Briefing for the Incoming Minister of Revenue – 2014

October 2014

Inland Revenue Department

Contents

Executive summary

New Zealand has a good tax and social policy system with good policy and administration. Our broad-base, low-rate tax (BBLR) policy settings allow New Zealand to have robust tax collections at low or moderate rates of tax.

Keeping tax bases broad helps ensure that taxes bias decisions as little as possible. This promotes economic efficiency and growth. This is reinforced by keeping tax rates as low as possible.

New Zealand has coherent tax policy settings. This has many advantages. It helps to ensure that taxes are fair and efficient. It has a less obvious benefit in helping consultation to work very well in New Zealand. It also makes it easier for our courts to decide what is, and what is not, tax avoidance.

Despite our relatively low tax rates, the progressivity of New Zealand's tax system does not appear to be substantially out of line with other countries. Nevertheless, the question of how progressive the tax system should be involves tradeoffs between fairness and efficiency considerations and is a call for the Government to make. If the Government wanted to change the progressivity of the tax system, it would be important to ensure that the tax system continues to fit together and maintains its coherence.

If the Government considers that the current system provides a reasonable tradeoff between fairness and efficiency concerns, there is no "burning platform" requiring an urgent and radical shift in tax policy settings. We consider that the main policy challenges will include maintaining and enhancing tax policy within our coherent BBLR tax policy settings, as well as focusing on the taxation of multinational firms. A particularly important focus is the Department's Business Transformation programme. This is more than an IT upgrade. It is a once-in-a-generation opportunity to modernise our tax and social policy administration.

This transformation provides a huge opportunity to make tax more simple, more open and more certain, to enable Inland Revenue to be more agile, effective and efficient, enable customers to self-manage with speed and certainty, enable the Government to make timely policy changes, and help Inland Revenue to work with other agencies to optimise interaction across government. For example, it will improve the quality and speed at which data can be shared with other agencies, such as the Ministry of Social Development. Through our transformation we will be able to improve the tax system for New Zealanders and ensure that customers pay the taxes they should and receive the benefits to which they are entitled. However, the size and complexity of the transformation should not be under-estimated. It is a multi-year programme with costs likely to be well in excess of $1 billion.

A key challenge will be implementing Business Transformation while maintaining business as usual. While Business Transformation is being implemented, there may be difficulties in implementing some policy changes. Many policies are straightforward to implement, but, some will have major systems implications. This will inevitably complicate and potentially delay the implementation of Business Transformation. This is not to say that policy changes with systems implications cannot be implemented – the Government can reasonably expect to be able to make policy changes – but this may delay the transformation and the benefits that come with it.

Finally, there are long-term fiscal pressures that will need to be addressed at some point. New Zealand's ageing population will increase the demands placed on the health and social security systems. Unless the Government wants to meet these costs solely by cuts in other areas of government spending, more revenue will be required to help meet these demands. How this revenue should best be collected will need to be considered, but this work can be spread over the medium term.

1. Introduction

Good tax and social policy systems are an essential part of a fair, efficient and productive economy. While good policy settings are important they are only part of the equation. Good administration is also required.

This briefing provides an introduction to Inland Revenue and its responsibilities. It discusses how New Zealand's tax system compares with those in other countries. The briefing also discusses a number of key policy and operational opportunities and challenges, and identifies a number of risks that you should be aware of.

Almost one-third of New Zealand's GDP is collected in tax. This is a major intervention in the economy so it is important that the tax system works well. Few policy instruments will add as much to the general well-being of New Zealanders as a well-functioning tax system. No other government institution interacts as much with New Zealanders as Inland Revenue.

Taxes create costs. In addition to the revenue raised (which is a transfer from taxpayers to the Government) there will be a set of additional or "deadweight" costs. These include costs to taxpayers in complying with the tax system, costs to Inland Revenue in administering the tax system and distortionary costs because of the way that taxes can cause firms and individuals to do things that simply would not be sensible in the absence of tax. For example, taxes can discourage people from working as long or as hard as they would in the absence of tax or from investing in businesses. Taxes can cause firms to invest in inefficient ways.

Over time, Inland Revenue has increasingly been used as an agency for delivering social policy programmes. Social policy measures administered by Inland Revenue also create compliance costs, administration costs and distortionary costs. Good administration and good policy will keep all of these costs to a minimum.

The tax system is a major national asset. Taxes raise money to finance government spending. This is essential if New Zealand is to provide the healthcare, education and other government services that its citizens expect. A robust tax base and high levels of voluntary compliance are critical. At the same time Inland Revenue needs to have effective enforcement so that the minority of taxpayers who do not willingly comply are compelled to do so. Taxes and social policy delivered by Inland Revenue such as Working for Families tax credits and Child Support have been essential for successive governments in helping create a system that is as fair as possible. Again good administration and policy are both critically important.

Inland Revenue collects over 81 percent of unconsolidated revenue. We also collect Student Loan and Child Support obligations, disburse Working for Families tax credits, administer KiwiSaver and make Paid Parental Leave payments to parents who leave a job to care for a baby.

Over and above this, we work closely with a number of key agencies including the Ministry of Social Development, Accident Compensation Corporation, Ministry of Education, Ministry of Business, Innovation and Employment (MBIE), Ministry of Justice, NZ Police and NZ Customs. This involves working together to deliver joint services as well as providing information which can be essential for these other agencies to perform their duties well. We have been increasingly working with other agencies to find better ways of operating across the Government and are exploring sharing information with other agencies such as MBIE. Our Business Transformation programme will, over time, provide a vehicle to improve the accuracy and timeliness of information flows to other agencies.

Vision of a good tax and social policy system

There should be a clear vision of what the tax system is setting out to achieve. The tax system should meet this vision as consistently and coherently as possible.

Our vision of a good tax and social policy system is as follows:

- It should work smoothly and be as much "in the background" as possible.
- Individuals and businesses should be able to conduct their affairs without worrying too much about tax implications.
- People should be able to comply easily with their tax obligations, and non-compliance should be difficult.
- The tax system should operate with speed and certainty.
- Income should be taxed broadly under the personal and corporate income taxes, and consumption taxed broadly under the GST rules.
- It should be straightforward for people to collect their correct social entitlements.
- The tax system should provide the best possible value for money.
- Good consultative processes are essential to ensure a shared understanding of tax policy frameworks and to ensure better policy outcomes.

Complementary roles of the Minister of Revenue and the Commissioner of Inland Revenue

The Minister of Revenue and the Commissioner of Inland Revenue have important complementary roles in providing a good tax and social policy system.

As Minister of Revenue you are accountable for the overall working of New Zealand's tax system and for Inland Revenue as a government department. You are responsible for the governance of Inland Revenue and budget decisions for its programme of work. Decisions on tax policy and social policy delivered by Inland Revenue are made jointly by you and the Minister of Finance or the appropriate Minister in the case of social policy. Inland Revenue's Policy and Strategy team, jointly with the Treasury, provides advice to Ministers on policy. It also supports the passage of legislation through Parliament.

Constitutionally, tax can only be levied according to laws enacted by Parliament. Inland Revenue has an obligation to levy tax in accordance with the law to the best of its ability. The Commissioner has statutory independence from Ministers to ensure Inland Revenue is able to levy tax and carry out its duties independently. The Commissioner also carries prime responsibility for Inland Revenue's performance.

Starting position

New Zealand is starting from a fortunate place. We have a good tax and social policy system based on good policy and administration. Our broad-base, low-rate (BBLR) tax policy settings allow New Zealand to have robust tax collections at low or moderate rates of tax.

Inland Revenue is well regarded. For example, in June 2014, Trans Tasman's Independent Board of Advisors awarded Inland Revenue the title of Government Department of the Year.

A formal review of Inland Revenue was carried out in May 2011 under the Performance Improvement Framework (PIF) by the State Services Commission, the Treasury and the Department of the Prime Minister and Cabinet. The Review concluded that "Over the range of services it delivers, Inland Revenue is, on balance, a very well managed department. It displays admirable strengths in both its policy advice functions and in much of its operations."

Of the 33 performance ratings made, Inland Revenue was ruled:

Strong	10
Well placed	16
Needing development	4
Weak	0

The areas rated as needing development largely related to Inland Revenue's ability to manage on-going business change and, in particular, its Business Transformation challenge – the modernisation of the tax and social policy system through business process re-engineering, supported by new technology.

A follow-up review in October 2013 concluded that Inland Revenue continues to have a "big brain and a strong body" and was stepping up to challenges identified in the initial PIF review. It noted, however, that these challenges have become more complicated with the widespread sharing of information and the increasing importance of working across agencies. It identified challenges associated with balancing Inland Revenue's business as usual (BAU) activities at the same time as implementing its Business Transformation programme and the cross-agency initiatives.

Business Transformation – a once-in-a generation opportunity to change how we operate

Inland Revenue's biggest opportunity but also its biggest challenge is Business Transformation. The Business Transformation programme provides a once-in-a generation opportunity to stand back and consider how we can improve our performance as a whole. This requires adapting to a changing world. Increasingly taxpayers expect to interact with services digitally with fast response times. Modern technology is creating opportunities for two-way transfers of information between business systems and Inland Revenue.

Business Transformation is at an early stage. Our aim is to build capacity to make substantive improvements in the future. For example, an early goal is to get much better up-to-date information from firms on salaries and wages of individuals in a way which makes it easy for businesses to supply full and correct information at source. This will not only have an impact on the tax and social policy system that Inland Revenue administers, it will provide information which helps other agencies, such as the Ministry of Social Development, in performing their duties. The tax system is a national asset with benefits that extend beyond Inland Revenue.

A key challenge is to implement the Business Transformation programme while at the same time continuing with BAU. On the policy front there will be important tradeoffs. While many policy changes will be straightforward to implement, policy changes with major systems implications will inevitably complicate and potentially delay the implementation of Business Transformation. They may also add to overall investment costs. It can be challenging to determine how difficult policy changes with significant systems implications will be to implement and how costly they will be until implementation is attempted.

This is not to say that policy changes that involve systems implications should not be attempted. Governments will reasonably expect to make policy changes, some of which will have systems implications. It is simply that as we implement Business Transformation, we must continue to fulfil our core function of maintaining a good tax and social policy system. There will be challenges associated with operating old and new systems at the same time while we migrate our customers to new business processes. Business Transformation is an investment that will make it easier to implement policy changes with systems impacts in the future.

Business Transformation is a long-term programme. It provides substantial opportunities to increase Inland Revenue's performance and improve the delivery of all-of-government public services. It is also a large outlay financially, with costs likely to be well in excess of $1 billion. Thus, it is a key risk to Inland Revenue and the Government and involves particularly important funding decisions. Cabinet has considered and endorsed the programme, and noted the business case in Parliament. Governance oversight for the successful implementation of Business Transformation will be an important focus for you.

Economic chief executives' policy vision

As well as having accountability for Inland Revenue, the Commissioner of Inland Revenue has a role in the performance of the wider government sector. For example, she is one of a group of Economic Chief Executives who share a vision of measures which are important in improving the overall well-being of New Zealanders. The group has identified the following four priority areas where they are examining problems and opportunities for change:

- improving outcomes for Māori and Pasifika;
- the compulsory schooling sector and tertiary education system;
- the primary sector and the environment; and
- internationalisation.

Having a robust tax base and a good tax system provides the Government with the revenue it requires to make progress in these areas.

2. Size and scope of Inland Revenue's activities

Inland Revenue interacts with many different entities and individuals. In 2013–14, our tax customers included:

- Individuals – about 1.15 million customers filed annual tax returns.
- Employers – about 195,000 employers filed over 2.0 million Employer Monthly Schedules.
- Companies – about 420,000 companies filed returns.
- GST filers – 630,000 registered customers filed 3.0 million GST returns.

In that year Inland Revenue:

- received 5.5 million customer service contacts; and
- received 26.1 million self-help service enquiries.

Inland Revenue manages or shares administration of the following social policy programmes:

- **Working for Families tax credits**
  We administer the programme jointly with the Ministry of Social Development, distributing $2.5 billion in entitlements to support working families.

- **Child support**
  We collect child support payments. In 2013–14 we collected $450 million from 175,000 paying parents and distributed $240 million to custodial parents.[1]

- **KiwiSaver**
  We jointly administer KiwiSaver by collecting contributions and transferring them to scheme providers for investment. In 2013–14, we distributed $4.1 billion to scheme providers on behalf of 2.4 million members.

- **Student loans**
  We jointly administer this programme with the Ministries of Education and Social Development (StudyLink). In 2013–14, we had 721,000 borrowers.

- **Paid parental leave**
  On behalf of the Ministry of Business Innovation and Employment we make payments to parents who take leave from their job or business to care for a new baby. In 2013–14, we made $165 million in payments to 26,000 applicants.

[1] The balance goes to the Crown to offset sole parent benefits paid to custodial parents by the Ministry of Social Development.

Organisation

Inland Revenue's Executive Leadership Team (ELT) comprises nine second-tier managers reporting directly to the Commissioner. This structure has been in place since 4 February 2013, following a review of the ELT in late 2012, and now places greater focus on delivering services for customers and driving our change programme over the next few years.

We manage our functions and operations through the following groups:

- **Policy and strategy** – undertakes policy development, forecasting and analysis, tax law drafting and strategic planning.
- **Service delivery** – provides taxpayer information and education, and carries out compliance activities. It is also the main point of interaction for customers making payments and filing returns.
- **Office of the Chief Tax Counsel** – provides technical taxation advice, rulings and dispute review services.
- **Information, intelligence and communications** – manages corporate and customer information, data analytics and customer intelligence, and internal and external communication.
- **Change** – supports the Investment Board to determine our investment portfolio, ensures the delivery of that investment portfolio, and develops and maintains our enterprise architecture.
- **Corporate integrity and assurance** – provides corporate support and service functions, including governance, legal, risk, assurance, procurement and the Christchurch Rebuild programme.
- **Performance, facilities and finance** – delivers financial and planning services and manages our facilities.
- **Technology strategy and operations** – delivers IT operations and services.
- **People and culture** – delivers human resources services.

We have four governance boards:

- **Strategy Board** – focusing on longer-term organisational strategy development including environmental scanning, strategic planning and resourcing implications.
- **Investment Board** – focusing on investment-related decisions for Inland Revenue.
- **Portfolio Governance Authority** – governs approved projects and programmes within Inland Revenue's single investment portfolio.
- **Business Performance Board** – focusing on shorter-term financial and business performance, resource management, and operational and financial planning.

