

OFFICE OF THE MINISTER FOR TERTIARY EDUCATION
AND OFFICE OF THE MINISTER OF REVENUE

Chair
Cabinet

STUDENT LOAN BORROWERS OVERSEAS

PROPOSAL

1. This paper proposes that:
 - the amnesty on student loan penalties be extended;
 - borrowers overseas be automatically entitled to a three year repayment holiday with repayment obligations based on the size of borrowers' loan balances when the holiday ends;
 - the penalty rate when borrowers fail to meet their repayment obligations be reduced;
 - interest write-offs for borrowers ineligible for interest-free loans be abolished;
 - the meaning of 'borrowers overseas' be redefined;
 - interest write-offs that have been incorrectly given are not required to be reversed in cases where borrowers have repaid their loans;
 - the hardship provisions are altered so that they do not preclude borrowers being granted hardship relief in respect of payments made and that the Commissioner is given the discretion to remove the obligation to make repayments if payment would cause hardship;
 - borrowers are required to advise Inland Revenue when they have been, or expect to be, overseas for more than six months; and
 - the possibility of an overdue amount being subject to both interest and late payment penalties be removed.
2. The changes requested by the Cabinet Policy Committee at its meeting of 11 October 2006 have been incorporated into this paper. The additional information requested by that Committee (in relation to the treatment of overseas borrowers in other countries, the possibility of reciprocal agreements for the collection of student loans and the planned communication of the policy changes) is outlined in paragraphs 40-42 and paragraph 78.

EXECUTIVE SUMMARY

3. Interest-free loans have been accompanied by an amnesty on student loan penalties. Work on analysing the impact of interest-free loans and the amnesty has raised questions about the current regime for student loan borrowers overseas – this work has shown that the current approach is not working. In particular, the repayment regime for borrowers overseas is unaffordable for many and, combined with the existing penalty regime, may act as a deterrent for borrowers to return to New Zealand. This is contrary to the intent of both the amnesty and interest-free loans. This paper intends to rectify those problems.

4. A data match with the New Zealand Customs Service (Customs) will help Inland Revenue to ensure that borrowers receive their correct entitlements and obligations. Work on the data match has raised issues about the working of the existing amnesty. It is estimated that as a result of a historic data match to establish entitlement to interest-free loans, 37,000 student loan borrowers will be identified who are currently being treated as resident but who should be treated as non-resident. It is also estimated that a further 6,000 borrowers will be identified as part of a separate exercise as having been non-resident in past years but who have returned to New Zealand and regained residency.

5. Once a borrower is identified as non-resident, the correct non-resident assessments must be established, resulting in penalties on borrowers' accounts if they have not met their obligations. Establishing the correct assessments will, on average, increase loan balances in the order of \$13,000 – \$14,000 per borrower.

6. It is estimated that almost 80 percent of borrowers will have failed to meet their non-resident obligations, meaning that the existing regime for non-resident borrowers is not working in its current form. This paper recommends the following solutions:

- extend the amnesty on student loan penalties to 31 March 2008 with a penalty to be added to borrowers' loan balances if they do not come within it or fail to comply with its terms (to address the problem in the past of debt escalation discouraging borrowers from returning to New Zealand);
- introduce a three year automatic repayment holiday for borrowers overseas with repayment obligations based on a three tier system according to the size of borrowers' loan balances when the holiday ends (to address the problem going forward of debt escalation discouraging borrowers from returning to New Zealand);
- reduce the penalty rate from 2 percent to 1.5 percent per month when borrowers fail to meet their repayment obligations (so as to be less punitive when borrowers do not meet their obligations);

- remove the existing interest write-offs for borrowers ineligible for interest-free loans (because the write-offs are inconsistent with the policy intent of interest-free loans); and
 - redefine the meaning of ‘borrowers overseas’ so that borrowers ineligible for interest-free loans would be subject to the overseas repayment regime provisions (so as to simplify which repayment regime borrowers are subject to).
7. The constraints of Inland Revenue’s student loan system have meant that the proposal to extend the amnesty on student loan penalties uses a different process than the existing amnesty. The system constraints also limit the options for setting repayment obligations going forward.
8. An estimated 41,000 borrowers have incorrectly received \$143 million in interest write-offs which will need to be reversed. It is recommended that borrowers who have repaid their loans as at the date of announcement of policy changes in relation to student loan borrowers overseas not be required to have any interest write-off that was incorrectly given reversed.
9. It is also recommended that amendments be made to:
- ensure that payment of obligations during the year does not preclude borrowers from being granted hardship relief in respect of those payments;
 - give the Commissioner the discretion to remove the obligation to make repayments if payment would cause serious hardship;
 - require borrowers to advise Inland Revenue when they have been, or expect to be, overseas for more than six months; and
 - remove any possibility of an overdue amount being subject to both interest and late payment penalties.
10. It is recommended that legislative changes to give effect to the proposals be included in the Student Loan Scheme Amendment Bill, planned for introduction in October 2006.

BACKGROUND

11. Interest-free student loans have increased the financial incentive for borrowers not to advise Inland Revenue when they go overseas. To mitigate this risk, Cabinet has agreed to a data match between Inland Revenue and Customs to determine which borrowers are eligible for interest-free loans (CAB Min (06) 5/4 refers).

PENALTIES ARISING FROM BORROWERS DETERMINED TO BE NON-RESIDENT

12. A historic data match in April 2007 will result in Inland Revenue becoming aware of an estimated 37,000 borrowers who are being treated as resident in New Zealand but who are actually overseas and non-resident. In addition, it is estimated that Inland Revenue will identify a further 6,000 borrowers who should have been treated as non-resident in past years as part of a separate exercise. These borrowers will be excluded from the historic data match because they have returned to New Zealand. Of the borrowers that will be identified as non-resident (whether as part of the historic match or as part of the separate exercise), an estimated 4,000 borrowers have repaid their loans.

