
Editorial

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Editors

1.0 ARTICLES IN THE CURRENT ISSUE

In this second issue of the *New Zealand Journal of Taxation Law and Policy* (the *Journal*) for 2023 we feature four articles. The articles focus on the new business continuity test (BCT) for companies, whether New Zealand should have a wealth tax, a practitioners' views on dispute resolution in New Zealand, and tax compliance supporting cash flow management for small businesses in Australia.

In the first of the four articles, Vijay Mistry observes that for decades, the Continuity of Ownership Test (COT) forced a company to forfeit its losses if greater than 51 per cent of its shareholding changed between the year it incurred a loss, and year that loss was offset. This created inequities and inefficiencies that were so severe, that they impeded what would otherwise be rational and non-tax driven commercial transactions. Following years of advocacy, expedited by the urgency to provide tax relief to counter the economic impact of the COVID-19 pandemic, the government supplemented the COT with the BCT. Now, a company can carry forward its losses, despite breaching the COT, as long as it does not make any non-permitted "major changes" in its "business activities" for a five-year "business continuity period".

Mistry reviews the BCT's introduction into the tax loss carry forward rules. The author discusses the rationale behind the reform and explains how the new test operates, focusing on its scope and implications. Overall, Mistry comments that the government should be commended for its formulation and enactment of the BCT. Adopting its framework from both the United Kingdom and Australia, it enables most commercially sensible (and not tax-driven) corporate transactions to now occur largely unimpeded. Most impressively, Mistry argues, it incentivises growth and innovation, whilst also upholding the rules' original function, making loss trading impossible.

David Sutton, in the second article, comments that the current challenging global environment in the wake of the COVID-19 pandemic has created stresses within societies around the world. These stresses include supply chain disruptions, inflation outstripping increases in income, and a rapid increase in interest rates. The incidence of these developments has fallen heavily on less wealthy sections of New Zealand society. Concurrent with these developments, Sutton argues that 'loose' government fiscal policies and similarly 'loose' RBNZ monetary policies, extending long after the exigencies of the pandemic warranted such interventions, have played an important role in propelling house prices and rental costs rapidly higher. This confluence of factors has resulted in a growing perception that those less well-off are bearing the greatest burdens of these developments, and that those better off should be imposed upon to share more of the pain. These influences, the author argues, have given life to an increasingly vocal view that New Zealand society needs to consider the introduction of a wealth tax. The Green Party of Aotearoa New Zealand advanced this policy going into the 2020 general election and have retained that policy. There are some indications that the New Zealand Labour Party may be considering the introduction of such a tax at some point after the 2023 general election.

Sutton's inquiry outlines a wealth tax, including the current Green's proposed tax, the case for and against it, and prospective alternatives to it. The case is presented by the author that a wealth tax is not the best way to address the wealth distribution challenges New Zealand faces and that a combination comprehensive capital gains tax/inheritance tax is better fit for purpose option.

In the third article, Andrew Maples observes that the tax dispute resolution process in New Zealand was reformed in 1996 following the report of the Organisational Review Committee, "Organisational Review of the Inland Revenue Department" in 1994. In late 2019 and early 2020, some tax practitioners (along with Inland Revenue personnel), were interviewed in respect of one aspect of the dispute process – facilitated conferences. While not the focus of the interviews, the tax practitioners also expressed concerns about the wider operation of the disputes' resolution process itself. Maples considers the issues raised by the tax practitioners, and their suggestions for improvement to the process.

Melissa Belle Isle, Brett Freudenberg and Tapan Sarker, in the fourth and final article, observe that small businesses are recognised as a major contributor to economies, and it is important to understand what can support their continued success. Viability of small business has been associated with successful management of cash flow.

The authors report the findings of a survey as to whether Australian small businesses in the service sector consider that their tax compliance activities support their business cash flow management.

Their findings suggest that compliance with business tax systems has advantages for cash flow management and that small business owners realise a greater benefit from taxes that have more regular compliance activities. However, it does not appear that literacy in relation business tax, financial statements and computerised accounting software is necessarily related to the cash flow management practices considered. Belle Isle et al argue that these findings might be insightful to other jurisdictions in term of how they might design their tax system to assist small business better manage their cash flow.

2.0 POLICY, LEGISLATIVE AND CASE LAW DEVELOPMENTS

2.1 Legislative and Policy Developments

Since our last *Editorial* in the March 2023 issue of the *Journal*, legislative and policy developments have been minimal, although there have been a number of orders in council enacted, including support for those affected by the flooding in February 2023. A bill was introduced to pass on child support payments collected by Inland Revenue to sole parents receiving a main benefit (to take effect from July 2023 assuming the bill is enacted). The Taxation (Annual Rates for 2022—23, Platform Economy, and Remedial Matters) Bill (No 2) received assent just in time for the 2023 financial year end on 31 March 2023. Inland Revenue released its new escalation policy and process for technical issues during March 2023; we comment on this further below.

