Making it easier for borrowers to repay their student loans

A government discussion document

Hon Peter Dunne
Minister of Revenue

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CHAPTER 1

Introduction

1.1 The Government is considering changes to the way borrowers pay back student loans and how the student loan scheme is administered by Inland Revenue. The aim is to make it easier for borrowers to manage their loans, pay back what they owe, and to encourage earlier repayment.

1.2 The focus is on removing the current end-of-year assessment and square-up, earlier detection of PAYE errors, reducing penalties, and improving online services to make it easier for borrowers to manage their accounts. These measures, coupled with new online technology will allow Inland Revenue to provide a more responsive and flexible service to borrowers.

1.3 To reduce the time borrowers must spend on managing their loan accounts, and to improve the overall service to borrowers, only large overpayments will be refunded. Consequently, some borrowers may pay back their loans earlier than they would otherwise.

1.4 We seek your views on the ideas set out in this discussion document. Chapter 2 sets out the background to the changes, while the following chapters outline the impact on borrowers who are employees, self-employed, or based overseas. The final chapter outlines the enhancements and new services proposed for student loan online services.

1.5 This work is not intended as a wider review of student loan scheme policy.

1.6 This discussion document has been prepared as part of a consultation process. Consultation will also take place through an online forum. If the Government decides to proceed, submissions on the ideas explored in this paper will be taken into account in designing policy proposals that could be included in legislation introduced into Parliament later this year. Changes could apply from 1 April 2011 at the earliest, depending on the nature of the changes. To meet these tight timelines, written submissions or those made via the online forum, must be received by 17 July 2009.

1.7 The online forum is available at www.ird.govt.nz/studentloanforum so you can comment on the ideas raised and we encourage you to do so. You can also let us know your views by making a written submission. Written submissions should be addressed to:

Student Loan Proposals
C/ - Deputy Commissioner, Policy
Policy Advice Division
Inland Revenue Department
PO Box 2198
WELLINGTON 6140

Or email policy.webmaster@ird.govt.nz with “Student Loan Proposals” in the subject line.

1.8 Feedback made through the online forum and written submissions may be the subject of a request under the Official Information Act 1982, which may result in their publication. The withholding of particular written submissions on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. Those making written submissions who consider there is any part of it that should properly be withheld under that Act should clearly indicate this.

Summary of proposed changes

Employees

- The repayment threshold would be set on a pay-period basis – weekly, fortnightly, four-weekly or monthly – rather than an annual basis.
- Borrowers and students who only work for part of the year may be required to make repayments during the time they work.
- Major PAYE errors would be identified and corrected earlier than they are now.
- If an employer under-deducts loan repayments, future deductions could be adjusted to correct the error. A lump sum payment would not be due, and late payment penalties would not apply.
- Most overpayments would be used to reduce the loan rather than be refunded.
- Borrowers could seek a refund of overpayments only if the amount was significant and caused by an employer error.

Self-employed

- The late payment penalty (currently 19.56 percent a year) for non-payment of a borrower's repayment would be replaced with interest on the outstanding amount.
- Under-payments resulting from the year-end square-up would be collected over the next three interim instalments.

Overseas borrowers

- The late payment penalty imposed on overseas-based borrowers who fail to pay their repayment obligations on time would be replaced with a higher rate of interest on the outstanding amount.

New online services for all borrowers

- Online services would be similar to those that are used to manage bank accounts.

CHAPTER 2

Background

2.1 More than half a million people have student loans, and this number grows each year. Most borrowers are people who have finished their studies and are paying off their loans. The repayment system they experience is complex and requires a yearly assessment and square-up of how much they paid and how much they borrowed over the year. This administrative requirement can be a burden for some borrowers. Many borrowers receive statements and letters from Inland Revenue several times a year, and may have to contact the Department by phone if they have questions about their loan balance or repayment levels. Borrowers may also experience delays in getting a response from the Department since Inland Revenue has to perform many of these tasks manually, which consumes significant administrative time and resources. These resources could be devoted to more front-line support for borrowers and taxpayers generally. The Government considers that there is room to improve the administration of the scheme.

Reasons for change

2.2 The student loan scheme is a major Crown asset and it is essential that it be well managed. Each year approximately 60,000 new borrowers join the scheme. The nominal value of loans totalled $9.573 billion in June 2008.

2.3 The existing student loan scheme is difficult to administer and potentially confusing to borrowers. This is largely because the systems are modelled on tax principles, which place an emphasis on absolute accuracy over simplicity. This stress on accuracy results in high compliance costs. For example, borrowers have to square-up their loan payments each year which often results in unforeseen debt, or little change in outcome compared with the time and resources invested by borrowers and Inland Revenue. The current rules carry with them the risk of significant late payment penalties, a deterrent which is essentially an income tax concept, and which is of questionable suitability in administering student loans.