13. Borrowers' repayment obligations and entitlement to certain interest write-offs differ depending on whether they are resident or non-resident.¹ When a borrower's residency status is updated the correct non-resident assessments must be established. Because the vast majority of, if not all, borrowers will have failed to have met their obligations, penalties will apply to the overdue amounts. It is estimated that establishing the correct assessments and penalties would, on average, increase loan balances in the order of \$13,000 – \$14,000 per borrower (bringing the average loan balance of affected borrowers to \$28,000 - \$30,000).

GOING FORWARD – A NEW REGIME FOR BORROWERS OVERSEAS

Extending the amnesty on student loan penalties

14. The existing amnesty allows borrowers non-resident as at 31 March 2006 with arrears and penalties to apply to Inland Revenue and have all penalties written off, provided that they meet their obligations under the Student Loan Scheme Act 1992 for two years.

15. Because the historic data match is not expected to occur until April 2007, borrowers whose correct residency status is established as a result of this match will not be eligible to come within the amnesty on student loan penalties (applications close on 31 March 2007). Not establishing borrowers' arrears until after the amnesty ends will undermine the amnesty's policy intent – to give borrowers in arrears a fresh start and to encourage borrowers to return to New Zealand.

16. To ensure that the purpose of the amnesty is not undermined, we consider that the application period for the amnesty should be extended until 31 March 2008. There is a risk that if the amnesty is not extended its objectives will be called into question, given that more non-residents will have penalties owing after the amnesty than before it.

¹ Borrowers are considered non-resident if they have been out of New Zealand for more than 325 days in any 12-month period, provided they do not have a permanent place of abode in New Zealand.

17. Under the existing amnesty eligible borrowers must have their correct liabilities established and then penalties are written-off when they come within the amnesty.² The constraints of Inland Revenue's student loan system mean that the process of bringing the accounts of the 37,000 borrowers identified as non-resident as a result of the data match up to date would take 29 full time equivalent staff members 19 months to complete, not including the time taken to bring borrowers within the amnesty. Our recommended approach, therefore, is to use a different process for the extended amnesty. Like the existing amnesty, the extended version would apply to borrowers who were non-resident as at 31 March 2006.

18. It is recommended that the extended amnesty apply as follows:

- the Commissioner is not required to raise non-resident assessments for past years if he has not already done so;
- non-resident borrowers with arrears have existing penalties removed and assessments cancelled up to the date that a new repayment regime for borrowers overseas is introduced (compounding interest at the applicable rate(s) would apply on the loan balance over the period of default);
- borrowers have the chance to apply to Inland Revenue for the amnesty and establish a repayment behaviour going forward in place of not establishing/removing penalties;
- borrowers who apply for the amnesty and establish the required repayment behaviour do not have any penalties on their accounts;
- the Commissioner is given a once only discretion to follow up any missed repayment and, provided the payment is made within one month of the Commissioner contacting the borrower, the missed payment is not treated as a failure to establish the required repayment behaviour;
- borrowers who do not apply for the amnesty, or who apply but do not establish the required repayment behaviour, have a one-off penalty added to their loan balance;
- borrowers have until 31 March 2008 to apply;
- the 6,000 borrowers who will be identified as having been non-resident in past years but who have returned to New Zealand and regained residency as at 31 March 2006 will not be subject to any penalty (compounding interest at the applicable rate(s) would apply over the period of default); and
- the 4,000 borrowers who have repaid their loans as at the date of announcement of the changes will not have their loans reopened.

² It is a legislative requirement for the correct liabilities to be established.

19. While the above process is different to the existing amnesty, the net effect of the approach is an extension of the existing amnesty with a one-off penalty added to the loan balance of borrowers if they do not come within it or fail to comply with its terms. Compounding interest would continue to apply on the loan balance of borrowers who come within the amnesty.

Required repayment behaviour

20. Borrowers will be required to apply to Inland Revenue to come within the amnesty. It is recommended that borrowers be considered to have complied with the amnesty terms if they repay an amount based on the size of their loan balance each year for two years as follows:

- \$1,000 for loan balances of \$15,000 or less;
- \$2,000 for loan balances of \$15,001 - \$30,000; and
- \$3,000 for loan balances of over \$30,000.

21. Payments would be due six monthly and would go towards reducing the amount owed by the borrower. It is further recommended that the Commissioner have the ability to reduce the amount payable in cases of serious hardship. Borrowers would be required to provide proof of the hardship and would still be expected to show some commitment to repay, even if it is just a nominal amount.

Penalty added to borrowers' loan balances

22. If borrowers do not apply for the amnesty, or fail to meet the required repayment behaviour, a one-off penalty would be added to their loan balance as a penalty for being non-compliant. We consider it important from an equity perspective that borrowers who have demonstrated that they want to do the right thing (ie borrowers who comply with the amnesty terms) are better off than those who do not.

23. It is recommended that the penalty added to borrowers' accounts be:

- the lesser of 5 percent of the borrower's loan balance or the penalties under the existing rules;
- in proportion to the degree of non-compliance with the required repayment behaviour so that borrowers who meet part of the required repayment behaviour are not subject to the full penalty;
- be subject to compounding interest until it is repaid or until the borrower returns to New Zealand and is eligible for an interest-free loan;
- added as at 31 March 2008, for borrowers who do not come within the amnesty; and

- added at the end of the tax year in which the failure to meet the amnesty terms occurred, for borrowers who come within the amnesty but fail to meet the required repayment behaviour.

