

Tax administration in a digital world

*An officials' issues paper to support
future tax administration*

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Prepared by Policy and Regulatory Stewardship, Inland Revenue

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Tax administration in a digital world – an officials’ issues paper to support future tax administration

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CHAPTER 1

Introduction

- 1.1 New Zealand is fortunate to have a tax system that works well. New Zealanders have access to high quality public services, funded by a tax system which strives to simplify requirements and to minimise costs.
- 1.2 The system works well for individuals who have employment and investment income which is subject to withholding and reported to Inland Revenue during the year. For them, tax assessments are largely automated.
- 1.3 The Government's investment in Inland Revenue through its Business Transformation programme has improved administration of the tax and social payments system as well as enabling further improvements through a more digital system.

The case for change

- 1.4 While the tax system works smoothly and efficiently for most earners, it works less well for people with a variety of income sources including those who receive benefits through the tax system, or for small businesses.
- 1.5 Working better would mean being more effective at collecting tax, being fairer by ensuring everyone pays the tax they should, ensuring people receive the payments they are entitled to, lowering overall cost for operating the system, and making more contribution to wider economic goals. These are consistent with the Government's long-term objective of a tax system that is fair, balanced and promotes the long-term sustainability and productivity of the economy.
- 1.6 The way business operates is changing to become fully digital. This is more than transactions happening online. Digital is becoming the complete and "natural system" for businesses. This means tax calculations can be embedded in the software businesses use and tax can become an automated process that happens as a by-product of other processes.
- 1.7 Inland Revenue's Business Transformation programme – the modernisation of its systems and how taxpayers and other parties interact with them – is nearing completion. Business transformation has digitised Inland Revenue and enables Inland Revenue to transact digitally with taxpayers and their representatives. It has created the platform for further development of a digital tax system.
- 1.8 These factors led the Government to include an examination of tax administration on its 2021 tax policy work programme. Inland Revenue has led this work so that it can advise the government.

A fully digital system

- 1.9 Businesses are moving online and this shapes our thinking about the future world in which the tax system will operate. Key features of this world are likely to be:
 - Businesses operating in a digital ecosystem – that is, they're connected digitally to their suppliers and customers.
 - Administration of tax and social policy payments integrated into broader economic systems, for instance individuals or businesses can use a common digital identity across a range of services.

- Tax administration processes embedded in the natural systems businesses are using, that is, the systems that businesses use to suit their business rather than to suit tax obligations.
- Digital processes enabling data to flow in real time.

1.10 Further features of this future tax administration could include:

- Taxpayers granting and managing consents to the party or parties they want to represent them or manage their tax affairs and with whom they are comfortable having their data shared.
- Processes being streamlined through there being one source of truth for data and information. Rather than there being separate data repositories that need to be reconciled, participants would access this data when needed.
- Increased partnering between Inland Revenue and the external parties who provide the apps and services that taxpayers will use.

The potential benefits

1.11 Greater automation of tax obligations is likely to mean better compliance because compliance improves when paying tax is the easy thing to do. It is harder to get it wrong or for taxpayers to manipulate the data. It will also mean lower compliance costs, and less stress and risk for taxpayers, and lower administration costs for Inland Revenue.

1.12 Also, the integration of tax and payment systems into broader economic systems will create value throughout the economy through more efficient processes or through providing a spur to innovation.

A suggested route to get there

1.13 Moving to a more digital tax and payments system will involve a series of steps. It will build on developments already underway such as businesses operating their management systems digitally and tax calculations being embedded in the software businesses use.

1.14 Over the next decade, officials believe further changes for tax administration will be most pronounced for the small business sector – that is the self-employed, micro and small-medium businesses. For individuals receiving wage and salary income and investment income where PAYE and resident withholding tax are deducted, tax is already largely automated. Large businesses are adopting digital processes, but their affairs and tax are sufficiently complex to require a mixture of automation and manual intervention.

1.15 Developing digital natural systems within social policy is more complex as this is not the target market for third party innovation. However, business models are emerging that help with the transition to work or that focus on budgeting support with the payback being fewer debt issues to manage downstream. Potentially, social policy interventions that reduce costs to society could be considered for Government subsidy, as occurred previously with payroll software.

1.16 The needs of taxpayers, social policy customers, and businesses vary. What functions as the natural system for one may not work for another. The trend towards tax occurring in natural systems will be driven by innovation in the private sector developing products and services that meet customer need. In turn, this will mean greater external party involvement in the tax system with

Inland Revenue's focus being one of facilitation, third party support and standard setting.

- 1.17 While we see a greater involvement of external parties, for reasons of skill, privacy, or cost some taxpayers will want to deal directly with Inland Revenue. Inland Revenue will continue to serve them. Similarly, social policy customers, whose affairs can be complex and personal, may also wish to continue a direct relationship with Inland Revenue. Having a direct channel to Inland Revenue puts appropriate pressure on the private sector to make sure their service offerings truly innovate and add value as customers will always have the option of managing their own affairs.

How this fits with other processes

- 1.18 The administration of the tax and transfer system comprises many dimensions such as policy, operations, design and delivery. In total, these relate to Inland Revenue's strategy as administrator of the system. Moving forward will require evolution in all aspects of Inland Revenue's strategy.
- 1.19 This issues paper focuses on these policy elements that could, if not addressed, be potential blockages to achieving a more digital system:
- The regulatory framework applying to external parties, including intermediaries and other entities which interact with the tax and payments system.
 - The rules, frameworks and scope of data sharing.
 - How tax legislation could support a more digital future.