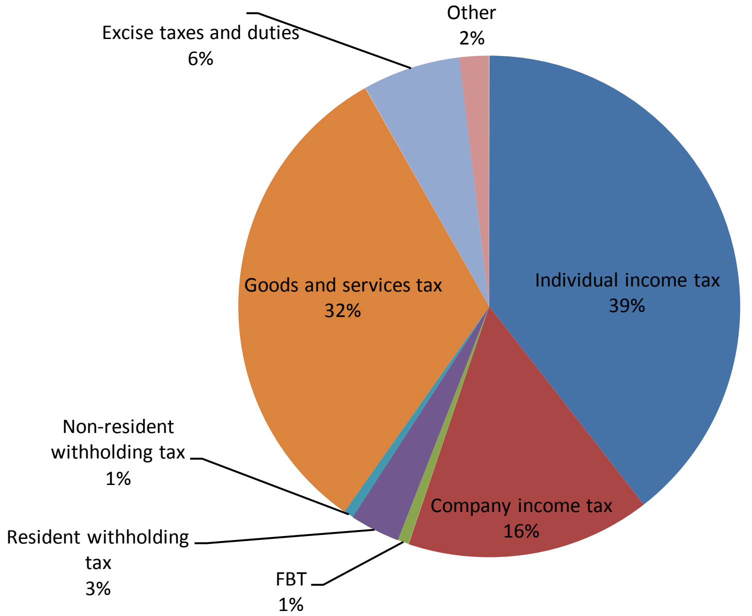
In addition to these boards, Inland Revenue also has a Risk and Assurance Committee which consists of four members, all of whom are external to Inland Revenue. It was established to provide independent advice to assist the Commissioner in the effective and efficient discharge of the Commissioner's statutory and governance responsibilities and accountabilities.

Inland Revenue currently operates in 26 offices in 17 cities and towns. At 30 June 2014 we employed 5,788 people (5,641 FTEs); of these 73 percent work in our Service Delivery team. Our organisational values are based on trust and integrity, valuing people, innovating to make a difference and working together. These support a culture based on good relationships, continuous improvement and collaboration. They help make Inland Revenue the world-class revenue organisation we want to be and help to ensure that we continue to be one of New Zealand's most trusted organisations.

3. The New Zealand tax system and how it compares internationally

Despite moderate tax rates, New Zealand collects relatively large shares of revenue from its three major tax bases: personal income, company income and GST. As shown in figure 1, more than 90 percent of our tax revenue is collected from these or similar taxes (including resident and non-resident withholding taxes and fringe benefit tax). We have removed taxes on transactions or turnover that international tax reviews such as the Henry Review in Australia or the Mirrlees Review in the United Kingdom have identified as being particularly inefficient. These include stamp duty and cheque duty.

Figure 1: Composition of tax revenue (year ended June 2013)

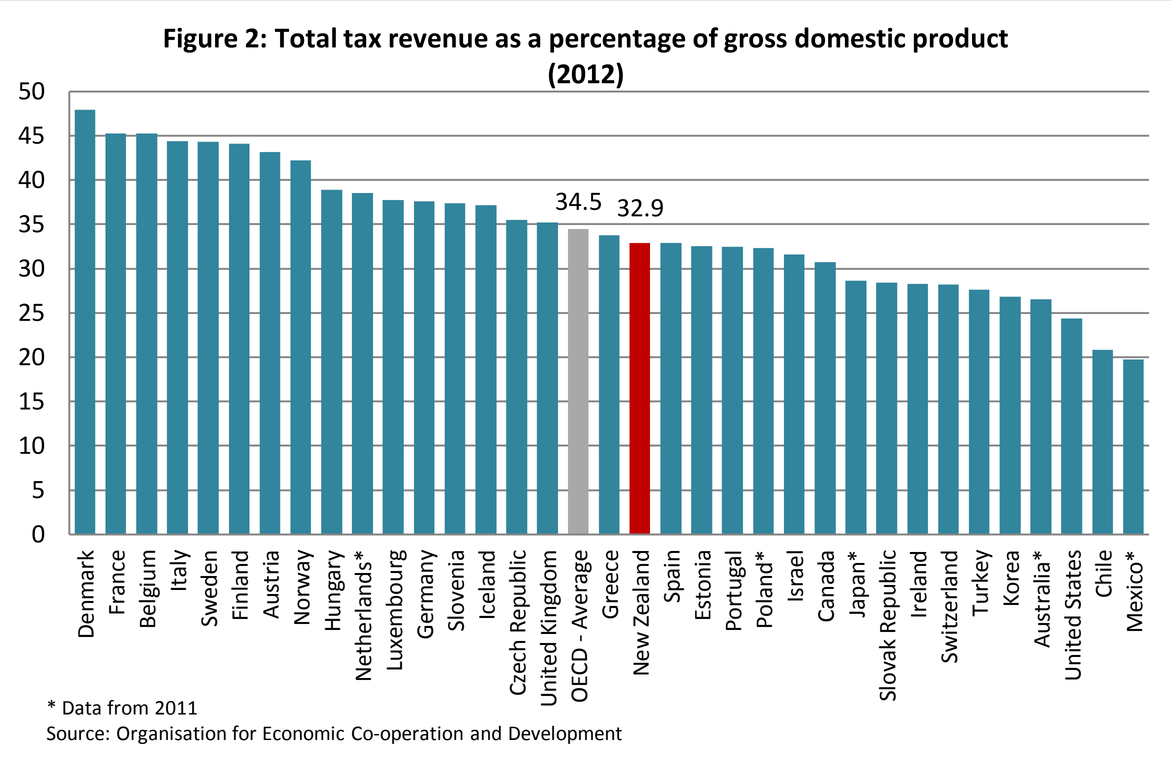


Source: Treasury (Tax Outturn data)

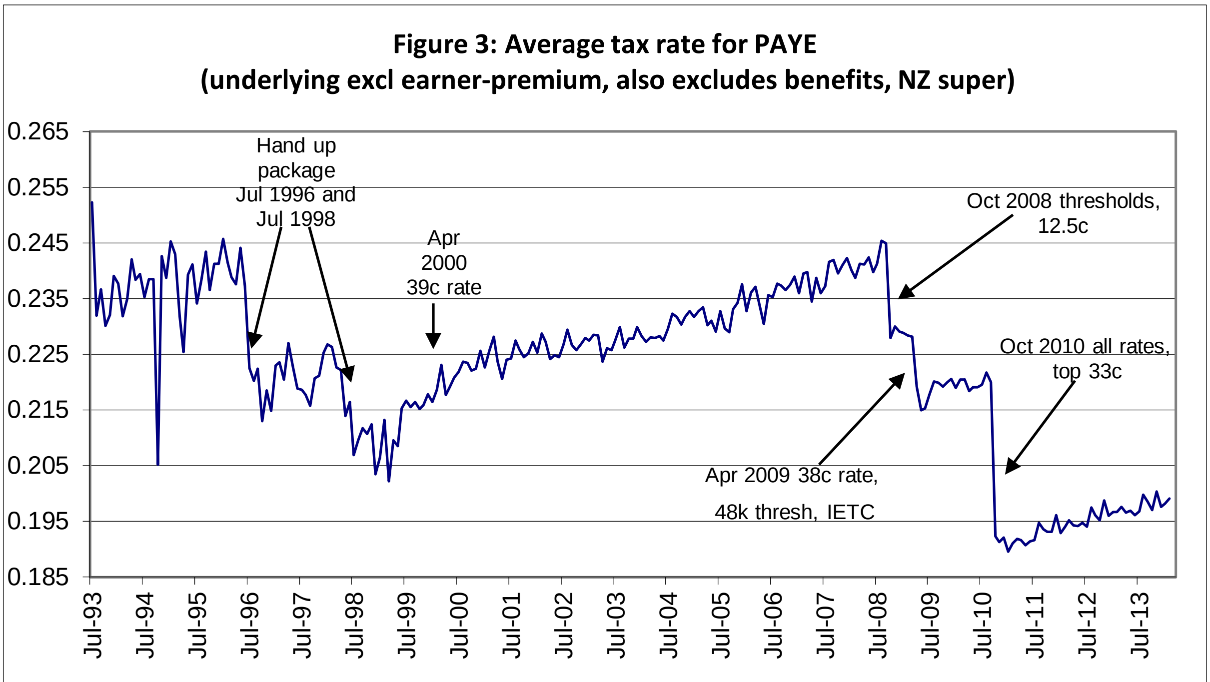
One notable change in recent years is that the proportion of revenue from individual income tax has decreased while the proportion of revenue from GST and company income tax has increased. Between the years ended June 2010 and June 2013, individual income tax reduced from 48 percent to 39 percent of total revenue, while company income tax increased from 13 percent to 16 percent of total revenue, and GST from 24 percent to 32 percent. This "switch" in tax revenue is partially attributable to the increase in the GST rate from 12.5% to 15% and reductions to individual income tax rates from 1 October 2010.

For the 2012–13[2] year, New Zealand's tax revenue amounted to 32.9 percent of GDP (see figure 2). This placed New Zealand just below the OECD average of 34.5 percent. New Zealand's ratio of revenue to GDP has increased in recent years. It was 31.0 percent in 2009–10. This increase mainly reflects New Zealand's recovery since the global financial crisis.

[2] Note that under the OECD methodology, the 2012 year means 1 July 2012 – 30 June 2013. For most other OECD countries, it means 1 January 2012 – 31 December 2012.



Some increase in tax collections is also attributable to fiscal drag, which occurs when average tax rates increase as a result of wage growth if no adjustments are made to income-tax brackets. Average tax rates for PAYE earners are shown in figure 3. There have been a number of tax cuts which have seen average tax rates fall. At other times, average tax rates have slowly increased because of fiscal drag. The average tax rate has fallen from about 25% in July 1993 to slightly less than 20% at present.



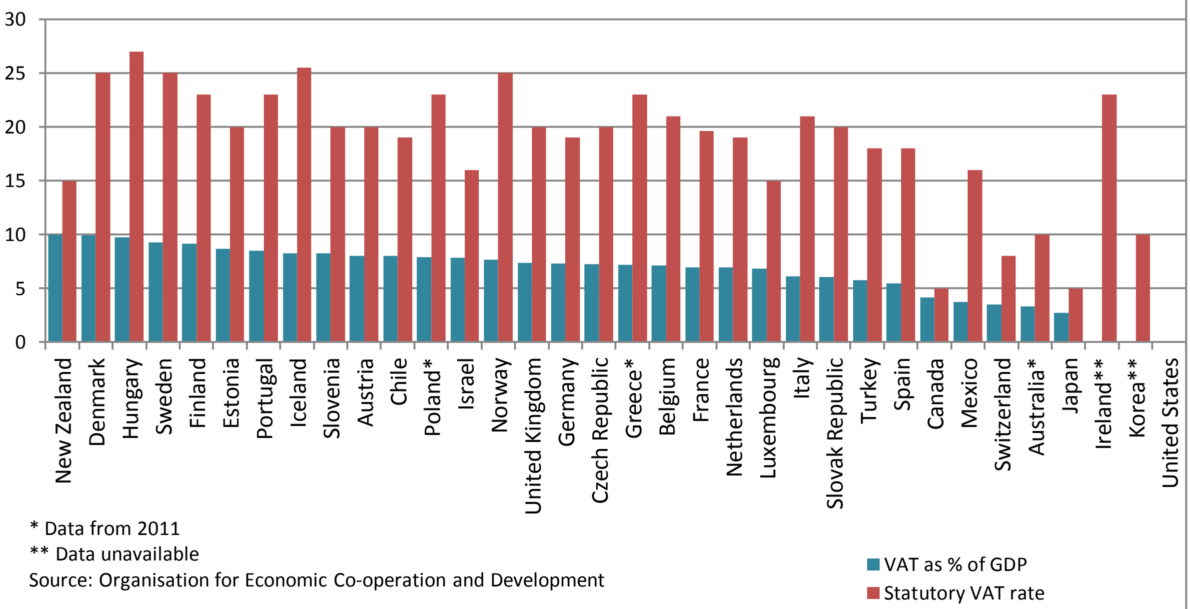
GST, company tax and personal income tax collections

Compared with other countries, New Zealand has very broad bases for GST, personal income tax and company tax.

Despite having a low rate of GST, New Zealand's GST collections amounted to 10 percent of GDP in 2012–13 – the highest in the OECD. Even following the increase in the GST rate from 12.5% to 15% in 2010, New Zealand still has the sixth lowest GST rate in the OECD (excluding the United States, which does not have a GST). The very high amount of tax raised despite New Zealand's relatively low rate of tax mainly reflects the fact that New Zealand's GST base is particularly broad.

However, it also reflects a different tax treatment of government appropriations from other countries. Other OECD countries typically make government departments exempt from GST whereas New Zealand levies GST on the Government's appropriations to government departments but allows departments to claim input credits on their purchases. If New Zealand adopted the more common treatment of making government departments exempt from GST, we estimate it would have collected just under 8.5 percent of GDP in GST. This would mean New Zealand would have collected about the eighth highest amount of GST as a proportion of GDP for the 34 OECD countries shown in figure 4.[3]

Figure 4: Value added (goods and services) tax rates and revenues (2012 in percentages)



* Data from 2011
** Data unavailable
Source: Organisation for Economic Co-operation and Development

[3] A common measure of the breadth of the VAT/GST base is C-efficiency (sometimes referred to as the VAT revenue ratio). By this measure we estimate that New Zealand would still have the second broadest VAT/GST base after Luxembourg if New Zealand had adopted the more common practice internationally of exempting government departments.

Figure 5 shows that New Zealand collects the sixth highest amount of personal income tax as a percentage of GDP among OECD countries. At the same time it has the seventh lowest top personal marginal tax rate in the OECD. Again this result largely reflects the success of New Zealand's BBLR paradigm. New Zealand has a relatively broad income base and does not allow salary and wage earners to claim deductions for the many expenses that can be claimed in other countries. This reduces compliance costs. In addition, we do not provide the large tax incentives for retirement savings that many other countries have.

