MAKING TAX SIMPLER

BETTER ADMINISTRATION OF SOCIAL POLICY

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The ninth in a series of government discussion documents working towards a better tax and social policy administration system for New Zealanders

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Making Tax Simpler — Better administration of social policy

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CHAPTER 1

OVERVIEW

INTRODUCTION

Inland Revenue is modernising its tax and social policy administration, which will reshape the way it works with customers, and improve policy and legislative settings. The Government's objective is for the revenue system to be as fair and efficient as possible. For Inland Revenue customers, the revenue system should be simple to comply with, making obligations and entitlements easy to get right and difficult to get wrong.

This discussion document explores some proposals for improving the way social policy entitlements and obligations are administered by Inland Revenue. These entitlement and obligation payments are:

- Working for Families Tax Credits;
- child support;
- student loan repayments; and
- KiwiSaver.

The focus here is not on changing the fundamental policy settings. Rather, this document focuses on improving the way those social policies are administered by Inland Revenue, taking advantage of the opportunity offered by the modernisation of Inland Revenue's systems.

Improving the administration of social policy payments will mean more customers will receive the right amount at the right time. It will bring Inland Revenue closer to giving customers confidence that payments they receive are full and correct and will not have to be repaid, therefore reducing the possibility of debt to Inland Revenue. Payments will be able to reflect and quickly respond to changes in customers' income.

This can be achieved through basing payments on recent actual income over shorter periods than the current annual assessment, and making more frequent and manageable payments during the year. Customers will find it easier and simpler to provide Inland Revenue with the information required to apply for, receive or make their payments, or to update their family circumstances.

Key definitions will be aligned and there will be greater flexibility for Inland Revenue to address unusual circumstances.

The changes proposed in this document, and covered in previous consultation documents, build on better information and administrative improvements to the way customers interact with Inland Revenue as a result of the modernisation of the revenue system. The changes will enable and encourage customers to manage their obligations and entitlements with speed and certainty using modern technology.

A GOVERNMENT PROGRAMME OF ADMINISTRATIVE IMPROVEMENT

Building on the 2015 Green Paper

A good social policy system can be thought of as having good policy supported by good administration. The starting point for the 2015 *Government Green Paper on tax administration* (the *Green Paper*) is that New Zealand has a good tax and social policy system. The opportunity before Government is to make it even better.

The *Green Paper* reflected on how the social policies administered by Inland Revenue had been incrementally changed over many years. Those policies were grafted into an existing tax administration system – a system which was primarily designed to support tax policy.

The *Green Paper* outlined some early high-level thoughts on how to improve Inland Revenue's administration of social policies, by designing policies and processes that would be customer-focused and "fit for purpose". Focusing on the customer is a key feature of the changes being made to Inland Revenue – making it easier for customers to get their obligations and entitlements right from the start, difficult to get wrong and making it easier to correct any errors or update any changes in circumstances.

Social policy payments should be calculated on a more responsive basis, provide more certainty for individuals and families, and result in less debt. There would be a shift towards using existing information to help customers get the right payment at the right time.

Information sharing and Better Public Services

The proposals are part of a wider public sector programme of change. Inland Revenue is also involved in information sharing and cross-agency work to improve public services, such as SmartStart.[1]

Information sharing has the potential to improve the information used to administer social policies in Inland Revenue and the administration of social policies by other Government agencies. Some of these proposals are covered in the *Proposals for modernising the Tax Administration Act* discussion document, and also in the consultation on the Approved Information Sharing Agreement between Inland Revenue and the Ministry of Social Development.

Inland Revenue works with other agencies to deliver social policy. In particular, it works with the Ministry of Social Development on the delivery of Working for Families Tax Credits to beneficiaries and applications for child support, and with StudyLink on the transfer of student loans.

[1] SmartStart is a website that provides step-by-step information and support to help parents access the right information and services for them and their baby. See more information at https://smartstart.services.govt.nz

These arrangements are expected to continue.

The social policy proposals follow on from previous consultation documents

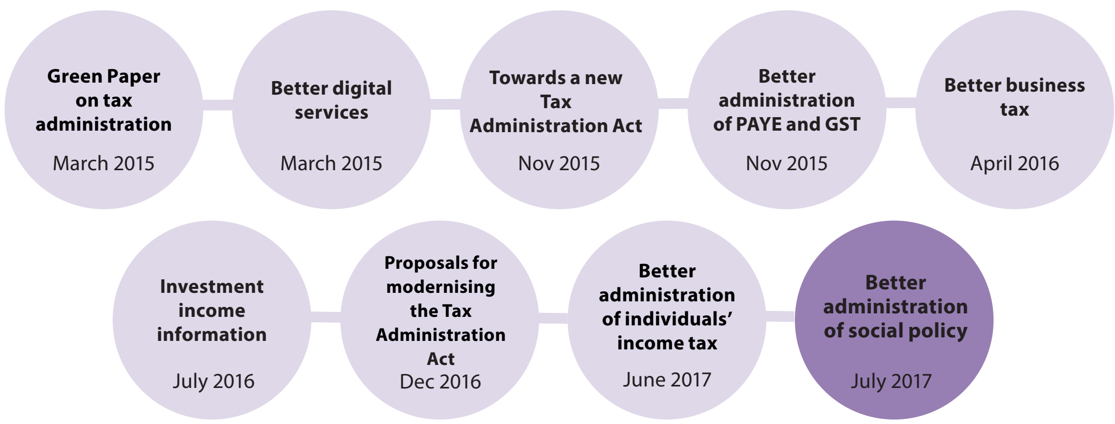
This document is the ninth in the *Making Tax Simpler* series, which began in March 2015. The *Green Paper* proposed that changes would be considered and introduced in sequential stages. The social policy proposals take into account earlier changes to digital technology, GST, PAYE, investment income, business tax and individuals' end-of-year tax obligations.

Ultimately, the *Making Tax Simpler* proposals seek to make it easier for customers to get their payments and entitlements right from the start. Although each previous consultation document focused on a particular area, those proposals will impact on the administration of social policy as well.

The *Better digital services* discussion document identified the major role of digital technology in making tax and social policy simpler for New Zealanders.

The PAYE system collects information and payments from employees' salary and wages for tax and social policy purposes, such as student loan deductions and child support payments. The *Better administration of PAYE and GST* discussion document explored possible changes to simplify the KiwiSaver enrolment process and how integrating the provision of PAYE information into the payroll process would reduce compliance and administrative costs. It proposed providing more frequent employment information, which could improve several processes, including calculating social policy payments. These proposals are included in a Bill currently before Parliament.[2] These changes will contribute to the proposals outlined in this document to shorten the period of assessment for social policies.

THE CONSULTATION TIME LINE FOR THE MAKING TAX SIMPLER SERIES



[2]Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill.

The *Better business tax* officials' issues paper discussed alternatives to current provisional tax methods. Subsequent legislative amendments include the new Accounting Income Method (AIM), which uses provisional information provided by businesses more frequently, resulting in provisional tax payments that better reflect the income patterns of businesses. AIM will be available from 1 April 2018. Information provided under AIM could also be used for improving the accuracy of social policy payments. The amendments also removed the 1% incremental late payment penalty on Working for Families Tax Credit debt.

The *Investment income information* discussion document explored providing more investment income information (in some cases more frequently) and also looked at how the quality of the information provided could be improved. These proposals are also included in a Bill currently before Parliament. Again, this information means the Government can consider shorter periods of assessment for social policies.

The discussion documents *Towards a new Tax Administration Act* and *Proposals for modernising the Tax Administration Act* examined some of the core concepts in the Tax Administration Act, focusing on the roles of the Commissioner, taxpayers, intermediaries and information. This included discussion and proposals about the collection of information, and better use of information sharing, including in the social policy context.

The *Better administration of individuals' income tax* discussion document set out proposals for Inland Revenue to monitor information it receives to help individuals to get their taxes right during the year, including updating information for customer accounts. It also considered proposals to better use existing and new information to make it easier for customers to interact, to update their tax codes promptly and address issues with secondary tax. A similar approach would also be used for social policy information.

The proposals in this discussion document provide the opportunity to:

- ensure customers receive their correct entitlements or fully meet their obligations by making the rules and processes easier to understand;
- provide greater certainty around payments;
- make payments more accurate and improve the access to and timing of payments; and
- improve agility while maintaining the coherence and integrity of the system.

A core principle underpinning these proposals is that people should not be entitled to any less government support than they are currently entitled to receive.

SUMMARY OF PROPOSALS

The Government is interested in your feedback on the proposals in this discussion document as summarised on the following pages.

Chapter 3: Making payments certain, accurate and timely

- Assessments would continue to be based on current family circumstances, such as residence, employment or benefit status, and care of children.
- If the customer's income is already known to Inland Revenue during the year (observable income), Working for Families Tax Credits or child support amounts would be based on recent actual income information provided throughout the year.
- If a customer's income is not known to Inland Revenue during the year or not confirmed during the year (non-observable income), Working for Families Tax Credits or child support amounts would be based on estimates of income or recent income information from previous years.

Working for Families Tax Credits

There are three options:

- *With observable income* – look at recent income over a fixed period and current family circumstances to determine the entitlement for the current period.
- *With observable income* – use income information as it is reported to Inland Revenue to calculate an annualised figure and adjust ongoing payments accordingly, with a reassessment whenever new income information is reported.
- *With non-observable income* – use information provided through the year to better estimate income and make instalment payments, with an end-of-year square-up to confirm actual income.

These options would be supported by an end-of-year check to ensure that families had not missed out on any of their annual entitlement owing to changing income.

Child support

There are four options:

- Retain the past income annual assessment but shift the start of the child support year so that it is after income tax obligations are completed. This would mean more recent annual income can be used to determine payments.
- *With observable income* – look at recent income over a shorter fixed period and current family circumstances to determine the entitlement for the current period.
- *With observable income* – use income information as it is provided to Inland Revenue to calculate an annualised figure and adjust ongoing payments accordingly, with a reassessment whenever new information is reported.
- *With non-observable income* – use information provided through the year to estimate income and make instalment payments, with an end-of-year square-up to confirm actual income.

Chapter 4: Better payment options

- Child support liable parents who have employment income would have compulsory deductions from salary and wages or schedular payments.

- Child support liable parents who do not have compulsory deductions would have to pay more frequently and earlier than currently.
- Child support obligations could be met through payments made directly to third parties that are of direct benefit to the child, subject to conditions.
- Child support payments could be available for receiving carers as soon as they are received (or deemed to be received) by Inland Revenue.
- Receiving carers would have options for how frequently they receive payments, including at the same time as they receive Working for Families Tax Credits.
- Student loan borrowers with adjusted net income such as schedular, casual agricultural or election-day income would be required to use the SL tax code to make student loan repayments.
- Student loan borrowers with other forms of adjusted net income would be required to make more regular payments throughout the year.

Chapter 5: Managing missed payments and overpayments better

- Overpayments and missed payments of Working for Families Tax Credits and student loans would be addressed promptly rather than waiting until a 7 February due date.
- A small balance write-off would apply consistently across the social policies.
- A range of options would be available for most customers to manage an overpayment or missed payment.
- Penalties and/or interest would not apply while overpayments or missed payments are being actively managed.
- Inland Revenue would be able to set a due date and impose penalties and/or interest when the debt is not being managed, there is fraud or the customer has a history of non-compliance.

Chapter 6: Aligning and updating key definitions

- Align the wording of key definitions when they relate to the same concept across different social policies.
- Align the rules for shared care of a dependent child at a minimum of 35 percent of ongoing care with reference to any care orders, and a default measure of number of nights in care for the period of the shared arrangement or what is most appropriate in the circumstances.
- Align the maximum age of a child to be at the end of the calendar year they turn 18.
- Change the definition of "financially independent" to refer to a set dollar amount rather than 30 hours of work a week, and ensure the benefit reference is to being on a benefit or receiving a full-rate student allowance.

- Align the minimum age of a financially independent child to 16 years.
- Align the residence definition, with a person no longer resident once they are out of the country for more than 183 days, unless specific exemptions apply.
- Require a dependent child to meet the "physically present in New Zealand" test to qualify for Working for Families Tax Credits, or meet one of the exemptions that deem a person to be New Zealand based.
- More closely align the definition of income used for child support to the definition used for Working for Families Tax Credits so that:
    - tax losses from past years are ignored; and
    - more types of income are included in the definition.
- Other minor changes to align the definitions of income across Working for Families Tax Credits and student loans, when appropriate.

Chapter 7: Customers with unusual circumstances

- Introduce general principle-based discretions for the different social policies administered by Inland Revenue.
- Develop guidance for Inland Revenue staff on when to apply discretions.

Appendix 1 sets out some background information on how assessments are determined for Working for Families Tax Credits and child support.

Appendix 2 shows a comparison of the different definitions of income.

INVITATION TO COMMENT

You are invited to make a submission on whether the proposed changes in this discussion document would improve the administration of social policy for customers and what impact you think they would have. Questions in Chapters 3 to 6 offer specific points for you to consider and comment on.

Following consideration of the submissions, the Government will refine the proposals and consider what changes to proceed with. It will also consider when it would be best to implement any changes. These proposals require amendments to legislation. At this stage the Government intends to introduce an amending bill in 2018. There will be further opportunity to comment on the legislative changes as part of the Parliamentary process.

HOW TO MAKE A SUBMISSION

You can make a submission:

- online at: *www.makingtaxsimpler.ird.govt.nz*
- by email to: *policy.webmaster@ird.govt.nz*, with "Better administration of social policy" in the subject line
- by post to:
  "Better administration of social policy"
  c/- Deputy Commissioner
  Policy and Strategy
  Inland Revenue
  PO Box 2198
  Wellington 6140

The online webpage includes options to complete a survey or post comments. The closing date for submissions is **15 September 2017**.

It would be helpful if longer submissions could include a brief summary of the main points and recommendations.

Official Information Act 1982

Submissions may be the subject of a request under the Official Information Act 1982, which may result in their release. Parts of submissions may also be summarised or quoted in official documents, which may also be subject to a request for public release. It is anticipated that a summary of submissions would be made public on the *Making Tax Simpler* website.

The withholding of particular submissions, or parts thereof, on the grounds of privacy, or commercial sensitivity, or for any other reason, will be determined in accordance with that Act. Authors making submissions who consider that there is any part of the submission that should be properly withheld under the Act should clearly indicate this.

CHAPTER 2

WHY THE NEED TO CHANGE?

INLAND REVENUE ADMINISTERS FIVE SOCIAL POLICIES

Inland Revenue's social policies	*Current spend and recipients*[3]
Student loans Joint responsibility for student loans with the Ministry of Education and the Ministry of Social Development (StudyLink). Collects repayments from student loan borrowers.	• $1.2 billion student loan repayments collected. • 730,000 total borrowers. • 105,000 borrowers with an overdue student loan debt.
Working for Families Tax Credits Administers Working for Families Tax Credits jointly with the Ministry of Social Development. Comprises five tax credits: • family tax credit; • in-work tax credit; • parental tax credit; • child tax credit (closed to new customers); and • minimum family tax credit.	• $2.4 billion Working for Families Tax Credits paid.
Kiwisaver Collects contributions and transfers them to KiwiSaver providers for investment. Pays the member tax credit.	• $5 billion KiwiSaver funds passed to KiwiSaver scheme providers. • 2.6 million people enrolled.

[3]The figures in this table have come from Inland Revenue's 2016 Annual Report.

Child support Collects child support payments from liable parents and distributes these payments to carers and the Crown.	• $474 million child support payments from 170,000 liable parents. • $280 million paid to carers, the balance was retained by the Government to offset against the cost of benefits paid.
Paid parental leave Makes payments (on behalf of the Ministry of Business, Innovation and Employment) to parents who take leave from their employment to care for a baby.	• $217 million paid parental leave distributed to parents. • 26,300 parents a year.