2.4 The majority of borrowers are likely to be comfortable with the use of online services so there is scope to move from the current inefficient paper-based system to one which is primarily online. An electronic environment would improve the services available online which will give borrowers, especially those based overseas, greater access to information about their loans whenever it suits them. Expanding online services will also free up Inland Revenue resources to focus on proactive services and better support for borrowers.

Necessary trade-offs

2.5 For borrowers, these ideas, if implemented, would improve services, reduce compliance costs and allow a high degree of self-management. Other benefits include protecting the value of the Crown's asset, and enabling administrative resources to be used more effectively to focus on higher value activities.

2.6 However, the gains, which largely arise from moving employed borrowers to a pay-period based assessment, are likely to result in higher costs for some borrowers and some employers. For example, the pay-period assessment will mean that borrowers who work part of the year are likely to be paying more towards their loan during that time than under the current annual assessment system. Similarly, there will be some increase in compliance costs for non-compliant employers. For example, an employer will be contacted by Inland Revenue if he or she continues to make incorrect repayment deductions.

CHAPTER 3

Borrowers who are employees

Current rules

3.1 Borrowers are required to advise employers that they have a student loan so that employers make deductions from borrowers' salary and wages during the year via the PAYE system. Inland Revenue monitors the correct use of codes and contacts employers if there is a problem. The student loan deduction rate is 10 percent of a salary or wage when, for the pay-period, a borrower earns more (on an annual basis) than the student loan repayment threshold. This annual repayment threshold is currently $19,084 (which equates to $367 per week). Borrowers who earn an annual income below this threshold do not have to make repayments towards their loan.

3.2 Repayments deducted during the year are squared-up at year-end through the personal tax summary process if requested by borrowers. If too little has been paid through the PAYE system during the year, the shortfall is due on 7 February of the year following (or 7 April if the borrower has a tax agent). Penalties are imposed if this is not paid on time. If the borrower is due a refund it is issued upon request up to six months after the assessment.

3.3 Finally, borrowers in hardship can apply to Inland Revenue to have their repayment obligation reduced.

Proposed changes

3.4 Under the proposed changes, repayment deductions would continue to be deducted by employers each payday through the PAYE system. However, the repayment obligation would be set on a weekly, fortnightly, four-weekly or monthly basis, instead of an annual basis. As noted above, the current annual repayment threshold of $19,084 equates to a repayment threshold of $367 per week for those paid weekly. If the borrower earned over this amount in a week the employer would start making a student loan deduction. One implication of this change is that those with fluctuating incomes may pay more than is required under the current rules.

Example: Working while studying

Lisa is a university student and works during the Christmas break. She earns $900 a week for the eight weeks she works, and has an annual income of $7,200.

Under the current system, Lisa won't have to make repayments as her annual income does not exceed the $19,084 annual repayment threshold.

Under the new proposals, Lisa's weekly income for the period she works will be above the repayment threshold. Over the Christmas break, Lisa will have $53.30 deducted from her pay each week for her student loan repayments. This is 10 percent of $533, which is her weekly gross income of $900 less the repayment threshold of $367.

3.5 Inland Revenue will check the amounts of student loan repayments deducted using information currently provided by employers to identify non-deduction and other errors, and contact employers to correct these when spotted. If a minor error in deduction occurs – either an under-deduction or an over-deduction because the employer makes a calculation error, the error will be ignored. Small overpayments would be put towards reducing the balance of the student loan, resulting in the loan being paid off earlier than otherwise.

Example: Repayment error

Underpayment

Arjun has finished studying. He now works full-time for a small employer who has a manual payroll system. He is paid weekly. When Arjun started his job his employer miscalculated his student loan repayments for the first month and he now owes $500 in repayment deductions. The employer did not spot the error when preparing the PAYE return.

Under the current system, Arjun would be sent a bill for $500 after the end of the tax year.

Under the proposed changes, the error may be spotted by Inland Revenue through its ongoing monitoring, or Arjun might notice it when checking his account online.

Once identified by Inland Revenue, it would contact Arjun's employer to correct the deduction amount for the future. Inland Revenue would consider the problem corrected and take no further action.

Overpayment

Had Arjun overpaid by $500, the new proposals mean that Inland Revenue would contact Arjun's employer to correct the deduction amount for the future, and would apply the overpayment to his student loan balance. Arjun's student loan would then be paid off a bit faster.