Scope

- 1.20 Tax and transfer administration is a broad topic. It covers the way taxpayers determine and pay their tax obligations, and understand and receive their social policy entitlements. It includes actions taken by Inland Revenue and third parties that facilitate or enforce these processes.
- 1.21 This issues paper does not look at all aspects of tax and social policy administration. Its focus is where policy changes, potentially leading to legislative changes, will be required to give effect to a more digital tax system. This means it does not address these issues:
- Changes to rates and bases: bases refer to who faces a tax obligation or is entitled to a benefit, while rates refer to how much tax or benefit they pay or receive.
 - Digital developments in other parts of Government – a separate exercise is considering potential opportunities to leverage opportunities from business transformation to support a unified Public Service.
 - Administrative functions where a more digital world is not having an impact, such as processes relating to ruling and disputes.
- 1.22 This paper outlines themes and directions. As ideas evolve, specific policy initiatives will be developed and proposed to the Government for inclusion in the tax and social policy work programme.

About this consultation process

- 1.23 The policy issues covered in this issues paper are complex. There is a potential to solve current problems but also create new issues and risks. A steady and careful pace of change allows management of risks as they arise.
- 1.24 This issues paper builds on the engagement we have already had with many parties involved in the tax and transfer system. It sets out key themes identified from that engagement and from reviewing international developments. This engagement will be ongoing.

Making a submission

- 1.25 This issues paper is an invitation to provide feedback. We have included questions as prompts for this feedback, but you are not limited to these questions in how you respond.
- 1.26 Please send your feedback to policy.webmaster@ird.govt.nz with "Tax Administration in a Digital World" in the subject line by **31 March 2022**.
- 1.27 Alternatively, or in addition, we are happy to meet you if there are issues you want to discuss.
- 1.28 Submissions may be the subject of a request under the Official Information Act 1982, which will result in their publication unless there are grounds under that Act for the information to be withheld. The withholding of responses on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. If you consider that any part of your submission should properly be withheld under the Act, please clearly indicate this.

CHAPTER 2

Frameworks

- 2.1 From previous studies of the tax system¹ we have identified four pillars that set out the core framework for the administration of the tax and social policy system to function well:
- **Fairness:** This is crucial for maintaining social licence and promoting voluntary compliance. It means people in similar situations being treated similarly and those in different situations being treated differently.
 - **Integrity:** The systems collect the revenue that Parliament has mandated, and people receive what they are entitled to.
 - **Efficiency:** This is about minimising the total cost of administering the tax and payments system. This includes the compliance costs, including emotional costs, to taxpayers and recipients, and administration costs to Inland Revenue.
 - **Effectiveness:** The system contributes to other elements of the New Zealand economy and society. An example could be how data supplied to Inland Revenue can be used for non-tax purposes.
- 2.2 There are also other perspectives which can provide weight or emphasis to the pillars. The first is the impact of technology.
- 2.3 In a more digital world, how Inland Revenue and its partners think about technology will also shape how the administration of the tax and social policy system evolves. A core part of Inland Revenue's business transformation was developing a digital platform for the tax system. In terms of how this could evolve, we have been influenced by the OECD's publication *Tax Administration 3.0: The Digital Transformation of Tax Administration*.²
- 2.4 Technology enables key concepts, such as:
- A greater integration of tax and social policy administration into the natural systems that individuals and businesses are using for regular tasks.
 - Efficiency through accessing data in real time and removing redundancy.
- 2.5 Consideration of technology prompts various questions:
- How do we ensure taxpayers have control over the systems and processes they will use for managing their tax and social policy entitlements so that they maintain trust in Inland Revenue?
 - How can processes be automated since this can be the key to efficiency gains?
 - How do we think about the boundary between Inland Revenue and external parties so that processes are handled in the most efficient way from a system perspective?

¹ For example, The Tax Working Group. <https://taxworkinggroup.govt.nz/>

² OECD. (2020). *Tax Administration 3.0: The Digital Transformation of Tax Administration*. <https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/tax-administration-3-0-the-digital-transformation-of-tax-administration.htm>

- 2.6 The above-mentioned can apply equally well to tax systems around the world. The final framework we have considered, and which has particular weight for the New Zealand system, is He Ara Waiora.³
- 2.7 Under te Tiriti o Waitangi-the Treaty of Waitangi, the government is committed to work with Māori to actively protect Māori interests and to consult with Māori on matters significant to them.
- 2.8 He Ara Waiora is a framework centred on an ao Māori view of wellbeing. It was initially developed for the Tax Working Group by Māori thought leaders, Ngā Pūkenga, who continue to work with the Treasury to develop and apply He Ara Waiora to policy work.
- 2.9 The principles of He Ara Waiora are derived from mātauranga Māori and are relevant to the wellbeing of all New Zealanders. These principles emphasise: co-ordination and alignment, partnership, collective and strengths-based actions, protecting and building mana, and stewardship, as illustrated by these examples:
- **Kotahitanga:** Kotahitanga encompasses the unity of people, actions, purpose, and vision. Through kotahitanga, He Ara Waiora encourages people to work together for the benefit of all, driven by a shared purpose and inspired by shared aspirations.
 - **Whanaungatanga:** Focusses on relationships and kinship. Relationships with iwi, hapū, and whānau Māori interests are essential to addressing challenges, and improving economic and social outcomes for Māori and New Zealand.
 - **Manaakitanga:** This value is associated with care, relationships, and reciprocity. Manaakitanga requires maintaining a focus on improved wellbeing and enhanced mana for all New Zealanders.
 - **Tiakitanga** – Tiakitanga is about guardianship and has connotations of responsibility and obligation. Tiakitanga helps promote long term sustainability.
- 2.10 Consideration of He Ara Waiora encourages us to consider:
- Are there ways of improving outcomes for all New Zealanders, including Māori, through greater involvement of external parties in providing services to taxpayers or social payment recipients?
 - How do concepts of trust and reciprocity play out in the tax and payments system?

