



PARLIAMENT OF THE COOK ISLANDS

PARLIAMENT PAPER NO. 138

Rarotonga.

Mr Speaker,

I have the honour to present on behalf of the Public Expenditure Review Committee report on complaint received regarding Revenue Management Division at Ministry of Finance.

I have the honour to be,

Sir

Hon. Mark Brown
Prime Minister
Minister Responsible for the Office
Public Expenditure Review
Committee



**MINISTRY OF FINANCE AND ECONOMIC MANAGEMENT
GOVERNMENT OF THE COOK ISLANDS**

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26 March 2022

Mr Geoff Stoddart
Chairman
Public Expenditure Review Committee

By electronic email: geoff.stoddart.raro@gmail.com

Kia Orana Mr Stoddart

**PUBLIC EXPENDITURE REVIEW COMMITTEE: REPORT ON COMPLAINT RECEIVED REGARDING
REVENUE MANAGEMENT DIVISION AT MINISTRY OF FINANCE – MR JOHN SCOTT, MRS TARA
SCOTT AND ESCAPA DEVELOPMENTS LIMITED**

1. I refer to the Public Expenditure Review Committee (PERC) dated 18 March 2022 (the PERC report or report) which was sent to Mr Garth Henderson (Financial Secretary, Ministry of Economic and Financial Management).
2. This letter contains the Revenue Management Division's (Revenue Management) comments regarding the PERC report.
3. PERC report extract (refer p.2):

A letter notifying that PERC would conduct a review under its statutory authority was delivered to the Collector on 6 January 2021. Included in its letter to the Collector, PERC requested an interview with appropriate staff members who had been handling the complainant's affairs. The letter was acknowledged by the Collector same day. However, it took 7 months before the Collector indicated he was ready for an interview plus 3 further delays of a fortnight then one week and repeated until finally on 21 October 2021 a meeting was held. The delays by the Collector in agreeing to meet are unprecedented in the history of PERC.

4. Revenue Management's comments:
 - The PERC report has omitted relevant information relating to the COVID-19 pandemic.
 - In 2019 COVID-19 first appeared and in January 2020 the World Health Organisation declared that the spread of COVID-19 was a pandemic. Shortly after the Cook Islands border



was closed. This effectively shut down tourism overnight. As we all know this has had a devastating effect on our economy, the private sector and community.

- The COVID-19 pandemic is a truly unprecedented with its devastating effects being felt around the globe.
- As part of the Government's Economic Recovery Plan Inland Revenue was asked to administer a number of financial support measures. They included the Wage Subsidy, Training Subsidy, Business Grant, Sole Trader Grant, Training Grant and Isolation Payment.
- On top of routine everyday tasks, to date, this has involved undertaking approximately 32,803 reviews of the applications submitted and distributing \$103 million to qualifying applicants. Successfully administering the financial support measures placed a massive burden on Revenue Management's already stretched resources.
- The PERC report also omits information relating to delays caused by PERC.
- On 12 August 2021 the Collector contacted PERC to arrange time for the interview. The Collector was prepared to meet straight away. Six days later PERC Chairman responded advising that he had other high priorities taking up his time and that he would return from planned leave on 14 September 2022. This delayed holding the interview by a further month.
- On 16 September the PERC Chairman emailed the Collector providing a list comprising of 10 additionally letters, statements and an email he considered during his review. The Collector responded on the same day noting that *"with the move to Alert Level 2, Revenue Management priority has been administering the reinstated Wage Subsidy, Sole Trader Grant and Business Grant. For this reason, we need time to review the additional correspondence and schedules that you are now referring to"*.
- The PERC Chairman agreed to meet on 7 October 2021. Subsequently, due to unplanned staff leave Revenue Management could not meet on the agreed date. As noted the meeting took place two week later.

Personal Income Tax

5. PERC report extract (refer p.3):

RMD had accepted the non filing of personal tax returns in a letter issued by a Mr Batchelor in 2002. However, RMD initially did not have their record (file copy) which indicated RMDs records were deficient with an important ruling by a senior staff member not retained. Later however it was discovered that a copy of the letter had been e mailed by Mr Scott to Mr Bayne at RMD in 2016.

6. Revenue Management's comments:

- Over the past three years Inland Revenue has introduced and embedded a policy which requires all taxpayer correspondence be saved in RMS (the tax system). This is standard practice for tax administrations.
- Another process that has been introduced and embedded over the past three years is to scan and attach file a copy of all manually filed tax returns in RMS.



- Standard Operating Procedures which documents both processes were developed last year and are currently been finalised with technical assistance from the Pacific Financial Technical Assistance Centre (PFTAC).
- The steps taken confirms that Inland Revenue has taken proactive steps to implement policies to ensure taxpayer correspondence and manually filed returns are securely stored in RMS. This ensures that if a letter is received today it can be located in RMS in 20 years' time.
- RMS was first introduced by Revenue Management in 1997.
- As the report notes Inland Revenue reviewed RMS records but was not able to locate a copy of inland Revenue's 2002 letter or the important ruling. This confirms that when the 2002 letter and the important ruling was issued a copy of either document was not saved into RMS.
- It should be noted that a copy of the 2002 letter that was emailed to Revenue Management in 2016 was stored at the time it was received in the Complainant's RMS correspondence records.
- As the PERC Chairman later notes RMS was first introduced in 1997. Inland Revenue's letter of 2002 was issued some 20 years ago in 2002. Mr Stoddart was the Treasurer of Revenue Management at this time. As such Mr Stoddart would be best placed to confirm the reason for not saving a copy of Inland Revenue's 2002 letter or the important ruling in RMS.
- It may be that Inland Revenue's practice in 2002 was to retain hard copies of a letter or ruling issued to a taxpayer. If this is the case it seems unreasonable to expect that some 20 years later Inland Revenue should be able to locate a hardcopy of either document.

7. PERC report extract (refer p. 3):

An update of the position in respect of non filing of personal tax returns was enquired on by Mr Bayne for RMD in 2016 and explanatory correspondence was exchanged by the parties with seemingly continued acceptance of the position. The matter next arose on date 28-8-18 when a Mr Tekanene of RMD issued a letter to Mr Scott threatening prosecution for failing to file returns for the years 2010-2017.

8. Revenue Management's comments:

- The information provided is not accurate and relevant information has been omitted.
- The Cook Islands tax system is based on voluntary compliance. This means the obligation to file an income tax return containing income they receive is that of the taxpayer. In this case the Complainant.
- In December 2017 the Complainant disclosed to Inland Revenue income had been received which become taxable from 1 January 2014. On the same day Inland Revenue advised that under section 8 of the Income Tax Act 1997 every taxpayer who derives income, whether that income was assessable or not, was required to file a return.
- Section 8 of the Income Tax Act 1997 relevantly states:

Annual returns - Subject to the provisions of this Act and of any regulations under this Act, ***every taxpayer shall for the purposes of the assessment and levy of income tax furnish to the Collector in each year a return or returns in the prescribed form***



or forms setting forth a complete statement of all assessable and non-assessable income derived by that taxpayer during the preceding year, together with such other particulars as may be prescribed. [Emphasis added]

- At this point the Complainant was aware that he had an obligation to file returns. This is confirmed by section 8 of the ITA and Inland Revenue's 2002 letter.
- Despite Inland Revenue's December 2017 advice and legislated requirement to file a return the Complainant did not file the overdue and outstanding returns.
- Inland Revenue obtained information which confirmed that the Complainant had received assessable income in 2010, 2011, 2012, 2013, 2014, 2015, 2016 and 2017.
- The report notes that subsequently on 28 August 2018 inland Revenue issued a letter requesting the Complainants overdue 2010 to 2017 returns be filed. At this point the oldest of these outstanding returns was over seven and a half years overdue.
- Prosecution for not filing overdue and especially long overdue returns is standard practice and a common compliance tool used by all tax administrations.

9. PERC report extract (refer p. 3):

Mr Scott replied just 2 days later on 30-8-18 agreeing to file and again explained the reason he had not filed was that he had credits (prior year losses) to utilise and no assessable income. As his wife Mrs Scott was in similar position and had incurred modest taxes against bank interest income and other, then he agreed to file returns for her as well and claim the expected refunds. The situation was well explained by Mr Scott in timely letters to RMD.

10. Revenue Management's comments:

- As noted earlier, in December 2017, the Complainant advised Inland Revenue that he had received income that would become taxable from 1 January 2014. Inland Revenue advised the Complainant on the same day that under section 8 of the Income Tax Act 1997 every taxpayer who derives income, whether that income was assessable or not, is required to file a return.
- Despite Inland Revenue's advice the Complainant did not to file his 2010 to 2017 income tax returns prior to the issue of Inland Revenue's 28 August 2018 regarding the overdue returns.

11. PERC report extract (refer p. 3):

Mr Scott Returns were lodged soon after on 4-10-18. Refunds were calculated amounting to \$7,358.41. On 20 March 2020 18 months after filing, Scott complained in writing that no assessments had been issued and no refunds received. By November 2020 when complaint came to PERC over 2 years had gone by without processing of the returns.

12. Revenue Management's comments:

- As part of the Government's Economic Recovery Plan Inland Revenue was asked to administer a number of financial support measures. They included the Wage Subsidy, Trading Subsidy, Business Grant, Sole Trader Grant and Training Grant.



- On top of routine everyday tasks, to date, this has involved undertaking approximately 32,803 reviews of the applications submitted and distributing \$103 million to qualifying applicants. Successfully administering the financial support placed a massive burden on Revenue Management's already stretched resources.
- In September 2018 Inland Revenue provided the Complainant and the Complainant's wife a further extension to file their outstanding 2010, 2011, 2012, 2013, 2014, 2015, 2016 and 2017 returns.
- To assist the Complainant and Complainant's wife Inland Revenue provided their assessable income details obtained by Inland Revenue. Providing this information saved the Complainant from having to go through a lengthy process to obtain details relating to multiple bank accounts and banks.
- This enabled the Complainant to file the outstanding 16 income tax returns by the extended due date.
- The 16 returns filed did not set out assessable and non-assessable income derived in the prescribed form. For this reason, and to date, the requirements of section 8 of the ITA have not been met.
- Both the Complainant and the Complainant's wife's subsequent and due returns have not yet been filed.

13. PERC report extract (refer p. 3):

In correspondence to RMD dated 9-1-21 the information was again laid out for Mr Richardson of RMD with tables showing the calculations. By October 2021 being 3 years after filing, no assessments or refunds had issued.

14. Revenue Management's comments:

- As noted earlier, to date the Complainant has not filed the returns which meet the requirements of section 8 of the ITA. If Inland Revenue processed the returns, based on information provided by the Complainant, they would be nil returns because the prescribed form contains no assessable or non-assessable income. In fact, they contained no financial information at all.

