In Confidence
Office of the Minister of Revenue

Cabinet

IMPLEMENTING NEW ZEALAND'S FUTURE REVENUE SYSTEM

Proposal

1. I seek Cabinet's consideration of, and approval to, commence implementation of a customer-centred revenue system that is designed to fit seamlessly into people's lives, as outlined in the attached business case. Further to consideration by the Cabinet Committee for State Sector Reform and Expenditure Control at its meeting on 18 November, 2015, one recommendation has been removed, and minor technical accounting adjustments have been made to financial recommendations following advice provided by The Treasury. These technical adjustments make clearer the net impact of these decisions on the Crown's operating balance but do not alter the substance of the recommendations, or the amounts required.

2. I am seeking Cabinet's agreement to:

- invest in the implementation of New Zealand's future revenue system;
- starting implementation with GST, including all supporting technical infrastructure and co-existence solutions as the first stage;
- additional Crown funding for Inland Revenue of up to \$896 million[1] to complete transformation; and
- additional Crown funding of up to \$109 million[2] as a contingency to be held by the Ministers of Finance and Revenue.

Executive summary

3. Inland Revenue is well positioned to commence implementation. Following Cabinet's approval to commence the design phase (SEC Min (14) 15/2 and Cab Min (14) 36/2 refer), the department has continued to recruit a highly experienced team and selected a commercial-off-the-shelf (COTS) software package for tax and social policy. This, alongside supporting capabilities, will deliver significantly higher productivity savings than previously thought. As the savings generated throughout the course of implementation will be re-invested in transformation, Inland Revenue's contribution is accordingly significantly higher than previously indicated.

4. Inland Revenue will require additional Crown funding of up to \$896 million to complete transformation, significantly less than originally anticipated. Additional Crown

[1] Excludes capital charge, depreciation and inflation
[2] Ibid

funding, in line with established public sector practice, is also required for a contingency of up to $109 million to be held by the Ministers of Finance and Revenue. The revised costs to transform Inland Revenue are between $1,500 million and $1,690 million.

5. This investment will deliver a modern, digital revenue system that will serve the needs of all New Zealanders, improve government's ability to make policy changes faster and more cost-effectively, protect the government's ability to continue to collect tax revenue and distribute entitlements, contribute to a healthy, growing economy, and create an information asset to deliver improved outcomes.

6. Transformation will re-shape the way the department serves New Zealanders. Simple, certain and open customer-centred services will be designed and delivered in partnership with others inside and outside government. A review of policy and legislative settings is currently underway as part of the *Making Tax Simpler* consultation to ensure that they are as simple as practically possible.

7. The programme will make a significant contribution to our Business Growth Agenda and achieving our targets for Better Public Services Results 9 and 10. Over the next nine years it will deliver cumulative financial benefits to the Crown of between $2,950 million to $5,960 million.[3]

8. There is no question that transformation is complex and challenging. Therefore, considerable emphasis has been placed on developing the capabilities required to manage and mitigate risks and issues. I am confident that the department has the right focus and capabilities to successfully deliver the programme.

9. It is apparent that the transition to a new platform must be completed once started; therefore this is the major investment decision. Halting part way through implementation will increase operational risk and costs.

10. I recommend that implementation start with GST, as it is relatively simple, has sufficient volume to provide experience for Inland Revenue and deliver benefits to customers.

11. In addition to regular reporting, annual programme updates will be prepared, which will provide Ministers with visibility of delivery progress, updated costs and benefits, and any material changes. This will support draw down of funding through the Budget process. In addition, an interim update will be prepared that provides Ministers with visibility of delivery progress and any trade-offs that need to be considered.

Business transformation will enable a modern, customer-centric revenue system

12. The world has changed. The shift to digital and greater globalisation has reshaped how businesses and individuals interact and connect, as well as their expectations of

[3] Excludes capital charge, depreciation and inflation

government. What was acceptable in the past no longer meets the demands of customers today.

13. New Zealand's revenue system must keep pace with change to protect the government's ability to continue to collect tax revenue and distribute entitlements. A modern revenue system will make it simpler, more open and certain for New Zealanders to pay their tax and receive their entitlements, significantly contribute to a healthy, growing economy, and contribute to a public service that is focused on better outcomes for New Zealanders.

14. I believe the revenue system[4] should put customers at the centre and help them from the start, rather than when things go wrong. It should serve the needs of all New Zealanders, improve government's ability to make policy changes faster and more cost-effectively, and create an information asset to deliver improved outcomes.

15. There is no doubt that Inland Revenue's systems need replacement to improve resilience and agility. They have reached the end of their life and are not sustainable in the medium to long term. The FIRST system[5] is aging, extremely complex, very difficult and costly to maintain, and inflexible.

16. Business transformation is a long-term programme to modernise New Zealand's revenue system. Cabinet has already agreed (SEC Min (13) 4/4 and CAB Min (13) 10/ 4 refer) to change the revenue system through business process and technology change.

17. However, transformation is far more than just updating a computer system: it will re-shape the way Inland Revenue works with customers, including improvements to policy and legislative settings. Transformation will simplify how services are delivered by changing how customers interact with a digitally-based revenue system. Government will be able to leverage its information asset to better understand and meet customers' circumstances and needs.

Inland Revenue is well positioned to commence implementation

18. New Zealanders have been, and will continue to be, consulted regarding potential changes to the revenue system. The *Making Tax Simpler* discussion documents released to date have been well supported and have generated considerable interest.

