

Regulatory Impact Statement

Transitional regulations during Inland Revenue's business transformation

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by Inland Revenue.

It provides an analysis of options to deal with the potential for delays to Inland Revenue's transformation process caused by the need for prompt regulatory change.

In developing options to deal with the issue, analysis was undertaken of previous transitional regulations, the Legislation Advisory Committee Guidelines, the Cabinet Manual and various reports of the Regulations Review Committee. None of the previous transitional regulations had considered the option of allowing delegated regulations to be made to remedy transitional issues.

Consultation was undertaken with the Legislation Design and Advisory Committee (LDAC), Crown Law, the Ministry of Justice and the Treasury. This consultation resulted in the clarification in the scope of the empowering provision under option 2 (the preferred option). No wider consultation was undertaken on the proposal because of time constraints. The time constraints resulted from the need to have the proposal enacted as soon as possible given the benefits of the transitional regulation-making provision and the timing of the transformation process. The lack of wider consultation raises a risk that potential problems with the proposals have not been fully identified. However, consultation during the select committee process will mitigate this risk to some extent.

Parliament delegating the power to the executive to make regulations that can override primary legislation (under options 2 and 3) risks the separation of powers and fundamental common law principles. However, the proposed safeguards will moderate those risks. Further, Inland Revenue considers that the risks from option 2 are less than the risks to the rule of law from the status quo. Making changes to the tax administration rules and processes by way of delegated regulations under option 3 could adversely impact taxpayers' perceptions of the integrity of the tax system (as opposed to making any changes by Orders in Council or legislative amendments).

None of the policy options would impair private property rights or restrict market competition.

The impact of any regulations made under the empowering provision would need to be considered at the time.

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EXECUTIVE SUMMARY

1. As part of Inland Revenue's business transformation, changes to legislation and administrative processes will be required in a range of areas, including supporting the upgrade to new technology. Some of these issues will require a prompt regulatory response to avoid the potential for delays to the transformation process.
2. Ideally any issues arising from the transformation would be remedied by an amending Act, given the constitutional importance of tax and the certainty that primary legislation gives to both taxpayers and Inland Revenue. In some cases this will be both necessary and achievable, as it is anticipated that tax bills will be introduced in each year during the transformation process. The problem is that the process leading up to when a bill can be introduced can be complex and time-consuming. This risks valuable taxpayer and Commissioner resources being tied up pursuing outcomes that are not consistent with the policy intent, when a remedy for the issue cannot be achieved quickly. The delays prior to enactment also risk causing uncertainty for taxpayers. There is also a risk that the process could create hurdles that may delay the business transformation process, impede the orderly transition from the old system (FIRST) to the new system (START) and increase the cost of the transformation.
3. In developing options to deal with the issue, analysis was undertaken of previous transitional regulations, the Legislation Advisory Committee Guidelines, the Cabinet Manual and various reports of the Regulations Review Committee. None of the previous transitional regulations had considered the option of allowing delegated regulations to be made to remedy transitional issues.
4. Consultation was undertaken with the Legislation Design and Advisory Committee (LDAC), Crown Law, the Ministry of Justice and Treasury. No wider consultation was undertaken on the proposal because of time constraints. The time constraints resulted from the need to have the proposal enacted as soon as possible given the benefits of the transitional regulation-making provision and the timing of the transformation process.
5. The preferred option is to enact an empowering provision to provide for transitional regulations and exemptions to be made by Order in Council during the business transformation process. Inland Revenue considers this would support an orderly transition from FIRST to START, and avoid delays and increased costs for the business transformation process, while minimising the administrative costs and compliance costs. Inland Revenue also considers that while there are some risks associated with using transitional regulations to remedy transitory issues, the use of regulations is a more sustainable option than the status quo.

STATUS QUO AND PROBLEM DEFINITION

Inland Revenue's transformation programme

6. The Government's objective for the revenue system is for it to be as fair and efficient as possible in raising the revenue required to meet the Government's needs. For taxpayers the tax system should be simple to comply with, making it easy to get right and difficult to get wrong. It should serve the needs of all New Zealanders, put customers at the centre and help them from the start, rather than when things go wrong.
7. The shift to digital and greater globalisation has reshaped how businesses and individuals interact and connect, and their expectations of government.
8. Businesses are increasingly using software packages to automate processes and reduce their compliance burden. Businesses have consistently ranked tax as their highest compliance priority, and it often contributes the most to their overall compliance burden. Compliance costs could be reduced by making better use of businesses' everyday processes and systems to meet tax obligations. Enabling businesses to spend less time on tax and more time on running their business will support Government's wider goals of building a more competitive economy and delivering better public services.
9. The ways in which individuals work has changed with different types of employment and working arrangements. The New Zealand workforce has become more casualised as permanent employment has become less common, and temporary, casual and contract work has become more prominent. Other trends include part-time and temporary workers increasingly holding multiple jobs, and more self-employment and small businesses. Many of the current tax policies and administrative processes were designed for an era when New Zealand's workforce was more strongly characterised by salary and wage earners in permanent full-time employment arrangements.
10. To protect the Government's ability to collect sufficient revenue to keep providing services, it is important that New Zealand's revenue system keeps pace with change and is as efficient as possible. The fiscal challenges associated with an ageing population and associated demand for high quality healthcare and other services will add impetus to the need for a highly efficient and responsive revenue system. To meet these challenges, Inland Revenue requires a fundamental shift in the way it thinks, designs, and operates.
11. The Government has agreed to change the revenue system through business process and technology change. A digitally-based revenue system, simplified policies, and better use of data and intelligence to better understand customers will simplify how services are delivered and change how customers interact with the revenue system.
12. Having a good overall revenue system means having both good policies and good administration. While the policy framework is fundamentally sound, there is an opportunity to review current policy and legislative settings as levers to help modernise the revenue system and ensure it is responsive to global changes.
13. There is no doubt that Inland Revenue's computer systems (known as FIRST) need replacement to improve resilience and agility. They have reached the end of their life and are not sustainable in the medium to long term. The FIRST systems are aging, extremely complex, very difficult and costly to maintain, and inflexible.

