

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Government Administration and Expenditure Review Committee

Inland Revenue's July 2018 Transformation Update

Proposal

- 1 This paper provides an update regarding Inland Revenue's progress in modernising the revenue system. I am asking Cabinet to note the progress made to date and the preparations underway for implementing the next set of changes in April 2019. As outlined in the attached Transformation Update dated July 2018, these changes are significant as they will affect most New Zealanders to some degree.

Executive Summary

- 2 Modernisation of the revenue system is now well underway, with the first two releases having been successfully implemented. Release 2 went live on 17 April 2018 introducing a pay-as-you-go option for provisional tax for small businesses, the automatic exchange of information (AEOI) to help combat global tax avoidance, improvements to the collection of employment information, and new online services for withholding taxes, fringe benefit tax, gaming machine duty and payroll subsidy.
- 3 The next release in April 2019 will be significant as the products in scope – income tax and Working for Families – affect most New Zealanders. New systems and processes combined with legislative changes will result in the biggest changes individual customers have experienced since the introduction of the personal tax summary in 2000.
- 4 Changes to the collection of employment and investment income information, and changes to the administration of individuals' income tax¹ mean that, over time, most wage and salary earners will pay what they need to and get what they're entitled to during the year, instead of having to wait until the end of the year. Working for Families tax credits entitlements will be more accurately monitored throughout the year to minimise the risk of customers being under or over paid. Inland Revenue will automatically issue refunds or tax to pay to customers whose only income is from salary, wages or investments.
- 5 The average value of end-of-year refunds or tax to pay will reduce over time as Inland Revenue receives more detailed, timelier information from employers and payers of investment income.
- 6 Customers' interactions with Inland Revenue will change significantly over the next few years. There will be far less need for them to contact Inland Revenue as their tax and entitlements will be adjusted during the year as their circumstances change. Transitioning customers to new processes and reporting requirements will require on-

¹ Subject to legislation

going engagement and careful management. Meeting customer demand may be challenging for the department for a time.

- 7 This has been evident in the experiences of customers this year. Inland Revenue is well aware of the recent frustrations resulting from issues with its online services and is placing the highest priority on ensuring they remain available during this period of peak demand. Running old and new systems in parallel has added to the complexity and fragility of Inland Revenue's technical environment. Completing transformation as quickly as possible will minimise the amount of time the old and new systems need to co-exist and is the best way to manage risk.
- 8 Some implementation decisions to be made over the coming months will influence the degree to which the changes being made impact individuals and other participants in the revenue system, such as intermediaries. Inland Revenue will make further changes to its operating model to reflect shifts in customers' behaviour.
- 9 Once Release 3 is implemented in April 2019, we will have a significantly improved ability to make changes to tax products, including any tax-related recommendations from the Tax Working Group we decide to accept. Ideally, any changes arising from the Welfare Expert Advisory Group would align with the introduction of new systems and processes, to minimise costs and impacts on both customers and Inland Revenue.

Background

- 10 A modern digital revenue system will help ensure that revenue is available to fund the high-quality public services New Zealanders expect and deserve. Customers will spend far less time and effort ensuring they meet their obligations and receive their correct entitlements. Tax will be correctly withheld and assistance provided at the time it is needed, contributing to a more productive, sustainable and inclusive society and economy.
- 11 New Zealand's revenue system is being transformed in four broad, over-lapping stages – digital services, tax, social policy and a final wrap up. The systems, processes and legislative settings that support taxes and entitlements are being modernised in a series of releases within these stages. This is now well underway, with the first two releases having been successfully implemented. Major releases will typically occur on an annual cycle until 2021 to align with the beginning of the tax year in April.
- 12 Transformation is far more than an upgrade of technology; it is a fundamental review of how the revenue system is administered. A combination of changes to policy, process, technology and the organisation design of Inland Revenue are transforming the revenue system and deliver the outcomes committed to government. Once Transformation is completed, Inland Revenue will be agile, effective and efficient, customers will be able to self-manage with speed and certainty, and the Government will be able to make timely policy changes.
- 13 The timeframe for, and the costs and benefits / outcomes of Transformation which Inland Revenue committed to government remain unchanged.

