

Organisational Review of the Inland Revenue Department

**Report to the Minister of Revenue
(and on tax policy, also to the Minister of Finance)
from the Organisational Review Committee**

April 1994

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Statement by the Minister of Finance and the Minister of Revenue

Last year the Government asked a Review Committee chaired by the Rt. Hon. Sir Ivor Richardson to carry out a fundamental, strategic review of the Inland Revenue Department and its activities.

The Review Committee was to 'investigate and recommend the optimal organisation arrangements for the tax assessment and collection system, and other activities that are currently part of the tax system, the provision of taxation policy advice, legislative management and Ministerial servicing'. That review has now been completed.

The Inland Revenue Department is an important agency of the State. It collects more than 80% of total Government revenue as well as administering social policy programmes as diverse as the Student Loans and Child Support schemes. Every citizen has a vital interest in New Zealand having an effective and efficient Inland Revenue Department which administers the law properly and at least cost to taxpayers who are required to comply with that law.

The review has concluded that although the Inland Revenue Department has made significant improvements to tax administration in recent years some important issues need attention. Detailed recommendations for change are set out in Part 1 of the Report.

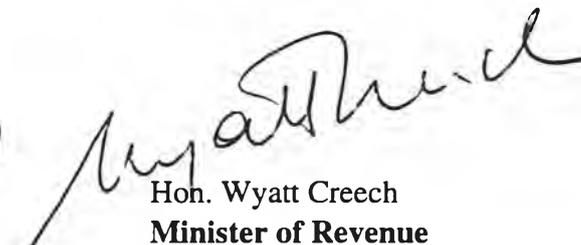
One of those recommendations, aimed at improving the process by which taxation policy is developed, has already been implemented by the Government in the form of a new Generic Tax Policy Process which provides a clear strategic focus for tax policy and a more structured way of consultation with taxpayers affected by proposed changes.

The other recommendations require detailed planning and design before they can be introduced. They must be introduced smoothly and with minimum disruption to the services provided to the public by Inland Revenue. The Government has authorised the Inland Revenue Department to proceed with that detailed planning with the aim of having all the changes in place by October 1995. Legislation will be introduced as necessary to support those changes.

The Government welcomes the Review Committee's Report. Not only does it provide a blueprint for taking Inland Revenue confidently into the next century but it will ensure that New Zealand maintains its position as a world leader in public administration.



Rt. Hon. Bill Birch
Minister of Finance



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Report on the Organisational Review of the Inland Revenue Department

Dear Ministers

We have pleasure in submitting our Report on the organisation of IRD. The Report deals with the terms of reference that you requested us to examine, and presents recommendations on the issues we identified during the Review.

We have consulted extensively with many people from government departments and the private sector in New Zealand, and several overseas tax administrations. We are grateful for all the valuable information we have received, in particular for the help received from the Advisory Committee, from many people in the Inland Revenue Department, and from Treasury and the State Services Commission who seconded staff to our Project Team. We are particularly indebted to Liz Sinclair and the other members of the Project Team.

We have tested the recommendations in the Report with IRD, with other departments that would be most affected by our recommendations and, to a limited extent, with the private sector through the Advisory Committee.

The Report is strategic in nature and the first of three phases of the full Organisational Review. We have developed our recommendations only to a level of detail that demonstrates the recommendations are practical and represent the best solution, and would enable the next two phases, detailed planning and implementation, to reflect our intentions.

The Report concludes that IRD has made significant improvements to tax administration in recent years. But some important issues need attention.

We have proposed a clarification of the roles of the Commissioner and the Chief Executive of IRD and some structural changes that build on IRD's current approaches.

We believe that New Zealand's tax administration in the 1990s should be based on three strategic directions that underpin our recommendations:

- 'customer' services that focus on voluntary compliance in order to maximise revenue;
- technical and communication skills that provide the best advice on all tax matters; and
- efficient automated processes that handle the bulk of returns and information.

With the adoption of these recommendations the New Zealand tax administration can move confidently into the future.

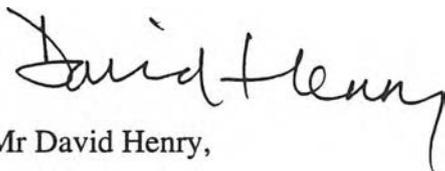
Yours sincerely



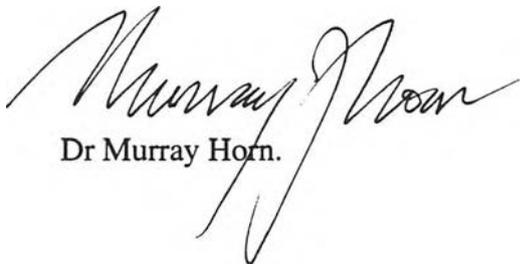
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Part I:
Summary and
Recommendations

1 Summary

1.1 Introduction

Following the recommendations of the Valabh Working Party (July 1993), the Minister of Revenue appointed a Review Committee to

investigate and recommend the optimal organisation arrangements for the tax assessment and collection system, and other activities that are currently part of the tax system, the provision of taxation policy advice, legislative management and Ministerial servicing.

This Organisational Review is the first of three phases: strategic, detailed planning and implementation. The Minister of Revenue also appointed an Advisory Committee to assist the Review Committee, and to be responsible for the second and third phases.

The Review Committee wishes to record its thanks for the assistance received from numerous people in government departments and from the private sector in New Zealand, and from several overseas tax administrations.

1.2 Background to tax administration in 1994

Since land tax was introduced in New Zealand in 1878, the number and complexity of taxes have grown at an accelerating pace. The nature of tax administration has changed over recent years: in particular, the expansion of the narrow tax base to a broader base, the mechanisation of tax assessments that used to be done manually by IRD staff and the introduction of self-assessment. But the guiding principles of the tax Acts date back to the 1916 legislation and have never been recast to meet current conditions.

IRD now administers nine Acts. The Department carries out several social policy functions in addition to administering tax, operates one of the most advanced computer tax information systems in the world, and employs some 5200 permanent staff in 35 offices. IRD collects some \$21 billion net revenue each year, and has an annual budget of \$379 million.

1.3 A vision for tax administration

The Review Committee developed a vision for tax administration in New Zealand. The main elements of this vision, which is similar to the statement in IRD's 1993-1994 Corporate Plan, 'The IRD in 1997', are:

- IRD is collecting the highest net revenue over time that is practicable within the law;
- voluntary compliance is regarded as the norm, and non-compliance is regarded as socially unacceptable;
- taxpayers respect the tax administration, and believe it is fair, helpful and efficient;
- taxpayers believe that if they disagree with any decision, the dispute will be handled fairly and quickly;

- the costs of compliance with the law are reduced to the lowest level consistent with IRD's overall objective and the mix of taxes and other revenues chosen by the Government; and
- tax administration is based on legislation that is well understood by taxpayers, and is presented in the simplest manner possible.

1.4 Key issues

As a result of its consultation, with the Government, the public and private sectors and with the wider taxpaying community, the Review Committee has noted several key issues which are now summarised:

- IRD's objective needs to be stated in more specific terms and more strategic performance measures are required to enable the Government and IRD to assess IRD's strategic level achievements;
- the costs of compliance, whilst comparing favourably with overseas jurisdictions, have an adverse effect on the fundamental strategy of voluntary compliance;
- a more structured approach to tax policy formation is needed;
- the drafting of tax legislation requires fundamental change;
- an updating and clarifying of the roles of the Commissioner and Chief Executive of IRD and of the relationship with Ministers is required;
- the resolution of tax disputes needs to be quicker and less cumbersome;
- IRD's role in the delivery of social policy functions needs to be carefully specified, given the impacts on the core business of collecting tax;
- although IRD has made major changes in its operations over the last five years, there is scope for further improvement, such as increasing some 'technical' skills, more consistent interpretation of tax legislation, and more focus on specific groups of taxpayers.

1.5 A new objective for tax administration

Tax administration should have an objective that specifies what Government wishes to achieve, and enables Government and the tax administration to assess how well the objective has been achieved. In particular, the objective should make allowance for tax administration having to operate within a complex tax system that aims for the optimum balance of several partly conflicting factors such as tax efficiency, compliance and administration costs.

In meeting accountabilities to the Minister, the primary objective for IRD should be:

The Inland Revenue Department will collect over time the highest net revenue that is practicable within the law having regard to the resources available to IRD, the importance of promoting compliance, especially voluntary compliance, by all taxpayers with Inland Revenue Acts, and the compliance costs incurred by taxpayers.

Additional objectives are proposed for the tax administration's policy development, social policy and information supply functions.

A tax administration 'health' report should be prepared to assist Government and IRD management assess how well the objective is being achieved. IRD should develop and maintain a set of macro indicators for the purpose of assisting Government and IRD in making strategic decisions for tax matters.

1.6 The roles of Commissioner and Chief Executive of IRD

The legislative framework for tax administration today is still based on the thinking and methods used in the 1920s. But major changes in the last 70 years, such as the shift to self-assessment and the increasing use of technology, are not reflected in the current legislation. The roles of the Commissioner and the Chief Executive of IRD now operate within the framework of the State Sector, Public Finance and Inland Revenue Acts. Tax collecting has particular features with implications for the two roles:

- the Minister of Revenue is ultimately responsible to Parliament for the tax administration;
- the tax administrator has a statutory duty to quantify tax liability;
- but the resources available to the tax administrator are limited;
- the principle of voluntary compliance is central to tax collecting in New Zealand;
- modern technology enables the bulk of assessments to be processed using computers;
- tax enforcement aims to ensure compliance, exercising independent judgement in the quantification of taxpayers' obligations; and
- the tax administrator has responsibilities to Parliament, to Government/the Minister of Revenue, and to taxpayers.

These features have implications for this Review, in particular the relationships between the tax administrator, the Minister and taxpayers, and the significance of the adjudication responsibility.

A major judgmental element is involved in assessing the final quantification of taxpayers' liability, and this element has a crucial relationship to perceptions of the integrity of the tax system. Where judgement or adjudication relates to a proposed adjustment to the self-assessed liability, or where a specific or general binding ruling is required, the functions should be carried out by a separate unit within the tax administration. The Review Committee recommends that adjudication be given appropriate legislative recognition.

The three Acts that provide the legal framework for the tax administrator, also present some potential conflicts regarding the privacy of taxpayer information, management within limited resources, and the scope for Ministerial direction to the tax administrator.

The constitutional basis on which taxes are collected and the fundamental strategy of voluntary compliance require that the integrity of the tax system be protected. That means that the treatment of individual taxpayers is free from political influence,

information regarding their affairs is kept confidential, and taxpayers are treated impartially. To protect the integrity of the tax system, the Minister, the Commissioner and taxpayers should all be assured that there is a 'no go' area where the Commissioner exercises a wholly independent judgement. The Review Committee recommends specific criteria for defining the 'no go' area and machinery for resolving any disagreement between the Minister and Commissioner regarding their application.

Section 4 of the Inland Revenue Department Act 1974 should be amended to recognise the practicalities of operating within limited resources. A periodic audit should be carried out to check that management of limited resources is best directed to the achievement of the overall objective for the tax administration.

1.7 Tax disputes resolution

Most taxpayers' queries to IRD are resolved quickly. But taxpayers and IRD may not agree on the facts or interpretation of the law. Current procedures and practices for resolving disputes are not satisfactory, particularly for taxpayers. Yet it is vital that taxpayers believe any dispute will be handled fairly and quickly. Otherwise they may not be willing compliers in the future. Recommendations to improve disputes resolution are:

- a revised tax disputes resolution process should be introduced. At the pre-assessment phase a revised approach is designed to ensure that, so far as possible, assessments will be correct. This will be supported by the availability of information, evidence exclusion provisions and early application of appropriate expertise. Post-assessment, the recommended approach provides for more effective taxpayer initiated litigation, subject to standard judicial procedures and timetabling; and
- a simple, 'fast track', non-precedential procedure for dealing with small claims should be introduced as part of the jurisdiction of the Taxation Review Authority.

A comprehensive review of the present arrangements for resolving tax disputes through the High Court and the Taxation Review Authority would require considerable time. Although there is evidence of problems that contribute to overall delays at this stage of the process, the proposed new process should address most of the current concerns. A period of time should be allowed to assess the impact of these changes. Accordingly, it is recommended that a review of the operation of the new procedures for disputes resolution should be carried out two years after all elements of the new procedures are in place.

1.8 Costs of compliance

Compliance costs include direct, opportunity and 'psychic' or anxiety costs, and fall mainly on businesses. They can have serious effects on the economy, including discouraging the start-up and expansion of business. If compliance costs are too high or uneven, they lead to resentment and endanger voluntary compliance. Yet voluntary compliance systems tend to increase compliance costs. Overall, New Zealand's compliance costs are similar to the costs of other countries. The key is to achieve a balance that best meets the overall objective of the tax administration.

The proposed objective for IRD includes taking account of compliance costs. The Generic Tax Policy Process (GTPP) described below requires consideration of compliance costs at each stage of the process of developing and implementing tax legislation. That should go a long way to providing a proper focus on those costs and impacts.

The Review Committee notes that these compliance cost questions arise in other governmental areas.

1.9 Tax policy advice

The Review Committee was asked to report on tax policy advice at an early stage of the Review. This was done, and the principles and process described in this Report have been approved by Cabinet. The GTPP is currently being implemented.

The previous tax policy development process had several problems. The subject matter is complex, and tax legislation is very complex and difficult to understand. The tax policy process was not clear, neither were the accountabilities for each stage of the process. There was insufficient external consultation during the process.

With appropriate implementation, the GTPP should resolve or very substantially reduce the policy development problems. The process has five phases: strategic, tactical, operational, legislative, and implementation and review. The process features external consultation and feedback, appropriate cost-benefit analyses. It requires a specific focus in the tax administration's organisation structure. The process should be reviewed before the end of 1994 to determine if further improvements are needed.

The requirements of the GTPP should be reflected in the organisation structure of tax administration. Several options were considered, including a separate ministry of tax policy. However, it was concluded that tax policy advice would benefit most by utilising the comparative advantage that IRD has regarding the practical operation of tax collecting. This would require a close relationship with the tax administration. The Review Committee therefore recommends an IRD Tax Policy Development Unit reporting directly to the Chief Executive. This unit should have resources that enable it to at least match the best tax policy advice available from other areas such as the private sector and Treasury. It will also be responsible for Ministerial servicing activities, such as drafting correspondence.

1.10 Legislative drafting

The IRD Tax Policy Unit should also have a Legislative Drafting Section. This section should have overall responsibility for all tax legislation drafting, including the rewrite of the Inland Revenue Acts. The section should develop a new drafting style that provides for clear statements of the intent of the legislation, uses clear and simple language, and does not attempt to cover every eventuality. Parliamentary Counsel Office should provide final quality assurance of draft legislation.

1.11 Social policy functions

IRD currently carries out several social policy functions: collection of National Superannuitant Surcharge, ACC levies, Family Support for non-beneficiaries, assessment and debt collection for Student Loans and administration of the Child

Support scheme. IRD is responsible for some aspects of policy as well as delivery, and it also supplies income data to the Department of Social Welfare and the Accident Compensation Corporation to help combat abuse.

The Review has considered whether these functions are appropriate for a tax administration, and whether there are better ways to carry out parts of the functions. Two principles are recommended:

- IRD's core business is the assessment and collection of tax revenue; and
- any non-core functions that IRD is required to administer through its collection system and income related data base should be undertaken through a contract with the responsible agency.

Carrying out some social policy functions can be detrimental to core tax functions: for instance, by reducing focus on core tax activities. But it is difficult to determine whether some social policy functions are or are not core tax activities, or how well they fit with core tax.

The Review Committee has concluded that the current administrative arrangements for National Superannuitant Surcharge, Family Support and ACC levies need not change, and that IRD's current structural arrangements that treat Child Support as a separate customer segment should continue in the interim. But the longer term arrangements for Child Support should be considered in the context of the current Trapski Review of the scheme.

If IRD is to continue to undertake assessment and debt collection under the Student Loans scheme, then an explicit funding and service agreement should be agreed between the Ministry of Education and IRD.

1.12 Design criteria to underpin the tax administration's organisation structure

The structure of the tax administration should be based on clear criteria that will ensure it is capable of meeting its objective, and of carrying out its functions in the most efficient and effective manner. Analysis of current issues, and the future needs of tax administration, indicate eight criteria are critical. The tax administration should:

- concentrate on the core business of assessing and collecting tax revenue;
- take advantage of the level of automation already achieved and the common information data base;
- improve customer focus, particularly through vertical integration of design and delivery;
- impartially apply the law and protect the integrity of the tax system by separating the adjudicative function within the structure;
- improve consistency and quality of technical activities by ensuring a sharper focus on this aspect;
- structurally differentiate between the three strategic functions performed by IRD, namely policy, adjudication and operations;

- determine the optimal delivery mechanisms by an assessment of where the work needs to be done; and
- ensure the recruitment, development and retention of quality people.

1.13 Options for the organisational structure

The principles and directions, together with other recommendations above, determine several key aspects of the tax administration's organisational structure. Some additional aspects require further assessment.

Consideration was given to having one or more of the three strategic functions operate as Crown Entities. This could encourage a more 'arms length' relationship, both between the functions, and with the Government. The Review Committee concluded however that the need for Government to have, and to be seen to have, direct control of tax collection dictated against the Crown Entity form. In addition, there needs to be close relationships between the three strategic functions. The Review Committee concluded that the tax administration should be a single organisation, constituted in the form of a government department.

The strategic focus of taxpayer operations could be based on revenue type, operational function or customer group. The current structure is based primarily on functions. A revenue basis was assessed, but found wanting because it would require multiple contacts for many business taxpayers and involve duplication of activities. It was concluded that a structure based primarily on customer focus would not incur additional costs but, critically, would enable the best practicable services to be provided to meet identified needs of each customer segment.

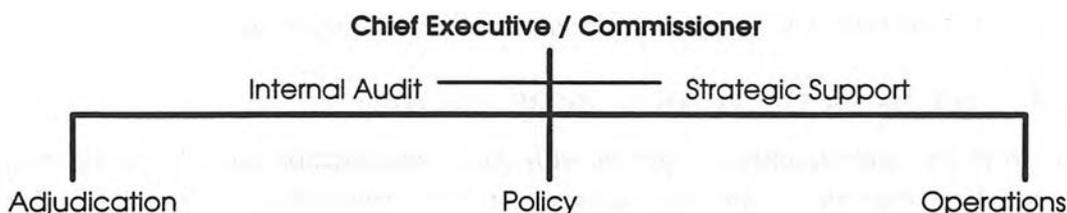
1.14 The organisational structure recommended for tax administration

The recommended structure is summarised in the following diagrams. The key features of the components reporting to the Chief Executive (CE) are:

- the three strategic business units: Policy, Adjudication and Operations;
- the CE has a minimum number of managers reporting directly, so concentration can be focused on new and changed activities, and critical strategic issues; and
- the strategic support functional areas will report to a strategic support manager. Given the nature of these functions, they are likely to have considerable direct involvement with the CE. The strategic functions will be: Information Technology (Strategic Planning), Human Resources, Finance, Communications, Corporate Planning, and Legal Services. The Contracts Management Advice and Internal Audit functions will report directly to the CE.

The functions of the Policy Unit and the Adjudication Unit were outlined previously (ref. paras. 1.9 and 1.6 respectively)

Three Strategic Business Units of IRD



The Operations business unit will carry out all design and delivery activities. Customer service delivery will be separated initially into three distinct groups: Child Support (CS), Corporates, and Individual and Business. Child Support functions will be similar to present, but will report directly to a CS business manager. Corporates will also report to a separate Corporates manager. Each customer segment will carry out its own service design functions.

The Review Committee would have liked to see one or more additional business units, possibly small and medium sized businesses. But there was insufficient information to be certain that the most appropriate groups/segments had been selected. The Review Committee reluctantly decided that further division of the large customer group of Individual and Business should await collection and analysis of additional information. The Review Committee expects that by the beginning of 1996, following research, the Individual and Business segment will have been broken down into smaller, more specific segments such as Small Business.

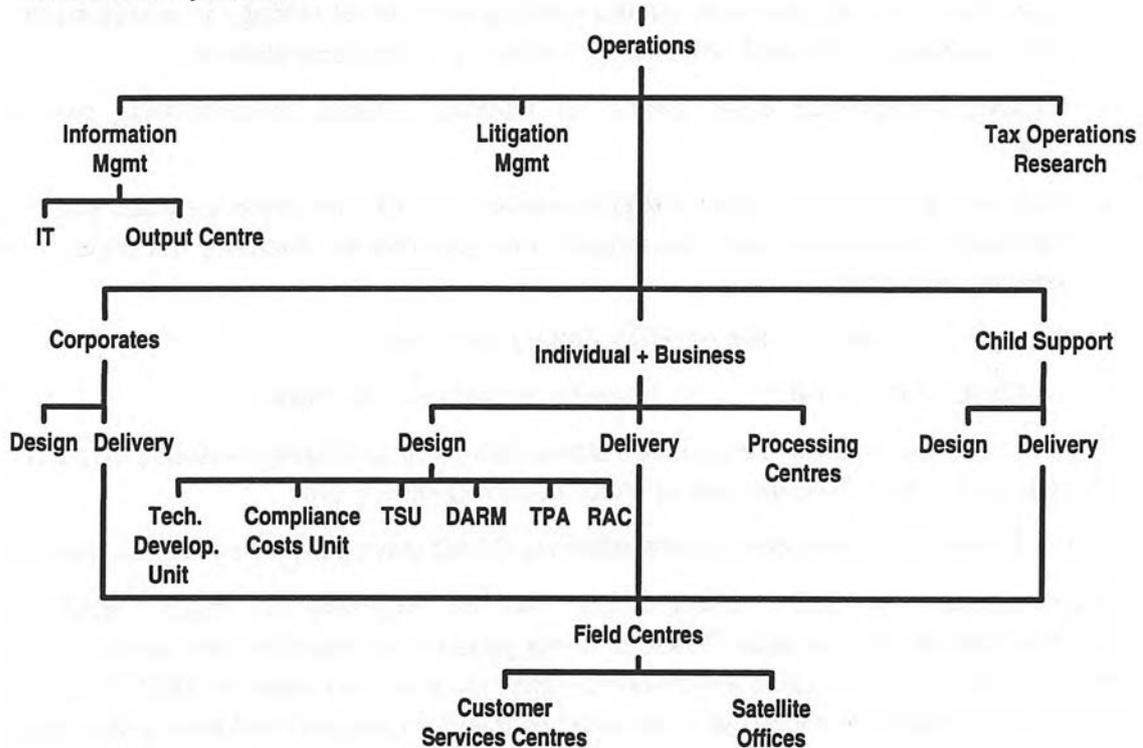
Field delivery will be carried out in a new arrangement of local offices. A small number of Field Centres will undertake all direct delivery functions, including specialist functions. About seven Field Centres are envisaged, but the details and exact numbers will be developed in phase 2 of the Review. Each Field Centre will have smaller Satellite Offices that focus on local service needs, in particular, functions that require face-to-face contact with taxpayers. Some Field Centres in metropolitan areas will also have small Customer Service Centres located for customer convenience to provide counter services.

Additional features of the Operations structure include:

- Information Management which will develop and manage information technology systems, and manage the Output Centre which undertakes mass individual mailings. The section will have a close relationship with the strategic IT support function;
- Litigation Management will manage all litigation, mostly that arising as a result of taxpayer disputes. Internal and external legal specialists will handle individual cases;
- a Tax Operations Research Unit will carry out research to determine the needs and behaviour of taxpayer groups, and contribute to the 'health' report;
- Processing Centres will be in the Individual and Business group to facilitate co-ordination of all processing activities. Regular reviews should check Processing Centres maintain the most appropriate technology and methods, and are located to best advantage;

- two temporary units will be part of the Individual and Business design function: a Compliance Costs Unit that will expedite the compliance costs strategy, and a Technical Development Unit that will expedite the improvement of technical skills in all delivery functions; and
- a seven-step programme is recommended to assess and test additional sub-contracting of some delivery functions.

Overall Tax Operations



1.15 Sub-contracting for delivery

No organisation in the public or private sector is self-sufficient. They decide what they can best do themselves, and what goods and services they will obtain from others. About 14 percent, or \$55 million of the \$395 million output cost of IRD in 1992-1993, was paid to third-party suppliers of goods and services. There are widely recognised good practices in sub-contracting, but the special nature of tax collection dictates some additional principles to ensure appropriate accountability to Parliament.

Functions such as general management, strategy development, management of policy development and high level adjudication should not be sub-contracted. There is scope for further sub-contracting of other functions, and a seven-step programme is recommended to analyse the practical issues, test additional sub-contracting, and review the results at regular intervals. A contracting specialist will advise managers and the CE on each step of the programme.

1.16 Benefits, costs and transitional arrangements for the recommended structure

The results of implementing the Review Committee's recommendations are expected to significantly enhance IRD's efficiency and effectiveness over time. In particular:

- the Government should, as a result of the GTPP and the associated structural changes, receive better tax policy advice;
- legislative drafting proposals should produce substantial savings in administration and compliance costs and enhance the voluntary compliance strategy;
- taxpayer compliance costs should be reduced without compromising revenue flows;
- proposed structural changes and enhancements to the tax system should promote voluntary compliance, and thus support the objective of obtaining the highest net revenue over time;
- through more effective use of IRD's limited resources;
- by a better focus on IRD's core business and strategic direction;
- over time, the Review Committee's structural recommendations will improve IRD's efficiency and reduce the cost of Vote: Inland Revenue; and
- the Review Committee's recommendations should have positive economic impacts.

Improvements in IRD's effectiveness can be expected to make significant contributions to tax revenue flows. It is not possible to quantify any revenue gains because too many variables are involved, many outside the control of IRD. However, even a very small enhancement in the level of revenue collected will have a significant fiscal impact. To give an indication of the orders of magnitude involved, if the New Zealand tax revenue gap is the same magnitude as that estimated for the US, a decrease in the tax revenue gap of 1 percent would yield about \$35 million of income tax revenue per annum.

With respect to the direct efficiency gains arising from the Review Committee's recommendations, conservative estimates of the savings and costs of implementing the recommended structure are: \$7 million savings to Vote: Inland Revenue each year after the transition, and \$28 million for the cash transitional costs. Phase 2 of the Review should develop detailed plans that will enable these costs and savings to Vote: Inland Revenue to be specified more accurately. The Review Committee believes that IRD management should be able to implement the new structure below the cash transitional cost figure outlined above.

The implementation process is anticipated to take some 18 months, concluding by 1 October 1995. The Report emphasises that the way the structure is developed and implemented will determine to a significant extent whether all the expected benefits are realised. Transitional recommendations are made.

2 Summary of recommendations

Objective of tax administration

1. In meeting accountabilities to the Minister, the primary objective for IRD should be -

The Inland Revenue Department will collect over time the highest net revenue that is practicable within the law having regard to:

- the resources available to the Inland Revenue Department;
- the importance of promoting compliance, especially voluntary compliance, by all taxpayers with Inland Revenue Acts; and
- the compliance costs incurred by taxpayers.

This primary objective should be incorporated into a revised section 4 of the Inland Revenue Department Act.

(ref. para. 8.2)

2. In addition the following objectives should be adopted for the policy function -

In accordance with the strategic and detailed policy as determined by Ministers, the Inland Revenue Department will:

- identify, develop and recommend specific tax policies that will raise tax revenue in the most economically efficient and equitable manner; and
- provide tax policy advice that meets the performance measures specified by Government.

(ref. para. 8.1)

3. The following objectives should be adopted for the social assistance and information supply functions -

The Inland Revenue Department will:

- administer social assistance regimes within the law, to agreed performance standards, at least cost; and
- supply within the law required information to other government agencies, to agreed performance standards, at least cost.

(ref. para. 8.3)

4. The Chief Executive of IRD should, as part of the Department's on-going strategic planning cycle, prepare a 'health report' for the Minister of Revenue. This will:

- provide Government with a clear picture of the full set of major issues confronting the tax administration in the achievement of its objective, including any 'pressure points', so that the Government has all of the information necessary in order to

make purchase and ownership decisions that are in the best long-run interests of the tax administration;

- integrate new and existing strategies;
- contain a description of the requirements to operationalise policy initiatives, so that the Government can make purchase decisions consistent with its wider strategies and the overall objective for the tax administration; and
- state how IRD is dealing with any problems developing in the operation of tax legislation reported through the generic tax policy process.

(ref. para. 8.4)

5. IRD should develop and maintain a set of macro information, or indicators, for the purpose of assisting Government and IRD management in making strategic decisions for tax matters and, in particular, as input for the 'health report'. The information may also be useful for high level performance measurement, but such use should be secondary.

(ref. para. 8.5)

Roles of the Commissioner and Chief Executive of the Inland Revenue Department

6. Separate structural focus should be given to the area of the tax administration where there is both a high concentration of the adjudicative component and a close proximity to the final quantification of an individual taxpayer's liability.

(ref. para. 9.2.1)

7. The recommended structural focus should be achieved by the appointment of a second-tier manager within IRD in charge of the review of proposed adjustments and final quantification of liability, primarily in contentious cases where taxpayers have been audited, and of the provision of specific and general binding rulings.

(ref. para. 9.2.1)

8. In phase 2, IRD should undertake such detailed analysis and testing as required for the legislative specification of a separate adjudicative function.

(ref. para. 9.2.2)

9. Amendment is required to section 4 of the current Inland Revenue Department Act 1974 to incorporate the following features:

- explicit recognition of the Commissioner's requirement to operate within limited resources in the care and management of all of the functions committed to the charge of the Commissioner;
- protection of the integrity of the tax system, including a clear definition of what is to be protected; and
- provision for Ministerial directions and their publication.

A draft of the amended section 4 of the Inland Revenue Department Act follows:

- S4 (1) Every Minister and Officer of any Department having responsibilities under this Act or any other Act in relation to the collection of taxes and other functions under the Inland Revenue Acts will at all times use their best endeavours to protect the integrity of the tax system.
- (2) Without limiting the meaning of 'integrity of the tax system' it reflects:
- (i) taxpayer perceptions of that integrity;
 - (ii) the rights of taxpayers to have their liability determined fairly, impartially and according to law;
 - (iii) the rights of taxpayers to have their individual affairs kept confidential and treated with no greater or lesser favour than the tax affairs of other taxpayers;
 - (iv) the responsibilities of taxpayers to comply with the law;
 - (v) the responsibilities of those administering the law to maintain the confidentiality of the affairs of taxpayers; and
 - (vi) the responsibilities of those administering the law to do so fairly, impartially and according to the law.
- (3) The Chief Executive of the Department appointed under the State Sector Act 1988 is designated the Commissioner of Inland Revenue.
- (4) The Commissioner is charged with the care and management of the taxes covered by Inland Revenue Acts and with such other functions as may be conferred on the Commissioner.
- (5) In collecting the taxes committed to the Commissioner's charge and notwithstanding anything in the Inland Revenue Acts the Commissioner will collect over time the highest net revenue that is practicable within the law having regard to:
- (i) the resources available to the Commissioner;
 - (ii) the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and
 - (iii) the compliance costs incurred by taxpayers.
- (6) The Governor-General may by Order in Council and with due regard to the provisions of this section and of the State Sector Act 1988 and the Public Finance Act 1989 issue directions to the Commissioner in relation to the administration of the Inland Revenue Acts.
- (7) Every Order in Council made under subsection (6) will as soon as practicable after it is made:
- (i) be published in the *New Zealand Gazette*; and
 - (ii) be laid before the House of Representatives together with any accompanying statement of reasons for the Order in Council and with the advice of the Commissioner in relation to the matter.
- (8) An Order in Council made under subsection (6) will become binding on the Commissioner 7 days after it is made.

(9) For the purposes of this section 'tax' includes any revenue or entitlements covered by the Inland Revenue Acts and 'taxpayers' and 'taxes' will be construed accordingly.

(ref. para. 9.4.1)

10. To provide assurance to taxpayers, Ministers and Parliament as to the integrity of the tax system in an environment where care and management in the administration of the Inland Revenue Acts have been explicitly recognised, there should be an independent and periodic audit of the tax administration conducted by the Controller and Auditor General, to ensure that there are adequate internal guidelines for the exercise of care and management and that these guidelines are being followed.

(ref. para 9.5.1)

11. The current IRD customer charter should be amended to include more explicit recognition of:

- taxpayers' rights to expect that the quantification of their liability will be impartial and in accordance with tax law;
- taxpayers' rights to expect that their individual affairs will be treated with no greater or lesser favour than the tax affairs of other individuals; and
- taxpayers' obligations under the law, in order to achieve more of a balance in the charter between the rights and obligations of taxpayers.

(ref. para. 9.4.3)

12. The Minister should not receive information on the tax affairs of individuals, or information that allows the identification of individuals. Exceptional circumstances where the provision of information may be in the public interest are:

- where the Commissioner is satisfied that information on individuals is required to develop and frame legislation; and/or
- in a situation where the individual has already approached the Minister and can objectively be seen to have waived the right to confidentiality in some particular aspect of the individual's affairs and the Commissioner is satisfied that the Minister needs that information; and/or
- any other situation where the Commissioner concludes that he/she must give information to the Minister (for example, as 'early warning' concerning issues for which the Minister may be expected to account for the actions of the Department).

(Note: this recommendation is concerned with the Commissioner providing the Minister with relevant information. It does not allow the release by the Minister of that information.)

(ref. para. 9.5.2)

Tax disputes resolution

13. A revised tax disputes resolution process should be introduced, with a revised approach to the pre-assessment phase.

(ref. para 10.7)

14. Legislative changes should be made to introduce 'all cards on the table' and appropriate evidence exclusion provisions, to remove the legal requirement for a taxpayer to lodge an objection with the Commissioner and to provide for taxpayer-initiated litigation to be subject to standard judicial timetabling.

(ref. para. 10.7)

15. A review of the operation of the new procedures for disputes resolution should be carried out two years after all the elements of the proposals are in place.

(ref. para. 10.8)

16. A simple, 'fast track', non-precedential procedure for dealing with small claims should be introduced as part of the jurisdiction of the Taxation Review Authority.

(ref. para. 10.7)

Costs of compliance

17. IRD should continue the current compliance costs reduction strategy which includes:

- provision of effective information on compliance cost impacts for the tax policy design process;
- an effective focus at the operational level on researching and identifying compliance cost issues for specific taxpayer groups; and
- appropriate analyses and use of compliance costs information to identify opportunities for compliance costs reduction, and assessment of the costs and benefits associated with these opportunities.

(ref. Section 11)

Tax policy advice

18. IRD should have a Tax Policy Development Unit:

- to provide the highest quality advice to Government which at least matches that available elsewhere;
- reporting direct to the Chief Executive;
- understanding the practical operation of business and other income earning activities;
- with the best mix of skills and experience at both managerial and staffing levels;
- supplemented as necessary by appropriate external specialists to complement internal skills; and

- structured to suit the needs of specialists, multiple projects and many internal and external relationships.

(ref. para. 12.6)

19. IRD should ensure that its management and communication processes are suited to their role in the GTPP.

(ref. para. 12.6)

20. The Review Committee endorses the recommendation by the Valabh Committee that high priority be given to the rewrite of tax legislation, and recommends that the rewrite be incorporated into the planning phases of the GTPP and completed as soon as possible.

(ref. para. 12.8)

21. The Review Committee recommends:

- the legislative drafting style should be changed to provide for clear statements of purpose, principles and rules employing a simple plain language approach in much shorter sentences avoiding undue detail;
- both in the rewrite and in other tax legislation the distinctive role and powers of adjudication should be separately identified; and
- a framework should be developed to ensure that changes to improve simplicity and clarity are consistent with, and support, the need to protect the integrity of the tax base.

(ref. para. 12.9)

22. To clarify responsibilities for drafting tax legislation, the Review Committee recommends:

- in keeping with the GTPP, IRD normally should be responsible for drafting tax legislation. This will utilise IRD's information and other comparative advantages;
- such drafting, which is to reflect the intent of the policy design, should be done in consultation with Treasury;
- in exceptional cases where Treasury is responsible for all phases of the GTPP for a particular policy issue, Treasury should prepare draft legislation and then forward it to the IRD Legislative Unit for checking overall consistency with tax legislation;
- in all cases the IRD Legislative Unit should be accountable for overall drafting of tax legislation, including the rewrite of Inland Revenue Acts, and for checking drafts to ensure overall consistency with tax legislation. (The Legislative Unit will be a separate part of the Tax Policy Development Unit); and
- Parliamentary Counsel Office should provide final quality assurance of draft legislation.

(ref. para. 12.10)

Social policy

23. The following principles should be adopted in considering the structural fit of the administration of social policy regimes within IRD:

- IRD's core business is the assessment and collection of tax revenue, rather than all Government revenue. Any other revenue collection functions that IRD is asked to undertake will have potentially detrimental impacts on the effectiveness with which it carries out its core business and is able to meet the needs of Government and its core customer groups; and
- when IRD is being asked to administer, through its collection system and income related data base, all or part of a policy scheme for which ownership falls within another agency of Government, then that agency should be required to contract with IRD for the delivery of that function.

(ref. para. 13.2)

24. As both the National Superannuitant Surcharge and the Family Support schemes are tax-like in nature and closely akin to core business, they should continue to be located within IRD.

(ref. paras. 13.3.1 and 13.3.3)

25. The current explicit funding and contracting arrangements between Accident Rehabilitation Compensation Insurance (ARCI) Corporation and IRD should continue.

(ref. para. 13.3.2)

26. If IRD is to continue to administer the Student Loans assessment and debt collection function because of the current design of the scheme, an explicit funding service agreement should be instituted between the Ministry of Education and IRD.

(ref. para. 13.3.4)

27. The possible structural implications of the administration of the Child Support scheme should be considered by the Trapski Review.

(ref. para. 13.3.5)

28. The current structural arrangements which treat Child Support as a separate customer segment within IRD should continue in the interim.

(ref. para. 13.3.5)

Structural options and evaluations

29. The tax administration should be structured as a single organisation which includes policy, operational and adjudicative activities.

30. The tax administration organisation should be constituted in the form of a government department.

31. The organisational structure of IRD should be primarily based on a customer focus model, rather than a revenue type or functional basis, in order to best achieve the tax administration's objective.
32. The delivery of IRD services should be based on an analysis of the most cost-effective number of sites given where field work is needed, and the requirements for reasonable access by taxpayers and their agents to a local office. This includes the replacement of the current regional and district structure with a structure based on Field Centres, Satellite Offices and Customer Service Centres.
- (ref. Section 16)

Recommended structure

33. Three separate management streams, headed by an appropriate second-tier manager, should be established to reflect the three strategic activities of IRD:
- policy;
 - adjudication; and
 - operations.
34. All operational activities, including both design and delivery for all of the customer segments, should be integrated under the leadership of a Chief Operating Officer (COO) who will report directly to the CE.
35. The Operations area of the organisation initially should be structured into three customer segments:
- Corporates (corporates and associated businesses with a turnover of more than \$100 million);
 - Child Support; and
 - Individual and Business.
36. Detailed design and development of further customer segments such as small business should be substantially completed by the beginning of 1996.
37. Processing Centres should be retained and report to the Individual and Business operations manager.
38. Field delivery services should be provided through a combination of relatively large Field Centres with a high concentration of specialist expertise and regional support services. Smaller Satellite Offices and Customer Service Centres should be attached to the Field Centres for management purposes.
39. A major task during phase 2 of the Review should be the detailed design of the number and location of Field Centres, Satellite Offices, Customer Service Centres and the associated numbers and types of staff required. This work should be

undertaken within the framework and according to the principles outlined in this Report, and should consider:

- opportunities for achieving further economies of scale;
 - reasons for significant cost variations between offices; and
 - detailed job design.
- 40.** A stand-alone Technical Development Unit should be established to report to the manager of the design function. The purpose of the unit will be to provide a specific focus and pool of expertise to raise technical standards.
- 41.** A Tax Operations Research Unit should be established to develop data on further segmentation required and on the strategic contribution of specific operational activities to the achievement of IRD's objective.
- 42.** The litigation management function should be established as a separate unit reporting to the Chief Operating Officer and the unit should be responsible for the management of all litigation.
- 43.** Information technology functions, including systems development and the Output Centre but excluding strategic activities, should constitute a separate unit reporting to the Chief Operating Officer.
- 44.** A strategic support activity should be established consisting of strategic IT, human resources, communications, finance, quality management, and planning and development. The strategic support activity should be organised under a second-tier manager, but individual functional areas should have direct access to the CE as necessary.
- 45.** Corporate support service activities should be the responsibility of line managers, operating within corporate policies.
- 46.** The Compliance Costs Reduction Unit should be retained to examine compliance costs issues across the operations area.
- 47.** A contract management advisory function to report directly to the CE should be established, to provide expert advice on the assessment and testing of options for sub-contracting.
- 48.** Phase 2 of this Review should undertake the detailed design of the optimal size and functions of Head Office.
- (ref. Section 17)
- 49.** A comprehensive customer service strategy should be developed for the organisation which includes the following elements:
- clear strategic direction;
 - management commitment;
 - definition of customer groups and identification of needs;

- incentives at the organisational level;
- re-engineering of business processes;
- surveying customers and monitoring progress; and
- customisation of information systems.

Sub-contracting options for delivery

50. The Inland Revenue Department should introduce a seven-step programme:

- Step 1.** Analyse all main tax administration functions in order to identify which functions should *not* be sub-contracted. The guidelines and the results of the preliminary analysis outlined in Section 18 should be used as a basis for the analysis.
- Step 2.** Carry out a detailed analysis of the practical issues associated with sub-contracting (including the utilisation of statutory powers), with a view to moving to a carefully planned phased development including testing, evaluation and review.
- Step 3.** Assess which functions have the greatest potential to be carried out at lower cost by contractors. Establish a priority list for the next step.
- Step 4.** Carry out cost-benefit analyses for the functions, in the order established in step 3, in order to determine if sub-contracting should be tested for that function. The analyses should include the questions posed in paragraph 18.5, and preliminary discussions with some interested contractors. If the results of analysis favour sub-contracting, performance criteria should be determined to assess the results of tests in step 5. Establish priorities for testing.
- Step 5.** Test sub-contracting options for the selected functions in order to demonstrate whether in practice the function is carried out by the contractor(s) to the overall advantage of IRD. An appropriate part and quantity of each function selected should be put up for tender. Tender specifications should be developed, followed by suitable tendering procedures and selection. After an appropriate period for each test, the results should be checked against the original cost-benefit analysis and performance criteria. A decision should then be made to increase or decrease the amount of sub-contracting of that function. This exercise should be carried out without favouring either the sub-contractor or IRD; that is, the same tasks should be undertaken, and the same operational constraints should apply. In practice, there are likely to be overlaps between the steps proposed, and some tests may need to be undertaken for more than a year to make it worthwhile for the contractor.
- Step 6.** Develop internal competition for those functions that must be undertaken in-house. Additional initiatives should be introduced that lead to an appropriate degree of internal competition. There are several recognised approaches to gaining benefits from internal competition that IRD could develop further. Constructive competition between internal units is a

powerful incentive when the best performers receive sincere and widely broadcast praise from executives. Best performance can also be clearly linked to internal promotion. In general, competition is better between teams or units than between individuals. Care should be taken to avoid the potential for destructive competition and the perception of internal competition being a passing fashion. IRD's current emphasis on Quality Management will help in that direction.

Step 7. Review competition and contestability regularly. Decisions relating to sub-contracting should be reviewed at appropriate intervals. In particular, any function that is sub-contracted should be put out to tender after a period that is fair to both contractor(s) and IRD - about three years is a common period.

(ref. Section 18)

51. The current recommendations for sub-contracting some Child Support debt management and some other debt management activities should be revisited in the light of the steps recommended above, and IRD should report to Government accordingly, early in phase 2 of the Review.

(ref. para. 18.6)

Benefits, costs and transitional arrangements

52. The Review Committee recommends that the Government:

- note that the recommended structural changes are expected to significantly improve the effectiveness of the tax system and IRD, and thus increase tax revenue flows over time;
- note that the recommended structural changes are expected to generate fiscal costs and benefits for Vote: Inland Revenue as follows:
steady state fiscal savings, ie following transition - \$7 million per annum
indicative cash transition costs - \$28 million;
- note that, based on the immediate efficiency gains identified by the Review Committee, the payback period for the recommended structure is four years;
- note that the above estimates of annual fiscal savings do not take into account any additional efficiency gains which may be identified during the detailed design and cost benefit work to be undertaken in Phase 2;
- note that the above estimates do not take into account the tax revenue impact of the effectiveness improvements to IRD, nor any general contributions the changes may make to improving New Zealand's economic performance;
- agree that the IRD should now proceed to Phase 2 of the Review (detailed planning and design of the Review Committee's proposals) with the assistance of a Steering Committee structure chaired by the IRD, with representatives from central agencies and persons nominated by the New Zealand Law Society and the New Zealand Society of Accountants;

- agree in principle that the target timeframe for implementing the Review Committee's proposals be 1 October 1995 and that analysis in phase 2 proceed on this basis; but
- agree that the detailed cost-benefit analysis to be done in Phase 2 of the Review consider the relative costs and benefits of alternative implementation timeframes, especially with regard to the management of transitional costs;
- invite the Chief Executive of the IRD to report to the Cabinet Strategy Committee by 1 June 1994 on Phase 2 including the following
 - (i) terms of reference for the Steering Committee.
 - (ii) a detailed work programme for Phase 2 together with a critical path for completion.
 - (iii) consultation and reporting requirements, particularly with respect to the Review Committee's recommendations that impact on other departments and agencies.
 - (iv) a process for progressing legislative changes.
 - (v) resource requirements for Phase 2.
 - (vi) the management of internal and external advertising and filling of key management positions.
 - (vii) a programme to establish a Tax Operations Research Unit, an immediate priority of which would be to identify further taxpayer segments.
 - (viii) the development of strategies that will be employed to manage human resource/industrial relations issues and fiscal risks.
- agree that Phase 2 of the Review should be undertaken progressively and be completed no later than six months after the filling of the second tier management positions;
- invite the Chief Executive of IRD to report to the Ministers of Revenue, Finance and State Services before that time on any issues requiring more immediate resolution; and
- agree, subject to the cost benefit analysis, that the Review Committee's proposals be progressively implemented, concluding by 1 October 1995, and that detailed planning and implementation proceed on that basis.

(ref. Section 19)

Part II:
Text of the Report

3 Introduction

3.1 Background to the Report of the Organisational Review Committee

The First Report of the Valabh Working Party, July 1993, recommended an organisational review of IRD that had also been proposed in IRD's Corporate Plan. The Minister of Revenue concurred. He noted in the preface to the Valabh Report that, following rapid development of the taxation system over the past 10 years

it is now appropriate to take stock and to determine the best possible arrangement of functions and structures for the Department for the next 10 years.

Cabinet approved the terms of reference for the Review recommended in the Valabh Report, as set out in Appendix A. The Review is to

investigate and recommend the optimal organisation arrangements for the tax assessment and collection system, and other activities that are currently part of the tax system, the provision of taxation policy advice, legislative management and Ministerial servicing.

The Review is to consist of three phases: strategic, detailed planning and implementation. The first phase is the responsibility of the Organisational Review Committee.

3.2 The Organisational Review Committee

The Minister of Revenue appointed an independent Review Committee comprising Court of Appeal Judge, Sir Ivor Richardson (chair); IRD Chief Executive, David Henry; and Deloitte Touche Tohmatsu Australia Managing Partner, Management Consulting, David Edwards, and also including Secretary for Treasury, Dr Murray Horn when the Review Committee was considering the policy advice function. On policy advice matters, the Review Committee reports to the Ministers of Revenue and Finance, and the reporting date overall is 31 March 1994.

An Advisory Committee was established whose brief was to assist the Review Committee and, after the first phase of the Review, to be responsible for making detailed recommendations for implementation.

3.3 The Review process and Report structure

The Review Committee was further assisted by an independent Project Team, whose members received considerable information from an IRD unit established for this purpose. The Review Committee worked closely with the Advisory Committee comprising IRD executives, representatives from the Department of the Prime Minister and Cabinet, State Services Commission and Treasury, and an experienced chartered accountant and barrister and solicitor nominated by their respective organisations. The Review Committee and Project Team interviewed many people to discuss their views on aspects of tax administration: IRD staff, people from several

government departments, representatives and tax practitioners from a range of organisations and societies, and staff from several overseas tax administrations. The interviews were confidential, therefore no names are listed. However, the Review Committee is very grateful for their invaluable help.

The Report concentrates on presenting the main recommendations, and providing sufficient additional information to assist with an understanding of the context and rationale. Additional supporting information, including some details of the recommendations, is in the appendices. The sections are ordered logically to progress the reader towards each recommendation; every section starts by explaining its place in this progression. However, as most aspects of tax administration are somewhat interdependent, there is a degree of overlap in some sections. Cross references to other sections are noted. All tables of figures are derived from IRD sources except where otherwise specified.

4 Background and current situation

This section provides:

- a general background of tax administration in New Zealand;
- an overview of how IRD operates; and
- sufficient context to explain the more specific findings, analyses and recommendations that follow.

Additional details on the operations of IRD are provided in Appendix B.

4.1 The basis for New Zealand's tax legislation was developed 70 years ago

New Zealand became a colony of the United Kingdom in 1840 and for many years relied primarily on customs duties for its revenue source. Stamp duties were introduced in 1866. Land tax was first imposed in 1878, and income tax in 1891. But until the second world war, the yield from income tax was relatively small. For instance, income taxes for the year ending 31 March 1914 amounted to 554,000 pounds; by 1939 taxes were 14,800,000 pounds. The substantial development of the welfare state from 1938 required funding from a mass tax.

