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TAX INFORMATION
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Inland Revenue
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YOUR OPPORTUNITY TO COMMENT

Inland Revenue regularly produces a number of statements and rulings aimed at explaining how taxation law affects taxpayers and their agents. Because we are keen to produce items that accurately and fairly reflect taxation legislation and are useful in practical situations, your input into the process, as a user of that legislation, is highly valued.

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Public Consultation
Office of the Chief Tax Counsel
Inland Revenue
PO Box 2198
Wellington 6140

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IN SUMMARY

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OPERATIONAL STATEMENTS

Operational statements set out the Commissioner's view of the law in respect of the matter discussed. They are intended to be a preliminary view in the absence of a public binding ruling or an interpretation statement on the subject.

OPERATIONAL STATEMENT OS 13/01: THE COMMISSIONER OF INLAND REVENUE'S SEARCH POWERS

Introduction

1. This statement outlines how Inland Revenue will exercise one of the Commissioner's information gathering powers: the search powers under sections 16, 16B and 16C of the Tax Administration Act 1994 and the Search and Surveillance Act 2012. The statement aims to provide taxpayers and their advisers with information about what to expect when the Commissioner uses these powers, and the Commissioner's expectations of taxpayers.
2. This Operational Statement is supplemented by the Standard Practice Statement 10/02 *Imaging of electronic storage media* (or any subsequent replacements of this SPS) and is to be read in conjunction with that SPS.
3. Legislative references within this Operational Statement are to the Tax Administration Act 1994 unless otherwise stated.

Application

4. This Operational Statement applies from 1 September 2013.

Summary

5. Under section 16 of the Tax Administration Act 1994 (TAA) and Part Four of the Search and Surveillance Act 2012 (SSA) the Commissioner, or any authorised Inland Revenue officer, has powers to fully and freely access places and documents for the purpose of inspecting any documents, property, process or matter which are considered necessary or relevant for the purpose of collecting any tax or carrying out any function lawfully conferred on the Commissioner.
6. These powers are granted to the Commissioner to enable her to carry out her statutory duties. These duties include those set out in sections 6 and 6A, to protect the integrity of the tax system and to collect over time the highest net revenue practicable within the law, having regard to the Commissioner's resources, the importance of promoting compliance and the compliance costs incurred by taxpayers.
7. Sections 16B and 16C support these powers of access by enabling the Commissioner to remove documents for copying and/or full and complete inspection.
8. Section 16(1) is a warrantless power of entry. This means that, except for private dwellings, the Commissioner does not need to obtain a warrant to access all lands, buildings and places and to all documents.
9. In order to access a private dwelling, the Commissioner must obtain either:

   (a) a warrant under section 16(4); or

   (b) the consent of an occupier.
10. The Commissioner can remove documents, including electronically stored information, and retain them for copying or inspection or both. In order to remove documents from any place, for inspection, the Commissioner must obtain either:

    (a) a warrant under section 16C(2); or

    (b) the consent of an occupier.
11. Warrants can only be obtained from District Court Judges, Judges of the High Court, or from other issuing officers that have been authorised by the Attorney-General (refer to the definition of "issuing officer" in the SSA and to section 108 of the SSA: other issuing officers can include Registrars, Deputy Registrars, Community Magistrates and Justices of the Peace when authorised by the Attorney-General).
12. Information used for warrant applications will be confidential until, in most cases, the conclusion of the investigation and any litigation.
13. Inland Revenue officers will apply best practice in using these search powers, including following these guidelines, to ensure compliance with sections 4, 5, 6, 21 and 22 of the New Zealand Bill of Rights Act 1990 (Bill of Rights Act).
14. The SSA provides a number of clarifications to the Commissioner's powers, as well as setting out requirements for Inland Revenue officers and taxpayers to follow. The SSA also sets out the process by which warrants are obtained.
15. This Operational Statement (OS) provides taxpayers and their advisers with information about what to expect when the Commissioner exercises her search powers, including information on the protocols the Commissioner will follow in relation to legal privilege

and the non-disclosure right under sections 20 and 20B to 20G of the TAA. This OS also provides information on the Commissioner's expectations of taxpayers and their advisers, and what the legislation requires them to do.

16. The Commissioner's search powers will generally be exercised when, in the Commissioner's opinion, other means of obtaining information are inappropriate or inadequate. Other information gathering powers do not have to be used before the Commissioner exercises the section 16 search powers, but these search powers could be exercised in conjunction with those other information-gathering powers.

17. Occupiers of places accessed by the Commissioner under section 16 are required by section 16(2) to assist the Commissioner by providing all reasonable facilities and assistance for the effective exercise of section 16, and to answer all proper questions relating to that exercise. Inland Revenue officers can use reasonable force, including the services of a locksmith, where necessary to open property, such as locked doors and cabinets.

18. When documents are removed, owners will be provided with the opportunity to inspect and copy documents at the Inland Revenue office to which the documents are taken. And where practicable, Inland Revenue officers will follow a standard process in relation to the protections in section 20 (legal privilege) and sections 20B to 20G (non-disclosure right).

19. Occupiers and other taxpayers who take steps to destroy documents or who fail to assist as required under section 16, or otherwise obstruct the Commissioner, could be liable to prosecution under the TAA and SSA. The penalties for such offences range from fines to sentences of imprisonment.

20. The Commissioner considers the powers provided in sections 16, 16B and 16C to be essential to Inland Revenue's compliance functions and duties under the Revenue Acts. These powers will be exercised responsibly, preserving legal privilege and non-disclosure rights of taxpayers (and others), and in compliance with the New Zealand Bill of Rights Act where applicable.

Legislation

21. The following legislative provisions are relevant to this OS:

    (a) Sections 6, 21, 22, 23 and 28 of the Bill of Rights Act.

    (b) Sections 16, 16B and 16C of the TAA.

    (c) Section 20 of the TAA (the legal privilege applying to information subject to the information-gathering powers in sections 16, 17, 17A, 18 and 19).

    (d) Sections 20B to 20G of the TAA (the non-disclosure right for tax advice documents subject to the information-gathering powers in sections 16, 17, 17A, 18 and 19).

    (e) Section 3, subparts 1, 3, 4, 7, 9 and 10 of Part 4 (except sections 102, 103(3)(b)(ii), 103(7), 115(1)(b), 118, 119 and 130(4)), and the Schedule of the SSA.

    (f) Section 60 of the Evidence Act 2006 (EA 2006).

Search and Surveillance Act 2012

22. The SSA aims to ensure search and surveillance powers are exercised consistently and in ways which balance law enforcement priorities with civil rights.

23. The powers in the TAA are supplemented by various provisions of the SSA. These include clarifications to the Commissioner's powers, requirements for Inland Revenue officers and taxpayers to follow, and the process by which warrants are obtained.

24. Not all of the provisions in the SSA apply to the Commissioner. Refer to Appendix I for a table summarising the parts of the SSA that apply (including an explanation of how only those parts of the SSA that are listed in the SSA Schedule apply).

25. The SSA takes effect on the TAA from the earlier of the date of effect given by any Order in Council for the application of the SSA to the TAA, or 1 April 2014.

26. Refer to Appendix I for an explanation of how the SSA applies to the TAA.

Definitions

27. The following terms are used in this OS:

Computer system

Section 3 of the SSA defines this as follows:

> **computer system**
>
> (a) Means—
>
> (i) a computer; or
>
> (ii) 2 or more interconnected computers;
>
> (iii) any communication links between computers or to remote terminals or another device; or
>
> (iv) 2 or more interconnected computers combined with any communication links between computers to remote terminals or any other device; and
>
> (b) includes any part of the items described in paragraph (a) and all related input, output, processing, storage, software or communication facilities, and stored data.

Document

Section 3 of the TAA defines this as follows:

> "**document**" means—
>
> (a) a thing that is used to hold, in or on the thing and in any form, items of information:
>
> (b) an item of information held in or on a thing referred to in paragraph (a):
>
> (c) a device associated with a thing referred to in paragraph (a) and required for the expression, in any form, of an item of information held in or on the thing

Enforcement officer

Section 3 of the SSA defines this as follows:

> **enforcement officer** means—
>
> (a) a constable; or
>
> (b) any person authorised by an enactment specified in column 2 of the Schedule, or by any other enactment that expressly applies any provision in Part 4, to exercise a power of entry, search, inspection, examination, or seizure.

Inland Revenue officers to whom the Commissioner has delegated the authority to exercise section 16 fall within this definition of "enforcement officer."

Full and complete inspection

Section 3 of the TAA defines this as follows:

> **"full and complete inspection"—**
>
> (a) includes use as evidence in court proceedings:
>
> (b) does not include removal to make copies under section 16B

Inland Revenue officer in charge

This term is not defined in the TAA. This is the Inland Revenue officer who has charge of the search. They will identify themselves to the occupier and will be the primary contact point for the occupier and their adviser. This means that all communication between the occupier and Inland Revenue officers will be made through the officer in charge. This person has delegated authority from the Commissioner to exercise sections 16, 16B and 16C of the TAA and the ancillary provisions of the SSA. They will hold a delegation of authority card which can be shown to occupiers and their advisers as confirmation of the delegation.

Necessary or relevant

This term is not defined in the TAA. It is what is necessary or relevant in the Commissioner's opinion that is pertinent. "Necessary or relevant" for the purposes of section 16 means that the documents are necessary or relevant for any of the following purposes:

- Collecting any tax or duty under any of the Inland Revenue Acts;
- Carrying out any other function lawfully conferred on the Commissioner;
- Likely to provide any information required for the purposes of any of the Inland Revenue Acts or the Commissioner's functions.

Occupier

The term occupier is not defined in the TAA. For the purposes of sections 16 and 16C, the term is given a wide meaning. It includes all persons entitled to be on the premises, including employees, tenants and family members, and is not restricted to the owner or lease holder. This may or may not include the taxpayer under investigation. In this OS, the term "occupier" is used interchangeably with "taxpayer." The Inland Revenue officer in charge will take reasonable measures to satisfy themselves that the occupier they are dealing with has lawful occupation of the place and is the appropriate person to deal with, and may also require other occupiers to provide assistance or answer proper questions. See also paragraphs 53(a) and 112.

Private dwelling

Section 16(7) of the TAA defines this as follows:

> **"private dwelling"** means any building or part of a building occupied as residential accommodation (including any garage, shed, and other building used in connection therewith); and includes any business premises that are or are within a private dwelling.

Proper questions

This term is not defined in the TAA. For the purposes of section 16(2)(b), proper questions are those relating to the effective exercise of powers under section 16. This does not include investigative questions, but can include dual purpose questions (where discussion about documents, property, processes or other matters contained on the premises can overlap with the substantive investigation). See paragraphs 78 to 94 below for a discussion of how these will be managed.

Reasonable facilities and assistance

This term is not defined in the TAA. For the purposes of section 16(2)(a), the provision of reasonable facilities and assistance means such assistance as the Inland Revenue officer in charge of the search considers necessary for the effective exercise of the search powers. This is reinforced by the SSA, and examples include unlocking cabinets, providing access to bathroom and kitchen facilities, the provision of electricity, and remaining outside specified areas when required to do so (see paragraphs 97 to 99 below).

Remote access search

Section 3 of the SSA defines this as follows:

> **remote access search** means a search of a thing such as an Internet data storage facility that does not have a physical address that a person can enter and search

Search power

Section 3 of the SSA defines this as follows:

> **search power**, in relation to any provision in this Act, means—
>
> (a) every search warrant issued under this Act or an enactment set out in column 2 of the Schedule to which that provision is applied; and
>
> (b) every power conferred under this Act or an enactment set out in column 2 of the Schedule to which that provision is applied, to enter and search, or enter and inspect or examine (without warrant) any place, vehicle, or other thing, or to search a person

The power in section 16, including the power to access private dwellings under warrant, is a search power for the purposes of the SSA.

Operational Practice

Overview

28. This section sets out the operational practice authorised Inland Revenue officers will follow when exercising search powers, the Commissioner's expectations of taxpayer and their advisers, and their statutory obligations.

29. This section covers the following matters:

    (a) When Inland Revenue will use section 16.

    (b) Warrants.

    (c) Entry, Identification and Advice of Rights.

    (d) Exercising search powers (including taxpayers' obligations):

        (i) Access;

        (ii) Search;

        (iii) Assist ants;

        (iv) Reasonable facilities and assistance;

        (v) Proper questions;

        (vi) Power to exclude;

        (vii) Other activities;

        (viii) Electronically stored information;

        (ix) Removal of documents.

    (e) Legal advisers, tax agents and support persons.

    (f) Legal privilege and the non-disclosure right.

    (g) After the search:

        (i) Access to documents;

        (ii) Return of documents.

    (h) Offences.

When Inland Revenue will use section 16

30. The efficient and effective use of information gathering powers such as those provided in sections 16, 16B and 16C are necessary for the Commissioner to obtain information to verify various tax liabilities, to deter and detect offending, and to assist in tax collection.

31. The Commissioner will use section 16 where it is considered appropriate in the context of the particular investigation, and where it is reasonable. This includes cases where, in the Commissioner's opinion, there is a risk or history of non-compliance and/or a lack of co-operation, where it is likely that documents may be at risk, or likely that the case involves revenue offending (tax crimes, including fraud and evasion). Section 16 can also be used to address problems of aggressive tax planning and tax avoidance.