19. There is no question that transformation is complex and challenging, and will continue to attract on-going interest from a wide range of stakeholders. Over the last two years Inland Revenue has worked hard to ensure that it is well positioned to commence implementation and successfully deliver the changes needed.

[4] The revenue system includes the people, policy, processes, technology and data used to deliver the taxation and social policies that Inland Revenue administers, and the information Inland Revenue collects and provides to others.

[5] The term FIRST refers to three separate capabilities which collectively work together to support services: the FIRST core mainframe; the FIRST satellite systems that support services such as online filing; and the FIRST integration layer, which links the FIRST core to the satellite systems.

20. An experienced team who have delivered transformational change of this scale and complexity has been recruited from within New Zealand and overseas. The department has acquired and developed key skills, including strong commercial capabilities to enable complex multi-vendor arrangements to be managed, and expertise in transformational change given the scale of change envisaged for customers and staff.

21. Additional capability has been sourced from the market, including a COTS software package for tax and social policy. FAST Enterprises LLC's (FAST) GenTax solution has been selected as the basis of the new platform. GenTax is a configurable system with broad functionality. It is widely used by US state governments and by a number of national revenue authorities.

22. One of the advantages of selecting a COTS solution is that it will enable Inland Revenue to keep place with advances in technology.

23. Developing approaches to ready customers and staff for change has been a key focus. Implementation of the future revenue system will be a joint effort between Inland Revenue and business, industry, practitioners, customers and across government.

Independent assurance reviews have confirmed that the programme is well managed and governed

24. Three independent assurance reviews have been undertaken during 2015 and are summarised below.

25. The Office of the Auditor General (OAG) reviewed the programme's governance arrangements and published its findings in April 2015. The OAG found that *"...Inland Revenue's governance of the programme has provided clear direction, and supported clear and effective decisions."* In addition the OAG noted that the *"Strengths of Inland Revenue's governance of the programme include a comprehensive and clear governance structure, an established methodology, and an advanced approach to managing risks."*

26. KPMG, the programme's independent quality assurance (IQA) provider, undertook a third IQA and second technical quality assurance (TQA) review in July 2015. KPMG's key finding was that *"Overall the Programme continues to be managed in accordance with good industry practice, and the controlling processes are, in our view, robust and fit for purpose."* In addition, KPMG noted that *"...governance mechanisms continue to function effectively...."*

27. A Gateway review conducted in September 2015 rated the overall status of the programme as Amber/Green. The review team noted that this is "*... an increase in delivery confidence since the last Gateway Review,*" and *"... at this stage reflects very favourably on the Programme."* The review team also noted that *"Inland Revenue has invested significantly in developing in-house staff and bringing in experienced individuals and fresh expertise. In addition, a one-team ethos has been nurtured with delivery partners."*

Modernising the revenue system requires wide-ranging change

28. New Zealand's future revenue system will be digitally-based, highly automated, and designed to fit seamlessly into people's lives. Simple, certain and open customer-centred services will be designed and delivered in partnership with others inside and outside government.

29. Increasing integration with private and public business partners is a key feature of the future revenue system. Inland Revenue is partnering with the software industry to enable early business benefits to be delivered by enabling third party software applications to connect with Inland Revenue over the internet. An application programming interface (API) is currently being piloted by Inland Revenue, Xero and MYOB which will enable digital submissions of GST returns from their software.

30. This is the first step in integrating the revenue system with businesses' own financial systems and cycles to reduce compliance costs, enabling them to spend more time on running and growing their businesses.

31. To administer a modern revenue system, Inland Revenue will have to change the way it works and make more intelligent use of information. In the future, enhanced analytics capabilities will enable Inland Revenue to work with other agencies to better understand customers' circumstances and needs across wider government, and to identify policy and service design opportunities to improve outcomes for New Zealanders.

32. For example, solutions are being co-designed with the Ministry of Business, Innovation and Employment (MBIE) for use of the New Zealand Business Number (NZBN) and to allow immigrants to digitally register for tax.

33. Updating the department's enterprise systems is essential to support Inland Revenue's future operating model. Part of Inland Revenue's funding contribution includes capital set aside for replacement of these systems.

A revenue system which is logically connected, simply delivered

34. Policy changes are required to modernise and simplify requirements for customers. Proposals under consultation would allow Inland Revenue to use PAYE information more effectively to support existing social policy processes and ensure better matching of assistance to individuals' needs. More accurate and timely PAYE information would assist

Inland Revenue to intervene more quickly to correct errors and to improve individuals' access to social policy entitlements. Not only would this improve delivery of services to individual customers, it may also generate administrative savings across government by streamlining processes and/or reducing duplication.

35. I have released two more discussion documents in the *Making Tax Simpler* series, with specific proposals to:

- set a framework for the Tax Administration Act 1994 that clearly lays out the roles of the key parties in the tax system and ensures that the use of modern technology is appropriately provided for; and
- design digital services which, as much as possible, integrate tax requirements into tasks that taxpayers would already be doing to run their business or organisation.

36. We are still considering further proposals for business tax.

37. The review of policy and legislative settings currently underway will frame and support modernisation of the revenue system. Where possible, these changes will be aligned with other changes to minimise impacts for customers and Inland Revenue. However, if this not possible there could be additional costs of change.

