Taxation (Transformation: First Phase Simplification and Other Measures) Bill

Bill Number 41-1

Regulatory Impact Statements

Prepared by Policy and Strategy, Inland Revenue

June 2015

Regulatory Impact Statement

Simplifying the collection of tax on employee share schemes

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Inland Revenue.

It provides an analysis of options to simplify the collection of tax on employment income an employee receives under an employee share scheme (ESS). Specifically, it explores the idea of changing the way income tax on employee share scheme benefits is collected.

None of the options discussed in this RIS are intended to alter the recognition or valuation of tax payable on an ESS benefit or change employers' ability to deduct for income tax purposes the value of any ESS benefits provided to employees. These issues are part of a separate project that is on the Government's tax policy work programme.

The policy proposals in this RIS have been advanced ahead of this other project on employee share schemes so that it can be included as part of a package of measures in a June 2015 taxation bill that demonstrates the Government's commitment to delivering tangible change through Inland Revenue's Business Transformation programme. These measures had to be fiscally neutral, straightforward to administer and implement, and not pre-empt any wider policy reforms scheduled for later stages of Inland Revenue's Business Transformation programme.

Inland Revenue released an issues paper in April 2015 entitled *Simplifying the collection of tax on employee share schemes*. The issues paper acknowledged that a number of problems exist with the way that tax is collected from benefits received under an employee share scheme. It sought comment on our definition of the problem with the current system, three options to allow employers to account for tax on employee share scheme benefits on their employees' behalf, and whether the collection mechanism should be compulsory or apply at employers' election.

A total of 17 submissions were received on the issues paper. Submissions broadly agreed with our problem definition and the reasons for considering legislative change to shift the point at which tax is collected on ESS benefits. The majority of submissions were supportive of the idea of shifting the obligation to collect tax on ESS benefits to the employer. However, this support was conditional on:

- Employers having the choice of collecting tax on ESS benefits; or
- In the alternative, if employers did not have any choice, existing schemes should be outside the scope of any change – that is, employers with existing schemes should be outside the scope of any obligation to collect tax unless they chose to opt in.

If source taxation applied to ESS benefits, submissions expressed a strong preference that the PAYE system be used, rather than the FBT system or a separate withholding tax system.

Submissions also recognised that if employers had the choice of whether to collect tax it would be reasonable for them to provide information to Inland Revenue about the employees who received an ESS benefit. However, submissions varied on what information should be disclosed.

As a result of submissions and the need to improve the overall efficiency of collecting tax on ESS benefits, our preferred option is to use the PAYE system to collect tax and for employers to have the choice to withhold tax. Allowing the collection of tax to be optional permits employers to evaluate the tax benefits and costs so that the employer's obligation to collect tax using the PAYE rules applies when, in the employer's view, it is most efficient to do so.

Inland Revenue considers that its information requirements can be met if the value of any ESS benefits is disclosed using the employer monthly schedule (EMS). Including the value of these benefits in the EMS would not automatically create an obligation to withhold tax. We recognise that this disclosure requirement may increase compliance costs for some employers in terms of valuation and funding the payment of tax. These costs, however, are currently incurred by employees.

The Treasury and the Accident Compensation Corporation were involved in the policy development of the recommended proposal and agree with conclusions reached.

Inland Revenue does not hold comprehensive information on the number of employee share schemes offered in New Zealand or the number of employees involved in such schemes. We are aware that large corporate taxpayers commonly use these schemes as part of their remuneration strategies. Our analysis has been based on comments received from submissions on the officials' issues paper *Simplifying the collection of tax on employee share schemes*, the expected outcomes under the options considered and contrasted against the status quo, and the current tax law that applies to employment income in the form of ESS benefits.

None of the policy options restrict market competition, impair property rights, reduce the incentive for businesses to provide these schemes, or override fundamental common law principles.

There are no other significant constraints, caveat or uncertainties concerning the analysis undertaken.

Peter Frawley
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3 June 2015

STATUS QUO AND PROBLEM DEFINITION

Current policy and law

1. Collecting tax at the source of income earned by a taxpayer is an important feature of modern tax systems. Collection at source ensures there is more accurate reporting of income and reduced collection risk. Collection at source also gives the Government the ability to leverage the tax system to provide social policy outcomes – for example, the various social policy programmes that rely on accurate reporting of individual and household incomes such as child support, student loans and Working for Families tax credits.

2. Benefits[1] provided to an employee under an employee share scheme (ESS) are "employment income" under the Income Tax Act 2007. Unlike most employment income or benefits, such as salary and wages or a use of a company car, however, it is not currently subject to tax at source under either the Pay As You Earn (PAYE) or Fringe Benefits Tax (FBT) rules. This means that employee recipients of ESS benefits must file an individual tax return to account for the ESS benefits as income and pay the tax on those benefits themselves.

Current practice

3. The collection of tax on ESS benefits has not been well understood to date and a number of companies have been accounting for ESS benefits through the PAYE system despite the law not providing for this. To clarify the correct treatment, Inland Revenue released a Large Enterprises Update in November 2013 which advised employers that ESS benefits are not subject to either PAYE or FBT so should not be included in their employer monthly schedule or FBT return. Instead they were advised that any employee receiving an ESS benefit must file an IR 3 tax return for the income year in which they receive it.

4. Following this Large Enterprises Update, stakeholders, including the Corporate Taxpayers Group have requested as a high priority a legislative amendment to permit employers to account for tax on ESS benefits at source, preferably through the PAYE system.

The problem

5. The current collection mechanism requiring an employee to file a return and account for the tax on ESS benefits imposes compliance costs on taxpayers and administrative costs on Inland Revenue. As no tax is deducted at source, the obligation to return the ESS benefit as income may be unfamiliar territory for employees who may not be used to not filing tax returns with Inland Revenue. Further complications can arise if the employee needs to sell shares to meet any tax obligations and, if the obligation is large enough (the residual income

[1] The "benefit" under an ESS is, in the case of an acquisition of shares, the amount by which the value of the shares when they were acquired is more than the amount paid or payable for them. Share options provided to employees are generally not taxed until they are exercised, at which time the tax treatment in the previous sentence applies.

tax is $2,500 or more)[2] the employee could find themselves subject to the provisional tax rules and use of money interest (UOMI).

6. These tax compliance costs can also:

- act as a barrier to the attractiveness of employee share schemes as a form of remuneration;
- affect the likelihood of voluntary compliance by the employee; and
- potentially result in lost tax revenue.

7. When contrasted against the collection of tax under the PAYE system or the FBT rules, the current rules for collecting tax on ESS benefits is arguably inefficient for both employees and Inland Revenue.

8. The question to be addressed in this RIS is what improvements can be made to the collection of tax on ESS benefits to help simplify and improve the overall efficiency of the tax system.

OBJECTIVES

9. The main objective of this review is to simplify the way tax is collected on ESS benefits in order to improve the overall efficiency of the tax system.

10. The optimum option should:

- minimise compliance costs on employees;
- minimise administration costs for Inland Revenue;
- reduce the risk of non-compliance in connection with the taxation of ESS benefits; and
- be fiscally neutral.

11. This review is not intended to pre-empt any wider policy reforms scheduled for later stages of Inland Revenue's Business Transformation Programme. It is also not intended to alter the recognition or valuation of tax payable on an ESS benefit or change employers' entitlements to deduct the value of any ESS benefits provided to employees. These issues are part of a separate project that is on the Government's tax policy work programme.

12. We also note that the chosen option is not intended to affect the status quo treatment of employee share scheme benefits for student loans, child support, Kiwisaver, Working for Families Tax Credits and the ACC earners' levy.