15. PERC report extract (refer p.4):

In an email issued by RMD dated 11 January 2021 RMD advised that in view of a PERC investigation being undertaken, that action on the personal tax returns would be put on hold. PERC considers that there was no justification for continued non action and the matter could have been resolved notwithstanding a PERC review.

16. Revenue Management's comments:

- This is correct in that an email was issued to the Complainant advising that no further action would be taken until the conclusion of the PERC investigation.
- No further action was taken in the event that the PERC report concluded that contrary action should be taken.



17. PERC report extract (refer p.4):

There was never any indication the PERC review would not continue once the complaint had been received and assessed as justifying investigation. It is relevant to again record that it took 8 months until the Collector was willing to allocate an interview time with PERC and that the original complaint to RMD of non processing of the returns was 18 months after filing. This was March 2020 and staff resources at RMD were not stretched due to the sometimes suggested covid impact. Further comment on this aspect is recorded later in this report. It is further noted by PERC that RMD was able to issue various e mails and lengthy letters advising inter alia what the law was, yet still did not assess the returns.

18. Revenue Management's comments:

- The letters and emails being referred to were issued prior to the email of 11 January 2021 referred in the report and preceding paragraph.
- It should be noted that the emails and "lengthy" letters referred to were issued in response to correspondence received from the Complainant.
- The returns were not assessed due to the fact, as noted previously and communicated to the Complainant in the "lengthy" letters, that in order for the returns to be assessed for 2010 and subsequent years the returns for 2009 and prior years needed to be filed. This is a requirement under section 205A of the ITA. Once this requirement had been met losses carried forward could be claimed. The relevant returns were never filed, consequently the 2010 and subsequent returns could not be assessed to include any loss carry forward.
- As noted earlier as part of the Government's Economic Recovery Plan Inland Revenue was asked to administer a number of financial support measures. They included the Wage Subsidy, Trading Subsidy, Business Grant, Sole Trader Grant, Training Grant and Isolation Payment.
- On top of routine everyday tasks, to date, this has involved undertaking approximately 32,803 reviews of the applications submitted and distributing \$103 million to qualifying applicants. Successfully administering the financial support measures placed a massive burden on Revenue Management's already stretched resources.

19. PERC report extract (refer p.4):

Records at RMD appeared incomplete in that the earlier filed returns in 1999 and 2000 were not locatable. The Complainant's copies of those years returns contained record of the depreciation schedule of a business asset and the amount of unexpired depreciation which was the source of the carried forward losses because that asset had become redundant. If this aspect had been accepted by RMD then matters could have been resolved.

20. Revenue Management's comments:

- Electronic versions of the 1999 and 2000 tax returns are held on RMS. RMS does not record full details of any financial statements submitted with the tax returns, it records the total income for the year and the tax payable for the year.
- Given that these periods were, at the time of the correspondence, in the vicinity of 20 years old hard copies were no longer held.



- The Complainant held the required information to complete and file returns for the 2001 to 2009 years. This matter could have been resolved by the Complaint simply filing the 2001 to 2009 returns as required.

21. PERC report extract (refer p.4):

For RMD, Mr Richardson by letter 21-10-20 asked for returns 2001-2009 to substantiate the losses carried forward. Mr Scott replied promptly on 24-10-20 saying he held a letter from Batchelor advising no returns were required until he had assessable income. With RMD not having records to identify the claim for balance of depreciation (\$44,408) then the matter stalemated. Combined with the Collectors stance that no action would be taken until completion of the PERC review, a further delay of another year onto an already unreasonable time span for processing tax returns occurred. It was not until interview with PERC on 21 October 2021 that the matter was progressed with a copy of the 2000 balance sheet with depreciation evidenced.

22. Revenue Management's comments:

- The 2002 letter referred to earlier by the PERC Chairman and the Complainant was superseded by section 205A of the ITA. This provision was enacted to give effect to the Tax Amnesty which provided that outstanding tax returns for periods prior to 2010 did not need to be filed.
- Section 205A of the ITA is subject to section 205A(2) of the ITA which provided that if a taxpayer wished to claim losses from periods prior to 2010 they must file the required tax returns.
- It is on the basis of this provision that the Complainant was advised that in order to claim the losses he was attempting to carry forward to the 2010 tax year he was required, under the section 205A(2) of the ITA, to file the tax returns for the return periods prior to 2010.
- As noted earlier, under section 8 of the ITA the Complainant and the Complainant's wife were required to file returns.
- As confirmed by PERC, the required supporting information, the balance sheet, was not provided by the Complainant or the Complainant's wife until the day of the interview on 21 October 2021. Three years after filing the outstanding returns.

23. PERC report extract (refer p.4):

Mr Richardson for RMD took a strict statutory approach advising that returns must be filed as per section 205 of the Income Tax Act. He advised PERC 'That is what the Act says' claiming there was no discretion available. He was unwilling to accept by way of signed letter from Mr Scott that there was no assessable income and as such nil returns could be entered to RMD's records with the depreciation claim being utilised in future when he and his wife did have assessable or taxable income.

24. Revenue Management's comments:

- As noted previously the requirements to file the tax returns for the 2001 to 2009 years are contained within sections 205A (requirement to file) and 8 (returns to be in specified form) of the ITA.



- This place the obligation to file income tax returns on the taxpayer. It is not up to Inland Revenue to compile tax returns on behalf of taxpayers based on correspondence or other information provided by the taxpayer.
- As noted earlier, under section 8 of the ITA the Complainant and the Complainant's wife were required to file returns.

23. PERC report extract (refer p.4):

Mr Richardson for RMD took a strict statutory approach advising that returns must be filed as per section 205 of the Income Tax Act. He advised PERC 'That is what the Act says' claiming there was no discretion available. He was unwilling to accept by way of signed letter from Mr Scott that there was no assessable income and as such nil returns could be entered to RMD's records with the depreciation claim being utilised in future when he and his wife did have assessable or taxable income.

25. Revenue Management's comments:

- It is noted that the PERC Chairman is referring to the economic approach having been tested in the High Court in the Cook Islands. It would be helpful if he could provide the court case(s) he is referring to so the relevance of the decisions to the current situation could be reviewed.
- Notwithstanding PERC Chairman's failure to provide the court reference, the preparation of personal income tax returns is not a difficult or time-consuming activity.
- The Complainant could have easily completed and filed his returns for the 2001 to 2009 years in a very short period of time, particularly given returns would only need to record the losses carried forward from prior years.
- By requiring the Complainant to complete the returns he was not placed under any undue economic pressure.

Summary Observations and Conclusions (PERC report, p.5)

26. Revenue Management comment:

- PERC's summary observations and conclusions should be revised in light of the information contained in this letter.
- As stated previously the returns for 2010 to 2017 could not be processed to include the losses carried forward from prior years until the returns for the 2001 to 2009 years were filed by the Complainant.
- Inland Revenue's letter of 21 October 2020 advised the Complainant of the requirement to file the tax returns for the periods prior to 2010 if he wished to claim the losses carried forward in the 2010 and subsequent returns. The letter stated:

"As these matters relate to periods prior to the 2010 income tax returns, under the provisions of s.205A(2) of the Income Tax Act (see attached), it would be necessary for all income tax returns for the earlier periods to be filed to verify the amounts recorded.



According to our records there have been no returns filed for either yourself or Tara for the 2000 to 2009 years inclusive. Unless you are able to file the returns for these periods the "credits" carried forward to 2010 will be disallowed."

- Close to 18 months have passed since the above letter was sent to the Complainant and the returns in question (2001 – 2009) have still not been filed with Inland Revenue.
- Had Mr. Scott filed the tax returns for the periods in question (2001 – 2009) following RMD's letter of 21 October 2020 the issues around the personal income tax could have been resolved shortly thereafter.
- It is accepted that Revenue Management has not met all of its obligations under the Charter. However, it should be noted that the Charter also imposes obligations on taxpayers, most notably where it states:

"For this Charter to work effectively, we rely on each taxpayer to provide all the relevant information when dealing with Revenue Management."

- Had the Complainant provided the relevant information, the returns for the 2001 to 2009 years, when requested the Collector and Revenue Management staff would have been better positioned to meet their obligations under the Charter.

Personal Income Tax Recommendation (PERC report, p.5)

27. Revenue Management Comment:

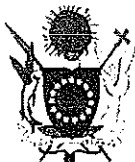
- Revenue Management does not agree with this recommendation.
- In order for the Collector to assess the 2010 to 2017 tax returns, as submitted by the Complainant, it is necessary, under the sections 205A(2) and 8 of the ITA for the 2001 to 2009 returns to be filed.
- The PERC Chairman has raised the issue in the report of the economic approach and suggested that this should be applied to not require the returns to be prepared and filed by the Complainant.
- Revenue Management considers there would only a minimal economic cost to the Complainant in preparing the returns and complying with his obligations under the ITA, consequently there is no basis for deviation from the legislative obligations placed on Mr. Scott to file the tax returns in question.
- Once these returns have been filed by Mr. Scott Revenue Management will be in a position to assess the his 2010 to 2017 returns which have been submitted by the Complainant.

Company Tax

Assessments

28. PERC report extract (refer p.6):

In response to enquiry whether other taxpayers with non-standard balance dates might be charged with excessive additional tax, he commented that if businesses paid their tax by due date this would not be an issue. However, this contention misses the point that non-standard balance dates can be the cause of overcharge even if tax is paid on time.



Less astute taxpayers may be getting charged tax they do not owe without realising. Mr Toleafoa advised that this was something his office was working on.

29. Revenue Management's comments:

- This a system issue which existed prior to 2018. As the PERC Chairman is aware a project has commenced to upgrade RMS. As part of the upgrade this issue will be resolved.
- Revenue Management have undertaken reviews to determine the impact this issue may have had on other taxpayers.

Communication failure

30. PERC report extract (refer p.7):

On 4 May 2021 Ms Linda Ailao for RMD received Escapa's submission that a reconciliation of RMDs records against amounts paid by Escapa was out by \$285,582. A follow up was sent by accountant Marten almost 3 months later on 22 July 2021 without response. No reply ever arrived. Mr Toleafoa for RMD in correspondence dated 29 November 2021 accepted that there was failure to inform the company of fresh postings and a tidy up of assessments and reconciliations. In view of the complaint to PERC being under action, as well as a concerning letter of objection submitted by the accountant for Escapa, it is not considered acceptable to make material value adjustments in favour of Escapa and not directly communicate the corrections immediately. PERC considers the communication failure does not reflect an acceptable level of service. In spite of the sometimes expressed delays because of covid diversions, it was noted that staff during 2020 and 2021 were able to issue multi page correspondence to the company explaining what the law was and describing at length the application of penalties (additional tax) yet failed to address the real issues. PERC recommends that better oversight of staff by the Collector in dealing with high end issues be required in future.