Transforming Inland Revenue's organisational capabilities

38. To support these changes, Inland Revenue will need a different set of capabilities than it has today. Fundamental shifts are required to support new processes, tools, and ways of working.

39. In the future, Inland Revenue will be a smaller organisation working in partnerships and alliances across government and the private sector. The workforce will be more knowledge-based, supported by greater analytical capability. Change will be managed through progressive transition states. Inland Revenue will have a robust, consistent, fair and efficient approach to transitioning people, and is proactively engaging with the Public Service Association (PSA) and TaxPro.

40. The organisation's infrastructure also needs to be modernised to support a new and more efficient operating model. Some enterprise systems were implemented up to 18 years ago and do not provide for modern ways of working.

The priority is delivery of the technology platform

41. New technology based around GenTax will be a major catalyst for the modernisation of the revenue system. Both the old and new platforms will need to be supported during the transition. The co-existence of business functions and technical capabilities is arguably among the most complex challenges to be managed.

42. Transitioning to the new platform as quickly as possible is the best way to manage this complexity as this will limit the period of time that the platforms need to co-exist. This approach is consistent with other agencies that have adopted GenTax. Inland Revenue's operational risk profile will rise over the period of the transition to the new platform as fundamental changes are introduced to a complex environment. It is Inland Revenue's intention that customers do not experience any degradation of service quality during transition.

Starting with a simple tax will provide confidence

43. I recommend that implementation start with GST as it is relatively simple, has sufficient volume to provide experience for Inland Revenue and deliver benefits to customers. I understand that this is consistent with other GenTax implementations where the majority have started with a sales tax.

44. The roadmap below outlines Inland Revenue's current view of delivery sequencing. The proposed sequencing aligns well to Government priorities, balances delivery risk and impacts on customers, and enables delivery of benefits as soon as practically possible.

45. Stage 1 will also include the implementation of all supporting technical infrastructure and co-existence solutions. Inland Revenue proposes to focus on tax products in Stage 2, and social policy in Stage 3. Stage 4 will focus on any remaining taxes and duties, such as gaming duties.[6]

46. I expect Inland Revenue to regularly engage with Ministers to ensure that our priorities are understood and that no decisions are taken that close off future policy options. Officials have advised me that, at this point in time, nothing precludes different sequencing to align with changes in priorities (although there may be some consequential implications for costs, benefits and risks).

Costs, benefits and required funding

47. I believe this is a good investment because it will:

- provide confidence in the continued collection of tax revenue and distribution of entitlements;
- improve government's ability to implement policy changes faster and more cost-effectively;

[6] While the programme will conclude by 2021, cost information has been presented over 10 years to 2023/24 until fiscal neutrality is achieved

- make it easier for people to do the right thing and hard not to, thus growing voluntary compliance and making a significant contribution to Result 10;
- deliver cumulative compliance cost savings (economic benefits) until 2023/24 of between $1,200 million to $2,025 million, and make a significant contribution to the Business Growth Agenda and Result 9; and
- deliver cumulative financial benefits to the Crown, made up of additional Crown revenue and efficiency savings, until 2023/24 of between $2,950 million to $5,960 million.[7]

48. The Crown funding required (until 2023/24) for Inland Revenue, of up to $896 million,[8] to complete transformation, is significantly less than originally anticipated. In line with established public sector practice, additional Crown funding is required for a contingency of up to $109 million[9] to be held by the Ministers of Finance and Revenue.

49. The revised incremental costs to complete transformation (until 2023/24) are between $1,500 million and $1,690 million.[10] Costs and benefits to other Crown organisations and other stakeholders in making any changes, if required, to their systems and processes are not included.

50. There are still some uncertainties surrounding the co-existence of the old and new platforms which may impact on time and costs. These uncertainties will be resolved over the coming months as the detailed design of co-existence is progressed.

51. Modernisation of the revenue system is one of the biggest levers this Government has to enable businesses to spend more time running their businesses and less time on compliance. In particular, smaller businesses[11] are expected to benefit to a greater degree as compliance tasks are typically performed by the owner/operator. The expected time saving is between 18 to 26 hours per annum. Businesses that choose to use cloud based software that is integrated with Inland Revenue will see a reduction in their compliance effort.

52. Improved voluntary compliance, proactive customer assistance, and better use of information and analytics to identify non-compliance will deliver additional Crown revenue. Reductions in manual processing, routine customer contacts, support functions and overhead costs will deliver administrative savings. All things being equal, Inland Revenue will be approximately 25%-30% smaller in 2023/24 than it is today.

53. The estimated benefits are premised on current policy and legislative settings. However, a number of the policy proposals undergoing consultation, and planned for future consultations, have potential to enable wider benefits. Subject to the outcome of public consultation and Government's decisions on these proposals, there is potential for further benefits including further reductions in compliance costs, improved fairness/equity and

[7] Excludes capital charge, depreciation and inflation
[8] Ibid
[9] Ibid
[10] Ibid
[11] Approximately 90% of businesses have five or fewer employees

integrity of the revenue system. These benefits and any additional costs will be quantified in more detail following consultation, and included in future Programme Updates.

The Commissioner will enter into a number of long-term commercial arrangements

54. The Commissioner will need to enter into a number of commercial arrangements, some long-term, to support implementation. These include:

- the acquisition of GenTax software and implementation services to be provided by FAST;
- software to supplement GenTax such as support and development tools;
- an identity and access management solution; and
- an enterprise content management solution.

