

Cabinet Committee on State Sector Reform and Expenditure Control

JULY 2017 UPDATE - STAGE 2 OF TRANSFORMING NEW ZEALAND'S REVENUE SYSTEM

Proposal

1. This paper provides an update regarding preparations for implementing Stage 2 of New Zealand's revenue system. I am asking Cabinet to note the progress being made, as outlined in the attached Transformation Update dated July 2017.

Executive Summary

2. Significant progress has been made in modernising the revenue system with the migration of GST to new systems and processes. While customers with simple and straight-forward GST transactions are working well with new systems and processes for GST, there are some negative impacts for customers with more complex circumstances. Tax agents in particular are experiencing some challenges from having to work in two systems (FIRST and START).¹ To address these issues some targeted improvements are underway, such as a dedicated GST phone queue for tax agents.

3. Three months on from go-live, work is beginning to stabilise. Inland Revenue has experienced some service impacts as both customers and staff get used to working with the new system and these will be reflected in the department's annual performance results. While the department is making every effort to minimise the impact on customers, the introduction of new services and the need to work in two systems until transformation is complete means there is likely to be some impact as people get used to new services. Inland Revenue is actively involving agents and customers in design and training as a way of mitigating the impacts.

4. GST is a relatively simple tax. Complexity for both customers and Inland Revenue increases significantly from here as both Stages 2 and 3 are substantially more complex than Stage 1. There are also dependencies between these stages, meaning that they will overlap and run concurrently for a period during 2018/19. Inland Revenue is currently tracking slightly behind schedule with solution design and build for Stage 2 and is working to get back on plan.

Proactive release This document was released by Inland Revenue under section 81(1B) of the Tax Administration Act 1994. This release supports the purposes of the Official Information Act 1982 by progressively increasing the availability of official information to the people of New Zealand.

¹ START stands for simplified tax and revenue technology and is the name chosen by Inland Revenue for the GenTax software provided by FAST Enterprises LLC

5. Once Stage 2 has been fully implemented, the effort required by businesses to keep on top of their tax obligations will be significantly reduced. There will be fewer errors, less chance of getting into debt, less need for compliance checks, and greater certainty. The benefits of using eServices or software will become more apparent.

6. Making individuals' income tax obligations simpler and more certain are proposed during Stage 2. Most individuals will pay what they need to and get what they're entitled to during the year without having to do anything. Earlier, more complete and more accurate information will be provided to Inland Revenue on their behalf. Digital accounts will be pre-populated and individuals will only need to confirm that the information in their account is correct. Inland Revenue will calculate any tax owed or refund due.

7. Implementation will be through a series of releases over 2018 and 2019. All income tax products, the first release of Stage 3 - Working for Families, and gaming machine duty will be migrated to new systems and processes. Working for Families will be migrated to START at the same time as income tax begins to be processed in START on 1 April 2019. This will minimise the impacts of co-existence on both customers and Inland Revenue, and ensure that customers continue to receive timely payments. Income and provisional tax information will be collected in START from 1 April 2018 to enable pre-population to begin.

8. The Accounting Income Method (AIM) option for calculating provisional tax and the Automatic Exchange of Information (AEOI) with international tax treaty partners will be implemented from 1 April 2018. AIM will enable smaller businesses to better match their tax payments to their cash flow.

9. Improvements to how pay-as-you-earn (PAYE) and investment income information are collected and used mean Inland Revenue will more quickly receive income information from people's employers and information about any interest they have earned on investments. With more up-to-date information, Inland Revenue will be better able to ensure people pay and receive the right amounts.

10. These changes will affect a wider group of stakeholders over a longer period of time compared to implementing GST. Work with groups such as software developers and a group of progressive small business accountants is underway to ensure that changes are successfully designed and implemented to meet the needs of customers. Active engagement with key stakeholders and industry groups continues and will step up over the remainder of 2017 and into 2018.

11. Inland Revenue is now operating two core systems and operational risk has increased due to co-existence. 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 minimises disruption for customers.

