Regulatory Impact Statement

Time period for refunds under the Income Tax Act 2007

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Inland Revenue.

The question in this Statement is whether the time period for taxpayers to request a refund of overpaid tax under the Income Tax Act 2007 should be four years.

Officials have discussed the proposal with the New Zealand Institute of Chartered Accountants and the New Zealand Law Society. The Institute agrees in principle that there is a case for aligning the times for requesting refunds and increasing tax assessments at four years, although it has a residual concern that the design of the PAYE system results in people being over-taxed in certain circumstances. The Law Society Tax Committee also has concerns about the proposal because the Commissioner has power in certain circumstances to increase assessments for periods longer than four years.

Consultation was limited to these representative bodies due to time constraints. Additional issues may also be raised during the select committee process. Officials also note that the issue was published as part of the Government's tax policy work programme on 16 March 2012.

The Treasury agrees with our analysis.

Officials have not quantified how many taxpayers are likely to be affected by this policy proposal, and therefore we have not quantified the size or extent of the problem historically, nor forecast this for future periods.

Other than as disclosed, no other significant gaps, assumptions, dependencies, constraints, caveats or uncertainties have been identified in the analysis. The proposed change will not impose any compliance costs on taxpayers. The proposed change does not impair private property rights, reduce market competition, provide disincentives to innovate and invest or override common law principles.

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STATUS QUO AND PROBLEM DEFINITION

1. The question in this Statement is whether the time period for taxpayers to request a refund of overpaid tax under the Income Tax Act 2007 should be four years.

2. If too much tax has been paid, the excess amount is refundable to the taxpayer. Over the years, the time periods for requesting refunds under the Income Tax Act have varied from between three and eight years.

3. The refund period was aligned with the time bar (four years) in 1944. At the time, it was considered that the time period for a taxpayer to claim a refund should be aligned with the time period for the Commissioner to amend an assessment. With the introduction of PAYE in 1957, the refund period was increased to six years in recognition of the possibility that employers could make mistakes in their calculations. It was increased to eight years in 1968. In 2004, the refund period was amended. The current period is four years from the date of assessment, with an eight-year period applying when the overpayment results from a clear mistake or simple oversight.

4. The long periods for refunds were established in an era when the administrative environment was based on assessments carried out by the Commissioner. Departing from four years for a refund was aimed at ensuring taxpayers were not unduly prejudiced by any errors made by employers or the Commissioner when the PAYE scheme was introduced (as systems were not computerised).

5. The time limits on refunds of tax paid in excess, and on the Commissioner amending assessments when insufficient tax has been paid, represent a trade-off between achieving finality and ensuring the correct amount of tax has been paid.

6. In today's modern tax administration environment, there is a question whether an eight-year period is consistent with the policy objective of reaching a balance between the finality of a taxpayer's tax position at the earliest practicable stage and the accuracy of that position.

7. When alignment of the refund period with the time bar was proposed in 2003 as part of a review of the disputes process, submitters generally disagreed with the proposal to reduce the refund period from eight years to four years. The proposal was seen to represent a significant reduction in taxpayer rights and was not relevant to the review of the disputes process.

OBJECTIVE

8. The objective is to ensure that finality of a taxpayer's tax position at the earliest practicable time is balanced with the accuracy of the position. The time limit on refunds when too much tax has been paid, and on the Commissioner amending assessments when insufficient tax has been paid, represents a trade-off between achieving finality and ensuring that the correct amount of tax has been paid.

REGULATORY IMPACT ANALYSIS

9. The options that we have identified include retaining the status quo or amending the Income Tax Act 2007 to reduce the time period for refunds to four years.

10. The preferred option is to amend the Income Tax Act 2007 to reduce the time period for refunds under the Income Tax Act 2007 to four years from the year of assessment. This would then be applied consistently to all refunds. In the case of tax credits cashed out separately from the income tax process, such as the donations tax credit, this option would also result in the time period for taxpayers requesting refunds becoming four years from the end of the relevant tax year.

