The Treasury

Budget 2015 Information Release

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- [1] 6(a) - to prevent prejudice to the security or defence of New Zealand or the international relations of the government
- [2] 6(c) - to prevent prejudice to the maintenance of the law, including the prevention, investigation, and detection of offences, and the right to a fair trial
- [3] 6(e)(iv) - to damage seriously the economy of New Zealand by disclosing prematurely decisions to change or continue government economic or financial policies relating to the entering into of overseas trade agreements.
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- [12] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
- [13] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage
- [14] Not in scope

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Inland Revenue
Te Tari Taake

Briefing note

Reference:	BN2015/170
Date:	7 April 2015
To:	Gary White, Tax Policy Advisor to the Minister of Finance Maraina Hak, Tax Policy Advisor to the Minister of Revenue
cc:	Naomi Ferguson, Commissioner Inland Revenue
	[9] Executive Support Advisor, Commissioner
	Giles Southwell, Chief Financial Officer
	Matt Benge, Deputy Commissioner Policy and Strategy (Acting)
	Tony Morris, Investigations Manager, Investigation and Advice
From:	David Udy, Deputy Commissioner Service Delivery (Acting)
Subject:	**Extending investment in revenue-generating initiatives**

This briefing note presents options for extending investment in revenue-generating initiatives within Vote Revenue as requested by the Minister of Finance.

In Budget 2012, Inland Revenue received total funding of $98 million (over five years) for increased activity in the areas of aggressive tax planning, fraud, unfiled returns and collection of older debt. We have successfully returned more than what was expected in terms of additional revenue as well as cash. Continuation of this funding beyond 2016/17 will give additional annual revenue of $113 million for an annual cost of $20 million.

Through our investigative activity we are also seeing additional areas of risk where for on-going investment of $74 million for each five-year period we could return further revenue of $642 million.

1. New investment proposal - revenue investment opportunity in Investigations

We recommend extending investment in the three areas identified below. with [9] These reflect a combination of strong revenue-generation opportunities and investment in protecting and improving the integrity of the tax system and managing emerging risks. At the same time they position us to respond to OECD and cross-border compliance matters such as automatic exchange of information and base erosion and profit shifting.

Aggressive tax planning

We have identified where we can widen our activities and address emerging risks in the following areas:

- international issues, including transfer pricing
- associated specialised areas, such as the valuation of financial instruments
- significant enterprises group (which is corporates with an over $30 million turn-over)
- analytical capability to undertake risk assessments
- high-income individuals, in particular new immigrants (not currently addressed in our high wealth individual programme and a world-wide emerging risk).

Property compliance

This risk area is growing, and one of the emerging risks we are seeing has been speculative activity in and around new subdivisions, particularly within the growing Auckland and Christchurch property markets.

Investment into this area would allow:

- more resource to be applied to this labour-intensive work in establishing intention of resale
- expansion of our analytical capability
- ability to provide further customer education

Addressing the hidden economy

The hidden economy[1] undermines the integrity of tax and social policy systems. Further investment in this area provides the opportunity to:

- address more fraudulent activity, especially organised attacks on the tax administration and its systems
- scale up work looking at a greater number of "at risk" industries within the hidden economy (to date we have mainly concentrated efforts around the hospitality and construction industry groups)

Revenue assurance – leading into transformation

The Investigations group has recently adopted the operations management planning framework, and we plan to realise the benefits over the next few years, whilst achieving the same targets in regards to discrepancies identified. As set out in our four-year plan these benefits are targeted to offset cost pressures within our baseline, such as remuneration, and therefore cannot be reinvested into investigations activity.

[9]

Further investment now will provide the opportunity to retain existing capability, as any increase in staff would be limited to the replacement of those who leave the organisation. This would enable additional revenue generation to start to happen from the 2015/16 year.

[9]

The type of people who we expect to be recruiting for this investment will be involved in the complex part of investigations. Part of the pre-positioning is to ensure that we have the capability now (as average time to fully develop the capability is three years) to ensure that performance is not eroded while we transform.