24. The average penalty added to borrowers' loan balances would be \$1,050. A penalty of this level recognises that penalties have accumulated on borrowers' accounts under a repayment regime which is unaffordable for many.

Borrowers who come within the existing amnesty

25. Borrowers who come within the existing amnesty would become subject to the new amnesty terms but would be given credit for repayments already received. For example, if a borrower had applied for the existing amnesty and had met their repayment obligations for one year, they would only have one year of repayments left to make to meet the amnesty terms (repayments would be based on the size of their loan balance, as outlined above). Generally, the extended amnesty is more favourable than the existing amnesty because the required repayments are lower and the penalty added when borrowers come within the amnesty but do not meet its terms is lower.

Equity issues

26. While it could be argued that the recommended approach is inequitable for resident borrowers whose arrears have already been established and compliant non-resident borrowers, the equity arguments can also be made with the existing amnesty. It could also be argued that it is inequitable that the 6,000 borrowers who were non-resident but who had regained their residency are not subject to any penalty on their accounts (these borrowers are not eligible to come within the existing amnesty³).

27. On the other hand, it could be argued that extending the amnesty as outlined above is in fact equitable because the current repayment regime for non-residents is unaffordable for many (and as a consequence of the unaffordable regime penalties have accumulated on borrowers' accounts).

Repayment regime for borrowers overseas going forward

Existing regime

28. Non-resident repayment obligations were designed so that loans would be repaid in a maximum of 15 years. This is achieved by requiring quarterly payments of a fixed amount of the principal (based on the loan balance at the beginning of the tax year following the year of departure), plus the estimated interest for the year. If the loan balance is less than \$15,000, \$1,000 of principal is required each year. For loans over \$15,000, principal of 1/15th of the original loan balance is required.

³ Borrowers who have regained residency as at 31 March 2006 are not eligible to come within the existing amnesty.

29. For many borrowers the amount that they are expected to pay is simply not achievable. For example, a non-resident borrower with a loan balance of \$60,000 will have a repayment obligation in the first year following departure from New Zealand of nearly \$8,000. A resident borrower would need to have income of nearly \$100,000 to have the same liability.

Going forward

30. Given that it is estimated that almost 80 percent of borrowers have failed to meet their non-resident obligations, the non-resident repayment regime is clearly not working in its current form. The existing regime is unaffordable for many borrowers and is not consistent with the objective of encouraging borrowers to return to New Zealand. We consider that the repayment regime for borrowers overseas must be changed at the same time the amnesty is extended for the amnesty to meet its stated objectives. The constraints of Inland Revenue's student loan system limit the potential options for setting repayment obligations for borrowers overseas (for example, setting obligations on a table mortgage basis is not possible with the existing system).

31. Going forward, we recommend that from 1 April 2007 borrowers overseas be automatically entitled to a three-year repayment holiday. Borrowers would not have repayment obligations for that period but compounding interest would apply to the loan balance. After the repayment holiday ends, annual repayment obligations would be based on the size of borrowers' loan balances.

Repayment holiday

32. A limited repayment holiday means that those going overseas short term have their loan balances increase at a reasonable rate (ie at the annual interest rate), removing a barrier to such borrowers returning to New Zealand. A repayment holiday acknowledges the New Zealand tradition of taking OEs – which can confer benefits on New Zealand – during which borrowers typically have low incomes.

33. Furthermore, migration statistics for the general population show that around 70 percent of New Zealanders return within three years. This suggests that giving a three-year repayment holiday would cover the majority of cases and would leave the penalty regime to deal only with those non-compliant, long term emigrants. Charging interest while borrowers are on the holiday is sufficient to cover the Government's cost of borrowing and administration.

34. One potential disadvantage of a repayment holiday is that it would not distinguish between those going overseas on a short term basis and those going overseas long term. While it may be perceived as inequitable that borrowers in New Zealand have compulsory obligations while those overseas do not for three years, this perception risk is minimised somewhat in that the holiday only applies for a limited period. Furthermore, income contingency protects domestic borrowers when their

earnings are below a threshold. Borrowers in New Zealand are also entitled to interest-free loans, while those overseas are not.

Detailed design

35. It is recommended that borrowers who do not use the full holiday period be entitled to use the remainder of the period the next time they became an overseas borrower.

36. It is also recommended that borrowers could opt not to use the repayment holiday if they wished. It is further recommended that borrowers who are already overseas as at 1 April 2007 are entitled to a repayment holiday as follows:

- borrowers who have been compliant and borrowers who have been non-resident for less than one year are entitled to a three-year repayment holiday;
- borrowers who have been non-compliant and who come within the amnesty and meet its terms are eligible to apply to Inland Revenue for a three-year repayment holiday once they have met the amnesty's required repayment behaviour (if borrowers did not apply to Inland Revenue they would automatically be entitled to a three-year holiday the next time they became an overseas borrower);
- borrowers who have been non-compliant and who do not come within the amnesty or who come within the amnesty and fail to meet its terms are entitled to a repayment holiday depending on the length of time they have been non-resident:
 - borrowers who have been non-resident for one year or more but less than two years are eligible for a two-year holiday;
 - borrowers who have been non-resident for more than two years but less than three years are eligible for a one-year holiday; and
 - borrowers who have been non-resident for more than three years are not eligible for a repayment holiday.

Repayment obligations once holiday ends / if holiday not used

37. It is recommended that after the repayment holiday ends, or if borrowers elect not to use the repayment holiday, annual repayment obligations (with payments due six monthly) would be based on the size of borrowers' loan balances as follows:

- \$1,000 for loan balances of \$15,000 or less;
- \$2,000 for loan balances of \$15,001 - \$30,000; and
- \$3,000 for loan balances of over \$30,000.