³ He Ara Waiora. <https://www.treasury.govt.nz/information-and-services/nz-economy/higher-living-standards/he-ara-waiora>

CHAPTER 3

Scene setting – the shift to digital

- 3.1 The shift to digital, that is transactions or processes happening through digital channels, is the fundamental concept driving our view of the future and provides the context for this issues paper.
- 3.2 Efficiency, convenience, and effectiveness are factors underpinning the development of a more digital economy, with COVID-19 providing an added spur. We see no reason for this shift to slow and we anticipate that digital channels and systems will become even more dominant.
- 3.3 Transactions happening digitally is not new. What is influential, however, is the extent to which complete business systems are online. It is the shift to businesses operating digitally, rather than undertaking some digital transactions, that is important.
- 3.4 Inland Revenue too is providing an increasing amount of its services and functions online. Thanks to the Government's investment in business transformation, the revenue system now operates on a digital platform and Inland Revenue can interact online with taxpayers, payment recipients and a range of intermediaries and business partners.
- 3.5 Inland Revenue, however, is not driving the shift to digital. Adapting tax and social policy systems to facilitate digital interaction is about keeping up with how people are living their lives and doing business. Equally, failure to adapt presents risks that the tax system would negatively affect revenue raising, integrity and fairness.
- 3.6 New Zealand is not alone in moving in this direction. Across member countries of the OECD, we see – with variations in focus or pace – a consistent pattern. These are summed up in the OECD's *Tax Administration 3.0: The Digital Transformation of Tax Administration*.⁴ In mid-2020, the United Kingdom's Her Majesty's Revenue and Customs released *Building a trusted, modern tax administration system*⁵ which canvasses many of the same issues and suggests heading in the same direction as described in this issues paper.
- 3.7 There are similar themes in policy development within other government departments. Examples include the *Strategy for a Digital Public Service*⁶ and the *Digital Strategy for Aotearoa*.⁷ This latter strategy is motivated by the world we live in becoming more digital and ensuring that New Zealand can leverage the economic and social advantages of innovative technologies.
- 3.8 Work within government to establish the consumer data right is relevant to the issues explored in chapter 5 about sharing data. Development of the Digital

⁴ OECD. (2020). *Tax Administration 3.0: The Digital Transformation of Tax Administration*. <https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/tax-administration-3-0-the-digital-transformation-of-tax-administration.htm>

⁵ HM Revenue & Customs, HM Treasury. (2020). *Building a trusted, modern tax administration system*. <https://www.gov.uk/government/publications/tax-administration-strategy/building-a-trusted-modern-tax-administration-system>

⁶ New Zealand Government. (2019). *Strategy for a Digital Public Service*. <https://www.digital.govt.nz/digital-government/strategy/strategy-summary/strategy-for-a-digital-public-service/>

⁷ New Zealand Government. (2021). *Towards a Digital Strategy for Aotearoa*. <https://www.digital.govt.nz/digital-government/strategy/towards-a-digital-strategy-for-aotearoa/>

Identity Services Trust Framework,⁸ which the Department of Internal Affairs is leading, is building towards a trusted system of digital identity which will be a key ingredient of the tax and payments system.

What a more digital tax system means

- 3.9 Increasingly smaller companies are using software to run their business, particularly to manage their financial record keeping, invoicing and calculation of tax obligations. They are spending less time on the more routine aspects of accounting and tax and are freed up to focus more on running their business.
- 3.10 The shift of business management into digital channels means tax calculations can be embedded in the software businesses use. This is referred to as tax occurring in the business's natural systems.
- 3.11 The effect is that meeting tax obligations becomes a by-product of non-tax processes. This is a paradigm shift for taxpayers and tax administration. Compliance is built in. It reduces the scope for errors and options for non-compliance (though still reliant on the quality of data that is inputted), while also reducing the burden of compliance arising from using different processes for taxation and other aspects of business.
- 3.12 Exactly how this will play out in terms of details and pace is unknown, as it will be driven by private sector innovation and uptake by taxpayers. This issues paper considers what foundations are needed to allow the system to evolve.
- 3.13 Not all people and businesses will adopt digital ways of operating and some will continue to self-serve for tax. However, there are already signs of new products and services being developed which give us confidence that the uptake of digital processes will continue to grow. Examples we are aware of include:
- Financial intermediaries who provide accounting software and automate much of the tax calculation for self-employed contractors.
 - Platforms that provide job matching services, but which also manage payment and tax deductions.
 - A software developer whose focus is on lower income people who might struggle to maintain control over their finances. Via an app, an accurate picture of people's financial circumstances is developed by compiling information from various sources and this is used to provide tailored services, such as budgeting or prompts when significant payments are due.

