In Confidence

Office of the Minister of Revenue

Chair, Cabinet Government Administration and Expenditure Review Committee

Inland Revenue's July 2021 Transformation Update

Proposal

1 This paper provides an update regarding Inland Revenue's progress with modernising the revenue system. I am asking Cabinet to note Inland Revenue's plans for implementing the final changes and completing the transformation programme.

Executive Summary

2 Inland Revenue's transformation programme will conclude by 30 June 2022. As far as customers are concerned, it will be complete in October 2021 when the final changes that will affect them go-live. Child support will move to new systems and processes, and Inland Revenue's online services will be significantly improved. After that, the focus of the programme will be on more internal activities such as decommissioning of heritage systems and processes, which will largely be invisible to anyone outside Inland Revenue.

3 Inland Revenue is very focused on making the most of the investment that has been made in its capabilities. The department's ongoing support of our COVID-19 response, including the implementation of the resurgence support payment earlier this year, is an excellent demonstration of its agility and customer focus.

4 This year's issuing of automatic income tax assessments for around 3.2 million customers is further proof of that focus. Inland Revenue began issuing assessments on 26 May 2021, with the bulk of assessments, some 2.1 million, issued by 10 June 2021. The department expects to finish sending all assessments to customers by mid-July 2021. Customers due to receive a refund now get it far more quickly than before and the majority of customers don't need to do anything as Inland Revenue works it all out for them. It can be a shock to customers who are told they have tax to pay. They have until 7 February 2022 to pay the amount they owe and there are a range of payment options available, including instalment arrangements.

5 The modernisation of the revenue system will continue beyond the programme, as Inland Revenue continues to look for opportunities to improve how services are delivered. Maturing the use of its new assets and capabilities and driving further value from them will be a key focus for the department in the next few years. This will include opportunities to work across agency boundaries and with the private sector to improve wider outcomes for New Zealanders.

Inland Revenue is preparing for the final changes in its transformation programme

6 Transformation has involved a combination of changes to policy, process, technology, and Inland Revenue's people capabilities. Significant changes have been made in all these areas since implementation began in February 2017.

7 Changes to policy and legislative settings to frame and support the modernisation of the revenue system have now been completed. This has included simplifying requirements for customers where possible, more frequent reporting of employment and investment income information, and automatic year-end assessments for individuals.

8 By way of example, when income tax moved to new systems and processes in April 2019, it became clear that approximately 1.5 million people were on an incorrect prescribed investor rate (PIR). People who invest in a portfolio investment entity, such as KiwiSaver schemes, select a tax rate, referred to as their PIR. At the time, people on a PIR that was too high could not get their overpaid tax refunded as it was a final tax and those on a PIR that was too low paid tax at their marginal tax rate (which was often higher than their PIR).

9 Following changes to legislation, from 1 April 2020, Inland Revenue has provided portfolio investment entities with correct PIRs for people on an incorrect rate. From the year ending 31 March 2021, portfolio investment entity income is included in the end-of-year income tax assessment process and automated where possible. This means that people on a PIR that is too high will have their overpaid tax refunded and those on a rate that is too low will pay tax at the correct PIR rather than their marginal tax rate.

10 Most individual customers no longer have to do anything at the end of the year to work out whether they have a refund or tax to pay. This is making a real difference. For the year ending 31 March 2018, the last year before automatic year-end assessments were introduced, just over 1 million customers claimed refunds totalling $451 million. For the year ending 31 March 2020, approximately 1.8 million people received refunds totalling $713 million. Of this, approximately 1.6 million customers earning less than $70,000 received refunds totalling $641 million (90% of the total value of refunds issued).

11 The issuing of automatic income tax assessments is still a relatively new process. It was run for the first time for the year ending 31 March 2019. As changes to employment and investment income reporting were introduced progressively, the year ending 31 March 2021 was the first full year Inland Revenue received more detailed information about recipients of investment income more often. Improvements are being made each year, for example issuing assessments more quickly, and Inland Revenue will continue to focus on how it can make this process run as smoothly as possible, including how it communicates with customers. Prior to the introduction of automatic year-end assessments, customers had to request a personal tax summary to claim a refund and could choose not to ask for one if they owed tax.

12 New processes, underpinned by new technology, are making tax and payments simpler and more certain. All the products Inland Revenue administers are now running on new systems and processes, with the exception of child support. Online services are available for all these products, making it easier for customers to do more for themselves, with less effort, and without needing to contact Inland Revenue. Customers can now see their tax and payments, and what they need to do in a single place.

