Shining a light on the unintended consequences of the powers granted to Inland Revenue to collect information for tax policy purposes

I Introduction

> To protect the integrity of the tax system the Minister, the Commissioner and taxpayers should all be assured that there is a 'no-go' area where the Commissioner exercises a wholly independent judgement… [T]he Commissioner must exercise independent judgement on the tax affairs of individual taxpayers and must not be subject to Ministerial direction in relation to those decisions…[1]

This passage is from the 1994 Organisational Review of Inland Revenue led by Sir Ivor Richardson. It acknowledges that the "integrity of the tax system" depends on tax administration being, and being *seen* to be, politically neutral. Political neutrality is the principle on which New Zealand's state sector generally is "founded".[2] Political neutrality is especially important in tax administration. "Taxpayer perceptions of the integrity of the tax system" have long been recognised as "crucial" to upholding voluntary compliance.[3] Any threat to political neutrality (or the appearance of such) in tax administration is therefore problematic.

In December 2020, Parliament enacted (under urgency) section 17GB of the Tax Administration Act 1994 (**TAA**). Section 17GB(1) states:

> A person must, when notified by the Commissioner that the person is required to provide information under this section, provide any information that the Commissioner considers relevant for a purpose relating to the development of policy for the improvement or reform of the tax system.

This paper examines the unintended consequences of section 17GB. These unintended consequences may be surfacing only now because of the use of urgency to enact section 17GB. This meant that the provision could not be considered by Select Committee, including with the benefit of public submissions.

The fatal flaw underlying section 17GB—and the focus of this paper—is that the provision risks creating at least the perception that the exercise of Inland Revenue's coercive powers is linked to the viewpoints or actions of politicians (including the Minister of Revenue). Section 17GB therefore potentially compromises the perception of political neutrality in tax administration, and should be repealed. If a power to gather information for tax policy purposes is required, then—in order to preserve the integrity of the tax system—this power should be conferred on Stats NZ, not Inland Revenue.

To examine the unintended consequences of section 17GB, this paper:

- in section II, discusses the origins of section 17GB;
- in section III, analyses section 17GB's impact on the integrity of the tax system; and
- in section IV, recommends changes to address section 17GB's unintended consequences.

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1 *Organisational Review of the Inland Revenue Department* (April 1994) [Richardson Review] at [9.4.1].
2 Cabinet Office *Cabinet Manual 2017* at [3.58].
3 Richardson Review, op cit, at [9.3].

II Section 17GB: a mere clarification?

According to Inland Revenue's Commentary on the Taxation (Income Tax Rate and Other Amendments) Bill, section 17GB was intended to "clarify" that Inland Revenue's powers included "being able to require persons to provide information solely for the purpose of tax policy development".[4]

While providing "context" to Parliament for section 17GB's enactment, the Minister observed "how complex the tax affairs are of some wealthy taxpayer groups".[5] The Minister noted that the Commissioner "believe[d] that she already ha[d] the right to collect information for policy purposes, not just for enforcement purposes" under (what is now) section 17B of the TAA; however:

> …[t]here are tax professionals who act as intermediaries for wealthy individuals who say that that is not a correct interpretation of that section and that the proper interpretation of that section is that the information has to be for administration or enforcement, which gives it an enforcement frame rather than a policy frame.

Therefore, "rather than have that battle", the Government instead "clarif[ied]" that "information that the commissioner needs for policy purposes can be collected by the commissioner".

Section 17GB goes beyond a mere clarification, however. Unlike other information-gathering powers in the TAA, section 17GB is constrained by neither the boundaries of taxpayers' existing legal obligations under the Inland Revenue Acts, nor by the "administration or enforcement" of matters arising from (or connected with) the functions lawfully conferred on the Commissioner.[6] Rather, section 17GB concerns the possible development of future tax laws. The section 17GB power is akin to conferring on a law enforcement agency (eg, the Police) the power to request information to uncover conduct that, although not currently unlawful, 'should' be made unlawful.

III Section 17GB and the integrity of the tax system

The importance of political neutrality

The Richardson Review extract quoted above recognises that political neutrality is vital to the good administration of the New Zealand tax system. Tax administration relies on voluntary compliance – the Commissioner has a duty to collect over time the highest net revenue practicable, but in doing so, must have regard to:[7]

> …the importance of promoting compliance, **especially voluntary compliance**, by all persons with the Inland Revenue Acts.
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> [Emphasis added.]