What the future could look like

- 3.14 A fully digital tax and payments system would involve the administration of that system being integrated in broader economic systems. People would grant and manage consents to the party or parties they want to represent them or manage their tax affairs and with whom they are comfortable having their data shared. Processes would be streamlined through there being one source of truth for data and information – participants access this data when needed rather than there being separate data repositories that need to be reconciled. Inland Revenue is often, but not always, the holder of this information. Inland Revenue's role would evolve to ensure a seamless boundary between it and

⁸ New Zealand Government. *Digital Identity Services Trust Framework*. <https://www.digital.govt.nz/digital-government/programmes-and-projects/digital-identity-programme/trust-framework/>

external parties. Inland Revenue partners with external parties to manage risk and ensure the integrity of the tax and transfer system.

- 3.15 Aspects of this system are in place. For instance, external parties already play a major role in the system supporting taxpayers. A more digital world will, however, shift the nature of these entities' involvement with the taxpayer and the tax system.
- 3.16 The vision is also idealised. It will need to be adapted as risks and tensions emerge between developing a more efficient system and maintaining the integrity of the tax and social payments system. However, it guides our thoughts as how the system should evolve over the near term.

Implications for taxpayers

- 3.17 The impact of an increasingly digital business environment will differ by type of taxpayer. Most individuals receive income with PAYE deducted and investment income with tax already withheld. Third parties (employers and financial institutions) supply this data to Inland Revenue and this pre-populates taxpayers' income tax returns. This flow of information is largely automated and imposes low compliance costs on taxpayers. The scope for improvement is likely to be limited, though there may be digital innovations to improve outcomes for some sub-groups such as individuals who receive social policy payments or who have debt to Inland Revenue.
- 3.18 However, it's a different story for other types of taxpayers. Compared with individuals who earn wages from which PAYE is deducted, the self-employed, micro and small business segments tend to have more complex tax arrangements. Typically, they have been a harder group for Inland Revenue to serve. Evidence suggests they face high compliance costs relative to the tax they pay and may not be as compliant with their tax obligations.⁹
- 3.19 Larger businesses have complex and bespoke tax affairs that make them less receptive to the types of standardised solutions anticipated for smaller companies. However, there are still opportunities to improve how administration of the tax system works for them, for instance around minimising the compliance costs for the data they supply and how they supply it.

Inland Revenue's role

- 3.20 The ideas discussed above are consistent with Inland Revenue's business transformation. The potential policy and legislative changes discussed in this paper complement the technological capability arising from business transformation.
- 3.21 A more digital future will involve further change. Inland Revenue's digital transformation has strengthened its ability to deliver services based on core information, involving collection and payment of money and processing at scale. More tailored services, which increasingly the public expects in the digital environment, are likely to come from private sector entities. For example, integrating financial management with tax management for a small business or providing budgeting assistance for someone with debt. Digital channels provide the opportunity for private sector entities to deliver customised services that

⁹ See for instance Ana Cinta G. Gabral and Norman Gemmill. (2018). *Estimating Self-Employment Income-Gaps from Register and Survey Data: Evidence for New Zealand*. Working Paper 07/2018. Victoria University of Wellington. <http://researcharchive.vuw.ac.nz/handle/10063/7625>

can more effectively and efficiently meet taxpayers' needs. The impact of these developments is that for these taxpayers Inland Revenue will act more as an enabler and the customer-facing parts of tax compliance would be delivered by private sector entities.

- 3.22 These shifts are motivated by making routine tasks, including tax, easier for customers. This produces lower compliance costs. It will also bring compliance benefits for the tax system. Where calculation and payment of tax is automated, compliance is improved because non-compliance requires more effort. Basic, unintentional errors are removed from the system. Digital transactions leave a footprint so make non-compliance riskier, and when business operations are fully digitised it's harder to push transactions into a non-digital space. These developments mean we think a more digital and automated tax system will make it more likely that everyone is paying the tax they should, resulting in higher overall tax revenues for given tax settings.
- 3.23 Inland Revenue will evolve as a digital entity just as other businesses are doing. In a more digital world, issues like data security become even more important. Operating models will also need to adapt to take advantage of the technology Inland Revenue's business transformation has delivered. For instance, a different approach may be needed for onboarding new users of gateway services than has traditionally applied to Inland Revenue accepting a new tax agent into the tax system. Where external parties have the primary relationship with the taxpayer, Inland Revenue's relationship with those external parties will need to focus on how the system works overall.
- 3.24 New business models, for instance greater use of crypto assets, and new ways for taxpayers to meet their obligations will present risks as well as opportunities. An advantage that Inland Revenue has is its membership of international bodies such as the OECD, which enables New Zealand to participate in global solutions to challenges such as the taxation of multinationals. Within New Zealand, Inland Revenue will also need to participate with the private sector in the development of new business models to ensure the tax base is protected.

