

4 February 2019

Public Rulings
Office of the Chief Tax Counsel
Inland Revenue
Wellington

By email: PublicConsultation@ird.govt.nz

Re: ED0201: Standard Practice Statement – Voluntary Disclosures

1. Introduction

- 1.1 The New Zealand Law Society welcomes the opportunity to comment on Exposure Draft 0201: Standard Practice Statement: Voluntary disclosures (ED0201), which replaces SPS 09/02: Voluntary Disclosures. (All paragraph references below correspond to those in ED0201; unless otherwise stated, all legislative references are to the Tax Administration Act 1994.)
- 1.2 The Law Society welcomes this updated and modernised guidance from the Commissioner regarding voluntary disclosures. The guidance is simple, thorough and easy to navigate. We appreciate the structure and layout of ED0201, including the decision to incorporate examples into the main body of the guidance. This is a substantial improvement over SPS 09/02 and should greatly improve the navigability of the guidance for professionals and other interested parties.
- 1.3 For this reason, the comments below focus on a single significant issue – the changes to the assurance of non-prosecution. We also make minor comments on ancillary issues.

2. Assurance of non-prosecution

Overview

- 2.1 A consistent and functional voluntary disclosure regime is a fundamental aspect of New Zealand's tax system. As the Commissioner notes at paragraph 6, many disclosures in New Zealand are unprompted. Further, at paragraph 49 the Commissioner acknowledges that the "*taxpayer has the best knowledge of their tax affairs*" and there is an expectation that disclosure will therefore be full and complete.
- 2.2 It has always been accepted that the assurance of non-prosecution in circumstances where a pre-notification voluntary disclosure has been made was to encourage taxpayers to come forward and disclose errors.
- 2.3 However, at paragraph 93 the Commissioner indicates a possible dilution of the extant non-prosecution assurance. The Law Society submits that the non-prosecution assurance should not be potentially eroded without close consideration of the implications for voluntary

compliance. We urge the Commissioner to seek further guidance and consider feedback on this point.

- 2.4 While the Commissioner's ability to detect non-compliance is constantly improving, taxpayers will continue for the foreseeable future to have the best knowledge of their tax affairs. In this light, taxpayers ought to remain incentivised to comply voluntarily.
- 2.5 The Law Society submits that, if the application of the assurance of non-prosecution for pre-notification voluntary disclosures is uncertain, the voluntary disclosure regime could be significantly undermined in an unintended manner. If taxpayers no longer have certainty that a pre-notification voluntary disclosure gives rise to an assurance of non-prosecution, voluntary compliance could be discouraged. The possibility of prosecution, however remote, could instead cause taxpayers to opt to 'sweep it under the rug'. In these circumstances, the Commissioner could not guarantee that she would detect the undisclosed tax shortfalls, and the black economy could grow proportionally, as could the Commissioner's compliance and investigation costs.
- 2.6 In summary, the Law Society is concerned that any erosion of the assurance of non-prosecution would undermine its very purpose.

Specific comments

- 2.7 The assurance of non-prosecution for taxpayers making pre-notification voluntary disclosures will be eroded if ED0201 is issued in its current form. The assurance was previously set out in SPS 09/02 at paragraph 9:

"When a taxpayer makes a pre-notification disclosure, the Commissioner's practice is not to consider subsequent prosecution action against them in respect of the tax shortfall that they have voluntarily disclosed. However, Inland Revenue may consider prosecution action when a taxpayer makes a post-notification disclosure that involves evasion or similar offending."

- 2.8 In ED0201, this assurance, while still available, is now conditional. ED0201 provides at paragraphs 92 – 93 that:

"92. If a taxpayer makes a full voluntary disclosure before they are first notified of a pending investigation, the CIR will not (subject to [93] below) consider prosecution action against them for the tax shortfall that has been voluntarily disclosed. This is on the basis that any subsequent prosecution action in this circumstance would not aid voluntary compliance."

