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# Industry Partnerships and Targeted Amnesties at Ingrained Evasion - A New Approach to an Old Tax Problem?

## **Abstract**

The New Zealand Government proposed in August 2004 a 'radically' new approach to address evasion in industries which is perceived to be ingrained, namely targeted amnesties. With a general election and other 'more pressing' issues, the proposal has not been significantly advanced. This paper provides further guidance for implementing a modified targeted amnesty concept, including a proposal from the author to consider incorporating targeted amnesties within the existing Industry Partnerships program that the IRD has been developing since late 2001. Although the Government's proposal addresses concerns with evasion that is ingrained in some industry groups it makes no direct links between the targeted amnesties proposal with the IRD's Industry Partnership program. Clearly, to raise expectations that amnesties would only be targeted to industry partners would run counter to one of the core concepts for tax administration in New Zealand – the protection of the integrity of the tax system including taxpayer perceptions of that integrity.

## **Keywords**

amnesties, tax evasion, New Zealand, tax

## **Cover Page Footnote**

I wish to thank officials from the Inland Revenue Department for providing valuable comments on an earlier draft of this paper and for an anonymous referee for their helpful suggestions to improve the paper; the opinions expressed in this paper and any errors are mine. An earlier version of this paper was presented at the 2006 Australian Tax Teachers Association Conference in Melbourne.

# INDUSTRY PARTNERSHIPS AND TARGETED AMNESTIES AT INGRAINED EVASION – A NEW APPROACH TO AN OLD TAX PROBLEM?

*Adrian Sawyer\**

The New Zealand Government proposed in August 2004 a ‘radically’ new approach to address evasion in industries which is perceived to be ingrained, namely targeted amnesties. With a general election and other ‘more pressing’ issues, the proposal has not been significantly advanced. This paper provides further guidance for implementing a modified targeted amnesty concept, including a proposal from the author to consider incorporating targeted amnesties within the existing Industry Partnerships program that the IRD has been developing since late 2001. Although the Government’s proposal addresses concerns with evasion that is ingrained in some industry groups it makes no direct links between the targeted amnesties proposal with the IRD’s Industry Partnership program. Clearly, to raise expectations that amnesties would only be targeted to industry partners would run counter to one of the core concepts for tax administration in New Zealand – the protection of the integrity of the tax system including taxpayer perceptions of that integrity.

## Introduction

While many may associate the word ‘amnesty’ with the idea of sanctuary or a pardon, the word derives from the Greek root for ‘amnesia’, meaning a forgetting or putting something into oblivion.<sup>1</sup> Thus one would infer from this that a tax amnesty would be the act of a revenue authority willing to forgive past actions and forget taxes owed, albeit within certain constraints. However, such a view would be naïve at best, with

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1 See *The Concise Oxford Dictionary* (1993).

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revenue authorities *possibly* being willing to forgive some back taxes and/or penalties, but never forget the taxpayers taking advantage of the amnesty!

The New Zealand Government has proposed a 'radically' new approach to address evasion in industries which is perceived to be ingrained, namely targeted or limited scope amnesties.<sup>2</sup> Tax evasion is an old problem, as old as taxation itself. Finding measures that are effective in reducing, and in some instances eliminating, evasion are elusive. New ideas to deal with this old problem nevertheless emerge from time to time.

A carefully guarded proposal was exposed for public scrutiny in mid August 2004,<sup>3</sup> with initial responses polarised around the perceived effectiveness and long term implications of amnesties in general. The populist response to the proposals was largely dismissive, but more carefully scrutinised and reasoned comment is generally supportive, at least as far as refinement of the policy and development of draft legislation is concerned. Submissions were called for on the policy proposal, with a majority in favour with advancing the proposal further, with some suggesting it be broadened to a full scale tax amnesty.

Sawyer<sup>4</sup> analyses the proposal and suggests some changes to the level of rebating (or forgiveness) that should apply to past years, along with expressing concern over the apparent lack of analysis of the tax amnesty literature.<sup>5</sup> This article does not set out to

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2 Much of this background information is drawn from: Sawyer, A, 'Targeting Amnesties at Ingrained Evasion – A New Zealand Initiative Warranting Wider Consideration?' (2005) 3 *Journal of the Australasian Tax Teachers Association* 84.

3 New Zealand Government, Options For Dealing With Industry-Wide Tax Evasion: a government discussion document (August 2004).

4 See Sawyer, above n 2, 23-6.

5 Ibid 26, Sawyer comments that it was only a surprise telephone call that confirmed the Inland Revenue Department (IRD) had reviewed the relevant tax compliance literature concerning tax amnesties prior to releasing the discussion document (although this is not evident from the discussion document). However, in the interests of making the discussion document readable to as wide an audience as possible, IRD tax policy officials determined that references to the literature would be omitted. Thus, if one accepts this statement at face value (there is no evidence to suggest otherwise) then the IRD was informed by the tax amnesty literature to some degree, the level of which is not able to be ascertained with certainty. Nevertheless, this 'admission' does not assure the reader of the discussion document that the proposal is research-informed unless the reader is also conversant with Sawyer's analysis; see Sawyer, above n 2. Furthermore, given the sensitive nature of tax amnesties, the IRD was not prepared to consult broadly outside of the Department

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revisit this analysis since there has been no publicly noticeable progress on the proposal, which is not unexpected given the September 2005 General Election, subsequent delay in forming a government, and the setting of new priorities (including a previously unannounced amnesty for student loan defaulters<sup>6</sup>).

This targeted tax amnesty proposal thrust New Zealand into the international spotlight, since New Zealand is not renowned as a country that favours amnesties as a tax compliance tool. This should not be come as a surprise since the prior research on tax amnesties is mixed, with extreme caution urged by researchers when governments frame the scope and application of the amnesty. Evidence also suggests that the post-amnesty environment must be such as not to adversely affect existing compliant taxpayers.<sup>7</sup>

The targeted tax amnesty proposal has the potential to encourage some of those that deliberately do not comply to 'come clean' with a degree of 'forgiveness', as well as encourage some that try to comply in most respects, but have not been fully compliant, to come forward.

An initiative of the Inland Revenue Department (IRD), along with the Australian Tax Office (ATO), is that of building Industry Partnerships.<sup>8</sup> The IRD recognises that

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(although I have been subsequently advised that the Department did consult with external parties prior to the release of the discussion document), since there was genuine concern that information could become public prior to the release of the discussion document.

6 Essentially, the proposal, contained in the Taxation (Annual Rates and Urgent Measures) Bill, provides that non-resident student loan borrowers who have overdue student loan assessments when the amnesty commences will be eligible for the write-off of penalties charged on those overdue assessments, if they meet the conditions provided. The amnesty starts on 1 April 2006 and finishes on 31 March 2007. It applies to both those non-resident borrowers who have advised the IRD of their departure and those who have failed to do so. Borrowers will be entitled to the benefit of the amnesty if they give an undertaking to the Commissioner of Inland Revenue (CIR) that they will fully comply with all of their obligations under the *Student Loan Scheme Act 1992* for a two-year period. Overdue assessments will be added back to the loan balance on the date they originally became due and be subject to interest from that date. Borrowers who give an undertaking to meet their obligations for a two-year period and fail to adhere to it may have a proportion of any assessments which have been added back to the loan balance and written-off penalties reinstated.

7 See Sawyer, above n 2, 3-15.

8 Information is available from the IRD's website; see, eg: <<http://www.ird.govt.nz/aboutir/media-centre/media-releases/2002/media-release-2002-05-20.html>>.

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facilitating such partnerships is an important way of removing barriers to voluntary compliance with tax laws. The more the IRD understands the needs of an industry the better it should be able to tailor its service to businesses. To this end, the IRD is taking a co-ordinated approach with a broad range of industry groups (particularly those with a significant level of cash transactions) and is actively seeking input from these groups through Industry Partnerships. The Industry Partnership is just one mechanism by which the IRD gathers 'intelligence' on taxpayers, with the targeted amnesty another mechanism yet to be tested.

