

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Government Administration and Expenditure Review Committee

February 2018 Update – Delivering the next step in the Transformation of New Zealand’s revenue system

Proposal

- 1 This paper provides an update regarding preparations for implementing the next steps in the modernisation of New Zealand’s revenue system. I am asking Cabinet to note the progress being made. Inland Revenue’s Transformation Update dated February 2018 is available from the Cabinet Office.

Executive Summary

- 2 In November 2015, Cabinet agreed to invest in the implementation of New Zealand’s future revenue system (CAB-15-MIN-0249 refers). A modern, digital, revenue system will serve the needs of all New Zealanders. Customers will spend far less time and effort ensuring they meet their obligations and receive their correct social policy entitlements, as tax will be correctly withheld and assistance provided at the time it is needed. The government will have greater ability to make policy changes faster and more effectively and will be better able to use the information Inland Revenue holds to deliver improved outcomes for New Zealanders.
- 3 Transformation is enabled by a combination of changes to policy, process, technology and the organisation design of Inland Revenue. It is far more than an upgrade of technology and is an opportunity to fundamentally review how the revenue system is administered and consider what changes may be needed.
- 4 New Zealand’s revenue system will be transformed in four broad stages – digital services, tax, social policy and a final wrap up. Modernisation of the revenue system is now well underway. GST has been administered using new systems and processes since February 2017.
- 5 Remaining taxes and entitlements will be moved to START¹ in a series of releases over 2018 to 2021 to reduce risk and business and customer impacts. Release 2 will go-live on 17 April 2018 and will improve customer experiences, reduce the effort required by businesses to meet their obligations and improve customer compliance. It will also set the scene for more comprehensive changes to be introduced in release 3 in 2019.
- 6 The key changes for customers in release 2 include employers being able to provide PAYE information to Inland Revenue every payday if they choose to,² and the introduction of the accounting income method option for calculating provisional tax.

¹ START stands for simplified tax and revenue technology and is the name Inland Revenue has chosen for its new system

² Subject to legislation

Withholding taxes, fringe benefit tax, payroll subsidy, and gaming machine duty will be moved to START.

- 7 Compared to GST, the significantly larger scope and complexity of tax types, and proposed legislative changes for release 2, means there are much wider implications for customers. Business customers will need to progressively adapt their systems and processes to ensure they continue to meet their obligations.
- 8 Inland Revenue is on schedule to implement release 2 on 17 April 2018 as planned. Delivery of our 100 day plan commitments is not dependent on release 2. The Families Package, Best Start and increases to Paid Parental Leave will be delivered by Inland Revenue in their existing heritage systems, and migrated to START in line with the release plan.
- 9 Major releases will typically occur on an annual cycle in each of the next four years, to align with the beginning of the tax year (April 2018 to 2021). Inland Revenue recognises the need for further discussions with Ministers to ensure that the release plan is well aligned with the government's priorities.
- 10 Based on the current release plan, remaining taxes, Working for Families and Best Start will be implemented in START in April 2019, KiwiSaver and Student Loans in April 2020, and Child Support in April 2021.
- 11 The implementation of release 3 in April 2019 is a key tipping point for tax policy agility. Following that, we will be in a far stronger position to implement any recommendations made by either the Tax Working Group and/or the Welfare Working Group.
- 12 Maintaining momentum is critically important, as Inland Revenue is now operating two systems and the department's risk profile has therefore increased. It will remain high until transformation is complete, due to the need for old and new systems to co-exist. Migrating products and services to START as quickly as possible will limit the period of time that the core systems need to co-exist, is the best way to manage risk, and will minimise any confusion or disruption for customers. Officials assure me they are confident the challenges of co-existence are in hand and that the collection of revenue, payment of entitlements and delivery of services will continue uninterrupted during transformation.

Background

- 13 In March 2013, Cabinet accepted that transformation of the revenue system was required. A number of potential investment options for modernising the revenue system were presented, ranging from "do nothing" through to an all of government solution. Cabinet agreed to invest in modernising the revenue system through business process re-engineering, supported by new technology (CAB Min (13) 10/4 refers).
- 14 In November 2015, Cabinet agreed to invest in the implementation of New Zealand's future revenue system (CAB-15-MIN-0249 refers). A multi-year funding envelope was approved, together with a financial delegation of \$1,870 million to complete transformation. The funding envelope comprises new funding from the Crown of between \$800 million and \$1,005 million with the balance of funding provided by Inland Revenue through administrative savings and capital reserves.