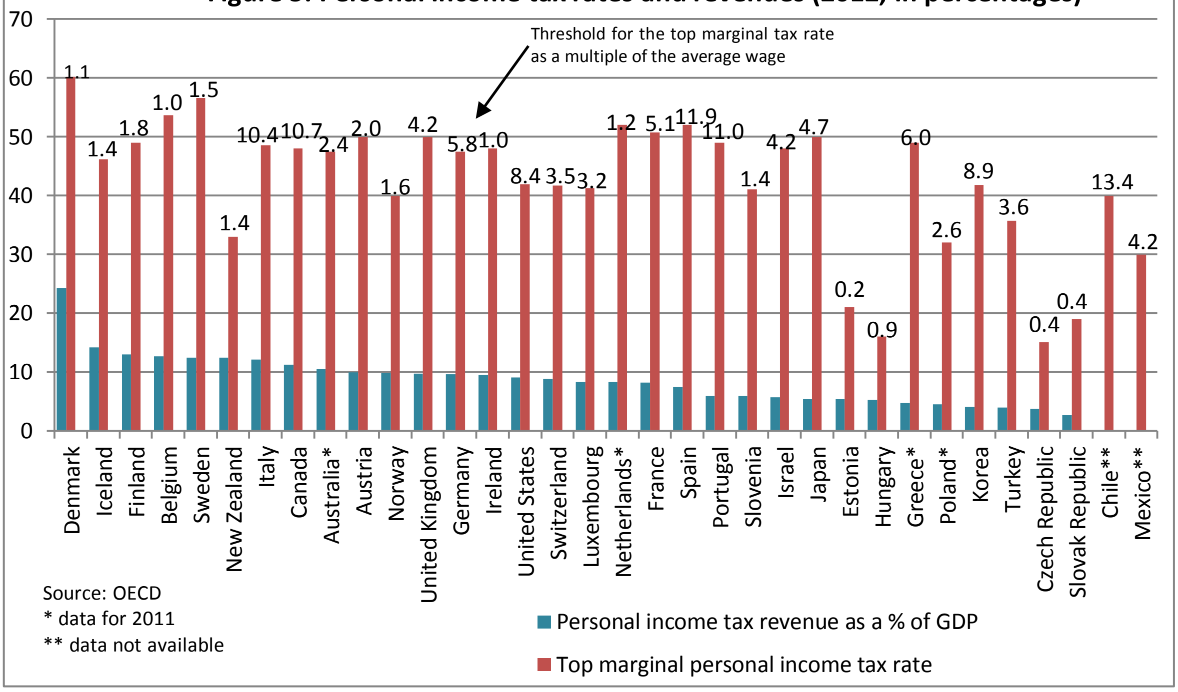
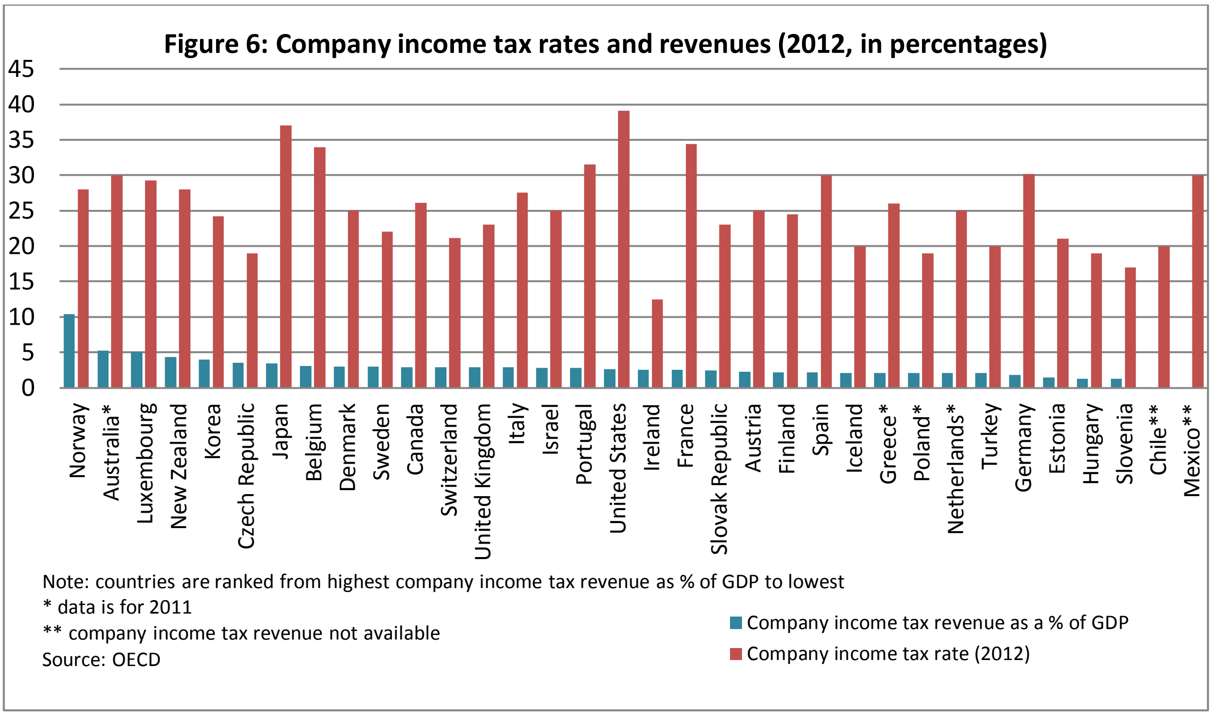


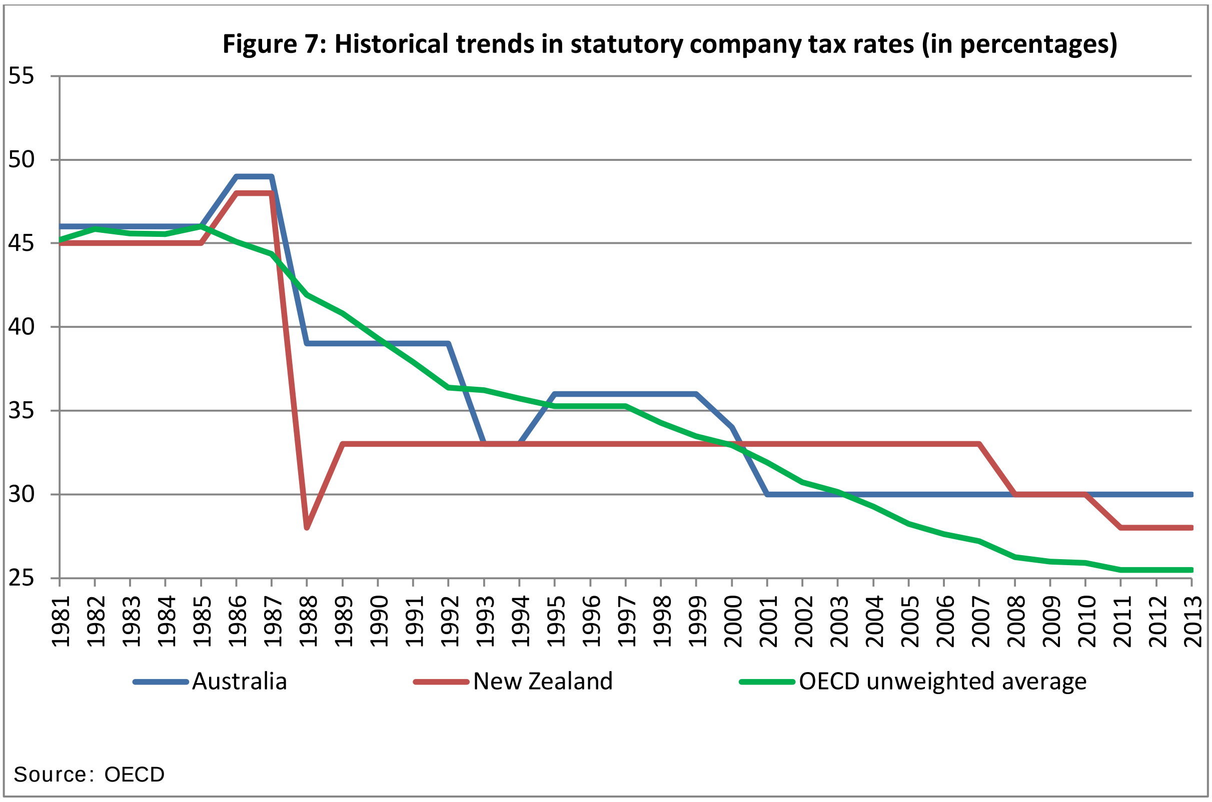
Figure 5: Personal income tax rates and revenues (2012, in percentages)

A further reason why New Zealand is able to collect such a large amount of tax revenue from personal income tax is because, in general, New Zealand's tax scale is relatively flat. The top tax rate of 33% begins to apply at a low level of income (1.4 times the average wage) and the difference between the top and bottom tax rates is relatively small (22.5 percentage points).

Company tax is New Zealand's third main tax base. In 2012–13, New Zealand collected 4.4 percent of GDP in company tax, which is the fourth highest in the OECD (see figure 6 below). This is despite New Zealand having only the eleventh highest company tax rate in the OECD. Again, this is testimony to New Zealand's relatively broad bases in relation to the taxes that it levies.



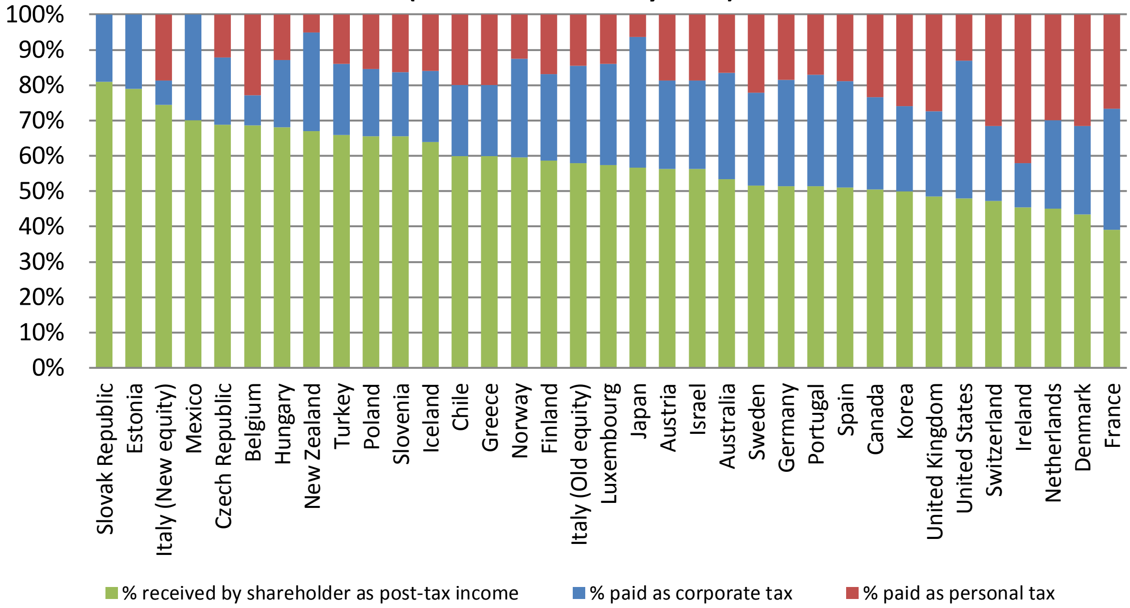
Despite cuts in 2008–09 and 2011–12 to New Zealand's company tax rate it still remains higher than the OECD average. Company rates have been declining around the world but since 2008, the pace of the decline has slowed markedly (see figure 7).



New Zealand's company tax rate is lower than Australia's although the Australian Government has announced that the corporate rate will be falling to 28.5% from 1 July 2015. This will bring it very close to the New Zealand rate. However, large firms will be subject to a 1.5% additional levy, keeping their total corporate tax rate at 30%.

New Zealand's full imputation system means that profits are eventually taxed at shareholders' marginal rates when dividends are paid. Shareholders can claim tax credits for company taxes that have been paid which prevents company profits from being double taxed. This leads to a relatively low overall tax rate on corporate profits once they are distributed. Figure 8 shows that New Zealand has the 8th lowest total tax rate on distributed profits across OECD countries.[4]

Figure 8: Composition of distributed company profits (tax rates as at 1 July 2012)



Source: OECD

Administration and compliance

How easy it is for taxpayers to comply with their obligations and how the tax system is administered are important in determining the overall effectiveness of the tax system.

There are few international comparisons of compliance costs that include New Zealand. Evans and Tran-Nam (2014)[5] provide warnings about difficulties in making international comparisons but have concluded that compliance costs for New Zealand individuals and small-medium enterprises (SMEs) are likely to be low by international standards. They comment that New Zealand may be atypical in bucking the worldwide trend of increasing compliance costs for SMEs. They suggest that New Zealand's key strengths are its very lean business environment and relatively simple tax legislation.

The World Bank and PricewaterhouseCoopers regularly survey how easy it is to pay taxes in countries around the world. Most recently, New Zealand has ranked 9th among OECD countries and 23rd overall as shown in table 1. New Zealand's position has improved since 2012, when New Zealand ranked 10th among OECD countries and was 36th overall.

[4] In figure 7 it is assumed that dividends are received by shareholders on the top personal marginal tax rate.
[5] Evans, C. and Tran-Nam, B., 2014, *Tax compliance costs in New Zealand: An international comparative evaluation*, Paper presented to the Conference Tax Administration in the 21st Century, Wellington, June 2014, available at http://nzpublicfinance.com/tax-administration-conference/.

Table 1: Ease of paying taxes (2014) – ranking in OECD

	Survey rank	Rank amongst OECD		Survey rank	Rank amongst OECD
Ireland	6	1	Greece	53	18
Canada	8	2	Slovenia	54	19
Denmark	12	3	United States	64	20
United Kingdom	14	4	Spain	67	21
Luxembourg	15	5	Turkey	71	22
Switzerland	16	6	Belgium	76	23
Norway	17	7	Austria	79	24
Finland	21	8	Portugal	81	25
New Zealand	**23**	**9**	Germany	89	26
Korea, Rep.	25	10	Israel	93	27
Netherlands	28	11	Slovak Republic	102	28
Estonia	32	12	Poland	113	29
Iceland	37	13	Mexico	118	30
Chile	38	14	Czech Republic	122	31
Sweden	41	15	Hungary	124	32
Australia	44	16	Italy	138	33
France	52	17	Japan	140	34

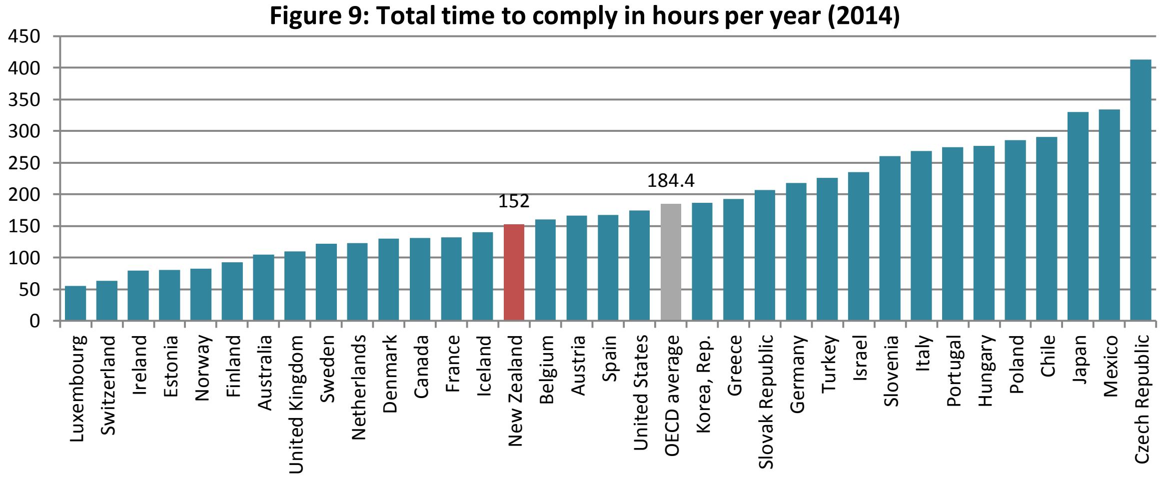
Source: PricewaterhouseCoopers

A significant component of these surveys is the total time it takes each year for a hypothetical business to comply with its tax obligations.[6] New Zealand is recorded as requiring 152 hours, an improvement over the 172 hours for the 2012 survey. The OECD average reduced from 185.5 to 184.4 hours over the same period (see figure 9).

