DIRECTIONS FOR TAX ADMINISTRATION: TWO RECENT REPORTS

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The effectiveness of the tax system is crucial to the funding of government. The tax administration is given exceptional powers to enable it to enforce tax laws and thus achieve revenue outcomes acceptable to government. The performance of the tax administration affects the efficiency of the national economy. But though it is crucial to the functioning of government and the economy and though it raises major questions as to the application of public law values, tax administration has not been a major field of study for lawyers. However, that may be changing and, co-incidentally, substantial governmental reviews of tax administration in Australia and New Zealand have recently been published.[1] For ease of reference they will be referred to as the Australian Report and the New Zealand Report respectively.

The two reports provide a convenient base from which to discuss key features of future tax administration in our two countries. Unless otherwise stated all data are taken directly from these reports as is much of the expression of the reasoning. After quickly sketching the background to tax administration and the special features of tax collecting today, this paper discusses major issues of tax administration for the future. There is particular emphasis on the roles of the Commissioner and Chief Executive,[2] the relationship with the relevant Minister, tax policy development and legislative drafting, adjudication of tax liability and tax dispute resolution, and structural arrangements including sub-contracting options for delivery and social policy functions.

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1 Commonwealth Parliament Joint Committee of Public Accounts, *An Assessment of Tax* (Report No 326, November 1993); New Zealand, Organisational Review Committee, *Organisational Review of the Inland Revenue Department* (Report to the Minister of Revenue and the Minister of Finance, March 1994). The New Zealand Report has been approved by the Government and is in the process of implementation. The Australian Government is in the process of implementing some of the recommendations of the Australian Report. A summary of the recommendations of the Australian Report can be found at xxiv to xlii of the Report. For the New Zealand Report the summary recommendations can be found at 11 to 22 of the Report.

2 In New Zealand there is both a Commissioner of Inland Revenue under the Inland Revenue Act 1974 and a Chief Executive of the Department of Inland Revenue under the State Sector Act 1988. Currently both roles are performed by the one person.

THE BACKGROUND AND SPECIAL FEATURES OF TAX COLLECTING

The Australian Tax Office (the ATO) employs over 18,000 people operating out of 25 branch offices and 17 regional offices (branch office outposts). It has responsibility for the expenditure of over $1.12 billion and the collection of revenue totalling in 1992/93 over $74.7 billion from over 10 million citizens. The New Zealand Inland Revenue Department (the IRD) employs some 5,800 people in 35 offices. It collects some $21 billion net revenue each year and has an annual budget of $380 million.

Tax collecting was not always a large scale operation. In 1911/1912 the total staff of the ATO was only 105 and as late as 1939/40 income tax collected totalled only £16.4m. In New Zealand income tax yielded only £554,000 in 1914 and £14.8 million in 1939. Wartime needs and the development of the welfare state required substantial funding from a mass tax.

The nature of tax administration has changed markedly over recent years in three major respects. The first development is the expansion of a relatively narrow tax base to a much broader base with more emphasis on revenue raising and less on the immediate pursuit, through incentives in the tax system, of particular economic and social goals. But because of its information base and enforcement culture, the tax administration may be required to administer social policy legislation such as child support. The second change is the large-scale automation of tax collecting. The third development, which is facilitated by that automation process, is the move to self-assessment.

The legislative provisions governing the administration of the tax system date back to the introduction of the Income Tax Assessment Act in 1936 in Australia and the Land and Income Tax Act in 1916 in New Zealand, a point to which I shall return in discussing legislative drafting. It is sufficient for present purposes to note that the legislation in both our countries does not deal in a coherent way with taxpayer assistance and taxpayer audit which are central to modern tax collecting.

There are seven special features and responsibilities of tax collecting. They have major implications for tax administration generally, including the dual roles of the Commissioner as adjudicator and chief executive of the tax administration. They are:

(1) Ultimately, the Minister is responsible to Parliament for the tax administration. Accordingly the Minister must have the power to direct the Chief Executive/Commissioner on any matter relating to the operation of the tax administration in accordance with, and subject to, the relevant statutes.

(2) Taxes are imposed by Parliament. The tax administrator quantifies the statutory liability and constitutionally neither the tax administrator nor the Government can simply suspend the operation of all or part of those laws.

(3) The resources available to the tax administrator for the determination of the taxes of all taxpayers, and the collection of those taxes, are limited. The tax administrator must make decisions as to the management of those resources.

(4) The principle of voluntary compliance, coupled with appropriate enforcement action, is central to efficient and effective tax collecting.