13 Moving high-volume, simple transactions online was always the intent of transformation. Inland Revenue is seeing a reduction in the number of calls it receives. Nevertheless it can still be difficult for customers to get through to the department at busy times. Customers who can are using self-service options. The majority of correspondence received from customers is now digital and use of myIR remains high. This frees Inland Revenue up to provide more personal support to customers who have complex needs as

well as to those who are unable to use digital services. Call centres and appointments are available for customers in these situations and will remain so.

14 More compliance effort is now upfront rather than waiting until the end of the year when customers may find themselves in debt. This is because Inland Revenue has new analytical tools allowing it to see more, and see it earlier, so errors or non-compliance, whether inadvertent or deliberate, are more quickly identified and addressed. For example, Inland Revenue now proactively contacts Working for Families customers during the year when it can see things have changed to ensure their payments are adjusted as quickly as possible when their circumstances change. This helps to minimise the number of customers with debt at the end of the year and the value of any debt. High-volume/low-value compliance risks are dealt with much more effectively, for example every return that can generate a refund is automatically checked by Inland Revenue's systems. This enables the department's tax technical specialists to focus on more complex, higher value customer interventions, such as audits or investigations.

15 The transformation programme has resulted in significant changes not only for Inland Revenue's customers, but also for its people. A new operating model with new capability-based roles and new workplace technology have been progressively introduced. Roles in Inland Revenue are focused on transferable skills such as customer service or digital literacy, as well as new capabilities such as data analytics. This is enabling people to build their capabilities as work changes. Significant training programmes have also been conducted ahead of each release. On average, Inland Revenue's front line people have had around 3 days' of mandatory training for each of the five releases so far, equating to 18 days of training overall per person.

16 Inland Revenue has been transforming for over five years. The 2021/22 year will bring this huge programme to a close with the implementation of the final changes.

The final changes affecting customers will be implemented in October 2021

17 The final customer-facing changes are being implemented in two releases during 2021. Paid parental leave, unclaimed money, duties[1], and New Zealand foreign trusts went live on new systems and processes at 4pm on 28 February 2021, slightly ahead of schedule. These products are running smoothly with few issues encountered following go-live.

18 Child support will move to new systems and processes in October 2021. Following go-live, child support customers will have better visibility of their obligations and payments in myIR, Inland Revenue's secure online service, and be able to do more for themselves, including registering online and advising the department of any changes in their circumstances.

19 In addition to improved online services, legislative changes have been enacted that will improve the administration of child support. Since 1 April 2021, Inland Revenue has not charged incremental penalties on outstanding balances for child support, and the situations where child support penalties can be written off have been simplified. Together, these changes will make child support penalties fairer and more effective.

20 Other changes will take effect progressively. When child support moves to new systems and processes in October 2021, deductions of financial support from payments made by an employer will be compulsory for newly liable parents. Employers are already required

[1] Including casino, lottery and totalisator duty, and the problem gambling levy.

to deduct child support when the liable parent has chosen employer deduction as a payment method or has defaulted on a payment. This change will therefore only affect employers who do not currently deduct child support or employers with an increased number of employees they must make deductions for.

21 From 1 April 2022 changes that impact on child support assessment will apply. For example, a wider definition of “income” will be used for child support purposes. Investment income will be automatically included to get a better picture of an individual’s ability to support their children. Any losses carried forward from an earlier year will no longer be used to offset income as part of calculating child support obligations.

22 Information sharing and communication with other agencies will improve through the use of portals and secure file transfer. The processing of child support payments and employer deductions will be streamlined and will help to ensure receiving carers get their child support as soon as possible after a due date.

23 As part of the final release in October 2021, Inland Revenue will also upgrade the online services all its customers use. A more modern look and feel for myIR, and simplified presentation of information, will make it easier for customers to focus on what is relevant and important. The layout will adapt to fit the size of any screen without loss of functionality, making it seamless to use myIR across different devices, including mobile phones. Simplified navigation will allow customers to easily find and do what they need to do.

24 Solution design for the final release has been completed, and Inland Revenue is on track with testing its systems and processes to ensure that everything will work as intended. Two independent assurance reviews will begin shortly, as has been the case ahead of previous major releases, and the results will be reported to the Minister of Finance and me in due course.

25 Similar to previous major releases, Inland Revenue will be closed to customers for a short period to enable the cutover to new systems and processes. Cutover is scheduled to take place over the Labour Day weekend and, at this stage, officials estimate that it will take approximately six days. This means that Inland Revenue will be closed to customers for up to three days either side of the weekend, which is similar to the amount of time the department was closed for the releases implemented in April 2019 and April 2020. The length of the closure will be confirmed through a series of three mock go-lives, which are full dress rehearsals for go-live, that begin in July 2021. Inland Revenue will make payments in advance to customers for any entitlements they are due to receive during the period the department is closed, such as Working for Families.