Working for Families Tax Credits assist families with children with the cost of living and help improve the returns from working. Child support helps ensure that parents are contributing to the cost of caring for their children. Student loans help with the cost of higher education, and for domestic borrowers is repaid according to their income. KiwiSaver helps customers to save for retirement. Further information on these social policies can be found on Inland Revenue's website.

Paid parental leave is not covered in this discussion document.

CHALLENGES WITH DELIVERING SOCIAL POLICIES WITHIN A TAX ADMINISTRATION

An effective social policy system requires both good policy and good administration. Without good administration, the policy will not achieve the outcomes that Government and customers want. The tax administration system has some advantages for delivering income-based social policies, such as strong links to income information and a wide customer base. It also has characteristics that mean it is not fully "fit for purpose". These characteristics include the annual April to March tax-year cycle, the extension of time for filing, and the focus on making the customer get their income details right, backed by strong penalty rules.

The outcome of a tax administration approach to social policy raises questions about the timeliness and accuracy of payments, including whether the approach is responsive to the changing needs of customers. Delays and the complexity of the rules can impact on customers' decisions to enter work or study, especially when savings are limited and income is tight. Uncertainty over the level and timing of payments, as well as whether they are correct, can affect the decisions customers make. For example, some families will choose to wait and only apply for tax credits at the end of the tax year to avoid the risk of being overpaid during the year and incurring debt.

Inland Revenue was assigned administration of the different social policies over several decades, with some transferred from other agencies and some specifically designed for Inland Revenue. The result is customers are now faced with different rules and processes for their various payments. It is complex and confusing, making it difficult for customers to understand their obligations or claim their correct entitlements. If customers do not know what the rules are, they are less likely to comply, more likely to get it wrong or give up trying.

The modernisation of Inland Revenue's systems provides an opportunity to take a fresh look at the administrative rules and processes for the social policies Inland Revenue administers. Better administration of the social policy payments will go some way towards making them less complex and easier to understand. The new systems are also intended to have better agility so any changes Governments make to the complexity of the policy settings can be implemented more efficiently.

FOUR OBJECTIVES GUIDING THE SOCIAL POLICY PROPOSALS

Four main objectives were used to guide improvements to the administration of social policy:

- *Focus on the customer* to ensure they get *correct entitlements* – take-up rates should be high and customers should receive all their entitlements available under the law when they are needed. This will help to ensure the policy objectives are achieved. Similarly, everyone should *fully meet payment obligations* for child support or student loans. Payments should be easy to get right and hard to get wrong. To do this the administration would need to be:
  - *easier to understand* – customers are more likely to take up entitlements and meet their obligations if they know what the rules are – if the rules are intuitive and fit in with the key events in their lives; and
  - *easier to access* – the level of customer effort should be low and information should be easy to update (especially changes in circumstances) and reused across different social policy payments.
- Provide *certainty and predictability* so customers can budget and make decisions about their future with less risk or stress. They will know what changes will mean for their future social policy payments. Ideally, when customers receive payments they should have confidence to spend the money and not worry that Inland Revenue will ask for any of it back.

- Provide for *timely and accurate payments* – payments need to adjust quickly to reflect changes in customers' lives, such as new relationships or moving into work. A process that responds quickly to deliver the right amount at the right time based on current circumstances is ideal.
- Provide for an *agile system* that can easily and quickly change to reflect the Government's policies and priorities or changes in customer expectations while maintaining *coherence* and *integrity*. This will build trust in the payments, the system as a whole and Inland Revenue's ability to deliver.

The challenge is that these objectives can sometimes conflict. For example, some people will prefer the certainty of constant payments even if the payments do not accurately reflect their current situation. Others will prefer more accurate payments that quickly adjust with changes in circumstances.

Please bear in mind these objectives and consider which objectives are more important to you when commenting on specific proposals. Also consider concerns about equity and fairness between customers, and efficiency and effectiveness for delivering the right outcomes.

In addition to meeting these objectives, it is a core principle of the proposals that people should not be entitled to any less government support than they are currently entitled to receive.

THE MAIN FOCUS OF THIS DISCUSSION DOCUMENT

The main focus of the proposals in this discussion document is on the family-based Working for Families Tax Credits and child support payments. However, some of the proposals can also be applied to the repayment of student loans for domestic borrowers who earn income other than salary and wages.

Following on from the *Green Paper* discussion document reflecting the four objectives, this discussion document looks at proposals to:

- improve the accuracy, certainty and timeliness of payments for Working for Families Tax Credits, child support and student loan repayments (in Chapters 3 and 4);
- prevent debt being incurred from customers missing payments to Inland Revenue or from being overpaid entitlements (in Chapters 4 and 5);
- align and update common definitions (in Chapter 6); and
- work with people who have unusual or exceptional circumstances differently to achieve better outcomes (in Chapter 7).

CHAPTER 3

MAKING PAYMENTS CERTAIN, ACCURATE AND TIMELY

This chapter discusses proposed changes to:

- Working for Families Tax Credits; and
- child support.

SUMMARY OF PROPOSALS IN THIS CHAPTER

- Assessments would continue to be based on current family circumstances, such as residence, employment or benefit status, and care of children.
- If a customer's income is already known to Inland Revenue during the year (observable income), Working for Families Tax Credits or child support amounts would be based on recent actual income information provided throughout the year.
- If a customer's income is not known to Inland Revenue during the year or not confirmed during the year (non-observable income), Working for Families Tax Credits or child support amounts would be based on estimates of income or past income information from previous years.

Working for Families Tax Credits

There are three options:

- *With observable income* – look at recent income over a fixed period and current family circumstances to determine the entitlement for the current period.
- *With observable income* – use income information as it is reported to Inland Revenue to calculate an annualised figure and adjust ongoing payments accordingly, with a reassessment whenever new income information is reported.
- *With non-observable income* – use information provided through the year to better estimate income and make instalment payments, with an end-of-year square-up to confirm actual income.

Child support

There are four options:

- Retain the past income annual assessment but shift the start of the child support year so that it is after income tax obligations are completed. This would mean more recent annual income can be used to determine payments.

QUESTIONS FOR READERS

3.1 Which is the **least** important to you of these three objectives?

- Certainty – what you get paid is correct.
- Timeliness – payments adjust quickly to changes in your income.
- Consistency – payments are constant over time and don't change from month to month.

3.2 Which is the **most** important to you of these three objectives?

- Certainty – what you get paid is correct.
- Timeliness – payments adjust quickly to changes in your income.
- Consistency – payments are constant over time and don't change from month to month.

- *With observable income* – look at recent income over a shorter fixed period and current family circumstances to determine the entitlement for the current period.
- *With observable income* – use income information as it is provided to Inland Revenue to calculate an annualised figure and adjust ongoing payments accordingly, with a reassessment whenever new information is reported.
- *With non-observable income* – use information provided through the year to estimate income and make instalment payments, with an end-of -year square-up to confirm actual income.

DETERMINING ENTITLEMENTS AND OBLIGATIONS

Generally, two elements are used to determine entitlements and obligations for income-targeted social policies. First, does the person or their family meet the entry criteria for the social policy? Second, how much income do they have? The first determines if they qualify for that social policy, while the second determines the amount of the obligation or entitlement.

The Government proposes several options for improving how Working for Families Tax Credits are administered. Each has an emphasis on different objectives of timeliness, accuracy and consistency. The Government is interested in which of these options customers most prefer and why.

Family or individual circumstances

Whether a person or their family meets the entry criteria for a social policy depends on their circumstances. For example, the family tax credit depends on the recipient having children in their care, and the in-work tax credit also requires that a single person works 20 hours or more a week and does not receive a main benefit.[4]

Payments are expected to continue to reflect current family or individual circumstances, such as whether the person is currently caring for a child or residing in New Zealand. This is important to ensure policy objectives are met. The onus will continue to be on the customer to keep Inland Revenue informed of any changes in their family or individual circumstances that affect their entitlements or obligations.

Amount of income

Most social policies administered by Inland Revenue use an annual income assessment – often using the same annual period as income tax (1 April to 31 March). This is modified in various ways to create weekly, fortnightly, monthly or annual payments but these are still based on an annual income assessment. This reflects that for tax purposes income is determined on an annual basis and social policy payments are administered within the tax system.

For Working for Families Tax Credits, customers look forward and estimate their annual family income for the tax year. Instalment payments are then based on those estimates. Alternatively, the family can wait until

[4]Main benefits include Jobseeker Support, Sole Parent Support and Supported Living Payment.

the end of the tax year, report income actually earned in that tax year and receive a lump sum payment.

Child support takes the approach of using past annual income information, from either the previous calendar year or two tax years back. However, if the customer has a significant drop in income, they can estimate their income for the remainder of the current child support year.[5] A square-up at the end of the year determines how close the estimate was to actual income. The square-up only applies to the part of the year the estimate was for.

Student loan domestic borrowers with wages or salary automatically repay their loans through deductions from their employment income, with repayments reflecting the length of their pay period. Borrowers with adjusted net income[6] make repayments at the end of the year and sometimes in the following year based on adjusted net income received in the past year.

OPPORTUNITY FOR A NEW APPROACH TO HOW INCOME IS ASSESSED

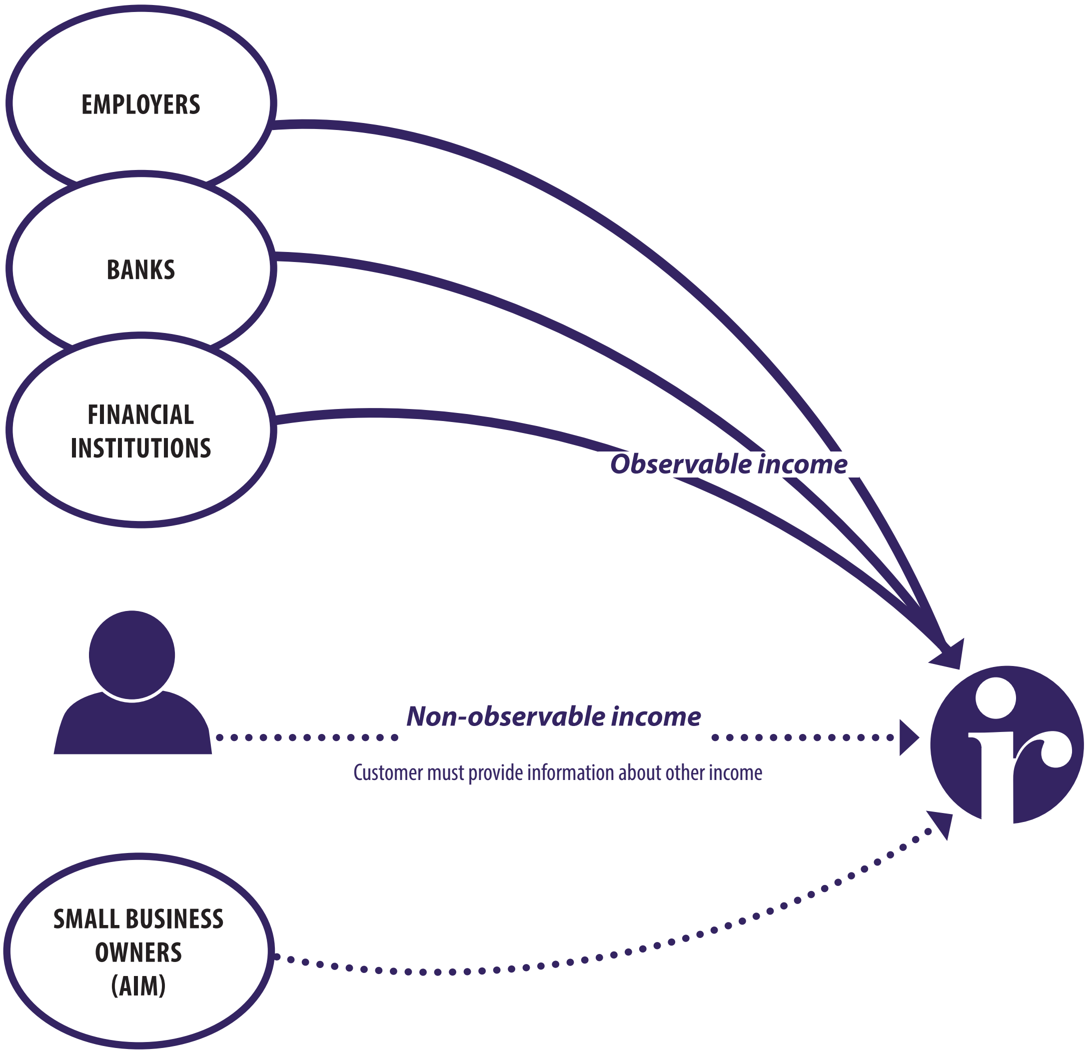
Observable income = *income information that is provided to Inland Revenue by a third party such as an employer during the year and includes child support payments made through Inland Revenue.*

Non-observable income = *income information that is not reported from a third party during the year and is provided directly by the customer.*

[5] The child support year is the same as a tax year – 1 April to 31 March.

[6] "Adjusted net income" is a defined term in the student loan legislation and covers a wide range of sources of income. It generally means income other than wages or salary.

OBSERVABLE VS NON-OBSERVABLE INCOME



From 1 April 2019, Inland Revenue expects to receive employment income information shortly after each payday. From 1 April 2020, financial institutions will provide information on interest earned and dividends paid every month. This means that Inland Revenue will know, and be able to observe, most of the income of most social policy customers from these sources as it is paid during the year.

If the customer's income is observable during the year, the Government proposes that Inland Revenue would be able to assess Working for Families Tax Credits or child support amounts based on recent actual income information provided throughout the year, as it does now for student loan repayments.

If the income is not observable (for example, overseas income or distributions of trust income), another approach is required. In some cases Inland Revenue and the customer will only know at the end of the year what their income is – for this group an annual assessment will have to remain. In other cases new information might allow for better estimates and payments during the year. The new Accounting Income Method (AIM) for calculating and paying provisional tax will give Inland Revenue a clearer picture of the income being earned by some small business owners during the tax year.

Having different assessments based on whether the income information is observable or non-observable is similar to proposals in the *Better administration of individuals' income tax* discussion document. That document proposes that income tax filing obligations be based on whether income has been reported during the year. The *Better administration of individuals' income tax* discussion document also discusses how Working for Families Tax Credits customers with only reportable types of income would no longer need to file end-of-year tax returns solely because they are social policy customers, as Inland Revenue would already hold all the required income information.

Working for Families Tax Credits

The proposals would apply to the family tax credit, the in-work tax credit and the parental tax credit but would not apply to the minimum family tax credit as it is calculated as a top-up payment rather than an abated credit.

The estimates approach means payments are almost always wrong

A summary of how Working for Families Tax Credits are currently determined is set out in *Appendix 1*.

Families that get paid Working for Families Tax Credits during the year are required to estimate their income for the year ahead and have a "square-up" of the estimate with their actual income at the end of the year. The result is often that families end up being overpaid and at risk of penalties and interest, or underpaid and not receiving the full support when it is needed. Some families prefer to avoid the risk of debt by seeking a lump sum payment only at the end of the year.

For the 2015 tax year, as at the beginning of June 2016, there were nearly 300,000 families who had a square-up.

Paid during the year by Inland Revenue	Total families (number)	Total families (%)
Exactly correct[7]	1,850	0.5%
Underpayment	152,382	41.7%
Overpayment	87,646	24.0%
Lump sum paid after the end of year	58,023	15.9%
No square-up[8]	65,307	17.9%
Total	365,208	100.0%

[7]Exactly correct in this context means the total Working for Families Tax Credits paid during the year were within $1 of the annual entitlement.

[8]The vast majority of those with no square-up were beneficiaries paid by the Ministry of Social Development and are assumed to be paid correctly. The rest have not yet filed for the 2015 tax year.