[2] Residual income tax is the positive amount of tax still owed by an individual after subtracting the amount of any tax credits – such as tax paid by the employee through the PAYE system.

13. Trade-offs will inevitably be made across the various objectives. For example, solutions that seek to minimise Inland Revenue's administrative costs may impose compliance costs on employers.

REGULATORY IMPACT ANALYSIS

14. Four options (including the status quo) are considered in this RIS for the collection of tax on ESS benefits. These options, which were canvased in the April 2015 officials' paper, are:

- Option 1 (status quo) – individuals must declare any ESS benefits in their tax return which is filed at the end of the year and any tax is collected as part of the end-of-the-year annual assessment.
- Option 2 – employers collect tax on any ESS benefits through the PAYE system.
- Option 3 – employers collect tax on any ESS benefits through the FBT system.
- Option 4 – employers collect tax on any ESS benefits through a separate withholding tax system.

15. Options, 2, 3 and 4 will tax ESS benefits at source and shift the tax obligation from employees to employers.

16. The impact of each option is summarised in the attached annex to this RIS. None of the options have:

- Social, cultural or environmental impacts.
- Fiscal impacts, although it is expected that collection of revenue should be improved by shifting the collection of tax from employees to employers.

17. In addition, we have considered whether the preferred option of collecting tax by employers should be compulsory or elective. This discussion is set out below.

Collection of tax options

Option 1 (status quo)

18. Option 1 is to retain the status quo as described under the heading "Status quo and problem definition". We recognise that for some schemes it is more efficient for the employee to retain responsibility for meeting any tax obligations arising from the receipt of an ESS benefit and this is reflected in our comments under the heading "Conclusions and recommendations".

Option 2: PAYE (preferred option)

19. Under this option, the employer withholds PAYE on the value of the ESS benefits and pays this amount to Inland Revenue as part of the employers' "employer monthly schedule" (EMS).

20. The main advantages of this option are:

- PAYE is a very efficient method of collecting tax and an important part of modern tax systems.
- Most payroll systems have fully automated the tax compliance obligations for PAYE and so the costs to comply with and for Inland Revenue to administer the PAYE system are relatively low.
- Despite the concerns about applying PAYE to a non-cash form of employment income (below), submitters generally preferred the PAYE option as it is generally well understood by employers and maintains the economic incidence of tax on the employee.
- The PAYE system is also better integrated with the Government's social policy programmes, subject to legislative modifications to the Accident Compensation Act 2001 and the Kiwisaver Act 2006 to ensure that amounts subject to PAYE withholding are not taken into account under these Acts.

21. The main disadvantage with this option is one of application. The underlying principle with PAYE is that tax can be readily withheld as the employees' salary and wages are in cash. However, in the case of ESS benefits (which are shares and not cash) there is an in principle difficulty with applying PAYE. To make PAYE work, employers would have to:

- recover the cost of tax from the employee, that is – deducting the tax from the employee's wage or salary;
- sell a portion of the employee's ESS entitlement on their behalf to fund the tax – assuming the ESS arrangement provided the employer with this power; or
- provide a cash gross-up to accompany the ESS benefit to fund the PAYE. Employers raised concerns that in situations where the employee and the employer had reached a bargain in terms of an employee's remuneration and ESS entitlements, an additional gross-up could make the ESS too expensive for the employer.

22. Employer concerns about funding tax payments are the same faced by employees when they have to account for tax themselves.

Option 3: FBT

23. Under this option, employers' calculate FBT on the value of any ESS benefits received by the employee and pays this tax to Inland Revenue.

24. The main advantages of this option are:

- FBT is conceptually a purer method of taxing non-cash benefits.
- FBT is designed specifically to tax non-cash benefits and remuneration received by an employee.
- FBT is designed with equity in mind by ensuring that non-cash remuneration received by employees is subject to tax at a similar level to cash remuneration. The gross-up aspect described above is built into the FBT rules via the tax rate structure and the cost of FBT and the legal incidence of the tax falls on the employer.

25. This option has a number of shortcomings, including:

- All employers have payroll systems that broadly comply with the requirements of the PAYE rules. The provision of fringe benefits, however, is less common and some employers would not have the requisite compliance systems in place to meet their obligations under the FBT rules. Using FBT as a means of collecting tax at source would therefore be unfamiliar to some employers and require them to develop new systems to manage compliance with the FBT rules. This would likely increase employer tax compliance costs over and above those incurred by employees under the status quo and could make it unattractive for employers to provide an ESS.
- From an Inland Revenue systems perspective, FBT – being a tax on the employer – is not fully integrated with the systems used to report and manage employees' child support obligations.
- For tax technical reasons, tax collected under the FBT rules means it does not count for the purposes of tax relief for employees in a cross-border context. New Zealand's Double Tax Agreement network treats FBT as an employer tax. As such, employees cannot claim any credit for New Zealand tax paid.

Option 4: Alternative withholding tax system

26. A separate method of withholding, such as using withholding regulations, was initially considered but not advanced due to constraints on Inland Revenue's ability to implement the change. As noted in the officials' issues paper *Simplifying the collection of tax on employee share schemes*, we considered there was little justification for developing a new system of withholding tax when alternative well-developed systems such as PAYE and FBT already exist.

27. Reactions from tax specialists to this option were mixed. While some considered it an optimal option, others were concerned about the prospect of having to develop new compliance systems. Others did not see the case for duplicating compliance costs under a new withholding system when the PAYE system (option 2) could be used.

Implementation: compulsory or elective

28. There are two approaches to implementing the collection of tax on ESS benefits at source. They are the compulsory approach or elective approach.

Compulsory approach

29. There are administrative efficiencies for Inland Revenue if option 2 applied to all ESS.

30. A compulsory option, however, presents a number of problems for employers and a key theme in submissions was how a source basis of collection was not appropriate for all schemes, see paragraph 48. Employers were also concerned about the impact a compulsory set of rules would have on:

- the employer's working capital – for example, if the employer is a start-up company or funding the payment of tax on the ESS benefit generally;
- agreements or understandings that exist for current schemes if it is not possible for the employer to sell shares on the employee's behalf to meet any tax liability on the ESS benefits, or otherwise affect any contractual agreements about the value of any benefits provided under the scheme;
- bargains struck between the employer and the employee and the risk to the employer having to fund the tax payable on ESS benefits;
- employee tax entitlements or obligations – for example, if the employee is a short-term tax resident of New Zealand or has tax losses or expenses he or she wishes to use against any tax liability created by the ESS benefit.

31. Submissions argued that existing schemes would need to be removed (grandparented) from the scope of any change as it would be time consuming and costly to renegotiate existing ESS agreements to provide for tax collection at source.

32. Consideration of a compulsory approach to collection of tax on ESS benefits, including grandparenting, was not advanced in recognition that in some situations it is more efficient for the employee to remain responsible for the payment of tax on ESS benefits under the status quo. This conclusion assumed, however, that any elective approach to the tax collection of ESS benefits would be supported by appropriate disclosures from the employer to Inland Revenue about their employees' (including ex-employees where any legacy entitlement exists) ESS entitlements.

Elective approach

33. An elective approach to collecting tax at source was strongly preferred by tax specialists and employers for the very reasons why compulsory rules were considered undesirable. Allowing the collection of tax to be optional permits employers to evaluate the tax benefits and costs so that the employer's obligation to collect tax using the PAYE rules applies when, in the employer's view, it is most efficient.

34. An elective approach is an effective way of reducing compliance costs. The risk with flexibility is that it reduces the efficiency of collecting tax at source. Flexibility creates additional administration costs and, by itself, does not deal with Inland Revenue's concerns in terms of ensuring employee compliance. Submissions argued that the choice should be the employer's and not the employee's. Inland Revenue agrees and further notes that any election not to withhold tax should be done on a per-scheme basis as opposed to a per-employee basis.