31. Revenue Management's comments:

- Despite of the significant impact COVID-19 has had on Revenue Management, as noted earlier, it is agreed there was a communication failure which did not reflect an acceptable level of service.

Transfer of VAT refunds across to company tax without notification

32. PERC report extract (refer p.7):

In interview on 21 October 2021 staff of RMD claimed the transfers to company tax were not VAT refunds rather they were overpayments of tax by the company as a result of the company filing its VAT returns in two parts. However, no advice of this classification had ever been given by RMD to the company between 1997 when the VAT system started and year 2021. PERC considered the contention was a rear guard attempt to not pay interest on late paid and non-notified VAT transfers. It should be noted that VAT refunds in the case of importers largely result because of VAT paid on imports which are not yet sold and as a result a timing difference results wherein the credit for VAT import VAT exceeds sales VAT for that month. Many importers have this effect reflected in their returns. PERC is of the view that the classification of transfers across to company tax (late and /or un-notified) is not a



sustainable argument by the Collector and his staff. However subsequently in a meeting with Mr Richardson on 10 December he advised that his office would not continue the contention that transfers were overpayments.

33. Revenue Management's comments:

- The provisions of s.29 of the VAT Act deal with the requirements around VAT credits and the Collector's powers and obligations with respect to VAT credits (when they can be withheld, notification requirements etc.). The provisions of section 29 are clear in that they are only applicable to VAT refunds calculated in accordance with the provisions of section 16 of the VAT Act.

- Section 29 of the VAT Act relevantly states:

Refunds of excess credits - (1) Subject to this section, if a refund is due to a registered person under section 16, the Collector will refund the amount to the registered person not later than 15 working days following the day on which the return of the registered person was received by the Collector.

- Put simply, a VAT refund under the provisions of section 16 of the VAT Act only arises when a VAT return is submitted with the result of the return being a refund, i.e. the VAT content of the expenses plus any credit adjustments plus any import VAT paid for the period is more than the VAT content of the income received plus any debit adjustments for the period.
- Section 29 of the VAT Act does not apply in a situation where a taxpayer has VAT to pay for a period and pays more than the amount due.
- The PERC Chairman's contention that the section 29 of the VAT Act applies in this situation is wrong in law and shows a possible lack of understanding of the construction and interpretation of the VAT Act.
- The PERC Chairman comments in the report that "no advice of this classification had ever been given by RMD to the company between 1997 when the VAT system started and year 2021." The current administration cannot be held accountable for the incorrect interpretation and application of the VAT Act by previous administrations. This includes the period from 1997 to 2008 when The PERC Chairman was the Collector and responsible for the administration of the VAT Act.
- The PERC Chairman alleges in his report that "PERC considered the contention was a rear-guard attempt to not pay interest on late paid and non-notified VAT transfers". Revenue Management strongly refutes this allegation and reiterates that the action of the current administration in this regard was to correct the incorrect interpretation and application of the VAT Act by previous administrations.
- With respect to the payment of interest on VAT refunds it should be noted that interest is only payable on VAT refunds under the provisions of section 30 of the VAT Act when the provisions of section 29 of the VAT Act have not been complied with. As noted above the provisions of section 29 of the VAT Act only apply where a VAT refund is calculated in accordance with the provisions of section 16 of the VAT Act.
- As an overpayment of VAT is not a refund calculated in accordance with the provisions of section 16 of the VAT Act the provisions of section 29 of the VAT Act are not applicable to



the credit and, consequently, the section 30 of the VAT Act is also not applicable. For this reason the Collector has no liability to pay interest on these amounts.

- The PERC Chairman states in his report that “PERC is of the view that the classification of transfers across to the company tax (late and/or un-notified) is not a sustainable argument by the Collector and his staff.” Revenue Management does not agree with or accept this view.
- The PERC Chairman further claims in his report that “subsequently in a meeting with Mr Richardson on 10 December he advised that his office would not continue the contention that the transfers were overpayments.” This claim is factually incorrect.
- It has always been the position of Revenue Management and Mr. Richardson that the transfer of VAT overpayments were not subject to the provisions of section 29 of the VAT Act and, with the exception of three periods between January 2019 and September 2020, the credits in Escapa’s VAT account were a result of overpayments, not as a result of VAT refunds calculated in accordance with the provisions of section 16 of the Act. Mr. Richardson did concede that with respect to VAT periods, that resulted in refunds as calculated in accordance with section 16 of the VAT Act, the provisions of section 29 of the VAT Act had not been complied with.

34. PERC report extract (refer p.7-8):

In addition to transactions described under Value Added Tax hereunder, other examples of non-recorded payments and move around of entries over time by RMD were observed during the PERC review.

- I. a payment of \$9,214 made for Deferred VAT on 20-1-16 was much later (February 2021) shown as a payment toward company tax with posting date 27-3-18.*
- II. Two VAT transfers on a February 2021 reconciliation disappeared on a later version and were replaced by different months transfers at different amounts.*

35. Revenue Management’s comments:

- There is a distinction between a refund for the purposes of section 29 (which is calculated in accordance with section 16) and an overpayment which simply where they have paid more than the VAT payable. The requirement for notification under section 29(5) of the VAT Act only requires the notification where there is a refund that is transferred and therefore this does not apply to overpayments. Also, section 30 of the VAT Act only stipulates for interest to be paid on refunds and not overpayments.

36. PERC report extract (refer p.7-8):

These recordings evidence that there had been move around of entries over time by RMD without notification and the company complaint is justified in that it could not rely on information from RMD which is later changed without direct notification.

37. Revenue Management’s comments:

- There is a distinction between a refund for the purposes of section 29 (which is calculated in accordance with section 16) and an overpayment which simply where they have paid more than the VAT payable. The requirement for notification under section 29(5) of the VAT Act



only requires the notification where there is a refund that is transferred and therefore this does not apply to overpayments. Also, section 30 of the VAT Act only stipulates for interest to be paid on refunds and not overpayments. Under the VAT Act, the Collector is only required to provide notification when it involves a refund. Since the amounts applied were overpayments, there is no statutory requirement to provide notification.

Value Added Tax

The Complaints Described

38. PERC report extract (refer p.8):

The Escapa company complained of the non issue of assessments, the non-issue of statements, the issue of incorrect statements, non-payment of valid VAT refunds, the non payment of interest on unpaid or late paid refunds of VAT and the transfer of some VAT refunds to company tax without notification as is required by the legislation.

39. Revenue Management's comments:

- The Collector accepts that during the 21 month period from January 2019 to September 2020 there were three VAT periods (April 2020, June 2020 and July 2020) where refunds were calculated in accordance with the provisions of section 16 of the VAT Act where transfers were made and the provisions of section 29 of the VAT Act were not complied with.
- Of the remaining periods the credits, which the PERC report refers to refunds, are as a result of overpayments on VAT and, as noted above, sections 29 and 30 of the VAT Act are not applicable to these periods.

40. PERC report extract (refer p.9):

It became apparent in the review by PERC that the integrity of information produced by RMD was poor.

41. Revenue Management's comments:

- Agreed, Revenue Management stated on a number of occasions before the PERCA review that there were issues with the opening and closing balances on the Deferred Import VAT statements. It did not require a PERC review to advise what was already known and being addressed through system upgrades.

42. PERC report extract (refer p.9):

Mr Richardson for RMD conceded in a letter to Escapa dated 21 October 2020 'We are currently working on system fixes to correct these issues' and 'we prefer not to issue statements'. Non statement issue was a specific complaint of Escapa. Similarly, on 31 December 2020 'we are aware there are issues regarding the Import VAT statements that affect the opening and closing balances on the statements'. PERC notes that the production of statements at month end, was since 1997, an integral part of the Deferred Vat system and by issuing the statement, importers then had the tally of what they were expected to pay within 20 days of month end. Our review concluded that the



integrity of information produced by Revenue Management on statements could not be relied on balance wise.

43. Revenue Management's comments:

- Mr. Stoddart has taken selected quotes from Mr. Richardson's letter of 21 October 2020 in relation to Import VAT statements. The full extract from this letter on the matter of the statements is as follows:

"Currently system issues which can affect account balances on Customs statements have been identified. The assessments recorded on the statements are correct. However, the opening and closing balances are not always correct.

"We are currently working on system fixes to correct these issues. However, in the interim we prefer not to issue statements unless specifically requested to as this can cause confusion. The current fixes include an automatic review of all accounts which is scheduled to be finalised and undertaken before Christmas. Customs is also implementing a new Customs system, ASYCUDA World, over the next twelve months. As part of the implementation any remaining account issues will be resolved. Going forward statements will be issued which contain correct opening and closing balances."

- This clearly shows that Revenue Management was aware of the issues with the statements and was taking steps to correct them as well as advising of the steps that were being taken to correct the issues.

The Value Added Tax (VAT) system described

44. PERC report extract (refer p.9):

VAT is charged on imported goods at time of import and even with a "Deferred VAT System" which allows for payment of that tax on imports each calendar month on 20 following, this still regularly results in refunds because much imported stock is not sold by the end of the month it was received in country. As a result, VAT which is both an import tax and a sales tax, has been incurred but sales have not yet occurred. Monthly return forms provide for a credit for the former. This is similar for all importers and is termed a 'timing difference' in accounting terms and is one reason there is a regular batch of VAT refunds payable to importers each calendar month. The complainant company was a regular importer of goods

45. Revenue Management's comments:

- Whilst it is noted that Escapa was a regular importer and claiming credits for import VAT paid it should be noted that in addition to the activity involved in the importation of goods, Scott's Farm, Escapa also undertakes another activity, Muri Beach Club Hotel (MBCH). Both of these activities are under the single VAT registration and the VAT payable on the activities of MBCH generally exceeded the import VAT paid by Scott's Farm.
- For this reason Escapa was not generally in a refund situation as may be the case with other importers.



46. PERC report extract (refer p.10):

The VAT system provides for Group Registration and filing for companies or businesses with common ownership. Separate income tax returns are however required at year end. Much has been made in correspondence by Revenue Management from 31 December 2020 and forward of the registration and filing format used by Mr Scott for his businesses. However, this was considered by PERC to be a smoke screen to defer attention to the real issues. In Mr Scott's case, two divisions of his operations under Escapa Developments Ltd were, since the beginning of the VAT system in 1997 processed with separate VAT returns. These were Scott's Farm operations and Muri Beach Club Hotel. This was accepted by the office Revenue Management through until early 2021 when as a result of examination in the course of his complaints, it was observed that the businesses were not separate for Income Tax purposes. The Escapa company agreed to consolidate the returns thereafter. It should be noted however that the presentation 1997 to 2021 did not affect the amount of tax payable or refundable throughout the previous 24 years.