Most business people, and taxpayers generally, willingly meet their obligations, and it is the IRD's intention to continue to enhance its systems to make it easier for them to do so. This includes tailoring a full range of responses including help, support and education, in addition to carrying out appropriate compliance activity, which may involve the IRD removing barriers to voluntary compliance. The responses also involve the IRD seeking to do all it can to assist those who try to comply but who do not always succeed, which is an integral part of the Compliance Model.<sup>9</sup> The IRD recognises that there is also a need to deal firmly with those who deliberately decide not to comply with the law and who therefore evade their responsibilities to society. In the IRD's view, the community would expect the IRD to do this.

This article proposes an innovative approach for increasing levels of tax compliance in New Zealand, namely that of combining the proposed targeted tax amnesty program with the Industry Partnership scheme. As I will discuss later, there are significant constitutional and administrative law issues that require investigation, should these two initiatives be combined in some manner, along with careful consideration of the influence this may have on compliance behaviour. My proposal is not entirely an original idea, since targeted tax amnesties at industries with high levels of evasion has been recommended previously in Australia by the Cash Economy Task Force.<sup>10</sup> Nevertheless, combining targeted tax amnesties with the Industry Partnership scheme is a new idea which I cautiously suggest later in this article to be worth pursuing.

Future developments arising as a result the initial proposal, and the possible role of using Industry Partnerships, have the potential to shape international approaches to tax amnesties. However, this should not be taken to suggest that Industry Partnerships should be treated as a necessary precondition for industry targeted

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9 For a brief discussion of the Compliance Model, see  
<<http://www.ato.gov.au/print.asp?doc=/content/5704.htm>>.

10 Cash Economy Task Force (CETF), *Improving Tax Compliance in the Cash Economy: Report to the Commissioner of Taxation* (1998).

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amnesties. Any future developments would need to be carefully managed in view of the importance of protecting the integrity of the tax system. Clearly there should never be any expectation that an industry that has a partnership with the IRD would be targeted with an amnesty offer. Discussion of such potential developments is beyond the scope of this paper but may be relevant to the future debate over targeted tax amnesties should draft legislation emerge. In this context, with Australia also facing ingrained evasion in certain industries, for which the Australian Tax Office (ATO) is charged with the task of redressing, this New Zealand proposal may potentially be a useful weapon for improving tax compliance on both sides of the Tasman.

The remainder of this article is organised as follows. Section 2 provides a brief review of the tax amnesty literature and a summary of the proposed targeted tax amnesties drawing from the earlier work by Sawyer,<sup>11</sup> along with a review of the earlier work by the Cash Economy Task Force recommending the use of targeted tax amnesties. Section 3 provides an analysis of the Industry Partnership concept, initially reviewing the concept as it emerged in Australia (a forerunner to the New Zealand initiative), followed by a review of the New Zealand scheme. This discussion is set in the context of the Compliance Model that is used by both the ATO and IRD. The current position of Industry Partnerships in New Zealand is critically reviewed, including the successes of the scheme as touted by the IRD in its Annual Reports and media statements (such as through reduced levels of debt and outstanding returns, along with successful prosecutions for evasion), but also the failure to 'grow' the scheme to include more industries within the Industry Partnership scheme. Implementation considerations are discussed in section 4, including estimating the tax gap, dealing with non-Industry Partnership members, and how the scope of the Industry Partnerships scheme may be extended beyond the current level of coverage. Section 5 offers concluding comments, including consideration of the risks of combining the Industry Partnership scheme with the targeted amnesties proposal, and sets out areas for future research, including analysis of the final legislation (should it emerge) and the outcome of any implemented targeted amnesties.

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11 Sawyer A, 'Targeting Amnesties at Ingrained Evasion – A New Zealand Initiative Warranting Wider Consideration?' (2005) 3 *Journal of the Australasian Tax Teachers Association* 84.

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### Targeted Tax Amnesties – a summary so far

The August 2004 discussion document<sup>12</sup> proposes that limited scope amnesties would be offered to operators in some industries in which tax evasion presents a particular set of problems that could be unnecessarily costly for the tax administration to tackle using traditional tax education and audit systems. The proposal was to ‘test the waters’ through opening up the proposal to submissions, and as a result of deliberations, determine if draft legislation should be prepared in order to provide legal support to the proposal. Essentially these limited amnesties would:

be a one-off opportunity for people in a targeted industry to come forward and disclose their past evasion;

allow the IRD to offer amnesties to some industries or other groups, at its discretion (but subject to a series of safeguards);

offer an attractive advantage for evaders to disclose undeclared income under the terms of an amnesty by limiting the number of years for which income would have to be disclosed; and

be backed up by intensive audit activity focused on those who, within the industry in question, do not come forward under an amnesty offer.

A request was made by Sawyer<sup>13</sup> under the *Official Information Act 1992* for a copy of the submissions made on the proposal. A total of 14 submissions were made, including that of ICA and Business NZ. Analysis revealed that five (36%) were strongly or mildly in support of the proposals, four (29%) offered weak support or other ideas that could be developed, and two (14%) expressed no view on the proposals (that is, they were largely irrelevant). In terms of the contribution made by the content of the submissions, seven (50%) provided useful ideas and analysis, four (29%) some ideas, with three (21%) were not at all relevant to the target amnesty proposal.

The large submissions commented on issues of structural problems within the New Zealand tax system and the penalties regime, and tended to prefer the offering of a general amnesty over the targeted amnesty proposal. With specific relevance to the proposal itself, issues of the boundaries, incentives to come forward, managing changes and safeguards were raised as potential concerns. Most submissions, from an academic analysis, were devoid of reasoning that was informed from the content of

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12 New Zealand Government, *Options For Dealing With Industry-Wide Tax Evasion: a government discussion document* (August 2004).

13 See Sawyer, n 11, 110.



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the tax amnesty literature and associated research, and offered comments that were largely anecdotal. Sawyer observes that it will be interesting to see what the Government makes of the submissions when it publicly announces whether the proposal will proceed to the next stage.<sup>14</sup>

It is important, before going any further, to review what we know about tax amnesties from the relevant tax compliance literature. Sawyer<sup>15</sup> provides an extensive summary of the tax compliance literature internationally (predominantly sourced from the United States as well as the limited but yet important contribution from Australia and New Zealand. It is not proposed to repeat that discussion here, but several key findings from the tax amnesty literature are worth restating. The main benefits and costs of a tax amnesty can be summarised as follows. The benefits of amnesties include:<sup>16</sup>

- generating an immediate increase in tax revenues;
- reducing administrative costs;
- improving post-amnesty voluntary compliance through better record-keeping and monitoring of individuals who were previously non-filers or did not declare all of their income; and
- improving post-amnesty voluntary compliance if the amnesty is part of a larger effort directed at reforming the tax system, such as through improved enforcement efforts, reasonable and equitable civil and criminal penalties, and more extensive and improved taxpayer services and education.

The costs of amnesties include:<sup>17</sup>

- Producing small and overstated amnesty revenues (in relation to revenues arising from normal audit activities); and
- Reducing post-amnesty voluntary compliance from:
  - previously honest individuals who view the amnesty as unfair,
  - individuals who are now less motivated by guilt to pay their taxes,
  - individuals who are now aware of the presence of non-compliance,
  - individuals who now realise that the government is unable to enforce the tax laws, and

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14 See Sawyer, above n 11, 110.

15 See Sawyer, above n 11, 85-94.

16 This discussion is based on a paper by J Alm, 'Tax Policy Analysis: The Introduction of a Russian Tax Amnesty' (Working Paper No 98/6, International Studies Program, Georgia State University, 1998) 4.

17 See Alm, *ibid* 4.

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- individuals who anticipate that another amnesty may be given in the future.

An excellent overview of tax amnesties conducted internationally was undertaken by Hasseldine in the mid 1990s.<sup>18</sup> Hasseldine provides a summary of the advantages and disadvantages of tax amnesties, reviews prior research on tax amnesties, including empirical research, followed by an analysis of the success or otherwise of various US state<sup>19</sup> and national tax amnesties in other countries.<sup>20</sup> It is clear from the review that amnesties tend to cover a particular tax type or types, rather than be limited to specific industries. Furthermore, Hasseldine's review of tax amnesties offers a template for issues to be resolved prior to conducting an amnesty. Specifically this summary provides an excellent template for the process of contemplating the possibility of an amnesty, its design and subsequent implementation (should an amnesty be considered necessary and advantageous to improving compliance), and the process of evaluation after the amnesty is complete. Hasseldine's decision parameters are reproduced in Table 1:<sup>21</sup>

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18 DJ Hasseldine, 'Tax Amnesties: An International Review' (1998) 52(7) *Bulletin for International Fiscal Documentation* 303-10.

