Inland Revenue
Te Tari Taake

QUESTION WE'VE BEEN ASKED QB 17/03

TAX ADMINISTRATION ACT 1994 - THE PERIOD FOR WHICH A PRIVATE OR PRODUCT RULING APPLIES

> The binding rulings regime has operated for over 20 years. From time to time, the Commissioner will publish guidance about certain aspects of the regime that may be of wider interest.
>
> Over the years, Inland Revenue has developed internal policies concerning the period a private or product ruling will be issued for. This item sets out the Commissioner's current practice on the period of the ruling, in the interests of informing ruling applicants and their agents. However, as a result of submissions received from public consultation on this item, the Commissioner will be recommending that issues regarding the period of a ruling (and whether there should be legislative change) be further considered as part of the broader changes to the binding rulings regime discussed in the recent discussion document *Making tax simpler – Proposals for modernising the Tax Administration Act* (December 2016).

All legislative references are to the Tax Administration Act 1994 unless otherwise stated.

This Question We've Been Asked is about ss 91EB(1)(b) and 91FB(1)(b).

Question

1. We have been asked what the Commissioner's practice is on the length of the term of a private or product ruling.

Answer

2. While the binding rulings legislation in Part 5A recognises that a private or product ruling must state the period for which the ruling applies, the legislation does not specify what that period should be. This is left to the discretion of the Commissioner. The Commissioner considers that when exercising this statutory power, the relevant factors that should be taken into account include (depending on the relevant circumstances):

    - the nature of the arrangement that is the subject of the ruling application;
    - the taxation laws on which the ruling is sought;
    - the desire to provide certainty to the applicant;
    - consistency and fairness as between different ruling applicants;
    - the fiscal risk to the Crown if the ruling is later found to understate the correct tax liability;
    - the degree of certainty as to the legal correctness of the decision; and
    - the likelihood or risk of the Commissioner's interpretation of the law changing over time.

3. In determining the period for which a ruling should apply, the Commissioner's practice has been along the following lines:

a) Where an arrangement has a term or expected life of less than three years, such as a share repurchase that is planned on a particular day, the Commissioner will issue a ruling for a period that is the exact term or expected life of the arrangement. The Commissioner may, however, provide a ruling for a longer period if there is material uncertainty about either the date of implementation or the length of the term or expected life of the arrangement, in order to allow a reasonable period for the arrangement to be completed.

b) Where an arrangement has a term or expected life of more than three years, the Commissioner will generally rule for a period of three years from the date of issue of the draft or final ruling. The Commissioner considers that a period of three years is a reasonable balance between the relevant matters set out above, particularly the desire to provide certainty to applicants and the risk of the Commissioner's interpretation changing over time.

c) If the arrangement was entered into before the date of issue of the draft or final ruling, the Commissioner will generally add the time that has elapsed since the arrangement was entered into to the three-year period (to the extent reasonable and permitted by legislation).

d) The Commissioner will consider the applicant's circumstances in determining the period of the ruling. If there are particular features of the arrangement that would make ruling for a period of three years undesirable (for example, if the arrangement has a fixed life of three years and six months, or where the parties have agreed to renegotiate the terms of the arrangement after four years), the Commissioner may agree to extend the period beyond three years.

e) On a reissue of a ruling, where an arrangement has a remaining term or expected life of more than five years, the Commissioner will generally rule for a period of five years from the date the previous ruling ceased to apply, having regard to criteria such as:

- the added certainty for the taxpayer if the ruling applies for a longer period, particularly if the arrangement is likely to be on-going for a substantial time;
- whether the issues ruled on are likely to be affected by any new case law; and
- whether any of the issues are potentially contentious.

Otherwise, the reissue would be for a maximum of three years for on-going arrangements.

f) Periods in excess of five years (for a new ruling or a reissue) will only be considered by the Commissioner in exceptional circumstances where, due to the special characteristics of the particular arrangement and the application of the taxation laws, a shorter period would not be sensible. This may include situations where:

- the taxation law will not apply until a date in the future that would be outside a three- or five-year period (for example, if the ruling is on the application of the base price adjustment formula (s EW 31 of the

Income Tax Act 2007) and the financial arrangement is not expected to mature for 10 years); or

- the taxation law must be applied over the life of the arrangement and it would not be possible or sensible to try to reverse out the tax treatment after three or even five years, such as a ruling in relation to the spreading method that applies to a rental prepayment over the life of a 15-year lease.

