

Cabinet Committee on State Sector Reform and Expenditure Control

DELIVERING STAGE 1 OF NEW ZEALAND'S FUTURE REVENUE SYSTEM

Proposal

1. This paper provides an update regarding Inland Revenue's progress in preparing for implementation of Stage 1 of New Zealand's future revenue system, as directed by Cabinet (CAB-15-MIN-0249 refers). I am asking Cabinet to note progress, as outlined in the attached Transformation Update dated November 2016.

Business transformation is a long-term programme to modernise New Zealand's revenue system

2. Transformation will deliver a modern, digital, revenue system that serves the needs of all New Zealanders. It will improve government's ability to make policy changes more quickly and cost effectively, contribute to a growing, healthy economy, and create an information asset to deliver improved outcomes.

3. The goal is a revenue system that is simple to comply with, making it easy for customers to get things right and difficult to get wrong. As a result of transformation voluntary compliance will increase, and the effort required by customers to meet their obligations and receive their correct entitlements will reduce.

4. Transformation will re-shape how customers interact with government and Inland Revenue, and will include improvements to policy and legislative settings. In the future, most customers will not need to interact with Inland Revenue. Those with less complex needs will use automated, straight-through digital services that take less time and are more efficient.

5. Inland Revenue will put customers at the centre. This means helping customers from the start rather than when things go wrong and making more intelligent use of information. Customers expect government to provide intuitive and personalised services. Organising activities around customers and outcomes and improved analytical capabilities will enable Inland Revenue to generate insights that create better value for customers and government, and make sense of increasing volumes of data. The quality and frequency of the information available to Inland Revenue will improve providing opportunities for broader access to this information when it is needed.

6. In the future earlier, more complete and more accurate information will be available to Inland Revenue which will mean fewer under or over payments for customers. Information will be checked when it is received and errors fixed wherever possible. Increasingly, customers won't have to do anything as their information will be provided to Inland Revenue

on their behalf. For those that do, their systems and processes will be integrated with Inland Revenue's and part of their everyday activities.

7. Inland Revenue will ensure Ministers have on-going visibility of the costs and benefits of transformation. High-level design of Stages 2 and 3 is underway as a key input to confirming the costs and benefits of Stage 2. Once detailed design is further advanced Stage 2 costs and benefits will be reported to Cabinet by March 2017 to coincide with the Budget process. Stages 2 and 3 are being considered together given the close linkages between income information and the calculation of social policy entitlements.

8. The timing of transformation updates in July and December each year with a report back in March to confirm any inputs required for the Budget process is likely to be a recurring pattern.

Through transformation, Inland Revenue is making a significant contribution to Government priorities

9. Transformation will make a significant contribution to improving digital interactions with government, the Business Growth Agenda, and achieving Better Public Services Results 9 and 10. Once Stage 1 is implemented customers will be able to use their New Zealand Business Number (NZBN) to identify themselves to Inland Revenue and be able to authenticate their identity to Inland Revenue using RealMe as an option.

10. A key feature of the future revenue system is greater integration between public and private business partners. Inland Revenue has made significant strides in this area. In recent months customers using cloud-based accounting software have been able to integrate tax into their business processes. The GST filing service through accounting software was made available to all MYOB and Xero GST-registered customers in July 2016 - more than 185,000 businesses.¹ From January to 31 October 2016 there were more than 43,000 GST submissions. More than half of these have been received since the end of the pilot in June 2016. The number of submissions received since July 2016 has increased significantly compared to the pilot period.

11. This is positively impacting customers' perceptions of the effort required from them to meet their GST obligations. Inland Revenue has recently completed its 2016 survey of compliance costs for small and medium enterprises (SMEs). Surveyed customers were very positive about the service. One respondent stated "*Using Xero saves a lot of time, so I basically put zeroes to most timing questions*". Another said "*Our GST is calculated by our accounting software so the time involved is minor*".

12. Customers estimated in the 2016 survey that the time spent meeting their GST obligations was 14 hours a year. This is down from the estimate of 24 hours each year in the 2013 survey. The time spent complying with income tax obligations was estimated at 6 hours a year in 2016 - reduced from 12 hours a year in 2013.

¹ Source: Xero annual meeting presentation, 20 July 2016. MYOB do not publish comparable figures.