19 For an early study of various US state amnesties, see VL Fisher, 'Recent Innovations in State Tax Compliance Programs' (1985) 38 *National Tax Journal* 365-371, and SE Crane and F Nourzad, 'Tax Rates and Tax Evasion: Evidence from the California Amnesty Data' (1990) 43 *National Tax Journal* 189-199. For a comment from a United States' State Commissioner of Revenue, see IA Jackson, 'Amnesty and Creative Tax Administration' (1986) 39 *National Tax Journal* 317-323. An interesting analysis of the influence of a change in governor and an amnesty is considered by EA Posner, 'Law and Social Norms: The Case of Tax Compliance' (2000) 86 *Virginia Tax Review* 1781-1819, 1808-10.

20 There has not been any US Federal tax amnesty, although commentators have considered the merits of such; see for example, LP Martinez, 'Federal tax amnesty: Crime and Punishment Revisited' (1991) 10 *Virginia Tax Review* 535-585; and GP Moran, 'Tax Amnesty: An Old Debate as Viewed from Current Public Choices' (1992) 1 *Florida Tax Review* 307-331.

21 See Hasseldine, above n 18, 308-9.

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**Table 1: Amnesty decision parameters for tax agencies – based on Hasseldine (1998)**

<b>A</b>	<b>Prior to the decision to offer a tax amnesty</b>
1	Assess level of voluntary compliance.
2	Assess taxpayer attitudes to paying taxes and to tax amnesties.
3	Assess severity of current penalty provisions. Is any strengthening required? What is the current policy on voluntary disclosure? How well known is this policy? Is any change desirable?
4	Assess adequacy of audit coverage. Do citizens perceive that they could be caught (and punished) for evading tax? Can greater funding be allocated to enforcement activities?
5	Examine the results of previous tax amnesties, in particular those conducted in similar jurisdictions
6	Assess the amount of revenue expected under a tax amnesty
7	Is legislative authorisation necessary for an amnesty to take place?
8	Is there a better alternative to a tax amnesty to encourage compliance, for example, the non-filer programme of the US?
<b>B</b>	<b>The design and administration of a tax amnesty</b>
1	Is there a better alternative to a tax amnesty to encourage compliance, for example, the non-filer programme of the US? Taxes. What (or offences) are to be included?
2	Who will the amnesty apply to? Most likely, non-filers can participate, but what about known delinquents? Are there any other eligibility issues needing consideration?
3	Over what time period will the amnesty run? Will any extension be required?
4	Which officers will be responsible for staffing the amnesty?
5	What sort of media campaign will be run to encourage amnesty participation? Should assurances be given that this is a 'once-only' amnesty?
6	Other operation aspects of the amnesty – eg form design, toll-free numbers, liaison with tax practitioners, will instalment arrangements be permitted, etc?
<b>C</b>	<b>After a tax amnesty has finished</b>
1	Compute gross and net amnesty revenue.
2	Construct a database of amnesty participants. Examine the characteristics of amnesty participants and isolate common trends and features. Use this information in future enforcement activities.
3	Assess level of voluntary compliance and taxpayer sentiment.
4	Make appropriate media releases.

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Sawyer notes that there has been almost a dearth of studies on amnesties conducted in Australasia, which largely reflects the minimal usage of tax amnesties in Australia and New Zealand.<sup>22</sup> The only major study is the review by Hasseldine<sup>23</sup> in 1989 of both the Australian and New Zealand general tax amnesties conducted in 1988. Hasseldine, in his conclusion,<sup>24</sup> observes that many taxpayers may still be ignorant of their reporting requirements and need further help (notwithstanding the amnesty), and furthermore, some taxpayers may need to receive additional audit attention or be encouraged via some other method to comply – the amnesty is not a stand-alone method to remedy non-compliance.

Since Sawyer,<sup>25</sup> an important contribution to the amnesty literature was made by Torgler and Schaltegger.<sup>26</sup> The authors observe that although many tax amnesties have been conducted all around the world, evidence on their long-term effects is largely lacking. Torgler and Schaltegger analyse the impact of voter participation on tax amnesties using experiments. They conclude there is strong evidence that individuals are more compliant when they have the opportunity to vote coupled with communication among group members prior to the vote. However, discussion before voting is an essential feature to increase group cooperation: it enhances the moral costs of free-riding and thus increases the social norm of compliance, generating higher tax compliance. They also find that amnesties tend to increase tax compliance, but they find, contrary to prior research, that an amnesty with an increase in the post-amnesty enforcement parameters does not outperform an amnesty without changes in the enforcement factors. Their results also indicate that a second amnesty does not improve tax compliance. Furthermore, amnesty expectations reduce the positive effects of an amnesty, and when the government does not keep its promise, tax compliance decreases. If a government has the intention to increase the long-term effects of a tax amnesty,<sup>27</sup> its commitment should be reliable, and only one amnesty should be conducted.

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22 Sawyer, A, 'Targeting Amnesties at Ingrained Evasion – A New Zealand Initiative Warranting Wider Consideration?' (2005) 3 *Journal of the Australasian Tax Teachers Association* 84, 94.

23 See Hasseldine, above n 18.

24 See Hasseldine, above n 18, 522.

25 See Sawyer, above n 22.

26 Torgler B and Schaltegger CA, 'Tax Amnesties and Political Participation' (2005) 33(3) *Public Finance Review* 403, 426-7. See also the authors' other recent study: Torgler B and Schaltegger CA, 'Tax Amnesties in Switzerland and Around the World' (2005) 38 *Tax Notes International* 1193.

27 Arguably this is a core aspect of the Government's targeted amnesty proposal.

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At the time of writing,<sup>28</sup> no further progress has been made, publicly at least, than was commented on by Sawyer.<sup>29</sup> The intervention of a 2005 General Election campaign, a period of hiatus until a new coalition government was formed,<sup>30</sup> and a new legislative program was announced (including dealing with 57 reinstated bills and a new tax bill!), leaves little time to advance this proposal. Indeed, the new Taxation (Annual Rates and Urgent Measures) Bill includes a new student loan penalty amnesty, which is anticipated to be the focus of IRD attention for the immediate future, along with the ongoing rewrite of the Income Tax Act 2004.

The concept of a targeted tax amnesty, including amnesties directed at particular industries, is not entirely new. For example, a type of targeted amnesty (although not at particular industries) occurred in Ireland, where the Waiver of Certain Tax, with the Interest and Penalties Act 1993 introduced two separate and distinct amnesties. The 'incentive amnesty' applied to individuals only and covered liabilities for income tax, surtax, capital gains tax, income levy, health contributions and employment and training levy for periods prior to 5 April 1991. The amnesty allowed an individual to settle outstanding liabilities for the taxes by paying 15% of the untaxed income or gains not later than 14 January 1994. Returns were not required in respect of years prior to 5 April 1991, but this was conditional on making a correct return for 1992/93. Once these two requirements were met, the individual's liability to 5 April 1991 was regarded as discharged in full.<sup>31</sup>

In the context of industries, evidence from Australia, dating back to 1998 from the Cash Economy Task Force (CETF),<sup>32</sup> supports the notion of targeted tax amnesties. In particular, the CETF observes that tax amnesties seek to obtain improved compliance outcomes, generally in return for indemnity from prosecution or whole or partial

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28 This was completed in mid-March 2006 and hence does not include any developments after that time.

29 Sawyer A, 'Targeting Amnesties at Ingrained Evasion – A New Zealand Initiative Warranting Wider Consideration?' (2005) 3 *Journal of the Australasian Tax Teachers Association* 84.

30 For further discussion on the process of forming the new Government, see Sawyer A, 'Political Parties Negotiate Tax Policy Initiatives' (2005) 40 *Tax Notes International* 424. For further discussion on the election outcome and ensuing political tax environment, see Sawyer A and Tan LM, 'Editorial' (2005) 11(4) *New Zealand Journal of Taxation Law and Policy* 389.