(5) Modern technology enables the great bulk of taxes to be collected using a data processing operation, supported by the judgement of tax officials, which reconciles

any tax collected at source with the self-assessed returns of taxpayers and identifies non-compliers.

(6) The tax enforcement function ensures, so far as possible, that taxpayers comply with their obligations. Within this function the tax administration exercises an independent judgment in investigating and quantifying obligations of particular taxpayers and collecting their taxes.

(7) In the discharge of tax collecting functions the tax administrator has responsibilities to Parliament, to the Government/Minister and to taxpayers.

These features and responsibilities have implications in three areas of tax administration:

(1) The relationship between the tax administration and the Government/Minister. This concerns the provision to the Minister of information relating to tax collecting, and the scope of Ministerial directions to the tax administration.

(2) The relationship between the tax administration and the taxpayers. Given that the tax administrator has finite resources, taxpayers should be assured that these resources are being applied appropriately — and that their rights are being protected.

(3) The significance of the structural organisation of the adjudication responsibilities of the tax administration.

Although the issues can be conveniently grouped under the heading of "adjudication" or considered in the context of a split between the conventional chief executive and special adjudication functions, there is no single solution which fully answers the problems arising in all three areas.

THE ROLES OF THE TAX ADMINISTRATOR AND MINISTERIAL RELATIONSHIPS

Tax legislation in both countries concentrates all functions and powers in a single administrator, the Commissioner. It does not differentiate between adjudication and management of tax matters. Nor does it deal specifically with the relationship between the tax administrator and the Minister.

Both reports dealt at some length with the degree of independence of the Commissioner from Ministerial direction and the provision of information to help the Minister fulfil his or her responsibilities to Parliament. Both concluded that accountability principles required the Minister to have the capacity to instruct the Commissioner in the exercise of administrative powers. As the Australian Report puts it, democratic principles require that elected representatives be accountable for those actions which affect citizens.[3] Both reports also emphasised the need to protect the integrity of the tax system against improper use of the powers of direction and recommended a mechanism for tabling any such directions in Parliament. In this regard the key to balancing the features and responsibilities of tax collecting outlined above is to determine those special aspects of tax collecting for which a tax administrator requires independence and which accordingly constrain Ministerial direction and control.

3 Australian Report, above n 1 at para 3.77.

The principle of voluntary compliance is central to tax collecting. Taxpayer perceptions of the integrity of the tax system are crucial to maintaining voluntary compliance. Taxpayers will be particularly concerned that the application of tax law to individuals is free from political influence. Taxpayers have to feel:

(1) that their own affairs are receiving impartial treatment;

(2) that the affairs of others are being treated impartially; and

(3) that the rights of the individual are being upheld.

To protect the integrity of the tax system the Minister, the Commissioner and taxpayers should all be assured that there is a protected area where the Commissioner exercises a wholly independent judgement. Three criteria define and protect that "no-go" area:

(1) the Commissioner must exercise independent judgment on the tax affairs of individual taxpayers and must not be subject to Ministerial direction in relation to those decisions;

(2) the Commissioner is not subject to any directions relating to any interpretation of tax law;

(3) any directions given on any other matter are given for the purposes of administration of the tax Acts and are consistent with other relevant legislation (for example, public finance and human rights legislation).

In addition to these criteria, good management principles should ensure that, in practice, there is an appropriate buffer above the "no-go" area. Administrative policies and procedures are normally determined by the Chief Executive rather than the Minister. For example, whilst it is appropriate for the Minister to be assured that there exists an audit case selection system which reflects best practice and that such a system is being properly used, such assurance would normally be available from briefings provided by the Chief Executive and from the independent audit process.

A related matter is the balancing of the second and third features of tax collecting identified above. Constitutionally the Commissioner is required to collect the taxes imposed by law. It is not a matter of private bargain. It is not for the Commissioner to decide who is to pay tax. But it is not possible for the Commissioner operating within limited resources to ensure that every cent of due tax is collected. Explicit statutory recognition of the management of limited resources in the efficient and effective collection of taxes is needed. The New Zealand Report saw the primary objective for the tax administration as being to collect over time the highest net revenue that is practicable within the law, having regard to the resources available to the Department, the importance of promoting compliance by all taxpayers with the tax Acts and, in that connection, the compliance costs incurred by taxpayers. "Over time" indicates the obvious need for the tax administration to balance short and long-term implications of possible management strategies and "highest net revenue" means actual revenue less administration (collection) costs.

