
| Regulators (Inland Revenue) | Costs of the process of determining whether to apply remedial process. | Low | Medium |
| | Cost of process of remedying anomaly. | Low | Medium |
| | Increased risk of judicial review for using, or failing to use, remedial power. | Low | Medium |
| Wider government | N/A | N/A | N/A |
| Other parties (Courts) | Cost for very small risk of increase in judicial review requiring further resources. | Low | High |
| Regulations Review Committee | Cost for reviewing any regulations or exemptions made under the preferred option. | Low | High |
| Total Monetised Cost | - | - | - |
| Non-monetised costs | - | Low | Medium |

| Expected benefits of proposed approach, compared to taking no action | | | |
|--|--|--------|--------|
| Regulated parties (Taxpayers) | Increased certainty would allow taxpayers to better organise their affairs and plan for the future. | Medium | High |
| | Reduced need to seek advice on legislative anomalies. | High | High |
| | Less risk of getting into dispute with Inland Revenue over a legislative anomaly. | Medium | Medium |
| Regulators (Inland Revenue) | Reduced administrative costs dealing with taxpayers affected by a legislative anomaly, including less need to give advice and less risk of disputes. | Medium | High |
| Wider government | N/A | N/A | N/A |
| Other parties | N/A | N/A | N/A |
| Total Monetised Benefit | - | - | - |

| | | | |
|-------------------------------|---|--------|------|
| Non-monetised benefits | - | Medium | High |
|-------------------------------|---|--------|------|

5.3 What other impacts is this approach likely to have?

There is a risk of adverse public perception that tax laws are being changed through Order in Council or by the use of the Commissioner’s exemption-making power. Such a perception could undermine the integrity of the tax system and the perception of the rule of law. This risk would be mitigated by several elements. The most important element would be the fact that the tax laws would not be overridden, and it would be optional for taxpayers to apply any remedial actions. Further, both Orders in Council and exemptions issued by the Commissioner would be subject to parliamentary disallowance, so protecting the role of parliament in the process. In addition, any remedial actions would be only temporary and would expire in three years after having been made.

Another risk could be that the public perceive that lobby groups influence issues which are considered. The consultation and publication requirements would mitigate this risk to some extent. Further, the fact that any regulations or exemptions made under the power would be subject to disallowance would add to the transparency.

5.4 Is the preferred option compatible with the Government’s ‘Expectations for the design of regulatory systems’?

The preferred option is compatible with the Government’s ‘Expectations for the design of regulatory systems’. The preferred option should deliver, over time, a stream of benefits in terms of lower compliance and administrative costs that are in excess of its costs or negative outcomes.

The optional nature of the preferred option means that it has the least adverse impact on property rights and individual autonomy.

It conforms to established legal and constitutional principles and is similar in nature to the statutory remedial power recently enacted in Australia.

The empowering provision under the preferred option would have scope to evolve in response to changing circumstances or new information on the system’s performance. The two methods of exercising the remedial power in the preferred option provide that flexibility to evolve.

Section 6: Implementation and operation

6.1 How will the new arrangements work in practice?

The preferred option will need to be implemented by a legislative amendment to the Tax Administration Act 1994. Specifically, an empowering provision would need to be enacted to allow regulations and exemptions to be made.

The amendment could be included in the next available tax bill. The amendment could apply from the date of enactment. Explanation of the amendment and its effect could be contained in a *Tax Information Bulletin*, which would be released shortly after the bill received Royal assent.

The implementation of the preferred option would require an internal Inland Revenue process to determine if a recommendation should be made to use the power to seek an Order in Council or deal with the anomaly by way of an exemption issued by the Commissioner. The internal process will be developed by Inland Revenue.

Taxpayers and agents will be able to suggest cases when it could be appropriate to use the power. They will also be involved during the consultation process examining any proposed use of the power.

6.2 What are the implementation risks?

There is a risk that there could be a large number of issues raised by taxpayers with Inland Revenue that need to be considered under the proposed power.

However, as noted above, this risk is considered to be low because there is evidence of the number of legislative anomalies that are discovered each year and the number suitable for the remedial power is likely to be a subset of those issues.

Inland Revenue received 140 referrals from all sources for remedial amendments between October 2015 and October 2017. Only a small subset of those referrals is likely to be appropriate for the proposed option. Furthermore, under the similar Australian provision only approximately 22 applications were received in the first six months. Of those only two were considered appropriate for the remedial power. It is acknowledged that while the Australian provision is similar to the preferred option discussed below, the differences in the tax systems might lead to a different number of suggestions being made. Overall, the evidence suggests that the proposed option is unlikely to require a significant amount of the resources for Inland Revenue to manage the process, and the analysis proceeds on that basis.

There is a small risk of an increase in judicial review but as discussed above this risk is considered to be small.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

Inland Revenue would monitor the effectiveness of the proposed changes in the first 12 months of operation. The monitoring would involve a review of any regulations and exemptions made under the empowering provision within that period to see whether they were consistent with the intended policy.

7.2 When and how will the new arrangements be reviewed?

In general, Inland Revenue monitoring, evaluation and review of new legislation takes place under the generic tax policy process (GTPP). The GTPP is a multi-stage policy process that has been used to design tax policy (and subsequently social policy administered by Inland Revenue) in New Zealand since 1995. The final step in the process is the implementation and review stage, which involves post-implementation review of legislation and the identification of remedial issues. Opportunities for external consultation are built into this stage. In practice, any changes identified as necessary following enactment would be added to the tax policy work programme, and proposals would go through the GTPP.

The Regulations Review Committee would have a role in monitoring and reviewing any regulations or exemptions (being disallowable instruments) made. The committee examines all regulations, investigates complaints about regulations, and examines proposed regulation-making powers in bills for consistency with good legislative practice. The committee reports to the House and other committees on any issues it identifies. The House can “disallow” a regulation, and would have the ability to disallow exemptions issued by the Commissioner (as these would be disallowable instruments), meaning it no longer has force.