14. Since FIRST was implemented, a number of income-related social policies have been added to the platform. Implementing social policies within a platform designed for tax administration has added layers of complexity and risk to Inland Revenue's business processes and technology infrastructure. This in turn limits the department's ability to respond to government policy priorities.

15. However, business transformation is far more than just updating a computer system. It is a long-term programme to modernise New Zealand's revenue system, and will re-shape the way Inland Revenue works with customers, including improvements to policy and legislative settings and enabling more timely policy changes. A new operating model and new systems will be the catalysts for these changes.

Dealing with legislative issues during business transformation

16. As part of Inland Revenue's business transformation, changes to legislation and administrative processes will be required in a range of areas, including supporting the upgrade to new technology. Part of the transition will involve migrating information to the new processing system. The way this information is migrated between the old and new system will mitigate as much as possible the risk of transitional legislative issues occurring. However, it is likely that through the process of this large and complex change programme (including the migration process) issues may arise that require a prompt regulatory response.

17. The current issue relates to the administration of tax, rather than the substantive quantification of a taxpayer's tax liability. In other words, it relates to the processes and administration of the tax system under the Tax Administration Act 1994 and not the quantification of tax liabilities under the Income Tax Act 2007. The Tax Administration Act 1994 covers a wide range of tax administration processes and rules including:

- Rules relating to the role of the Commissioner, taxpayers and intermediaries;
- Processes around information collection, record-keeping and tax returns;
- Secrecy rules;
- Disputes procedures;
- Assessment processes and rules;
- The processes for binding rulings and determinations;
- The rules around the charging of interest and penalties;
- The process for challenging a tax assessment; and
- The rules for recovering and transferring tax.

18. The transformation is intended to affect a large proportion of the tax administration rules and processes, and it is impossible to anticipate where any issues might arise.

19. Legislation can be made either through the enactment of an Act (primary legislation), through an Order in Council (secondary legislation) or through a regulation made by an official or government agency (tertiary legislation or delegated regulations). Generally, changes to the Tax Administration Act 1994 are made by amendment Acts, but there are a limited number of regulations covering tax administration. The working party that recommended the enactment of the Tax Administration Act (separate from the Income Tax Act), also recommended that the Act should be rewritten with greater attention given to the use of regulations for tax administration.¹ The working party recommended that provisions that were of a mechanical or administrative nature should be contained in regulations.² The recommended rewrite has not been undertaken. However, the wider role of regulations in tax administration is being reviewed as part of the business transformation process.

20. Ideally any issues arising from the transformation would be remedied by an amending Act, given the constitutional importance of tax and the certainty that primary legislation gives to both taxpayers and Inland Revenue. In some cases this will be both necessary and achievable, as it is anticipated that tax bills will be introduced in each year during the transformation process.

21. The benefits of using the legislative process include:

- the issue would be subject to significant parliamentary scrutiny (including through the select committee process);
- the process would allow for public consultation; and
- any amendments would be formally published as part of the principal Act.

22. Legislative amendments offer a wide range of options, including amendments that have a fiscal impact, retrospective application, are unfavourable to taxpayers, and such amendments are not subject to any time limits. Legislative amendments also provide taxpayers with a high-level of certainty once they are enacted because they cannot generally be judicially reviewed and can only be amended through the legislative process.

23. The problem is that the process leading up to when a bill can be introduced can be complex and time-consuming. The process can be further complicated when it spans an election period. When a remedy for a transitional issue cannot be achieved quickly, valuable taxpayer and Commissioner resources can be tied up pursuing outcomes that are not consistent with the existing policy intent. The delays prior to enactment can cause uncertainty for taxpayers. The process can also create hurdles that may delay the business transformation process, impede the orderly transition from FIRST to START and increase the cost of the transformation.

24. It is envisaged there would be two main situations when a prompt regulatory response may be needed. The first situation is when a process aligned with the current computer system is examined and found to be inconsistent with the current law because of the limitations of the current system. A regulatory response would be needed to provide a bridge between the current process and the correct process in the new computer system. The second situation is when the new computer system offers a more efficient or different process to that currently legislated. A prompt regulatory response could reduce the delay in getting the law

¹ *Second Report of the Working Party on the Reorganisation of the Income Tax Act 1976* (September 1993) 35.

