

## Standard Practice Statement

### Finalising Agreements in Tax Investigations

This statement also appears in *Tax Information Bulletin* Vol 27, No. 9 (October 2015)

#### Introduction

1. This Standard Practice Statement ("SPS") sets out the principles and parameters for finalising agreements in tax investigations by resolving issues that may be in dispute.
2. "Dispute" in this context includes both a difference of opinion on the application of the law that may occur during the course of an investigation as well as issues where the formal disputes resolution process contained in Part 4A of the Tax Administration Act 1994 ("the TAA") has been initiated.

#### Application

3. This SPS applies from 21 August 2015 and replaces Standard Practice Statement IR-SPS INV-350 *Finalising agreements in tax investigations* (see *Tax Information Bulletin* Vol 10 No 8 (August 1998)).
4. This SPS applies to agreements reached by resolving disputed issues, whether or not as part of the statutory disputes process, and is intended to be complementary to and not replace the Commissioner's SPSs relating to disputes, *SPS 11/05 Disputes resolution process commenced by the Commissioner of Inland Revenue* ("SPS 11/05") and *SPS 11/06 Disputes resolution process commenced by a taxpayer* ("SPS 11/06") or other publications issued in replacement by the Commissioner.
5. This SPS should also be read in conjunction with *IS 10/07 Care and Management of the taxes covered by the Inland Revenue Acts – Section 6A(2) and (3) of the Tax Administration Act 1994* ("IS 10/07"), *SPS 06/03 Reduction of shortfall penalties for previous behaviour* ("SPS 06/03"), and *SPS 09/02 Voluntary disclosures* ("SPS 09/02") or other publications issued in replacement by the Commissioner.
6. Although, when finalising an investigation, staff should discuss with the taxpayer their ability to pay any taxes that are to be assessed as a result of the final agreement reached (see paragraphs 31 and 32 below), this statement does not apply where the agreement results from negotiations to settle tax debt as provided for by sections 176, 177, 177A, 177B, 177C and 177D of the TAA. In addition, this statement does not apply to settlements

involving the use of the Commissioner's general discretion under section 6A of the TAA including the settlement of litigation.

## Summary

7. For the purposes of this SPS, "resolution" involves an exchange of information or argument that enables either Inland Revenue or the taxpayer to change their view on how the law applies to that taxpayer's situation. In such cases the matter will be resolved on the basis of that changed understanding, resulting in either an agreed adjustment or the dispute being abandoned by Inland Revenue.
8. Wherever possible conflicts and disputes between the Commissioner and taxpayers should be resolved by discussion and agreement. Both the Commissioner and taxpayers can help to facilitate this resolution by disclosing in a timely and useful way all relevant information. Issues should not be resolved and agreements finalised for the sake of expediency or involve coercion to complete the investigation. All issues must be resolved issue by issue, based on the law and the evidence available.
9. Although there is an expectation that taxpayers will sign any final agreement in good faith, it is acknowledged that where a final agreement is signed by a taxpayer prior to the issuing of a Notice of Proposed Adjustment (NOPA) or a Notice of Response (NOR) from the Commissioner, the taxpayer may still potentially contest the issues that were subject to the final agreement, by following the statutory disputes process. However, when a final agreement is entered into after disputes notices have been issued, the signed agreement precludes the taxpayer from commencing a challenge (in a hearing authority) in relation to those issues finalised in the agreement.

## Background

10. Investigations will generally be finalised by way of either resolving issues that are in dispute or by "settlement"; through the use of the Commissioner's general discretion contained in section 6A of the TAA.
11. The Commissioner will generally not consider using the general discretion contained in sections 6A of the TAA to finalise an investigation. However, Inland Revenue recognises that good management practices occasionally require departure from normal operational practices in exceptional cases. For this reason Inland Revenue may settle a case outside the terms of this SPS but within the parameters of the care and management provisions. The Commissioner's view of how the care and management provisions apply is outside the scope of this SPS, but is set out in IS 10/07.
12. Although the Courts have not specifically considered whether the Commissioner can reach settlement with a taxpayer before litigation or the formal disputes process has started, the Commissioner considers that, in principle, there is no impediment to this being done.

13. Inland Revenue practice is to endeavour to resolve disputes and other issues arising from tax investigations through the process of reaching resolution with taxpayers by discussion, if at all possible.
14. It is essential for Inland Revenue and taxpayers that a code of good practice in relation to how issues are resolved, and agreements finalised, be defined. This SPS ensures that taxpayers, when attempting to resolve issues with the department that may be in dispute, will be treated consistently, impartially and in accordance with the law by Inland Revenue.
15. These guidelines apply to finalising agreements by resolving issues that may be in dispute in respect of all the Inland Revenue Acts, although the principal focus is on the Income Tax Acts 2004 and 2007 and the Goods and Services Tax Act 1985. These comments, with the necessary modifications, apply equally to the other Inland Revenue Acts (as listed in the Schedule to the TAA).