The constitutional basis on which taxes are collected and the fundamental strategy of voluntary compliance require that the integrity of the tax system be protected. Drawing the threads together, the New Zealand Report recommended an amendment to s 4 of the Inland Revenue Department Act 1974 to the following effect:

(1) Every Minister and officer of any Department having responsibilities under this Act or any other Act in relation to the collection of taxes and other functions under

the Inland Revenue Acts will at all times use their best endeavours to protect the integrity of the tax system.

(2) Without limiting the meaning of "the integrity of the tax system" it reflects—
  (i) taxpayer perceptions of that integrity;
  (ii) the rights of taxpayers to have their liability determined fairly, impartially and according to law;
  (iii) the rights of taxpayers to have their individual affairs kept confidential and treated with no greater or lesser favour than the tax affairs of other taxpayers;
  (iv) the responsibilities of taxpayers to comply with the law;
  (v) the responsibilities of those administering the law to maintain the confidentiality of the affairs of taxpayers;
  (vi) the responsibilities of those administering the law to do so fairly, impartially and according to law.

(3) The Chief Executive of the Department appointed under the State Sector Act 1988 is designated the Commissioner of Inland Revenue.

(4) The Commissioner is charged with the care and management of the taxes covered by the Inland Revenue Acts and with such other functions as may be conferred on the Commissioner.

(5) In collecting the taxes committed to the Commissioner's charge and notwithstanding anything in the Inland Revenue Acts the Commissioner will collect over time the highest net revenue that is practicable within the law having regard to:
  (i) the resources available to the Commissioner;
  (ii) the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and
  (iii) the compliance costs incurred by taxpayers.

(6) The Governor-General may by Order in Council and with due regard to the provisions of this section and of the State Sector Act 1988 and the Public Finance Act 1989 issue directions to the Commissioner in relation to the administration of the Inland Revenue Acts.

(7) Every Order in Council made under subsection (6) will as soon as practicable after it is made:
  (i) be published in the *New Zealand Gazette;* and
  (ii) be laid before the House of Representatives together with any accompanying statement of reasons for the Order in Council and with the advice of the Commissioner in relation to the matter.

(8) An Order in Council made under subsection (6) will become binding on the Commissioner 7 days after it is made.

(9) For the purposes of this section "tax" includes any revenue or entitlements covered by the Inland Revenue Acts and "taxpayers" and "taxes" will be construed accordingly.

TAX POLICY DEVELOPMENT

Both reports examined the tax policy development process. In Australia there has been a long–standing separation of policy and procedural matters between the Treasury and

the ATO respectively. The Australian Report considered it incomprehensible that any policy advice to government would be provided without advice as to how the policy would be implemented. It recommended that a tax administration brief prepared by the ATO be submitted by the Treasury to Cabinet setting out the administration implications of each policy proposal involving amendment to any tax legislation. It went on to draw attention to compliance costs for taxpayers of policy initiatives and recommended that all future tax legislation be supported by a taxation impact statement detailing the impact on taxpayers of the legislation, including the total compliance cost and the extent to which the simplification objective has been achieved.

The New Zealand Review Committee was asked to report on tax policy development at an early stage of the review. The previous policy process had several problems. Inherent difficulties are the complexity of the subject matter and of the legislation. But the tax policy development process itself was not clear nor was the level of Ministerial and departmental (Treasury and IRD) accountability for each stage of the process. There was also insufficient external consultation and analysis of the impacts of policy changes. A generic tax policy process recommended by the Review Committee was approved by Cabinet and is being implemented. The process has five phases: strategic, tactical, operational, legislative, and implementation and review. It features external consultation and feedback and appropriate cost benefit impact analyses. Specific focus on policy is provided in the tax administration's organisation structure referred to below.

COMPLIANCE COSTS

Inevitably the costs of compliance are a major issue for taxpayers and tax administrations. High compliance costs can have serious effects on the economy when they influence decisions on employment and economic growth. They are also important because of their potentially detrimental effect on voluntary compliance. But while very important for those reasons, compliance costs are only one of three cost factors which have to be weighed. The other two are administration costs incurred by the tax administration and other indirect effects that influence the overall efficiency of the economy ("deadweight losses").

Examples of deadweight losses include: a business deciding not to employ any additional workers because taxes increase the cost of labour to the employer; disincentives to work harder; taxes encouraging people to move into the "black economy" or barter arrangements; tax-induced investment leading to sub-optimal investment patterns; and the amount of time spent searching for tax loopholes. In that way deadweight losses represent an opportunity cost of taxation. Estimates of deadweight losses vary dramatically, but for income taxes are typically in the range of 20 per cent to 50 per cent of the revenue collected.