² *Second Report* (1993) 36.

to line up with the new process, so as to provide a smooth transition from the old law to the new law.³

OBJECTIVES

25. The **main objective** is to support an orderly transition from the old system (FIRST) to the new system (START), and avoid delays and increased costs for the business transformation process.

26. All options are assessed against the status quo in relation to the main objective and the following criteria:

- (a) **Compliance efficiency:** the compliance cost impacts on taxpayers should be minimised as far as possible;
- (b) **Administrative efficiency:** administrative costs to the Government should be minimised as far as possible;
- (c) **Sustainability:** the option should support the coherence and integrity of the tax system and the rule of law.

27. The criteria have equal weighting because they are considered to be equally important. There are trade-offs between the different criteria and the main objective. For example, option 3 meets the main objective and reduces both compliance and administrative costs, but in doing so undermines the rule of law and the integrity of the tax system.

28. The main objective could be seen to overlap with the criteria to some extent, in that any reduction in delays in the transformation process would generally have a consequent reduction in compliance costs for taxpayers and administrative costs for the Government. As a result, Inland Revenue has taken care to ensure that any benefits from a reduction in delays to the transformation process are not double-counted.

29. However, while there is a possible overlap, Inland Revenue considers that the main objective is distinct from the criteria. The main objective is to prevent delays to, and increased costs for, the transformation process. This objective is independent of whether this results in a minimisation of compliance costs for taxpayers or administrative costs for the Government.

REGULATORY IMPACT ANALYSIS

30. Officials have identified three options to address the problem:

- **Option 1 (the status quo):** The first option considered is retaining the status quo, so not enacting any transitional regulation empowering provision. This would mean no specific transitional regulations for Inland Revenue's business transformation process. Instead, any transitional issues would be remedied by an amending Act;

³ For a discussion of this problem see Regulation-making powers that authorise transitional regulations to override primary legislation (Report of the Regulations Review Committee, I.16J, July 2014).

- **Option 2 (Orders in Council and exemptions) (preferred approach):** The second option is to enact a regulation-making empowering provision to allow transitional regulations and exemptions to be made by Order in Council. This option would still allow issues to be dealt with by an amendment Act if it was deemed appropriate.
- **Option 3 (Hybrid approach):** The third option is to enact an empowering provision that allows regulations and exemptions to be made either by Order in Council or by the Commissioner under a delegated authority, depending on the nature of the transitional issue. This option would still allow issues to be dealt with by an amendment Act if it was deemed appropriate.

31. There are no social, environmental or cultural impacts associated with any of the identified options.

Option 1

32. The first option considered is retaining the status quo, so not enacting any transitional regulation-making empowering provision. This would mean no specific transitional regulations for Inland Revenue's business transformation process. Instead, any transitional issues would be remedied by an amending Act. An amending Act would be able to cover the entire scope of issues that might arise during the business transformation process.

Assessment against objective and criteria – option 1

Main objective

33. This option does not meet the main objective because the delays in the legislative process may hinder the orderly transition from the old system to the new system. Delays could be caused by the complex and time-consuming process leading up to when a bill can be introduced. This would delay or increase the cost of the transformation process.

34. It is noted that there are often several taxation Bills going through the House at any given time, so any remedial issues could be added to an existing Bill. This would arguably reduce any delays to the transformation process. However, rushing an amendment through an existing bill may raise issues about the sustainability of the option (which is discussed below).

Compliance efficiency

35. Inland Revenue considers that overall option 1 would result in uncertainty for taxpayers in the interim while an amendment is progressing through the legislative process, causing undesirably high compliance costs for taxpayers. The delays would hinder the ability for taxpayers to plan for the future and invest with confidence. Specifically, taxpayers would need to assume that any proposed retrospective amendments would be enacted as promised, and that any amendments made during the process would not materially affect them. Taxpayers may need to seek advice during the period of uncertainty, which would mean taxpayers would incur compliance costs.

36. Option 1 would also require taxpayers to commit resources to issues that are inconsistent with the policy intent, including in disputes with the Commissioner. The Commissioner is unable to ignore the law under her care and management powers, so she would need to apply the law as it currently stands.⁴ This may result in taxpayers having to commit resources to transitional issues.

37. In contrast, a benefit of option 1 would be all changes would be made by primary legislation so this would be easily accessible to the public. In this respect, option 1 would minimise taxpayers' compliance costs, because unlike the other options there would be no need to reconcile the various different pieces of legislation. Option 1 would also provide much more certainty for taxpayers than the other options because the remedies would not be subject to judicial review or disallowance. This certainty would mean there would be little risk to taxpayers of any plans being undermined in the future after the remedial legislation has been enacted. However, Inland Revenue considers the benefits would be minor compared to the compliance costs under option 1.

