

August 2006 newsletter to clients and colleagues

Inappropriate use of IRD administrative procedures

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Managing communications and disputes with IRD is a small but extremely important part of our business and can have a big impact on our abilities to get appropriate outcomes for our clients.

If you are a member of the Institute of Chartered Accountants I also urge you to forward to NZICA any examples of such issues and I would appreciate being kept informed so that we can work together for the good of the NZ tax system.

IR10 accounts information form

IRD encourages taxpayers to lodge IR10 forms in substitution for financial statements.

Refer for example a 1993 TIB which stated (inter alia):

- *The IR10 is an integral part of Inland Revenue's E-File system..*
- *we are encouraging accountants to use both the E-File system and the IR10..*
- *there is a lack of information disclosure when using an IR10 compared with the information disclosed in the financial statements ... (but) If no conclusive evidence is held to prove a fraudulent or wilful misleading by the taxpayer, no statute-barred back year assessment will be re-opened under section 108..*
- *Because of these concerns some E-Filers and other agents choose to send paper returns so they can attach more disclosure information.*

- *We'd like to assure agents that this is not necessary and that they can continue to use the IR10 and E-File returns confidently*

I am aware however of situations where IRD has set aside information included in financial statements, including an example where IRD claimed that a return was not statute barred because of lack of disclosure, even though a relevant capital gain was clearly disclosed in financial statements.

I urge you to be wary of this, notifying NZICA of any such attempts by IRD to set aside a legitimate statute bar. If IRD will not give a clear undertaking that it will respect its own advice in this regard, then it may be necessary to encourage all taxpayers to lodge financial statements and refuse to use IR10 forms.

Including penalties in an agreed adjustment

IRD published practice is to reach agreement with the taxpayer on any shortfall penalties at the same time as other tax adjustments and to include these shortfall penalties on the agreed adjustment form unless the taxpayer advises otherwise, or circumstances exist where it is inappropriate to do so, eg prosecution – refer TIB Vol 13:9 (September 2001). However I am aware of examples where IRD has neglected to do that and reserves the ability to add penalties later.

Thus a taxpayer may accept a position they think is incorrect after weighing up the cost of defending it, and then find that the actual tax charge has doubled or worse.

If you receive an 'agreed adjustment' form (a badly misnamed document in the first place) you should immediately check that IRD has disclosed any proposed penalties, and also insist on a reasonable amount of time in which to respond.

Correspondence timeframes

When a taxpayer or advisor writes to IRD, IRD will often take weeks, months or even longer to reply. In our experience however it seems to be routine that IRD requires a taxpayer to respond to an 'agreed adjustment' form within two weeks or less, and this time is sometimes truncated further with the time for correspondence to exit the IRD system. This allows very little time to engage a professional and/or to reach a considered position.

I have lodged formal complaints in respect of even worse behaviour, such as

- allowing only four days to respond, then three or four months passing with no sign of IRD's answer to our explanation, or
- timing a letter so IRD knew the advisor was overseas and giving seven days to respond.

In my view IRD should allow taxpayers and advisors four weeks to respond, and a quicker reply being simply a bonus with both parties having an interest in expediting matters by cooperation rather than artificial compulsion.

I have raised this issue with several parts of IRD and hope to influence some improvement shortly.

Electronic communications

IRD encourages taxpayers to communicate with IRD electronically – eg lodging tax returns electronically, using IR10 forms in substitution for financial statements etc. However there are areas where IRD will not extend similar convenience to taxpayers and advisors

IRD will send taxpayer information by post or by fax – either of which can go astray inadvertently or be intercepted. However IRD consistently refuses to send information by email, even though it is quite straightforward to save an attached document with a unique password so that only the intended recipient can open the document.

I have also had situations where IRD has taken a great deal of persuading to release an electronic copy of a NOPA or other large document, even by passworded CD. Fortunately recent challenges have been successful so your expectation should be that IRD does provide such documents electronically albeit not currently by email.

Section 141KB relief from shortfall penalties

I have written several times on this issue. A recent letter from the Minister of Revenue advised that as of early June IRD had ruled on 11 applications for such relief, accepting 10 and rejecting one. I am aware however that as at the date of that letter two such applications had been declined by IRD and it is possible there may be more.

I urge members to forward details of such applications to NZICA, especially where IRD has turned them down.

Also remember that currently all such applications must be lodged with IRD by 1 October 2006

The perils of making a voluntary disclosure to IRD

Section 141G provides a 75% reduction in penalty for disclosing an error to IRD, but where the shortfall is temporary (eg many GST or PAYE errors) the comparable section 141I 75% reduction is not in addition to that for disclosure, so in effect the taxpayer is gets no credit for disclosing the error.

While the NZICA code of ethics requires Chartered Accountants to recommend that a client error is disclosed to IRD, it can result in an audit of issues of which IRD may have remained unaware, and an inordinate amount of time defending the client's position whether successfully or otherwise. You need to keep this in mind and weigh up the consequences when making such a decision.

Conclusion – examples for NZICA

I understand that members have issues with various aspects of tax administration but as was my experience from 1994 to 2002 the Institute's tax director is struggling to gather enough examples to support the issues raised.

It is important that the Institute is made aware of any so they can lobby more effectively on our behalf. In the absence of evidence to the contrary IRD's assertions will stand