Administration costs are by far the smallest of the three components of the economic costs (the Australian Report recommended that they be reduced to below one per cent but not at the expense of an increase in compliance costs). And compliance costs vary considerably according to tax type and the size and nature of the business or other income earning activity. The Australian Report concluded that compliance and

administration costs combined might well be between 10 per cent and 15 per cent of tax collected or between $7.5 billion and $11 billion.[4]

But the tax policy choice itself effectively determines the levels of theoretical revenue and deadweight losses and has a strong influence over the levels of compliance and administration costs. This makes it all the more important to address compliance costs, along with other costs, at every stage of the tax policy development process. The next place to tackle compliance costs is in the development of the operational policy and procedures of the tax administration which have an immediate and direct effect on costs to taxpayers.

LEGISLATIVE DRAFTING

Both reports criticised the present income tax legislation. They did so on two counts. The first is that the legislation needs radical updating. The second is that the current approach to drafting is unsatisfactory.

Initially income tax was a relatively minor tax contributing modest revenue to the Government. For many years, however, it has been a mass broad-based tax which has had, and continues to have, a significant impact on the functioning of the economy. The subject-matter itself is complex and in a modern economy the tax system has to be tailored to a great range of commercial circumstances, national and international. It is necessarily sophisticated in its reach and coverage.

All that accepted, from the perspective of good tax administration there are two major problems with the present income tax legislation. One is that in its design it does not meet modern requirements of tax collecting. It is deficient in two respects. The original administration base for the legislation dates back to 1936 (in Australia) and 1916 (in New Zealand). At that time the tax liabilities of the limited numbers of taxpayers were individually assessed. In the world of the 1990s the processing of the great bulk of taxpayers' returns and the receipt of tax payments are largely mechanical. At the same time sophisticated audit and enforcement programs have been developed.

The other design deficiency is that layers and layers of major changes and new regimes have been added over the years without any attempt until recently (in both New Zealand and Australia) to re-order and re-write the legislation in a coherent form.[5] Yet the legislation has grown in Australia from 126 pages in 1936 to over 5,000 in 1993. In New Zealand it has grown from 169 sections and 43 pages (for both land tax and income tax) in 1916 to 436 sections and 543 pages in 1976, with a dramatic surge to 833 sections and 2038 pages in 1993.

The second major problem with the present income tax legislation is the drafting approach itself. Certainty and precision are sought through the detailed expression of policies in the variety of complex circumstances in which they will operate. The result is that the intent is often blurred in a torrent of convoluted language.

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4 Ibid at para 5.63.

5 One of the recommendations of the Australian Report was to completely re-draft the income tax legisation. As a consequence, the Tax Law Improvement Project began its three year task of re-writing, re-numbering and re-ordering the legislation in July 1994. One of the fruits of the project has been the Tax Law Improvement (Substantiation) Bill 1994, a re-draft of the substantiation provisions. It was introduced into the House of Representatives on 8 December 1994.

Simplicity of expression is recognised as one of the criteria of a good tax system and sentence length is an indicator of readability and comprehensibility of the legislation. An empirical study of the readability of New Zealand tax laws was carried out by Tan and Tower.[6] The study focused on income tax and goods and services tax amendments which had been passed after the Waugh Committee[7] had strongly recommended that tax legislation be drafted in simple and clear language understandable to the ordinary taxpayer so that the intent of the legislation is clear. The study revealed that the average sentence length of the survey sample of income tax amendments post-Waugh was 135 words. After examining other indicators of readability, including word length (syllables) and the use of the passive voice and comparing the results with pre-Waugh legislation, the study concluded that no progress had been made in simplifying the tax law to make it more readable and understandable. In a 1994 study[8] by Tan and Tooley, 69 per cent of the tax practitioners surveyed considered tax legislation difficult to read. On the same theme the Australian Report concluded:

> As possibly the most important piece of economic legislation in Australia, the Committee found the Act was in desperate need of a comprehensive overhaul. Not only has the Act developed into a complex and incomprehensible mass of convoluted, legalistic and pedantic provisions but, most importantly, the uncertainty of its meaning acts as a positive detriment to the welfare of Australia.[9]

It is obvious that those comprehension problems must have a direct bearing on the difficulties, and so the cost, of administering the legislation and the difficulties, and so the cost, of complying with the legislation.

