

# 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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- [6a] 9(2)(ba)(ii) - to protect information, where the making available of the information would be likely otherwise to damage the public interest
- [7] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand
- [8] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
- [8a] 9(2)(f)(ii) - to maintain the current constitutional conventions protecting the collective and individual ministerial responsibility
- [9] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [10] 9(2)(h) - to maintain legal professional privilege
- [11] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice
- [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.

## **EXTENDING INVESTMENT IN INLAND REVENUE'S INVESTIGATION AND COLLECTION ACTIVITIES**

### **Proposal**

1. This paper proposes that funding be allocated to Inland Revenue in Budget 2015 in order to bolster investigation activities, thus generating additional revenue. It also proposes that funding allocated in Budget 2012 for investigation and collection activities be extended for a further three years.

### **Executive summary**

2. Inland Revenue received funding in Budget 2012 for increased activity in the areas of aggressive tax planning, fraud, unfiled returns and collection of older debt. This initiative has been successful, with returns being higher than expected.

3. The department forecasts that continuation of this funding beyond 2016/17 would give additional annual revenue of \$113 million for an annual cost of \$20 million.

4. Through its investigative activity, Inland Revenue has identified additional areas of risk relating to the hidden economy, aggressive tax planning and property compliance.

5. As well as helping the department to manage these emerging risks, funding of \$74 million allocated to this area in Budget 2015 would generate significant additional revenue, estimated at \$642.388 million over five years. The funding would also assist the department with protecting and improving the integrity of the tax system.

### **Background**

6. In order for Inland Revenue to achieve its outcomes of collecting revenue and distributing payments and entitlements, it is important that voluntary compliance levels continue to increase. Inland Revenue believes that it would be strategically beneficial for the Government to invest in initiatives that improve compliance, generate additional revenue and reduce the risk of revenue leakage.

7. Inland Revenue is constantly reviewing compliance risk areas, looking for opportunities to reduce non-compliance and applying international best practice where possible. Targeting deliberate non-compliance maintains public confidence in tax administration and protects the integrity of the tax system.

8. Inland Revenue continues to achieve efficiencies in its management of collection and investigation activities. As set out in the department's four-year plan, these benefits are

targeted to offset cost pressures within the baseline, such as remuneration, and therefore cannot be reinvested into these activities.

9. In 2009, a successful three year Budget Bid (“Revenue Protection and Growth”) resulted in a dedicated focus by Inland Revenue on hybrid financial arrangements employed by large multinational enterprises, especially zero coupon optional convertible notes (“OCNs”) which had been used to fund New Zealand operations but also create interest deductions without associated economic costs.

10. The Budget 2009 investment allowed Inland Revenue to build capability to understand, detect and address complex financial arrangements in large multinational enterprises. This targeted focus showed that financial arrangements had become more complex, and more prevalent among medium-sized enterprises. Further funding in Budget 2012 helped Inland Revenue to continue this work on aggressive tax planning.

11. Budget 2010 provided further funding for work within the property compliance area. This was used to build on the success of property compliance initiatives implemented with funding received in 2007/08. Using the OECD Compliance model Inland Revenue identified several key areas of risk, including property speculation and the misuse of Loss Acquiring Qualifying Companies (LAQC). Inland Revenue had this funding base-lined in 2014 to allow work to continue in this area.

12. Budget 2012 also allocated money to Inland Revenue for addressing fraud within the hidden economy. Inland Revenue had identified that it had seen a ten-fold increase in the value of detected fraud since 2008 and a significant increase in the number of fraud cases detected. Funding has been used to develop analytics, early detection processes and identity fraud intelligence systems.

**Comment: Additional funding for investigative activity**

13. This paper seeks additional funding of \$74 million over five years for investigative activity. This investment is forecast to return revenue of \$642.388 million over five years, a return of \$8 for every \$1 spent. The following table provides further detail.

<b>Funding sought</b>	<b>2015/16 \$0.000m</b>	<b>2016/17 \$0.000m</b>	<b>2017/18 \$0.000m</b>	<b>2018/19 \$0.000m</b>	<b>2019/20 &amp; \$0.000m</b>
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

14. If the return on investment falls below 8:1, officials will report back to me seeking direction on whether the initiative should continue. Officials will also report back to me on the overall outcomes, effectiveness and value for money of extending this activity.

15. The funding would be applied to activities in the areas of aggressive tax planning, property compliance, and the hidden economy.