47. Revenue Management's comments:

- Agreed with the comments regarding group registration. It should be noted that with group registration a single VAT return is filed each month by the group filing representative, separate VAT returns are not filed by each group member and then consolidated into a single VAT return by Revenue Management. This return includes the activities of all group members and any refund due to one group member is offset against any VAT payable by other group members to give an overall VAT position for the group. This is similar to the approach that Escapa was advised in December 2020 must be applied with a single VAT return covering the activities of both Scott's Farm and MBCH.
- The PERC report makes the allegation that *"this was considered by PERC to be a smoke screen to defer attention to the real issues."* Again Revenue Management strongly refutes this and considers this to be a baseless slur on the integrity and character of Senior Revenue Management staff by Mr. Stoddart and PERC.
- Earlier examples can be provided where Mr. Richardson has applied a similar ruling to other taxpayers in the same situation (filing separate VAT returns for different activities under the same VAT registration) as Escapa.
- Again this is another example of the current administration having to take action to correct incorrect interpretation and application of the VAT Act by previous administrations including during the period from 1997 to 2008 when the PERC Chairman was Collector of Inland Revenue and responsible for the administration of the VAT Act.

Analysis of the Complaint

48. PERC report extract (refer p.10):

A core aspect of the Escapa company's VAT complaint is that the company was not given refunds it was entitled to in a timely manner. Over time a number of staff were involved in the processing of returns and looking at the position. Much later, in view of the complaint escalating, the Collector instructed that all matters be channelled through his senior officer Alan Richardson. This was advised to PERC in the interview in October 2021.



49. Revenue Management's comments:

- As noted previously it is accepted that, prima facie, there were three VAT periods between January 2019 and September 2020 where Escapa had VAT refunds as calculated in accordance with section 16 of the VAT Act where section 29 of the VAT Act was not complied with. In all other periods between these months Escapa had VAT payable once the activities of both Scott's Farm and MBCH were consolidated into a single VAT. Consolidating both activities into a single return is required under the VAT Act.

50. PERC report extract (refer p.10-11):

A condensed summary is that many refunds claimed were either not paid to Escapa or were used to pay other tax under company tax. Use of a VAT refund (transfer) is governed by section 29 of the VAT Act. Importantly, transfer of a VAT refund, and/ or interest owing thereon requires notification to the taxpayer as per section 29(5). The right of set off or transfer by the Collector lapses if not acted upon within 15 days of filing a return with refund claim. In material examined by PERC 11 transfers to company income tax were examined. These totalled \$81,856. Mr Richardson for the Collector conceded in interview that none of the transfers were notified to the Escapa company. From records examined by PERC regarding these 11 amounts at least 5 were also not transferred within the 15 days limit before interest was payable. Accordingly, in at least 5 transactions the Collector also did not have authority to transfer. As such it is apparent that in view of the legislative requirements not being met, that interest is payable by the Crown on all. It is recommended that the Collectors staff calculate interest owing and report to the taxpayer company.

51. Revenue Management's comments:

- The legal argument around whether there were VAT refunds available has been discussed in the response to previous comments. As previously noted three periods were identified between January 2019 and September 2020 where Escapa was entitled to VAT refunds that were transferred and prima facie section 29 of the VAT Act had not been not complied with in undertaking these transfers.
- It is accepted that there was no notification of the transfers. However, with the exception of the three periods that resulted in VAT refunds as calculated under the provisions of section 16 of the VAT Act there was no legal obligation to issue notification of the transfers. Notwithstanding the lack of a legal obligation to issue notification Revenue Management accepts that notification should have been issued for all transfers made. However, failure to notify Escapa of the transfers does not invalidate them or make them unlawful.
- The PERC report's contention that there were more than the three periods involved where transfers were made, prima facie, that did not comply with section 29 of the VAT Act is an incorrect interpretation of the VAT Act. For this reason, Revenue Management does not agree with the recommendation made in relation to any period apart from the three periods previously mentioned in bullet point one above.

52. PERC report extract (refer p.11):

Two separate transfers were observed where notification was made. However, these only occurred as a result of enquiry by the company itself to a tax office staff member because



Escapa believed a net position of refunds was due to it and it was therefore unnecessary to pay 2 amounts which related to PAYE and Vat for July 2020. The complainant company was enquiring after refunds for May 2020 and June 2020. The date of enquiry was 20 August 2020 well after the 15 days provided for refund processing which should have occurred around 4 June and 5 July.

53. Revenue Management's comments:

- It should be noted that the 15-day period referred to in the report is 15 working days as provided for under section 29 of the VAT Act. The report, in the last sentence of this paragraph, appears to have calculated the dates based on 15 days as opposed to 15 working days.
- This is yet another example of incorrect interpretation of the VAT Act.
- If this interpretation of 15 days has been applied by previous administrations the Collector may have paid significant amounts of interest on VAT refunds where there was no legal liability to pay interest or interest being paid for greater periods than the liability existed for.

54. PERC report extract (refer p.11):

PERC concluded that the legislative requirements had not been met and taxpayer expectations had not been met.

55. Revenue Management's comments:

- Revenue Management accepts that prima facie the legislative requirements were not met in relation to the three periods where VAT refunds were calculated in accordance with the provisions of section 16 of the VAT Act.
- Revenue Management also accepts that, in spite of there being no legal requirement, by not issuing notification of transfers made from other periods the taxpayer's expectations were not met.

Customs Import VAT System Described

56. PERC report extract (refer p.12):

A description of the current system was obtained from Customs and VAT staff in interview on 21 October 2021. At that time, and over the period that the complaint to PERC extends, a report known as Nexus was generated from a system known as Cosmos. This system was introduced in more recent years to supersede the monthly Deferred VAT (Payment) statement traditionally produced out of the 'Revenue Management System' (RMS) which is the computer system which had been operating since 1997. The Collectors staff advised that they tried to integrate Cosmos to RMS. The Nexus report should reconcile to RMS however the 2 systems have not been fully compatible. The complaint to PERC is in part, reflective of the systems not being compatible. PERC was advised that re-entry of data over a 3-year period had been required.

57. Revenue Management's comments:

- The Customs system being referred to is named 'CUSMOD' not Cosmo. CUSMOD was first introduced in the Cook Islands in 2011/2012.



- During the interview of October 2021, the PERC Chairman was advised that Nexus reports are extracted from CUSMOD and that these statements are correct. This is not reflected in the report.
- CUSMOD and RMS are fully compatible.
- The issues faced relates to either the Government network or RMS outages or power supply issues. When this occurs, information is not transferred from CUSMOD to RMS.
- Revenue Management has worked with the Government's ICT over the past three years regarding the outage issues. The Government network is currently undergoing changes which will fix this issue.
- PERC was advised at the interview that credits were incorrectly recorded in RMS. Those credits dated back to 1997 and the PERC Chairman's term as Treasurer of Revenue Management. He was also advised that credits were recorded RMS and had accrued right up to his departure in 2008. The PERC Chairman appeared surprised by this and did not offer any explanation as to why this occurred. He moved on with his question which suggests that he may not have been aware this issue.

58. PERC report extract (refer p.13):

PERC was advised in interview with customs staff that only between 40 to 45 businesses use the Deferred Payment VAT system. This is a small number to service and it has not grown greatly over many years, it being reflective of the small country size of the Cook Islands. The Collector's staff also advised that they were now proceeding with a new system called Azycuda World which would facilitate the processing of import duty charges and VAT. This was shown in correspondence dated October 2020 wherein it was to be implemented over the following 12 months however appears not to have been achieved with statements using the original system continuing to be issued as late as February 2022. The cost of a new system compared to a cost of effecting fixes to the earlier system was not investigated by PERC however it is disappointing that the problems with current system were not actioned as advised in October 2020, either as a bridging measure or permanent fix.

59. Revenue Management's comments:

- The Customs system being referred to is 'ASYCUDA World' not 'Azycuda'.
- Staff of the Revenue Management Division, including the Collector, met with a group of local accountants on 23 November 2020. The PERC Chairman attend this meeting.
- At the meeting he questioned cost of the ASYCUDA World system. He was advised that there was no cost and that it was being covered via donors and PACER PLUS funding.
- He was also advised that NZ Customs had determined that it was no longer feasible for them to continue servicing CUSMOD. For this reason, support relating CUSMOD will be switched off in June 2022. The planned ASYCUDA go live date is 30 June 2022. The Cook Islands Customs Service is on track to achieve this. This is the permanent fix referred to in the report.
- A temporary RMS fix is also in the final stages of implementation with user testing underway. Any RMS system change is costly and takes time to implement.



60. PERC report extract (refer p.13):

It Mr Richardson of RMD was interviewed on 17 November and again on 10 December 2021. He advised that he commenced employment at the office in November 2019. At that time, he advised there was a total of near \$5 million in VAT refunds not paid out to claimants. He further advised that staff had later got the amount reduced to \$3 million and moving toward \$2 million presently.

61. Revenue Management's comments:

- The VAT credit amounts specified are not solely VAT refunds. This is the total of all credits within the VAT system and includes refunds (as per section 16 of the VAT Act), overpayments, payments received where returns have not yet been assessed etc.
- This report and data was not available until 2018, after Mr. Eyre had ceased his employment with Revenue Management. This means he would not have been aware of this issue.

62. PERC report extract (refer p.13-14):

Mr Philp Eyre a former long serving senior officer at RMD was interviewed regarding his experience with the VAT refund system. He was employed from 1998 through to February 2018 a period of 20 years. He was the principal VAT officer responsible for audits and issuing of VAT refunds. The system which operated during his tenure was that a 'batch' of refunds claimed would be issued usually just before the expiry of 15 days from 20th of each month. An average months refund total with exceptions excluded, was in the range \$150k to \$200k. Most returns and refund claims are filed on or about 20 of each month. By paying these before expiry of the 15 days limit, this avoided liability of the Crown for interest (Sec 30 VAT Act). Mr Eyre advised that at times, up to 3 batches of refund cheques would be issued in a one-month period to avoid interest payments to taxpayers. These were invariably done by cheque payment although nearer the end of his time, refunds to taxpayers' bank accounts were being introduced where account numbers were held.

63. Revenue Management's comments:

- The PERC report states that that former Revenue Management employee Mr. Philip Eyre had stated an average month's VAT refunds, with exceptions excluded, totaled between \$150k and \$200k. Data extracted from RMS shows that VAT refunds for the 2014 to 2017 calendar years were as follows:

○ 2014	\$7,647,476
○ 2015	\$7,244,251
○ 2016	\$8,081,613
○ 2017	\$8,763,613
- This is an average of \$661k in VAT refunds each month during this four-year period. This is significantly greater than the \$150k - \$200k stated by Mr. Phillip Eyre. This variance between actual monthly VAT refunds and Mr. Eyre's recollection of the amount refunded must bring into question the veracity of other amounts (VAT carrying amount) where he has relied on his recollection / memory of the amounts.