38. Repayment obligations set in this manner would be relatively simple for borrowers to understand, are more affordable than the existing repayment regime and are sufficiently high so that repayments would exceed interest charges for most borrowers, resulting in borrowers' loan balances decreasing over time. Hardship provisions would be retained so that borrowers could renegotiate their repayment obligations with Inland Revenue if they are unable to meet them.

39. The disadvantage of a tiered system is that there is potential inequity around the steps. With a \$15,000 loan balance, the repayment obligation is 7 percent of the principal. With a loan balance of \$15,001, the repayment obligation is 13 percent of the principal. We do consider, however, this system to be more equitable than one where repayment obligations are fixed and not based on the size of borrowers' loan balances (such as a repayment obligation of \$1,000 per year for all borrowers).

Treatment of borrowers overseas in other countries

40. The treatment of borrowers overseas in other countries is outlined below:

Country	Treatment of overseas borrowers
Australia	No annual repayment obligations while non-resident for tax purposes. Borrowers' loans increase at the rate of inflation. Voluntary repayments of \$500 or more attract a 10% discount (eg if a borrower repays \$500, their loan balance will decrease by \$550).
England	Annual repayment obligations of borrowers who provide income details are 9% of gross income above a threshold. The threshold is calculated by reference to the price level index of the borrower's country of residence. For example, a borrower living outside England but living elsewhere in the United Kingdom with an income of £50,000 pounds would have a repayment obligation of £2,250. Annual repayment obligations of borrowers who do not provide income details are a fixed amount, based on the price level index of the borrower's country of residence. For example, a borrower living outside England but living elsewhere in the United Kingdom would have a repayment obligation of £2,952. A defaulting borrower may be required to repay the whole of their loan. The rate of interest (equal to the rate of inflation) may be tripled.
Canada	Annual repayment obligations are calculated on a table mortgage basis. Borrowers who default may be reported to a credit agency (default can affect a borrower's credit rating) and legal action may be taken. Interest charged on the loan is equivalent to the rate of interest charged on loans by chartered banks to their most credit-worthy customers + 2.5% (if a floating interest rate is selected) or + 5% (if a fixed interest rate is selected). Tax credits for a portion of the interest are available.

Reciprocal agreements for the collection of student loans

41. Between mid-2000 and early 2003 the possibility of a reciprocal agreement with Australia for the collection of student loans was actively pursued by Inland Revenue. It was also raised at Ministerial level. However, as Australia does not require

payments from its non-resident borrowers, full reciprocity could not be achieved. An alternative of the Australian Tax Office (ATO) acting on Inland Revenue's behalf on a fee basis was also explored. The ATO's conclusion was that the proposal did not appear to be financially advantageous to either party.

42. The possibility of a reciprocal agreement was also pursued with the United Kingdom with a possible option being developed. However, the United Kingdom showed little interest in this proposal. On 15 September 2006 the Commissioner raised the issue with the United Kingdom Acting Chairman. He undertook to look into it further, but indicated that current significant organisational changes and other priorities would likely mean that there would be little to no interest in taking up this issue.

Setting the penalty rate going forward

43. The current penalty rate when borrowers fail to meet their obligations is 2 percent per month compounding on the amount outstanding, which equates to an annual rate of 26.82 percent (the rate applies to borrowers in New Zealand and borrowers overseas). This rate is often criticised as being too punitive.

44. The penalty rate needs to be set at a level which is not excessive but which discourages borrowers from repaying other debt in preference to meeting their student loan obligations. We therefore recommend that the penalty rate be set at 1.5 percent compounding per month, which is equivalent to a annual rate of 19.57 percent (similar to standard credit card rate). We recommend that this rate apply from 1 April 2007 and apply to both borrowers in New Zealand and borrowers overseas.

Removing interest write-offs for borrowers ineligible for interest-free loans

45. We consider that the interest write-offs that can apply when borrowers have been overseas for more than six months and are not eligible for interest-free loans should be reviewed. It is expected that very few borrowers are eligible for these write-offs. The interest write-offs are as follows:

Full interest write-off for borrowers studying

46. Currently, resident borrowers who are not eligible for an interest-free loan for an entire tax year may be eligible for a full interest write-off for the entire year if they have studied for part of that year. Eligible borrowers who complete their study part way through the academic year are entitled to a full interest write-off to 31 March the following year. Borrowers receive the write-off even if they have been overseas for most of the year.

Base interest write-off for resident borrowers

47. Borrowers who are not eligible for an interest-free loan, who retain their tax residency and who earn below the repayment threshold are eligible to have their base interest written off for up to two years.

Partial base interest write-off for resident borrowers

48. Borrowers who are not eligible for an interest-free loan, who retain their tax residency and whose base interest charged is more than half of their repayment obligation are eligible to have the difference written off for up to two years.

Recommendation

49. Because retaining interest write-offs for borrowers overseas is inconsistent with the policy intent of interest-free loans (which is to encourage borrowers to remain in, or return to, New Zealand) we recommend the write-offs for residents be abolished from 1 April 2007. Abolishing the full interest write-off for borrowers studying would mean that the data match that currently occurs between the Ministry of Education and Inland Revenue to verify borrowers' study status could be removed.

Interest write-off for borrowers studying full-time overseas

50. The Commissioner can grant an exemption to the interest-free loans rules regarding time overseas so that borrowers who are studying full-time overseas at postgraduate level are eligible for interest-free loans. We recommend that this exemption be extended from 1 April 2007 so that borrowers studying overseas at undergraduate level are also eligible. This would mean that the existing base interest write-off/reduction for non-resident borrowers studying overseas could be abolished.