*Aggressive tax planning*

16. Through funding allocated in Budget 2012, Inland Revenue has achieved significant success in the area of aggressive tax planning. However, the department has identified emerging risks and opportunities for widening of activities in this area.

[9]

18. Additional funding allocated in Budget 2015 would be used for work in relation to:

- international issues, including transfer pricing
- associated specialised areas, such as the valuation of financial instruments
- significant enterprises (corporates with a turn-over of more than \$30 million)
- improving analytical capability for undertaking risk assessments
- high-income individuals, in particular new immigrants (a world-wide risk not currently addressed in the department's high-wealth individual programme).

*Property compliance*

19. This risk area continues to grow, with an emerging risk being speculative activity in around new subdivisions, particularly within the growing Auckland and Christchurch property markets. Investment into this area would allow:

- more resources for work in establishing intention of resale
- expansion of analytical capability
- further customer education.

*Hidden economy*

20. The term hidden economy refers to people and businesses that operate outside the tax and social policy systems, undermining the integrity of those systems. Investment in this area provides the opportunity to:

- address more fraudulent activity, especially organised attacks on the tax administration and its systems
- address activity in a range of "at risk" industries within the hidden economy.

21. To date, work has focused on the construction and hospitality industries. Inland Revenue considers that there are a number of further areas that require attention.

**Comment: "Extending" Budget 2012 funding for three years**

22. Extending the Budget 2012 revenue investment funding for Vote Revenue would cost \$59.952 million over three years, with additional revenue of \$339.441 million over three years, a return on investment of \$6.20 for the revenue-generating component and \$5.50 for the cash-generating component.

Description	2015/16 \$0.000m	2016/17 \$0.000m	2017/18 \$0.000m	2018/19 \$0.000m	2019/20 \$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

*Aggressive tax planning*

23. Funding allocated in Budget 2012 for addressing aggressive tax planning was applied to continue work commenced from Budget 2009 on ensuring that large and medium-sized enterprises do not enter into inappropriate financial arrangements that lower their taxable income.

24. Inland Revenue has been very successful to date, with cumulative assessed revenue of \$620 million and a return on investment of \$62.43:1 as at 30 June 2014. (Note that a number of large-value complex financing cases were completed in 2013/14 as the flow-through of the Budget 2009 funding, so a slightly lower return is expected for future years.)

25. Extending Budget 2012 funding for three years, in addition to the additional funding through Budget 2015 discussed above, will enable Inland Revenue to continue and expand this work.

#### *Fraud*

26. Funding allocated in Budget 2012 for addressing fraud within the hidden economy was applied to work on high-volume/low-value claim [9] \_\_\_\_\_ The cumulative assessed revenue of this initiative is \$15 million, with a return on investment of \$3.74:1.

27. Extending Budget 2012 funding for three years to continue to address fraudulent activity links into wider Government initiatives, such as efforts to target organised crime.

#### *Unfiled returns and overdue debt*

28. On-time filing and paying is fundamental to a successful tax system based on voluntary compliance. Inland Revenue aims to engage as soon as possible with taxpayers who do not meet their filing and paying obligations on time.

29. Funding allocated in Budget 2012 for addressing unfiled returns was applied particularly to reducing the overall number of unfiled returns with a high assessment value or of importance to the effectiveness of the tax system, such as employer monthly schedules. Attempting to collect the return in the early stages is more successful in being able to collect resulting debt.

30. This initiative has been very successful, with a cumulative assessed value of \$152 million and a return on investment of \$19.64:1 at 30 June 2014.

31. Budget 2012 funding also provided the opportunity to collect debt that had been accumulating over recent years, especially through the global financial crisis. This was in line with international trends to address challenges governments were having with increasing debts. Focus is on those cases which generate a reasonable return on investment.

32. The cumulative cash collected for the debt initiative is \$147 million, with a return on investment of \$11.45:1 at 30 June 2014.

33. Extending funding for three years would enable a continuation of the revenue returns and cash collection results, as well as continuing to influence the long-term compliance behaviour of those who receive regular contacts from Inland Revenue to induce filing or payment. It would strongly support Inland Revenue's debt strategy vision of a smaller and less impaired debt book.

34. Without a continuation of Budget 2012 funding, Inland Revenue [9]

\_\_\_\_\_ Available resource must be spread across other collections areas, including child support and student loans.