32. It is not necessary for the Commissioner to use other avenues to obtain the information or other powers, such as section 17, before exercising section 16.

33. The power under section 16B will be exercised in situations where it is considered reasonable to do so in order to prevent the Commissioner's investigations being hindered or where copying of the documents on the premises is not practicable.

34. The powers under section 16C will be exercised when it is reasonable to do so to retain documents for full and complete inspection, including the use of those original documents in court proceedings.

35. The Commissioner recognises the intrusive nature of the exercise of section 16, and the need to use section 16 in a way that recognises the importance of the rights and entitlements affirmed in other enactments, including the Bill of Rights Act, the Privacy Act 1993 and the Evidence Act 2006, while ensuring the effectiveness of the Commissioner's investigative tools. The Inland Revenue officer in charge will explain clearly to occupiers what their rights and obligations are (see paragraphs 49 and 57 to 59).

Warrants

36. Section 16(1) is a warrantless power of entry. This means the Commissioner does not need to obtain a warrant to access all lands, buildings (except for private dwellings) and places, and all documents.

37. In order to access a private dwelling, the Commissioner must obtain either:

    (a) a warrant under section 16(4); or

    (b) the consent of an occupier.

38. It is the Commissioner's practice to apply for warrants in relation to accessing private dwellings. This provides occupiers with judicial oversight, helping balance their privacy rights against law enforcement needs. If part of a search area is found to contain a private dwelling, and if a private dwelling warrant is not already held, the officer in charge will seek either the occupier's consent, or a warrant before searching that area.

39. The Commissioner can remove documents, including electronically stored information, and retain them for copying or inspection or both. In order to remove documents from any place, for inspection, the Commissioner must obtain either:

    (a) a warrant under section 16C(2); or

    (b) the consent of an occupier.

    Note: The Commissioner does not require a warrant, or the consent of an occupier, to remove documents for copying (under section 16B). Copying of documents, including the imaging of electronically stored information, can occur either on-site or elsewhere.

40. The Commissioner will obtain warrants under section 16C to remove and retain documents in most cases where section 16 is being used. Although section 16C states that documents can be removed and retained with the occupier's consent, the Commissioner will generally obtain warrants for the removal of documents under section 16C. In most cases, having a warrant to remove the documents will reduce the amount of time Inland Revenue staff will be present at taxpayers' premises and will provide a clearer framework for claiming and protecting legal privilege and the non-disclosure right.

41. Subpart 3 of Part 4 of the SSA sets out the process by which warrants are to be obtained. One of those requirements is for the warrant application to contain a description of the items believed to be in the place, vehicle or other thing sought by the Commissioner (section 98(1)(e) of the SSA). Section 103(4)(g) of the SSA requires the warrant itself to contain a description of what may be seized. The Tax Administration (Form of Warrant) Regulations 2003 reflects this requirement, which satisfies the SSA requirements. A more detailed description of the documents to be seized is not required, and in addition, section 123 of the SSA allows Inland Revenue officers to seize other documents that are in plain view during the section 16 search. Section 123 authorises Inland Revenue officers to do this where they have reasonable grounds to believe they could have seized the items under a private dwelling search warrant, a section 16C(2) warrant, or under section 16(1).

42. Where the Commissioner intends to use section 16 to inspect any property, process or matter (other than documents), then the requirements of sections 98(1) and 103(4)(g) of the SSA to describe the item to be seized do not apply. This is because the requirement to describe items to be seized cannot apply to items that are going to be inspected, not seized.

43. These warrant applications are made without notice to the occupier, and can include confidential information. Where the relevant secrecy or confidentiality rules apply the Commissioner will generally seek to keep the information confidential. Other information may be disclosed either in whole or part at the conclusion of the investigation and any litigation resulting from that investigation. In some cases, this information may still be protected after the investigation or litigation has ended.

44. While section 100(3) of the SSA provides for oral applications for warrants, the Commissioner will generally seek warrants by written application.

Entry, Identification and Advice of Rights

Entry

45. Section 16(1) provides the Commissioner with wide powers of access to all lands, buildings and places, and documents. This includes motor vehicles, business premises, warehouses, and private dwellings under a court warrant. This is reflected in section 110 of the SSA.

46. Inland Revenue officers exercising search or seizure powers are able to use reasonable force in respect of any property (for example, to open doors and access cabinets). This is specifically provided for in sections 110(c), 113(2)(b) and 131(3) of the SSA. Those powers do not authorise the use of force against persons.

47. One example of reasonable force is the use of a locksmith to gain entry if no one is present or if the occupier refuses entry. The use of non-Inland Revenue personnel, such as locksmiths, is also authorised by provisions in the TAA and SSA which permit Inland Revenue officers to bring along such assistants as they consider necessary (see paragraphs 67 to 71 for further discussion). Where locksmiths or other means of reasonable force are used to gain entry, and new locks and/or keys are required, the Inland Revenue officer in charge will attempt to contact the property owner and provide them with the new keys.

48. The Inland Revenue officer in charge will accompany all assistants when they first enter the place to be searched, and will supervise any assistant that is not an Inland Revenue employee or a Police constable as the

Inland Revenue officer in charge considers reasonable in the circumstances.

Identification and notices

49. When entering premises under section 16, the Inland Revenue officer in charge of the search will:
    (a) Announce their intention to enter under section 16.
    (b) Identify him/herself by name or by unique identifier.
    (c) Produce evidence of their identity.
    (d) Provide the occupier with a copy of the search warrant, if any.
    (e) Where the search is not being carried out under a warrant, provide the occupier with a written notice setting out:
        (i) That the search is taking place under section 16; and
        (ii) The reason for the search. This will be in general terms describing the nature of the investigation, but not setting out specific detail. For searches being carried out under warrants, the reason for the search is set out in the warrant.
    (f) Accompany any assistant that is not an Inland Revenue employee or a Police constable when that assistant first enters the place.
50. The Inland Revenue officer in charge will also identify themself to the occupier as the main contact person for the occupier and their adviser during the search of the premises.
51. If the occupier is not present during the search, the Inland Revenue officer in charge of the access will leave the following in a prominent position at the place (or in the vehicle):
    (a) A copy of the search warrant (where the search was carried out under a search warrant);
    (b) A notice setting out:
        (i) The date and time of the start and finish of the search;
        (ii) The name or unique identifier of the Inland Revenue officer in charge of the search;
        (iii) Where the search was exercised without a warrant, that it took place under section 16, and the reason for the search;
        (iv) The address and contact details of the Inland Revenue officer to whom enquiries should be made;
        (v) If nothing was seized, the fact that nothing was seized;
        (vi) If documents were seized, the fact that documents were seized;
        (vii) If documents were seized, and where an inventory is not provided at this time, a statement that an inventory will be provided within seven days after the seizure;
        (viii) If documents were seized, the information set out in paragraph 112 to the extent applicable.
52. Where it is not reasonably practicable to take the steps set out in paragraph 49, section 131(4)(b) of the SSA enables the Commissioner to provide this information to the occupier or owner within seven days after the search.
53. By taking the above steps, the Inland Revenue officer in charge of the search will have met the identification and notice requirements of sections 16(6) and 16C(4) and section 131 of the SSA. However, in the following circumstances, sections 131(1)(b)(ii), 131(2) and 131(6) of the SSA permit the Inland Revenue officer in charge to elect not to carry out some of these requirements:
    (a) Where the Inland Revenue officer in charge has reasonable grounds to believe the person present during the search is not the occupier of the place or is not the person in charge of the vehicle or other thing being searched, the Inland Revenue officer in charge will not provide that occupier with the information in paragraphs 49 and 51;
    (b) Where it is impracticable to do so, the Inland Revenue officer in charge can elect not to carry out paragraphs 49(d) and (e);
    (c) Where there are operational reasons (such as safety or prejudice to the investigation or the access), the Inland Revenue officer in charge can elect not to carry out paragraph 49; and
    (d) Where the Inland Revenue officer in charge has reasonable grounds to believe that no person is lawfully present, then they can elect not to carry out paragraph 49.
54. In the following circumstances, section 134 of the SSA enables Inland Revenue to apply to a Judge for a postponement of the requirements in paragraph 51:
    (a) Where compliance would endanger the safety of a person; or
    (b) Where compliance would prejudice on-going investigations.
55. Section 132 of the SSA sets out identification and notice requirements for remote access searches. In addition to remote access searching, the

Commissioner is also able to access computer systems under section 16(1) because of the broad nature of the language used in that section.

56. To ensure the Commissioner's powers in this regard are exercised in a reasonable manner, and consistently with the Bill of Rights Act, the Inland Revenue officer in charge will, if possible, do the following upon completion of a computer system search:

    (a) send an electronic message to the email address of the thing searched setting out:

        (i) The date and time of the start and finish of the search;

        (ii) The name or unique identifier of the Inland revenue officer in charge of the search;

        (iii) The address of the Inland Revenue office to which inquiries should be made.

    (b) Where it is not possible to deliver this electronic message, the Inland Revenue officer in charge will take reasonable steps to identify the user of the thing searched and send the above information to them.

Advice of rights

57. The Commissioner's use of section 16 is subject to the reasonableness requirement of section 21 of the Bill of Rights Act.

58. To ensure the search powers in the TAA and the SSA are exercised consistently with the protections in the Bill of Rights Act, the Inland Revenue officer in charge of the search will provide the occupier with the following:

    (a) Advice of the occupier's ability to consult and instruct a lawyer.

    (b) An explanation of the occupier's obligation to provide reasonable facilities and assistance and to answer proper questions.

    (c) An explanation of the privilege against self-incrimination under section 60 of the Evidence Act, where proper questions are being asked that may also constitute investigative questions (refer to paragraphs 78 to 94 for more information on proper questions).

    (d) A general explanation of the processes that will be undertaken on-site.

59. The Inland Revenue officer in charge of the search will provide the occupier with a written copy of the above information.

Exercising search powers (including taxpayers' obligations)

Access

60. Access will be undertaken at a time the Commissioner considers will balance causing minimal disruption to the occupier with the purpose of the search and the operational needs of the investigation.

61. Where no-one is present at the premises being searched, Inland Revenue officers are able to use reasonable force to gain access. This includes forced entry or engaging the services of a locksmith to enter the premises, and disarming alarms.

Search

62. The power of access in section 16 includes the power to search for items covered by that section.

63. Noting the restrictions set out in the SSA, the Commissioner's view is that officers are not empowered to directly search persons. However, occupiers are required to provide Inland Revenue staff with reasonable facilities and assistance in carrying out the search. This includes emptying their pockets if asked to do so, handing over documents and devices such as cellphones or USB drives, and allowing the Inland Revenue officer to search inside items such as handbags, briefcases and backpacks.

64. Where Inland Revenue officers have reasonable grounds to believe that documents, including electronically stored information, are on an occupier's person, Inland Revenue officers may request the assistance of Police to search that person where the Police powers to do so apply. Where Police are called on to assist IR officers, any constable is able to exercise any power ordinarily exercisable by them (section 113(3) of the SSA).

65. Any such search of a person will be conducted with decency and sensitivity and in a manner that affords to the person being searched, the degree of privacy and dignity that is consistent with achieving the purpose of the search (as set out in the SSA).

66. The search may extend to any item the person is carrying or that is in the person's physical possession or immediate control (including briefcases, handbags and backpacks).

Assistants

67. Section 16(2A) authorises Inland Revenue to bring such assistants as the Commissioner may consider necessary, and section 113(4) of the SSA sets out the Commissioner's obligations in relation to those assistants. Examples of assistants include other Inland Revenue staff, digital or other computer forensic

experts, locksmiths, Police officers, dog control officers, interpreters, landlords and local council staff.

68. Where an assistant is not an Inland Revenue employee or a Police constable, the Inland Revenue officer in charge will accompany that assistant when they first enter the place to be searched, and provide such supervision as is reasonably necessary. Where the assistant is a constable, section 113(5) of the SSA makes it clear that these requirements do not apply.

69. Assistants have all of the powers given to them under section 113 of the SSA that the Inland Revenue officer in charge authorises them to use. This includes authorising an assistant to use reasonable measures to access computer systems, and authorising locksmiths to use reasonable force in respect of any property.

70. Assistants can also be used where occupiers are obstructing entry or the search and seizure. Inland Revenue can call on the assistance of Police or other security specialists.

71. Where the Commissioner has engaged the services of non-Inland Revenue staff to assist in the exercise of section 16, they will be required to have first signed a declaration of secrecy under section 87.

Reasonable facilities and assistance

72. The Commissioner's search of premises requires some degree of assistance from those in normal possession of those premises, including unlocking doors and providing electricity. Section 16(2) requires occupiers to provide reasonable facilities and assistance to Inland Revenue officers.

73. Refer to paragraph 58 for further information as to what occupiers will be told.

74. The obligations to answer proper questions and provide assistance under section 16(2) do not amount to a detention within the meaning of section 23 of the Bill of Rights Act. However, occupiers will be treated with humanity and respect for the inherent dignity of the person, as set out in section 23(5) of the Bill of Rights Act.

75. Where occupiers are required to provide assistance, they will be asked to do so at an early stage. Wherever possible, the Inland Revenue officer in charge will avoid keeping occupiers longer than is necessary for them to assist during the course of the search.