51. To qualify for the exemption it is recommended that borrowers provide Inland Revenue with verification from the New Zealand Qualifications Authority that their study leads towards a qualification equivalent to level 7 (bachelors degree level) on the New Zealand Register of Quality Assured Qualifications. It is also recommended that borrowers provide Inland Revenue with evidence from their overseas tertiary education provider that establishes their full-time enrolment in the undergraduate course. This approach would be consistent with the current treatment for borrowers studying overseas at postgraduate level.

Redefining 'borrowers overseas'

52. Currently, borrowers' residency status for student loans purposes is based on tax residence. Tax residence can be difficult to determine because it is subject to whether a person has a permanent place of abode in New Zealand which is not always clear cut. It also makes administration of the student loan scheme difficult and costly and

makes it complicated for borrowers to understand which repayment regime they are subject to.

53. Going forward, from 1 April 2007 we consider that repayment obligations should be de-linked from tax residence and instead based on whether borrowers satisfy the eligibility criteria for an interest-free loan. Aligning repayment conditions with when a borrower ceases to be entitled to an interest-free loan will provide simplicity in that there will be just one clear cut rule for both – borrowers are either eligible for an interest-free loan and therefore subject to the repayment regime for borrowers living in New Zealand or not eligible for an interest-free loan and subject to the repayment regime for borrowers overseas. Borrowers who are granted an exemption to the interest-free rules regarding time overseas and who lose their tax residency would be required to declare their worldwide income to Inland Revenue so that their repayment obligations (which would be based on their income) could be calculated.⁴

INTEREST WRITE-OFFS INCORRECTLY GIVEN

54. Resident borrowers are eligible to receive a base interest write-off if their income is below the repayment threshold or a partial base interest write-off if the base interest they are charged is more than half of their repayment obligation. Borrowers must file a tax return or respond to a personal tax summary (PTS) to be entitled to the interest write-offs. Inland Revenue has, however, been giving interest write-offs to all borrowers showing as resident in the above two categories, regardless of whether they have responded to a PTS.

55. If a borrower's residency status is changed to non-resident, the interest write-offs that were received while the borrower was non-resident will be reversed. It is estimated that 36,000 borrowers will be identified as part of the historic data match and a further 5,000 borrowers will be identified as part of a separate exercise as having incorrectly received interest write-offs (borrowers in this second category will not be identified as part of the historic data match because they returned to New Zealand before 1 April 2006).⁵ The amount of interest write-offs to be reversed for the affected borrowers is estimated as follows:

⁴ Generally, borrowers who are overseas for more than six months are ineligible for an interest-free loan. In certain circumstances, however, the Commissioner of Inland Revenue can grant an exemption to this rule.

⁵ Not all borrowers identified as non-resident as part of the historic data match or the separate exercise received base interest write-offs that they were not entitled to receive.

Interest write-off reversal	Average per borrower	Total⁶
Borrowers identified as non-resident as part of historic data match	\$3,700	\$126m
Borrowers identified as non-resident as part of separate exercise	\$3,300	\$10m
Borrowers who have repaid their loans	\$1,700	\$7m
Total	\$3,500	\$143m

56. It should be noted that the figures above underestimate the true increase in borrowers' loan balances because of the effect of compounding interest. It is estimated that the actual increase could be in the order of an additional \$40 million.

57. It is likely that affected borrowers will feel aggrieved at seeing their loan balances increase when interest write-offs are reversed. However, we see no reason why such borrowers should keep the interest write-offs they have received. Not reversing the interest write-offs would mean that these borrowers are better off than compliant resident borrowers (who earn above the repayment threshold or whose base interest charged is at least half of their repayment obligation) and compliant non-resident borrowers. Reversing interest write-offs received by non-resident borrowers would have the effect of correcting their loan balances and would be consistent with the treatment under the existing amnesty. Inland Revenue is considering how to best communicate interest write-off reversals to affected borrowers.

Borrowers who have repaid their loans

58. Of the borrowers that Inland Revenue will identify as non-resident (either as a result of the data match or as a result of the separate exercise), it is estimated that 4,000 borrowers will have received a letter from Inland Revenue congratulating them on repaying their loan. You are asked to agree that borrowers who have repaid their loans as at the date of announcement of the above policy changes not be required to have any interest write-off that was incorrectly given reversed.

MINOR OR REMEDIAL CHANGES

Hardship

59. The Student Loan Scheme Act allows for relief from payment of a borrower's compulsory repayment obligation in cases of serious hardship. However, there is conflict in the wording of the provision and Inland Revenue's opinion is that relief cannot be given in respect of any payment that has already been made.

⁶ Totals may not add due to rounding.

60. We recommend that an amendment be made to the hardship provisions to ensure that payment of obligations during the year do not preclude borrowers from being granted hardship relief in respect of those payments. We further recommend that the Commissioner be given the discretion to remove the obligation to make payments which would otherwise have fallen due during the year if it is considered that the borrower is likely to qualify for relief from his or her annual compulsory repayment obligation on the grounds of serious hardship.

Requirement for borrowers to advise Inland Revenue when leaving New Zealand

61. Currently, borrowers are required to advise Inland Revenue when they have been, or expect to be, out of New Zealand for more than three months. We recommend that this time period be changed to six months, which would link more closely with entitlement to interest-free loans. (Generally, borrowers who have been overseas for more than six months are ineligible for interest-free loans.) The amendment would apply from 1 April 2007.