The experience of those who have to interpret and apply the legislation suggests that the only way to improve the position is to change the drafting approach to seek greater simplification and clearer expression of the intent of the legislation. The object should be to aid to the maximum the reader's understanding of the text. Two steps were recommended by the New Zealand Working Party on the Reorganisation of the Income Tax Act 1976:

(1) Adopting draft guidelines which prefer plain words, short sentences, short sections and the use of active voice and present tense. A striking example of what can be achieved is the Working Party's re-drafting of the core provisions of the Income Tax Act in 14 simply expressed sections and five pages of legislative text.

(2) A statement of the purpose and principles of the particular measure.[10]

The importance of a changed approach to legislative drafting was recognised in New Zealand by the Minister of Finance and the Minister of Revenue when receiving and tabling the Working Party report in the House. They said:

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6 L M Tan and G Tower, "The Readability of Tax Laws: An Empirical Study in New Zealand" (1992) 9 *Australian Tax Forum* 355.

7 Tax Simplification Consultative Committee, *Final Report* (1990).

8 L M Tan and S Tooley, *Tax Simplification in New Zealand: A Practitioner's Perspective* (Paper presented at the Sixth Annual Australasian Tax Teachers' Conference, Sydney, January 1994). An edited version of this paper has appeared, under the title "New Zealand Tax Simplification: Progress to Date" (1994) 48(5) *Bulletin for International Fiscal Documentation* 236.

9 Australian Report, above n 1 at xviii.

10 Working Party on the Reorganisation of the Income Tax Act 1976, *Second Report* (P P B31, September 1993) at ii.

> The Government is determined to achieve a better understood tax system. Its objective is more logical, coherent and understandable taxation legislation. The achievement of this objective will help reduce compliance costs. The re-organised legislation will itself significantly contribute to this aim. The structure of the legislation devised by the Working Party will mean that the policy intent of the legislation will be able to be more quickly understood. Perhaps more importantly, the restructured legislation will provide a sound and durable foundation for simplification as the legislation is reviewed and amended in the future. The Government strongly supports both these objectives.[11]

The standard judicial approach to the interpretation of legislation is to consider its purpose, scheme and language. Clear statements of the policy intent and underlying principles in setting the rules for determining tax liability would assist all users of the legislation. If that approach is taken there should be less justification for attempting to identify and provide in detail for every conceivable fact situation.

That was the message from the New Zealand Report. On the same theme the Australian Report identified complexity, uncertainty and the legislative style and manner of expression as major difficulties. The Australian Report recommended what it described as a priority simplification re-draft within two years and the full simplification of the Act within five years.[12]

ADJUDICATION OF TAX LIABILITY AND DISPUTE RESOLUTION

Both reports were concerned with the quality of decision-making following audit. Both emphasised the development of a "right first time" philosophy. Both recommended a separation of responsibilities between audit and adjudication with the investigator issuing a notice of proposed adjustment as a prelude to a final meeting or conference, but with the final adjudication and assessment being made by a different officer. However, the New Zealand Report also proposed other major changes to the dispute resolution process. The reasons for this are worth noting.

Various concerns were raised with the New Zealand Review Committee. On its assessment of those concerns it reached two central conclusions. The first was that the present dispute resolution process was deficient. The second was that the way tax disputes are resolved is critical to perceptions of fairness and has wider impacts for the tax administration. The concerns raised with the Review ranged across five broad areas:

(1) The dispute resolution process allows the IRD a number of opportunities to re-consider the correctness of an assessment. The ability to re-visit can lead to uncertainty in the mind of the taxpayer as to their final tax liability, delay the resolution of the dispute and reduce the incentive for the IRD to get the assessment right the first time. For example, according to a report prepared for the IRD, about 29 per cent of objections were allowed in full and 19 per cent in part, 10 per cent because the previous assessment was considered wrong and 30 per cent because new information had come to hand. Next, and following the disallowance of objections, about one third of requests for a case stated were conceded to some extent by the IRD and so cases were not filed for hearing — 14 per cent of those for cost benefit reasons.

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11 Ibid at iii.

12 Australian Report, above n 1 at para 5.38.

(2) A higher level of expertise is required earlier in the process. The concern was that appropriate expertise was not being applied within the IRD sufficiently early in the pre-assessment and dispute resolution processes.

(3) Resolving tax disputes can take an unacceptably long time. There are excessive delays at different stages of the process. For instance, in November 1993, almost 60 per cent of the cases before the High Court had been filed for more than 15 months. Eighty per cent of cases decided by the Court of Appeal in the last five years were more than 5 years old; 25 per cent were more than 10 years old. The average time from a taxpayer's request to file a case stated, to a decision by the IRD to not file, was 8.3 months. There is now a legislative requirement to file within six months.

