

Winning and losing with Inland Revenue

As the taxman muscled up his hunt for rich tax-dodgers, experts say the tactics used are too intimidating

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Tax is at the heart of every citizen's relationship with the government. The full power of the state makes off with - depending on your tax bracket - a significant proportion of what you have earned.

That means the line between what Inland Revenue can claim from you - and its behaviour in making sure it collects what it is legally entitled to claim off you - is one of the most important lines in defining the liberty of the citizen.

Ten years ago, the IRD's approach to enforcement was so draconian and unfair it caused a public outcry, which led to a select committee inquiry.

Select committee inquiries come along about as frequently as new reality TV shows these days, but the difference about that inquiry - chaired, incidentally, by the current Minister of Revenue, Peter Dunne - was that it led to legislation allowing the IRD to be more flexible in its approach to enforcement.

But there is growing concern among the country's tax practitioners over increased aggression from the IRD in enforcing the tax rules.

All tax practitioners spoken to emphasise that the problem is nowhere near as bad as it was in the mid-1990s.

But the fear is that, without some corrective action, it could end up that way again.

In a recent address to a tax conference tax specialist Jeff Owens said that the IRD was not particularly receptive when behaviour of its officials was challenged.

"I believe that when IRD behaviour steps outside acceptable boundaries, taxpayers need to challenge IRD and claim compensation for

unnecessary cost ... [but] challenging such behaviours often leads to stonewalling by Inland Revenue.

"In a recent tax dispute I documented 11 examples of inappropriate IRD behaviour ranging from the mundane (misspelling the taxpayers' and advisers' names) to quite serious - deliberately misquoting legislation, charging a penalty four times as large as available in legislation, withholding a legitimate refund.

"Even then, the IRD's response was to simply apologise and undertake to do better in future."

Mr Owens said taxpayers were, in any case, reluctant to challenge the IRD - "the cost of doing so often exceeds the tax and penalties at stake."

"Maybe this is deliberate on the IRD's part, but it is certainly not the way to run a tax system."

The Institute of Chartered Accountants' tax director, Craig Macalister, said the IRD at times "let itself down quite badly." He acknowledged one of the most difficult areas - penalties, and how they are applied - was now being reviewed.

But the penalties issue, he said, highlighted a mindset issue within the IRD.

A difficult area since 2003 has been the issue of unacceptable tax positions. A major bone of contention has been that, even if taxpayers discovered their own error and "put their hand up" they still got stung with a hefty penalty

"In the arsenal of tax penalties it was pretty much a nuke 'em all."

This issue highlighted a mindset problem, he said, because the response from Inland Revenue officials has been that they have to follow the law.



CRAIG MACALISTER: This issue has seriously eroded confidence in the IRD and in the tax system'



BOB RUSSELL 'We should try to fix every problem that's pointed out to us'

"But the IRD advised the government to implement that law. They also have the ability to advise the government to change the way they act but for three years they have dragged their heels."

The technical nature of most tax reform matters means that, in general, the politicians follow the IRD's advice, unless there is a massive groundswell of public opinion against a move.

But the fallout from the position on the unacceptable tax position penalties regime, even though it now looked as though it would be fixed, was likely to linger, Mr Macalister said.

"This issue has seriously eroded confidence in the IRD, and in the tax system."

What might seem to be a relatively trivial issue - the times involved in turning around correspondence - has also emerged as a major issue.

Mr Owens cites numerous cases of the IRD routinely requiring a taxpayer to respond to an "agreed adjustment" - an IRD reassessment of the taxpayer's tax position - within very short time frames.

A two-week deadline had become routine, he said, and there had been worse cases. One allowed the taxpayer only four days - and the IRD then took more than three months

to respond to the taxpayer's response. In another case, an agreed adjustment was sent at a time the IRD knew the taxpayer's adviser was overseas - and it demanded a response within seven days.

"Conversely, when a taxpayer or adviser writes to IRD, the IRD will often take weeks, months or even longer to reply."

He suggests having at least four weeks as the norm - and the IRD says it is interested in

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that idea.