Charging interest

62. Interest on student loans is charged under the loan contract not the Student Loan Scheme Act. Interest ceases to be payable once an amount becomes overdue as overdue amounts are subject to a monthly two percent compounding penalty. Until last year the contract provided for this. However, the 2005 and 2006 loan contracts are missing the necessary wording and it is possible that student loan arrears could be subject to both interest and late payment penalties. (For borrowers present in New Zealand for six months or more the interest would be written-off because such borrowers are eligible for interest-free loans.) StudyLink will restore the appropriate wording in next year's contracts.

63. We recommend that a legislative amendment be made to remove any possibility of an overdue amount being subject to both interest and late payment penalties. The amendment would apply from the date of commencement of the Student Loan Scheme, ie from 1 April 1992.

ADMINISTRATIVE COSTS

64. The processes required to action the proposed policy changes are very manually intensive. Therefore, there is a high administrative and resource cost associated with the implementation of the proposed policies. System changes will be made in 2007/08 to automate some of the processes for future years.

65. It is estimated that following administrative funding is required to implement the changes:

	\$ million increase / (decrease)			
	2007/08	2008/09	2009/10	2010/11 & out-years
Operating	6.645	0.768	0.919	0.919
Advertising (other operating)	2.000	-	-	-
Capital	1.675	-	-	-
Total	10.320	0.768	0.919	0.919

66. A \$2 million advertising component in 2007/08 will communicate the complex policy changes to borrowers (in New Zealand and overseas) and key influencers (such as family, friends and colleagues) in New Zealand.

67. You are asked to increase funding to implement the changes as follows:

Vote Revenue	\$ million increase / (decrease)					
	2007/08	2008/09	2009/10	2010/2011	2011/12	2012/13 & outyears
Operating balance impact	8.512	0.635	0.786	0.786	0.786	-
Debt impact	1.675	-	-	-	-	-
No impact	0.133	0.133	0.133	0.133	0.133	-
Total	10.320	0.768	0.919	0.919	0.919	-

68. In addition, you are asked to approve the following changes to appropriations to implement the changes:

	\$ million increase / (decrease)					
	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13 & outyears
Departmental Output Expense: Services to inform the public about entitlements and meeting obligations (funded by revenue Crown)	8.495	0.518	0.669	0.669	0.669	-
Service to process obligations and entitlements (funded by revenue Crown)	0.100	-	-	-	-	-
Management of debt and outstanding returns (funded by revenue Crown)	0.050	0.250	0.250	0.250	0.250	-
Capital Contributions to the Department Capital Investment	1.675	-	-	-	-	-
Total Operating impact	8.645	0.768	0.919	0.919	0.919	-
Total Debt impact	1.675	-	-	-	-	-

69. Furthermore, you are asked to agree that the drawdown of the \$2 million advertising component of the above appropriations requires approval by joint Ministers, following consideration of the proposed advertising programme and strategy.

70. Inland Revenue officials have advised that they may be able to use departmental savings to fund part of the administration costs and will report back to joint Ministers later this year on whether this is possible.

FISCAL IMPLICATIONS

71. The recognition of historical interest and penalties on the accounts of those borrowers identified as non-resident is estimated to have the following impact, which increases the operating balance by a corresponding amount:

	\$ million increase / (decrease)			
	2006/07	2007/08	2008/09	2009/10 & outyears
Fair value recognition	141.960	-	-	-

72. You are asked to increase funding for the proposals as follows:

	\$ million increase / (decrease)			
	2006/07	2007/08	2008/09	2009/10 & outyears
Operating balance impact	156.623	2.496	2.630	2.630
Debt impact	23.000	23.000	6.000	6.000
No impact	-	-	-	-
Total	179.623	25.496	8.630	8.630

73. We recommend the following changes to appropriations to put into effect the proposals:

	\$ million increase / (decrease)			
	2006/07	2007/08	2008/09	2009/10 & outyears
Vote Revenue				
Other Expenses to be Incurred by the Crown:				
Student Loan Fair Value Recognition	135.775	-	-	-
Vote Social Development				
Bad Debt Provisions	20.848	2.496	2.630	2.630
Total Operating	156.623	2.496	2.630	2.630

74. It is recommended that you agree that the above changes to appropriations for 2006/07 be included in the 2006/07 Supplementary Estimates and that, in the interim, these expenses be met from Imprest Supply.

75. The above adjustments are estimates and there may be a need to revisit the appropriation impact if the assumptions underlying the estimates change significantly.

LEGISLATIVE REQUIREMENTS

76. We recommend that legislation to give effect to the above proposals be included in the Student Loan Scheme Amendment Bill, planned for introduction in October 2006. The Bill gives effect to the data match between Inland Revenue and Customs and currently has a category 2 priority – must be passed before the end of the year.

77. The existing amnesty ends on 31 March 2007. Ideally, legislation to extend the amnesty and to change the repayment regime for borrowers overseas would be enacted prior to this date to avoid least retrospective application.

PUBLICITY AND COMMUNICATION OF POLICY CHANGES

78. We plan to issue a press statement outlining the changes upon the introduction of a Bill. Officials are currently working through a strategy to communicate the policy changes to borrowers. The changes will also be publicised in a Tax Information Bulletin following the passing of a Bill.

FURTHER WORK

79. A business case for rebuilding Inland Revenue's student loan system is due to be considered as part of the Budget 2007 process. Officials will also report to joint Ministers on:

- a strategy to increase repayments made by student loan borrowers overseas by June 2007; and
- the impact/effectiveness of the key policy changes in this paper by June 2008 and the actual cost of these policies with any unspent portion being returned to the Crown.

80. We have been advised by Treasury officials that they will be seeking improvements not only in the systems underpinning the student loan debt recovery, but also the strategy and departmental accountabilities for ensuring improvements in the way the student loan scheme is managed and debt, especially in relation to borrowers overseas, is recovered.