The "'no-go' area" identified by the Richardson Review—in which the Commissioner must exercise "wholly independent judgement"—reflects the concern that, if the exercise of Inland Revenue's coercive powers might appear to have been influenced by a political actor (eg, the Minister of Revenue), there is

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4 Inland Revenue *Taxation (Income Tax Rate and Other Amendments) Bill; Commentary on the Bill* (December 2020) at 21.

5 (2 December 2020) 749 NZPD.

6 Cf Tax Administration Act 1994, section 17B(1)(a) and (b).

7 Tax Administration Act 1994, section 6A(2)(b).

a risk that Inland Revenue's powers might be seen to have been exercised for political purposes. Taxpayers might therefore view their relationship with, and obligations to, Inland Revenue as being influenced by politicians (and their viewpoints), rather than dependent on objective criteria established by law. In that case, a taxpayer's tax obligations risk becoming—in the public psyche—a battle of political ideologies, rather than obligations established by law and administered by politically neutral officials.

Sections 6 to 6B of the TAA demarcate the Richardson Review's 'no-go' area. Section 6(1) imposes a duty on relevant Ministers and officials to "use their best endeavours to protect the integrity of the tax system". The phrase "integrity of the tax system" includes:[8]

> (a) the public perception of that integrity; and
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> (b) the rights of persons to have their liability determined fairly, impartially, and according to law; and
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> (c) the rights of persons to have their individual affairs kept confidential and treated with no greater or lesser favour than the tax affairs of other persons; and
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> (d) the responsibilities of persons to comply with the law; and
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> (e) the responsibilities of those administering the law to maintain the confidentiality of the affairs of persons; and
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> (f) the responsibilities of those administering the law to do so fairly, impartially, and according to law.

Section 6B expressly constrains the manner in which the political arm of government may direct Inland Revenue. Section 6B(1) provides for the Governor-General (effectively, the Government) to issue directions to the Commissioner by Order in Council, thereby requiring a level of both formality and transparency. Section 6B(2) prohibits the giving of directions "concerning the tax affairs of individual persons".

Section 6B(2) upholds public confidence in Inland Revenue by ensuring that its extensive (but necessary) powers are exercised in a politically neutral way. A similar safeguard applies in respect of the Commissioner of Police, for example, who (by section 16(2) of the Policing Act 2008) is not responsible to, and must act independently of, government in performing certain functions (eg, the enforcement of the law in relation to individuals, and the investigation and prosecution of offences).

The problem with section 17GB

The subject-matter of section 17GB, and how it was enacted, pose a challenge to the critical requirement that Inland Revenue act independently in its dealings with particular taxpayers. While matters of tax *administration* (ie, monitoring and enforcement of existing tax law) are apolitical, matters of tax *policy* (especially the appropriate burden of tax, and the "fairness" of the tax system) may be inherently political. It is therefore inevitable that a decision whether, and against whom, to exercise the section 17GB power could appear to be politically driven.

That reality conflicts with the fact that, legally, the power to exercise section 17GB is conferred on the *Commissioner*: it is the Commissioner who must form the view that the information requested is

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8 Tax Administration Act 1994, section 6(2).

"relevant for a purpose relating to the development of policy for the improvement or reform of the tax system".

This conflict between that reality and the legal position is a fundamental design flaw of section 17GB, which jeopardises the integrity of the tax system. The use of section 17GB in Inland Revenue's "high-wealth individuals research project" (**HWI Project**) illustrates this point.

The HWI Project

The HWI Project involves Inland Revenue requesting from approximately 400 "high-wealth tax resident individuals" (and their families), under section 17GB, information about "the assets they own, entities they have an interest in, and gains made" in the 2016 to 2021 income years.[9] The purpose of the HWI Project is to better understand the rate of tax paid by high-wealth individuals on their "economic income", with a view to identifying problems requiring potential law reform.

Public statements made by the Minister of Revenue regarding the HWI Project—including the following three examples—might create the appearance that the exercise of the section 17GB power in this case was subject to political influence:

1. The parliamentary debate on section 17GB (quoted in section II above) indicated that the desire to gather information on "some wealthy taxpayer groups" was the impetus for its enactment.