76. When requiring assistance from occupiers, Inland Revenue will take into account the following factors:

    (a) The compliance cost to the occupier;

    (b) The need for occupiers to also meet the needs of their business during the search (where the search occurs during that business' working hours); and

    (c) The purpose for which the search powers are being exercised.

77. Where the occupier is required to provide assistance, the Inland Revenue officer in charge will inform them of the reason for this, and that they have the right to refrain from making any incriminating statement (unless it is a proper question within the parameters discussed in paragraphs 78 to 94).

Proper questions

78. When the search power in section 16 is being exercised Inland Revenue staff are statutorily empowered under section 16(2)(b) to ask questions which occupiers must answer.

79. The SSA also imposes additional obligations on occupiers to provide access or other information that is reasonable and necessary to allow Inland Revenue to access data in computer systems or other data storage devices or internet sites (section 130 of the SSA).

80. The answers to questions asked under section 16(2)(b) can be required in writing or under statutory declaration. Generally, it is the Commissioner's practice to require oral answers to these questions during the search, although the occupier can be asked to provide answers in writing or under a statutory declaration.

81. Any questions asked under section 16(2)(b) must be "proper" questions. Proper questions are those relating to the effective exercise of powers under section 16:

    (a) This includes basic questions such as name, address and occupation.

    (b) It does not include investigative questions, which are questions directed at obtaining evidence of offending or of the taking of the underlying tax position. Questions of this kind will be put to the occupier separately under a voluntary interview or an inquiry under sections 18 or 19.

82. However, the Commissioner recognises that discussion about the material contained on the premises can overlap with the substantive investigation. So when asking questions of this dual nature, Inland Revenue officers will ensure occupiers understand that questions relating to investigative aspects form part of a voluntary interview and they may leave after the "proper question" has been answered (see the discussion at paragraphs 88 to 94 about the privilege against self-incrimination).

83. If an interview is considered necessary, then this will generally be arranged for a date after the search has been completed. Ensuring that any investigative interview is conducted separately from the search will

allow the taxpayer time to discuss their circumstances with an advisor and to appropriately obtain advice. Doing so may also allow time for the taxpayer to make a post-notification voluntary disclosure under section 141G(1)(b).

84. This means that, unless the taxpayer has previously been advised of this, the exercise of section 16 will qualify as notification of a pending or started tax audit or investigation under section 141G(4). Any questions asked during the search under section 16(2)(b) will be confined as much as possible to "proper questions" so that the search does not constitute an interview for the purposes of section 141G(5)(a) or (b). Inland Revenue's view is that any dual purpose questions do not by themselves constitute an "interview" for the purposes of section 141G(5)(a) or (b), providing that the principal purpose of asking that dual purpose question is to ask a proper question.

85. Although a search will qualify as notification (for the purposes of the voluntary disclosure regime), it will depend on the facts of each case as to whether or not the Commissioner has started the audit or investigation (per the criteria in section 141G). The Commissioner's view is that inspections conducted in the course of the search for the purposes of determining relevance will generally not trigger the criterion in section 141G(5)(b) (unless purely investigative questions arise during the search) .

86. This means that generally a voluntary disclosure made following the exercise of section 16 (and until the conclusion of the first interview) will be a post-notification disclosure in terms of section 141G(3)(b). Where possible, the Inland Revenue officer in charge of the access will provide the occupier with a letter recording the notification of the start of an audit or investigation. Refer to SPS 09/02 Voluntary disclosures and SPS 07/02 *Notification of a pending audit or investigation* for more information. The forms for making voluntary disclosures can be found at **www.ird.govt.nz** (*IR 281 Voluntary disclosure*).

87. If an occupier refuses to answer a proper question, or leaves without answering it, this could give rise to a prosecution for obstruction (see paragraphs 97 to 99).

88. However, section 60 of the Evidence Act provides a privilege against self-incrimination where a natural person is required to provide specific information by a person exercising a statutory power or duty. This privilege is reflected in section 130(2) of the SSA, when a person is required to provide access or other information for computer systems.

89. The privilege only relates to information that would be likely to incriminate the person under New Zealand law for an offence punishable by a fine or imprisonment. It does not relate to liability for shortfall or other civil penalties under the TAA.

90. Section 60(3) of the Evidence Act restricts this privilege when an enactment removes it either expressly or by necessary implication. Section 16(2)(b) does remove the privilege in relation to "proper questions."

91. What this means in practice is that Inland Revenue officers may ask questions relevant to the inspection of documents, property, processes or matters and the occupier is compelled to answer them, but these questions will not extend to investigative ones. This practice applies to sections 6 and 28 of the Bill of Rights Act, by giving section 16(2) a meaning consistent with the rights and freedoms in that Act and with the common law right to silence.

92. Where such questions fall into both categories (dual purpose questions), the Inland Revenue officer will explain that the occupier has a right under section 60 of the Evidence Act not to answer the question if it would be likely to incriminate them. The privilege only relates to information asked of the person; it does not extend to documents. Providing passwords and other computer system and internet access information is not information that is likely to incriminate a person.

93. Where occupiers are required to answer proper questions, they will be asked to do so during the course of the search, and the Inland Revenue officer in charge will inform them of the reason for this, and that they have the right to refrain from making any statement that may incriminate them.

94. If an occupier is unsure as to which questions are proper, having a professional tax adviser or lawyer present can assist. However, Inland Revenue does not consider that it is necessary to await the arrival of any adviser before asking any proper question.

Power to exclude

95. Under section 116 of the SSA, the Inland Revenue officer in charge can secure the place or thing being searched, and where the officer has reasonable grounds to believe any person will obstruct or hinder the search (or any other power being exercised during the search), can exclude any person from the place, vehicle or thing.

96. In practice, this means that occupiers may be asked to remain outside a specified area, to keep away from other occupiers or Inland Revenue officers, or to leave the premises. Failing to do any of these things could

result in the occupier being liable to prosecution for obstruction.

Obstruction and other offending

97. Failing to keep away from other occupiers or Inland Revenue officers, or failing to remain outside an area specified by the officer in charge, may constitute an offence under section 143H (obstruction) leading to possible prosecution.

98. Obstruction also includes failure to provide reasonable facilities and assistance, failure to answer proper questions, hiding or destroying documents (including electronically stored information).

99. Such activities may also result in the taxpayer having to pay an increased shortfall penalty under section 141K.

Other Inland Revenue activities

100. Inland Revenue officers may also do the following in the course of exercising the Commissioner's search powers under the TAA and SSA:

(a) Take photographs, sound, or video recordings.

(b) Record discussions with occupiers.

Because these discussions are not an interview (refer to the discussion on "proper questions" at paragraphs 78 to 94), they are not subject to the guidelines in SPS 12/01 *Tape recording Inland Revenue interviews*; and where an interpreter is being used, the discussion will generally be audio-recorded as normal practice to provide an accurate record for both the occupier and the Commissioner. Where taxpayers are being interviewed, this will be conducted separately and is subject to the guidelines in that SPS.

(c) Question other occupiers who are present (for example, employees, tenants, family members, but not children under 14 years of age).

(d) Re-enter the premises after the search has been completed, but where this is a private dwelling, only if all items described in the warrant have not been seized or the search was completed within the last four hours or less.

101. Inland Revenue officers will also take a record of any cash or other valuables found during the search. This includes counting and photographing the items, because such assets could be representative of undeclared income. The items will generally not be seized by Inland Revenue.

Electronically stored information

102. Refer to the following Standard Practice Statements for information on:

(a) SPS 13/01 *Retention of business records in electronic format, application to store records offshore, and application to keep records in Māori* (or any subsequent replacement SPS) for guidelines on retaining business records in electronic format.

(b) SPS 10/02 *Imaging of electronic storage media* (or any subsequent replacement SPS) for Inland Revenue's practice when taking an image of electronic storage media.

103. The SSA confirms the Commissioner's approach to imaging of electronically stored information as set out in SPS 10/02.

104. Sections 110(h) and (i) and sections 113(h) and (i) of the SSA confirm, as did *Avowal Administrative Attorneys Ltd & Ors v District Court at North Shore & Anor* [2010] NZCA 183, that the Commissioner can access, preview and image (clone) electronically stored information. These sections specifically authorise the Commissioner to do the following:

(a) Use reasonable measures to access computer systems or other data storage devices, whether located in whole or in part at the place being searched;

(b) To copy any intangible material accessed, including previewing, cloning or other forensic methods;

(c) To copy material either before or after removal from the premises.

105. In addition, section 130 of the SSA authorises the Commissioner to require a person with knowledge of a computer system to provide access information and other assistance that is reasonable and necessary to allow Inland Revenue to access data.

106. Refer to the following paragraphs in this OS for discussion of these relevant aspects:

(a) Paragraphs 88 to 94 for a discussion of the privilege against self-incrimination.

(b) Paragraphs 112(d) and 127 to 139 for information on the privileges and confidentialities that apply.

(c) Paragraphs 55 to 56 above for an explanation of how the notice requirements in the SSA apply to Inland Revenue accessing electronically stored information.

107. Inland Revenue's Digital Forensics Unit (DFU) is a unit of specialist computer forensic staff that is independent from the Investigations unit. Wherever possible, the Commissioner will use staff from DFU to carry out the access, searching and copying of electronically stored information.

108. Examples of situations where it might not be possible to use DFU include where the size of the operation

means there are not enough DFU staff to attend at every site, and the Commissioner could either contract in external specialists, or require Investigations staff to remove electronic storage devices and deliver them to DFU for imaging. In all of these cases, a clear chain of custody over the electronic storage device will be maintained, and claims of legal privilege and the non-disclosure right (under sections 20 and 20B to 20G) can be made as described in this OS (see paragraphs 136 to 139). DFU will generally take custody and control of electronic storage media removed under either section 16B or 16C.

Removal of documents

109. Inland Revenue officers can remove documents that are necessary or relevant to the investigation. They can be removed for copying under section 16B or for inspection under section 16C. Inland Revenue officers can also remove other documents under section 123 of the SSA, which relates to the seizure of items in plain view.

110. The power in section 16B to remove documents accessed under section 16 in order to make copies was provided to the Commissioner to address the risk of documents being destroyed, removed or tampered with in certain cases. Section 110(d) of the SSA authorises the Commissioner to seize anything that is the subject of the search, and under section 110(g), to copy any document that may lawfully be seized. Under section 110(i), the Commissioner can copy electronically stored material (this subsection reflects the case law). These sections also provide the Commissioner with an alternative to copying on-site where it is not possible or practicable to do so.

111. In order to remove documents under section 16C, the Commissioner requires either a warrant or the consent of the occupier. Neither a warrant nor consent is required in order to remove the documents for copying under section 16B.

112. When documents are seized, and the Inland Revenue officer in charge is satisfied that the documents are owned by the occupier, they will provide the occupier with a notice (or provide one within seven days after the seizure), setting out:

    (a) A general description of what has been seized (the inventory). For example, the number of folders or boxes of documents removed, and the number of hard drives imaged.

    (b) Information about the occupier or owner's right to access the seized documents under sections 16B(4) and 16C(5).

    (c) Information about the occupier or owner's right to apply for access to any document relating to the search warrant application or the exercise of the search power that led to the seizure, as provided for in section 133(2)(a)(ii) of the SSA. Generally, information used in warrant applications will be confidential until the conclusion of the investigation and any litigation.

    (d) Information about the legal privilege and non-disclosure right in sections 20 and 20B to 20G. Note that other categories of privilege in the SSA do not apply to tax matters (refer to the Schedule to the SSA and Appendix I of this OS for an explanation of which parts of the SSA apply to the TAA).

113. By providing the notice referred to in paragraph 1120, Inland Revenue will have complied with the requirement in section 133 of the SSA to provide an inventory.

114. If the Inland Revenue officer in charge of the search is satisfied that none of the items seized are owned by the occupier, then this notice will not be provided to the occupier. Where the Inland Revenue officer in charge has reason to believe someone else is the owner of the documents, they will provide a notice to that person within seven days after the seizure. When documents are removed from, for example, a tax agent's office, the notice will be provided to the tax agent, not to each individual client whose records may have been uplifted.

115. In the following circumstances, section 134 of the SSA enables Inland Revenue to apply to a Judge for a postponement of the requirements in paragraph 112:

    (a) Where compliance would endanger the safety of any person; or

    (b) Where compliance would prejudice on-going investigations.

116. When the Inland Revenue officer in charge is uncertain of the status of items, they will be removed under section 112 of the SSA. For the purposes of the inventory and notice requirements, the time of seizure will start from when a decision is made as to whether or not the documents are necessary or relevant. If they are not relevant, they have not been seized, and will be returned to the owner or occupier.

117. In addition, documents or electronic storage devices that relate to other matters the Commissioner needs to investigate can also be removed under section 123 of the SSA (seizure of items in plain view) during the exercise of section 16. Such items will also be subject

to the notice and inventory requirements described above.

118. Documents removed for copying under section 16B will be returned as soon as practicable. Refer to paragraphs 142 to 145 for further information on the return of documents.

119. Documents removed under section 16C will be retained for as long as necessary for a full and complete inspection. This includes use in court proceedings. If the Commissioner determines that documents removed under section 16B for copying will be required for a full and complete inspection, the Commissioner will either:

(a) Seek the consent of the occupier; or

(b) Obtain a warrant under section 16C(2).