Administrative efficiency

38. Option 1 would have a significant detrimental administrative impact for Inland Revenue. The delays in remedying transitional issues during the transformation process would mean Inland Revenue would have to find work-arounds until an amendment is passed. Inland Revenue would need to commit resources to work with taxpayers during the period of uncertainty, including providing advice. When a remedy could not be achieved quickly, Commissioner resources could be tied up pursuing outcomes that were not consistent with the policy intent (including in disputes).

39. There would no Executive and parliamentary costs in the first instance because the status quo would not require any legislation to be passed initially. However, option 1 would incur ongoing Executive and parliamentary costs in passing the remedial legislation.

Sustainability

40. The first option would generally support the sustainability of the tax system but would raise rule of law issues.

41. Amending all legislative issues through amendments Acts would support the coherence of the tax system because it would generally allow time to consider the broader aspects of any remedies. In other words, adopting the full parliamentary process would generally allow the broader context and consequences of any proposed remedies to be scrutinised through the select committee process and broad public consultation (except when the legislation is passed under urgency or added to an existing Bill).

42. Option 1 would also generally support the integrity of the tax system as primary legislation would provide legal certainty for taxpayers. There would be no legal risks when the remedies are enacted by amendment Acts. Further, the integrity of the tax system would be supported by having all the remedies in the principal Act, because taxpayers would only need to refer to the Act to understand the law. This means there would be no need for them to weigh different types of legislation in interpreting the law.

⁴ IS 10/07: Care and management of the taxes covered by the Inland Revenue Acts – section 6A(2) and (3) of the Tax Administration Act 1994

43. However, there is a risk that the urgency of some issues may result in legislation being rushed through either under urgency or by adding it to a Bill already going through the House. Adopting such an approach is arguably inconsistent with best parliamentary practice, as it avoids the very parliamentary and public scrutiny that is intended by the process. This would undermine many of the benefits of this approach discussed above. In other words, in practice there is a risk that option 1 would undermine the sustainability of the tax system, because it would not have the expected checks or balances.

44. Bill Moore, Acting Chief Parliamentary Counsel, Parliamentary Counsel Office noted to the Regulations Review Committee that trying to remedy all transitional issues through legislative amendments during major computer changes may be showing less respect for the rule of law than using transitional regulations.⁵ The challenges to the rule of law can arise when it is stated that the transitional issues will be remedied by retrospective amendments enacted later. This means taxpayers have to apply the current law and run the risk the approach will be retrospectively undermined, or they have to ignore the current law and hope that the amendment is enacted as proposed.

Option 2

45. The second option is to enact a regulation-making empowering provision to allow transitional regulations and exemptions to be made by Order in Council.

46. As with other transitional regulation-making provisions, regulations and exemptions made under the provision could override primary legislation.⁶ Specifically, the exemption and regulation-making power would enable the delegated legislation to expressly or impliedly:

- Amend, suspend or override a provision in the Tax Administration Act 1994;
- Define or amend a term in the Tax Administration Act 1994; and
- Exempt a person from a provision of the Tax Administration Act 1994.

47. The scope of issues that could be remedied by transitional regulations under option 2 is limited to those:

- that are consistent with the current policy intent (see the safeguards below); and
- that are necessary or desirable for the orderly implementation of the business transformation.

48. This means that the regulation-making ability would not allow for any general policy-making ability. Any issues that represented a change in policy would need to be dealt with by an amendment Act. Further, it only allows issues that relate to the orderly transition to be remedied by regulations. This prevents the power being used to remedy general issues not related to the business transformation process.

⁵ Regulation-making powers that authorise transitional regulations to override primary legislation (Report of the Regulations Review Committee, I.16J, July 2014).

⁶ Regulation-making powers that authorise transitional regulations to override primary legislation (Report of the Regulations Review Committee, I.16J, July 2014).

49. Inland Revenue considered alternative constraints on the scope of the regulation-making power, such as:

- they could only be made in respect of certain specified rules or processes;
- they could only be made when they were taxpayer-favourable; or
- they could not be made when they were retrospective in application.

50. However, Inland Revenue considers that none of the alternative constraints are appropriate limits on the scope of the empowering provision. Inland Revenue considers it is not possible to limit the regulation-making power to specified rules or processes. As noted above, the transformation process is intended to affect a large proportion of the tax administration rules and processes, and it is impossible to anticipate where any issues might arise. As a result, Inland Revenue considers that it would not be possible to anticipate what processes or rules should be subject to the empowering provision. This is consistent with Professor John Burrows' testimony to the Regulations Review Committee's investigation into transitional regulations.⁷ Burrows noted that sometimes "it is just beyond the powers of human foresight to be able to work out exactly how it will work in the early stages."⁸ As a result, Inland Revenue considers it is not possible to set a bright-line for the rules and processes that could be covered by the empowering provision.

51. Inland Revenue considers that when a current process is determined to be inconsistent with the current law in a way that was favourable to taxpayers, then a prompt regulatory response would be needed to bring the process back into line with the current law. This could arguably be taxpayer unfavourable but consistent with the policy intent. As a result, Inland Revenue considers that whether an issue is taxpayer-friendly is not an appropriate constraint on the scope of the empowering provision. In addition, some issues may be discovered to be inconsistent with the law that require a prompt retrospective response to prevent compliance costs for taxpayers. As a result, Inland Revenue considers that retrospectivity is not an appropriate limit on the scope of the regulation-making power.