## **Standard Practice**

### **Agreements, whether reached by resolution or settlement, must be made on a principled basis**

16. Assessments arising as a result of the resolving disputed issues are no different from tax assessments issued in other circumstances and must be made on a principled basis.
17. On many occasions the New Zealand Courts have stated that the Commissioner merely acts in the quantification of tax due, and it is the taxing Acts that charge tax. The Commissioner has a duty to assess the tax properly payable within the terms of the statutory framework and in carrying out that duty the Commissioner must be completely impartial. All assessments arising as a result of resolving disputed issues must conform to the relevant Revenue Act.
18. This does not mean that the Commissioner has an absolute obligation to collect the "right" amount of tax. Section 6A of the TAA charges the Commissioner with the care and management of taxes and so, as stated previously in this SPS, she may be able to settle issues in dispute in some cases. Any settlement must be within the boundaries set out in IS 10/07. The principles relating to the settlement of cases are outside the scope of this SPS.

### **Reaching final agreement through resolution**

19. A final agreement reached by resolving issues with a taxpayer represents an agreement on the relevant facts and the application of the law to those facts. The process of resolution is one that will occur on an issue by issue basis. Resolution is not to be seen as a process of bargaining between the parties where issues are traded off against each other. The Commissioner will consider representations from the taxpayer or their adviser on the relevant issues in the dispute and these issues will be resolved on their individual merits.

20. Any resolution should be based on a genuine agreement as to the relevant facts and be the result of the application of the law to those facts. Issues should not be resolved and agreements finalised for the sake of expediency or involve coercion to complete the investigation.
21. In the context of formal disputes (where either the Commissioner or the taxpayer has issued a NOPA) the Commissioner accepts that a final agreement will not be reached in all cases. Where agreement is not reached the disputes resolution process will continue to apply and SPSs 11/05 and 11/06 should be followed.

### **Fundamentals of resolution**

22. The process of reaching resolution is one that must occur on an issue-by-issue basis.
23. Inland Revenue will not agree to resolve issues in some circumstances. These are:
  - where such an agreement would mean not assessing an amount which is clearly assessable, or allowing a deduction, rebate or credit that is clearly not allowable;
  - where agreement would require Inland Revenue to act contrary to a settled view of the law (for example as stated by the Courts, or an Inland Revenue Public Ruling or Interpretation Statement);
  - where the only consideration is the taxpayer's ability to pay (for further discussion on this matter please see paragraphs 31 and 32 below);
  - where an adjustment can be made only on an "all or nothing basis"; that is, either an adjustment would be made for the total amount in question or no adjustment be made at all. For example, the assessability of a transaction may depend solely on such concepts as whether the taxpayer is carrying on a business or whether there was a profit making purpose. Generally, on the facts the taxpayer either satisfies the criteria for assessability of income or the taxpayer is not liable for tax in respect of that transaction;
  - where the matter relates to use of money interest (UOMI) and/or prosecution action.
24. Situations where Inland Revenue may agree to resolve issues are:
  - where the quantum of a disputed amount depends on the facts. For example, a claim may be subject to apportionment and there could be doubt as to the correct portion to be allowed (for instance, how much is deductible as business expenditure and how much is non-deductible because of its private nature);
  - when an adjustment may rely on a question of valuation for which there are competing bases. For example, in the determination of an arm's length transaction for GST purposes;
  - when an item may not be subject to precise computation. For example, the estimation of living expenses in an assessment based on assets accretion methodology; and
  - where an issue of quantum or valuation has been resolved for one period and is likely to apply to prior periods.

In these cases, where determination of the taxable income will depend on

the facts, a factual position must be agreed between the taxpayer and Inland Revenue.