"93. In circumstances where the CIR forms the view that a taxpayer's actions or omissions is such that non-prosecution could lead to voluntary compliance more generally being undermined, the CIR may still proceed with that subsequent prosecution action. It is emphasised that the decision to prosecute in these circumstances will be a rare occurrence and will require the approval of a senior officer."

- 2.9 While the Law Society acknowledges that the Commissioner believes it would be a rare occurrence for a pre-notification voluntary disclosure to result in a prosecution action, prosecution action is still nonetheless a possibility. This change is substantial and could have unintended and unhelpful consequences.
- 2.10 The Law Society considers that the threat of prosecution for taxpayers making pre-notification voluntary disclosures undermines the Commissioner's duty under section 6A to

promote voluntary compliance. It is also inconsistent with the stated purposes of the Part 9 penalties regime (pursuant to section 139). Those purposes are:

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

- 2.11 The threat of prosecution for taxpayers making pre-notification voluntary disclosures may discourage voluntary compliance in a manner that is inconsistent with section 139(a). Further, taxpayers who make a pre-notification voluntary disclosure are *not* non-compliant, and so should not be subject to the penal sanction contemplated by section 139(c).

Encouraging voluntary compliance

- 2.12 The substantial reductions in shortfall penalty available for those taxpayers who make pre-notification voluntary disclosures encourage voluntary compliance. The Commissioner's current assurance of non-prosecution similarly encourages voluntary compliance. The penalties regime encompasses both civil and criminal penalties. If the penalties regime is intended to discourage non-compliance, then the incentives to comply ought to apply equally to civil and criminal penalties.

- 2.13 The Commissioner states at paragraph 21 that:

"The purpose of imposing shortfall penalties is to encourage voluntary compliance, and to address non-compliance in a way that is consistent, impartial and proportionate to the seriousness of that breach."

- 2.14 That purpose arguably applies equally to the imposition of criminal penalties.

- 2.15 The Law Society submits that even a low risk of prosecution could act to discourage compliance for taxpayers who are attempting to do the right thing. The very making of a pre-notification voluntary disclosure is evidence that Part 9 is encouraging voluntary compliance. Taxpayers who make pre-notification voluntary disclosures do so to avoid the harsher penalties and potential prosecution that may come with a post-notification disclosure.

Ensuring consistency and impartiality

- 2.16 Introducing conditionality to the assurance of non-prosecution creates uncertainty. Introducing uncertainty is contrary to the purpose of the penalties regime as it increases discretion and risks undermining consistency and impartiality.
- 2.17 Certainty is one of the Commissioner's five key principles for facilitating compliance, according to Inland Revenue's 2018 Annual Report.¹ Certainty is necessary to ensure that the penalties regime remains consistent and impartial.

¹ Inland Revenue Annual Report 2018 at 45. Available at <https://www.ird.govt.nz/resources/0/7/0774560a-7b44-4c03-8a76-cebe59f042c3/annual-report-2018.pdf>. Accessed 15 January 2019.

- 2.18 Sections 141 – 141L are drafted to ensure that the penalties regime is fair for all taxpayers. This was acknowledged by the Commissioner in his report to the Minister of Finance in 2009,² which stated that *“the compliance and penalties rules were designed to promote a fairer enforcement of the Inland Revenue Acts”*.
- 2.19 The trade-off in favour of consistency and impartiality when applying Part 9 is a limitation on the Commissioner’s discretion to prosecute. The Commissioner has hitherto been content to limit her discretion to prosecute a taxpayer making a pre-notification voluntary disclosure, presumably on the basis that to do so promotes voluntary compliance. No information has been provided as to why she may now be unwilling to accept that limitation.