35. The trade-off for providing the employer with a choice is the need for Inland Revenue to have better information about when an employee receives an ESS benefit.

36. Submissions received on the officials' paper recognised that if the employer had the choice to collect tax, it was reasonable for the employer to provide information to Inland Revenue about the employees who received an ESS benefit in cases where tax was not collected at source. Submissions varied on what information should be disclosed, however. Those advocating the use of PAYE considered that employers' payroll system would meet Inland Revenue's needs. Other employers considered that the information should be separately disclosed by some other means.

37. We considered two means by which the relevant information could be received by Inland Revenue.

- ***The employer monthly schedule (EMS)***: The data points contained in the employer monthly schedule provides Inland Revenue with the information needed to administer the collection of tax on ESS benefits (irrespective of employers' election to withhold tax on the benefit). This information can be captured in a timely and administratively efficient manner without any impact on Inland Revenue's technology platforms and meet the objective that Inland Revenue can implement with minimum cost. This option will create reconciliation errors due to amounts not being counted for Kiwisaver and when the employer chooses not to withhold tax. Inland Revenue considers these errors can be tolerated as the critical information is captured and can be examined as part of any end-of-year square up process.

- ***Other alternatives – information request, letter or new Inland Revenue form***: We considered other means by which the requisite information could be captured – for example, employees' tax file numbers and the value of the ESS benefit and when it was received. This information could be captured by way of an information request, letter or a new Inland Revenue form. Inland Revenue had

concerns about whether, when contrasted against the EMS, the information would be received in a timely manner and how it would be integrated into Inland Revenue's FIRST system. Resolving these problems would increase implementation costs and raise administration risks in terms of consistent application of the proposal change, retrieval of employers' decisions about withholding, and enforcing compliance.

38. We recognise that for some employers the requirement to disclose the value of employees' ESS benefits will involve some cost. Specifically:

- the need to value shares received by employees, and
- for certain schemes ensure that the receipt of any ESS benefits is appropriately captured by employers' payroll systems. New Zealand employers whose employees participate in a global ESS may also need to ensure they receive information from their international group about any ESS benefits that vest in their New Zealand employees.

39. These costs are currently incurred by employees under the status quo.

CONSULTATION

Initial consultation

40. Preliminary consultation was undertaken by officials during the policy development phase of the project and development of an officials' issues paper. Organisations consulted included the Corporate Taxpayers Group, Chartered Accountants Australia and New Zealand, PricewaterhouseCoopers and Ernst & Young. Comments from stakeholders indicated employers and employees would generally prefer that PAYE applied to ESS benefits.

Officials' issues paper

41. In April 2015, officials released the issues paper *Simplifying the collection of tax on employee share schemes*, which is available at http://taxpolicy.ird.govt.nz/publications/2015-ip-employee-share-schemes/overview.

42. The issues paper discussed changing the collection of tax from ESS using the PAYE system, the FBT rules or a separate withholding tax. Both tax collection systems would shift the collection of tax on ESS benefits to a source basis. The issues paper also discussed whether any change should be mandatory or not.

43. To allow for the possibility that any reforms resulting from the issues paper could be included in a proposed taxation bill scheduled for introduction in June 2015, five weeks were allowed for consultation before submissions closed on 5 May 2015. A total of 17 submissions were received.

44. Submissions were broadly supportive of the idea of shifting the point of taxation to source, provided that the employer had the ability to elect to use the rules. Submissions also recognised that any elective use of the rules would need to be accompanied by a suitable disclosures system to allow Inland Revenue to know which employees had received an ESS benefit. Those who supported changing the collection of tax to source, agreed with the problems officials identified with the status quo. The PAYE system was the generally preferred method of collection.

45. Two submissions were strongly opposed to any change from the status quo.

46. The arguments for making any change elective, including not proceeding at all with the changes, were similar.

Main submission points

47. The main submission points centred on:

- Source basis collection is not appropriate for all schemes
- Impacts on employers
- Impacts on employees
- Interaction with the Government's social policy programmes

Source basis collection is not appropriate for all schemes

48. Submitters identified a number of instances when taxing ESS benefits at source would be inappropriate. These instances included:

- **Executive schemes**: Submissions noted that the recipients of shares under an executive scheme were generally sophisticated taxpayers who would be used to meeting their own tax obligations. Shifting the collection point to the employer would therefore not result in a reduction in compliance costs. Submissions also noted concern about situations when the tax payable, due to the size of the benefit, could exceed the taxpayer's net salary (assuming the employer is unable to sell a portion of the share entitlement on the executive's behalf to meet the tax liability on the ESS benefit).
- **International schemes**: Global employee share schemes, where the issuer of the shares is a non-resident with no other tax obligations in New Zealand, could be required to comply with the New Zealand PAYE rules for a relatively small number of New Zealand employees.
- **Schemes offered by start-up companies**: Employee share schemes are a cost effective means of remunerating staff in situations when the company does not have substantial working capital to support monetary remuneration and for

recruitment reasons need to provide a competitive remuneration package. Imposing source taxation on these schemes would make it more costly for the employer to provide and remove the advantages of including a non-cash component in a remuneration package.

49. A number of submissions noted problems with the way the Income Tax Act 2007 taxes ESS benefits with particular regard to identifying when an ESS benefit is derived and its value. Currently, the employee is responsible for these obligations as part of filing a return of income. If the collection point is moved to a source-basis, these obligations fall on the employer. The valuation of ESS benefits was identified as a particular concern for start-up companies and other non-listed companies whose shares would have to be valued and the cost of such activity would be borne by the employer.

Impact on employers

50. Submissions expressed concern at the rework required for existing payroll systems if the obligation to withhold tax was mandatory.

51. Others noted existing schemes would need to be renegotiated and any benefits would need to be re-priced. Specifically, submitters were conscious that changing the point of tax collection could interfere with existing bargains struck between employers and employees. For example, if the employer was required to withhold tax at source on ESS benefits there is a risk that the employer would have to gross-up the benefit to take into account any tax payable to Inland Revenue. Grandparenting of existing schemes, if the collection of tax at source was not optional, was suggested.

52. Others noted concerns about the ability for employers to sell shares to meet employee tax obligations. A number noted that it would not be possible to sell shares if:

- the contract under which the ESS benefit is provided did not allow for the employer to sell shares;
- the employer may in certain periods be unable to sell shares because of prohibitions under other legislation, for example, the sale of share may be illegal for reasons of insider trading during "black out" (restrictions on trading) periods or other restrictions and covenants applicable in employment contracts;
- shares in the company may not be readily sold – "illiquid shares"; this is particularly relevant for start-up companies.

53. The concern underlying these comments is the impact taxing at source would have on the employer's working capital if the employer had to pay tax on the employee's behalf. Submissions did not accept that the cashflow effect of collection at source would be adequately remedied by the employer selling a portion of the employee's share entitlement to meet any tax obligations – assuming this was allowable under the relevant employee share scheme in the first place.

54. A few submissions commented on the information requirements needed to calculate the value of rights and options under an employee share scheme. Some thought the requirement

would be difficult to comply with while others noted that in their experience employers will be aware of the option exercise price as it will be specified in the share scheme offer documentation provided to the employee.

55. Other technical matters were raised in connection with how taxation at source would apply to past employees who might have legacy entitlements under an employee share scheme and the interaction of the proposals on employee entitlements under the Holidays Act 2003.[3]

Impact on employees

56. Submissions noted that some employees could have expenses and losses to use against any tax payable on an ESS benefit. Since these employees would be filing a return in any event, there is no point in the employer also bearing a tax compliance cost. More importantly, other employees, particularly those who are non-residents may have tax obligations in other countries. Imposing tax at source could act as a disincentive. These points argue against the use of the FBT rules.