12. The tax policy work programme, the implementation of Stage 2, and Budget 2017 changes combined mean that Inland Revenue has limited capacity to implement additional changes.

Business transformation is a once-in-a-generation opportunity to modernise New Zealand's revenue system

13. A modern, digital, revenue system will serve the needs of all New Zealanders. It will help customers to get their tax and social policy payments right first time, avoid errors and give them a clearer view of what they've paid and what they owe during the year. The revenue system will be simple to comply with and responsive to customers' changing circumstances. It will be easy for customers to get things right and difficult to get wrong. They 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.

14. More complete information will be available to Inland Revenue earlier, which will lead to greater accuracy and mean fewer under or over payments for customers. Government will be able to make policy changes more quickly and cost effectively and there will be more opportunities to provide broader access to the information Inland Revenue holds.

15. Modernising the revenue system will significantly contribute to improving digital interactions with government, the Business Growth Agenda and a growing, healthy economy, along with achieving Better Public Services Results 7, 9 and 10.

GST has been migrated to new systems and processes and customer behaviour is changing

16. It's now easier for customers with simple and straight-forward transactions to file and pay their GST on time. Better digital services have given customers more control. They can choose from more filing and paying options, can set up reminders for due dates and change their previous returns, all without needing to contact Inland Revenue.

17. Shifts in customer behaviour are already evident and customer uptake of new services is strong. At the end of May 2017, more than 625,000 returns had been filed using the new web service and an additional 66,000 returns were filed through customers' accounting software. This service has only been available to Xero and MYOB customers since April 2016 and is being extended to a wider group of software providers as part of Stage 2. More than 9,400 new migrants, visa holders and organisations had used the new digital registration service via the Ministry of Business, Innovation and Employment (MBIE) to register for an IRD number.

18. For the year to date to May 2017, 77% of customers filed their GST returns electronically, compared with 72% for the year to date to May 2016 and 63% for the year to date to May 2015.

19. However there have been some negative impacts for customers with more complex circumstances. Some customers, particularly tax agents, experienced challenges with initial set-up tasks, navigating the new system and working in a digital environment for the first time.

20. The department is now operating two core systems and operational risk has increased due to co-existence. The co-existence of business functions and technical capabilities is amongst the most complex challenges to be managed for both customers and Inland Revenue.

21. An on-going challenge for tax agents is the need to work in two systems during the period of co-existence. Inland Revenue has worked with agents and their representative groups to identify the top five issues with the new GST system. These are notifications, client maintenance, bank account maintenance, reports and printouts, and transaction management. Inland Revenue is currently exploring which of these can be fixed before Stage 2. Tax agent focus groups will be set up by July 2017 to discuss both Stage 1 and Stage 2 functionality.

22. In addition to migrating GST to START, Inland Revenue replaced some elements of its foundational technology as part of Stage 1. This included new data centres and the workflow management system for contact centres.

23. Three months on from go-live, work is beginning to stabilise. Inland Revenue has experienced some service impacts as both customers and staff get used to working with the new systems and to managing work across two systems. To address these issues, work is underway to deliver targeted improvements. For example, a new phone queue for tax agents to deal with any GST-related matters they have in a more timely way.

24. Inland Revenue remains on track to realise the benefits committed from the implementation of Stage 1.

25. New Zealand businesses are continuing to secure a considerable amount of transformation work. Over the period from July 2014 to May 2017, 74% of contractor and consultant spend went to New Zealand resident businesses. Both Inland Revenue's delivery partners, FAST and Accenture, have recruited New Zealand staff. FAST have employed 11 New Zealanders out of 55 total employees in New Zealand and more are likely to be employed. Accenture have employed in excess of 40.

The lessons learnt from implementing GST are being applied to future stages

26. Considerable effort is going into applying the lessons learned from Stage 1 implementation, including valuable insights on customer readiness, to Stage 2 design and delivery planning. The insights gained are shaping Inland Revenue's approach in three key areas in particular – co-existence, customer user experience, and stakeholder engagement.