Proportional to the seriousness of the breach

- 2.20 It is accepted that the Commissioner ought to penalise non-compliance. However, the Commissioner’s punitive response to a tax shortfall must be proportional to the seriousness of the breach. Proportionality recognises that, realistically, the Commissioner is reliant on the voluntary compliance of taxpayers if she is to avoid a ballooning investigation budget. If the potential penalty is out of proportion with the taxpayer’s perception of their error or does not adequately recognise the steps they have taken to correct the error, then compliance will be discouraged, contrary to sections 6A and 139(a).
- 2.21 The Law Society submits that any prosecution in circumstances where a pre-notification voluntary disclosure is made, no matter how rare, cannot be proportionate to the ‘offending’. The elements of cooperation, remorse and reparation inherent in any pre-notification voluntary disclosure would make any subsequent prosecution disproportionate. The Commissioner need not rely on her discretion to prosecute to ensure that a penalty be proportional. The statutory shortfall penalties are sufficient in the circumstances.

Conclusion

- 2.22 The Commissioner states at paragraph 93 that prosecution will only be contemplated if she *“forms the view that a taxpayer’s actions or omissions [are] such that non-prosecution could lead to voluntary compliance more generally being undermined”*. The Law Society considers that the risk of discouraging voluntary compliance by introducing conditionality to the assurance of non-prosecution outweighs the risk of voluntary compliance being undermined by not doing so.
- 2.23 However, should the Commissioner feel that this conditionality is necessary, detailed examples should be provided about the circumstances when the Commissioner would and would not prosecute notwithstanding she was in receipt of a pre-notification voluntary disclosure. While still lacking the certainty sought by the Law Society, this would offer taxpayers some ability to determine the extent to which they might be at risk of prosecution if they made a pre-notification voluntary disclosure.

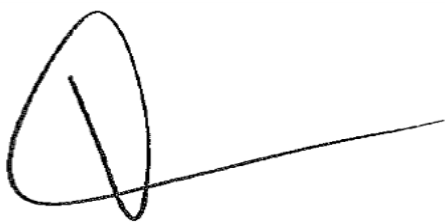
² Inland Revenue Department, Te Tari Taake, *Application of shortfall penalties under the compliance and penalties rules*, Report to the Ministers of Finance and Revenue for the year ended 30 June 2009, pursuant to section 141L of the Tax Administration Act 1994.

3. Ancillary issues

- 3.1 The Law Society has two ancillary points to make about ED0201.
- 3.2 First, we note that at paragraph 33 the Commissioner has expanded her expectations for a disclosure to qualify as 'full and complete' by requiring that the taxpayer gives "*sufficient detail of the tax shortfall including its amount*". This requirement is qualified with reference to paragraph 52, which appears to encourage cooperation between the taxpayer and the Commissioner to arrive at the correct calculation of the tax shortfall. The Law Society accepts that it is not unreasonable for a taxpayer to attempt to estimate their shortfall. However, we expect that the Commissioner will not apply paragraph 33 independently of the subsequent commentary to invalidate disclosures which require further work to ascertain the correct tax liability. As the Commissioner is aware, the accounting abilities of taxpayers vary and many taxpayers would struggle to accurately estimate their tax shortfall at first instance, especially if full records are not available, and the spirit of their disclosure should not be undermined by inadvertent errors.
- 3.3 Second, the Law Society invites the Commissioner to expand her commentary on the availability of the assurance of non-prosecution to include confirmation that it is available to an individual who owns or controls a company making a pre-notification voluntary disclosure. This would recognise that it is that individual who has taken the steps towards voluntary compliance. This would improve compliance by assuring taxpayers who own or control a company that they can make a disclosure on behalf of the company with confidence and certainty as to how they personally will be treated.

We hope you find these comments helpful. If you have any questions or wish to discuss the comments, the Tax Law Committee convenor Neil Russ can be contacted through the Law Society's Law Reform Adviser Emily Sutton (Emily.Sutton@lawsociety.org.nz / 04 463 2978).

Yours faithfully

A handwritten signature in black ink, consisting of a large, stylized loop followed by a long horizontal line extending to the right.

Andrew Logan
Vice President