Legal advisers, tax agents and support persons

120. The Commissioner considers it preferable to have legal advisers or tax agents present during a search. This assists the occupier, as well as the Commissioner, in several ways. Having advisers present can reduce the amount of time Inland Revenue is present at the premises, reducing business interruption and our presence in the home. It can facilitate the answering of proper questions, assist with the resolution of issues regarding legal privilege and non-disclosure, and may reduce the stress for the occupier.

121. Inland Revenue encourages occupiers to have a professional adviser present, such as a lawyer, accountant or other tax adviser, and to consult with their advisers in private.

122. Waiting for legal advisers to arrive can delay the search, and result in Inland Revenue staff being present on the site for longer than necessary. It is the Commissioner's practice to be present on a site for the minimum amount of time necessary to conduct the access, including copying and removal of documents, so as to cause the least disruption to occupiers and businesses that is consistent with achieving the purpose of the search.

123. Therefore, occupiers will be provided with a reasonable opportunity to contact a legal adviser, and a decision as to when the search will commence will be made by the Inland Revenue officer in charge of the search. Inland Revenue officers do not have to wait until advisers arrive before commencing the search, imaging of electronically stored material, or removal of documents (see paragraphs 127 to 139 for the legal privilege and non-disclosure right process).

124. Where proceedings have been commenced (for example, an injunction) in relation to the exercise of section 16, section 180(2)(a) of the SSA authorises the Commissioner to continue with the search.

125. Occupiers may also prefer to have a tax agent or other support person present; however that person's presence must not interfere with the search.

126. The presence of other support persons will also be at the discretion of the Inland Revenue officer in charge of the search, and will take into account the occupier's particular circumstances, as well as those of the premises and the search (see to paragraphs 95 and 96).

Legal privilege and the non-disclosure right

127. For the purposes of the Commissioner's search powers, the only privileges or confidentialities that apply to Inland Revenue's ability to access and seize documents are those provided for in sections 20 to 20G. The privileges and rights to confidentiality in section 102 and in subpart 5 of Part 4 do not apply to the Commissioner's search powers because they have been specifically excluded by the Schedule to the SSA and by sections 20 and 20B. In practice, however, Inland Revenue regards the section 20 privilege as extending to litigation privilege where New Zealand lawyers (as defined by the Lawyers and Conveyancers Act 2006) are involved. For this purpose, litigation privilege is regarded as covering documents created for the dominant purpose of advising or assisting on reasonably apprehended litigation.

128. Confidential communications between legal practitioners and their clients that meet the criteria under section 20 are privileged from disclosure under section 16. This does not apply to documents made or brought into existence for the purpose of committing or furthering the commission of some illegal or wrongful act (section 20(1)(c)).

129. Sections 20B to 20G set out the criteria for claiming a non-disclosure right over tax advice documents subject to the information gathering power in section 16. A document is not a tax advice document if it was created for purposes that include committing, or promoting or assisting the committing of, an illegal or wrongful act (section 20B(2)(c)).

130. But for these limited exceptions, an information holder has the right to not disclose a document that is eligible to be a tax advice document. See Standard Practice Statement 05/07 *Non-disclosure right for tax advice documents* (or any subsequent replacements of the SPS) for more information.

131. The Commissioner will adhere to the provisions of sections 20 to 20G regarding legal privilege and the non-disclosure right for tax advice documents when

exercising sections 16, 16B and 16C including when imaging electronic storage media.

132. See Standard Practice Statement 10/02 *Imaging of electronic storage media* (or any subsequent replacements of the SPS) for more information on the Commissioner's practices when imaging electronic storage media.

133. As decided in *A Firm of Solicitors v District Court at Auckland* [2006] 1 NZLR 586, the mere removal and imaging of documents that may be legally privileged or subject to the non-disclosure right, does not breach that right or privilege, because there is no disclosure of those documents. This is confirmed by sections 110(h) and (i) and sections 113(2)(h) and (i) of the SSA which specifically authorise the accessing, previewing and cloning of intangible material in computer systems or other data storage devices.

134. The Commissioner is not responsible for asserting privilege or the non-disclosure right for taxpayers, but will advise occupiers of these rights where documents potentially subject to privilege or the non-disclosure right under sections 20 and 20B to 20G are anticipated.

135. A blanket claim of legal privilege or of the non-disclosure right across all documents is not a valid claim. As set out in the process below (paragraph 136), the Commissioner will provide an adequate opportunity for the owner of hard copy documents to review the documents to enable particularised claims to be made within a reasonable timeframe.

136. Where practical, Inland Revenue officers will use the following process in relation to section 20 (legal privilege) and sections 20B to 20G (the non-disclosure right):

(a) Provide the occupier with the opportunity to seek advice and make particularised claims under section 20 and sections 20B to 20G.

(b) In relation to electronically stored documents that are potentially subject to legal privilege or non-disclosure right claims, to copy or image, seal and remove them, or to remove the electronic storage device containing those documents for imaging off-site.

Where electronically stored documents have been imaged:

(i) The imaged copy will remain in the custody of DFU, and will not be released to Inland Revenue investigators until after this process is complete; and

(ii) The owner can provide a list of keywords to DFU to be used to identify documents to which section 20 or sections 20B to 20G apply.

(c) In relation to hard copy documents that are potentially subject to legal privilege or non-disclosure right claims, to seal and remove them.

(d) Work with the owner of the documents to agree a process for:

(i) Storage of the documents;

(ii) Making particularised claims of legal privilege or non-disclosure within a reasonable timeframe; and

(iii) Reviewing and resolving disputed privilege and non-disclosure right claims within a reasonable timeframe.

Where particularised claims are not made, and disputed claims are not resolved, within the agreed timeframe, the Commissioner will then continue to use the documents for investigative purposes.

137. While the Commissioner might agree to documents potentially subject to claims of legal privilege or the non-disclosure right remaining sealed for a reasonable period until the owner has the opportunity to review them, make particularised claims, and resolve any disputed claims, where the owner has neglected or chosen not to do so, the Commissioner can take any steps necessary to enable the investigation to continue.

138. In addition, section 180(2)(b) of the SSA specifically authorises the Commissioner to continue with the investigation when proceedings have been commenced in relation to the exercise of section 16 or the use of any evidential material obtained from the search. Taxpayers can apply to the High Court under section 180(3) of the SSA for interim orders overriding section 180(2).

139. If the claim of legal privilege or the non-disclosure right cannot be resolved between the Commissioner and the person making the claim, either party can apply to a District Court Judge for orders under section 20(5) as to whether the claim for legal privilege is valid, or under section 20G as to whether the document is a tax advice document (or for related orders regarding tax contextual information).

After the search

Access to documents

140. Where the Commissioner removes a document under section 16B, the owner is entitled under section 16B(4) to inspect and obtain a copy of the document that is removed:

(a) At the time of removal; or

(b) At reasonable times subsequent to the removal.

141. Where the Commissioner removes and retains a document under section 16C, the owner is entitled under section 16C(5) to obtain a copy of the document either at the time of removal or at reasonable times thereafter.

Return of documents

142. The Commissioner will return original documents as soon as practicable, as required by section 16B(2). This includes electronic storage media removed for imaging.

143. Where documents have been removed for retention and inspection under section 16C, the originals will not be returned until the Commissioner has completed a full and complete inspection of those documents. A full and complete inspection includes the use of the documents in court proceedings, therefore the Commissioner may not be able to provide a timeframe by which documents are likely to be returned.

144. However, under section 16C(7), the Commissioner can make certified copies of documents retained under section 16C, and those copies are admissible as evidence in court as if they were the original documents. Therefore, unless there are good reasons to retain the originals, the Commissioner will generally copy and return original documents retained under section 16C.

145. Examples of good reasons to retain the original documents are:

(a) Where the Commissioner intends to undertake forensic examination of the documents.

(b) Where the documents are unable to be quickly organised and analysed (this could be due to the poor state of the documents or poor recordkeeping by the owner).

(c) Where a certified copy will not provide the best evidence in court proceedings (for example, marks on the original document may be illegible on the copy).

Offences

146. The importance of the Commissioner being able to obtain information under sections 16, 16B and 16C means that it is an offence to obstruct the Commissioner or an authorised officer in carrying out those powers, and it is an offence to provide the Commissioner with false information in relation to the exercise of section 16.

147. There are a number of specific offences in the TAA and the SSA relating to search powers, as well as offences under the Crimes Act 1961. The TAA and SSA offences are:

(a) Obstruction under section 143H.

(b) Not providing information when required to do so by a tax law, under section 143(1)(b).

(c) Knowingly not providing information under section 143A(1)(b).

(d) Knowingly not providing information with intent to evade tax or obtain a refund or payment of tax, under section 143B(1)(b) and any of (f), (g) or (h).

(e) Knowingly providing false, incomplete or misleading information under section 143A(1)(c).

(f) Knowingly providing false, incomplete or misleading information intending to evade tax or obtain a refund or payment of tax, under section 143B(1)(c) and any of (f), (g) or (h).

(g) Aiding, abetting, inciting or conspiring with another person to commit an offence against the TAA, under section 148.

(h) Failing to comply with a direction under section 117(1) of the SSA when a search warrant is pending, being an offence under section 176 of the SSA.

(i) Failing to stop a vehicle as soon as practicable when required to do so, under section 177 of the SSA.

(j) Failing to carry out obligations in relation to computer systems when required to do so by section 130(1) of the SSA, which is an offence under section 178 of the SSA.

(k) Disclosing information acquired through the exercise of a search power, under section 179 of the SSA.

(l) Knowingly failing to comply with section 87(1)(a)before accessing restricted information, under section 143E(1)(a).

(m) Knowingly communicating any restricted information in contravention of section 87(1)(b) after having certified in the manner prescribed by section 87(3), under section 143E(1)(b).

148. If convicted of an offence under section 143H, a taxpayer will be liable for a fine of up to $25,000 for the first offence, and up to $50,000 for each subsequent offence.

149. Where the failure to provide information (for example, answers to proper questions, or reasonable facilities and assistance) is done knowingly and with the intention to commit evasion or a similar offence, a taxpayer could be liable for a fine of up to $50,000, or imprisonment for up to five years, or both.

150. Failing to assist with a search when required to do so under section 130(1) of the SSA carries a maximum sentence of imprisonment of three months.

151. And under section 179 of the SSA, disclosing information acquired through the exercise of a search power carries a maximum sentence of imprisonment of six months (and a fine for body corporates of up to $100,000).

152. Decisions to prosecute will be made in accordance with the Solicitor-General's Prosecution Guidelines and Inland Revenue's Prosecution Framework.

Summary

153. The powers in sections 16, 16B and 16C of the Tax Administration Act are essential to the compliance functions and duties of the Commissioner. They will be exercised along with the powers in the Search and Surveillance Act, preserving legal privilege and non-disclosure rights, and in compliance with the New Zealand Bill of Rights Act where applicable.

This Operational Statement is signed on 26 July 2013.

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Legal & Technical Services – Investigations & Advice

APPENDIX I: SUMMARY OF THE APPLICATION OF THE SSA TO THE TAA

Section 89 of the SSA sets out the extent and manner in which the general provisions in Part 4 of the SSA apply to:

(a) powers conferred by other Parts of the SSA; and

(b) other enactments.

In relation to other enactments, this is done by enlisting the assistance of a schedule to the SSA: section 89(2) states that Part 4 applies in respect of powers conferred by the enactments listed in column 2 of the Schedule to the SSA.

The use of a schedule in this way makes it clear that the only provisions which apply to the TAA are those listed in the Schedule. The Schedule itself consists of four columns, listing as follows:

(a) Column 1 states the Act;

(b) Column 2 specifies a section of that Act (the specific search powers);

(c) Column 3 contains a brief description of the power in that section; and

(d) Column 4 sets out which provisions in Part 4 of the SSA apply.

The TAA is listed in column 1 of the Schedule, and the Commissioner's search power (section 16) and power to remove and retain documents under warrant (section 16C(2)) are listed in column 2.

Column 4 states that only subparts 1, 3, 4, 7, 9 and 10 (except sections 102, 103(3)(b)(ii), 103(4)(g), 103(7), 115(1)(b), 118, 119 and 130(4)) of Part 4 apply to these powers (subpart 2 contains the warrant application rules).

Act	Content		Applies to TAA
Part 1	General provisions – interpretation		Yes – Inland Revenue officers fall within the definition of "enforcement officers". Plus the TAA is amended to adopt subparts 1, 3, 4, 7, 9, and 10 of Part 4 (except for ss 102, 103(3)(b)(ii), 103(4)(g), 103(7), 115(1)(b), 118, 119 and 130(4)), ie, a new s 16(6A).
Part 2	Police powers		No
Part 3	Enforcement officers' powers & orders		Some – see below (because of the definition of "enforcement officer").
	Subpart 1	Surveillance device regime Declaratory orders	Not able to apply for surveillance device warrants, but some surveillance activities are permissible without a warrant. Yes.
	Subpart 2	Production orders	Yes, but Commissioner will generally use section 17 of the TAA.
	Subpart 3	Misuse of Drugs Act search powers	No.
	Subpart 4	Powers of search incidental to arrest/detention	No.
Part 4	Subpart 1	Application of this part	Yes.
	Subpart 2	Consent searches	No.
	Subpart 3	Application for, and issuing of, search warrants	Yes.
	Subpart 4	Carrying out search powers	Yes, with some exclusions: ss 102, 103(3)(b)(ii), 103(4)(g), 103(7), 115(1)(b), 118, 119 and 130(4)).
	Subpart 5	Privilege and confidentiality	No.
	Subpart 6	Procedures for seized/produced materials	No.
	Subpart 7	Immunities	Yes.
	Subpart 8	Reporting	No.
	Subpart 9	Offences	Yes (but not all are available).
	Subpart 10	Miscellaneous	Yes.
Part 5	Amendments to other enactments	s 302 amends TAA	Yes.
Sch.	Application of specified provisions of Part 4 to other enactments		Yes – to sections 16 and 16C(2) TAA.