QUESTIONS FOR READERS

3.3 Do you like the approach where you don't have to tell Inland Revenue about changes in employment income or interest and dividends, with Inland Revenue adjusting payments automatically as information is received from employers, banks or companies?

3.4 For Working for Families Tax Credits, do you see value in moving away from estimating annual income with an end-of-year square-up and towards using recent actual income information?

When a customer has been overpaid Working for Families Tax Credits, they have until 7 February to repay the amount. If the amount is not repaid it becomes debt and is subject to the interest and penalty rules.

Of the families that were overpaid for the 2015 tax year:

- 46.1 percent fully repaid the overpayment before the due date;
- 53.9 percent did not repay the overpayment before the due date; and of these:
  - o 18.8 percent have now fully repaid the overpayment and any interest and penalties; and
  - o 35.1 percent remain in debt.

For a majority of those who are overpaid or underpaid during the year the difference between their annual entitlement and instalments is within 20 percent of their entitlement, so the estimate is relatively close, but for a third of customers the difference is greater than 20 percent.[9]

The annual period of assessment can also lead to inconsistencies. Customers who are on a main benefit are assessed monthly, whereas families who have similarly low incomes in a month, but are not receiving a main benefit, are assessed on an annual basis.

Improving the estimation of annual income

The extensive changes being made to modernise Inland Revenue's systems mean administrative improvements would be made to the current estimation of annual income (both observable and non-observable).

Customers will be encouraged to regularly update their circumstances, and non-observable income estimates, and Inland Revenue will use information it receives during the year to pro-actively encourage this. Some customers may be required to re-estimate their income quarterly – such as seasonal workers or part-year workers.

However, administrative improvements, supported by legislative changes,[10] will not address all issues with the annual assessment approach, in particular when an increase in income later in the year means earlier payments of Working for Families Tax Credits have to be repaid. Nor will it fully address the problems with over and underpayments that arise from using an estimate of income and the uncertainty this causes.

It is proposed that the option of a lump sum payment after the end of the year would still be available.

Using more recent income information and a fixed shorter assessment period

By using observable income information received during the year, the Government proposes an option that looks at recent past income information and uses this to calculate Working for Families Tax Credits. The entitlement would be based on a period shorter than a year. The length of the shorter period of time is a question the Government is interested in hearing views on and is discussed later in this chapter. The examples use four weeks or a month, but it could also be quarterly periods or a number of weeks to match pay periods.

Under this option, at the end of each

[9] See page 47 of the 2016 Annual Report for Inland Revenue.

[10] For example, schedule 31 of the Income Tax Act 2007, which automatically adjusts customers' income estimates upwards, would be removed.

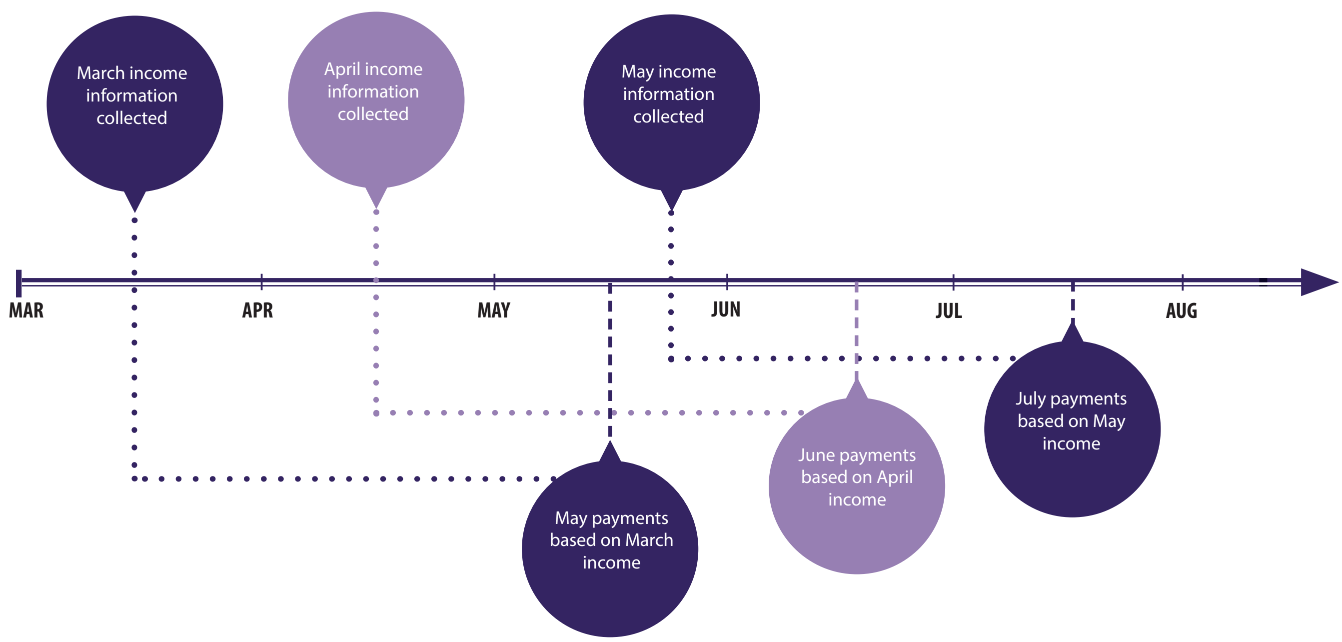
period the income details for that period would be checked and used to calculate tax credits to be paid in the next period. As it takes time for Inland Revenue to process it, the payment period will always lag slightly behind the income period.

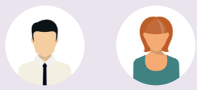
For example, the May entitlement could be based on income information received for March. This information would be received by Inland Revenue in April and used to calculate May entitlements.

This option reduces much of the inaccuracy that currently occurs from trying to estimate income.

There would be no requirement for customers to update annual income estimates during the year or undergo a square-up calculation at the end of the year. There would be no under or overpayments as a result of income changes as actual income is being used. Working for Families Tax Credits debt would be greatly reduced as a result. Families would know that whatever they receive they keep, as long as their family circumstances are correct.

DELAY BETWEEN INCOME CHANGE AND FLOW THROUGH TO ENTITLEMENT





MURRAY AND AMY

Murray and Amy have a four-year-old daughter Kate. Amy stays at home and looks after Kate while Murray works. Under the current annual system they estimate their family income will be $60,500 for the year. Their Working for Families payments are $60 each week ($3,120 over the year).

The nature of Murray's job means there are periods of high earnings and times when there is limited work available so it is difficult for them to estimate exactly.

At the end of the year their income is confirmed as $62,578 and their actual annual entitlement is calculated as $2,690.70. This means they have been overpaid by nearly $430. If they are unable to repay this by the due date they will be charged penalties and interest.

Under the shorter periods of assessment proposal, their Working for Families Tax Credits would be based on actual income received in a previous period, removing the need to estimate.

Working for Families Tax Credits payments

4 week periods	Employment income	Shorter periods	Annual period based on $60,500 estimate
1	$5,249	$109.03	$240
2	$5,937	$0.00	$240
3	$5,565	$37.93	$240
4	$5,080	$147.06	$240
5	$5,369	$82.03	$240
6	$7,446	$0.00	$240
7	$4,711	$230.08	$240
8	$1,000	$660.92	$240
9	$1,655	$660.92	$240
10	$3,836	$426.96	$240
11	$5,443	$65.38	$240
12	$5,577	$35.23	$240
13	$5,710	$5.31	$240
Total	**$62,578**	**$2,460.87**	**$3,120**
Entitlement based on actual income		**$2,460.87**	**$2,690.70**
Overpayment to be repaid		**$0**	**$ 429.30**

Note: Numbers are based on current Working for Families Tax Credits settings. These will change on 1 April 2018.

QUESTIONS FOR READERS

3.5 How important is it that payments react quickly to a change in income, compared to remaining mostly constant?

3.6 How quickly should payments change in response to income changes? What is the appropriate period to consider past income information? For example, daily, each pay period, four-weekly, monthly, quarterly, annually? Why do you prefer that period of time?

Under this approach, payments of Working for Families Tax Credits would automatically adjust during the year as income varies rather than staying mostly constant. This could impact on a family's ability to budget and plan ahead. Customers would be notified of each period's entitlement, and online calculators would help customers see the impact an income change has on payments.

Depending on how their income fluctuates during the year, a family would receive different amounts of entitlement at different times compared to the current annual assessment basis. The payments would more closely match variations in income, with more paid after low periods of income and less paid after high periods of income. There are two exceptions. First, if a family's income remains under the abatement threshold,[11] a change in income between periods would have no effect – they would continue to receive the maximum payment. Second, if a family's income remains above the point of full abatement, they would continue to receive no payment.

The impact is mainly for those who earn over the abatement threshold and below the point of full abatement – that is, they are entitled to an abated payment. Payments would more closely match their income in recent periods and there would not be the risk of over or underpayments. However, total payments over time would also potentially change due to the shorter assessment period.

For some families the entitlements they receive over 12 monthly periods or 13 four-weekly periods, compared to the current annual system, could be different – they could receive more or receive less. The difference would depend on a number of factors, including:

- the length of the period of assessment (a shorter period of assessment would create greater differences); and
- the amount of income they receive in a period compared to the abatement threshold and the point at which payments are fully abated.

If a family has income that is below the abatement threshold for some periods and income that is above the abatement threshold in other periods, they would receive less in 12 months compared to the current annual system. This is most likely to affect families whose income is near $36,350 (that is, the abatement threshold). It is proposed that these families would receive a catch-up payment to make sure they received their full annual entitlement based on their end-of-year income.

A family with income in some periods above the full abatement threshold and some periods below would receive more than under the current annual system.

A further example of the potential impact of this proposal is shown on the following pages.

[11]The annual abatement threshold as at 1 April 2017 is $36,350. An equivalent monthly abatement threshold would be around $3,030.

JACK AND ANN

Jack and Ann have a nine-year-old son Lynn. The family estimate at the start of the year that they will earn $51,500. The nature of Jack's job means the family's income fluctuates, and they try their best to update their income estimate. After a period of high earnings they increase their estimate in September to $57,500. In February after a period of low earnings they change their estimate again to $56,000. Under the shorter periods of assessment proposal, Jack and Ann would not need to tell us about these income changes.

At the end of the year they confirm their income is $55,959 and their actual annual entitlement is calculated at $4,179.98. This means even though they tried their best to estimate their income correctly they have been underpaid by $205.98.

Under the shorter periods of assessment proposal, Jack and Ann's Working for Families Tax Credits would automatically adjust as Jack's income changes. This better reflects the family's income and need at the time.

They no longer need to update their income during the year if it changes, and no longer need an end of year square-up.

While Jack and Ann would receive more under shorter periods than they would under the annual period, this additional amount would not need to be repaid.

Working for Families Tax Credits payments

4 week periods	Employment income	Shorter periods	Annual period based on estimates
1	$3,231	$563.08	$396
2	$3,923	$407.38	$396
3	$3,969	$397.03	$396
4	$6,492	$0.00	$396
5	$6,492	$0.00	$396
6	$4,615	$251.68	$227
7	$4,577	$260.23	$227
8	$4,538	$269.01	$227
9	$4,654	$242.91	$227
10	$4,692	$234.36	$227
11	$3,615	$476.68	$277
12	$2,546	$660.92	$316
13	$2,615	$660.62	$316
Total	**$55,959**	**$4,424.22**	**$3,974**
Entitlement based on actual income		**$4,424.22**	**$4,179.98**
End-of-year payment		**$0**	**$ 205.98**

Note: Numbers are based on current Working for Families Tax Credits settings. These will change on 1 April 2018.

Using past income to determine payments in a later period means a delay between income received and payments adjusting. Two scenarios are worth considering:

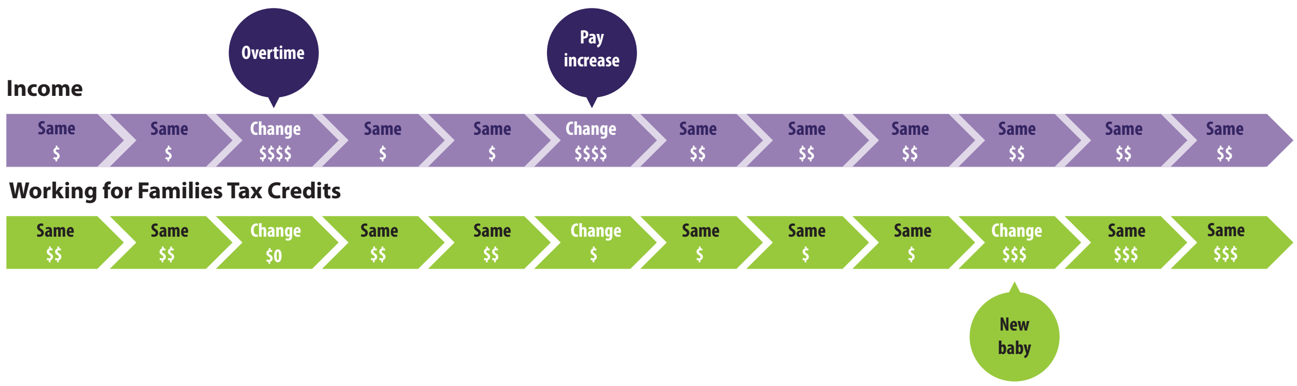
- If a family's income increases, their Working for Families Tax Credits would not decrease until the following payment period. There would be a period in-between in which the family would be earning a higher income without a reduction in tax credits.
- If a family's income decreases, their Working for Families Tax Credits would not increase until the following payment period. There would be a period in-between in which the family would be earning a lower family income without any increase in tax credits.

A problem with having a longer period of assessment (such as a quarter of the year), is that the delay between the time that income decreases and the time that Working for Families Tax Credits increase could raise cashflow issues for some families. A benefit of the proposal to have a shorter period of assessment is that this problem is much less of an issue. However, if having a longer period of assessment is ultimately preferred, consideration could be given to mitigating these cashflow issues by providing an option which would allow some payments to be brought foward as an advance.

Using recent income information with continuous reassessments as information is received

Another option for families with observable income would be to base assessments on the customer's most recent income information. As income changes during the year, the family's entitlement would adjust in response.

PROPOSED OPTION FOR OBSERVABLE INCOME: CONTINUOUS REASSESSMENTS



Materiality thresholds would be applied to prevent making changes for very small changes in income

JOANNE

Example of continuous reassessment

Joanne works 30 hours a week for $1,200 per fortnight. She gets $69.54 a fortnight in child support payments. Inland Revenue receives her income information shortly after each payday and, along with her child support received, calculates an equivalent annual family income of $33,094. Joanne is paid the maximum Working for Families payment of $328 a fortnight.

During a busy period at work Joanne agrees to work the next four Saturday shifts. As a result her next two fortnightly pays are $1,520. Inland Revenue receives this information and calculates an annual figure of $39,628. Her child support received hasn't changed (an annual amount of $1,808), making her equivalent annual family income $41,436. This changes how much Working for Families Tax Credits she will receive in the next two fortnightly pays – the payment will drop to $276 a fortnight.

When Joanne returns to normal shifts her pay goes back to $1,200 a fortnight. Inland Revenue receives this information and recalculates the equivalent annual income ($33,094). Fortnightly payments of Working for Families Tax Credits go back to $328.

The income information would be used to calculate a daily entitlement amount that would continue to be paid (weekly or fortnightly) until Inland Revenue receives the next income information and calculates an updated amount. Customers would be notified of the change in payment.

The advantage of this proposal is that income changes would be taken into account as soon as the information is reported to Inland Revenue.

How frequently payments change would depend on how often income information changes.