### **Penalties, tax in dispute, and use of money interest**

25. Penalties, if applicable, should be discussed along with the substantive issues and can, where the taxpayer and the Commissioner are able to reach agreement on these, be included in the final agreement. This includes shortfall penalties and late payment penalties. Shortfall penalties will not be used as leverage to achieve an agreement. That is, staff may not impose shortfall penalties of a less culpable category (for example, reducing a penalty for “gross carelessness” to “not taking reasonable care”) to persuade a taxpayer to agree to a proposed adjustment on a substantive tax issue. Conversely, staff may not use the potential of increasing the category of shortfall penalty or the likelihood of prosecution action being taken by the Commissioner, as leverage for finalising tax investigations.
26. The Commissioner may impose civil penalties<sup>1</sup> after a taxpayer has been prosecuted, even where the prosecution is unsuccessful (section 149(4) of the TAA). However, where a shortfall penalty has been imposed on a taxpayer, prosecution action cannot be taken (section 149(5) of the TAA). These are important outcomes for taxpayers and staff should ensure that taxpayers are aware of potential actions that may be taken in their case. For this reason the potential application of shortfall penalties should be discussed with the taxpayer, even in situations where prosecution action is being considered. In these circumstances, and consistent with the “all cards on the table” approach fundamental to the disputes regime, the taxpayer should at least be made aware that the imposition of shortfall penalties and/or prosecution action is being contemplated and may be taken notwithstanding a final agreement being reached on the substantive issues.
27. While it is preferable that final agreements include agreement as to the level of shortfall penalties to be imposed, failure to agree on penalties will not preclude a final agreement on the substantive issues being reached. Where agreement is not reached on the question of penalties the final agreement should note this and inform the taxpayer that the agreement does not cover penalties and that the taxpayer may still be liable for the imposition of shortfall penalties. The taxpayer and their adviser should not be left to make inferences about penalties.
28. The final agreement that is drafted and sent to the taxpayer for their signature should merely reflect the oral agreement already reached. Even where this is done, disagreement over the terms of the written agreement may occur. For example, a situation may arise where the taxpayer reads the agreement, crosses out the paragraph dealing with penalties and returns it to Inland Revenue whereupon the investigator’s team leader/manager signs the agreement as so amended. The taxpayer may in these circumstances believe that Inland Revenue has agreed not to impose any penalty. However, the effect of the amendment made by the taxpayer is simply that penalties are no longer covered by the agreement and accordingly have still to be agreed or, failing agreement, will be addressed through the disputes resolution process. In these circumstances any modification of the document should be discussed with the taxpayer in the first instance. A new document reflecting any accepted changes, and

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<sup>1</sup> As this term is defined by section 3(1) of the TAA.

making it clear that penalties are still to be agreed should then be sent to the taxpayer.

29. In the case of shortfall penalties, discussion can occur and agreement can be reached as to the correct penalty that should be imposed. Where a shortfall penalty is to be imposed then there may also be discussion around the percentage of the penalty (such as whether it may be *reduced* for previous behaviour, etc., or *increased* for obstructing the Commissioner in determining the correct tax position in respect of the taxpayer's tax liabilities). The SPSs dealing with the reduction of shortfall penalties should be referred to, including SPS 06/03 and SPS 09/02.
30. Where an agreement is signed involving an increase in tax payable, an assessment will follow which will set a new due date for the payment of the increased tax. The taxpayer will be liable for UOMI from the original due date. However, provided the interest charged up to the date of assessment and the tax assessed in the notice is paid by the new due date, the UOMI from the date of the notice of assessment will be cancelled (section 183C(1)).

### **Ability of the taxpayer to pay**

31. When finalising an investigation, staff should discuss with the taxpayer their ability to pay any additional taxes that are to be assessed as a result of the agreement reached. Staff must also ensure that the taxpayer is aware of how to obtain information relating to Inland Revenue's debt collection processes and available payment options, including the availability of financial relief.
32. The ability of the taxpayer to pay the tax is not relevant in determining their tax liability. When the facts and law support issuing an assessment but the taxpayer will not be able to pay the tax, the assessment will be issued. The taxpayer should then apply under the relevant sections of the TAA for financial relief by either requesting an instalment arrangement or stating why recovery would place them in serious hardship (sections 177, 177A, 177B, 177C and 177D of the TAA). The administration of the remission and relief provisions of the TAA are outside the scope of this SPS.

### **Timing of final agreements**

33. Agreements should be finalised at the completion of an investigation, after discussing the proposed adjustments with the taxpayer and their representatives. It is only after this discussion that any agreement should be formalised in writing.
34. Due to the limitation of time for amending assessments contained in sections 108 and 108A of the TAA it may be necessary, where periods under investigation are about to become time-barred and are not able to be reopened, to finalise the investigation before all issues in dispute have been resolved. In this circumstance, it may be necessary for the Commissioner to seek a final agreement for the agreed issues and issue a Commissioner's NOPA in respect to those issues that are unresolved. The disputes process will then be followed in respect of these unresolved issues. In circumstances where time-barred years are reopened, the Commissioner will continue to attempt to reach resolution in respect of all issues in dispute or, where agreement cannot be reached, to follow the disputes process.

35. Where an investigation covers a number of years, it may be possible to make an assessment on a year-by-year basis so that any dispute may be limited to particular years. Where this situation arises, any agreement reached will not be a precedent for the treatment of future years (except where the matter concerns an adjustment arising from an agreed adjustment in a previous year or where an issue subject to an agreed adjustment spans more than one year).
36. While it is recognised that there may be circumstances where an agreement is finalised post assessment, such an occurrence should be avoided. It should occur only in rare circumstances, such as where the circumstances stated in section 89C of the TAA apply. For instance, the Commissioner has good reason to believe that issuing a NOPA may cause the taxpayer to leave New Zealand and therefore makes an assessment of additional tax in respect of periods under investigation. As it transpires, the taxpayer does not leave the country and a final agreement is subsequently reached with the taxpayer.