OPERATIONAL STATEMENT OS 13/02: SECTION 17 NOTICES

All legislative references are to the Tax Administration Act 1994 (TAA) unless otherwise stated.

Introduction

1. This Operational Statement ("OS") outlines the procedures Inland Revenue will follow when issuing notices, including third party requests, under section 17. The section, which relates to requisitions for information, is one of Inland Revenue's information-gathering powers. Other information-gathering powers (such as section 16) can be and are used by the Commissioner in conjunction with section 17 but they are not discussed in this OS.
2. The OS has been updated to incorporate amendments to the legislation concerning these powers, to incorporate principles, particularly in respect of non-disclosure rights, established in cases that have been decided since Standard Practice Statement 05/08 *Section 17 Notices* was published in 2005. It also outlines the impact of the recently enacted Search and Surveillance Act 2012 (the SSA) on the Commissioner's power to obtain information under production orders.

Application

3. The OS applies from 14 August 2013 and replaces Standard Practice Statement 05/08 *Section 17 Notices*, published in *Tax Information Bulletin* Volume 17, No 6 (August 2005).

Background

4. Before the Commissioner can verify or make an assessment of a person's tax liability, information (including non-documentary information which is within a person's knowledge) is needed. The legislation provides the Commissioner with the necessary powers, including section 17, to collect information. Section 17 empowers the Commissioner to require any person to furnish in writing any information and to produce for inspection any documents that are considered "necessary or relevant" to exercise the Commissioner's statutory functions.
5. Inland Revenue staff will usually request information and documents without expressly relying on section 17. This practice fosters a spirit of reasonableness and mutual cooperation.
6. If, however, information is not provided voluntarily or in a timely manner the Commissioner is able to use section 17 to demand the information by issuing a notice under the section. In some cases the information gathering process may be commenced by issuing a section 17 notice. For example, this may occur where there have been prior instances of non-cooperation from the taxpayer and/or their advisers. Non-compliance with the section 17 notice will result in the Commissioner invoking the statutory remedies.
7. Any request for information with express reference to section 17 will generally contain reference to taxpayers' right to make a claim for non-disclosure to ensure that the recipient of the notice is aware of this statutory right belonging to the taxpayer. However in some cases the nature of a request may not warrant a reference to the right to claim non-disclosure, such as where the request is for information that relates purely to information which is not contained in tax advice documents.
8. SPS 05/07 *Non-disclosure right for tax advice documents* provides information on what constitutes a tax advice document, and sets out the process for making a claim of non-disclosure.

Legislation

Tax Administration Act 1994

9. The relevant sections are as follows:

> **3 Interpretation**
>
> (1) In this Act, unless the context otherwise requires,—
>
> **document** means—
>
> (a) a thing that is used to hold, in or on the thing and in any form, items of information:
>
> (b) an item of information held in or on a thing referred to in paragraph (a):
>
> (c) a device associated with a thing referred to in paragraph (a) and required for the expression, in any form, of an item of information held in or on the thing
>
> **17 Information to be furnished on request of Commissioner**
>
> (1) Every person (including any officer employed in or in connection with any Department of the Government or by any public authority, and any other public officer) shall, when required by the Commissioner, furnish in writing any information and produce for inspection any documents which the Commissioner considers necessary or relevant for any purpose relating to the administration or enforcement of any of the Inland Revenue Acts or for any purpose relating to the administration or enforcement of any matter arising from or connected with any other function lawfully conferred on the Commissioner.
>
> (1B) For the purpose of subsection (1), information or a document is treated as being in the

knowledge, possession or control of a New Zealand resident if—

(a) The New Zealand resident controls, directly or indirectly, a non-resident; and

(b) The information or document is in the knowledge, possession or control of the non-resident.

(1C) For the purpose of subsection (1B) and sections 143(2) and 143A(2)—

(a) in determining whether a non-resident is controlled by a New Zealand resident, the New Zealand resident is treated as holding anything held by a person who is resident in New Zealand, or is a controlled foreign company, and is associated with the New Zealand resident; and

(b) A law of a foreign country that relates to the secrecy of information must be ignored.

(1D) If information in writing is required, or documents must be produced, the Commissioner may require that the information be furnished, or the documents be produced, to a particular office of the Department.

(2) Without limiting subsection (1), the information in writing which may be required under this section shall include lists of shareholders of companies, with the amount of capital contributed by and dividends paid to each shareholder, copies of balance sheets and of profit and loss accounts and other accounts, and statements of assets and liabilities.

(3) The Commissioner may, if the Commissioner considers it reasonable to do so, remove and retain any documents produced for inspection under this section for so long as is necessary for a full and complete inspection of those documents.

(4) Any person producing any documents which are retained by the Commissioner under subsection (3) shall, at all reasonable times and subject to such reasonable conditions as may be determined by the Commissioner, be entitled to inspect the retained documents and to obtain copies of them at the person's own expense.

(5) The Commissioner may require that any written information or particulars furnished under this section shall be verified by statutory declaration or otherwise.

(6) The Commissioner may, without fee or reward, make extracts from or copies of any documents produced for inspection in accordance with this section.

The Search and Surveillance Act 2012

10. The SSA came into effect on 1 October 2012, although for Inland Revenue it will take effect from 1 April 2014, or an earlier of the date if given effect by an Order in Council. The relevant sections are sections 3 and 123, and Schedule to the SSA.

11. The SSA contains a detailed list of basic powers that a person exercising search powers can make use of. Refer to Operational Statement 13/01 *The Commissioner of Inland Revenue's search powers*, published in relation to section 16 concerning these powers.

Analysis of key changes

The new definition of "document"

12. The definition of "book and document" and "book or document" in section 3(1) was repealed and replaced with "document" effective from 29 August 2011. The words "book and document" throughout the TAA were replaced with the new term "document". The reason for the update is to remove references to redundant technology and to future proof the definition as some of the old terminology refers to out of date technology such as computer reels and perforated reels.

13. The definition of "document" is much wider than the repealed definition of "book and document" as it clearly includes all forms of information storage. It does not, however, extend the old definition. Rather it updates it by removing references to redundant technology. The definition of "document" should not, therefore, affect departmental practice as the repealed definition of "book and document" included any records in electronic form. This view was confirmed by the High Court in *Avowal Administrative Attorneys Ltd v District Court at North Shore* (2009) 24 NZTC 23,252 where Venning J rejected the appellant's argument that a computer hard drive did not come within the old definition of "book and document". The Court of Appeal [2010] 3 NZLR 661 confirmed the position taken by Venning J that the definition of "book and document" included "any other type of record" which was wide enough to encompass computer hard drives.

Non-disclosure right

14. The Commissioner's wide information gathering powers under section 17 are subject to legal professional privilege (section 20) and to non-disclosure right for a tax advice document (sections 20B to 20G). The High Court in *Blakeley v C of IR* (2008) 23 NZTC 21,865 considered the scope of protection against disclosure of a tax advice document provided by sections 20B to 20G. The case concerned a section 17 notice issued to the appellant requiring him to provide a list of names and IRD numbers of clients to whom he had provided tax advice in respect

of certain transactions. The appellant declined to provide the information on the basis that it would involve the disclosure of a tax advice document which was protected by section 20B. The High Court dismissed the appeal and confirmed the finding of the District Court that the right to non-disclosure of a tax advice document in respect of the information required is not available to the appellant. The following observations made by the Court indicate the scope of non-disclosure right:

- The protection afforded by section 20B is more confined than legal professional privilege. It is not a new substantive right of equivalent utility to legal professional privilege. It was a creature of statute and protected defined parts of a limited category of written communications.
- The plain words of the legislation gave no protection to the information from disclosure sought by the Commissioner.
- Tax contextual information contained in the opinions would not be protected from disclosure even if the tax advice itself was.
- Waiver did not arise under sections 20B to 20G. The protection against disclosure provided by the legislation was not susceptible to waiver. The right to disclosure must be claimed by following the detailed procedure set out in section 20D. If the procedure set out in the legislation was not followed, there would be no right to non-disclosure.

Litigation on an even basis

15. In a number of cases it has been argued that section 17 is subject to the principle that litigation should be conducted on an even basis and therefore the Commissioner should not be allowed to seek information once the proceedings have been issued. In *Vinelight Nominees Ltd v C of IR* (2005) 22 NZTC 19,298 the Commissioner viewed the taxpayer's returns as being fraudulent and misleading and sought to reissue assessments. After the taxpayer filed proceedings to challenge the Commissioner's decision, the Commissioner issued section 17 notices to seek information relating a statement made in the taxpayer's notice of response. The High Court declined to make a declaration, as sought by the taxpayer, that the Commissioner could not use section 17 to obtain information once the court proceedings had commenced. The Court considered that the Commissioner's dominant motivation was not to gain advantage as a litigant, but rather to assist the making of the revised assessments. The Court however concluded that the principle of litigation on an even basis limits the scope of section 17 and that a section 17 notice could not be issued for the sole purpose of extracting information to use in the legal proceedings; the principle to be applied on a case by case basis.
16. *Chesterfield Preschool Ltd v C of IR* (No 2) (2005) 22 NZTC 19,500 was another High Court case concerning the scope of section 17. Fogarty J's views on section 17 differed from those of Simon France J in *Vinelight*. Fogarty J considered that the principle of litigation on an even basis did not apply in the context of disputes concerning the recovery of unpaid tax. He said that section 17 was intended by Parliament to be an effective instrument for obtaining information, particularly documents, and that was its purpose. There was no basis of suspending the Commissioner's powers under section 17 even though some aspects of the proceedings have become subject to the High Court rules.
17. The High Court in *Next Generation Investments Ltd (in liq) v C of IR* (2006) 22 NZTC 19,775 noted the conflicting views in *Vinelight* and *Chesterfield* as to the scope of section 17 but did not endorse either of them. Priestley J preferred the balanced use of section 17 adopted by France J in *Vinelight*. He said that the Commissioner's powers could not be exercised in an unfettered way. As a statutory power, it would be subject to an application for a judicial review should it be used *ultra vires* or in some other improper manner.
18. In *Foxley v C of IR* (2008) 23 NZTC 21,813 the Court said that the *Vinelight, Chesterfield* and *Next Generation* cases established that the Commissioner may use section 17 to request information, at least until challenge proceedings are on foot, and potentially beyond, provided that the powers are exercised for a proper purpose.
19. The Commissioner's search and seizure powers were challenged in *Tauber v C of IR* (2011) 25 NZTC 20,071 by way of a judicial review. The applicants claimed that the conduct of the search by the Commissioner was a breach of the New Zealand Bill of Rights Act 1990 (NZBORA). Venning J referred to the decision of the Court of Appeal in *Commerce Commission v Air New Zealand* [2011] 2 NZLR 194 which involved the consideration of a non-disclosure order and the impact of section 27(3) of the NZBORA on the information gathering powers of the Commerce Commission. In that case the Court of Appeal approved the approach of Simon France J in *Vinelight* where he said that the principle of litigation on an even basis limits the scope of section 17, and it could not be used for the sole purpose of extracting information to use in the legal proceedings.

20. These cases confirm that Inland Revenue's information gathering powers may be exercised up until the time challenge proceedings are commenced. They may, on occasion, be exercised after the legal proceedings are commenced provided they are used for a proper purpose, not to gain an otherwise unachievable advantage, and not used for the purpose of extracting information for use in the proceedings.

Use of section 17 notice post liquidation/bankruptcy

21. The Commissioner may use her section 17 powers to obtain documents/information from a liquidator without first obtaining an order under section 256(1)(a) of the Companies Act 1993 for the purpose of giving effect to her statutory duties such as to ascertain a correct tax liability, for prosecution and other related matters: *Next Generation Investment Ltd (in liq) &Ors v C of IR* (2006) 22 NZTC 19,775.

Access to audit work papers

22. Since the publication of SPS 05/08 the Commissioner's policy on access to audit working papers has been updated to provide guidelines effective from 29 April 2008. The Protocol on *Access to Audit Working Papers* (Protocol) was signed between the New Zealand Institute of Chartered Accountants (NZICA) and Inland Revenue on 29 April 2008. Requests to access to audit working papers will be made on the basis of the policy outlined in the Protocol. A copy of the document can be found at: **http://www.ird.govt.nz/technical-tax/general-articles/ga-access-to-audit-working-papers.html**

23. Documents that are prepared solely for audit purposes in relation to a client's accounting or tax positions and exposures constitute "audit working papers". They are the property of the auditor and not of the client. Working papers in relation to other work undertaken by an external auditor are referred to as "other working papers". They may include tax work papers, such as papers compiled in order to complete the tax return or to provide tax advice. Other working papers form part of the taxpayer's records, whether they are held by the auditor, the taxpayer or a third party.