For some customers with regular income, or no changes in family circumstances, there may be only a few changes during the year. Also, if income remains below the abatement threshold, a change in income would not change the level of entitlement.

For others there may be several changes every month, reflecting a high degree of change in their income or family circumstances.

Not every change would trigger a reassessment. There would be thresholds applied to prevent changes to payments for very small changes in income.

As with the earlier option, the shift from an annual assessment to continuous reassessments would mean customers receive different amounts at different times.

QUESTION FOR READERS

3.7 If you have non-observable income, do you see benefit in an option that uses more information declared during the year to set interim payments? What would be the best period of assessment given there would be compliance costs from providing more frequent information?

When income is not observable

The options are more constrained when Inland Revenue is not receiving income information from a third party during the year. In this situation the Government proposes that either the current annual estimate would remain in place with improvements, or customers could provide additional income information throughout the year and have payments based on shorter periods.

There would continue to be an end-of-year square-up to check actual income for the year against information provided during the year.

Using declarations of non-observable income information to make assessments

When a customer has business income, they may be providing provisional information through the Accounting Income Method (AIM). This could be used by Inland Revenue to recalculate Working for Families Tax Credits entitlements for the next AIM period. The entitlements would be reassessed each time new information is provided through AIM.

Customers not using Accounting Income Method (AIM) could provide information on their business income for the previous two months, for example. This information would be used to recalculate their Working for Families Tax Credits entitlements for the next two months. Inland Revenue would reassess the entitlements each time new information is submitted.

OPTIONS FOR NON-OBSERVABLE INCOME

	Certainty	Regular payments	Compliance costs
End-of-year lump sum	High	No regular payments	Low
Annual income estimate	Low	Payments throughout the year	Medium
Regular income declarations	High	Payments throughout the year	High

QUESTION FOR READERS

3.8 For child support do you see value in moving to shorter, more recent periods of past income information?

Child support

As with the proposals for Working for Families Tax Credits, the Government has considered several options to improve the administration of child support.

It is proposed that an annual income assessment would be retained. In some cases Inland Revenue does not have the necessary information for some parents to use other options (for example, those parents living overseas).

Changing the child support year to use more timely income information

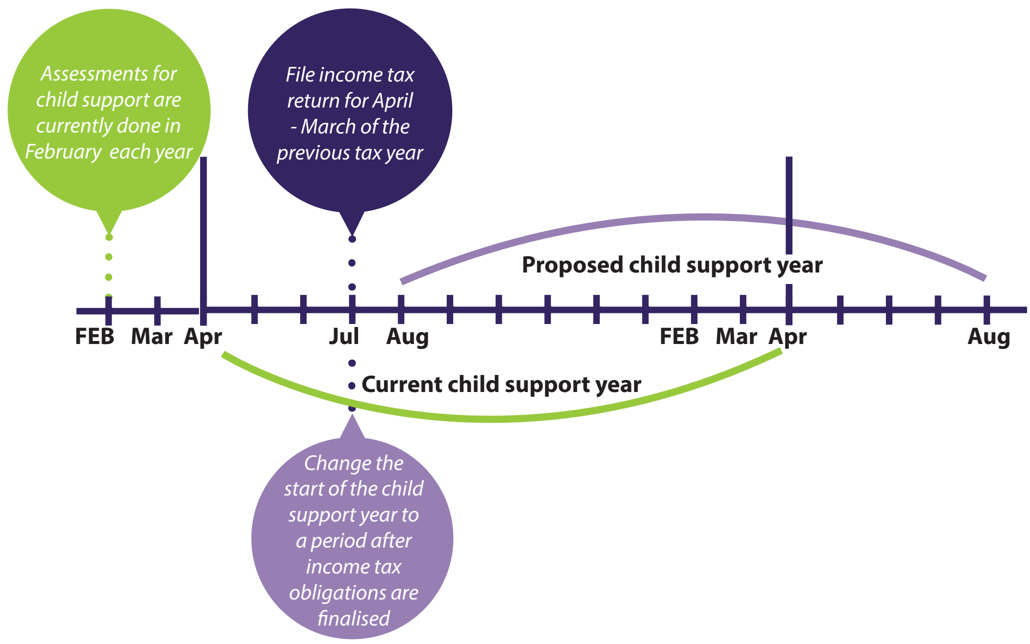
One option to improve the timeliness of income information for child support assessments, whether observable or non-observable, is to change the start of the child support year to a period after income tax obligations are finalised – for example, July. Child support assessments could then be made using income confirmed from the previous tax year (rather than the last calendar year or two years ago). All the customer's income, including interest income, would be used in the assessment as set out in Chapter 6.

This could improve the timeliness of the income information used but would not address the issues arising when income changes during the year or the difficulties with estimating current year income. To get full advantage of using confirmed income information shortly after the end of the tax year, the extension of time rules for filing through a tax agent would also need to be considered.

CHANGING THE CHILD SUPPORT YEAR TO A PERIOD AFTER INCOME TAX OBLIGATIONS ARE FINALISED

Currently if income is only from salary and wages or interest, the salary and wages from the previous calendar year are used as the annual income figure.

If other types of income are received the last filed tax return income is used – which can be income from two years prior to the current child support year.



Using observable income information with fixed shorter assessment periods

Another option is to keep using recent actual income information but to shorten the period to something more recent, such as the previous month. This is similar to the option to use shorter periods for Working for Families Tax Credits assessments. The income information used would be more current and more likely to reflect the liable parent's ability to pay and the level of support required by the receiving carer. For example, the May child support assessment could be based on the income information received in March.

Because child support requires the income of both parents to determine who is the liable parent and the amount of child support to be paid, both parents would ideally need to have the same period of assessment for their income.

Using past observable income information with continuous reassessments

Another option is to use past income information to determine the assessment but to reassess payments when either parent has a change in income. Reassessments would be made only when new income information (or changes in family circumstances) is reported, for example, from employers.

A materiality threshold would be required to ignore very small changes in income. In the earlier Working for Families Tax Credits example, Joanne's change in fortnightly pay would mean about 40 cents difference in fortnightly child support payments.

For changes that are over the materiality threshold, Inland Revenue would make the adjustments and notify customers of payment changes. Some customers could end up with many reassessments during the year as their or the other parent's income changes.

If a customer has business income and is providing provisional information about their income through AIM, Inland Revenue could use it to reassess child support obligations for the next AIM period. Those who are not using AIM could provide regular information about their business income for the previous one or two months, which Inland Revenue could use to reassess their entitlements for the next period. At the end of the year the actual annual income would be compared to the provisional information and any adjustments would be made.

If the customer is the liable parent and they provide information showing no income for a period, the minimum child support obligation would apply. At the end of the child support year, the actual income for the year would be compared to the provisional information reported during the year, and over or underpayments determined. This is broadly similar to the current estimations process but utilises better information about the way the parent earns income during the year. While the payments may be more timely under this option, they are less certain than the current system.

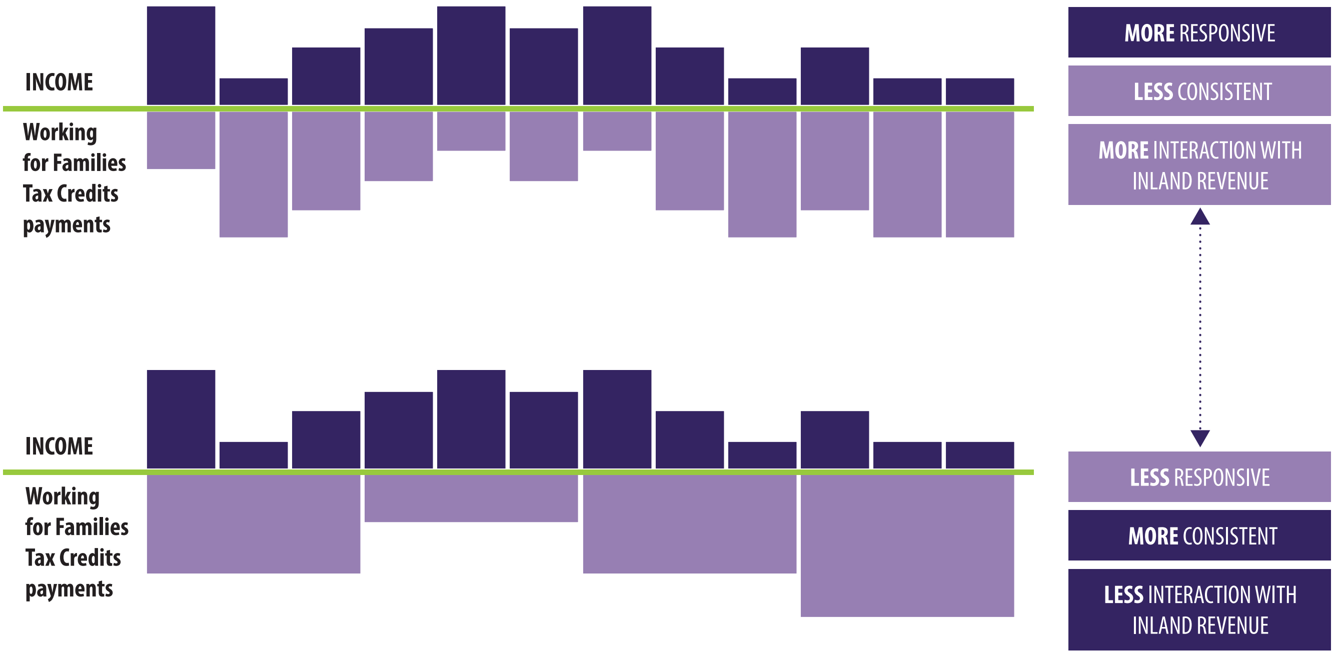
QUESTION FOR READERS
3.9 What factors should the Government take into account when setting the period?

Balancing timeliness and consistency in setting the period of assessment

One of the key features of the options outlined for both Working for Families Tax Credits and child support is the use of shorter periods of assessment such as monthly or daily (continuous). There is no perfect length of assessment period that suits everyone. Different groups of customers will have their own preferences and reasons for wanting payments measured over different periods of time. This comes down to trade-offs between different objectives, mostly the timeliness of payments (how quickly payments can change to reflect changes in income) and consistency (how long payments stay the same).

A longer period of assessment means:	***A shorter period of assessment means:***
variability in income is less relevant, as highs and lows in weekly income are offset against each other	variability in income is more relevant, as high and low income periods matter more to the level of payment
payments are less volatile, more consistent and reliable, making it easier to budget	there is more volatility in payments, so customers may not know what they will be paid, or be required to pay, in the future
payments are less responsive to changes in income, so it will take a while for payments to change after income changes	payments would respond faster to changes in income, so they more closely reflect current income, needs and ability to pay
customers who would be declaring their non-observable income for the period would have fewer interactions with Inland Revenue	customers with non-observable income would have to provide information to Inland Revenue more often

SHORTER VS LONGER PERIOD



In comparison, most main benefit payments are based on weekly income assessments, although some benefits are assessed on annual income. Paid parental leave is based on an average of weekly income over the previous 26 or 52 weeks (depending on how long the person has worked). For families whose only income is a main benefit, their Working for Families Tax Credits entitlement is assessed monthly rather than annually for the months they receive the benefit. This is explained further in *Appendix 1*. In the United Kingdom, the universal credit payment is based on monthly income assessments (as monthly pay periods are common).

Consideration will be given to payday cycles. Months or quarters will have different numbers of payday cycles, especially in leap years. This can create extra variability in income solely due to the number of weeks in each month or quarter. There would be less variability in income information and assessments if the period was four or eight weeks, for example.

The Government is interested in whether customers prefer shorter or longer periods of assessment and why.

NO CHANGE TO ANNUAL ASSESSMENT FOR STUDENT LOAN REPAYMENTS

For domestic borrowers with salary and wages, the current system of payday deductions would continue to apply. Repayments are deducted from wages and paid to Inland Revenue alongside PAYE. The amount of the deduction is calculated based on the income earned in that pay period.

There are no repayment changes if you are an overseas-based borrower and have no New Zealand employment income.

The remaining concern is how domestic borrowers with other sources of income (known as "adjusted net income") such as investment income and business income, can make loan payments during the year as their income is earned, rather than waiting until the end of the year.

It is proposed that the annual assessment for domestic borrowers with adjusted net income will be retained. However, the Government proposes to collect payments during the year as income is earned, to avoid the requirement for a large end-of-year lump sum payment. Chapter 4 discusses how the amount and frequency of these payments will be determined.

CHAPTER 4

BETTER PAYMENT OPTIONS

This chapter discusses proposed changes to:

- child support; and
- student loans for domestic borrowers with adjusted net income.

SUMMARY OF PROPOSALS IN THIS CHAPTER

- Child support liable parents who have employment income would have compulsory deductions from salary and wages or schedular payments.
- Child support liable parents who do not have compulsory deductions could have to pay more frequently and earlier than currently.
- Child support obligations could be met through payments made directly to third parties that are of direct benefit to the child, subject to conditions.
- Child support payments could be available for receiving carers as as soon as they are received (or deemed to be received) by Inland Revenue.
- Receiving carers would have options for how frequently they can receive payments, including at the same time as they receive Working for Families Tax Credits.
- Student loan borrowers with "adjusted net income" such as schedular, casual agricultural or election-day income would be required to use the SL tax code to make student loan repayments.
- Student loan borrowers with other forms of income to include as "adjusted net income" would be required to make more regular payments throughout the year.

CHANGES FOR CHILD SUPPORT PAYMENTS

Alongside the proposals for shorter periods of assessment, the Government proposes to change the dates when liable parents must pay and when payments are made to receiving carers. The objectives are to get payments from or to customers as quickly as possible and minimise the chances of incurring debts. The changes in technology and the provision of employment information more frequently offer an opportunity to improve the timing of payments.

Currently, the child support annual assessment is divided equally into monthly amounts. Each monthly obligation is due from liable parents by the 20th of the following month (for example, the June monthly amount is due by 20 July). If the customer is a beneficiary or has a compulsory or voluntary wage deduction in place, child support payments are made alongside PAYE deductions through the payroll system. This could be weekly, fortnightly or monthly, depending on their pay frequency. Payments through wages are already the most common way of paying. Currently, approximately 73 percent of New Zealand resident liable parents who receive only salary and wage income pay their child support current liability and/or debt by way of employer deductions at some stage during the year.[12]

Once the information provided by employers confirms a deduction has been made from the customer's pay, the child support amount is treated as being paid by the liable parent even if the employer has not yet passed the funds to Inland Revenue.[13]

If a liable parent is not a beneficiary or in debt, and therefore is not subject to a compulsory deduction, the liable parent is able to choose the means of payment that best suits them, as long as they pay by the 20th of the following month. If Inland Revenue receives the child support payment before the due date, the payment is deemed to be received on the day it is due.[14]

Once payment has been made by the liable parent, Inland Revenue generally passes that payment to the receiving carer on the 7th of the following month. So for the month of June the liable parent has until 20 July to pay to Inland Revenue and Inland Revenue has until 7 August to pass the money on. These dates are set out in legislation and took into account the due dates for employer monthly schedules and cheque clearance processes. They are no longer appropriate, and are inconsistent with how child support debt payments are received and paid out.

CURRENT PAYMENT PROCESS FOR CHILD SUPPORT

[12]Data from the tax year ending 31 March 2016. Approximately 63 percent of all domestic liable parents who earn salary and wage income and other types of income paid by employer deductions at some stage.

[13]If the employer fails to pass the money on it becomes an employer debt to Inland Revenue.

[14]Section 146(2) of the Child Support Act 1991.

QUESTIONS FOR READERS

4.1 Child support – Do you support compulsory child support wage deductions for all liable parents with employment income?

4.2 Child support – Are there any particularly significant compliance costs to have compulsory deductions of child support from customers who receive employment income subject to withholding taxes? What are these?