Consistency and predictability of the tax system are rated by the private sector as being particularly important. New Zealand has had a BBLR tax framework and a reasonably stable set of tax policies since the mid-1980s. Deloitte released the Asia Pacific Tax Complexity Survey Report in early 2014[7], in which 90 percent of survey respondents said that New Zealand's tax system is consistent and predictable. This reduces compliance costs and adds to business certainty. This is important in ensuring that New Zealand is a good place to invest.

[6] Details can be found at http://www.doingbusiness.org/methodology/paying-taxes.
[7] See http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-ap-2014-tax-complexity-survey.pdf.

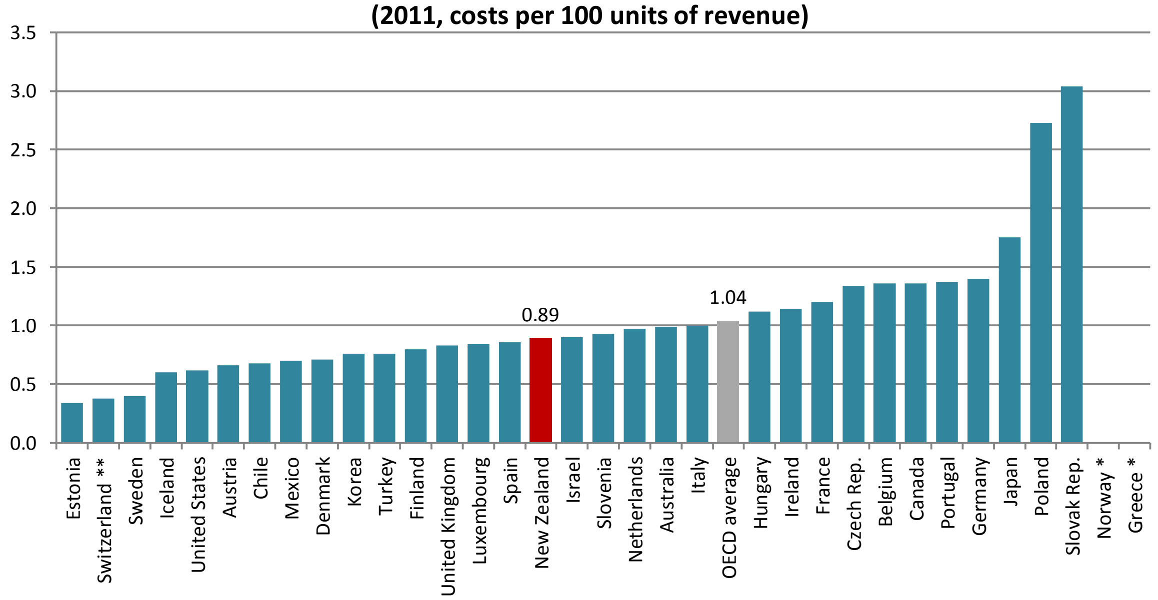
Figure 9: Total time to comply in hours per year (2014)



Source: World Bank and PricewaterhouseCoopers

Figure 10 illustrates the average cost of collecting revenue for OECD countries. Revenue authorities may administer and implement other government policies (for example, Inland Revenue also administers KiwiSaver). This figure only looks at the administrative costs for tax functions.

Figure 10: Aggregate administrative costs for tax functions to net revenue collections
(2011, costs per 100 units of revenue)



* No data
** VAT administration only
Source: Organisation for Economic Co-operation and Development

New Zealand has a cost of $0.89 per $100 of revenue raised in 2011–12 which is somewhat less than the OECD average of $1.04 per $100 raised. New Zealand's cost is up slightly from $0.88 per $100 of revenue in the 2009–10 year. At that stage the OECD average was $0.98 per $100 of revenue raised.[8]

Inland Revenue's administration compares favourably on other measures of value for money and administration costs. In a 2011 international benchmarking study of revenue departments in 10 countries including New Zealand, Australia and the United Kingdom, New Zealand ranked in the top three countries for 26 out of the 42 indicators used.[9]

Income inequality and progressivity

There have been growing international concerns about income inequality and the role of progressivity in tax systems.

Government spending, as well as taxes and transfer payments, will affect inequality and the progressivity of a fiscal system.[10] There appears to be a lack of international comparisons which take account of the progressivity of government spending more broadly. In the benchmarking exercise below we restrict our attention to taxes and transfer payments. Transfer payments are payments from the Government to households such as Working for Families tax credits.

A common measure of income equality is the Gini coefficient. A rise in the Gini coefficient means that household incomes are less equal.[11] In figure 11 countries are ranked by the Gini coefficient for disposable income across the total population (i.e. income net of taxes and transfer payments). New Zealand's Gini coefficient for disposable income is very similar to Australia's and both are slightly above the OECD mean.

Figure 11 shows Gini coefficients before taxes and transfers. As with other countries, New Zealand's Gini coefficient after taxes and transfers is lower than its pre-tax Gini coefficient. Taxes and transfers tend to reduce inequality.[12]

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[8] These results should be interpreted with some caution. A low cost does not necessarily mean a high level of efficiency. It could also mean that a country could be doing little to collect taxes that are legally due.

[9] Her Majesty's Revenue and Customs and Cap Gemini Consulting, 2011, "International Tax Benchmarking Final Report – 2011", www.hmrc.gov.uk/research/benchmarking.pdf.

[10] See Aziz, O., Ball, C., Creedy, J., and Eedrah, J., 2014, *The distributional impact of population ageing in New Zealand*, *New Zealand Economic Papers,* March, estimates that health and education spending reduced the Gini coefficient (and reduced inequality) by about 9% in 2010.

[11] A Gini coefficient of zero signifies that there is full income *equality* while a Gini coefficient of one represents maximum income *inequality*. In calculating the Gini coefficients households are equivalised. The data we present uses individuals as the basis of analysis. For details see http://www.oecd.org/els/soc/IDD-ToR.pdf.

[12] A much more extensive discussion of Gini coefficients and other measures of inequality is included in the Ministry of Social Development's *Household incomes in New Zealand: Trends in indicators of inequality and hardship 1982 to 2013, July 2014*. There are minor differences in the methodologies used by the Ministry of Social Development and the OECD.

Figure 11: Gini coefficient in OECD countries (2011)

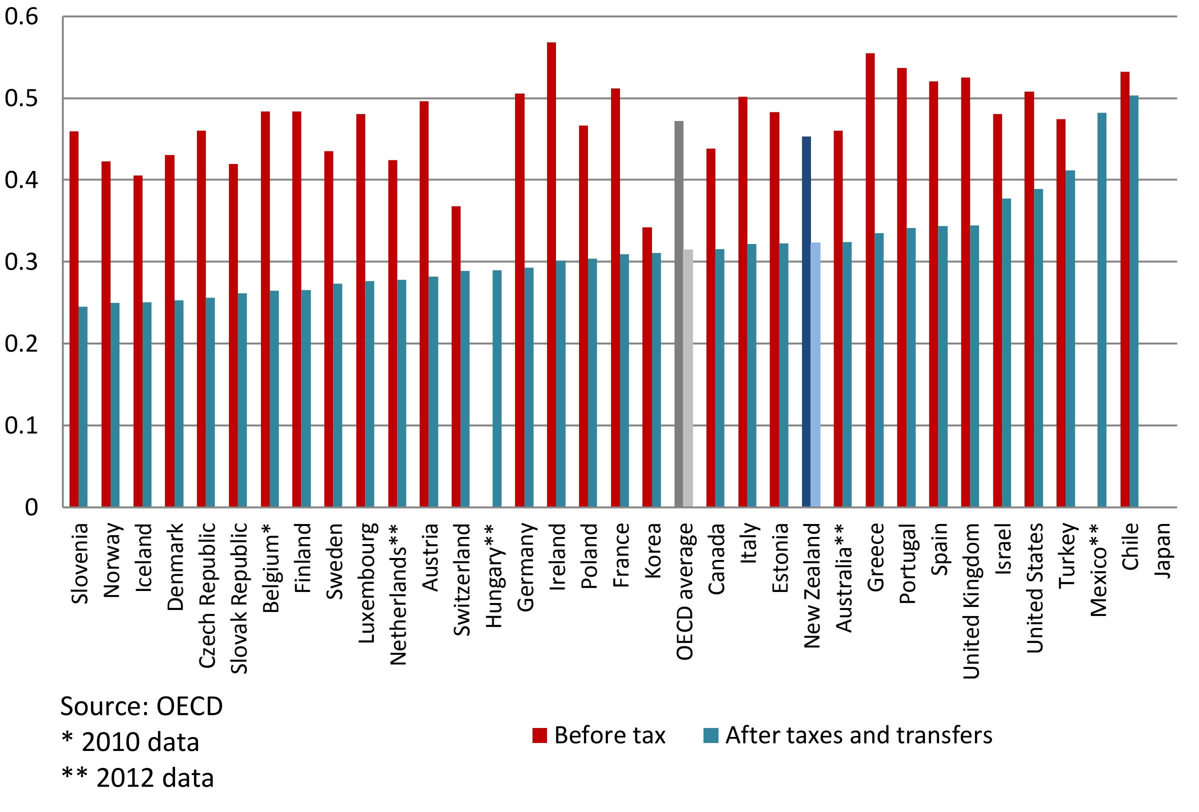
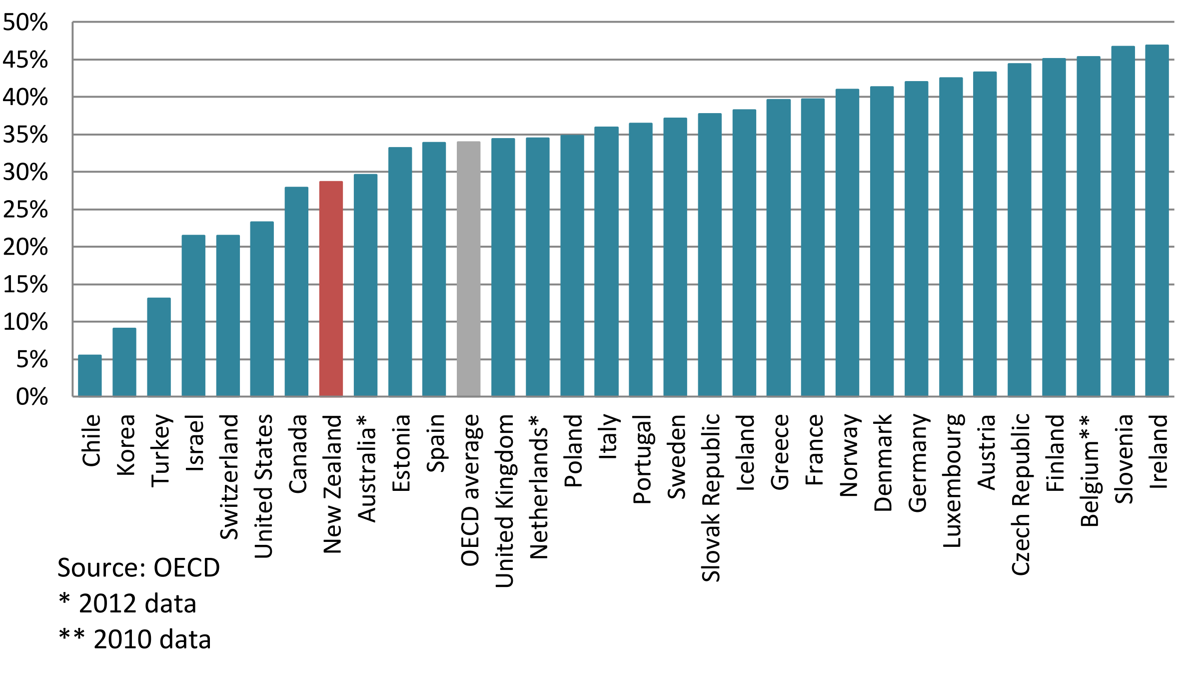
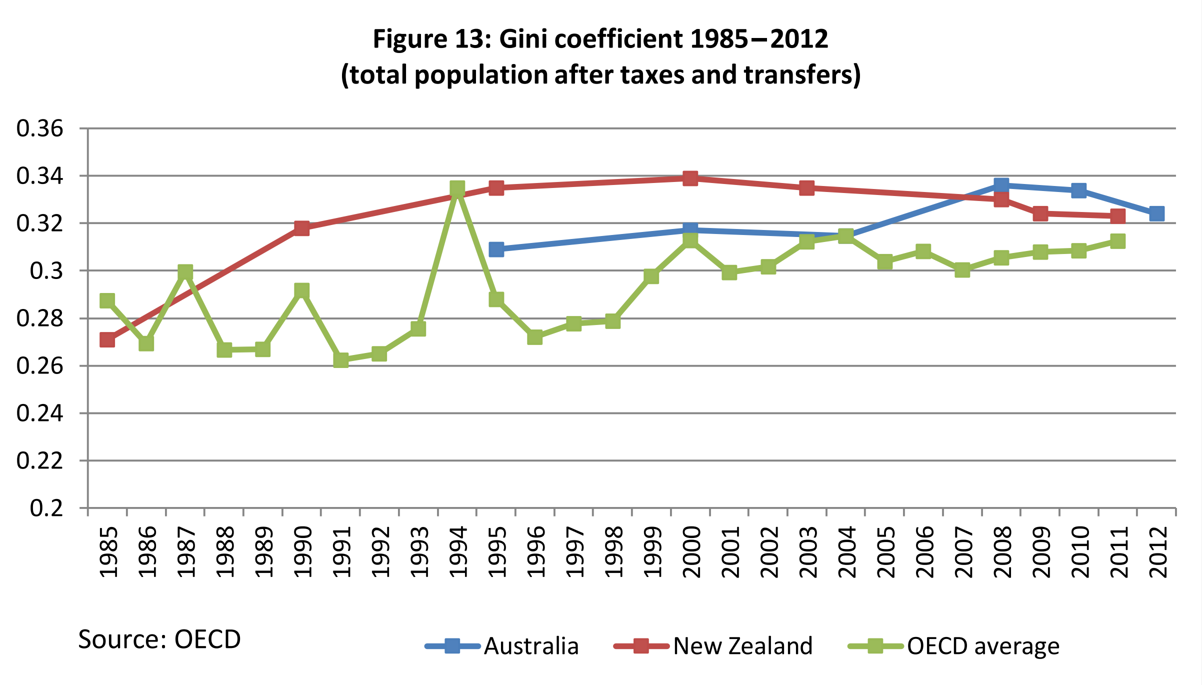


Figure 12 shows the percentage reduction in the Gini coefficient across the OECD that arises as a result of taxes and transfer payments. New Zealand's tax and transfer system provides a similar reduction in measured income inequality to Australia and Canada, but a smaller reduction than the OECD average.