The go-live of Release 2 was successful

- 14 Release 2 was successfully implemented on 17 April 2018:

- 14.1 It is now easier for customers to meet their obligations for withholding taxes, fringe benefit tax, payroll subsidy, gaming machine duty, and GST. As at 29 June 2018, more than 30,000 returns had been filed using the new online eServices.
 - 14.2 The accounting income method (AIM) provides a pay-as-you-go option for small businesses for provisional tax. As at 29 June 2018, just over 1,100 customers were using AIM.
 - 14.3 The AEOI with international tax treaty partners helps combat global tax avoidance.
 - 14.4 Employers are now able to send their information to Inland Revenue on payday if they choose to do so (they will have to do so from 1 April 2019). As at 29 June 2018, approximately 3,000 payday returns had been filed by just over 500 customers.
 - 14.5 Income information is now being collected in START² enabling pre-population of individuals' information to begin.
- 15 Responses from business customers and tax agents since go-live are largely positive. As with all new services, Inland Revenue expects uptake of AIM and payday reporting to be modest in the first year.
 - 16 Lessons learned from implementing the Release 1 GST changes in February 2017 were applied to planning for Release 2. Changes made included greater engagement with stakeholders, more user involvement in design, and a more structured approach to supporting customers and staff in the period immediately after go-live.
 - 17 The Families Package, Best Start and increases to Paid Parental Leave have been implemented in Inland Revenue's heritage systems, and will be migrated to new systems and processes in line with the release plan.

The changes being implemented from April 2019 are more significant

- 18 More comprehensive changes will be introduced in Release 3 in 2019. These include making tax simpler and easier for individuals,³ mandatory reporting of PAYE information every payday for employers, changes to the reporting of investment income information, and migrating income tax and Working for Families to new systems and processes.
- 19 Release 3 is significant as the products in scope affect most New Zealanders. It is more complex and higher risk than the first two releases, as changes to systems, processes and legislation will affect businesses, individuals and financial institutions. For individual customers, these changes⁴ will be the largest they have experienced since the introduction of the personal tax summary in 2000.
- 20 In addition to new systems and processes and legislative reforms, changes are also being made to Inland Revenue's capabilities to better support customers.

² START stands for simplified tax and revenue technology and is the name Inland Revenue has chosen for the GenTax software provided by FAST Enterprises LLC

³ Subject to legislation

⁴ Ibid

Changes to policy and legislative settings

- 21 Changes to the collection of PAYE information, the collection and use of investment income information, and changes to the administration of individuals' income tax⁵ mean that, over time, most salary and wage earners will pay what they need to and get what they are entitled to during the year. Working for Families tax credits entitlements will be more accurately monitored and adjusted throughout the year. These changes are being progressively introduced and will be fully implemented by the 2020/21 year.
- 22 Inland Revenue will also make use of the more detailed, timelier information it will progressively receive from employers and payers of investment income to proactively help individuals during the year to ensure they pay and receive the right amounts. As a result, over the next few years the average value of end-of-year refunds or tax to pay will reduce.
- 22.1 For the year ended 31 March 2019, all individuals will have their end-of-year income assessed by Inland Revenue. Refunds or tax to pay will be automatically issued to customers Inland Revenue is confident it holds enough income information about. This will include most salary and wage earners. All refunds will be paid by direct credit, with limited hardship or practicality exemptions. Amounts of tax to pay under \$20 will be written off.
- 22.2 For the year ended 31 March 2020, employers will file employee information every payday, and some payers of investment income will voluntarily provide more detailed information about recipients of investment income more often. This will allow Inland Revenue to act earlier to help customers get things right. More people will pay what they need to, and receive what they are entitled to during the year, so there will be fewer customers with end-of-year balances and their balances will be smaller.
- 22.3 For the year ended 31 March 2021, Inland Revenue will receive more detailed and timely employment and investment income information for individuals. The number of customers with end-of-year balances should drop further, as should the average amount.
- 23 It will take two complete tax cycles for the benefits of the changes to individuals' income tax, employment and investment income information to be fully realised.
- 24 The obligation for customers to self-assess will remain at the core of the revenue system. While more income will have tax withheld from it and more customers will have income reported on their behalf, customers will continue to be responsible for reporting income, assessing liabilities and meeting obligations. Inland Revenue will make it easier for customers to see what they've paid and what they owe, and provide tailored services to help them get things right from the start.
- 25 While Inland Revenue will finalise end-of-year refunds or tax to pay for as many people as possible in the future, there will always be people who have to provide information because the department does not have it. This includes people who earn income that isn't already reported to Inland Revenue by their employer or financial institution, for example people who earn business, rental or overseas income.