64. PERC report extract (refer p.14):

Mr Eyre advised that the approximate average 'carrying amount' of total VAT refunds held and not paid out was well under \$500,000 at any one time. It is expected that there is a carrying amount of VAT refund claims because not all claims are automatically accepted as valid. Some are audited which is by far the main reason some are held temporarily. Some are released for payment after audit and some may be adjusted before payment. Mr Eyre advised that he recalled only one period when the total was near or over the \$500k level when some government departments which did not understand the system, made erroneous claims and once these were extracted out, the carrying amount fell to well under \$5 00k. This historic average contrasts greatly with the \$5 million position reported by Mr Richardson in late 2019 when he commenced and the approximate \$2 million held from claimants in late 2021.

65. Revenue Management's comments:

- As noted above, the veracity of Mr. Phillip Eyre's recollection of the carrying amount of VAT refunds must be considered in light of the fact his recollection of the value or refunds issued each month was less than 1/3rd of the actual value of refunds issued each month.
- The figure suggested by Mr. Eyre must also be considered in the context of the reports available at the time which only reflected the value of VAT refunds held as opposed to all VAT credits (refunds or otherwise) that are recorded in the current credit report produced.
- As of 16 December 2019, total VAT credits relating to periods prior to 2018 were \$880,149 from a total of \$2,746,187. Given that this was in the vicinity of two years since Mr. Phillip Eyre had resigned from Revenue Management it would be reasonable to assume that the total VAT credits for periods prior to 2018 (around the time Mr. Phillip Eyre resigned) would have been substantially higher than the figure as of 16 December 2019.

66. PERC report extract (refer p.14):

Assuming toward all refund claims are valid then the cost on the crown from not paying VAT refunds is substantial. Using a midpoint between the \$5 million dollars withheld at November 2019 and \$2 million at December 2021, then an unnecessary cost of around \$420,000 per year has been incurred by Revenue Management calculated using the prescribed rate of 12% as per section 30 of the VAT Act.

67. Revenue Management's comments:

- Revenue Management accepts there is an interest liability under section 30 of the VAT Act in relation to VAT refunds that have not been released in accordance with section 29 of the VAT Act. However, it is considered the approach taken by PERC in determining any interest liability is overly simplistic.



- This is further exacerbated by calculating the estimated interest liability on all VAT credits where there is only a liability in relation to VAT refunds calculated in accordance with the provisions of section 16 of the VAT Act.

68. PERC report extract (refer p.14):

PERC was advised that refunds are only made if a bank account number to pay to is held. Although Mr Richardson in December 2021 advised they could do cheque refunds if pressed. The change to only making refunds to nominated bank accounts is considered a contributing factor to the deteriorated VAT refund position overall. It should be noted that the legislation does not provide for the Collector to withhold a VAT refund because he does not have a bank account reference to pay to. In view of the cheque system continuing to operate widely in the Cook Islands and in view of a large percentage of VAT returns continuing to be filed manually (78% in 2020), then it is also unreasonable to expect all transactions to be done by internet banking. PERC recommends that the cheque system for refunds continue to be actively utilised where no bank account number is held to avoid taxpayer dissatisfaction and cost on the Crown through having to pay late refund interest.

69. Revenue Management's comments:

- It is Revenue Management's preference to pay refunds by direct credit to bank accounts although there are still instances where cheques are issued. It is noted that whilst PERCA has recorded that in 2020 only 22% of VAT registered taxpayers filed online the data obtained from RMS shows that during the year to 31 December 2021 67.88% of all VAT returns filed were filed online. This indicates that there has been a significant increase in the use of online filing and electronic technology.
- This aligns with Revenue Management's strategy regarding electronic filing of returns.
- Given the historic and ongoing issues with contacting taxpayers it is considered that paying refunds by direct credit is a more efficient process in comparison to issuing cheques.
- At times it is difficult to get cheques mailed/delivered to taxpayers or contacting taxpayers to advise that there is a cheque available to be collected.
- Making refunds by direct credit also gives taxpayers quicker access to their refunds as there is no waiting time for the cheque to clear.
- As noted above there has been no evidence of a deterioration on the VAT refund position other than anecdotal comments by a previous Revenue Management employee which have been shown to be inconsistent with the data extracted from RMS.

From a Crown Perspective

70. PERC report extract (refer p.15):

It should be noted that the material liability of government in late 2019 and through to late 2021 for tax refunds is not reflected in published accounts. Note #22 of the last issued Crown accounts for the June 2019 year discloses that unlike prior years no tax refunds owing were recorded in the accounts. As such, a major shortcoming in the Crown accounts is evident. It is noted that the accounts were qualified in respect of taxation in the 2019 Audit Report. Furthermore, enquiries to the MFEM Treasury division by PERC show



that no Accounts Payable summaries being Tax Refunds are passed on to Treasury Division by RMD. This failure leads to Treasury, then Audit not having information which is critical in being able to verify the completeness, the correctness or otherwise, plus the net worth of the Crown in published accounts. It should be noted also that the Collector of Revenue Management is on record with the Audit office as being unwilling to allow Audit staff access to records citing confidentiality. This however contradicts section 27 of the Public Expenditure Review Committee and Audit Act which requires the Audit Office conduct all audits of the Crown.

71. Revenue Management's comments:

- This does not form part of the complaint made with PERC.
- It appears that the PERC Chairman is not aware of the solution which has been implemented which allows the Audit Officers to access information held by Revenue Management. This is surprising given he is the PERC Chairman.
- A long-term fix will be included in a proposed Tax Administration Act. This was considered in a 2020 Tax Review which was conducted by the Pacific Financial Technical Assistance Center.

72. PERC report extract (refer p.15):

Staff of the Revenue Management Division including the Collector, met with a group of local accountants on 23 November 2020. At that meeting, concern was expressed regarding the workings of the VAT system. In answer to a question, Mr Toleafoa for RMD conceded that the VAT refund system had been quote 'neglected'. At that time, it was also conceded that the provisional tax module within the RMS system did not work properly. The Collector Mr Mitchell advised the meeting that the problems started when Mr Phillip Eyre left the RMD which was February 2018. This revelation aligns to the deteriorated position of near \$5 million dollars of unpaid VAT refunds being held by RMD around November 2019 which was toward two years after Mr Eyre resigned.

73. Revenue Management's comments:

- As noted earlier, the total value of VAT 'credits' as of 16 December 2019 relating to periods prior to 2018 was \$880,149.
- Given that this was in the vicinity of two years after Mr. Phillip Eyre resigned it would seem probable that the total VAT credits relating to periods prior to Mr. Eyre's resignation would have reduced significantly during the two year period between Mr. Eyre's resignation and December 2019 and a significant portion of the approximately \$5 million in credits in November 2019 may have related to periods prior to Mr. Eyre's resignation. Consequently, it is possible that the VAT refund system had not deteriorated to the extent assumed in the report.

74. PERC report extract (refer p.15):

It is apparent that serious failures in the VAT system have occurred since 2018. It was the Collectors responsibility to ensure the VAT system continued to operate in accordance with the law and taxpayer expectations. PERC has concluded there was management failure to replace staff member Mr Eyre in February 2018 with a person of comparable experience and familiarity to issue refunds along with management failure to monitor that the



process continued. Alternatively, there was failure to elevate other existing staff to his duties promptly, to ensure the VAT refund system which is an integral part of operations, continued to operate satisfactorily. This failure to elevate existing staff also applied to any replacement for Mr Eyre who proved unsatisfactory.

75. Revenue Management's comments:

- The suggestion that there have been serious failures in the VAT system since 2018 is based on anecdotal statement from a previous employee of Revenue Management. There is no documentary evidence to substantiate Mr. Eyre's comments. Data extracted from RMS confirms there are significant variances between Mr. Eyre's recollection and the actual position regarding VAT refunds during his employment.
- Following the resignation Mr. Eyre another local staff member was given responsibility for the processing and releasing of VAT refunds. At the time of Mr. Eyre's resignation this local staff member had developed over 10 years' experience working for Revenue Management. She was and still is considered suitably qualified to undertake the role.
- The delays in appointing a permanent replacement for Mr. Eyre reflects the difficult and competitive recruitment environment in which Revenue Management operates as opposed to any failure on the part of management.

Conclusions and Closing Recommendations

76. PERC report extract (refer p.16):

This was a complaint that had been elevated to the Financial Secretary in view of the delays and non-resolution. It was a complaint which took 9 months for the Collector to allocate PERC an interview time. It was a complaint that the Collector much later instructed his staff to coordinate communication through one senior officer Mr Richardson. In all of the circumstances, time pressures on staff notwithstanding, PERC has concluded that there were significant management failures in resolving matters.

77. Revenue Management's comments:

- As noted in this letter information provided in the report is not accurate and, in some instances, not correct.
- Revenue Management does not agree with all of the conclusions reached by PERCA.
- Revenue Management is of the opinion that there have been significant errors in the interpretation of the VAT Act by PERCA which have resulted in incorrect conclusions with respect to certain aspects of the complaint in relation to the VAT matters.
- Consequently, the overall conclusion that all areas of the complaint have been sustained is incorrect.

78. PERC report extract (refer p.14):

A number of recommendations have been included in this report in respect of operations in order to overcome the problems observed and it is suggested that these aspects be monitored by the Secretary of Finance and the Office of the Public Service Commissioner.



79. Revenue Management's comments:

- As noted previously Revenue Management does not agree with all of the conclusions and subsequent recommendations contained within the report. Notwithstanding this it is the decision of the Financial Secretary and Public Service Commissioner whether they consider closer monitoring is required having considered both the PERCA report and the response by Revenue Management.

80. PERC report extract (refer p.14):

In view of the significant failures by the Collector in not addressing the taxpayer's complaints, and not successfully addressing the acknowledged problems at Revenue Management, it is recommended that the management shortcomings and report conclusions be taken into account in the Collectors next performance review.

81. Revenue Management's comments:

- As noted above it is the decision of the Financial Secretary as to whether he considers further action is required having considered both the PERCA report and the Revenue Management response which disputes a number of the conclusions and subsequent recommendations based on those conclusions.

82. As you know disclosure of taxpayer specific information is limited by section 7 of the ITA. Please ensure that taxpayer information provided by Revenue Management is either anonymised or the relevant taxpayers have approved for their taxpayer specific information to be released publicly.

A handwritten signature in black ink, appearing to read 'Xavier Mitchell', written in a cursive style.