### Financial implications

35. The following changes to appropriations would give effect to the initiative to fund investigations activity, proposed for inclusion in Budget 2015.

Vote Revenue Minister of Revenue	\$ million – increase / (decrease)				
	2015/16	2016/17	2017/18	2018/19	2019/20
Departmental Output Expenses: Investigations (funded by Revenue Crown)	7.440	16.602	16.602	16.602	16.602
Non Departmental Other Expenses: Impairment of Debt and Debt Write-offs	5.199	11.601	11.601	11.601	11.601
Total Operating	12.639	28.203	28.203	28.203	28.203

36. The forecast increase in tax revenue would be as follows:

Vote Revenue Minister of Revenue	\$ million – increase / (decrease)				
	2015/16	2016/17	2017/18	2018/19	2019/20
Tax Revenue	64.720	144.417	144.417	144.417	144.417

37. The following changes to appropriations would give effect to the initiative to extend the Budget 2012 revenue investment funding for three years:

Vote Revenue Minister of Revenue	\$ million - increase / (decrease)				
	2015/16	2016/17	2017/18	2018/19	2019/20
Departmental Output Expenses: Investigations (funded by Revenue Crown)	-	-	9.584	9.584	9.584
Management of Debt and Outstanding Returns (funded by Revenue Crown)	-	-	10.400	10.400	10.400
Non Departmental Other Expenses: Impairment of Debt and Debt Write-offs	-	-	(6.525)	(6.525)	(6.525)
Total Operating	-	-	13.459	13.459	13.459

38. The forecast increase in tax revenue and cash collected would be as follows:

	\$ million – increase / (decrease)				
	2015/16	2016/17	2017/18	2018/19	2019/20
Vote Revenue Minister of Revenue					
Tax Revenue	-	-	113.147	113.147	113.147
Cash Collected	-	-	37.500	37.500	37.500

### Consultation

39. The Treasury has been consulted and does not support the proposals in this paper.

[8]

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41. However, Treasury agrees that time-limited funding is preferable to base-lining of further investigation funding, as this allows for better evaluation of the extent to which funding should be extended, including consideration of both diminishing returns and the impact that Inland Revenue's Business Transformation will have on investigations.

### Human rights

42. The proposed initiative is not inconsistent with the Human Rights Act 1993 and the Bill of Rights Act 1990.

### Legislative implications

43. There are no legislative implications as a result of the proposals as provided in this paper.

### Regulatory impact analysis

44. A Regulatory Impact Statement has not been prepared due to the operational nature of the proposals in this report.



## Recommendations

46. I recommend that Cabinet

1. **Agree** to incorporate an initiative in Budget 2015 for Revenue investment for Vote Revenue, specifically covering areas of aggressive tax planning, property compliance and addressing the hidden economy.
2. **Note** that a Revenue investment in Inland Revenue would cost \$73.848 million over five years, with additional tax revenue of \$642.388 million over five years and impairment of \$51.603 million, a net return on investment of \$8.00.
3. **Approve** the following changes to appropriations to give effect to the initiative in recommendation 1 above, with a corresponding impact on the operating balance:

Vote Revenue Minister of Revenue	\$ million – increase / (decrease)				
	2015/16	2016/17	2017/18	2018/19	2019/20
Departmental Output Expenses: Investigations (funded by Revenue Crown)	7.440	16.602	16.602	16.602	16.602
Non Departmental Other Expenses: Impairment of Debt and Debt Write-offs	5.199	11.601	11.601	11.601	11.601
<b>Total Operating</b>	<b>12.639</b>	<b>28.203</b>	<b>28.203</b>	<b>28.203</b>	<b>28.203</b>

4. **Note** that as a result of the initiative in recommendation 1 above, there is a forecast increase in tax revenue, as set out in the following table:

Vote Revenue Minister of Revenue	\$ million – increase / (decrease)				
	2015/16	2016/17	2017/18	2018/19	2019/20
Tax Revenue	64.720	144.417	144.417	144.417	144.417