52. As a result, under option 2, issues that have a fiscal impact, retrospective application, or are unfavourable to taxpayers could be remedied either by an amendment Act or by Order in Council. It would be necessary to determine whether the proposal was consistent with the current policy intent to determine which legislative vehicle was appropriate.

53. Given the similar nature of the regulation-making power and the exemption-making power Inland Revenue considers that similar safeguards should apply. The safeguards, modelled on the Legislation Advisory Committee Guidelines (2014 edition) (LAC Guidelines), would be:

- **Exercise consistent with policy intent:** Any regulations or exemptions made would have to be consistent with the policy intent of the primary legislation, and would not allow for any general policy-making ability.

⁷ Regulation-making powers that authorise transitional regulations to override primary legislation (Report of the Regulations Review Committee, I.16J, July 2014).

⁸ Regulation-making powers that authorise transitional regulations to override primary legislation (Report of the Regulations Review Committee, I.16J, July 2014).

- **Parliamentary scrutiny:** The regulations and exemptions would be disallowable instruments, and so would be subject to disallowance under the Legislation Act 2012 by resolution of the House of Representatives.
- **Judicial review:** The courts would have a role in determining whether the delegated law-making power had been lawfully exercised. The High Court may declare that the subordinate legislation is invalid on a variety of grounds if it is outside the scope of the empowering provision.
- **Subject to time limits:** Any regulations or exemptions made under the power to address a transitional issue would expire after three years, consistent with the principles prescribed by the Regulations Review Committee. Further, it is proposed that the empowering provision would only apply for the duration of the business transformation process, and would expire at the end of Stage 4 in 2021. If the relevant issue was ongoing after the expiry date, it would need to be amended in the primary legislation. Such issues would be included in a taxation bill before the expiry date.
- **Necessity for consultation:** Before advising on any proposed regulations or exemptions, Inland Revenue would be required to undertake consultation. Depending on the issue, consultation could take a variety of forms, including broad public and private sector consultation or targeted consultation (if the particular issue had no visible impact on taxpayers). The empowering provision would require Inland Revenue to include the outcome of that consultation in the advice on the regulation or exemption.
- **Transparency:** Assisting taxpayers to meet their tax obligations is an important part of Inland Revenue's role in the tax system. Taxpayers must be informed if their rights and obligations are to be understood. A legislative instrument made under the proposed amendment would be required to be published in the legislative instrument (LI) series in accordance with the Legislation Act 2012.

Assessment against objective and criteria – option 2

Main objective

54. Option 2 would allow transitional regulations to be made by Order in Council which would support the orderly transition from the old system to the new system by avoiding delays (or increases in the cost of the process). This option would meet the main objective.

Compliance efficiency

55. Option 2 would significantly reduce taxpayers' compliance costs compared with the status quo, but there are some minor risks.

56. The speed by which regulations could be made would mean that taxpayers would not face the costs of the delays in resolving issues. It would provide qualified certainty for taxpayers within a short time. This would allow taxpayers to organise their affairs and to plan for the future without having long periods of uncertainty that could be caused by the parliamentary process. This would reduce the need for taxpayers to seek advice during the period of uncertainty. However, as the transitional regulations would expire after three years, the certainty would only be for a set period.

57. However, remedying the transitional issues by way of regulation would slightly increase the costs for taxpayers in having to refer to two different types of legislation, and determining how the two relate. This may cause some interpretive issues that may have a compliance cost for taxpayers.

58. Further, while taxpayers would have certainty in a short time for transitional issues, it would not be the same quality of certainty as under option 1. Unlike primary legislation, regulations are subject to disallowance by Parliament and judicial review. This means that there would be a small risk that taxpayers' expectations could be undermined. This risk would be reduced by undertaking consultation prior to the making of the regulations.

Administrative efficiency

59. Option 2 would significantly reduce administrative costs for the Government compared with the status quo. The reduced costs would come from the reduction in delays and in resources needed to be committed to the process for remedying the issues. The reduction in delays would mean that Inland Revenue could more quickly deal with issues which should reduce the resources needed to assist taxpayers during the periods of uncertainty.

60. It is also possible that process changes could be made to option 2 that would allow regulations to be made almost as quickly as under a delegated authority under option 3. For example, Inland Revenue could obtain Cabinet approval that transitional regulations by Order in Council could proceed directly to the Cabinet Legislation Committee with draft regulations. This would reduce the administrative costs for Inland Revenue further.

61. The intention would be to amend the primary legislation by an amendment Act for any issues that were ongoing. This would mean that for some transitional issues both the regulation-making process and the parliamentary process would need to be completed. This duplication of effort would give rise to some increased administrative costs.

62. Option 2 would incur Executive and parliamentary costs in enacting the empowering provision. However, option 2 would require less parliamentary resources on an ongoing basis because some issues would be able to be remedied by Order in Council. Executive resources would still be needed to deal with the Orders in Council.