31 For a discussion, see PFK, Tax Amnesties Work in Ireland, PFK newsletter (Autumn 2004).

32 Cash Economy Task Force (CETF), Improving Tax Compliance in the Cash Economy: Report to the Commissioner of Taxation (1998) 41-43. It should not come as a complete surprise that the Chair was David Butler, the current IRD Commissioner!

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remission of monetary penalties that would otherwise apply. Tax amnesties are usually instituted to seek improved outcomes in terms of:<sup>33</sup>

- taxpayer registration;
- lodgement of tax documents (eg income tax returns);
- reporting of correct information in tax documents (eg unreported income, over-claimed expenses); or
- payment of outstanding taxes.

The CETF notes that the tax compliance literature indicates that an amnesty must offer incentives, and that these incentives should contain both reward and consequence components for taking up the amnesty offer, and consequences for not taking up the offer. This reward component is generally a reduction or elimination of penalties that would normally apply to non compliant behaviour. The consequence component is generally a credible threat that, after the amnesty, noncompliant behaviour will be detected and dealt with severely.<sup>34</sup>

The CETF could not identify any direct evidence about the impact of a tax amnesty on the cash economy, although there is evidence that amnesties can play a significant positive role in improving compliance given the right conditions. It is suggested that an amnesty targeted at the cash economy could cover:<sup>35</sup>

- unreported cash receipts;
- false records;
- failure to lodge returns;
- outstanding tax payments; and
- compliance with Sales Tax, PAYE, PPS and RPS obligations.<sup>36</sup>

The CETF also observes that experience suggests that including social security, studies assistance and perhaps other government programs in a wider-than-tax business amnesty could provide significant benefits to business, the government and ultimately the community. Thus, argues the CETF, it seems desirable to include social security at least in an amnesty for the cash economy.<sup>37</sup>

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33 See CETF, above n 32, 41.

34 See CETF, above n 32, 42.

35 Ibid.

36 In New Zealand this would be GST, PAYE, and certain withholding payment taxes. There is no equivalent to the Reportable Payments System in New Zealand.

37 See CETF, n 32, 42.

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Taking advantage of the amnesty would not prevent a business from being subsequently audited; that is a tax amnesty is about forgiveness, not forgetting! In fact, the CETF recognises that it is important to ensure that a proportion of businesses using an amnesty are subjected to subsequent scrutiny to ensure that the amnesty is not used to deflect revenue authority attention away from serious non-compliance. It would be expected that businesses using an amnesty would make the most of the opportunity to 'come clean', and subsequent scrutiny should find no significant non-compliance.<sup>38</sup>

The success of an amnesty is in part dependent on the revenue authority's ability to detect and follow up those taxpayers who do not participate in the amnesty. Therefore, prior to the amnesty the revenue authority should conduct extensive research and benchmarking, and should also encourage community tip-offs (or anonymous information) in order to enhance follow-up effectiveness.<sup>39</sup>

In the light of the above discussion the CETF supports the use of targeted amnesties to address non compliance in the cash economy provided the ATO (or IRD in the case of New Zealand) can mount effective communication and enforcement activities. The CETF also considers that industry and community groups should be encouraged to develop their own solutions to the problems created by the cash economy that affect them, with the ATO providing important support to help such initiatives succeed.<sup>40</sup>

Specifically, the CETF considers that:<sup>41</sup>

- the most appropriate approach for the ATO would be to offer amnesties on an industry basis where that industry has been the subject of a comprehensive risk assessment;
- there should be a specific limited time frame imposed;
- up-front activity be conducted to identify the problem and demonstrate the ATO's intention to follow-up;
- to be effective the amnesty would need to be across the whole of government; and
- it is imperative that the amnesty is supported by an effective communication strategy.

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38 See CETF, n 32, 42-3.

39 See CETF, n 32, 43.

40 See CETF, n 32, 43.

41 See CETF, n 32, 43 (my emphasis).

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The emerging recommendation is that targeted amnesties be considered as part of an integrated approach to improving compliance in the cash economy. This, I would argue, could involve targeted amnesties at particular organisation's industries within an Industry Partnership in New Zealand.

As far as I am aware, the CETF's proposed targeted amnesties have not been conducted, or if they have, implementation was in a clandestine manner on a small scale with no comment from the targeted industries. Such inaction, however, should not imply the concept is not worth developing in New Zealand.

Following this summary of the tax amnesty literature, the current situation regarding the New Zealand Government's proposal for targeted tax amnesties (and the earlier recommendation by the CETF for targeted tax amnesties in Australia), I now turn to exploring the development of the Industry Partnership schemes in Australia and New Zealand (set in the context of the Compliance Model).

### Industry Partnerships

#### Australian Industry Partnerships and the Compliance Model

Industry partnerships commenced in the mid 1990s in Australia. Within an industry partnership and its associated industry organisations, the aims of the ATO are to:<sup>42</sup>

- identify ways to minimise the costs of complying with tax obligations;
- advise of emerging issues that may be relevant or significant to the industry;
- develop better strategies to address compliance risks in the industry;
- better understand and meet the communication needs of the industry; and,
- seek feedback on its service delivery and performance.

The ATO also seeks to develop a charter with each industry that becomes part of an industry partnership. A wide variety of industries are part of the industry partnership scheme in Australia.<sup>43</sup> Meetings between the ATO and industry representatives are

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42 See ATO, *Tax Office Primary Production Industry Partnership - General Information* (October 2003), available at:

<<http://www.ato.gov.au/businesses/content.asp?doc=/Content/18139.htm>>.

43 Industry partnerships exist between the ATO and the following industries: Charities and Non-profit; Conservation; Education; Food; General Insurance; Government (state, federal and local); Health; Motor Vehicles & Luxury Car Tax; Mining and Energy; Property & Construction; Retirement Villages; Primary Producers; Taxis; Tourism;



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also designed to be a sharing of intelligence between the ATO and industry representatives.<sup>44</sup>

Many of the industry partnerships in the last five or so years have been utilised to ensure a particular industry is prepared for GST and tax reform measures (such as A New Tax System – ANTS, as well as Australian Business Number (ABN), Pay as You Go (PAYG) and Business Activity Statements (BASs); to assist industry associations to identify issues from an industry perspective; to work with industry bodies to resolve these issues; to use industry associations to deliver products to meet identified needs; and to establish a successful partnership with the ATO's intention to assist a greater number of businesses in a focussed and coordinated way.<sup>45</sup>

The ATO recognised that it could not address the problems presented by the cash economy on its own. Rather, it saw building community partnerships as critical to achieving greater ATO presence in the community. The industry partnerships have proved helpful in implementing tax reform, although the Australian National Audit Office (ANAO) reports that external representatives to these partnerships have advised of a reduction in the effectiveness of these partnerships following conclusion of the major implementation phase of tax reform.<sup>46</sup> The ANAO concludes that ATO industry partnerships can be a valuable resource in dealing with the cash economy, especially when all parties can see a benefit from such a relationship. If managed well, partnerships can bring about sound results such as during the implementation of the new tax system. Importantly, the ANAO concludes that '... it is important that all parties to the partnership benefit from the relationship and that the ATO continues to use the opportunity for effective two-way communication and cooperation.'<sup>47</sup>

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Telecommunication; Transport (with sub groups Shipping and Road Transport); Financial Suppliers; Gambling; Media; Pharmaceutical's; Tax professionals; Sport and Entertainment; see Australian National Audit Office (ANAO), Performance Audit ATO Progress in Addressing the Cash Economy Australian Taxation Office The Auditor-General Audit Report No 35, 2001–02 (11 March 2002) 27.

44 Details of meeting minutes and issues registers are maintained and available on the ATO's website.

45 See, generally, information on industry partnerships on the ATO's website: <http://www.ato.gov.au>.

46 See ANAO, n 43, 6.

47 See ANAO, n 43, 28.

## INDUSTRY PARTNERSHIPS AND TARGETED TAX AMNESTIES

A key aspect of the success of the industry partnership has been the relationship of this approach to the ATO's Compliance Model.<sup>48</sup> The Compliance Model advocates for a hierarchical approach to the administration of the taxation system, requiring a flexible regulatory regime with a wide range of enforcement options which can be applied on an escalating basis of severity.