(4) The IRD's role as "player" as well as "referee" is viewed as unfair. The current tax disputes process requires the taxpayer to raise an objection to their assessment with the IRD. Objections are usually considered by the same person who carried out the original audit, although any decision to disallow the objection is made by a superior officer.

(5) The costs of pursuing a tax dispute are too high. Taxpayers incur direct costs such as legal fees, as well as more indirect psychic and opportunity costs. The median amount of tax in dispute for a sample of cases over a six-month period in 1991 was just some $5,000 for objections, and $20,000 for cases filed. The Review Committee was told that many taxpayers, once aware of both the costs and the delays involved in pursuing objections aimed at recovering the disputed tax, decide to drop the dispute. The resulting perception is of paying too much tax by default. Disgruntled taxpayers undoubtedly tell other people and cannot be expected to be willing compliers in the future.

The design of a dispute resolution process requires consideration of the framework within which the process operates. That framework incorporates the objectives, sanctions and incentives involved. The tax administration's objective should be to prevent unnecessary disputes arising and to resolve those disputes that remain fairly, expeditiously and according to law. The process should encourage:

(1) the Commissioner to apply appropriate resources to getting the assessment right in the first place;

(2) the taxpayer to disclose all relevant information as early as possible in the assessment process; and

(3) both the taxpayer and Commissioner to avoid undue delay in resolving any disputes that do occur.

Appropriate sanctions on both Commissioner and taxpayer should give effect to these incentives. This requires an effective linkage between the operation of the disputes process and the incentives/penalties regime.

The success of a disputes resolution process can be measured by whether:

(1) it identifies disputes at the earliest possible stage and enables them to be dealt with on a timely basis;

(2) true independence is brought to bear in the evaluation of the points at issue by people with the appropriate skills, knowledge and authority;

(3) adequate legal analysis is applied to the points at issue to ensure that the law has been correctly interpreted; and

(4) communication between the Commissioner, and the taxpayer or their representatives, has been direct and open, with the purpose of ensuring that all relevant information has been obtained.

Another pre-assessment issue could be addressed under the binding rulings regime which exists in Australia and is currently being implemented in New Zealand. Applying public law and estoppel principles, the House of Lords has held in a series of cases in recent years that the United Kingdom tax administration may under certain conditions be barred from making assessments contravening understandings previously reached between the taxpayer and the tax administration.[13] There are no contemporary decisions of the High Court of Australia in point and there is a division of opinion in the latest decision of the New Zealand Court of Appeal.[14] The potential application of the English judicial approach in particular cases is productive of uncertainty, delay and cost for taxpayers and the tax administration. If it is open for a taxpayer to seek a binding ruling, there seems to be no reason of principle or policy why the taxpayer should not be required to follow that course if seeking to bind the Commissioner and no cause for concern if the binding rule regime excludes any other method of impugning a proposed assessment in that respect.

Pre-assessment, the New Zealand Report recommended:

(1) At the conclusion of an audit, and in cases where the IRD feels that more contact with the taxpayer will be required before an accurate assessment can be issued, a notice of proposed adjustment should be issued to the taxpayer, specifying a time limit within which the taxpayer is to respond.

(2) If the taxpayer does not accept the proposed adjustments, pre-assessment conferences may be held with the intention of identifying and resolving issues, particularly relating to issues of fact. These conferences may be formal or informal depending on the circumstances of each case.

(3) A "cards on the table" notice (supported by an evidence exclusion provision) may be given, at the discretion of the Commissioner, where a notice of proposed adjustment is issued. The underlying object is to provide an appropriate incentive for disclosure of the factual basis for the arguments of the taxpayer and the Commissioner.

(4) There should be provision for the taxpayer to waive the statutory time bar restrictions for a limited period while the conference process is being followed.[15]

Post-assessment, in the case of major disputes the New Zealand Report recommended:

(1) Retention of the requirement for the taxpayer to pay 50 per cent of the assessed liability. This is to maintain an incentive for the taxpayer to resolve the dispute as quickly as possible.

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13 See, for example, *Preston v Inland Revenue Commissioner* [1985] AC 835 and *Matrix Securities Ltd v Inland Revenue Commissioner* [1994] 1 All ER 769.

14 *Brierley Investments Ltd v Bouzaid* [1993] 3 NZLR 655.