Sustainability

63. Inland Revenue considers that while there were some risks associated with using transitional regulations to remedy transitory issues, the use of regulations would be a more sustainable option than the status quo.

64. Support for using transitional regulations to deal with issues during a major systems change comes from Professor John Burrows in testimony to the Regulations Review Committee's investigation into transitional regulations.⁹ Burrows noted:

⁹ Regulation-making powers that authorise transitional regulations to override primary legislation (Report of the Regulations Review Committee, I.16J, July 2014)

So what one is looking for is a smooth transition from the old law to the new. If things go wrong, if say an IT system is just not ready to cope with the new system for a while, what's one to do? One can just do nothing, and that means getting into a mess, or try to pass amending legislation, which will take a very long time, given Parliament's Order Paper— [an] amending Act is a very slow and cumbersome way of doing it. So there has to be some efficient way of ensuring that things can be dealt with fairly quickly, and it seems to me that a regulation-making power, provided it's properly constrained, is an acceptable way of doing that.

65. Mr Moore also voiced support for the use of transitional regulations to remedy issues in situations involving a significant change programme.¹⁰ Mr Moore suggested it was more consistent with the rule of law than relying on legislative amendments in the context of a significant change. Further, aligning the proposal with the LAC Guidelines supports the sustainability of the option. As a result, Inland Revenue considers the use of transitional regulations in the current context will generally support the sustainability of the tax system better than the status quo.

66. There are some risks under option 2. There is a risk that the incentive on the Government would be to use the regulation-making power when it would be more appropriate to remedy the issue by a legislative amendment. However, as noted above, the scope of the regulation-making power is limited, and is subject to disallowance and judicial review, so Inland Revenue considers the relevant risk is low.

67. Further, there could be a risk of some incoherence because the full parliamentary process may not be followed (at least initially). The possible incoherence could arise from a remedial regulation not undergoing the same level of scrutiny as a statutory amendment, and so there would be a risk it would lack the appreciation of the broader context. Taxpayers would need to interpret the primary legislation and any regulations, and there would be a risk the remedy would be unintentionally in conflict with the intent of another part or provision in the Act. Given that the regulations must be consistent with the existing policy intent, this would mean they were ultra vires. However, the regulation-making process does contain some level of scrutiny through the consultation and ministerial processes, so Inland Revenue considers the risk of incoherence to be low.

68. The regulation-making process does not provide the same level of certainty as the parliamentary process. Regulations are subject to parliamentary disallowance and judicial review. Further, the speed by which regulations are made means there is a risk of mistakes. This means there would be a risk to the integrity of the tax system if the remedy is overturned, and taxpayers' expectations are undermined. Taxpayers may question the integrity of the tax legislation if it could not be relied on. However, Inland Revenue considers this risk to be low because of the proposed safeguards.

69. While there would be an obligation to consult, the regulation-making process would not have the same level of public input as the full parliamentary process (which includes the select committee process). As a result, there would be a risk that taxpayers could perceive that the remedy was unfair or partial to a group of taxpayers. This could risk adversely impacting on taxpayers' perceptions of the integrity of the tax system. Inland Revenue considers this risk to be small.

¹⁰ Regulation-making powers that authorise transitional regulations to override primary legislation (Report of the Regulations Review Committee, I.16J, July 2014).

70. Orders in Council are regularly used to deal with transitional issues, and standard processes and safeguards could be put in place to mitigate many of the risks to the integrity of the tax system discussed above.¹¹

Option 3

71. The third option is to enact an empowering provision that allows regulations to be made either by Order in Council or by the Commissioner under a delegated authority, depending on the nature of the transitional issue.

72. A regulation could be made under delegated authority when the matter is of minor technical detail, with little impact on the rights of individuals. Delegated regulations could not be retrospective. When the matter is more than procedural, is clearly not taxpayer favourable, or has a fiscal impact, it would be made by Order in Council (as under option 2). The same requirements listed above under option 2 would apply to regulations made under option 3. As a result, regulations could be made by Order in Council when the matter was consistent with the current policy intent. Any issues that represented a change in policy would need to be dealt with by an amendment Act.

Assessment against objective and criteria – option 3

Main objective

73. Option 3 would allow transitional regulations to be made by Order in Council or by delegated authority which would support the orderly transition from the old system to the new system. It could prevent delays more effectively than either option 1 or 2. The speed that transitional issues would be able to be remedied would reduce the chances of hurdles arising that would delay the transformation process (or increase costs). This option would meet the main objective.

Compliance efficiency

74. Option 3 would significantly reduce taxpayers' compliance costs relative to the status quo but with significant risks.

75. The speed by which regulations could be made would mean that taxpayers would not face the costs of the delays in resolving issues. It would provide qualified certainty for taxpayers within a shorter time than either option 1 or 2. This would allow taxpayers to organise their affairs and to plan for the future with the shortest periods of uncertainty. This would reduce the need for taxpayers to seek advice during the period of uncertainty. However, as the transitional regulations would expire after three years, the certainty would only be for a set period.