4.3 Child support – If there were to be exemptions from this proposal, what reasons do you think would justify not having compulsory wage deductions? Are there other ways to have compulsory deductions while protecting a person's privacy?

4.4 Child support – Should liable parents not subject to wage deductions be required to make child support payments more regularly? What would be an appropriate period of time?

Compulsory wage deductions for liable parents

Liable parent payment rates are particularly low when they first enter the child support scheme – only 24 percent make their first three payments on time. Once a liable parent is in debt, compulsory wage deductions can be applied, which significantly increases the number of payments made on time, reduces debt and ensures the carer receives payments.

The 2011 child support reforms proposed to introduce compulsory wage deductions on all domestic liable parents who were employees. This change was not implemented at the time, partly due to issues with making changes to Inland Revenue's computer system (FIRST).[15]

The Government proposes that child support deductions from employees' wages be compulsory for all domestic liable parents in the same way as PAYE and student loan deductions.[16] This process could be automated to apply a deduction when a customer enters the scheme or when they move into work. This would be helpful for liable parents first entering the scheme and result in them getting their payments right from the start and avoid going into debt. It would also ensure consistent treatment between beneficiaries and non-beneficiaries.

It is expected that Inland Revenue would notify liable parents of their payment obligation and would instruct the employer to deduct child support payments. The Government is interested in whether there would be any particularly significant compliance issues from this proposal and, if so, how they could be addressed.

When expanding compulsory deductions was previously considered there were concerns about privacy, and some submitters did not want their employers to know they were in the child support scheme. At that time, the Office of the Privacy Commissioner considered that, on balance, the public benefit of making compulsory deductions appeared to justify the privacy impacts on compliant individuals, but that additional operational safeguards would be needed to minimise impacts on privacy if this change was implemented. There are no exemptions currently for compulsory wage deductions for beneficiaries or those in debt.

The Government is interested in whether there are specific circumstances that would justify an employer not being notified and the liable parent being able to make payment through some other means than compulsory wage deductions. Alternatively, are there ways to have compulsory wage deductions made while protecting a person's privacy?

Payments from other income

For liable parents who do not have deductions from salary and wages, for example because they earn most of their income from investments such as shares or from business activities, the Government proposes to require earlier payments than currently.

The Government is interested in whether liable parents not subject to compulsory wage deductions should be required to make payments more

[15]FIRST is the heritage IT computer system being replaced by START as part of the modernisation of Inland Revenue's systems.

[16]Inland Revenue would continue to have the discretion not to apply a deduction if it was inappropriate to do so.

QUESTION FOR READERS

4.5 Child support – Would you use a provision to make child support payments directly to third parties providing goods or services that directly benefit your child? Of the criteria previously considered, are there any that you believe should be changed to make this option available to more customers?

regularly, for example fortnightly. If payments were more regular, what would a reasonable period be?

Recognising private payments

The 2011 child support reforms also agreed to allow private payments a liable parent made directly to third parties, such as boarding school fees, to be recognised as meeting part or all of their child support obligation. That is, instead of making a payment to Inland Revenue, the liable parent could pay someone who was providing goods or services for the direct benefit of the qualifying child.[17] There were several restrictions around this proposal, including that:

- parents and carers must agree in writing that the private payment meets or partially meets the child support obligation;
- the payment made is acceptable to Inland Revenue and of direct benefit to the qualifying child;
- the receiving carer is not receiving a main benefit;
- the liable parent or receiving carer does not have a child support debt;
- the care of the child is not shared between the parents; and
- the qualifying payment is at least 10 percent of the child support payable for the child.

The proposal was not implemented, partly due to issues with Inland Revenue's FIRST system, and recognition that the criteria would mean few parents would be likely to take up the option. The Government is interested in whether this option should be reintroduced and whether more child support parents would use this option if some of the criteria were changed. For example, should this option be available if the liable parent or receiving carer has child support debt? Some criteria will remain, especially the requirement for agreement between parents and carers and the requirement not to be receiving a main benefit. Further detail on the original option can be found in Chapter 9 of the discussion document *Supporting children* (September 2010) and in the *Child Support Amendment Bill* commentary (2011).[18]

Making payment to receiving carers as soon as funds are received and processed

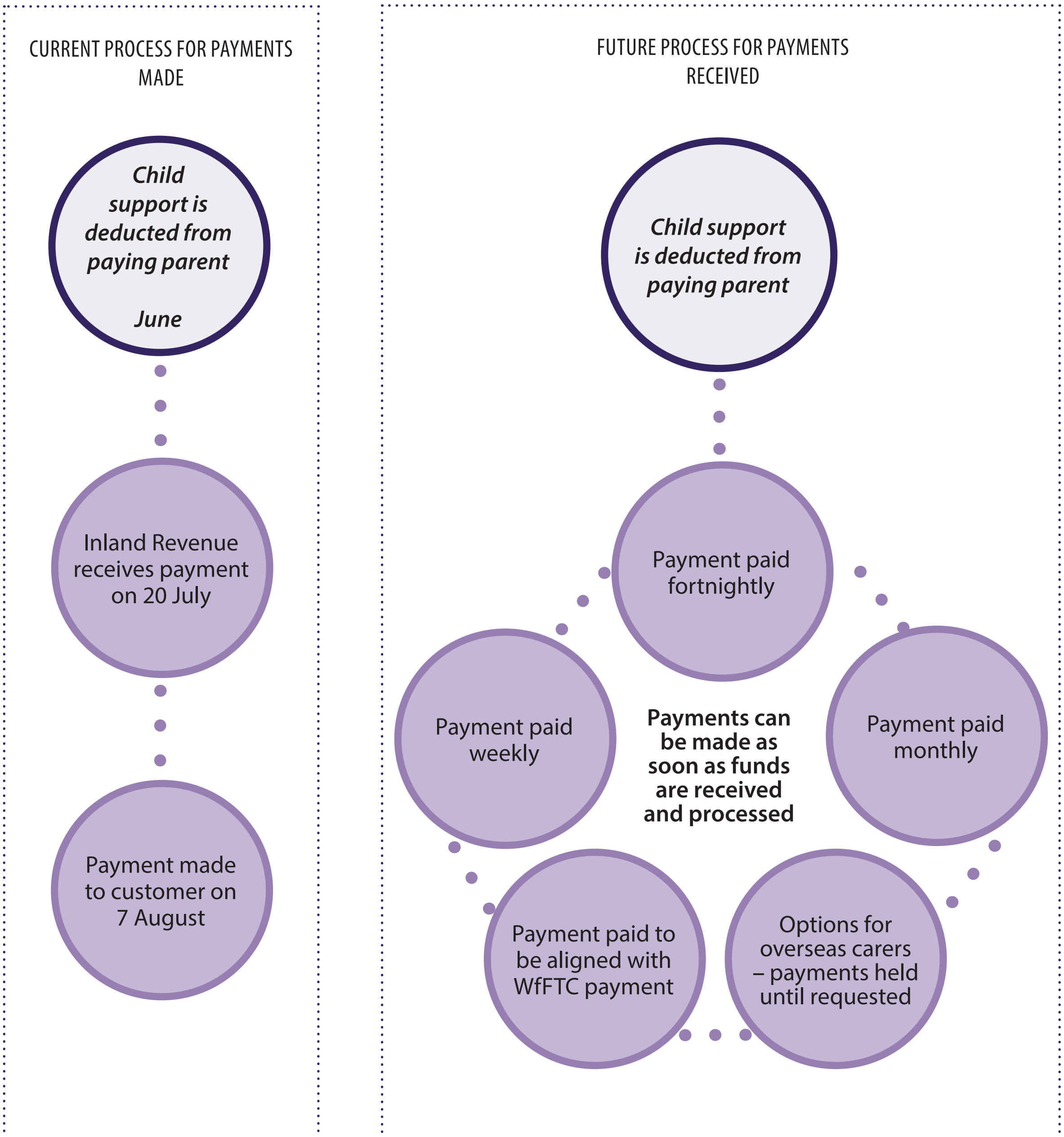
The Government proposes to clarify that Inland Revenue can make payments to receiving carers as soon as funds have been received and processed.

The Government is interested in whether receiving carers should be able to determine for themselves how frequently child support collected is paid to them. For example, some overseas receiving carers may prefer less frequent payments because they incur bank fees on international transfers or cheque deposits. Other receiving carers may want child support to be paid at the same time as their Working for Families Tax Credits.

[17] The Australian Child Support scheme has a similar "non-agency payments" option.

[18] *Supporting children – A Government discussion document on updating the child support scheme,* (September 2010), available at http://taxpolicy.ird.govt.nz/publications/2010-dd-supporting-children/overview
Child Support Amendment Bill – Commentary on the Bill (October 2011), available at http://taxpolicy.ird.govt.nz/publications/2011-commentary-child-support/overview

FREQUENCY OF CHILD SUPPORT PAYMENTS TO RECEIVING PARENT



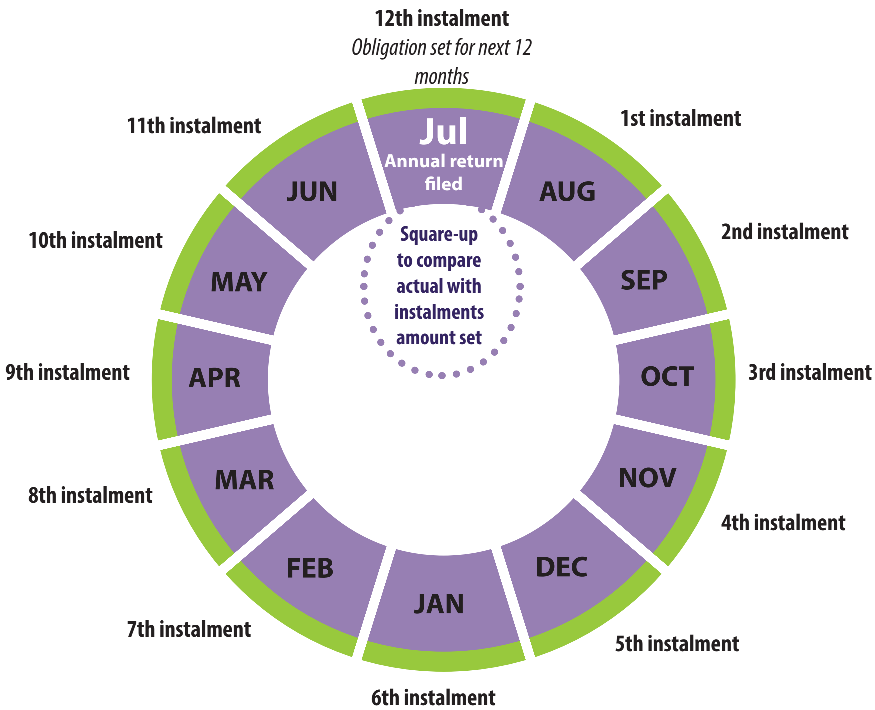
FREQUENT REPAYMENT OF STUDENT LOANS DURING THE YEAR

It is proposed that for domestic borrowers with salary and wages, the current system would continue, that is, New Zealand-based salary and wage earners have student loans repayments deducted from their income through their employers. The deductions are made at the same time and frequency as their PAYE and are treated as "full and final". That means for most there are no further payments to be made at the end of the tax year. For the year ending 31 March 2015, around 85 percent of student loan borrowers only had these wage deductions. Similarly, there would be no change to the repayment of student loans from overseas-based borrowers, which requires two instalment payments during the year, or to the situation of beneficiaries with student loans.

Currently, for domestic borrowers who earn other income ("adjusted net income"), at the end of the year their student loan assessment is based on the amount of that income for that year. Most borrowers have approximately 10 months to pay the obligation, otherwise late payment interest applies.

If domestic borrowers have an end-of-year assessment over $1,000, they are required to make additional repayments throughout the following year, similar to provisional tax, with payments required in three equal lump sums. Approximately 20 percent of student loan borrowers with adjusted net income are required to make these interim payments. To avoid the year-end bill and possibility of provisional payments, some borrowers make voluntary payments throughout the year.

SET STUDENT LOAN OBLIGATION ON PAST YEAR'S INFORMATION



QUESTIONS FOR READERS

4.6 Student loans – Should student loan borrowers who earn schedular, casual agricultural and election-day income be required to have student loan repayments deducted from this income?

4.7 Student loans – How often should student loan extra repayments be made through the year to reflect adjusted net income received by a domestic student loan borrower? Would extra deductions from wages and salary make it easier for borrowers? What would be the impact on compliance costs?

The Government is seeking to improve the timeliness of student loan payments for domestic borrowers with adjusted net income. The following proposals would replace the current provisional payment rules. The frequency of the payments will depend on the type of adjusted net income the borrower earns.

Payments could be through extra deductions from salary and wages or other schedular income, or regular direct payments could be required. Most borrowers who have adjusted net income also have income from wages or schedular income. In the year ended 31 March 2015, 49 percent of borrowers who had an adjusted net income assessment also earned wages or salary, and 39 percent earned schedular income subject to withholding taxes.

Deductions from schedular, casual agricultural and election-day income

For adjusted net income that is similar to wages and salary, such as schedular, casual agricultural or election-day income, the Government proposes student loan repayments be deducted from these types of income.[19] As with other salary and wage earners, 12 percent would be deducted from income above the repayment threshold each payday. This proposed change will mean the vast majority of domestic borrowers will have regular student loan deductions from employment income.

At the end of the year there would be an assessment of the adjusted net income to determine whether the payments made during the year mean additional payments are still required or a refund is due.

Setting the repayment obligation using income information received during the year

For domestic borrowers with other sources of income such as investment income and business income, the Government proposes they would also make loan repayments during the year as their income is earned. The amount and frequency of payments during the year will be based on the income information provided.

For borrowers using the Accounting Income Method (AIM), the amount of the repayment could be based on the provisional information provided through AIM on their provisional income earned for the one or two month period.

Borrowers who have adjusted net income and are not using AIM could declare the amount of adjusted net income they consider they have received in the previous two months and make loan repayments accordingly. Alternatively Inland Revenue could use the borrower's previous year's assessment of adjusted net income to estimate their income for the year and calculate loan repayments with smaller repayments, being required more frequently.

At the end of the year there would be an assessment of that year's adjusted net income to determine if there is an amount to pay or refund. Any additional obligation the borrower has after this assessment would be collected through additional regular payments in the following year. If the borrower had paid more than required, the overpayment could be offset against the loan or offered as a refund.

[19] 80 percent of borrowers who had schedular income claimed no schedular expenses against their income, so their gross and net income was the same, and they were in the same position as salary and wage earners. They would be required to use an SL tax code in conjunction with their WT, CAE or EDW tax codes.

These proposals would reduce the end-of-year obligations for borrowers and reduce the likelihood of missed payments and late payment interest being charged.

The Government is interested in how often these extra repayments should be made during the year, if they are not made through extra wage deductions.

CHAPTER 5

MANAGING MISSED PAYMENTS AND OVERPAYMENTS BETTER

This chapter discusses proposed changes to:

- Working for Families Tax Credits;
- child support; and
- student loans for domestic borrowers.

SUMMARY OF PROPOSALS IN THIS CHAPTER

- Overpayments and missed payments of Working for Families Tax Credits and student loans would be addressed promptly rather than waiting until a 7 February due date.
- A small balance write-off would apply consistently across the social policies.
- A range of options would be available for most customers to manage an overpayment or missed payment.
- Penalties and/or interest would not apply while overpayments or missed payments are being actively managed.
- Inland Revenue would be able to set a due date and impose penalties and/or interest when the debt is not being managed, there is fraud, or the customer has a history of non-compliance.

