

11 May 2011

Open letter to:

Hon Peter Dunne  
Minister of Revenue  
Parliament Buildings

Bob Russell  
Commissioner of Inland Revenue

Via email: [peter.dunne@parliament.govt.nz](mailto:peter.dunne@parliament.govt.nz) [bob.russell@ird.govt.nz](mailto:bob.russell@ird.govt.nz)

*This letter also published on our website, with an invitation to interested parties to endorse our recommendations.*

Dear Sirs

## **IRD audit procedures and communications**

We recommend that Inland Revenue publish a standard practice statement as to how it will conduct tax investigations and audits, and also communications generally. We have set out our recommendations out in the attached table (columns A and B) along with further comments in respect of existing standards and what we observe in practice.

### **Comment**

Our observations and recommendations are based on experiences of our clients and colleagues throughout New Zealand.

Some of our recommendations are drawn from legislation; some from IRD published standards, but mostly are what we consider to be simply reasonable behaviour in a business context.

We have raised the majority of these issues previously in other contexts but to date have not seen any resulting improvements in IRD staff behaviour.

With respect, we believe that the behaviours expected by IRD senior management are not what is actually practiced in the field, and it is very difficult to get such issues addressed in any meaningful way.

While some aspects are covered in IRD standard practice statements and other publications, in general standards are not set in any measurable way, and they should be brought together in one document rather than spread around.

If IRD consider any of our proposals are not reasonable then we invite further comment and explanation. Otherwise we recommend that they be published as a public statement so that both IRD staff and their customers know what behaviour is expected to be upheld.

Before publishing this document we have sought comment from a range of clients and colleagues and are confident that the proposals in this submission are widely supported.

We would welcome the opportunity to discuss these issues and look forward to your favourable responses.

Yours sincerely



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**Jeff Owens**  
Director

Topic	Appropriate standard/ submission	IRD published standard	What IRD actually does	Other notes/examples
0.5				
1	<b>Conduct of IRD investigations and audits</b> Audits should generally be commenced within 3 and at most 4 years following the year in question	n/a	IRD sometimes issues an assessment close to the 4 year timebar cut-off so that it isn't caught by the timebar.	IRD says it doesn't have the resources to conduct more frequent audits. We say it should be much more efficient to conduct regular reviews covering recent years than to take years of activity to investigate very old transactions
2	<b>4 year time bar</b> Outside of the 4 year timebar, returns should only be reopened in very unusual circumstances	See section 108 of the Tax Administration Act	Sometimes IRD opens years outside the timebar and then uses the limited exclusions to defeat the timebar. The exclusions are that a return fails to mention 'income' even though the taxpayer thinks a receipt is not income, and where a return is fraudulent or wilfully misleading "in the Commissioner's opinion"	We have seen a number of cases where IRD has reopened returns that are 5 or more years old, and often 8-10 years and even older. Taxpayers will generally struggle to find records that are more than 7 years old and thus outside of the statutory record keeping requirements
3	<b>Imputation credits and timebar</b> Imputation credits should be subject to the 4 year timebar	n/a	IRD sometimes reopens very old imputation periods and cancels imputation credits even where no records exist, on the basis that imputation returns are not 'assessed'	This may require legislative amendment but in the meantime should be dealt with by IRD publishing appropriate policy
4	<b>Preparation and conduct of interviews</b> In general IRD should give taxpayers time to prepare for a visit from IRD	<b>SPS 07/02 NOTIFICATION OF A PENDING AUDIT OR INVESTIGATION</b> sets out commentary in this area, indicating that surprise visits are the exception rather than the rule. IRD's booklet IR297 states "If you're linked to a tax agent for the tax type we're going to investigate, we'll contact them first and send a followup letter to both of you"	We are aware of IRD conducting surprise visits to taxpayer premises	IRD should write to taxpayer AND accountant and request an interview at a time that suits all. The IRD should save unannounced visits for when a cooperative approach doesn't work.
4.1	IRD staff must announce themselves, and produce warrant and business cards		We are aware of IRD staff coming into businesses unannounced and don't reveal themselves	
4.2	IRD should not arrive at inconvenient times		IRD has been reported as turning up at busy times, removing cash register etc	
4.3	When IRD conducts an interview with a taxpayer, in general questions that require some consideration should be provided in advance		IRD staff often refuse to provide questions in advance - this leads to ambush tactics, a taxpayer answering questions to which IRD may already know the answers, and IRD making out they are being untruthful	In one audit interview we attended the inspector was explicitly instructed by a senior officer to provide his questions in advance - he provided 5 questions 12 hours in advance and then at the interview read through several hundred further pre-prepared questions
5	<b>Professional support</b> A taxpayer must always be told their rights in an interview situation - this includes the right and indeed encouragement to have professional assistance /representation		We have struck many situations where taxpayers have answered IRD questions without professional guidance, and given answers that are not factually correct and disadvantaging the taxpayer, especially around 'intention'.	We have also been told that IRD staff have told some taxpayers that they do not require their agent's assistance for some tax administration, leading to taxpayer errors
6	<b>Documenting agreement between taxpayer and IRD</b> 'Agreed adjustment' forms should only be issued when IRD and a taxpayer have reached substantive agreement. Otherwise these should be described as IRD proposals	<b>Shortfall penalties in respect of agreed adjustments (QB 2104 TIB 13/9 September 2001)</b> In most instances, both the taxpayer and Inland Revenue will come to an agreement as to what adjustments are to be made to the return, thus avoiding the necessity to enter the disputes process. As a result of this agreement, both the taxpayer and Inland Revenue sign an "agreed adjustment" form which lists the item and amounts that have been agreed upon as requiring adjustment.	IRD routinely issues "agreed adjustment" forms and describes them as an agreement when in fact there is no agreement, and sometimes even when it is clear the taxpayer does NOT agree	