The main principles underlying the Compliance Model are:<sup>49</sup>

- understanding taxpayer behaviour;
- building community partnerships;
- increasing flexibility in ATO operations to encourage and support compliance; and
- more and escalating regulatory options to enforce compliance.

The ATO sees implementation of the Compliance Model as a means to enable it to develop more targeted compliance improvement strategies which address particular industry issues and practices but not unnecessarily increase compliance costs for the general community. This implies that regulation should be responsive to different industry structures and conduct, as illustrated in Figure 1.<sup>50</sup>

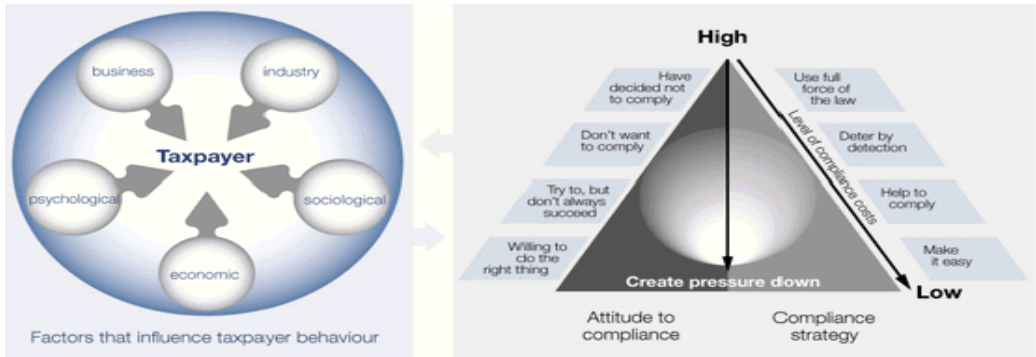
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48 For a brief discussion of the Compliance Model, see the ATO's website: <http://www.ato.gov.au/print.asp?doc=/content/5704.htm>. For more recent academic analysis, see Hobson K, 'Championing the Compliance Model: From common sense to common action?' in Braithwaite V (ed), *Taxing Democracy: Understanding Tax Avoidance and Tax Evasion* (2003).

49 See ATO, above n 48.

50 The original version of the Compliance Model appeared in CETF, *Improving Tax Compliance in the Cash Economy: Report to the Commissioner of Taxation* (1998), summary. The latest version appears in ATO, *Update: Compliance Program 2005-06* (13 October 2005), available at: [http://www.ato.gov.au/content/downloads/ARL\\_61826\\_N7769-08-2005.pdf](http://www.ato.gov.au/content/downloads/ARL_61826_N7769-08-2005.pdf).

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Figure 1: Integrating the Compliance Model into ATO Activities<sup>51</sup>

### Industry Partnerships: New Zealand Industry Partnerships

Industry Partnerships commenced in late 2001 in New Zealand as a long-term initiative to improve compliance in small and medium sized businesses, albeit a concept emanating from Australia.<sup>52</sup> Specifically the Industry Partnership initiative has developed from the IRD's strategic direction and business plan, *The Way Forward*,<sup>53</sup> and follows the principles of its Compliance Model.<sup>54</sup> In one respect, the Industry Partnership turns the theory of the Compliance Model into practice (reality). Industry Partnerships come within the responsibility of the Deputy Commissioner, Service Delivery. The professional and trade associations within these Industry Partnerships are providing assistance to their members to enable them to meet their tax obligations which is seen as part of running a successful business. The associations also see benefits in their members having a better understanding of their tax obligations and being able to access the resources and services available to help them meet these, including the expertise of using a tax agent.<sup>55</sup> The IRD is seeking to learn about their specific issues and address them with improved information, processes, services or legislation/regulation. The IRD also seeks to develop a profile of each

51 See ATO, above n 48.

52 The similarity in approach should not come as a surprise given that the current IRD Commissioner was formerly a Deputy Commissioner in the ATO.

53 IRD, *Inland Revenue Business Plan - The Way Forward - 2001 Onwards* (2001).

54 IRD, *Agents Answers Issue 38* (October 2002). The IRD also utilises the Compliance Model originally developed by the Centre for Tax System Integrity at the Australian National University in conjunction with the ATO.

55 IRD, *Agents Answers Issue 39* (November 2002).

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industry in terms of its overall levels of, and attitudes to, compliance. In particular, the IRD states:<sup>56</sup>

We are working with our industry partners to make it as easy as possible for people in these industries to comply with their tax obligations by removing barriers, providing information and tailoring assistance programmes to suit their specific needs. We want to give members every opportunity to comply with their tax obligations. For those who have fallen behind, for example with outstanding returns and debt, we want to help them get up-to-date. ...

We will be encouraging industry members to make voluntary disclosures to get themselves back on track, taking advantage of the reduced shortfall penalties associated with making a voluntary disclosure. To date there are 14 Industry Partnerships in operation,<sup>57</sup> although this term may be better expressed along the lines

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<sup>56</sup> See IRD, n 55.

<sup>57</sup> There are 14 identified sectors that the IRD has a relationship with (termed an Industry Partnership). These are set out along with the member organisations: (1) Automotive repair and services, Motor Trade Association (Inc) NZ, Vehicle Service Federation, New Zealand Brake and Clutch Specialists Association, New Zealand Engine Reconditioners Association; (2) Bricklaying services, NZ Master Masonry Trades Federation Inc; (3) Carpentry services, Certified Builders' Association of New Zealand Inc, Registered Master Builders Federation; (4) Electrical services, Electrical Contractors' Association of New Zealand, New Zealand Electrical Institute Inc; (5) Entrepreneurial services, Home Business New Zealand Limited, Grey Skills; (6) Gardening and landscaping services, New Zealand Arboricultural Association, Landscape Industries' Association of New Zealand Inc, Mr Green, Jim's Group; (7) Hairdressing and beauty salons, New Zealand Association of Hairdressers Inc, The Association of Beauty Therapists of New Zealand Inc; (8) Long-distance bus transport, Bus & Coach Association New Zealand Inc, Tourism Industry Association New Zealand; (9) Painting and decorating services, Master Painters' New Zealand Association Inc; (10) Plastering and ceiling services, Interior Systems Association of New Zealand Inc; (11) Plumbing services, Master Plumbers, Gasfitters, and Drainlayers of New Zealand Inc; (12) Services to agriculture, New Zealand Fruitgrowers Federation, New Zealand Winegrowers, Rural and Associated Contractors' Federation of New Zealand Inc, Kiwifruit Contracting Association, Marlborough Vineyard Contractors Association, Marlborough Winegrowers' Association; (13) Smash repairing, Collision Repair Association; (14) Taxi and other road transport, New Zealand Taxi Federation.

The IRD's 2005 Annual Report refers to 19 industry partnerships; see Inland Revenue, Annual Report (2005) 31. However, this Annual Report contains an error. I have been advised by the IRD that this occurred due to a simple miscalculation by the Annual Report's author when tabulating the number of relationships from a table that categorised them by type not by sector (or Industry Partnership). This resulted in the incorrect number of 19 being ascribed to sectors the IRD works with, as opposed to the total number of

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that the IRD has currently formed a number of relationships in 14 sectors. For internal purposes, the Industry Partnership initiative has created a nomenclature to categorise the different types of relationships formed.

For example, a relationship formed with an association that represents businesses from one of the 14 Australian New Zealand Standard Industry Classifications (ANZSICs) the IRD works with is termed an 'Industry Partnership' relationship. In contrast, a relationship formed with a group that assists the IRD to connect to its desired audience when there is no other available or direct linkage is termed an 'alliance'.<sup>58</sup>

The IRD, like the ATO, intends to remove barriers to voluntary compliance and to assist those who try to comply but who do not always succeed, which is in accordance with the Compliance Model. Industry Partnerships have an important education element as well as a means to encourage compliance. The IRD clearly states that it must deal firmly yet professionally with those who deliberately decide not to comply with the law and therefore evade their responsibilities to society.

