Everything must change

Perhaps the biggest global trend in tax administrations is so called 'Transformation' projects. We are changing our computer systems. Or, we are changing our structure. Or, we are changing our culture to be more customer-focused. Or, we are changing our models and the way we measure success.

My contention is that it is not enough. We need to replace all those 'ors' with 'ands'.

Even some simple examples of changes that will help our customers require us to change our processes, our policy, our people, our partnerships, the way we use data, and our technology – all at the same time.

To truly serve our customers, <u>everything</u> must change.

What's wrong with the current system

I was sitting having a refreshing glass of ale last week, and amazing at the number of craft breweries that have popped up in Wellington lately. I started daydreaming about how they do their tax.

The owner, Josh, used to be a Creative Director at a marketing agency until he realised that brewing his own beer would be more fun than selling someone elses. So he jumped onto the Companies Office website to register a new company, a brewery. At Inland Revenue, we don't notice this. And if we did, well, we have lots of information available for Josh, <u>lots</u> of information however he wants it, but he hasn't done anything wrong <u>yet</u>, so why would <u>we</u> do anything? And the last thing Josh wants to do is spend his evenings on a Government website or at a seminar about tax. He wants to brew beer.

Ten months later, it's time for the first income tax return. This slips Josh's mind until the last minute – but that's OK, it can't take too long to find all those receipts carefully laid aside in puddles all over the brewery. He is somewhat surprised that he appears to owe $30,000 in tax. He doesn't have $30 in the bank, so that's going to be an issue. But not to fear, he doesn't have to pay for around 8 months.

A couple of months later he gets a letter from us asking where his $10,000 provisional tax payment is – plus, in January he will be paying us another $10,000, just before he has to pay the $30,000 tax on last year. That's over a year and a half of tax to pay inside of six months.

In a moment of sheer inspiration brought on by utter panic and looming deadlines, ex Creative Director Josh packages his six different beers up into a beautifully designed Christmas gift pack, sells it on New Zealand's main internet trading portal, TradeMe, and watches all the cash he needs to pay his tax roll on in.

A beautiful daydream it was, until I reached the end of my ale, and realised that when he fills in next year's return, he doesn't include any of the TradeMe sales, as there are no receipts lying around. Six months later my data team gets hold of a load of TradeMe records, finds that Josh hasn't declared any of this income, and the dream turns into a nightmare.

We didn't <u>want</u> any of this to happen. From a NZ perspective, we wanted Josh to succeed, and to export loads of his glorious ale to Australia.

This story may be an exaggeration, but it is not far from the truth.

A while back I sat alongside a small business owner in New Plymouth as he tried to file his monthly employee tax return online …. First, he couldn't remember his tax number, then he couldn't find it online without first knowing his memorable phrase.

Then when he finally got into our system, his payroll software didn't talk directly to ours. He went through filling in the needed details, with a lot of cutting and pasting between switching between three screens – his bank, payroll and Inland Revenue. Not at all simple, and prone to error.

We also know that cashflow is a major problem for small businesses. We get a lot of feedback about the pain of provisional tax when income isn't coming in as expected. Not only is the cash not there to pay the tax, but small businesses can't wait until after the end of the tax year to get a refund back. They need the cash to survive today. If we can help owners like Josh to get good systems in place to start with, and match their tax payments as closely as possible to the timing of their income, we know it will be a great help.

It could be better

So what could we do differently.

When Josh registered online with the Companies Office, that registration should have flowed immediately to our software, which noticed in a nanosecond that he had never run a company before, and could use some help. That evening when Josh goes online to check out some brewing blogs, using the internet cookie from the Companies Office site, we serve him up web banners advertising free trial accounting software for new businesses. When he goes to check what his mum is up to on Facebook, he sees ads letting him know that Inland Revenue has people standing by to help budding brewers like himself get all their tax affairs right <u>before</u> they start making mistakes. Josh clicks through, and speaks with our online assistant, also taking advantage of the software offer, and registering for GST.

Every 2 months Josh's software prepares a GST return for him to send to Inland Revenue, with the single press of a button. On the third of these returns, our software notices that for the first time Josh appears to have turned a profit. It sends him emails about how important it is to prepare to pay income taxes. We also give him different options to help manage his cash flow. Rather than having to pay provisional tax on guesstimates of his income and in big lumps, Josh can choose to pay based on his actual earnings, with the banks forwarding a proportion of each deposit on to Inland Revenue. Or he can pay on the basis of his accounting profit, from his shiny new accounting package. Every two months it works out his GST and Income tax obligations for him, and all Josh has to do is click the Confirm button.