⁵ Ibid

Migrating income tax and Working for Families to new systems and processes

- 26 Release 3 in April 2019 will complete the migration of income tax and implement Working for Families (the first release of Stage 3) in START. It will progressively improve experiences for both business and individual customers, and is a key trigger point for reducing the compliance costs faced by small-to-medium sized businesses.
- 27 The effort required by businesses to keep on top of their tax obligations will be significantly reduced. The likelihood of errors will be much reduced, resulting in greater certainty, fewer interactions, and less need for compliance checks. Businesses will be able to meet their tax obligations at minimum cost and minimum disruption. They will have:
- 27.1 on-line services for all tax products - for example filing returns, setting up payment plans and including attachments
 - 27.2 integrated tax and business processes
 - 27.3 faster, more accurate tax information, providing near real-time visibility of tax during the year, and
 - 27.4 faster tax refunds.
- 28 Individual customers will progressively have easy, digital access to all the income and personal information Inland Revenue holds about them. This will make it easier for them to understand what their obligations and entitlements are and why, and they will be able to self-help the majority of the time. New myIR services will make it easy for individual and family customers to see:
- 28.1 what they've paid and what they owe
 - 28.2 whether they have a refund or a tax to pay and when it was automatically issued to them⁶
 - 28.3 who they receive Working for Families payments for, and who they share the care of children with
 - 28.4 why their Working for Families entitlement amount has changed, and
 - 28.5 the personal information (such as name, address, bank account details) Inland Revenue holds about them.

Transitioning customers to new processes and requirements

- 29 Inland Revenue is working through how best to transition customers to new processes and reporting requirements. During the transition period, some customers will no longer need to contact the department and some will do so to seek reassurance. At times, meeting customer demand may be challenging. This has been evident during the peak filing period this year.
- 30 During June 2018, Inland Revenue experienced some issues with its digital services and is carefully monitoring them in managing the peak period of demand from April to July.

⁶ Subject to legislation

Inland Revenue is well aware of the frustration customers experienced as a result of these challenges.

- 31 Inland Revenue's heritage systems and processes are complex and fragile. As new systems and processes are introduced, co-existence (the need for old and new systems to connect with each other) has introduced a further layer of complexity. Completing transformation as quickly as possible will minimise the amount of time the old and new systems need to co-exist and is the best way to manage this risk.
- 32 Customer experience through Inland Revenue's online channels has returned to the levels normally expected at this time of the year. Inland Revenue did not apply late filing and late payment penalties to GST returns filed and paid by 4 July 2018. Once the peak filing period has passed, Inland Revenue will identify what further enhancements could be made to its digital services.
- 33 A customer information campaign will, subject to appropriate approval,⁷ ensure New Zealanders understand what is changing, how it affects them and what they need to do.

Changes to Inland Revenue's capabilities

- 34 To administer a modern revenue system, Inland Revenue will have to change the way it works and make more intelligent use of information. New skills and abilities are required to better understand customers' circumstances and needs across wider government, and to identify policy and service design opportunities to improve the overall wellbeing of New Zealanders.
- 35 The implementation of a new data and intelligence platform from late 2018 will enable Inland Revenue to better understand customers' needs, tailor services to them, and help them get things right from the start. Errors and non-compliance, both inadvertent and deliberate, will be better detected and detected earlier.