Relationship between SSA production orders and TAA production orders

24. Section 71 of the SSA contains a production order power that is similar to the Commissioner's power under section 17A of the TAA.

25. The SSA production order can only be used where there are reasonable grounds to believe that the documents sought constitute evidential material in respect of an offence, and that the documents are or will be in the possession or control of the person to whom the production order is used. Failure to comply with a production order under section 71 of the SSA carries with it a one year sentence of imprisonment.

26. However, because sections 16 and 17 provide very broad powers of obtaining information, Inland Revenue will generally use section 17 and not rely on a production order under the SSA, unless there are circumstances that may warrant the use of an SSA production order instead of one under the TAA. A production order power under the SSA will only be used with the approval of the Group Tax Counsel or Group Manager, Investigation and Advice.

Operational Practice

Section 17 Notices

27. Section 17 gives the Commissioner the power to require persons to produce for inspection documents which the Commissioner considers necessary or relevant for any purpose relating to the administration or enforcement of the Inland Revenue Acts. It is most often used in the context of the investigation of a taxpayer's correct tax position, but can also be used, for example, in liquidation/insolvency situations to obtain information/documents, provided it is not used for improper purposes. However a section 17 power cannot be invoked for questionable or improper purpose, such as to gain advantage over other creditors or for debt recovery.

28. We would generally not use the section 17 powers for the sole purpose of requiring taxpayers to provide outstanding returns as the Commissioner can, under section 17A(3), apply for a court order requiring the taxpayer to provide the tax return if a taxpayer does not provide a tax return on time.

29. The new definition of "document", although broad, does not extend the old definition of "book or document" but instead updates it by removing references to redundant technology. The new definition does not, therefore, affect Inland Revenue's current practice as it is considered that the repealed definition included any records in electronic form.

30. Case law confirms that the Commissioner may exercise the information gathering powers pursuant to section 17 up until the time challenge proceedings are commenced. They may, on occasion, be exercised after the legal proceedings are commenced provided they are used for a proper purpose, not to gain an otherwise unachievable advantage, and not used for the purpose of extracting information for use in the proceedings.

31. Section 17 authorises Inland Revenue to require written answers to questions relating to the

documents requisitioned under the section, and also written answers relating to other information. Such answers, if self-incriminatory, are nevertheless admissible against the person who made them: *Singh v C of IR* (1996) 17 NZTC 12,471; *R v Sew, Hoy*, CA 315/91 & CA 316/91, 6 December 1991. However section 17 does not authorise questions unrelated to the documents, such as questions that directly seek to compel confession to elements of offending that may have been committed by, e.g. using the documents

32. Where information is to be demanded under section 17, a notice will be issued in writing. Prior to issuing a section 17 notice, Inland Revenue will consider a number of factors that are outlined below:

The reason for requiring the information

33. The Commissioner will only require disclosure of information considered necessary or relevant and that is reasonably required in the circumstances of the case.

The impact of the demand on the suppliers of information

34. The Commissioner will be reasonable in relation to the quantity of information sought and the timeframe for providing that information. Reasonable time will be allowed where there is genuine difficulty in obtaining and/or providing the information requested.

Reasons an informal request is not appropriate

35. Generally a section 17 notice will only be issued following a failure to provide information previously requested or where specific issues have been identified and attempts to resolve these issues have failed. However, there will be occasions where a section 17 notice may be issued without a prior informal request. For instance where:

- there have been prior instances of non-cooperation from the taxpayer. A refusal or failure to comply with an informal request or more formal request (that is one mentioning section 17) may be regarded as non-co-operation; or
- the Commissioner considers that a delay, or a less informal approach may unreasonably increase the risk of non-compliance; or
- the taxpayer's adviser has been uncooperative in the past (including in respect of matters unrelated to the taxpayer) may be a relevant factor in deciding whether a section notice should be issued without a prior informal request.

Whether information is available publicly

36. Inland Revenue will generally not use section 17 where information held by public bodies such as Land Information New Zealand, the Companies Office and Quotable Value New Zealand is available publicly. Public availability of information does not, however, prevent Inland Revenue from requiring information to be provided under section 17.

Whether the disclosure of tax contextual information is required

37. Where a section 17 notice contains a reference to the non-disclosure right for tax advice documents, the notice will also refer to when the tax contextual information (as defined in section 20F(3)) is required to be disclosed. If the Commissioner does require such a disclosure, that requirement will generally be the subject of a subsequent notice. However, in rare cases the notice will contain a requirement to disclose the tax contextual information as part of the disclosure requirement for the section 17 notice. For further information on the operation of the right to claim non-disclosure and the definition of key terms refer to the SPS 05/07 *Non-disclosure right for tax advice documents* and to the discussion below.

38. Where the disclosure of the tax contextual information is required as part of the disclosure requirements in the section 17 notice, the tax contextual information must be provided on the form *Tax contextual information disclosure (IR 520)* which contains a statutory declaration.

The effect on the dispute resolution process

39. The dispute resolution process relies on full and prompt disclosure by both the Commissioner and the disputant. Inland Revenue will use a section 17 notice where previous requests for information have not been complied with. The use of a section 17 notice prior to commencement of the dispute resolution process may mean that the number of matters entering the process will be reduced.

40. The disputes resolution process may be truncated and an amended assessment issued where a taxpayer has failed to comply with a section 17 notice during the dispute process: section 89N(1)(c)(vi).

Inland Revenue's intention to ensure compliance with the notice

41. Generally, Inland Revenue will use a section 17 notice only where it is prepared to invoke statutory remedies in the event of non-compliance.

The use of section 16 powers

42. In some cases, rather than demanding information under section 17 Inland Revenue will access the documents under section 16, which gives the Commissioner the power to enter all places (in the case of a private dwelling, either the consent of an

occupier or a warrant is required) for the purposes of inspecting documents. For further information on the Commissioner's policies in respect of section 16 please refer to OS 13/01.

Multiple sources

43. Nothing in section 17 precludes Inland Revenue from seeking information from multiple sources and from sources other than the affected taxpayer, whether before or after seeking the information directly from the relevant taxpayer.

Multiple notices

44. Separate section 17 notices may be issued for different information and documents. If the Commissioner requires the information to be delivered to Inland Revenue, the notice will state that the information is to be delivered, or the documents to be produced, to a particular office of the Inland Revenue.

Request for significant amount of documentation

45. Where a significant amount of documentation is required, the person providing the information will be permitted to send documents to the nearest Inland Revenue office. That office will arrange for the documents to be forwarded to the office conducting the investigation. Where the delivery cost would be reduced by $20 or more by sending documents to the nearest Inland Revenue office then it is considered that the amount of documentation is significant. In this circumstance Inland Revenue would generally accept the request to send the documents to the nearest office.

Delegation

46. The decision whether or not to issue a section 17 notice has been delegated to various responsible officers. A decision to issue a section 17 notice will generally be peer reviewed by the delegated officer's team leader. The exercise of the discretion to require disclosure of the tax contextual information is limited to officers at appropriately high level of delegated authority and any decision to require tax contextual information is signed off by Manager, Investigations or by Team Leader, Legal and Technical Services.

Legal professional privilege

47. A taxpayer is entitled, and should have sufficient time, to seek legal advice in respect of whether any information or documents are subject to legal professional privilege. Section 20 covers the solicitor-client privilege. It provides that information is privileged from disclosure if it is a confidential communication passing between a legal practitioner and another legal practitioner (acting in their professional capacities) or a legal practitioner and a client, and it is brought into existence for the purpose of obtaining or giving legal advice or assistance. There are, however, exceptions to the privilege. Privilege does not apply when the communication was brought into existence for the purpose of committing some illegal or wrongful act. Also financial information and investment records kept in connection with solicitors' trust accounts are not privileged.

48. The privilege recognised by section 20 is not a complete code as it does not cover litigation privilege and other communications protected from disclosure at common law. Inland Revenue considers that the Commissioner's powers under section 17 are subject to legal professional privilege contained in section 20 and litigation privilege at common law. In practice, however, Inland Revenue regards the section 20 privilege as extending to litigation privilege where New Zealand lawyers (as defined by the Lawyers and Conveyancers Act 2006) are involved. For this purpose, litigation privilege is regarded as covering documents created for the dominant purpose of advising or assisting on reasonably apprehended litigation.

Right to claim non-disclosure for tax advice documents

49. The Commissioner's information gathering powers (including section 17) are subject to the statutory right to claim non-disclosure for tax advice documents. The right to claim non-disclosure relates to tax advice documents that are required to be disclosed under a section 17 notice. The right to claim non-disclosure belongs to the taxpayer. The statutory provisions contain time periods in which the taxpayer (or their authorised advisor) is required to make the necessary claim for non-disclosure. The taxpayer (or their authorised tax advisor) will be given at least 28 days to claim the non-disclosure right for those documents eligible to be tax advice documents, and required to be disclosed under the section 17 notice. This time period will be specified in the notice. The taxpayer or their authorised advisor can make the claim for non-disclosure by completing the form *Tax advice document claim (IR 519)*.

50. The Commissioner will review the documents and information received in terms of the section 17 notice, and the information provided on the form IR 519. It will then be decided whether disclosure of the tax contextual information from the documents eligible to be tax advice documents is required. If the tax contextual information is required, a subsequent section 17 notice will be issued for the tax contextual

information allowing at least another 28 days to provide the information.

51. The tax contextual information must be provided in the prescribed form, *Tax contextual information disclosure (IR 520)*. The form IR 520 contains a statutory declaration which needs to be completed by a tax advisor. For further information on tax contextual information and the necessary disclosure requirements, refer to the SPS 05/07 *Non-disclosure right for tax advice documents* or consult your tax advisor. A copy of the SPS can be found on Inland Revenue's website **www.ird.govt.nz.**

52. In rare cases the Commissioner may require both the claim for the non-disclosure right and the disclosure of the tax contextual information from those documents that may be eligible to be tax advice documents in the one section 17 notice. In such cases, a taxpayer (and/or their authorised tax advisor) will be given at least 28 days to comply with all the disclosure requirements of the section 17 notice.

53. The discretion to require disclosure of the tax contextual information from documents eligible to be tax advice documents will be exercised sparingly in order to minimise compliance costs, and so as not to undermine the spirit of the non-disclosure right rules. Accordingly, an exercise of this discretion will be limited to officers of Inland Revenue at an appropriately high level of delegated authority.

54. There is no requirement for a person to disclose tax advice documents under a discovery obligation in challenge proceedings. The disclosure of tax contextual information may still be required.

Advice and other work papers prepared by accountants

55. SPS 05/07 *Non-disclosure right for tax advice documents* outlines the Commissioner's policy on *Access to Advice and other Workpapers Prepared by Accountants* in respect of section 17 notices with effect from 22 June 2005.

Access to audit work papers

56. Requests for access to audit working papers will arise only in the course of enquiries conducted by investigators or in other special cases, although a request for audit working papers will not be a routine part of Inland Revenue's investigations. In the first instance the information will be requested from the taxpayer, and requests to a taxpayer's auditor for access will only be made in exceptional circumstances.

57. This approach does not imply that audit working papers enjoy any privilege from disclosure unless they are tax advice documents to which section 20B to 20G apply. A request by an Investigator for access to audit papers will be made only after obtaining the authorisation of the appropriate manager who will need to consider whether the information requested is "necessary or relevant" for the administration of the Tax Acts.

58. Requests for audit working papers and other papers made pursuant to section 17 will be "formal requests". They will include details such as when and where the records are to be made available.

Correction of information

59. Where a taxpayer has complied with an information requisition then, in accordance with section 6 of the Privacy Act 1993 (Information Privacy Principle No. 3), the taxpayer will be allowed to seek access to and correction of that information where Inland Revenue has incorrectly recorded the information.

Changes to Section 17 Notices

60. In following the process concerning section 17 every attempt will be made to maintain contact with the taxpayer so as to provide an opportunity for concerns to be raised. Inland Revenue expects information holders to contact Inland Revenue where there is genuine difficulty in complying with the demand at the earliest possible time and not when the time for compliance has passed.

61. Any change to the date for compliance must be agreed before the expiration of the original date. Beyond this, the offence for non-compliance has already occurred and an extension of time will not be given.

62. Where modification of the notice is agreed it will be recorded in writing.

63. Any change to the date for compliance set out in the section 17 notice should also consider the impact the change of date may have on the time periods allowed for claiming the right of non-disclosure.

Requests to persons other than the taxpayer

64. Some holders of information, such as banks, are willing to provide information but require Inland Revenue to state its legal authority before they will release the information. Generally, where information is required from persons other than the taxpayer and cooperation is likely, Inland Revenue will initially seek the information by a letter, although the letter may follow a discussion and may contain reference to section 17.

65. That letter is not a formal section 17 demand. However, generally where the letter is not complied with, a section 17 notice will be issued so that the third

party recipient is informed of the consequences of their non-compliance before further action is taken.