27. While Inland Revenue is dealing with the co-existence challenges of working in two systems, it has become apparent that it is more difficult for customers to do so. The release plan for Stage 2 recognises the need to minimise the impacts of co-existence and the volume of change being introduced for customers as well as Inland Revenue.

28. Customer user experience will increasingly focus on end-to-end services. Dedicated roles have been established to focus on customer experiences, including digital. Opportunities will be provided for tax agents and businesses to validate new eServices and provide their

feedback before go-live to help ensure that new services meet their and their customers' needs.

29. Although transformation is about creating a modern, digital, revenue system, the focus is not solely on designing digital services. Customer contact today is very heavily reliant on the voice channel and Inland Revenue consistently receives feedback that customers like the experiences they have with the contact centres. Through transformation, Inland Revenue will ensure that contact centres continue to be able to support customers as well as investing in digital channels.

30. Inland Revenue will engage with stakeholders more and engage earlier. An account management function has been established with dedicated resources and a clear mandate to ensure all stakeholders understand and are ready to adopt the changes being introduced in Stage 2. Through their Account Manager, stakeholders will have a single view of all changes they need to be aware of including migration of products and services to START, AEOI and changes to the collection of information.

31. Inland Revenue is working with groups such as software developers, and a group of progressive small business accountants to ensure that these changes are successfully designed and implemented and meet the needs of customers. Active engagement with key stakeholders and industry groups continues and will step up over the remainder of 2017 and into 2018.

Transformation is moving to a model of a series of releases within stages

32. Stage 2 will be implemented in a series of releases over 2018 and 2019 as this reduces risk and business and customer impacts. There are also dependencies between Stages 2 and 3, meaning they will run concurrently for a period during 2018/19.

33. The AIM option for calculating provisional tax and AEOI will be implemented from 1 April 2018. All income tax products, the first release of Stage 3 – Working for Families, and gaming machine duty will be progressively migrated to new systems and processes.

34. By April 2019 customers will have:

- More on-line services for all tax products;
- Integrated tax and business processes;
- Faster, more accurate tax information, providing near real-time visibility of tax;
- Faster tax refunds; and
- Less likelihood of tax debt and more payment options.

35. Improvements to how PAYE and investment income information are collected and the implementation of AEOI will be made progressively:

- From 1 April 2018 AIM will be introduced, employers will be able to voluntarily file PAYE information on a payday basis, and financial institutions will be able to voluntarily report non-residents information for AEOI.

- From 30 June 2018 financial institutions will be required to report non-residents information for AEOI.
- From 1 April 2019 employers will be required to file PAYE information on a payday basis, the electronic filing threshold will be reduced, and payers of investment income will be able to voluntarily file detailed information about recipients each month or the months in which payments are made.
- From 1 April 2020 payers of investment income will be required to file detailed information about recipients each month or the months in which payments are made.
- From 1 April 2021 the first full year of pre-populated PAYE and investment income information will be available.

36. Working for Families will be migrated to START at the same time as income tax begins to be processed in START on 1 April 2019. This will maintain customer experiences and minimise the impacts of co-existence for both customers and Inland Revenue.

37. Income and provisional tax information for the 2018/19 year will be collected in START from 1 April 2018. This will include the AIM option for calculating provisional tax and PAYE information from employers voluntarily filing on payday. From 1 April 2018, Inland Revenue will begin pre-populating income information. FIRST will process income tax returns for the 2017/18 tax year and process all prior period returns until 31 March 2019. Any challenges with historical income tax and related data will be resolved in FIRST before being migrated to START on 1 April 2019.

38. Migrating income tax and Working for Families together avoids splitting the administration of Working for Families across two systems. It removes the need to build a complex set of connections between FIRST and START, and prevents the slower processing times that would result from data moving between the two systems. Migrating income tax and Working for Families together maintains the timeliness of payments and customer experiences.