INTERVENING EARLIER WHEN THE RISK OF DEBT ARISES

The proposals in Chapters 3 and 4 to improve accuracy, shorten the period of assessment and change the timing of payments should significantly reduce the risk of debt arising. When debt does arise, the proposals should identify any overpayment or missed payment earlier and taking action at that time should reduce its size. This chapter looks at further proposals to better manage social policy debt.

Debt can arise in three different ways:

- An obligation to pay is missed – such as a liable parent missing the due date for a payment.
- There is an overpayment of an entitlement for Working for Families Tax Credits or to a receiving carer for child support.
- Too little is deducted from income to cover a payment obligation, for example, student loan repayments.

If a customer does not fully repay an overpayment or pay an obligation by a required date, penalties and/or interest may apply. Each of the social policies Inland Revenue administers has different rules around due dates and the application and rate of penalties and/or interest. For Working for Families Tax Credits and student loan customers the due date is usually 7 February, which is at least 10 months after the obligation arose and at a time when there is often pressure to pay other bills. Child support obligations are currently due 20 days after the end of each month, with penalties applying but no interest.

The current approach does not always distinguish between those struggling to do the right thing and those who are deliberately non-compliant. It waits until the debt is due, and uses penalties and/or interest to encourage payment. This works for some customers but for others it can mean the debt grows faster than their ability to repay. If customers are aware, they can contact Inland Revenue to make repayment arrangements, which could mean some penalties are written off or are not imposed, or they can apply for hardship relief. This can result in inconsistent treatment based on customers' knowledge of the rules.

Inland Revenue has several ways to collect debt and has been moving to intervene earlier to reduce levels of debt. However, the legislation generally takes the approach of first imposing penalties and writing them off later.

The Government proposes to build further on the early intervention approach to help customers get things right from the start. This means intervening earlier when the risk of debt arises for Working for Families Tax Credits and student loans, and to change the approach to child support debt to help make payments manageable.

The proposals build on successes from the 2012 changes to student loan repayments which almost eliminated missed payment debt from salary and wage income for student loan borrowers. Changes to the penalty rules for income tax and Working for Families Tax Credits came into effect from 1 April 2017. This removes the 1% monthly incremental late payment penalty for unpaid debt. Use-of-money interest and initial late payment penalties still apply.

The main proposal in this chapter is for Inland Revenue to have a range of tools to help customers manage any overpayment or missed payment. Most customers want to pay their debt and will actively seek out how to do so. Alternatives would be available for those who are not able to self-manage or not willing to meet their obligations. Hardship provisions will continue to be available to those who qualify.

Ignoring small amounts

When family circumstances change there can be an understandable delay in telling Inland Revenue. This delay could result in an overpayment of Working for Families Tax Credits. If the overpayment is small, it could cost Inland Revenue more in time and resources to collect than the value of the amount. For this reason legislation often has thresholds under which debts are not collected.

QUESTIONS FOR READERS

5.1 Do you think there should be a consistent threshold or separate thresholds for different social policies to ignore small balance amounts?

5.2 Should there be different thresholds for ignoring small amounts of income for different social policies? Or should all income be reported but payments only paid/collected as a result, if the payment exceeds a specified threshold?

5.3 What factors should be considered when setting either income thresholds or payment thresholds?

5.4 Do you agree that any overpayment or missed payment should be self-managed by the person who owes the amount, if at all possible?

In the *Better administration of individuals' income tax* discussion document, the Government is consulting on the personal tax thresholds, including the $20 threshold when tax debt need not be paid, and the $200 income threshold for having to file. There are several small balance thresholds across the different social policies – all setting thresholds at different levels. For example, there is a $20 annual small balance write-off for Working for Families Tax Credits, student loans and overseas child support liable parents.[20] For domestic liable parents there is an under $1 small balance write-off. In terms of income being disregarded there is:

- a $1,500 threshold for additional other income for student loans purposes;
- a $500 threshold for changes in taxable income for child support; and
- a $5,000 threshold for other types of family scheme income for Working for Families Tax Credits.

The Government proposes to apply the under $20 annual small balance write-off consistently for all Working for Families Tax Credits, child support and student loan customers. The Government will continue to review the rules for under $1 assessments and rounding of amounts. When the small debt is owed to a receiving carer or liable parent from the receiving carer, the Government would make the payment and write-off the debt.[21] Integrity measures would be put in place to stop customers abusing this provision.

Currently, amounts less than $5 that have been collected but not paid to a receiving carer need not be paid until the cumulative balance exceeds $5.[22] This would be removed to reflect the negligible cost in making refunds electronically, in line with the proposals around personal tax refunds in the *Better administration of individuals' income tax* discussion document.

The Government is interested in whether people think separate thresholds should continue to apply when small amounts of income are required to be reported. Or should all income be reported but any resulting payments would only be paid or collected when the amount exceeds a specified threshold? What factors should be considered when setting either income reporting thresholds or payment thresholds? It is expected that customers would be able to report income changes and family circumstance changes more easily through online accounts.

Customers managing the payment themselves

Earlier feedback has indicated it is important that social policy customers have some say and control over how their debt is managed. The Government proposes that most social policy customers with an overpayment or missed payment would be able to select a preferred repayment method and the frequency of repayment such as in full or spread over several weeks. As the missed payments or overpayments would be managed more quickly than under the current system, no penalties or interest would apply while the amount is being self-managed.

[20] In some cases Inland Revenue is able to refrain from assessing small amounts.

[21] This currently can happen when a receiving carer owes a liable parent but not the other way around.

[22] Section 146(3) of the Child Support Act 1991.

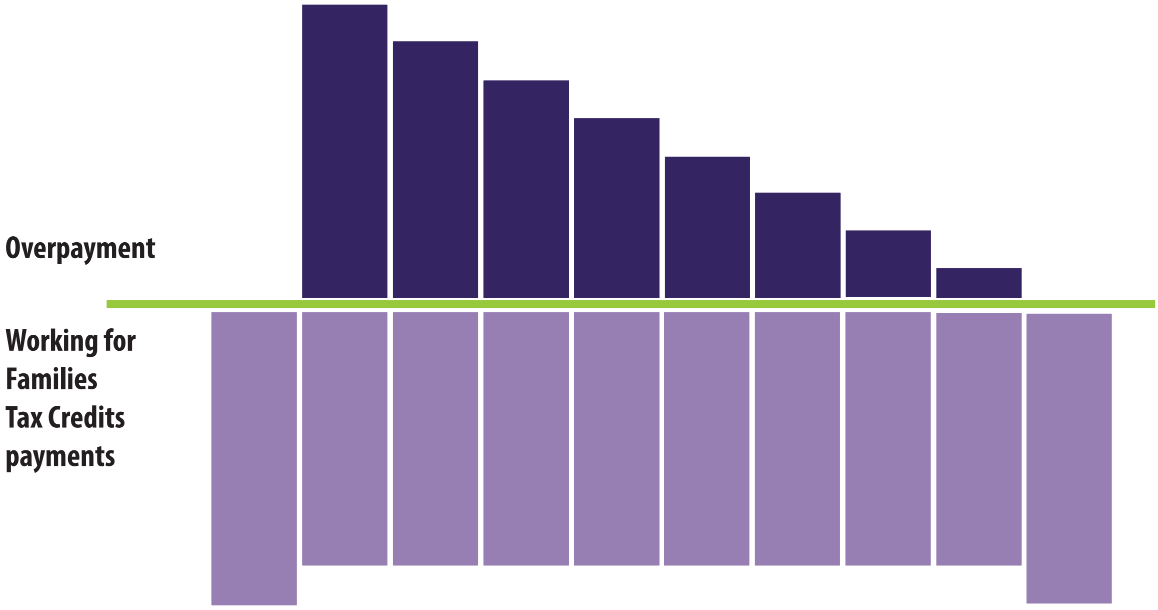
Rather than waiting until 7 February after the tax year, any Working for Families Tax Credits overpayment or missed student loan payment would be identified much earlier, at the end of the shorter period or the tax year, and required to be managed then. The customer would be required to choose a repayment option and if they do not self-manage the repayment, Inland Revenue would choose a repayment method for them.

Recovery through future entitlement payments

One option, whether the debt is managed by the customer or Inland Revenue, is to recover any debt from future entitlement payments. Currently, Inland Revenue pays Working for Families Tax Credits to families who have a Working for Families Tax Credits debt. This option would enable some of the ongoing payments to repay the debt. This option is currently used for child support receiving carers who have an overpayment debt. Again, no penalties and/or interest would apply while this option is in place.

With shorter periods of assessment there might be times when a customer has no current entitlement but expects to have a future entitlement, for example, they will soon be returning to full-time work or a child will be returning to their care. Debt repayment from future entitlements would be an option for some customers, although this would be closely monitored.

WORKING FOR FAMILIES TAX CREDITS - RECOVERY THROUGH FUTURE PAYMENTS



Recovery through wages and bank accounts

When there is no ongoing entitlement from which to make a repayment, another option for customers and Inland Revenue is to have payments deducted from wages or from bank accounts. This option is currently used for student loans, Working for Families Tax Credits and child support debt, and is also used for child support ongoing obligations.

Most customers have some salary or wage income subject to PAYE deductions, and payroll systems are already required to make various deductions. If the customer has no employment income (including no main benefit payments), deductions can be made direct from the customer's bank account.

Inland Revenue would discuss with the customer the most appropriate method of payment and set the amount and frequency of the deductions. The objective is to ensure payments are regular and manageable.

Again, no penalties or interest would be charged while this recovery option is in place.

Imposing a due date, penalties and interest

While these options will suit most customers, there will always be a requirement for stricter debt collection actions. Inland Revenue would retain the ability to notify a customer that an amount is due in full. After a given date, penalties and/or interest would be applied to the balance. The date would reflect the compliance history of the customer and the circumstances of the debt.

Existing tools for addressing serious non-compliance would also be retained, such as information matching and the ability to make arrests at the border.

CHAPTER 6

ALIGNING AND UPDATING KEY DEFINITIONS

This chapter discusses proposed changes to:

- Working for Families Tax Credits;
- child support;
- KiwiSaver; and
- student loans.

SUMMARY OF PROPOSALS IN THIS CHAPTER

- Align the wording of key definitions when they relate to the same concept across different social policies.
- Align the rules for shared care of a dependent child at a minimum of 35 percent of ongoing care with reference to any care orders, and a default measure of number of nights in care for the period of the shared arrangement or what is most appropriate in the circumstances.
- Align the maximum age of a child to be at the end of the calendar year they turn 18.
- Change the definition of "financially independent" to refer to a set dollar amount rather than 30 hours of work a week and ensure the benefit reference is to being on a benefit or receiving a full-rate student allowance.
- Align the minimum age of a financially independent child to 16 years.
- Align the residence definition, with a person no longer resident once they are out of the country for more than 183 days, unless specific exemptions apply.
- Require a dependent child to meet the "physically present in New Zealand" test to qualify for Working for Families Tax Credits, or meet one of the exemptions that deem a person to be New Zealand-based.
- More closely align the definition of income used for child support with the definition used for Working for Families Tax Credits so that:
    - o tax losses brought forward from past years are ignored; and
    - o more types of income are included in the definition.
- Make minor wording changes to align the definitions of income across Working for Families Tax Credits and student loans, when appropriate.

INCONSISTENT DEFINITIONS MAKE THE PAYMENTS HARDER TO UNDERSTAND

Common definitions, such as "resident" or "carer" are used across the different social policy payments that Inland Revenue administers. Sometimes the same term is used and it means the same thing. In other cases the same term is used but the meaning is different, and occasionally different terms are used when referring to the same thing. This can cause confusion and increase the chance of something going wrong.

Some definitions also seem overly complicated or out of date. Feedback on the *Green Paper* has indicated that customers struggle to comply with the rules when they don't understand what they mean or they don't fit naturally with what is going on in their lives.

Some common definitions have been reviewed to see if they can be simplified, updated and aligned to make the whole system easier to understand and use.

The general approach is to align definitions when they refer to the same thing. It is only when there is a significant reason to justify a difference that definitions would not be aligned. An example would be the definitions of "principal caregiver" in Working for Families Tax Credits and "primary carer" in the Parental Leave and Employment Act, as the paid parental leave definition is intended to cover a much wider group of carers, including pregnant women.

FAMILY CIRCUMSTANCES DEFINITIONS

Dependent or qualifying child

Shared care of child

Both child support and Working for Families Tax Credits can be paid when the care of a child is shared between carers, as long as a minimum amount of care is provided. What that minimum amount is and how it is measured differs between the two schemes. So it is possible that a person could be receiving payments for having shared care of a child for Working for Families Tax Credits but not for child support.

A person must provide at least 35 percent of ongoing care of the child to receive child support payments. The proportion of ongoing care is measured primarily by the number of nights in care, although daytime care can also be considered. Inland Revenue can also rely on what is set out in care orders and agreements.

The Working for Families Tax Credits requirement is for a person to have 33.3 percent of care over either a four-month period or a tax year to be a principal caregiver and therefore entitled to receive payments of tax credits.[23] The legislation does not set out how the percentage of time is measured – Inland Revenue currently measures how many hours of care a parent has (both day and night).

The Government proposes to align the way shared care is determined. The child support shared care legislation was amended in 2013 and shared care was given specific attention

[23] There is a specific rule for parental tax credit given it is paid out over 10 weeks only.

QUESTION FOR READERS

6.1 For the maximum age of a child, should the requirement that they be in school be retained or removed?

in Parliament. The Government proposes that the Working for Families Tax Credits rules be aligned to the existing child support rules for determining shared care by changing the Working for Families Tax Credits principal caregiver eligibility rules. This would mean a minimum level of 35 percent of ongoing care.

The basis of measuring ongoing care would also be aligned. Inland Revenue would be able to rely on care orders and use nights of care. However, in some cases these may not be appropriate, and Inland Revenue would be given discretion to use the most appropriate measure for the circumstances.

The Working for Families Tax Credits four-month/tax year rule for determining shared care would also be replaced by a rule that determines the percentage based on the period of time that the shared care arrangement applies.[24]

This technically could result in some customers qualifying for Working for Families Tax Credits for very short periods. However, the definition of "principal caregiver" excludes carers when care is provided on a temporary basis.

Maximum age of child

The United Nations Convention on the Rights of the Child defines a child as someone under 18 years-old. Legislation for Working for Families Tax Credits and child support generally supports this maximum age but has provisions that allow the maximum age of a child to be extended when the 18 year-old is still in school.

The criteria are slightly different in that the Working for Families Tax Credits extension applies to the end of the calendar year in which the child in school or tertiary education turns 18. For child support the education extension ends when the child in school turns 19. In both definitions the child must still be attending an educational institution. The Government proposes to remove the educational requirement and to end the extension at the end of the calendar year the child turns 18. This would have an impact on child support parents and carers with a child aged 18 who turns 19 after the end of the calendar year and is continuing in school.

The Government is interested in views about whether the requirement to be in education should be retained or dropped – that is, the age is extended to the end of the calendar year the child turns 18 regardless of whether they are in school, as long as they remain financially dependent on the carer. Dropping the schooling requirement would simplify the administration of the scheme.

Financially independent child

As part of the definition of "dependent child", there is a definition of "financially independent". A child is considered financially independent if they are:

- working 30 hours or more a week, or working in what is considered full-time work under an employment contract; or
- receiving a main benefit from Work and Income or a student allowance.

[24] For example, if there was an agreement for care to be shared over an eight-month period, the percentage of care for each carer would be measured over that eight months rather than a four-month period or tax year.

QUESTIONS FOR READERS

6.2 What is the minimum amount of money for a child to be considered financially independent for Working for Families Tax Credits and child support purposes? What factors should be considered when determining the amount? Should the amount be regularly updated?

6.3 Do you agree that a child receiving a reduced level of student allowance due to parental support should continue to be a dependent child?