[1] The hidden economy is defined as individuals and businesses that operate outside the tax and social policy systems.

Return on investment

Extending funding, on an ongoing basis, into new investigative activity for an investment of $74 million over a five-year period would return further revenue of $642 million, a return on investment of $8.00.

Funding sought	2015/16 $0.000m	2016/17 $0.000m	2017/18 $0.000m	2018/19 $0.000m	2019/20 & out years $0.000m
Additional Revenue	$64.720	$144.417	$144.417	$144.417	$144.417
Operating costs	$7.440	$16.602	$16.602	$16.602	$16.602
Impairment cost	$5.199	$11.601	$11.601	$11.601	$11.601
ROI (Net Revenue* / Operating costs)	**$8.0**	**$8.0**	**$8.0**	**$8.0**	**$8.0**
ROI (Revenue / Operating costs)	**$8.7**	**$8.7**	**$8.7**	**$8.7**	**$8.7**

* Net Revenue equals Additional Revenue less Impairment Cost

2. Proposal to baseline Budget 2012 revenue investment funding

From Budget 2012 funding, Inland Revenue proposed a return of $475 million in revenue and $188 million in cash (over 5 years), for increased activity in targeted compliance areas. The last year of this funding is 2016/17. We propose permanently including this funding within the Vote Revenue baseline. Targeted compliance areas are as follows:

- *Aggressive tax planning* – The cumulative assessed revenue of this initiative is $620 million to 30 June 2014, with the 2013-14 ROI of $62.43 ($11.60 target) for every dollar spent. A number of large-value complex financing cases were completed in 2013-14 as a result of flow-through of the Budget 2009 funding.

- *Fraud (hidden economy)* – The cumulative assessed revenue of this initiative is $15 million to 30 June 2014, with the 2013-14 ROI of $3.74 (target $3.10) for every dollar spent.

- *Unfiled returns* – The cumulative assessed value of the unfiled returns initiative is $152 million to 30 June 2014, with an ROI of $19.64 ($2.90 target) for every dollar spent in 2013/14

- *Debt collection of older debt* – The cumulative cash collected for the debt initiative is $147 million to 30 June 2014 with an ROI of $11.45 ($5.50 target) for every dollar spent in 2013/14.

With continuation of Budget 2012 funding, there are still sufficient risk areas which will enable us to return this level of revenue on an ongoing basis.

Base lining the Budget 2012 revenue investment funding for Vote Revenue would cost $60 million over three years, with additional revenue of $339 million over three years, a return on investment of $6.20.

Description	2015/16 $0.000m	2016/17 $0.000m	2017/18 $0.000m	2018/19 $0.000m	2019/20 & out years $0.000m
Additional revenue			$113.147	$113.147	$113.147
Additional cash			$37.500	$37.500	$37.500
Operating cost			$19.984	$19.984	$19.984
Impairment cost / (saving)			-$6.525	-$6.525	-$6.525

Revenue Generating Initiatives (ATP, Unfiled Returns, HE)

Additional revenue			$113.147	$113.147	$113.147
Operating cost			$14.468	$14.468	$14.468
Impairment cost			$23.599	$23.599	$23.599
ROI Revenue (Net Revenue*/Opex)			$6.2	$6.2	$6.2
ROI Revenue (Revenue/Opex)			$7.8	$7.8	$7.8

* Net Revenue equals Additional Revenue less Impairment Cost

Cash Generating Initiatives (Debt)

Additional revenue			$0.000	$0.000	$0.000
Additional cash			$37.500	$37.500	$37.500
Operating cost			$5.516	$5.516	$5.516
Impairment cost / (saving)			-$30.124	-$30.124	-$30.124
Cash ROI (Negative impairment/Opex)			$5.5	$5.5	$5.5
Cash ROI (Cash collected/Opex)			$6.8	$6.8	$6.8

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