Xavier Mitchell
Director, Revenue Management Division

PUBLIC EXPENDITURE REVIEW COMMITTEE

PO Box 659, Rarotonga,

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18 March 2022

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Mr Garth Henderson
Financial Secretary
Ministry of Finance and Economic Management
Rarotonga

Kia Orana Mr Henderson,

PUBLIC EXPENDITURE REVIEW COMMITTEE: REPORT ON COMPLAINT RECEIVED REGARDING REVENUE MANAGEMENT DIVISION AT MINISTRY OF FINANCE

This report describes a complaint received from a Cook Islands resident taxpayer Mr John Scott ('complainant' or 'taxpayer') in relation to personal tax returns for himself and his wife as well as the tax affairs of his company Escapa Developments Ltd, hereinafter referred to as 'Escapa' or 'complainant company'.

The complaint is summarised with a history of dealings, its components, an analysis is provided, where appropriate the tax law is cited, the Revenue Management Charter is noted, and conclusions and recommendations are made based on the findings by the Public Expenditure Review Committee (PERC) including acknowledgements made during interview with Revenue Management Office (RMD) staff. The material examined by PERC, as well as review notes has been examined by staff of the Government Audit Office who have contributed to this report.

The complaint was received in November 2020 and was accompanied by material issued by the office of Revenue Management including a number of complaint letters by the complainant taxpayer and Escapa to RMD. The issues raised were either not responded to, addressed only after a lengthy time period or not resolved between the complainant and RMD.

The complaint was referred to PERC in view of

- no timely or resolving replies by RMD to the taxpayer's concerns;
- the desirability for an independent person or body to examine the records and integrity of the processing systems referred to in the complaint.

The PERC committee met and considered the concerns had merit in view of the RMD Charter providing 'for resolving disagreements, ... we will work with you to try and reach an outcome quickly and simply'.

Legislative Authority

The complaint was examined under the authority of section 14 (1) (c) and (d) of the Public Expenditure Review Committee and Audit Act 1995- 96 which provides for audits in respect of reliability of systems and procedures and the integrity of information produced as well as legitimate issues of public concern.

The purposes of the Act also provide in section 3 for the accountability of servants of the Crown and to enable parliament to be informed of the management of public money.

The Objective of the Investigation

Was to ascertain if there were shortcomings in the service and systems which lead to allegations by the complainant and Escapa that inter alia, taxes had been recorded which were incorrect. And whether information originating from RMD was in a number of instances incorrect or could not be relied on.

A letter notifying that PERC would conduct a review under its statutory authority was delivered to the Collector on 6 January 2021. Included in its letter to the Collector, PERC requested an interview with appropriate staff members who had been handling the complainant's affairs. The letter was acknowledged by the Collector same day. However, it took 7 months before the Collector indicated he was ready for an interview plus 3 further delays of a fortnight then one week and repeated until finally on 21 October 2021 a meeting was held. The delays by the Collector in agreeing to meet are unprecedented in the history of PERC. The committee considers that people who complain to PERC rightly have an expectation that it will be taken seriously and acted upon promptly if prima facie, there appears to be validity in the complaint.

The meeting on 21 October 2021 was conducted by the Chairman of PERC with the Collector and 4 of his staff and was of 2 hours 40 minutes duration. In view of the detailed nature of some aspects of the complaint, three sets of documents were left with RMD for review at the end of the interview. It took in excess of another month for responses to be received from RMD on these.

PERSONAL INCOME TAX

The complainant complained of the non-issue of assessments after filing tax returns, and the non-payment of refunds.

Historically the taxpayer complainants (both Mr and Mrs Scott) had not filed personal tax returns since year 2002 because they had no taxable income. Instead, he had accessed capital amounts from his company for living expenses which capital originated from loans or shareholders current account with the business. It should be noted that this is acceptable business and tax treatment. RMD had accepted the non filing of personal tax returns in a letter issued by a Mr Batchelor in 2002. However, RMD initially did not have their record (file copy) which indicated RMDs records were deficient with an important ruling by a senior staff member not retained. Later however it was discovered that a copy of the letter had been e mailed by Mr Scott to Mr Bayne at RMD in 2016.

An update of the position in respect of non filing of personal tax returns was enquired on by Mr Bayne for RMD in 2016 and explanatory correspondence was exchanged by the parties with seemingly continued acceptance of the position. The matter next arose on date 28-8-18 when a Mr Tekanene of RMD issued a letter to Mr Scott threatening prosecution for failing to file returns for the years 2010-2017.

Mr Scott replied just 2 days later on 30-8-18 agreeing to file and again explained the reason he had not filed was that he had credits (prior year losses) to utilise and no assessable income. As his wife Mrs Scott was in similar position and had incurred modest taxes against bank interest income and other, then he agreed to file returns for her as well and claim the expected refunds. The situation was well explained by Mr Scott in timely letters to RMD.

Returns were lodged soon after on 4-10-18. Refunds were calculated amounting to \$7,358.41. On 20 March 2020 18 months after filing, Scott complained in writing that no assessments had been issued and no refunds received. By November 2020 when complaint came to PERC over 2 years had gone by without processing of the returns.

Because of the non resolution of matters which by then had extended to Value Added Tax and Company Income Tax which are addressed later in this report, the complainant forwarded his complaints to the Financial Secretary to whom the Collector has a reporting line. He presented letters dated 4-4-20 and 18-8-20. Enquiry to the Collector in October 2021 revealed that no input was made by the Financial Secretary other than advising the Collector that he would leave matters with him.

In correspondence to RMD dated 9-1-21 the information was again laid out for Mr Richardson of RMD with tables showing the calculations. By October 2021 being 3 years after filing, no assessments or refunds had issued.

In an e mail issued by RMD dated 11 January 2021 RMD advised that in view of a PERC investigation being undertaken, that action on the personal tax returns would be put on hold. PERC considers that there was no justification for continued non action and the matter could have been resolved notwithstanding a PERC review.

There was never any indication the PERC review would not continue once the complaint had been received and assessed as justifying investigation. It is relevant to again record that it took 8 months until the Collector was willing to allocate an interview time with PERC and that the original complaint to RMD of non processing of the returns was 18 months after filing. This was March 2020 and staff resources at RMD were not stretched due to the sometimes suggested covid impact. Further comment on this aspect is recorded later in this report. It is further noted by PERC that RMD was able to issue various e mails and lengthy letters advising inter alia what the law was, yet still did not assess the returns.

Records at RMD appeared incomplete in that the earlier filed returns in 1999 and 2000 were not locatable. Mr Scott's copies of those years returns contained record of the depreciation schedule of a business asset and the amount of unexpired depreciation which was the source of the carried forward losses because that asset had become redundant. If this aspect had been accepted by RMD then matters could have been resolved.

For RMD, Mr Richardson by letter 21-10-20 asked for returns 2001-2009 to substantiate the losses carried forward. Mr Scott replied promptly on 24-10-20 saying he held a letter from Batchelor advising no returns were required until he had assessable income. With RMD not having records to identify the claim for balance of depreciation (\$44,408) then the matter stalemated. Combined with the Collectors stance that no action would be taken until completion of the PERC review, a further delay of another year onto an already unreasonable time span for processing tax returns occurred. It was not until interview with PERC on 21 October 2021 that the matter was progressed with a copy of the 2000 balance sheet with depreciation evidenced.

Mr Richardson for RMD took a strict statutory approach advising that returns must be filed as per section 205 of the Income Tax Act. He advised PERC 'That is what the Act says' claiming there was no discretion available. He was unwilling to accept by way of signed letter from Mr Scott that there was no assessable income and as such nil returns could be entered to RMD's records with the depreciation claim being utilised in future when he and his wife did have assessable or taxable income.

However, the Collector does have discretion to depart from the strict requirements utilising the economic approach for best use of time and resources, and having regard to the quantum of taxes involved. The economic approach has been tested and confirmed in the High Court of the Cook Islands in respect of taxation. It is unfortunate that such an approach was not taken and it perhaps reflects a lack of knowledge by the Collector and staff.

Summary observations and conclusions

1. There was a lengthy gap of 18 months from tax return filing to first follow up by the complainant. Follow up by the complainant was justified.
2. Within that 18 months, there was no communication from RMD to the taxpayer that the figures submitted were in any way disputed.
3. The lack of records at RMD, particularly the tax returns filed in 1999 and 2000 meant the Collectors staff were not able to identify the loss amount from depreciation write off to be carried forward.
4. The non-processing of returns for the years 2010 – 2017 into assessments and the subsequent non-payment of claimed refunds is now over a period of 3 years.
5. A proactive communication approach would likely have bridged the information shortfall at RMD and the matter could have been resolved much earlier.
6. The published RMD Charter undertakes to look at problems '**promptly to achieve a solution**'. The long delays do not reflect promptly working to achieve a solution. In interview, the Collector Mr Mitchell conceded that the Charter obligation had not been met.

Personal Income Tax Recommendation

It is recommended by PERC that the Collector assess the information at hand and give priority to assessing, and issuing the claimed refunds.

COMPANY TAX

The company complained of

- incorrect assessments of company tax being produced by RMD
- later reissued assessments and adjustments showing in reconciliation statements which also did not reflect the true position.
- non recorded payments
- the transfer of VAT refunds across to company tax without notification
- Failure or unreasonable delays in reply to concerning correspondence
- overcharged additional tax

Background

The company has what is termed a non-standard balance date for its year end accounting and tax return filing. A standard balance date is 31 December annually. However, many companies have balance dates which are different than 31 December. Escapa has a 30 June balance date. One of the effects of having a non standard balance date is that provisional tax due dates are also non-standard meaning they are away from the standard 1 June and 1 December annually. It is however acceptable to have a non-standard balance date and the onus is on RMD to apply the correct due dates of provisional tax to such companies.

Company assessments 2016 to 2019

The company contracted a Rarotonga chartered accountant Ms Cecile Marten to prepare and file its year end returns. As such, most but not all information to and from Revenue Management flowed through that accountant's office. PERC examined material in relation to the complaints being assessments, correspondence and reconciliations. Enquiries were put to the Collector and his staff at interview on 21 October 2021. Further questions were put to Mr Richardson of RMD on 10 December 2021. Additional written questions were put to Mr Toleafoa and replied to in writing by him with date 29 November 2021.

Detail of the company's complaints and RMD responses

Assessments

The company complained of incorrect assessments with errors in the provisional tax due dates and resultantly overcharged additional tax for 'late' payment in several instances when in fact no late payment had occurred. Outside of the tax amnesty period which covered years up to 2016 when additional tax was waived, only in two instances was a late payment made which attracted additional tax. It is not considered necessary to detail all amounts and dates, suffice to say that the additional tax was overcharged in some periods by tens of thousands of dollars.