This definition is used in both Working for Families Tax Credits and child support.[25]

A problem with referring to hours is that the amount of money a person can receive while working 30 hours can vary. This can lead to situations when a teenager working 30 hours at $15.75 an hour ($472.50 a week) is considered financially independent while another working 20 hours at $30 per hour ($600 per week) is treated as not financially independent.

Another issue is that employers do not automatically tell Inland Revenue the number of hours each employee works, so financial independence based on work hours is self-declared or manually checked with employers. Additionally, a parent may not know each week how many hours the child is working, especially if the child is paid a fixed amount rather than an hourly rate.

The Government proposes to replace the current hours criteria with a dollar amount. This would be easier to understand and administer, and would address the current inequity with an hours definition. The preference at this stage is an amount equivalent to 30 hours a week at the minimum wage. As with the current hours rule, there would continue to be a requirement for the period of time the income is above the threshold to be "more than temporary". For example, children who earn income above the threshold only in one week in school holidays are not treated as financially independent. Submissions are invited on what is an appropriate dollar amount for a child to be considered financially independent and the period of time for a job to be more than temporary.

The other criterion refers to receiving a main benefit or a student allowance. A concern with the current wording is that it does not distinguish between a person who receives a full rate of payment and one who receives a reduced rate because of ongoing assistance from their parents. Specifically, the student allowance can be reduced as a result of a parental income test.

Feedback is sought on whether the criteria of receiving a main benefit or a student allowance should be retained, including when a child is receiving a reduced student allowance as a result of a parental income test.

Minimum age of financially independent child

The Child Support Act has no minimum age when considering whether a child is financially independent – in theory if a one-year-old was financially independent, under the formula assessment no child support would be payable. For Working for Families Tax Credits and main benefits, a child has to be at least 16 years old before the financially independent test applies. This minimum age makes sense when the financially independent test is based on full-time work and receipt of a main benefit – as children under 16 are required to be in full-time schooling and cannot apply for a main benefit.

Even if the financially independent test is changed to a dollar amount the main sources of income for most customers are work or benefit. It

[25] It is also used in the Social Security Act and a similar concept (independent circumstances) is used for student allowances.

would be rare for younger children to have significant amounts of income in their own name from interest and dividends or part-time employment.

The Government proposes that the minimum age at which the financial independence test is applied be 16 years for child support as well.

Resident and residency

While governments negotiate double tax agreements to determine the country that has the right to impose and collect tax, there tend not to be similar agreements for social payments and loans.

The definition of resident is different between the various social policy payments. It generally refers to the tax definition of residence (which includes a permanent place of abode test) or common law concepts of ordinarily resident. For KiwiSaver, member tax credits are paid to help improve the adequacy of members' retirement income. They are paid to members who have "mainly" resided in New Zealand in the year the tax credit relates to. This can make it difficult for customers to know when they no longer qualify for a member tax credit.

The distinction between being resident and not resident is important. For example, Working for Families Tax Credits are intended to be paid for children in New Zealand, student loan borrowers are not charged interest when they are based in New Zealand, and KiwiSaver member tax credits are paid to members who reside mainly in New Zealand.

For student loans, a person is treated as being New Zealand based if they have been living in New Zealand for 183 or more consecutive days, or have approval to be treated as New Zealand based while overseas. This means they are no longer New Zealand based once they have been outside of New Zealand for 184 consecutive days unless an exemption applies. The rule is clear and easy to understand, and the Government does not intend to change this definition.

The Government proposes introducing this "day count" for KiwiSaver, child support and Working for Families Tax Credits. The proposal for 183 days presence in New Zealand will be a "bright line" test that customers can easily understand and measure. The period would be sufficient to cover most short-term overseas holidays or travel.

Similarly, the Government proposes to include some of the student loan "deemed New Zealand based" tests in other definitions. These treat some borrowers overseas as if they were still in New Zealand and covers people such as New Zealand diplomats. The requirement that people in New Zealand are lawfully present will also be retained and applied consistently. Working for Families Tax Credits and KiwiSaver will also retain their own additional requirements. For example, Working for Families Tax Credits require a person to be a permanent resident, so those on work or study visas are not eligible.

In addition, each of the social policy payments has additional criteria, such as requiring permanent residency for a period of time or a physical presence in the country. These other criteria would remain.

QUESTIONS FOR READERS

6.4 Is a 183 day count a suitable period of time for determining eligibility to social policy payments administered by Inland Revenue? In what situations should a person overseas for a longer period still be deemed to be New Zealand resident?

6.5 Should Inland Revenue have the ability to cease child support assessments when all parents, carers and children reside overseas?

6.6 Should a dependent child have to meet the permanent resident test before Working for Families Tax Credits are paid, or is it sufficient that the principal caregiver is a permanent resident and the child is physically present in New Zealand?

Child support

The child support residency requirements are wider and refer to New Zealand citizens as well as residents. This means New Zealanders who permanently reside overseas can still use the New Zealand child support system if required. The Government is not proposing to change these rules.

However, if all parents and children reside overseas there is very limited ability for Inland Revenue to administer any request to collect child support. The Government is considering whether a discretion should be introduced to allow the Commissioner to suspend the child support assessment in such cases.

Some parents who are not New Zealand citizens are still part of the child support scheme as they are ordinarily resident in New Zealand. The ordinarily resident test is met if they have a permanent place of abode in New Zealand or they meet a "day count" test. The test is 183 days in New Zealand to be eligible and 325 days out of New Zealand to lose resident status. The definition of resident for these parents who are not citizens would be aligned to the "day count" approach.

Working for Families Tax Credits: child or caregiver is resident

To qualify for Working for Families Tax Credits either the principal caregiver or the child must be resident. There is no requirement for them both to be resident. It seems unusual for New Zealand to pay a child-based tax credit for a child who is not resident or physically present in New Zealand. The Government proposes to change the residency requirements for Working for Families Tax Credits so that the qualifying child must meet the "physically present in New Zealand" test or one of the exemptions that deem a person to be New Zealand based.

The Government is interested in views on whether the child should also have to meet the New Zealand permanent residence test or whether it is sufficient for either the child or the caregiver to be a New Zealand permanent resident. In particular, Inland Revenue is aware of situations when a caregiver is a citizen or a permanent resident and they have the ongoing care of a child present in New Zealand who is not yet a permanent resident.

Other definitions

The Government is also looking at making minor changes to the following definitions:

- *Principal caregiver/carer* – the Working for Families Tax Credits and child support definitions are slightly different and would be aligned.
- *Dependent child/qualifying child* – both definitions refer to the same child in Working for Families Tax Credits and child support, so it is intended to use the same term.
- *Main benefits/income-tested benefits* – some parts of Inland Revenue legislation have not been updated to reflect changes in terminology for main benefits.

DEFINITION OF INCOME

The definition of "income" has a big impact on the amount of support or extent of liability for payments. Determining what is included as income for income-tested payments is a significant policy decision. The current approach for social policy is to use a common definition of income, such as the Income Tax Act definition of "net income", and to make adjustments to include or exclude other specific types of income as appropriate. This takes advantage of information received through the tax system and recognises that not everyone receives or need worry about all types of income.

This discussion document is not reviewing what makes up the breadth of the definition of income. Instead, the focus is on where the income definitions across the social policy payments differ and whether those differences are due to policy decisions or because the definitions were developed at separate times in different environments.

Child support income definition

Most of the income definitions are already similar as a result of legislative changes since 2011. The definition now in place for Working for Families Tax Credits and student loan repayments is consistent with the definition used for main benefit payments, and almost identical to the definitions for community services cards and the parental income tests for student allowances. The exception is the income definition used for child support formula assessments. Child support is based on taxable income only, and other sources of income are only considered if they are recognised through an administrative review.

For most Inland Revenue customers the income used for their social policies is very simple. They only earn salary and wages (including a main benefit or ACC), interest or dividends. It is effectively the same income used for tax purposes. The only difference is whether tax losses from previous years are included. They are for calculating taxable income but are generally excluded or ignored for social policy. Again, most customers do not have tax losses so there is no difference in effect.

Ignoring past tax losses brought forward for child support

Currently, the definition of income used in the child support scheme uses the "taxable income" definition and therefore includes tax losses carried forward from previous years. In contrast, Working for Families Tax Credits and student loan repayments use "net income" as the base, which excludes tax losses carried forward. One of the objectives of child support is that the level of financial support parents provide for their children in that year is determined according to their relative capacity to do this. It would be at odds with that objective to reduce one parent's relative capacity to support a child in that year due to tax losses that occurred in an earlier year. This suggests that tax losses from previous years should not be used to reduce the amount of child support payable in the current child support year.

QUESTION FOR READERS

6.7 Do you agree that the child support income definition should be extended to more closely align with the definition for Working for Families Tax Credits and student loans? Are there any components of the definition of income that you consider should not be aligned and why?

The Government proposes to align the base of the social policy income definitions to refer to net income, which means changing the child support definition to exclude tax losses carried forward from previous years. Fewer than 600 child support parents had tax losses in the 2015 tax year.

Other adjustments to child support income definition

During the 2013 child support reforms it was agreed to widen the definition of income for child support to include most of the other adjustments used in the Working for Families Tax Credits and student loan definitions of income.[26] However, this was not implemented, partly due to issues with Inland Revenue's FIRST system.

For the group of customers who have other types of income, and who claim Working for Families Tax Credits or repay student loans, alignment with other social policy payments delivered by Inland Revenue would simplify processes and obligations as income would need only be reported once for all social policies.

The modernisation of Inland Revenue's systems provides the opportunity to reintroduce the wider definition of income for child support. The Government proposes to do this to better align with the definition used for Working for Families Tax Credits, as originally legislated in the Child Support Amendment Act 2013 and subsequently repealed.

In re-introducing the wider definition of income for child support, the Working for Families Tax Credits deduction allowed for maintenance payments (including, child support) in the definition of income would be excluded to avoid circularity in calculations. The child support formula already takes into account any other child support obligations when determining liabilities.

Other technical changes to align income definitions

The Government has identified other minor areas where the definitions are not aligned or when wording changes would improve clarity and reduce misunderstanding. These are set out on the following page.

[26] *Supporting children - A summary of feedback on the discussion document* (July 2011), available at http://taxpolicy.ird.govt.nz/publications/2011-other-supporting-children-feedback-summary/overview

Social policy payment	*Changes to definitions*
Working for Families Tax Credits	Currently the definition of income includes a general "catch-all" provision. Under this provision non-beneficiary income distributed from a trust (when a person is not the settlor) is included as income. The Government is considering introducing a specific legislative provision covering such income. Such a provision would clarify the current definition and align the Working for Families Tax Credits legislation with the current student loan income definition.
Student loans	For the undistributed income from close companies adjustment, the Government is proposing to align the voting interest percentage with the percentage used for Working for Families Tax Credits income. This will include an associated persons test to prevent opportunities to structure shareholdings in close companies to reduce student loan repayment obligations. For the specific retirement savings contributions adjustment the Government is proposing to align the adjustment with the other social policy payments. This brings in a previously approved policy which was not implemented at the time. There would also be alignment for depreciation loss allowed on the sale of a building.

A list of the various components of the definition of income is included in *Appendix 2*.

Some differences in the definitions would still remain after these changes – there are good policy reasons for these differences that reflect the underlying purpose of the product or the nature of the group being tested. For example, some definitions apply to individual income only, such as student loan repayments, and others to family income.

CHAPTER 7

CUSTOMERS WITH UNUSUAL CIRCUMSTANCES

This chapter discusses proposed changes that would apply across:

- Working for Families Tax Credits;
- child support;
- student loans; and
- KiwiSaver.

SUMMARY OF PROPOSALS IN THIS CHAPTER

- Introduce general principle-based discretions for the different social policies administered by Inland Revenue.
- Develop guidance for Inland Revenue staff on when to apply discretions.

DESIGNING PROCESSES FOR THE MAJORITY OF CUSTOMERS

Families and individuals face numerous situations which impact on their ability to pay or receive the various social policy payments. To try to legislate for all these possibilities would result in lengthy and complex legislation which would not aid customers' understanding of the rules. Instead it would more likely risk misinterpretation. Even then new situations could arise that had not been catered for.

Inland Revenue is aware of cases when a very small number of customers are in situations not covered by the law, or the law applies a process that results in the policy objectives not being achieved in their situation (even though it works appropriately for everyone else).

If a simple legislative amendment is possible this will always be the preferred approach. However, it may not always be possible and, even when it is possible, the time needed to pass legislation means some customers may face significant financial difficulties in the interim.[27] Currently, legislation provides very specific and focused authority for Inland Revenue to determine how specific processes should apply to an individual. These are generally referred to as discretions and are relatively common in child support.

The Government proposes to provide Inland Revenue with additional authority to work with customers who have unusual circumstances in order to achieve the intended policy outcome for the specific social policies. Legislative discretion, as part of understandable and accessible legislation that covers the vast

[27] Or the specific unusual case may no longer exist by the time legislation is passed and implemented.

QUESTIONS FOR READERS

7.1 Do you support the proposal for more principle-based general discretions for the specific social policies with guidance for Inland Revenue staff on how it is to be applied?

7.2 What do you think are the key principles that should govern how Inland Revenue applies the discretion?

majority of customers and situations, is considered to be the most effective mechanism for ensuring policy outcomes for these customers and the Crown.

WHETHER TO HAVE SPECIFIC OR GENERAL DISCRETIONS IN LAW

There are two approaches that could be used: specific discretions targeting specific issues or general discretions that apply more broadly. Most current discretions are specific and have been introduced in response to particular issues. However, as they are narrow in application they can exclude customers in similar situations.

Rather than developing very specific discretions in an adhoc fashion over time as issues arise, the Government proposes to set in place more principle-based general discretions for the specific social policies Inland Revenue administers. For example, there could be discretion that allows the Commissioner to determine in-work status for Working for Families Tax Credits that would allow for very unusual working arrangements to be recognised for customers who would otherwise be ineligible. There would be guidance for Inland Revenue staff on when and how discretionary authority should be used.

It is important to note that discretions would not be used as a permanent solution to patch up incomplete policy – the first and best preference is to improve the policy settings and the legislation when a simple solution exists.

Discretions would be used when it is determined:

- there is no other existing remedy that would cater for the unusual circumstance;
- the circumstance is at odds with the basic assumptions in the law; and
- the policy outcome is not being achieved.

UNUSUAL CIRCUMSTANCES DIFFICULT TO LEGISLATE IN ADVANCE

Legislation and policy inherently rely on some basic assumptions that do not hold for a small number of people. They are also based on what lawmakers currently understand and anticipate will happen. History shows how difficult it is to anticipate changes in technology or society.

The types of assumptions inherent in social policy legislation administered by Inland Revenue are:

- all children have legal guardians or parents;
- individuals subject to the law are within New Zealand's range of authority to administer the law;
- individuals can be uniquely identified, found and contacted;
- people are not constrained from complying with the law, for example, because of natural disasters or acts of war;
- people will actively participate;
- if people do the right thing, they will get the right outcome; and
- people have full capacity to "act", for example, they are capable of

making payments and filling in forms.

Parliament has provided Inland Revenue with some broad discretion as part of the recent child support reforms. As an example, the child support legislation assumes that a qualifying child has two parents and that they are not living together. Legislation is written on that basis. However, there are cases when the child is cared for by a "non-parent caregiver" and the parents are still living together, or there is only one parent of the child to make a child support formula assessment against. In these situations the legislation gives authority to Inland Revenue to modify the application of the law to fit the actual facts of the case so the correct policy outcome is achieved.[28]

Unusual circumstances can be thought of as situations that:

- have not been considered or foreseen by lawmakers;
- are not considered significant enough to specifically legislate for; or
- are inconsistent with the assumptions inherent in the legislation.