The current income tax structure and legislation dates back to 1916. There have been numerous changes over the years such as some rewriting of the Income Tax Act in 1923, 1954 and 1976. But the guiding principles of the Income Tax Act have not been amended to reflect current conditions.

From the mid 1980s, in conjunction with other changes to economic management, successive Governments have introduced a range of fundamental changes to the tax system. The cumulative effect of these changes to tax administration has been massive.

- 1985** Fringe Benefits Tax (FBT) introduced.
National Superannuitant Surcharge introduced.
- 1986** GST commenced at 10 percent.
Family Support Tax Credits and Guaranteed Minimum Family Income (GMFI) introduced.
- 1988** Current tax rates introduced - 24 percent on income up to \$30,875; 33 percent thereafter.
- 1990** GST increased to 12.5 percent.
- 1991** Land Tax repealed.
- 1992** IRD assumes responsibility for assessment and collection of Child Support from the Department of Social Welfare.
IRD responsible for collecting information for ACC.
IRD responsible for assessment and collection of Student Loan repayments.
Estate duty repealed.
Major changes to ACC levies such as the Earner Premium introduced for non-work accidents.

In addition, over the last 10 years there have been important technical changes to the tax laws aimed at maintenance of the New Zealand tax base. Examples are the introduction of an 'accruals' regime dealing with the timing of income and expenditure and the international tax regime.

4.2 Several government departments participate in taxes and user charges

- IRD collects all direct taxes, GST and various duties;
- Customs Department collects GST on imported items, excise, alcohol, tobacco and customs duties;
- Ministry of Transport collects road user charges and motor vehicle fees;
- Ministry of Commerce collects energy resources levies; and
- Treasury and IRD advise Government on tax policy.

Total revenue collected amounts to some \$25 billion, of which IRD collects \$21 billion, or 80 percent.

4.3 Income Tax and GST comprise some 98 percent of revenue collected by IRD

A breakdown of the revenue collected by IRD in the year ending 30 June 1993 is shown below.

Revenue Type	Amount (\$000)	Percentage
• Income tax (including FBT)	16,526,843	78.05
• GST (excluding GST collected by Customs)	4,273,582	20.18
• Estate, gift, stamp and cheque duties	191,024	0.90
• Gaming, lottery, and totalisator duties	101,961	0.48
• Child Support	82,778	0.39
• Land Tax	(19,639)	(0.09)
• Student Loans	3,931	0.02
• Credit card duty and approved issuer levy	10,796	0.05
• Unclaimed monies and other	<u>3,040</u>	<u>0.02</u>
Total	21,174,316	100.00

4.4 The statutory role of IRD is to administer nine revenue Acts

Nine Acts of Parliament currently prescribe the activities carried out by IRD, and define the statutory role of the Commissioner of IRD to 'administer' the legislation:

- Income Tax Act 1976 (including Fringe Benefits Tax);
- Goods and Services Tax Act 1985;
- Estate and Gift Duties Act 1968;
- Stamp and Cheque Duties Act 1971;

- Gaming Duties Act 1971;
- Inland Revenue Department Act 1974;
- Child Support Act 1991;
- Student Loan Scheme Act 1992; and
- Unclaimed Money Act 1971.

IRD also collects Accident Compensation levies as an agent for ARCI Corporation.

4.5 The nature of taxes and tax administration has changed

The nature of the tax system has changed over recent years. Three major changes that have affected tax administration are: the expansion of the narrow tax base to a broad base (including expansion of the income tax base, and the introduction of GST and FBT); the introduction of advanced technology to perform operations that were once done manually by IRD staff; and substantial self-assessment by taxpayers. These changes are fundamental to the way tax administration is managed and organised.

4.6 Major changes to the organisation structure of IRD commenced in 1988-1989

Prior to 1988, IRD was organised principally by tax type in two groups, Operations and Compliance. The Head Office of IRD carried out policy and research, technical, compliance, legal, operations (systems) and supporting corporate services and finance functions. Four Regional Offices co-ordinated and supported 28 District Offices that carried out the direct assessment and collection of taxes and duties (operations), debt management and audit functions (compliance).

The addition of FBT, National Superannuitant Surcharge, GST, Family Support and GMFI added considerably to IRD workload. Furthermore, self-assessment began to be introduced in 1986. Staff had increased 56 percent from 3300 in 1984 to 5150 in 1988. IRD commenced a major change process in 1987-1988 that in some ways anticipated the subsequent requirements of the State Sector Act 1988 and the Public Finance Act 1989.

The restructuring that commenced in 1988-1989 was a major modernisation of IRD aimed at:

- increasing focus on customer service;¹
- replacing outdated technology under a five-year information systems development plan (the FIRST system plus re-engineering business processes in the light of opportunities created by technology);
- responding to the State Sector and Public Finance Acts;
- better measurement of performance;

¹ For the purposes of discussion in this Report, the term 'customer' facilitates a focus on the concept of customer service, and does not imply an element of choice that a customer may have in other circumstances. The term encompasses both internal and external groups.

- reducing the number of management levels;
- introducing an improved system for corporate planning; and
- facilitating self-assessment by taxpayers.

4.7 The current structure is based on 13 'programmes'

The organisation structure of IRD divides activities into 13 programmes: seven to deliver services, and six to support delivery. The delivery programmes and their main activities and resources allocated for the year ending 30 June 1994 are:

Seven programmes to deliver external services

Legislative Affairs

Functions: provide tax policy development and advice, with the exception of Child Support, assist in tax legislation and forecast revenue for all taxes administered

Location: Head Office

Resources: 40 'person years' (one PY equivalent to one full time staff person), \$3 million budget

Rulings

Functions: formulate and communicate the Commissioner's policy on the interpretation and application of revenue law administered by IRD

Location: Head Office

Resources: 53 PYs, \$3 million budget

Taxpayer Services

Functions: respond to taxpayer enquires, provide taxpayer education, carry out activities for Income Maintenance, Student Loans, supply of information and collection of ACC levies; provision of Ministerial services and the Problem Resolution Service

Locations: Directorate at Head Office, delivery at Regional and District Offices

Resources: 1000 PYs, \$35 million budget

Revenue Assessment and Collection

Functions: process all tax returns, bank tax payments, open mail and either respond or pass to District Offices, account for all revenue to the Crown

Locations: Directorate at Head Office, three Processing Centres (Upper Hutt, Hamilton, Christchurch)

Resources: 999 PYs, \$41 million budget

Debt and Return Management

Functions: inform taxpayers of need to file returns, issue automatic reminders and follow up if necessary, identify non-payment, issue automatic reminders, take action on non-payers

Locations: Directorate at Head Office, delivery at Regional and District Offices

Resources: 643 PYs, \$22 million budget

Taxpayer Audit

Functions: risk assessment, all tax audits including payroll (PAYE, FBT), GST, income tax, investigation and international. Follow up action for non-compliers

Locations: Directorate at Head Office, delivery at Regional and District Offices

Resources: 1320 PYs, \$50 million budget

Child Support

Functions: register and assess Child Support customers, respond to enquiries, recover overdue payments, provide policy advice and assist in design of legislation for Child Support

Location: Directorate at Head Office, delivery at Regional Offices and 12 District Offices

Resources: 610 PYs, \$20 million budget

Six internal programmes to support delivery**Information Technology**

Functions: plan and develop information systems for all IRD functions, deliver and support computer operations, manage sub-contracted computer operations (mainly Government Computing Services)

Location: Head Office Directorate and one Output Centre at Porirua that prints and mails out about 16 million items each year

Resources: 371 PYs, \$58 million budget

Human Resources and Support Services

Functions: provide human resources and administrative policies, systems and services including industrial relations, payroll, building management, typing, mailroom, records

Locations: Directorate at Head Office, delivery at Regional and District Offices

Resources: 628 PYs, \$63 million budget

Planning and Development

Functions: assist in development of corporate plans, design and advise on management policies and processes, provide corporate services including communications and staff development and training

Location: Head Office

Resources: 67 PYs, \$5 million budget

Finance

Functions: produce financial reports for IRD managers, several government agencies and Parliament, develop financial policies, operate the budgeting process, provide services such as purchasing and property

Location: Head Office

Resources: 35 PYs, \$3 million budget

Legal Services

Functions: provide legal advice to other programmes - mainly regarding tax disputes, manage tax objection cases

Location: Head Office and Regional Offices

Resources: 40 PYs, \$3 million budget

Internal Audit

Functions: evaluate IRD operations, and report to the CE on the efficiency and effectiveness of management policies, procedures and controls

Location: Head Office

Resources: 13 PYs, \$1 million budget

Total resources: 5819 PYs, \$307 million budget

- The costs of the six support delivery programmes together with the \$72 million direct/indirect costs (eg capital charge and depreciation) are allocated to the output classes.
- This results in a total budget of \$ 379 million.

4.8 1993-1994 output class costs

The programme costs shown in paragraph 4.7 are rolled up into output classes for government budgetary and reporting purposes. The output classes from the 1993/94 Corporate Plan are shown below.

Output Class Costs 1993/94	<i>1993/94 Vote</i>	
	<i>(\$000)</i>	<i>%</i>
<i>Output Class</i>		
Tax		
Policy Advice	4,961	1.31
Taxpayer Information Services	73,456	19.37
Revenue Assessment and Collection	70,548	18.60
Management of Overdue Tax and Returns	47,159	12.43
Taxpayer Audit	87,495	23.07
Sub-Total	<u>283,619</u>	<u>74.78</u>
Non-Tax		
Assessment and Collection of Child Support	55,455	14.62
Administration of Income Maintenance	7,346	1.94
Student Loan Scheme	4,227	1.11
Supply of Information to Other Agencies	1,659	0.44
Collection of ACC Levies*	26,000	6.86
Tax Education Office Services	968	0.25
Sub-Total	<u>95,655</u>	<u>25.22</u>
Total Department	<u>379,274</u>	<u>100</u>

* The costs of collection of ACC levies are charged to the Accident Rehabilitation and Compensation Insurance Corporation.

All costs are GST exclusive.

4.9 The IRD Corporate Plan 1993-1994 explains how IRD intends achieving its agreed performance levels

The Plan includes the following points:

The Purpose of the Inland Revenue Department is to serve the community by:

- collecting revenue to fund the work of the New Zealand Government
- contributing to the achievement of the Government's social policy objectives according to law and in the most effective and efficient manner.

Principles - Liabilities and Entitlements

Liabilities and entitlements under the laws administered by Inland Revenue are created by Parliament when it makes those laws.

Liabilities

The laws require every person to pay the correct amount - no more and no less.

The best way to achieve this is for each person to voluntarily comply.

To encourage the highest possible level of voluntary compliance, IRD aims to:

- administer the laws in a consistent, impartial, courteous and prompt manner
- make it as easy as possible for people to comply with the laws, by letting them know their rights and obligations
- deter and detect those who do not comply and take appropriate action against them
- keep the costs of complying to a minimum.

Entitlements

IRD also aims to help people receive any entitlements they have under those laws.

The Corporate Plan also describes a vision of IRD in 1997 that 'is designed to give a longer term focus to IRD planning and to place the 1993/94 Plan in context'. The vision refers to all key areas such as legislation, customer service, technology and IRD as an employer, in a modern, practical and inspiring way. The plan describes the 'output classes' and the higher level outputs such as performance measures.

5 Achievements of IRD

This section describes some of the major achievements of IRD during its recent period of major change, 1989 to 1994. These achievements:

- recognise that IRD has had many major successes; and
- serve to balance Section 7, External factors and key issues, which deliberately selects key issues where there is some need for improvement.

5.1 IRD has successfully implemented a large change programme

In 1988 IRD faced a number of problems. The most serious by far related to its information systems. IRD's systems were outdated, inflexible and close to collapse. The Government approved a comprehensive modernisation of the Department with major emphasis on using the opportunities to increase the tax take and reduce costs, which modern integrated information systems permit.

The modernisation programme was large and complex. It had to deal with IRD-specific problems but also accommodate the changes required by the public sector reform process. It had to be flexible enough to respond to Government tax and social policy changes (for example the addition of Child Support to IRD's responsibilities). It had to pay for itself in reduced costs. And the fiscal risk had to be managed to maintain the flow of revenue to the Government.

The modernisation process was phased in over a five-year period. The results of the programme in efficiency terms have been dramatic. Administrative savings of \$80 million a year are now being realised. In terms of enforcement activities, outstanding returns have been reduced by 42 percent from 1991 to 1993 and net collectable debt reduced by 38.4 percent from 1990 to 1993. Banking of revenue is now done 24 hours quicker on average, representing an interest saving to Government of \$25 million a year.

5.2 IRD has achieved good performance against its agreed output specifications

In recent years, IRD has met most of its agreed output specifications, with only relatively minor shortfalls. The Annual Report for the year ending June 1993 listed only a small proportion of items 'not achieved'. This has been attained in an environment of increasing performance specification. IRD has achieved this level of performance within budgets that have been reduced each year.

5.3 IRD has implemented an integrated information system that is rated as amongst the best of its type in the world

IRD has developed and implemented an integrated information system that brings together all the main components of the total tax administration process. Called FIRST, the system has a single central data base of taxpayer information that links the main administration processes. Whilst there were initial teething problems, two years

of operation have demonstrated that the huge changes have been more than worthwhile, and all the main performance targets were achieved. A recent benchmark study completed by Price Waterhouse used IRD's management of information technology as an example of 'best practice' in both the public and private sector in New Zealand and Australia. There has been a constant procession of visits by overseas tax authorities seeking to learn from FIRST.

5.4 IRD is introducing a philosophy and practice of customer service

The need for a focus on customer service was recognised as one aspect of the 1988-1989 restructuring. This has since been a key strategy for IRD, and has been complemented by a major quality management programme. Several recent surveys of individual taxpayers' views have rated IRD's customer service high relative to comparable organisations. A recent benchmark exercise carried out by Price Waterhouse rates IRD's customer service practices as amongst the best compared with other public and private sector organisations in New Zealand and Australia.

5.5 IRD was selected by Government to administer the new Child Support Act 1991

The Government required an agency to administer the Child Support Act, and selected IRD as the most capable and efficient agency for the particular needs of the Act. IRD implemented a large and rapid programme to develop the functions, programmes and skills required. This entailed recruiting and training some 600 staff, about half from the Department of Social Welfare. Although there were transitional problems, the scheme is now operating reasonably well although it continues to be controversial. The collection rate has increased from some 30 percent of the amount assessed to close to 70 percent. There are, however, some questions of principle about how well Child Support fits into the mainstream of tax administration; these issues are discussed in Section 13, Social policy functions.

5.6 Overall IRD staff continue to demonstrate a high degree of commitment, in spite of the major changes

Staff of IRD have demonstrated their willingness to change rapidly and successfully in work methods, in particular those required as a part of the new computer based systems. This suggests that IRD has a sound base on which to build any changes.

5.7 IRD has continued to invest in its development as an organisation

During the period of change, IRD has invested in its own development so that it is able to increase its overall performance and improve efficiency. Initiatives include well developed planning and monitoring processes, the introduction of quality management, the development of skills and knowledge profiles for all staff, a competency based manager development programme, systems and processes to support accountability, internal costing systems, contracts for internal services, the

development of a job design methodology, performance appraisal and performance based remuneration, development of a Programme Evaluation capacity, and the development of its Corporate Communications capability including greater attention to communications planning.

All this has been achieved whilst maintaining revenue. However, there are some areas which have not received the same level of attention during this period of change. Section 7, External factors and key issues, identifies these areas together with other issues which need attention so that IRD develops to meet the changing environment in which it will operate through to the year 2000.

6 A vision for tax administration

A vision for tax administration provides a necessary framework for this Review.

The 'vision' underpins much of the discussion and several of the recommendations in this Report and encompasses the objectives discussed in Section 8, Objective of tax administration. To the extent that the tax administration also carries out other functions based on tax concepts and according to a mandate from Government, the principles of the vision apply equally to those functions.

The Review Committee notes that its 'vision' is similar in many respects to the statement in the IRD 1993-1994 Corporate Plan entitled: The IRD in 1997.

6.1 A 'vision' for New Zealand's tax administration

- IRD is collecting the highest net revenue over time that is practicable within the law.
- Voluntary compliance is regarded as the norm, and non-compliance is regarded as socially unacceptable.
- Taxpayers respect the tax administration, and believe it is fair, helpful and efficient.
- Taxpayers believe that if they disagree with any decision, the dispute will be handled fairly and quickly.
- The costs of compliance with the law are reduced to the lowest level consistent with IRD's overall objective and the mix of taxes and other revenues chosen by Government.
- Tax administration is based on legislation that is well understood by taxpayers, and is presented in the simplest manner possible.

This will require:

- an empowered workforce with a high level of skill and expertise for the provision of policy advice, correct application of the law, assistance to taxpayers and the enforcement of liability;
- a clear customer focus; and
- advanced systems and processes for the processing of information and money for the great bulk of revenue collecting.

7 External factors and key issues

This section:

- lists assumptions about external factors which will affect tax administration; and
- summarises key issues which the Review Committee has identified in relation to the tax administration.

7.1 Assumptions about external factors that affect tax administration

The public sector regulatory environment will remain

The State Sector Act 1988 and the Public Finance Act 1989 are expected to provide the basic framework for government departments for the foreseeable future.

Technology will be used in new ways

The impacts will be faster processing, enabling better and easier access to data. There will be more use of electronic communications such as video, and direct exchanges between computers. This will help provide better service to customers and enable more flexibility in deciding where the work is performed. Accessing and manipulating information can be done almost anywhere.

Public sector agencies will continue to operate under tight fiscal constraints

Pressure will continue, to ensure economical management of Government resources, and to demonstrate this through the achievement of appropriate performance measures. In some areas IRD will need to compete for scarce resources including highly skilled people.

There may be more targeting of social assistance

This could place greater reliance on information collected on various forms of income.

Concern about privacy of information and individual rights will continue

Further data exchange between government agencies will continue to raise concerns about misuse of information. If tax information is used for other purposes, it may affect voluntary compliance.

Most people have increasing expectations of customer services

This appears likely to continue as competition, quality management and freedom of choice expand throughout society. Customer diversification will continue to grow, resulting in groups of taxpayers with specific needs. For instance, the percentage of older people will increase, as well as the focus on the needs of those from different ethnic backgrounds.

There is increased diversity of commerce and increasing internationalisation of New Zealand's economy

This is resulting in more complex financial products and transactions and increased transfer of funds internationally. In particular, this has implications for tax policy and IRD's compliance activities.

Tax reform is expected to be on-going and substantial

7.2 Several key issues have been identified that any new structure should address

There are three categories of issues identified: strategic, policy and legislation, and operational.

Strategic issues

7.2.1 There are ambiguities between the roles of the Commissioner and the Chief Executive of IRD (refer Section 9, Roles of the Commissioner and the Chief Executive of IRD)

The Valabh Committee identified several actual or potential conflicts that have resulted mostly from the different requirements of the Inland Revenue Department Act, and the later State Sector and Public Finance Acts. The problems relate mainly to the interplay of those Acts and, in particular, how to balance the requirement of the Inland Revenue Department Act for the Commissioner 'to administer' the Act and collect all the tax due, with the requirements of the other Acts in relation to the efficient and effective management of the resources available to the Commissioner. Other associated problems include:

- the degree of independence of the Commissioner from Ministerial direction and the provision of information to help the Minister fulfil delegated responsibilities;
- the relationship between management and adjudication in tax matters; and
- the effect of these on the integrity of the tax system and the fundamental strategy of voluntary compliance.

7.2.2 IRD's legislative objective is not achievable (refer Section 8, Objective of tax administration)

An interpretation of the legislation is that IRD is required by the Inland Revenue Department Act to 'administer' the Act and, amongst other things, to collect 'all' the tax. For many practical reasons, this objective is impossible to achieve. But there is a clear general expectation that IRD will collect the most revenue that it can within certain limitations. Other factors affecting the ability to meet requirements under legislation are also relevant such as the exercise of good management, and the need for trade-offs between factors such as compliance costs and information requirements.

7.2.3 IRD's performance measures do not adequately measure its strategic level achievements (refer Section 8, Objective of tax administration)

IRD is generally regarded as well advanced in the development of performance measures relative to other state sector organisations. But, in parallel with the previous issue (lack of specific objective), there are no really effective measures that assist IRD management or the Government to assess how well IRD is achieving its strategies, for instance, the enforcement and the compliance costs strategies. Currently it is difficult to know whether IRD's allocation of resources is the most effective and efficient. There has been a concentration on output measures to the exclusion of outcome measures. As a result, IRD's performance is currently judged by an excessive number of output measures, although IRD has recognised the need to refine these in order to concentrate more on broader measures. It is not possible to measure exactly some macro areas, but more information could be produced to assist in high level decision making.

IRD's much improved information systems could provide a good base for the refinement of its performance measures.

7.2.4 Tax administration is likely to have more major changes in future

The last decade has been one of rapid and major change for tax administration, and for IRD. Although the pace of change may slow, further major tax and related changes could be made by Government. Other activities, or different emphases could result from a different objective or changed strategies.

It will be important for the structure of tax administration to be sufficiently flexible to be able to cope with further changes.

7.2.5 Compliance costs in New Zealand are high (refer Section 11, Costs of compliance)

Numerous people have told the Review Committee that compliance costs are too high. Their concerns relate to the direct costs, time and anxiety costs of complying with tax obligations, as well as the costs of supplying other information. Comments such as 'why should we be unpaid tax collectors' are common. Studies have indicated that compliance costs are an issue for most tax administrations, and all taxpayers are affected to some degree. The burden falls heavily on small businesses. Apart from perceived unfairness, the problem may be exacerbated because New Zealand has a higher proportion of small businesses than many other developed countries.

Compliance costs that are perceived as unacceptably high are known to affect both voluntary compliance and the behaviour of the individuals affected, for instance, by resorting to evasion, and by not employing more staff because of the associated compliance requirements. The solution will be attained by an appropriate balance of the many factors involved - from initial policy design, through to administration and review.

7.2.6 There is scope to increase IRD's customer focus in some important areas (refer Section 14, Structural issues)

Section 5, Achievements of IRD, notes that IRD has improved its customer services considerably, as endorsed by a recent Price Waterhouse benchmark study that rated IRD practices amongst the best in many aspects compared with both public and

private sector organisations. But there are several areas where more specific targeting would be very beneficial. IRD has already recognised this to a considerable extent, for instance in targeting by Small Business Advisory Officers, Superannuitant Liaison Officers, Maori Community Officers and its recently formed Corporate Audit group (dealing with large organisations). The computerised telephone service, which is a source of complaints, is currently being improved.

There is scope, however, for more targeting, particularly in relation to businesses. This should increase voluntary compliance through better mutual understanding of compliance requirements.

Policy and legislation issues

7.2.7 There has been considerable criticism of recent tax policy development (refer Section 12, Tax policy advice)

Criticism of policy development is a result of many interrelated aspects, including the complexity of the subject matter, some confused and changing requirements, unclear roles and accountabilities, an unsatisfactory policy and legislation development process, and the quality of the advice itself. Given that tax legislation provides the primary method of raising revenue to pay for all government expenditure, it is critical that the best possible tax policy advice is available to Ministers.

(Section 12, Tax policy advice, describes the Generic Tax Policy Process that is expected to resolve or very substantially reduce these problems.)

7.2.8 IRD's structural arrangements for tax policy advice do not emphasise sufficiently the importance of the role (refer Section 12, Tax policy advice)

The quality of tax policy advice is critical to the tax system, and to tax administration. Currently, policy advice development is carried out in the Legislative Affairs Unit of IRD. Treasury also has a Policy Unit. The Director of the IRD unit reports to a Deputy Commissioner, who reports to the Commissioner. Positioning policy advice at a third-tier reporting level does not sufficiently emphasise the importance of the role.

7.2.9 The complexity and language of tax legislation is jeopardising compliance (refer Section 12, Tax policy advice)

Most people associated with New Zealand's tax legislation consider it to be unnecessarily complex and detailed, while failing to make the intent of the legislation clear. The results include unnecessarily high costs of compliance, and serious perceptions of unfairness with the attendant risks to voluntary compliance. The Joint Committee enquiry into the Australian Tax Office summed up the problem: 'The Parliament cannot expect the general public to observe a tax law that it cannot readily understand.'

The Valabh and Waugh Committees noted the serious problems associated with New Zealand's tax legislation, and proposed solutions.

Operational issues

7.2.10 Resolution of many tax disputes is too slow and cumbersome (refer Section 10, Tax disputes resolution)

There are several problems with the operation of the current tax disputes system: unacceptable delays and uncertainty for taxpayers that lead to disincentives for taxpayers to pursue disputes, particularly if they relate to small amounts. The Commissioner is perceived to have the role of both 'player' and 'referee', and the system has perverse incentives that can lead to taxpayers and the administration withholding relevant information during pre-assessment that would otherwise expedite resolution. Some business managers and tax practitioners have doubts about the expertise of some of the IRD staff involved. Again, this is adversely affecting voluntary compliance. Staff of IRD, on the other hand, consider that some practitioners resist legitimate enquiries by IRD.

The tax dispute procedures should be improved to ensure much faster and fairer resolution. The dispute resolution proposals outlined in Section 10 will reduce these concerns.

7.2.11 Some social policy activities do not fit well with IRD's core tax activities (refer Section 13, Social policy functions)

IRD administers several social policy functions. Most of these have been integrated into other IRD functions to a large extent, and are operating efficiently. There are some questions of principle about whether these activities are fundamentally different from the core business of collecting tax. Child Support is relatively new to IRD and has a separate structure that enables better focus. Child Support often involves very emotional situations between adversarial parents that the IRD officer has to deal with. This requires different skills from those needed for core tax situations.

7.2.12 The present method of separating IRD's programme design and delivery is causing problems of consistency and accountability (refer Section 15, Design criteria and principles)

The design and delivery of programmes/functions are separated. The organisation structure formally brings them together only at the Management Board level. There are numerous interactions between the programmes because of the integrated nature of the business, and there is some overlap of both monitoring and accountability for programme delivery. However, the separation of functions appears to be contributing to some problems in consistency and quality of service delivery.

There is scope to change relationships between design and delivery aspects of tax administration in order to improve the quality of delivery.

7.2.13 Information technology is a critical part of tax administration (refer Section 14, Structural issues)

Nearly all tax administration activities are now carried out using IRD's FIRST information system. FIRST is rated in recent benchmarks as amongst the best managed information system- often *the* best - amongst comparable public and private organisations. The most recent benchmark noted that IRD's Information Technology (IT) budget is some 20 percent of IRD's total personnel and direct operating costs.

The IT plan indicates further advances in technology which could have considerable influence on the efficiency and effectiveness of tax administration, for instance, document imaging and automated taxpayer contact. The structure and operations should clearly take advantage of these facilities where they can be applied cost effectively, for example, staff and contractors being able to work in the location most suited to them and their customers.

Technology can increasingly be used by IRD to support any form of operations that is required. Cost is more likely to be the deciding factor than whether or not technology is capable of performing an operation.

7.2.14 There are opportunities to improve efficiency by sub-contracting more service delivery (refer Section 18, Sub-contracting options for delivery)

Most organisations, including IRD, sub-contract selected functions; for example, IRD already outsources much of its Information Technology. But there is scope for IRD to sub-contract more of its delivery functions. Potential advantages include the on-going incentive inherent in a competitive environment to provide goods and services to the highest quality and at the least cost, as well as enabling IRD to concentrate more on its critical functions by using additional skills and effort available from other organisations. But there could be associated problems, including negative perceptions by taxpayers of contractors' motivations, reduced control, and IRD's lack of experience in specifying contracts with appropriate measures. Taxpayers may view sub-contracting parts of tax collection as unacceptable.

Clearly sub-contracting should be approached with caution, but there are some opportunities which should be pursued.

7.2.15 Some of IRD's human resources policies do not match future needs (refer Section 14, Structural issues)

IRD was exceptionally successful in introducing major changes that involved most staff working in significantly different ways, affecting skills, relationships and behaviour. There was minimal interruption to work or revenue flow. The human resources policies were a major contributor to this success, in particular the use of re-deployment, with severance as a last resort. But one result is that a small proportion of the staff are not suited to their new jobs.

Any structural changes will need to be accompanied by human resources policies and practices that ensure staff are matched to the requirements of the job.

7.2.16 There are gaps in IRD's technical skills (refer Section 14, Structural issues)

It is clear from feedback from tax practitioners, business, and IRD themselves, that the level of technical skills is lower than it should be. For example, only 27 percent of Taxpayer Audit staff currently have degrees. There are differing external perceptions of present skill levels. A recent survey, based on the responses of 114 tax practitioners, by Massey University found that 52 percent thought the technical and communications skills of IRD staff were not adequate. On the other hand, independent market research conducted for IRD on its small business tax information service indicates that 85 percent of small businesses were satisfied with the advisory service they had received.

IRD as well as the business sector has been affected by the increasingly complex nature of commerce and taxation. In particular, keeping up to date with tax changes demands considerable time and effort. IRD is planning to improve skill levels. The Review Committee believes this plan should be given the highest priority.

8 Objective of tax administration

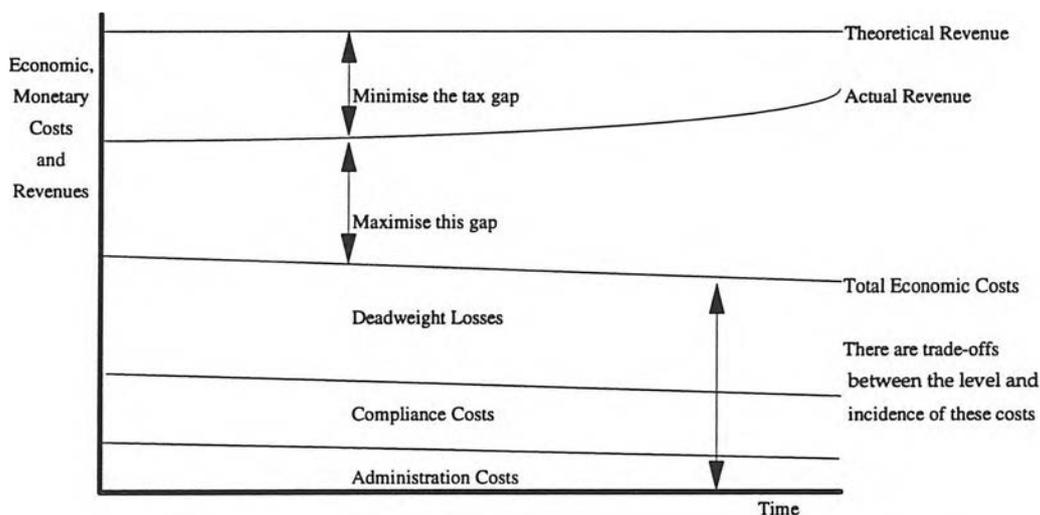
The aim of this section is to examine and establish what tax administration should achieve - its objective.

This objective must be clear and unambiguous so the Government, as well as the tax administration, can determine how well the objective is being achieved.

A clear objective is of paramount importance as it provides a basis for Government to assess immediate results (such as the achievement of purchased outputs). It also provides a framework to assess and make decisions about longer term needs.

8.1 Government needs tax policy advice to assist in making tax decisions

Tax administration is one component of the total tax system which has an overall objective that comprises: *sufficiency* of revenue for the Government, *efficiency* (a mix of taxes that collects the required revenue while minimising distortions to the economy, and administration and compliance costs, given other objectives), and *fairness*. The aim of tax policy advisers is to optimise the design of taxes that meets these requirements. (The relationship between tax policy and the total tax system is considered in Section 12, Tax policy advice.) The following diagram indicates some of the efficiency considerations involved.



Given a certain revenue requirement, and subject to the Government's equity concerns, tax policy should design the most readily assessable and collectable taxes. In this way, the gap between the theoretical revenue available under tax law and the actual amount of revenue collected (the 'tax gap') will be minimised. At the same time, the total economic costs of the tax system should be minimised. These costs comprise administrative costs incurred by the tax administration, compliance costs borne by taxpayers, and other indirect effects that have an impact on the overall efficiency of the economy ('deadweight losses').

Examples of deadweight losses include: a business deciding not to employ any additional workers because taxes increase the cost of labour to the employer; disincentives to work harder; taxes encouraging people to move into the 'black economy' or barter arrangements; tax-induced investment leading to sub-optimal investment patterns; and the amount of time spent searching for tax loopholes. In that way deadweight losses represent an opportunity cost of taxation. Estimates of deadweight losses vary dramatically but, for income taxes, are typically in the range of 20 percent to 50 percent of the revenue collected.

Administration costs are by far the smallest component of the economic costs (in New Zealand, currently about 1.8 percent of the net IRD tax revenue of approximately \$21 billion in 1993/94).

There are trade-offs between the level and incidence of these economic costs. For example, in the 1980s the world-wide trend in tax reform was to reduce marginal income tax rates, with the resulting revenue losses offset by a broadening of the tax base (such as increased indirect taxes). Even though these reforms will have increased certain administration and compliance costs, the offsetting reduction in deadweight losses was expected to be so substantial that significant net economic benefits will have resulted from the reforms.

It is worth noting that the choice of tax law effectively determines the levels of theoretical revenue and deadweight losses, and has a strong influence over the levels of compliance and administration costs. The role of the tax administration in influencing the compliance and administration costs, while important, is much less significant than the actual choice of tax law.

Government obviously has an overriding aim to achieve the balance that provides the revenue needed for its expenditure, while meeting fairness considerations and minimising distortions to the economy. The aim of tax policy advice is to assist Government achieve this balance.

Section 12, Tax policy advice, explains the Review Committee's recommendation that a tax policy function should continue to be part of the tax administration. The Review Committee also recommends the following objective for the tax policy function:

In accordance with the strategic and detailed policy as determined by Ministers, the Inland Revenue Department will:

- **identify, develop and recommend specific tax policies that will raise tax revenue in the most economically efficient and equitable manner; and**
- **provide tax policy advice that meets the performance measures specified by Government.**

8.2 Tax administration needs an overall objective that fits in with the needs of the total tax system

Once tax legislation has been passed by Parliament, the role of the tax assessment and collection function (the 'tax administration') is to administer those Acts (listed in Section 4, Background and current situation) that provide for assessment and collection of revenue. Like most developed countries, New Zealand bases its tax

collection on the fundamental strategy of voluntary compliance. Voluntary compliance is not a goal in itself, but is considered to be the most efficient and effective basis for tax collection, and underpins all aspects of tax collection in New Zealand.

Section 4, Background and current situation, notes that IRD's 'Purpose' is to serve the community by:

- collecting revenue to fund the work of the New Zealand Government; and
- contributing to the achievement of the Government's social policy objectives

according to law and in the most effective and efficient manner.

IRD's Corporate Plan 1993-1994 lists additional principles and other details that describe how it will achieve this Purpose.

Apart from a few explicit discretions in the legislation, an interpretation of the total tax legislation is that the Commissioner is obliged to assess and collect all taxes that are due regardless of the resources and costs involved. The Review Committee agrees with the view of the Valabh Committee that this is not a realistic objective. Clearly, the Commissioner, like other chief executives, is subject to resource constraints imposed by Parliament. So the Commissioner cannot be expected to collect *all* taxes. The objective of the tax administration function of IRD therefore should be changed to match the current needs and situation.

The Review Committee considers the objective for the tax administration function of IRD should incorporate several elements, namely that IRD should:

- operate within the law;
- collect the highest revenue that is practicable over time. (This recognises that the tax administration's objective should not be to collect either 'all' or only 'some' revenue);
- collect revenue at the least administrative cost;
- operate within the resources appropriated by Parliament; and
- have regard for the compliance costs incurred by taxpayers (Section 11, Costs of compliance, explains this).

The Review Committee recommends the following objective which should be incorporated into a revised section 4 of the Inland Revenue Department Act. The objective combines the elements above with the requirement for an unambiguous and clearer objective -

In meeting accountabilities to the Minister, the primary objective for IRD should be -

The Inland Revenue Department will collect over time¹ the highest net revenue² that is practicable within the law having regard to:

- **the resources available to the Inland Revenue Department;**
- **the importance of promoting compliance,³ especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and**
- **the compliance costs incurred by taxpayers.**

The requirement to balance short term and long term considerations, and to have regard to the importance of promoting voluntary compliance, will be important moderating influences in circumstances where the objective may otherwise prompt an unnecessarily vigorous and short-term approach to revenue collection. Furthermore the Final Adjudication function outlined in Section 9, Roles of the Commissioner and Chief Executive of IRD, should ensure a balanced approach to tax assessment and collection within IRD.

One significant implication from the objective is that IRD will be entitled to enter into compromise settlements with taxpayers, rather than pursue the full amount of assessed tax, in cases where there are legitimate differences of view about the facts in dispute and the costs of litigation are high. Such settlements raise important issues for all taxpayers and require explicit guidelines to protect the integrity of the tax system consistent with the objective of collecting the highest net revenue over time, within the law.

8.3 An objective is also required for IRD's social assistance and information supply functions

IRD also carries out social assistance and information supply functions that are outside the narrow tax administration functions, but are nonetheless produced efficiently as a part of IRD's operations.

The Review Committee recommends the following objective for IRD's social assistance and information supply functions. The emphasis should be on good management, and on meeting the needs of the agencies involved. This additional objective is:

¹ *Over time* indicates the obvious need for the tax administration to balance short and longer term implications of possible strategies before deciding on any particular course of action. *Over time* is intended to capture the concept of net present value (a valuation technique common to business as well as governments) and appears to be the best short and non-technical means of capturing the concept.

² *Highest net revenue* means actual revenue less administration (collection) costs.

³ *Promoting compliance* will have many aspects, but principally come within the overarching strategy of voluntary compliance.

The Inland Revenue Department will

- **administer social assistance regimes within the law, to agreed performance standards, at least cost; and**
- **supply within the law required information to other government agencies, to agreed performance standards, at least cost.**

8.4 Reporting on the 'health' of the tax administration

The key to an objective is that it provides sufficient high level direction for strategies to be developed, and resources to be applied. In addition, it should assist the Government to monitor the tax administration's performance in terms of how well the objective is being achieved. It should also provide a strong incentive for the tax administration to research the benefits of its strategies and resource allocation.

The Chief Executive of IRD should, as part of the Department's on-going strategic planning cycle (which feeds into the Government's Budget planning process), prepare a document for the Minister of Revenue which will:

- provide Government with a clear picture of the full set of major issues confronting the tax administration in the achievement of its objective, including any 'pressure points', so that the Government has all of the information necessary in order to make purchase and ownership decisions that are in the best long-run interests of the tax administration;
- integrate new and existing strategies;
- contain a broad description of the requirements to operationalise policy initiatives, so that the Government can make purchase decisions consistent with its wider strategies and the overall objective for the tax administration; and
- state how IRD is dealing with any problems developing in the operation of tax legislation reported through the generic tax policy process.

8.5 Strategic indicators to assess the 'health' of tax administration

There is universal agreement that some macro measures relating to tax, such as compliance costs, cannot be measured exactly. Some other macro measures, in particular deadweight losses, present extreme measurement difficulties. These difficulties have resulted in a dearth of macro measures. Therefore the Government and IRD management are starved of macro information, but flooded with micro level measures, and left to make decisions critical to New Zealand's economy with a substantial imbalance of information.

The report of the Joint Committee of Public Accounts of the Australian Parliament, November 1993, entitled *An Assessment of Tax*, (the 'ATO Report') notes that the Australian Tax Office (ATO) had set for itself at least two standards by which it believed its revenue collection efficiency should be judged:

- the extent to which the revenues budgeted are actually collected; and/or
- the extent to which the total amount of tax correctly payable is in fact collected.

The ATO Report notes the latter is often referred to as the 'tax gap', and suggests a third possible indicator of efficiency is the cost of collecting revenue as a proportion of total revenue collected. Another measure noted as relevant is efficiency and effectiveness in the processing of taxpayer returns. The ATO Report expresses the opinion that the ATO should aim to reduce the cost of collection to below 1 percent of revenue within two to three years, but not at the expense of an increase in compliance costs to taxpayers. The ATO Report acknowledges that the standards proposed above suffer from inherent measurement and practical difficulties, but when taken together, provide a general basis for evaluation of the efficiency of revenue collection practices.

The following list of potential macro information is indicative only. The best information possible should be collected and analysed, taking account of all relevant information in New Zealand and from overseas. The information should include trends, comparisons against short and long term forecasts, and appropriate surveys for:

- tax gap: the best estimate of the difference between theoretical and actual revenue;
- taxpayer compliance costs;
- total administration costs;
- deadweight losses;
- taxpayer perceptions as a measure of voluntary compliance; and
- macro benchmarks: against appropriate overseas tax administrations, and parts of some organisations in New Zealand.

See Appendix C for a fuller discussion.

8.6 Recommendations

8.6.1 In meeting accountabilities to the Minister, the primary objective for IRD should be -

- **The Inland Revenue Department will collect over time the highest net revenue that is practicable within the law having regard to:**
 - **the resources available to the Inland Revenue Department;**
 - **the importance of promoting compliance, especially voluntary compliance by all taxpayers with the Inland Revenue Acts; and**
 - **the compliance costs incurred by taxpayers.**

This primary objective should be incorporated into a revised section 4 of the Inland Revenue Department Act.

8.6.2 In addition, the following objectives should be adopted for the policy function -

- **In accordance with the strategic and detailed policy as determined by Ministers, the Inland Revenue Department will:**
 - **identify, develop and recommend specific tax policies that will raise tax revenue in the most economically efficient and equitable manner; and**

- provide tax policy advice that meets the performance measures specified by Government.

8.6.3 And the following objective should be adopted for the social assistance and information supply functions -

- The Inland Revenue Department will:
 - administer social assistance schemes within the law, to agreed performance standards, at least cost; and
 - supply within the law required information to other government agencies, to agreed performance standards, at least cost.

8.6.4 The Chief Executive of IRD should, as part of the Department's on-going strategic planning cycle (which feeds into the Government's Budget planning process), prepare a 'health report' for the Minister of Revenue. This will:

- provide Government with a clear picture of the full set of major issues confronting the tax administration in the achievement of its objective, including any 'pressure points', so that the Government has all of the information necessary in order to make purchase and ownership decisions that are in the best long-run interests of the tax administration;
- integrate new and existing strategies;
- contain a description of the requirements to operationalise policy initiatives, so that the Government can make purchase decisions consistent with its wider strategies and the overall objective for the tax administration; and
- state how IRD is dealing with any problems developing in the operation of tax legislation reported through the generic tax policy process.

8.6.5 IRD should develop and maintain a set of macro information, or indicators, for the purpose of assisting Government and IRD management in making strategic decisions for tax matters and, in particular, as input for the 'health report'. The information may also be useful for high level performance measurement, but such use should be secondary.

9 Roles of the Commissioner and Chief Executive of the Inland Revenue Department

The terms of reference of the Review require it

to consider and make recommendations on the future statutory and administrative roles and responsibilities, and the associated accountabilities, of the Chief Executive and Commissioner(s) of the Department of Inland Revenue or similar entities.

This section considers the roles of the Commissioner and Chief Executive (CE) of IRD in terms of how the business of tax administration should operate within the framework of legislation that includes the Inland Revenue, State Sector and Public Finance Acts. Currently both roles are performed by one person. (Appendix D provides more details.)

The legislative framework for tax administration today is still based on the thinking and methods used in the 1920s. But there have been major changes in most aspects of tax administration over the last 70 years. Now the majority of assessments are done through a computer system that automatically carries out that function. There are several parts of the current legislation that do not reflect the way that tax is collected in the 1990s.

9.1 Tax collecting has particular features and responsibilities

There are seven features and responsibilities of tax collecting which have implications for the roles of the Commissioner and CE of IRD. They are:

- ultimately, the Minister of Revenue is responsible to Parliament for the tax administration. Accordingly the Minister must have the power to direct the CE/Commissioner on any matter relating to the operation of the tax administration in accordance with, and subject to the relevant statutes;
- taxes are imposed by Parliament. The tax administrator quantifies the statutory liability and constitutionally neither the tax administrator nor the Government can simply suspend the operation of all or part of those laws;
- the resources available to the tax administrator for the determination of the taxes of all taxpayers, and the collection of those taxes, are limited. The tax administrator must make decisions as to the management of those resources;
- the principle of voluntary compliance, coupled with appropriate enforcement action, is central to efficient and effective tax collecting in New Zealand;
- modern technology enables the great bulk of taxes to be collected using a data processing operation, supported by the judgement of tax officials, which reconciles any tax collected at source with the self-assessed returns of taxpayers and identifies non-compliers;

- the tax enforcement function ensures, so far as possible, that taxpayers comply with their obligations. Within this function the tax administration exercises an independent judgement in investigating and quantifying obligations of particular taxpayers and collecting their taxes; and
- in the discharge of tax collecting functions the tax administrator has responsibilities to Parliament, to the Government/Minister of Revenue and to taxpayers.

9.1.1 Implications for the Review

The features and responsibilities outlined above have implications for the Review in three areas:

- the relationship between the tax administration and the Government/Minister. This concerns the provision to the Minister of information relating to tax collecting, and the scope of Ministerial directions to the tax administration;
- the relationship between the tax administration and the taxpayers. Given that the tax administrator has finite resources, taxpayers should be assured that these resources are being applied appropriately - and that their rights are being protected; and
- the significance of the structural organisation of the adjudication responsibilities of the tax administration.

Although the issues can be conveniently grouped under the heading of 'adjudication' or considered in the context of a split between the conventional chief executive and special adjudication functions, there is no single solution which fully answers the problems arising in all three of the above areas.

9.2 Structural focus for adjudication

9.2.1 Separate structural focus is required

Separate structural focus is required in those high profile areas of the tax administration where perceptions of the integrity of the tax system are particularly important. Good performance in these areas will contribute to greater taxpayer compliance, particularly voluntary compliance, and thereby to the collection of the highest net revenue over time.

Specific concerns identified by the Review Committee relate to the efficiency and effectiveness of revenue administration in ensuring that:

- there is an adequate focus on the correct and impartial application of tax law to the affairs of individual taxpayers and the development of the necessary skills to ensure that this takes place;
- there are more adequate quality control procedures in the determination of liability of individual taxpayers, particularly where that determination is likely to be contentious or occurs in an adversarial context; and
- resources can be targeted at these high profile areas and resource use is transparent.

In the course of the final quantification of an individual taxpayer's liability and in making binding rulings, there is a major judgmental element involved. This is the most crucial part of the adjudication function and its performance significantly affects taxpayer perceptions. The Review Committee considers that the areas that need particular structural focus are:

- the review of a proposed adjustment to the self-assessed liability of a taxpayer, arising from a review of that taxpayer's affairs, and the final quantification of that liability primarily in contentious cases; and
- the provision of binding rulings.

The proposed grouping of high level adjudicative functions should be given structural effect within a single tax administration organisation and should be a separate output class for appropriation purposes. The performance of these functions should be the specific responsibility of one manager at the second tier of management within the larger organisation. This arrangement will:

- maximise the focus on these high level adjudicative functions within the organisation, including the provision of a much needed injection of high-level technical expertise; and
- ensure that any disputes, or trade-offs with the rest of the organisation are required to be managed by the CE/Commissioner (which reflects the appropriate level for the management of trade-offs and resolution of disputes).

9.2.2 The adjudication role requires legislative recognition

The Review Committee also considers the separation of the adjudicative from the managerial function should be given appropriate legislative recognition. Paragraph 12.2 recommends that in rewriting the current tax legislation, the drafters should identify and reflect the separate functions and powers of adjudication and management (CE). Desirably, this change would be effected now, with the title of Commissioner reserved to the adjudication role, and the title of CE reserved exclusively to the CE role.

However, there are two constraints which preclude immediate implementation. First, much further detailed evaluation and testing are required to arrive at a definition of the precise scope and boundaries of the adjudication functions suitable for long-term legislative expression. The intertwining of elements of adjudication and management which has developed over decades cannot be unravelled overnight. Defining the ultimate boundaries identifying high level adjudication as the subject of special focus is a process that will benefit from detailed analysis and testing together with operational experience of the proposed structure. Second, it will take some years to fully accommodate differentiating the roles of Chief Executive and Commissioner in the current Act and double tax agreements. For this reason, adjudication is used throughout this Report to reflect this role and, consistent with current legislation and bilateral agreements, the titles of CE and Commissioner are used jointly.

The second-tier allocation of adjudicative responsibilities is a first step. It is important for the reasons discussed. However, the goal should be to move as quickly as possible to the clearest and most practical expression of the adjudicative function

and powers for tax collecting purposes. That will be important for clarifying the special responsibility of the adjudicator/Commissioner as the delegate of the Chief Executive. It will assist the structural separation of adjudication and operations which the Review Committee recommends in Section 17, Recommended structure. It will also facilitate consideration of further structural development, should that be considered appropriate in the future.

Starting at phase 2, IRD should undertake such detailed analysis and testing as required for the legislative specification of a separate adjudicative function.

9.2.3 Separation is important for disputes resolution

The separation of the final adjudication function is a central feature of the Review Committee's recommendations on tax disputes resolution described in Section 10, Tax disputes resolution. It is also discussed in Section 16, Structural options and evaluation and Section 17, Recommended structure. It is also extensively discussed in Appendix D, Roles of the Commissioner and Chief Executive of the Inland Revenue Department, particularly in paragraphs 60 to 99 and in Appendix E, Tax disputes resolution.

9.3 Statutory framework for tax administration

Three areas of legislation govern tax administration. Some reconciliation between these is required as the potential for Ministerial direction and control appears to be very restricted under the Inland Revenue Acts but is not constrained in other respects except through:

- convention and good management practice;
- a specific provision in the State Sector Act regarding individual employees; and
- the requirement in the Public Finance Act that financial instructions be 'lawful'.