39. Student Loans, Child Support and KiwiSaver payments are based on the incomes of individuals, rather than a combined family income so the same issues do not arise. Student Loan, Child Support and KiwiSaver will be migrated to START as part of Stage 3 as planned. This does not affect the timing of the Government's programme of legislative social policy reforms.

40. Inland Revenue is currently tracking slightly behind schedule with solution design and build for Stage 2 and is working to get back on plan. The department is confident this can be achieved without disrupting future implementation dates.

Customers' tax affairs will be further simplified during 2018 and 2019

41. AIM will enable smaller businesses to calculate provisional tax to pay based on more real-time information so that payments better reflect cash flows. Tax payments will be smaller and more frequent. AIM will make filing and paying tax easier so customers can

focus on running their businesses with tax as a secondary consideration. Software will help with correctly classifying transactions to ensure tax is right from the start, which will reduce errors and provide customers with greater confidence that they've done the right thing.

42. Changes to the collection and use of PAYE and investment income information mean that Inland Revenue will more quickly receive income information from people's employers and information about any interest they have earned on investments. With more up to date information, Inland Revenue will be able to react more quickly when people's circumstances change to ensure they pay and receive the right amounts.

43. These changes, once fully implemented, will significantly reduce the effort required by businesses to keep on top of their tax obligations. There will be fewer errors and interactions with Inland Revenue, less chance of getting into debt, and less need for compliance checks. Businesses will have greater certainty that they've done the right thing.

44. Making individuals' income tax obligations simpler and more certain are proposed during Stage 2. Consultation on a discussion document proposing that most individuals would not have to provide information to Inland Revenue closes shortly. The main proposal is that people who only receive income which is reported to Inland Revenue would no longer have to provide year-end income information or file returns. Inland Revenue would automatically calculate and issue refunds or request payment of tax owed, above agreed thresholds. A summary of the submissions received will be provided to the Ministers of Finance and Revenue to consider in September 2017.

45. The benefits to customers using eServices or software to meet their obligations will become more apparent during Stage 2.

These changes cover a wide range of stakeholders over an extended period

46. Business customers, employers, tax agents, and payroll intermediaries will need to adapt their systems and processes to ensure they continue to meet their obligations and/or their customers' needs. The key changes are:

- AIM will be an option for businesses for calculating their provisional tax through internet connected accounting software.
- Employers will file payroll details on a pay period basis and more of them will file electronically.
- START will make it simpler and faster for customers to manage all their tax obligations with greater certainty.

47. The implementation of AEOI and improvements to the collection and use of investment income information will mean additional changes for financial institutions and payers of investment income. Financial institutions will experience changes in a number of different areas reflecting their various roles in the revenue system.

48. Additional resourcing and support will be required for some areas in Inland Revenue to meet customer demand during the period of change and co-existence. Inland Revenue is expecting and planning for increased customer contacts in specific areas over the period that new requirements and changes to systems and processes are progressively introduced.

A greater proportion of Inland Revenue people will adopt new systems and processes

49. Once Stage 2 is implemented, START will be the new tool for all front-line staff to look up employer and income tax information. A significant number, approximately 4,000 staff, are already familiar with START and using it for some of their day-to-day work. For most, it will mean using START for a much larger proportion of their work.

50. Similarly to Stage 1, training will consist of pre-learning, classroom and post go-live training. Refinements to reflect the larger and more complex scope of Stage 2 include more time for informal and on-the-job learning, more tailored practice prior to go-live and smaller groups for classroom-based training.

51. Inland Revenue's organisational design will change in early 2018. Those designing customer services will be as close to the customer as possible and people working with customers will be empowered to make more decisions and resolve customers' issues more quickly. Three new groups will be established by January 2018 and the majority of front line staff will transfer across to new roles in them. This timing ensures the department will be well-positioned for the implementation of Stage 2 beginning from 1 April 2018.

52. 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.

Budget 2017 changes have some limited impacts on transformation and these are being managed

53. Changes in tax thresholds, Working for Families rates and the removal of the Independent Earner Tax Credit were announced in Budget 2017. These changes apply from 1 April 2018 and will impact on some Stage 2 and 3 products.