Figure 12: Reduction in the Gini coefficient (total population) on account of the tax and transfer system (2011)



Measured income inequality has been increasing in most OECD countries since the mid-1980s. Figure 13 shows that between 1985 and 2011, the average Gini coefficient for disposable income for OECD countries increased from 0.287 to 0.312.[13] Measured income inequality in New Zealand increased rapidly between 1985 and 1990 and continued to increase until 2000. However, the level of measured income inequality in New Zealand has gradually decreased since 2000.[14] The Gini coefficient is now very close to what it was 20 years ago.



As noted earlier, New Zealand and Australia have relatively small differences between the Gini coefficient before and after taxes and transfers compared with the OECD average. It might be thought that this is because New Zealand has a relatively unprogressive income tax system with a relatively low top marginal tax rate and no tax-free threshold. There are, however, a number of other reasons why there may be a relatively small difference in New Zealand. For example:

- Social security systems. In some countries unemployment-related benefits and government pensions can be substantial and depend on earnings in earlier years. Those who have earned more in the past get greater benefits. By contrast New Zealand and Australia have payments that do not depend on prior earnings. This is arguably more progressive in a lifetime sense. It may, however, mean that New Zealand and Australia appear to have a smaller difference between Ginis before and after taxes and transfers.

[13] Data from the OECD database is only provided for certain years. Figure 15 smoothes changes between recorded data points.
[14] These coefficients should be interpreted with some caution. Part of the reason for the decline in the Gini coefficient for New Zealand between 2000 and 2010 may have been due to the increasing use of trusts and companies for sheltering income from higher rates of personal tax (as was discussed in our 2008 BIM). Likewise at least some of the large increase in the Gini coefficient between 1985 and 1990 may have resulted from a broadening of the tax base including the introduction of the fringe benefits tax and the removal of tax shelters. This may have meant that more of the true income received by higher income earners was declared as personal income.

- New Zealand and Australia have full imputation systems. Once profits are distributed as dividends, tax ends up being paid at shareholders' marginal rates. But if the company rate is close to the personal rate, there can be little personal tax paid on dividends. Taxes on shareholders but not on companies are accounted for in the gap between the two Gini measures. This means that a country like New Zealand with a substantial company tax rate and little additional personal taxes on dividends may look like it is doing little to correct for inequality. If we were to reduce our company rate, it would look like we are doing more to correct for inequality but this would not be the reality.

The measures also attempt to rank inequality across households of different sizes by adjusting for family size using a process of equivalisation. How best to account for differences in family size is an open question. There will be many other differences between countries. All of these considerations make differences in Gini coefficients before and after taxes and transfers difficult to interpret.[15]

A simpler and more comprehensible approach is to focus on tax progressivity either across individuals or couples with the same number of children. A progressive tax system is one where average tax rates rise with income. Those on higher incomes pay a higher fraction of their income in tax than those on lower incomes. OECD data allow us to examine how average tax wedges change as income increases for different OECD countries.

The average tax wedge faced by individuals is the net tax paid as a proportion of income. Net tax includes all central government and local government income taxes, as well as social security contributions and payroll taxes (many other countries have these taxes). It also takes account of certain transfers, such as tax credits paid under the Working for Families programme and the Independent Earner Tax Credit. ACC levies are not included in New Zealand's calculations.

New Zealand tends to have relatively low average tax wedges. Figure 14 shows the average tax wedge across OECD countries for an individual on the average wage and for a single-income couple with two children on the average wage. New Zealand has the second lowest average tax wedge for an individual and the lowest average tax wedge for a couple with two children. The difference between the figure reported for the individual and the couple is the effect of the Working for Families programme.

[15] Creedy, J. (2013) *Alternative Distributions for Inequality and Poverty Comparisons*, Treasury Working Paper 13/11 describes how sensitive Gini inequality measures can be to exact assumptions made.

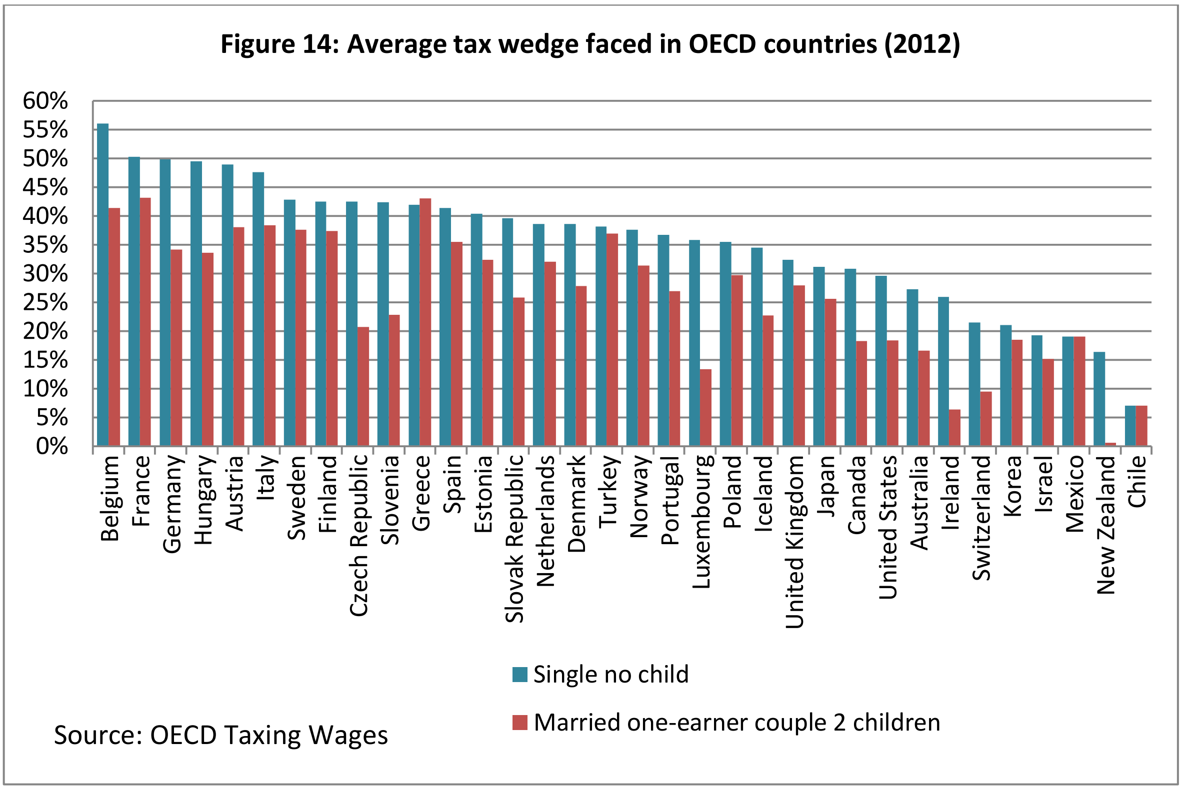


Table 2 shows the average tax wedge for different levels of income, from 50 percent of average earnings (in New Zealand this amounts to $25,639 – just below 40 hours per week at the minimum wage) to 500 percent of average earnings (which in New Zealand was $256,390).

Table 2: Average tax wedge for different households (2012)

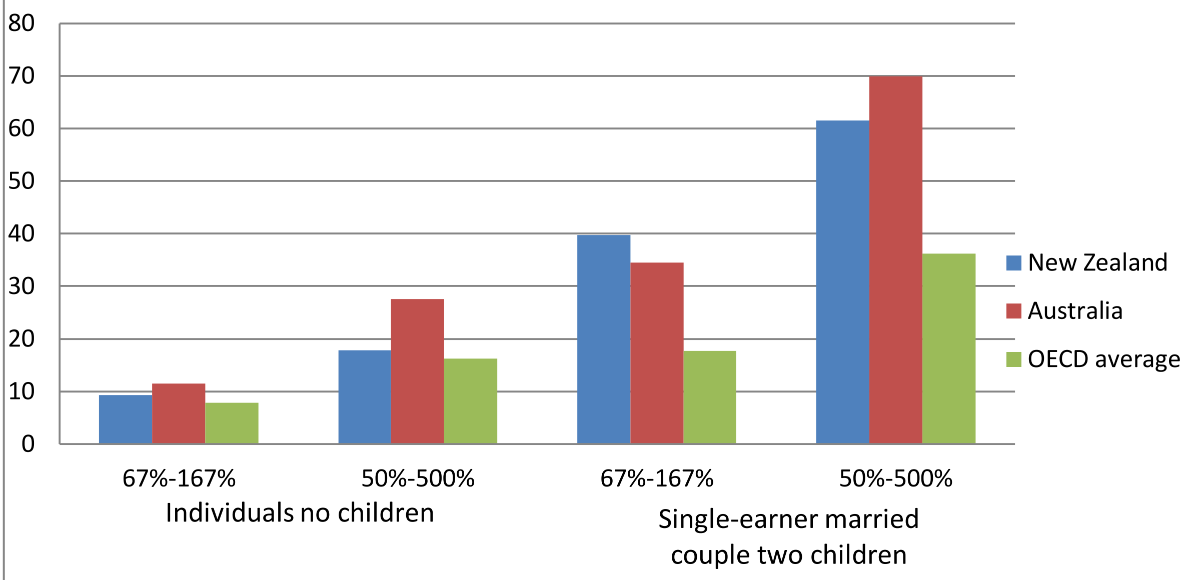
	50% of average earnings	67% of average earnings	100% of average earnings	167% of average earnings	250% of average earnings	500% of average earnings	Average tax wedge difference	
							50%-500%	67%-167%
Individuals with no children								
New Zealand	11.6	13.1	16.4	22.4	25.6	29.4	17.8	9.3
Australia	15.6	21.5	27.2	33.0	36.7	43.2	27.6	11.5
OECD average	28.6	32.1	35.7	40.0	42.4	44.9	16.3	7.9
Single-earner married couple with 2 children								
New Zealand	-32.1	-18.2	0.55	21.4	25.6	29.5	61.5	39.7
Australia	-26.6	-3.7	16.5	30.8	35.8	43.3	69.9	34.5
OECD average	6.4	16.6	26.1	34.2	38.2	42.6	36.2	17.7

Source: OECD Taxing Wages

The progressivity of the tax system can be measured by how much the average tax wedge changes as incomes change. For an individual without children, New Zealand's average tax wedges are low compared with OECD averages but the difference in the average tax wedge across different income ranges is very similar to OECD averages.

In New Zealand, a substantial amount of redistribution is directed to low- to middle-income families with children, for example through the Working for Families programme of tax credits. As well as redistributing to families with children, the programme increases progressivity across different families with children. For a single-earner couple with two children, increases in average tax wedges are similar to Australia, but greater than OECD averages. These increases in average tax wedges are captured in figure 15.

Figure 15: Average tax wedge difference (2012)



Source: OECD Taxing Wages

This measure of progressivity, like the Gini coefficient, is incomplete. It focuses only on labour income. Taxes on capital income are also important but hard to compare across countries. The measure does not allow for differences in the treatment of capital gains. Capital gains tend to be earned by higher income earners. Many other countries have low tax rates on capital gains, but New Zealand has no general capital gains tax. The measure also ignores GST. Many countries attempt to exempt certain goods and services partly on progressivity grounds. Both of these factors may make New Zealand's tax system less relatively progressive than figure 15 would suggest.

On the other hand, New Zealand has a more comprehensive income tax base than most other OECD countries and, in particular, of income accruing on retirement savings. Exempting income accruing on retirement savings typically provides bigger benefits to higher income households. This is an important reason why the tax systems in other countries will often be less progressive than they appear. This will tend to make New Zealand's tax system more relatively progressive than figure 15 would suggest.

Perhaps most importantly, figure 15's measure of progressivity includes only income which is reported as income by individuals. Thus, it will not include much of the income of many higher-income earners which can be accumulating in companies or trusts. New Zealand probably goes further than most countries in ensuring that this income is taxed at rates which are not too far out of line with tax rates on higher personal incomes.

To sum up, it is extremely difficult to make international comparisons on how progressive tax and transfer systems are or how they affect inequality. We have provided two measures which seem to point in somewhat different directions. At the same time, neither of them suggest that New Zealand is particularly extreme.

When considering progressivity and fairness issues it is important to take account of other taxes as well as income taxes. Figure 16 provides Treasury estimates of how net taxes (that is, income taxes plus GST minus transfer payments) vary across income deciles taking account of the GST that different households actually pay.[16] On average, the bottom four deciles pay negative amounts of net tax. Their income tax and GST payments are smaller than the transfer payments they receive. Households on higher incomes pay positive amounts of net taxes. Their net payments are necessary to fund transfers to lower-income deciles as well as funding other forms of government spending.

Figure 16: Average gross and net tax (including GST) paid by decile of equivalised household disposable income (2012-13*)

Source: Treasury
* income data is from 2012-13 Household Economic Survey, inflated based on BEFU 2014 assumptions

[16] An underlying assumption is that personal income taxes are ultimately borne by the individuals receiving the income and GST is ultimately borne by individual consumers. In practice, taxes can have "general equilibrium" effects, changing prices throughout the economy. These general equilibrium effects are being ignored. Other taxes such as company tax will also affect households but are not included.

Effective marginal tax rates, efficiency and fairness

When additional income is earned, a household only gets to keep a fraction of it because some part may go in tax and other parts may go in abating benefits. The effective marginal tax rate (EMTR) measures the total impact of taxes and loss of benefits when an additional dollar of income is earned. It adds together the extra tax paid and the loss of benefits.

High EMTRs can significantly reduce incentives to work more or save, because large increases in before-tax income will only result in small increases in disposable income. This can have an adverse impact on economic efficiency, because it deters people from doing what would be sensible in the absence of tax.

Recent estimates for New Zealand for the year ending 31 March 2014 are shown in table 4. These EMTRs include personal income tax rates, ACC levies, child support, student loan repayment obligations, as well as benefit abatements, and Working for Families entitlements and abatements – entitlements and obligations controlled by the Government that affect the disposable income available to the individual.

Table 3: Effective marginal tax rates faced by individuals

(year ended 31 March 2014 modelled on 2012 incomes, includes tax, ACC earner premium, benefit abatement, Working for Families, accommodation supplement, child support, & student loans)

EMTR faced	Percentage of taxpayers	Number of taxpayers	Median income (closest $5,000)
Less than 30%	54.4%	1,870,050	$20,000
30-39%	31.4%	1,078,900	$60,000
40-49%	7.1%	245,700	$45,000
50-59%	3.9%	134,850	$55,000
More than 60%	3.1%	108,150	$35,000

Source: Inland Revenue

Although some taxpayers do face high EMTRs, they are the minority. Only 14 percent of taxpayers face EMTRS of over 40% and only 7 percent face EMTRs of over 50%.[17] Nonetheless many of those who face very high EMTRs of over 60% have relatively low incomes.