The key to reconciliation is to determine the *special features* of tax administration for which a tax administrator requires independence under any legislation and which constrain Ministerial direction, control and accountability particularly under the Public Finance Act. Both the CE and Commissioner functions have an interest in the efficient administration of tax collection on a basis of voluntary compliance. Taxpayer perceptions of the integrity of the tax system are crucial to maintaining voluntary compliance.

Taxpayers will be particularly concerned that the application of tax law to individuals is free from political influence. Taxpayers have to feel:

- that their own affairs are receiving impartial treatment; and
- that the affairs of others are being treated impartially; and
- that the rights of the individual are being upheld.

The Review Committee recommends adoption of the points that follow in the remainder of this section.

9.4 Protecting the integrity of the tax system

9.4.1 Criteria and a procedure are required to protect the integrity of the tax system

To protect the integrity of the tax system the Minister, the Commissioner and taxpayers should all be assured that there is a 'no-go' area where the Commissioner exercises a wholly independent judgement. Three criteria define and protect that 'no-go' area:

- the Commissioner must exercise independent judgement on the tax affairs of individual taxpayers and must not be subject to Ministerial direction in relation to those decisions;
- the Commissioner is not subject to any directions relating to any interpretation of tax law; and
- any directions given on any other matter are given for the purposes of administration of the Inland Revenue Acts and as reflected in the proposed section 4 of the Inland Revenue Department Act and are consistent with the State Sector Act, Public Finance Act and other relevant legislation (the human rights legislation for example);

In addition to these criteria, good management principles should ensure that, in practice, there is an appropriate buffer above the 'no go' area. Administrative policies and procedures are normally determined by the Chief Executive rather than the Minister.

For example, whilst it is appropriate for the Minister to be assured of the existence of an audit case selection system which reflects best practice and that such a system is being properly used, such assurance would normally be available from briefings provided by the CE and from the independent audit process recommended at paragraph 9.5.1. It should not ordinarily be necessary and may well be undesirable for the Minister to seek to influence the actual criteria for audit selection.

However, the following procedure is intended to provide a principled basis for resolving any situation where there is confusion over whether Ministerial control and accountability conflicts with the Commissioner's independence in the 'no-go' areas. A transparent process is required in the event that the existing procedures of mediation and discussion have not achieved resolution. There is ample precedent for transparency in government direction over areas where officials or official bodies have statutory or semi-judicial responsibilities. The criteria outlined above and the procedure described below are consistent with the recommendations first of the Public and Administrative Law Reform Committee in 1986 and then of the Legislation Advisory Committee in 1991 which have been approved by Cabinet. The procedure is similar to that which overrides a recommendation of the Ombudsman for the release of official information.

The procedure is not intended to replace existing procedures of discussion between the Minister and the CE/Commissioner, and of mediation (by the State Services Commissioner for example) in the event that the different views cannot be easily reconciled.

The Minister may give a direction in relation to tax administration, even after contrary advice from the CE/Commissioner, provided that:

- such a direction is consistent with the criteria above; and
- the direction is made by Order in Council and is gazetted and tabled in Parliament as soon as practicable; and
- the Order in Council is tabled with the CE/Commissioner's written advice and with sufficient information so that the intent of the order is clear and any consequences for resource allocation and performance are signalled appropriately; and
- the direction becomes effective 7 days after the Order in Council is made.

There may be cases where the CE and/or the Commissioner and Minister disagree with respect to a Ministerial direction but the direction is unrelated to the integrity of the tax system as defined above and as set out in the proposed draft of section 4 of the Inland Revenue Department Act. In such cases a tabling procedure is not appropriate. These issues are common to other chief executives of departments and ministries.

The Review Committee's proposed replacement draft of section 4 of the Inland Revenue Department Act ensures protection of the integrity of the tax system is preserved by extending the protection of independence to *all decisions involving individual taxpayers*, whether these are related to the performance of CE functions or related to the role of the Commissioner.

The integrity of the tax system is not simply a matter between the CE/Commissioner and the Minister. It also includes the interaction between the total tax administration and individual taxpayers.

9.4.2 Only limited resources are available for the collection of taxes

It is not possible for the CE of IRD, operating within limited resources, to ensure that every cent of due taxes is collected. Explicit statutory recognition of the management of limited resources in the efficient and effective collection of taxes is needed. A proposed draft of a replacement of section 4 of the Inland Revenue Act which would address a range of specific care and management issues is included in the recommendations below.

9.4.3 Customer charter requires amendment

To reflect the approach adopted in this section, the current IRD customer charter should be amended to include the following:

- taxpayers' rights to expect that the quantification of their liability will be impartial and in accordance with tax law;
- taxpayers' rights to expect that their individual affairs will be treated with no greater or lesser favour than the tax affairs of other individuals; and
- taxpayers' obligations under the law, in order to achieve a better balance in the charter between the rights and obligations of taxpayers.

9.5 Monitoring and reporting frameworks

9.5.1 Reassuring taxpayers and Parliament of proper and consistent management of finite resources

If the legislation is amended to recognise specifically the existence of administrative discretion in the application of finite resources to the collection of taxes, it becomes all the more important to ensure that perceptions of the integrity of the tax system are not diminished. A periodic independent audit of internal procedures and guidelines for the exercise of care and management should be undertaken to assure Parliament and taxpayers that there has been proper and consistent exercise of management responsibility in tax administration. The audit would be undertaken by the Office of the Controller and Auditor General.

9.5.2 The Minister should have all necessary information

The Minister should have all information necessary to fulfil his/her obligations to Parliament but should not receive information on the tax affairs of individuals or information that allows identification of individuals. Exceptional circumstances where the provision of information may be in the public interest, even though there is no power to direct in individual cases, are:

- where the Commissioner is satisfied that information on individuals is required to develop and frame legislation; and/or
- in a situation where the individual has already approached the Minister and can objectively be seen to have waived the right to confidentiality in some particular aspect of their affairs and the Commissioner is satisfied that the Minister needs that information; and/or
- any other situation where the CE/Commissioner concludes that he/she must give information to the Minister (for example, as 'early warning' concerning issues for which the Minister may be expected to account for the actions of the Department).

(Note: this recommendation is concerned with the Commissioner providing the Minister with relevant information. It does not allow the release by the Minister of that information.)

9.6 Recommendations

9.6.1 Separate structural focus should be given to the area of the tax administration where there is both a high concentration of the adjudicative component and a close proximity to the final quantification of an individual taxpayer's liability.

9.6.2 The recommended structural focus should be achieved by the appointment of a second-tier manager within IRD in charge of the review of proposed adjustments and final quantification of liability, primarily in contentious cases where taxpayers have been audited; and of the provision of specific and general binding rulings.

9.6.3 In phase 2 IRD should undertake such detailed analysis and testing as required for the legislative specification of a separate adjudicative function.

9.6.4 Amendment is required to section 4 of the current Inland Revenue Department Act to incorporate the following features:

- **explicit recognition of the Commissioner's requirement to operate within limited resources in the care and management of all of the functions committed to the charge of the Commissioner;**
- **protection of the integrity of the tax system including a clear definition of what is sought to be protected; and**
- **provision for Ministerial directions and their publication.**

A draft of the amended section 4 of the Inland Revenue Department Act follows:

- S4 (1) Every Minister and Officer of any Department having responsibilities under this Act or any other Act in relation to the collection of taxes and other functions under the Inland Revenue Acts will at all times use their best endeavours to protect the integrity of the tax system.
- (2) Without limiting the meaning of "the integrity of the tax system" it reflects:
- (i) taxpayer perceptions of that integrity;
 - (ii) the rights of taxpayers to have their liability determined fairly, impartially and according to law;
 - (iii) the rights of taxpayers to have their individual affairs kept confidential and treated with no greater or lesser favour than the tax affairs of other taxpayers;
 - (iv) the responsibilities of taxpayers to comply with the law;
 - (v) the responsibilities of those administering the law to maintain the confidentiality of the affairs of taxpayers; and
 - (vi) the responsibilities of those administering the law to do so fairly, impartially and according to law.
- (3) The Chief Executive of the Department appointed under the State Sector Act 1988 is designated the Commissioner of Inland Revenue.
- (4) The Commissioner is charged with the care and management of the taxes covered by the Inland Revenue Acts and with such other functions as may be conferred on the Commissioner.
- (5) In collecting the taxes committed to the Commissioner's charge and notwithstanding anything in the Inland Revenue Acts the Commissioner will collect over time the highest net revenue that is practicable within the law having regard to:
- (i) the resources available to the Commissioner;
 - (ii) the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and
 - (iii) the compliance costs incurred by taxpayers.

- (6) The Governor-General may by Order in Council and with due regard to the provisions of this section and of the State Sector Act 1988 and the Public Finance Act 1989 issue directions to the Commissioner in relation to the administration of the Inland Revenue Acts.
- (7) Every Order in Council made under subsection (6) will as soon as practicable after it is made:
- (i) be published in the *New Zealand Gazette*; and
 - (ii) be laid before the House of Representatives together with any accompanying statement of reasons for the Order in Council and with the advice of the Commissioner in relation to the matter.
- (8) An Order in Council made under subsection (6) will become binding on the Commissioner 7 days after it is made.
- (9) For the purposes of this section “tax” includes any revenue or entitlements covered by the Inland Revenue Acts and “taxpayers” and “taxes” shall be construed accordingly.

9.6.5 To provide assurance to taxpayers, Ministers and Parliament as to the integrity of the tax system in an environment where care and management in the administration of the Revenue Acts has been explicitly recognised, there should be an independent and periodic audit of the tax administration conducted by the Controller and Auditor General to ensure that there are adequate internal guidelines for the exercise of care and management and that these guidelines are being followed.

9.6.6 The current IRD customer charter should be amended to include more explicit recognition of:

- taxpayers' rights to expect that the quantification of their liability will be impartial and in accordance with tax law;
- taxpayers' rights to expect that their individual affairs will be treated with no greater or lesser favour than the tax affairs of other individuals; and
- taxpayers' obligations under the law, in order to achieve a better balance in the charter between the rights and obligations of taxpayers.

9.6.7 The Minister should not receive information on the tax affairs of individuals, or information that allows the identification of individuals. Exceptional circumstances where the provision of information may be in the public interest are:

- where the Commissioner is satisfied that information on individuals is required to develop and frame legislation; and/or
- in a situation where the individual has already approached the Minister and can objectively be seen to have waived the right to confidentiality in some particular aspect of their affairs and the Commissioner is satisfied that the Minister needs that information; and/or
- any other situation where the Commissioner concludes that he/she must give information to the Minister (for example, as 'early warning' concerning issues for which the Minister may be expected to account for the actions of the Department).

(Note: This recommendation is concerned with the Commissioner providing the Minister with relevant information. It does not allow the release by the Minister of that information.)

10 Tax disputes resolution

The objective proposed in Section 8, Objective of tax administration, requires IRD to have regard to the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts. Taxpayers' compliance is affected by their perceptions of tax disputes resolution. This section considers how disputes resolution affects tax administration, and what actions can be taken to meet the objective.

The Review Committee believes that

- the present disputes resolution process is deficient; and
- the way disputes are resolved is critical to taxpayer perceptions of fairness, and has wider impacts for the tax administration.

The interdependency and importance of these issues led the Review Committee to address them together in one section of the Report. Appendix E provides additional details relating to tax disputes resolution.

10.1 A definition of 'tax dispute'

IRD deals with numerous situations each day where taxpayers are querying the basis of their tax assessment. For example, the taxpayer may have identified an additional item that they believe should be taken into account. The majority of these queries are not contentious and are resolved without leading to a dispute. A 'tax dispute' occurs when a taxpayer and the Commissioner do not agree on the facts and/or interpretation of tax law on which the taxpayer's assessment has been based.

In considering the disputes resolution process, it is also important to distinguish between those activities that can contribute to disputes prevention, and those that are part of a resolution process once a dispute has actually arisen.

10.2 Tax disputes can be broadly categorised

1 Low revenue implications (less than \$10,000 per dispute)

- Relatively simple and not setting a precedent. Example: deductibility of overseas travel expenditure claim for a spouse.
- Relatively complex, may set a precedent. Example: whether FBT is GST inclusive or exclusive.

2 High revenue implications (more than \$10,000 per dispute)

- Relatively simple and not setting a precedent. Example: the tax treatment of an employee allowance.
- Relatively complex, may set a precedent. Example: transfer pricing mechanisms.

10.3 Several concerns have been expressed about the tax disputes resolution process

IRD can reconsider whether an assessment made by IRD is correct

The current disputes resolution process allows IRD a number of opportunities to reconsider the IRD's assessment decision. This ability to revisit can lead to uncertainty for the taxpayer, delay the disputes resolution process and reduce the incentive for IRD to get the assessment right first time. For example, about one-third of requests for cases stated in 1993 were conceded by IRD; around one-sixth of these were conceded because it would be too costly to pursue the cases.⁴

A higher level of technical expertise is required earlier in the process

The Review Committee has heard concerns that the process of disputes resolution is unacceptably lengthened as there is an inadequate level of expertise applied prior to the generation of an assessment. Only when cases have achieved the status of 'disputes' are they referred progressively upwards in the technical hierarchy culminating in the involvement of a Regional or Head Office solicitor.

Resolving tax disputes can take an unacceptably long time

There are excessive delays at different stages of the process. For instance, in November 1993, almost 60 percent of the cases before the High Court had been filed for more than 15 months. Eighty percent of cases decided by the Court of Appeal in the last five years were more than five years old; 25 percent more than 10 years old. The average time from a taxpayer's request to file a case stated, to a decision by IRD not to file, was 8.3 months. There is now a legislative requirement to file within six months.

IRD's role as 'player' as well as 'referee' is viewed as unfair

The current tax disputes process requires the taxpayer to raise an objection to their assessment with IRD. IRD effectively has the role of both 'player' and 'referee'. Objections are usually considered by the same person who carried out the original audit, although any decision to disallow the objection is made by a superior officer.

The costs of pursuing a tax dispute are too high

Taxpayers incur direct costs such as legal fees, as well as more indirect psychic and opportunity costs. The median amount of tax in dispute for a sample of cases over a six-month period in 1991 was just some \$5000 for objections, and \$20,000 for cases filed. The Review Committee has been told that many taxpayers, once aware of both the costs and delays of objections aimed at recovering the disputed tax, decide to drop the dispute. The resulting perception, of paying too much tax by default, may lead to disgruntled taxpayers who undoubtedly tell other people and who may not be willing compliers in the future.

⁴ 'Case stated' is the mechanism by which, at the request of a taxpayer, the Commissioner places an unresolved dispute before the Court.

10.4 Resolution of tax disputes is often ponderous

One obvious aim of tax administration is to take actions that avoid tax disputes. But, even given the inevitability of a certain level of dispute, the Review Committee is convinced that more disputes arise than are necessary, and that the disputes resolution procedures should be improved. Some specific examples are:

- many disputes are caused and/or resolution delayed because relevant information is withheld by the taxpayer or IRD;
- there are perverse incentives in the current procedures to withhold information prior to reassessment; and
- many disputes get to Court that could and should have been settled by discussion and full disclosure of the factual basis for argument.

10.5 There should be a comprehensive approach to resolution of tax disputes

The Commissioner's first aim is to *prevent* disputes, and second to *resolve* fairly and quickly those disputes that cannot be prevented. The Review Committee recommends that IRD develop a comprehensive approach to tax disputes, with the following elements:

- every practical effort is made to ensure that assessments are correct before they are issued;
- any dispute is identified at the earliest practical time;
- communication between the taxpayer and IRD is direct and open to ensure that all information relevant to the dispute is available as soon as possible; and
- appropriate independent advice to IRD is introduced at the earliest practical time. This will involve the earlier commitment of specialist skills, such as legal skills.

10.6 Separate final adjudication

The audit investigation and final quantification of liability should, as far as practicable, be clearly separated. The purpose is to provide an impartial application of tax law and greater application of technical expertise to the affairs of individuals prior to the issue of an assessment. In turn this will decrease the likelihood and grounds for disputes (refer paragraph 9.2).

10.7 IRD should develop specific rules and guidelines for disputes

IRD should adopt new procedures for preventing and dealing with disputes. These should follow the points outlined below, and be refined in consultation with taxpayers and practitioners and having regard to any recommendations made by the Compliance and Penalties Review. The pre-assessment activities set out below will provide the Department with a set of administrative procedures designed to improve the quality and timeliness of assessments and reduce the likelihood and grounds for subsequent dispute.

The post-assessment activities represent a significant simplification of procedures and will provide incentives on both parties for disputes to be resolved earlier. In addition, compliance costs for taxpayers, particularly those with smaller amounts in dispute, will be lessened and the level of certainty will increase.

Pre-assessment activities

- At the conclusion of an audit, and in cases where the Department feels that more contact with the taxpayer will be required before an accurate assessment can be issued, a notice of proposed adjustment/s should be issued to the taxpayer, specifying a time limit within which the taxpayer is to respond.
- If the taxpayer does not accept the proposed adjustments, pre-assessment conferences may be held with the intention of identifying and resolving issues, particularly relating to issues of fact. These conferences may be formal or informal depending on the circumstances of each case.
- A 'cards on the table' notice supported by an evidence exclusion provision may be given, at the discretion of the Commissioner, where a notice of proposed adjustment is issued - to provide an appropriate incentive for disclosure of the factual basis for the arguments of the taxpayer and Commissioner.
- There should be provision for the taxpayer to waive the statute bar time limit restrictions for a limited period while the conference process is being followed.

Post-assessment resolution of major disputes

- Retention of the requirement for the taxpayer to pay 50 percent of the assessed liability. This is to maintain an incentive for the taxpayer to resolve the dispute as quickly as possible.
- Facility for the taxpayer to seek resolution of a dispute by starting proceedings in the ordinary way. As with other commercial litigation, the taxpayer and IRD would be subject to judicial management of all aspects of the case, including timing. (The Review Committee considers there is no need for special procedures, such as the case stated, for tax disputes, and is of the view that because of the proposed 'all cards on the table' pre-assessment approach, there will be only limited need for interlocutory procedures if the matter goes to court.)
- Procedures to ensure the taxpayer is fully aware of alternative courses to resolve any tax dispute, such as administrative review procedures. This should include the opportunity to pursue either or both litigation and review, and to terminate one or more courses at any time.

Post-assessment resolution of minor disputes

- Continuation of IRD's established Problem Resolution Service (the Ombudsman has commented favourably on this service).
- Provision for an independent external body to advise taxpayers if they request this. The present Ombudsman fulfils that role adequately.
- A small claims procedure should be introduced.

Two-thirds of tax disputes are concerned with amounts of less than \$10,000, and most of these are non-precedential. There appear to be opportunities for introducing simpler, 'fast track' procedures for these small claims similar to those now available in the tax courts in the US and Canada, and as recommended by the ATO Report. Rather than setting up another tribunal, the Taxation Review Authority should be given that special responsibility as part of its jurisdiction.

This proposal should be pursued in phase 2 of this Review, involving other parties as appropriate.

10.8 A review of the operation of the new disputes resolution procedures should be carried out

A comprehensive review of the present arrangements for resolving tax disputes through the High Court and the Taxation Review Authority would require considerable time. There is certainly some evidence that problems are occurring at this stage of the process which contribute to overall delays. It is also clear from other jurisdictions that there are considerable advantages in having a substantial portion of tax disputes dealt with by a specialist tribunal.

The proposals set out in this section should address the majority of current concerns with the disputes resolution process. A period of time should be allowed to see how these changes have worked. The effectiveness of the disputes resolution process should be reviewed two years after all the elements of the proposal are in place. At that point it may be appropriate to consider whether a wider review of the operation of the litigation processes is warranted.

10.9 Specific solutions are needed for tax queries and for each type of tax dispute

The aim of the recommendations above is to provide clear, effective and widely understood solutions for taxpayers when they have a tax query, or for any reason a taxpayer disputes an IRD assessment. The following table summarises the overall aim.

Table 10. 1: Solutions by tax type

	Problem	Solution Step 1	Solution Step 2 (if required)
Group 1	1. Clarification or Confirmation	Taxpayer contacts IRD Taxpayer Services	
	2. 'Process Problem' (small scale)	Taxpayer contacts IRD Problem Resolution Officer	Taxpayer contacts Ombudsman
Group 2 'Disputes'	1. Small amount simple/ non-precedential	Taxpayer uses proposed Small Claims procedure within Taxation Review Authority jurisdiction	
	2. Large amount and/or complex/ precedential	Taxpayer takes case to Taxation Review Authority or High Court Commissioner responds	Commissioner or Taxpayer may take case on appeal.

Group 1: Clarification or confirmation issues (these are not 'disputes').

Group 2: Small and large disputes of a simple/non-precedential or complex/precedential nature.

10.10 The issue of privilege should be considered

The New Zealand Society of Accountants has submitted that privilege should extend to tax advice given by its members so that they are on an equal footing with legal practitioners.

Privilege is an ancient common law rule of evidence. It is designed to protect communications between client and lawyer for the proper administration of justice. However it might be appropriate to reconsider professional privilege generally in relation to revenue matters. The growing trend in openness in litigation is also of relevance.

The Review Committee does not see that the consideration of extending privilege as sought, is properly a part of this Review. The Review Committee understands that questions of privilege are included in the current Evidence Project of the Law Commission.

10.11 Recommendations

- A revised tax disputes resolution process should be introduced with a revised approach to the pre-assessment phase.
- Legislative changes should be made to introduce 'all cards on the table' and appropriate evidence exclusion provisions, to remove the legal requirement

for a taxpayer to lodge an objection with the Commissioner and to provide for taxpayer initiated litigation to be subject to standard judicial timetabling.

- **A review of the operation of the new procedures for disputes resolution should be carried out two years after all the elements of the proposals are in place.**
- **A simple, 'fast track', non-precedential procedure for dealing with small claims should be introduced as part of the jurisdiction of the Taxation Review Authority.**

11 Costs of compliance

The objective proposed in Section 8, Objective of tax administration, requires IRD to have regard to the compliance costs incurred by taxpayers. This section considers how compliance costs affect tax administration, and what actions can be taken to meet the objective.

The costs of compliance is a major issue that has many components. Because of its importance it has been a focus of attention for the Review Committee. Appendix F has additional details on the subject.

11.1 Compliance costs are an important factor in the tax system and a key issue for tax administration

New Zealand businesses are very concerned about compliance costs

The Review Committee received this clear message in submissions and discussions, plus reinforcement of the message from several studies of compliance costs.

Compliance costs fall more heavily on business than on wage, salary and investment income earners, and fall particularly heavily on small businesses. This is of special concern in New Zealand's economy where 82 percent of businesses employ less than five staff, and 90 percent employ less than 10.

There is little information available, but recent studies indicate that some compliance costs are very high

The Sandford study of 1991 is the only comprehensive indication of taxpayer compliance costs in New Zealand. The study assessed compliance costs to the taxpayer for PAYE in 1991 at 1.92 percent of tax revenue collected from that source; for FBT, 1.73 percent; for GST, 7.3 percent. But the combined compliance costs for business income tax of sole proprietors, partnerships, public and private companies and trusts were estimated at \$1,226 million in 1989-1990, or 19.6 percent of income tax revenue.

High compliance costs can have serious effects on the economy

High compliance costs are an economic concern as they may impact on employment and economic growth by discouraging the start-up and expansion of business. They are also important because of their potentially detrimental effect on voluntary compliance.

Compliance costs in New Zealand are similar to other countries, and are significant

Analysis of 11 studies of compliance costs in various countries suggests that, although comparisons are problematic, New Zealand's compliance cost problems are generally no greater than those in other tax administrations. But current information does not take account of additional taxpayer compliance costs imposed by use of the tax administration for delivery of some social policy objectives of Government such as Child Support. Recent additions and changes to legislation have added further burdens

to taxpayer compliance. On the other hand, changes such as the new Employer Filing and Tax Agent electronic filing systems and increased tax thresholds have reduced compliance costs.

11.2 The first place to tackle compliance costs problems is during development and review of tax policy

Section 12, Tax policy advice, describes a Generic Tax Policy Process (GTPP) that the Review Committee has designed to ensure that, amongst other things, compliance costs are addressed appropriately at every stage of the tax policy development process. Tax practitioners, in particular, support the view that policy design is the most effective means of addressing compliance costs. The GTPP includes specific provisions to ensure that:

- new tax policy initiatives are fully costed and considered to allow Government to make appropriate trade-offs between taxpayer, administrative and economic costs. Costings should include the best practicable estimates of compliance costs;
- compliance costs receive explicit focus in the post-implementation review of legislation, and in the identification of remedial issues requiring legislative amendment; and
- appropriate external organisations and individuals are consulted so that their views, including the practical implications of policy developments, can be taken into account.

The GTPP provides an appropriate structure for the process, but its effectiveness will be dependent on the quality of information that is available, particularly about compliance costs. External advisers are expected to provide invaluable assistance, but the principal source of information will be the tax administration itself.

11.3 The tax administration must balance compliance and other costs

The second place to tackle compliance costs is through the operational policies and procedures of the tax administration which have an immediate and direct effect on costs to taxpayers. Any steps that are taken ought to have regard to these considerations as specified in the new proposed objective for IRD (in Section 8, Objective of tax administration).

IRD has already developed a strategy for compliance costs, and has established a Compliance Costs Reduction Unit to implement these strategies. One immediate focus for the unit is improving the compliance costs information base. IRD has also added the reduction of compliance costs to its Corporate Plan objectives and compliance costs are one of the cornerstones of the IT Plan for new projects. The Review Committee endorses IRD's approach in this area.

11.4 Compliance costs generally

While the terms of reference did not ask the Review Committee to consider compliance costs questions in other areas of Government, it is interesting to note that

the United Kingdom has introduced the concept of compliance cost assessments. These are a structured appraisal that all government departments must prepare when evaluating policy proposals likely to affect businesses. The purpose is to inform Ministers and officials of the likely costs of businesses complying with new or amended regulations well before a decision is taken on whether or not to go ahead with the proposals (refer Appendix F, Compliance costs in the New Zealand tax system, para 43).

11.5 Recommendations

IRD should continue the current compliance costs reduction strategy which includes:

- **provision of effective information on compliance cost impacts for the tax policy design process;**
- **an effective focus at the operational level on researching and identifying compliance cost issues for specific taxpayer groups; and**
- **appropriate analyses and use of compliance costs information to identify opportunities for compliance costs reduction, and assessment of the costs and benefits associated with these opportunities.**

12 Tax policy advice

This section is concerned with how tax policy advice should be developed. It:

- summarises recent events and the main factors that have contributed to difficulties in the development of tax policy legislation;
- briefly describes IRD's policy role;
- proposes key principles and approaches that should underpin a successful policy process; and
- describes a new Generic Tax Policy Process (GTPP), together with some important control features.

Supporting details are provided in Appendix G.

The Review Committee was asked to report on policy advice at an early stage of the Review. This was done, and the principles and process presented in this section have been approved by Cabinet. Treasury and IRD have developed an interdepartmental protocol which sets out how the GTPP is to be given effect, including allocating roles and responsibilities. Subsequent work by the Review Committee has developed further detail on legislation issues and on the organisation structure and resourcing necessary for the provision of policy advice. The Review Committee has made no further recommendations on the policy process itself in this Report.

12.1 Major changes in the economy have involved tax policy developments

Section 4, Background and current situation, explains that from the mid 1980s successive Governments have introduced a range of fundamental changes to the tax system. This gave rise to a large increase in the amount of policy advice required and in resulting legislation.

New Zealand's tax system is now widely regarded as one of the most effective and least distortionary in the world. But some serious concerns have been expressed, both inside and outside Government, regarding aspects of tax policy development.

12.2 The tax policy problem has several components

The subject matter is complex

Tax policy design must address many factors that inevitably involve some trade-offs. There are potentially significant social and economic impacts that require close consideration of both strategic and detail issues. It can therefore be difficult to specify exactly what policy advice is required. But without such specificity, the policy advisers are in a difficult position regarding the direction their advice should take.

The tax policy process was not clear, neither were accountabilities for the stages of the process

At both Ministerial and departmental levels, roles and accountabilities at each stage of the tax policy development process needed to be more clearly and formally defined. Treasury was generally accountable for the concepts and macro aspects of tax policy development; IRD for the more detailed aspects. But this division of activities did not reflect a wide overlap of common interest. In addition, the tax policy process itself had not been clearly specified or agreed, and had not ensured that strategic issues, and issues of detail, were dealt with in an appropriate sequence, at the appropriate level, or in the appropriate forum.

The Officials Tax Committee (OTC) has provided a partial solution to a mix of tax policy problems. It comprises officials from the Department of the Prime Minister and Cabinet, IRD and Treasury. It reports to the Prime Minister as Chair of the Cabinet Strategy Committee on tax policy, and has a valuable co-ordinating role.

There has been insufficient external consultation

There have been problems in the last few years with a lack of consultation at several stages of the policy development process. This has led to some tax policies and legislation not taking sufficient account of external views and potential problems. The most evident example was the problems experienced with changes to the way business entertainment expenses are treated for tax purposes. Clearly there are limitations, such as Budget secrecy, on the amount and timing of external consultation. But past examples such as GST demonstrate how effective consultation can be. It is clear that appropriate external input is critical to identifying practical difficulties in implementing a proposal to change taxes.

New Zealand's tax legislation needs radical updating

The original base for the legislation dates back to 1916. In its design, it does not meet the modern requirements of tax collecting in two major aspects. The limited number of taxpayer returns early this century were largely assessed manually. However, mechanisation of the processing of taxpayer returns and payments and the advent of self-assessment have not been accompanied by corresponding changes in the legislation. The other design deficiency is that layers of major changes and new regimes have been added on over the years without any attempt, until recently, to reorder and rewrite the legislation in a coherent way. Yet the legislation has grown from 169 sections in 43 pages in 1916 to 833 sections in 2038 pages in 1993.

The Government has committed itself to the rewriting of the tax legislation over a five-year period. The reordering of the income tax legislation has been completed and the draft legislation is before the House of Representatives. That will provide the base from which the rewrite can be carried out. The Review Committee considers the rewrite is a high priority for the tax administration.

The rewrite should reflect the separate roles of adjudication and management

In the current legislation there are hundreds of references to specific functions and powers of the Commissioner. The present drafting approach and terminology do not distinguish adjudication from management.

In the rewrite and any other tax legislation the drafters should, so far as practicable, identify and reflect the separate functions and powers of adjudication and management respectively. That will accord with the structure and process recommendations of the Review Committee.

The current approach to drafting tax legislation is unsatisfactory

The subject matter of tax legislation is complex. Currently the legislation attempts to deal with the complexity and to provide certainty and precision through the detailed expression of policies in the variety of complex circumstances in which they operate. As a result the intent is often blurred in a torrent of convoluted language in sentences of an average length, measured by a 1992 study, of 135 words. Tax practitioners, Treasury and IRD agree that the legislation is difficult to read and understand. That must have a direct bearing on the difficulties and the cost of administering the legislation and the difficulties and the cost for taxpayers of complying with the legislation.

What is needed has already been recommended by the Working Party on the Reorganisation of the Income Tax Act 1976 and has been endorsed by the Minister of Finance and the Minister of Revenue when receiving and tabling the report. Legislative drafting should provide for clearer expression of the purposes and intent of the legislation, and strive for greater simplification. If that drafting approach is adopted there should be less justification for attempting to provide in detail for every conceivable variety of circumstance.

More understandable legislation will also produce substantial savings in administration costs and compliance costs and will, at the same time, enhance the voluntary compliance strategy.

Finally, there is a further unrelated but important set of problems with legislative drafting. Treasury and IRD both prepare legislation for the Parliamentary Counsel Office, but the accountabilities for the drafting process are not clear. The Review Committee recommendations to address these problems are set out in paragraph 12.9. There is a fuller discussion of the legislative drafting problems in Appendix H.

IRD's policy advice should be more prominent and strengthened

The Review Committee has heard considerable anecdotal evidence that IRD tax policy advice is often overpowered by the advice from Treasury and the private sector. The GTPP provides a framework for IRD to utilise its comparative advantage in tax policy development. To realise this advantage IRD will need to ensure that its policy development resources are suited to the redefined policy responsibilities, and that the organisational structure provides sufficient emphasis for this critical role. This is elaborated on in paragraphs 12.6 and 17.3.

12.3 Tax policy development should be based on key principles and approaches

The Review Committee decided to tackle the overall problem outlined in 12.2 by first defining the principles that should underpin tax policy advice. This is elaborated on in paragraphs 12.6 and 17.3.

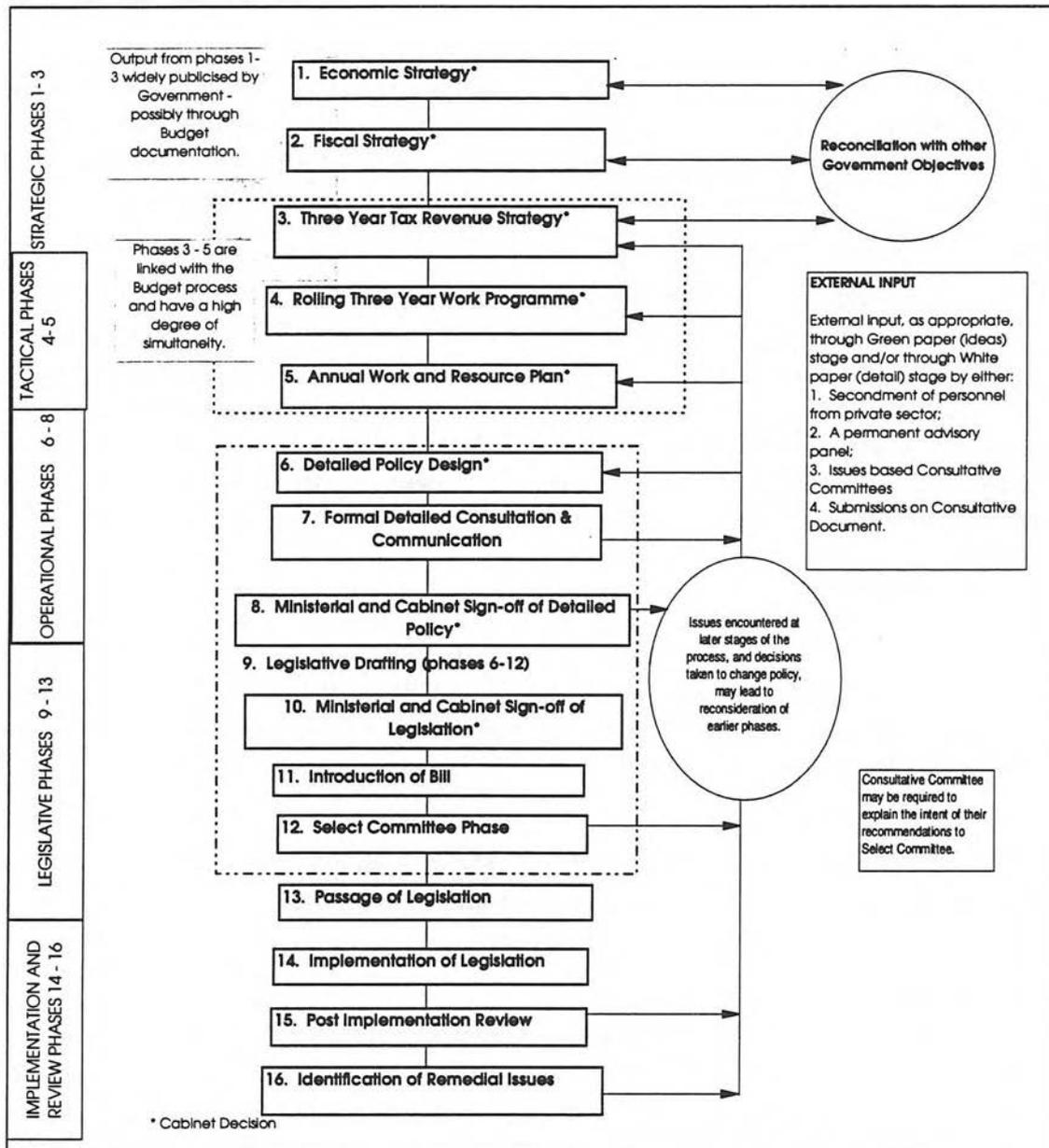
- Key strategic issues should be resolved early in the policy development process. This includes ensuring an effective link between economic and revenue strategies, and settling issues of principle at a broad level.
- The fundamental intentions of tax policy should be thoroughly debated to ensure a wide exchange of views and understanding, and consistency with other Government policies. Once agreed, the intentions should be communicated as soon as practicable to all people involved.
- The roles and responsibilities of all participants in the tax policy process should be clear.
- The policy development process should specify trade-offs relevant to the policy (such as revenue impact, compliance and administration costs, economic objectives, social objectives and implementation).
- Appropriate external people and/or other government departments should be consulted at all stages of the policy development process, and particularly at the early stages, unless there are specific reasons for excluding them.
- The results of implementing tax policy, and the policy process itself, should be reviewed regularly for adherence to the intended direction and potential improvements. Remedial action should be taken as soon as practicable.
- The management of tax policy, and the drafting of any subsequent legislation should reflect best practices, including clear accountability, specification and monitoring of performance, the provision of free and frank advice from officials, and optimum use of resources.

12.4 A Generic Tax Policy Process is now being implemented

A new Generic Tax Policy Process (GTPP) has been developed by the Review Committee, approved by Cabinet, and is now being implemented.

The main steps of the GTPP are depicted in the following diagram. The GTPP addresses all the principles and approaches proposed above, and will enable efficient and effective resolution of all the current problems. But the success of the GTPP will be dependent on sound implementation, including appropriate management and resources, and commitment from all the key players - without these, many of the intended benefits will not be realised. Some related points are noted for consideration in Section 19, Benefits, costs and transitional arrangements.

Generic Tax Policy Process



The GTPP has three main objectives:

- to encourage early, explicit consideration of key policy elements and trade-offs;
- to provide an opportunity for substantial external input into the policy formation process; and
- to clarify the responsibilities and accountabilities of participants in the process.

The process identifies all points where Cabinet decision is required. The process should make it easier for Cabinet to keep an overview of tax policy development because the strategy and the key outcomes will have been clearly specified and discussed before detailed work proceeds. The GTPP also has the advantage of being more consistent with the current Budget process.

There are five distinct but integrated groups of phases in the 16-step process:

Strategic phases:

include economic strategy, fiscal strategy and a three-year revenue strategy. The policy advice should cover broad cost-benefit analyses, and enable Cabinet to make clear and non-conflicting decisions that can be communicated widely. A key feature of the process is the greater focus on strategic planning in tax policy development and on maintaining linkages with these strategies in subsequent phases of the process.

Tactical phases:

include a rolling three-year work programme, and an annual work and resource plan. The plans for developing the policy should include identifying relevant concepts, scoping, sequencing, priorities, and resource requirements. The focus should be on practical plans that will ensure the policies can be implemented in an efficient and effective manner, with minimal call for later changes. The next year's work programme should receive most attention, with regular updating of the following two years' programmes.

Operational phases:

include detailed policy design, formal detailed consultation, and Ministerial and Cabinet approval of detailed policy. The result should be policy specifications that are ready for implementation. The focus of policy development and external input should be on adding maximum value consistent with the stated intentions and objectives of the policy. The legislative phases may proceed in parallel with this phase.

Legislative phases:

will be similar in principle to the present. The task should be more straightforward than at present, especially at the select committee stage, because of improved policy specifications and more extensive consultation.

Implementation and review phases:

include implementation of legislation, post-implementation review and identification of remedial issues. A key feature is the specific integration of these phases into the total GTPP. This will include implementing computer systems, staff training, taxpayer and practitioner communication and education, and an enforcement strategy. After an appropriate period, a formal review should be carried out to assess the results of the policy and its implementation. Any improvements identified should be dealt with rapidly.

Within these five phases, the respective roles and responsibilities of Treasury and IRD should be allocated according to the principle that each Department should concentrate on those areas where it has a comparative advantage.

In general this will mean that Treasury will have primary responsibility for the strategic and tactical phases, and IRD will have primary responsibility for the operational and subsequent phases.

Within these responsibilities managers have to have the scope to make the best use of the collective talents of both Departments.

12.5 The GTPP features external consultation and feedback

The GTPP includes formal external input and consultation at five different phases of the process:

- 'green paper' stage, where policy options are considered;
- 'white paper' stage, where detailed design issues are considered;
- during legislative drafting to ensure legislation meets all requirements;
- select committee, as at present; and
- post-implementation review.

Although the GTPP phases are described sequentially, several will overlap and interact. The three- and one-year work programmes will provide the formal links, but the management of all phases will need to recognise the points at which their work interacts with others, and establish appropriate communication channels.

Consultation must be genuine. External people must not feel their views are requested for the sake of appearance. The GTPP makes provision for the form of consultation most appropriate to the particular part of the process. Possible forms include:

- consultative committees formed to address specific issues;
- a panel of private sector advisers; and
- specialists seconded from the private sector.

12.6 The requirements of the GTPP should be reflected in organisation structures

The concerns described at the beginning of this section suggest the need to give specific focus to the structural arrangements for delivery of tax policy advice from the tax administration. In particular, the arrangements should ensure that an appropriate level of management focus and skills is applied.

The Review Committee considered several options, including setting up a separate ministry for tax policy. However, it concluded that there are advantages in retaining a stand-alone policy unit that is structurally linked to IRD. This link will be especially important to readily access the operational arms of IRD, and so gain information from IRD staff closest to taxpayers about the likely impacts on the customer base, as well as the practical needs of tax administration. As explained in Section 8, Objective of tax administration, this policy unit should identify and develop specific tax policies that will raise tax revenue in the most economically efficient and equitable manner, and provide tax policy advice that meets performance measures specified by Government.

The importance of tax policy requires involvement of the best specialists on tax and related disciplines in New Zealand. It is therefore vital that IRD is able to at least match the expertise at all levels that other players, such as Treasury and the private sector, are applying to tax policy development.

12.6.1 Recommendations:

- **IRD should have a Tax Policy Development Unit:**
 - to provide the highest quality advice to Government, at least matching that available elsewhere;**
 - reporting directly to the Chief Executive;**
 - understanding the practical operation of business and other income earning activities;**
 - with the best mix of skills and experience at both the managerial and staffing levels;**
 - supplemented as necessary by appropriate external specialists to complement internal skills; and**
 - structured to suit the needs of specialists, multiple projects and many internal and external relationships.**
- **IRD should ensure that its management and communication processes are suited to their role in the GTPP.**

The structural arrangements for the unit are considered further in Section 16, Structural options and evaluation.

12.7 The operation of the GTPP should be reviewed

The change to the GTPP and implementing the recommendations above will require a period of adjustment. Detailed planning and implementation are likely to identify further scope for improvement. But some problems may also become apparent. It is therefore recommended that a further appraisal of the quality of policy formation be completed by the end of 1994 (noting that implementation has already started). This appraisal should be carried out by the Department of the Prime Minister and Cabinet.

The GTPP appraisal team should report to the Minister of Finance and Deputy Minister of Finance on:

- how well the GTPP is working in practice;
- whether there are any significant outstanding problems with any aspect of the quality of tax policy formation;
- whether any amendments to the GTPP are necessary in the light of experience; and
- whether any further detailed examination of any aspect of tax policy formulation is appropriate.

12.8 The rewrite of tax legislation should be expedited

The Review Committee fully supports the current project to rewrite the Inland Revenue Acts, and to introduce simplification. As noted earlier, the Review Committee considers that this rewrite is a very high priority for tax administration, although the programme has not been examined sufficiently to make specific recommendations about timing or resources.

The Review Committee endorses the high priority recommended by the Valabh Committee for the rewrite of tax legislation, and recommends that the rewrite be incorporated into the planning phases of the GTPP and completed as soon as possible.

12.9 Tax legislation should be drafted clearly

The Review Committee recommends:

- **the legislative drafting style should change to provide for clear statements of purpose, principles and rules employing a simple, plain language approach in much shorter sentences and avoiding undue detail;**
- **both in the rewrite and in other tax legislation the distinctive role and powers of adjudication should be separately identified; and**
- **that a framework be developed to ensure that changes to improve simplicity and clarity are consistent with, and support, the need to protect the integrity of the tax base.**

12.10 Accountabilities for drafting should be explicit

To clarify responsibilities for drafting tax legislation, the Review Committee recommends:

- **in keeping with the GTPP, IRD will normally be responsible for drafting tax legislation. This will utilise IRD's information and other comparative advantages;**
- **such drafting, which is to reflect the intent of the policy design, will be done in consultation with Treasury;**
- **in exceptional cases where Treasury is responsible for all phases of the GTPP for a particular policy issue, Treasury will prepare draft legislation and then forward it to the IRD Legislative Unit for checking overall consistency with tax legislation; and**
- **in all cases the IRD Legislative Unit will be accountable for overall drafting of tax legislation, including the rewrite of Inland Revenue Acts, and for checking drafts to ensure overall consistency with tax legislation. (The Legislative Unit will be a separate part of the Tax Policy Development Unit); and**
- **Parliamentary Counsel Office should provide final quality assurance of draft legislation.**

13 Social policy functions

13.1 IRD currently administers a number of social policy schemes

The Review Committee gave considerable attention to the issue of the structural fit of the social policy functions which are currently undertaken by IRD. These activities include:

- collection of the National Superannuitant Surcharge;
- collection of ACC levies;
- administration of Family Support for non-beneficiaries;
- assessment and debt collection function for Student Loans;
- administration of the Child Support scheme; and
- supply of income and employment commencement and cessation data to other agencies.

The different schemes are all separate output classes with separate detailed reporting, except for the National Superannuitant Surcharge which is incorporated into each of the four core tax output classes (Taxpayer Information Services, Revenue Assessment and Collection, Management of Overdue Tax and Returns, and Taxpayer Audit). The schemes, with the exception of Child Support, are administered by the core tax functional units. Child Support is a distinct unit with separate reporting lines within IRD. ACC levies are collected by IRD under an explicit agreement including the transfer of funding from the Accident Rehabilitation and Compensation Insurance (ARCI) Corporation to IRD.

IRD has the prime responsibility for the operational design and policy for all of the schemes, except the ACC levies. In some cases other agencies have the primary responsibility for macro-policy, eg the Ministry of Education for the Student Loan scheme and the Department of Social Welfare (DSW) for Family Support. In the case of the Child Support scheme, in practice it is not clear whether IRD or DSW has the primary macro-policy responsibility.

Supply of income and employment commencement and cessation data is undertaken within the framework of a memorandum of understanding with the receiving agencies. The memorandum deals with issues of confidentiality in particular. The Review Committee considers this appropriate and makes no further comment.

13.2 Two key principles for considering structural fit have been developed

The Review Committee has developed two key principles as a basis for determining the prime responsibility for the policy and/or delivery of social policy schemes in which IRD is currently involved, and for considering the optimal location of any future social policy functions. These are:

- **IRD's core business is the assessment and collection of tax revenue, rather than all Government revenue. Any other revenue collection functions that IRD is asked to undertake may have potentially detrimental impacts on the effectiveness with which it carries out its core business and is able to meet the needs of Government and its core customer groups; and**
- **when IRD is being asked to administer, through its collection system and income related data base, all or part of a policy scheme whose ownership falls within another agency of government, that agency should be required to contract with IRD for the delivery of that function.**

In developing these principles the following points were noted:

13.2.1 Undertaking non-core activities can be detrimental to the tax administration

The detrimental effects of performing non-core activities can include:

- a loss of focus on core tax administration activities which may manifest itself in inefficient practices and insufficient management time and attention. Significant management attention has been devoted to many of these functions, particularly in the set-up phase. In addition, a different culture and set of skills may be required for administering these schemes which IRD would otherwise not have to acquire;
- the opportunity costs for IRD of undertaking non-core functions. For example, although in the future the IRD may be able to move to 'no returns' for the great bulk of taxpayers for core tax purposes, the requirements of the social policy schemes may continue to make some returns mandatory. Assuming that these functions need to be undertaken the Government should, however, consider the relative opportunity costs across public sector agencies; and
- the additional compliance costs for taxpayers such as employers which could affect voluntary compliance in tax matters. If the activities are to continue then presumably compliance costs will be an issue.

13.2.2 It is difficult to define whether some social policy activities are core business

Determining how closely some of the social policy activities 'fit' with the core tax administration functions is not entirely straightforward. This is because of definitional problems. Some of these activities could be described as marginal add-ons to the tax system and closely related in purpose and design to taxes, eg the Family Support Tax Credit and the National Superannuitant Surcharge. In these cases it can be argued that IRD is justifiably involved in their delivery. In other cases, such as Student Loans and Child Support, the schemes provide entitlement to financial assistance and are not as easily equated with tax activities.

Ultimately these definitional issues are a matter of judgement. In the Review Committee's view, the bulk of these current activities are not core taxation activities and therefore should ideally be carried out by some other agency. This would have the two main advantages of concentrating organisational focus on core tax functions while reducing compliance costs for individuals in dealing with their tax affairs.

13.2.3 Where IRD performs non-core activities, an explicit service contract should apply

The Review Committee recognises that IRD has in the past been asked to perform non-core social policy activities because it already has access to an extensive information base of income data needed to carry out other assessment processes. In addition IRD has a well-developed 'enforcement' culture which is effective for collection activities. Finally, because it already has efficient information and high volume processing systems, there are low marginal costs and economies of scope in incorporating additional functions based on taxable income, especially in comparison with other public sector systems.