- 15 The changes being delivered by transformation will:
- 15.1 Provide confidence in the continued collection of tax revenue and distribution of entitlements.
 - 15.2 Improve the Government's ability to make policy changes faster and more cost-effectively.
 - 15.3 Grow voluntary compliance by making it easier for people to get it right.
 - 15.4 Create an information asset to deliver improved outcomes for New Zealand.
 - 15.5 Deliver cumulative additional Crown revenue of \$2,880m–\$6,175m by 2023/24.³
 - 15.6 Deliver cumulative compliance cost savings (economic benefits) for small-medium sized enterprises in particular, until 2023/24 of between \$1,330m to \$2,265m (a reduction of 18-26 in the hours spent on compliance each year by 2023/24).
 - 15.7 Enable Inland Revenue to realise administrative savings of \$495m–\$580m by 2023/24.

Modernisation of the revenue system is now well underway

- 16 In February 2017, GST was successfully moved to Inland Revenue's new system, START. New services mean it's now quicker and easier for customers with straight-forward transactions to manage their GST online. Customers with more complex circumstances have experienced some challenges. Changes have been made to the new GST online services since go-live to improve the experiences of customers.
- 17 Inland Revenue has confirmed it remains on track to realise the benefits committed from the implementation of Stage 1. These are improved experiences for customers, compliance cost reductions for small–medium sized businesses and administrative savings for Inland Revenue.

Changes will be delivered in smaller, more manageable steps for customers and Inland Revenue

- 18 Moving to a release-based approach means the four broad stages of transformation will overlap. Taxes and entitlements will be moved to START in smaller steps, reducing risk and business and customer impacts. At the same time, transformation will move into social policy products (Stage 3) earlier than planned.
- 19 Major releases will typically occur on an annual cycle in each of the next four years to align with the beginning of the tax year. Inland Revenue recognises the need for further discussions with Ministers to ensure the release plan is well aligned with the government's priorities and acknowledge that it may need to be reassessed to ensure our objectives are met.
- 20 The release plan is Inland Revenue's current view of the sequence in which remaining taxes and entitlements will be moved to new systems and processes in a way that best balances delivery risk, cost to deliver, and impacts on customers. This has taxes moving

³ The lower end of this range is already included in Government's fiscal forecasts

in two releases over April 2018 and April 2019, and Working for Families and Best Start moving in April 2019.

- 21 Following that, KiwiSaver and Student Loans will be implemented in April 2020, and Child Support will be implemented in 2021. Alternative sequencing for the order in which Child Support, KiwiSaver and Student Loans are moved to START is possible and other options are being explored. Officials inform me that they will be better placed to reassess the release plan towards the end of 2018. By then, some key activities, including a high-level analysis of how the social policy products will work in START, will have been completed.
- 22 Where possible, policy changes will be aligned with other changes such as moving products to new systems and processes, to minimise the impacts for customers and Inland Revenue.
- 23 The release plan will be reviewed regularly, at least annually after each major release, to ensure the optimal plan is being delivered—taking into account government priorities, new opportunities that are identified, customer experiences and benefits, co-existence and business needs.

The next major release will go-live on 17 April 2018

- 24 Release 2 in April 2018 will include:
 - 24.1 Introducing the accounting income method option for calculating provisional tax.
 - 24.2 Implementing the automatic exchange of information with international tax treaty partners.
 - 24.3 Enabling employers to send their information to Inland Revenue on payday if they choose to do so.⁴
 - 24.4 Moving withholding taxes,⁵ fringe benefit tax, payroll subsidy, and gaming machine duty to new systems and processes.
 - 24.5 Collecting income information in START so that pre-population of individuals' information can begin. Pre-population means the information Inland Revenue already holds about people will be made available to them so they don't have to provide it to the department again.
- 25 Based on the lessons learned from implementing GST, Inland Revenue has recognised the need for better design input from customers. Tax agents in particular are actively involved in transformation, and opportunities are being provided for customers to validate services. Aspects of the new system are being co-designed with tax agents, who are also testing it to ensure the design of new services meets their needs. A similar approach will be adopted with payroll professionals.
- 26 Following the implementation of release 2, the administration of many more products will be split across Inland Revenue's old and new systems. Although Inland Revenue's intent is to ensure that customer service levels are maintained during transformation and

⁴ Subject to legislation

⁵ Including resident withholding tax, non-resident withholding tax, residential land withholding tax, and approved issuer levy

to make the use of two systems as invisible as possible to customers, many more customers will need to work between them, compared to GST.