REGULATORY IMPACT STATEMENT

81. A regulatory impact statement is attached. A business compliance cost statement is not required because the proposal does not impose any compliance costs on business.

HUMAN RIGHTS ACT

82. The proposals in this paper appear to be consistent with the rights and freedoms affirmed in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993. A final view will be possible after the amendments are drafted for inclusion in the Bill.

CONSULTATION

83. Inland Revenue, the Ministry of Education, the Treasury, the Ministry of Social Development and the Ministry of Justice have been consulted in the preparation of this paper.

RECOMMENDATIONS

84. We recommend that Cabinet:

Amnesty on student loan penalties

1. **Agree** to extend the amnesty on student loan penalties so that:
 - the Commissioner is not required to raise non-resident assessments for past years if he has not already done so;
 - non-resident borrowers with arrears have existing penalties removed and assessments cancelled up to the date that a new repayment regime for borrowers overseas is introduced (compounding interest at the applicable rate(s) would apply on the loan balance over the period of default);
 - borrowers have the chance to apply to Inland Revenue for the amnesty and establish a repayment behaviour going forward in place of not establishing/removing penalties;
 - borrowers who apply for the amnesty and establish the required repayment behaviour do not have any penalties on their accounts;
 - the Commissioner is given a once only discretion to follow up any missed payment and, provided the payment is made within one month of the Commissioner contacting the borrower, the missed payment is not treated as a failure to establish the required repayment behaviour;
 - borrowers who do not apply for the amnesty, or who apply but do not establish the required repayment behaviour, have a one-off penalty added to their loan balance;
 - the amnesty applies to borrowers who were non-resident as at 31 March 2006;
 - borrowers have until 31 March 2008 to apply;
 - borrowers who will be identified as having been non-resident in past years but who have returned to New Zealand and regained residency as at 31 March 2006 will not be subject to any penalty (compounding

interest at the applicable rate(s) would apply over the period of default); and

- borrowers who have repaid their loans as at the date of the announcement of the changes will not have their loan reopened.
2. **Agree** that borrowers be considered to have complied with the terms of the amnesty if they repay an amount based on the size of their loan balance each year for two years (with payments due six monthly) as follows:
- \$1,000 for loan balances of \$15,000 or less;
 - \$2,000 for loan balances of \$15,001 - \$30,000; and
 - \$3,000 for loan balances of over \$30,000.
3. **Agree** that the Commissioner be given the discretion to reduce the amount payable in cases of serious hardship.
4. **Agree** that the penalty added to borrowers' loan balances when they do not come within the amnesty or fail to meet its terms be:
- the lesser of 5 percent of the borrower's loan balance or the penalties under the existing rules;
 - in proportion to the degree of non-compliance with the required repayment behaviour so that borrowers who meet part of the required repayment behaviour are not subject to the full penalty;
 - subject to compounding interest until it is repaid or until the borrower returns to New Zealand and is eligible for an interest-free loan;
 - added as at 31 March 2008, for borrowers who do not come within the amnesty; and
 - added at the end of the tax year in which the failure to meet the amnesty terms occurred, for borrowers who come within the amnesty but fail to meet the required repayment behaviour.

Repayment regime for borrowers overseas going forward

5. **Agree** that the existing repayment regime for non-resident borrowers be abolished and that from 1 April 2007:
- borrowers overseas automatically be entitled to a three-year repayment holiday;

- borrowers who do not use the full holiday period be entitled to use the remainder of the period the next time they became an overseas borrower; and
 - borrowers have the ability to elect not to use the repayment holiday.
6. **Agree** that borrowers already overseas as at 1 April 2007 be entitled to a repayment holiday as follows:
- borrowers who have been compliant and borrowers who have been non-resident for less than one year be automatically entitled to a three-year repayment holiday;
 - borrowers who have been non-compliant and who come within the amnesty and meet its terms are eligible to apply to Inland Revenue for a three-year repayment holiday once they have met the amnesty's required repayment behaviour;
 - borrowers who have been non-compliant and who do not come within the amnesty or who come within the amnesty and fail to meet its terms be automatically entitled to a repayment holiday depending on the length of time they have been non-resident:
 - borrowers who have been non-resident for one year or more but less than two years are eligible for a two-year holiday;
 - borrowers who have been non-resident for more than two years but less than three years are eligible for a one-year holiday; and
 - borrowers who have been non-resident for more than three years are not eligible for a repayment holiday.
7. **Agree** that annual repayment obligations after the holiday ends or for borrowers who elect not to use the repayment holiday (with payments due six monthly) be set at:
- \$1,000 for loan balances of \$15,000 or less;
 - \$2,000 for loan balances of \$15,001 - \$30,000; and
 - \$3,000 for loan balances of over \$30,000.

Penalty rate going forward

8. **Agree** to reduce the penalty rate applicable when borrowers in New Zealand and borrowers overseas fail to meet their obligations from 2 percent per month compounding on the amount outstanding to 1.5 percent per month from 1 April 2007.

Interest write-offs for borrowers ineligible for interest free loans

9. **Agree** that the full interest write-off for resident borrowers studying (and the data match between Inland Revenue and the Ministry of Education to verify borrowers' study status) be abolished.
10. **Agree** that the base interest write-off for resident borrowers earning under the repayment threshold be abolished.
11. **Agree** that the partial base interest write-off for resident borrowers whose base interest charged is more than 50 percent of their repayment obligation be abolished.
12. **Agree** that the Commissioner of Inland Revenue be able to grant an exemption to the interest-free loans rules regarding time overseas so that borrowers who are studying full-time overseas at undergraduate level are eligible for interest-free loans and to abolish the base interest write-off/reduction for non-resident borrowers studying overseas.
13. **Agree** that in defining study status for borrowers studying at undergraduate level:
 - undergraduate level is study that leads towards a qualification equivalent to level 7 (bachelors degree) on the New Zealand Register of Quality Assured Qualifications;
 - applicants must provide Inland Revenue with verification from the New Zealand Qualifications Authority that establishes the equivalency of the course; and
 - applicants must provide Inland Revenue with evidence from their overseas tertiary education provider that establishes their full-time enrolment in the undergraduate course.
14. **Agree** that the changes in recommendations 9 – 13 apply from 1 April 2007.