Where it is administratively practical from the Government's overall point of view for IRD to continue to administer social policy activities, an explicit contracting mechanism should apply. This would include:

- clarification of the relative roles and responsibilities of the lead agency and IRD, including macro-policy, delivery decisions, monitoring and accountability;
- specification of the level and quality of service to be provided by IRD, including performance standards and indicators; and
- funding for IRD administrative activities being provided by the lead policy agency.

13.3 Application of principles to current social policy activities

The Review Committee has applied the two principles outlined in paragraph 13.2 to draw conclusions about the appropriate structural arrangements for the social policy schemes currently administered by IRD.

13.3.1 National Superannuitant Surcharge is part of core business and appropriately administered by IRD

The National Superannuitant Surcharge scheme is tax-like in nature and therefore IRD is the appropriate organisation to administer the collection of the surcharge. The current integration of surcharge collection within the common IRD business processes is appropriate and should continue.

13.3.2 The Family Support scheme is tax-like in nature and therefore closely aligned to IRD's core business

Although there is some definitional debate about the purposes of the scheme, Family Support as currently constituted can be considered a form of negative taxation. The Review Committee therefore considers that it should continue to be administered by IRD as part of its core activities. Ministers have recently confirmed the continued placement of the scheme within IRD. The current role of DSW in the provision of macro-policy development on this scheme is appropriate.

13.3.3 Collection of ACC levies is appropriately administered on a contractual basis

ACC levies are user charges. The revenue received is not considered direct Government revenue and is instead directed to a specific purpose. The Review Committee considers that the current explicit funding and intended contracting arrangements between ARCI Corporation and IRD are appropriate and should

continue. These arrangements provide a useful model for other non-core administration activities carried out by IRD on an agency basis.

13.3.4 The assessment and debt collection function for the Student Loans scheme is not core IRD business and should be the subject of a contract with the Ministry of Education

Student Loans are not considered a core taxation activity. The Ministry of Education clearly has the responsibility for the policy of the overall scheme and is the agency which loans the money. IRD only performs the assessment and collection function, although it is recognised that the nature and parameters of these functions are specified in detail in legislation and are closely intertwined with the income tax assessment and collection process. Nevertheless the Review Committee considers that it would be desirable for the overall oversight of the scheme, including debt collection, to rest with the Ministry of Education.

If IRD is to continue to administer the collection function because of the current design of the scheme, then an explicit funding and service agreement should be instituted between the Ministry of Education and IRD.

13.3.5 The appropriate organisational location of the Child Support scheme is best considered in the context of the Trapski Review of the scheme

The issues in this area are more complex. To some extent Child Support appears to be a function in search of its proper home. There are debates about the nature of the scheme and its essential objectives which bear on the delivery function responsibility. In summary, the two major views about the nature of the scheme are that it is designed primarily to ensure:

- the protection of the social and financial welfare of dependent children where the parents are no longer living together. This clearly falls within the primary responsibilities of DSW; and
- the collection of revenue to offset Government expenditure on the Domestic Purposes Benefit, and therefore may appropriately be sited within the Government's primary revenue collection agency: IRD.

There is force in the first view and the Review Committee considers that the macro-policy function should rest with DSW. However, the Review Committee does not consider this an appropriate stage at which to make a firm recommendation on the delivery responsibility. The Trapski Review of the Child Support scheme will cover broad issues such as the nature and the design of the overall scheme. This Review does not want to pre-empt the findings of that more detailed exercise. It therefore proposes that these issues and the possible structural implications be more fully outlined in a memorandum to the Trapski Review and that the current structural arrangements which treat Child Support as a separate customer segment within IRD continue in the interim.

13.4 Recommendations

13.4.1 The following principles should be adopted in considering the structural fit of the administration of social policy schemes within IRD:

- **IRD's core business is the assessment and collection of tax revenue, rather than all Government revenue. Any other revenue collection functions that IRD is asked to undertake will have potentially detrimental impacts on the effectiveness with which it carries out its core business and is able to meet the needs of Government and its core customer groups; and**
- **when IRD is being asked to administer, through its collection system and income related data base, all or part of a policy scheme whose ownership falls within another agency of Government, then that agency should be required to contract with IRD for the delivery of that function.**

13.4.2 As both the National Superannuitant Surcharge and the Family Support schemes are tax-like in nature and closely akin to core business, they should continue to be located within IRD.

13.4.3 The current explicit funding and contracting arrangements between the ARCI Corporation and IRD should continue.

13.4.4 If IRD is to continue to administer the Student Loans collection function because of the current design of the scheme, an explicit funding and service agreement should be instituted between the Ministry of Education and IRD.

13.4.5 The possible structural implications of the administration of the Child Support scheme should be considered by the Trapski review.

13.4.6 The current structural arrangements which treat Child Support as a separate customer segment within IRD should continue in the interim.

14 Structural issues

This section considers the issues that have not already been addressed in previous sections. These issues are either structural, or they have major structural significance. While each issue is considered separately, the nature of tax administration is such that most issues interact with each other.

14.1 Tax administration has a growing need for specific customer focus

The Review Committee heard numerous favourable comments on the improvements in customer service over recent years. However, many businesses and tax practitioners consider that IRD should segment services in order to focus on particular areas of business and customer needs. There is a high level of support for IRD's recently formed separate corporate audit group, and for the Taxpayer Audit modernisation programme with its four segments: corporate, medium and small businesses, and non-business. The clear intent is through an 'account manager' and team approach to build a closer relationship and better understanding of the businesses concerned.

IRD commissions many customer surveys. Most of the surveys of individual taxpayers (of whom there are more than two million) rate IRD overall as providing above average customer services compared with other New Zealand organisations. This high rating contrasts with many significant complaints received during the course of the Review from businesses and tax practitioners. However by far the largest concern of businesses and tax practitioners is the burden of compliance (discussed in Section 11, Costs of compliance). In many cases, complaints relate to tax policy and legislation rather than administration of that legislation. Additional points of significance to the structure are:

Corporate businesses: concern about several administrative problems has been voiced. For example, in large urban areas where there are several tax offices, taxpayers are arbitrarily routed to a particular office on an alphabetical basis. (This is known as the 'Alpha Split'.) There have been instances where replies to correspondence have taken about eight weeks or, for very substantive issues, a year. Apart from compliance costs, corporates' main concerns are IRD's lack of focus on, and knowledge of some specific industries. Tax practitioners say IRD has made little use of 'materiality' in audit; their tendency has been to pursue any matter however small rather than focusing on the most significant matters.

These aspects are being recognised by IRD in the Taxpayer Audit modernisation, and from 1 March 1994 a separate audit structure for corporate taxpayers has been put in place to address these concerns. This includes having a manager for each industry type, eg forestry, mining and primary producers.

Small and medium businesses: most have their income tax handled by tax practitioners. Some have noted that they often have difficulties getting technical advice from IRD, and that technical advice and services from different IRD offices are often inconsistent and difficult to access. IRD has in recent years established a small

business advisory service particularly aimed at new business. This service has been well received and the demand is increasing. This reinforces the need to focus on specific customer groups.

Non-business taxpayers: mostly express a relatively high level of satisfaction with IRD's services. There are several groups that have significantly different requirements for tax, age or ethnic reasons: for instance, some elderly people on superannuation, and some recent immigrants who may not have experience of paying tax under a voluntary compliance system.

Customer information: IRD has considerable knowledge of some taxpayer groups, but there are significant gaps in this knowledge, particularly in some business areas. Some form of research function will be important to improve the understanding of customer needs, to assess what is the most effective form of communication, and to assess the most cost-effective approach for each specific customer segment.

The structure should facilitate solutions to the issues above, in particular:

- inconsistencies between offices;
- variable quality and quantity of technical advice;
- delays in answering queries, particularly from businesses;
- more face-to-face communication being needed for some customer groups;
- provision of services through multiple channels and approaches; and
- facility to research and assess customer and related information.

14.2 Geographic distribution of work and levels of management

IRD's management and activities have to be geographically distributed rather than operated from one location. For instance, most taxpayer services must be near the customers. Multiple Processing Centres are needed for disaster recovery. The current structure is based on programmes and geographically spread between Wellington Head Office, four Regional Offices, 26 District Offices and three Processing Centres. Analysis has raised some issues:

- there are inconsistencies between Regional and District Offices, both in operational matters and advice to taxpayers;
- the separation of programme design and delivery leads to some lack of co-ordination. Their common reporting line is at the Management Board level; and
- the Regional Office role is to provide co-ordination of service delivery and resources and some specialist functions, and managing Child Support directly. This contributes to some problems of consistency, and adds a level of management.

14.3 Technical and interpretative advice

Following on from paragraphs 14.1 and 14.2, there are concerns about the quality and consistency of advice on the interpretation of legislation. They relate to:

- duplication and double-handling in the disputes resolution process;
- fragmentation of technical skills throughout IRD;

- several aspects of audit that are being addressed in the current Taxpayer Audit modernisation programme such as lack of industry knowledge; and
- the volume of change experienced in IRD over the last five years which has led to a lack of focus on the development and maintenance of technical skills among staff.

14.4 Social policy functions

Section 13, Social policy functions, describes social assistance activities and issues. Additional factors for consideration regarding the organisational structure are:

- all social assistance functions except Child Support have been integrated into the core tax operations with minimal disruption, although they have involved considerable effort and management time especially during the transition phase;
- the management and delivery of Child Support has been kept separate for a two-year implementation period that recently ended; and
- Child Support has some special requirements that are significantly different from the rest of core tax and the other social assistance functions. The main difference is the need to deal face-to-face with parents who are often in a very emotional state. This contact requires different skills and approaches not normally associated with tax collection activities.

14.5 Information technology

IRD's FIRST information system is a very effective tool that integrates information about taxpayers, processes the information, and enables IRD activities to access the information. FIRST has been rated as amongst the best of its type in recent major benchmarks of information technology (IT). But IRD's IT budget for information systems is some 20 percent of the total IRD personnel and direct operating expense budget - a very significant proportion. This is higher than some other large organisations, reflecting the on-going development costs, its specialist and integrated nature and the scope of the system which is broader than most other organisations'. Key points with regard to structure are:

- FIRST's integrated and advanced approach provides considerable flexibility for tax administration, both now and in the foreseeable future; and
- IT need not be a barrier to service delivery or any other IRD operations.

Several technology changes are currently being investigated or are planned by IRD. These could have significant impacts on how IRD carries out its operations:

- 'imaging' to capture documents in computer storage and allow remote access. IRD has a trial underway that could lead to major changes in work processes, and remove barriers to the location of some work;
- electronic data capture, already being utilised in some areas such as filing returns, could further replace paper-based systems and reduce some administration and compliance costs; and

- better access to information for both staff and customers through the use of terminals in remote locations, enhanced telephone systems and stand-alone information stations.

14.6 Overseas tax administrations

The Review Committee approached several overseas tax administrations to gain an understanding of their structures. It became clear that each tax administration is structured to suit the social, political and economic environment in the particular country and any comparisons should take these differences into account. In particular it should be noted that many of the fundamental concepts underpinning the recent changes in the New Zealand public sector are not uniformly present in these countries. All the information collected will be retained as a practical resource for IRD.

Some particular points regarding the countries surveyed are:

- most countries organise their tax administrations on a functional basis with additional segmentation by either customer grouping or tax type;
- a number of countries, notably the Netherlands and Sweden, have developed a customer segmentation approach with sections for individuals and business taxpayers. In the Netherlands this approach has led to the concept of team working, where autonomous teams carry out tax functions for a group of taxpayers;
- Australia has recently announced what is primarily a customer segment approach. It has also been experimenting with team based approaches;
- all the countries have a district/local presence. The majority of countries have a three-tier structure with a Head Office undertaking mostly design activity, and a regional structure co-ordinating delivery undertaken by local offices;
- most tax administrations surveyed carry out social policy collection functions. A number also undertake collection of customs duties;
- the head of the tax administration carries out statutory as well as administrative functions; and
- few countries have any formal measures for assessing the tax gap or the effectiveness of the overall tax administration system. In the past few years a number of administrations, eg Australia, Canada, and the Netherlands, have moved away from such an approach and have focused on analysing compliance rates across different taxpayer groups.

15 Design criteria and principles

This section briefly outlines the major criteria and principles which were used by the Review Committee to develop and evaluate the various structural options.

15.1 The Review Committee has developed eight design criteria for the development and evaluation of structural options

During the course of the Review the Committee developed a set of key issues in relation to tax administration. Together with some external factors that will affect tax administration, these were summarised in Section 7, External factors and key issues. The subsequent sections have detailed many of the issues. These have been developed into eight design criteria that have been used in the development and evaluation of structural options.

These design criteria largely relate to the unique features and demands of the tax administration business. They are a subset of the overriding principle that the organisational structure should support and facilitate achievement of the fundamental objective of tax administration set out in Section 8, Objective of tax administration. The eight key design criteria are:

- concentrate on the core business of assessing and collecting tax revenue;
- take advantage of the level of automation already achieved and the common information data base;
- improve customer focus particularly through vertical integration of design and delivery;
- impartially apply the law and protect the integrity of the tax system by separating the adjudicative function within the structure;
- improve the consistency and quality of technical activities by ensuring a sharper focus on this aspect;
- structurally differentiate the three strategic functions performed by IRD, namely policy, adjudication and operations;
- determine the optimal delivery mechanisms by an assessment of where the work needs to be done; and
- ensure the recruitment, development and retention of quality people.

15.1.1 Core business

A primary evaluative criterion is the relative extent to which the structural option is able to facilitate IRD's objective of obtaining for the Government over time the highest net revenue within the law that is practicable. This objective requires consideration to be given to compliance costs incurred by taxpayers as a result of the activities of the tax administration, as these affect voluntary compliance and therefore the amount of revenue collected. The costs to the tax administration also need to be considered.

In effect, this criterion requires a constant focus on defining and being aware of the organisation's core business in order to meet its overall objective and to undertake activities supporting this objective in as efficient and cost-effective a manner as possible. The Review Committee considers IRD's core business is the assessment and collection of tax revenue. The application of this criterion raises questions about the 'fit' of social policy schemes as discussed in Section 13, Social policy functions, and the degree to which these may deflect attention from core business. The objective of maximising net revenue over time within the law also underlies the analysis of the functions which may be sub-contracted.

15.1.2 Automation and information data base

The level of automation of IRD's work processes already achieved, as outlined in paragraph 14.5, both in the Processing Centres and District Offices, coupled with the potential future developments in technology applications, provides the opportunity for IRD to take full advantage of technology. This allows the organisation to be more sharply focused on aspects such as technical competence and customer service.

The automation is based on common systems, which in turn provide a common information data base that can be accessed and modified throughout the organisation. It is this common data base that facilitates any integration that is required within the organisation. This also means the information system is not a constraint on the organisation structure that can be adopted.

15.1.3 Customer focus

One of the priority areas of the Review has been a significant need to increase the degree and type of customer focus. This is outlined in more detail in Section 14, Structural issues. Improved customer focus and excellent customer service are seen as a critical means of maintaining and increasing the level of compliance and thereby helping to achieve IRD's overall objective. This will also aid the efficient enforcement of the law in relation to debt and return management activities.

The Review Committee emphasises the need for a comprehensive customer-based focus and philosophy across IRD which will have both structural and non-structural aspects. A key aspect of any structural realignment around customer groupings is the vertical integration of management responsibility for design and delivery functions, and thus clear accountability at a very senior level for all of the services provided to the customer group. Another key implication is that IRD requires detailed and on-going information on its key customer groups and their specific needs.

15.1.4 Impartial application of the law

A key component of obtaining the highest net revenue, by supporting voluntary compliance, rests on taxpayer perceptions of the integrity of the tax system. Perceptions about integrity are tightly linked to the impartial application of the law and the exercise of the administration's coercive powers and decision making powers with respect to the affairs of individual taxpayers.

Thus the Review has devoted considerable attention to issues such as:

- the definition of the nature of the relationship between the Minister of Revenue and the Commissioner of Inland Revenue, in some critical areas;

- improvements to the disputes resolution process; and
- the structural separation of the final adjudication and rulings activities from other operational activities, particularly audit and litigation management.

15.1.5 Quality of technical and policy activities

The Review Committee recognises the urgent need to improve the quality of technical activities within IRD. This is more fully discussed in Section 14, Structural issues. Structural options were examined which would facilitate improvements in technical standards using mechanisms such as:

- the concentration of specialist expertise in a small number of sites to promote greater consistency and to give effect to a national tax system, eg in areas such as litigation management and adjudication. Concentration of skilled staff also assists with the achievement of critical mass;
- specific structural focus on technical matters, for example, through the establishment of a central co-ordinating Technical Development Unit;
- specific managerial responsibility for key technical functions at both a Head Office and local delivery level; and
- appointment of highly skilled experts to appropriate management positions at the most senior level, eg the policy and adjudication managers at the second tier.

15.1.6 Three strategic functions of IRD

The Review Committee has identified the need to;

- give more prominence to and strengthen the policy development role, reporting directly to the CE; and
- separate the adjudication activity from the routine enforcement activities, combining it with rulings, reporting directly to the CE.

The other major activity can appropriately be described as Operations, integrating design and service delivery.

The Review Committee has identified these three functions as the three major strategic business functions for IRD:

- adjudication activities requiring the exercise of some of the Commissioner's important statutory powers;
- policy development and review; and
- operations: integrated design and service delivery focused on particular taxpayers.

The Review Committee considers it vital to distinguish these three functions which are fundamentally different because they require specialist expertise and unique production processes. Different structural arrangements, staff, performance indicators and human resources policies will be required for each. A separate managerial focus for each functional area is required. For example, while each area should have a second-tier manager, these are likely to be experts in their own field and the operations manager would not be expected to be 'interchangeable' with the adjudicative or policy manager.

15.1.7 Where the work needs to be done

The key criterion for determining the local delivery structure is the smallest number of permanent sites necessary to undertake the required activities on a cost-effective basis. Decisions on the number and types of offices should be based on an analysis which includes:

- where the work needs to be done, eg the type and degree of 'field' presence required to undertake the activity at least cost and most effectively;
- any economies of scale which might be available through centralisation and concentration of staff and activities;
- limiting specialist functions to a small number of sites to facilitate consistency and a critical mass of staff and/or skills;
- ability to manage key characteristics of the workload such as very stark workload peaks; and
- reasonable access by taxpayers to a local IRD office.

Applying this analysis it is clear that Processing Centres should be retained. They provide for very efficient and accurate automated processes that handle the bulk of returns and create data bases that provide vital information to the rest of the organisation. Local delivery patterns are also likely to be different throughout the country and local offices will not be mirror images of each other.

15.1.8 Recruit, develop and retain quality people

IRD's staff will be its most important resource in achieving the changes described in this Organisational Review. IRD must be able to recruit, develop and retain staff with appropriate skills and expertise, not just in specialist areas such as policy, adjudication and audit, but throughout the organisation. In designing the structure it will therefore be important to consider issues such as how appropriate levels of critical mass and synergy can be achieved for groups of staff at different levels of the organisation, and how (where applicable) to foster the development of an approach based on work teams.

Structural change will also need to be underpinned by appropriate human resource strategies targeted at meeting business needs. These will be an important tool in managing the transition process and promoting the cultural changes required, for example, achieving the desired level of customer focus. There should be adequate strategic focus on human resource issues at the senior management level.

15.2 A number of generic organisational and management principles were also applied to the evaluation

The Review Committee also applied several standard management and organisational principles to aid in the development and evaluation of the structural options. These principles are concerned with the issues which are of generic application to any public or private sector organisation.

Will the structure facilitate:

- clear and non-conflicting objectives within and between units;
- clear lines of accountability and specification of roles and responsibility;
- delegation and authorities as close to the operations as possible ;
- span of control of a feasible size, which allows efficient oversight and monitoring;
- clear information and communication flows; and
- co-operative behaviour and decision-making that incorporates appropriate consultation.

Does the structure organise the work in an optimal way that:

- links or integrates business processes which utilise common information and systems;
- maximises any benefits to be obtained from economies of scale or use of technology; and
- minimises work flow duplication.

16 Structural options and evaluation

The Review Committee developed and considered a range of structural options for all levels of the organisation. The key questions posed in the development of the structural options include:

- whether IRD should remain a single organisation;
- whether a departmental or some other organisational form would be most desirable for the tax administration;
- the basic orientation and building blocks of the structure, in particular to what extent the organisational structure should be based on customer groups, functional activities or revenue types;
- the structural 'fit' of social policy activities such as administration of the Child Support and Student Loan schemes;
- at the delivery level, the optimal structural means of ensuring efficient and cost-effective management and delivery of services; and
- particularly at the Head Office and corporate level, the structural means of ensuring greater management focus, and the enhancement of specialist expertise in the key areas of adjudication, policy and operations.

The other major structural option considered during the Review was the extent to which the further sub-contracting of IRD functions was desirable and possible. The Review Committee's conclusions on these issues are discussed in Section 18, Sub-contracting options for delivery.

Some of these issues have been discussed in earlier parts of the Report, in the context of particular issues, particularly Section 9, Roles of the Commissioner and the Chief Executive of IRD, and Section 12, Tax policy advice. The major components are summarised here with the aim of providing an overview of all the major structural options considered.

16.1 The review considered the desirable number of organisations and most appropriate type of organisational form(s) for the tax administration

IRD is one of the largest public sector organisations. Early consideration was given to the possibility of re-configuring current activities into two different entities. Underlying this was the assumption that some activities of IRD can, and should be, separated from the rest of the functions currently undertaken by the Department. In particular, consideration was given to whether it would be possible or desirable to:

- undertake tax policy in a separate organisation such as a ministry;
- carry out the wider adjudicative powers of the Commissioner in a separate agency; and
- carry out operational activities of the tax administration through a Crown Entity.

16.1.1 A separate tax policy ministry is not appropriate

The Review Committee considered the establishment of a separate tax policy ministry which would deal with legislative policy and which would give effect to a policy/operational split within the tax administration. A policy ministry allows a strong focus on the recruitment and development of strategic policy and specialist staff. It also minimises the potential for legislative policy makers to be 'captured' by operational issues and for senior management attention and focus on policy and strategic issues to be 'crowded out' by day-to-day operational concerns.

Early analysis of structural arrangements for tax policy advice concluded that the key and unique perspective that IRD can bring to the tax policy advice process is its detailed knowledge of operational issues and the administration of tax law. This perspective requires close organisational links with the operational activities of the tax administration and an understanding of the issues facing business taxpayers in particular. IRD's comparative advantage in tax policy formation arises from its direct links with the rest of the tax administration.

The Review Committee therefore concluded that the establishment of a separate tax policy ministry is not desirable given the advantages in retaining a stand alone policy unit that is structurally linked to the operational arm of the tax administration. Sufficient structural focus can be given to the policy area by establishing a separate internal policy unit which reports directly to the CE, appointing a very senior and experienced policy specialist to the second-tier policy manager's position, and by implementing the GTPP. But if at any time there is a danger of policy not receiving the appropriate level of attention and support, then the question of a separate policy ministry, if only for a specific period, should be readdressed.

16.1.2 A separate adjudicative agency is not appropriate

Careful consideration was also given to the desirability of separating out into an entity outside the Department, the adjudicative functions which are undertaken by the Commissioner and which relate to individual taxpayer affairs. Locating these functions within a Crown Entity would help to ensure political independence and impartiality in the application of quasi-judicial functions and powers. The perception of the independence and impartial application of law to the affairs of individual taxpayers is considered to be a cornerstone of voluntary compliance.

This option was, however, rejected for several reasons. There are significant benefits in performing adjudicative and other tax administration functions within the same organisation, albeit under separate management streams, because these activities make mutually reinforcing contributions to the single objective. The flow-on effects related to quality may be less immediate and direct if adjudication is performed in another organisation. It is difficult in practice to fully separate out the functions and activities which require the Commissioner to exercise adjudicative powers from other activities of the tax administration.

In addition, as currently drafted the Inland Revenue Acts assume that there is only one tax agency and thus include hundreds of separate provisions of different kinds referring to the 'Commissioner'. Any organisational split into two agencies would necessitate a comprehensive rewrite of the Revenue Acts in order to accurately define roles and responsibilities in tax administration for two different agencies. This

effectively bars immediate separation as the rewrite is expected to take some years and is a prerequisite for full separation. For the same reason, New Zealand's double tax agreements would require re-negotiation over some years.

As discussed in Section 9, Roles of the Commissioner and the Chief Executive of IRD, the Review Committee considers that the requirement for the impartial application of adjudicative powers is starkest in the area of the final quantification of an individual taxpayer's liability, particularly in cases arising from audit. It is also particularly important in the related area of binding rulings. This is where the perceptions of the independence and integrity of the process are likely to have the most direct effects on voluntary compliance. The Review Committee therefore proposes that these final adjudication functions and the provision of binding rulings be located within a separate delivery and management stream, reporting directly to the CE. This function will require very clear delegated powers, specific specialist skills and adequate resourcing.

16.1.3 A separate agency for operational activities is not needed or desirable

Separating out operational activities from policy and strategic issues can create benefits by ensuring that there is a strong management focus on the most efficient and cost-effective means of providing services and meeting customer needs.

Taxes involve the exercise of the coercive power of the State to appropriate private income. Taxes are formally levied by Parliament, reflecting the constitutional convention that taxes should not be raised without political representation. This, together with retaining direct Ministerial oversight over IRD's use of sometimes intrusive statutory powers, suggests a high level of political accountability must be associated with all tax functions, from the determination of the taxes/tax rates through to their collection. A departmental form facilitates the required political accountability.

Consideration has been given to whether constituting the operational activities of the IRD as a Crown Entity could be desirable. A Crown Entity form may be useful to ensure political independence and impartiality in the production of outputs and particularly for operational and non-policy activities, by properly restricting Ministerial involvement to strategic ownership issues.

However, Ministers are likely to want to keep a close relationship with IRD, given the size of the fiscal risk (\$21 billion) to the Government associated with the operations of the Department. They will want to closely monitor the Department and may require corrective action to be taken immediately, where this is needed. A departmental arrangement facilitates the required relationship, partly because the monitoring and accountability arrangements for departments are well-established.

16.1.4 A departmental framework is appropriate for IRD

It has therefore been concluded that tax policy advice, adjudication and tax operations should be organisationally linked within the same structure. The departmental form is considered the most appropriate joint framework for these activities. Within this structure there must be very clear delegations to the managers of these three key activities to achieve accountability and a significant level of independence, and to be able to discharge their responsibilities.

16.2 Some social policy functions currently administered by IRD are part of its core business. Others should be administered on an explicit service contract basis

As outlined more fully in Section 13, Social policy functions, the Review Committee also considered the structural fit of the social policy schemes which are currently administered by IRD. The Review Committee developed two principles which should guide the consideration of the appropriate structural arrangements for IRD's involvement in these areas. Applying these two principles led to the following recommendations:

- both the National Superannuitant Surcharge and the Family Support scheme are tax-like in nature and therefore closely akin to core business and appropriately located within IRD;
- collection of ACC levies is not part of core IRD business, but the current explicit funding and intended contracting arrangements are an appropriate mechanism for clarifying the nature of the relationship between IRD and ARCI Corporation;
- the Student Loan scheme is clearly not a core taxation activity. IRD should undertake the administration of the scheme under an explicit service and funding agreement with the Ministry of Education; and
- there is debate about how closely aligned the Child Support scheme is to taxation activities. The Review Committee considers that this issue would most appropriately be considered within the context of the recently established Trapski Review of the Child Support scheme.

16.3 There are three possible basic structural building blocks for the tax administration

The three primary types of structural building blocks which are used by tax administrations are:

- revenue basis where the organisational structure is founded on differentiation by revenue types;
- functional basis, where the structure is founded on functions and activities; and
- customer basis where the organisational structure is focused on its external (and internal) customers.

The Review Committee considered the application of all three of these structural building blocks to IRD.

International evidence on which of these approaches is most effective for the tax administration is inconclusive. Most tax administrations use a mix of these approaches, with some structural elements based on customer-groups and other elements, eg returns processing structured on a functional basis. This is also the case in New Zealand. While IRD is currently structured largely on a functional basis, it has introduced the first elements of customer segmentation and also reports on a revenue basis. This indicates that the choice of the structural building blocks for the tax administration is likely to be a question of the best balance of these structural

approaches given the particular New Zealand circumstances, rather than choosing one approach and rejecting all the others.

16.3.1 A revenue-based structure is not desirable and information systems can be used for reporting by revenue type if required

In its Report to the Government, the Valabh Committee outlined a possible structural model for IRD based on differentiation by revenue type. The Review Committee developed and evaluated such a model in which the different units would be Income Tax, PAYE, GST, Social Policy and other miscellaneous revenues.

The strengths of this structure include the high degree of transparency and accountability for the administration of the different revenue streams. This allows accurate reporting to Government on each particular revenue stream. It also facilitates functional specialisation by tax type, where the performance of each function, such as audit, can be adjusted to fit the detail of each revenue stream. It would allow IRD to identify, and hold accountable, a single manager who is responsible for the administration and operation of each tax type. A revenue-based approach may lead to some degree of improved taxpayer focus by concentrating attention on the needs of the taxpayer in relation to the payment of a particular tax. There is currently some revenue specialisation within functions, eg centralisation of activities related to non-resident withholding tax.

However, the Review Committee considered that these benefits do not outweigh a number of problems that are inherent in a revenue-based structure:

- as noted in Section 11, Costs of compliance, the tax system and tax administration should place particular emphasis on the costs of complying with tax laws. A revenue-based structure would lead to multiple points of contact for taxpayers paying more than one revenue, particularly most business taxpayers. This would result in confusion for the taxpayer and an increase in compliance costs, together with multiple contacts and increased administrative costs for IRD;
- a revenue-based structure would require agreement on how debits and credits are offset across different revenue streams;
- the performance of the same set of functions within each revenue stream may disperse the benefits from common processes such as economies of scale, as each revenue stream may wish to vary particular processes used. The need for some consistency across revenues would require careful management; and
- a revenue-based structure may lead to duplication of functions and activities. For example, each revenue stream could have its own taxpayer education and facilitation, debt collection and audit functions. A revenue-based structure works most efficiently when there is only a small number of revenues.

While a revenue-based structure has some merit, the Review Committee considers that these benefits can be gained through other structural arrangements without incurring increased compliance costs for the taxpayer or possible duplication within the administration. The use of the integrated information base currently held by IRD can allow accurate reporting on, and accountability for, the administration and costs of

a particular revenue stream. The organisation of the policy advice function partly on revenue lines facilitates this focus and analysis.

16.3.2 A function-based structure is currently used but a change of emphasis is needed

The Review Committee also considered a purely function-based structure for IRD. The current IRD structure operates primarily on a functional basis, with separate units and management streams for the major functional areas of Audit, Debt and Return Management, Revenue Assessment and Collection, and Taxpayer Information Services. Three Processing Centres and an Output Centre were established to take account of the economies of scale inherent in centralising relatively routine and high volume activities.

A functional structure facilitates concentration and specialisation of skills and tasks across customer groups. It recognises that many of the activities performed for different taxpayers are essentially the same, that these can be effectively streamlined and that different functional areas, such as audit, require specialised skills.

A functional structure can, however, militate against the importance of defining key customer groups, establishing their particular needs and meeting them. While the Review Committee sees considerable merit in retaining some aspects of a functional structure, such as Processing Centres, it believes that it is now timely to change the primary building block of the organisation to a more customer focused approach. The level of automation already achieved, both via the Processing Centres and the established work processes, provides an opportunity to focus more on specific customer needs. The structural design can provide powerful signals and incentives about the organisation's key areas of focus.

16.3.3 A more customer-based structure is needed

16.3.3.1 Requirements for greater customer focus

In recent years customer focus and the requirement to effectively identify the needs of, and manage relationships with customers has emerged as *the* critical strategic issue facing organisations in the public and private sectors alike. It is generally accepted that this issue will define whether or not an organisation is successful, however that success may be defined. The Review Committee has already identified customer focus as an important issue for the tax administration.

Customer focus is going to be an important management issue for tax administration, not for altruistic reasons but because it will be critical to the administration's ability to achieve its fundamental objective. The Review Committee has developed a clear objective for the tax administration function to obtain the highest net revenue, over time and within the law. Unless demands from business taxpayers for improved service are met, their voluntary compliance may be affected.

Any organisation concerned about customer focus must identify who its internal and external customers and stakeholders are. In the case of a tax administration the issues are not entirely straightforward. The Minister purchases the outputs of the agency on behalf of Parliament. In order to deliver outputs of the highest quality to the Minister, and to achieve its fundamental objective, IRD must identify the needs of its customers and target services and strategies to meet their specific requirements.

As IRD is effectively a monopoly, customer focus will need to be a strategy that is consciously pursued, rather than something that is catalysed by competitive market pressures.

16.3.3.2 Structural options for improving customer focus

Modifying structure around customer groupings can provide a very strong catalyst for achieving a cultural and managerial shift towards greater customer focus. Structures can be modified in various ways to impact on the type of customer service provided. There is a continuum of options ranging from major structural change requiring unique processes, work organisation and specialist skills, through to relatively minor changes to existing processes, structures, staffing and management systems. There is a menu of possible solutions, including:

- full structural realignment around broad customer groupings;
- establishment of a separate unit or a single management stream to deal with a particular customer group, eg Child Support or corporates, within a functional structure;
- establishment of specific resources, and designated officers devoted to particular customer groups, eg small business advisory officers;
- establishment of an account manager approach to co-ordinate activities for specific taxpayers. This approach is possible within a range of broader structural options; and
- building in customer segments at the design level so that someone is accountable for designing a set of total services to meet the needs of a particular group, eg superannuitants, and can act as a 'product champion' at a senior level in the organisation.

The Review Committee's conclusion was that full structural alignment around customer groupings was desirable.

16.3.3.3 Non-structural mechanisms for improving customer focus

In addition to structural solutions, there is a range of other strategies and mechanisms which should be employed as part of a comprehensive customer service approach. These are outlined in more detail in Section 17, Recommended structure.

16.4 A number of structural options for the delivery level were considered

The Review Committee undertook a detailed analysis of the current activities performed by IRD in order to derive a set of principles and assumptions about the most appropriate structural options for delivery of services at the local level. The analysis took into account the following factors:

- where the work is done, ie the type and degree of 'field' presence required to undertake the activity. For example, the Taxpayer Audit programme requires a heavy audit field presence in dispersed geographical areas where small/medium businesses are located. Thus, although it is possible to centralise audit activities,

because of the large amount of travelling time and costs it is more cost-effective to have a relatively large number of locations available;

- any economies of scale which might be available through greater centralisation of functions. A high level analysis of economies of scale was inconclusive in determining whether further centralisation of functions would necessarily lead to economies of scale;
- a desire to limit specialist functions to a small number of sites to facilitate consistency and a critical mass. For example, it is desirable to concentrate the specialist skills required for adjudication, litigation management and corporate taxpayer activities to only a small number of sites;
- the ability to manage key characteristics of the tax operation such as workload peaks, for example, by having the flexibility to move staff between local offices in metropolitan areas; and
- reasonable access by taxpayers or their agents to a local IRD office.

16.4.1 A re-designed, three-level field structure is considered optimal

Several local delivery scenarios were modelled and their impacts on the above factors assessed. The scenarios were differentiated by the number and size of local offices, the type of office, the functions performed at each location and the varying management and accountability lines which could be applied.

The key local delivery structures proposed by the Review Committee are:

- Field Centres, which are relatively large offices which would undertake all functions and would provide management oversight together with specialist and support functions for a number of 'attached' local offices. (Satellite Offices and/or Customer Service Centres);
- Satellite Offices, which are smaller than Field Centres and responsible to them, which undertake the major activities required at that location; and
- Customer Service Centres, which are relatively small offices, located in metropolitan areas, focusing on direct customer contact activities but with ready access to the full range of functions and expertise from the Field Centre. Initially these are likely to be present only in the metropolitan centres such as Auckland and Wellington.

16.4.2 This field structure has a number of advantages

The delivery structure achieves the following:

- approximately seven prime centres of activity - the Field Centres - facilitate the achievement of effective vertical integration of design and delivery on a national basis. This is crucial to the objectives of improving consistency, and facilitating the segmentation of the structure on a customer basis to improve customer focus and reduce taxpayer compliance costs;
- by dismantling the current region and district structure through aggregation of specialist resources from Districts into Field Centres, and correspondingly disaggregating specialist resources from Regional Offices, it is possible to achieve

a better overall distribution of these key resources. This creates a greater concentration of technical and specialist skills which in turn improves IRD's ability to achieve consistency of legislative interpretation. This will be important in improving the overall quality of technical advice to taxpayers and generally 'getting it right'. It will also have specific benefits in areas like disputes resolution; and

- a cost-effective solution which addresses the issues identified by the Review Committee in this Report. The Review Committee is satisfied that the proposed delivery structure achieves this, and that the work to be done in phase 2 will demonstrate in more detail what can be achieved under these arrangements.

The concept of Processing Centres, which perform a high volume of relatively automated tasks, was retained in all the structural options considered.

16.5 A number of structural options were considered for corporate and Head Office activities

The Review considered a range of options for the functions and activities which should be sited at the corporate level. In particular, attention was focused on criteria for determining which functions and activities should report directly to the CE. The focus was on:

- *areas with particular strategic importance*, eg corporate planning and strategic information technology development, which require direct CE involvement;
- *areas where independent and impartial powers are exercised* on delegation from the CE/Commissioner, eg the final adjudication and rulings areas;
- *the likelihood of an impact across a number of parts of the organisation*, eg the contracts management advisory function, which could conceivably apply to large parts of the organisation; and
- *major functional areas requiring direct CE oversight*, eg the three strategic business areas.

The number of areas with a direct reporting relationship to the CE is limited by considerations of the feasible span of control for a CE who also has considerable interaction with the Minister. The Review Committee concluded that the CE should:

- provide leadership, support and co-ordination, as required, to the three strategic areas of adjudication, policy and operations;
- address overall strategic issues: internal audit and probably strategic IT and contract management advice. This would be the choice of the individual CE; and
- manage the Ministerial relationship.

This in turn means that the operational area should come under the oversight of a specially designated, and highly skilled operations manager at the second tier. This manager would be responsible for a number of specialist units and, through a number of customer segment groups, responsible for a number of delivery offices and design functions. The specialist operational units reporting directly include Compliance Costs Reduction, Litigation Management, Technical Development and Tax Operations Research, as well as groups responsible for particular customer segments.

The Review did not examine in full detail the optimal size and functions of Head Office required under the recommended option because this would more appropriately be dealt with in phase 2 of the Review.

16.6 Recommendations

- **The tax administration be structured as a single organisation which includes policy, operational and adjudicative activities.**
- **The tax administration organisation be constituted in the form of a government department.**
- **The organisational structure of IRD be primarily based on a customer focus model, rather than on a revenue type or functional basis, in order to best achieve the tax administration's objective.**
- **The delivery of IRD services be based on an analysis of the most cost-effective number of sites, given where field work is needed, and the requirements for reasonable access by taxpayers and their agents to a local office. This includes the replacement of the current regional and district structure with a structure based on Field Centres, Satellite Offices and Customer Service Centres.**

17 Recommended structure

This section presents the recommended organisation structure for IRD. In particular, it builds on the preceding three sections of the Report.

17.1 There are three strategic business units

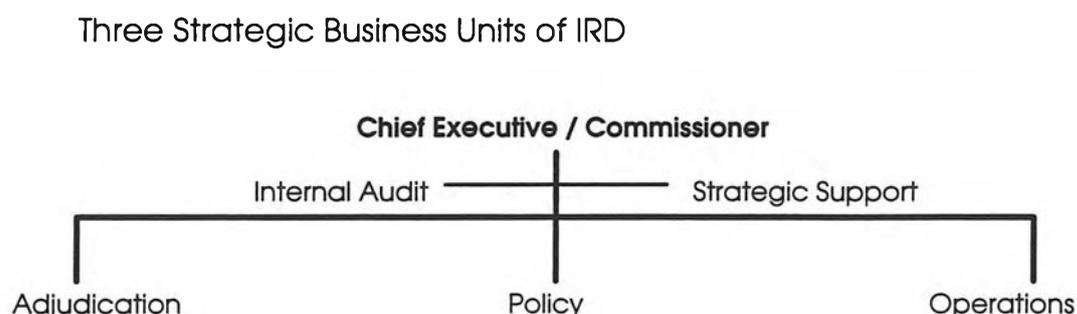
The recommended organisational structure incorporates a number of significant changes to the current arrangements. At the highest level the proposed arrangements structurally differentiate between the *three strategic business units* of IRD, namely:

- policy;
- adjudication; and
- operations.

The proposed changes are summarised below in the high-level structural chart: *Three Strategic Business Units of IRD* which represents the key accountability relationships. Communication and lateral links have not been shown but they will be critical to the efficient operation of the organisation.

The Chief Executive (CE) will have a crucial role in providing and implementing the strategic vision for the organisation. In particular, the CE will need to focus on the key strategic issues for the Department, such as the correct degree of emphasis for each of the three business units and the management of the sub-contracting process. A significant workload will also be involved in managing organisational change and in a high level of interaction with the Minister. Given these key tasks, it is desirable to limit the number of managers reporting directly to the CE to the heads of the three business areas, plus the heads of Internal Audit, Contracts Management Advice and Strategic Support functions.

Each of the three Strategic Business Units will be headed by a very experienced and senior second-tier manager reporting directly to the CE. These managers will be focused on a clear purpose and vision for their business area and will operate within very clear delegated authorities. This structure is shown below.



Because the Operations business is the most complex, the Review Committee begins with a short discussion of the Adjudication and Policy businesses and the Strategic Support Services, before discussing the Operations area in detail.

17.2 Adjudication

The role of the adjudication function will be to provide a specific and strong focus on the correct and impartial application of tax law to the affairs of individual taxpayers.

This will be done by ensuring the Final Adjudication function, ie the final quantification of an individual taxpayer's liability, is clearly defined and structured as a separate unit reporting to the CE, and operating under delegated authority. This should facilitate the appropriate level of independence and management focus and the application of expert resources.

Initially the Adjudication Unit will deal primarily with cases where a divergence in view between IRD and the taxpayer is apparent after the pre-assessment conference. The Adjudication Unit will be accountable for the final quantification of liability for all of the above cases. A sample of other cases where an adjustment was made will also be considered.

The Rulings Unit will produce both taxpayer specific and general rulings, including rulings and determinations which are binding on the Commissioner and individual taxpayers. The unit is located under the adjudication stream because the provision of rulings represents the application of tax law to the affairs of individual taxpayers with a crucial influence on their liabilities. A further consideration is that binding rulings may expose the Crown to significant fiscal risk, and accordingly a high level focus is appropriate. The unit will also benefit from the top-flight technical expertise of the adjudication manager at the second tier.

The adjudication function will have important relationships with the Policy, Taxpayer Audit, Litigation Management and Technical Development areas.

To achieve the objectives of consistency and high quality, it is likely that the adjudication resources will be concentrated in a very small number of sites only, probably in the Head Office and in Auckland.

It is envisaged that the Adjudication function, including Rulings, will have approximately 70 staff.

17.3 Policy

The role of the policy function will be to identify, develop and recommend specific tax policies that will raise tax revenue in the most economically efficient and equitable manner. This will be done through a separate Tax Policy Unit which will report directly to the CE. Direct reporting will facilitate appropriate management attention to the policy function, and application of the right resources to this activity, particularly at the senior level. It will also give this key strategic activity a sufficiently strong separate focus, involving the active support of the CE.

The operation of the policy activity will be strengthened by a number of other mechanisms including:

- the implementation of the Generic Tax Policy Process (GTPP);
- ensuring that the quality and training of staff is sufficient to enable them to operate on an equal level with other key players in the policy arena, such as Treasury;
- a separate Legislative Unit accountable for drafting tax legislation; and

- ensuring that IRD can consider the feasibility of policy proposals with greater understanding through its increased focus on customers.

The Policy Unit will also have responsibility for undertaking Ministerial servicing activities, such as correspondence.

The Policy Unit will have key relationships with the Adjudication and Operations areas, particularly the Tax Operations Research Unit and the Corporates segment. The current size of the unit (40 staff) is considered appropriate.

17.4 Strategic support

Strategic support functions at the national level consist of the Human Resources (HR), Finance, Strategic Information Technology (IT), Legal, Corporate Planning and Communications, as well as other aspects of national corporate strategy, eg EEO and Quality Management.

These functions have two components - strategic advice and provision of service. The emphasis for the national office will be on strategic advice, both to the CE and the total organisation. Typically, the service activities will be the responsibility of line managers, operating within corporate policies. For example, line managers will be responsible for personnel functions, financial management and the provision of other administrative support to their units.

The exception is Legal, which will cover both strategic advice and provision of services at full cost recovery.

The strategic support functional areas will report to a strategic support manager at the second tier. Given the nature of these functions they are likely to have considerable direct involvement with the CE.

Strategic Information Technology will be separated out from the IT 'Operations' activities to provide assurance that the strategic advice to the CE is not 'captured' by the IT area, swamped by IT operations management issues and, equally, that it receives appropriate attention at very senior management levels given its strategic importance. The specific reporting arrangements of the strategic IT function should be a CE decision.

17.4.1 Contract management advice function

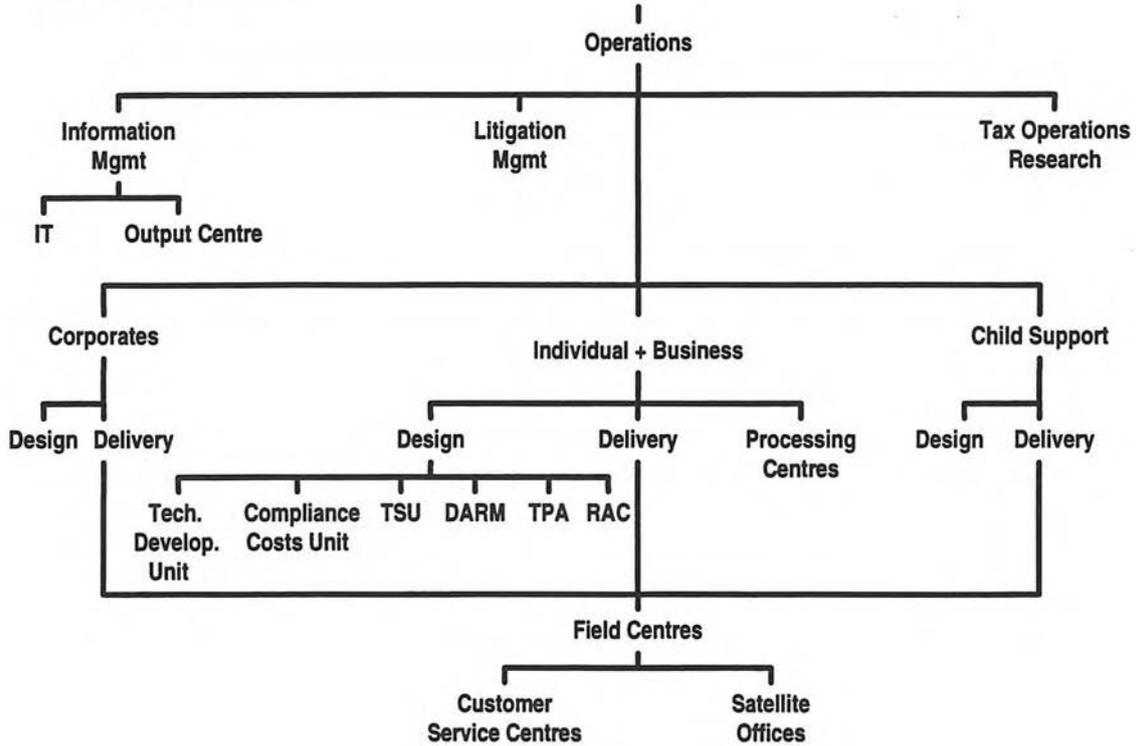
Section 18, Sub-contracting options for delivery, describes proposals relating to the testing of options for the sub-contracting of tax administration delivery functions. Expert advice on the management of this process will be required. This resource will report directly to the CE, given the strategic importance of the issue and the need for independence of contracting advice from the specific operational areas which may be subject to testing of sub-contracting options.

17.5 Operations

The role of the Operations function will be to provide highly efficient and effective delivery services, with a particular focus on meeting customer needs.

The recommended structure for the Operations area is summarised below.

Overall Tax Operations



All operational activities will be under the management control of a Chief Operating Officer (COO), reporting to the CE, and with the appropriate expertise to deal with a management position of this scale. The COO will be responsible for ensuring each of the customer segments is operating autonomously and effectively, and that any necessary co-ordination between segments is taking place.

The major components of the Operations activity will be:

Customer segments

Corporates, Child Support and Individual and Business with design and delivery integrated within each segment.

Field delivery structure

Field Centres, Customer Service Centres (CSCs) and Satellite Offices appropriate for each segment.