13. Overall, the customers surveyed felt that compliance costs have reduced due to better service from Inland Revenue, less paperwork, a move to digital filing and improved online services. The survey is the key mechanism for measuring progress in realising the economic benefits of transformation.

14. Inland Revenue originally estimated that small and medium businesses would spend approximately 9 fewer hours a year on GST compliance by 2023/24 as a result of the changes being introduced in Stage 1. The steps the department has taken over the last year have already significantly reduced customers' perceptions of effort for GST, broadly in line with the estimates made. The overall target is to reduce the average hours small and medium businesses spend on meeting their compliance obligations across all tax types by 18-26 hours per annum by 2023/24.

Inland Revenue is on track and on budget to successfully implement Stage 1 by the end of April 2017 or earlier if possible

15. Stage 1 is the first step in delivering a digitally-based, highly-automated revenue system that fits seamlessly into people's lives. New and improved services, reduced compliance costs and better access to information are expected to benefit small/medium enterprises and not-for-profit organisations.

16. Extensive engagement and communication is underway to ready customers and stakeholders for the changes being introduced. In June 2016 Inland Revenue's Changing for You website went live to raise awareness among small business owners about what dealing with tax might look like in the future. The site had received more than 52,000 unique visits as at the end of October 2016.

17. From June to October 2016, in conjunction with the Minister for Small Business and the Ministry of Business, Innovation and Employment (MBIE), Inland Revenue participated in the "Taking care of business" small business road-shows. The road-shows were an opportunity to talk to local businesses about the initiatives being introduced to make tax simpler and reduce compliance effort, including new GST services and the new Accounting Income Method (AIM) for calculating provisional tax.

18. Engagement with tax agents and other tax professionals is on-going. Inland Revenue is offering webinars and is speaking at a number of conferences. In addition Inland Revenue established a small tax agent group in September 2016. This group acts as a sounding board regarding how informed and ready they and their customers are leading up to Stage 1 go-live. Engagement with the not-for-profit sector is also underway and will continue.

19. On-going engagement with the tax sector, government consultation on policy changes, and the Changing for You campaign all provide New Zealanders with a voice on how tax administration can be simplified for future generations.

20. Direct communication with customers about the changes to GST administration began in October 2016 and will continue up to and following go-live by the end of April 2017 or earlier if possible. Most impacted customers will receive multiple communications that will

be supported by information on Inland Revenue's website and by radio and digital advertising.²

21. Implementing GST in START³ will introduce new online services that will enable customers to:

- Amend their GST returns and accounts;
- Register for GST;
- Register as a preparer of tax returns;
- Set up payment plans;
- Include attachments; and
- Track their GST payments and refunds.

22. In addition:

- Customers will be able to use their NZBN and RealMe to identify and authenticate themselves to Inland Revenue.
- The range of services available through the Companies Office will be enhanced to ensure incorporated entities can continue to be able to incorporate with the Companies Office, get an IRD number, register for GST and register as an employer as part of the same transaction.
- New immigrants will be able to digitally register for an IRD number.

23. I am confident that preparations for go-live are well in hand, with the development of START on track, testing well underway, and customer and staff communications in train. Stringent criteria will need to be met before a decision to go-live is made to ensure that services and systems work as expected. The readiness of customers, Inland Revenue, and the programme for go-live will be assessed regularly over the coming months.

24. The July 2017 transformation update will provide an overview of the results of the go-live of Stage 1, and include customer uptake of new services if this is available.

Rigorous and comprehensive testing, including customer validation of new services, is underway

25. From late August through to November 2016 customer user experience validation of new services being introduced in Stage 1 took place. Inland Revenue checked with customers that the new services:

- personalise and simplify their interactions with Inland Revenue
- provide certainty and assurance that they have met their obligations
- minimise the effort required by them to pay and/or receive the right amounts, and

² As per Cabinet Office Circular CO (15) 4, this expenditure will require the approval of the Minister of Revenue.

³ 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.

- are intuitive, easy to use and enable them to manage their own affairs.

26. In October 2016, customers were involved in validating the accessibility of new services from their own premises using their own devices. Customer involvement will continue right throughout transformation.