Other aspects that would indicate that unusual circumstances exist are:

- small numbers affected (potentially only one person) – if a significant number of people are affected the better solution would be to legislate;
- infrequent – situations would be rare, as it is not efficient to set up processes that might never be used again; and
- incorrect outcomes – following the law gets to an outcome that is inconsistent with the policy intent, usually due to an unforeseen combination of factors and the complexities of the person's life.

PRINCIPLES THAT WOULD GOVERN APPLICATION OF DISCRETION

In applying a discretion to an unusual circumstance Inland Revenue would need to consider in the context of the circumstance:

- **equity** – given the unique facts of the case, whether substantive justice has been achieved in a way that maintains equity between customers;
- **fairness** – whether the outcome is what would be expected considering everything that has an effect on the situation; and
- **reasonableness** – whether it is rational and acceptable to the average person facing that situation.

Inland Revenue would also need to take into account the rights and interests of all affected or potentially affected parties, any risks to the integrity of the law, the impact on customer compliance, the degree to which the policy objectives are not being met and the resources available to address the issue.

In general, it is expected that the use of a discretion would be applied to the customer's benefit and that it would not be used to remove or reduce a social policy entitlement or to impose or increase a social policy obligation. However, as child support is basically

[28] Section 7B of the Child Support Act 1991.

QUESTION FOR READERS

7.3 Should more use be made of regulations to set out criteria that Inland Revenue must consider?

money going from one person to another it would not be possible to require the use of a discretion for child support to benefit all affected customers. In these situations the discretion would look at what is necessary to achieve the right policy outcome in that unusual situation. The child support legislation already includes provisions for affected parties to challenge the outcome of a discretion by formally objecting.

The approach here complements the discussion in Chapter 6 of *Proposals for modernising the Tax Administration Act* discussion document on the role of the Commissioner and the proposal to allow more administrative flexibility in limited circumstances, for example, cases when the relevant legislation does not adequately deal with a particular situation owing to the complexity of the legislation.

Making greater use of regulations

The *Proposals for modernising the Tax Administration Act* discussion document also discussed a potential greater use of regulation in tax administration. The Social Security Legislation Rewrite Bill, currently before Parliament, sets out regulation making powers to cover a variety of areas, including how discretions would be applied or the criteria that would need to be considered. The intention is that "matters relating to detail and administration will be more appropriately located in delegated legislation to provide an appropriate degree of flexibility and responsiveness to changes in society".[29]

[29]From the Explanatory Note of the Social Security Legislation Rewrite Bill.

CHAPTER 8

NEXT STEPS

This discussion document outlines some proposals to improve how Inland Revenue administers Working for Families Tax Credits, child support, student loans and KiwiSaver and seeks your feedback.

Following consideration of the submissions, the Government will review the proposals and consider what to implement in the new START system.

Most proposals will require changes to legislation and an amending bill is intended to be introduced to Parliament in 2018. The public will have a further opportunity to comment on the legislative changes as part of the Parliamentary process.

Additionally, as Inland Revenue begins to move the social policy rules from its current FIRST system into the new START system it is likely that other areas will be discovered where small improvements to administration can be made. If these require a change in legislation there will be an opportunity to make submissions.

You can follow progress on the development of the modernisation of Inland Revenue's systems at http://www.ird.govt.nz/transformation/

APPENDIX 1

BACKGROUND ON HOW PAYMENTS ARE CURRENTLY DETERMINED

This appendix sets out some background material on how Working for Families Tax Credits are determined, and how child support is assessed. This may help when considering the options in Chapter 3.

WORKING FOR FAMILIES TAX CREDITS

Current annual estimates approach hard for customers to get right and easy to get wrong

Currently, a family has an annual Working for Families Tax Credits entitlement based on whether they receive a main benefit, the number of children they care for and weekly hours of work. The amount a family receives is dependent on their annual family income. Income under $36,350 a year is ignored. For every dollar of income over this amount, a family's entitlement reduces by 22.5 cents until it is fully abated.[30] They are entitled to be paid after the end of the tax year once their income and circumstances for the year have been confirmed, with payment made as a lump sum. This can mean a family caring for a child on 1 April 2017 would receive a lump sum payment around July 2018.

Most families require more timely support and opt to receive weekly or fortnightly instalment payments during the year, based on an estimate of their annual income and circumstances. The payments are the annual entitlement divided into 52 weekly or 26 fortnightly payments. They do not reflect how income is earned through the year.

The estimate is made in February before the start of the next tax year (1 April). Customers can update their details during the year, re-estimate their annual income and have instalment payments adjusted based on changes in family details or changes in their annual income estimate. The estimate is also rounded up and instalment payments rounded down to reflect they are instalments rather than final payments, and to reduce the risk of overpayment. In some cases, Working for Families Tax Credits payments could be stopped if a re-estimate determines the family has already received their full annual entitlement.

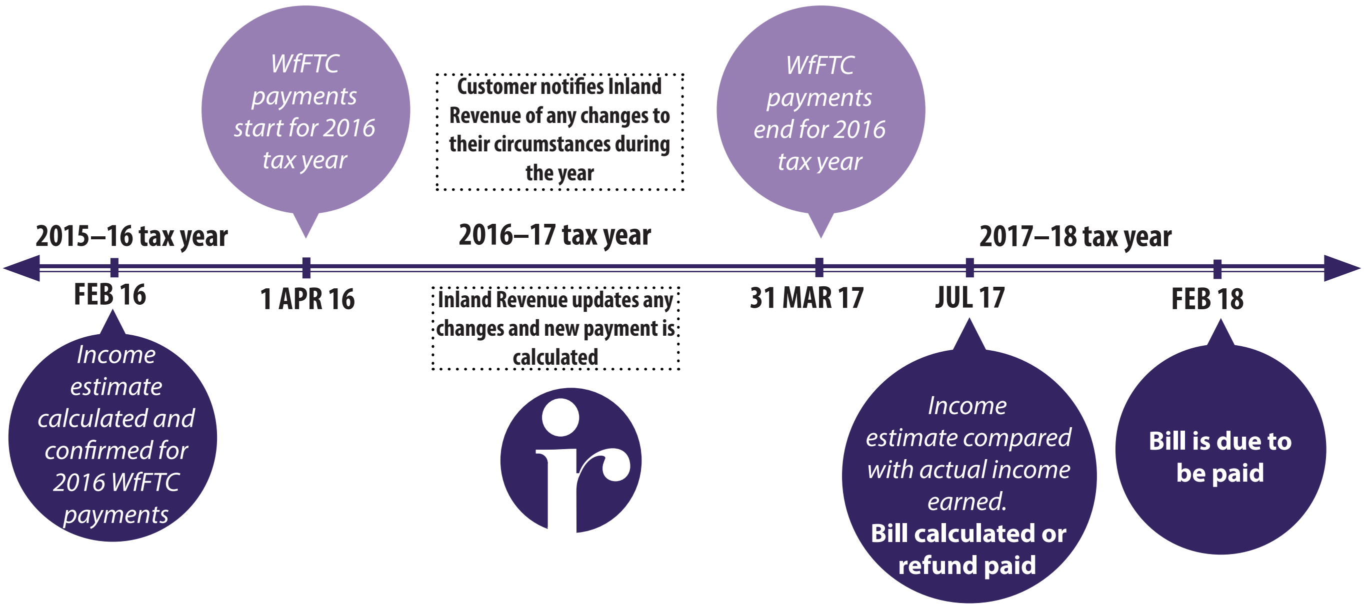
After the income tax return and family details for the tax year are confirmed, around July, the annual entitlement based on actual past income is compared to the total instalment payments. Any remaining entitlement is paid out in a lump sum. Any overpayment is repayable. The process repeats itself each tax year.

Customers receiving a main benefit during the year are treated differently

The annual assessment approach means that some families may not be entitled to any assistance because, over the year, their income is too high. For example, if a family estimates their income in February and they have a low income period at the start of the year, they would get paid during the year based on their estimate. Part way through the year if the family income increases they will have a debt at the end of the year when their annual income is confirmed. This can occur even if they were unemployed for parts of the year.

[30] These are the current abatement settings. From 1 April 2018, the annual income threshold will be $35,000 and the rate at which payments reduce for every dollar over that amount will be 25 cents in the dollar. Family tax credit rates will also increase for children aged under 16 years.

HOW INCOME ESTIMATES WORK



To address this issue, the current legislation "turns off" the annual assessment when a customer is receiving a main benefit and instead shifts to a monthly assessment period for the time they are on the main benefit. This allows Work and Income to pay the maximum amount of family tax credit to customers on main benefits even if they would otherwise not qualify because their annual income is too high. Income earned before or after being on a main benefit is ignored. This ensures that families have full financial support in periods of unemployment. However, these rules do not apply to families who may have a similarly low income in a month but are not receiving a main benefit. For customers not on a main benefit, the annual assessment approach is applied.

CHILD SUPPORT

The child support system already uses past period income information to determine child support obligations. Assessments for child support are currently done in February each year for the year starting 1 April. If income is earned only from salary and wages or interest payments, the salary and wages from the previous calendar year (January to December) are used as the annual income figure in the assessment.[31] If other types of income are received, the last filed tax return income is used – that is, income from two years ago. The income figure is adjusted by inflation to reflect that it is not current, but there is no square-up at the end of the year against the income actually earned in that year.

[31] Any interest income received is ignored for this group.

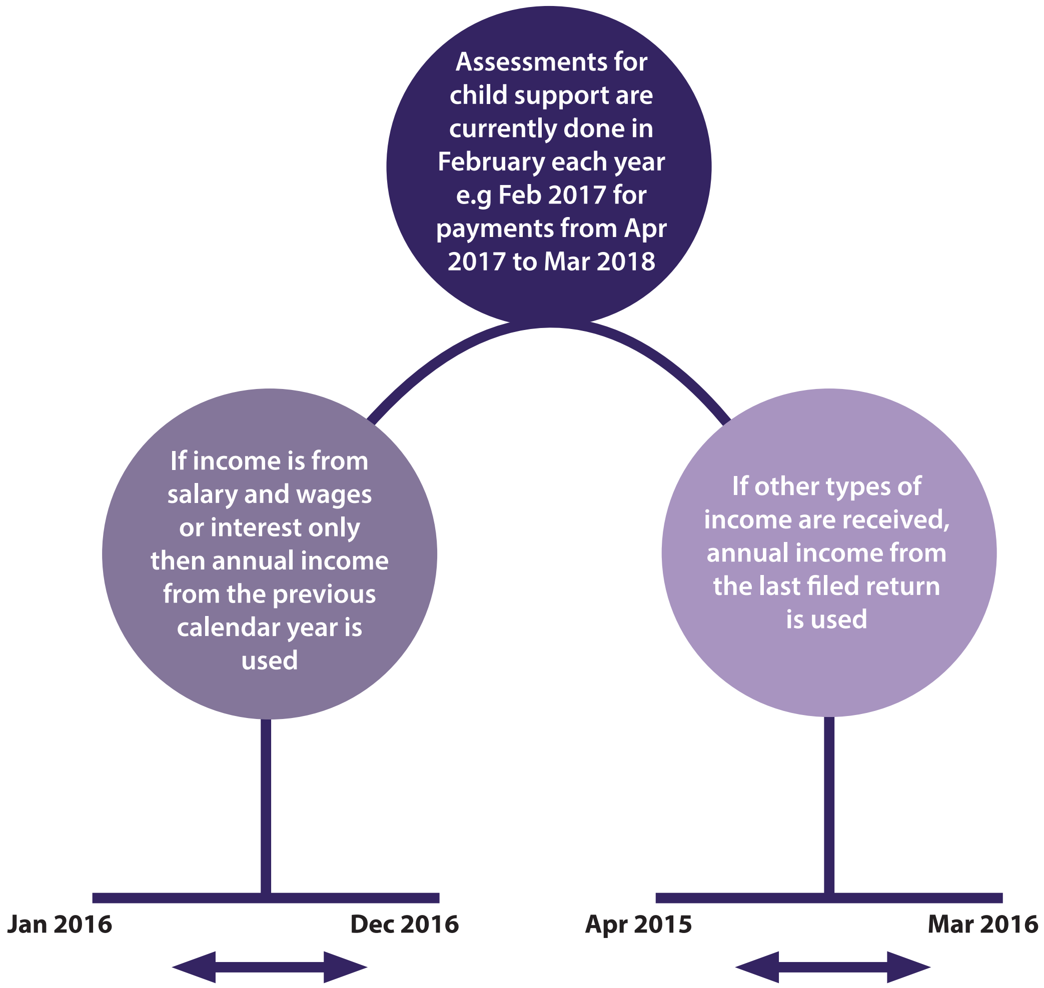
Using past income information means the assessment is certain but not always a good indicator of a liable parent's current ability to meet the payment (or the receiving carer's need for support). If a parent has a significant drop in income, they can estimate their income for the remainder of the current year, with a square-up after the end of the child support year to determine how accurate the estimate was compared to actual income. This can lead to overpayments or underpayments.

In determining income for child support, parents are entitled to a living allowance and can claim a dependent child allowance. If the income is below these allowances, a liable parent would pay the minimum child support amount.[32] If income is above these allowances, child support payments are a result of the formula assessment that looks at relative income and care levels and child expenditure.

[32]There are some exceptions for specific circumstances such as when a liable parent is in prison with no income.

HOW INCOME IS USED FOR CHILD SUPPORT NOW

The child support system uses past period income information to determine child support obligations



APPENDIX 2

COMPARISON OF KEY INCOME DEFINITIONS FOR: WORKING FOR FAMILIES TAX CREDITS, CHILD SUPPORT AND STUDENT LOANS

✓ Included in income x Not included in income

TYPE OF INCOME	Working for Families Tax Credits	Child support (current rules) [33]	Child support (2013 reform proposal)	Student loans
Net income	✓	✓	✓	✓
Available tax losses	x	✓	x	x
Non-resident foreign source income	✓	✓	✓	✓
Net loss from investment or business activity	x	x	x	x
Exempt income				
- Overseas pensions	✓	x	✓	✓
- Maintenance payments (for example child support)	✓	x	x	x
- Salary or wages exempt from income tax	✓	x	✓	✓
- Half of income from annuity under a life insurance policy	✓	x	✓	✓
Portfolio Investment Entity (PIE) income				
- Income attributed by a PIE unless the PIE is a superannuation fund or retirement savings scheme	✓	x	✓	✓
- Distributions from a listed PIE	✓	x	✓	✓
Main income equalisation accounts				
- Deposits made	✓	x	✓	✓
- Refunds received (excluding interest)	x	x	x	x
Share of undistributed income of a closely held company	✓	x	✓	✓
Associated persons share included	✓	x	✓	x
Certain contributions to retirement savings schemes[34]	x	x	x	✓
Certain distributions from superannuation schemes, distribution of retirement scheme contribution	✓	x	✓	✓
Settlor share of non-beneficiary income or undistributed income of a closely held company owned by trustees	✓	x	✓	✓
Employment benefits (person has *no* control over company)				
- Salary sacrifice for private use of motor vehicle	✓	x	✓	✓
- Value of short-term charge facilities	✓	x	✓	✓
Employment benefits (person has control over company)				
- Taxable value of attributed fringe benefits + related FBT	✓	x	✓	✓
Non-beneficiary income from a trust (not settlor) (specifically provided)	x	x	x	✓
Depreciation loss (allowed 2002–03 or earlier income year) clawed back on sale of buildings	✓	x	✓	x
Income greater than $500 derived by dependent child	✓	x	x	x
Child tax credit	x	x	x	x
Other income (subject to exclusions and $5,000 de minimus)	✓	x	✓	x
Deduction from income for maintenance payments made (for example child support)	✓	x	✓[35]	x

[33]Other than through an adminstrative review.

[34]Contribution already included in a return of income for the income year the contribution is made and therefore in "net income" for social policy purposes.

[35]Deduction allowed under the 2013 child support proposal but would have required amendment to avoid circularity in income calculation.