Under the current system, if Arjun notices the overpayment and requests a summary of earnings and a personal tax summary from Inland Revenue, he could get the overpayment refunded to him at the end of the year. Otherwise, it would be applied to his loan balance.

3.6 A major overpayment, as a result of an employer error, would be refunded if requested by the borrower. If there is a major underpayment, it would be collected from the borrower over following pay-periods through a higher rate of deductions. For example, the deduction rate for that borrower would increase to 12 percent, rather than the standard 10 percent.

3.7 Some borrowers may have a job which pays less than the current repayment threshold of $19,084 a year. Under the proposed changes, if they take a second job, there would be an option to apply the "unused" threshold left from their first job (the difference between their income from the first job and the repayment threshold) to their second job. If the borrower does not make use of this option, loan repayments would be made from the first dollar of income from that second job.

Example: Income from a second job

Peter has two jobs. He receives $326 a week from his main job and $77 a week from his second job.

Under the new proposals, the weekly repayment threshold is $367. Peter has $41 of "unused" repayment threshold per week from his main job ($367 minus $326 = $41).

He applies this unused repayment threshold to his second job.

He pays $3.60, or 10% of $36 ($36 being his secondary income in excess of the repayment threshold), each week, rather than $7.70, or 10% of $77 ($77 being his total secondary weekly salary).

If he didn't apply his unused repayment threshold from his main job to his second job, the extra $4.10 ($7.70 minus $3.60) would be applied to his loan balance each week.

3.8 If the borrower receives interest and dividend income below a combined threshold (say $1,500 a year), that income would be ignored when calculating repayments. This will allow wage and salary earners to remain with the simpler system of pay-period deductions rather than being required to complete a return of income. Currently, any amount of such income is counted towards the income used to calculate repayment obligations.

3.9 Borrowers in hardship would continue to be able to apply to Inland Revenue to have their repayment obligation capitalised or reduced.

3.10 The 10 percent voluntary repayment discount would continue to apply to any repayments of $500 or more above the compulsory repayment obligation, if there were no arrears.

We welcome submissions on:

- The idea of disregarding minor overpayments and underpayments during the year and making corrections against future repayments only. In effect this means that Inland Revenue would not worry too much about small errors.
- The impact on students who work in their holidays or borrowers who work part of the year having to make repayments.
- Doing away with the year-end square-up to free-up resources for other things, like better online services.
- Overpayments being applied to the balance of the loan. This would mean that the loan could be paid off quicker. A refund would be allowed if an employer error leads to a major overpayment.

- The idea that major underpayments are recovered through increased deductions each pay-period. Currently overpayments are paid back in a lump sum after an end-of-year square-up.

- Do you think that $1,500 (of combined interest and dividends) is an appropriate threshold for making extra payments?

- Any other changes you think we should consider.

CHAPTER 4

Self-employed borrowers or those with other income

Current rules

4.1 If a borrower has income other than from salary and wages they are required to file a return at the end of the year and square-up their income tax and student loan repayment obligations. This is because there is no accurate proxy for measuring their income during the year, as there is for those paid by salary or wages.

4.2 If the student loan residual repayment obligation is $1,000 or more the borrower is required to make three interim repayments during the year. Late payment penalties apply from the third and final instalment date if payments have been missed. Currently, no late payment penalty applies to the earlier two payment dates.

4.3 If too little has been paid during the year through interim instalments the shortfall is due on 7 February of the year following (or 7 April if you have a tax agent). Penalties are imposed if the shortfall is not paid on time.

4.4 The annual repayment threshold for repayments (currently $19,084) applies and is the same as that for wage and salary earners.

Proposed changes

4.5 Under the proposed changes, the system would generally remain the same. Borrowers would be required to file a return at the end of the year and square-up their student loan repayment obligations. All interest and dividend income would continue to be part of the end-of-year student loan repayment calculation. The annual repayment threshold for repayments (currently $19,084) would continue to apply.

4.6 Borrowers would be required to pay one-third of their liability on the three interim repayment dates if their annual student loan residual repayment obligation is $1,000 or more.

4.7 If the borrower does not pay their three interim instalments by the due date it will attract interest at, say 6.8 percent, from the due date. The interest rate would be the same as that for overseas-based borrowers, which at present is 6.8 percent. However, it would not attract a late payment penalty, as is currently the case. This approach would give borrowers an incentive to pay during the year but does not result in the application of much more significant late payment penalties (currently 1.5 percent a month or 19.56 percent a year).

Example: Missing a payment

Anjii is self-employed and is required to make three student loan payments of $4,000 each throughout the year.

Anjii misses his first payment, which was due on 28 August. He makes the payment at the end of September. Under the current system, he is not charged interest until the third instalment date which is 7 May of the following year.