2. In June 2021, while discussing "tax fairness" before the Finance and Expenditure Committee, the Minister stated that the HWI Project would enable "us to gather some more information to build a comprehensive picture of income which will enable better decisions in the future".[10]

3. In April 2022, in a speech entitled "Shining a light on unfairness in our tax system", the Minister stated that it "beggars belief we currently don't know what rate of tax is paid by the top cohort in New Zealand on their economic income", which is why:[11]

> We [Cabinet] moved to address this data gap… Inland Revenue was allocated funds to conduct research [the HWI Project] relating to the tax paid by the wealthiest New Zealanders relative to their economic income.

Together, these statements might appear at odds with the fact that the decision to deploy section 17GB is the Commissioner's to make. Before section 17GB was even enacted, the Minister appears to have identified a particular group of taxpayers against whom the power would be used. And there is at least the appearance that the criterion for inclusion in the HWI Project (ie, a taxpayer's level of wealth) was selected by the Minister, not the Commissioner.

The appearance of the Minister's influence over the HWI Project has been reflected in its media coverage also. Articles on the HWI Project have, for example: referred to "David Parker's long, long

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9 Inland Revenue "High-wealth individuals research project" (28 September 2021) <ird.govt.nz>.

10 Finance and Expenditure Committee "2021/22 Estimates for Vote Revenue" (9 June 2021) <parliament.nz>.

11 David Parker "Shining a light on unfairness in our tax system" (speech at Victoria University of Wellington, 26 April 2022).

game towards a fairer tax system";[12] speculated whether "David Parker [has] a cunning plan";[13] and suggested that the Minister "ordered the [HWI Project]".[14] Therefore, rightly or wrongly, and appreciating that media comment may carry its own slant, the Minister's name is—in a quite literal sense—written all over the HWI Project. That, in turn, entrenches in the public consciousness the perception that coercive powers legally vested in the Commissioner can be exercised at the instigation of politicians.

The expected output of the HWI Project is a report to be published in mid-2023, shortly prior to the next election. The Minister has stated that the HWI Project's findings may well "feed into future tax policy development". The timing of the release of this report may further contribute to the perception of the section 17GB power being exercised for political purposes.

Finally, no direction to undertake the HWI Project was issued by Order in Council under section 6B of the TAA. In the absence of this, the media and the public are left with the Minister of Revenue's speeches, but no formal and transparent record of where the line has been drawn between the Minister's and Inland Revenue's roles in exercising the section 17GB power.

Summary

When defining the "integrity of the tax system", section 6(2)(f) of the TAA refers to the responsibility on those administering the law to do so "fairly, impartially, and according to law". It is no coincidence that the words "fairly, impartially, and according to law" appear as a composite expression: how can it be said that a coercive power, like section 17GB, has been exercised in a politically neutral (and therefore impartial) way when its exercise is untethered to any existing legal obligation?

Because section 17GB need not be exercised by reference to an existing legal standard, it is inevitable that the power will instead be exercised by reference to some political standard or objective. As a result, the exercise of the section 17GB power compromises the perception of impartiality in tax administration, to which section 6(2)(f) refers. That being so, section 17GB undermines the integrity of the tax system, and (by extension) the voluntary compliance on which it is based. Section 17GB should therefore be repealed.

IV Recommended changes to address section 17GB's unintended consequences

To what extent is it appropriate that tax policy information be gathered? What are the boundaries?

Access to relevant data is, of course, critical to the development of effective tax policy. However, the type of data, and how it is gathered, must not undermine the integrity of the tax system.

In 2018, the Government asked the Tax Working Group (**TWG**) to consider "better approaches to understanding the wealth, capital income, and effective tax rates of individuals particularly those in the

12 Bernard Hickey "David Parker's long, long game towards a fairer tax system" (28 April 2022) The Spinoff <thespinoff.co.nz>.