54. Inland Revenue has carefully considered how best to manage implementation of the Budget 2017 changes. The changes will be implemented in Inland Revenue's constrained heritage environments through the department's annual income tax cycle for businesses and individuals. There will be close co-ordination between the work required to implement the Budget changes and transformation, including ensuring customer communications are consistent and aligned.

Transformation is the key vehicle for delivering Inland Revenue's contribution to Better Public Services and wider government outcomes.

55. Initiatives being considered as part of Stage 2 that will enable improved outcomes for customers include:

- A more automated solution, integrated with START, to support the approved information sharing agreement (AISA) between Inland Revenue and the Ministry of Social Development (MSD).
- Inland Revenue will recognise all business customers by their New Zealand Business Number (NZBN) once MBIE has extended it to non-incorporated entities. This requires Inland Revenue to enhance the NZBN capabilities delivered as part of Stage 1.
- Inland Revenue and the Department of Internal Affairs (DIA) are exploring enabling digital registration and maintenance of customer information for individuals, including birth data.

56. Inland Revenue continues to work with other government agencies to share information that will unlock the value of data held by the public sector and simplify customers' interactions with government. Amendments to the Tax Administration Act 1994 (CAB-16-MIN-0654) enable Inland Revenue to extend information sharing with the NZ Police in cases of serious crime to include non-individuals and deceased persons. Cabinet approved (CAB-17-MIN-0208) an AISA between Inland Revenue and MSD in May 2017 which consolidates and expands information sharing with MSD.

Modernisation of the revenue system is now well underway and remains inherently high risk

57. Inland Revenue has made significant progress with the implementation of Stage 1. However GST is a relatively simple tax. Complexity for both customers and Inland Revenue increases significantly from here. Both Stages 2 and 3 are substantially more complex than Stage 1. The requirements for co-existence, integration, testing, stakeholder engagement and change management are exponentially greater and more intensive compared to Stage 1.

58. As noted in paragraph 20, the department is now operating two core systems and operational risk has increased due to co-existence. The co-existence of business functions and technical capabilities is amongst the most complex challenges to be managed for both customers and Inland Revenue. 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.

59. Stage 2 is very complex. It includes the migration of multiple products to new systems and processes, and legislative changes. These changes affect a wider group of stakeholders over a longer period of time compared to implementing GST.

60. There are some emerging risks that Ministers should be aware of for Stage 2:

- The complexity of Stage 2 and the progressive implementation of changes mean that releases require careful sequencing to ensure that customers, tax agents and software developers can absorb and adapt to new systems, processes, services and legislation. Inland Revenue's ability to deliver these changes and support them following go-live will also be a key consideration in finalising the release plan.

- Some stakeholders with critical roles in the revenue system, such as software developers and large employers, may not be able to meet desired implementation timeframes. On-going engagement between Inland Revenue and stakeholders will bring any issues to light in a timely way. Any issues or trade-offs that may need to be made will be highlighted for Ministers to consider.
- The ability of customers to absorb change may be tested. For some, changes to their systems, processes, services and reporting requirements will span three years – 1 April in each of 2018, 2019 and 2020. As some changes are being introduced on a voluntary basis first, this will be made clear to customers in engagements with them and communications material.
- Customers may perceive that their compliance costs have increased as a result of being required to report PAYE and investment income information more frequently. Emphasising the longer-term vision for the future revenue system – right first time, greater integration with business processes, less need to interact with Inland Revenue – will go some way towards addressing any perceptions of greater effort.
- Inland Revenue’s customer facing staff are facing a period of significant change. In the early months of 2018 they will be moving into new roles in a new organisation design, and may be responding to increased customer contacts as releases in Stage 2 are implemented.

61. A summary of the most significant risks for transformation as at June 2017 is included in appendix 2 of the attached Transformation Update.

62. The implementation of Stage 2 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. Aligning with changes in priorities is possible, although there may be some consequential implications for costs, benefits and risks. Any material changes or trade-offs would be highlighted for Ministers to consider.