11. The time limit on the Commissioner to increase an assessment of tax is generally four years from the year of assessment. The Commissioner requires a period in which to determine the accuracy of taxpayer assessments. Extending this time period would be contrary to the objective of ensuring that finality of a taxpayer's tax position is reached at the earliest practicable stage.

12. The question then becomes should the time period for taxpayers requesting refunds of tax also be four years. Setting this period at four years aligns the time period for taxpayers requesting refunds with the time period for the Commissioner increasing an assessment.

13. This approach would also mean that taxpayers requesting refunds would be treated similarly. For example, the refund period for taxpayers who are personal tax summary taxpayers would remain at four years and other taxpayers would have their time period reduced to four years from the year of assessment.

14. In the case of tax credits cashed out separately from the income tax process, such as the donations tax credit, officials recommend that the time period for taxpayers requesting refunds should be four years from the end of the relevant tax year.

15. The proposed new refund period is similar to that in other jurisdictions – for example, the time period in the United States is three years, and in the United Kingdom, Ireland and Australia is generally four years.

16. Officials considered other options such as changing the time period for the Commissioner to amend assessments when insufficient tax has been paid to eight years to align with the current extended refund period. This option was disregarded because it would be contrary to the policy objective of ensuring that finality of a taxpayer's tax position, balanced with sufficient consideration of that position, is reached at the earliest practicable stage.

17. The impact of the preferred option is a reduced period of time for taxpayers to contact Inland Revenue to request refunds of overpaid tax. Since the proposal would reduce the time period for requesting a tax refund through an amended assessment, the amendment would have a positive fiscal impact. However, since expected refunds from amended assessments are not specifically included in the revenue forecasts, it would have no impact on the forecast baseline. Officials have not quantified how many taxpayers are likely to be affected by this policy proposal, and therefore we have not quantified the size or extent of the problem historically, nor forecast this for future periods.

CONSULTATION

18. Officials discussed the proposal with the New Zealand Institute of Chartered Accountants and the New Zealand Law Society. The Institute agrees in principle that there is a case for aligning the times for requesting refunds and increasing tax assessments at four years, although it has a residual concern that the design of the PAYE system results in people

being over-taxed in certain circumstances. Officials note that there is a very active industry built around firms checking for refunds on behalf of individuals that should help to address this concern.

19. The Law Society Tax Committee also has concerns about the proposal because the Commissioner has power in certain circumstances to increase assessments for periods longer than four years.

20. Limited consultation has been undertaken due to time constraints. Additional issues may be raised by a wider group of interested parties quite appropriately during the select committee process. Officials note the issue has been published externally as part of the Government's tax policy work programme since March 2012 and this has not resulted in any proactive engagement on the issue by any interested parties.

21. Inland Revenue has also consulted with the Treasury which agrees with our recommendation.

CONCLUSIONS AND RECOMMENDATIONS

22. The recommended option is to amend the Income Tax Act 2007 to reduce the time period for refunds to four years from the year of assessment. This means that there would be alignment of the time periods for requesting refunds and the Commissioner increasing an assessment. Such an amendment would ensure that finality of a taxpayer's tax position is reached at the earliest practicable time. Since the proposal would reduce the time period for requesting a tax refund through an amended assessment, the amendment would have a positive fiscal impact.

IMPLEMENTATION

23. The necessary legislative change would be included in the tax bill scheduled to be introduced in July 2012, with application from the 2013-14 income year. There is no need for transitional provisions.

24. No implementation risks have been identified. Implementation can be managed within existing systems.

MONITORING, EVALUATION AND REVIEW

25. There are no plans to monitor, evaluate and review the time period for refunds under the Income Tax Act 2007 following this amendment. This is because the reform achieves a long term alignment objective. If any specific concerns are raised, officials will determine whether there are substantive grounds for review under the Generic Tax Policy Process. Also, the Income Tax Act 2007 is subject to regular review by officials.