- 27 Moving to a release based approach has mitigated the impacts of co-existence for both customers and Inland Revenue to the greatest extent possible. Making changes in a series of releases means that the complexity of changes being introduced is balanced across the releases.
- 28 Release 2 in 2018 will set the scene for the more comprehensive changes to be introduced in release 3 in 2019. From 2019, it will be easier for customers to understand what their obligations and entitlements are and why, and they will be able to self-help the majority of time. This will reduce the time and effort they spend meeting their obligations and mean there is little need for them to interact with Inland Revenue. Release 3 is a key trigger point for reducing the compliance costs faced by small-medium sized businesses.

Customers are being actively supported to ensure they are ready for April 2018

- 29 Existing channels that achieved good awareness will be used again for release 2 to help customers understand the changes being introduced. New approaches, including regional seminars for tax agents and more hands-on support for both customers and tax agents, will help target groups who may need more support. Around 250 seminars are being held by Inland Revenue around New Zealand to update tax agents and businesses on the changes happening in April 2018, including the accounting income method. About 16,000 customers in total are expected to attend one of the seminars, which begin in February and run until early May 2018.
- 30 Inland Revenue continues to work closely with tax professional bodies and to meet regularly with software providers and payroll developers. This collaborative approach will continue, as the department recognises that New Zealanders rely on their advisors, such as tax agents, accountancy firms and corporates, to help them make sure they have done the right thing.
- 31 There will also be a focus on raising awareness among small businesses, encouraging them to seek more information from their tax agent, if they have one. Marketing to customers began in late February 2018.

Plans for readying Inland Revenue staff to support customers through the changes being made in release 2 are well advanced

- 32 Alongside implementing new systems and processes and consulting on policy changes, Inland Revenue is also changing the way it works. On February 12 2018, Inland Revenue began the move to a new organisation: agile, intelligence-led and built around the needs of customers. This means that people designing customer services will be as close to the customer as possible and people working with customers will be able to make more decisions and resolve customers' queries and issues more quickly. Customers will increasingly be able to talk to one person to get more of their queries resolved.
- 33 Inland Revenue will continue to have a presence in the communities it is represented in today and will continue to look for opportunities to co-locate with other government agencies.

- 34 The changes being introduced by transformation will mean that Inland Revenue will need fewer people in the future. This has been well signalled to staff. All things being equal, Inland Revenue will be approximately 25%-30% smaller at the end of transformation than it is today. Implementing a new organisation design will enable Inland Revenue to deliver the administrative savings committed to (CAB-15-MIN-0249 refers) as part of the department's funding contribution towards transformation.
- 35 As much as possible, any reductions will be managed through attrition and flexible workforce arrangements. Since mid-2016, Inland Revenue has adopted a deliberate approach of filling the majority of vacancies with fixed-term employees. As at 31 December 2017, the department had approximately 560 people on fixed term agreements representing around 10% of the total workforce. The conclusion of fixed-term arrangements will contribute significantly to the future reduction in workforce. If there is a need to reduce the number of people in particular roles, Inland Revenue will look at options for doing that and will discuss them with staff and the unions as appropriate.

Customer experiences will improve over 2018 and 2019, independently of the major releases

- 36 Customers' behaviours and expectations have changed and will continue to evolve. As customers embrace technology, they expect things to move faster: instant responses, instant access to information and immediate solutions wherever they are and on their platform of choice. Only by improving and modernising its technology and changing its organisation design can Inland Revenue significantly enhance experiences for customers and meet their needs.
- 37 Work is underway to reduce the time and effort customers spend in finding the right information, and then understanding it, and to help customers understand what they need to do and make it easy for them to do so. A digital solution to the "what's my IRD number" customer pain point is being developed and a Business Survival Guide has been developed for young businesses.
- 38 Although there is a particular focus on improving digital experiences, the experiences of all customers will be enhanced, regardless of how they choose to interact with Inland Revenue.

Transformation remains inherently high risk

- 39 Beginning transformation in February 2017 with GST was a deliberate and considered choice. GST is a relatively simple tax and there was very little legislative change. From here on, implementation becomes much more complex. Multiple changes are being introduced to the systems and processes that customers use to meet their obligations and determine their entitlements, along with some legislative changes that affect how often and how they do that.
- 40 Halting partway through implementation will increase operational risk, be costly because two core systems will have to be supported and maintained and may potentially constrain government's agility to make change.
- 41 A summary of the most significant risks for transformation as at January 2018 is included in Appendix 5 of Inland Revenue's Transformation Update dated February 2018, available from the Cabinet Office.

- 42 Transformation combined with the tax policy work programme and Budget 2017 changes means that Inland Revenue has limited capacity to implement additional changes. The ability of stakeholders to absorb additional changes also needs to be considered.