Work on policy and legislative settings continues on a broad range of fronts and is tracking as expected

27. The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill contains the law changes needed to implement Stage 1, the business tax package announced as part of Budget 2016 and the Automatic Exchange of Information (AEOI).⁴ It also contains the law changes needed to allow transitional regulations and administrative exemptions to resolve any potential issues during the co-existence⁵ of FIRST and START.

28. Workshops to design, implement and communicate the new Accounting Income Method (AIM) for calculating provisional tax announced as part of Budget 2016 are underway. Inland Revenue is working with a range of key parties including software developers, small business accountants, and the Chartered Accountants of Australia and New Zealand (CAANZ). Regular workshops are planned with CAANZ in the lead up to the implementation of AIM on 1 April 2018. Discussions with software developers about how AIM might be accommodated into software are also underway.

29. An Omnibus Bill is expected to be introduced in February 2017 to implement the policy changes arising from the administration of PAYE and GST, and investment income information. This Bill will also include any critical law changes needed for Stage 2. Legislative amendments are Inland Revenue's preferred approach with transitional regulations and administrative exemptions limited to issues identified too late for inclusion in a Bill.

Transformation is tracking well financially

30. Inland Revenue reports actual versus expected spend for transformation every month as part of its regular reporting to the Minister of Finance and me. Transformation is currently tracking under budget for Stage 1 due to less effort being required to manage co-existence impacts than initially thought, and to timing differences resulting from commercial agreements and enabling technology costs.

31. Customer communications and engagement activity will ramp up in the lead up to Stage 1 and enabling technology costs will be incurred. However the department is forecasting remain under budget for Stage 1. The Minister of Finance and I will discuss the

⁴ AEOI will enable the discovery of formerly undetected tax evasion. It provides for the exchange of non-resident financial account information with the tax authorities in the account holders' country of residence. Participating jurisdictions that implement AEOI send and receive pre-agreed information each year, without having to send a specific request.

⁵ Co-existence refers to the requirement to support both FIRST and START during the transition, as customer information will be split across both systems until all products are administered in START.

treatment of any remaining under-spend with Inland Revenue once Stage 1 has gone live. The department has a good track record of returning under-spent funding having returned \$5.1 million following the design phase, which was completed in December 2015.

32. Effective cost management has also meant that the majority of the contingency funding set aside has not been required to date. As Inland Revenue has previously advised (CAB-15-MIN-0249 refers), a substantial proportion of the contingency has been allocated to the early stages of transformation. Inland Revenue will seek authorisation from the Ministers of Finance and Revenue (CAB-15-MIN-0249 refers) to move unused contingency funding to later periods.

Planning for Stage 2 is well underway as it is significantly bigger in scope and complexity than Stage 1

33. In line with the roadmap attached as an annex and noted by Cabinet (CAB-15-MIN-0249 refers) a small, separate team within the programme has been working to confirm the scope of Stage 2 and mobilise the resources needed to begin detailed design. This approach has ensured that the majority of the programme can focus their efforts and attention on ensuring successful implementation of Stage 1.

34. The scope of Stage 2 is all tax products including AIM, gaming machine duty⁶ and AEOL. Stage 2 will also include enhanced online services for customers for the products in scope and some new contact options such as a possible extension of click-to-chat following a pilot period.

35. In preparation for Stage 3, Inland Revenue has begun engaging with the Minister of Finance and me on the objectives and scope of the proposals to reform the administration of the social policy programmes that the department administers.

36. Transformation, combined with the implementation of Budget 2016 measures and other initiatives such as base erosion and profit shifting and foreign trusts, will mean a significant volume of change for customers, staff, other stakeholders, and Inland Revenue. As a result Inland Revenue envisages that re-prioritisation will be required if further initiatives are added.

37. Inland Revenue is continuing to engage widely with other public sector agencies to share its experience and insights. This will continue.

Transformation remains inherently high-risk

38. While Inland Revenue is well positioned, transformation is in its early stages and remains inherently high risk. Implementation risk for Stage 1 is being mitigated by starting with a relatively simple tax, keeping technical integration for co-existence to a minimum, and proactively supporting customers and staff to understand and adopt new services.

⁶ Gaming Machine Duty is a stand-alone duty, not linked to other taxes in Stage 2. However implementing this in stage 2 or 3, should allow the FIRST mainframe to be decommissioned at the end of Stage 3 rather than at the end of Stage 4 as originally envisaged.