Interaction with the Government's social policy programmes

57. Submissions generally endorsed the position that ESS benefits are counted towards an employee's child support and student loans obligations and Working for Families tax credit entitlements. Taxation at source was seen as a way of supporting the integrity of these programmes. It was noted that ESS benefits should not count for the purposes of the Accident Compensation Act 2001 and the Kiwisaver Act 2006.

58. The officials' issues paper noted the intention was not to change the status quo treatment of ESS benefits under the Government's social policy programmes.

Consultation with government agencies

59. The Treasury and the Accident Compensation Corporation were consulted and agree with our conclusions. The Ministry of Business, Innovation and Employment and Ministry for Social Development were also consulted.

CONCLUSIONS AND RECOMMENDATIONS

60. The current collection of income tax on ESS benefits presents a number of problems for employers and employees. The current rules are not necessarily well understood and the requirement that the employee must file an individual tax return to account for the ESS benefits as income and pay the tax on those benefits can lead to non-compliance. We

[3] Inland Revenue notes that shifting the tax collection point to the source of the benefit does not directly impact on employee entitlements under the Holidays Act. Entitlements under the Holidays Act are based on the employee's remuneration package, not the tax treatment of such benefits.

consider that there are good efficiency and tax system integrity arguments for shifting the income tax collection point from employees to employers. We considered several options that would achieve this outcome, such as the PAYE rules (option 2), the FBT rules (option 3) or a separate system of withholding (option 4). Options 3 and 4 did not meet most of the required objectives of:

- minimising compliance costs on employees;
- minimising administration costs for Inland Revenue;
- reducing the risk of non-compliance in connection with the taxation of ESS benefits;
- be fiscally neutral;
- not affecting employees' entitlements or obligations for student loans, child support, Working for Families tax credits, Kiwisaver and the ACC earners' levy.

61. Option 2 met most of the objectives but may impose additional compliance costs on employers. Consultation with stakeholders suggested that these compliance costs meant that taxing ESS benefits at source is not always appropriate or efficient. We accept these concerns and adjusted our view about whether option 2 should have compulsory application.

62. We recommend reforming the collection of tax on ESS benefits by:

- allowing the employer to choose to withhold tax on any ESS benefits received by an employee using the PAYE system (option 2 using an elective approach).
- requiring the employer to disclose the value of any ESS benefits via the employer monthly schedule – this would apply in all cases whether the employer chose to withhold tax or not.

63. We recommend any legislative changes be included in the taxation bill scheduled for introduction in June 2015 and apply from 1 April 2017.

64. The recommended option takes into account the compliance cost concerns identified in submissions. Using the PAYE system to improve the collection of tax on employee share benefits transfers compliance costs that are currently borne by the employee to the employer. From an employee's perspective, officials consider that taxation of employee share benefits at source is a better approach to collecting tax. It is a more consistent and coherent approach to taxing employment income. It is also consistent with the general policy of simplifying employees' tax obligations. Subjecting an employee to a potentially complex filing requirement for what may be a small tax liability when that employee would not otherwise have to file a return is inconsistent with the policy objective of simplicity and reduced compliance costs.

65. For the most part, it is more efficient for the employer to bear the cost of compliance. As submissions have already argued however, where this does not hold true, the employer can elect not to withhold tax under the PAYE system.

66. The trade-off for providing the employer with a choice is the need for Inland Revenue to have better information about when an employee receives such a benefit.[4] Employers may need to update their payroll systems to capture the requisite information.

67. The disclosure requirement may also create additional compliance costs for employers whose shares are not traded on a market exchange. As noted earlier, these costs exist currently, but they are borne by the employee. As the shares are issued by the employing company (or international group or an entity under the control of the employer), the employer is likely to have better information about the value of any share benefits.

IMPLEMENTATION

68. If approved, the preferred option will require changes to the Income Tax Act 2007, the Tax Administration Act 1994, the Kiwisaver Act 2006 and the Accident Compensation Act 2001.

69. These changes can be included in the next taxation bill scheduled for introduction in June 2015.

70. The legislative changes would apply from 1 April 2017 to allow employers and software developers' sufficient time to implement the necessary payroll and information systems changes to allow withholding and comply with the disclosure of ESS benefit information to Inland Revenue.

71. When introduced into Parliament, a commentary on the bill will be released explaining the amendments and further explanation of their effect will be contained in a Tax Information Bulletin, which would be released shortly after the bill receives Royal assent.

72. Inland Revenue will administer the proposed changes. Enforcement of the changes would be managed by Inland Revenue as business as usual.

73. The proposed changes largely align with Inland Revenue's existing systems. It is expected that using the EMS to receive information about ESS benefits may generate return errors if the employer does not withhold tax. These errors would require Inland Revenue to undertake additional manual work to correct. However, this is seen as a reasonable trade-off for the improved information Inland Revenue would receive about employees' ESS benefits. Inland Revenue is preparing suitable communications materials for employers about the changes.

74. Submissions recognised the importance of counting the value of ESS benefits for determining employee social policy entitlements and obligations and that any changes to the collection of tax should not change the status quo. As noted in the officials' paper, it is not

[4] It is possible that the disclosure requirement would also apply to ex-employees in the rare case when legacy entitlements might exist under an employee share scheme agreement. This may require, if the employer does not already do so under the scheme, additional communications between the employer and ex-employee regarding any entitlements.

the intention to change the way ESS benefits are treated for the purposes of child support, student loans, Working for Families tax credits, ACC and Kiwisaver. ESS benefits should not count for the purposes of the ACC earners' levy and Kiwisaver contributions and changes are required to the Accident Compensation Act 2001, and the Kiwisaver Act 2006 to ensure this outcome.

75. ESS benefits would continue to count toward child support, student loans and Working for Families tax credits.

MONITORING, EVALUATION AND REVIEW

76. In general, Inland Revenue monitoring, evaluation and review of collecting tax on ESS benefits would take place under the generic tax policy process (GTPP). The GTPP is a multi-stage policy process that has been used to design tax policy (and subsequently social policy administered by Inland Revenue) in New Zealand since 1995.

77. The final step in the process is the implementation and review stage, which involves post-implementation review of legislation and the identification of remedial issues. Opportunities for external consultation are built into this stage. In practice, any changes identified as necessary would be added to the tax policy work programme, and proposals would go through the GTPP.

SUMMARY OF IMPACTS OF THE OPTIONS (INCLUDING THE STATUS QUO)

Option 1: Status quo

Description	**Impacts**			
No tax withheld at source.	*Employees*	*Employers/payroll intermediaries and software developers*	*Tax system(by reference to the integrity of the tax system, impact on Inland Revenue and revenue impact)*	*Society (by reference to social policy programmes administered by Inland Revenue)*
Advantages	-	-	-	-
Disadvantages	Compliance costs associated with filing returns and payment of tax on any ESS benefits received. If the amount of tax payable exceeds $2,500, the employee faces the prospect of having to comply with the provisional tax rules and accounting for tax in instalments throughout the year. Employees need to have cash resources to meet any tax obligations.	-	Risk to the tax base from employee non-compliance. Inland Revenue incurs higher administration costs associated with processing returns and any necessary enforcement action. Elevated tax collection risk due to employees being uncertain about their obligations under the Income Tax Act 2007.	-
Mitigating factors	Employees can sell shares to meet any tax liabilities.	-	-	ESS benefits counted towards any obligations/entitlements for child support, student loans or Working for Families tax credits.
Conclusion:	**Employee bears the cost of compliance and associated tax risk. Inland Revenue faces increased non-compliance risk.**			