One example of poor integrity of information will however be described. For the year 2019 an initial assessment with tax to pay and credit (payment) entries was issued on 1 March 2021 which arrived at a nil balance – nothing to pay. A 2 months later reconciliation report dated 2 May 2021 had it ending with an unfathomable **credit** of \$313,296.

Mr Toleafoa for RMD advised by letter dated 29 November that the registration details had not been updated before the income tax returns were submitted online to reflect the non-standard balance date. As a result, the provisional tax was processed using incorrect periods with incorrect amounts. Once the provisional tax was corrected to reflect the non-standard balance date of 30 June, the additional tax also corrected. Fresh assessments were issued later in 2021 which moved the position toward correctness.

In response to enquiry whether other taxpayers with non-standard balance dates might be charged with excessive additional tax, he commented that if businesses paid their tax by due date this would not be an issue. However, this contention misses the point that non-standard balance dates can be the cause of overcharge even if tax is paid on time. Less astute taxpayers may be getting charged tax they do not owe without realising. Mr Toleafoa advised that this was something his office was working on.

Non recorded payments

Ms Marten accountant for Escapa, submitted a detailed comparison of payments made by the company against what was showing as received by RMD. Payments totalling \$285,582 were not showing in RMDs records. A payment of \$241,059 paid on 1-11-18 including

\$501 thereof for PAYE was not showing as received in any reports up to May 2021 when it belatedly appeared as a rejig of the year 2016 statement for company tax. The posting date was observed as 31-5-21. This crediting largely bridged the difference. Noteworthy also is that the \$501 was still not put against the PAYE it was received for.

Communication failure

On 4 May 2021 Ms Linda Ailao for RMD received Escapa's submission that a reconciliation of RMDs records against amounts paid by Escapa was out by \$285,582. A follow up was sent by accountant Marten almost 3 months later on 22 July 2021 without response. No reply ever arrived. Mr Toleafoa for RMD in correspondence dated 29 November 2021 accepted that there was failure to inform the company of fresh postings and a tidy up of assessments and reconciliations. In view of the complaint to PERC being under action, as well as a concerning letter of objection submitted by the accountant for Escapa, it is not considered acceptable to make material value adjustments in favour of Escapa and not directly communicate the corrections immediately. PERC considers the communication failure does not reflect an acceptable level of service. In spite of the sometimes expressed delays because of covid diversions, it was noted that staff during 2020 and 2021 were able to issue multi page correspondence to the company explaining what the law was and describing at length the application of penalties (additional tax) yet failed to address the real issues. PERC recommends that better oversight of staff by the Collector in dealing with high end issues be required in future.

Transfer of VAT refunds across to company tax without notification

In interview on 21 October 2021 staff of RMD claimed the transfers to company tax were not VAT refunds rather they were overpayments of tax by the company as a result of the company filing its VAT returns in two parts. However, no advice of this classification had ever been given by RMD to the company between 1997 when the VAT system started and year 2021. PERC considered the contention was a rear guard attempt to not pay interest on late paid and non-notified VAT transfers. It should be noted that VAT refunds in the case of importers largely result because of VAT paid on imports which are not yet sold and as a result a timing difference results wherein the credit for VAT import VAT exceeds sales VAT for that month. Many importers have this effect reflected in their returns. PERC is of the view that the classification of transfers across to company tax (late and /or un-notified) is not a sustainable argument by the Collector and his staff. However subsequently in a meeting with Mr Richardson on 10 December he advised that his office would not continue the contention that transfers were overpayments.

In addition to transactions described under Value Added Tax hereunder, other examples of non-recorded payments and move around of entries over time by RMD were observed during the PERC review.

- (i) a payment of \$9,214 made for Deferred VAT on 20-1-16 was much later (February 2021) shown as a payment toward company tax with posting date 27-3-18.

- (ii) Two VAT transfers on a February 2021 reconciliation disappeared on a later version and were replaced by different months transfers at different amounts.

These recordings evidence that there had been move around of entries over time by RMD without notification and the company complaint is justified in that it could not rely on information from RMD which is later changed without direct notification.

Overall the integrity of information produced in respect of company tax assessments and statements was poor in the period leading up to commencement of the PERC investigation and through until mid-2021 when corrections were actioned.

VALUE ADDED TAX

The complaints described

The Escapa company complained of the non issue of assessments, the non-issue of statements, the issue of incorrect statements, non-payment of valid VAT refunds, the non-payment of interest on unpaid or late paid refunds of VAT and the transfer of some VAT refunds to company tax without notification as is required by the legislation.

The complainant described the deferred VAT system as in 'total disarray' in fact he believed it would not be an exaggeration to describe it as a 'shambles' adding that 'The problem is that it has been allowed to drift over an extended period of time despite attention being directed to its faults. It used not to be thus' In interview with Mr Scott he described the situation as one of public concern because he knew of other taxpayer dissatisfaction.

At the time of lodging his complaints with PERC, the complainant claimed his company was owed VAT refunds in excess of \$35,000. Mr Scott referred to 'Incomprehensible ridiculous statements have become the norm oscillating between phenomenal credit opening balances on the one hand and equally stupid debit balances on the other'. 23 pages of statements were provided to PERC in evidence of this. Later statements throughout 2021 and into 2022 contained 'line throughs' on the opening or closing balances. PERC limits its examples description of non-reliable information to the following 4 instances.

- a statement for February 2021 with opening balance of \$33,556 Debit. It has just one entry on it mid-month for \$3,071. The statement ends with a debit balance of \$53,995. Both the open and close balances are then ruled out.
- Two statements were issued for February 2020 with different balances and not ruled out. The first dated 19 February for \$22,567 credit, the second dated 17 March for \$19,096 credit.
- Two statements were issued for May 2020 with different balances. The first dated 12 May for, \$13,837 Dr, the second dated 12 June with \$21,743 Dr and ruled out.

Prima facie the taxpayer was entitled to believe nothing was owing as at June 2020 but much later, in 2021 Customs and Revenue Management were alleging large sums were unpaid as at June 2020.

- Large credit balances on statements were not taken into account. Example (a) \$64,334 Nov 2018. Example (b) February 2019 read zero but March started with a \$73,020 credit brought forward. Although these were of arguable validity, the company was not advised the balances could not be relied on until October 2020.

It became apparent in the review by PERC that the integrity of information produced by RMD was poor.

Mr Richardson for RMD conceded in a letter to Escapa dated 21 October 2020 'We are currently working on system fixes to correct these issues' and 'we prefer not to issue statements'. Non statement issue was a specific complaint of Escapa. Similarly, on 31 December 2020 'we are aware there are issues regarding the Import VAT statements that affect the opening and closing balances on the statements'. PERC notes that the production of statements at month end, was since 1997, an integral part of the Deferred Vat system and by issuing the statement, importers then had the tally of what they were expected to pay within 20 days of month end. Our review concluded that the integrity of information produced by Revenue Management on statements could not be relied on balance wise.

The complainant wrote to the Collector on 20 March 2020 questioning why he should continue to pay import VAT when the Ministry should be paying him. With no response, the complainant elevated the matter to the Financial Secretary on 4 April 2020 without success. Mr Scott wrote again on 18 August 2020 in greater detail and only then obtained a response from the Collector addressing none of the issues except an undertaking to look into the points noted in the letter and provide a response. Mr Richardson commenced correspondence on matters 2 months later in late October 2020 and the matter came to PERC in November 2020. Unreasonable time delays are apparent especially in view of concerns existing and communication thereon going back to pre covid times.

Over the months February to June of 2020 the complainant withheld payment of VAT on each filed return adding a notation drawing attention to the Collectors inaction and asking 'Please clarify the position'

The Value Added Tax (VAT) system described

VAT is charged on imported goods at time of import and even with a "Deferred VAT System" which allows for payment of that tax on imports each calendar month on 20th following, this still regularly results in refunds because much imported stock is not sold by the end of the month it was received in country. As a result, VAT which is both an import tax and a sales tax, has been incurred but sales have not yet occurred. Monthly return forms

provide for a credit for the former. This is similar for all importers and is termed a 'timing difference' in accounting terms and is one reason there is a regular batch of VAT refunds payable to importers each calendar month. The complainant company was a regular importer of goods.

The VAT system provides for Group Registration and filing for companies or businesses with common ownership. Separate income tax returns are however required at year end. Much has been made in correspondence by Revenue Management from 31 December 2020 and forward of the registration and filing format used by Mr Scott for his businesses. However, this was considered by PERC to be a smoke screen to defer attention to the real issues. In Mr Scott's case, two divisions of his operations under Escapa Developments Ltd were, since the beginning of the VAT system in 1997 processed with separate VAT returns. These were Scott's Farm operations and Muri Beach Club Hotel. This was accepted by the office Revenue Management through until early 2021 when as a result of examination in the course of his complaints, it was observed that the businesses were not separate for Income Tax purposes. The Escapa company agreed to consolidate the returns thereafter. It should be noted however that the presentation 1997 to 2021 did not affect the amount of tax payable or refundable throughout the previous 24 years.

Analysis of the complaint

A core aspect of the Escapa company's VAT complaint is that the company was not given refunds it was entitled to in a timely manner. Over time a number of staff were involved in the processing of returns and looking at the position. Much later, in view of the complaint escalating, the Collector instructed that all matters be channelled through his senior officer Alan Richardson. This was advised to PERC in the interview in October 2021.

It is not considered useful to detail all VAT claims by the complainant company with filing dates and timelines which followed. Noteworthy is that there had been no dispute on the accuracy of the VAT returns by the company. They were all accepted as correct on an 'as filed' basis. Only one return in the material examined had an error in its preparation by the taxpayer and his was for the month of January 2020 where an arithmetic error resulted in a payment in of \$8,943 when in fact no payment was required.

A condensed summary is that many refunds claimed were either not paid to Escapa or were used to pay other tax under company tax. Use of a VAT refund (transfer) is governed by section 29 of the VAT Act. Importantly, transfer of a VAT refund, and / or interest owing thereon requires notification to the taxpayer as per section 29(5). The right of set off or

transfer by the Collector lapses if not acted upon within 15 days of filing a return with refund claim. In material examined by PERC 11 transfers to company income tax were examined. These totalled \$81,856. Mr Richardson for the Collector conceded in interview that none of the transfers were notified to the Escapa company. From records examined by PERC regarding these 11 amounts at least 5 were also not transferred within the 15 days limit before interest was payable. Accordingly, in at least 5 transactions the Collector also did not have authority to transfer. As such it is apparent that in view of the legislative requirements not being met, that interest is payable by the Crown on all. It is recommended that the Collectors staff calculate interest owing and report to the taxpayer company.

