

Inland Revenue report: Consideration of extension of bi-lateral funding requests - supplementary information to Budget 2010 paper

Date:	29 March 2010	Priority:	High
Security level:		Report number:	IRD 2010/29

Action sought

	Action sought	Deadline
Minister of Finance	Note the contents of this report	In preparation for the Joint Minister's meeting on 30 th March 2010
Minister of Revenue	Note the contents of this report	In preparation for the Joint Minister's meeting on 30 th March 2010

Contact for telephone discussion (if required)

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Briefing note

Date: 29th March 2010

To: Michael Nutsford
Tax Policy Adviser to the Minister of Finance (Bill English), Parliament

Olivia Williams
Advisor to the Minister of Revenue

From: Martin Scott
Group Manager, Assurance

Subject: Budget sensitive - consideration of extension of bi-lateral funding requests - supplementary information to Budget 2010 paper

In late November 2010, Inland Revenue submitted a paper for Ministerial consideration entitled “Budget 2010 – a world class tax system”. Within the body of this paper, reference was made to the following three potential investment areas –

- Debt compliance
- Addressing the hidden economy
- Property compliance

These bids were time limited with funding ending in 2014/15 at the latest.

Inland Revenue has recently been asked to consider the implications of the extension of these areas of focus on a permanent basis. The attached memorandum provides –

- a summary of financial information and options for each area
- background, outcomes and benefits for each of the areas of focus
- benefits of permanent extension of funding and factors for consideration &
- breakdown of additional options for consideration including cost, financial benefits and net revenue return (options are over and above those detailed in the November 2010 paper)

Please could the attached information be placed before the joint Minister’s for their consideration.

Martin Scott
Group Manager, Assurance

Budget 2010 sensitive - consideration of extension of bi-lateral funding requests - supplementary information to Budget 2010 paper

The attached memorandum provides an overview of the following areas of focus -

- Debt compliance
- Addressing the hidden economy
- Property compliance

The following supporting information is also provided for your consideration -

- A high level summary of Inland Revenue's preferred options
- a summary of financial information and options for each area
- background, outcomes and benefits for each of the areas of focus
- benefits of permanent extension of funding and factors for consideration &
- breakdown of additional options for consideration including cost, financial benefits and net revenue return (options are over and above those detailed in the November 2010 paper)

High level summary of preferred options

SUMMARY OF OPTIONS - AT YEAR ONE

\$000	Debt (Option 3)	Hidden economy (Option 3)	Property (Option 1)	Total
Cost	10,240	6,696	6,644	16,936
Revenue	77,000	23,000	45,000	100,000
Net Benefit	66,760	16,304	38,356	83,064
Rate of return	8:1	3.5:1	7:1	

SUMMARY OF OPTIONS - AT YEAR TEN

\$000	Debt (Option 3)	Hidden economy (Option 3)	Property (Option 1 - 4 year period)	Total
Total Cost	162,251	85,239	26,576	247,490
Revenue	1,293,600	419,000	180,000	1,712,600
Net Benefit	1,131,349	333,761	153,424	1,465,110
Rate of return	8:1	5:1	7:1	

Summary of financial information and options for each area

Debt \$000					
Year 1	Option 1 - As presented in Nov 2009, five year investment	Option 2 - Increased investment from year one, constant through ten year period	Option 3 - 40 additional FTE for the ten year period	Variance Option 1 vs Option 2	Variance Option 1 vs Option 3
Cost	3,606	10,240	10,240	6,635	6,635
Cash Collected	45,000	100,000	100,000	55,000	55,000
Revenue	34,650	77,000	77,000	42,350	42,350
Net Benefit	31,044	66,760	66,760	35,715	35,715
Rate of Return	9:1	8:1	8:1		
Total - 10 Years	Option 1	Option 2	Option 3	Var Op1 to Op2	Var Op1 to Op3
Total Cost	30,241	122,791	162,251	92,550	132,010
Cash Collected	505,000	1,230,000	1,680,000	725,000	1,175,000
Revenue	388,850	947,100	1,293,600	558,250	904,750
Net Benefit	358,609	824,309	1,131,349	465,700	772,740
Rate of Return	13:1	8:1	8:1		
Average FTEs per year	70	109	150		

Hidden Economy \$000					
Year 1	Option 1 - Investment over four years addressing two industries only	Option 2 - Ongoing investment to address additional industries	Option 3 - 27 additional FTE for the ten year period	Variance Option 1 vs Option 2	Variance Option 1 vs Option 3
Cost	5,818	5,818	6,696	0	878
Revenue	20,500	20,500	23,000	0	2,500
Net Benefit	14,682	14,682	16,304	0	1,622
Rate of Return	3.5:1	3.5:1	3.5:1		
Total - 10 Years	Option 1	Option 2	Option 3	Var Op1 to Op2	Var Op1 to Op3
Total Cost	22,397	58,180	85,239	35,783	62,842
Total Revenue	113,000	299,500	419,000	186,500	306,000
Net Benefit	90,603	241,320	333,761	150,717	243,158
Rate of Return	5:1	5:1	5:1		
Average FTEs per year	55	57	84		

