

Inland Revenue administration of tax residence – September 2010 update

We alert clients and contacts to serious problems in IRD's administration of determinations of residence for taxation purposes, and conclude that instead of submitting IRD forms, individuals with tax residence questions need to seek professional guidance.

In Appendix 1 we summarise eight or so examples brought to Owens Tax Advisors Limited in recent months. We will update this schedule as more cases come to light.

In Appendix 2 we have set out some background to this issue.

Common factors we have observed include:

- A strong IRD tendency to rule (frequently incorrectly) that taxpayers (to their detriment) have become or remain NZ tax resident;
- IRD staff who are clearly not experienced in the relevant legislation and case law;
- in many cases IRD reaching quite arbitrary conclusions, but forcing the cost of dispute onto the taxpayer by requiring a formal NOPA;
- IRD obviously not concerned at the significant costs imposed on taxpayers, refusing to take them into account when reaching a resolution. This is a significant concern raised by the recent review of the dispute regime, specifically that taxpayers are giving up on disputes because they cannot afford to pursue them.

While clients tend to refer more difficult cases to Owens Tax Advisors and we have generally been able to get appropriate outcomes, the commonality of issues indicates to us that the system is badly broken.

We have had some recent discussions with IRD senior personnel on these issues. They have indicated some degree of movement:

- IRD proposes to centralise residence decisions with a couple of dedicated teams instead of the current system of allocating them arbitrarily;
- IRD is prepared to review the IR886 residence form, which we think is currently quite misleading

We are cautiously positive about these changes.

However we won't know how successful this is until the changes had been put into place.



Further, this does not undo the damage that has already been caused, and despite very poor IRD admin processes and the costs imposed on taxpayers, IRD is still holding firm on some disputes.

Finally, IRD is reinforcing its position that once Inland Revenue has issued a determination (and in our experience these are frequently poorly researched and often quite arbitrary) the only way to challenge is through the formal dispute process, in particular with a notice of proposed adjustment. We consider this attitude is arrogant and overbearing, imposes significant unnecessary costs on taxpayers, and in any case is incorrect under the relevant legislation.

Until such time as IRD has clearly improved its processes we recommend as follows:

- refuse to complete the current IR886 form -- it is not a legislative requirement and is misleading;
- we have developed what we consider to be a greatly improved form which we use for our own clients;
- if you do need to determine tax residence, don't go to IRD for guidance, go to a tax expert (we are of course pleased to assist);
- do not be afraid to complain or elevate matters if IRD take an inappropriate stance.

Links:

[Appendix 1: Recent and current examples](#)

[Appendix 2: Background](#)

Appendix 1: Recent and current examples

Recent and current examples include the following:

1. a New Zealand couple that lived in Europe for nearly 3 years:
 - a. were given quite misleading guidance from Inland Revenue as to how they should respond to a question in respect of availability of a residence;
 - b. IRD deemed them New Zealand resident and forced them through an expensive dispute process;
 - c. eventually IRD capitulated.
2. an individual that left New Zealand in 2001 and has never returned:
 - a. at an early stage he specifically notified IRD of his non residence;
 - b. nine years later IRD wrote to him, inviting him (somewhat pointlessly) to dispute his non resident status;
 - c. IRD described a student loan balance as a "notice of provisional assessment" or "NOPA", and to respond with a "notice of proposed adjustment" (also a NOPA).
 - d. IRD capitulated on this one, but there was certainly some cost involved.
3. a married couple that left New Zealand in 2001:
 - a. when they returned in 2010 IRD told them they had to fill in an IR886 "residence" form;
 - b. IRD then enquired why they hadn't returned nine years of foreign sourced employment income;
 - c. Upon our involvement IRD quickly capitulated (we considered it obvious they were not NZ resident).
4. an individual that left New Zealand and moved to the UK on a long term basis;
 - a. he had left open the possibility that he could return one day;
 - b. IRD ruled that because he had not stated he was leaving permanently, he had retained a New Zealand residence;
 - c. after a dispute process IRD capitulated.