13 Pattrick Smellie "Does David Parker have a cunning plan?" (3 May 2022) BusinessDesk <businessdesk.co.nz>.

14 Tom Pullar-Strecker "Inland Revenue hits brick wall trying to contact 14 rich-listers" (2 July 2022) <stuff.co.nz>.

top decile".[15] In its final report, the TWG highlighted a lack of information about (among other areas) the distribution of income, wealth and taxation, and effective tax rates, and therefore recommended that:[16]

> …the Government build the ability of its agencies, including Inland Revenue and Stats NZ, to provide such information and make it available to the public for information and research purposes…

The TWG specifically recommended Government:[17]

- fund an oversampling of this group in existing wealth surveys
- include a question on wealth in the Census
- request Inland Revenue to regularly repeat its analysis of the tax paid by high-wealth individuals (Inland Revenue, 2016)
- commission research, using a variety of sources of data on capital income (including administrative data) to estimate the wealth of individuals.

Advice from Inland Revenue and the Treasury to the TWG stated that oversampling high-wealth individuals in wealth surveys might not be effective at filling the data gap on wealth and income; Stats NZ had previously investigated, and decided against, this approach.[18] Overseas experience suggests the efficacy of oversampling has been limited by very low response rates. This is presumably why the TWG recommended oversampling as but one of a suite of options for gathering data on high-wealth individuals. As an aside, it is acknowledged that many overseas jurisdictions have better access to data on wealth than New Zealand by virtue of having capital gains and/or inheritance taxes.

The TWG's third recommendation (to repeat the previous analysis by Inland Revenue on tax paid by high-wealth individuals) refers to the 2016 *HWI – Wealth Accumulation Review* (**2016 Review**).[19] The 2016 Review was commissioned by Inland Revenue to "consider wealth accumulation" and the "exposure … to taxation as wealth accumulates". The 2016 Review has been made publicly available (in part) under the Official Information Act 1982. It involved a "specific review" of 18 high-wealth individuals (purportedly "representative of different aspects of this population"), and "an examination of population wide data".

The 2016 Review is quite different from the HWI Project in two respects:

1. The 2016 Review was initiated from within Inland Revenue, in response to a comment made at a tax conference that "in terms of wealth taxation 'income tax does this heavy lifting'".[20] It did not therefore have the appearance of being politically influenced.

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15 Inland Revenue and the Treasury *Responding to Ministers on wealth, capital income and effective tax rates in the top decile: Background Paper for Session 23 of the Tax Working Group* (November 2018) at [1].

16 Tax Working Group *Future of Tax: Final Report Volume I – Recommendations* (21 February 2019) at [28].

17 At [29].

18 Inland Revenue and the Treasury, op cit, at [6] – [8].

19 Inland Revenue *HWI – Wealth Accumulation Review* (June 2016) (obtained under Official Information Act 1982 Request to the Chief Tax Counsel, Inland Revenue).

20 At 4.

2. The 2016 Review did not rely on coercive information-gathering powers. Rather, the report used balance sheet and IR10 filings (where available), market values of listed companies, and National Business Review estimates of wealth. Despite the "lack of consistent" information in some respects, and the inability to give "precise estimates", the authors of the 2016 Review felt they were nonetheless "able to make some informed observations about the tax paid nature of this group's wealth".[21]

Two points emerge from the TWG's findings above, and the previous attempts to research wealth distribution and effective tax rates (both here and abroad). The first is that some research on wealth and income *can* be undertaken, even in the absence of a power such as section 17GB. The second is that such research has clear limitations (eg, the need to rely on unofficial datasets like the National Business Review "Rich List").

Therefore, "build[ing] the ability" of government agencies to gather "good quality data" on "the current functioning of the tax system", as the TWG recommended, seems appropriate. That said, it is essential to maintain effective boundaries as to the nature of the information requested, and (critically) the way—including by whom—it is requested.

What data it is appropriate to gather will depend on the research being undertaken. As a general rule, the information requested should be as objective as possible, and intrude on taxpayers' privacy interests as little as possible. For instance, disclosures related to a person's real estate assets might attract a lesser privacy interest than disclosures regarding what a person spends their money on.

In my view, however, the key to ensuring that tax policy information is collected in a way that upholds the integrity of the tax system is to focus on *who* is gathering it. To that end, I argue that the power to gather information for tax policy purposes should be conferred on Stats NZ, not Inland Revenue.