Operations relevant to all segments

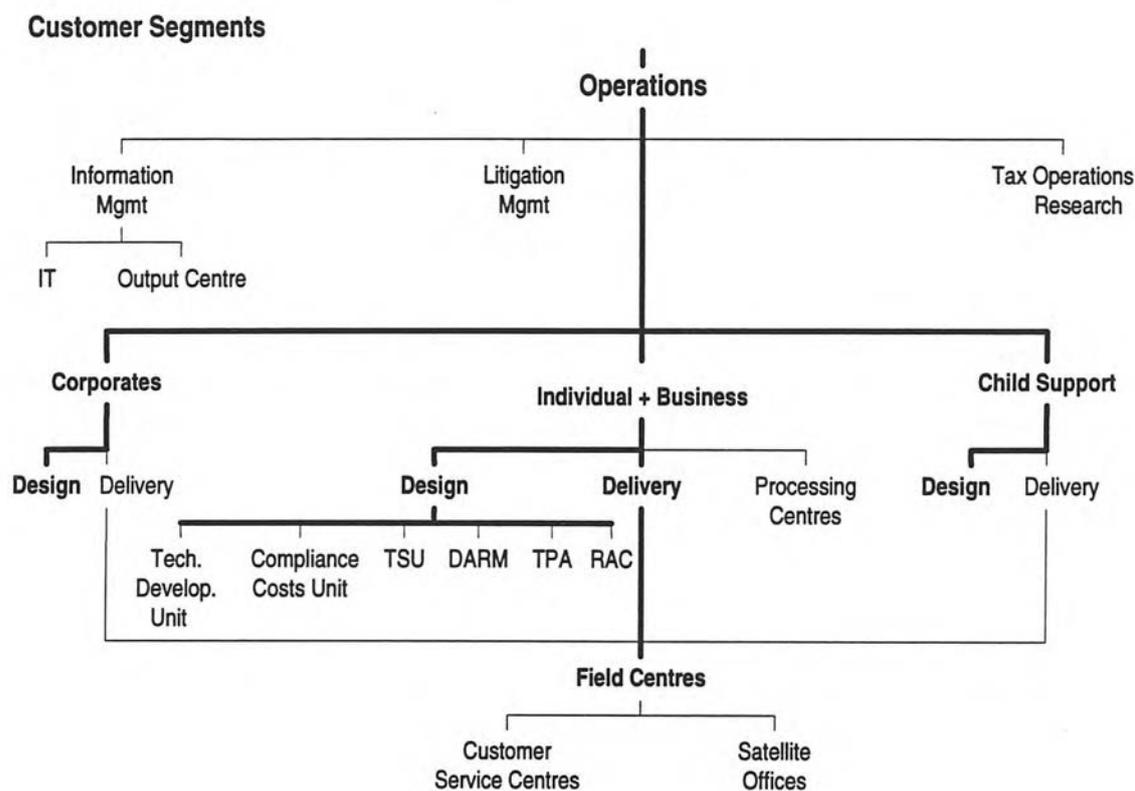
Processing Centres, Information Management and Litigation Management.

Specialist support activities for Operations

Technical Development Unit, Tax Operations Research Unit and Compliance Costs Reduction Unit.

17.6 Initially three customer segments will be established

The customer segmentation structure is set out below.



The Operations area will be organised on the basis of customer segments that incorporate integrated design and delivery within single management streams. Each segment will be an autonomous operational unit responsible for providing high quality services to the designated customer group. All functions except the shared processing and common specialist support activities will be performed within each segment. Initially three customer segments are proposed:

- Corporates;
- Child Support; and
- Individual and Business.

The Review Committee would have liked to see one or more additional business units, for instance small and medium sized businesses. But there was insufficient information to be certain that the most appropriate groups/segments had been selected. The Review Committee reluctantly decided that further division of the large customer group of Individual and Business should await collection and analysis of additional information.

It is expected that significant progress towards further segmentation will be made rapidly, once the initial segmentation has been implemented and the Tax Operations Research Unit is producing results. The Review Committee expects that by the beginning of 1996, following research, the Individual and Business segment will have been broken down into smaller more specific segments such as small business.

The customer segments will have key relationships with other units in the Operations area, particularly with the Processing Centres on a day-to-day basis. The segments will also require strong links with the Compliance Costs Reduction Unit and the Technical Development Unit. It is expected that Child Support service delivery will be carried out in the Field Centres, some Satellites and some CSCs, so strong links to the manager of the Individual and Business segment will be needed to ensure appropriate provision of support services. Each segment will also have partial ownership of the relevant parts of the information systems and will require printing to be done through the Output Centre. Some integration and overall co-ordination of the information requirements will be managed by the Chief Operating Officer.

17.6.1 Corporates

This segment is defined on a similar basis to the current Corporates segment in Taxpayer Audit, ie corporates and associated businesses with an annual turnover of more than \$100 million, and some selected industries. It will be responsible for performing all functions for taxpayers within this group. This will be the first formal customer segment to be recognised structurally.

The unit will probably be represented in only two geographical locations, ie Auckland and Wellington, as presently established.

17.6.2 Child Support

This segment would operate on the same basis as at present and would have a separate management stream responsible for both operational design and delivery functions. Child Support services would be delivered by dedicated staff in the Field Centres, Satellites and CSCs. Local Child Support managers would report directly to national office.

17.6.3 Individual and Business

This would deal with all medium business, small business, salary, wage earner and investment income taxpayers, and social policy functions excluding Child Support. All functions would be performed for the customers within this segment. It would also pick up other activities such as unclaimed monies, duties etc.

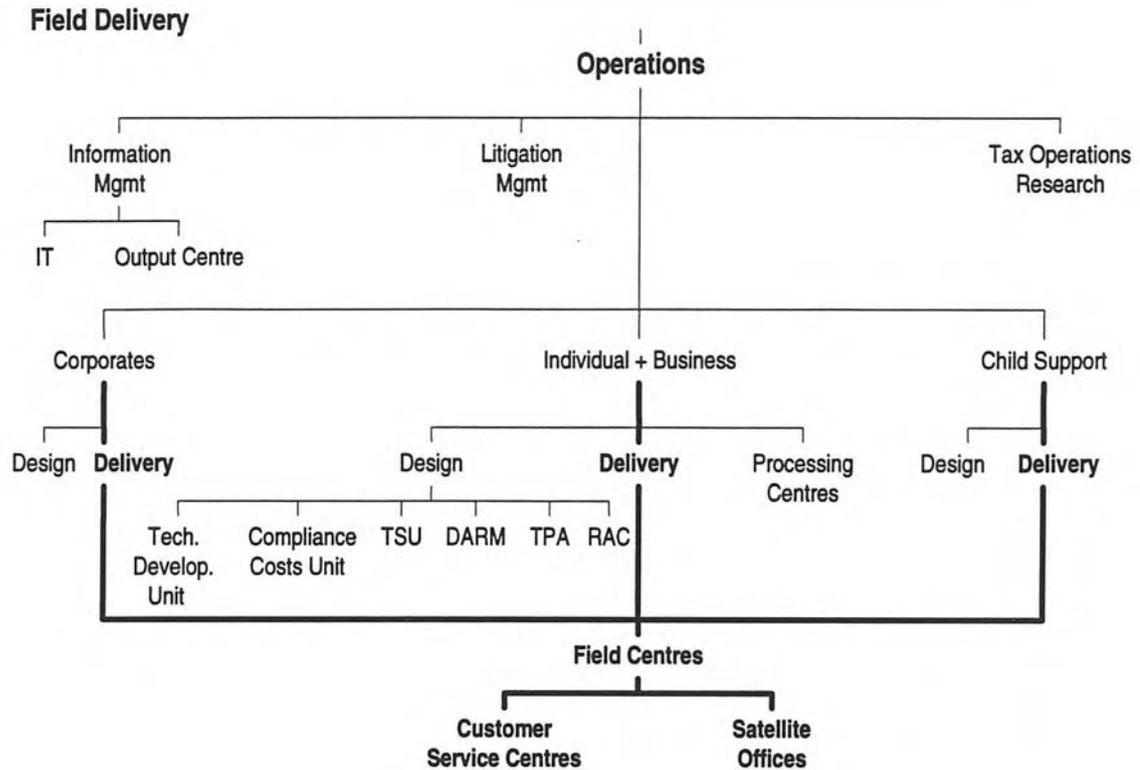
For some of the social policy activities it is recommended that explicit service contracts for the operational delivery functions be developed between IRD and the principal policy agency.

Some aspects of further segmentation within this group already exist, for example the small business advisory service. Further segmentation of this area is expected to result from the work of the Tax Operations Research Unit. In the meantime the concept of work teams, eg on a small business/salary and wage-earner basis within all or part (eg Taxpayer Services function) of this area should be examined in phase 2 of the Review.

17.7 Field delivery structure

This will be organised on the basis of Field Centres, with Satellite Offices and CSCs attached as appropriate. The field delivery structure for Corporates, Child Support, and Individual and Business will be separate but co-located and sharing common support services as appropriate. Litigation Management will also be represented in

two Field Centres, probably Auckland and Wellington. The recommended field delivery structure is shown below.



Local offices will not be mirror images of each other. There will be differentiation at the local level of the size and type of office, to take account of where the work is done and to provide maximum organisational flexibility to meet demographic and other changes in an efficient and cost-effective manner. It is expected that IRD will also continue to hold temporary agencies where appropriate, eg in some areas to cope with peak workloads.

The final numbers and locations of local offices should be determined during phase 2 of the Review. However, preliminary estimates would suggest that there will be approximately 14 Satellites and six CSCs. A relatively large number of local sites will continue to be required because of the high field content of audit work and debt recovery work, especially for the small to medium business sector. In addition, a relatively dispersed geographical presence is required for Taxpayer Services Unit (TSU) counter services and for advisory work.

17.7.1 Field Centres

There will be approximately seven Field Centres located in areas with a reasonable population base and within a two hour drive to 90 percent of the customer base for that centre. Field Centres will be the largest type of local office.

For the Individual and Business segment there are likely to be separate functional units for TSU, Debt and Return Management (DARM) and Audit work. These will be co-ordinated by a Field Centre manager. In addition, some specialist technical functions such as legal services will be concentrated at the Field Centre level, and this expertise will be available to Satellite Offices and CSCs as required.

A number of Satellites and/or CSCs will be attached to each Field Centre. The Field Centre manager will have the responsibility for overseeing and managing the operations of the attached local delivery sites.

The Corporates and Child Support customer segments will report directly to Head Office, with internal contracting with the Field Centre managers for provision of support services.

The Corporates segment will have a presence in two Field Centres - Auckland and Wellington. It is anticipated that Child Support will be located in a similar number of sites as at present - in the order of seven Field Centres and five Satellites.

17.7.2 Satellite Offices

A Satellite Office will undertake functions for the Individual and Business segment which are appropriate for the particular location. Some Satellites may undertake only non-business and small business audit depending on their location and the size of the Office.

The Satellite Office manager will report directly to the Field Centre manager. Between three to five Satellite Offices will be attached to each Field Centre.

There may be a Child Support presence, internally contracting with the Satellite Office manager for provision of services.

Satellites will have a minimum level of support services on site, drawing on specialists and other support services, eg legal and finance, from the Field Centre.

17.7.3 Customer Service Centres (CSCs)

These will be relatively small offices focusing on direct customer contact activities but with ready access to the full range of functions and expertise from the Field Centre. They will be located in metropolitan areas only at this stage, and will be administered from the Field Centre in that city. There will be no alpha split in the metropolitan areas.

Customer Service Centres will undertake counter work (both TSU and DARM) for the Individual and Business and Child Support segments. More complex issues will be referred to the Field Centre. Phone and correspondence work will be undertaken by CSCs for the Field Centre in non-counter peak periods. It is expected that work and/or staff can be relatively easily shifted across the city from Field Centre to CSCs and between CSCs.

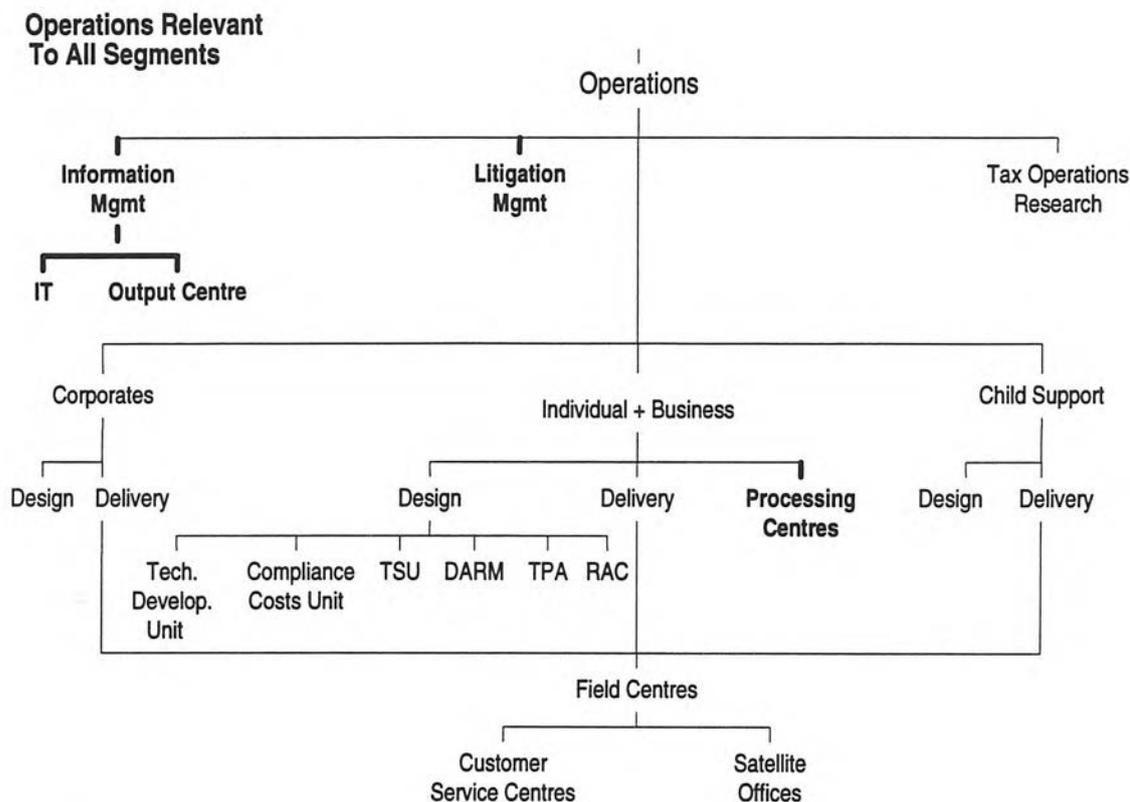
17.7.4 Advantages of proposed delivery structure

In place of the present four Regional Offices and 26 District Offices, there will be approximately seven Field Centres and associated Satellites and CSCs. The advantages identified in Section 16: Structural options and evaluation will be available under the proposed structure:

- vertical integration of design and delivery can be achieved on a national basis. This will improve consistency and facilitate customer segmentation and focus;
- concentration of technical and specialist resources will improve the quality and consistency of legislative interpretation; and
- a cost-effective result that will address the issues identified in this Report.

17.8 Operations relevant to all segments

There are a number of operational activities which will provide services to all of the customer segments. These functions are highlighted below.



17.8.1 Processing Centres

Processing Centres will be retained and will report within the Individual and Business segment to facilitate the close co-ordination between the processing and field delivery arms. In addition, there will be an ongoing need to review the work undertaken in Processing Centres and the methods employed, in order, for example, to take full advantage of new technologies such as imaging.

17.8.2 Information Management Unit

This unit brings together the operational arms of the Information Technology area, which deal with the detailed design and service delivery of information technology as a support to the line managers who 'own' the business systems. Location within Operations facilitates co-ordination and management of relationships with the primary customers of IT. This unit would also include the Output Centre.

The FIRST system and the current high degree of integration of common information across the organisation will be retained. A key linkage will be required to the strategic IT function. The vital role of the Information Management function is the support and development of the technology systems which are critical to the organisation.

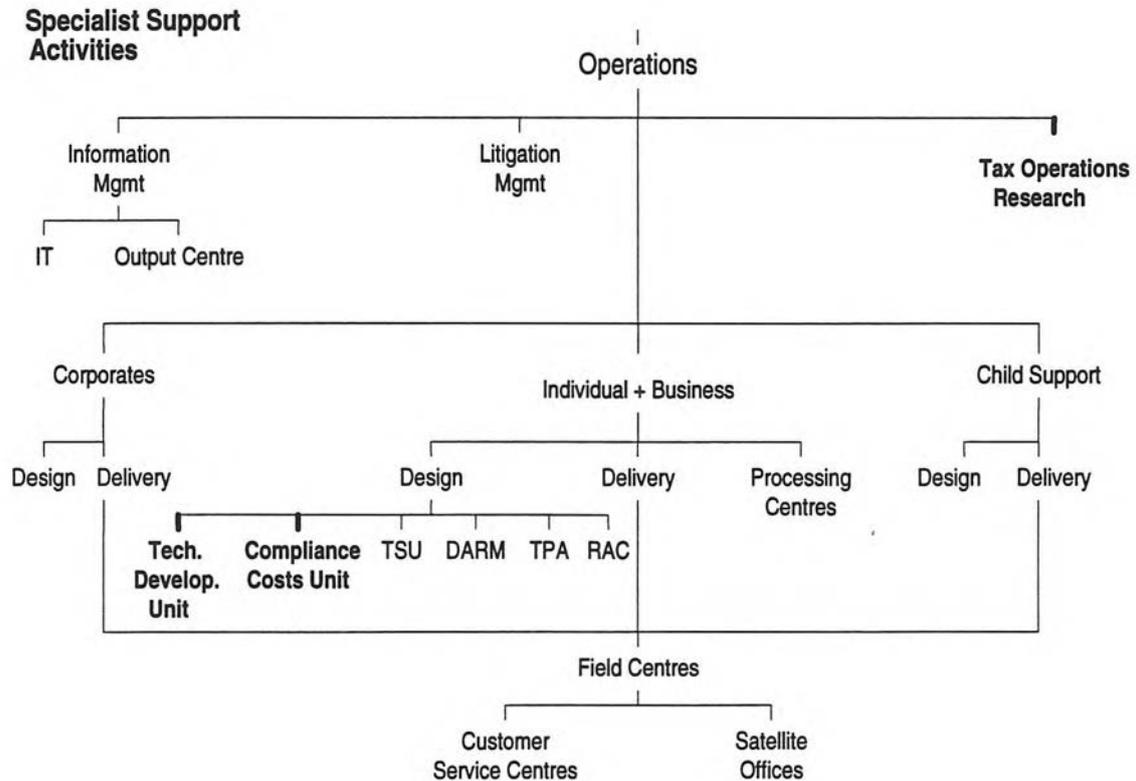
17.8.3 Litigation Management Unit

This stand-alone unit will deal with the management of all post-adjudication litigation. It is likely to be located in two sites, Wellington (Head Office) and Auckland. This area will have key relationships with Audit, Adjudication and the Chief Operating Officer. It provides appropriate managerial independence for the oversight of litigation.

Litigation Management is a function separate from Legal Services, which is located in Corporate Services. The litigation area may utilise resources from the Legal Services area, as well as managing external legal resources used during the litigation process.

17.9 Specialist support activities

A number of specialist support units will be established to give focus to particular important areas of concern. These are summarised in the diagram below.



17.9.1 Technical Development Unit

This will be a stand-alone unit reporting to the manager of the Design function. The purpose of the unit will be to provide a specific focus and set of expertise, to provide advice and assistance to operational areas, to raise the technical standards within the organisation. It will assist in the full range of technical development activities required which may include skill development, information requirements, monitoring and the development of appropriate systems and processes.

The Technical Development Unit will have a limited life. It will be expected to make itself obsolete over time as its activities become part of all operational activities.

The unit will have close relationships with the Design function in all segments, but particularly with the Individual and Business and Corporates segments and with Policy, Adjudication, and Human Resources.

17.9.2 Tax Operations Research Unit

This unit will undertake analysis on the needs of specific customer groups, how these can best be addressed, and how the cost-effectiveness of initiatives can be assessed. The unit will also examine ways of quantifying the relative benefits of investing resources in customer service and enforcement activities. This will provide the basis for testing the allocation of resources in these areas, and for improving the customer service and enforcement strategies. The unit may also be involved in the report on the health of the tax system which is described further in Section 8, Objective of tax administration.

The unit will have close relationships with Policy, Corporate Planning, Strategic Information Technology, and the Design function in the segments, particularly in the Individual and Business area, where its work will be of critical importance in determining whether there should be any further segmentation or targeting, eg of small business.

17.9.3 Compliance Costs Reduction Unit

This unit will operate on the current basis, examining compliance cost issues across the Operations area and providing a focus for the identification and management of compliance costs across the tax administration. It will be located under the Design function in Operations. Detailed recommendations for the unit are provided in Section 11, Costs of compliance.

The unit will have a close relationships with Policy and the Tax Operations Research Unit, and with the Design function in all segments.

It is envisaged that this unit may operate with a 'sunset clause'; its key objective being to make compliance costs the on-going concern of line managers.

17.10 Strategic underpinnings of the new structure

Some key strategies and processes will underpin the operation of the structure.

17.10.1 A comprehensive customer service focus

Structural change on its own will not achieve the required level of customer focus. IRD staff will need to continue to develop their understanding of the practical operation of their customers' businesses. A comprehensive set of strategies and mechanisms should be implemented and current customer-focused initiatives strengthened. This would build on the quality management strategies already adopted by IRD.

The key mechanisms should include:

- **Strategic direction:** The importance of customer focus must be recognised and incorporated into the key strategic statements.
- **Management commitment:** Management commitment to customer focus must be clearly and publicly stated at all levels in the organisation, and incorporated into

accountability/incentive and development programmes on an individual basis, preferably as transparently as possible.

- **Definition of customer groups and identification of needs:** The establishment of a specialist Tax Operations Research Unit will best facilitate analysis of the taxpayer/customer base and determine the needs of specific customer groups, how these can best be met, and how the cost-effectiveness of these measures can be assessed.
- **Incentives at the organisational level:** It is possible to introduce various mechanisms which provide a 'competitive incentive' between internal units. Corporate human resources strategies including recruitment, remuneration, performance incentives, equal employment opportunity, and education programmes should be used in a comprehensive way to foster a customer focused culture.
- **Re-engineering business processes:** Key business processes should be mapped on an inter-functional/inter-unit basis and analysed to determine how they can operate more efficiently and more effectively meet customer needs. For example, it may be that the current scope and boundaries of the major functional divisions such as TSU and DARM require change. The Review Committee has also considered and recommended changes to two high profile processes, ie the GTPP and the new disputes resolution process, to better meet customer needs. The operation of a quality management system will also include a strong customer focus and should lead to process improvements.
- **Survey customers/monitor progress:** Customer feedback on performance, both general and from key groups, should be sought on a regular basis. In the tax administration context this may be done as part of, or as an input to research on compliance behaviour generally.
- **Customisation of information systems:** IRD's current information system is based upon a unique customer identifier. This will form an invaluable basis for developing the specialist reports needed for IRD to operate with a number of specific customer segments and to monitor performance on customer-group based indicators.

17.11 Recommendations

Three separate management streams, headed by an appropriate second-tier manager should be established to reflect the three strategic activities of IRD:

- **policy;**
- **adjudication; and**
- **operations.**

All operational activities, including both design and delivery for all of the customer segments, should be integrated under the leadership of a Chief Operating Officer who will report directly to the CE.

The Operations area of the organisation should be initially structured into three customer segments:

- Corporates (corporates and associated businesses with a turnover of more than \$100 million);
- Child Support;
- Individual and Business.

Detailed design and development of further customer segments, such as small business, should be substantially completed by the beginning of 1996.

Processing Centres should be retained and report to the Individual and Business operations manager.

Field delivery services should be provided through a combination of relatively large Field Centres with a high concentration of specialist expertise and regional support services and smaller Satellite Offices and Customer Service Centres should be attached to the Field Centres for management purposes.

A major task during phase 2 of the Review should be the detailed design of the number and location of Field Centres, Satellite Offices, Customer Service Centres and the associated numbers and types of staff required. This work should be undertaken within the framework and according to the principles outlined in this Report, and should consider:

- opportunities for achieving further economies of scale;
- reasons for significant cost variations between offices; and
- detailed job design.

A stand-alone Technical Development Unit should be established to report to the manager of the design function. The purpose of the unit will be to provide a specific focus and set of expertise to raise technical standards.

A Tax Operations Research Unit should be established to develop data on further segmentation required and the strategic contribution of specific operational activities to the achievement of IRD's objective.

The litigation management function should be established as a separate unit reporting to the Chief Operating Officer and the unit should be responsible for the management of all litigation.

Information technology functions, including systems development and the Output Centre but excluding strategic activities, should constitute a separate unit reporting to the Chief Operating Officer.

A strategic support activity should be established consisting of strategic IT, human resources, communications, finance, quality management and planning and development. The strategic support activity should be organised

under a second-tier manager, but individual functional areas should have direct access to the CE as necessary.

Corporate Support service activities should be the responsibility of line managers, operating within corporate policies.

The Compliance Costs Reduction Unit should be retained to examine compliance cost issues across the operations area.

A contract management advisory function to report directly to the CE should be established to provide expert advice on the assessment and testing of options for sub-contracting.

Phase 2 of this Review should undertake the detailed design of the optimal size and functions of Head Office.

A comprehensive customer service strategy should be developed for the organisation which includes the following elements:

- clear strategic direction;**
- management commitment;**
- definition of customer groups and identification of needs;**
- incentives at the organisational level;**
- re-engineering of business processes;**
- surveying customers and monitoring progress; and**
- customisation of information systems.**

18 Sub-contracting options for delivery

This section expands on the recommendations in Section 17, Recommended structure, to introduce a phased programme for sub-contracting some delivery functions where there is an overall advantage to IRD, and so a contribution to achieving IRD's objective.

18.1 Every organisation sub-contracts some activities

No organisation in the public or private sector is self-sufficient. Organisations decide what they can best do themselves, and what goods and services they will obtain from others. These supplies of goods and services are provided by other people or companies through appropriate contracts.

Tax administrations everywhere sub-contract some of their activities; New Zealand is no exception. About 14 percent, or \$55 million, of the \$395 million output cost of IRD in 1992 - 1993 was paid to third-party suppliers of goods and services, including some \$37 million (64 percent) of Information Technology operating expenditure. Other specialist services, personnel and support services are currently sub-contracted or contracted-in, such as courier and postage, approximately \$7 million (mostly from the Output Centre, which prints and mails out 16 million pieces a year); printing, \$6 million and legal, \$3 million. There is also significant sub-contracting within the public sector and, in respect of social policy, IRD may be regarded as performing service delivery functions for the Ministry of Education, the Department of Social Welfare and ARCI Corporation.

Section 17, Recommended structure, notes that the Review Committee's limited analysis indicates that all functions currently carried out by IRD should continue in some form. The question to be addressed is: what outputs or functions could or should be sub-contracted, and what should remain 'in house'?

18.2 Decisions on sub-contracting should be based on guidelines appropriate for the special needs of the tax administration

There are several well established principles and approaches that provide a basis for general decisions relating to sub-contracting. Tax administration has some additional specific requirements in relation to both tax legislation and perceptions of tax collecting. These principles and requirements have been combined as guidelines:

Ultimate responsibility for tax administration must not be alienated from the State

Taxes are formally levied by Parliament, and involve exercising the most coercive power of the State. Legislation requires IRD to 'administer' the collection of tax. This means that Government will need at least an administration function that takes responsibility for and controls tax collection on its behalf.

A high level of political accountability must be associated with tax administration

Paralleling the previous point, taxpayers expect that politicians will remain accountable for the collection of all taxes. This expectation is not at all in conflict with the convention that Government and Ministers must not be able to influence the tax affairs of individuals.

Tax functions involving a high level of judgement in assessing a taxpayer's liability should be undertaken in-house by tax administration staff

The adjudication function was considered at length by the Valabh Committee. The Review Committee has concluded that tax functions which involve significant independent judgement in the original quantification of a taxpayer's liability present special difficulties in meeting taxpayer perceptions. Delivery of these functions should not be considered for sub-contracting if the difficulties of meeting taxpayer perceptions are not resolved.

Competition provides one of the strongest incentives for performance

Competition, including internal competition, generally provides the strongest incentives for the provision of least cost, high quality services. Numerous studies have demonstrated this, including recent studies of public services in many countries. Monopoly rights should only be retained where this is necessary to meet the tax administration's objective. This potential spur from competition means that:

In principle, IRD's functions should be made competitive or contestable.

Every function should be carried out in the most efficient and effective way

One of the most important roles of management is deciding what will be the most efficient and effective way of achieving each of the organisation's objectives. This will involve assessing a range of resources, systems and so on to determine the method most suited to the organisation. The decision should be based on an appropriate analysis that takes into account all significant costs, benefits and risks over a time period.

18.3 A range of functions should continue to be carried out by tax administration staff

Every tax administration function *could* be sub-contracted. In a sense, Government already has sub-contracted tax administration to IRD. In deciding which functions should be sub-contracted, IRD has a range of options; in theory, from sub-contracting every function, to carrying out every function in-house. As noted above, IRD has decided at present to sub-contract some 14 percent of its functions, or work to the value of \$55 million.

A practical way to address the question of what should be considered for sub-contracting is to start to eliminate those functions that should be carried out in-house by using the guidelines proposed in paragraph 18.2. Every other function will then be a potential candidate for sub-contracting.

The Review Committee has carried out an assessment of the main functions of IRD by applying the guidelines, and concluded that the following functions should be carried out in-house:

- general management of tax administration;
- strategic and business planning, including developing tax collection strategies and other corporate strategies such as human resources;
- management of policy advice;
- management of Ministerial services;
- designing broad operating practices and procedures;
- management of the tax administration data base, rules and software;
- management of the rulings functions, including the determination of the content of rulings. (This is a critical and new function. It needs close control, at least during its initial development);
- the proposed Final Adjudication function;
- management of legislative drafting; and
- Taxpayer Audit. (Audit involves several levels of adjudication, and should not be considered for sub-contracting unless the difficulties of meeting taxpayer perceptions are resolved.)

18.4 Other functions appear to be suitable for sub-contracting, fully or in part

The Review Committee has carried out a preliminary assessment of the main tax administration functions that are not listed above and concluded that several functions could potentially be sub-contracted. This conclusion took into account several potential benefits, in particular:

- benefits from competition and transparency, including comparisons;
- the ability to access additional skills and innovative methods; and
- the ability to smooth peak workloads.

There is clearly a need for considerably more analysis before any decision is made. Decisions should be based on the guidelines above, in particular that every function should be carried out in the most efficient and effective way. It is therefore necessary to undertake appropriate cost-benefit analyses and a phased approach, including practical tests, to assess whether and how each function, or some parts of each function, could be carried out in a more efficient and effective way by contractors. The Review Committee has made no attempt to find out if there are suitable contractors available, willing and capable of carrying out specific functions in a manner that meets the required standards, or whether their charges would be competitive with IRD. However, experience in New Zealand indicates that suitable sub-contractors will be available for most types of work.

18.5 Rigorous tests should be applied in assessing options for sub-contracting

Every case will be different but, in general, an analysis of options for sub-contracting should provide satisfactory answers to the following questions:

- can IRD carry out the function in a more efficient and effective way than at present?
- is it practical to specify and measure the products or services?
- is the function sufficiently self-contained?
- is it practical to manage any necessary relationships between the organisations, in particular, information flows?
- is there a significant risk that any incentive arrangements could be perceived as affecting the integrity of the voluntary compliance strategy?
- can any fiscal and other significant risks be managed satisfactorily?
- can it be demonstrated that the costs and benefits of sub-contracting this function would be better than carrying it out in-house?

18.6 A programme for developing sub-contracting should be introduced

Sub-contracting should not be viewed as a separate activity. Rather, it should be considered as one of many normal ways that IRD achieves its objectives, and is therefore integrated into IRD's management of the myriad of functions, activities and systems that comprise the total tax administration.

Both the analysis and management of sub-contracting requires specialist skills. As recommended in the previous Section 17: Recommended structure, a separate contract management advice function should be established to facilitate the development of these skills. IRD already has some skills in particular areas of contracting, but it is likely that additional skills will be necessary to ensure that the best information is available to management in making sub-contracting decisions and that every contract, including the present contracts, are managed in the best way.

Sub-contracting raises complex issues. It is inevitably a matter of concern in the management of risk. The Review Committee's view is that functions should only be sub-contracted if it is demonstrated that there are overall advantages in doing so.

18.7 Recommendations

IRD should introduce a seven-step programme:

- Step 1 Analyse all main tax administration functions** in order to identify which functions should *not* be sub-contracted. The guidelines and the results of the preliminary analysis outlined in Section 18 should be used as a basis.
- Step 2 Carry out a detailed analysis of the practical issues** associated with sub-contracting (including the utilisation of statutory powers), with a view to moving to a carefully planned, phased development including testing, evaluation and review.

- Step 3 Assess which functions have the greatest potential to be carried out at lower cost by contractors.** Establish a priority list for the next step.
- Step 4 Carry out cost-benefit analyses** for the functions, in the ranking established in step 3, in order to determine if sub-contracting should be tested for that function. The analyses should include the questions posed in paragraph 18.5, and preliminary discussions with some interested contractors. If the results of analysis favour sub-contracting, performance criteria should be determined to assess the results of tests in step 5. Establish priorities for testing.
- Step 5 Test sub-contracting options for the selected functions** in order to demonstrate whether in practice the function is carried out by the contractor(s) to the overall advantage of IRD. An appropriate part and quantity of each function selected should be put up for tender. Tender specifications should be developed, followed by appropriate tendering procedures and selection. After an appropriate period for each test, the results should be checked against the original cost-benefit analysis and performance criteria. A decision should then be made to increase or decrease the amount of sub-contracting of that function. This exercise should be carried out without favouring either the sub-contractor or IRD; that is, the same tasks should be undertaken, and the same operational constraints should apply. In practice, there are likely to be overlaps between the steps proposed, and some tests may need to be undertaken for more than a year to make it worthwhile for the contractor.
- Step 6 Develop internal competition** for those functions that must be undertaken in-house. Additional initiatives should be introduced that lead to an appropriate degree of internal competition. There are several recognised approaches to gaining benefits from internal competition that IRD could develop further. Constructive competition between internal units is a powerful incentive when the best performers receive sincere and widely broadcast praise from executives. Best performance can also be clearly linked to internal promotion. In general, competition is better between teams or units, than between individuals. Care should be taken to avoid the potential for destructive competition and the perception of internal competition being a passing fashion. IRD's current emphasis on Quality Management will help in that direction.
- Step 7 Review competition and contestability regularly.** Decisions relating to sub-contracting should be reviewed at appropriate intervals. In particular, any function that is sub-contracted should be put out to tender after a period that is fair to both the contractor(s) and IRD - about three years is a common period.

The Review Committee also recommends that the current recommendations for sub-contracting some Child Support debt management and some other debt management activities be revisited in the light of the steps recommended above, and IRD should report to Government accordingly early in phase 2 of the Review.

19 Benefits, costs and transitional arrangements

This section:

- summarises the major benefits expected from the Review Committee's recommendations;
- discusses the broader revenue consequences of the Review Committee's recommendations;
- outlines the transitional and longer term impacts of the Review Committee's recommendations on Vote: Inland Revenue; and
- comments on transitional arrangements, especially the implementation timeframe and implementation process.

19.1 The Review Committee's recommendations are expected to significantly enhance IRD's efficiency and effectiveness and improve services to stakeholders

The Review Committee's recommendations for the structure of IRD present a vision for the development of the tax administration for the rest of this century which should significantly improve the overall efficiency and effectiveness of IRD. The Review Committee believes that the recommended structural changes and associated initiatives will improve IRD's performance in the following ways:

19.1.1 The Government should, as a result of the GTPP and proposed structural changes, receive better tax policy advice

The GTPP provides a basis for:

- the orderly development of tax policies in a phase by phase process;
- substantial external input into the policy formation process;
- analysis of costs, benefits and impacts at various stages of the process;
- post-implementation review of the changes; and
- establishing clear accountabilities and responsibilities for tax policy development based on the comparative advantages of IRD and Treasury.

Within IRD, the policy advice function is strengthened: the manager of the Policy Unit has no other responsibilities and has a direct reporting line to the Chief Executive.

19.1.2 Proposed changes in legislative drafting should produce substantial savings in administration and compliance costs and enhance the voluntary compliance strategy

The rewriting of the confusing and dated income tax legislation and the adoption of a drafting approach employing plain language and providing clear statements of intent and principles in setting rules for determining tax liabilities should produce much better, more understandable legislation. This will provide substantial cost savings for all parties involved in interpretation, enforcement and disputes.

19.1.3 Taxpayer compliance costs should be reduced without compromising revenue flows

Without prejudicing revenue flows, the Review Committee's recommendations should reduce compliance costs in a variety of ways. The most significant changes proposed by the Review Committee are:

- the emphasis given to compliance costs issues in the GTPP;
- substantial changes to the disputes resolution process, which should reduce the time taken to settle disputes and should improve access to disputes resolution procedures;
- the Corporates Unit should allow IRD to reduce the compliance costs incurred by such taxpayers as specialist approaches and improvements in service are identified and implemented. Further segmentation should also lead to reduced compliance costs for other taxpayer groups; and
- the Tax Operations Research Unit provides a vehicle for identifying other taxpayer segments which would benefit from a more focused approach.

Although the impact of the Review Committee's recommendations on compliance costs cannot be accurately quantified at this stage, a 1 percent reduction in the total compliance costs incurred by business taxpayers will result in resource savings of about \$12 million per annum in New Zealand.

19.1.4 Proposed structural changes and enhancements to the tax system should promote voluntary compliance and thus support the objective of obtaining the highest net revenue over time

Voluntary compliance, and the objective of obtaining the highest net revenue over time, should be enhanced by the range of structural changes proposed by the Review Committee.

Of particular significance is the proposed Final Adjudication function, which will enhance the perceived integrity of the Commissioner's final assessment of a taxpayer's liability in cases where the final assessment is likely to have a high profile or be made in an adversarial context. It should enhance taxpayers' perceptions of the integrity of the tax system through correct, consistent and impartial application of tax law. The adjudicative function should therefore facilitate voluntary compliance and the goal of realising the highest level of net revenue over time.

Customer segmentation should have a similarly positive effect on voluntary compliance.

19.1.5 More effective use of IRD's limited resources

Effectiveness will also be improved through:

Explicit recognition of a 'care and management' power in IRD's legislation and working towards a clear objective, also defined in legislation

Greater consistency through the concentration of management and specialist resources into Field Centres

The issue of consistency in operational practices and procedures between IRD offices will be addressed by centralising the management and delivery of some core operational activities and specialist functions into Field Centres. Consolidating specialist resources (such as Final Adjudication and Litigation Management) into a limited number of locations will also give those functions emphasis and critical mass in those sites.

Focusing senior management attention into three key areas: opportunities for better skill management, increased customer focus and opportunities for re-engineering work processes

Customer segmentation allowing IRD to develop and maintain specialist skills

The Corporates Unit allows IRD to develop and maintain a concentrated core of specialist skills and knowledge of this particular segment. This should improve IRD's effectiveness in a critical area of tax collection.

Recognition being given to the overall need to improve technical standards within IRD

The proposed Technical Development Unit will have a mandate to identify means of improving overall levels of technical skill levels throughout IRD. Furthermore, the recommendations for new and distinct specialist functions, particularly Final Adjudication and the arrangements for Corporate taxpayers, allow for the concentration and development of the appropriate expertise in these highly technical areas. Improvements in technical standards will reduce compliance costs for taxpayers while increasing IRD's own efficiency (through, for example, the need for less rework within the Department).

19.1.6 Better focus on IRD's core business and strategic direction

The proposed objective for the tax administration provides a clear basis to assess and determine longer term needs and strategies.

The proposed Tax Operations Research Unit provides a dedicated resource to research key issues such as the provision of greater customer focus, trends and developments in tax administration systems, and the balance of resources between facilitation and enforcement activities. The unit's work should provide an analytical foundation for determining the strategic direction of IRD's operational activities.

The Review Committee's recommendations in respect of arrangements for the administration of 'social policy' functions are also expected to lead to a stronger focus on IRD's core tax business.

19.1.7 Over time, the Review Committee's structural recommendations will improve IRD's efficiency and reduce the fiscal cost of Vote: Inland Revenue

Efficiency gains are made through the Review Committee's structural proposals, the rationalisation of some management layers and the number of support staff, as functions are centralised into Field Centres. Accordingly, the recommended structural changes should reduce the cost of Vote: Inland Revenue over time, with an acceptable payback period to the Government for the initial restructuring cost. Details are provided in paragraph 19.3 below.

19.1.8 The Review Committee's recommendations should improve New Zealand's overall economic performance

The tax system and tax administration have pervasive effects on all aspects of economic life in New Zealand. Improvements in tax policy formation and reductions in taxpayer compliance costs and improved efficiency and effectiveness on the part of IRD provide a basis for improving the economic well-being of all taxpayers, greater revenue flows to the Government (discussed in greater detail below), and better economic performance for New Zealand.

19.2 Revenue impacts

Structural improvements of IRD can both reduce Government expenditure on Vote: Inland Revenue over time and increase Government revenues. The major monetary gains from a more efficient and effective IRD will be through increases in revenue collected rather than from reduced administration costs. This reflects the nature of tax administration: currently the amount spent on administering the tax system represents only about 1.8 percent of net tax revenue of \$21 billion. Even a very small enhancement in the level of revenues collected, however, would have a significant fiscal impact.

A useful framework for understanding the potential revenue benefits from initiatives which improve the administration system is through the impact on the tax revenue gap. This gap is the difference between actual revenue collected and that which is intended by the law. As such, a more efficient tax administration could provide the Government with an alternative and potentially superior way of meeting its revenue requirements.

While the Review Committee has not quantified specific revenue gains from implementing its recommendations, the gains could be significant. The tax revenue gap for New Zealand has not been estimated, but the US Internal Revenue Service estimated a tax revenue gap of about 20 percent of potential federal tax revenue. A conservative assumption which assumes that improvements in effectiveness would decrease the income tax revenue gap by 1 percent would increase revenue by roughly \$35 million per annum.

Although the tax revenue impact of the Review Committee's proposals is extremely difficult to quantify, the Review Committee is confident that the tax revenue impact will be significant. The Review Committee believes that the tax revenue gains are likely to far exceed the direct fiscal impact of the proposed changes to Vote: Inland Revenue.

19.3 Transitional and longer term fiscal impact on Vote: Inland Revenue

Beyond the transition period, the annual cost of Vote: Inland Revenue will decrease from current forecast levels because the Review Committee's proposals will improve IRD's efficiency. The Review Committee has estimated the fiscal savings beyond the transition period ('steady state' savings), indicative transitional costs and the payback period.

19.3.1 Analysis of the level of costs and benefits in 'steady state'

The Review Committee stresses that its estimate of 'steady state' costs and benefits is intended to give orders of magnitude only. Detailed estimates of the direct on-going impact on Vote: Inland Revenue can only be provided once detailed design and costing work (such as job evaluation and job size exercises) have been completed as part of phase 2 of the Review.

In estimating the costs and benefits in 'steady state', the Review Committee focused on the following sources of costs and benefits:

- changes to staffing costs arising from the proposed new structure; and
- associated changes in operating and accommodation costs.

In estimating these costs, the Review Committee considered the direct impacts of the proposed structural changes on Vote: Inland Revenue. Three points should be noted. First, the Review Committee has undertaken a high level strategic review of IRD and has not completed a detailed efficiency study. Phase 2 design and implementation will assess efficiency levels under the new structure. Secondly, the Review Committee did not quantify costs and benefits arising indirectly from other initiatives such as options for sub-contracting (discussed in Section 18, Sub-contracting options for delivery). Thirdly, based on the tentative results of its high level analysis of economies of scale, the Review Committee assumed that there were no operational economies of scale in consolidating functions into Field Centres. The phase 2 design and implementation process should review this assumption in depth.

19.3.2 Analysis of the level of transitional costs

Estimates of transitional costs are problematic, as they will vary significantly according to the implementation path chosen and the arrangements that are able to be made with respect to:

- timing of announcements;
- timing of implementation;
- the change management strategy employed;
- the degree to which IRD can manage its accommodation costs;
- the negotiations with employees and their representatives; and
- the number of affected staff.

The more significant transitional costs estimated by the Review Committee are:

- staff related costs;

- management of accommodation requirements;
- building fit-out costs for those staff and functions that are relocated into Field Centres; and
- the risks associated with structural change.

The estimates presented in paragraph 19.3.3 below are indicative and are presented for cost-benefit purposes. The analysis conservatively assumes that the transitional costs would be incurred in one year but in reality it is likely that this expenditure would be spread over two years.

19.3.3 Impact of transitional and 'steady state' costs and benefits on Vote: Inland Revenue

In the 'steady state', fiscal savings arise from the rationalisation of some management positions and the number of support staff as functions are reorganised into Field Centres.

As referred to above, the level of transitional costs can vary considerably depending on the transition path adopted. The Review Committee stresses that these costs have been calculated on a conservative basis and that careful management of these costs could allow the new structure to be implemented at a cost below the figure indicated. A key factor in determining the level of transitional costs is the management of long term accommodation requirements.

The estimated steady state fiscal savings and transitional cash costs are:

'Steady State' Fiscal Savings Per Annum:	\$7 million
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Indicative Cash Transitional Costs:	\$28 million
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Note: the 'steady state' fiscal savings do not take into account possible changes to IRD's depreciation costs. This item can only be estimated once the final impact of structural changes on IRD's fixed asset base have been quantified. As a result of this omission, the 'steady state' fiscal savings figure does *not* represent changes to IRD's annual appropriation.

Based on the estimated cash transition costs, the payback period for the Review Committee's recommended structure is four years. The Review Committee's proposals therefore represent a worthwhile investment for the Government, as the 'owner' of IRD. On this basis alone the Government should proceed to a detailed design and implementation of the Review Committee's proposals in phase 2. This analysis of costs and benefits will be enhanced by other efficiencies that should be identified in phase 2 and the impact of timing changes for transition costs. These figures do not include the tax revenue impact of the expected improvements to IRD's effectiveness, and do not take into account the wider favourable impacts on the New Zealand economy.

19.3.4 Risks

In addition to the transitional cash costs detailed in paragraph 19.3.3 above, a complete analysis of costs and benefits must consider the risks associated with the proposed structural changes, of which the revenue risk is crucial. Major structural change of this type always has risks, but will be heavily influenced by IRD's

management of the transition. Restructuring over the period 1989 to 1994 shows that these risks are able to be appropriately managed. The Review Committee believes that a key factor in minimising the risks, particularly the tax revenue risk, is to make the recommended structural changes in as short a timeframe as possible. A longer implementation timeframe itself carries on-going staff morale and productivity risks. The management of these issues during the transition is discussed in paragraph 19.4 below.

19.4 Transitional issues

A critical issue in moving to the recommended structure is to manage the transitional issues so that the range of transitional costs and revenue risks are minimised and the benefits obtained at an early stage. These issues, together with the effectiveness of the change process generally will be critically affected by the implementation timeframe and process chosen.

19.4.1 Implementation timeframe

In determining the implementation timeframe, consideration will need to be given to striking an appropriate balance between:

- the desire to implement the new structure, and obtain the resulting benefits as quickly as possible;
- the potential size of the transitional costs depending on the implementation timeframe that is otherwise preferred;
- the amount of time required to develop the detailed implementation plan; and
- the desire to minimise the level of disruption arising from the change process, which will have a crucial bearing on the level of fiscal risk generated by the change process.

Minimising disruption also involves trade-offs between, on the one hand, providing certainty to staff about what is to happen to them, as soon as is practicable, and on the other hand ensuring that staff perceive the change process as operating fairly. This may require additional time spent on communicating with staff about the change process, and/or allowing open competition for a wider range of jobs in the appointment process, so that staff whose jobs are affected by the new structural arrangements have a fair opportunity to compete for other jobs.

Striking the right balance between these factors will be very important, given that the way the change process is handled will have a significant bearing not only on the operation of the new structural arrangements and the management of transitional fiscal risks, but also on the success of the changes in culture and attitude that need to be associated with the new structure. This will be a critical issue for consideration in the early stages of phase 2.

19.4.2 Implementation process

Subject to the judicious management of transitional issues and costs noted above, the Review Committee is in general agreement with IRD's proposal to implement the new structures progressively over an 18-month period, concluding by 1 October 1995.

Implementation should commence with detailed planning and, in parallel, critical aspects of the structural change such as establishment of the Tax Operations Research Unit and the appointment of key managers should be completed. This is in line with the original suggestion in the Valabh Working Party's First Report, that key appointments for the new structure would be made in May/June 1994.

This process should involve:

- advertising senior positions, both internally and externally;
- adopting the principle of the best person for the position, but seeking to introduce from external sources the appropriate expertise vital to ensure that the changes identified are achieved and the benefits realised;
- advertising and appointing down to level two of the organisation by the end of June 1994 or at the earliest possible stage, so that these individuals are able to drive the detailed and on-going change process; and
- proceeding as quickly as possible, recognising that significant benefits over and above those quantified can be realised.

The early establishment of the Tax Operations Research Unit will be important to making rapid progress on the identification of information requirements and analysis necessary to develop the customer segmentation approach. The unit's expertise may also be required to gather the information necessary to test issues such as the exact nature of geographic distribution required for the various functions carried out by each customer segment.

19.4.3 Implementation planning issues

The implementation planning to be undertaken in phase 2 should also address a number of issues. Three have particularly high priority:

- development of strategies and detailed planning for communication with managers, staff and key external customer groups about the changes and impacts arising from the new structures. This will be an important influence on attitudes to the change process;
- development of human resources management strategies, policies and procedures as part of the change process. It will be critical for line managers to be committed to the new structure. Procedures must ensure that the job descriptions and person specifications are fully in concert with the new structure and result in the best person for each position; and
- identification of legislative changes required to give effect to the changes proposed. These will need to be integrated into the tax policy work plan. Critical changes may need to be addressed at a very early point in the implementation process.

