2012/13 financial review of the Inland Revenue Department

Report of the Finance and Expenditure Committee

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Inland Revenue Department

Recommendation

The Finance and Expenditure Committee has conducted the financial review of the 2012/13 performance and current operations of the Inland Revenue Department, and recommends that the House take note of its report.

Introduction

The Inland Revenue Department (IRD) manages New Zealand's tax system, collecting about 80 per cent of core Crown revenue ($53.8 billion in 2012/13). It also administers several government programmes, including KiwiSaver, student loans, Working for Families tax credits, child support, and paid parental leave. The Commissioner of Inland Revenue is Naomi Ferguson.

Financial and service performance

The department's total income for 2012/13 was $695.4 million, an increase of 3.6 percent on 2011/12. Output expenses in 2012/13 totalled $654.4 million, about 1.8 percent below those of the previous year and 4.5 percent below budgeted spending.

Inland Revenue exceeded the appropriation for KiwiSaver Kickstart payments by $3.762 million as a result of an increase in enrolments in the last four months of the 2012/13 financial year. Although some increase was forecast, the number of people enrolling surpassed expectations.

The department achieved 44 of its 58 performance measures for the year, with an overall success rate of 76 percent, compared with 69 percent in 2011/12, when the Canterbury earthquakes disrupted some services, and 84 percent the year before. Its achievements in 2012/13 included increasing its use of digital services; some improvement in recovering debt; inroads into the hidden economy, property speculation, tax avoidance, and fraud; and helping prevent unwarranted benefit payments by sharing information with other public service agencies.

At 30 June 2013, the department employed 5,475 full-time-equivalent staff, 3 percent more than in 2012.

Business transformation programme

Ministers have agreed in principle to proceed with the business transformation programme, which aims to update IRD's technology, policies, processes, and systems over 10 years at an estimated cost of roughly $1–1.5 billion. A plan has been developed, comprising four stages: enabling secure digital services, redesigning and redeveloping the platform for business taxes, meeting the needs of social policy programmes, and a "sweep-up" stage for other matters. A business case for the first stage will be developed later in the 2014 calendar year.

The commissioner emphasised that the transformation programme is much more than the replacement of IRD's ageing computer system; it also entails improving the department's policies, processes, and systems to meet the expectations of the Government and the

public about appropriate levels of service. She noted that the computer system remains secure and works well, and could continue to deliver what is currently required of it for many years; but it cannot provide many more services which the Government and the public might expect of it.

Some of us are concerned that progress on the programme seems very slow. Despite the urgent tone of IRD's briefing to the incoming minister about it some five years ago, the Government had still only reached an "in principle" decision; this is worrying since the technology currently limits a government's ability to implement new policies. The department also seems to have problems maintaining customers' privacy and answering phone calls.

The commissioner said that the programme is a massive undertaking, which IRD is approaching in a very considered way, with Ministers' full cooperation. A lot of preparatory work has gone into understanding the current system, what is involved in the transformation, and what services are wanted by the public. It has already taken a number of the preliminary steps, and has upgraded online services, introduced voice identification for customers and a mobile application, and secured a contract for continuing support of the existing mainframe.

Scoping study and Capgemini consultants

We heard that $50 million has been spent so far on scoping work, on improving the department's understanding of its current system and what it will take to convert it, and on initial proprietary work within the department for the stages ahead.

We sought clarification of Capgemini's consultancy role, as we would be concerned if the firm were writing the design specifications for the project and then bidding for it. The commissioner told us that Capgemini's involvement ceased in March 2013. It had assisted the department with some high-level diagnostic work and with some of the scoping. It did not participate in the preparation of the business case, nor in discussions with Ministers. Capgemini received about $23 million of the $50 million spent so far.

Opportunities for New Zealand businesses

We are aware that the IRD has been criticised for the way its approach appears to exclude smaller New Zealand suppliers from participating in the transformation programme. We asked whether one of its objectives is helping New Zealand's information technology (IT) sector to develop.

The commissioner said the IRD's main goal is to achieve the best possible value for money for New Zealanders in developing a 21st-century tax administration system that is fit for purpose. She told us that the department had deliberately adopted a sourcing strategy that would provide opportunities for New Zealand businesses, including those in the IT sector.

We heard that in October the department started seeking expressions of interest for a high-level design partner to work with it on the first stage of the programme, and to revalidate some of the business case for future stages; it expects to make a selection by June 2014. We note that it specified organisations that have been involved in managing and designing a project worth more than $100 million, which would appear to cut out all New Zealand IT companies. However, the commissioner told us there is scope for organisations to form consortia with local firms, and there will also be numerous opportunities for New Zealand businesses of all kinds to take on pieces of the project. For example, the department is

already seeking support with testing, and plans to seek services to support the development of mobile applications in the new year. There will also be opportunities for businesses to support the department in managing other aspects of its organisational change programme.

Telephone and online services

IRD has been providing more self-service and digital options for customers, and reports a high level of satisfaction with its online services.

However, it had difficulty meeting the demand for telephone services; high demand in the fourth quarter led to a decrease in customer satisfaction and failure to meet some targets. We were told that the department aims to answer 75 percent of calls within 3 minutes.