55. A range of suppliers, many of them New Zealand businesses, are already providing services to the programme. In the last financial year, 86 supplier agreements were entered into, just over half of which were with small and medium enterprises (SMEs) and New Zealand based organisations.

Ensuring commercial arrangements are well managed

56. Two dedicated Commercial Directors that are experienced in managing complex, multi-vendor environments, have overall responsibility for managing sourcing and commercial activity for transformation.

57. Supplier performance and relationships are managed through a range of mechanisms. Suppliers providing on-going services are regularly assessed against a balanced scorecard which tracks performance across a number of areas, including engagement effectiveness, cost management, delivery performance, team performance, and scope management. Supplier performance is reviewed through the appropriate governance forums.

Purchase of GenTax software and FAST implementation services

58. An open, multi-step approach that is consistent with the government's rules of sourcing was used to identify the core COTS provider. FAST has a high degree of fit with the requirements of the revenue system and provides significantly better value for money than alternatives.

59. The Commissioner wishes to give FAST a commitment to provide all services related to the implementation of GenTax throughout the life of the programme.

Non-core COTS software and services for standard functions

60. All-of-Government (AoG) contracts and capabilities will be used where they are available, where they support the business outcomes of the revenue system and Inland Revenue, and are cost effective. For example, Inland Revenue and the Government Chief Information Officer (GCIO) are working closely to identify requirements for data centres and

how the infrastructure-as-a-service (IaaS) AoG panel will support these. Any new capabilities that Inland Revenue identifies will be discussed with the GCIO to assess whether they could be added to existing AoG contracts.

Once started, halting implementation will increase risk and cost

61. Previously I had advised that the department would present a series of investment decisions, each of which would identify on and off ramps. It is apparent however that the transition to a new platform must be completed once started; therefore this is the major investment decision.

62. Halting part way 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.

Risks and mitigations

63. Overall the programme is considered to be inherently high risk. Accordingly, considerable emphasis has been placed on developing the capabilities required to manage and mitigate risks and issues. The programme's management of risk was recognised as "an exemplar" in the September 2015 Gateway review.

64. The key risks Cabinet should be aware of are:

a. Timeframes and costs, particularly regarding the co-existence of old and new technology platforms, may change as Inland Revenue begins implementation. This will be mitigated as far as possible by the work to be undertaken over the coming months. Ministers will be provided with visibility of any material shifts in costs, benefits and risks.

b. Continuing to recruit and retain experienced resources of the right calibre will be critical to success. The department has put in place retention strategies and succession plans to help mitigate this risk.

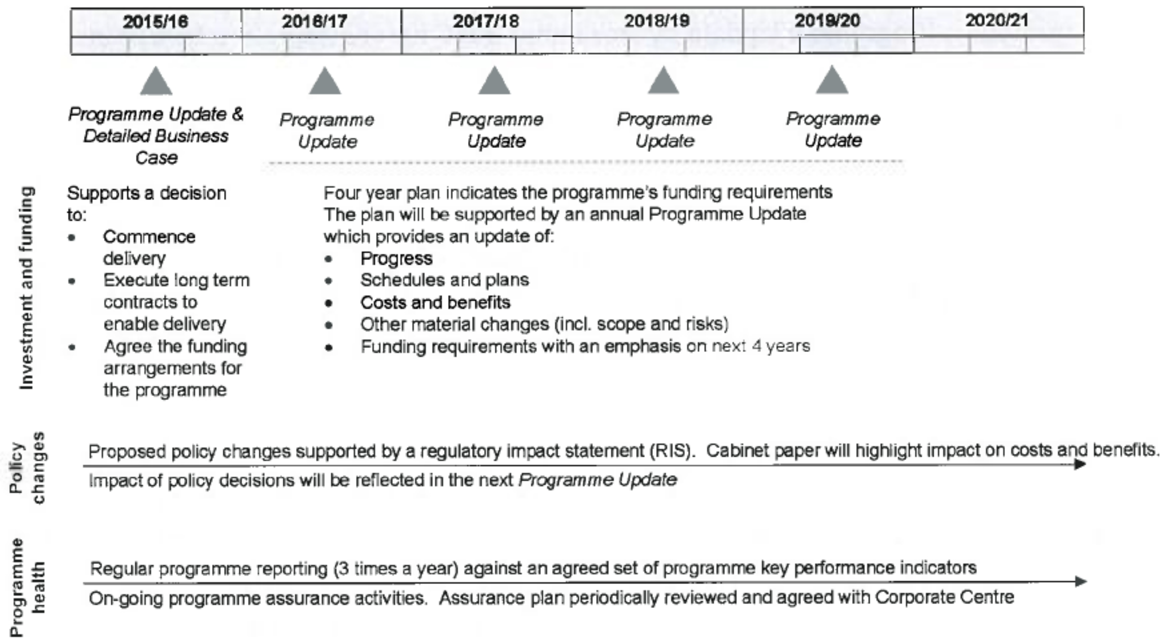
c. Customers and staff must embrace change for the expected benefits to be realised. On-going awareness and education campaigns for customers and proactive change management processes for staff will ensure that changes are understood and adopted.

d. 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. As previously discussed, on-going dialogue with Ministers will ensure that changes in priorities are understood and that any implications for costs, benefits or risks are highlighted. Implementing large-scale change successfully requires clear scope and a dedicated focus. I have previously advised (SEC (14) 49 refers) that one of the risks facing Inland Revenue is that "... senior management is distracted by competing priorities and pressures." I am of the view that delivery of the programme should be Inland Revenue's over-riding priority. Removing any doubt about our expectations will reinforce to the department the importance we place on achieving the expected outcomes and benefits.