The information provided by the industries assists the IRD to better understand that particular industry to ensure the department can target its assistance, education and enforcement. Anonymous information will continue to be used to identify those taxpayers opting out of the system. Audits may be conducted following examination of industry and IRD information.<sup>59</sup> The intention is to not only streamline tax processes, but also to increase levels of education and assistance which should lead to higher levels of voluntary compliance. Like the Australian model, Industry Partnerships assist the IRD to develop and implement an enforcement model that addresses high risk cash economy activities.

Specifically from a business perspective, the IRD acknowledges that businesses need to be assured that they are not being habitually undercut by competitors who offer cheaper, 'cash' prices for work. When the IRD finds a business that is deliberately underpaying its tax (for example, by doing under-the-table jobs), it will carry out an audit and, if necessary, prosecute. This approach is premised on the basis of fairness to the majority of businesses that are 'doing the right thing'. The industries the IRD

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relationships the IRD had at that time in the 14 sectors – the latter being the correct position.

58 For example, the relationship with the Fruitgrowers Federation (although made up of producers) assist the IRD to work closely with the agricultural contracting sector.

59 IRD, *Industry Partnerships Media Release* (May 2002).

## INDUSTRY PARTNERSHIPS AND TARGETED TAX AMNESTIES

works with conduct much of their business in cash, so there are significant opportunities available to some operators to do under-the-table jobs.<sup>60</sup>

The IRD announced in 2002 that it would be surveying members of the industries with which we have formed a partnership to gather information about their industries and the tax issues they face.<sup>61</sup> The IRD provided me with the results of the only two surveys conducted to date. The questionnaires were designed for each industry with input from the industry associations. The questionnaires are not about members' individual affairs, but about the issues members encounter in managing their tax and suggestions they have for improvements to the IRD's services.

In 2003, the Department stated that for the painters and decorators, and electrical industries, outstanding returns and the number of debt cases have been reduced, there has been an overall reduction in outstanding debt and the percentage of total debt under arrangement has more than doubled. This followed a survey of these industries to determine the needs of their members, and proactively contacting electrical contractors and painters to promote the Industry Partnership and use of the IRD's free advisory services.<sup>62</sup> The Master Painters Survey,<sup>63</sup> encouraged painters to review the way they account for GST in response to a specific need. Approximately 80% of the respondents viewed not paying tax on cash jobs as unacceptable. The demographics of 'cash operators', according to the survey respondents, were unemployed or retired people, full time wage earners making extra cash or non-association members. Advertising, more IRD audit presence and stiffer penalties were major suggestions for dealing with this problem. The survey of members of the Electrical Contractors Association of NZ,<sup>64</sup> like the Master Painters Survey, found that approximately 80% of respondents viewed not paying tax on cash jobs as unacceptable, with the demographics of 'cash operators' being similar, namely beneficiaries, small operators ('one man bands'), employees of electricians making extra cash at weekends or non-association members.

A brief survey of the websites for many of the associations forming part of an Industry Partnership revealed direct reference to a code of conduct for members, including the

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60 See IRD, above n 59.

61 IRD, *Partnerships to enhance tax administration services and improve compliance Enterprises Newsletter* (September 2002), a copy of which is available at:  
<<http://www.enterprisens.org.nz/publications/2002/sept02/page03.pdf>>.

62 IRD, *Agents Answers Issue 51* (November 2003).

63 Based on a response rate of 195 of a total 588 members nationwide (33%).

64 Based on a response rate of 409 of a total 1391 members nationwide (29%).

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requirement to act ethically. A number also made specific reference to the need to maintain records and proper books of accounts, both are critical to meeting reporting obligations including that for tax purposes. The most extensive website with respect to taxation is that maintained by Home Business New Zealand, with links to numerous IRD news items, tax developments and useful information.<sup>65</sup>

The IRD has promoted the Industry Partnership concept beyond New Zealand. In an address to an international tax conference, Commissioner David Butler stated:<sup>66</sup>

Since 2001, Inland Revenue NZ has worked in partnership with industry groups to combat the cash economy. Our approach targets small to medium size businesses. ...

This partnership approach has been welcomed by all (15) of the industry groups to date; an example of this support shown by one industry group (ECANZ) in a regular industry newsletter where they described people willing to operate outside the tax laws as 'cash cowboys' who pose a risk to the reputation of their industry from a safety and quality perspective. Industry groups also recognise the competitive benefits of a 'level playing field' where the burden of taxation is evenly spread. A joint survey between Inland Revenue and two industry groups found that 63% in one industry and 76% in the other industry feel it is unacceptable for people to do cash jobs and not pay tax on them.

Promotion of the Industry Partnership schemes also appears in recent IRD annual reports. In the 2004 Annual Report, the IRD states:<sup>67</sup>

In all, ten industries have been covered, with most of the cases completed being in the agricultural contracting, hairdressing, collision repair and painting and decorating industries. The total value of discrepancies identified was \$5.5 million. The most common discrepancies arose from:

- purporting to charge GST,
- understating or overstating sales to evade GST payments,
- not declaring income,
- failing to account for PAYE.

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65 See <http://www.homebizbuzz.co.nz/section.php3?CategoryID=1>.

66 Butler D, 'Challenges of Globalising Tax Systems - New Zealand's Journey' Address to the 2004 ATAX International Conference on Tax Administration (Sydney, 2004).

67 IRD, *Annual Report* (2004), 45.

## INDUSTRY PARTNERSHIPS AND TARGETED TAX AMNESTIES

Prosecutions have been taken when appropriate. ...

In 2004-5 we will set up Industry Partnership assurance teams that focus specifically on issues arising from deliberate non-compliance. The teams will undertake investigations and address the return and debt issues associated with Industry Partnership industries, as well as gathering further community intelligence.

Earlier in the 2004 Annual Report, the IRD comments that:<sup>68</sup>

Industry Partnership continues to trial new approaches, such as a tactical campaign conducted with fruit pickers and contractors in the Hawke's Bay region, using media coverage of prosecutions as a starting point. An Industry Partnership team mailed orchardists in the area, and then visited more than 115 orchards, providing information and advice on filing returns and paying taxes. This was supported by posters and leaflets, a 0800 number and classified advertising.

We have received positive feedback from the industries involved, for example Don Fraser, Chief Executive of the New Zealand Master Painters Association said 'At our conference ... several happy situations were recounted where people had problems and had rung the Industry Partnership and had them solved very quickly and amicably ... All the feedback we've had has been positive ... there was some apprehension of course when we decided we were going to have an industry partnership with Inland Revenue, but that was dispelled very early on by people visiting the various associations, and once you get a few good experiences coming out, good news travels quite fast.

Considering the targeted tax amnesty proposal, the General Manager of the Electrical Contractors Association of New Zealand (ECANZ was one of the Industry Partnership organisations surveyed), Ray Barbara, also backs the amnesty despite some reports which said his organisation did not believe it would work. Barbara is reported as stating:<sup>69</sup>

We think they've got a big job ahead but we will be pleased to see them start it. ... If an amnesty forms part of the logic to get people to comply with the rules, we don't have a problem with that. It's no different to the gun laws - you want people to license

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68 See IRD, above n 67, 36.

69 Revington M, 'Cashed Up' (2005) *Unlimited Magazine* (March 1) available at: <http://www.sharechat.co.nz/features/unlimited/article.php/a6a29dba>.



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their guns, [so] you say 'bring them in and we won't nail you'. It's just another tool you can use to get people to comply.

However, the Executive Director of the Master Painters Association (another Industry Partnership organisation surveyed), Don Fraser, is doubtful that an amnesty would work, 'but you can't rubbish the initiative'.<sup>70</sup>

Industry groups like ECANZ and the Master Painters Association, which have been working with the IRD to target tax evasion within their industries, argue that cash operators drag standards down and are a 'blight' on the industry as a whole because they are less accountable and undercut reputable members. Fraser comments that the most noticeable change since the Master Painters Association began working with the IRD in 2002-3 has been the members' attitudes towards the IRD and the IRD's attitude towards the Association's members. The members' view of the IRD, in Fraser's view, was of an organisation notoriously difficult to deal with, but one that has become more friendly and helpful. When Fraser first told his members that the IRD wanted to work with the Master Painters Association, they were suspicious, but the IRD set up a 0800 number and provided a contact group for his members to consult if they had any tax problems. Fraser comments:<sup>71</sup>

The department tells us it reduced the outstanding tax by a significant amount and our members felt markedly better that they were able to solve their problems in an amicable way.