5. a couple with infant children that moved to the Middle East for an indefinite period:
 - a. IRD ruled that they retained a New Zealand residence because they retained a residence in New Zealand (irrelevant -- it was rented out);
 - b. they were on a secondment (false);
 - c. after a dispute process IRD capitulated.
6. a European national that moved to New Zealand to work for 12 months that spanned two income years:
 - a. she had been overtaxed on the first year's income and slightly undertaxed for the second year;
 - b. IRD issued a refund cheque for the first year, but demanded immediate payment for the second year;
 - c. Small dollars involved a lot of admin hassle.
7. an individual that went to the Middle East on a one-year renewable contract:
 - a. she intended to stay for at least two years but with a few weeks back in New Zealand to catch up with the family;
 - b. Unfortunately her tenants trashed the rental property and left without paying rent and she was forced to stay to sort out the mess;
 - c. Because the residence form did not specify a date of return, IRD refused to rule on residence until she did actually return;
 - d. on the form that had already been signed and submitted to IRD, IRD later instructed the taxpayer to amend the date of *intended return* with the date *she actually returned* [I am sure the IRD would take a very dim view of a taxpayer that signed a document and then later amend that to read something different];
 - e. IRD then ruled that her overseas income remains taxable New Zealand because: she was only physically gone for a year (true); she retained a residence in New Zealand (irrelevant -- it was rented out); she had a husband in New Zealand (false -- IRD knew that they are legally separated); she has children in New Zealand (irrelevant, the children are independent adults);
 - f. despite all of the above factors being drawn to the attention of senior IRD personnel, IRD will not budge. The matter has been with IRD since December 2007.



8. an individual that in 2006 left New Zealand on an 18 month secondment;
 - a. IRD (inexplicably and perversely) issued a determination to say that he had ceased New Zealand residence;
 - b. he subsequently returned to New Zealand;
 - c. later still, he left New Zealand, bought a house and moved his family overseas for an indefinite employment contract, IRD (even more inexplicably and perversely) issued a determination to say he had retained in New Zealand residence, and must reopen previous tax returns;
 - d. We were able to get IRD to capitulate on the current residence, but despite IRD's two blunders IRD will not back off on collecting the grand sum of \$9,000 being the difference between New Zealand and foreign tax, and by far exceeded by the costs incurred by IRD and the taxpayer. This matter was originally with IRD in October 2006 and they have STILL not reached a sensible conclusion.



Appendix 2: Background

In May 2010 Owens Tax Advisors Limited published an article in the Institute of Chartered Accountants Journal –

copy available at www.owenstax.com/tax-residence.html .

The article set out and discussed the legislation that determines tax residence and its implications for the taxation of individuals.

We concluded with some concerns about the way that Inland Revenue has been administering these issues, and concluded with the following:

- Never let your client file a document with IRD without having it carefully checked by an expert – and that certainly doesn't mean an IRD employee;
- Ensure you understand tax residence issues – or refer to an external expert;
- If IRD disagrees with a taxpayer's position but tries to force you into lodging a NOPA , object in strong terms and advise NZICA.

In August, the Institute of Chartered Accountants issued a media release "Tax residence questionnaire has expensive consequences"¹ – stating (inter alia):

NZICA has recently fielded a number of complaints from its tax agent members on this issue. The tax agents have been approached by people who have completed the form and then been told by Inland Revenue that they remain New Zealand residents.

“The Inland Revenue reply is a legal document that, left unchallenged, may mean the taxpayer is bound to that outcome. Further, if the affected person wants to challenge that decision, it will cost considerably more than if they had sought professional advice in the first place.”

“We are aware of situations that have cost \$2,500 to challenge Inland Revenue's reply. That is a lot of money to pay for an innocent error,” said Mr Macalister. “We are also aware that Inland Revenue's decisions are inconsistent: two taxpayers in very similar scenarios can be treated differently.”

Mr Macalister is concerned that this is an example of Inland Revenue unnecessarily putting taxpayers to additional costs.

¹ See www.nzica.com/AM/Template.cfm?Section=Tax_news&Template=/CM/ContentDisplay.cfm&ContentID=21494

“This issue can be very easily addressed, but Inland Revenue seems to be quite content with the current practice. If you are thinking about filling in this form, we recommend you seek professional advice,” he said.

This article updates those observations