Property \$000					
Year 1	Option 1 - Ongoing investment addressing speculator activity and behaviour				
Cost	6,644				
Revenue	45,000				
Net Benefit	38,356				
Rate of Return	7:1				
Total - 10 Years	Option 1				
Total Cost	26,576				
Total Revenue	180,000				
Net Benefit	153,424				
Average FTEs per year	71				
Rate of Return	7:1				

Debt compliance

Background & approach

- Between 2004 and 2008, the total tax base grew by 35%, but total tax debt increased by 91% (\$1.92 billion)
- Inland Revenue acknowledges that tax debt is growing at a rate that is outpacing its capacity to deal with it, and this bid is in response to concerns noted by both OAG and FEC. IR cannot manage this growth without investment in specific resources
- As at 30th June 2009, there were 353,300 cases of tax debt, totalling \$5.060 billion
- Use of industry standard technology (campaign management tools and a predictive dialler) supported by additional people resources (to maximise asset utilisation) leading to -
 - increased earlier intervention in the debt cycle for customers displaying specific debt risk – particularly the high volumes of customers with lower level debt
 - reducing the need for more costly interventions for aged debt for both customers and Inland Revenue
 - maximising coverage and community presence

Outcomes & Benefits

- Strengthening the value of the debt asset to Government by reducing existing impairment levels (thus supporting the New Zealand Government in maintaining its credit rating & borrowing ability). *[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions]*. This initiative will improve the level of this impairment and the additional cash collections will reduce the level of overdue debt (and number of taxpayers in debt) which will result in a reduction in the annual impairment expense.
- Contacting greater volumes of customers (improved customer coverage) displaying specific debt risk &
- Encouraging ongoing voluntary compliance

Benefits of permanent extension of funding

- Ongoing strengthening of the tax debt asset for Government through reducing existing impairment levels.
- Ability to continue to improve and build on customer coverage and voluntary compliance
- Configuration of technology & people investment over time to assist in asset improvement for Child Support and the support of wider organisational campaign approaches, in line with our annual publication regarding Inland Revenue's Compliance Management Programme

Factors for consideration

- All three options reflect an increase in resources for this area of focus. In terms of recruitment, it will be important for Inland Revenue to secure the appropriate skill-sets and capability to maximise the return for this potential funding initiative. This may include both in house and outsourced capability.
- With an increased level of debt compliance activity, this will generate an increase in work requiring both legal and specialist expertise and this has been reflected in the costs provided.
- Proposed rate of return 8:1 - \$8 return for each \$1 invested

\$000	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	Total
Debt - Option 1											
Gross operating impact	2,903	6,645	6,405	4,432	2,031						22,416
Overheads (24.2%)	703	1,608	1,550	1,073	492						5,425
Depreciation		600	600	600	600						2,400
Total cost inc overheads	3,606	8,853	8,555	6,105	3,123						30,241
Cash collection	45,000	150,000	150,000	105,000	45,000	10,000					505,000
Revenue	34,650	115,500	115,500	80,850	34,650	7,700					
Net operating impact	31,044	106,647	106,945	74,745	31,527	7,700					358,609
Gross capital impact	3,000										3,000
Net capital impact	3,000										3,000
FTE	43	109	109	75	34						370

\$000	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	Total
Debt - Option 2											
Gross operating impact	8,245	8,645	9,645	9,645	9,645	9,645	10,245	10,245	10,245	10,245	96,450
Overheads (24.2%)	1,995	2,092	2,334	2,334	2,334	2,334	2,479	2,479	2,479	2,479	23,341
Depreciation		600	600	600	600	600					3,000
Total cost inc overheads	10,240	11,337	12,579	12,579	12,579	12,579	12,724	12,724	12,724	12,724	122,791
Cash collection	100,000	150,000	150,000	140,000	130,000	120,000	110,000	110,000	110,000	110,000	1,230,000
Revenue	77,000	115,500	115,500	107,800	100,100	92,400	84,700	84,700	84,700	84,700	947,100
Net operating impact	66,760	104,163	102,921	95,221	87,521	79,821	71,976	71,976	71,976	71,976	824,309
Gross capital impact	3,000										3,000
Net capital impact	3,000										3,000
FTE	109	109	109	109	109	109	109	109	109	109	1,090

\$000	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	Total
Debt - Option 3											
Gross operating impact	8,245	11,370	12,370	12,370	12,370	12,370	12,970	12,970	12,970	12,970	120,975
Overheads (24.2%)	1,995	2,752	2,994	2,994	2,994	2,994	3,139	3,139	3,139	3,139	29,276
Outsourcing/Accommodation		1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	9,000
Depreciation		600	600	600	600	600					3,000
Total cost inc overheads	10,240	15,722	16,964	16,964	16,964	16,964	17,109	17,109	17,109	17,109	162,251
Cash collection	100,000	200,000	200,000	190,000	180,000	170,000	160,000	160,000	160,000	160,000	1,680,000
Revenue	77,000	154,000	154,000	146,300	138,600	130,900	123,200	123,200	123,200	123,200	1,293,600
Net operating impact	66,760	138,278	137,036	129,336	121,636	113,936	106,091	106,091	106,091	106,091	1,131,349
Gross capital impact	3,000										3,000
Net capital impact	3,000										3,000
FTE	109	150	150	150	150	150	150	150	150	150	1,459