However - in a response to Mr Owens' speech notes - the IRD says it has a number of performance goals for its auditing activity and it has to meet those.

"That's all very well," Mr Owens said. "But currently it is often the IRD that takes up the lion's share of that time - for example, giving the taxpayer two weeks to respond, IRD using another five

months, and then imposing another two-week response time on the taxpayer."

Ernst & Young tax partner Geof Nightingale agrees the timing of correspondence is a significant issue.

"They're still pretty slow turning around correspondence. You might get information request and have 14 or 21 days to respond; you compile all that, and then six or 12 months might elapse before you get a letter in your in-tray saying this is why we think your position is wrong, and you have 14 or 21 days to respond."

And there are instances of IRD activity he describes as bordering on the intimidating.

"They are isolated instances, but they do still happen, where the IRD uses intimidation to get what it wants. They might look at a family structure or trust or business structure, and say they don't like the way it's working, and here's an assessment of the tax position.

"Or they give a large number of questions - I've seen one as long as 200 questions. Maybe there's some intent to get the taxpayer to cave in before a full audit. And that maybe does come over as intimidatory."

He also noted the IRD's enthusiasm to meet its targets for auditing times could have an effect on the quality of the work.

"They can take a lot of time to get through the audit - and, in some cases, that's because the taxpayer is slow. But then [the IRD] starts to run out of time, and the quality of their analyses starts to decline."

Mr Nightingale also suggests the IRD is "prone to asserting tax avoidance too early, before they have enough evidence."

An interesting perspective on relations between the IRD and taxpayers is provided by barrister Mike Lennard. Mr Lennard used to work for Inland Revenue - one of his biggest scalps was the Acton tax case a few years ago - and he notes the frustrating behaviour of some taxpayers.

In a recent presentation to the Institute of Chartered Accountant's conference Mr Lennard noted that "taxpayers can be nasty, greedy, dishonest and stupid" and that professional advisers have an obligation to "give frank

advice and try to encourage decent behaviour."

"But a department of state's standard of conduct must be better than the worst citizens' and everyone is entitled to due process ... Investigators' behaviour can erode taxpayers' respect, willingness to comply."

He backs up one of Mr Nightingale's concerns - a preparedness by some IRD staff to allege avoidance or other breaches on insufficient evidence. There was an inbuilt incentive for IRD staff to do this, he pointed out - it allowed them to justify re-opening statute-barred years. However, this approach eroded taxpayers' respect for the IRD and made settlement harder.

A lot of problems would be avoided, he suggested, if the IRD was more prepared to sit down face to face with taxpayers. It might lead to taxpayers being more upfront - "whether you can say something to someone's face is a good test of whether you believe it," he points out.

And this might reduce elements such as "dubious conclusions from paper records, argumentative correspondence" as well as providing a "quicker, clearer, cheaper exchange of information."

Mr Lennard is also optimistic about one key element of the IRD's current approach - a willingness to engage in debate with tax practitioners, something which has not always been there in the past.

In response to all this, the IRD notes it is taking some steps to improve matters, particularly in the penalties area.

But by and large all it does is point to its customer satisfaction surveys.

"Our client satisfaction levels are pretty high, in almost everything you would like to pick, including tax agents," the IRD's deputy commissioner for service delivery Bob Russell said.

"We should try to fix every problem that's pointed out to us," he said.

"Yes, there are costs associated with disagreeing with us. To some extent there's not a lot we can do about that. Tax legislation is complex legislation."

On the turnaround of correspondence times, he said the IRD was looking at moving to "a standard of 21 to 28 days" - which is almost in line with Mr Owens' suggestion of 28 days.

"We are issuing some guidelines which will encourage a bit more flexibility there. We're not dismissing Jeff's comments on that at all."

On the speed of auditing, the IRD's group manager of assurance, Martin Scott, said this was also driven by a desire to reduce costs to the taxpayer as well as by internal IRD performance targets.

"We are encouraging staff to put a time frame on things ... we do want to move through the audits relatively quickly, because the longer we are there, the longer we are imposing compliance costs onto the taxpayer. Although we want to check, we want to minimise the impact on businesses."