65. I am advised that with large scale transformation programmes such as this, these complexities and level of risk are to be expected. I am confident that the department has the right focus and capabilities to successfully deliver the programme.

Providing assurance to Ministers

66. Annual programme updates will be prepared which will provide Ministers with visibility of delivery progress, updated costs and benefits, and any material changes. The diagram below provides an overview of future reporting arrangements.



67. In addition to the annual Programme Update, an interim update will be prepared providing Ministers with visibility of delivery progress and any trade-offs that need to be considered.

68. Inland Revenue will continue to refine monthly status reporting, including key performance indicators (KPIs), and incorporate these in future Programme Updates.

69. An assurance management plan, which has been agreed with the corporate centre, is in place for the programme. The forward plan will be reviewed with the corporate centre at the end of each phase. This quality assurance process will ensure that:

- there is an overall plan for implementing proactive assurance activities;
- there is capacity for conducting planned and ad hoc reviews;
- on-going IQA and internal reviews are undertaken;
- Gateway reviews are undertaken at both programme and project level; and

- progress is continuously monitored by central monitoring agencies.

Next steps

70. The next steps are to:

- complete preparation for implementation of Stage 1;
- promote bills for Cabinet's 2016 legislative programme;
- complete the pilot application programming interface (API) for GST, and implement APIs for PAYE and income tax progressively over 2016/17;
- execute commercial arrangements (some long-term) to allow implementation to commence;
- commence implementation of stage 1 with a view to completion by July 2017;
- provide an interim progress update by July 2016 for consideration by Cabinet; and
- provide a Programme Update by December 2016 for consideration by Cabinet.

Financial implications

Costs to complete transformation

71. New funding for capital and operating expenditure of up to $896 million (excluding contingency) a further $109 million as a contingency to be held by the Ministers of Finance and Revenue, and up to $295 million for depreciation and capital charges is required from the Crown, as detailed in table 1 below.[12]

72. Capital and operating incremental expenditure is estimated to be between $1,500 million and $1,690 million, and depreciation and capital charges are estimated to be between $640 million and $715 million to 2023/24, including contingencies, as detailed in table 1 on the next page. Costs and benefits to other Crown organisations and other stakeholders in making changes, if required, to their systems and processes are not included.

[12] Figures exclude inflation

Table 1 – Costs to complete transformation and sources of funding in real terms

	Funding for the period 2015/16 to 2023/24 (in real terms)		
	From Crown	From Inland Revenue	Total
Cash items			
Operating costs	\$530m - \$670m	\$450m - \$435m	\$980m - \$1,105m
Capital costs	\$270m - \$335m	\$250m - \$250m	\$520m - \$585m
Total	**\$800m - 1,005m**	**\$700m - \$685m**	**\$1,500m - \$1,690m**
Non-cash and notional items			
Depreciation	\$75m - \$125m	\$315m - \$310m	\$390m - \$435m
Capital charge	\$135m - \$170m	\$115m – \$110m	\$250m – \$280m
Total	\$210m – \$295m	\$430m - \$420m	\$640m - \$715m

73. Fiscal implications resulting from any proposed policy changes are not included in the revised costs and benefits included in this paper. Full fiscal implications will be included in final policy advice to Cabinet following policy consultation. Once decisions have been made, fiscal implications will be included in future Programme Updates.

Inland Revenue's contribution

74. Inland Revenue's contribution to capital and operating expenditure is expected to be between \$685 million and \$700 million, and to depreciation and capital charges is expected to be between \$420 million and \$430 million to 2023/24, as detailed in table 1 above.[13]

75. To maximise its funding contribution, Inland Revenue has re-directed the majority of its existing capital reserves and discretionary asset improvement funding to transformation. This approach has effectively limited Inland Revenue's non-transformation spending to ensuring that the heritage environment continues to function, managing the annual tax return cycle, and critical investment in plant, property and equipment. As a consequence, any new government initiatives will likely require further funding for Inland Revenue.

76. In addition, Inland Revenue is seeking approval to re-apply \$16.5 million from the design phase to implementation. This is contingent on implementation commencing in January 2016. If implementation commences after this date, some or all of this funding will be required to fund the programme until approval to commence implementation is secured.

77. Inland Revenue is seeking approval to apply administrative savings resulting from the programme of between \$460 million and \$540 million as part of its funding contribution to the programme.

[13] Figures exclude inflation

Financial delegation

78. The department requires certainty of funding over the life of the programme to enable implementation to commence, and to allow the Commissioner to enter into long-term commercial agreements.

79. The Commissioner of Inland Revenue will require a financial delegation of up to $1,870 million[14] for capital and operating expenditure, as well as up to $740 million for depreciation and capital charges in respect of the incremental costs of the transformation programme from 1 July 2014 to 30 June 2024.

2015/16 impact on operating balance of the Crown

80. Inland Revenue estimates the cost of implementation in 2015/16 to be $46 million for capital and $71 million for operating expenditure. Inland Revenue can fully fund the capital from its existing reserves, however new funding will be required for operating expenditure. Crown funding will be a pre-commitment against Budget 2016.