¹¹ At least 30 transitional regulation-making provisions have been enacted in the last 10 years: see Regulation-making powers that authorise transitional regulations to override primary legislation (I.16J, July 2014). Some of situations have involved computer system changes like the student loan reform.

76. As noted above, it is also possible that process changes could be made to option 2 that would allow regulations to be made almost as quickly as under delegated authority. For example, Inland Revenue could obtain Cabinet approval that transitional regulations by Order in Council could proceed directly to the Cabinet Legislation Committee with draft regulations. This may mean there is little efficiency gained by delegating the authority to make regulations to the Commissioner, and may undermine any benefits under option 3 as compared to option 2.

77. However, remedying the transitional issues by way of Orders in Council or delegated regulations would increase the risk of taxpayers having to interpret the law by reference to three types of legislation, and determining how the three relate. This risks causing increased compliance cost for taxpayers.

78. Further, while taxpayers would have certainty in a short time for transitional issues, it would not be the same quality of certainty as under either option 1 or option 2. Both delegated regulations and Orders in Council are subject to disallowance by Parliament and judicial review. Delegated regulations would be likely to face greater scrutiny from Parliament. This means that there would be a reasonable risk that taxpayers' expectations would be undermined.

Administrative efficiency

79. Option 3 would significantly reduce administrative costs for the Government compared with the status quo. The reduced costs would come from the reduction in resources needed to be committed to the process for remedying the issues. This would be especially the case for minor issues when they are remedied by delegated regulations. The reduction in delays would mean that Inland Revenue could more quickly deal with issues which should reduce the resources needed to assist taxpayers during the periods of uncertainty.

80. The intention would be to amend the primary legislation via an amendment Act for any issues that are ongoing. This would mean that for some transitional issues both the regulation-making process and the parliamentary process would need to be completed. This duplication of effort would give rise to administrative costs for Inland Revenue.

81. Option 3 would incur Executive and parliamentary costs in enacting the empowering provision. However, option 3 would require less parliamentary resources on an ongoing basis because some issues would be able to be remedied by Order in Council or delegated regulations. Executive resources would still be needed to deal with the Orders in Council but this would be less than under option 2. Inland Revenue resources would be needed to deal with the making of any delegated regulations.

Sustainability

82. Inland Revenue considers the use of both Orders in Council and delegated regulations would reduce the sustainability of the tax system compared to the status quo.

83. Under option 3 the full parliamentary process may not be followed (at least initially). This means there would be a risk of some incoherence. This could arise from a remedial regulation not undergoing the same level of scrutiny as a statutory amendment, and so there is a risk it would lack the appreciation of the broader context. This would especially be the case for delegated regulations which would not undergo the same level of scrutiny as either Orders in Council or amendment Acts. Taxpayers would need to interpret the primary legislation, any Orders in Council and any delegated regulations, and there would be a reasonable risk the

remedy would be in conflict with the intent of some other provision in the Act. If the regulation was in conflict with the policy intent it would be ultra vires.

84. The regulation-making process would not provide the same level of certainty as the parliamentary process, as both Orders in Council and delegated regulations are subject to parliamentary disallowance and judicial review. Further, the speed by which regulations are made means there is an increased risk of mistakes. Owing to the reduced scrutiny for delegated regulations the risk would be increased compared to option 2. This means there would be a reasonable risk to the integrity of the tax system of the remedy being overturned, and taxpayers' expectations being undermined. Taxpayers may question the integrity of the tax legislation if it could not be relied on.

85. Using delegated regulations to deal with transitional issues is unprecedented and could risk undermining the integrity of the tax system. It could be considered to be inconsistent with fundamental constitutional principles to allow the Commissioner to override primary legislation with delegated regulations. Taxpayers may have concerns about whether the use of the approach is justified and may question why it is being used. This may risk creating negative taxpayer perceptions about the integrity of the remedies. It may also be seen as creating an undesirable precedent for future changes to the tax system.

86. There is a risk that the incentive on the Government and the Commissioner would be to use the regulation-making power when it would be more appropriate to remedy the issue by a legislative amendment. However, as noted above, the scope of the regulation-making power is limited, and is subject to disallowance and judicial review, so Inland Revenue considers the relevant risk is low.

87. Delegated regulations would not have the same level of public input as the full parliamentary process (which includes the select committee process) or the process for making Orders in Council. As a result, there would be a reasonable risk that taxpayers may perceive that the remedy is unfair or partial to a group of taxpayers. This would be especially a risk for delegated regulations. This could risk undermining taxpayers' perception of the integrity of the tax system.

CONSULTATION

88. Consultation has been undertaken with the Legislation Design and Advisory Committee, Crown Law, the Ministry of Justice and the Treasury. The consultation involved meeting with the relevant agencies and providing them with a draft of the Cabinet paper for comment.

89. The Legislation Design and Advisory Committee did not support option 3. It considered that option 3 had not been sufficiently justified, unnecessarily complicated taxpayer's ability to access the law and delegating such powers to an official was unprecedented. The Committee agreed with the proposal to remove the ability for the Commissioner to make delegated transitional legislation.