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7 <b>Inclusion of all tax types and proposed liabilities</b>	IRD should tell the taxpayer up front what tax types are being investigated, what years are covered, who is involved and how long it will take.	Shortfall penalties in respect of agreed adjustments (September 2001). The Commissioner's 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, e.g. prosecution.	IRD almost never disclose the quantum of backdated interest, late penalties or possible shortfall penalties - and in some cases don't even mention them. We are aware of IRD even leaving out some tax types altogether	This can leave taxpayers in a position of signing up to something that is much bigger than what they realise
8 <b>Dealing with related entities</b>	When IRD is investigating or auditing taxpayers, related entities should be dealt with simultaneously rather than complete one audit and then move onto other entities with similar potential issues (see 7 above)	n/a		IRD's practices cause repetition of effort and expense
9 <b>Basis for an agreed settlement</b>	The basis for IRD's position must be clear, and provided in a format for the taxpayer to review - for example as an editable excel spreadsheet		IRD staff generally refuse to provide calculations in spreadsheet form	IRD policy is to generally not release editable spreadsheets, and yet IRD want taxpayer information in electronic form. We see no basis for this position
10 <b>Audits should be conducted in a timely manner</b>	IRD should publish and be held to reasonable measurable standards for completing an audit. Appropriate steps are collect information, analyse, fine tune, complete within say 2 - 6 months at the most.	There are standard practices published in TIBs, and vague undertakings as to timeliness - see for example IR297	IRD often demands information in fixed timeframes but then takes months to analyse and respond, then demands more information in a short time, and so on for several rounds. The taxpayer incurs cost each round and sometimes capitulates due to that cost.	We are often called in to resolve IRD audits that have dragged on for two or three years when they could and should have been completed in a few weeks
11 <b>A voluntary disclosure should be treated as a request to re-assess, not an invitation to conduct an audit</b>	If a taxpayer makes a voluntary disclosure then IRD should allow a reasonable time for the taxpayer to complete any information gathering and calculations	The tax administration Act provides a 100% or 75% reduction in penalties where a pre notification disclosure is made.	Unfortunately IRD often moves immediately to announcing an audit, thus closing off the opportunity for a pre and even post notification disclosure	
12 <b>Agreement not reached - move to disputes phase</b>	If IRD disagrees with a taxpayer's position or voluntary disclosure, in due course IRD should issue a Notice of Proposed Adjustment' (NOPA) setting out its detailed arguments	<b>SPS 08/01: DISPUTES RESOLUTION PROCESS COMMENCED BY THE COMMISSIONER OF INLAND REVENUE 12.</b> The early resolution of a dispute is intended to be achieved through a series of steps specified in the TAA. The main elements of those steps are: (a) a notice of proposed adjustment ("NOPA"); this is a notice that either the Commissioner or taxpayer issues to the other advising that an adjustment is sought in relation to the taxpayer's assessment..... 7.1. The Commissioner is not precluded from further investigating an amended assessment issued on the basis of the taxpayer's tax return and, if necessary, issuing a NOPA to the taxpayer.	From time to time IRD issues an amended assessment and forces the taxpayer to set out their arguments by way of NOPA. IRD has accepted this is not appropriate in individual cases, but won't clarify the standard for future.	This pushes the bulk of the relevant compliance costs onto the taxpayer
13 <b>Removal of records</b>	If IRD staff need to take records they must arrange copying themselves, and leave the originals with the taxpayer		From time to time IRD remove records from a taxpayers' premises and hold them for an extended period, and sometimes lose them	In addition the taxpayer needs to have a clear understanding of what records the IRD holds.
14 <b>names and contact details</b>	IRD must supply names, telephone numbers and email addresses of all staff working on an investigation, including team leader and supervisors	n/a	If a customer can't get hold of the IRD investigator or is unhappy with progress, then they need to know how to contact other appropriate staff	