While New Zealand has high EMTRs for some, compared with other OECD countries, New Zealand has low EMTRs overall. Our relatively low EMTRs are likely to reduce economic distortions and support economic efficiency.

[17] The figures reported in Table 3 include child support and student loan repayments. Child support payments involve meeting a parental obligation and a student loan repayment obligation reduces a student's future liability so these are less like taxes. Excluding student loan repayment obligations and child support from the model lowers EMTRs – close to 95 percent of taxpayers would face an EMTR of less than 50% and close to 90 percent would face an EMTR of less than 40%.

4. The policy development process

The Generic Tax Policy Process (GTPP) has operated since 1994 to ensure better, more effective tax policy development through early consideration of key policy elements and tradeoffs of proposals, such as their revenue impact, compliance and administrative costs, and economic and social objectives. Another feature of the process is that it builds external consultation and feedback into the policy development process, providing opportunities for public comment at several stages.

Consultation throughout the policy process contributes to greater transparency of policy-making, allowing the Government to set out the policy objectives of proposals and the tradeoffs it has made in developing them. The process therefore helps the public to understand the rationale behind Government policy proposals. It also helps to ensure that when Ministers are making policy decisions, they are fully informed of different views and can judge them on their merits. This improves tax policy.

The consultative process cannot be used for changes that require immediate action to protect the revenue base. It would not be possible to move quickly and, at the same time, to engage in wide consultation on changes to close a recently identified loophole, for example to block a scheme that is losing the country hundreds of millions of dollars in revenue.

The GTPP is widely accepted as the way to make tax policy, and tax professionals and professional associations expect it to be used. It leads to cooperation, assistance and frank dialogue.

New Zealand's private sector is particularly well informed on tax policy issues. In large part this is a legacy of the open and constructive policy debates that started 30 years ago and were consolidated into the GTPP 20 years ago. In recent years there has also been growing engagement with the academic community on tax reform. For example, Victoria University, together with Treasury and Inland Revenue, this year organised a conference on tax administration in the 21st century. This is helping us embark on an open process of engaging with the wider community on the opportunities that are opened up as part of Inland Revenue's Business Transformation programme.

Developing a new tax policy work programme

One of the first steps for the new Government in relation to the GTPP is to develop a three-year revenue strategy that is effectively linked with the Government's economic strategy. The next stage is developing a tax policy work programme that gives effect to the revenue strategy. At present, the work programme covers an 18-month period.

Developing the tax policy work programme involves scoping broad policy proposals and prioritising and sequencing the development of initiatives. We also look at budgeted resource requirements, the time needed to develop, legislate for and implement initiatives, and the methods of consultation and communication to be employed throughout the process.

This stage of the GTPP culminates in a joint report by Inland Revenue and the Treasury to the Minister of Finance and the Minister of Revenue recommending a tax policy work programme. Once approved, the work programme becomes a detailed tax policy agreement between the Government and the two departments. We will be reporting to you and the Minister of Finance on possible measures for the tax policy work programme early next year.

The tax policy work programme is generally made public, attracting strong interest from the tax and business communities, to whom it provides greater certainty and an understanding of the Government's direction in tax policy.

As time passes, and the work programme is updated and new policy initiatives are added to it, there is a risk that there will be more items on the programme than can be reasonably progressed. It is therefore important that when items are added to the work programme, existing priorities are reviewed to ensure that the Government's expectations across the work programme are met.

The work programme in recent years

The work programme over the last three years has been aimed at supporting the Government's priorities of responsibly managing the Government's finances and tax system, building a more competitive and productive economy, delivering better public services and rebuilding Canterbury.

In line with the focus on building a more competitive and productive economy, Treasury and Inland Revenue conducted a Savings and Investment Taxation Review. We reported on this in September 2012. The aim was to find whether changing fundamental tax settings would have been likely to lead to a material improvement in economic performance. The conclusion was that the more radical departures from current settings that were investigated were likely to lower economic welfare and that our current BBLR settings remain fit for purpose.

Since the completion of the Savings and Investment Taxation Review, the tax policy work programme has concentrated on three areas:

- making improvements to tax and social policy within the context of the Government's BBLR tax framework;
- international taxation and taking measures to prevent base erosion and profit shifting (BEPS); and
- Business Transformation and Better Public Services (BPS).

Developing a new tax policy work programme will be a top priority for Ministers and officials.

Setting priorities

The tax policy work programme must balance the resource requirements of the Minister of Revenue's main tax policy initiatives against those required for initiatives introduced by other Ministers – for example, in the areas of social policy or sector reforms – which can have substantial tax implications. It must also allow room to meet private sector concerns when tax legislation is identified as causing unintended problems in practice.

Key issues

You will need to decide whether work that is currently underway should continue to proceed. Some of the key issues that we are currently working on include:

- *Improvements to tax and social policy within the BBLR tax framework*. There is a closely held companies review aimed at making the rules simpler and more coherent. A discussion document is planned for early 2015.
- *International tax and BEPS*. Officials are focusing on preventing profit shifting using related-party debt, removing tax advantages from certain investment vehicles and ensuring that the international tax rules keep pace with changes in a global economy. We are involved with the work of the OECD in this area. We are scoping work on the OECD's draft proposals on Automatic Exchange of Information (AEOI) so that options and costings can be provided to Ministers before this year's G20 Summit in mid-November.
- *Business transformation*. We are finalising a consultation document on secure digital services for consultation early in 2015, and developing a consultation document on GST and PAYE collection of information. In addition we are also progressing further "tax administration for the 21st century" policy work in a series of discussion documents to be released later in 2015 and over the coming years.
- *Information sharing.* We are implementing an information-sharing agreement with the New Zealand Police.

Lapsed bills

Ministers will need to consider whether bills that have lapsed with the dissolution of Parliament prior to the election should be reinstated. The only bill in this category is the Taxation (Income-sharing Tax Credit) Bill that was introduced in August 2010.

5. Policy challenges

An on-going challenge for any tax system is to raise revenue to pay for government services in a manner that is as fair and efficient as possible.

Generally, the New Zealand tax system measures up well against this challenge. As discussed in earlier chapters, New Zealand's tax bases are broad, and personal income tax and GST rates are low. This has the effect of reducing distortions and increasing economic efficiency. The system is effective in raising revenues. By international standards, it is also relatively administratively efficient and imposes a lower level of compliance costs on taxpayers than in many other countries.

We have a tax system that is much more coherent than in most other countries. We tax very broad measures of personal and company income and expenditure at rates which are designed to "stick" and not be easily structured around. The alignment of the trustee tax rate with the top personal rate and the relatively small difference between the company tax rate and the top personal rate together minimise the scope for trusts and companies to be used to shelter income from higher rates of personal tax. Our full imputation system means that on distribution to domestic taxpayers, corporate income ends up being taxed at shareholders' marginal rates.

New Zealand is also fortunate to have a healthy consultative approach to tax reform. This is helped by the general coherence of the tax system and a very limited use of the tax system to deliver special incentives. Consultation in New Zealand is about making improvements to the tax system in the context of generally well-understood principles, rather than the much more contentious issue of whether a particular industry should receive bigger or better incentives than others.

This coherence has helped courts to decide what is and what is not tax avoidance, which has helped to maintain robust tax flows. Tax avoidance is very difficult to define unless there are clear principles underlying the tax system.

The Mirrlees Review in the United Kingdom emphasised the benefits of coherence when it observed:

> "The tax and benefit system should have a coherent structure based on clearly defined economic principles. There should be a clear vision of the ideal system, in which the various elements fit properly together and from which unnecessary distortions have been eliminated."[18]

A number of other reviews of the tax system in recent years have supported New Zealand's basic approach to taxation including the Tax Working Group that reported to the Government in January 2010.

[18] Institute for Fiscal Studies, *Tax by Design: the Mirrlees Review*, Chapter 20, Conclusions and Recommendations for Reform, p. 470.

This is not, however, a reason for complacency. It is important to continually examine whether there are ways to improve the fairness and efficiency of taxes. In addition, the tax system should be flexible enough to respond to changing economic circumstances or changing government priorities.

A fundamental question is whether the current tax system strikes an appropriate balance between fairness and efficiency considerations.

The answer to this question rests on value judgements that must ultimately be made by the Government. The role of officials is to advise on the possible ways of achieving the Government's distributional goals as efficiently as possible.

There is no perfect tax system and there will always be difficult tradeoffs. A more progressive tax system is likely to come with higher EMTRs and higher costs through lower efficiency of taxes. If a more progressive tax system were desired, it would be critically important to maintain coherence and ensure that higher rates of income tax cannot be easily structured around.

If the Government were to want greater progressivity, taxes are of course only one way of doing this. Alternatives may be additional transfer payments (for example, Working for Families tax credits) or additional forms of Government spending targeted at the poor (for example, additional healthcare or education spending).

Provided that the Government is broadly satisfied that the current tax system provides a reasonable tradeoff between fairness and efficiency concerns, we do not consider there is any "burning platform" requiring an urgent and radical restructuring of the tax system. Our key policy challenges would be to keep a broad-based and coherent tax framework, and to continue enhancing the tax system within this framework while focusing on international tax initiatives and base erosion and profit shifting (BEPS), and Business Transformation. The Business Transformation initiative in particular is a very important and substantial stream of work. Making progress here will make it easier to implement tax reforms that have significant systems implications in the future.

Irrespective of what happens in the short run, there is also the potential longer term challenge of additional fiscal costs associated with an ageing population. Unless the Government intends to deal with this pressure solely through cuts in government spending, the question will be how to raise additional tax revenue in the longer term.

This chapter discusses:

- maintaining and enhancing tax and social policy system within the BBLR framework;
- combatting international tax avoidance and the work on the BEPS project with the OECD; and
- adapting the tax system to future revenue pressures and government priorities.

The critically important issue of tax administration and Inland Revenue's Business Transformation programme is discussed in the next chapter.

Maintaining and enhancing tax and social policy within the current BBLR tax policy framework

New Zealand's BBLR paradigm

Since the late 1980s, New Zealand has maintained a broad-base, low-rate taxation framework. In practice, BBLR means the tax system is not used to deliver incentives or encourage particular behaviours.

A BBLR framework does not imply anything specific about the level of the top personal marginal tax rate. Indeed, when the top personal marginal tax rate was 39%, this was still a relatively low top marginal tax rate by international standards. By BBLR, we mean that tax bases are broad and tax rates are kept as low as possible while remaining consistent with the Government's distributional objectives.

Fragility of BBLR

While New Zealand has had a BBLR tax system for almost 30 years, BBLR and the constructive consultation it fosters are fragile things. Some tax practitioners have noted that, if a few lobbyists were successful in gaining tax concessions for their clients, it would quickly become impossible for them to avoid joining the bandwagon. Small concessions, while not significant in themselves, lead to a loss of coherence and framework.

For this reason, it is important for you to decide at the outset whether you wish to continue with the BBLR approach and, if so, apply it as consistently as possible.

BBLR and future tax changes

Having a consistent tax framework does not mean that tax changes are unnecessary. New court decisions, financial innovation, changing business practices and new developments overseas will mean that there is a constant need for change in order to maintain a well-functioning BBLR tax system.

For example, changes have been introduced to address R&D blackhole expenditure because of concerns about overreach and firms being unable to claim deductions for valid business expenses. New rules were introduced for employee allowances and foreign superannuation because of uncertainties and unintended consequences of the existing legislation. There are current concerns that the current rules on debt capitalisation can be penal. There are concerns that the loss limitation provisions for look-through companies are too complicated and that there are uneven tax rules applying to different closely held entities. Tax changes can also be needed to plug unintended "holes" in the tax system.

There will be a number of motivations for reforms in this area. Some changes will be clarifying law that is unclear. Others will be reinforcing the policy framework. Yet others will be responding to things that matter to various stakeholders and which need to be fixed promptly. Many parts of society have a stake in the tax system and it is important that the tax system is constantly maintained to address potential concerns.

There are other fundamental issues which will need to be looked at over time. In the absence of adjustments to tax thresholds, average tax rates will tend to rise because of fiscal drag. This is likely to be particularly burdensome for those on incomes around $48,000, where the marginal personal income tax rate increases from 17.5% to 30%. As Government finances improve there could be questions around if and how to deliver any personal or business tax reductions.

New Zealand also needs to take account of developments in other countries. For example, tax changes in Australia should continue to be monitored as they can have important implications for New Zealand. A particular focus will be Australia's White Paper due out at the end of 2015. If, for example, there were a substantial reduction in the Australian company tax rate, the question of whether New Zealand should follow suit would arise.

There are several conflicting considerations when deciding on the most appropriate company tax rate for New Zealand.

Too high a rate may discourage productive investment and decrease labour productivity. It can also encourage multinational enterprises to find ways to shift their profits away from New Zealand.

On the other hand, cutting the company rate can provide a windfall gain to shareholders of companies that operate in New Zealand. Many of these shareholders are non-residents. If replacement taxes are needed, they are likely to fall predominantly on New Zealanders. The overall effect can be to make New Zealanders as a whole worse off.

Reducing the company rate below the top personal income tax rate makes it attractive for individuals on higher marginal rates to shelter income in companies to sidestep these higher rates.

Our overall view is that there is not a good case for further company rate cuts at present. However, this is something that needs to be kept under review.

International tax and BEPS

A second policy challenge is to ensure that our tax rules are up to date and result in multinational firms paying a fair and efficient amount of tax in New Zealand.

It is important that New Zealand continues to be a good place to base a business and that taxes do not get in the way of this happening. Tax rates for individuals as well as companies can be important in this regard. Having a clear, consistent and well-understood policy framework is also helpful. An important on-going focus is to ensure that we have a well-maintained network of double tax agreements.

It is also important that our international tax rules are fair and seen to be fair. Base erosion and profit shifting (BEPS) is a problem where companies can arrange their affairs so that profits earned in a taxable jurisdiction are either allocated to a low-tax jurisdiction, or are subject to arrangements that result in no taxable profits being declared anywhere. Critically, the causes of BEPS are many and varied. There is no silver bullet solution.

Compared with other countries, New Zealand has fairly robust international tax rules that make it less vulnerable to BEPS. We have strong thin capitalisation, controlled foreign company (CFC), and anti-arbitrage rules. We are, however, still vulnerable to BEPS on some margins. Since 2012, the OECD has devoted considerable resources to coordinate and develop international solutions to BEPS issues. A number of deliverables are scheduled for the second half of 2014, with the remainder scheduled for 2015. New Zealand has been an active participant in the OECD process.

At the same time, some projects on the tax policy work programme are investigating domestic law changes that would help to combat BEPS. We will report to you with updates on these projects in due course. However, it is important that New Zealand continues to participate in the OECD process: real progress on BEPS will require collective action by the international community.

BEPS should not be seen as anti-business. Its goal is to make company taxes more transparent and even in their application across companies and countries. It is not in the interest of New Zealand businesses and individual taxpayers if multinational companies are able to avoid paying their fair share of taxes in New Zealand or elsewhere.