Some key design and implementation decisions have yet to be made

- 36 The changes being introduced for customers as part of Release 3 are significant. Inland Revenue advise me that some implementation decisions to be made over the coming months will influence the degree to which these changes impact customers and other participants in the revenue system, such as intermediaries. The key areas to be considered include:
 - 36.1 How to ensure a smooth transition for individual customers through changes to the way tax is assessed and refunds are paid out. Depending on the design of services and processes, there will be different implications for the amount of contact individual customers will have with Inland Revenue, and for the business models of other participants in the revenue system, such as intermediaries.
 - 36.2 When and how to ensure compliance with newly introduced requirements, such as payday reporting, or changed requirements, such as the lower electronic filing threshold.⁸ Allowing a reasonable period of time for customers to transition is essential, particularly those who have customised systems or who are currently

⁷ Cabinet Office Circular CO (15) 4

⁸ From 1 April 2019, the threshold for electronic filing will reduce from \$100,000 of PAYE and employer superannuation contribution tax to \$50,000

not using digital services. Decisions about how long this period should be have yet to be made.

- 37 These decisions could potentially involve trade-offs between achieving desired outcomes, maintaining service levels, retaining public confidence in the revenue system, and encouraging continued voluntary compliance. I am assured by Inland Revenue that any significant implications and potential trade-offs will be highlighted for Ministers to consider before decisions are finalised.

Upcoming releases are crucial to our plans to improve the fairness, balance and structure of the tax system and to overhaul the welfare system

- 38 Once Release 3 has been implemented, we will have significantly improved agility for any changes we wish to make to tax products. START will be the delivery vehicle for any of the Tax Working Group's tax-related recommendations we accept.
- 39 However, the complex inter-relationships between income and social policy will continue to place some limits on agility. Full policy agility will be provided once Transformation is complete.
- 40 I am discussing how best to proceed with opportunities to improve the administration of social policy, identified as part of the Making Tax Simpler consultation, with Inland Revenue.
- 41 Our 100 day plan changes were implemented in FIRST,⁹ however this is not ideal as the changes will have to be re-implemented in START in line with the release plan. Any other changes that would need to be implemented in FIRST to meet desired effective dates, for example changes to social policy products other than Working for Families, would also need to be implemented twice. This could affect Inland Revenue's ability to provide the appropriate focus on and resource for transformation, and increase the risk of delivery and benefit realisation timeframes not being met.
- 42 Timeframes for implementing any recommendations made by either the Tax Working Group or Welfare Expert Advisory Group that we accept will need to be considered in this light. The cost and benefit assumptions in the business case for Transformation assumed that implementation of policy and system changes would be aligned.

There will be further changes to Inland Revenue's organisation design

- 43 During 2017, Inland Revenue consulted with its people on changes to the organisation design of its customer-facing areas. Implementation of the changes began in February 2018, with further changes to come.
- 44 As the changes to policy and legislative settings take effect and as more products are migrated to START, customers' interactions with Inland Revenue will change considerably. Inland Revenue's interactions with other participants in the revenue system, such as intermediaries, will also change. Accordingly, Inland Revenue will need to change its operating model to reflect these new ways of working and shifts in customers' behaviour.

⁹ Inland Revenue's existing system, being replaced by START

- 45 Between April and August 2018, the Executive Leadership Team is working with a range of staff and experts on how Inland Revenue could best work in 2021/22. The focus is on the parts of the organisation that support the customer-facing functions. The Public Service Association, Taxpro and the National Union of Public Employees are being involved at key points. All three unions have been invited to nominate members to take part in this work.
- 46 Further change will occur in 2019, including in customer-facing areas. Once Transformation is complete, Inland Revenue's overall workforce is expected to reduce by 25–30%. Inland Revenue is continuing to use workforce management principles to guide decisions on filling vacancies as they arise. For example, avoiding permanent external appointments to existing positions in the current organisation structure. Instead, Inland Revenue is filling vacancies with fixed-term employees. The conclusion of fixed-term arrangements will contribute to the reduction in the workforce and realisation of business case benefits.
- 47 Inland Revenue is carefully monitoring the potential industrial action and do not expect it to have an impact on the transformation programme.