Confer the power on Stats NZ

As New Zealand's official data agency, Stats NZ has an existing mandate to gather various forms of information from the public. Stats NZ, unlike Inland Revenue, also has no role in the administration and enforcement of tax law. Accordingly, were the information-gathering power for tax policy purposes to be vested in Stats NZ (instead of Inland Revenue), this would be more consistent with Stats NZ's existing functions, and prevent Inland Revenue from being seen to act under political influence in exercising coercive powers.

My proposal would achieve what might (loosely) be described as a 'separation of powers' between the gathering of information for possible future tax reform (on the one hand), and the administration of existing tax law (on the other). This would reduce the risk of Inland Revenue's critical collection and enforcement roles being coloured by the perception that it exercises its coercive powers for political purposes. For the reasons outlined above, that would better preserve the integrity of the tax system (including voluntary compliance).

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21 Ibid.

Does Stats NZ have the capability?

Stats NZ is well-versed in gathering large quantities of data from the public (eg, through the Census and Household Economic Survey). However, it might be argued that Stats NZ does not have the necessary expertise to carry out tax-specific initiatives (like the HWI Project).

Any such limitation in Stats NZ's capability could, it is suggested, be rectified in two straightforward respects:

1. If information-gathering for tax policy purposes is considered a priority, then Stats NZ should be provided the mandate and appropriate resources to build its ability to carry out tax-related data initiatives (consistent with the TWG's recommendation).

2. To the extent additional tax expertise is required for a given project, consideration could be given to seconding personnel from the Treasury (or, if necessary, Inland Revenue) to assist Stats NZ. Secondments from Inland Revenue could undermine, to some extent, the separation of information-gathering for policy purposes from Inland Revenue's collection and enforcement roles. Regardless, this approach would still, overall, be a marked improvement on the current section 17GB in protecting the integrity of the tax system. Importantly, in terms of perceptions, it would mean that requests for tax policy-related information were issued by a different agency (Stats NZ) from that which is responsible for enforcement and compliance (Inland Revenue).

Would this increase compliance costs?

Given the extent of taxpayer information held by Inland Revenue, it might be argued that Inland Revenue is best placed to conduct research for tax policy purposes in a way that minimises compliance costs (by not requesting duplicate information from taxpayers). Stats NZ and Inland Revenue already have a memorandum of understanding in relation to data-sharing, however.[22] It is suggested that this (and any empowering legislation) should be updated (as required) to allow sharing of taxpayer-specific (rather than simply aggregated) information by Inland Revenue to Stats NZ, insofar as is necessary to enable information-gathering for tax policy purposes to be conducted as efficiently as possible.

Measuring success

The unintended consequences of section 17GB identified in this paper relate primarily to the way in which information-gathering for tax policy purposes is perceived by taxpayers. The success of my proposal rests in the Government, officials, and the public each having available to them the data needed to make informed decisions regarding tax policy, but in a way that maintains the perception of Inland Revenue being apolitical in exercising its coercive powers.

Although perceptions may be challenging to measure, they are no less important. New Zealand is currently in the welcome position of having a public service that ranks highly for its efficacy, transparency, and perceived lack of corruption.[23] A critical aspect of this favourable perception is the

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22 Inland Revenue "Statistics New Zealand (Stats NZ)" (28 April 2021) <ird.govt.nz>; Tax Administration Act 1994, Schedule 7, Part C, clause 20.

23 Public Service Commission "New Zealand Public Service among most trusted in the world" (26 January 2022) <publicservice.govt.nz>.

perception of political neutrality, which (for the reasons set out above) section 17GB risks compromising.

V Conclusion

Access to quality data to inform debate and decisions regarding tax policy is important. The TWG concluded that New Zealand currently has gaps in the data available for this purpose.

In the pursuit of access to data, it is, however, critical that we not take for granted the importance of having a tax system based on widespread—if not universal—voluntary compliance. A cornerstone of voluntary compliance is the community's acceptance that a person's tax obligations are determined fairly, impartially, and according to law; ie, free from political influence. Even the perception that the exercise of a coercive information-gathering power by Inland Revenue has been subject to political influence is a threat to the tax system as a whole.

That being so, in my opinion, it is critical that the collection of additional data for tax policy purposes is separated from Inland Revenue. The 'no-go' area identified in the Richardson Review some 30 years ago must remain sacrosanct.