There is also a growing problem with purchases of goods and services from abroad escaping the GST that would be applied on domestic purchases. It is clear that the consumption in New Zealand of goods and services purchased by New Zealand residents should be subject to GST. The biggest problem is how to tax digital imports (for example, purchases of digital music) which is a question of enforceability, rather than a conceptual one. As the digital economy grows there is a concern that the leakage of GST revenues could grow. This is a particular concern for New Zealand because of the importance of its GST base.

The most productive way forward is likely to be to work with the OECD in this area. The OECD is currently examining a way of countries cooperating to levy GST on imported services, including intangibles, and is likely to recommend the GST registration of non-resident suppliers as the best solution – an option that could also be extended to low-value goods.

Meeting evolving priorities and future revenue needs

In the longer term, future pressure or changing government priorities may require departures from current practice and changes in the tax system.

Some future changes can already be foreseen. As New Zealand's population ages, there will be pressures to raise further revenue to pay for future increases in expenditure on health and pensions. Changes may also be desired for other reasons, such as to change the progressivity of the tax system.

Potential changes to the tax system fall into three categories: increasing tax rates, broadening existing tax bases or introducing new taxes into the mix. There are no easy options.

There is also the possibility of spending additional amounts on enforcement but there needs to be a substantial return on investment. Raising additional revenue involves a transfer of resources from the private sector to the Government. There are costs imposed on the private sector as a result so the additional revenue raised should not be thought of as all being a social gain. At the same time extra enforcement can improve fairness.

Increasing tax rates

The most obvious way to increase revenue would be to increase tax rates. Either the GST or income tax rates could increase. However, difficulties arise with either choice.

Increasing the GST rate always raises fairness concerns, although these may be overstated. GST is regressive in terms of income but broadly proportional in terms of consumption which may be a better measure of an individual's lifetime income. Fairness concerns may put pressure on the broad GST base, with calls for zero-rating of certain items. This is undesirable. Zero-rating goods and services will introduce large complexities in the systems that currently do not exist. Moreover, as a fairness measure, zero-rating items of expenditure is poorly targeted as high-income earners generally spend more money on most goods and services than low-income earners. This means that zero-rating certain goods and services will be a less effective way of helping low-income households than a fixed cash payment to each household. Zero-rating certain goods and services is generally a very inefficient way of helping the poor.[19]

Changing income tax rates, on the other hand, raises potential coherence concerns. New Zealand has a close relative alignment between the top personal income tax rate and the company income tax rate. If these rates were to diverge, potentially complex measures would be required to maintain the integrity of the tax system. That is, measures would need to be introduced to ensure that personal income is taxed at the appropriate personal income tax rate and not avoided through artificial shifting of personal income to lower-taxed entities.

[19] Suppose, for example, that the average saving for a household through zero-rating certain goods or services from GST was $600 but the top decile gained $750 and the bottom decile gained $450. It would obviously be more helpful to the poor for each household to be given $600 as a lump-sum grant than for these goods and services to be zero-rated.

The top personal marginal tax rate is currently aligned with the trustee tax rate. If the top personal rate were to increase, it would be important to also increase the trustee tax rate. Otherwise it would be easy for many to use trusts to shelter their incomes from higher rates of personal income tax.

One particular coherence concern relates to the tax treatment of portfolio investment entities (PIEs). Currently, if an individual on the top tax rate earns income directly, this is taxed at a rate of 33%. If instead the same income is earned through a PIE, the tax rate is capped at 28%. This is inconsistent with the general principle of "making tax rates stick" (i.e. making sure that the personal tax scale applies in practice). If higher rates of personal income tax were to increase significantly, we consider that this issue would become much more pressing. It would be important to evaluate how PIEs and other savings entities, including KiwiSaver funds, should be taxed. The Government would need to decide on whether higher tax rates should be applying to:

- all income;
- just to salaries and wages (effectively abandoning the BBLR approach); or
- most forms of capital income but not locked-in retirement savings.

We would not favour abandoning the BBLR approach.

Broadening tax bases

Broadening the tax base is also consistent with BBLR. The largest area of non-taxation of income in New Zealand that could practically be taxed is capital gains. Capital gains are concentrated at the top of the income and wealth distribution, so taxing capital gains is likely to increase the progressivity of the tax system without the need to increase tax rates. There would be an increase in efficiency on some margins as formerly untaxed income would be taxed. However, taxing capital gains only when assets are sold and ring-fencing capital losses, as generally occurs, can impose other efficiency costs. Capital gains taxes also tend to be complex.

The design of such a tax is critical: many of its pros and cons depend specifically on how it is designed and implemented. They cannot be evaluated in the absence of a detailed discussion of exactly how such a tax would operate.

There are other gaps in the income tax base, although taxing these would be difficult and unusual internationally. These include:

- Imputed income from personal assets, such as from a person's principal residence or perhaps from holiday houses or other assets. If two people earn the same salary but one has a mortgage-free home and the other is required to pay rent, the first has a higher ability to pay tax. A theoretical case can therefore be made for taxing imputed income (the rental value of one's own home) as part of a person's income. However, suggested moves in this sort of direction have led to very widespread opposition in the past. An alternative might be to restrict such a tax to second houses or holiday homes.

- A risk-free imputed return on rental housing. Concerns have often been raised about New Zealand having a large level of investment in rental property. The Tax Working Group in 2010 raised the question of whether rental properties should be taxed on an imputed rental return rather than being taxed on their net rental income. This would be likely to raise additional revenue from this sector but would raise some difficult borderlines. At the same time it would tend to increase the relative tax advantage of investing one's own capital into owner-occupied housing.
- Including financial services in the GST base (financial services are currently exempt from GST). This has been extensively researched in other countries but the general consensus is that a broad and well-designed inclusion of financial services is unlikely to be feasible.

Potential new tax bases

Several new tax bases have been suggested from time to time.

Any tax on a new base should be assessed on its merits. There are good reasons for caution, particularly if the base is selective. If taxes appear ad hoc, this is likely to increase taxpayer uncertainty and decrease predictability. This can impose efficiency costs over and above the efficiency cost of the tax itself.

A payroll tax could raise additional revenue but could create biases between taxes on the employed and the self-employed. It could cause firms to reduce staff and lead to disruptive market adjustments. Much like an increased rate of GST, it would impose a greater tax on labour income but it is more likely to be prone to manipulation and avoidance.

A land tax would be expected to fall on owners of existing land by lowering the value of land by the present value of the future taxes. This could appear ad hoc in falling only on those who have wealth in one particular form. It could also be difficult for particular groups of people (especially retirees, farmers and Māori authorities).

Another possibility is an estate duty or inheritance tax. This would be likely to increase progressivity but could be easy to structure around unless supported by other tax changes such as the reintroduction of gift duties that would add to complexity. The Tax Working Group considered but generally rejected this direction.

A further possibility would be additional recourse to environmental taxation. Left to themselves, firms and individuals may have insufficient incentive to look after the environment. This is because pollution imposes costs on others, sometimes referred to as "negative externalities". Some countries have carbon taxes but New Zealand already has an Emissions Trading Scheme which targets carbon emissions. While this area should be kept under review, there may be limited ways of raising revenue if the aim is merely to offset externalities and make firms and individuals confront prices that better reflect the social costs of their actions.

Given that there are no very easy options for boosting future revenue flows it is all the more important to keep existing tax bases broad.

6. Administration opportunities

Chapter 5 discussed the policy challenges ahead. In this chapter we discuss the other crucial part of an efficient tax system – the tax administration.

What is tax administration?

Tax administration in its broadest sense is the collection of rules, processes and interactions that govern the dealings between people and Inland Revenue in meeting obligations and/or receiving entitlements.

The key participants in this system are:

- Parliament – which sets the rules on how the tax system is to function.
- The Commissioner – who is responsible for the administration of the rules enacted by Parliament. This includes the care and management of the tax system, while considering the resources available, the importance of promoting voluntary compliance by all taxpayers and compliance costs incurred by taxpayers.
- Taxpayers – including social assistance recipients and their agents who must comply with the obligation imposed on them by Parliament.
- The courts – which ensure that the rules are applied appropriately.

The key functions of tax administration are:

- to provide assistance or information to help people understand and comply with their obligations;
- to quantify a person's tax liability and/or social assistance entitlement or obligation; and
- to collect or disburse the liability or entitlement.

These functions are supported by:

- policy settings such as the use of withholding taxes to provide effective and efficient collection mechanisms and a penalty structure for non-compliance;
- assurance activities to ensure that non-compliance is identified and addressed; and
- a disputes resolution process to ensure tax issues are dealt with in a fair and efficient manner.

Income information is a key input into tax administration. Inland Revenue plays a significant role in providing this information to other agencies such as the Ministry of Social Development to assist them in administering the welfare system. This role will continue to expand as we work more closely with other government agencies to deliver public services which the Government and the public expect. Increasing the sharing of income information across agencies will have to be balanced against the need to protect taxpayer privacy and maintaining the integrity of the tax system. We also link some of our services with those of other agencies to provide seamless customer services. A recent example is that parents can now apply for an IRD number for their baby when they register the birth with the Department of Internal Affairs.

What sort of tax administration do our customers want?

IR for the Future, our strategic vision document, describes what Inland Revenue wants to achieve for New Zealanders and how it will deliver on Government priorities and contribute to more cohesive public services. Our vision, based on the concept of a good tax and social policy system as set out in chapter 1, is to be a world-class revenue organisation, recognised for service and excellence. Such a system should also allow for the efficient and timely implementation of Government policy and contribute to and support broader "all-of-government" goals.

In June 2014, in conjunction with the Treasury and Victoria University, we hosted the tax conference, *Tax Administration for the 21st century*. Its purpose was to explore ways of making tax easier and reducing both compliance and administration costs without sacrificing other tax policy objectives such as raising revenue and ensuring fairness and efficiency.

Stakeholders such as businesses and their advisors indicated a similar view at the conference but with particular focus on the following:

- The ability to self-manage their affairs with more speed, certainty and predictability with access to the right people at the right time with the necessary skills to provide that certainty. In other words, it was their view that Inland Revenue should move away from processing returns and undertaking other low-value activities and concentrate on high-value services to taxpayers to enable them to manage their affairs with certainty.
- The need to consider policy and legislative settings and not merely current business processes and rethink how tax administration could be improved. This is more than just digitising existing processes and Inland Revenue replacing its ageing information technology system. All aspects within the tax administration system should be up for discussion.
- The need for New Zealanders, businesses and their advisors to be involved in the design of the rules and processes that underpin tax administration. The tax administration system has to work for them.

- The cost of change must be closely considered and managed to ensure that it is not merely shifting costs from Inland Revenue to taxpayers or vice versa. There must be an overall net benefit to society through a real reduction of compliance and administrative costs.
- Ensuring that there is continued maintenance of the tax system while tax administration modernisation is being undertaken.

Where are we now?

Over the last 20 years, successive governments have used Inland Revenue's core function of collecting and distributing money to implement various social policies, such as KiwiSaver and Working for Families tax credits. It is now becoming increasingly difficult for Inland Revenue to run the tax and social policy system with ageing technology and increasingly complex processes. As a consequence, our organisational performance is under pressure.

We are increasingly unable to rapidly and economically implement tax and social policy changes and other Government priorities. This is because of the current complexity of information technology systems and business processes. For example, implementation of recent legislative changes to the Child Support scheme is taking longer than it did to first implement the scheme using Inland Revenue's Future Inland Revenue Systems and Technology (FIRST) system in 1991.

It is becoming increasingly challenging to satisfy changing customer expectations for easier and less costly ways to receive entitlements and meet obligations. Businesses have consistently ranked compliance with tax obligations as their highest compliance priority, and it often contributes the most to the overall compliance burden of businesses. We need to minimise the cost, time and stress of customers complying with their obligations. We also need to better position Inland Revenue to meet changing customer needs.

Voluntary customer compliance levels are relatively high but they have been static or under pressure, and targets for 2015 will be difficult to meet. In recent Budgets, additional time-limited funding has been received to target non-compliance activities such as the cash economy and unfiled returns. While valuable, this addresses the consequence of a system under pressure rather than the core problem.

Taxation and social policy debt levels have been increasing, which can put the integrity of the revenue system at risk. Again, in recent Budgets, we have received additional funding to target debt levels. A key contributor to the level of outstanding debt is the compounding effect of the interest and penalties rules applying to unpaid amounts (for example, an unpaid income tax debt doubles in value within about four years).

Inland Revenue's customer satisfaction levels for our four main communication channels – digital, correspondence, telephone and face-to-face are high but are not increasing. As an organisation with a strong customer focus, we want these to improve.

Customer Satisfaction – *Online Services*

Overall satisfaction	2011–12*		2012–13	
Customer group	**Satisfied**	**Very satisfied**	**Satisfied**	**Very satisfied**
National Results	95%	80%	94%	78%
Individuals (overall)	92%	75%	93%	75%
Business (overall)	99%	85%	96%	81%

*Survey was only conducted for three quarters during 2011–12

Customer Satisfaction – *Voice and Correspondence Channels*

Overall satisfaction	2010–11		2011–12		2012–13	
Customer group	**Satisfied**	**Very satisfied**	**Satisfied**	**Very satisfied**	**Satisfied**	**Very satisfied**
National Results	86%	69%	86%	69%	82%	64%
Individuals (overall)	84%	66%	85%	68%	79%	62%
Business (overall)	89%	72%	86%	69%	85%	66%

While FIRST will continue to support the administration of the tax and social policy system, the platform and processes have become extraordinarily complex as they have evolved over time, and implementing changes has become expensive, time-consuming and risky. This has made administration of the revenue system more difficult and costly. In the worst possible scenario, there is a risk of operational failure that could severely affect the Government's ability to collect and disburse money. Inland Revenue's preference is to minimise policy changes that are implemented in FIRST. However, we recognise that the Government may want changes. In considering options to implement those changes we will assess the impact on the FIRST system, to ensure the risk of disruption is not pushed to unacceptable levels before choosing alternative options to implement change. We are already experiencing periods of high system unavailability due to technology disruption which affect service delivery to customers and staff productivity.[20] Inland Revenue's availability target for its mission-critical ICT systems is 99.9 percent. During the period July 2012 to June 2014 we did not meet this target on:

- 16 occasions in relation to the availability of our e-channels; and
- 6 occasions in relation to the availability of FIRST.

We know that during these periods of unavailability, customers are unable to file their tax returns with us or access our online services.

FIRST is our core operating system. It identifies and registers customers by number, calculates tax liabilities and social assistance entitlements and obligations, amounts owing or refunds due, handles returns, correspondence and ensures that tax totals are recorded for Crown revenue purposes. Connected to this core system through an integration layer are separate systems dealing with, for example, KiwiSaver and online services used by tax agents and taxpayers.

[20] Typical service availability for mission-critical ICT systems is 99.9%, which means the system should be available almost all of the time.