66. Any section 17 notice issued to a third party such as a bank should refer to the non-disclosure right. The recipient of the notice may then choose to contact the taxpayer to confirm whether the taxpayer or their authorised tax advisor wish to claim the non-disclosure right or legal professional privilege over documents required to be disclosed under the section 17 notice issued to the third party.

67. Where a formal section 17 notice is issued to a third party such as a bank it will be subject to an independent review by Legal and Technical Services before its issue.

Controlled non-residents

68. Under section 17(1) Inland Revenue may require a New Zealand resident to provide information in circumstances where the resident's non-resident employees or agents hold the information/documents for the resident. Section 17(1B) gives Inland Revenue the power to require a New Zealand resident to provide information held by a non-resident entity controlled directly or indirectly by the New Zealand resident. For example, if a husband and wife have 51% of the shares in a foreign company, Inland Revenue can issue a section 17 notice requiring them to furnish information held by the foreign company. Section 17(1C) sets out further rules for determining whether a non-resident is controlled. In particular it provides that foreign secrecy laws are to be ignored.

69. If obtaining of the information would be a costly or difficult exercise then generally it would not be required where the tax at stake is immaterial, or when Inland Revenue has access to this information through other sources.

Medical information

70. In rare instances Inland Revenue may seek access to an individual's medical records. For example, there may be medical reasons given by the taxpayer for the failure to provide information or documents, or for not meeting tax obligations. In some case Inland Revenue may consider it necessary to verify the medical reasons for such failures. Such requests will only be made after careful consideration and will be made by an appropriate delegated officer.

Requests for certain information from tax agents

71. Inland Revenue may seek certain information from tax agents under section 17 where it becomes aware of particular transactions or arrangements entered into by taxpayers in order to identify other taxpayers who may have entered into similar transactions or arrangements.

72. In the first instance, Inland Revenue will attempt to identify those taxpayers without recourse to requesting information from tax agents. However Inland Revenue may ask tax agents likely to have involvement with the arrangements in question to provide a list of clients who may have entered into a particular (or similar) arrangement.

73. These requests will only be made in limited circumstances and only where it is considered the transactions or arrangements are likely to involve tax avoidance or evasion, or other offences leading to prosecution for offences. Before making such requests to tax agents, investigators must first take all reasonable steps to obtain the necessary or relevant information from the taxpayer(s) or other third parties.

74. Before making a request for information, staff will take into account a range of factors including:
    - the impact of the request on taxpayers' perception of the integrity of the tax system;
    - the size of client bases involved, and the practicalities and the relative cost of compliance with the section 17 request;
    - the level of perceived risk of taxpayers seeking to remove assets or leave the jurisdiction;
    - the complexity of the arrangement, and the reasonableness of the expectation that the advisor will be able to identify the taxpayers in question;
    - the level of revenue considered to be at risk;
    - Inland Revenue's ability to obtain the information from other sources.

75. An Inland Revenue officer will then arrange to meet with the particular tax agent to advise that a formal section 17 notice is to be made, to provide a draft copy of the notice, explain the scope and matters to be covered in the notice and whether a formal notice is in fact the best way of achieving Inland Revenue's objectives. Subject to any changes made to the draft notice the final notice will be sent to the tax agent. Any changes to the draft notice will be approved by an appropriate delegated officer.

76. The tax agent will have the option to provide the information without a formal demand.

77. Before any request for information is made, an independent review of the proposed request will be carried out by appropriately delegated officers to ensure the necessary criteria have been applied.

This will include determining that the arrangement in question is clearly described and the parameters of the request are clear (for example, the scope of the request, the time period covered, the form of the response and the level of the detail required). Reference to this approval will be stipulated in the notice to the particular firm.

78. The notice will offer where practicable Inland Revenue assistance to extract the information, and will also allow a reasonable time (to be specified) to provide the information.

79. The tax agent can either contact the Manager, Investigations and Advice or the Group Manager, Investigations and Advice if he/she wishes to query the scope or authority of the investigator to request the information in the notice.

Non-compliance with a section 17 notice

80. It is an offence not to comply with a section 17 notice. An offence has occurred where a person does not provide, or knowingly does not provide, information to the Commissioner when required to do so by a tax law: sections 143 and 143A. Furthermore it is an offence for a person knowingly not to provide information to the Commissioner or any other person when required to do so, with the intention of evading the assessment or payment of tax: section 143B. However, a person cannot be convicted of an offence for not providing information or knowingly not providing information (other than tax returns and tax forms) if the person proves that they did not have that information in their knowledge, possession or control: sections 143(2)(a) and (b) and 143A(2)(a) and (b). Control here is used in its wider sense and includes information held by others on one's behalf.

81. If the non-compliance with a section 17 notice relates to a requirement to disclose tax contextual information from tax advice documents, as required by section 20F, a number of offences may have occurred, including:

    (a) Offences under sections 143 to 143B; or

    (b) An offence under section 143H (obstruction); or

    (c) An offence under the Crimes Act 1961 (false statements or declarations).

82. Where non-compliance occurs, Inland Revenue will not reissue a section 17 notice in a different format. However, those receiving section 17 notices will have the ability to request a new due date for compliance with the notice so long as the request is made before the expiration of the original due date.

83. In the event of non-compliance, a request for an explanation of why prosecution action should not be taken will generally be issued before further action is taken. A request for an explanation will state that as the section 17 notice has not been complied with an application for a court order under section 17A is being sought and/or prosecution action is being considered. A request for an explanation will not be issued in all cases, for example, where there have been delays in supplying information previously.

84. A request for an explanation does not entitle the taxpayer or their authorised tax advisor to claim (for the first time or to make a subsequent claim) the non-disclosure right for tax advice documents that were required to be disclosed under the original section 17 notice.

85. Before an application for a court order under section 17A can be made there is a requirement for the Commissioner to use section 17, and the person to whom the notice has been issued must have failed to provide the information requested under that section 17 notice.

86. If the Commissioner chooses to prosecute a person for not complying with a section 17 notice, then depending on the elements of the particular offence, there are different time limits within which the Commissioner must file charging documents to begin prosecution action:

    - the time limit is 6 months for the offence of not knowingly providing information when required to do so;
    - the time limit is 10 years for the absolute liability offence of not providing information when required to do so; and
    - there is no time limit for the offence of knowingly not providing information when required and the offender does so with the intention to evade the assessment or payment of tax.

87. Once the offence is committed prosecution action will be commenced within a reasonable time of the date of non-compliance. In general, prosecution would not be commenced where a person complies with the requirement to provide information after the stipulated time but prior to issue of a summons by the Court.

Relevance of Search and Surveillance legislation to the information gathering powers

88. The rules in in the newly enacted SSA affect the TAA. For instance, the production order regime (Part 3, Subpart 2) and the power to seize items in plain view (section 123) in the SSA may be relevant to the Commissioner's information gathering powers. However Inland Revenue will generally use section 17 and not rely on the production order under the SSA.

This Operational Statement is signed on 14 August 2013.

Graham Tubb

Group Tax Counsel

Legal & Technical Services – Investigations & Advice

LEGISLATION AND DETERMINATIONS

This section of the *TIB* covers items such as recent tax legislation and depreciation determinations, livestock values and changes in FBT and GST interest rates.

DETERMINATION CFC 2013/01: NON-ATTRIBUTING ACTIVE INSURANCE CFC STATUS (TOWER INSURANCE LIMITED)

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

This power has been delegated by the Commissioner of Inland Revenue to the position of Investigations Manager under section 7 of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

Under sections CQ 2(1)(h) and DN 2(1)(h) of the Income Tax Act 2007, subject to sections CQ 2(2B) and DN 2(2), no attributed CFC income or loss arises from a CFC that is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC that is an insurer meeting the requirements of a determination made by the Commissioner under section 91AAQ of the Tax Administration Act 1994 is a non-attributing active CFC. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because insurance income is otherwise treated as passive income and an attributable CFC amount by section EX 20B(3) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). TOWER Insurance Limited has made application in respect of the CFC set out below.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of determination

The CFC to which this determination applies is:

Name	Jurisdiction
National Pacific Insurance (Tonga) Limited	Kingdom of Tonga

Interpretation

In this document, unless the context otherwise requires:

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a CFC as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994 I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2012–13 income year.

This determination is signed by me this 14th day of August 2013.

John Trezise

Investigations Manager

LEGAL DECISIONS – CASE NOTES

This section of the *TIB* sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, Court of Appeal, Privy Council and the Supreme Court.

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

INTEREST DEDUCTIBILITY AND NEXUS TRA 03/11

Case	TRA 03/11
Decision date	9 July 2013
Act(s)	Income Tax Act 2004, Tax Administration Act 1994
Keywords	Interest deductibility, incurred, nexus

Summary

The disputant did not incur the interest payments and no direct nexus existed between the payments made by the disputant and the disputant's income-earning process.

Impact of decision

This decision confirms that interest can only be deducted where it is incurred by the person and that there must be a direct link between the expense and the income-earning process for nexus to be met.

Facts

The disputant practices as a chartered accountant through his company Accounting Limited. In 2005, 2006 and 2007, the disputant claimed deductions for interest on amounts paid to the bank on behalf of the WY Trust ("the Trust"). The disputant, his wife and business partner are directors of Accounting Limited and trustees of the Trust.

The disputant and his wife are also shareholders of another related loss attributing qualifying company Farm Limited. The sole director of Farm Limited is the disputant's wife. In the 2005 to 2007 income years, a portion of Farm Limited's losses were attributed to its shareholders and were subsequently offset against the disputant's personal income.

On 6 June 2000, Accounting Limited agreed to guarantee the Trust's indebtedness to the bank. On the same date the disputant and others guaranteed Accounting Limited's indebtedness to the bank.

On 30 June 2000, the Trust borrowed $420,000 from the bank and advanced this sum to Accounting Limited by way of loan. On 1 February 2002, the Trust assigned the loan balance to Farm Limited.

The Trust advanced a further $250,000 it had borrowed from the bank to Accounting Limited on 14 April 2004. This was recorded in Farm Limited's accounts as a loan from the Trust to Farm Limited.

In the 2005 to 2007 income years, the bank charged the Trust interest on the borrowed funds. Farm Limited received interest from Accounting Limited on the outstanding loan balance but Farm Limited did not pay interest on the amount owed to the Trust. In the 2005 to 2007 income years, the disputant personally paid the interest charged by the bank to the Trust.

The disputant claimed deductions for the interest payments. The Commissioner disallowed the deductions and imposed shortfall penalties.

Decision

Was interest incurred?

The Commissioner asserted that it was the Trust that incurred the interest as opposed to the disputant.

The disputant submitted that he had entered into an oral agreement with the bank and the Trust to pay the interest directly. While there was no written documentation evidencing this agreement, the disputant stated that the agreement was recorded in a Trust Minute. The disputant also stated that he understood that his liability under his guarantee for Accounting Limited's obligations included its obligations under the guarantee of the Trust's indebtedness. The disputant considered the Trust to be under a "moral obligation" to repay the interest.

The Taxation Review Authority ("the Authority") found that there was no evidence of a written agreement and the Trust Minute recorded no enforceable agreement. Further, there was no obligation on the disputant under his guarantee of Accounting Limited's indebtedness to pay the interest payments on the Trust's behalf. At most the disputant had an indirect contingent liability which would only be triggered upon default by the Trust.

The Authority concluded that there was no "definitive commitment" on the disputant to make interest payments.

Was there sufficient nexus between the payments and the disputant's income-earning activities?

The disputant submitted that as guarantor in respect to the interest owing by the Trust, and as a result of the disputant repaying the interest, the Trust in turn became obliged under the contractual doctrine of indemnity and/or the restitutionary doctrines of contribution and reimbursement, to repay the disputant an equivalent amount.

The Authority found that there was no right to indemnity as there was no default and the disputant was not liable as guarantor to make payment. Likewise, there was no right to claim contribution because the disputant and the Trust were not co-sureties and the disputant had no obligation to contribute to the payment of the interest. Further, there was no right to claim reimbursement as the disputant had not been compelled by law to make interest payments.

In the alternative, the disputant argued there was nexus because the borrowed funds assisted in maintaining the Trust capital (and therefore its ability to support the advances to Farm Limited). This in turn enabled Farm Limited to derive assessable income, with the resulting tax consequences assessable to the disputant. The Authority referred to *Case S5* (1995) 17 NZTC 7,056 (TRA), which confirms that there must be a direct link between the payments and the income-earning process and indirect "side benefits" are insufficient. Although the Authority accepted the payment of interest may have indirectly increased the disputant's income, that benefit was not sufficiently direct.

Shortfall penalties

The Authority considered that in these circumstances reasonable care would include exercising reasonable diligence to determine the correctness of a return and keeping adequate books and records amongst other considerations.

The Authority found that the disputant, in his capacity as an accountant, was in a position to research the law on interest deductibility and to take legal advice if necessary. In addition, as the disputant was a businessman with extensive farming interests, he could be expected to have a high level of knowledge and experience regarding business transactions and tax legislation. Accordingly, the Authority considered the disputant had shown a lack of reasonable care and was therefore liable under section 141A of the Tax Administration Act 1994.

Further, the Authority considered that the disputant was not entitled to a 75% reduction for a temporary shortfall under section 141A of the Tax Administration Act 1994.