Option 2: Collection using the PAYE system (preferred option)

Description	Impacts			
	Employees	*Employers/payroll intermediaries and software developers*	*Tax system(by reference to the integrity of the tax system, impact on Inland Revenue and revenue impact)*	*Society (by reference to social policy programmes administered by Inland Revenue)*
Tax on ESS benefits is collected using the Pay As You Earn (PAYE) system				
Advantages	Employees have more certainty about the tax treatment of ESS benefits including their obligations. Reduced compliance costs.	Increased employee certainty about the tax treatment of ESS benefits may support the take up of such schemes and inclusion in remuneration packages. All employers have PAYE systems.	Improved compliance. Improved tax collection. Reduced revenue risk. Reduced administration costs for Inland Revenue from fewer individual tax returns and follow up enforcement action.	ESS benefits counted towards any obligations/entitlements for child support, student loans or Working for Families tax credits.
Disadvantages	Possible risk that tax payable on ESS benefits could exceed income.	Employers need to change payroll systems to include ESS benefits. If compulsory, it may: • affect the employer's working capital by having to fund the necessary tax payments; • alter agreements or understandings between the employee and employer; • unnecessarily interfere with the employee's tax entitlements or obligations.	-	Possibility that reconciliation errors are created due to amounts not being counted for Kiwisaver and when the employer chooses not to withhold tax. This will require additional rework of the EMS by Inland Revenue.
Mitigating factors	Employee and employer can agree to sell part of employees' ESS entitlement to meet any tax obligations.	Grandparenting existing schemes could be considered to mitigate the effects on employers.	-	Additional legislative change to ensure ESS benefits do not count for the purposes of the ACC earners' levy and Kiwisaver.
Conclusion:	**Transaction costs associated with collecting tax on ESS shifted from the employee and Inland Revenue to the employer. Issue over whether tax payable on ESS benefits can be solved, for the most part, by the employer selling shares to meet tax obligations.**			

Option 3 Collection using the FBT system

Description	Impacts			
Tax on ESS benefits is collected using the Fringe Benefit Tax rules	*Employees*	*Employers/Payroll intermediaries and software developers*	*Tax system(by reference to the integrity of the tax system, impact on Inland Revenue and revenue impact)*	*Society (by reference to social policy programmes administered by Inland Revenue)*
Advantages	Employees have more certainty about the tax treatment of ESS benefits including their obligations. Reduced compliance costs.	Increased employee certainty about the tax treatment of ESS benefits may support the take up of such schemes and inclusion in remuneration packages. The gross up of tax on the fringe benefit means that any resulting tax obligation will not exceed the employee's income.	Improved compliance. Improved tax collection. Reduced revenue risk. Reduced administration costs for Inland Revenue from fewer individual tax returns and follow up enforcement action.	ESS benefits counted towards any obligations/entitlements for student loans and Working for Families tax credits.
Disadvantages	Problems with getting appropriate tax relief if the employee is a non-resident under New Zealand's Double Taxation Agreement network.	May create additional compliance costs on employers. Need to change FBT reporting systems to include ESS benefits. FBT obligations may apply to employers who have limited experience with FBT. Out of step with international practice. For global employee share schemes, the FBT rules would affect employees' ability to receive tax relief under New Zealand's DTA network.	Out of step with international practice.	Systems constraints means that ESS benefits are not counted for child support purposes.
Mitigating factors	-	Inland Revenue education programmes to improve employer understanding about their FBT obligations including online calculators.	-	-
Conclusion:	**Conceptually purer method for taxing non-cash benefits, but has implementation problems and could apply to employers who are not familiar with the tax obligations arising from providing non-cash benefits.**			

Option 4: Collection using a withholding tax

Not considered in depth due to concerns that Inland Revenue would not be able to implement the method. Alternative well-developed systems such as PAYE and FBT already exist.

Recommended proposal: Employer election with data capture using the PAYE's employer monthly schedule (EMS)

Description	Impacts			
Employer to choose to withhold tax on any ESS benefits received by an employee using the PAYE system Employers disclose the value of any ESS benefits via the employer monthly schedule – this would apply in all cases whether the employer chose to withhold tax or not.	*Employees*	*Employers/payroll intermediaries and software developers*	*Tax system(by reference to the integrity of the tax system, impact on Inland Revenue and revenue impact)*	*Society (by reference to social policy programmes administered by Inland Revenue)*
Advantages	Employees may have increased certainty about the tax treatment of ESS benefits including their obligations. Reduced compliance costs.	Increased employee certainty about the tax treatment of ESS benefits may support the take up of such schemes and inclusion in remuneration packages. Reduced impact on employers if the obligation to pay tax stresses employers' working capital or interferes with bargains struck between the employer and employee. Cost of compliance is shifted from the employee to the employer when the employer considers there is an overall net benefit to do so.	Improved compliance. Improved tax collection. Reduced revenue risk. Reduced administration costs for Inland Revenue from fewer individual tax returns and follow up enforcement action.	ESS benefits counted towards any obligations/entitlements for student loans and Working for Families tax credits. ESS benefits counted for child support purposes.
Disadvantages	Advantages described above are not fully captured if employers decide	May create additional compliance costs on employers.	Advantages described above are not fully captured if employers decide	Possibility that reconciliation errors are created due to amounts not

	not to withhold tax on ESS benefits received by employees. Risk of unintended non-compliance if the employer chooses not to withhold and the employee is unaware of their tax obligations.	Need for legacy record keeping to ensure that elections are properly captured. Employer responsible for declaring any ESS benefits entitlements accruing to ex-employees.	not to withhold tax on ESS benefits received by employees. Risk of unintended consequences if the employer chooses not to withhold and the employee is unaware of their obligations under the Income Tax Act 2007. Election is more expensive for Inland Revenue to administer.	being counted for Kiwisaver and when the employer chooses not to withhold tax. This will require additional rework of the EMS by Inland Revenue.
Mitigating factors	Employee share agreement should clearly articulate the employee's tax obligations. Inland Revenue to develop a suitable communications strategy to inform employers about their obligations.	Employer can elect not to withhold tax.	Inland Revenue captures income information about ESS using the EMS.	Additional legislative change to ensure ESS benefits do not count for the purposes of the ACC earners' levy and Kiwisaver.
Conclusion:	**Takes into account employers' compliance cost concerns about shifting the obligation to collect tax at source and improves the integrity of the tax system by using the PAYE system to improve the collection of information about employee entitlements under an ESS.**			

Regulatory Impact Statement

Co-location and secrecy

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Inland Revenue.

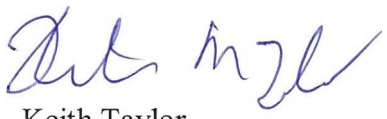
It provides an analysis of options to remove a significant barrier to Inland Revenue employees co-locating with employees of other state agencies.

The analysis involved examining Inland Revenue's current co-location arrangements in Christchurch and other regional offices. The special circumstances of the co-location arrangements in Christchurch were noted. The analysis was limited to examining options for removing barriers to Inland Revenue sharing call centres and administrative areas with other government agencies. The analysis did not examine secrecy issues with reception and front counter areas. The analysis also did not examine any wider options for co-locating with other government or private sector agencies.

The consultation on this proposal involved discussing the secrecy issues with Inland Revenue employees that were involved in the current co-location arrangements. The Privacy Commissioner was also consulted.

The policy options will not:

- impose additional costs on businesses
- impair private property rights, restrict market competition, or reduce the incentives on businesses to innovate and invest, or
- override fundamental common law principles .