The commissioner told us it is always hard to plan for peak season. Normally, it starts in May or June, but this year saw unexpectedly heavy demand from April, when call-centre staff were still being trained. The change was mainly because of advertising by personal tax summary intermediary companies, after IRD introduced a new service for them. The commissioner told us that people are increasingly using online services, which will help to reduce call volumes; but it also means that people who call now tend to raise more complex issues, so calls take longer and require a higher level of skill to answer.

IRD expects call volumes in 2014 to again peak earlier than they used to, and it intends to bring in additional capacity.

Tax compliance activity

The department received additional funding in the 2010 and 2012 Budgets to improve tax compliance in areas such as the hidden economy, the property sector, and aggressive tax planning.

Property compliance work targeting people who trade in properties for profit has been extremely successful. IRD told us it found some $54 million dollars in tax due, representing a rate of return on each dollar of funding it received of $8.40, compared with a target of $6.80. Its plans for future baseline funding and resourcing will continue to focus on this very important area of risk.

International tax arrangements

With increasing foreign ownership in key sectors of the economy and the increasingly complex internationalisation of businesses, we consider it important that IRD work to ensure businesses pay their fair share of tax in this country. IRD told us it has been working with the OECD on international tax issues, including base erosion and profit shifting. As well as this multilateral work, it also focuses on such issues as related party debt within New Zealand.

Some of us consider that the department should invest more resources in such work, and give more visibility to its efforts, as it has done with its property compliance work. It would provide important reassurance to PAYE taxpayers if all businesses, including multinational companies, were seen to be paying their fair share.

The commissioner told us she will give thought to how the department could publicise its work more effectively. She said the department continues to tackle tax avoidance. Regarding aggressive tax planning, its return on investment this year was $42 for every dollar spent, against a target of $11. It has undertaken several prosecutions, with good results, and feedback from the tax profession suggests there is now less aggressive tax

activity and avoidance than there used to be. We were told that the department has not estimated the amount of revenue lost from tax avoidance and evasion, as it judges that the considerable resources needed to do so can be used better in other ways, including understanding why people do not comply, so the reasons can be addressed.

Community compliance teams

The department is increasingly having teams of its staff specialise on specific regions, getting to know and be known by the communities to improve voluntary compliance. Community compliance teams come to understand the seasonal risks in their areas—for example, with transient fruit-picking operators—and they work with the community, local employers, industry groups, and other government departments to address issues of avoidance. We commend this approach and are pleased to hear it is proving successful.

The department is also working to improve the way it communicates with New Zealand's increasingly diverse population. For example, in Auckland community compliance officers work with Auckland Regional Migrant Services to understand the changing demographics and encourage compliance. The department has a number of bilingual staff, and its voice identification system is tested to ensure that it can deal with different accents.

Staff

We wish to record our appreciation of the professionalism of IRD's staff, and of the very high-quality work they do on behalf of all New Zealanders.

Some of us would like to see IRD locate more of its resources in regional areas where overhead costs tend to be lower than in the main centres. The commissioner told us that two factors in particular influence the department's resource distribution. It seeks to concentrate its resources in areas where there are specific risks. It also needs to maintain a high level of skills in the services it provides. It is one of the largest employers of accountants in New Zealand, and can attract staff with professional expertise more easily in the larger centres.

Foreign account information-sharing

We note that United States legislation known as the Foreign Account Tax Compliance Act (FATCA), due to take effect from July 2014, will require financial institutions in other countries to provide the US tax authorities with certain information about the accounts of US citizens of interest to the authorities. We consider this a significant measure; while we do not object to tax transparency, we believe that reciprocity should apply in any such requirements. We understand that New Zealand is negotiating an intergovernmental agreement with the United States with the aims of reducing the costs of complying with FATCA for New Zealand financial institutions, and of gaining reciprocity, so that the United States would be required to provide New Zealand with comparable information it holds about New Zealand account-holders. We heard from the IRD that a recent multilateral agreement provides for reciprocal information-sharing between many countries.

Consultants

Some of us are concerned about the amount being spent by IRD on consultants, particularly for surveying of customers' satisfaction and perceptions. The commissioner said all its procurement complies with government rules. Surveys of customers help IRD to understand shifts in community perceptions and attitudes to compliance and risk, so it can

develop appropriate services. It considers it important to understand whether New Zealanders feel that services meet their expectations, and if not, what needs to change.

Appendix

Approach to financial review

We met on 4 December 2013 and 29 January 2014 to consider the financial review of the Inland Revenue Department. We heard evidence from the Inland Revenue Department, and received advice from the Office of the Auditor-General.

Committee members

Paul Goldsmith (Chairperson)
Maggie Barry
David Bennett
Dr David Clark
John Hayes
Hon Shane Jones
Dr Russel Norman
Hon David Parker
Rt Hon Winston Peters
Jami-Lee Ross
Hon Kate Wilkinson

Evidence and advice received

Office of the Auditor-General, Briefing on Inland Revenue Department, dated 4 December 2013.

Organisation briefing paper, prepared by committee staff, dated 2 December 2013.

Inland Revenue Department, responses to committee questions, dated 29 November and 20 December 2013.