Other important issues are:

- consultation with employee representatives in the change process;
- detailed examination of structural and job design issues at all levels of the structure, but in particular at Head Office and Field Centre level. An examination of these issues should, for example, provide a more detailed test of whether

economies of scale exist in the delivery of operations at the Field Centre level in particular and consider the use of work teams;

- identification of process re-engineering opportunities that may arise from the new structural arrangements, especially at the Field Centre and Customer Service Centre levels;
- detailed design for key strategies recommended by the Review Committee, eg customer focus, disputes resolution;
- modification of output class structures and performance standards consistent with the new structure;
- modification of management information systems and processes, including how these processes are to operate during the transition period itself;
- development of key management committees to facilitate co-ordination within the structure;
- development of a detailed timetable and process for the testing of options for sub-contracting of delivery; and
- identification of appropriate vision, mission, purpose and role statements for each of the organisational units, together with statements of their underlying philosophies, principles and practices.

Given the complexity of the issues involved in managing the transitional issues, it is likely that IRD will require external expertise to assist in the development of workable approaches in various areas.

There are a considerable number of tasks that will need to be completed in the initial implementation planning period. To allow the Government to monitor progress in implementing the Review Committee's recommendations, the Review Committee recommends that IRD be required to report to Ministers within one month of the Cabinet making decisions on structural issues, with a complete list of tasks to be undertaken and a critical path for their completion.

19.5 Recommendations

The Review Committee recommends that the Government:

- **note that the recommended structural changes are expected to significantly improve the effectiveness of the tax system and IRD, and thus increase tax revenue flows over time;**
- **note that the recommended structural changes are expected to generate fiscal costs and benefits for Vote: Inland Revenue as follows:**
steady state fiscal savings, ie following transition - \$7 million per annum
indicative cash transition costs - \$28 million;
- **note that, based on the immediate efficiency gains identified by the Review Committee, the payback period for the recommended structure is four years;**

- note that the above estimates of annual fiscal savings do not take into account any additional efficiency gains which may be identified during the detailed design and cost benefit work to be undertaken in Phase 2;
- note that the above estimates do not take into account the tax revenue impact of the effectiveness improvements to IRD, nor any general contributions the changes may make to improving New Zealand's economic performance;
- agree that the IRD should now proceed to Phase 2 of the Review (detailed planning and design of the Review Committee's proposals) with the assistance of a Steering Committee structure chaired by the IRD, with representatives from central agencies and persons nominated by the New Zealand Law Society and the New Zealand Society of Accountants;
- agree in principle that the target timeframe for implementing the Review Committee's proposals be 1 October 1995 and that analysis in phase 2 proceed on this basis; but
- agree that the detailed cost-benefit analysis to be done in Phase 2 of the Review consider the relative costs and benefits of alternative implementation timeframes, especially with regard to the management of transitional costs;
- invite the Chief Executive of the IRD to report to the Cabinet Strategy Committee by 1 June 1994 on Phase 2 including the following
 - (i) terms of reference for the Steering Committee.
 - (ii) a detailed work programme for Phase 2 together with a critical path for completion.
 - (iii) consultation and reporting requirements, particularly with respect to the Review Committee's recommendations that impact on other departments and agencies.
 - (iv) a process for progressing legislative changes.
 - (v) resource requirements for Phase 2.
 - (vi) the management of internal and external advertising and filling of key management positions.
 - (vii) a programme to establish a Tax Operations Research Unit, an immediate priority of which would be to identify further taxpayer segments.
 - (viii) the development of strategies that will be employed to manage human resource/industrial relations issues and fiscal risks.
- agree that Phase 2 of the Review should be undertaken progressively and be completed no later than six months after the filling of the second tier management positions;
- invite the Chief Executive of IRD to report to the Ministers of Revenue, Finance and State Services before that time on any issues requiring more immediate resolution; and

- **agree, subject to the cost benefit analysis, that the Review Committee's proposals be progressively implemented, concluding by 1 October 1995, and that detailed planning and implementation proceed on that basis.**

Part III:
Appendices

Appendix A

Terms of reference

Objective

The objective of the review is to investigate and recommend the optimal organisation arrangements for the tax assessment and collection system, and other activities that are currently part of the tax system, the provision of taxation policy advice, legislative management and Ministerial servicing.

The recommendations must take full account of the public service management principles as set out in the State Sector Act 1988, the Public Finance Act 1989 and likely future directions of public sector reform. They should also have regard to the social, economic and fiscal interests of Government, and international trends in tax administration.

Scope

The review is to be comprehensive, involving a fundamental re-examination of the philosophies, purpose, principles and practices, and the current organisational arrangements. The review is to be strategic in nature with a focus on the key functions and activities and the associated major processes that must be undertaken, only involving detail where it is necessary to demonstrate the recommendations are practical and represent the best solution.

In particular the review is:

1. to identify the key functions and activities and major processes which make up the tax assessment and collection system, and other activities that are currently part of the tax system, the provision of taxation policy advice, legislative management and Ministerial servicing;
2. to identify and make recommendations on the appropriate management structures for those functions for which a Chief Executive and a Minister must remain directly responsible with particular reference to tax policy advice, Ministerial service and legislative management;
3. to identify and make recommendations on the appropriate management structures for any functions that are inherently a Government monopoly but for which a Minister need not or ought not to be directly responsible;
4. to identify and make recommendations on the appropriate management structure for any functions which are capable of being carried out under contract;
5. to identify an organisational structure to bring all components of the tax system together;
6. to identify the appropriate vision/mission/purpose/role for each of the organisation units, including the underlying philosophies, principles and practices;

7. to consider and make recommendations on the future statutory and administrative roles and responsibilities, and the associated accountabilities, of the Chief Executive and Commissioner(s) of the Department of Inland Revenue or similar entities;
8. to define in broad terms the benefits, costs, impacts and associated risks of the recommendations; and
9. to develop and make recommendations on an appropriate transitional arrangement to achieve the outcome of the review.

Structure

The review will be carried out under the control and guidance of a Review Committee. The Committee will report to the Minister of Revenue, except that in respect of the policy advice function the Review Committee should report to the Ministers of Finance and Revenue jointly.

The Review Committee will comprise two individuals external to the public service, one chosen for expertise in undertaking reviews of this type and the other for knowledge of the tax system and its administration, together with the Chief Executive of the Inland Revenue Department. One of the external members will Chair the review. The Review Committee should be complemented by the Secretary of Treasury when it is considering and deliberating on recommendations in respect of the policy advice function.

The Review Committee will guide and drive the review, including deciding the scope of the study, key appointments for undertaking the review, work plans, resourcing, timing, methodologies and also being involved in the progressive development of the solutions through workshops, seminars and presentations.

The Review Committee will be assisted by an Advisory Committee comprising:

- the Chief Executive (as Chair);
- one representative (at a senior level) from each of the Inland Revenue Department, the Treasury, the State Services Commission, and the Department of the Prime Minister and Cabinet; and
- an independent person appointed following consultation with the New Zealand Society of Accountants.

The Advisory Committee will receive regular briefings throughout the first phase of the review and will participate in key workshops, seminars and presentations.

Individuals will contribute the representative views, reactions and ideas of their organisations to ensure wherever possible the final recommendations have the support of the various external agencies and stakeholders.

After the first phase the Advisory Committee will function as a Steering Committee and be responsible for making detailed recommendations and implementation.

Reporting

The Review Committee will report progress formally on a regular basis to the Minister of Revenue.

Timing

The review should commence not later than 1 July 1993, and the Review Committee is to report in all respects to Government by 31 March 1994, for Government decisions in April 1994. Key appointments for any new structures should be made during May and June 1994 with detailed implementation commencing 1 July 1994. Detailed implementation planning should involve any new appointees.

Appendix B

The business process of the Inland Revenue Department

Introduction

This appendix describes the major business process of the Inland Revenue Department.

The Purpose of the Inland Revenue Department is to serve the community by:

- collecting revenue to fund the work of the New Zealand Government
- contributing to the achievement of the Government's social policy objectives according to law and in the most effective and efficient manner.

This purpose is achieved through six major functions which together comprise the IRD business process. These functions are:

- Identify and Register Customers;
- Establish Liability and Entitlement;
- Collect Tax and Social Assistance Revenue;
- Disburse Social Assistance and Overpaid Tax;
- Supply Information to Other Agencies; and
- Provide Policy Advice and Monitor Legislation.

Structure of appendix

In outlining each of the major functions, standard headings have been used:

Purpose - describes the reasons the functions are performed;

Steps - sets out the key activities in carrying out the function; and

Linkages - highlights the connection or relationship between one function and the others. Some links between functions are common to all and are described below. The linkages specific to each function are detailed within the description of that function. External links are not covered in this paper.

Common linkages

- Underpinning the administration of the tax system is the use of unique IRD numbers. A single number is allocated to each of the Department's customers, and used internally and externally (eg, the IRD number and GST number are the same, and the IRD number is used by banks to collect withholding tax). The function responsible for the allocation of IRD numbers is critical as it provides the information base which enables the Department to identify, classify, and contact its customers. The *Identify and Register Customers* function therefore has a

fundamental linkage with all other functions. (Note: The information that the Department needs to hold about customers is determined by legislation and alters from time to time.)

- All the Department's activities revolve around administration of the legislation for which it is responsible. Monitoring this legislation through day-to-day operations is a responsibility of each function. This links all operational functions to the *Provide Policy Advice and Monitor Legislation* function in ensuring that any anomalies, weaknesses or omissions are identified and considered, and any appropriate remedial legislation is developed.

Legislation administered by IRD

IRD is responsible for administering the following legislation:

- Income Tax Act 1976 (including Fringe Benefit Tax);
- Goods and Services Tax Act 1985;
- Estate and Gift Duties Act 1968;
- Stamp and Cheque Duties Act 1971;
- Gaming Duties Act 1971;
- Inland Revenue Department Act 1974;
- Child Support Act 1991; and
- Student Loan Scheme Act 1992.

In terms of the Accident Rehabilitation and Compensation Act 1992, the Commissioner of Inland Revenue is the collecting agent for the Accident Rehabilitation and Compensation Insurance (ARCI) Corporation in respect of certain levies.

The Commissioner of Inland Revenue is the collecting agent for unclaimed monies under the Unclaimed Money Act 1971.

IRD business process major functions

Identify and Register Customers

Purpose

To identify the Department's customers and obtain accurate information about them in order to perform the functions necessary to manage the tax administration.

Base information is established (eg, name, address) and a single, high-integrity IRD number is allocated to uniquely identify each customer within the system, eg, a customer uses their IRD number for all purposes - such as GST identification.

The information held about a customer enables the Department to meet the customer's specific needs - such as supplying the appropriate forms.

Steps:

- determine the information needs of the Department (legislative requirements) and those of its customers;
- identify the Department's customers;
- gather information on those customers (eg, biographic/demographic/revenues), allocate IRD numbers, record required details and maintain data base. (Information is collected initially when a customer registers and is subsequently updated from returns and other information supplied by the customer); and
- ensure customers understand the correct use of their unique IRD number.

Linkages

Customer information is used by all other functions. Examples are, to:

- find out a customer's mailing address so that an assessment or refund can be issued; and
- identify the tax rate applicable to a customer, eg individual or corporate.

Access by the other functions to the information held about any customer is made possible by the use of unique IRD numbers.

Establish Liability and Entitlement**Purpose**

To establish and quantify a customer's liability or entitlement for tax or social assistance. This is to ensure they pay or receive the correct amount.

Steps:

- determine customer needs;
- develop and issue returns and forms for customers to complete;
- ensure customers are aware of their rights and obligations, and receive appropriate information and assistance, eg advertising, customer enquiry service;
- receive and process returns and forms. Validate information supplied (check with customer if necessary), and make adjustments if required, eg correct mathematical errors. Generate and issue notices of assessment or entitlement (eg Income Tax, Family Support);
- identify customers who have not furnished returns and take appropriate action, eg issue reminder notices, raise default assessments, prosecute for failure to furnish;
- carry out audits to detect non-compliance and minimise future non-compliance; and
- resolve disputes.

Linkages

This function is closely linked to:

- *Identify and Register Customers* - as it requires access to the stored profile data to issue information to customers, and assist in calculating assessments and entitlements. The *Establish Liability and Entitlement* function also provides information from which the data base is updated;
- *Supply Information to Other Agencies* - as the information established enables the Department to supply specified information to external agencies, eg information contained in business accounts is extracted and forwarded to Statistics New Zealand; and
- *Collect Tax and Social Assistance Revenue* and *Disburse Social Assistance and Overpaid Tax* - these functions use the assessments to ensure liabilities are paid by the customer, and entitlements and overpayments are paid or refunded by the Department.

Collect Tax and Social Assistance Revenue**Purpose**

To collect and bank the tax and social assistance revenue due from customers.

This is achieved by recording and accounting for the various payments received, and updating customers' accounts and the appropriate bank accounts, ie Crown Revenue receipts, ACC. Reconciling and accounting to Government on the Crown Revenue Accounts then occurs.

Steps:

- issue appropriate payment forms to customers;
- receive and process payments - cash/cheques/direct credits;
- bank payments to the relevant bank accounts, reconcile and report to Government;
- update customers' accounts including any late payment penalties or use of money interest (debit or credit); and
- identify customers with outstanding liabilities and take appropriate recovery action (eg, negotiate arrangement to pay, place seizure order on customers' funds, commence bankruptcy proceedings).

Linkages

This function is closely linked to:

- *Identify and Register Customers* - as the information held is required for the correct identification of customers and crediting of payments;
- *Establish Liability and Entitlement* - as information from this is used to ensure customers make the required payments; and
- *Disburse Social Assistance and Overpaid Tax* - as the recording of the payment details is vital to the disbursement process eg, the Child Support Agency can only

pay the custodial parent when it has collected the payment due from the liable parent.

Disburse Social Assistance and Overpaid Tax

Purpose

To make payments of social assistance to eligible customers; and to refund any amounts paid by customers that exceed their established tax or social assistance liability.

Steps:

- identify social assistance entitlement (eg, Family Support, Child Support);
- identify overpayment of revenue (eg, Income Tax refund, ACC Earner Premium);
- offset credits against liabilities where requested by the customer or where allowed by the legislation eg, transfers to spouse, transfers to another tax type;
- make payment or refund by cheque, or direct credit the customer's bank account; and
- reconcile customers' accounts, and Crown accounts.

Linkages

This function is closely linked to:

- *Identify and Register Customers* - as information maintained on the data base (eg, customers' address or bank account number) enables disbursements to be made correctly; and
- *Establish Liability and Entitlement and Collect Tax and Social Assistance Revenue* - as the liability/entitlement and payment information recorded by these functions is required to determine the amount of a disbursement.

Supply Information to Other Agencies

Purpose:

- to provide specified customer information to the Department of Social Welfare (DSW) and the Accident Rehabilitation and Compensation Insurance Corporation (ARCI) to assist those agencies to detect and minimise social assistance fraud and abuse, and to assist DSW to establish customers' eligibility for a Community Services card. The information is provided in accordance with the Inland Revenue Department Act 1974 and the Privacy Act 1993; and
- to provide information to Statistics New Zealand to assist in statistical analysis and the preparation of national statistics.

Steps:

- establish annual information supply requirements with DSW, ARCI and Statistics;

- receive information request from DSW, ARCI about specific customers. (Identifiers are provided by DSW and ARCI - IRD numbers and customer names are key identifiers);
- match identifiers provided with information held. If confirmed, and requested information is held, supply details as requested;
- supply information requested by:
 - DSW - on Family Support customers (used for determining eligibility for the Community Services card); and
 - Statistics - from business tax returns eg, total sales, total depreciation claimed; and
- report to the Privacy Commissioner six monthly or on request, on the supply of information to DSW and ARCI ie, number of cases matched, criteria used.

Linkages

This function is closely linked to:

- *Identify and Register Customers* - as the data base is scanned to confirm the identifiers supplied by the external agencies; and
- *Establish Liability and Entitlement* - as the details furnished by customers, ie, Family Support applications, tax returns and employer schedules are the key source of information supplied to other agencies.

Provide Policy Advice and Monitor Legislation

Purpose

To provide Government with sound and timely advice on proposed legislation, report on existing legislation and forecast revenue flows.

Steps:

- Government determines its policy objectives (legislative work programme);
- receive request from Government for advice or initiate provision of advice;
- obtain information through the other functions and from issues identified by the courts or from court rulings, on areas that require remedial legislation to correct errors or anomalies or to overcome avoidance of tax or social policy obligations;
- research, consult, analyse, identify and evaluate options. Formulate recommendations. Report to Government on the development and implementation of policy ie, revenue/economic impact and customer compliance and administration costs;
- provide Government with a revenue forecast for the year ahead, revise this forecast at six months and report against it;
- provide assistance to committees considering Government tax policy initiatives; and
- draft legislation.

Linkages

This function is closely linked to all the other functions. In carrying out each of the functions, IRD monitors existing legislation and identifies any requirement or potential for legislative change or development. Implementation of new legislation impacts right across the business process.

Appendix C

Strategic indicators of the 'health' of the tax administration

Strategic decision making needs high level performance indicators

Tax administrations throughout the world are grappling with the problem of how to measure the high level, or macro, performance of their tax administration. Several of the tax administrations contacted by the Review Committee commented that they recognise the importance of the problem and are currently examining possible approaches, but no solutions were suggested.

The ATO Report noted that the Australian Tax Office (ATO) had set for itself at least two standards by which it believed its revenue collection efficiency should be judged:

- the extent to which the revenues budgeted are actually collected; and/or
- the extent to which the total amount of tax correctly payable is in fact collected.

The ATO Report notes the latter is often referred to as the 'tax gap', and suggests a third possible indicator of efficiency is the cost of collecting revenue as a proportion of total revenue collections. Another measure noted as relevant is the efficiency and effectiveness in the processing of taxpayer returns. The ATO Report states that the ATO should aim to reduce the cost of collection to below 1 percent of revenue within two to three years, but not at the expense of an increase in compliance costs to taxpayers. The ATO Report acknowledges that the standards proposed above suffer from inherent measurement and practical difficulties but, when taken together, they provide a general basis for evaluation of the efficiency of revenue collection practices.

IRD has suggested that the ultimate aim of analysis for the development of tax policies should be to forecast:

- the increase or decrease in the total tax revenue;
- the marginal change in compliance costs for taxpayers;
- the marginal change in deadweight loss;
- the marginal change in administration costs; and
- trends in average compliance, deadweight and administration costs.

The following chart, International Comparisons: Statistics, Facts and Figures, presents a number of IRD statistics against those from seven overseas administrations. Significant differences between tax legislation, department responsibilities, procedures and reporting methods obviously place some limits on the value of direct comparisons. In particular:

- 'Total tax revenue as a percentage of GDP' has been included as it helps to explain why 'costs of collection as a percentage of total net tax revenue' vary so widely (eg, Sweden);
- Child Support costs, revenues and taxpayer assistance statistics have been excluded from both New Zealand and Australia figures. As no other tax administrations listed collect Child Support, the exclusion brings all countries onto a similar footing;
- tax administrations in Australia, Canada, the UK and the US do not collect GST or VAT;
- correspondence statistics for Australia and Ireland are not available, which distorts the taxpayer assistance ratios provided for those countries; and
- calculation of Australia's 'return for dollar spent' on debt collection is based on direct salary data (excluding administration costs) and debt loaded onto their debt collection system. The system records debt as soon as it becomes overdue, therefore late payments not involving ATO intervention will be included in this statistic.

INTERNATIONAL COMPARISONS: STATISTICS, FACTS & FIGURES									
	NEW ZEALAND	AUSTRALIA	CANADA	DENMARK	SWEDEN	UNITED KINGDOM	UNITED STATES		
COUNTRY DATA									
Total tax revenue as a percentage of GDP (1990)	38.20%	30.80%	37.10%	48.60%	56.90%	36.70%	29.90%		
Population (1990)	3,397,000	16,650,000	26,527,000	5,134,000	8,407,000	57,121,000	248,710,000		
RETURN PROCESSING									
Total Indiv & Coy Refrns	2.41M	10.13M	19.8M	4,465,000	8.1M	8.9M	119.5M		
Total GST/VAT Returns	1.8M	N/A	2M	430,000	430,000	N/A	N/A		
% of indiv refrns filed electronically	7.3%	60%	11%	The need is limited. figures are reported electronically	80-90%	Not Available	9.4%		
% of coy refrns filed electronically	15.9%								
Ratio: % indiv returns to popln	67%	59%	72%	86%	92%	14%	46%		
ADMINISTRATION STAFF									
Number of Revenue Staff:									
Total	5,819	17,726	27,000	5,700	15,300	69,360	119,000		
Ratio: staff to tax returns	1:414	1:551	1:733	1:783	1:529	1:128	1:1,004		
Ratio: staff to net revenue	1:\$3.62M	1:\$4.21M	1:\$4.44M	1:DKK 74.6M	1:SEK48M	1:1.10M	1:US\$8.49M		
PERFORMANCE STATISTICS									
GENERAL									
Costs of collection as a % of total net tax revenue (*)	1.26%	1.25%	1.1%	1.0%	0.65%	2.09%	0.65%		
DEBT COLLECTION									
Collectable and Uncollectable									
Debt as a % of total net revenue	5.21%	5.65%	4.8%	7.2%	5.2%	13.3%	7.01%		
Return per \$ spent	38.8	\$231	C\$32.26	Not Available	SEK 12 - 13	Not Available	US\$26.31		
TAX AUDIT									
Audit results as a % of total revenue	2.86%	2.00%	2.62%	2.1%	0.50%	Not Available	2.60%		
Return per \$ spent	\$11.38	A\$9	C\$11.63	DKK 7.3	SEK 5	UK 4.9-9.0	US\$10.03		
% of returns examined	3.7%	Not Available	Not Available	15%	4%	Not Available	1.00		
Individuals -corporations	26.5%	Not Available	Not Available	40%	3%	Not Available	2.36		
TAXPAYER ASSISTANCE									
Number of Enquiries									
Phone	1,967,508	3,180,204	14,799,000	1,087,300	Not Available	25m	67,265,220		
-Correspondence	980,286	Not Available	1,011,506	16,600	Not Available	150M	202,256		
-Counter Enquiries	927,730	1,399,059	1,869,000	100,500	Not Available	5M	7,246,743		
Total	3,875,524	4,579,263	17,609,506	1,204,400	Not Available	183M	74,734,219		
Ratio: % Total assists to Popln	114.09%	27.50%	66.38%	32.25%	Not Available	321.05%	30.05%		
Ratio: Total assists to Staff	666:1	269:1	652:1	269:1	Not Available	2638:1	628:1		
*Bold type is used when 'Cost' incl capital expenditure but excl the cost of activities performed for other bodies									

Macro performance indicators are difficult to measure

There is universal agreement that some macro measures such as the level of compliance costs cannot be measured exactly. Some other macro measures, in particular deadweight losses, present extreme measurement difficulties.

Following the passing of the Public Finance Act 1989, performance measures have been directed primarily to the outputs that IRD will deliver. The number of output measures is now over 150. Given that number, IRD is currently developing a hierarchy of importance for output measures.

The need for accurate performance measures has precluded reliance on macro measures because of concern that they cannot be measured accurately. Consequently Government and IRD management have been starved of macro level measures, but flooded with micro level measures. As in many other countries, decisions critical to the economy have been made with a substantial imbalance of information.

Proposed objective of macro indicators

The objective is to measure outputs at several levels; to differentiate between the end uses; and to tailor each set of information according to the specific needs of IRD.

IRD should develop and maintain a set of macro information indicators that will help Government and IRD management make the highest level strategic decisions for tax matters. The word 'indicator' recognises that there will not be the same high degree of accuracy that is associated with the word 'measure'. The objectives proposed for these macro indicators are:

- all macro indicators should have the aim of assisting the Minister and/or IRD management make strategic decisions in relation to tax; and
- the macro indicators should enable an overall assessment to be made of how well IRD is meeting its overall objective, and contribute to the proposed 'health' report.

Some macro indicators could be used also as specific performance measures of IRD and the Chief Executive's performance. It is assumed that social assistance macro measures will be undertaken by the originating agency, and that IRD's social assistance indicators will accordingly be operational rather than macro.

Proposed approach to macro indicators

Where it is not possible to quantify exactly a macro indicator, best efforts should be made to provide the most accurate practicable assessment that will assist in making related decisions. In some instances this could initially be no more than a description and analysis of related factors and their effects.

Regular contact should be maintained with overseas administrations to draw on their experience and developments.

IRD should develop the best macro indicators

In practice, some macro indicators will be more relevant to policy advice, some to broad assessment of how well IRD is meeting its objective, and some to assessing IRD's performance. However, because the objective proposed for macro indicators is

to assist in strategic decision making, any additional use of the indicators should be secondary.

The list of potential macro indicators below is far from complete. Considerable thought and work has been expended world-wide on such issues without reaching a conclusion as to which indicators are most important, and how to measure some of them. The following list is intended only as a starting point for developing what should become a critical management tool:

- *best estimate of theoretical revenue*: trends, and against long and shorter term forecasts;
- *actual revenue collected*: trends, and against long and shorter term forecasts;
- *tax gap*: factors, measures and trends;
- *deadweight losses*: identify and assess those elements that are most relevant to tax administration, in particular to policy advice;
- *taxpayer compliance costs*: broken down to main categories of business and individual taxpayer; trends, and against long and shorter term forecasts;
- *total administration costs*: trends, and against long and shorter term forecasts;
- *net revenue collected*: trends, and against long and shorter term forecasts;
- *taxpayer perceptions as a measure of voluntary compliance*: regular independent surveys of all key taxpayer groups to show views and trends on influential matters. For example, businesses views on IRD technical abilities, customer service attitudes and service levels;
- *tax disputes assessment*:
 - surveys of taxpayer objections on a confidential sampling basis, showing perceptions of the process, fairness, speed etc, and trends; and
 - key figures and trends, such as total amounts assessed, after appeals and actually collected;
- *return on taxpayer audit*:
 - amounts recovered per dollar spent; trends, and against long and shorter term forecasts; and
 - trends in key business groups; and
- *macro benchmarks*:
 - for specific functions, with other industries in New Zealand. These could include: customer service, debt management and proportions of expenditure such as on market research; and
 - for macro indicators such as those above, with overseas tax administrations, noting that such comparisons cannot be exact.

Appendix D

Roles of the Commissioner and Chief Executive of the Inland Revenue Department

Introduction and summary of issues

1. In addition to being a Chief Executive of a large government department, the current role of the Commissioner of Inland Revenue as defined in law also includes specific roles, powers and responsibilities for administering the tax law, especially with respect to the application of that law to individual taxpayers. Current responsibilities for tax administration are expressed in the Inland Revenue Acts while responsibilities of chief executives of government departments and ministries are defined in the State Sector Act 1988 and Public Finance Act 1989. One person is charged to perform roles relating to all three of these pieces of legislation.
2. The nature of the roles of the Chief Executive and Commissioner of Inland Revenue, the sheer size of their responsibility and their pervasive impact upon the lives of all New Zealanders, would suggest that they should form a subject of inquiry in any fundamental examination of the machinery of tax collection. The Organisational Review of Inland Revenue has been charged with that examination and has considered the two roles. However, the Review Committee has also been concerned about the roles for a number of more specific reasons which are now discussed.
3. The Inland Revenue Acts imply substantial independence for the Commissioner of Inland Revenue in administration of those Acts and in applying the law in prescribed, and sometimes quite specific, ways to the affairs of individual taxpayers. The Commissioner is specifically allocated roles, responsibilities and powers under the tax legislation.
4. The legislative scheme relating to income tax dates back at least to 1916. During the intervening years the activities involved in administration of taxes have changed substantially from a manual process, where the return of each taxpayer was subject to individual attention by the Commissioner or by an officer of the Department, to the present system where most taxpayers have their tax liability determined by a computer process on the basis of their self-assessed returns. For the majority of New Zealanders, who have most of their tax deducted from their income at source, paying tax has become a relatively routine affair which seldom involves individual attention from an officer of the Department in the determination of final liability for that taxpayer.
5. The changing nature of the business of tax administration over seven decades raises the question of whether the degree of independence of the Commissioner implicit in the legislation should continue to be extended to processes which are largely mechanistic and require general managerial skills rather than particular skills in applying tax law to the affairs of individuals.

6. Another factor impacting on the appropriateness of the present revenue legislation, and the independence of the Commissioner in administration of that legislation, is the accountability framework governed by the State Sector Act 1988 and the Public Finance Act 1977. These two more modern Acts impose new responsibilities on chief executives which may not have been conceived of at the inception of the current scheme of revenue legislation. The integration of the three areas of legislation, which now collectively determine the framework for tax administration in New Zealand, has therefore been a focus of concern for the Review Committee and has been examined in conjunction with questions as to the appropriate level of accountability and independence for the Chief Executive and Commissioner of Inland Revenue.

7. The first Report of the Valabh Working Party recommended, as part of the terms of reference, that the Organisational Review was

To consider and make recommendations on the future statutory and administrative roles and responsibilities, and the associated accountabilities, of the Chief Executive and Commissioner(s) of the Department of Inland Revenue or similar entities.

8. The Valabh Working Party also considered it important to clarify the basis upon which information regarding the tax administration was to be provided to the Minister, and to recognise by legislative amendment that the administration of the Inland Revenue Acts was subject to the finite resources allocated for that purpose.

9. Examination of these matters has led the Review Committee to consider what structural arrangements will best provide for clear accountabilities, an adequate level of independence for the tax administration and effective integration of the three pieces of legislation governing tax administration.

10. As with other areas of the Organisational Review, the Review Committee has made comparisons with overseas jurisdictions. However, as New Zealand is very advanced in developing public sector management and accountability arrangements, overseas comparisons have been of limited value in this area. Many of the issues addressed in this appendix have not yet been dealt with in other countries.

11. Three areas are now discussed:

- integration of the Inland Revenue Acts with the State Sector and Public Finance Acts;
- monitoring and reporting frameworks for the tax administration; and
- providing structural focus for the accountability and independence of the tax administration.

Integration of the Inland Revenue Acts with the State Sector and Public Finance Acts

12. The State Sector and Public Finance Acts are taken as a 'given' in the Review Committee's analysis of these issues. Any alteration to these Acts is outside the terms of reference for the Review.

13. As a result, the fundamental question is:

How does the business of tax administration operate within the framework of the State Sector and Public Finance Acts?

14. In answer to this question, specific reference to the current tax legislation (which is not a 'given') is also required. At present, section 4 of the Inland Revenue Department Act 1974 makes the Commissioner responsible for the administration of the Inland Revenue Acts. However, the Inland Revenue Acts are non-specific as to the categorisation and allocation of work that will allow tax administration to take place and the level of resources to be made available for tax administration. Consequently, there is significant scope for the application of the State Sector and Public Finance Acts in defining the accountability and monitoring frameworks that ensure efficient, effective and economical completion of the work involved in tax administration.

15. The three areas of legislation need to operate together as each has a distinct contribution to make to defining the legal framework for efficient, effective and economical tax administration. However, if impediments exist to the effective integration of these three areas of legislation, the Review Committee is required to address these impediments.

The interest of the Chief Executive and Commissioner in voluntary compliance and integrity of the tax system

16. Ultimately the Minister of Revenue is responsible to Parliament for the tax administration. Accordingly, the Minister must have the power to direct the Chief Executive/Commissioner on any matter relating to the operation of the tax administration in accordance with, and subject to, the relevant statutes.

17. The State Sector Act and Public Finance Act focus primarily on responsibility and accountability in the management of government departments, including the Inland Revenue Department, whereas the Inland Revenue Department Act focuses primarily on the responsibility and independence of the Commissioner in the administration of the Inland Revenue Acts. The Inland Revenue Acts set the rules for quantification of liability and for treatment of taxpayers. A balance is required between managerial and Commissioner independence on the one hand, and accountability for efficient, effective and economical management to Government on the other.

18. Three sets of legislation govern tax administration. Some reconciliation between these is required as the potential for Ministerial direction and control appears to be very restricted under the Inland Revenue Acts but is not constrained in other respects except through:

- convention and good management practice;
- a specific provision in the State Sector Act regarding individual employees; and
- the requirement in the Public Finance Act that financial instructions be 'lawful'.

19. Section 33 of the State Sector Act makes specific provision for the independence of chief executives with respect to actions on individual employees, but there are no other clear statements in this or any other legislation of any respects in which chief

executives are independent from the wishes of their Ministers in the administration of departments. However, section 4 of the Inland Revenue Department Act charges the Commissioner, and not the Minister, with the administration of the Inland Revenue Acts and the Inland Revenue Acts specify very little scope for Ministerial intervention. There is a need for reconciliation in order to provide a coherent framework for the management of the Inland Revenue Department.

20. *The key to reconciliation and balance is to determine the special features of the tax administration for which the Commissioner requires independence under the Inland Revenue Acts and which constrain Ministerial direction, control and accountability under other legislation.* The special feature(s) of the tax administration may also serve to delineate appropriate boundaries for managerial independence under the State Sector and Public Finance Acts.

21. The operation of the tax system, and its effective, efficient and economical administration are critically dependent on a strategy of voluntary compliance. Taxpayers' perceptions about the integrity of the tax system underpin this strategy. One factor influencing taxpayers' perceptions in this regard is the freedom of the application of tax law from political influence. This freedom is important to ensure that taxpayers feel that their own affairs are receiving impartial treatment and that the affairs of other taxpayers are also being treated impartially. Therefore, the independence of the Commissioner in applying tax law to particular taxpayers is crucial.

22. The managerial (Chief Executive) interest in the integrity of the tax system stems from a concern to collect tax in the most cost-effective way. Greater voluntary compliance on the part of taxpayers, and self-assessment, are widely recognised as particularly cost-effective forms of tax collection.

23. Even in a hypothetical situation where a strategy of voluntary compliance was not pursued, the integrity of the tax system would be of vital interest to both the Commissioner and Chief Executive functions in order to protect the constitutional rights of taxpayers as individuals.

24. Therefore, both the Commissioner and Chief Executive functions have an interest in voluntary compliance and the integrity of the tax system. The interests overlap and the managerial (Chief Executive) interest in cost-effective administration is in addition to the narrower, adjudicative interests of the Commissioner function in impartial application of tax law to taxpayers' affairs. The interests of the Commissioner function in voluntary compliance are therefore a subset of the wider interests of the Chief Executive function.

Defining the limits of political influence and independence for the Commissioner and Chief Executive of IRD

25. It follows that the effective integration of the State Sector, Public Finance and Inland Revenue Department Act must not put the perceived integrity of the tax system at risk but must also allow for accountability and associated managerial independence for the Chief Executive. To protect the integrity of the tax system the Minister, the Commissioner and taxpayers should all be assured that there is a 'no-go' area where

the Commissioner exercises a wholly independent judgment. Clarification is required as to precisely how the perceived integrity of the tax system is to be protected in instances of Ministerial direction over aspects of tax administration. The intention of the criteria and procedure outlined below is to *clarify* how decisions should most appropriately be made given the framework of the State Sector and Public Finance Acts and the requirement to protect the integrity of the tax system.

26. First, some minimum criteria are required to determine the point at which accountability and Ministerial direction adversely affect the integrity of the tax system by threatening the independence of the Commissioner. These criteria are intended to define a protected '*minimum*' or 'no-go' area. Good management practice would ordinarily provide a buffer *somewhat above* the minimum level suggested by the criteria below. The Minister should normally leave matters of administrative policy and procedure for the Chief Executive to determine.

27. The following procedure is intended to provide a principled basis for resolving any situation where there is confusion over whether Ministerial control and accountability conflicts with the independence of the Commissioner. A transparent process is required in the event that the existing procedures of mediation and discussion have not achieved resolution. This procedure is not intended to replace existing procedures of discussion between the Minister and the Commissioner and of mediation (by the State Services Commissioner for example) in the event that the different views cannot be easily reconciled.

28. Three criteria define and protect the 'no-go' area:

- the Commissioner must exercise independent judgment on the tax affairs of individual taxpayers and must not be subject to Ministerial direction in relation to those decisions;
- the Commissioner is not subject to any directions relating to any interpretation of tax law by the Commissioner; and
- any directions given on any other matter are given for the purposes of administration of the Inland Revenue Acts and as reflected in the proposed section 4 of the Inland Revenue Department Act and are consistent with the State Sector Act, Public Finance Act and other relevant legislation (the human rights legislation for example).

29. The Minister may issue a direction even after contrary advice from the Commissioner, provided that:

- such a direction is consistent with the criteria above; and
- the direction is made by Order in Council and is gazetted and tabled in Parliament as soon as practicable; and

- the Order in Council is tabled with the Commissioner's written advice and sufficient information so that the intent of the order is clear and any consequences for resource allocation and performance are signalled appropriately; and
- the direction becomes effective seven days after the Order in Council is made.

30. The written advice from the Commissioner may also incorporate the views of any other chief executives and organisations who are affected by the direction.

31. There is ample precedent for transparency in government direction over areas where officials or official bodies have statutory or semi-judicial responsibilities. The criteria and procedure outlined above are consistent with the recommendations first of the Public and Administrative Law Reform Committee in 1986 and then of the Legislation Advisory Committee in 1991, which have been approved by Cabinet. The recommended procedure is similar to that which overrides a recommendation of the Ombudsman for the release of official information.

32. The above analysis derives a clear protection of independence for the Commissioner functions arising from the administration of the Inland Revenue Acts. The Review Committee's proposed replacement draft of section 4 of the Inland Revenue Department Act ensures the protection of the integrity of the tax system is preserved by extending the protection of independence to *all decisions involving individual taxpayers*, whether these are related to the performance of Chief Executive functions or to the role of the Commissioner.

33. The protection of independence includes decisions on individual taxpayers that are related to the performance of the Chief Executive functions. As noted above, the interests of the Commissioner of Inland Revenue in voluntary compliance and the integrity of the tax system are a subset of the total managerial interests in these matters. This is because the Chief Executive, in addition to being concerned about the impartial application of the law to individual taxpayers, is also concerned about collecting tax in the most cost-effective way.

34. There may be cases where the Chief Executive and Minister disagree with respect to a Ministerial direction but the direction is unrelated to the integrity of the tax system as defined above and as set out in the proposed draft of section 4 of the Inland Revenue Department Act. In such cases a tabling procedure is not appropriate. These issues are common to other chief executives of departments and ministries.

A care and management provision

35. As it is not possible for the Chief Executive of IRD, operating within limited resources, to ensure that every cent of due taxes is collected, explicit recognition of the management of limited resources in the efficient and effective collection of taxes is required.

36. Consistent with good management practice, care and management of limited resources should be applied by the Chief Executive across the full range of functions of the tax administration, including functions which are subject to the convention of managerial independence and the statutory independence of the Commissioner in administering the Inland Revenue Acts. There is some doubt, however, as to the extent

to which the present wording of section 4 of the Inland Revenue Department Act, charging the Commissioner with 'administration' of the Inland Revenue Department Act, implies that care and management of limited resources overrides the more specific tasks and duties of the Commissioner defined in the Inland Revenue Acts.

37. A legislative provision giving explicit recognition to management within finite resources is required to be drafted as an amendment to the Inland Revenue Department Act.

38. In the United Kingdom, where the courts have determined the scope of the duty of care and management, the implication has also been drawn that the Revenue is legally bound by any views it may have expressed to taxpayers about the application of the tax law, on a care and management basis, to their affairs. This may have the undesirable consequence of introducing uncertainty with respect to the future application of tax law to taxpayers and of effectively binding the Commissioner on issues where this is not appropriate and where a formal ruling has not been considered or given.

39. If taxpayers have the option of seeking binding rulings it is difficult in principle to justify also binding the Commissioner by a process of implication. It would seem appropriate to give explicit recognition to this situation in the context of the proposed binding rulings regime. This regime should therefore specifically provide that a formal request for either a general or specific ruling becomes the only basis on which taxpayers can bind the Commissioner.

40. A draft of a revision to section 4 of the Inland Revenue Department Act is included with the recommendations in Section 9 of the Report.

Monitoring and reporting frameworks for the tax administration

41. The Review Committee considers that the provision of independent advice to the Minister on the purchase of outputs will be beneficial in the processing of the extra information suggested below. This advice may be in the form of a full-time purchase adviser, or an advisory board.

Monitoring the 'health' of the tax administration

42. If the accountability of the Minister to Parliament for purchase and ownership decisions is to be met, the Minister will require reports from the tax administration agency(s) that take account of the net revenue maximisation objective and the explicit recognition of management responsibility. The reporting arrangement should allow the Minister to fully account for purchase and ownership decisions (at the specified quantity and quality standards - including the integrity of outputs), and to have an input into the long term strategies and directions of the administration. There is a similar need for long term reporting across the public sector which may be partly addressed by the development of ownership agreements and multi-year plans.

43. While, relative to other public sector agencies, the quality of IRD's regular reporting is regarded as very good, there is considered to be a 'gap' in the processes as there is no systematic, formal reporting on the overall 'health' of the tax

administration. This gap should be filled, preferably in a manner that builds on existing reporting processes.

44. IRD currently produces a number of reports as part of the Budget planning cycle and reporting processes under the Public Finance Act. By their very nature, these reports are output specific and contain detailed performance measures. IRD also produces a range of strategic documents, such as the enforcement strategy, but these only give a long term strategic view in these particular areas. In its Second Report, the Valabh Working Party suggests regular reporting on the health of the tax legislation,¹ which is another example of a strategic document with particular focus.

45. However, a more overarching, strategic document which fills in the gaps left by these other more specific documents is required. This document should identify pressure points and trends in the 'health' of the tax administration which should aid in longer term purchase and ownership decisions. It should also state how IRD is dealing with any problems developing in the operation of tax legislation.

46. One objective of the Generic Tax Policy Process proposed by the Review Committee is to integrate the planning cycles for revenue and expenditure. A logical extension of this approach is to integrate revenue planning cycles with planning for the expenditure required to collect that revenue. The report on the health of the tax administration should perform this function. The three-year time horizon envisaged in the Generic Tax Policy Process should be matched by an equivalent time horizon for the planning required in the collection of that revenue. A further reason for the integration of these two processes is the significant interaction that must be expected between policy and operations. The Minister could then make decisions that supported the Government's Economic, Fiscal and Three-Year Tax Revenue Strategies.

47. The Review Committee considers that the appropriate mechanism for preparation of the report on the health of the tax administration should be decided between the Minister and the Chief Executive. One possibility is that the Chief Executive should be charged with the preparation of the report as part of their strategic planning function. Another possibility is that the Chief Executive should prepare the report in conjunction with an external panel, providing opportunity for wider influence in the setting of the strategic direction of the tax administration.

Further development and audit of internal guidelines for the exercise of care and management

48. In an environment where the exercise of administrative discretion has been explicitly recognised through legislative amendment, specific means are required to ensure that perceptions of the integrity of the tax system are not diminished. The tax administration, under the Review Committee's proposed legislation, will now have explicit recognition of its ability, for example, to enter into settlements in the litigation process and in the debt management area. Taxpayers may be concerned about the

¹ *Working Party on the Reorganisation of the Income Tax Act 1976: Second Report of the Working Party, September 1993*, p 83.

application of this authority and may also attempt to take advantage of the apparently increased discretion.

49. To ensure the proper and consistent use of managerial responsibility in these areas, the tax administration will be required to refine or develop internal guidelines for the exercise of care and management in the administration of the Inland Revenue Acts. The guidelines should be consistent with the objective of maximising net revenue over time according to the law and give guidance to staff on the proper procedures and considerations to take into account as they apply tax law.

50. To give assurance to taxpayers, and to Ministers and to Parliament, as to the integrity of the tax system, the internal guidelines, and the application of the guidelines, should be subject to an independent and periodic audit by the Office of the Controller and Auditor General. The results of the Revenue Administration Audit (RAA) should be published in a report to Parliament.

51. The RAA would comprise a review of internal guidelines, process and controls, to determine their adequacy, and a review of a sample of cases to determine whether the prescribed processes are being followed. The RAA would be undertaken annually, with the auditor determining the process and methodology for the audit.

Continuing scrutiny of complaints by the Ombudsman and disputes resolution through the courts

52. Complaints by individual taxpayers about the processes and actions of the tax administration would continue to be dealt with by the Office of the Ombudsman. The Review Committee is also proposing a simplified disputes resolution process. Reporting on the number of complaints and disputes would continue to occur as under the present accountability arrangements with the Minister and Parliament.

Customer charter

53. IRD's customer charter is an important vehicle for outlining to taxpayers their rights and obligations. As the managerial role in the administration of the Inland Revenue Acts is explicitly recognised, the external communication of these rights and obligations is likely to become more important for the maintenance of the perceived integrity of the tax system. As a result, the charter will require more explicit recognition of:

- taxpayers' rights to expect that their quantification of their liability will be impartial and in accordance with tax law;
- taxpayers' rights to expect that their individual affairs will be treated with no greater or lesser favour than the tax affairs of other individuals; and
- taxpayers' obligations under the law, in order to achieve better balance in the charter between the rights and obligations of taxpayers.

Information provision to the Minister

54. In order to fulfil his/her obligations to Parliament the Minister should have all relevant information. On occasion, the requirement for information may be perceived to be inconsistent with the integrity of the tax system and with freedom from political influence as outlined in paragraph 21 above.

55. As a consequence, the Minister should not receive information on the tax affairs of individuals, or information that allows the identification of individuals. Exceptional circumstances where the provision of information may be in the public interest, even though there is no power to direct in individual cases, are:

- where the Commissioner is satisfied that information on individuals is required to develop and frame legislation; and/or
- in a situation where the individual has already approached the Minister and can objectively be seen to have waived the right to confidentiality in some particular aspect of their affairs and the Commissioner is satisfied that the Minister needs that information; and/or
- any other situation where the Commissioner concludes that he/she must give information to the Minister (for example, as 'early warning' of issues for which the Minister may be expected to be required to account for the actions of the Department).

(Note: this is concerned with the Commissioner providing the Minister with relevant information. It does not allow the release by the Minister of that information.)

56. The Solicitor General has advised the Review Committee that, as presently drafted, section 13 allows the provision of such information to the Minister. However, information must not be disclosed to parties who are not listed as exceptions in section 13. In considering expansion of listed exceptions, due regard should be given to the likely impact on the integrity, or perceived integrity, of the tax system.

57. Provision of information to the Minister, as outlined above, will aid the Minister in giving directions relating to tax administration consistent with the criteria and procedure outlined in paragraphs 28 and 29 above.

Providing structural focus for the accountability and independence of the tax administration

58. The summary of issues contained in the first section of this paper raises the issue of the changing nature of the business of tax administration and whether, as a result of those changes, some aspects of what have traditionally been regarded as a single business now require a different legislative prescription. A closely related issue is whether different functions of the current tax administration should be given different and specific organisational focus to reflect their changed legislative status.

59. The second section of this paper examines the nature and degree of clarification that is required in legislation and in the operation of that modified legislation. This clarification may be given further support by a changed organisational structure(s) for the tax administration. Specific reasons for considering separate structural focus for

some, or all, of the roles of the Chief Executive and Commissioner of Inland Revenue are discussed in more detail below.

What are the specific reasons for considering separate structural focus?

60. A key element identified in assessing the optimal level of accountability, responsibility and independence of the Chief Executive and Commissioner of Inland Revenue, as discussed in the second section of this paper, is the perception of the overall integrity of the tax system and the consequences of that perception on voluntary compliance with tax law. The discussion of IRD's customer charter in Section 9, Roles of the Commissioner and Chief Executive of IRD identifies two aspects of tax collection which are of particular importance to taxpayers and their perceptions of the integrity of the tax system. The two points are:

- taxpayers' rights to expect that the quantification of their liability will be impartial and in accordance with tax law; and
- taxpayers' expectations that the tax affairs of other individuals will be determined impartially and in accordance with tax law.

61. Functions of the tax administration which have a particularly strong link to these two expectations may need to be identified and receive separate organisational focus in order to give a certain 'profile' of perceived impartiality and independence.

62. Other concerns relating to the roles of the Chief Executive and Commissioner of Inland Revenue identified by the Review Committee which might contribute to consideration of reorganisation of functions are:

- whether there is currently an adequate focus on the correct and impartial application of tax law to the affairs of taxpayers and the development of the necessary skills to ensure that this application takes place;
- whether the quality assurance and quality control procedures in the final determination of liability for individual taxpayers are adequate - particularly where that determination is likely to be somewhat contentious or occur in an adversarial context; and
- whether the current structural arrangements regarding the roles of the Chief Executive and Commissioner are optimal in the efficient, effective and economical management of the tax administration.

Which tax administration functions require special structural focus?

63. A frequently occurring theme in the discussion of the legislative framework for tax collection, and in the reasons listed above for consideration of separate structural focus, is concern over the application of tax law to the affairs of individuals. More specifically, this concern relates to 'adjudication' in the affairs of taxpayers.

Adjudication can be defined as:

- the exercise of judgment in the application of tax legislation to the affairs of individual taxpayers or groups/classes of taxpayers in order to determine liability.

64. Many of the current activities of IRD have elements of adjudication inextricably intertwined with the other elements that characterise their primary function. Taxpayer servicing, for example, includes an 'adjudicative' aspect as IRD officers assist taxpayers to apply the law in the preparation of their self-assessed returns. Nevertheless, the *primary* function of taxpayer servicing is to facilitate the voluntary compliance of *taxpayers in correctly assessing their own liability*. The primary function of taxpayer servicing also includes an element of educating and informing taxpayers - which is not adjudicative. The majority of activity in the taxpayer servicing area is non-contentious.

65. The present function of taxpayer audit also includes an element of adjudication, as tax law is applied to the affairs of individual taxpayers to ascertain discrepancies between the self-assessed returns of the taxpayer and the auditor's best estimate of the taxpayer's liability. Nevertheless, the *primary* purpose of the overall audit function is to encourage voluntary compliance, and therefore the collection of revenue, through *the detection of non-compliance*.