26 Given the sometimes complex circumstances of child support customers, and the changes to online services that all customers use, Inland Revenue is expecting some customers to get in contact as they get used to new ways of doing things. It is highly likely that customers will see some differences in the way the new system works compared to the old system. Inland Revenue is very focused on minimising any impacts on customers, however experience with previous releases shows that customer contacts increase following go-live until customers become familiar with the new systems and processes.

27 Inland Revenue is communicating and engaging regularly with customers and stakeholders about the changes being made to ensure they are ready for them. Closer to go-live, the department will send information directly to customers and stakeholders and will supplement this with content on its website and advertising to child support

customers. New functionality in myIR will enable customers to link directly to step-by-step demos / quick reference guides. This has not been possible for previous releases.

28 Once these changes have been implemented, following a period of early-life support, Inland Revenue's focus will turn to completing the final work on the programme which will be largely invisible to customers.

Risk remains high

29 Inland Revenue's operational risk profile has been high during transformation, largely due to co-existence. Co-existence refers to running old and new systems in parallel until all products have migrated to the new core platform. That risk, while much reduced, will remain until the programme closes. Ensuring Inland Revenue moves completely off its heritage systems and processes is critical to fully realise the benefits of transformation, and to reduce the department's operational risk to more normal levels.

30 The most significant risks I see for the remainder of the programme are:

30.1 Child support customers requiring more support than expected following the move to new systems and processes. To mitigate this, Inland Revenue has extensive communications and engagement activities planned, including sending information directly to customers to ensure they are aware of what is happening, and when. However, there is the potential for difficulties as child support customers can have complex and unique circumstances and can be hard to reach.

30.2 Retaining the specialist and skilled resources needed through until completion, in light of possible demand for these skills from other major change programmes. To mitigate this, Inland Revenue will work with other agencies if necessary to ensure that scarce and skilled resources can be made available in a way that does not put the successful completion of transformation at risk and manages the workloads of individuals appropriately.

30.3 The on-going and unknown impacts of COVID-19. To date, the pandemic has not had a significant impact on transformation timelines. Inland Revenue has been able to keep the programme on track through the disruption caused by the pandemic as a result of the capabilities implemented by transformation. However, the possibility remains that there may be an impact on the final release in the event of another significant outbreak. The main mitigation is planning and preparing to go-live remotely, as has been the case with the two most recent releases.

Inland Revenue is on track to complete its transformation programme by 30 June 2022

31 The majority of programme delivery activity will be complete by the end of 2021. The remaining activities to be concluded in the first half of 2022 will be focussed on completing any final technology changes including the decommissioning of all heritage systems. There are a significant number of old systems and supporting infrastructure that require careful turning off. There are also some key dependencies that require careful management, for example moving Inland Revenue's payroll solution to the cloud. Analysis has been completed to a very detailed level, and decommissioning is well underway.

32 As at May 2021, Inland Revenue had decommissioned approximately 60% of its heritage systems and removed around 15% of the infrastructure components from its heritage

data centres. There is not a direct correlation between applications and infrastructure, as much of the infrastructure supports multiple applications.

33 Inland Revenue intends to complete archiving of all heritage data by 31 March 2022, and to decommission all heritage systems by 30 April 2022. Decommissioning of remaining heritage networking and infrastructure will be completed by 30 June 2022.

34 While the transformation programme will conclude, some work will continue beyond 30 June 2022. For example, further refinement of Inland Revenue's enterprise support services platform and a re-fresh of the software used in contact centres. This is not unusual for a programme of this scale, scope, and duration and will not delay the closure of the programme.

35 Changes to Inland Revenue's operating model have been made progressively since 2018. This year, those changes will be completed. The department's new model for back-office services was established on 1 March 2021. Consultation on proposed changes to some customer-facing Team Lead and technical and compliance specialist roles was completed in May 2021. The resulting changes are expected to be completed by September 2021.

36 The number of full time equivalent staff, both those on permanent and fixed term contracts, has declined from 5,662 at 30 June 2016 to 4,269 at 31 March 2021. Inland Revenue has used contingent workers for approximately 20 years, to service its traditionally busy peak income tax periods. One of the aims of transformation was to smooth workflow over peak periods and reduce the need for a large contingent workforce. As a result of the changes made, Inland Revenue is now able to work much more efficiently and effectively and continue to provide the level of service customers expect with fewer people. For example, this year, the department did not need contingent workers to support the issuing of automatic income tax assessments.

37 Inland Revenue is continually updating its forecasts of how much it expects to spend on transformation until its completion in the 2021/22 financial year. By the 2021 October baseline update, the department will have a good idea of the amount of funding that may be handed back at the completion of the programme. It is possible that final adjustments may be made in the 2022 March baseline update.