63. Progress and risks are constantly re-assessed and regularly reported. Inland Revenue has been directed (CAB-15-MIN-0249 refers) to provide transformation progress updates to Cabinet by July and December each year. The next transformation update will be provided to Cabinet by December 2017.

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

64. Inland Revenue undertakes regular independent quality assurance (IQA) and technical quality assurance (TQA) reviews. Two external assurance reviews were completed towards the end of 2016.

65. A Gateway 4 (readiness for service) review in November 2016 found that “...*Stage 1 go-live appears feasible. Management issues, if addressed promptly, should enable successful delivery . . . and would maintain a strong position in readiness for Stage 2.*”

66. In December 2016 KPMG completed a fifth IQA and fourth TQA. The team noted that “... *planning for Stage 2 deployment has been initiated in parallel with Stage 1. This is encouraging, as is the feedback that this planning is leveraging the lessons-learned from Stage 1.*”

67. External reviews currently underway or recently completed include an IQA/TQA review undertaken by KPMG and a Gateway review. The results of these most recent reviews will be reported in the next progress update.

Next steps

68. The next steps are to:

- continue to work with stakeholders on the design and implementation of the AIM option for paying provisional tax;
- support the passage of the Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Bill which contains key transformation proposals;
- progress any technical legislative changes needed to support the implementation of Stage 2;
- prepare final proposals for modernising the Tax Administration Act for Cabinet to consider in November 2017;
- prepare a technical issues paper on PAYE adjustments and error correction for Cabinet to consider during August 2017;
- provide a summary of submissions on the Individuals discussion document for the Ministers of Finance and Revenue to consider by September 2017;
- progress Cabinet consideration of the release of the social policy discussion document; and
- prepare a transformation update for Cabinet to consider by December 2017.

Financial implications

69. The proposals in this paper have no financial implications.

Human rights implications

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

Legislative implications

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

Regulatory impact analysis

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

Publicity

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

Consultation

74. A copy of this paper has been provided to the Accident Compensation Corporation, DIA, the Department of Prime Minister and Cabinet, MBIE, the Ministry of Education, MSD, the New Zealand Customs Service and Statistics New Zealand.

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

75. Corporate Centre agencies were consulted on this update.

76. Since the March update, Inland Revenue has made progress with preparations for Stage 2, incorporating lessons learned from Stage 1. As Inland Revenue notes, Stage 2 solution design and build is tracking slightly behind schedule. They are confident this will not impact on release dates. The most recent Independent Quality Assurance review focused on Programme readiness to exit the Stage 2 Design Phase. We understand the report and recommendations will be reported to Joint Ministers late July. The next Gateway review will build on findings from this report.

77. Inland Revenue are on track to deliver the benefits expected from Stage 1. Organisational design will change early 2018 and further in 2019. The new organisational structure is intended to enable realisation of the benefits committed to in the 2015 Business Transformation business case. Following consultation with internal and external stakeholders, the release of income tax has been moved from 2018 to 2019, to align with Working for Families. We will continue to monitor Inland Revenue's progress towards future implementation dates and realisation of benefits. This includes monitoring risks that arise from coexistence between the old and new systems.

78. Inland Revenue continues to engage with the wider system, sharing lessons learned from Stage 1 and preparing for impacts from the implementation of Stage 2. The corporate centre will work with Inland Revenue to bring system impacts of Stage 2 to Ministers' attention.

Recommendations

I recommend that the Committee:

1. **Note** that Stage 2 is significantly more complex than the implementation of GST;
2. **Note** that Inland Revenue is moving to a model of a series of releases within stages to implement transformation;
3. **Note** that Stage 2 will be implemented in a series of releases over 2018 and 2019;
4. **Note** that the changes being introduced in Stage 2 affect a wide range of customers over an extended period;
5. **Note** that the next transformation update will be provided to Cabinet to consider by December 2017.

Hon Judith Collins
Minister of Revenue

/ /2017

Annex – Transformation Roadmap