Digital inclusion

- 3.25 A more digital world works well for those able to embrace those technologies but can create barriers for those not able or wanting to participate in this way. Digital exclusion will arise for those lacking access to digital services and devices, skills in using them, and motivation and trust to operate in digital channels. The Government estimates one in five people lack at least one of the elements to be digitally included.¹⁰ Groups who are less likely to be digitally included in New Zealand are: people living in social housing, individuals with disabilities, Pasifika, Māori, people living in large country towns, older members of society, and those not in the workforce.
- 3.26 However, people will use digital services if the benefit is clear and there are signs that innovative firms are finding ways to provide services catering for the digitally excluded. This will help bridge the barriers to accessing digital services. But these are at a fledgling state and at best will contribute to a solution rather than being the solution. Inland Revenue will continue to provide personalised services using non digital channels, such as phone and over the counter. Though these channels can appear more costly for service delivery, this has to be set against the right to access government services.

¹⁰ New Zealand Government. (2020). *Digital Inclusion Action Plan 2020-21*.
<https://www.digital.govt.nz/dmsdocument/174~digital-inclusion-action-plan-20202021/html>

- 3.27 In contrast, we think professional parties have the capability to operate digitally and consequently there is an expectation that these groups should use digital channels to interact with Inland Revenue.
- 3.28 A related aspect of the digital story is expectations around small businesses adopting digital accounting software or using tax agents. Uptake of digital software amongst small businesses is increasing as businesses look for efficiencies and find more tailored services. However, options for business taxpayers to self-serve in less digital ways will remain.

How the shift to digital shapes this document

- 3.29 We have grouped the impacts from more digital processes into three areas – though noting a significant degree of overlap amongst them. These are:
- **External parties:** Their potential to meet the needs of taxpayers and recipients of payments and what changes are necessary to facilitate this.
 - **Data:** Rationalising data collection and unlocking value through taxpayers authorising Inland Revenue to share their data.
 - **Tax rule changes:** Adapting the tax system to more digital processes and making changes that facilitate a more automated approach to determining tax obligations.
- 3.30 Our exploration of these topics is covered in the next three chapters.

Questions for submitters

- Does our emphasis on the shift to digital channels and processes resonate with your experience?
- Are there other economic or social trends that we are not giving sufficient weight to in terms of influences on tax and social policy administration?
- Are there other ways we should think about those who are digitally excluded or who might not see themselves in a digital story?

CHAPTER 4

External parties

- 4.1 External parties and intermediaries already play an important role in the tax and transfer system.
- 4.2 In a more digital environment this role is likely to expand as external parties play three overlapping roles:
- The traditional tax agent/intermediary function – helping taxpayers determine and pay their tax liabilities.
 - Providers of products and services that taxpayers use for a business purpose that as a by-product assist taxpayers with their tax. For example, a job matching website where the platform provider manages payments and tax obligations for employees and contractors.
 - Entities that provide access to services which are unrelated to tax, but which use tax information and require some form of access to data held by Inland Revenue.
- 4.3 The expanded role will come from the development of niche products and adaptation to suit smaller groups of customers. Inland Revenue's strength lies in delivering at scale, so is more attuned to standardised bulk-processing solutions, whereas we see the private sector complementing this with more customised services.
- 4.4 Another benefit from private sector involvement is the relationship such entities develop with taxpayers. Some taxpayers prefer to deal with their tax affairs through intermediaries rather than directly with Inland Revenue. This is particularly the case where software developers are providing new services based on integrating data from a range of sources, such as banking, tax, and other business records. Taxpayers who want advice based on a holistic view of their financial situation will get this from a private sector provider rather than Inland Revenue.
- 4.5 From a policy perspective, the issue is the regulatory environment in which external entities interact with the tax and payments system.

How Inland Revenue works with external parties

- 4.6 Given a greater role for external parties, the goal will be to create a seamless boundary between them and Inland Revenue so that their customers have a flexible and convenient experience when paying tax and receiving entitlements.
- 4.7 External parties will connect with Inland Revenue digitally through Inland Revenue's gateway services. Gateway services refer to the web services that allow third parties to integrate their services with Inland Revenue's systems.
- 4.8 With the conclusion of business transformation, Inland Revenue will be more open to accepting applications from external parties so that they can access the gateway services. In anticipation of this shift, Inland Revenue is engaging with a wide variety of entities to better understand their business models, the types of services they are providing and consequently the types of gateway services they want to access.

- 4.9 More information about Inland Revenue's gateway services and how external parties can access them can be found on Inland Revenue's website.¹¹