An on-going monitoring programme is in place to provide assurance to stakeholders

- 43 Inland Revenue undertakes regular independent quality assurance (IQA) and technical quality assurance (TQA) reviews, and Gateway reviews. Three external assurance reviews have been completed since the last progress update provided to Cabinet in mid-2017. All three reviews concluded that transformation continues to be well managed and governed. The Minister of Finance and I are provided with the opportunity to talk directly with the review teams. We also receive copies of the reports once they have been finalised.
- 44 Inland Revenue is required to provide transformation progress updates to Cabinet by July and December each year (CAB-15-MIN-0249 refers). The next update will be provided by July 2018.

Next steps

- 45 The next steps are to:
- 45.1 continue preparations for the implementation of release 2 in April 2018;
 - 45.2 support the passage of the Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Bill which contains key transformation proposals;
 - 45.3 progress any technical legislative changes needed to support the implementation of releases 2 and 3;
 - 45.4 Withheld under s18(c)(i) of the OIA
 - 45.5 Withheld under s18(c)(i) of the OIA
 - 45.6 work across government on the implementation options available to Ministers as part of transformation for reforms arising from the Tax Working Group and the Welfare Working Group; and
 - 45.7 prepare a transformation update for Cabinet to consider by July 2018.

Consultation

- 46 A copy of this paper has been provided to the Accident Compensation Corporation, the Department of Internal Affairs, the Department of 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 Statistics New Zealand.

Financial Implications

- 47 The proposals in this paper have no financial implications.

Human Rights

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

Legislative Implications

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

Regulatory Impact Analysis

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

Gender Implications

51 The proposals in this paper have no gender implications.

Disability Perspective

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

Publicity

53 I intend to ask Inland Revenue to publish this paper on its website once it has been considered by Cabinet.

Central agencies' comment (The Treasury, State Services Commission and Government Chief Information Officer)

54 Corporate Centre agencies were consulted on this update.

55 Inland Revenue's Business Transformation (BT) programme is significant, both for the department and wider society.

56 The Corporate Centre's delivery confidence assessment of the programme remains at amber/green. This assessment is based on past and current programme delivery, ongoing learning loops in place in the transformation programme and external delivery assurance. The next assurance reviews are underway, ahead of the planned Release 2 go-live in April. The Corporate Centre continues to have good visibility of the programme and the risks/mitigations due to high standards of reporting and transparency applied by the programme team.

57 Inland Revenue continues to work with external stakeholders as they prepare to implement Release 2; incorporating lessons learned from Stage 1. This includes closer involvement with tax agents. Broad learnings and capability from BT continue to be shared and deployed across other public service change programmes, reinforcing the open ways of working seen elsewhere in the programme. We understand external stakeholders will play an important role in the planning of future releases.

58 Ministers should note that any change which has a substantial operational impact on Inland Revenue could impact their ability to deliver Business Transformation and realise the benefits committed to in the 2015 business case. This includes delays to the organisational change programme and the implementation of proposed legislation. The risk of the transition from the legacy systems to the new system is being actively managed and monitored by the programme.

- 59 The Corporate Centre will work with Inland Revenue on the interaction between Business Transformation and proposed changes arising from other Government initiatives, including the Tax Working Group.
- 60 Inland Revenue's organisational change has featured in the media, largely due to the Public Service Association's court proceedings. The Corporate Centre will continue to work with Inland Revenue as they implement a new organisational structure, and bring new developments to Ministers' attention.

Recommendations

I recommend that the Committee:

- 1 note that the remaining stages of transformation will be implemented in a series of releases over 2018 to 2021;
- 2 note that maintaining momentum is critically important, as Inland Revenue is now operating two systems and the department's risk profile has therefore increased;
- 3 note that release 2 in April 2018 includes:
 - 3.1 introducing the accounting income method option for calculating provisional tax; and
 - 3.2 implementing the automatic exchange of information with international tax treaty partners; and
 - 3.3 moving withholding taxes, fringe benefit tax, payroll subsidy and gaming machine duty to new systems and processes;
- 4 note that major releases will typically occur on an annual cycle in each of the next four years to align with the beginning of the tax year;
- 5 note that the release-based approach moves taxes and entitlements to new systems and processes in smaller steps, reducing risk and business and customer impacts;
- 6 note that Inland Revenue will review the release plan by the end of 2018;
- 7 note that transformation is required to report to Cabinet on a six-monthly basis and the next update will be provided to Cabinet to consider by July 2018; and
- 8 note that Inland Revenue's Transformation Update dated February 2018 is available from the Cabinet Office.

Authorised for lodgement

Hon Stuart Nash

Minister for Revenue