66. The area of particular concern is where there is *both a high concentration of the adjudicative component and a close proximity to the final quantification of an individual taxpayer's liability*. Particular attention should be paid to areas which have a high potential for contention or are performed in an adversarial context. Special structural focus for this intersection will address the concerns.

67. One intersection of the components outlined above has been noted by the Review Committee during its consideration of the disputes resolution process. An important step in assessing taxpayers' liability correctly is the review of a proposed adjustment to the self-assessed liability of a taxpayer and the final quantification of that liability. The Review Committee considers that this review should be performed by a senior officer who is not the auditor proposing the adjustment. This point in the audit/disputes resolution process is:

- high profile;
- intimately associated with the exercise of judgment in the final quantification of a taxpayer's liability; and
- likely to be contentious and occur in a somewhat adversarial context.

68. Binding rulings is another function within the tax administration where these three points are present. Binding rulings are likely to attract a significant amount of attention; by definition, binding rulings lock the Commissioner into a particular interpretation of the application of the law to the affairs of individual taxpayers and groups of taxpayers; they may give rise to contention as taxpayers' liability is influenced in a direct and public way.

69. The Review Committee therefore proposes that the review of proposed adjustments arising from the audit process, and the new rulings function be included in the group of functions to be given separate structural focus.

Is it feasible to give these particular tax administration functions separate focus?

70. Given the reasons for considering structural focus outlined earlier, and given the description of functions derived above for which separate focus is to be considered, the feasibility of grouping these functions should be assessed.

71. The new group within IRD responsible for binding rulings is already proposed to be a discrete group, responsible to its own manager who will, in turn, report to a 'technical' Deputy Commissioner. Issuing binding rulings is proposed to be centralised and located within IRD Head Office. Provided that information feedback loops are maintained to and from the rest of the organisation (the remedial legislation segment of the policy advice function, for example) the highly specialised nature of this function would seem to lend itself to centralisation and thus to easier management and control.

72. Although the review of proposed adjustment is also highly specialised, it is likely that some geographic dispersion will be required for the review function to remain within reasonable proximity of the auditors proposing the adjustment, and the taxpayers whose affairs are being examined. However, this dispersion is not considered to make the separate grouping of this function unfeasible. Officers could be assigned or appointed for the express purpose of reviewing proposed adjustments arising from the audit process.

73. The Review Committee concludes that it is feasible to consider providing separate structural focus for the preparation of rulings and for the review of proposed adjustments arising from audit.

Is separate focus desirable?

74. The desirability of grouping the defined set of functions together can best be examined by reference to the specific reasons given at the beginning of this section for consideration of particular structural focus.

75. Grouping the functions together will allow concentration of managerial focus and permit the development of a particular culture and set of skills centred around the impartial application of law to the affairs of taxpayers. This is particularly helpful given that the functions are 'high profile' in that their operation impinges directly on the tax liability of taxpayers in a very public and transparent way. This is especially true for binding rulings which would be routinely published.

76. The high probability that these areas may be contentious and be performed in an adversarial context makes the increased perception of their impartiality very important.

77. The separation of the review of proposed adjustment should provide an additional quality assurance that the final quantification of a taxpayer's liability, arising from an audit by IRD, is as accurate as possible.

78. The use of resources, in the two areas proposed to be grouped together, can be clearly monitored through output specifications and associated performance measures. The Government, as purchaser and owner of the tax administration, can also specifically assess the trade-offs associated with allocation of resources between these and other areas of the tax administration.

79. One criticism of this grouping of functions is that it may represent a somewhat arbitrary splitting of an otherwise integrated process. The arbitrary split may be harmful if the division of responsibility for parts of the integrated process creates unmanageable and perverse incentives. This criticism is one of 'degree' on two bases:

- the degree to which the proposed division of the process is different from the arbitrary division of the process that occurs already (managerial convenience has led taxpayer audit to be separate from binding rulings, for example); and
- the degree to which any adverse incentives which may apply can be managed.

80. This last point is a function of the structure and managerial framework for the particular functions and for the tax administration as a whole. These are discussed below.

81. For the reasons summarised in paragraphs 75 - 78 the Review Committee is satisfied that the proposed grouping of adjudicative functions is desirable.

What organisational structure is most appropriate?

82. The feasibility and desirability of grouping the functions of binding rulings and review of proposed adjustments have been discussed above, but the most appropriate structural arrangements for these functions have not yet been discussed. Specific structural options are now considered below.

One organisation compared with two organisations

83. The strongest manifestation of separate focus is for the review of proposed adjustment and rulings functions to be performed by an organisation separate from the rest of the tax administration. This arrangement would maximise the independent public profile of the high level adjudicative functions.

84. Decisions affecting recruitment, retention and the development of a culture surrounding the correct and impartial application of tax law, would then be the clear responsibility of a single manager. Management of this area would not be 'submerged' within the management of the larger tax administration. Resource appropriation and use by this separate agency would be very clear. The interaction of the smaller adjudicative agency with the larger tax administration would also require some transparency as protocols were drafted prescribing the flow of information and actions required of participants from each agency.

85. The protocol between the two organisations would need to describe:

- the information requirements of the adjudicative agency, from the larger tax administration;
- the information feedback from the adjudicative agency to the larger tax administration as quality management issues are addressed in the review of proposed adjustments and in the issue of binding rulings; and
- the procedure for implementation, by the larger tax administration, of the outcomes of the review of individual taxpayers' affairs and of general and specific binding rulings.

86. Given the complex nature of the interactions described above it is probable that disputes between the two agencies would arise. In the event that these disputes were not readily resolvable by the Chief Executives, the logical point of resolution would be at Ministerial level. However, given that many of the disputes would concern the application of tax law to individual cases, and given the fundamental objective of protecting the integrity of the tax system, the involvement of *the Minister in this context is not appropriate*. The complex relationship described above is better managed within one structure because disputes between functions are referred to higher levels of management for resolution by management fiat if necessary.

87. The 'submersion' of the high level adjudicative functions within the larger tax administration should most appropriately be addressed by:

- adequate specification and monitoring of outputs and associated performance measures;
- scrutiny of the estimates by a Parliamentary select committee; and
- the proposed report on the overall 'health' of the tax administration.

88. As currently drafted, the Inland Revenue Acts assume that there is only one tax agency and thus include hundreds of separate provisions of different kinds referring to the 'Commissioner'. Any organisational split into two agencies would necessitate a comprehensive rewrite of the Inland Revenue Acts in order to accurately define roles and responsibilities in tax administration for two different agencies. This effectively bars immediate separation, as the rewrite is expected to take some years and is a prerequisite for full separation. For the same reason, New Zealand's tax agreements with other countries would require renegotiation over some years.

89. Separation of the high level adjudicative functions from the rest of the tax administration would be appropriate if separate objectives for each of the new organisations were required to be preserved and were not compatible. However, a single revenue-oriented objective for the tax administration has previously been defined by the Review Committee and both the high-level adjudicative and the other functions of tax administration have a significant, mutually reinforcing contribution to make to this objective.

90. Further, if the process oriented towards the achievement of a single objective were the responsibility of two separate organisations, there would be no single organisation responsible and accountable for the whole process and the achievement

of a single objective. As noted above, the organisational structure influences the degree of perverse incentives that may exist. The operation of two agencies may provide incentives for each to 'blame' the other for short-comings in the overall tax administration and for neither to be held completely accountable.

91. The consideration of the integration of the Inland Revenue Acts with the State Sector and Public Finance Acts contained in the second section of this paper clearly illustrates that *both* the Commissioner and Chief Executive functions of the tax administration have a vital interest in the integrity of the tax system and in voluntary compliance. Further, the Commissioner's interest is a *subset* of the interest of the Chief Executive. The separation of the overall tax administration into two agencies would not permit full control by the Chief Executive over an aspect in which he/she has a vital and overriding interest.

92. Although there could be significant focus on improving technical skills in the new adjudicative organisation there may also be a corresponding diminution in skills in the larger tax administration agency as:

- top quality experts are moved initially into the new agency; and
- the technical career path in the larger organisation is truncated; and
- both agencies compete in the labour market for the same resources.

93. An alternative view is that the reallocation of skills between the two departments might reflect the 'optimal' use of finite labour resources as high quality skills gravitated towards the higher profile function.

94. On balance, and after careful consideration of all of the above issues, the Review Committee concludes that the proposed grouping of high level adjudicative functions should be given structural effect within a single tax administration organisation rather than becoming the responsibility of a separate organisation.

Options for organisation within a single agency

95. Two options are considered for organisation of the proposed group of high level adjudicative functions within one agency. These are:

- organisation of rulings and review of proposed adjustment under a second-tier manager who is also responsible for the national delivery aspects of the review function and reports to the Commissioner; and
- organisation of rulings and review of proposed adjustment under a third-tier manager who is also responsible for the national delivery aspects of the review function and reports to a second-tier manager. The second-tier manager is also responsible for the technical areas which are most closely associated with the review and rulings functions (ie, taxpayer audit and the senior technical component of taxpayer services) and reports to the Commissioner.

96. Direct control by a second-tier manager would permit a higher level of managerial focus/attention on suggested grouping of functions. It would also make a larger contribution to the perceived profile of this area (both within the organisation and externally). The higher profile and prestige of this position will also permit the

recruitment and retention of a person with the most appropriate level of skills for this position.

97. Internal contracting between the second-tier manager responsible for the high level adjudicative functions and the second-tier manager/s responsible for other aspects of the tax administration would force explicit consideration of the interactions and potential trade-offs explicit and implicit in the requirements for a protocol between separate organisations outlined above. Conflict resolution between two second-tier managers would be addressed by the Commissioner. This is considered the appropriate level for resolution of this type of conflict.

98. Although the third-tier management does not provide the same degree of explicit focus as the first option, the linkages and feedback loops required between the high level adjudicative functions and closely related areas of the organisation would be more closely managed. To a certain extent, the proposed grouping of functions has a quality assurance component which may with advantage be integrated as part of a total quality management process throughout these closely related functions.

99. Organisation of the defined group of functions directly under a second-tier manager within a single tax administration agency and reporting to the Commissioner is considered the most appropriate structural expression of the high level adjudicative functions of the tax administration.

Appendix E

Tax disputes resolution

Background

1. During the course of the Review process, a number of concerns have been raised about the operation of the processes for resolving taxation disputes. These concerns primarily relate to the following areas:

- the disputes resolution process allows a number of opportunities for IRD to reconsider the correctness of the assessment. The Department reviews assessments at the objection stage and again when a case stated is requested. The consequence of this can be uncertainty for the taxpayer, and delay in the resolution process. It may also mean that the incentives on the Commissioner to get the assessment right in the first place are weakened. According to the IRD Report of the Dispute Resolution Evaluation (1993), 29 percent of objections were allowed in full and 19 percent in part, 10 percent because the previous assessment was considered wrong and 30 percent because new information had come to hand. About one-third of requests for a case stated were conceded to some extent by IRD and cases were not filed for hearing - 14 percent of those for cost-benefit reasons;
- the disputes resolution process, including hearings before the Courts and the Taxation Review Authority, can take an unacceptable length of time for both the Commissioner and the taxpayer. Three statistics highlight the problem:
 - according to the IRD Report of the Dispute Resolution Evaluation, the median time taken in the objection/request for a case stated process up to the decision not to file the case stated, was 8.3 months. (There is now a legislative requirement to file within six months);
 - as at November 1993, almost 60 percent of the cases stated to the High Court had been filed there for more than 15 months; and
 - in 80 percent of the tax cases decided by the Court of Appeal in the last five years the time lag from the end of the income years in question to the date of the Court's decision was more than five years (in 25 percent of the cases it was over 10 years) - and the Court's decision was usually given at the hearing or within a month;
- some business taxpayers in particular are concerned that the Commissioner effectively plays the dual roles of 'player' and 'referee' in the process, given that the taxpayer is required to submit to a process that is administered by the Commissioner, if they wish to object to their assessment. Under that process 70 percent of the objections are considered by the same person who performed the original audit. That inevitably reflects on the independence of audit review, although any decision to disallow the objection is made by a superior officer.

- business taxpayers were also concerned that appropriate levels of expertise are not being applied within IRD, to both the pre-assessment and disputes resolution processes; and
- the costs of pursuing disputes in the absence of a special fast-track, low cost process. According to the Report of the Dispute Resolution Evaluation, the median amount of tax in dispute was \$4863 for all objections but \$20,115 for cases filed. Disgruntled taxpayers are less likely to comply in the future if they feel that the costs of pursuing legitimate small disputes are too high.

Proposals for change

2. There are three important areas for consideration in relation to design of a disputes resolution process. These are:

- the framework within which any disputes process operates ie, objectives, incentives/sanctions etc;
- the 'pre-assessment' stage which provides a range of opportunities for dispute avoidance; and
- the 'post-assessment' stage in which disputes may formally arise - which provides opportunities for early resolution of disputes.

The 'pre' and 'post' assessment distinction is important, particularly in the activities of the Audit area. The proposals for change outlined below represent a package, and should not be considered in isolation.

Framework

3. Before attempting to establish the most effective mechanisms for dealing with different types of disputes, it is important to identify the framework within which the mechanisms will operate. This involves specifying:

- the objectives of disputes resolution;
- the factors which will be critical to the success of any disputes resolution process;
- any linkages which are important to the effective operation of the process; and
- incentives and sanctions required.

4. It is useful at this point to clarify what constitutes a 'dispute' for the purposes of this discussion. IRD deals with a variety of situations on a day-to-day basis where taxpayers are querying the basis of their assessment eg, because they have identified a subsequent item of information that they believe should be taken into account. These situations can be accurately described as 'clarification or confirmation', and do not involve contentious issues, or constitute a dispute.

'Disputes' arise when the Commissioner and taxpayer do not agree on the facts and/or interpretation of tax law on which an assessment has been based. Although the distinctions are arbitrary to some degree, it is useful to classify the types of disputes along these lines.

Revenue implications

	Small	Large
Simple/non-precedential	<p>These cases typically involve small business with non-tax specialist advisers and investment income earners. Disputes usually involve questions of fact.</p> <p>Example: <i>Whether sale of a business is a going concern for GST purposes.</i></p>	<p>These cases typically involve medium to large businesses. Usually disputes involve questions of fact and law.</p> <p>Example: <i>Tax treatment of an employee allowance.</i></p>
Complexity		
Complex/precedential	<p>These cases usually involve small to medium size businesses and taxpayers with complex business structures (such as overseas operations and/or links) or business in industries with special tax regimes. Issues are often both on questions of fact and law.</p> <p>Example: <i>Whether FBT is GST inclusive or exclusive.</i></p>	<p>These cases typically involve large corporate taxpayers with extensive resources and specialist advisers. Disputes usually involve complex transactions with substantial revenue and questions of fact and law.</p> <p>Example: <i>Transfer pricing.</i></p>

Note that small disputes are taken to be those with under \$10,000 tax in dispute. Simple cases are those where the facts are clear, and precedential implications are small. Complex cases are those where the facts and/or the law is complex and the precedential implications are high. Revenue implications relate to the amount of tax in dispute for a given taxpayer.

Objectives

5. The Commissioner's objectives in this area should be to:
 - prevent unnecessary disputes arising; and
 - resolve those disputes that do occur fairly and expeditiously, and in accordance with the law. (In some cases this will also assist with clarification of the law.)

Incentives and sanctions

6. The disputes resolution process should encourage:
- the Commissioner to apply appropriate resources to getting the assessment right in the first place;
 - the taxpayer to disclose all relevant information as early as possible in the assessment process; and
 - both the taxpayer and Commissioner to avoid undue delay in resolving any disputes that do occur.

Appropriate sanctions on both Commissioner and taxpayer should give effect to these incentives. This requires an effective linkage between the operation of the disputes process and the incentives/penalties regime.

Critical success factors

7. The success of a disputes resolution process can be measured by whether:
- it identifies disputes at the earliest possible stage and enables them to be dealt with on a timely basis;
 - true independence is brought to bear in the evaluation of the points at issue by people with the appropriate skills, knowledge and authority;
 - adequate legal analysis is applied to the points at issue to ensure that the law has been correctly interpreted; and
 - communication between the Commissioner, and the taxpayer or their representatives, has been direct and open, with the purpose of ensuring that all relevant information has been obtained.

Linkages

8. The disputes resolution process does not operate in isolation. Linkages must be identified and operate effectively with:
- taxpayer services which give taxpayers information which allows them to voluntarily comply with the tax system;
 - a comprehensive and consistent regime which provides appropriate incentives and sanctions both on the taxpayer and the Commissioner (as noted above). An effective regime should have an important influence on resolving difficulties before they arise by helping to establish expectations and standards;
 - an enhanced rulings function which delivers responsive, consistent, timely and accurate technical interpretation of legislation;
 - a complex legislative framework that imposes compliance costs on taxpayers. The disputes resolution process should not add to this situation by imposing any unnecessary monetary or psychic costs on the taxpayer;
 - the modernisation of taxpayer audit. The majority of disputes originate from assessments issued as a result of the audit process. One of the objectives of audit

modernisation is the early identification of remedial legislation issues and the prompt dealing with these issues through the legislative process. This will reduce the number of future disputes; and

- the taxation policy development process. Quality policy design and clear legislative drafting reduce the likelihood of disputes. The disputes resolution process should include analysis of the causes and results of disputes to ensure that policy issues are identified and referred to the policy development function for action.

Pre-assessment activity - avoiding disputes

9. It should be axiomatic that, as far as possible, assessments are correct before they are issued. This requirement applies generally but, in terms of the disputes process, is especially critical for assessments issued as part of the audit process. Pre-assessment procedures should be developed or amended to facilitate preventing and dealing with disputes in consultation with taxpayers and practitioners. The pre-assessment activities set out below will provide IRD with a set of administrative procedures designed to improve the quality and timeliness of assessments and reduce the likelihood and grounds for subsequent dispute.

10. In the audit situation, steps should be taken to ensure that, before an assessment is issued:

- appropriate legal and other expertise is applied, and generally there is adequate internal review;
- in cases where IRD feels that more contact with the taxpayer will be required before an accurate assessment can be issued, a notice of proposed adjustment/s should be issued to the taxpayer, specifying a time limit within which the taxpayer is to respond;
- if the taxpayer does not accept the proposed adjustments, pre-assessment conferences may be held with the intention of identifying and resolving issues, particularly factual issues. These conferences may be formal or informal depending on the circumstances of each case;
- a 'cards on the table' notice supported by an evidence exclusion provision may be given at the discretion of the Commissioner, where a notice of proposed adjustment is issued, to provide an appropriate incentive for disclosure of the factual basis of the arguments of both the taxpayer and the Commissioner;¹

¹ Section 21A of the Income Tax Act 1976 operates in this way in respect of offshore material except that it does not bind the Commissioner as well as the taxpayer and applies to a greater level of detail of documentation than is considered appropriate in a wider context. IRD considers it works well. Another example is the US Tax Court rule excluding reliance on documents not previously disclosed.

- the adjudication of the liability ie, the assessment, is separated from the audit function. It should become the responsibility of the Final Adjudication function;² and
- cases where there are significant revenue or precedential issues based on a completed audit/investigation and where initial agreement by the taxpayer is unlikely, despite attempts made during the audit process to reach an agreement, would form the focus of the adjudicative function. Some managerial guidelines defining 'significant' cases may include:
 - where the value of the amount in dispute is likely to be greater than \$10,000 - this could be the base position and tie in with proposals for 'fast tracking' small disputes;
 - cases below this amount where the issues at stake have the potential to affect a large number of taxpayers; and
 - a sample of all other cases where an adjustment has been made to a taxpayer's self-assessed return, whether or not there was agreement reached.

There should be provision to get the leave of the Court to adduce further information, but this would be granted only in special circumstances and after an appropriately rigorous enquiry.

There should be provision for a 'waiver' of time limit restrictions (eg, the statute bar) by the taxpayer for a limited period while the conference process is being followed.

The notice of proposed adjustment and conference process would need to be subject to the qualification that the Commissioner can depart from this process if it is necessary in his/her opinion to protect the revenue eg, in the case of dealing with criminal activities. The test case procedures would also need to be retained.

11. Improving the pre-assessment and assessment process with appropriate managerial oversight should enhance the quality of assessments and reduce the potential for subsequent disputes. To some extent the process outlined above reflects existing arrangements, but formalises and establishes these steps as requirements of the assessment process for audit. The formalising of these arrangements could either be dealt with by well-publicised communication of the changes by the Department, or by legislative change.

12. The prompt filing of returns and prompt issue of resulting assessments is basic to the overall administration process. Concerns have also been expressed to the Review Committee over delay in the issue of assessments in some cases which has the effect of stopping the time bar against subsequent amendment of assessments from running against the Department (four years after the end of the year in which the original assessment is made). This raises the issue of whether the time bar should start to run from the filing of the return.

² This approach is similar to that recommended by the ATO Report, p 279.

13. The allocation of resources to ensure that audits are carried out within time bars determined by Parliament is a management issue, and the start of the time clock should not be deferred. This in turn raises complex issues about the degree of disclosure of information required in tax returns and the actions required when the Commissioner is not satisfied with the tax return furnished. The Review Committee considers that the concerns raised are important and should be given attention in the context of the Compliance and Penalties Review underway. The concerns are also addressed by the proposed evidence exclusion procedure outlined above.

Post-assessment - disputes resolution

14. If every effort is made to ensure that the assessment is correct before it is issued, using the procedures suggested in this appendix, the law need no longer provide the opportunity for the Commissioner to revisit the decision through a procedure requiring objections to be made to the Commissioner.

15. Currently, the taxpayer must pay at least 50 percent of the assessed liability - ie, while the dispute is being resolved, if their objection has been disallowed. It would seem sensible to retain this concept as it provides a strong incentive on the taxpayer to resolve the dispute as quickly as possible, as opposed to prolonging the disputes process to avoid paying.

16. However, it would also seem reasonable under these circumstances to give the taxpayer the opportunity to initiate and pursue their objection directly through the Courts where the dispute would be subject to normal judicial timetabling, ie the timetable would not be 'controlled' by the Commissioner. The Commissioner would respond to the process initiated by the taxpayer. (This is the standard practice in the US.) There appears to be no clearly discernible reason of principle dictating the need for a special judicial procedure for taxation disputes, and little weight in the argument that the normal statement of claim procedure will require more time than the revised case stated process, given that the pre-assessment process including the evidence exclusion provision should substantially reduce any need for interlocutories.

Minor disputes or grievances

17. The three areas, or stages, noted above deal with the formal disputes resolution process. This process, and more particularly its later stages, tends to be generally used by larger individual or business taxpayers. Assurance must also be provided that there are effective processes in place to address the right of ordinary taxpayers to have any problems or grievances that arise in relation to their tax affairs dealt with fairly and promptly. These problems may be minor disputes over an assessment, or may be concerns relating to the use of the Commissioner's powers.

18. The normal expectation would be that the administration has an incentive itself to have procedures and mechanisms in place to deal expeditiously with these types of problems, as an ordinary part of good management practice. In addition there should also be a facility for the taxpayer to take their problem to an independent body outside of the administration, if they feel that is required.

19. The current situation is that IRD has a range of internal management procedures designed to identify and address problems that taxpayers may be experiencing in their interaction with the administration.

In particular, the Department has established a Problem Resolution Service to provide a specific mechanism to assist taxpayers. The feedback on this service is positive. The Ombudsman has commented to the Review that the Problem Resolution Service network has 'clearly been of assistance in resolving complaints informally'.

20. The Ombudsman is available as a further source of remedy for aggrieved taxpayers. This would appear to meet the requirements for an independent avenue of resolution noted above, and it would be questionable whether the establishment of a more specific tax mechanism, such as a Tax Ombudsman would add significant value to the present arrangements.

Operation of court processes

21. A comprehensive review of the functioning of the High Court and the Taxation Review Authority in relation to tax cases would require considerable time. There is certainly some evidence that problems are occurring at this stage of the process which contribute to the overall delays. However three points emerge clearly:

- by its very nature the case stated process itself possesses disadvantages when compared with the litigation processes associated with the proposals suggested here;
- as other jurisdictions have found, there are considerable advantages in having at least a substantial proportion of tax disputes dealt with by a specialist tribunal; and
- for the tax system to function effectively it is crucial that tax cases be dealt with promptly and be subject to appropriately rigorous judicial timetabling.

It would require considerable work to determine whether the current arrangements are fully effective. In principle, a specialist tribunal, with appropriate care taken over the specification of its functions and appointments made to it, would facilitate effective disputes resolution in the taxation area.

The proposals for change set out in paragraphs 9-16 above should address the majority of current concerns with the disputes resolution process. It is therefore suggested that a period of time should be allowed to see how these changes have worked. The effectiveness of the disputes resolution process should then be reviewed two years after all the elements of the proposals are in place, and at that point it may be appropriate to consider whether a wider review of the operation of the court processes is warranted.

Small claims

22. In relation to small claims, involving amounts under \$10,000, a fast track, non-precedential process for dealing with these type of claims should be available.

Apart from providing a process more suited to most small disputes it would encourage voluntary compliance generally.

23. The recent ATO Report, p 331, has recommended the establishment of a Small Taxation Claims Tribunal within the registry of the Administrative Appeals Tribunal to deal with amounts of tax in dispute less than A\$5000 subject to:

- payment of a non-refundable fee of A\$50 by the taxpayer;
- any decision of the tribunal is final and non-appealable; and
- the ATO having the option to refer the matter to the Federal Court of Australia provided all the taxpayer's costs, including legal representation, are met by the ATO.

24. In New Zealand, as noted in paragraph 1, it is estimated that cases involving amounts less than \$5000 make up somewhere around half of all disputes that taxpayers raise with the Department. However, given the costs of pursuing a dispute to litigation under the current processes, taxpayers may be advised not to do so.³

Rather than setting up another tribunal, it would be preferable for the Taxation Review Authority to be given that special responsibility, as is the case in America and Canada.⁴ This proposal should be pursued in phase 2 of this Review, involving other parties as appropriate.

³ Informal information from discussions with some NZSA members. And in the Taxpayer Audit Survey of 1992, 50 percent of taxpayers agreed it was too expensive to dispute an IRD ruling.

⁴ In America, taxpayers who are willing to forgo any possible appeals and who have less than \$10,000 at stake for any one tax period may elect to have their case tried by the Tax Court under the small tax case procedure, which is simpler and less costly than the regular procedure. Decisions delivered under this small case procedure amounted to 33 percent of the total Tax Court opinions in 1990. See 'Litigating with the IRS: Choosing your Forum', Frank S. Berall, *The Practical Tax Lawyer*, volume 6, Number 2, Winter 1992, pp 75-95.

Summary

25. This appendix sets out a range of options for dealing with different types of disputes or problems that may occur between taxpayers and the tax administration. These are summarised in the following diagram, under two groups:

Group 1: Clarification or confirmation issues;
Process problems.

(*Note:* these do not constitute a 'dispute' for the purposes of the discussion in this paper.)

Group 2: Small and large disputes of a simple/non-precedential or complex/precedential nature.

	Problem	Solution Step 1	Solution Step 2 (if required)
<i>Group 1</i>	1. Clarification or confirmation	Taxpayer contacts IRD Taxpayer Services	
	2. 'Process Problem' (small scale)	Taxpayer contacts IRD Problem Resolution Officer	Taxpayer contacts Ombudsman
<i>Group 2 'Disputes'</i>	1. Small amount simple/non-precedential	Taxpayer uses proposed Small Claims procedure within the Taxation Review Authority jurisdiction	
	2. Large amount and/or complex/precedential	Taxpayer takes case to Taxation Review Authority or High Court Commissioner responds	Commissioner or Taxpayer may take case on appeal.

Appendix F

Compliance costs in the New Zealand tax system

Introduction

1. This appendix:
 - provides some general background on compliance costs and why they are an issue of concern;
 - summarises and evaluates the information that is currently available in New Zealand about the nature and extent of compliance costs;
 - summarises and comments on the information available from other tax administrations about compliance costs;
 - makes comparisons, where possible, between compliance costs in New Zealand and other tax administrations; and
 - provides some general comment on other activities underway in New Zealand in relation to compliance costs, including the purpose and expected outcomes of this activity.

Background

2. The tax system serves two functions:
 - to raise revenue to fund Government programmes such as health and education; and
 - to redistribute income in a manner which society considers appropriate, reflected through the tax rate structure, the taxation regime and social policy measures.
3. Raising revenue through the tax system is not cost free. The tax system imposes three costs:
 - **efficiency or excess burden cost:** These are 'costs' generated by distortions introduced into the economy by taxation, which unduly influence the behaviour of individuals. For example, the opportunity time lost by taxpayers searching for tax loopholes;
 - **compliance costs:** Compliance costs are defined as the costs which individuals and organisations incur in meeting the requirements imposed on them by the tax laws and practices of the tax administration, over and above the payment of tax, and over and above any distortions inherent in the nature of the tax. These costs are normally classified into explicit costs which result directly from meeting tax requirements, psychic costs resulting from the anxiety that may be associated with what is required to meet tax obligations and tax planning costs such as fees to tax professionals; and
 - **administrative costs:** These are the costs incurred by the tax administration in running the tax system; ie, the cost to IRD of sending tax returns to customers and processing those tax returns is an administrative cost. Funds to cover administrative costs come ultimately from taxes themselves.

4. Over recent years in New Zealand, the tax system has been used not only to collect taxes but also as a mechanism for the delivery of social policy initiatives. These have imposed additional compliance costs on some customer segments such as employers and small businesses.

5. High compliance costs are an economic concern as they may impact on employment and economic growth by discouraging the start up and expansion of business. For example the consultative document on Tax Simplification considered that high compliance costs imposed on employers may inhibit the taking on of extra employees and the employer may instead opt for additional capital investment. Equally, if compliance costs fall disproportionately on small businesses, this may be of particular concern in the New Zealand economy where 82 percent of businesses employ less than five staff, and 90 percent less than 10.¹

6. Efficiency costs and compliance costs are inherent in all tax systems. Minimising compliance costs is important, but the aim of tax policy design is to achieve society's revenue and equity objectives while minimising the efficiency, compliance and operational costs overall in a manner acceptable to society. For example, Joel Slemrod in an article entitled 'What Makes A Nation Prosperous, What Makes It Competitive And Which Goal Should We Strive For?' stated that in his opinion 'the overall objective ought to be a low rate broad based tax system, one that minimises the role of the tax system in private decision making'. An over-emphasis on the reduction of one factor, such as compliance costs, may increase the cost of the tax system overall. For example, it would be possible to reduce compliance costs in the depreciation regime, by removal of the choice of diminishing value or straight line rates which could, in some instances, have a negative effect on revenue.

7. Reduction in the cost of the tax system overall will not necessarily involve trade-offs where needless costs of compliance or administration are being incurred. In these cases, costs can be removed with no adverse impact on the objectives of the tax system or increases in other costs.

New Zealand situation

8. There are two studies which attempt to quantify compliance costs in New Zealand. They are:

- *The Compliance Costs of Business Taxes in New Zealand*, by Sandford and Hasseldine, undertaken in 1991 (the 'Sandford study'); and
- *New Zealand Society of Accountants Submissions on Tax Simplification*, by J Shewan (Chairman NZSA Taxation Committee).

9. There is also a very recent study by Lin Mei Tan and Stuart Tooley of Massey University of the impact of the recommendations of the Tax Simplification Consultative Committee chaired by John Waugh (the 'Waugh Committee').

10. There is no known information on non-business compliance costs in New Zealand.

¹ 1992/93 Business Activity Statistics.

The compliance costs of business taxes in New Zealand

11. The most detailed and comprehensive information is the Sandford study. The methodology for this study was a mail survey to businesses. There were two mail surveys:

- one to employers concerning PAYE, FBT, ACC and Family Support; and
- the other to businesses - covering GST and business income tax.

12. The key results were:

- compliance costs of employers' PAYE are exceptionally regressive. Mean costs as a percentage of turnover vary at both ends of the scale with 2.2 percent for a firm with an under NZD\$30,000 turnover and 0.03 percent where the turnover is in excess of NZD\$50 million. The total compliance costs of PAYE taxes were estimated at NZD\$195 million in 1990-1991. This represents 1.9 percent of tax revenue from this source;
- total compliance costs for FBT were estimated at NZD\$8.5 million in 1990-1991. This represents about 1.7 percent of FBT revenue. The compliance costs for FBT were lower than expected. It was suggested that compliance costs were acting as a disincentive for smaller employers to offer fringe benefits;
- total compliance costs for GST were estimated at NZD\$453 million (7.3 percent of GST net revenue). The compliance costs for firms with less than NZD\$30,000 average net GST paid were 87.8 percent of the net GST paid. For firms with greater than NZD\$50million average net GST paid, compliance costs were 0.3 percent; and
- combined compliance costs for business income tax of sole proprietors, partnerships, public and private companies and trusts for business income tax were estimated at NZD\$1,226 million in 1989-1990, or 19.6 percent of business income tax revenue.

13. Sandford classified the results of his work into four broad categories of policy recommendations:

- **recognition:** For a public and organisational commitment by the tax administration to compliance cost reduction;
- **allocation:** That the allocation within the tax system of costs between compliance and administration needs to be considered as a whole;
- **minimisation:** That compliance costs should be minimised, taking into account other factors relating to the operation of the tax system; and
- **compensation:** That in some cases there is an argument from respondents that on the 'user pays' principle, the taxpayer be compensated for acting as tax collectors. While Sandford does not support this claim, there was the suggestion that compensation may be provided via the tax system itself by way of cash flow benefit. For example, the existing legislation allows smaller employers a longer return period for filing PAYE.

14. As an international comparison, Sandford found that as a percentage of revenue, VAT in the United Kingdom (UK) in 1986-1987 was 3.7 whereas GST in New Zealand in 1990-1991 was 7.3. Some reasons cited for this disparity were:

- VAT rate was 15 percent and GST was 12.5 percent;
- UK traders, unless regular refund traders, all submitted three-monthly returns as against variable return dates in New Zealand; and

- UK had a much higher threshold rate and only about 12.5 percent of voluntary registrations as opposed to New Zealand's 40 percent.

15. Sandford concludes that only much more detailed comparisons between the two regimes would have revealed the areas of significant difference in compliance costs.

16. The study was undertaken in 1991, but no work has been undertaken to update it. IRD considers that:

- at the time the study was undertaken in 1991, it provided a reasonable guide as to the magnitude of the compliance costs imposed by the tax system on businesses. Its main benefit was that it highlighted that compliance costs are unevenly distributed between businesses and that work must be undertaken to reduce those costs - especially those imposed on small businesses and employers;
- the survey provided little quantitative guidance about how compliance costs can be reduced because it provided average costs rather than marginal cost information, and changes occur at the margin; and
- where the report has been of great use is in the recommendations and the qualitative comments made by the survey respondents about the problems being experienced at the time. However, since the survey was undertaken, there have been considerable changes to tax policy and operations. At present, no work has been undertaken to update the study, but paragraph 47 below outlines further research planned in this area.

New Zealand Society of Accountants

17. The NZSA prepared a document for the Tax Simplification Consultative Committee in 1990. As part of the exercise, the Society attempted to quantify the compliance costs of 28 typical tax functions for the purposes of gauging the impact of certain changes such as raising thresholds or combining payment dates. The findings were summarised under the headings of small businesses, medium businesses, large businesses.

18. The document stressed that the information should only be used for its intended purpose, that is, to provide a broad overview of the cost savings which *may* be achieved by changing particular functions. The data confirms that the cost of preparing business taxes, such as PAYE, costs more for smaller firms than larger ones. This is a consistent message coming from all research.

The effectiveness of tax simplification in New Zealand - *An Analysis of Tax Preparers' Perspectives*, by Lin Mei Tan and Stuart Tooley

19. The study evaluates the effectiveness of the Tax Simplification Consultative Committee's recommendations.² It does not make any attempt to quantify the compliance costs savings or the level of compliance costs imposed. The findings of the study were presented at a conference in Australia in January 1994 but the paper has not yet been published.

20. The study is based on a mailed questionnaire sent to 150 chartered accountant firms randomly selected from a total of 1225 accounting firms listed in the NZSA 1992 Yearbook. Another 50 tax preparers were randomly selected from the Yellow Pages of the largest urban centres.

Findings on compliance costs

21. The following measures proposed by the Tax Simplification Consultative Committee reduced compliance costs:

- annualised FBT;
- the increased period in which to lodge an objection to an 'assessment';
- motor vehicle log-books; and
- tax record-keeping period reduced to seven years.

22. Those changes which were not perceived to have reduced the compliance costs imposed

² The Committee put forward a number of recommendations (176 in total) based on the following key principles:

- it should be recognised that most taxpayers honour their responsibilities and are honest;
- taxpayers generally should be able to understand and fulfil their own obligations with a minimum of outside help, and without fear of making errors;
- as many taxpayers as possible should be removed from the provisional tax system;
- tax rules should have empathy with good business practice;
- there should be common approaches to problems between taxpayer classes and tax types;
- pay-in dates should be as standardised as possible and existing tax systems should be used for any new taxes;
- thresholds should be seen to be appropriate;
- the system for the payment of interest by or to the IRD should be made workable;
- the penalty regime that applies should be accepted as reasonable by the taxpayer;
- the IRD should help to increase the level of taxpayer understanding by themselves maintaining a high standard of knowledge and efficiency; and
- the impact of social welfare policies on the tax system should be minimised subject to delivering social welfare policies at minimum cost.

on small businesses included:

- consolidation of payment dates of PAYE, Specified Superannuation Contribution Withholding Tax (SSCWT), interest and dividends Resident Withholding Tax (RWT) on the 20th day of the month;
- the date for payment of GST to the last working day of the month following the GST return period; and
- notifying the Commissioner by 30 June in the year in which the election for annualised FBT is first to apply.

23. The study notes that most thresholds were perceived by tax preparers to be appropriate. Only the NZD\$75 FBT exemption was considered inappropriate due to more recent changes to restrict the exemption to a maximum of NZD\$450 per quarter.

24. Further, tax return guides, IRD booklets, Tax Information Bulletins and legislation were widely used by practitioners. While IRD documents were perceived as clear, the Income Tax Act 1976 was not. The majority of respondents identified keeping up with changes in tax legislation, and reading and understanding the legislation, as the main difficulties they encountered. Overall, 56 percent thought the implementation of the Tax Simplification Consultative Committee proposals made compliance easier for small businesses.

25. Since the Sandford study, the Tax Simplification Consultative Committee and the exercise by NZSA, there have been some changes which will have impacted on compliance costs:

- Family Support is no longer paid out via the PAYE system. Therefore employers are relieved from involvement in its administration;
- Student Loans, Child Support and Employment Commencement and Cessation information requirements have put additional burdens on employers;³
- electronic filing of tax returns is now available. This facility eliminates the requirement to file a paper income tax return. Returns are electronically transmitted from a tax practitioner direct to IRD's mainframe computer system. Manual processing by IRD is removed and customers receive their assessments quicker; and
- Employer Filing simplified the return forms which employers are required to file. Information has been amalgamated into one form for PAYE, SSCWT, Child Support, Student Loans and Employment Commencement and Cessation information.⁴

26. The Treasury has recently written a report on the topic and their assumptions and conclusions from studies undertaken to date are in keeping with those of IRD. The New Zealand Business Roundtable has published a report on the marginal costs of taxation in New Zealand. This will add a further useful dimension to the picture.

³ Extensive efforts were undertaken by IRD to quantify the compliance costs impacts of these policies, but these were constrained by the limitations of the policy development timetables.

⁴ IRD estimates NZD\$1,274.00 cost savings to employers were achieved as a result of this change.

Compliance costs in other tax administrations

27. There have been a number of studies conducted overseas on compliance costs. Studies have been conducted in Canada, Australia, UK and the US. Summary details are:

United Kingdom

28. **UK VAT survey: Cedric Sandford. (This essentially compared VAT costs in 1977-1978 to 1986-1987.)**

Publication date: 1988

Purpose: To examine the costs of the UK VAT to see what general lessons it could offer for the public and private sector elsewhere.

Methodology: Data was derived from two mail surveys of VAT traders supplemented by face-to-face interviews and telephone interviews with some respondents.

Findings on compliance costs:

- when comparing compliance costs as a percentage of turnover, compliance costs reduced as the turnover of the trader increased. Where the turnover was under £500,000, the average was £7.80 for every £1000 of goods sold. Where the turnover exceeded £10 million, the average was 3 pence for the same value of goods sold;
- compliance costs are regressive because there are substantial economies of scale in collecting and remitting the tax;
- VAT provides a cash-flow benefit to the trader; and
- demand for quarterly VAT figures has improved the quality of records for many businesses.

General conclusion

- keep VAT structure simple;
- the revenue administration should invest in education to shorten the learning curve for businesses;
- fine tune tax administration; and
- increased filing frequency for larger firms and reduced frequency for smaller firms would increase equity overall;

Australia

29. **Compliance costs of public companies: income tax in Australia in 1986-1987: Jeff Pope**

Publication date: 1990

Purpose: To estimate the cost of business income tax in 1986-1987 and to address whether the year studied was a typical or atypical year regarding company compliance costs.

Methodology: Analysis of the results from 314 public companies which responded to a postal questionnaire. Results were grossed up and weighted so as to reflect the business taxpaying population as a whole. The report made a distinction between computational costs (unavoidable) and planning costs (avoidable).

Findings on compliance costs:

- compliance costs were 23.7 percent of public companies' tax revenue of AUD\$5650 million with an off-setting cash flow benefit of 16.7 percent (AUD\$954 million). (The figures stated are a direct quote. However, 16.7 percent of the revenue is actually AUD\$944 million);
- net compliance costs were 6.8 percent of revenue (AUD\$387 million); and
- overall, public companies incurred *mean* compliance costs of AUD\$62,604 comprising:
 - Computational AUD\$34,120; and
 - Planning AUD\$28,484.

Therefore computational costs account for 55 percent of total compliance costs.

General conclusion:

- completing company tax returns had become more onerous; and
- 84 percent of respondents used professional advisers.

Compliance costs in Australia were high in relation to revenue.

30. *The compliance costs of personal income tax in Australia: Jeff Pope*

Publication date: 1990

Purpose: To estimate the compliance costs of personal income tax in Australia in 1986-1987.

Methodology: A postal survey of 7000 registered voters throughout Australia sought information on time spent on tax affairs, fees paid to professionals and any incidental expenses incurred.

Findings on compliance costs -

- reasons for greater recognition of compliance costs as an issue are:
 - greater complexity of Income Tax legislation;
 - increased perception of complexity by professionals and the public;
 - increased real tax burden over time;
 - greater number of taxpayers becoming required to file tax returns; and
 - Australian Tax Office (ATO) tax guides and pamphlets are difficult to learn from.
- the author noted that Sandford and Slemrod accept that compliance costs of income tax are likely to be higher if the system is one of self-assessment rather than Commissioner assessment. (Under self-assessment, as in New Zealand, the taxpayer calculates their tax liability while, under Commissioner assessment, such as in the UK, the taxpayer provides information to the Commissioner who determines the tax liability of the taxpayer);
- estimated total costs are between AUD\$2780 million and AUD\$3809 million or 7.9 percent to 10.8 percent of revenue;
- compliance costs in Australia are high compared to the US with similar self-assessment systems;

- people with incomes under AUD\$10,000 incur relatively higher compliance costs; and
- compliance costs on average account for 2.6 percent of a taxpayer's income.

31. *Small business cost of compliance project: Ian Wallschutzky and Brian Gibson (Australia)*

Publication date: May 1993

Survey duration: November 1991 to November 1992

Purpose: To identify issues/areas where compliance costs can be reduced and to explore possible solutions. The primary focus was on reporting requirements and record keeping.

Methodology: Conducted case studies of 12 small businesses over a 12-month period by way of an initial and four subsequent quarterly interviews. Participants were volunteers from Melbourne, Sydney and Brisbane and were selected from a pool of volunteer businesses built up with the assistance of the project manager, a consultant and appropriate industry associations.

Findings on compliance costs:

- generally the problems encountered are with the taxes themselves and not the way they are administered;
- the scale and importance of compliance costs might have been overstated, though the project proceeded on the assumption that compliance costs for small businesses were high;
- after the project finished, researchers were left questioning the basic assumption. One of the factors for this was the lack of suggestions by participants for changes to the way the tax system is administered;
- businesses have placed too much emphasis on the cost and problems of complying with government regulations;
- compliance may take *time*, though this generally is not the norm, but most small businesses do not find tax compliance work *difficult*;
- compliance costs, however measured, do not seem to be significant;
- average cost of around AUD\$50 per hour may reflect the opportunity cost to small business;
- average time of 12 hours per month may reflect the time taken by small firms to fulfil their tax obligations; and
- in individual cases, time, cost and other problems can arise but these may be as much a fault of the small business concerned as they are with the 'system'.

32. *Australian Tax Office (ATO): Joint Committee of Public Accounts of the Australian Parliament*

Publication date: November 1993

Purpose: This report was prepared by the Joint Committee of Public Accounts of the Australian Parliament and comprised a review of the ATO over a two-year period.

Methodology: The Joint Committee of Public Accounts inspected various ATO offices, conducted public hearings and invited submissions.

Findings on compliance costs:

- moving to a 'Self-Assessment' regime, where the taxpayer calculated and paid their liability, placed added responsibility and therefore added cost on taxpayers;
- complexity of law has increased compliance costs;
- the move to self-assessment did not give due attention to the impact on taxpayers of the increase in compliance costs; and
- to date, analysis of the compliance cost implications of any tax policy has not been required.

General conclusions:

- taxpayers should have the resources available to understand and have the capacity to apply the law;
- ATO has a duty to provide this information for taxpayers;
- properly documented plain language guidelines need to be in place before the self-assessment regime is extended further;
- availability of documented information will increase compliance and reduce compliance costs;
- there is a need to redraft the Income Tax Assessment Act 1936 so that the general public can readily understand the law; and
- compliance costs should be considered during development of tax policy as a matter of course.

The Joint Committee of Public Accounts quoted findings of studies by the Australian Tax Research Foundation (ATRF) and the Jeff Pope publications, referring to their conclusions in stressing that compliance costs in Australia were proportionally higher compared to those of the UK:

- 'A 1991 study by the ATRF put the total cost of compliance of public companies in Australia for the 1986-1987 year at between AUD\$646 million and AUD\$1341 million, or between 11.4 percent and 23.7 percent of public companies' tax revenue.'
- Pope - '. . . put the cost of compliance for individuals at between 7.9 percent and 10.8 percent of tax revenue or about AUD\$4 billion.'

33. *The compliance costs of employment-related taxation in Australia:*

J Pope, R Fayle and D L Chen

Publication date: 1993

Purpose: To study and estimate the compliance costs of PAYE, FBT, Payroll Tax and Prescribed Payments System (PPS) in Australia.

Methodology: A postal questionnaire of 3000 businesses of which 745 responded.

Compliance costs as a percentage of revenue

Tax	Revenue AUD\$	Compliance costs AUD\$	Percentage of revenue
PAYE	43,672m	629m	1.4
FBT	1169m	128m	10.9

- PAYE compliance costs as a percentage of revenue are regressive - falling from 16.7 percent for employers who remit up to AUD\$9999 per year to 0.4 percent for those who remit AUD\$10 million and over. The estimated cash flow benefit is AUD\$839 million - 1.9 percent of revenue; and
- FBT compliance costs as a percentage of tax paid are particularly regressive, falling from 42.1 percent where up to AUD\$9999 is paid per annum, to 3.7 percent where AUD\$100,000 and over is paid. The estimated cash flow benefit to Government is AUD\$76 million or 6.5 percent of revenue.

Time spent by businesses on tax work

Tax	Time (mean hours per annum)
PAYE	158.4
FBT	172.6

The authors comment throughout that the compliance costs associated with these taxes, especially FBT, are particularly regressive. This is consistent with other studies undertaken internationally and is in keeping with comments by Sandford and Hasseldine in the New Zealand study - 'The compliance costs were particularly regressive in their incidence, falling with particular severity on small businesses'.

International comparisons

The authors note that these comparisons should be observed with caution due to differing tax systems. International comparisons were taken, only to place Australia in an international context. Comparisons are relevant to New Zealand for PAYE only.

PAYE compliance costs as a percentage of revenue

Country	Year of study	Compliance costs as a percentage of revenue
New Zealand	1990-1991	1.9
Australia	1989-1990	1.7 - incl. State payroll tax
Canada	1986	3.5
United Kingdom	1986-1987	1.0

FBT compliance costs as a percentage of revenue

Country	Year of study	Compliance costs as a percentage of revenue
New Zealand	1990-1991	1.7
Australia	1989-1990	10.9

The significant difference between these two countries may perhaps be attributable to the optional nature of FBT in New Zealand. However, this study noted that one in three

businesses in Australia hires professional help to assist in preparing and maintaining FBT records and returns.

Canada

34. *The administration and compliance costs of personal income tax and payroll tax systems in Canada 1986: Francois Vaillancourt*

Publication date: 1989

Purpose: To provide information on the magnitude and characteristics of compliance costs. At the time, the only publicly available study dated back to 1960 and was considered out of date.

Methodology - Approach was twofold:

- face-to-face interviews with individuals. This was seen as generally yielding more accurate results than either phone or mail surveys; and
- mail survey of employers.

Findings on compliance costs -

Costs to individuals of tax system:

- taxpayers preparing their own tax returns take 5.5 hours on average;
- taxpayers paid on average CAD\$69.00 to get a tax return completed by a professional;
- increases in complexity of legislation extend the time taken and cost of completing a tax return; and
- average total time and money costs for all Canadians is CAD\$117.20 per annum.