Under the new proposals, interest is charged from the date of the instalment that he missed. Anjii will be charged one month's interest (currently 6.8% per annum) on the $4,000. The interest charged will be $22.

4.8 Under the proposed changes, if a borrower overpays during the year, at the end of the year they will be able to get a refund or they can apply the overpayment towards their loan balance.

4.9 If at year-end a borrower has underpaid their liability, the underpayment will be collected over the next three interim instalments.

Example: Interim instalments

William is self-employed. Last year he underpaid his student loan repayments by $900.

Under the current system he would have to pay this all at once on 7 February of the following year (or 7 April if he had a tax agent).

Under the proposals, instead of paying the whole amount on the following 7 February (or 7 April), his following year's instalments will each be increased by $300 to recoup the underpayment. By the end of the year he will have made up the shortfall.

4.10 The 10 percent voluntary repayment discount would apply to any repayments of $500 or more above the compulsory repayment obligation, as long as there are no arrears.

4.11 Inland Revenue will still be able to set a due date and undertake debt collection if a borrower fails to meet their obligations.

4.12 If a borrower does not make their first and second loan instalments on time, they will be charged interest on the amount due from the date the payments were due, rather than a late payment penalty from the final of the three due dates.

4.13 This change is to encourage borrowers to make regular payments rather than wait until the final due date to make a lump sum payment.

4.14 It means that if a borrower is late with their first and second payments, they will pay interest under the proposals.

4.15 If a borrower overpays, they can get a refund or can apply the overpayment to the loan balance.

4.16 If the borrower underpays, they would pay off the debt in three instalments added to their regular loan payments, rather than paying it in one lump sum on 7 February (or 7 April if they have a tax agent). There would be no interest as long as interim payments were made on time.

We welcome submissions on:

- Interest being charged from the first repayment date if repayments are late, instead of late payment penalties from the final payment date.
- Repaying an underpayment at year-end by increasing the following year's interim instalments, instead of one lump sum at year-end.
- Any other changes you think we should consider.

CHAPTER 5

Borrowers who are based overseas

Current rules

5.1 Overseas-based borrowers are entitled to a three-year repayment holiday when they go overseas. Interest is still applied to the residual repayment obligation when a borrower takes a repayment holiday.

5.2 Overseas-based borrowers who are not on a repayment holiday have to pay between $1,000 and $3,000 each year, depending on their loan balance. Interest is also applied to the loan balances of overseas-based borrowers. Currently, this is 6.8 percent.

5.3 Late payment penalties of 1.5 percent per month (or 19.56 percent a year) are applied when borrowers fail to meet their repayment obligations.

Proposed changes

5.4 Under the proposed changes, overseas-based borrowers will still be entitled to a three-year repayment holiday. Interest would still apply to their loan while on a repayment holiday.

5.5 The current obligation to pay between $1,000 and $3,000 would remain.

5.6 A higher rate of interest, rather than the late payment penalties, would apply in the event of non-payment. Borrowers who do not meet their repayment obligations would be subject to interest on the shortfall. This interest rate would be, say, the interest rate on student loans plus a margin of 4 percent. This is in lieu of the much more significant 1.5 percent per month (19.56 percent a year) late payment penalty which currently applies. The replacement of penalties with interest for non-payment will reduce the rate at which student loan debt grows.

Example: Non-payment of loan while overseas

Peggy graduated and went on her OE three years ago. The three-year repayment holiday Peggy arranged before she left has recently ended, and she now has a repayment obligation. She does not make payment.

Rather than the late payment penalties of 1.5% per month that currently apply (which add up to 19.56% per annum), Peggy is charged a higher interest rate on the missed payment. The higher interest rate will continue until she has paid the outstanding amount.

5.7 The 10 percent voluntary repayment discount would apply to any repayments of $500 or more that are above the compulsory repayment obligation, if there are no arrears.

5.8 One of the key features of expanding online services is the option for overseas-based borrowers to deal with Inland Revenue by email. Currently it is difficult for Inland Revenue to provide services to overseas-based borrowers. For example, it is difficult to maintain a current address for many overseas-based borrowers and for borrowers to call during office hours because of international time differences.

We welcome submissions on:

- Doing away with late payment penalties, and replacing them with an extra rate of interest that would be less than the current penalty rate.
- Any other changes you think we should consider.

CHAPTER 6

New online services

Current process

6.1 Interactions between borrowers and Inland Revenue are mainly by phone and paper. At a minimum, borrowers receive statements twice-yearly. Any changes made to loan accounts during the year, for example, when a penalty is applied, automatically trigger a further paper statement.