Property compliance

Background & approach

- This bid builds on the success of the property compliance initiatives implemented with funding received in 2007/08 of \$14.65m
- Using the OECD Compliance model, IR identified several key areas of risk, including property speculation and the misuse of Loss Acquiring Qualifying Companies (LAQC)
- The program will return more than \$68m in assessed revenue by June 2010 using an innovative campaign approach
- The compliance message was delivered through a number of mediums
- As a direct result of the model there was a significant shift in behaviour relating to LAQC activity, increases in voluntary disclosures and reductions in loss offsets

Outcomes & Benefits

- The shift in the property market since work began in 2007/08 has resulted in a change in speculator activity and behaviour
- [deleted – free and frank]
- Further campaign work will be undertaken with funding outlined below

Benefits of permanent extension of funding

- Permanent funding as an ongoing feature of this initiative is not being sought after the 2013/14 financial year as -
 - a detailed programme of compliance activities within the wider New Zealand community will have been completed and evaluated
 - key learnings will have been adopted and will inform our ongoing risk analysis and intervention approach
 - potential changes to existing rules/legislation will reduce the pool of those investors requiring compliance interventions
 - Proposed rate of return 7:1 - \$7 return for each \$1 invested

\$000	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	Total
Property											
Gross operating impact	6,644	6,644	6,644	6,644							26,576
Total cost inc overheads	6,644	6,644	6,644	6,644							26,576
Offsetting savings/revenue	45,000	45,000	45,000	45,000							180,000
Net operating impact	38,356	38,356	38,356	38,356							153,424
FTE	71	71	71	71							284

Addressing the hidden economy

Background & approach

- Undermines the integrity of our tax and social policy systems
- In times of economic difficulty, tax evasion and fraudulent activities increase in this area
- Receiving increased effort / emphasis by other tax authorities
- More innovative campaign compliance approach designed to influence social norms, increase community presence and provide more preventative assistance
- Proposed approach aligns to other tax authorities, best practice and lessons learnt from Property Compliance Project

Outcomes & Benefits

- Bring Inland Revenue in line with international practises by implementing industry benchmarking. Initial focus on the hospitality and services industries.
- Improved compliance behaviour and taxpayer understanding of expectations (e.g. cash returned and benchmarking)
- Increased voluntary disclosures
- Increased re-entry of individuals and businesses back into the system through voluntary disclosures
- Improved understanding of drivers of non-compliance

Benefits of permanent extension of funding

- Ongoing focus on those industries that are prevalent in the hidden economy
- Continued increase in community presence reinforcing positive compliance behaviours through detection and resolution of non-compliant taxpayers
- Increased re-entry of individuals and businesses into the “system” through a variety of campaigns and compliance interventions
- Wider Government benefits i.e. reduction of exposure to benefit fraud

Factors for consideration

- Additional resource investment would enable Inland Revenue to take a phased approach to focusing on a greater number of “at risk” industries within the hidden economy
- By taking a campaign approach in managing the most appropriate interventions for compliance risks within industry groups, Inland Revenue will be able deliver a return on investment whilst ensuring effective investment in these areas
- Proposed rate of return 5:1 - \$5 return for each \$1 invested

\$000	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	Total
Hidden economy - Option 1											
Gross operating impact	5,818	5,818	5,818	4,943							22,397
Total cost inc overheads	5,818	5,818	5,818	4,943							22,397
Offsetting savings/revenue	20,500	31,000	31,000	20,500	10,000						113,000
Net operating impact	14,682	25,182	25,182	15,557							80,603
FTE	59	57	57	52							225

\$000	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	Total
Hidden economy - Option 2											
Gross operating impact	5,818	5,818	5,818	5,818	5,818	5,818	5,818	5,818	5,818	5,818	58,180
Total cost inc overheads	5,818	5,818	5,818	5,818	5,818	5,818	5,818	5,818	5,818	5,818	58,180
Offsetting savings/revenue	20,500	31,000	31,000	31,000	31,000	31,000	31,000	31,000	31,000	31,000	299,500
Net operating impact	14,682	25,182	25,182	25,182	25,182	25,182	25,182	25,182	25,182	25,182	241,320
FTE	59	57	57	57	57	57	57	57	57	57	572

\$000	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	Total
Hidden economy - Option 3											
Gross operating impact	6,696	8,727	8,727	8,727	8,727	8,727	8,727	8,727	8,727	8,727	85,239
Total cost inc overheads	6,696	8,727	8,727	8,727	8,727	8,727	8,727	8,727	8,727	8,727	85,239
Offsetting savings/revenue	23,000	44,000	44,000	44,000	44,000	44,000	44,000	44,000	44,000	44,000	419,000
Net operating impact	16,304	35,273	35,273	35,273	35,273	35,273	35,273	35,273	35,273	35,273	333,761
FTE	66	86	86	86	86	86	86	86	86	86	840