Two separate transfers were observed where notification was made. However, these only occurred as a result of enquiry by the company itself to a tax office staff member because Escapa believed a net position of refunds was due to it and it was therefore unnecessary to pay 2 amounts which related to PAYE and Vat for July 2020. The complainant company was enquiring after refunds for May 2020 and June 2020. The date of enquiry was 20 August 2020 well after the 15 days provided for refund processing which should have occurred around 4 June and 5 July.

PERC concluded that the legislative requirements had not been met and taxpayer expectations had not been met.

Another aspect of the complaint was the charging of interest to the complainant company in respect of the non-payment of VAT due on imported goods on 20th following month end. As already recorded in this report, the company between February and June 2020, plus other periods did not pay its Deferred VAT because overall it was owed refunds from earlier periods which were not forthcoming. As a result, interest at the heavy rate of 5% initially followed by 2% monthly had been recorded on subsequent statements issued by RMD. Revenue Management staff have considered this aspect in the course of the complaint to PERC as well as representations by the company and given an indication in meeting with PERC that in view of the company being owed refunds it is willing to waive that interest charged up. This aspect will need further work by both Revenue Management and the Escapa company to agree the core amounts owing and what amounts have already been paid. As some entries relate to year 2010 and year 2013 being 12 and 9 years back and are of doubtful verification by Revenue Management, then PERC recommends that in order to reach a settlement that where doubt exists, that doubt be exercised in favour of the taxpayer. It should be noted that taxpayers are only required to retain records for 5 years and in view of

a handful of amounts allegedly relating to 12 years ago which were not brought to attention until 2020 then the enforceability of same by the Collector is not strong.

PERC acknowledges that Ms Elizabeth Tetauru of Customs office had in late 2021 scheduled for discussion purposes what she thought was owed in Import VAT from missed payments as a result of amounts withheld by Escapa when other refunds were not given or not notified as transferred to company tax. She also scheduled some allegedly historic unpaid entries. However, this exercise is difficult for RMD as well as Escapa because statements have for several years not been correct with opening and closing balances unrecorded. It follows that reconciliation of a position going back several years would be difficult and for this reason PERC recommends working toward a settlement where if doubt exists then that be exercised in favour of the complainant company.

The poorly operating VAT refund system removed all confidence the Escapa company had in Revenue Management and meant that when in some months a payment was due, the company refrained from making it. In view of the alarmingly high amount of refunds held from 2019 right through until December 2021 at least (refer below), then it is reasonable to conclude that other taxpayers would also have become frustrated with the system. Compliance on filing returns and making payments is likely to have declined although difficult to measure. This is unfortunate as encouraging of compliance has long been a principle of tax office operations.

In interview on 21 October 2021 the Collector Mr Mitchell conceded that VAT operations were not adequately staffed after Mr Eyre left RMD in February 2018. He named employees who had in turn left being a Mr Hawkins and a Ms Pritchard.

Revenue Management advised Escapa by letter dated 21 October 2020

‘We are currently working on system fixes in the interim we prefer not to issue statements. The current fixes include an automatic review of all accounts which is scheduled to be finalised and undertaken by Christmas (2020)’

PERC observed that by February 2022, being one year and 4 months later, that system fixes are not apparent with statements still having balances ruled out.

Customs Import VAT System described

A description of the current system was obtained from Customs and VAT staff in interview on 21 October 2021. At that time, and over the period that the complaint to PERC extends, a

monthly report known as Nexus was generated from a system known as Cosmos. This system was introduced in more recent years to supersede the monthly Deferred VAT (Payment) statement traditionally produced out of the 'Revenue Management System' (RMS) which is the computer system which had been operating since 1997. The Collectors staff advised that they tried to integrate Cosmos to RMS. The Nexus report should reconcile to RMS however the 2 systems have not been fully compatible. The complaint to PERC is in part, reflective of the systems not being compatible. PERC was advised that re-entry of data over a 3-year period had been required.

It was also noted that in recent years, management had taken the decision to move customs operations to a separate physical premises with the separate Cosmos system referred to above included. PERC noted that historically customs and tax operations were merged in 1997 to achieve efficiencies and the structure has now been changed back to what it was pre 1997.

PERC was advised in interview with customs staff that only between 40 to 45 businesses use the Deferred Payment VAT system. This is a small number to service and it has not grown greatly over many years, it being reflective of the small country size of the Cook Islands. The Collector's staff also advised that they were now proceeding with a new system called Azycuda World which would facilitate the processing of import duty charges and VAT. This was shown in correspondence dated October 2020 wherein it was to be implemented over the following 12 months however appears not to have been achieved with statements using the original system continuing to be issued as late as February 2022. The cost of a new system compared to a cost of effecting fixes to the earlier system was not investigated by PERC however it is disappointing that the problems with current system were not actioned as advised in October 2020, either as a bridging measure or permanent fix.

Interviews with staff and former employee

Mr Richardson of RMD was interviewed on 17 November and again on 10 December 2021. He advised that he commenced employment at the office in November 2019. At that time, he advised there was a total of near \$5 million in VAT refunds not paid out to claimants. He further advised that staff had later got the amount reduced to \$3 million and moving toward \$2 million presently.

Mr Philp Eyre a former long serving senior officer at RMD was interviewed regarding his experience with the VAT refund system. He was employed from 1998 through to February 2018 a period of 20 years. He was the principal VAT officer responsible for audits and issuing of VAT refunds. The system which operated during his tenure was that a 'batch' of refunds claimed would be issued usually just before the expiry of 15 days from 20th of each month. An average months refund total with exceptions excluded, was in the range \$150k to

\$200k. Most returns and refund claims are filed on or about 20th of each month. By paying these before expiry of the 15 days limit, this avoided liability of the Crown for interest (Sec 30 VAT Act). Mr Eyre advised that at times, up to 3 batches of refund cheques would be issued in a one-month period to avoid interest payments to taxpayers. These were invariably done by cheque payment although nearer the end of his time, refunds to taxpayers' bank accounts were being introduced where account numbers were held.

Mr Eyre advised that the approximate average 'carrying amount' of total VAT refunds held and not paid out was well under \$500,000 at any one time. It is expected that there is a carrying amount of VAT refund claims because not all claims are automatically accepted as valid. Some are audited which is by far the main reason some are held temporarily. Some are released for payment after audit and some may be adjusted before payment. Mr Eyre advised that he recalled only one period when the total was near or over the \$500k level when some government departments which did not understand the system, made erroneous claims and once these were extracted out, the carrying amount fell to well under \$500k. This historic average contrasts greatly with the \$5 million position reported by Mr Richardson in late 2019 when he commenced and the approximate \$2 million held from claimants in late 2021.

Assuming toward all refund claims are valid then the cost on the crown from not paying VAT refunds is substantial. Using a midpoint between the \$5 million dollars withheld at November 2019 and \$2 million at December 2021, then an unnecessary cost of around \$420,000 per year has been incurred by Revenue Management calculated using the prescribed rate of 12% as per section 30 of the VAT Act.

PERC was advised that refunds are only made if a bank account number to pay to is held. Although Mr Richardson in December 2021 advised they could do cheque refunds if pressed. The change to only making refunds to nominated bank accounts is considered a contributing factor to the deteriorated VAT refund position overall. It should be noted that the legislation does not provide for the Collector to withhold a VAT refund because he does not have a bank account reference to pay to. In view of the cheque system continuing to operate widely in the Cook Islands and in view of a large percentage of VAT returns continuing to be filed manually (78% in 2020), then it is also unreasonable to expect all transactions to be done by internet banking. PERC recommends that the cheque system for refunds continue to be actively utilised where no bank account number is held to avoid taxpayer dissatisfaction and cost on the Crown through having to pay late refund interest.

From a Crown Perspective

It should be noted that the material liability of government in late 2019 and through to late 2021 for tax refunds is not reflected in published accounts. Note #22 of the last issued Crown accounts for the June 2019 year discloses that unlike prior years no tax refunds owing were recorded in the accounts. As such, a major shortcoming in the Crown accounts is evident. It is noted that the accounts were qualified in respect of taxation in the 2019 Audit Report. Furthermore, enquiries to the MFEM Treasury division by PERC show that no Accounts Payable summaries being Tax Refunds are passed on to Treasury Division by RMD. This failure leads to Treasury, then Audit not having information which is critical in being able to verify the completeness, the correctness or otherwise, plus the net worth of the Crown in published accounts. It should be noted also that the Collector of Revenue Management is on record with the Audit office as being unwilling to allow Audit staff access to records citing confidentiality. This however contradicts section 27 of the Public Expenditure Review Committee and Audit Act which requires the Audit Office conduct all audits of the Crown.

Staff of the Revenue Management Division including the Collector, met with a group of local accountants on 23 November 2020. At that meeting, concern was expressed regarding the workings of the VAT system. In answer to a question, Mr Toleafoa for RMD conceded that the VAT refund system had been quote 'neglected'. At that time, it was also conceded that the provisional tax module within the RMS system did not work properly. The Collector Mr Mitchell advised the meeting that the problems started when Mr Philip Eyre left the RMD which was February 2018. This revelation aligns to the deteriorated position of near \$5 million dollars of unpaid VAT refunds being held by RMD around November 2019 which was toward two years after Mr Eyre resigned.

Overall, the PERC committee found all components of the VAT complaint sustained.

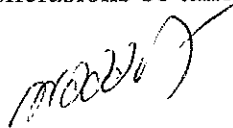
It is apparent that serious failures in the VAT system have occurred since 2018. It was the Collectors responsibility to ensure the VAT system continued to operate in accordance with the law and taxpayer expectations. PERC has concluded there was management failure to replace staff member Mr Eyre in February 2018 with a person of comparable experience and familiarity to issue refunds along with management failure to monitor that the process continued. Alternatively, there was failure to elevate other existing staff to his duties promptly, to ensure the VAT refund system which is an integral part of operations, continued to operate satisfactorily. This failure to elevate existing staff also applied to any replacement for Mr Eyre who proved unsatisfactory.

Conclusions and closing recommendations

This was a complaint that had been elevated to the Financial Secretary in view of the delays and non-resolution. It was a complaint which took 9 months for the Collector to allocate PERC an interview time. It was a complaint that the Collector much later instructed his staff to coordinate communication through one senior officer Mr Richardson. In all of the circumstances, time pressures on staff notwithstanding, PERC has concluded that there were significant management failures in resolving matters.

A number of recommendations have been included in this report in respect of operations in order to overcome the problems observed and it is suggested that these aspects be monitored by the Secretary of Finance and the Office of the Public Service Commissioner.

In view of the significant failures by the Collector in not addressing the taxpayer's complaints, and not successfully addressing the acknowledged problems at Revenue Management, it is recommended that the management shortcomings and report conclusions be taken into account in the Collectors next performance review.



Geoff Stoddart

Chairman

Public Expenditure Review Committee