15 New Zealand Report, above n 1 at 68 and 70-71.

(2) Facility for the taxpayer to seek resolution of a dispute by starting proceedings in the ordinary way. As with other commercial litigation, all aspects of the case including timing would be subject to judicial management. (The Review Committee considered there was no need for special procedures for tax disputes, and was of the view that because of the proposed "all cards on the table" pre-assessment approach, there would be only limited need for interlocutory procedures if the matter went to court.)

(3) The availability of alternative methods of resolving tax disputes. In particular, the taxpayer should have the option of review of the decision by the tax administration with the right to litigate the dispute without seeking review or if dissatisfied with the results of any review.[16]

The resolution of small disputes requires a different set of answers. The focus there is on the availability to taxpayers of processes for dealing with problems or grievances fairly, promptly and cheaply. Tax administrators have their own administration incentives to achieve that goal through internal management procedures such as a problem resolution service, through external monitoring of taxpayers' requests by Ombudsmen and through special small claims procedures.

As to small claims procedures, both the Australian Report and the New Zealand Report recommended the introduction of simpler fast-track procedures for small non-precedential claims (in Australia at the suggested level of $5,000) and with decisions of the tribunal (in Australia within the registry of the Administrative Appeals Tribunal; in New Zealand as a special responsibility of the Taxation Review Authority) being non-appealable.[17]

STRUCTURAL CHANGE

The New Zealand Report went further than the Australian Report in recommending major structural change. On its analysis of current issues and future needs of tax administrations it identified eight criteria as critical. The New Zealand tax administration should:

(1) concentrate on the core business of assessing and collecting tax revenue;

(2) take advantage of the level of automation already achieved and the common information data base;

(3) improve customer focus, particularly through vertical integration of design and delivery;

(4) impartially apply the law and protect the integrity of the tax system by separating the adjudicative function within the structure;

(5) improve the consistency and quality of technical activities by ensuring a sharper focus on that aspect of administration;

(6) structurally differentiate between the three strategic functions performed by IRD, namely policy, adjudication and operations;

(7) determine the optimal delivery mechanisms by an assessment of where the work needs to be done;

16 Ibid at 68-69 and 70-71.
17 Ibid at 68-69 and 71.

(8) ensure the recruitment, development and retention of quality people.[18]

The New Zealand Report recommended a division into three units reporting to the Chief Executive: Policy, Adjudication and Operations, each with specifically identified responsibilities.[19] The role of policy is to identify, develop and recommend tax policies. The role of adjudication is to provide a specific and strong focus on the correct and impartial application of tax law to the affairs of individuals at the final adjudicative stage and in producing taxpayer specific and general rulings. Although small units (less than 100 in each case) by comparison with Operations (over 5,500), the object of the separation is to provide appropriate independent and high level management focus, with the best application of expert resources, in order to raise the performance of the tax administration in those respects which are so crucial to modern tax collecting.

Tax operations require a different focus. They involve appropriate managerial and technical expertise in what is a major taxpayer-generated data-process operation supported and monitored by taxpayer assistance and enforcement programs. Those operations may be organised on a revenue type operational function or customer segmentation basis or, as is common in many tax administrations, a mixture of both. The difficulty with the revenue basis where there are several major streams as in New Zealand with income tax, goods and services tax and fringe benefit tax and so on, is that it requires multiple contacts with the tax administration for many taxpayers and involves duplication of activities by the revenue.

A functional structure facilitates concentration and specialisation of skills and tasks by type across customer groups. It recognises that many of the activities performed for different taxpayers are essentially the same, that these can be effectively streamlined and that different functional areas, such as audit, require specialised skills. A functional structure can, however, militate against the importance of defining key customer groups, establishing their particular needs and meeting them.

In recent years customer focus and the requirement to effectively identify the needs of, and manage relationships with, customers has emerged as *the* critical strategic issue facing organisations in the public and private sectors alike. It is generally accepted that this issue will determine whether or not an organisation is successful, however that success may be defined. Customer focus is going to be an important management issue for a tax administration. That is not for altruistic reasons, but because it will be critical to the administration's ability to achieve its fundamental objective of obtaining the highest net revenue over time that is practicable within the law.