81. In addition to the funding of $16.5m to be reapplied from the design phase, Inland Revenue can contribute a further $10 million in operating funding during 2015/16. The new operating funding required from the Crown (and corresponding impact on the Crown operating balance) is therefore $44 million.

Contingency arrangements

82. The appropriation includes a contingency of $109 million[15] for the life of the programme. I recommend that access to this contingency is authorised by the Ministers of Finance and Revenue.

83. In line with established public sector practice, funding contingencies have been based on the results of a Quantitative Risk Assessment facilitated by an independent expert, with the Ministers' contingency reflecting the difference between funding required at the 50^{th} and 85^{th} likelihood percentiles.

84. A sizeable portion of the contingency is allocated early in the programme to ensure there is sufficient funding for early periods.

Human rights implications

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

Legislative implications

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

[14] This includes spending on earlier phases of the programme of approximately $80 million.
[15] Excludes capital charge, depreciation and inflation

87. Depending on the outcomes of the *Making Tax Simpler* consultation series, changes to policy and legislative settings may be required to support modernisation of the revenue system. Any proposed changes would be subject to the usual generic tax policy process, including endorsement by Cabinet.

Regulatory impact analysis

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

Publicity

89. I will consider any publicity opportunities at an appropriate time.

Consultation

90. A copy of this paper has been provided to the Accident Compensation Corporation, the Department of Prime Minister and Cabinet, the Ministry of Social Development, the Ministry of Education, the New Zealand Customs Service and Statistics New Zealand.

Central agencies' comment (The Treasury, State Services Commission, Government Chief Information Officer, and Ministry of Business, Innovation and Employment)

91. Due to the scale, complexity and potential impact of Business Transformation, corporate centre agencies have engaged intensively with Inland Revenue over several years on the design of the programme, including the attached business case. We have reviewed the business case and the detailed information that underpins it. Our advice is to support the proposals in this paper.

92. We agree with Inland Revenue that there are significant risks for the successful execution of the programme, and that the risk profile will increase while Inland Revenue transitions between legacy (FIRST) and new core (GenTax) systems. We anticipate working closely with Inland Revenue as they work through the detail of how co-existence will be managed.

93. More generally, in a programme of this scale and duration, new risks and opportunities will emerge, reflecting changing circumstances, expectations, technology, or service advances. These may have implications for the current profile of costs and benefits. We will work with Inland Revenue to ensure that significant changes are signalled to Ministers in good time, and that advice on choices and their implications is clear and robust; and to identify and manage the system implications which arise throughout the programme.

94. Although there are significant risks, recent Gateway and IQA processes have indicated that the programme's governance and risk management are robust, and we are confident that Inland Revenue is well-prepared to manage implementation. The programme has an approved assurance plan and schedule of reviews, including a planned annual review from the Office of the Auditor General. Whilst assurance to Ministers sits with Inland Revenue, we will work with Inland Revenue to ensure that Ministers are appropriately advised in this regard.

95. The programme's preferred approach to delivery entails migrating discrete tax and social policy products from FIRST to GenTax, coupled with changes to legislation, over seven years. This approach greatly mitigates overall risk and avoids a 'big-bang' style implementation. It is the typical approach among jurisdictions which have implemented GenTax. The corporate centre supports this approach, and notes that asking Inland Revenue to accelerate delivery would reduce its effectiveness in mitigating risk. Limiting co-existence to as short a period as possible will also be important. As Inland Revenue has indicated, managing co-existence will be challenging; if retirement of FIRST is delayed or prevented, Inland Revenue will face significant costs, risks, and benefit deferral. We understand that failing to completely transition between systems is the norm for ICT enabled investments, resulting in higher costs and lower benefits than anticipated.

96. We note that a significant portion of Inland Revenue's contribution of funding to the programme consists of re-invested productivity savings. These will be derived mainly through reducing the size of Inland Revenue's workforce by a quarter, or 1,500 FTEs, beginning in 2018/19. In the event that these savings are not fully realised, Inland Revenue may require substantial further Crown funding to complete the programme.

97. Inland Revenue will have limited ability to respond to other priorities during transformation without receiving significant additional funding. Our advice is to limit additional policy and administrative changes as much as practicable during transition. However, we also believe it is important that Ministers consider strategic opportunities or issues for both Inland Revenue and the system throughout this time.

98. In the context of the Government ICT Strategy, we note there is a need for IR and the Corporate Centre to continue to work closely together and to identify and pursue opportunities that benefit both IR and the system. A particular focus for the corporate centre will be to ensure improved service to customers, including through joined-up delivery across agencies when this aligns with customer expectations.

99. Finally, although Inland Revenue is seeking a significant amount of funding for transformation, it is important to note that the replacement of the core platform represents approximately 20% of the total programme costs. The majority of the investment is focussed on business process change, and other non-core technologies and processes that Inland Revenue has referred to as 'enabling infrastructure'. We believe there are a number of opportunities, requiring further examination, to build on this enabling infrastructure and develop it for use beyond just Inland Revenue's transformation programme. We support the programme's approach to common capability, and anticipate working collaboratively towards better outcomes for both Inland Revenue and the wider system.