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3 June 2015

STATUS QUO AND PROBLEM DEFINITION

1. The current secrecy provision in the Tax Administration Act (section 81 of the TAA) does not allow Inland Revenue employees to communicate taxpayer information (including to other government agencies) except in limited, defined circumstances. Further, the provision requires employees to maintain, and assist in maintaining, the secrecy of taxpayer information. There are severe penalties for an Inland Revenue employee who knowingly breaches secrecy provisions. In addition, under section 6 of the TAA every Inland Revenue employee must use their best endeavours at all times to protect the integrity of the tax system (including the rights of the taxpayers to have their individual affairs kept confidential). The effective administration of the tax system relies on voluntary compliance. A critical element of voluntary compliance is taxpayers trusting that Inland Revenue will not disclose their information inappropriately.

2. One of the four key priorities of the Government is to ensure the delivering of better public services. Inland Revenue is investigating co-location opportunities as part of the future direction of service delivery. Co-location is aimed at providing a better service by standardising processes, reducing duplication of effort and delivering prioritised services to meet local needs. Inland Revenue is currently co-locating with other government agencies in some offices and call centres across New Zealand. While some co-locations have been able to be achieved while still maintaining physical separation between agencies (which minimises secrecy risks) such separation is not always possible — for example, in post-earthquake Christchurch co-locations are "open-plan". Specifically, about 370 Inland Revenue call centre and collections staff share an "open-plan" area with 130 Ministry of Social Development staff at Russley Road and 10-12 Inland Revenue staff at Durham Street are surrounded by about 70-80 Ministry of Social Development staff.

3. Under such an approach, Inland Revenue employees are exposed to the risk of inadvertently disclosing taxpayer information to other government agencies at co-located sites. This could arise if the other agency's employees were to overhear conversations (between Inland Revenue staff discussing a case, and conversations with taxpayers themselves), or if they happen to see Inland Revenue correspondence, or as a result of shared office facilities and equipment.

4. Given that further co-location is planned (including in open-plan sites) this gives rise to the issue of proximity with other government employees and inadvertent disclosure of taxpayer information with those employees. Inland Revenue considers that no amount of training or best practice guidelines or adopted behaviour is likely to adequately address the substantial risk of Inland Revenue employees inadvertently disclosing taxpayer information to other government employees in the co-location environment. Inland Revenue considers that architectural changes can be made to open-plan areas to reduce the risks. However, the changes would be costly and would arguably undermine the benefits of co-locating.

5. There is, therefore, a balance between maintaining the integrity of the tax system (including taxpayers' perceptions of the tax system) and delivering better public services through co-location.

6. Maintaining the status quo means the existing risk to employees of inadvertently breaching section 81 will remain, and so being subject to severe penalties. That this risk exists makes employees reluctant to work in an open-plan environment. In addition, given this risk, taxpayers may have concerns about the level of secrecy applying in a co-located environment, which may harm the perception of the integrity of the tax system. The current

risks also make Inland Revenue more reluctant to enter into co-location arrangements with other government agencies. Such a result is counter to the Government's policy of increasing efficiency in the delivery of government services and achieving cost reductions across government.

OBJECTIVES

7. The key objectives to facilitate co-location are to:
   (a) reduce the risks for Inland Revenue employees and co-located staff from other government agencies in a co-location environment;
   (b) confirm for taxpayers secrecy will be maintained in a co-location environment (bearing in mind the importance of taxpayer secrecy in the administration of the tax system); and
   (c) enable Inland Revenue to deliver better public services in an efficient manner without imposing significant additional administrative costs.

REGULATORY IMPACT ANALYSIS

8. Four broad options and the status quo (option 5) have been considered for addressing the problems and achieving the stated objectives. These options are:

- **Option 1:** lowering the overall secrecy standard in section 6 of the TAA to reduce the risks from co-locating with other government agencies. The current standard in section 6 for Inland Revenue officers to use "best endeavours" to protect the integrity of the tax system (including ensuring the individual affairs of taxpayers are kept confidential) is a very high threshold. Inland Revenue believes that lowering the general secrecy standard to "reasonable endeavours" could reduce some of the risks from co-locating;

- **Option 2:** deem the co-located staff from the other government agency to be Inland Revenue staff for the purposes of the secrecy provision. Option 2 would apply the same secrecy requirements to the co-located staff as apply to Inland Revenue staff in Inland Revenue open-plan areas and call centres;

- **Option 3:** include a specific provision that sets out the secrecy requirements in a co-location environment. The specific provision would mean that an Inland Revenue employee is deemed to have not breached section 81 by inadvertently disclosing tax secret information to a co-located employee of another government agency. The employee from the other government agency will have signed a secrecy certificate under section 87. The specific provision will only apply when the Commissioner of Inland Revenue considers that the risk of communication is consistent with her obligation at all times to use best endeavours to protect the integrity of the tax system;

- **Option 4 (preferred option):** include a general provision for communications by Inland Revenue employees where the Commissioner of Inland Revenue expects them to perform their duties. The employee will not breach the secrecy provision in those circumstances if the employee communicates the information unintentionally to an employee of Inland Revenue or an employee of another state agency subject to section 87 of the TAA;

- **Option 5:** maintain the status quo.

9. The impacts of options 1 to 4 and the status quo option, and whether they meet the objectives in paragraph 7, are summarised in the table below.

Option	*Meets objectives (a), (b), or (c)?*	*Fiscal/ economic impact*	*Administrative impact for Inland Revenue*	*Compliance impact for taxpayers*	*Risks*	*Summary*
Option 1	b,c	Nil	Lowering the overall standard in section 6 would not provide Inland Revenue employees with any clarity as to the required standard of secrecy in a co-located environment because: • the change would not affect the specific secrecy requirements in section 81; and • the employees would have to determine in any environment whether reasonable steps had been taken to protect the integrity of the tax system. The option would provide Inland Revenue with significant operational flexibility to deliver better public services in an efficient manner without imposing significant additional administrative costs.	Reducing the overall standard in section 6 could suggest to taxpayers a decreased focus on maintaining the integrity of the tax system, which could undermine taxpayers' perceptions of the tax system and voluntary compliance.	The broad-brush approach of reducing the overall standard may have unforeseen consequences in other situations or environments.	Option 1 does not meet all of the stated objectives. While it provides increased flexibility to Inland Revenue, it may undermine taxpayers' perceptions of the tax system and voluntary compliance.

Option 2	a, b, c	Nil	Option 2 would seem to provide Inland Revenue employees with clarity because they will be able to apply the same internal secrecy standards to co-located environments. The option would provide Inland Revenue with significant operational flexibility to deliver better public services in an efficient manner without imposing significant additional administrative costs.	Option 2 would suggest to taxpayers that the same high standards that apply internally in Inland Revenue would apply in co-located environments. However, it would arguably also allow sharing of information between Inland Revenue employees and co-located staff which could be inconsistent with the limited specific information sharing provisions in the TAA. In other words, the option may sanction more than is intended. If taxpayers consider that there is unlimited sharing of information, this may undermine taxpayers' perceptions of the tax system and voluntary compliance.	Section 81 only exempts communications for the purpose of carrying into effect the relevant legislation or performing a duty of the Commissioner. There is a risk that communications between Inland Revenue employees and co-located staff would not satisfy that requirement (even if the co-located staff were deemed to be Inland Revenue employees). This would mean that there is a risk that the option will not remedy the relevant policy problem. Having the co-located staff sign secrecy certificates under section 81 would mean that they were subject to the same sanctions for any secrecy breaches as Inland Revenue employees. However, there has been some level of opposition in the past from other government agencies to having their staff sign Inland Revenue secrecy certificates. As a result, there is a risk that the other agencies will not agree to sign the certificates.	Option 2 meets all of the stated objectives, but it arguably allows more information sharing than is intended.
Option 3	a, b, c	Nil	Option 3 would provide clarity to Inland Revenue employees by setting out the specific secrecy requirements in a co-located environment. It would also specify the requirement on the	Option 3 applies the same high standard of secrecy to the co-located staff (including imposing the same severe sanctions for any breaches). The option only applies to inadvertent sharing and does	There is a risk that the other agencies will not agree to sign the certificates.	While option 3 meets all the objectives, it only allows inadvertent communication of tax secret information in limited circumstances.