### **Form of agreement**

37. Where the final agreement reached is straightforward it is considered that use of the form *Agreement to amend assessment(s)* (IR 774) will be an appropriate means of recording the final agreement (see Appendix). However, in more complex cases a final agreement may be more appropriately recorded in letter form. For instance, a letter may be appropriate in cases where there are a large number of adjustments, a large number of revenues and/or periods subject to adjustment, or the adjustments are legislatively complex. Where a letter is used it must contain, as a minimum, all of the information contained in form IR 774 and be signed and dated by or on behalf of both parties. A copy of the IR 774 (or letter, where one has been used) must be provided to both the taxpayer and any agent that has been acting for the taxpayer at the time that the investigations is finalised. Where no adjustments are required a letter advising them of this fact, and that the investigation has been concluded will be provided to both the taxpayer and any agent that has been acting for the taxpayer.
38. It should be noted that a formal written agreement is not required where the assessment being made is as a result of the Commissioner exercising her discretion to correct an assessment pursuant to a taxpayer's request in terms of section 113 of the TAA. Please see *SPS 07/03 Requests to amend assessments* (originally published in *Tax Information Bulletin* Vol. 19, No 5 (June 2007)) or other publications issued in replacement by the Commissioner.
39. Where there are many issues in dispute it may not be possible to finalise an agreement in respect of them all. In this situation the disputes resolution process would be limited to the unresolved issues.
40. Where a situation involves a number of taxpayers, for example, partners or shareholders, an agreement reached through resolution with one person may not necessarily form the basis of an agreement for all the other parties. This is because it is important to consider the factual background to each person's involvement and the tax position taken by that person.

### **Adherence to agreement by Commissioner**

41. Where the issues in dispute have been resolved, Inland Revenue will adhere to the terms of this final agreement for the periods subject to the agreement. Re-examination of the taxpayer's affairs for the periods and issues covered by the final agreement would be undertaken only where, for example, new evidence suggests that the full material facts were not known to the Commissioner at the time of the agreement and in particular that tax avoidance, evasion or fraud has occurred. Any re-examination will also be subject to the time bar rules of sections 108 and 108A of the TAA.
42. Where a period has been adjusted following a partial review of a taxpayer's affairs (such as, for instance, a review in respect of a single issue following a policy ruling) nothing in this SPS prevents Inland Revenue from later undertaking a further review of that period (other than in respect of the particular issue or issues that have been the subject of the final agreement).

### **Agreement following commencement of disputes process**

43. Where the disputes process in Part 4A of the TAA has commenced by the issuing of a NOPA the taxpayer/disputant may not challenge an adjustment that has been agreed to in the final written agreement if:
  - that adjustment was proposed by the Commissioner during the disputes process, or
  - that adjustment was a matter specified in a notice from the Commissioner rejecting an adjustment proposed by the taxpayer/disputant during the disputes process.
44. As stated previously, at paragraph 9 above, although the Commissioner has an expectation that taxpayers will sign a final agreement in good faith, it is acknowledged that the taxpayer may, where the dispute process in Part 4A of the TAA has not commenced, subsequently contest the adjustments that have been agreed provided they do so within the statutory time frame and follow the statutory disputes procedures.

### **Failure to negotiate a final agreement**

45. Not all issues subject to dispute may be resolved and final agreement reached. During the resolution process Inland Revenue may enter into correspondence and discussions on a "without prejudice" basis. However, where a final agreement is not reached neither Inland Revenue nor the taxpayer may be bound by any factual or legal matters which may have been "agreed" on a without prejudice basis in any unsuccessful attempt to facilitate a final agreement.

### **Authority to approve final agreements**

46. The staff member who has undertaken the investigation is not authorised to approve the final agreement. There must be (and be seen to be) objectivity in the approval of final agreements. It is therefore necessary for an independent review of the case to be carried out by a person with authority

to approve the agreement. Generally, this will be a team leader or higher level person.

47. In cases where approval of an assessment is required at a certain delegated level, such as sections BG 1 (tax avoidance) of the Income Tax Act 2007, or sections 6 and 6A of the TAA (care and management), approval of any final agreement is to be given at that level. With respect to a scheme involving many participants, once the appropriate delegated person has approved the application of the avoidance provisions, individual agreements may be signed by a team leader.

This Standard Practice Statement is signed by me on 21 August 2015.

**Graham Tubb**  
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