However, a notable development in late April 2023 is the release of research surrounding High Net Wealth Individuals (HNWI), including both research undertaken by Sapere Research Group (commissioned by Olivershaw Ltd),¹ and by Inland Revenue and the New Zealand Treasury (released by the Minister of Revenue on 26 April 2023).²

2.2 Are the Wealthy Appropriately Taxed in New Zealand?

In the research undertaken by Sapere Research Group, the report suggests that HNWI in New Zealand pay more tax on average and represent a higher proportion of the tax take than what may be typically thought. The substantial report adopted standard modelling methodologies used in the OECD Taxing Wages study as the basis to review the income and tax of illustrative households to calculate the average effective tax rates paid by low, medium and high-income earners in New Zealand. It is an underestimation to say that their report's conclusions are highly contentious.

Key findings from the report include:

- the rich pay most of the tax collected in New Zealand and the richer a person is, the more tax they are likely to pay;
- effective tax rates are generally less than the statutory rates;
- average effective tax rates increase as the net real economic incomes of households increase;
- as a result of deliberate government policies, households of single employees renting face some of the highest average effective tax rates, and some of the highest marginal tax rates apply to some of the lowest income earners.

The reaction from a number of interest groups has been mixed. Oxfam have criticised the report for failing to consider GST and capital gains, such that the report ignores the failure of the New Zealand system to tax wealth (except for property rates).³ Other commentators suggest that it is important to analyse all of the reports collectively to gain a fuller appreciation, within the context of the limitations of the various methodologies employed.

The main findings of Inland Revenue's work relate to survey information obtained from around 300 high-wealth New Zealand families. The research found that the effective tax rate (tax paid divided by economic income) of the families over the period 2015-2021 varied but the median effective tax rate was 8.9 per cent. This can be seen in comparison to the New Zealand Treasury research, where a middle wealth New Zealander has an effective tax rate of 20.2%. New Zealand Treasury's work develops a taxable income capitalisation method for estimating the

¹ See Kieran Murray, John Wallace and Mehrnaz Rohani *Effective Tax Rates Imposed on the Incomes of New Zealand residents*, Report prepared for Olivershaw (April 2023). See also <www.wereonthemoney.co.nz/>.

² See Inland Revenue *High-wealth Individuals Research Project* (April 2023), and associated information sheets available at: <www.ird.govt.nz/>. For the NZ Treasury work, see Benjamin Ching, Tayla Forward and Oscar Parkyn *Estimating the Distribution of Wealth in New Zealand*, Working Paper 23/01 (April 2023) and associated methodology papers; available at <www.treasury.govt.nz/>.

³ See <www.oxfam.org.nz/news-media/>. This view is also supported by Tax Justice Aotearoa.

distribution of wealth in New Zealand. It combines Inland Revenue taxable income administration data with Stats NZ's Household Balance Sheet to give new estimates of the distribution of New Zealand individuals' wealth.

In announcing the release of the reports on 26 April 2023, the Minister of Revenue was quick to point out that no new taxes were being proposed at this time and that details of the Labour Party's tax proposals would come out nearer the General Election.⁴ The Prime Minister also confirmed this on 27 April 2023, along with the government's decision not to introduce any new form of tax or levy to pay for the infrastructure costs in responding to Cyclone Gabrielle.⁵

What can we take away from this is that there is considerable material to 'fuel the debate' over the tax mix in New Zealand, and that we should be looking out for details of some form of wealth taxation, most likely a capital gains tax (with possibly some form of rebalancing with income taxation) in the future. As such we look forward to seeing the Labour Party's election manifesto, along with the manifestos of other political parties with respect to tax.

2.3 Escalation Policy and Process for Technical Issues

On 20 March 2023, Inland Revenue released its escalation policy and process document which sets out Inland Revenue's process designed to ensure that its staff apply Inland Revenue's view of the law consistently.⁶ The document indicates that the process enables a view to be reconsidered if a staff member thinks it is incorrect. Importantly, the policy does not give taxpayers the right to have issues reconsidered. In particular, with limited exceptions, Inland Revenue staff must not apply an interpretation or position to a taxpayer (including in litigation and settlement) when they are aware this would be inconsistent with Inland Revenue's existing view.

The purpose of the process set out in the document is to:

- maximise certainty for Inland Revenue staff and taxpayers by establishing a consistent approach to technical decisions;
- constructively address and resolve differences of technical views within Inland Revenue; and
- build positive taxpayer perceptions of the integrity of the tax system and so promote voluntary compliance with tax legislation.