Recommendations

I recommend that the Committee:

Background

1. **Note** that on 18 March 2014 the Ministers of Finance and Revenue confirmed Inland Revenue's programme business case;

2. **Note** that Cabinet has agreed (SEC Min (13) 4/4 and CAB Min (13) 10/4 refer) that modernising the revenue system through business process re-engineering, supported by new technology is the preferred way forward;

*New Zealand's **future revenue system***

3. **Note** that the case for change outlined in the 2013 programme business case remains sound;

4. **Agree** to invest in the implementation of New Zealand's future revenue system;

5. **Note** that FAST Enterprises LLC's GenTax solution has been selected as the basis for the new technology platform;

6. **Note** that the programme roadmap has been confirmed following the design phase and will deliver New Zealand's future revenue system in four customer-focused stages:
   i. Stage 1: Enabling secure digital services from 2016 to 2017;
   ii. Stage 2: Streamline income and business tax processes from 2017 to 2019;
   iii. Stage 3: Streamline social policy delivery from 2018 to 2020;
   iv. Stage 4: Complete delivery of the future revenue system from 2019 to 2021;

7. **Agree** that Stage 1 will focus on:
   i. the end-to-end implementation of GST on GenTax;
   ii. implementation of all supporting technical infrastructure and co-existence solutions;
   iii. New Zealand Business Number information collection;
   iv. stabilisation of Inland Revenue's analytics and information environment;
   v. preparation for future stages;

8. **Note** that the outcomes of Stage 1 will be:
   i. the majority of customers will self-manage and use digital services;
   ii. businesses' compliance burden to fulfil their GST obligations will be reduced;
   iii. there will be fewer customer contacts and processing requirements for GST;
   iv. improved GST compliance;

9. **Note** that material changes in the scope, sequencing, timing, costs, benefits, risks and impacts on customers of Stages 2 to 4 will be agreed with Ministers;

Commercial arrangements

10. **Note** that the Commissioner of Inland Revenue will enter into a number of long-term commercial arrangements to support the implementation of New Zealand's future revenue system, including with FAST Enterprises LLC;

11. **Note** that Inland Revenue continues to work with officials from the Government Chief Information Officer and the Ministry of Business Innovation and Employment to leverage the capabilities available in all-of-Government contracts where they are available, fit-for-purpose and cost effective;

Contribution to wider Government priorities

12. **Note** that Inland Revenue's business transformation programme is a key vehicle for advancing this Government's objectives for business growth and its Better Public Services' goals;

13. **Note** that adding any further expectations to Inland Revenue's existing work programme will add risk to the delivery of this complex implementation;

14. **Note** that Inland Revenue and corporate centre agencies will work closely to identify opportunities for contributing to the Government's ICT strategy;

Costs to complete transformation and benefits

15. **Note** that new funding for capital and operating expenditure of between \$800 million and \$1,005 million,[16] and for depreciation and capital charges of between \$210 million and \$295 million is required from the Crown, as detailed in table 1;

16. **Note** that Inland Revenue's contribution to capital and operating expenditure is expected to be between \$685 million and \$700 million,[17] and to depreciation and capital charges is expected to be between \$420 million and \$430 million to 2023/24 as detailed in table 1;

17. **Note** that Inland Revenue has re-directed the majority of its existing capital reserves and discretionary asset improvement funding to transformation and, as a consequence, any new government initiatives will likely require further funding;

[16] Excludes capital charge, depreciation and inflation
[17] Ibid

18. **Note** that total incremental capital and operating expenditure is estimated to be between $1,500 million and $1,690 million,[18] and depreciation and capital charges[19] are estimated to be between $640 million and $715 million to 2023/24, including contingencies, as detailed in table 1;

19. **Note** that costs and benefits to other Crown organisations and other stakeholders in making any changes to their systems and processes are not included;

20. **Note** that, at the end of the programme, financial benefits to the Crown are estimated to be between $2,950 million to $5,960 million, and compliance cost savings are estimated to be between $1,200 million to $2,025 million[20];

21. **Authorise** Inland Revenue to apply administrative savings resulting from the programme as part of its funding contribution to the programme;

Future policy and legislative changes

22. **Note** that programme costs and timelines assume that implementation of policy changes are aligned with the programme roadmap;

23. **Note** that fiscal implications resulting from any proposed policy changes are not included in programme costs and benefits and that these will be included in final policy advice provided to Cabinet following consultation;

Appropriation decisions

24. **Note** that the financial figures in the detailed business case and this paper exclude the impact of inflation to enable comparisons with the programme business case;

25. **Note** that, given the duration of the programme, appropriations need to include an adjustment for inflation, therefore the appropriation tables and the matching financial delegation amounts include inflation as reflected in recommendations 28, 37, 38, 42 and 46 below;

26. **Note** that implementation will be complex and, once started, halting will increase cost and risk as two systems will have to be maintained and Inland Revenue's ability to realise administrative savings will be constrained;

27. **Direct** Inland Revenue to prepare an annual Programme Update for Cabinet consideration by December each year, and an interim progress update by July each year;

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[18] Excludes capital charge, depreciation and inflation

[19] Includes depreciation and capital charge already in Inland Revenue's baseline, i.e. capital amounts Inland Revenue will fund from reserves

[20] Excludes capital charge, depreciation and inflation

28. **Approve** the following changes to appropriations and departmental capital injections to give effect to the decision in recommendation 4 above;