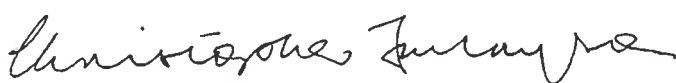
5. **Agree** to incorporate an initiative in Budget 2015 for extending the Budget 2012 revenue investment funding for Vote Revenue for three years.
6. **Note** that extending the Budget 2012 revenue investment funding for Vote Revenue would cost \$59.952 million over three years, with additional tax revenue of \$339.441 million over three years and a reduction in impairment of \$19.575 million over three years, a return on investment of \$6.20 for the revenue-generating component and \$5.5 for the cash-generating component.
7. **Approve** the following changes to appropriations to give effect to the initiative in recommendation 5 above, with a corresponding impact on the operating balance:

Vote Revenue Minister of Revenue	\$ million - increase / (decrease)				
	2015/16	2016/17	2017/18	2018/19	2019/20
Departmental Output Expenses:					
Investigations (funded by Revenue Crown)	-	-	9.584	9.584	9.584
Management of Debt and Outstanding Returns (funded by Revenue Crown)	-	-	10.400	10.400	10.400
Non Departmental Other Expenses:					
Impairment of Debt and Debt Write-offs	-	-	(6.525)	(6.525)	(6.525)
Total Operating	-	-	13.459	13.459	13.459

8. Note that as a result of the initiative in recommendation 5 above, there is a forecast increase in tax revenue and cash collected, as set out in the following table:

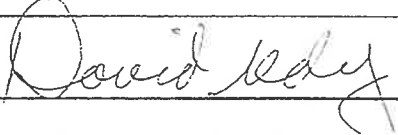
Vote Revenue Minister of Revenue	\$ million - increase / (decrease)				
	2015/16	2016/17	2017/18	2018/19	2019/20
Tax Revenue	-	-	113.147	113.147	113.147
Cash Collected	-	-	37.500	37.500	37.500

9. Agree the proposed changes to appropriations in recommendations 3 and 5 above be included in the 2014/15 Supplementary Estimates and that, in the interim, the increases be met from Imprest Supply.

*for*   
**Hon Todd McClay**  
 Minister of Revenue

16 14 2015  
 Date

## Consultation on Cabinet and Cabinet Committee Submissions

<p>Certification by Department:</p> <p>Guidance on consultation requirements for Cabinet/Cabinet committee papers is provided in the CabGuide (see Procedures: Consultation): <a href="http://www.cabguide.cabinetoffice.govt.nz/procedures/consultation">http://www.cabguide.cabinetoffice.govt.nz/procedures/consultation</a></p>	
<p><b>Departments/agencies consulted:</b> The attached submission has implications for the following departments/agencies whose views have been sought and are accurately reflected in the submission:</p> <p>The Treasury</p>	
<p><b>Departments/agencies informed:</b> In addition to those listed above, the following departments/agencies have an interest in the submission and have been informed:</p> <p>N/A</p>	
<p><b>Others consulted:</b> Other interested groups have been consulted as follows:</p> <p>N/A</p>	
<p>Name, Title, Department: David Udy, Deputy Commissioner, Inland Revenue (Acting)</p>	
Date:	15/04/2015
Signature	

<p>Certification by Minister:</p> <p>Ministers should be prepared to update and amplify the advice below when the submission is discussed at Cabinet/Cabinet committee.</p>	
<p><b>The attached proposal:</b></p>	
<p>Consultation at Ministerial level</p>	<p><input checked="" type="checkbox"/> has been consulted with the Minister of Finance [required for all submissions seeking new funding]</p> <p><input type="checkbox"/> has been consulted with the following portfolio Ministers:</p> <p><input type="checkbox"/> did not need consultation with other Ministers</p>
<p>Discussion with National caucus</p>	<p><input type="checkbox"/> has been or <input type="checkbox"/> will be discussed with the government caucus</p> <p><input checked="" type="checkbox"/> does not need discussion with the government caucus</p>
<p>Discussion with other parties</p>	<p><input type="checkbox"/> has been discussed with the following other parties represented in Parliament:</p> <p><input type="checkbox"/> Act Party      <input type="checkbox"/> Maori Party      <input type="checkbox"/> United Future Party</p> <p><input type="checkbox"/> Other [specify]</p> <p><input type="checkbox"/> will be discussed with the following other parties represented in Parliament:</p> <p><input type="checkbox"/> Act Party      <input type="checkbox"/> Maori Party      <input type="checkbox"/> United Future Party</p> <p><input type="checkbox"/> Other [specify]</p> <p><input checked="" type="checkbox"/> does not need discussion with other parties represented in Parliament</p>
Portfolio	Revenue
Date	16, 4, 2015
Signature	