When Josh starts selling on TradeMe, our software picks up the new transactions from its nightly feed, assesses that it is 99% likely to relate to Josh's brewery, and sends a little alert code to his software. When Josh next opens his accounting software, he gets an alert pop up saying 'Inland Revenue thinks you might have a new income source from TradeMe, would you like to import those transactions automatically into your accounts?'. Josh clicks yes, and from now on, all Josh needs to do to meet all his tax obligations is click a single button presented to him every two months.

Of course, if his tax affairs are at all complicated, he would be well advised to have an accountant or tax agent look over his accounts. But in its simplest form, tax should take Josh no more than a few minutes a month.

What would this take?

So if we already have these ideas, why isn't tax that easy for Josh now? It's easy to say because our **technology** isn't fit for the digital age, and that's true. Over the years we have bolted on layer upon layer to our aged software, and each new addition takes an increasing amount of time and money, so that many changes are now simply impractical. Our new software will make changes much quicker and cheaper. And small business owners will see some immediate benefits. They will soon be able to quickly amend their previous returns online. They will be able to create their own instalment plans for repaying debt, which our software will approve automatically if it meets basic criteria. They will be able to see all their various tax accounts in a single login, rather than having to continually switch between multiple accounts. These are examples of improvements that will come about simply because of the technology change.

But the technology change alone won't bring about any of the innovations in our story about Josh.

To immediately start getting Josh's attention when he starts his company, we need to change many of our existing **processes**. We need faster communication with other Government departments, in this case the Companies Office, where data flows in real time, and includes information about their web traffic. We need our own analytics to be running constantly to identify immediately that Josh is a first time business owner. And we need our communications to change that night so that we are advertising to Josh personally based on the information we have about him.

To offer Josh different options for when and how to pay provisional tax is going to require significant amounts of **policy** change. And it can only be made to work if we have new **partnerships** with banks and accounting software providers, to help deliver the tax system alongside us.

To help Josh get his TradeMe transactions into his automated tax system is going to require a fundamental rethink about how we use **data**. Currently our approach to data is about using it to find people who are deliberately trying to avoid tax. Public opinion is broadly on our side that we should be able to do this. However, to help citizens like Josh we need to use the data available to us to find and help those people who want to do the right thing. This requires a much more real-time and broad use of data, perhaps with some basic level of data sharing across the system. We may have legal permission for this, but we need to build public permission for it as well.

It's not just about the data analytics either. It's about how we measure success. Currently we are measured on our ability to recover debt. We are not measured on our ability to increase compliance and prevent debt. We have no way to measure our success in this area, and no tangible incentive to do so. That is crazy, but to continue to invest in this, we will need to be able to model and measure the increase in compliance.

All of these new interventions will also require new skills from our **people**.

The Compliance Model: a new way of thinking

But more important than the new skills, is a new way of thinking. This is the ability to step back from all the limitations of our current system, and ask 'What would an ideal system for Josh be?' This way of thinking is encapsulated in our new Compliance Model.

Our Compliance Model encourages us to think about each of our customers before considering how best to help and encourage them to comply with their obligations. People aren't good or bad taxpayers. Josh has been a 'good' taxpayer all his life, but is for the first time setting up a business, and now has a whole new set of circumstances to consider.

Despite being well educated, Josh doesn't currently have the **capability** to comply with his taxes. He doesn't know what his obligations are – he's never been in this situation before. And he doesn't have any systems or processes in place to help him.

Whereas previously Josh had no **opportunity** to avoid paying his taxes, for a period of time while his business is growing, he now does. A lot of his sales are at events or to a network of friends, where we can't easily trace the transactions.

And while we have no reason to believe that Josh intends to avoid taxes, in other words his **motivation** is right, he is about to enter a period of sharp cashflow issues, and nothing tests your motivation like that.

When our staff are dealing with Josh, they're asked to consider all these things. But, increasingly it's not just about our staff, it's about our software and analytics. We are moving to a place where our software starts to identify what is the best way that we can help each customer get things right. In our example, the decision to immediately offer Josh a deal on accounting software, was made on the basis of all the information available to us about Josh, including things like his previous use of technology when

interacting with Government, and the compliance rates of breweries that use software compared to those that do not.