The IRD naturally is reporting its 'success stories'; whether other Industry Partnerships will be as successful remains to be seen. According to Commissioner David Butler, IRD staff in Christchurch found that many taxi drivers just had poor record-keeping skills so the IRD developed a cash book for their use. Commissioner Butler comments:<sup>72</sup>

We offered to put that in place nationally and we've now seen a doubling in the registration of GST for taxi drivers and owners across the nation over the past two years. ...

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70 See Revington, *ibid.*

71 *Ibid.*

72 *Ibid.*

## INDUSTRY PARTNERSHIPS AND TARGETED TAX AMNESTIES

The ones who don't disclose any income and don't file, they're the ones we would target straight away. Those who are running a business, keeping good records, and are part of an industry group, we are quite happy to work with them to get it right.

Most recently, in the IRD's 2005 Annual Report, it states that in 2004–5 IRD auditors found a total of \$14.7 million in discrepancies in the industries covered by an Industry Partnership.<sup>73</sup> Furthermore, it claims to have improved compliance, with fewer debt cases and outstanding returns in the first eight industries covered by the partnership arrangements. Progress has been made in the debt recovery and overdue return areas. Between May 2002 and June 2005 the value of outstanding tax debt decreased by 5%, the number of debt cases decreased by 24%, and the number of outstanding returns decreased by 19%. These results are impressive. The results for the year ended 30 June 2005 for 7 of the Industry Partnerships appears in Table 2. The level of compliance success with the Plumbers, Automotive Repairs and Taxi Industry Partnerships is particularly noteworthy.

Table 2 Improvements to Compliance: 1 July 2003 to 30 June 2004<sup>74</sup>

Industry	Debt Reduction	Decrease in average age of debt case %	Decrease in outstanding returns %
Painters	8	10	11
Electricians	0.0	5	12
Hair & Beauty	0.4	13	12
Smash Repairs	(0.1)	14	4
Plumbers	20	13	29
Automotive Repairs	28	15	34
Taxi	17	11	21
National Comparison	10 increase	3	2

<sup>73</sup> IRD, *Annual Report* (2005) 31.

<sup>74</sup> Data is taken from Ferguson N and Papageorgiou S, 'Tax Administration' (2005) Paper presented at the ICANZ 2004 National Tax Conference (16-17 October) 9-10.

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In the 2005 Annual Report, the IRD indicates that it is developing its understanding of the broader impact of the Industry Partnership approach on overall compliance. For example, based on the first full year of the initiative (2002–3), when there were relatively few industries involved and relationships were being formed throughout the year, the IRD estimates are that additional taxable income of over \$5 million was declared, compared with nearly \$15 million in 2004–5.<sup>75</sup>

Currently there are Industry Partnership relationships with organisations in 14 industries. As noted earlier, many industry associations have now published articles on how to sort out tax affairs and obtain tax advice. In 2004–5 the IRD also established five new Industry Partnership ‘assurance teams’ to work with the five new Industry Partnerships.<sup>76</sup>

During 2004–5, the IRD gave high priority to tax evasion, particularly as a follow-up to Industry Partnership initiatives to educate and promote compliance among willing taxpayers. Examples of tax evasion include keeping cash transactions out of recording systems (working in the ‘cash economy’), understating income, or not deducting or accounting for PAYE. Fraud cases could involve claiming false GST credits, or, for very small number of tax agents, misappropriation of funds belonging to clients. Accompanying the targeting of audit work, the wide media attention given to prosecutions for evasion has added to the community’s understanding of the IRD’s approach.<sup>77</sup>

Specifically, in 2004–5, the IRD states that:<sup>78</sup>

We identified \$75.9 million in discrepancies in evasion cases. An increasing proportion of this has arisen from the work that our audit teams have followed up from Industry Partnership’s work in the cash economy.

\$14.7 million in discrepancies was detected from 16 industries covered by Industry Partnership, compared to the previous year, when ten industries were covered and \$5.5 million was found in discrepancies.

A quarter of all completed cases were in the agricultural sector—mainly fruit picking contractors—where \$8.5 million in discrepancies was assessed. The

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75 See IRD, above n 73, 31.

76 See IRD, above n 73, 31. Advice from the IRD suggests that this information is misleading – as at the time of writing there are only 14 Industry Partnerships in operation, not 19.

77 See IRD, above n 73, 42–3.

78 See IRD, above n 73, 42.

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second largest group was painters and decorators, where we assessed \$1.8 million.

For example, legitimate orchardists and wine growers, as well as contractors and pickers working in the industry, welcome the IRD's efforts to stamp out tax fraud, according to the 2005 Annual Report.<sup>79</sup> Specifically, the audit focus in 2004–5 was on services to orchardists and wine growers in the Bay of Plenty, Hawke's Bay, Otago and Marlborough.<sup>80</sup>

In summary the IRD's stance is clear for core hard non-compliant taxpayers, they will be the target of intense audit scrutiny. However, if businesses and taxpayers are in need of assistance and are part of an Industry Partnership, the IRD will provide reasonable assistance within the law and in accordance with the Compliance Model.

The final area for discussion is to consider in broad terms the issues involved in subsequently developing a mechanism for the IRD to combine the targeted tax amnesty proposal (assuming it proceeds to legislative phase) with the Industry Partnership scheme as a further approach to improving compliance in line with the objectives set out in the Compliance Model.

### Implementation Considerations

From a practical perspective, a major factor in the implementation process of targeted amnesties remains the announcement of whether the recently formed New Zealand Government will actually advance the proposal to the next stage as a result of the divided views of the public submissions. Assuming it does, draft legislation is not expected for some time, given the September 2005 General Election delays and the priorities in terms of other legislation (it is not expected that targeted tax amnesties rate high on the list). Furthermore, determination of the 'target industries' for an

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79 See IRD, above n 73, 43.

80 According to the 2005 Annual Report, over the last 12 months the IRD completed 184 cases, has a further 149 under way, assessed \$8.5 million in audit discrepancies, and took 11 successful prosecutions, with an average sentence of 14 months imprisonment. To prevent future non-compliance the IRD intends to strengthen the proof of identity required to issue an IRD number in line with the Department of Internal Affairs' proposed standard. Changes have also been proposed to withholding tax regulations for companies in the agricultural contracting sector. The IRD's audit teams have recently been working in the Marlborough region to check on the tax records of contractors and workers. The local growers and contractors feel that the IRD's presence in the area gives a more level playing field when competing for work.

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amnesty will be important, especially if incorporated in some manner with the Industry Partnerships, which is a core proposal advocated in this article.

From a more theoretical and econometrical perspective, Alm and Erard<sup>81</sup> estimate the amount of non-compliance and the tax gap in the United States, utilising an alternative approach to the more typical separation of formal and informal transactions. The authors examine the combined level of underreporting by formal and informal suppliers within those industry categories where informal activities are concentrated. The authors' estimate of non-compliance involves comparing national survey results on self-employment earnings within selected industry categories to the Internal Revenue Service's (IRS's) National Research Program statistics on the amounts actually reported for tax purposes. By focusing on a carefully chosen set of industry categories, the authors argue that the resulting estimate should encompass the vast majority of all non-compliance committed by informal suppliers as well as any non-compliance among formal suppliers within these categories.

Alm and Erard<sup>82</sup> identify those industries that they believe account for the vast majority of informal supplier activities. Their list contains 12 broad industry categories.<sup>83</sup> The degree of overlap between this list and the IRD's Industry Partnerships is substantial, especially when differences in categorisation of industries are adjusted for (along with an examination of the coverage of the more broad industry groupings<sup>84</sup>).

Alm and Erard comment on the relative strengths and weaknesses of their methodology, and test it against prior research.<sup>85</sup> Subject to the necessary adjustments between New Zealand and United States data, this approach could be adopted in New Zealand as an alternative methodology for estimating the size of the informal economy in a range of industries. This analysis in turn could form part of the basis for selecting industries for a targeted amnesty.