The ATO is moving to increase its customer focus with the business line divisions being Income Tax General/Medium (incorporating International), Income Tax Small Business, Income Tax Individuals Non-Business, Withholding Taxes and the Child Support Agency. The New Zealand Report recommended that the Operation's Business Unit (the other two units being Policy and Adjudication) should be divided initially into three distinct groups: Corporates, Child Support, and Individual and Business. Further division of the large customer group of individual and business into small customer segments, such as small business, is expected to follow by the beginning of 1996. The objective is to ensure that by a clear organised focus on the business and income earning activities of particular groups of taxpayers and the development of

18 Ibid at 124-126.
19 Ibid at 113-116 and 124-125.

teamwork and other processes to support that focus, there will also be a substantial change over time in the culture of tax administration. Underpinning the recommendations is the belief that tax administration in the 1990s should be based on:

(1) "customer" services that focus on voluntary compliance in order to maximise revenue;

(2) technical and communication skills that provide the best advice on all tax matters; and

(3) efficient automated processes that handle the bulk of returns and information.

SUB-CONTRACTING OPTIONS FOR DELIVERY

To use the expression "contracting out" tends, at least in New Zealand, to generate more heat than light. It is often viewed as an ideological stance by economic neanderthals who want the market to rule our lives and — by dismantling the welfare state — erode if not destroy social values which have cemented society together in this part of the world over the last 50 years. The reality is quite different. No organisation, whether in the public sector or private sector, attempts to be totally self sufficient. Organisations decide what they can best do themselves and what goods and services they will obtain from others. These supplies of goods and services are provided by other people or companies through appropriate contracts. Tax administrations everywhere sub-contract some of their activities. About 14 per cent or $55m of the $395m output cost of IRD in 1992/93 was paid to third party suppliers of goods and services.

The key questions for any tax administration are: what functions could and should be targeted and what remain in-house; what steps should be taken to assess, implement and review any sub-contracting? Sub-contracting raises complex issues. While there are widely recognised good practices in sub-contracting, the special nature of tax collecting dictates some additional principles to protect the integrity of the tax system and to ensure appropriate accountability to Parliament. Tax functions involving significant independent judgment in assessing a taxpayer's liability should be undertaken in-house. Ultimate responsibility for tax administration must not be alienated from the State and so functions such as general management of tax administration, strategic planning, management of policy development, management of the information base and taxpayer audit should not be sub-contracted. Where those constraints do not apply, every function should be carried out in the most efficient and effective way, those decisions being based on appropriate analysis which takes into account all significant costs, benefits and risks. Applying recognised management techniques, programs can be developed to analyse the practical issues, test additional sub-contracting and review the results at regular intervals.

The management of risk is a major concern. Fiscal risks must always concern Governments dependent as they are on an assured flow of revenue. Functions should be sub-contracted only where and to the extent that there are overall advantages in doing so.

SOCIALLY ORIENTED FUNCTIONS

Tax administrations have a superior information base and an enforcement culture supported by statutory powers which facilitate collection. Not surprisingly, Governments have allocated the responsibility for delivering some social policy functions and some public debt collecting to the tax administration. Child support may be considered a case in point.

Delegation of delivery responsibilities to the tax administration can be detrimental to tax administration in at least three respects. First, there is a reduced focus on core tax administration activities where different skills and cultures have to be developed. For example, dealing with non-custodial parents in child support imposes different stresses on the tax administration. Second, the presence of socially oriented responsibilities may rule out or reduce the opportunities for improving the administration of core functions. For example, the requirements of socially oriented schemes may continue to require returns from taxpayers even though the tax administration might otherwise have been able to move to "no returns" for the great bulk of taxpayers for core tax purposes. Third, compulsory participation and additional compliance costs for employers and other withholders under social policy add-ons may adversely affect their willingness to comply in core tax matters.

Even so, Government may determine that this delivery function can best be located in the tax administration. The key is to recognise that the tax administration's core business is the assessment and collection of tax revenue; that the assumption of other responsibilities may adversely affect its performance of its core business; and that any non-core function that the tax administration is required to carry out as a result of its processes and expertise should be undertaken through a contract with the responsible agency.

CONCLUSIONS

Taxation is a classic illustration of the community's interest in the balanced use of its limited resources. It is the primary means by which we provide for the funding of Government. Tax administration policy requires making choices as to resource allocation. Like economics and like the legal system, tax administration is concerned with behaviour. By establishing a system providing incentives and sanctions for taxpayers and the tax administration it promotes the central strategy of voluntary compliance by taxpayers and the efficient and effective performance of the tax administration. Over the last 10 years massive changes have occurred in our societies — changes in institutions, changes in processes, changes in the nature of governmental involvement in the economy and changes in the machinery of government. Much of that change has been the product of attitudinal changes in our society. In turn, changes in structure and processes have facilitated changes in the culture of organisations. If tax administration is to meet the needs of the times, it must be in the forefront of the change process in all those respects.