			Commissioner to ensure that the risk of communication is consistent with her obligation at all times to use best endeavours to protect the integrity of the tax system. Getting the co-located staff to sign a section 87 secrecy certificate would provide them with clarity as to the extent that they can disclose any information. Further, the relevant co-location arrangement agreement between Inland Revenue and the other government agency could set out any exceptions to the disclosure requirements and the process to be followed in case of any conflicts. The option would provide Inland Revenue with significant operational flexibility to deliver better public services in an efficient manner without imposing significant additional administrative costs in a co-location environment. However, the option will not enable the provision of better public services in a broader range of circumstances.	not sanction any wider sharing of information. This will suggest to taxpayers that the same high standards that apply internally in Inland Revenue would apply in co-located environments and reinforce taxpayers' perceptions of the tax system and voluntary compliance.		

Option 4	a, b, c	Nil	Option 4 provides clarity to Inland Revenue employees in a broad range of circumstances. It applies wherever the Commissioner of Inland Revenue expects them to perform their duties. This may extend beyond the strict confines of the office to include situations such as where two employees are driving to a location. The employee will not breach the secrecy provision in those circumstances if the employee communicates the information unintentionally to an employee of Inland Revenue or another state agency (eg, where they answer a phone call while travelling in the car). The option would provide Inland Revenue with significant operational flexibility to deliver better public services in an efficient manner without imposing significant additional administrative costs in a broader range of circumstances.	The exemption only applies if the person communicated to is subject to section 87. This means that they need to have signed a secrecy certificate. As a result, the same standard of secrecy that applies in Inland Revenue offices will apply to co-located offices. Inland Revenue considers that the option will reinforce taxpayers' perceptions of the tax system and voluntary compliance. While there is no specific reference to the obligation on employees to use their best endeavours at all times to protect the integrity of the tax system, the employees are still subject to section 6. While the more general nature of the provision could suggest more information sharing than is currently the case, this is not intended to be the case. Any sharing of information would have to be unintentional.	There is a risk that the other agencies will not agree to sign the certificates. There is a small risk that the general nature of the provision will suggest to taxpayers that Inland Revenue is lowering its overall secrecy standard. This could undermine taxpayers' perceptions of the tax system and voluntary compliance. However, the specific requirement in the proposed provision, that the sharing be unintentional, should mitigate any significant risk.	Option 4 is the preferred option because it meets all the objectives and allows inadvertent communication of tax secret information in a broader range of circumstances. Inland Revenue considers that the option will reinforce taxpayers' perceptions of the tax system and voluntary compliance.
Option 5 (status quo)	c	Nil	As discussed above at [6].	As discussed above at [6].	As discussed above at [6].	As discussed above at [6], there are significant risks with maintaining the status quo.

CONSULTATION

10. This proposal has been discussed with the Privacy Commissioner. The Privacy Commissioner said that it seemed very logical to remove barriers to having conversations in the open-plan environment. The Privacy Commissioner noted that the preferred option had to extend the confidentiality requirements to the co-located staff. The Privacy Commissioner also said that she did not have any issues with the proposed options.

CONCLUSIONS AND RECOMMENDATIONS

11. Inland Revenue prefers option 4 because it best achieves the stated objectives. Specifically, option 4:

- reduces the risks for Inland Revenue employees and co-located staff from other government agencies in a co-location environment;
- confirms for taxpayers that the same high standards that apply internally in Inland Revenue would apply in co-located environments, reinforcing taxpayers' perceptions of the tax system and voluntary compliance; and
- enables Inland Revenue to deliver better public services in an efficient manner without imposing significant additional administrative costs.

IMPLEMENTATION

12. Any legislative amendments will be included in the proposed Taxation (Business Transformation and Simplification) Bill, which is scheduled for introduction in June 2015, and could be implemented from the date of enactment.

13. No implementation risks have been identified. No changes need to be made to existing systems and there would be no other significant administrative issues.

MONITORING, EVALUATION AND REVIEW

14. There are no specific plans to monitor, evaluate and review the changes. If any detailed concerns are raised in relation to these changes, Inland Revenue will determine whether there are substantive grounds for review under the Generic Tax Policy Process (GTPP).

15. In general, Inland Revenue's monitoring, evaluating and reviewing of new legislation takes place takes under the GTPP. The GTPP is a multi-stage tax policy process that has been used to design tax policy in New Zealand since 1995. The final stage in the GTPP is the implementation and review stage, which involves post-implementation review of the legislation, and the identification of any remedial issues. Opportunities for external consultation are also built into this stage. In practice, any changes identified as necessary for the new legislation to have its intended effect would generally be added to the Tax Policy Work Programme, and proposals would go through the GTPP.

Regulatory Impact Statement

KiwiSaver opt-out for minors

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Inland Revenue.

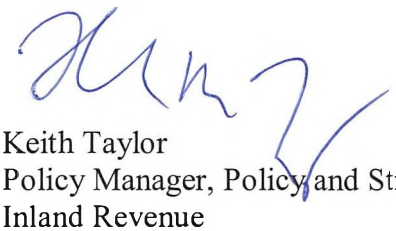
It provides an analysis of options to address the incorrect enrolment of minors into the KiwiSaver scheme.

This analysis includes a review of the legal rights and obligations granted and imposed on KiwiSaver members, KiwiSaver providers and employers in respect of the enrolment of minors. Statistical analysis of enrolment data since the inception of KiwiSaver has been undertaken to measure the extent of the issue. As there have been no documented cases of complaints from KiwiSaver members who had been enrolled as minors, it was not possible to measure the impacts at an individual level.

Workplace Savings NZ, who represent most KiwiSaver providers, were briefed on the issue and the options. In general, feedback received indicated that there was a need for Inland Revenue to take a greater role in verifying the age of new enrolments. Some providers also felt that an open ended opt-out provision that would allow an incorrectly enrolled member to annul their membership at any time would create too much uncertainty in the sector. Such a policy would mean that schemes would have a portion of their members that could, at any time, exit without further notice. These views have been taken into consideration when making the final recommendation.

None of the options in this statement would:

- impose additional costs on businesses;
- impair private property rights, restrict market competition, or reduce the incentives on businesses to innovate and invest; or
- override fundamental common law principles (as referenced in Chapter 3 of the Legislation Advisory Committee Guidelines).



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3 June 2015

STATUS QUO AND PROBLEM DEFINITION

1. KiwiSaver is a workplace savings scheme that is open to all New Zealand residents under the age of 65. People can join KiwiSaver by contracting directly with a KiwiSaver provider, electing to join through their employer, or through automatic enrolment when they start a new job.

2. Minors (children under the age of 18) can only join KiwiSaver if they have the consent of all of their legal guardians (if under 16 years) or co-sign with a guardian (if 16 – 17 years of age). These restrictions recognise that joining KiwiSaver, which locks in funds until the member is 65, is a serious undertaking and minors should be protected while they are vulnerable and supported as they get older. For this reason, minors are only able to join KiwiSaver by directly contracting with a KiwiSaver provider. As the providers will be processing an application to join KiwiSaver, these providers are best equipped to receive and review the necessary parental consent.