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81 Alm J and Erard B, 'Estimating the Informal Supplier Tax Gap', Paper presented at the 2005 Internal Revenue Service Research Conference, 5-7 June 2005, 2-3.

82 See Alm and Erard, *ibid*.

83 See Alm and Erard, n 81, 4. The 12 categories are: Food catering and roadside stands; Direct sales; Building maintenance/landscaping; Forestry, fishing, hunting, and trapping; Arts and entertainment; Construction; Teaching/lessons; Care of children and elderly (including home health services); Personal services; Auto repair and maintenance; Other repair and maintenance; Transportation and moving.

84 The overlap with the Australian industry partnerships is also high.

85 See Alm and Erard, n 81, 21-25.

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It should not be difficult for the IRD to have a complete list of members of a particular industry partnership, indeed the associations could make this available directly to the IRD.<sup>86</sup> The crucial issue is ascertaining non-members of the profession or trade, who may be more likely candidates for tax non-compliance, given that they are not regulated by the association, but may be operating in a manner creating a public perception that they are part of a professional or trade association.<sup>87</sup> Indeed there is an incentive for Industry Partnership organisations to not only ensure their members are tax compliant (and seeking assistance from the IRD where necessary) but also to remove members that not willing to be compliant. There is also an incentive to differentiate the association's members from non-members given that survey evidence to date indicates a strong willingness for Industry Partnership members to be tax compliant and a general intolerance for non-compliance.

The Industry Partnership scheme is relatively new with further scope for growth and expansion. To date, 14 industries are acknowledged by the IRD as having an Industry Partnership, although indications in the IRD's 2005 Annual Report suggest there are 19. However, this reference to '19' should be to the number of relationships the IRD has with various sectors rather than to the actual number of Industry Partnerships in place, which stands at 14. The gradual increase in Industry Partnerships since 2001-2 reflects not only the success of the regime over its four years of existence to date, but that a significant number of industries have concerns with cash transactions and associated tax evasion. It remains to be seen which industries will be included in future Industry Partnerships. If the industries included in Alm and Erard's<sup>88</sup> analysis are examined, then there would be scope to include the equivalent of the food catering and roadside stands, direct sales (marketing), arts and entertainment, teaching and lessons (education), and care of children and elderly (including home health services). Reviewing the industry partnerships in Australia, then charities and nonprofits, conservation, general insurance, mining and energy, retirement villages, telecommunication, financial suppliers, gambling, media, pharmaceuticals, sport and even *tax professionals*, could develop Industry Partnerships with the IRD!

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86 In many instances this can be ascertained through the organisation's website.

87 The resulting issue of potential liability under the *Fair Trading Act 1986*, that this conduct may give rise to, is beyond the scope of this article.

88 See Alm and Erard, above n 81.

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### Conclusions and future research

This article builds upon the earlier work of Sawyer,<sup>89</sup> suggesting that legislation enabling targeted tax amnesties should be developed and the concept explored in the context of the Industry Partnership program that the IRD has established (which is in turn modelled in part on the earlier Australian industry partnerships). However, no action may be taken that could, or be perceived to, compromise the integrity of the tax system, so it may well eventuate that the targeted tax amnesty proposal, if implemented, and the IRD's Industry Partnership program remain separate but complementary administrative tools. Recall that the CETF recommended the use of tax amnesties in industries where the cash economy is significant and the risks arising from extensive non-compliance are significant.<sup>90</sup> Nevertheless, the CETF's recommendation does not appear to have been taken up by the ATO. Where an industry's activities are largely dominated by cash transactions with serious and extensive risks of non-compliance, the Industry Partnership approach has been adopted where support has come from the member associations of the particular industry. Nevertheless, the proposed targeted amnesties are to be directed at 'ingrained evasion', which may suggest the objective is to manage or contend with tax evasion that has not been able to be reduced by other means available to the IRD.

The Industry Partnership approach, according to IRD statements in its annual reports and other media releases, appears to be returning 'dividends' in terms of increased compliance, assessments for previously uncollected revenues, and cooperation from the various associations with their members to promote and enhance the Industry Partnership experience. Without the IRD's explanation as to the basis for the '19' Industry Partnerships in its 2005 Annual Report (the number of sectors that the IRD has a relationship with), compared to the 14 'formalised Industry Partnerships in existence, one would infer that the IRD appears to be experiencing some difficulties with expanding the Industry Partnerships beyond the 14 identified industry sectors. While the immediate benefits appear obvious, the long term impact of these associations may not be as positive if the Australian experience comes to fruition where the ATO 'lost interest' somewhat with the workings of some industry partnerships after new legislative and regulatory measures were in place but not as

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89 Sawyer A, 'Targeting Amnesties at Ingrained Evasion – A New Zealand Initiative Warranting Wider Consideration?' (2005) 3 *Journal of the Australasian Tax Teachers Association* 84.

90 CETF, *Improving Tax Compliance in the Cash Economy: Report to the Commissioner of Taxation* (1998) 41-3.

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yet fully 'bedded down'.<sup>91</sup> A successful Industry Partnership requires a long-term commitment to tax compliance between the IRD and various associations within the industry, with the trust and cooperation built up over time easily lost.

There are clear synergies between the Industry Partnership model and the proposed targeted amnesties as tools for reducing tax evasion. Including targeted amnesties within an Industry Partnership model approach has appeal in that the IRD 'knows' the profile of the industry reasonably well and is likely to receive cooperation from the member associations, provided it follows 'best practice' in developing and implementing the proposal<sup>92</sup> A targeted amnesty has the potential to increase levels of compliance and shape the compliance attitudes of members of the industry. However, there are risks with this approach in that tax amnesties can have a negative response and reduce levels of compliance, particularly if there are expectations of future amnesties or if post-amnesty enforcement will not be any different in terms of audit presence and penalties.<sup>93</sup> A poorly conducted amnesty with an industry partner could do almost irreparable damage to the relationship, which I am sure the IRD will give careful consideration to in implementing any targeted amnesty.

Conducting targeted amnesties to industries with ingrained evasion that are not subject to an Industry Partnership has its own risks, including that of the expected lower level of IRD knowledge of the industry, possibly lower levels of compliance, less cooperation with industry organisations, and the like. However, this could be an approach for encouraging the establishment of an Industry Partnership or enhance an existing Industry Partnership in its infancy.

Nevertheless, I recognise that a further risk arises in that the creation or existence of an Industry Partnership could give rise to the expectation that a targeted amnesty may be offered to that particular industry, which could raise a number of potential concerns. Both the Industry Partnership program and the proposal for targeted amnesties are centred around the Compliance Model and focus on different aspects of encouragement and enforcement that may be utilised by a tax authority. Although there appears to be common complementary ground shared between these two initiatives, there has been no suggestion at any stage (from either the Government or IRD), that targeted amnesties would only be offered to industry partners.

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91 Australian National Audit Office (ANAO), Performance Audit ATO Progress in Addressing the Cash Economy Australian Taxation Office The Auditor-General Audit Report No 35 2001-2 (11 March 2002).

92 See, generally, the discussion in Sawyer, above n 89.

93 See Sawyer, above n 89.



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Furthermore, there is no suggestion (from either the Government or IRD) that partnerships are only formed with industries that feature the high levels of ingrained evasion that would be targeted with amnesty offers.

Future research will need to be undertaken to review the draft (and final) legislation if or when it emerges, including an examination of whether it reflects best practice in terms of the tax amnesty literature. Should this lead to one or more actual targeted tax amnesty(ies) being conducted, then a review of the success of each amnesty is necessary, in terms of revenue collected, information gathered on the profile of the industry, levels of noncompliance now and future projections of compliance levels.

It must also be remembered that this 'experiment', as some may view it, will be watched internationally to ascertain if a new model (of an old tool – the amnesty) will be a successful response to address part of the age old problem of tax non-compliance arising through tax evasion. The pessimists have already 'decried' the proposal; the optimists have welcomed it as a positive development without seeing the detail, while the realists, I would suggest, are cautiously optimistic that with the appropriate development and careful implementation, it can be successful, even if to a small degree. However, if it is not appropriately developed and implemented, then targeted tax amnesties may be an unfortunate experiment providing data with value only for critical academic analysis with the benefit of 20-20 hindsight.