Modernisation of the revenue system will continue after the programme closes

38 While the programme will come to an end, Inland Revenue itself will keep transforming as the changes made over the last few years are embedded and the department matures the use of its new capabilities. This will help to ensure the benefits of transformation are enduring.

39 When the government decided to invest in transformation, Inland Revenue committed to delivering a range of benefits over a 10-year period ending in 2023/24. Although the programme will come to an end, Inland Revenue will continue to report on the progress it is making with achieving its benefit commitments. As there will no longer be programme-specific reporting, the department is considering how it will continue to provide regular, transparent, and visible progress updates.

40 Looking ahead there are opportunities to maximise Inland Revenue's effectiveness and to drive further value from the significant investment made in transforming the department's capabilities. The optimal timeframe is from early-mid 2022, once the

programme has completed its key deliverables. Inland Revenue is already sharing its experience with others and there are undoubtedly opportunities to work further with both the public and private sectors to improve outcomes for New Zealanders.

41 It's important to note however that not every opportunity will be a good fit with Inland Revenue's capabilities. In my view, Inland Revenue's areas of strength are:

41.1 Delivering services based on core information, particularly income and customer data.

41.2 Collection and payment of money/processing at scale.

41.3 High-volume, digital transaction processing, rather than services that rely on high levels of discretion and/or an extensive customer-facing presence.

41.4 Delivering large scale, consistent, rules-based initiatives that leverage the capabilities of its commercial-off-the-shelf systems.

41.5 Analytical tools and capability, including 'what-if' analysis and risk assessment.

42 When considering how to leverage these strengths, there is a balance to be struck with ensuring Inland Revenue can continue to deliver its existing outcomes and respond to our priorities. Any proposals for Inland Revenue to take on additional work or new initiatives will need to be considered in this light.

Next steps

43 The next steps are to:

43.1 continue with preparations for the implementation of the final release in the programme;

43.2 continue with the on-going programme of independent quality assurance; and

43.3 provide a further progress update to Cabinet by November 2021.

Consultation

44 A copy of this paper has been provided to the Accident Compensation Corporation; the Department of Internal Affairs (Government Chief Digital Officer); the Department of the Prime Minister and Cabinet; the Ministry of Business, Innovation, and Employment; the Ministry of Education, the Ministry of Social Development; the New Zealand Customs Service; and Stats NZ.

Financial Implications

45 The proposals in this paper have no financial implications.

Human Rights

46 The proposals in this paper have no human rights implications.

Legislative Implications

47 The proposals in this paper do not require any changes to legislation.

Regulatory Impact Analysis

48 The proposals in this paper do not require a Regulatory Impact Statement.

Gender Implications

49 The proposals in this paper have no gender implications.

Disability Perspective

50 The proposals in this paper have no implications for people with disabilities.

Proactive Release

51 I propose to proactively release this Cabinet paper, and associated minutes, in whole within 30 working days of Cabinet making final decisions.

Central agencies' comment (The Treasury, Public Service Commission and Government Chief Digital Officer)

52 The Treasury, Public Service Commission and Government Chief Digital Officer recognise Inland Revenue's efforts to smoothly roll-out the Business Transformation programme. We are confident that the programme will end on-time and on-budget. This is a substantial achievement, especially given the additional work that was necessary as a result of COVID-19.

53 As Inland Revenue has identified, some risks remain, especially those relating to the go-live of the child support system (in October 2021) and the decommissioning of the heritage system (to June 2022). Central agencies consider appropriate steps are being taken to manage these risks.

54 In the previous update, we noted our concern "…about Inland Revenue's ability to sustainably realise the projected revenue uplift and administrative savings, while also maintaining the tax system's integrity at current levels." Those concerns remain. Funding was reprioritised in March 2021 to enable Inland Revenue to temporarily retain more staff, in addition to new time-limited funding for COVID-related work. However, further funding may need to be considered as the future shape and size of the organisation becomes clearer.

Recommendations

I recommend that the Committee:

1 note that paid parental leave, unclaimed money, duties, and New Zealand foreign trusts went live on new systems and processes on 28 February 2021;

2 note that child support will migrate to new systems and processes in October 2021 and that Inland Revenue's online services will be upgraded at the same time;

3 note that Inland Revenue estimates it will be closed for up to six days, including Labour Day weekend, to enable child support to migrate to new systems and processes and its online services to be upgraded;

4 note that Inland Revenue is on track to close the programme by 30 June 2022 after decommissioning of heritage systems and processes has been completed;

5 note that by the October 2021 baseline update Inland Revenue will estimate the amount of funding that may be handed back;

6 note the next progress update will be provided to Cabinet by November 2021.

Authorised for lodgement

Hon David Parker

Minister of Revenue