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<b>Communications generally (not just audit situations)</b>				
15 <b>Acknowledgment of correspondence</b>	When a taxpayer or advisor sends a document to IRD and requests that IRD acknowledge receipt, IRD must do so without fail	n/a	IRD often does not acknowledge receipt even when requested	From time to time we strike situations where IRD claims to have not received a document, e.g. NOPA, NOR, election form etc. IRD is then open to claiming months or even years later that it never received the document, leaving the taxpayer exposed to serious consequences
	IRD should also consider acknowledging receipt of all documents as a matter of course, whether or not requested	n/a	IRD rarely acknowledges receipt apart from income tax and GST returns which are processed through either their online filing or electronic filing from other systems.	IF the standard was that IRD acknowledges every receipt then exceptions will be easily identified and rectified. Acknowledgement can be as simple as an email reply
16 <b>Telephone 'away' message</b>	If IRD staff are away from a telephone for an extended period (say more than 24 hours) they should leave a message to that effect, and an alternative contact	n/a	IRD staff typically do not amend their 'away' message. We have struck situations where IRD staff are away on holiday or sick leave for weeks or months, whereas their message says they will reply 'as soon as possible'	
17 <b>Time allowed for taxpayer response</b>	The time allowed to consider and respond must be 'reasonable' - a starting position could be four weeks, but longer if complex issues and taxpayer must be invited to request longer if they need it	IRD internal standards require IRD staff to allow a 'reasonable' time for taxpayers to respond to correspondence	IRD generally allows four weeks to reply, but does not emphasise that longer is available if required. IRD sometimes backdates correspondence, and often the first few days of response time are used up by correspondence leaving the IRD system. Sometimes IRD allows even less than 4 weeks, down to as little as five days	At a recent NZICA disciplinary hearing a very senior IRD staff person stated that the four week guideline only applied to IRD requests for information and not to other communications. When he was reminded that his immediate boss has already told him that was wrong, he said 'that is just his opinion'
18 <b>Taking into account holiday period</b>	If a requested response time encompasses a holiday period e.g. Christmas/New year or Easter, appropriate time must be added to the requested response time	Supposedly no standard but this concept should surely be encompassed in the 'reasonable' test	IRD staff sometimes issue documents before a holiday period and fail to allow appropriate additional time for a taxpayer to respond.	
19 <b>IRD response times</b>	IRD should respond to taxpayers within a 'reasonable' time - if IRD thinks a reasonable time for taxpayers is 4 weeks then IRD should achieve the same	IRD Statement of Intent (commitment to government): We will respond to at least 85% of correspondence within three weeks of receipt	IRD often receives correspondence and then sits on it for many weeks and often months. We also believe that IRD's correspondence statistics include minor communications like requests to transfer tax credits, and exclude audit correspondence which can take much longer to deal with.	IRD says this is because staff are working on multiple projects - but so do tax agents and advisors
20 <b>Email correspondence</b>	If a taxpayer or advisor requests then IRD should agree to conduct communications by email	Some but not all IRD staff are permitted to communicate by email.	Interestingly many staff will not communicate by email but will communicate by fax, which is generally a less secure medium	IRD has been very gradually rolling out an email protocol but it has taken many years and is not yet consistently implemented. Email is of course environmentally friendly and means communications can be instantaneous instead of taking a few days to arrive at destination. Email also has a degree of automatic tracking and is generally more reliable than NZ Post.
21 <b>Emailing editable documents</b>	A document which IRD and customer both need to edit should always be made available in the appropriate format - for example Microsoft word or excel	Internal standard allows sharing of electronic documents on an exception basis only	Most IRD staff are very reluctant and initially refuse to provide documents in editable format. This forces the other party to try to recreate documents to verify calculations. This can occur in quite large spreadsheets	
<b>Enforcement</b>				
22 <b>IRD must follow its own standard practice statements and interpretation statements</b>	Where IRD does not follow appropriate standards then they should be appropriately dealt with within IRD and there should be appropriate recompense to the taxpayer for additional costs	Standard practice statements and interpretation statements, including this guide once published	From time to time IRD staff do not follow published standards. IRD staff breaching standards often impose significant unnecessary cost on taxpayers. On many occasions we identify and alert IRD management to the above behaviours.	At best IRD will sometimes apologise but provides no recompense to the taxpayer for additional costs imposed. This will also be a major factor in the behaviours repeating