	$m – increase/(decrease)								
	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24 & Outyears
Vote Revenue Minister of Revenue									
Departmental Other Expense: Transformation (funded by revenue Crown)	44.000	195.000	226.000	190.000	156.000	70.000	64.000	45.000	36.000
Inland Revenue Department: Capital injection	-	54.000	102.000	90.000	87.000	21.000	-	-	-
Total operating	**44.000**	**195.000**	**226.000**	**190.000**	**156.000**	**70.000**	**64.000**	**45.000**	**36.000**
Total capital	**-**	**54.000**	**102.000**	**90.000**	**87.000**	**21.000**	**-**	**-**	**-**

29. **Note** that Inland Revenue will use existing baseline transfer mechanisms to move money between years;

30. **Approve** the following fiscally neutral adjustment related to Business Transformation funding from within the existing departmental baseline in 2015/16, with no impact on the operating balance;

	$m – increase/(decrease)				
	2015/16	2016/17	2017/18	2018/19	2019/20
Vote Revenue Minister of Revenue					
Departmental Output Expense: Services to inform public about entitlements and meeting obligations (funded by revenue Crown)	(3.600)	-	-	-	-
Services to process obligations and entitlements (funded by revenue Crown)	(1.800)	-	-	-	-
Management of debt and outstanding returns (funded by revenue Crown)	(2.100)	-	-	-	-
Investigations (funded by revenue Crown)	(2.500)	-	-	-	-
Departmental Other Expense: Transformation (funded by revenue Crown)	10.000	-	-	-	-
Total operating	**-**	**-**	**-**	**-**	**-**

31. **Agree** that fiscally neutral adjustments to appropriations related to Business Transformation funding from within the existing departmental baselines in 2016/17 and the out-years be carried-out during the 2016 March Baseline Update, in line with Cabinet Office Circular CO 15 (4) (*Proposals with Financial Implications and Financial Authorities);*

32. **Agree** that the proposed changes to appropriations for 2015/16 above be included in the 2015/16 Supplementary Estimates and that, in the interim, the increases be met from Imprest Supply;

33. **Note** that the operating expenditure incurred in recommendation 28 above for 2015/16 will impact the 2015/16 operating balance;

34. **Agree** that the operating expenditure incurred under recommendation 28 above be a pre-commitment against the Budget 2016 operating allowance, and commensurately reduce funding available for other priorities;

35. **Agree** that the capital expenditure incurred under recommendation 28 will be a pre-commitment against the Budget 2016 capital allowance, and commensurately reduce funding available for other priorities;

36. **Note** that the appropriation implications of Inland Revenue's funding contribution will be addressed as part of the 2016 March Baseline Update;

37. **Note** the following increase in revenue as a result of the decision in recommendations above, with a corresponding impact on the operating balance;

	$m – increase/(decrease)								
	2015/16	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24 & Outyears**
Vote Revenue Minister of Revenue									
Tax Revenue: Direct & Indirect taxation	-	-	-	90.000	190.000	290.000	540.000	750.000	1,020.000

38. **Note** the following table shows the total impacts of the above decisions, with a corresponding impact on the operating balance and debt;

	$m – increase/(decrease)								
	2015/16	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24 & Outyears**
Total operating expenditure	44.000	195.000	226.000	190.000	156.000	70.000	64.000	45.000	36.000
Total increase in revenue	-	-	-	90.000	190.000	290.000	540.000	750.000	1,020.000
Total impact on operating balance	44.000	195.000	226.000	**100.000**	**(34.000)**	**(220.000)**	(476.000)	(705.000)	**(984.000)**
Total impact on capital allowance	-	54.000	102.000	**90.000**	**87.000**	**21.000**	-	-	-

39. **Note** that only the net impact from 2015/16 to 2019/20 will be counted against the Budget 2016 operating allowance;

Reapplying surplus funding from design phase

40. **Approve** the reallocation of funding of $16.5 million previously appropriated for the design phase to implementation phase;

41. **Note** that the reallocation of $16.5 million is contingent on implementation commencing in January 2016;

Contingency decisions

42. **Note** the funding contingency amounts that are contained within the funding decision in recommendation 28 above;

	$m									
	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24 & Outyears	Total over 9 years
Capital Ministers' contingency	-	17.0	5.0	5.0	5.0	2.0	-	-	-	34.0
Operating - Ministers' contingency	-	30.0	31.0	8.0	9.0	-	-	-	-	78.0
Depreciatio n-Ministers' contingency	-	-	3.0	5.0	5.0	-	-	-	-	13.0
Capital charge - Ministers' contingency	-	1.0	2.0	2.0	2.0	3.0	3.0	3.0	4.0	20.0

43. **Note** that in line with established public sector practice, funding contingencies have been based on the results of a Quantitative Risk Assessment facilitated by an independent expert, with the Ministers' contingency reflecting the difference between funding required at the 50th and 85th likelihood percentiles;

44. **Note** that the Quantitative Risk Assessment informs the overall size of the contingency, however it does not identify when the contingency might be required: consequently, a sizeable portion of the contingency has been allocated to the start of the programme to ensure sufficient funding for early periods;

45. **Authorise** the Ministers of Finance and Revenue to approve Inland Revenue requests to access the funding contingency as well as to move unused contingency portions to later periods, subject to consideration of a report outlining the rationale for accessing or moving the contingency;

Financial delegation decision

46. **Authorise** the Commissioner of Inland Revenue to incur capital and operating expenditure of up to $1,870 million and depreciation and capital charges of up to $740 million on the incremental cost of the business transformation programme, from 1 July 2014 to 30 June 2024.

Hon Todd McClay
Minister of Revenue

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