INTEREST DEDUCTIBILITY AND NEXUS TRA 02/11

Case	TRA 02/11
Decision date	9 July 2013
Act(s)	Income Tax Act 2004, Tax Administration Act 1994
Keywords	Interest deductibility, nexus

Summary

No direct nexus existed between the payments made by the disputant and the disputant's income-earning process.

Impact of decision

The decision confirms that there must be a direct link between the expense and the income-earning process for nexus to be met.

Facts

The disputant ("X Limited") is a loss attributing qualifying company that is in the business of beef and dairy farming. In the 2006 to 2007 income years, the disputant borrowed money from the bank which it advanced to two related companies, on land which it owns and on land that it leases from two related companies ("Y Limited" and "Z Limited"). These companies used the funds to purchase three farms and to repay/refinance an existing loan on another farm. X Limited operated its beef and dairy farming operations from the land purchased by Y Limited and Z Limited (and from land owned by the disputant).

X Limited paid the interest owed on the amounts borrowed from the bank. However, no interest was demanded or paid by Y Limited or Z Limited on the advances made by X Limited. X Limited ultimately claimed deductions for the interest paid to the bank. The Commissioner disallowed the deductions.

Decision

Were the funds used directly in the disputant's income-earning process?

The disputant submitted that the borrowed funds were used to acquire land on which the disputant carried on its farming business and, in respect of Y Limited, the borrowed funds were used to acquire farms with associated Fonterra shares. The disputant acquired the benefit of those shares in the form of Fonterra dividends.

The Taxation Review Authority ("the Authority") determined there was no evidence supporting the disputant's assertion that an agreement existed between the disputant, Y Limited and Z Limited, that provided for the acquisition of land and a subsequent lease back to the disputant in exchange for the loans.

The Authority stated that the decision in *Case S5* (1995) 17 NZTC 7,036 (TRA) was "directly on point", confirming that the disputant was not in the business of lending money and any benefits to the disputant were derived in its capacity as a lessee of land. Accordingly, the derivation of income by the disputant was an "indirect" consequence of the funds. The Authority agreed with the Commissioner that the provision of loans by the disputant was one step removed from the income-earning process of the disputant.

In addition, the Authority determined that no evidence of any agreement to assign the Fonterra dividends to the disputant was produced but that in any event, even if an agreement had existed, again that income was not derived from the use of the loaned funds.

The Authority also confirmed that assets were owned by Y Limited and Z Limited not the disputant and therefore the advances did not result in the acquisition by the disputant of an income-earning asset.

Barter transaction

The disputant asserted that it obtained a reduction in lease costs as a result of the interest-free loans and therefore a barter transaction existed.

The Authority was not satisfied, on the evidence, that there was any barter arrangement. The Authority determined that in any event, even if an agreement did exist, the interest expense wouldn't have had the necessary nexus to any barter income.

EXISTING BREEDING BUSINESS REQUIRED BEFORE DEDUCTIONS ALLOWABLE

Case	D and Others v Commissioner of Inland Revenue
Decision date	15 July 2013
Act(s)	Income Tax Act 2004, Income Tax Act 2007, Tax Administration Act 1994
Keywords	2008 and 2009 income tax years, commencement of business, intention, business of breeding bloodstock, deduction for cost of colt

Summary

The plaintiffs were unsuccessful in their challenge to the Commissioner's disallowance of deductions claimed for the cost of the colt by the plaintiffs as members of the syndicate. The High Court found a breeding business must be in existence before a deduction is allowable pursuant to section EC 39 of the Income Tax Act. An intention to have a breeding business at some time in the future did not meet the requirements of the section.

Impact of decision

The judgment establishes that an existing breeding business is required before a taxpayer can claim deductions of bloodstock for breeding under section EC 39(1) of the Income Tax Act 2007.

The judgment clarifies that carrying on a breeding business requires more than a hope or desire to use bloodstock for breeding in the future. In the absence of a commitment to a plan and a structure to establish a business, a speculative venture with a contingent intention to establish a breeding business will not be sufficient.

Facts

The Te Akau Stallion Syndicate No 1 ("the syndicate") was formed in 2008 and its objectives were recorded in a syndicate agreement. It purchased a thoroughbred colt at the 2008 Karaka sale for $550,000.

The stud was to be trained and raced to earn money for the syndicate members and to increase its worth as a stud stallion. It did not trial in 2008 but trialled three times in 2009, making no income in either year. The temperament of the colt deteriorated, and in 2009 it was gelded.

In the tax years 2008 and 2009, each member of the syndicate claimed a deduction for their respective share of the syndicate loss, which was made up of expenditure incurred in relation to the colt and a 75% diminishing value write-down of the purchase price.

The Adjudication Unit allowed deductions for expenses incurred in relation to the colt. However, deductions for the cost of the colt were denied on the basis the syndicate was not in the business of breeding bloodstock pursuant to section EC 39(1).

Five syndicate members ("the plaintiffs") challenged the Commissioner's finding in relation to the deduction for the cost of the colt. They contended the syndicate bought the colt for use as a stud stallion, with the intention of using it in their breeding business and so were entitled to deductions under section EC 39(1)(c).

Decision

Was an existing breeding business a prerequisite for section EC 39(1)?

To ascertain the meaning of section EC 39(1)(c), Judge Brewer canvassed the legislative history of the provision in accordance with section 5 of the Interpretation Act 1999.

His Honour first considered the predecessor to section EC 39, section 86H of the Income Tax Act 1976. Section 86H allowed deductions for bloodstock "used for breeding in the course of the conduct of any business of the taxpayer". He agreed with the Commissioner's submission that the application of section 86H required the taxpayer to first use the bloodstock for breeding "in the conduct of any business of the taxpayer". A taxpayer could not claim the value of bloodstock under section 89H if they were currently in the business of racing the bloodstock, with only an intention the bloodstock would be used for breeding in the future.

Judge Brewer then went on to consider the amendments to section 89H implemented by the Income Tax Amendment Act 1990 (No 3), the substantial re-enactment of the section in section EM 1 of the Income Tax Act 1994, and current form in the Income Tax Acts 2004 and 2007. His Honour noted there were no apparent changes in meaning between the 1994 and 2004 sections, and the 2004 and 2007 sections as supported by section YA 3 of the Income Tax Act 2004 and section ZA 3 of the Income Tax Act 2007, which confirmed the intention that the provisions would not change in effect between the earlier and later Acts.

His Honour agreed with the Commissioner's claim that the 1990 amendments to section 86H had extended the circumstances in which a taxpayer was entitled to make deductions for change in valuation of the bloodstock, but had not removed the requirement for a taxpayer to carry on a bloodstock breeding business. This was because the section expressly allowed deductions to be made in the business of breeding bloodstock in the 1994 Act and in the taxpayer's breeding business in the 2004 and current Acts. If the sections were intended to extend eligibility beyond breeding businesses, these words would be redundant.

Lastly, Judge Brewer looked at section EC 39(1)(a) and (b) to interpret subparagraph (c). All three subparagraphs allowed taxpayers to take the value of bloodstock into account in various circumstances, but in every instance this had to be "in their breeding business". This supported the conclusion that section EC 39(1)(c) allowed a taxpayer to write down the cost of bloodstock only when they had an existing breeding business.

The taxpayers alternatively argued that the scheme of the provisions focused on the identity of the taxpayer using the bloodstock, and so "their" in section EC 39(1) should be interpreted to draw a distinction between intended use of the bloodstock in the taxpayer's own business or in another taxpayer's breeding business. They claimed that because they had the intention of using the bloodstock in their breeding business, the requirements were met. His Honour dismissed this interpretation because it was incompatible with the legislative history of EC 39 and would significantly widen the application of EC 39.

Was the syndicate carrying on a breeding business?

While the finding for the Commissioner on the first issue was fatal to the plaintiff's case, Judge Brewer considered it would be of assistance to consider the second issue, particularly in light of the probability of an appeal by the unsuccessful party.

The taxpayers claimed that everything that was done to acquire the colt and train it was not exceptional in terms of breeding business models and consistent with it being part of a breeding business. They accepted the speculative nature of the venture, but argued this should not frustrate the intention of the taxpayers. They argued the legislative history showed a discernible move from a "use test" to an "intention to use test", and the "intention to use test" was for assessing when bloodstock became part of a breeding business, rather than when a breeding business commenced.

The Commissioner submitted that the activities carried on by the syndicate did not show an intention to engage in a business of breeding. While the colt was acquired as a potential stud stallion, this outcome was dependent on events. The activities that did occur were instead consistent with the raising and development of a racehorse. The future prospect of breeding the colt was a contingency plan, not an intention. The point at which the business would become a breeding business was when the stallion was standing at stud or at least marketed as a stud for breeding purposes. Because the colt was never advertised, marketed for present or future services or bred, no breeding business ever began.

His Honour accepted it was the intention of the syndicate to stand the colt at stud if it was feasible, but found it was an ideal outcome for the syndicate rather than a fixed intention. The acquisition and racing of the colt was preparatory to a breeding business, not the establishment of a breeding business. Buying bloodstock with an intention to stand it at stud in the future does not establish a breeding business. A speculative venture could be a breeding business, but it would require a commitment to a plan and structure to establish the business, rather than an objective that the bloodstock be developed so that a breeding business could come into fruition in the future.

ELIGIBILITY OF GOODS TO BE ZERO-RATED FOR GST PURPOSES

Case	[2013] NZTRA 04 TRA 31/11
Decision date	24 July 2013
Act(s)	Goods and Services Tax Act 1985
Keywords	Exported goods, incorporated in to other goods

Summary

The taxpayer entered into an agreement to export goods to an overseas-based purchaser. After entering the agreement there was a change of approach by the purchaser who arranged for the goods to be used in New Zealand to manufacture different goods. The taxpayer argued that its goods were still ultimately exported and therefore that supply could be zero-rated for goods and services tax ("GST") purposes. The Court found that the underlying goods had been consumed in New Zealand and therefore were not eligible to be zero-rated.

Impact of decision

This decision confirms that where there is manufacture, the old goods lose their identity and are consumed within the new goods.

Facts

The dispute involves a challenge to the Commissioner's assessment disallowing the zero-rating for GST purposes of supplies of stainless steel spheres, made by the disputant, to a company based in the United Kingdom.

The disputant submits that it supplied and exported the spheres to the United Kingdom, and that those supplies accordingly qualified for zero-rating under section 11 of the Goods and Services Tax Act 1985 ("the GST Act").

The Commissioner believed that the disputant did not export the goods as required under the GST Act, and therefore incorrectly returned the supplies in the relevant GST period as being zero-rated. The Commissioner contends the spheres were used in New Zealand in the manufacture of a sculpture, which was subsequently exported to the United Kingdom by another party.

Accordingly, the Commissioner made an adjustment to the GST period ending 31 July 2009 to increase the GST payable by the disputant.

Decision

In regards to the first issue, the disputant argued that the goods exported were the spheres, not the sculpture. The Commissioner contended that the spheres were incorporated into the sculpture here in New Zealand, and

it was the sculpture that was exported. Once incorporated in the sculpture the spheres no longer possessed an independent identity and could not constitute "goods" for GST purposes in their own right.

The Commissioner referred to a number of decisions from different jurisdictions and submitted that where there is manufacture, the Courts have held that old goods lose their identity and are consumed within the new goods. Judge Sinclair accepted the Commissioner's submissions that those principles are generally applicable here.

In *Wellington City Council v Attorney General* [1990] 2 NZLR 281, the Court of Appeal observed that whether a particular process has resulted in a product essentially different will be a question of fact and degree. Judge Sinclair found that the sculpture was very different from the spheres. For these reasons, Judge Sinclair found for the purposes of the GST Act the spheres were consumed and used in New Zealand in the manufacture of the sculpture, and accordingly the supplies of spheres were not eligible to be zero-rated.

In regards to the second issue, the Commissioner submitted that what is required by sections 11(1)(a), (b) and (c) is that the supplier of the goods is the person who exports the goods. Judge Sinclair agreed with that submission, and reiterated her earlier finding that it was the sculpture that was exported and this was not exported by the disputant.

In regards to the third issue, the disputant alleged that there was an informal agreement constituting an agency agreement between it and the company that manufactured and exported the sculpture under section 60(1) of the GST Act. The general manager of this company denied they were acting as the disputant's agent. Judge Sinclair also found that ownership of the spheres passed from the disputant to the United Kingdom company in New Zealand so that, at the time of the export, the disputant had no legal or beneficial interest in the spheres now incorporated into the sculpture on which to found an agency arrangement.

Finally, the disputant submitted that the Commissioner has discretion under sections 6 and 6A of the Tax Administration Act 1994 to allow zero-rating when the supplier does not export the goods. The Commissioner submitted that while she accepts the situation came about due to a change in terms of the disputant's contract of supply with the United Kingdom Company, and not because of any deliberate attempt to avoid payment of its tax obligation, she has no discretion to zero-rate the supply.

Judge Sinclair accepted the Commissioner's submissions that the care and management responsibilities set out in sections 6 and 6A of the Tax Administration Act 1994 do not authorise her to interpret or apply the GST Act in a manner which is inconsistent with the scheme of the legislation. In the present case, section 11(1) of the GST Act specifically requires that the supplier be the exporter. The GST Act does not provide any discretion to the Commissioner to deem someone to be the exporter to meet this requirement.

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