Costs to employers of tax system:

- compliance costs of employers having to retain and remit PAYE and personal income taxes averaged 0.1 percent of gross business income; and
- compliance costs decrease with an increase in firm size.

Administrative costs to Government:

- CAD\$771 million.

General conclusions

	CAD\$
Costs to individuals	1,951,033m
Costs to employers	2,752,125m
Costs to financial institutions	27,581m
Costs to Government	771,064m
Total	5,501,803m

The study did not examine compliance costs as a percentage of revenue collected.

United States of America

35. *The Income Tax Compliance Cost of Big Business: Joel Slemrod and Marsha Blumenthal*

Publication date: July, 1993

Purpose: To measure both the overall size and composition of the cost of big businesses complying with federal and sub-federal income taxes and also to investigate what features of a firm and its tax situation determine what its compliance costs will be.

Methodology: A postal questionnaire of 1672 businesses, of which 365 responded, on the co-ordinated Examination Program of the Internal Revenue Service (IRS) (1329 were active businesses at the time of mailing).

Findings on compliance costs:

- the total cost per business averaged USD\$1.57 million and for those in the Fortune 500 the cost was an average USD\$2.11 million;
- approximately 55 percent of the cost of tax compliance for a particular firm will be associated with use of their own personnel. About 30 percent will be non-personnel costs and approximately 15 percent of their costs will be associated with the use of outside assistance;
- the federal compliance cost to federal tax revenue ratio is 2.6 percent;
- large firms incur higher compliance costs; and
- a 10 percent increase in size leads to a 4 percent - 6.1 percent increase in compliance costs.

Sources of federal tax compliance costs raised by those surveyed:

- depreciation regime;
- alternative minimum tax (supported as a source by statistical analysis); and
- international tax Controlled Foreign Company (CFC) rules, transfer pricing, expense allocation, foreign tax credits.

Conclusions:

- as complexity increases, businesses resort to computerisation and improving the efficiency of their personnel;
- as complexity increases, the quality of the information provided to the IRS decreases. Fourteen companies said they had a lower level of compliance. Seven elected 'simpler' methods of compliance. Two said they lived with more 'risk'. Five said they applied a tighter concept of materiality;
- compliance costs vary by industrial sector - being higher for oil and gas and lower for retailing and wholesaling; and
- that state/local taxes are a significant source of compliance costs.

36. **The compliance costs of the US individual income tax system: by Marsha Blumenthal and Joel Slemrod**

Publication date: 1990

Purpose: To quantify compliance costs resulting from the individual income tax system.

Methodology: A mailed questionnaire survey of 2000 households seeking information on expenditure on time and funds to complete federal and state tax returns.

Findings on compliance costs:

- on average, a taxpayer spends 21.7 hours per year on tax affairs;
- the percentage of taxpayers hiring professional advisers increased with income;
- as stated by Sandford, Vaillancourt, Wicks and Slemrod in previous publications, compliance costs are considerably higher for the self-employed. They spent 60 hours per year undertaking activity to meet their tax obligations. The employed, retired and homemakers, on average, spent 21 hours;
- low to middle income earners have below average compliance costs; and
- high income earners pay more for professional assistance and have much higher compliance costs.

Summary: New Zealand and overseas studies

37. Most research concludes that compliance costs are a problem and should be afforded greater attention by revenue administrations when considering tax policy changes:

- '. . . legislation ought to take account of the impact of the proposed law on the costs of compliance to be borne by affected taxpayers.' - Jeff Pope *Charter Magazine*, August 1991, Australia; and
- '. . . like equity and efficiency, compliance costs should automatically figure and be taken into account in all tax policy debate.' - Cedric Sandford, article: 'The Cost of Tax Compliance' - 1990. (Recommendation to all tax administrations.)

38. Sandford notes that international comparisons must be undertaken with extreme care. It is usual to compare compliance costs as a percentage of tax. But before conclusions are drawn, allowances must be made for many factors. The method of comparison can be misleading. It is affected as much by the level of tax revenue as the value of the compliance costs. Increased tax rates can show remarkably reduced compliance costs.

39. Vaillancourt writes that care needs to be taken in interpreting some of the studies, due to either a restrictive definition of the costs or an inadequate sample size.

40. Setting aside the difficulties in drawing international comparisons, some consistent messages worth noting are:

- compliance costs are regressive and fall more heavily on small businesses;
- compliance costs fall more heavily on business than on wage, salary and investment income;
- tax administrations should take formal account of the impact of compliance costs when considering tax policy changes; and
- under a self-assessment regime, tax administrations should ensure taxpayers are empowered to apply the law to their tax affairs and understand their obligations.

41. While authors of the studies err on the side of caution when making international comparisons, the drawing together of data from the international information available does indicate clearly that compliance costs are an issue world-wide.

Income tax: compliance costs as a percentage of revenue

Country	Year of study	% of revenue
Canada	Not quoted in source material	3.6
NZ	1992	1.9
UK	1986-1987	1.0

Consumption tax: compliance costs as a percentage of taxable turnover

Country	Tax	Year of study	Taxable turnover	% of turnover
UK	VAT	1986-1987	£50 to £100,000	0.5
NZ	GST	1992	NZD\$100 to NZD\$250,000	0.7

Consumption tax: compliance costs as a percentage of revenue

Country	Tax	Year of study	% of revenue
UK	VAT	1986-1987	3.7
NZ	GST	1990-1991	7.3

Note: Paragraphs 38 and 40 detail the problems of making international comparisons.

Compliance costs as a % of revenue from the studies are assumed to be gross.

Initiatives being undertaken by overseas tax administrations in the compliance costs area**Australia**

42. In the case of Australia, individual programmes are being implemented to reduce compliance costs, such as electronic filing and the conversion of returns from a monthly to a quarterly basis for small taxpayers. Australia does not have a specific unit looking solely at compliance cost reduction.

United Kingdom

43. The UK has introduced the concept of compliance cost assessments. These are a structured appraisal that all government departments must prepare when evaluating policy proposals likely to affect businesses. Its purpose is to inform Ministers and officials of the likely costs to businesses of complying with new or amended regulations well before a decision is taken on whether or not to go ahead with the proposals. Each department has a Department Deregulation Unit to see that the assessments are prepared. The assessments are made public. They emphasise recurring and non-recurring (introduction) costs. This is in accordance with the model of compliance costs proposed by Cedric Sandford. This model considers that there is a learning curve which means, on the introduction of a measure, compliance costs are higher than they will be once the change has been bedded down. The Deregulation Units are to have a high profile.

United States

44. The US has introduced Compliance 2000. This is 'a Service-wide planning effort focusing on short-range and long-range compliance (enforcement) strategies'. As part of this document, Internal Revenue Service (IRS) states that one of their objectives is to enhance voluntary compliance. They consider 'a key component to enhancing voluntary compliance

is fairness and simplification. Substantial future efforts should be focused on ensuring and projecting a tax administration system that is fair and simple. The service will devote sufficient resources to:

- educating, informing and influencing the taxpayer population;
- advocating simpler and more equitable laws;
- redesigning and simplifying the tax administration system to reduce complexity, ambiguity and inequity in the laws, regulations, forms and notices;
- improving our ability to administer the laws; and
- correcting unintentional non-compliant behaviour in ways designed to educate the taxpayer and correct the behaviour in a positive mode.'

General

45. A common first step by revenue administrations (Australia, US, UK, Canada and New Zealand) to reduce compliance costs is to make a commitment to consider these costs when proposing tax policy changes:

- 'A commitment to simplify the tax laws.' - ATO document 'Future Direction for the Taxation Office 1987'; and
- 'To provide an efficient service by keeping to a minimum your costs of complying with the law.' - The Taxpayer Charter, Inland Revenue, UK.

New Zealand IRD's approach to compliance cost reduction

46. A clear and consistent message from all research is that compliance costs are too high. In New Zealand, IRD has made a commitment to take positive action to minimise compliance costs and, where possible, reduce them from their current levels. Accordingly:

- a management objective in the 1993-1994 IRD Corporate Plan, requires IRD to have regard to tax simplification and compliance costs when considering new legislation or policies. The Corporate Plan states that 'Voluntary compliance is improved by keeping compliance costs to a minimum';
- customer compliance cost savings is a key element in the selection criteria used to prioritise IRD's information technology development. For example, the Employer Filing project analysis identified the major benefit as being savings in customer compliance costs through employers filing a consolidated form;
- the approach of IRD is to concentrate on identifying the specific areas making up the greater problem which are within its sphere of influence to eliminate or improve; and
- to date IRD has:
 - established a strategic plan setting out quantifiable compliance cost reduction goals;
 - established a Compliance Cost Reduction Unit with a Department-wide mandate to ensure that the objectives of the strategic plan are realised;
 - considered what detailed research and information is required so that the impact of compliance costs can be fully considered in matters of policy; and

- implemented information technology systems and processes which enable the consolidation and linkage of information requirements across tax revenues. As a result customer contacts and the requirements on customers to provide information can be rationalised.

47. Research to be undertaken requires information from taxpayers:

- to identify the problems they are experiencing and to what extent they can be attributed to:
 - the policy reflected in the legislation;
 - obligations imposed by IRD; and
 - the accounting and organisational structure of the taxpayer;
- to quantify the compliance costs being imposed upon them so that the impact of proposed policy and administrative changes can be quantified; and
- to identify possible solutions.

48. IRD has arranged to undertake a survey of customers by way of focus groups and face-to-face interviews to determine exactly which aspects of their tax obligations are incurring the high costs so that any issues which the Department may reduce or minimise can be acted upon. This research was started in January 1994.

Conclusions

49. New Zealand taxpayers are concerned about compliance costs. That was a clear message in submissions and discussions and is reflected in studies. Compliance costs fall more heavily on business than on wage, salary and investment income. They are regressive and fall particularly heavily on small businesses which is of special concern in our economy where 82 percent of businesses employ less than five staff.

50. The Sandford study of 1991 is the only comprehensive indication of compliance costs in New Zealand. It assessed compliance costs for PAYE in 1991 at 1.9 percent of tax revenue from that source; for FBT at 1.7 percent; for GST at 7.3 percent; and for business income tax of sole proprietors, partnerships, public and private companies and trusts at 19.6 percent. While its conclusions are subject to various qualifications and there have since been various changes affecting compliance costs, in both directions, the significance of such costs for tax collection is clear. Excessive compliance costs, may in their effect, amount to a hidden tax on commercial activity.

51. High compliance costs are also an economic concern as they may impact on employment and economic growth by discouraging the start-up and expansion of business. They are also important because of their potentially detrimental effect on voluntary compliance.

52. Analysis of 11 studies of compliance costs in various countries suggests that, although such comparisons are problematic, the compliance cost problems in New Zealand are no greater than those in other tax administrations. Nevertheless, current information does not take account of recent additional compliance costs imposed by the use of the tax system for the delivery of various social policy objectives of the Government such as the Child Support scheme. (It is anticipated that the planned study being undertaken by the Treasury and the New Zealand Employers Federation will shed some light on this question.)

53. There are two critical avenues for dealing with compliance costs problems. First and most importantly, the tax policy development process must ensure that compliance cost impacts of new policy initiatives are fully costed and considered, to allow Government to make appropriate trade-offs between these and administrative and economic costs. Equally, compliance costs must be a matter for explicit focus in the post-implementation review of legislation and in the identification of remedial issues requiring legislative amendment in existing legislation. Comment from tax practitioners, in particular, supports the view that policy design is the most effective means of addressing compliance costs.

54. The Generic Tax Policy Process (GTPP), designed by the Review Committee, has a particular advantage in explicitly requiring consideration of compliance cost impacts at various stages of the process. The reliability of the assessment will be significantly assisted by the greater involvement of tax practitioners and other advisers, external to the public service, in this process through a variety of mechanisms.

55. The GTPP provides an appropriate structure for the consideration of compliance cost issues but the effectiveness of this will in a large part be dependent on the quality of available information about compliance costs. While, as noted, external advisers can assist, the principal source of this information will be the tax administration itself. This highlights the second avenue through which compliance costs can be addressed - that is, through the operational policies applied by the tax administrator.

56. The question of the balance that must be struck by the administration between reducing compliance costs and achieving other objectives such as reducing administrative costs, is the subject of discussion in Section 8 of the Report, Objective of tax administration. It is, however, very clear that the tax administration must have a major role in addressing compliance cost issues.

57. This role will require several things of the tax administration:

- provision of effective information on compliance cost impacts for the tax policy design process;
- an effective focus at the operational level on researching information and identifying compliance cost issues for various taxpayer groups, so that the information required above is available; and
- appropriate analysis and use of the information discussed in the previous point to identify opportunities for compliance cost reduction and assessment of the costs and benefits associated with these opportunities.

58. IRD has taken steps to develop appropriate strategies by establishing a Compliance Costs Reduction Unit. As a matter of priority it will strive to improve the compliance costs information base.

Note: The Review Committee acknowledges the assistance of the New Zealand Society of Accountants, the Treasury and the IRD Compliance Costs Reduction Unit in providing material for this appendix.

Appendix G

Detailed description of a generic tax policy process

Introduction

1. The Review Committee, as part of its terms of reference, has examined the provision of tax policy advice to Government and believes that the process described below will make a significant contribution to improved tax policy outcomes for Government.
2. The main concerns identified by the Review Committee in relation to tax policy advice prior to the general election were:

Subject matter

The subject matter is complex, with potentially significant social and economic impacts, and requires close consideration of issues at both a strategic and detailed level.

Roles and accountabilities

At all levels, roles and accountabilities at each stage of the policy development process need to be clearly and formally defined.

Quality of policy advice

Some concerns were expressed to the Review Committee regarding the quality of policy formation. It is envisaged that the Generic Tax Policy Process, as described below, may address many, if not all, of these concerns. However, after the Generic Tax Policy Process is established, a further appraisal of tax policy development is proposed in order to 'fine tune' the process, if necessary, and also to identify and remedy any residual concerns.

Process

Concerns were identified relating to the process for the development of policy. These are set out below as the objectives for the development of the Generic Tax Policy Process, and are addressed in the remainder of this paper.

Objectives of the Generic Tax Policy Process

3. The design of the Generic Tax Policy Process (GTPP) has three main objectives:

To encourage earlier, explicit consideration of key policy elements and trade-offs

This objective is intended to ensure that the appropriate amount of policy detail is considered at the appropriate stage in the process. Ministers should not be overly encumbered by detail but should have adequate information to appreciate the trade-offs that are implicit in any policy decision. This objective is addressed by the sequencing and linking of strategic, tactical and operational considerations.

To provide opportunities for substantial external input into the policy formation process

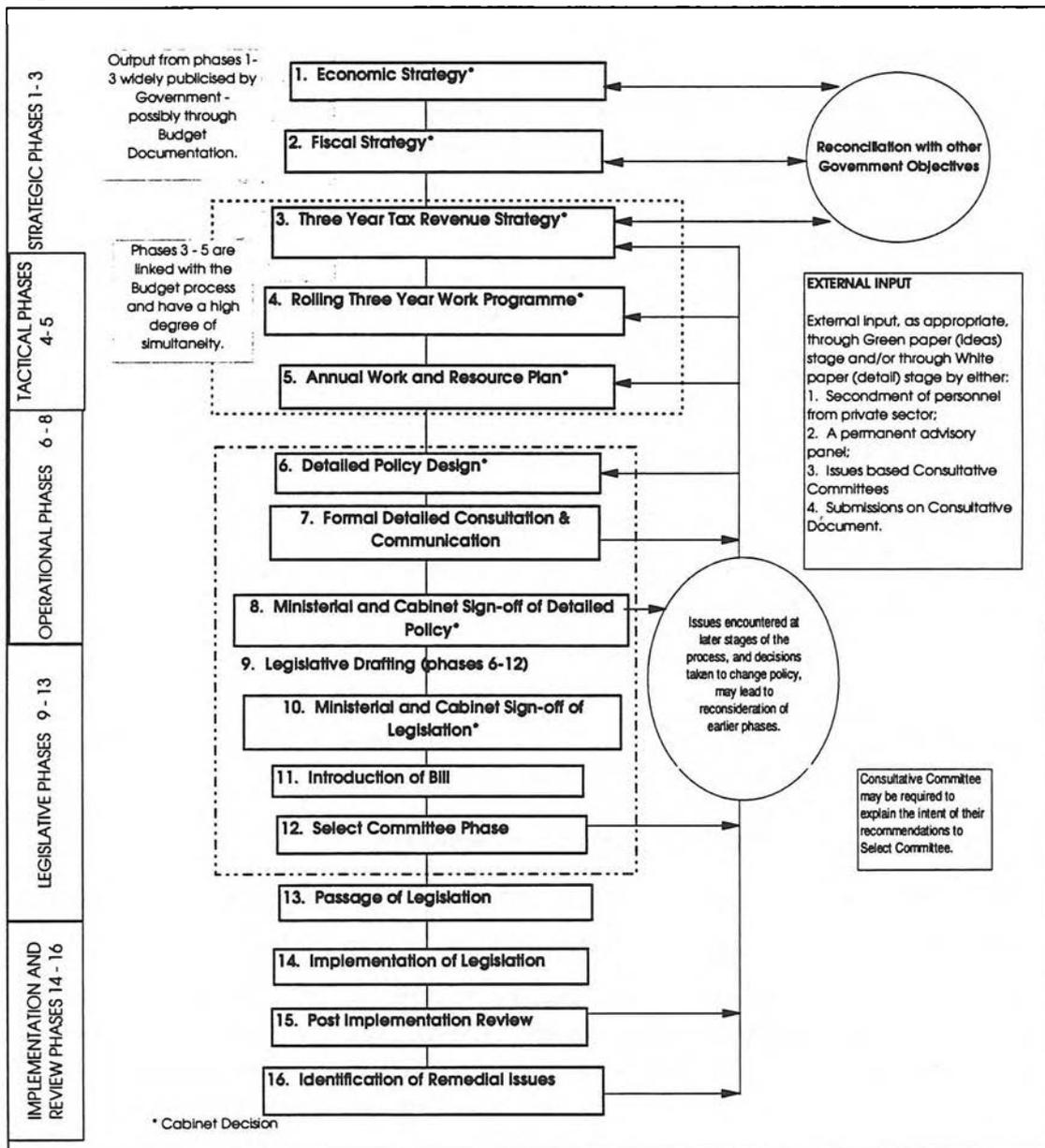
In order to increase transparency and provide for greater contestability and quality of policy advice, the process calls for input from sources outside Government during policy development at a conceptual stage and at a detailed level.

To clarify the responsibilities and accountabilities of participants in the process

A prerequisite for division of responsibility and definition of roles of each participant, is a well defined, structured process. Then, as participants are made accountable and responsible for phases of the process, their performance can be clearly monitored and appropriate purchase decisions can be taken by Government.

Figure 1 below provides an outline of a Generic Tax Policy Process. This is followed by a detailed description of the core process, external input and consultation, and process linkages and feedback loops.

Figure 1 Generic Tax Policy Process



Outline of core process

Strategic phases

4. A key feature of the process is a greater focus on strategic planning in tax policy development and in maintaining linkages with the strategy in subsequent phases of the process.
5. Strategic consideration relevant to tax policy begins at the overall economic level. Objectives such as economic growth, price stability and employment may be considered at this stage and, in adopting its preferred goal/s, the Government should be able to evaluate the short and long term trade-offs relative to other goal/s. The cost-benefit analysis required to evaluate trade-offs at this stage will be necessarily broad.
6. The Government, in pursuit of its economic goals, will then be able to adopt a fiscal strategy which is supportive of those goals. Broad revenue and expenditure decisions will be required at this stage, such as:
 - deciding between more or less expenditure; and
 - deciding between more or less revenue and also between sources of that revenue. (This decision could be expressed as a choice between taxes and borrowing and how much of each.)
7. The three-year tax revenue strategy then focuses on determining the Government's preferred way of meeting the need for tax revenue as expressed in the fiscal strategy. It is at this phase that choices between base maintenance and protection, and between base broadening and rate structures will be considered. It is also at this stage that some broad policy measures may be considered.
8. If, for example, base maintenance and base broadening are selected as the most appropriate means to achieve the requirement for more tax revenue, as expressed in the fiscal strategy, then a review of the range of deductions available to taxpayers may be indicated in the three-year tax revenue strategy. Other options, such as addressing the capital/revenue boundary, will have been evaluated in arriving at this broad policy choice.
9. Each strategic phase requires some firm commitment from Government so that the intent and objectives of specific policy in subsequent phases can be clearly specified and the policy implemented. Resolutions adopted by Cabinet will need to be unambiguous and non-conflicting. Further, these resolutions should be communicated to the public and to participants in the tax policy process so that the background and framework for any subsequent initiatives are clearly understood.
10. One way of communicating resolutions at the strategic level is through Budget announcements and documentation. This avenue is also consistent with another feature of the GTPP, which is the alignment of the planning cycles for tax revenue and expenditure into an integrated Budget process.
11. The three strategic phases also require reconciliation with the Government's other objectives. Social objectives such as income redistribution, for example, will require evaluation against the economic, fiscal and tax revenue strategies. Mechanisms for

implementing social policy on income redistribution, such as Family Support, often require use of the tax system which may need to be considered in the context of the three-year tax revenue strategy. The overall nature and magnitude of the Government's social programme may also be a matter for consideration at the economic and fiscal strategy level.

Tactical phases

12. The tactical phases of the GTPP are intended to set the 'ground-rules' for subsequent development of policy, giving effect to the Government's major strategies. The core activities associated with the tactical phases are conceptualising, scoping, sequencing, prioritising, and allocating resources for the development of policy initiatives.

13. The first of these phases is the construction of a rolling three-year work programme. The three tasks associated with this phase are described below and displayed in figure 2.

14. The first task in this phase is to consider the scope and overall magnitude (in the effect of policy, resource requirements, and elapsed time requirements) of each broad policy. A clear statement of objectives and intents should also be prepared showing how it is expected that the policy under consideration will contribute to the Government's major strategies. A preliminary assessment of the feasibility of the broad proposal could then enable a decision to be taken as to whether to proceed further with development of the policy.

15. The next task in this phase is the completion of broad policy design sufficient to suggest options for external consideration. Using the example of deductions claimed by taxpayers, as mentioned above, it may be logical that a starting point should be the present tests for deductibility of business expenditure, apportionment between business and non-business elements and also boundary issues, particularly when private benefits may occur. A wider consideration of deductibility issues might also include specific examination of deductions available for interest and depreciation. This example is not intended to suggest that these areas necessarily require examination.

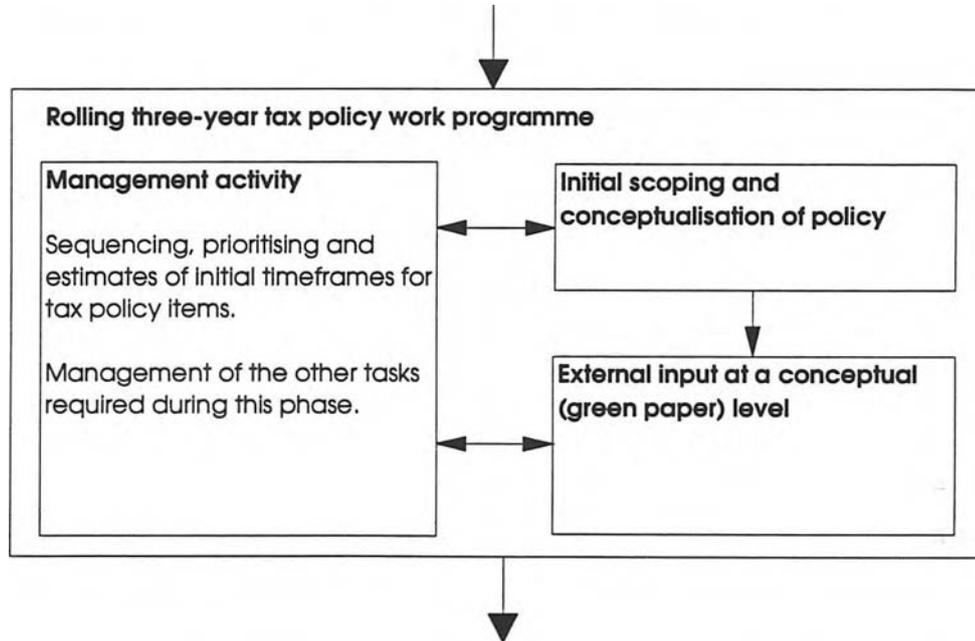
16. Further work including preliminary cost-benefit analysis is then required to develop policy options that can be subject to external consideration. Cost-benefit analysis during this, and during subsequent phases, should explicitly address compliance, administration and economic efficiency costs, contribution to the achievement of strategic objectives, and also:

- social objectives;
- simplicity;
- certainty (for taxpayers); and
- implementation constraints.

17. External input may then be sought in a 'green paper' context, as discussed below.

18. The task of the initial scoping and definition of broad policy, and the preparation and execution of consultation and external input, should proceed concurrently with the management, prioritisation and ordering of policy, which is the third group of tasks required for the preparation of the rolling three-year tax policy work programme. Consideration of issues during initial scoping and definition, and during 'green paper' external input, will have an impact on the prioritisation and ordering of policy.

Figure 2 Tasks required for preparation of the three-year work programme



19. The second tactical phase is the preparation of an annual work and resource plan. This phase is linked with departmental purchase agreements and, in determining funding required for the GTPP, should incorporate consideration of:

- budgeted resource requirements for the detailed development of the items specified in the rolling three-year work programme for the year ahead;
- estimated timeframes for development, legislation and implementation of policy in the year ahead; and
- strategy for communication and external input at a more detailed 'white paper' level in relation to those tax policy initiatives specified for the year ahead.

20. Resources required for the preparation of the annual work and resource plan and the operation of prior phases of the GTPP should also be considered. The plan should include capacity for unknown remedial activity (the treatment of redeemable preference shares is a past example) as a contingency on the assumption that some urgent, high priority work will be required.

21. The relationship between the annual work and resource plan and the rolling three-year work programme has its analogue in the preparation of expenditure estimates. There is a three-year time horizon, but greatest focus is on the immediate year ahead. By definition, the rolling three-year work programme and the annual work and resource plan should be revisited and/or revised on a yearly basis.

22. As in the first three phases, Government decisions should be unambiguous and non-conflicting.

Operational phases

23. The culmination of the operational phases should be Ministerial, and then Cabinet approval of policy that is 'ready to go' and fully implementable. The focus of policy development and external input during these phases should be on adding the maximum value, consistent with the stated intents and objectives, to the policy under consideration.

24. First, detailed development work is required by officials to give effect to the intents and objectives specified in the rolling three-year tax policy work programme. More specific and detailed cost-benefit analysis, as described in paragraph 16, should be conducted at this phase.

25. Using the example of business deductions, as developed earlier, work during this phase could include consideration of areas such as:

- evaluation of depreciation rates and formulae for specific asset types;
- strengthening substantiation requirements for deduction of expenditure by businesses yielding private benefit; and
- application of the removal of deductions for interest in specific instances.

26. Secondly, evaluation of alternatives should occur during detailed development and include more specific, detailed (and accurate) cost-benefit analysis.

27. The outcome of this detailed development work should be presented in the equivalent of a white paper, for the approval of Ministers and Cabinet. The detailed policy proposal should then be the subject of a further phase of external input and consultation as described below.

28. Any recommendations on the implementation detail, and/or specific modifications to policy, as a result of external input at the white paper stage should then be subjected to rigorous analysis by officials.

29. Another important activity during this part of the GTPP is communication by Government with interested parties about the specific nature of the policy under consideration, including the intents and objectives of that policy. Effective communication by Government should aid in the provision of constructive external input.

30. Legislative drafting may occur during the development of detailed policy design by officials, or as part of the consultation and external input sought in the next phase. Alternatively, legislation could be drafted during the legislative phases, after the policy has Ministerial and Cabinet approval.

Legislative phases

31. The *legislative* phases in the GTPP are viewed as being much the same as at present. However, prior phases of the process will have meant earlier and more thorough consideration of policy against Government's strategic objectives and more contestability in the advice given to Government (through more formalised external input at a variety of levels). As a result, the legislative phases, particularly the select committee phase, should proceed more smoothly than at present.

32. Operation of subsequent phases is also expected to be smoother given the factors mentioned above.

33. The legislative phases include:

- legislative drafting (which can occur anywhere in the process from the detailed development of policy through to the select committee phase);
- Ministerial then Cabinet approval of legislation. (Ministers ensure that the draft is consistent with the policy intent and then refer the draft through the necessary Cabinet committees);
- introduction of the Bill into the House (and the first reading);
- the select committee phase; and
- passage of legislation (including the second and third readings).

Implementation and review phases

34. Another area of increased focus within the GTPP is in the treatment of policy and legislation after the legislation has been passed.

35. Implementation of tax legislation will occur as at present and include:

- implementation of computer and people-based systems;
- staff training;
- taxpayer and practitioner communication and education; and
- enforcement strategy.

36. However, the implementation phase should be smoother due to the more thorough and considered process which has preceded it.

37. A new feature contained within the GTPP is the systematic review of legislation after it has been passed.

38. After a set period, specified at the time the detailed policy is approved and during which the operation of the legislation could be monitored, the review would tackle the following questions:

- Is the legislation effective given the intents and objectives of the policy?
- Can the legislation be improved given the intents and objectives?
- Have the intents and objectives changed?
- How effective/efficient was the policy development process?

39. The last phase of the GTPP, although not necessarily the last in chronological terms, is the identification of remedial issues. Remedial issues may be identified as a result of the post-implementation review described above, or they may be detected on an on-going and ad-hoc basis through experience gained in administering, and working with, policy and legislation.

40. The key avenues for identification of remedial issues, other than through formal review, will be through:

- audit of taxpayers' returns;
- general administration; and
- contact with taxpayers and practitioners.

41. Linkages between policy development and operation of the tax system need to be comprehensive, routine, and possibly more formalised and systematic.

42. The process allows for the fact that identification of remedial issues may be a significant source of important policy development work.

External input and consultation

43. More formalised external input and consultation are proposed at six different phases of the GTPP. These phases are:

- at the green paper stage, where policy options acceptable to Government are being considered (external input could be useful in developing these options for discussion, as well as in making any contribution to the overall discussion); and
- at the white paper stage, where detailed design issues are being discussed to enable the policy to be implemented and to best fulfil the Government's stated intents and objectives; and
- during the legislative drafting phase, to ensure that the translation of detailed policy into legislation reflects all of the value added at previous stages; and
- during the select committee phase, to make submissions, as at present, and possibly for any consultative committee to explain the intent of their policy recommendations to the select committee; and
- at the post-implementation review phase, to assist in the review of current legislation, as outlined above.

44. At any of these stages in the process there is a 'toolbox' of potential instruments which can be selected, as appropriate, to generate external input. These are described below.

Secondment of personnel from the private sector

Full-time secondment from the private sector to the policy development agencies may be appropriate if expert personnel from outside Government are required 'on tap' for consideration of policy initiatives, or if a closer, and more direct, working relationship between Government and external personnel is preferred.

A panel of private sector advisers contracted to provide advice

For more general issues, especially at the green paper level, a wider range of opinions may be sought on a regular basis. A panel of private sector advisers with some stability of membership (yet some provision for rotation) and with members drawn from a variety of occupational groups, may broaden the consideration of policy issues and add significant value.

Consultative committees constituted for specific issues

For specialised and technical issues, especially at the white paper level, groupings of appropriate subject-matter experts may add the most value to policy under consideration.

Public submissions on proposals contained in green or white papers

Public submissions can be used in conjunction with the tools described above, or they can be organised separately after the release of a discussion document at either the green or the white paper stage.

Possible retention of consultative committees through the select committee process so that they may explain the intent of their policy recommendations

This could also extend to members of any advisory group appearing before select committees to explain the intent of their policy recommendations. The aim is to provide some continuity between the advice tendered to Government, and the issues considered by the Parliamentary select committee during the legislative phases.

45. When advice is purchased from outside Government through semi-permanent advisory panels or secondment of private sector advisers, the contractual arrangements should provide for the extension of public service free and frank advice conventions, and obligations, to the external advisers. This extension will provide a measure of protection both for the advisers (who will feel free to tender their best advice to Ministers and Government), and for the Government (as these advisers will have similar duties of care and responsibility to their public sector counterparts).

Process linkages and feedback loops**Time linkages and simultaneous phases**

46. Although each phase of the GTPP is described sequentially, many are linked in time, and some will occur almost simultaneously.

47. If the Government publicises the output from the strategic phases in the Budget, then the timetable for completion of these phases will need to be co-ordinated accordingly. A further linkage at the strategic level is implied through the reconciliation of the Government's economic, fiscal and tax revenue strategies with other objectives.

48. Also, if the rolling three-year work programme and the annual work and resource plan are to give effect to the Government's three-year tax revenue strategy as announced in the Budget, then work on these three phases may need to proceed almost simultaneously. Given the significant amount of work that will be required to produce a three-year tax revenue strategy and, in particular, a rolling three-year tax policy work

programme, it is likely that there will be an on-going programme of research in these areas throughout the planning period.

49. The GTPP does not prescribe optimal timing for legislative drafting, indicating that drafting may occur at any phase from detailed tax policy design through to alterations to legislation as a result of consideration by select committee.

50. As the development of many major policies is likely to take more than one year, it is likely that, at any one time, different items of policy will be at different phases of the process. Work scheduling and resource planning will therefore require sufficient flexibility to cope with the tracking of individual policy items through the GTPP.

Feedback loops

51. Policy modifications may be considered at any of the following stages of the process and have implications for earlier phases:

- detailed consultation and communication;
- Ministerial and Cabinet sign-off of policy;
- select committee;
- post-implementation review; and
- identification of remedial issues.

52. Depending on the nature and degree of any modification suggested at any of the above phases, reconsideration of policy may be required at the following phases:

- detailed policy design (if the modification is consistent with the intents and objectives set out for the policy and can be achieved within existing timeframes and resources);
- annual work and resource plan (if the modification is consistent with the intents and objectives set out for the policy but requires additional resources or alteration of timeframes);
- rolling three-year work programme (if the modification is consistent with the three-year tax revenue strategy but some alteration is required to the intents and objectives set out for the policy); and
- three-year tax revenue strategy (in the event that consideration of any policy indicates that some alteration is required to the tax revenue strategy).

53. The GTPP includes the possibility that, even after more thorough evaluation of policy ideas at the strategic level, and even after increased external input at two stages, the Government may decide that the detailed trade-offs specified in any policy require some modification to be made. The feedback loops specified in the process will help ensure that debate which raises higher concerns is considered at the right level.

Conclusion

54. The adoption of the Generic Tax Policy Process as proposed by the Review Committee, and Government's clarification of responsibility and accountability for tax policy development, will make a significant contribution to improving the quality of

tax policy formation. These improvements directly address the concerns identified by the Review Committee relating to the process of tax policy formation and should indirectly address other policy formation concerns over time.

55. These improvements will result in a significant positive change in the way that tax policy is developed relative to the past. This change will require a period of adjustment, including time to implement new procedures.

56. In particular, some adjustment will be required as departments realign their resources to concentrate on their areas of greatest comparative advantage.

57. It is suggested that a further appraisal of the quality of policy formation be completed by the Department of the Prime Minister and Cabinet within 12 months of the process being implemented (ie before 31 December 1994) to examine:

- how the Generic Tax Policy Process is working in practice; and
- whether there are any outstanding problems with any aspect of the quality of tax policy formation.

58. If at this time concerns about the quality of tax policy formation still exist, then it should be considered whether:

- the Generic Tax Policy Process has been successfully implemented and/or requires amendment in the light of experience; and
- any more detailed examination of any aspect of tax policy formation is appropriate.

Appendix H

Tax legislation

1. New Zealand income tax legislation is complex, detailed and difficult to understand.

Initially income tax was a relatively minor tax contributing modest revenue to the Government. For many years, however, it has been a mass broad based tax and has a significant impact on the functioning of the economy. The subject matter itself is complex and in a modern economy the tax system has to be tailored to a great range of commercial circumstances, national and international. It is necessarily sophisticated in its reach and coverage.

2. All that accepted, from the perspective of good tax administration there are two major problems with present income tax legislation. One is that in its design it does not meet modern requirements of tax collecting. It is deficient in two respects. The original administration base for the legislation dates back to 1916 when the tax liabilities of the limited numbers of taxpayers were individually assessed. In the world of the 1990s the processing of taxpayers' returns and the receipt of tax payments is largely mechanical. At the same time, sophisticated audit and enforcement programmes have been developed.

The other design deficiency is that layers and layers of major changes and new regimes have been added on over the years without any attempt until recently to reorder and rewrite the legislation in a coherent form.

3. The basic legislative structure dates back to the Land and Income Tax Act 1916. The re-enactments of 1923, 1954 and 1976 (which for the first time separated the two taxes into two statutes) were consolidations incorporating all the amendments since the previous enactment. They were not revisions shaping the legislation to meet the current needs. So the present legislation is very dated. It has also grown extraordinarily as the following information shows.

Year of enactment	No of sections	No of pages
1916	169	43
1923	177	48
1954	246	179
1976	436	543
(1993 reprint of 1976 Act and amendments)	833	2038

4. The Australian experience is similar. The Joint Committee of Public Accounts of the Australian Parliament in its report 'An Assessment of Tax' (ATO Report) of November 1993 noted that when it was first passed in 1936, the Australian legislation covered 126 pages, but had grown to over 5000 pages. The ATO Report identified complexity, uncertainty and the legislative style and manner of expression as major difficulties. The ATO Report recommended what it described as a priority

simplification redraft within two years and the full simplification of the Act within five years (para 5.38).

5. Following the recommendations of the Waugh Committee in 1990 and the Second Report of the Valabh Working Party in 1993 on the Reorganisation of the Income Tax Act 1976, the New Zealand Government has committed itself to the rewriting of the tax legislation over a five-year period. The first step has been the reordering of the income tax legislation by the Working Party. The Working Party's draft legislation is before the House of Representatives.

That will provide the base from which the rewriting of the legislation can be carried through. In that process the administration machinery will be updated.

6. In that update it will be important for the drafters to keep in mind the distinction in structure and processes which the Organisational Review is drawing between adjudication and operations. In the current legislation there are hundreds of references to specific functions and powers of the Commissioner. The present drafting approach and terminology do not distinguish adjudication from management. With a view to emphasising that difference and to allowing for the clear separation of the Commissioner and Chief Executive roles, so far as practicable, the distinctive functions and powers of adjudication should be identified and reflected in the drafting.

7. The second major problem with the present income tax legislation is the drafting approach itself. Certainty and precision are sought through the detailed expression of policies in the variety of complex circumstances in which they will operate. In the result the intent is often blurred in a torrent of convoluted language.

Simplicity of expression is recognised as one of the criteria of a good tax system, and sentence length is an indicator of readability and comprehensibility of the legislation. An empirical study of the readability of New Zealand tax laws carried out by Tan and Tower was published in *Australian Tax Forum* 9 (1992) 355. The study focused on income tax and GST amendments which had been passed after the Waugh Committee had strongly recommended that tax legislation be drafted in simple and clear language understandable to the ordinary taxpayer so that the intent of the legislation is clear. The study revealed that the average sentence length of the survey sample of income tax amendments post-Waugh was 135 words. After examining other indicators of readability including word length (syllables) and the use of the passive voice and comparing the results with pre-Waugh legislation the study concluded that no progress had been made in simplifying the tax law to make it more readable and understandable. It concluded that tax legislation appeared to be very difficult to read by a high percentage of taxpayers.

The authors of the study made a similar study of Tax Information Bulletins and tax return guides. Their conclusions were that the usefulness of Tax Information Bulletins appeared to be limited to individuals with a high level of education and that only the tax return guides were written in a simple fashion.

In a 1994 study by Tan and Tooley, 69 percent of the tax practitioners surveyed considered tax legislation difficult to read. In commenting to the Review Committee on those findings, IRD agreed that tax legislation was very difficult to read and understand.

It is obvious that those comprehension problems must have a direct bearing on the difficulties and so the cost of administering the legislation and the cost of complying with the legislation.

8. The only way to improve the position is to change the drafting approach so as to seek greater simplification and clearer expression of the intent of the legislation. The object should be to aid to the maximum the reader's understanding of the text. Two steps were recommended by the Working Party on the Reorganisation of the Income Tax Act 1976:

- adopting draft guidelines which prefer plain words, short sentences, short sections and the use of active voice and the present tense.

A striking example of what can be achieved is the Working Party's redrafting of the core provisions of the Income Tax Act in 14 simply expressed sections and five pages of legislative text; and

- stating the purpose and principles of the particular measure.

9. The standard judicial approach to the interpretation of legislation is to consider its purpose, scheme and language. Clear statements of the policy intent and underlying principles in setting the rules for determining tax liability would assist all users of the legislation. A different drafting style which may be appropriate for other legislation will not meet the needs of tax legislation. If that approach is taken there should be less justification for attempting to identify and provide in detail for every conceivable fact situation.

The importance of a changed approach to legislative drafting was recognised by the Minister of Finance and Minister of Revenue when receiving and tabling the Working Party report in the House. They said:

The Government is determined to achieve a better understood tax system. Its objective is more logical, coherent and understandable taxation legislation. The achievement of this objective will help reduce compliance costs. The reorganised legislation will itself significantly contribute to this aim. The structure of the legislation devised by the Working Party will mean that the policy intent of the legislation will be able to be more quickly understood. Perhaps more importantly, the restructured legislation will provide a sound and durable foundation for simplification as the legislation is reviewed and amended in the future. The Government strongly supports both these objectives.

10. There will always be difficulties in applying tax legislation in marginal cases, however it is drafted. In these borderline cases clear language and structures and clear statements of intent will facilitate understanding and resolution of the problem. What is even more important is that the legislation is easy to administer and comply with in the great mass of cases not near the borderline. There, the key is the clarity of the intent and of the style of drafting.

Better, more understandable legislation, will produce substantial savings in administration costs and compliance costs and will at the same time enhance the voluntary compliance strategy.

Glossary and Commonly Used Abbreviations

ACC	Accident Compensation Corporation (NB The new name of the corporation is ARCI (see below). However the levies and premiums are commonly known as ACC levies and this wording has been used throughout the Report)
Adjudication	The exercise of judgement in applying tax legislation to the affairs of individual taxpayers, or groups/classes of taxpayers, in order to determine their tax liability
Administrative costs	The costs incurred by the tax administration in assessing and collecting taxes
ARCI Corporation	Accident Rehabilitation and Compensation Insurance Corporation
Assessment	The calculation by the Commissioner of Inland Revenue of the tax liability of a taxpayer
ATO	Australian Tax Office
ATO Report	A report of the Commonwealth Parliament Joint Committee of Public Accounts <i>An Assessment of Tax - A Report on an Inquiry into the Australian Tax Office</i> (November 1993)
ATRF	Australian Tax Research Foundation
Care and management	Managerial discretion as to the use of independent statutory powers in a cost-effective manner
Case stated	The mechanism by which, at the request of the taxpayer, the Commissioner of Inland Revenue places an unresolved dispute in front of the court or Taxation Review Authority
CE	Chief Executive
CIR	Commissioner of Inland Revenue
COE	Crown Owned Entity. A generic term covering the organisational form of government agencies that have their own legal status outside of the Crown, and which are not otherwise governed by the State-Owned Enterprise, Crown Research Institute or Crown Health Enterprise frameworks. In contrast, a department does not have a legal identity separate from the Crown
Compliance costs	The costs to taxpayers of meeting their obligations under tax law and in meeting the requirements and practices of the tax administration

Contestable	In this Report, used to describe a situation where a set of services provided by the IRD is opened up to other potential providers
COO	Chief Operating Officer
CS	Child Support
CSA	Child Support Agency
CSC	Customer Service Centre. A relatively small office providing direct customer contact services, typically (but not necessarily limited to) counter enquiries. This type of office is proposed in the Report
Customer segment	A separate and distinctive group of taxpayers forming the basis for structural units
DARM	Debt and Return Management (a functional unit within IRD). Also a class of outputs for Parliamentary estimates
Deadweight losses	The direct and indirect costs arising from the distortions introduced into the economy by taxation, such as changes in behaviour because of the existence of taxes. Also known as the 'excess burden' of taxation
Delivery	The delivery of tax outputs through field and Head Office units
Design	Refers to the establishment ('design') of operating policies and procedures for IRD's operational units
District Office	Current local tax offices, undertaking all or most of the functions required in that locality
DPMC	Department of Prime Minister and Cabinet
DSW	Department of Social Welfare
Economies of scale	Refers to efficiency savings through increasing the quantities of goods and services produced at a single location
Economies of scope	Refers to a situation where there are savings through the simultaneous production of a wide range of goods and services at a location or within an agency
EDP	Electronic Data Processing
EEO	Equal Employment Opportunities
Electronic filing	Submission of tax returns by electronic means rather than on paper
FBT	Fringe Benefit Tax

Field Centre	A relatively large field office undertaking all functions and providing management oversight of, and specialist support services for, attached Satellite offices and Customer Service Centres. This type of office is proposed in the Report
Final Adjudication	A functional unit concerned with high level adjudication, especially tax reassessments in contentious cases
FIRST	Future Inland Revenue Systems and Technology. This is IRD's integrated information system
GCS	Government Computing Services
GDP	Gross Domestic Product
GMFI	Guaranteed Minimum Family Income
GST	Goods and Services Tax
GTPP	Generic Tax Policy Process
HR	Human Resources
Interlocutory procedures	Applications for rulings in pending proceedings, eg disclosure of relevant documents
IRD	Inland Revenue Department
IRS	Internal Revenue Service (USA)
IT	Information Technology
Management Board	A senior management group within IRD, consisting of the Commissioner, Deputy Commissioners and Regional Controllers
MOR	Minister of Revenue
Net revenue	Actual revenue, less administration costs
NZSA	New Zealand Society of Accountants
OTC	Officials' Tax Committee
Output Centre	The IRD unit that undertakes the mass printing and mailing of forms, notices and cheques arising from automated activities
Outputs/output classes	Outputs are the goods and services produced by a department. For reporting and accountability purposes, similar outputs are grouped into output classes

Ownership interest	In the context of non-commercial public sector agencies, refers to the Minister's interest (on behalf of the Government) as 'owner' of the agency in ensuring that the agency has the ability to produce desired outputs, to an appropriate cost and performance standard, in the future
PAYE	Pay-As-You-Earn. Refers to the deduction of taxes as income is earned
PCO	Parliamentary Counsel Office
PPS	Prescribed Payments System
Privilege	A witness is said to be privileged in relation to a matter when he or she will not be compelled to disclose that matter in evidence
Processing Centre	An office whose primary task is the centralised high volume processing of payments, tax returns and other activities through the FIRST system
Purchase interest	Refers to a Minister's interest and responsibilities for determining which outputs the Minister (on behalf of the Government) will purchase from a department at an appropriate cost and performance standard
PY	Person-year. A person year is the equivalent of one full-time staff member working throughout the year
RAA	Revenue Administration Audit. A proposed audit of the tax administration to ensure that there are adequate internal guidelines for the exercise of care and management within IRD, and that these guidelines are being followed
RAC	Revenue Assessment and Collection (a functional unit within IRD). Also a class of outputs for Parliamentary estimates
Regional Office	Regionally based offices, in four geographical areas, responsible for co-ordinating service delivery of district offices. Regional Offices also undertake some specialist functions
Remedial legislation	Legislation enacted to remedy deficiencies or omissions in previous tax legislation
the 'Revenue'	A term covering the tax administration and tax revenue
Ruling/binding ruling	A ruling is an interpretation of the application of tax law issued by the Commissioner of Inland Revenue. If the ruling is a binding ruling, the Commissioner is then obliged to honour the ruling previously given
RWT	Resident Withholding Tax
Satellite Office	An office reporting to the nearest Field Centre, which undertakes the major activities required at that location. This type of office is proposed in the Report

Self-assessment	A process whereby taxpayers calculate their own tax liability on the tax form and the IRD accepts that return subject to later checks
SSCWT	Specified Superannuation Contribution Withholding Tax
Statute bar time limit restriction	Legal time limit on amending an assessment
Steady state	The period beyond the transition to the proposed organisational structure, when all planned organisational changes are complete
Sub-contracting for delivery	The delivery of IRD's functions and outputs by third parties, under a contract to IRD. IRD retains overall accountability to the Government for developing tax collection strategies, designing broad operating policies, and management of operations providing tax outputs (including contract management)
Tax administration	The agency responsible for the assessment and collection of tax liabilities
Tax base	The complete range of income and activities that is subject to taxation
Tax dispute	A dispute occurs when a taxpayer and the Commissioner do not agree on the facts and/or interpretation of tax law on which a taxpayer's assessment is based
Tax gap/tax revenue gap	The difference between the maximum possible revenue available under tax law, and the revenue actually collected. Thus, the tax revenue gap measures the additional revenue available if there was 100 percent compliance with tax law
Technical tasks/skills	In the context of tax administration, technical tasks are those requiring significant interpretation and judgement in the application of detailed and specialist knowledge of tax legislation and best tax practice
TIB	Tax Information Bulletin (IRD publication)
TPA	Taxpayer Audit (a functional unit within IRD). Also a class of outputs for Parliamentary estimates
TSU	Taxpayer Services (a functional unit within IRD). Also a class of outputs for Parliamentary estimates
Valabh Working Party	Working Party on the Reorganisation of the Income Tax Act 1976 (1993), chaired by Arthur Valabh
VAT	Value Added Tax (the European equivalent of NZ's GST)
Voluntary compliance	A strategy under which taxpayers meet their tax obligations, of their own volition, and without direct intervention by the tax administration

Waugh Committee

The Tax Simplification Consultative Committee (1990), chaired by John Waugh