90. Crown Law did not provide any comments on the proposals. It noted that as the primary legislative provision and regulations had not yet been drafted they were not able to provide a more detailed view on any legal risk arising at this stage.

91. The Ministry of Justice was of the view that officials would need to ensure that the proposed empowering provision was sufficiently defined. It accepted that Inland Revenue did not wish to take an overly narrow approach, but noted equally it was important that the discretion was not unfettered. The Ministry stated it should be drafted in the “most limited terms possible” while accepting the broad scope of the transformation process. The Ministry would prefer to see more clarity in relation to the scope of the power and the constraints placed on it. Specifically, the Ministry commented that the term “tax administration” should be defined. In response to this comment, the initial scope of the proposal was further clarified to emphasise that it would only apply to the tax administration rules and processes under the Tax Administration Act 1994, and not the calculation of a taxpayer’s tax liability under the Income Tax Act 2007. Further, the initial scope was clarified to emphasise that any regulations made would have to be consistent with the existing policy intent (so it would not provide a general policy-making ability). The Ministry was pleased to see that the proposal included safeguards such as subjecting the regulations and exemptions to disallowance and judicial review, time limits and consultation.

92. No wider consultation was undertaken on the proposal because of time constraints. The time constraints resulted from the need to have the proposal enacted as soon as possible given the benefits of the transitional regulation-making provision and the timing phase of the second business transformation process. Any delay in enacting the empowering provision could delay the business transformation process (or increase the cost), create uncertainties for taxpayers, and risk taxpayers and Inland Revenue having to commit resources to dealing with issues that are inconsistent with the current policy intent. The lack of wider consultation raises a risk that potential problems with the proposals have not been fully identified. However, consultation during the select committee process will mitigate this risk to some extent.

CONCLUSIONS AND RECOMMENDATIONS

93. The table below summarises our analysis of the options. Within this table the following symbols are used:

- ✓✓ Significantly better than the status quo
- ✓ Better than the status quo
- × No better than the status quo
- ×× Worse than the status quo

Options	Analysis against the objective and criteria
Option 1: status quo	Does not meet the main objective
Option 2: Orders in Council and exemptions	<p>Meets the main objective</p> <p>Compliance efficiency: ✓✓</p> <p>Administrative efficiency: ✓✓</p> <p>Sustainability: ✓</p> <p>Overall comment: Meets the main objective and best meets the criteria</p>

Option 3: Hybrid approach	<p>Meets the main objective</p> <p>Compliance efficiency: ✓✓</p> <p>Administrative efficiency: ✓✓</p> <p>Sustainability: ××</p> <p>Overall comment: Meets the main objective but there are risks to the coherence and integrity of the tax system.</p>
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94. Inland Revenue prefers option 2 for the following reasons:

- It meets the main objective of supporting an orderly transition from the old system (FIRST) to the new system (START).
- It applies an approach that is recognised constitutionally as appropriate and it meets the requirements of the LAC Guidelines, as opposed to option 3.
- It minimises taxpayer compliance costs by reducing the period of uncertainty, while reducing the risk any remedy will be overturned (in comparison to option 3).
- It reduces administrative costs for Inland Revenue compared with the status quo.

IMPLEMENTATION

95. Legislative changes to the Tax Administration Act 1994 would be required to implement option 2. Specifically, an empowering provision would need to be enacted that included the criteria set out above.

96. The amendment could be included in a Supplementary Order Paper at the select committee stage of the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill. This would allow consultation on the proposal as part of the normal select committee process. The amendment would apply from the date of enactment. Explanation of the amendment and its effect could be contained in a *Tax Information Bulletin*, which would be released shortly after the bill received Royal assent.

97. No systems changes would be required to implement option 2. Inland Revenue would be responsible for preparing advice on any Orders in Council but it would be the Executive Council that would make the regulations after consideration by Cabinet. It would require the use of the Commissioner's resources to consider applications for transitional regulations or exemptions. The administrative costs for Inland Revenue, compliance costs for taxpayers and fiscal costs for the Crown would need to be considered for any proposed regulations.

MONITORING, EVALUATION AND REVIEW

98. Inland Revenue would monitor the effectiveness of the proposed changes in the first 12 months of operation. The monitoring would involve a review of any regulations made under the empowering provision within that period to see whether they were consistent with the intended policy.

99. In general, Inland Revenue monitoring, evaluation and review of new legislation takes place under the generic tax policy process (GTPP). The GTPP is a multi-stage policy process that has been used to design tax policy (and subsequently social policy administered by Inland Revenue) in New Zealand since 1995. The final step in the process is the implementation and review stage, which involves post-implementation review of legislation and the identification of remedial issues. Opportunities for external consultation are built into this stage. In practice, any changes identified as necessary following enactment would be added to the tax policy work programme, and proposals would go through the GTPP.

100. The Regulations Review Committee would have a role in monitoring and reviewing any regulations made. The committee examines all regulations, investigates complaints about regulations, and examines proposed regulation-making powers in bills for consistency with good legislative practice. The committee reports to the House and other committees on any issues it identifies. The House can “disallow” a regulation, meaning it no longer has force.