39. The key risks facing transformation are:

- Recruiting and retaining experienced resources of the right calibre. Inland Revenue has developed retention strategies and succession plans to help to mitigate this risk.
- Customers and staff must embrace change for the expected benefits to be realised. On-going focus on preparing customers and staff for change and on driving uptake of new services will ensure understanding and adoption.
- Government may not be easily able to implement significant policy proposals at short notice as Inland Revenue may not easily be able to accommodate sudden changes in sequencing and priorities. On-going dialogue with Ministers will ensure that changes in priorities are understood and that any implications for costs, benefits or risks are highlighted.

40. Progress and risks will be constantly re-assessed and any new opportunities which arise will need to be balanced against any potential slowing of progress or increase in risk.

41. A robust assurance management plan is in place for transformation incorporating regular independent quality assurance (IQA) and Gateway reviews. KPMG is the department's IQA provider. The Minister of Finance and I receive copies of all IQA reports and are provided with the opportunity to meet with reviewers. Reviews completed to date have concluded that transformation is being managed and governed well.

Next steps

42. The next steps are to:

- continue preparations for the implementation of Stage 1 by the end of April 2017 or earlier if possible
- begin detailed design for Stage 2 in January 2017
- confirm the costs and benefits of Stage 2 by March 2017 as an input to Budget 2017, and
- implement the measures in the business tax package effective from 1 April 2017 that modernise and extend withholding rules, reduce the impact of late payment penalties, and enable greater sharing of information.

Financial implications

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

Human rights implications

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

Legislative implications

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

Regulatory impact analysis

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

Publicity

47. I intend to ask Inland Revenue to publish the November 2016 Transformation Update and this paper on its website once it has been considered by Cabinet.

Consultation

48. 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.

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

49. Corporate centre agencies were consulted on this update.

50. Since the July update, Inland Revenue has progressed into testing and data migration in preparation for stage one go-live. The latest assurance review focussed on the strategy adopted for this process, finding examples of good practice and making recommendations for improvement. Inland Revenue has accepted these recommendations and has actions planned or underway to incorporate them in run-up to go-live. The next Independent Quality Assurance activity will re-review this process and provide assurance over Inland Revenue's readiness to deploy.

51. Planning for stage two has begun. Stage two will see the remaining tax types Inland Revenue administers migrated to the new platform. As Inland Revenue notes, stage two is significantly larger in scope and greater in complexity than stage one. Minimising changes to the tax types in scope of stage two will be important for controlling risk. From a system perspective we have noted the need to detail in the March update the impact that stage two changes will have on wider central and local government systems, and the Crown's readiness for these proposals. We will work closely with IR to monitor the impacts of BT stage two on the system.

52. Inland Revenue continues to play an active role in system transformation leadership through their participation in GCIO Partnership Framework. Inland Revenue has a clearer approach to adopting common capabilities including RealMe and ICT capabilities such as IaaS, ECaaS and TaaS.⁷ Inland Revenue has also advanced information sharing through participating in the Gangs Intelligence Hub and working to enable more effective sharing with MSD through the AISA.⁸ Further opportunities are inherent in the proposed TAA

⁷ Infrastructure as-a-Service, Enterprise Content Management-as-a-Service, Telecommunications-as-a-Service.

⁸ Approved information sharing agreement.

reforms and we will continue to work closely with the BT programme to promote these and new opportunities for system improvement.

53. Recruitment for a new programme director is underway. It is not uncommon for programmes of this length to see changes to programme management. The programme has good governance structures in place, which will reduce the impact of this change as recruitment progresses.

Recommendations

I recommend that the Committee:

1. **Note** that Stage 1 of Inland Revenue's transformation is on track for implementation by the end of April 2017 or earlier if possible;
2. **Note** that customers' perceptions of the effort required by them to meet their GST obligations has reduced, in part due to the availability of digital filing;
3. **Note** that the July 2017 transformation update will provide an overview of the results of the go-live of Stage 1;
4. **Note** that the confirmed scope of Stage 2 is all tax products, including the Accounting Income Method for calculating provisional tax, gaming machine duty and the Automatic Exchange of Information;
5. **Note** that the costs and benefits of Stage 2 will be confirmed by March 2017 once the detailed design of this stage is further advanced.

Hon Michael Woodhouse
Minister of Revenue

/ /2016

Annex – Transformation Roadmap