Regulation of external parties

- 4.10 The traditional approach to regulation has focused on the roles that entities play in the tax system. The Tax Administration Act 1994 describes different types of entities, such as tax agents or PAYE intermediaries, with further sections of the Act defining the entry requirements and rights of the entity types.
- 4.11 This approach is becoming less fit for purpose. There are new entities whose services cross the boundaries that previously defined the types of entities. Overcoming the rigidities in the current framework has led to inefficient workarounds.
- 4.12 The following approach could form the basis of a new regulatory framework:
- As a starting point, all parties involved in the tax system must have an obligation to uphold the integrity of the tax system. What this means in practice might differ by the role the party plays, but the concept will still apply.
 - All external parties interacting with Inland Revenue through the gateway services would also be required to comply with the technical/compatibility and security standards that Inland Revenue sets for its gateway services.
 - External parties' access to Inland Revenue services and data should be based on the role they perform for their customers and what data is required to fulfil that role. A tax agent for all of a taxpayer's affairs would require access to all that taxpayer's files and data, whereas a party who assists a taxpayer claim a donation tax credit would have limited access based on providing that service.
 - The service the external party is providing for their customer will also dictate how they interact with the Inland Revenue system. Some parties will "read" data (for example access information held by Inland Revenue), while others will "write" or "amend" data (for example someone acting as a tax agent for a taxpayer who supplies data or a tax return to Inland Revenue).
 - Standards would apply to each of these functions. For example, if parties access data held by Inland Revenue, there would be obligations relating to privacy and secure storage of that data. If a party is amending data, there would be obligations around accuracy and reliability.
 - Failure to meet the standards could lead to loss of access.
- 4.13 Tax advisors are another group of external parties. Often their role will overlap with that of a tax agent and in a practical sense the roles of agent and advisor will be indistinguishable, but in a pure sense advisors' relationship is solely with the client (taxpayer) and not with Inland Revenue.
- 4.14 The advisor plays an important role in ensuring compliance, providing advice, and acting as a bridge between Inland Revenue and the taxpayer. They advise taxpayers based on their circumstances in ways that Inland Revenue is not suited to. For the tax system to work well, advisors need to act to support the integrity of the tax system.

¹¹ Inland Revenue. *Gateway services architecture*. <https://www.ird.govt.nz/digital-service-providers/guides-and-docs/gws-architecture>

- 4.15 Currently, there is no specific regulatory obligation on the advisor from the perspective of the revenue legislation, though in practice the majority are members of a professional organisation that imposes educational and ethical standards on them.
- 4.16 We are considering whether the regulatory framework should specify requirements for the tax advisor or whether general obligations for all parties to uphold the integrity of the tax system would be sufficient.

Regulation of systems

- 4.17 In a digital world, taxpayers will use systems that will “tell” them how much tax to pay.
- 4.18 This is like the role of the advisor but there is a subtle distinction between the advisor applying judgement to advise on how much tax to pay and a software programme applying rules to advise on how much tax to pay. From the perspective of the integrity of the tax system, for the first situation there is an expectation of care. For the second situation there is an expectation of following the rules.
- 4.19 Any regulatory framework for external parties needs to consider the role of system providers. We anticipate obligations on these entities relating to accuracy of tax calculation, with Inland Revenue support by testing of these systems.

Co-dependence of Inland Revenue and external parties

- 4.20 As external parties play a greater role in the administration of the tax and transfer system, there will be a greater interdependence between them and Inland Revenue. Potentially, Inland Revenue will need to view external parties’ operations as integral extensions of Inland Revenue’s operating model.
- 4.21 Feedback from the private sector suggests business transformation has provided an effective platform but that improvement is needed to enable external parties to participate effectively.
- 4.22 Different mechanisms may be required to support these developments. This would involve mechanisms to consider whole of system perspectives in investment decisions. It might also mean bringing additional perspectives into the consultation process for new tax policy proposals, to get feedback on the system and digital elements of any proposal.

Supporting the development of social policy

- 4.23 Inland Revenue administered social policies such as Working for Families can be difficult for recipients to manage. Eligibility and entitlement depend on family composition and estimates of income. Where recipients fail to notify Inland Revenue of changes in their circumstance, or do so with a delay, recipients may end up being overpaid, leading to debt.
- 4.24 It is possible that external parties could develop products that would help recipients identify if they are eligible for support and manage their entitlements. However, a factor that might deter investment in these types of products is that recipients will be lower income so their ability and willingness to pay may be limited.

- 4.25 Consequently, there is an argument that subsidising these products could be beneficial if it encouraged their development and uptake. The benefits could include:
- Improved fairness if people get the benefits they are entitled to.
 - Lower compliance costs for recipients.
 - Lower administration costs for Inland Revenue if there are fewer instances of under or over-payment.
- 4.26 A precedent for this intervention is the subsidy the Government provided to payroll intermediaries to encourage the use of specialist payroll firms.

Questions for submitters

- Are there roles that external parties play, or could play, in the tax and transfer system that have not been recognised?
- Do you agree that the regulatory framework for external parties, as currently set out in the Tax Administration Act, should change?
- Is the distinction between a tax advisor (who provides advice to a taxpayer about tax liabilities) and another intermediary involved in the tax system useful when considering the regulation of external parties?
- What changes does Inland Revenue need to make to enable external parties to contribute to the tax and payments system?
- Should the Government consider subsidies for products that assist social payment recipients?

CHAPTER 5

Data

- 5.1 In a digital world, data is important. Sharing and re-using data can create efficiency gains as data is accessed or collected in more automated ways or productivity gains as more ready access to data enables new products and services to be developed.
- 5.2 Two issues come to the fore. What data is collected and how it is managed.