In deciding whether to issue a ruling for a period in excess of five years, the Commissioner will take into account the same criteria that would be taken into account for a reissue. The value of the transaction or importance of the arrangement will not be a relevant factor.

In these exceptional circumstances, the Commissioner may be willing to rule for the whole term or expected life of the arrangement.

g) For a unilateral advanced pricing agreement (APA) that is issued in the form of a private ruling, the period of the ruling (for either a new APA or a reissue) will usually be five years. However, depending on the economic circumstances of the particular case, such as the relevant business cycle of the industry concerned, an APA may be issued for a longer period if agreed between the applicant and Service Delivery.

Explanation

4. The binding rulings regime was introduced in 1995 to give taxpayers greater certainty regarding the Commissioner's view of the tax implications of transactions and arrangements. A private ruling gives the Commissioner's interpretation of the tax law as it applies to a specific taxpayer and a particular arrangement. A product ruling gives the Commissioner's interpretation of the tax law as it applies to a particular "product" (where it is not practicable to identify the taxpayers who may enter into the arrangement). The Commissioner is required to apply the tax treatment prescribed in a private or product ruling for the duration of the ruling.

5. The binding rulings legislation (ss 91EB(1)(b) and 91FB(1)(b)) provides that a private or product ruling will apply "only for the period or tax year for which the ruling applies". Sections 91EH(1)(d) and 91FH(1)(e) provide that a private ruling or product ruling must state the "period or tax year for which the ruling applies". The term "tax year" is defined in s YA 1 of the Income Tax Act 2007 as "a period starting on 1 April and ending on 31 March".

6. The effect of these provisions is that the Commissioner is able to issue a private or product ruling that applies for either a particular "tax year" or for a specific "period".

7. However, other than the reference to a "tax year", the legislation does not specify the period a ruling should be issued for. The legislation does not, for example, set out any minimum or maximum periods for which a ruling can apply. As there is no legislative guidance on this issue, the Commissioner must decide what the appropriate period will be for each private or product ruling issued. This is a matter of reasonable administrative practice.

8. Where a private or product ruling applies, and has not ceased to apply under ss 91EB(2) or 91FB(2), the Commissioner is legally bound to apply the specified taxation law in the specified way for the period of the ruling if the taxpayer

applies the law as stated in the ruling (ss 91EA(1) and 91FA(1)). The only exception to this is where the taxpayer has issued the Commissioner with a notice of proposed adjustment to change the effect of a ruling previously applied by the taxpayer (ss 91EA(1A) and 91FA(1A)). This provides the taxpayer with certainty against changes in the Commissioner's interpretation of the tax law during the relevant period.

9. However, there is a fiscal risk to the Crown that an applicant's correct tax liability may be understated if the interpretation of the taxation law and how it applies to the arrangement is later found to be incorrect. This potential risk was recognised by the Government prior to the introduction of the binding rulings regime (in *Binding Rulings on Taxation (A discussion document on the proposed regime)* (Government discussion document, June 1994) (the Discussion Document)).

10. To minimise this risk, the Commissioner is not generally prepared to issue binding private or product rulings for an extended period. The Discussion Document noted that it was not intended that a private ruling would apply for an unspecified period as changing circumstances over time would make such an approach inappropriate. Issuing a binding ruling for a limited time allows the Commissioner to review any developments of the law and consider any implications for the ruling within a reasonable time frame.

11. When determining the appropriate period for which the Commissioner will issue a ruling, a balance must therefore be struck between a number of factors, including fairness to the applicant (who has invested time and money in applying for the ruling) and the appropriate level of risk if an incorrect or deficient ruling is issued for an extended period of time.

12. When deciding the appropriate period for a private or product ruling, the Commissioner will first consider the arrangement and the period requested by the applicant in their application. As noted in [2] above, the Commissioner will also take into account other factors, such as:

- the nature of the arrangement that is the subject of the ruling application;
- the taxation laws on which the ruling is sought;
- the desire to provide certainty to the applicant;
- consistency and fairness as between different ruling applicants;
- the fiscal risk to the Crown if the ruling is later found to understate the correct tax liability;
- the degree of certainty as to the legal correctness of the decision; and
- the likelihood or risk of the Commissioner's interpretation of the law changing over time.

References

Subject references
Period of the ruling

Legislative references
Tax Administration Act 1994, ss 91EA, 91EB, 91EH, 91FA, 91FB and 91FH

Income Tax Act 2007, definition of "tax year" in s YA 1

Other references
Binding Rulings on Taxation (A discussion document on the proposed regime) (Government discussion document, June 1994)