Having considered Josh's capability, opportunity and motivation, there are a number of things we can do to help. These are the words around the outside that we will all be used to – we can look at how we **educate** Josh, how we **design** the system, how we **legislate**, and so on. But they are really just <u>how</u> we do things, they don't help us answer <u>what</u> we should do. Thinking through what we should do to help Josh is the large teal circle. What can we do to help Josh get things **right from the start**, rather than waiting for him to get things wrong? What can we do to **make it easy** for Josh to comply, and equally as important, difficult for him to get it wrong, accidentally or intentionally? What can we do to give Josh **certainty** of where his tax obligations currently stand? What can we do to influence the **norms** that surround Josh in the brewing industry? And what can we do to better understand Josh and **involve** him in getting things right?

Thinking through all that, backed up by data analytics continually testing whether what we are doing is <u>actually</u> working, might lead us to an approach for Josh similar to that outlined in our story. But, an entirely different approach might be needed for someone else.

One size doesn't fit all

One of the criticisms I hear about our new model is that it's all about trying to help people do the right thing, but what about those who have no intention of doing the right thing, is being customer-centred all about being nice to them as well?

That is a fundamental misunderstanding of what customer-centred means. We will <u>always</u> treat everyone with courtesy and respect. But considering someone's capability, opportunity and motivation to comply with their tax may lead to quite a different approach taken for two different people.

Let's consider Jack, who has just registered a cafe at the Companies Office. Our software quickly runs analytics in the background and finds that Jack has on four previous occasions been a Director of a cafe, each of which has gone under owing significant amounts of money to us, his suppliers and staff.

Rather than our software kicking off a series of web banners to Jack promoting trial software and online contact, it may well kick into action a call from one of our Compliance Officers to say 'Welcome back Jack, so good to see you again. How can we ensure that the same thing isn't going to happen this time?'

Then, rather than us waiting for something to go wrong before we start to gather information about the financial affairs of the company, perhaps our systems continually gather and assess the data we would normally use in an investigation, programmed to spot trends that indicate dubious activity or liquidity issues, and bringing those to the attention of the Compliance Officer immediately.

And if Jack starts to miss return or payment dates, while of course we want him to succeed, based on his history perhaps our objective becomes minimising the damage he may cause to suppliers, and we move more swiftly on pursuing debt, with a different range of penalties available to us.

Once again, this requires more than changes to our technology. The technology is crucial, as it enables us to change our processes, but in this short example we also need a new approach to data, new legislation, new skills and people. This is what a

transformation is about, not a new computer system, but a new way of thinking about each customer, and having all the components of the tax system flexible enough to be able to apply the best approach to each individual.

The road less travelled by

The scale of change required to create a new tax system in the future can be paralysing. We need to make sure it doesn't stop us from doing what we can today. In the past year we have done a lot to make things easier for small business owners. Our website has become mobile friendly. Our first live trial of customers filing returns directly from their accounting software is happening, and is due to roll out to all customers shortly. Customers are now receiving SMS reminders about impending payment dates, and can even complete tax number registrations via text messages, instead of having to phone us. When they register a company they can now apply for a tax number at the same time.

But the big improvements are still ahead of us, and require system wide changes.

There have been transformation projects in tax administrations all over the world in the past few years, many of them about technology change. As we were scoping out the nature of our transformation, we spoke with many tax administrations about their experience. Without exception they recognised the need for system-wide transformation, but had decided that the technology change was big enough to manage on its own, without trying to do everything else. There is some merit in that, but it is equally true that a transformation project that stops at technology will bring about only a small portion of the change that is needed. It <u>may</u> be wise to phase the implementation, but the thinking and planning for the entire transformation needs to be done at the outset. If not, the technology change may fail to deliver what is required for all the other changes. And the longer the gap between any phases of implementation, the greater the risk of the whole not delivering the sum of the parts.

Last month I was privileged to spend a little time with Joel Slemrod, sharing with him our plans. After considering what he had heard, Joel applauded our plan, stating that this may be the first time he has seen a transformation plan that is trying to holistically change the entire tax system.

While that commendation feels great, it also feels very daunting. As our Executive Team considered the two possible paths ahead of us – deliver the technology change first and then worry about the rest, or plan for the whole lot and deliver concurrently – we have indeed chosen the path less travelled.

But I am convinced that only in changing the whole system at once do we truly deliver for our citizens and government the tax system they want and deserve. And that, will make all the difference.