Transformation is a complex undertaking and remains inherently high risk

- 48 Release 2 was a more complex implementation than GST. Release 3 is significantly more complex again. Multiple changes are being introduced to the systems and processes that customers use to meet their obligations and determine their entitlements, along with legislative changes that affect how often and how they do that.
- 49 Transformation combined with the Tax Policy Work Programme and Budget changes means that Inland Revenue has a full work programme. Factors that will need to be taken into account when considering new opportunities are:
- 49.1 Inland Revenue's ability to deliver
 - 49.2 customers' capacity to absorb change and Inland Revenue's capacity to support customers through change, and
 - 49.3 operational risk in light of co-existence of old and new systems.
- 50 A summary of the most significant risks for Transformation as at June 2018 is included in Appendix 4 of Inland Revenue's Transformation Update dated July 2018.

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

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

Next steps

53 The next steps are to:

- 53.1 continue preparations for the implementation of Release 3 in April 2019;
- 53.2 support the passage of the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Bill which contains key transformation proposals;
- 53.3 progress next steps in social policy legislative reforms, following further Ministerial discussions; and
- 53.4 prepare a Transformation update for Cabinet to consider by December 2018.

Consultation

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

Financial Implications

55 The proposals in this paper have no financial implications.

Human Rights

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

Legislative Implications

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

Regulatory Impact Analysis

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

Gender Implications

59 The proposals in this paper have no gender implications.

Disability Perspective

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

Publicity

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

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

- 62 Corporate Centre agencies were consulted on this update..The Corporate Centre's delivery confidence assessment of the programme remains at amber/green. This assessment is based on past and current programme delivery, ongoing learning loops in place in the transformation programme and external delivery assurance. The next assurance review is planned for August 2018. The Corporate Centre continues to have good visibility of the programme and the risks/mitigations due to high standards of reporting and transparency applied by the programme team.
- 63 Since the February update, Inland Revenue has successfully implemented Release 2 and continues preparations for Release 3. The Corporate Centre are mindful that this Release will affect significantly more New Zealanders, and will work with Inland Revenue to ensure the upcoming changes are well-signalled to their customers.
- 64 Ministers should note that any change which has a substantial operational impact on Inland Revenue could impact their ability to deliver Business Transformation and realise the benefits committed to in the 2015 business case. This includes delays to the organisational change programme and the implementation of proposed legislation. The risk of the transition from the legacy systems to the new system is being actively managed and monitored by the programme. The Corporate Centre notes the importance of Inland Revenue remaining on track to realise these benefits, and will focus on monitoring this progress over the next six months.
- 65 The Corporate Centre will work with Inland Revenue on the interaction between Business Transformation and proposed changes arising from other Government initiatives, including the Tax Working Group.
- 66 In late June, Inland Revenue featured in the media due to customer reports of prolonged response times for the MyIR service. Inland Revenue are keeping the Corporate Centre and Joint Ministers updated on this issue, and will consider what further improvements are needed to prevent issues occurring in the future.
- 67 Inland Revenue's organisational change has also featured in the media, largely due to the Public Service Association's court proceedings. The Corporate Centre will continue to work with Inland Revenue as they implement a new organisational structure, and bring new developments to Ministers' attention.

Recommendations

I recommend that the Committee:

- 1 note that Release 2 successfully went live on 17 April 2018;
- 2 note that Release 3 in April 2019 will introduce significant changes and includes:
 - 2.1 mandatory reporting of PAYE information every payday for employers;
 - 2.2 optional reporting of investment income information;

- 2.3 a new year-end process for individual customers;¹⁰
- 2.4 moving income tax and Working for Families to new systems and processes;
- 3 note that some key design and implementation decisions for Release 3 are still to be made;
- 4 note that once Release 3 has been implemented, START will be the vehicle for any recommendations of the Tax Working Group that are accepted;
- 5 note that Transformation costs and benefits assume that policy changes are aligned with system and process changes; and
- 6 note that the next Transformation update will be provided to Cabinet to consider by December 2018.

Authorised for lodgement

Hon Stuart Nash

Minister for Revenue

¹⁰ Subject to legislation