Data collection

- 5.3 Data collection is at the heart of tax collection. Inland Revenue is rethinking its approach to the data it collects and accesses.
- 5.4 Previously, access to data meant physical collection and storage. In a digital world, this will still be the case for much of the data that Inland Revenue needs. But, in some cases, it might be as practical and efficient for Inland Revenue to access data without the need to hold it. This question – whether data needs to be collected or whether it can be accessed, is within the frameworks that Inland Revenue is adopting to guide its approach to data.
- 5.5 These frameworks will continue to emphasise that the provision of required data is compulsory. Where possible, however, provision of that data should be simple for taxpayers to comply with – for example by focusing on existing financial information and where data is generated in digital channels using natural systems.
- 5.6 Inland Revenue has traditionally collected less data than comparable tax administrations. In the main, the focus has been on what data is needed for compliance rather than other purposes such as tax policy. A recent legislative amendment reinforced Inland Revenue's ability to collect data that relates to developing policy or reform of the tax system. Sometimes, this will lead to collection of additional data.
- 5.7 In other areas, for example relating to the data taxpayers supply as part of their tax return, there could be rationalisation of what is collected. External parties have suggested there is scope to simplify what is collected in ways that improve its usefulness. Work in this area will also address the format in which the data is provided.

Sharing data

- 5.8 Traditionally, the law in New Zealand (similar to many other tax jurisdictions) has required Inland Revenue to hold important tax data (classified as sensitive revenue information in the Tax Administration Act) as confidential and not disclose it to external parties. This constraint is imposed on Inland Revenue; unlike the Privacy Act this obligation does not sit within an overarching framework where the customer or taxpayer has control over their data.
- 5.9 The approach is based on balancing the powers Inland Revenue has to obtain information, with responsibilities to keep that data confidential.
- 5.10 The approach has exceptions. There are legislative dispensations so that Inland Revenue can share data with other government agencies for social policy or

enforcement purposes, where doing so will assist tax revenue collection, or if it is sharing the taxpayer's data directly with the taxpayer or the taxpayer's agent.

Data sharing with taxpayer consent

- 5.11 The question that now arises is whether Inland Revenue could share data with a non-government third party, where the taxpayer consents. Possible examples could include:
- when customers enrol with a financial institution, they may want Inland Revenue to share their identity data
 - when applying for a loan, taxpayers may want Inland Revenue to share their income data, and
 - taxpayers who are receiving budgeting advice may want Inland Revenue to share data about tax debts or upcoming tax payments.
- 5.12 Moving in the direction of enabling taxpayers to share their data more widely is consistent with the Government's policy to implement a new legislative framework for a consumer data right. (Legislation is planned for 2022.) The essence of this policy is to allow consumers to securely share data that is held about them with trusted third parties, using standardised data formats and interfaces. Security and privacy of consumer data will be addressed in this policy and will provide guidance for Inland Revenue's approach.
- 5.13 Any consideration of this issue points to consent being a fundamental element. Ensuring that consent is robust - that the person granting it understands the consequences of their consenting - is important both for any new areas of data sharing and, where applicable, existing areas of data sharing.
- 5.14 Inland Revenue has conducted research to better understand taxpayer attitudes to data sharing. The research suggests that taxpayers are comfortable about consenting to Inland Revenue sharing their data with external parties as long as:
- the benefit is clear and understandable
 - the taxpayer feels in control of consent, and
 - there is trust in Inland Revenue and the third party.
- 5.15 From Inland Revenue's perspective, there would also need to be safeguards so that any data sharing did not undermine taxpayers' trust in Inland Revenue as a steward of their data and manager of the tax system. For example, these points would need to be considered:
- Does the sharing of data, subject to taxpayer authorisation, align with ideas that are important for Māori?
 - The supply of the information to the third party will not damage the integrity of the tax system. Factors would include the intended use of the data and the ability of the receiving entity to satisfy security and privacy requirements.
 - The benefits to New Zealand of sharing outweigh the costs (there could be costs to Inland Revenue in meeting these requests).
- 5.16 Our current thought is that Inland Revenue would not charge for the data it shares, even if the data sharing were part of a commercial product or service. However, we are aware of different views on this and therefore are keen to explore it further.

Sharing statistical (anonymised) data

5.17 A different aspect of data sharing could be where statistical (therefore anonymised) information is made available by Inland Revenue to taxpayers or representative bodies. This could improve the quality of information available to external parties which can help research and decision making. A possible example of this would be enabling an iwi to see patterns amongst members with respect to average incomes or receipt of benefits.

Publishing debt data

5.18 Where tax debt is unpaid, particularly PAYE and GST which is collected on behalf of others, it can be a sign of a business under stress. This can be useful information for other businesses and enable them to make informed credit decisions. This could lead to wider economic benefits, for instance preventing a cascade of business failures when one business fails.

5.19 Inland Revenue already has a limited ability to share names of debtors with credit agencies. This sits as an exception to the principle of only sharing data with taxpayer consent. The Government has asked officials from the Ministry of Business, Innovation and Employment and Inland Revenue to undertake policy development to improve the availability of tax debt information.¹²¹³

Questions for submitters

- How do you view the concept of sharing sensitive revenue information, subject to taxpayers' consent?
- Do you have other examples of how data sharing could be applied beyond the tax system?
- What do you consider are important elements in a consent framework for data sharing?
- Do you agree making tax debt data more available, with controls, will have a significant positive benefit for the wider business community?
- Do you agree with the proposal to make more statistical (not individual) income and administrative information to wider groups, such as iwi or social groups?