6.2 Students who are still studying may have to contact both StudyLink and Inland Revenue to obtain a consolidated loan balance. This happens because StudyLink administers the current borrowings which are only transferred to Inland Revenue once a year. Once they are transferred, the loan balance is consolidated.

Online services for the future

6.3 Because it is likely that most borrowers are comfortable using electronic technology, Inland Revenue is looking toward expanding online services to enable borrowers to self-manage their loan accounts online to a greater extent than is currently possible.

6.4 When it's convenient for borrowers to do so, they would be able to access a number of services through a secure online service, including:

- viewing an up-to-date loan balance and transaction history;
- managing their loan account at any time, and from anywhere;
- applying for special tax or repayment codes to change deduction rates;
- increasing student loan deductions and viewing the impact of this change on their loan balance;
- requesting a refund of overpaid deductions; and
- contacting Inland Revenue by email.

6.5 Phone contact would be the exception and limited to complex cases that cannot be handled via online services. Paper contact would be kept to a minimum.

6.6 Loan balances would be transferred more frequently from StudyLink to Inland Revenue, allowing borrowers to have access to a consolidated loan balance without the need to contact two agencies.

We welcome submissions on:

- Whether you would like to be able to get in touch with Inland Revenue through other electronic channels such as email or text message. If you could access all your student loan information securely online, would you be happy for Inland Revenue to stop sending you this on paper?

- What services would you like to have available online to help you manage your loan account?

- Are there any other changes to online services that you think we should consider?

APPENDIX

Glossary of terms

Borrower: Any person with a student loan.

Interest rate: The rate at which interest is charged on your loan balance if you're an overseas-based borrower. The interest rate is adjusted every year. The interest rate for the 2009–10 tax income year is 6.8 percent.

Late payment penalties: Penalties incurred when you fail to meet your student loan repayment obligations.

Official Information Act 1982: The Act that regulates the release of government information to the public.

Online services: A system of providing services through the internet. A key feature of these proposals is to move student loan services to a web-based system.

Over-deductions (overpayments): When a borrower's student loan repayments made through the PAYE system have been too large and therefore the deductions have exceeded the compulsory repayment obligation.

Overseas-based borrowers: Any borrower who doesn't qualify for an interest-free student loan because they've been overseas for 184 or more consecutive days (and doesn't qualify for one of the exemptions).

PAYE system: This stands for "pay as you earn" and is a system where taxpayers make payments towards their tax liability and student loans through deductions from their salary and wages each pay period. Taxpayers select a tax code based on their yearly salary or wage and their employer uses this to determine the amount of deductions for income tax and student loan repayments.

Personal tax summary: A summary of your income for the year that indicates any income tax to pay or be refunded.

Repayment holiday: A period during which a borrower is not required to make payments towards their loan, although interest continues to accrue. A repayment holiday applies only to overseas-based borrowers.

Repayment obligation: The assessment of the amount owed on your student loan for a tax year. For New Zealand-based student loan borrowers, the obligation is equal to 10 percent of your income over the repayment threshold (any repayments you have already made are deducted from this to establish your year-end payments).

Repayment threshold: The amount you can earn in a tax year before you must start paying back your loan. For the tax year 1 April 2009 to 31 March 2010, the repayment threshold is $19,084.

Salary and wage earner: A person whose main source of income is from salary or wages paid by an employer.

Secondary income: Income from a job that is separate from and in addition to a taxpayer's main job.

Self-employed: A person who earns income from their own business activities rather than an employer.

StudyLink: A service of the Ministry of Social Development that helps students access financial support and other entitlements while they complete their studies.

Tax codes: Codes used by the PAYE system to determine the correct deductions. Taxpayers select a tax code by filling out the flow chart on the IR330 form when they start a job. The codes indicate whether a job is the taxpayer's main or secondary employment and whether they have a student loan. If a taxpayer's circumstances change, they may have to change their tax code.

Under-deductions (underpayments): When a borrower's student loan repayments made through the PAYE system have been too small and the repayments are less than the compulsory repayment obligation.

Voluntary repayment bonus: The proposed Government policy whereby borrowers who make voluntary repayments over a threshold of $500 in a tax year get a repayment bonus of 10 percent of the extra amount repaid applied to their student loan.

Voluntary repayments: A payment above your compulsory repayment obligation. You can make voluntary repayments even if you earn less than the repayment threshold. A voluntary repayment will reduce the term of your student loan. You can choose to pay off some, or all, of your student loan at any time.

Year-end square-up: An assessment process at the end of the tax year (31 March) to determine if a taxpayer has paid the right amount of income tax or made the right student loan repayments.