FIRST is primarily a revenue collection system and was designed in principle to support the administration of the tax system. Using it to administer social assistance programmes such as Working for Families tax credits results in both policy and administrative tradeoffs being made to ensure that the policy and administrative framework can be accommodated. This can result in inflexible design parameters. Analysis of the impact of implementing recent policy changes has shown that social policy changes such as child support and student loans can be very complex and costly.

Furthermore, FIRST was designed for a paper-based system where information from the taxpayer's paper tax return was entered into the system with the output generated in paper form and sent to the customer. It therefore does not cope well with demands for online access and immediate responses expected by today's customers. This increases both compliance costs and administration costs.

Current tax and social assistance policy settings have been designed to work within the FIRST framework. However the core component of Inland Revenue's success in delivering major initiatives during the past decade or so has been our ability to find ways to deliver "just enough, just in time" through modified systems and manual interventions and workarounds for those elements that cannot be automated in the time available. In doing so, layers of complexity and risk have been added to Inland Revenue's business processes and core technology infrastructure.

To reduce compliance and administration costs, the paradigm since the 2000s has been to remove the need for taxpayers, particularly salary and wage earners and those with investment income withheld at source, to file an annual tax return. To support this focus, withholding tax rules such as those applying to the portfolio investment entity regime have, for the majority of taxpayers, become final taxes. These withholding taxes usually use some income proxy to set the withholding tax rate, which can lead to elements of unfairness.

The way forward to modernise tax administration

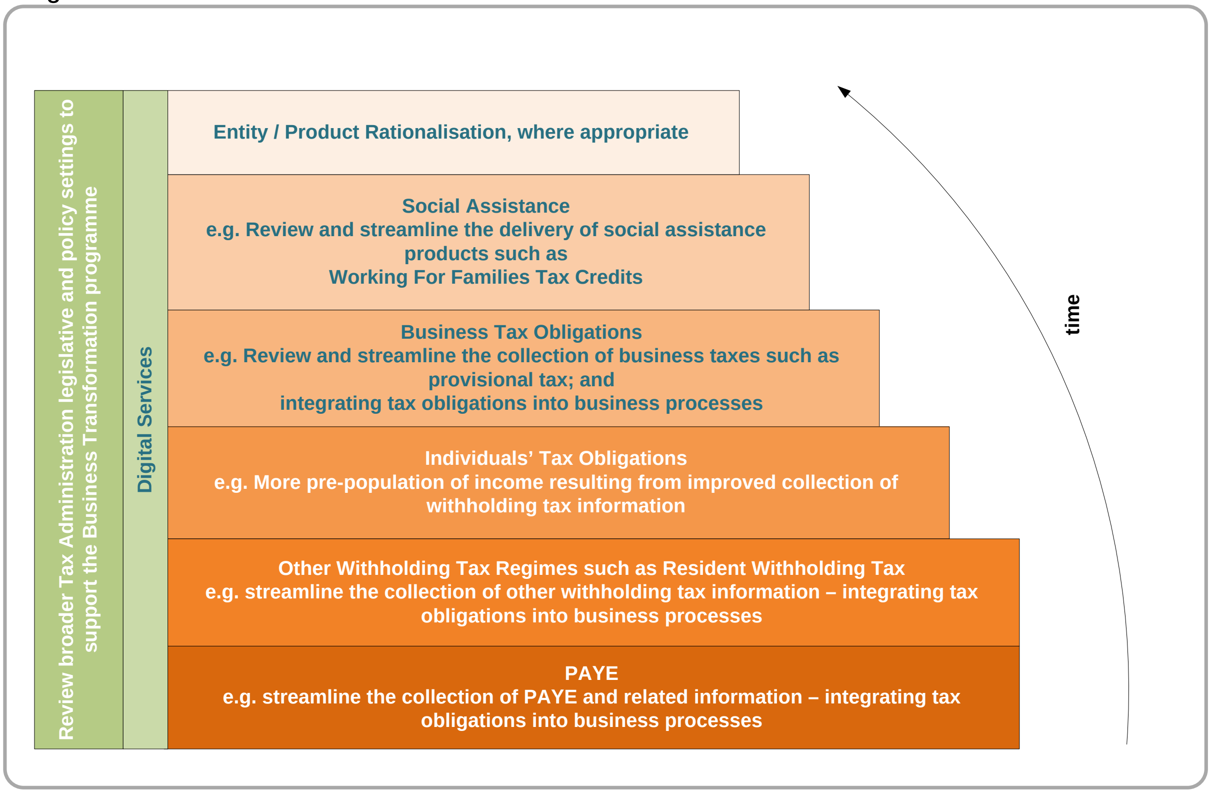
As noted in chapter 5, New Zealand's tax policy framework is robust and our tax policy settings are in good shape. Given this, the focus now needs to shift to tax administration to ensure we have a tax and social policy system that is easy for customers to comply with and simple for Inland Revenue to administer, and which allows Inland Revenue to better contribute to the delivery of more streamlined and cohesive government services. Furthermore, the tax administration landscape has changed over recent years, with technology advancements and the growth of the digital economy. We now have the opportunity to modernise tax administration for future generations of New Zealanders.

Modernisation of tax administration is not about replacing like with like, using new technology to lessen risks and maintain current business processes. The preferred way, which was endorsed by Cabinet in April 2013, is to modernise the revenue system through business process re-engineering, supported by new technology and taking into account how the digital economy provides real opportunities to radically improve tax administration. This should include a review of both policy and legislative settings to ensure they frame and support the modernisation of tax administration.

Inland Revenue has developed a "straw man" policy proposal to start the debate on what policy changes could be required to modernise tax administration. The main goal is to improve the administration of personal income tax, business taxes (such as company tax) and social policy to reduce both administrative and compliance costs, and increase certainty and predictability for taxpayers.

Improvements to the administration of these taxes (particularly personal income tax and social policy) will only be possible after a number of building blocks have been put in place, such as digital services, and streamlining the collection of information from withholding systems such as PAYE. Part of this work will be integrating tax obligations such as PAYE into normal business systems. The following diagram represents a depiction of the building blocks as envisaged by the policy vision.

Diagram No.1



An important element in this work is the engagement of customers, their advisors and the community in setting the framework and design. It is critical that their needs are understood and met in identifying opportunities for modernising the tax system. For example, tax obligations should be integrated into normal business processes so that those obligations are met as part of running one's business and are not an additional activity.

The last factor is the role the tax system, the Commissioner and information collected as part of tax administration have in supporting the wider delivery of government services. Inland Revenue interacts with more New Zealanders than any other government agency. While we currently contribute to the effective delivery of co-ordinated services and provide other agencies with income information, tax administration modernisation is an opportunity to rethink what this role should be.

Current challenges and opportunities

Over the last two years we have been engaging with Ministers on our plans to modernise the tax administration system – our Business Transformation programme. This engagement has included:

- the preparation and endorsement by Cabinet of a programme business case which sets out the need for change and investment, and the preferred way forward to modernise tax administration through business process re-engineering, supported by new technology; and
- the preparation and endorsement by Cabinet of a high-level roadmap for the delivery of this programme of work. We propose to deliver business transformation in four customer-focused stages over approximately 10 years, as illustrated by the following diagram.

Diagram No.2 – Business Transformation programme roadmap

Stage 1. Enabling secure digital services

- Advance channel strategy work including redesigning website and continuing development of customer tools with customers
- Encourage customers to self manage and use digital channels
- Improve the collection of GST and PAYE information from business
- Deploy services required to streamline PAYE, e.g. validation checks
- Develop integrated intelligence and interventions for PAYE

Key Outcomes:
- The majority of customers self-manage and use digital services
- Digital border established
- Businesses' compliance burden to fulfil PAYE [and GST] obligations is reduced
- Improved data accuracy and certainty of income tax deductions and social policy entitlements and obligations for individuals
- Fewer processing and customer contacts
- Customers have confidence that their personal information is secure

Stage 2. Streamline income & business tax processes

- Design of streamlined income and business tax processes with stakeholders
- Proof of concepts and/or pilots to test key design concepts
- Acquire/build additional services required to support income and business taxes
- Transition income and business taxes to the future state

Key Outcomes:
- Compliance burden to fulfill income and business taxes obligations is further reduced
- Fewer processing and customer contacts surrounding income and business taxes
- Compliance assurance activities are intelligence -led
- Increased reliability and flexibility (incl. policy agility) for income and business taxes

Stage 3. Streamline social policy delivery

- Design of streamlined social policy delivery with stakeholders
- Proof of concepts and/or pilots to test key design concepts
- Acquire/build additional services required to support social policy delivery
- Transition social policies to the future state

Key Outcomes:
- Social policy processes are digital and streamlined
- Fewer processing and customer contacts surrounding social policy
- Enforcement activities are more focused and require fewer resources
- Increased reliability and flexibility (incl. policy agility) for social policy products

Stage 4. Complete delivery of the future Revenue System

- Design, with stakeholders, of remaining services to be transitioned
- Proof of concepts and pilot to test key design concepts
- Acquire/build additional services
- Transition to the future state

Key Outcomes:
- Revenue system is flexible & government has policy agility
- Infrastructure supporting the revenue system is robust
- Revenue system compliance is higher
- Inland Revenue is intelligence-led, leaner & more productive
- Increased interoperability with other agencies/ 3rd parties

The first stage will lay the foundation. It provides the opportunity for the Government and Inland Revenue to consider how the tax and social policy system should operate within the wider government system to deliver more all-of-government services. This could involve the delivery to New Zealanders of more "joined-up" services with other agencies or the provision of income information and other services to other agencies to improve their services.

The desired outcomes at this stage are that our digital services will allow the majority of customers to self-manage, while businesses' compliance burden in fulfilling their PAYE and GST obligations will be reduced by using their normal business processes and systems to meet these tax obligations.

Also, our Business Transformation programme will enable and support a refocus of our compliance approach from reactive enforcement to proactively facilitating compliance. There is an opportunity to design a customer-centric environment which enables compliant behaviour "right from the start" rather than correcting non-compliant behaviour afterwards. The environment (and supporting systems) will be shaped around better understanding of customer behaviour and lifecycles. We will seek to shape this behaviour by influencing customers' capability, motivation and opportunities to comply. This system would be supported by multi-faceted interventions that promote compliance such as influencing social norms, customer service and enforcement.

A "request for proposal" for a design provider was released on 30 April 2014. The selected provider will help us to complete the overall design of the future change to the revenue system required to achieve *IR for the Future*. It is our intention to work with a number of service providers across a range of areas during our entire transformation programme. In other words, we will not be committed to one service provider. We also propose to use commercially available applications wherever possible to replace and modernise our information technology platform.

The Government, in Budget 2014, set aside funding as a tagged contingency, of $36 million in 2014–15 and $48.5 million in 2015–16 to allow us to:

- complete the overall design of the changes to the revenue system required to achieve our vision;
- advance work to integrate legacy and new technology platforms; and
- deliver early improvements to help us deliver our business-as-usual activities such as improvements to our secure on-line services to provide a more seamless service to customers.

Draw-down of this contingency funding will be subject to one or more business cases for consideration and approval by Cabinet to confirm the scope of the above work.

We will be working towards the development of a detailed implementation business case for stage 1 (Enabling secure digital services) of the Business Transformation roadmap which will present options for technology replacement, implementation options, and revised costs and benefits for the programme. It is our intention that this implementation business case will be provided to you by March 2016 for consideration and referral to Cabinet.

Stakeholder input into business transformation

In May this year, a Taxpayers' Simplification Panel was established by the Commissioner to give New Zealanders a voice in simplifying, modernising and transforming our business as part of the Business Transformation programme. This is one of several forums Inland Revenue will be using to ensure that New Zealanders have input into shaping the future administration of the revenue system.

Also we are in the process of establishing an information and communication technology reference group to assist us in understanding this specialised area. This group will provide an external and independent view as a "sounding board" for ideas and innovation and how we can deliver better services to our customers.

The generic tax policy process will be used to seek stakeholder input on any policy and legislative proposal to frame and support the Business Transformation programme.

The task ahead

The size and complexity of this programme of work should not be under-estimated. The programme is likely to be implemented over an 8 to 10-year timeframe. It will involve substantial input from:

You as Minister in:

- deciding on the policy and legislative changes to support the business transformation programme;
- considering recommendations from officials on the scope and pace of the programme to support the Government's investment;
- ensuring that officials are engaging with taxpayers, their advisors and the community so that their needs are understood and met;
- working closely with your Ministerial colleagues to support policy and legislative changes and investment and to steer and manage the scope and fit of the programme within the Government's wider policy and strategy settings such as the ICT strategy; and
- ensuring the balance between Business Transformation, maintenance of the current tax and social policy system, and the transition to our future state is well planned and delivered.

Parliament in:

- overseeing the passage and enactment of any legislation to support the programme; and
- reviewing Inland Revenue's Vote and performance.

Our customers including their advisors and other tax intermediaries in:

- engaging with Ministers, Parliament and officials in identifying their needs and the opportunities; and
- making submissions on consultative documents and proposed legislation, and implementing changes to their business systems.

Officials in:

- drafting consultative material and providing advice on policy legislative settings;
- developing business cases to support investment decisions;
- working with the tax community to understand their needs and the implementation of the modernisation of tax and social policy system;
- working with other agencies such as the Treasury, the State Services Commission and the Government's Chief Information Officer in the development of policy and legislative proposals and investment business cases and to ensure that the scope and direction of the programme fit into the wider governmental policies and goals;
- identifying and managing the risks associated with such a business transformation programme; and
- implementing the modernisation of the tax and social policy system, including system and business process changes and change management.

We recognise that the task of modernising the administration of the tax system (our Business Transformation programme) is a large and complex endeavour and will be a key priority and focus for you as Minister of Revenue. Embarking on this opportunity is not cost-free. There are likely to be times over the life of the programme that we may not be easily able to implement significant policy proposals. In other words the Government's priorities and our Business Transformation programme may not be able to be delivered contemporaneously. Tradeoffs may need to be made.

We know from previous experience that changes to social policy settings such as child support are likely to be very complex and costly to implement. Also, some tax measures are likely to have major implementation impacts such as the OECD's global automatic exchange of information proposal.

When considering policy changes it will be critically important to fully understand the administrative impact. This will allow Ministers to know what can be implemented, the cost, the timing of implementation and implications for the Business Transformation programme. A further consideration will be whether it makes commercial sense from an investment perspective to implement policy changes that will need to be re-implemented as part of the Business Transformation programme. It may be, at times, prudent to defer policy changes until they can be implemented as part of the Business Transformation programme at a later date. These will be difficult calls to make.

To manage this, we will work closely with you and your colleagues to ensure that any issues or constraints arising from the administrative impact of policy implementation are fully understood and any necessary tradeoffs that can be made are identified and discussed early.

The on-going need to continue to administer the tax system while implementing our transformation programme is likely to be challenging.

For example, a challenge will be maintaining or improving our current service levels during a period of extensive change.

These challenges aside, we look forward to working with you and your colleagues to make the most of the opportunity we have to make changes that will have a real benefit for our customers and achieve our vision of being a world-class revenue organisation, recognised for service and excellence.