¹² Ministry of Business, Innovation and Employment. *Insolvency Review Working Group*. <https://www.mbie.govt.nz/business-and-employment/business/regulating-entities/insolvency-review-working-group/>

¹³ Ministry of Business, Innovation and Employment. (2019). *Changes to insolvency law*. Proactive release. <https://www.mbie.govt.nz/assets/insolvency-law-reform.pdf>

CHAPTER 6

Simplification

- 6.1 There is a subtle interaction between a more digital world and simplification of the tax system. In a digital world data is cheap and, by comparison, people are expensive. This is a reversal where traditionally, data has been expensive and people relatively cheap.
- 6.2 This shift in relative costs increases the incentives for both taxpayers and Inland Revenue as tax administrator to adopt:
- Automated tax processes that do not require human intervention. Automation may not always require simplicity – computers are good at complex calculations. But it does generally mean eliminating complex judgements.
 - Tax rules that may not require as much accuracy in the determination of tax liabilities because the cost of achieving complete accuracy, through human intervention, outweighs any tax saved (by the taxpayer) or tax collected (by Inland Revenue).
- 6.3 The intention is not to reduce tax liabilities but, by making changes that simplify tax or make it easier for external parties to automate tax obligations, reduce the burden of tax. This rationale drives our thinking in the following areas.

How tax laws are written

- 6.4 Legislation provides the foundation of the tax system. A goal in a more digital tax and social policy system would be legislation that has logical foundations and supports machine learning so that tax and payment calculation can be automated within external party systems.
- 6.5 This has implications for the way tax laws are written and the systems that taxpayers use.

Simplifying the year-end tax return

- 6.6 Much of the complexity of determining income tax arises from the end of year adjustments. These serve to bring net income into closer alignment with underlying economic income but involve more calculations. For some, mostly larger firms, the greater accuracy is worthwhile. But for others the adjustments are being made solely to comply with tax rules and the cost of any accuracy gain outweighs the tax benefit, especially as many adjustments unwind in the subsequent year.
- 6.7 A possibility would be to give taxpayers flexibility to adopt an approach that best suits their business. This would enable businesses to match their income determination to those required for other purposes (for example, aligning with how they determine GST liabilities). For some this will mean moving closer to a cash basis (though capital/revenue distinctions will remain for most assets). Entities would be able to choose the approach that they adopted with the proviso that moving between different approaches would be limited to prevent opportunistic switching to gain a tax advantage.
- 6.8 Another example of this approach could be asset depreciation. Currently, there is a detailed schedule of assets with different depreciation rates applying to each category.

- 6.9 Some firms with very specialised assets may want to continue using the detailed schedule. But many small businesses and their advisors would be comfortable with only a few categories of assets, such as: motor vehicles, buildings, plant and equipment with motors, other plant and equipment, other. A simpler schedule would make it easier to apply machine learning and automate the allocation of assets to the correct group. The rate applying within each category would be averages of the rates applying to individual assets in that category. There would not be an option of picking and choosing to minimise tax outcomes. The simplicity arises from lack of choice and the goal is simplification (and the ensuing compliance cost reductions) and not tax minimisation.

Systems for paying tax

- 6.10 Innovative products are providing different options for businesses to manage their finances and pay their taxes. These can give businesses greater comfort that the tax they pay during the year better matches their annual tax liability. For instance, providing a different mechanism for tax collection, say through an intermediary, could allow contractors to elect out of withholding tax or provisional tax.
- 6.11 New products will need to show they do not pose risks to the tax system, for instance by ensuring tax payments occur with an accuracy and frequency at least as good as current rules. Business models which simply defer payment to Inland Revenue will not meet the tests of tax integrity or improved compliance. Legislation may be needed to ensure that acceptable products are not constrained.

The role of system assessment

- 6.12 Traditionally, tax system design has focussed on either Commissioner assessment or taxpayer self-assessment of tax liability. A more digital world would not necessarily change the obligation on taxpayers to self-assess their tax liabilities. But with external parties playing a greater role in assisting taxpayers to comply with and determine their tax liabilities, two questions arise:
- Should taxpayers be protected in relation to a tax shortfall if they have followed the advice and calculation of the external party?
 - What should the implication be for the external party who gets the calculation wrong?
- 6.13 One approach could be that the taxpayer has an obligation to take care to provide correct information while the intermediary becomes responsible for the interpretation of the tax law using the data provided. For example, the taxpayer provides a receipt to an intermediary for the purchase of a new computer, discharging the obligation to take care. The intermediary has the obligation to correctly code that expenditure as capital (a tax position). In case of an error in the information or the algorithm, the taxpayer would still have to pay any outstanding taxes. But the above approach to responsibilities would affect the party to which penalties are applied.
- 6.14 This issue is not new. For instance, there are rules in respect of employees whose tax obligations are not met because their employer does not return PAYE.

Sharing the certainty benefit

- 6.15 Much of the change proposed represents a move towards real time systems and away from end-of-year focussed systems. This raises a question about how long matters can be open to review by the Commissioner (the time-bar). This issue

is complex but a reduction in this period could be appropriate for taxpayers complying with tax obligations in a speedier way because their tax is being determined in their natural system. No changes to review periods would be considered for those who remain in traditional systems.

Questions for submitters

- What factors do you think are important for the automation of tax calculations?
- What consequences should taxpayers face if there is a tax shortfall, but they have relied on the calculation of an external party?
- What consequences should external parties face if there is a tax shortfall because of taxpayers relying on the calculations within the system provided by the external party?