Redefining 'borrowers overseas'

15. **Agree** that borrowers' residency status be de-linked from tax residence and instead be based on whether a borrower is eligible for an interest-free loan from 1 April 2007.

Interest write-offs incorrectly given

16. **Note** that it is estimated that 41,000 borrowers have received \$143 million in interest write-offs to which they were not entitled and these write-offs will need to be reversed.
17. **Agree** that borrowers who have repaid their loans as at the date of announcement of the above policy changes not be required to have any interest write-off that was incorrectly given reversed.

Minor or remedial changes

18. **Agree** that an amendment be made to the hardship provisions to ensure that payment of obligations during the year does not preclude borrowers from being granted hardship relief in respect of those payments.
19. **Agree** that the Commissioner be given the discretion to remove the obligation to make payments which would otherwise have fallen due during the year if it is considered that the borrower is likely to qualify for relief from his or her annual compulsory repayment obligation on the grounds of serious hardship.
20. **Agree** that borrowers be required to advise Inland Revenue when they have been, or expect to be, out of New Zealand for more than six months.
21. **Agree** that recommendations 18 – 20 apply from 1 April 2007.
22. **Agree** to an amendment to apply from 1 April 1992 to remove any possibility of an overdue amount being subject to both interest and late payment penalties for any liability which arises.

Administrative costs

23. **Approve** the following changes to increase funding to implement recommendations 1 – 22:

Vote Revenue	\$ million increase / (decrease)					
	2007/08	2008/09	2009/10	2010/2011	2011/12	2012/13 & outyears
Operating balance impact	8.512	0.635	0.786	0.786	0.786	-
Debt impact	1.675					-
No impact	0.133	0.133	0.133	0.133	0.133	-
Total	10.320	0.768	0.919	0.919	0.919	-

24. **Approve** the following changes to appropriations to implement recommendations 1 – 22:

	\$ million increase / (decrease)					
	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13 & out- years
Departmental Output Expense: Services to inform the public about entitlements and meeting obligations (funded by revenue Crown)	8.495	0.518	0.669	0.669	0.669	-
Service to process obligations and entitlements (funded by revenue Crown)	0.100	-	-	-	-	-
Management of debt and outstanding returns (funded by revenue Crown)	0.050	0.250	0.250	0.250	0.250	-
Capital Contributions to the Department Capital Investment	1.675	-	-	-	-	-
Total Operating impact	8.645	0.768	0.919	0.919	0.919	-
Total Debt impact	1.675	-	-	-	-	-

25. **Agree** that the drawdown of the \$2.000 million advertising component of the above appropriations requires approval by joint Ministers following consideration of the proposed advertising programme and strategy.

26. **Note** that Inland Revenue officials will report back to joint Ministers later in 2006 on whether it is possible to use departmental savings to fund part of the administration costs.

Fiscal implications

27. **Note** that the recognition of historical interest and penalties on the accounts of those borrowers having been identified as non-resident is estimated to have the following impact, which increases the operating balance by a corresponding amount:

	\$ million increase / (decrease)			
	2006/07	2007/08	2008/09	2009/10 & out-years
Fair value recognition	141.960	-	-	-

28. **Agree** to increase funding for the proposals in recommendations 1 – 22 as follows:

	\$ million increase / (decrease)			
	2006/07	2007/08	2008/09	2009/10 & out-years
Operating balance impact	156.623	2.496	2.630	2.630
Debt impact	23.000	23.000	6.000	6.000
No impact	-	-	-	-
Total	179.623	25.496	8.630	8.630

29. **Approve** the following changes to appropriations to put into effect the decisions in recommendations 1 – 22:

Vote Revenue	\$ million increase / (decrease)			
	2006/07	2007/08	2008/09	2009/10 & out-years
Other Expenses to be Incurred by the Crown:				
Student Loan Fair Value Recognition	135.775	-	-	-
Vote Social Development				
Bad Debt Provisions	20.848	2.496	2.630	2.630
Total Operating	156.623	2.496	2.630	2.630

30. **Agree** that the changes to appropriations for 2006/07 in recommendations 24 and 29 be included in the 2006/07 Supplementary Estimates and that, in the interim, these expenses be met from Imprest Supply.

Legislative requirements

31. **Agree** to give effect to the above recommendations in the Student Loan Scheme Amendment Bill, planned for introduction in October 2006.
32. **Note** that the Student Loan Scheme Amendment Bill has a category 2 priority – must be passed before the end of the year.
33. **Invite** the Minister for Tertiary Education and the Minister of Revenue to provide drafting instructions to the Parliamentary Counsel Office to give effect to the above recommendations.

Further work

34. **Note** that the business case for rebuilding Inland Revenue's student loan system will be considered as part of the Budget 2007 process.
35. **Direct** officials to report back to joint Ministers on:
 - a strategy to increase repayments made by student loan borrowers overseas by June 2007; and
 - the impact/effectiveness of the key policy changes in this paper by June 2008 and the actual cost of these policies with any unspent portion being returned to the Crown.

Hon Dr Michael Cullen
Minister for Tertiary Education

Hon Peter Dunne
Minister of Revenue