2.4 Legal costs and damages for emotional harm awarded to Mr Parore

In our December 2022 issue of the *Journal* it featured a comment on the litigation involving a Mr Parore.⁷ Since that was published, there has been a significant new development with legal costs and damages for emotional harm being awarded to Mr Parore. We asked Alisatir Hodson to provide us with a brief review of this development. In *Parore v The Attorney-General*,⁸ Her Honour Gwyn J considered whether a claim for compensation (*Baigent* damages)⁹ for breach of rights under the New Zealand Bill of Rights 1990 in a tax proceeding was warranted.

The then Commissioner of Inland Revenue (Commissioner) had used her statutory powers under the Tax Administration Act 1994 to effectively require Mr Parore to disclose his prospective defence to criminal charges. "When the charges were laid, a fair trial for Mr Parore was already an impossibility."¹⁰

Although counsel for the Commissioner said there was a proper substantive basis for the Commissioner bringing criminal charges against Mr Parore, her Honour did not accept that. "The right to silence is not a variable right, depending on the extent of perceived guilt or innocence."¹¹ Her Honour disregarded evidence about Mr Parore's compliance history.

⁴ Tom Pullar-Strecker "Richest Kiwis pay about half as much tax on the dollar as the average New Zealander" (2023) Stuff.co.nz (26 April 2023).

⁵ See Thomas Coughlan "Budget 2023: Chris Hipkins torpedoes capital gain tax, Cyclone Gabrielle response levy" (2023) NZ Herald online (27 April 2023); and Luke Malpass, "Labour to deliver 'no-frills' Budget with no new taxes – Hipkins" (2023) Stuff.co.nz (27 April 2023).

⁶ See Inland Revenue *Inland Revenue's Technical Issues Escalation Policy and Process* (Approved on 27 February 2023 by Commissioner Peter Mersi) (March 2023); available at <www.taxtechnical.ird.govt.nz/>.

⁷ Alistair Hodson "Comment: State Misconduct: Fair Trial Rights and Losing the Right to Silence – *Parore* 2021 to 2022" (2022) 28(4) NZJTL 333.

⁸ [2023] NZHC 1010.

⁹ *Simpson v Attorney-General* [1994] 3 NZLR 667 (CA) [*Baigent's Case*].

¹⁰ *Parore v The Attorney-General* [2023] NZHC 1010 at [71].

¹¹ Above n 10, at [78].

Inland Revenue argued that as Mr Parore had retained NZD55,673.51 of GST he had collected he had received a “windfall”.¹² This was due to the information in Mr Parore’s NOPA in the civil proceedings being deemed to be correct and the Court is not entitled to look beyond it;¹³ an example of why procedural timeliness in tax disputes is so important, not only for a taxpayer but also for Inland Revenue, as evidenced by the outcome in this case.

Her Honour concluded that a stay of prosecution was not a sufficient remedy for Mr Parore and that a declaration was necessary. The order by Gwyn J was that a declaration be given that Inland Revenue had breached Mr Parore’s right to silence as guaranteed by s 25(d) of the New Zealand Bill of Rights Act 1990. This is believed to be the first occasion that a taxpayer has been successful in New Zealand for a breach of their rights under the Bill of Rights Act 1990 with respect to taxation.

Her Honour was satisfied that an award of damages was also necessary to provide effective redress for the breach of Mr Parore’s rights. Damages were awarded for legal costs incurred in the sum of NZD70,989.86 and for emotional harm in the sum of NZD5,000. The damages were not awarded as costs in the usual sense, in terms of the High Court Rules 2016. Rather, the actual costs incurred were the appropriate basis for assessing the quantum of damages. The emotional harm award of NZD5,000 was a modest amount but significant in recognising the stress of being subjected to the substance of not one, but two, trials before the stay was ultimately granted (and subsequently upheld by the High Court).¹⁴ Her Honour’s preliminary view was that Mr Parore would also be entitled to costs on a 2B basis.

As noted by Wylie J in the earlier High Court decision,¹⁵ the associated rights which defendants enjoy as part of the right to a fair trial are the right to remain silent, the right not to be compelled to disclose a defence, the right to put the prosecution to proof, and the right to require the prosecution to prove its case beyond reasonable doubt.

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¹² Above n 10, at [96].

¹³ Above n 10, at [98]

¹⁴ Above n 10, at [92].

¹⁵ *Commissioner of Inland Revenue v Parore* [2021] NZHC 3405 at [50].

¹⁶ See Inland Revenue *Inland Revenue’s Technical Issues Escalation Policy and Process* (Approved on 27 February 2023 by Commissioner Peter Mersi) (March 2023); available at <www.taxtechnical.ird.govt.nz/>.