3. When a person enrols in KiwiSaver through their employer, either by electing to join or through auto enrolment, the employer sends the person's information to Inland Revenue through the existing PAYE system. Inland Revenue then passes that information on to a KiwiSaver provider. Inland Revenue does not perform any checks on the enrolment data to test whether the person is a minor or not.

4. Recent analysis of KiwiSaver enrolments has uncovered that as of April 2015 approximately 56,000 minors have been incorrectly enrolled in KiwiSaver through their employers, predominantly via auto-enrolment. Around 10,000 of these minors were under the age of 16 at the time of enrolment.

5. To date Inland Revenue has not received any complaints from minors who have been incorrectly enrolled into KiwiSaver through their employers. Furthermore, approximately 27,000 of the affected members have since transferred their KiwiSaver funds from one provider to another. However, should a member challenge their enrolment there is no remedy available under the KiwiSaver Act 2006 that will allow the member to exit the scheme.

6. Unlike a person over 65 or a non-resident, a minor is entitled to join KiwiSaver, albeit only by contracting directly with a provider. The current provisions available to reverse an invalid enrolment are only applicable to members who are not entitled to join KiwiSaver, not members who are entitled to join, but were enrolled through the wrong mechanism.

7. The Minors' Contract Act 1969 does provide that a person who has entered into a contract as a minor can apply to the court to have that contract nullified. We are not aware of any minors making use of this provision at this point. While this does provide some protection it comes at considerable cost to the applicant and potentially the provider who may have to argue the application in court.

8. This RIS addresses the question of whether the KiwiSaver Act should be amended to allow minors that have been incorrectly enrolled to annul their membership.

OBJECTIVES

9. The key objectives are:

a) Provide clearer protection to members who have been incorrectly enrolled in KiwiSaver when they were minors and who wish to annul their membership.

b) Reduce the compliance costs incurred by KiwiSaver members who were incorrectly enrolled and who wish to annul their membership.

c) Prevent the incorrect enrolment of minors.

d) Minimise disruption for those KiwiSaver members who have been enrolled incorrectly but who do not object to the enrolment.

e) Minimise the impact on the key objective of KiwiSaver – to encourage a long-term savings habit and asset accumulation by individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement

REGULATORY IMPACT ANALYSIS

10. Four options were considered as alternatives to the status quo. Options 2 and 3 would address future incorrect enrolments only, whereas options 4 and 5 would address historic cases as well. The options are:

- Option 1 (status quo): Inland Revenue takes no additional actions to prevent incorrect enrolments. KiwiSaver members who were enrolled as minors cannot annul their membership without applying to the courts under the Minors' Contract Act 1969.

- Option 2: Inland Revenue highlights to employers and KiwiSaver providers that minors can only enrol directly with a provider. *(Officials' preferred short-term administrative option)*

- Option 3: Inland Revenue develops a system to automatically check employer enrolments received and reject enrolments for minors. *(Officials' preferred long-term administrative option)*

- Option 4: A new opt-out provision is introduced so that members who have been enrolled incorrectly can end their membership.

- Option 5: A new opt-out provision is introduced so that members who have been enrolled incorrectly can end their membership at any time before their 19th birthday. *(Officials' preferred policy option)*

11. These options are not exclusive, for example options 2, 4 and 5 could be concurrently implemented.

Option 1: Status quo

12. Under the status quo:

- Inland Revenue does not monitor enrolments for minors.
- Employers incorrectly enrol minors into KiwiSaver and providers incorrectly accept those enrolments.
- Members who have been incorrectly enrolled have no access to redress under the KiwiSaver Act 2006 to annul their membership.
- Members who wish to annul their membership must apply to the court under the Minors' Contract Act 1969.

13. While there have been no complaints from incorrectly enrolled minors to date there is also no cost effective remedy should a member wish to exit the scheme. Members and providers in this situation would incur costs should the member wish to take the matter up under the Minors' Contract Act 1969.

Option 2 – additional communications to employers and providers

14. Under this option:

- Inland Revenue communicates with employers and KiwiSaver providers to highlight their obligations in respect of minors and the KiwiSaver enrolment rules.
- Resources and guides are reviewed to ensure these rules are sufficiently explained.
- Employers are advised on how minors can enrol so that they can pass this on to their employees who want to join KiwiSaver.

15. The main advantages of this option are that it imposes only minimal additional cost on Inland Revenue, no additional compliance costs on employers or providers and requires no legislative change.

16. The main disadvantages is that it is unlikely to be fully effective (that is some minors would continue to be incorrectly enrolled) and it does not provide an effective remedy for incorrectly enrolled minors wishing to exit the scheme.

Option 3 – Inland Revenue checks all enrolments for minors

17. Under this option:

- Inland Revenue implements a new system where all enrolments received are checked to ensure the person is not a minor.
- If the person is a minor a message would be sent back to the employer advising them that the enrolment is invalid. No information would be sent to the provider.

18. The main advantage of this option is that it would provide the best on-going protection for minors as it would, in the majority of cases, prevent them from being enrolled.

19. The disadvantages are:

- Inland Revenue would need to invest in system enhancements which would rely on legacy systems.
- Inland Revenue would need to release taxpayer confidential information back to the employer (i.e. that their employee is a minor).
- Inland Revenue's date of birth records are not 100 percent accurate so some incorrect rejections would be expected.
- No cost effective remedy is provided for the 55,000 already incorrectly enrolled minors if any of them should wish to exit the scheme.

Option 4 – Opt out members incorrectly enrolled as minors – no restriction

20. Under this option:

- The KiwiSaver Act 2006 is amended so that members who have been incorrectly enrolled can opt out of the scheme.
- Opt-outs would only be available if the member had not subsequently directly contracted with a provider and given the necessary consent.
- If a member opted out then they would have their contributions returned to them, their Government contributions returned to the Crown and their compulsory employer contributions returned to their employer.
- There would be no restriction on when this opt out could occur.

21. The advantages of this option are:

- Administration costs on Inland Revenue are minimised. The systems for unwinding the member's enrolment are already in place for incorrectly enrolled non-residents or pensioners.
- Members who were incorrectly enrolled are offered a cost effective remedy and can exit the scheme. Members who do not wish to exit the scheme are not disrupted.
- Reduces compliance costs by eliminating the need for incorrectly enrolled members to apply under the Minors' Contract Act 1969 should they wish to exit the scheme.

22. The disadvantages of this option are:

- Does not prevent the incorrect enrolment of minors.
- May encourage members to annul their membership when it is not in their long term interests to do so.

23. This last disadvantage is particularly relevant for members that were incorrectly enrolled but have since become adults and may have been contributing to their savings for several years. In these instances they would be able to withdraw all of the contributions they had made but they would lose the benefit of the crown contributions and their employers' compulsory contributions. This could be attractive in the short term but may be detrimental in respect of longer term objectives such as providing for retirement.

Option 5 – Opt out members incorrectly enrolled as minors until 19th birthday

24. Under this option:

- The KiwiSaver Act 2006 is amended so that members who have been incorrectly enrolled can opt out of the scheme at any time before their 19th birthday.

- Opt outs would only be available if the member had not subsequently directly contracted with a provider and given the necessary consent.

- If a member opted out then they would have their contributions returned to them, their Crown contributions (i.e. the kick-start payment and member tax credits) returned to the Crown and their compulsory employer contributions returned to their employer.

25. The opt-out would be available until the member has turned 19 so that they have at least one year as an adult to consider their situation.

26. The advantages of this option are

- Administration costs on Inland Revenue are minimised. The systems for unwinding the member's enrolment are already in place for incorrectly enrolled non-residents or pensioners.

- Members who were incorrectly enrolled are offered an effective remedy and can exit the scheme up until their 19th birthday. Members who do not wish to exit the scheme are not disrupted.

- Reduces compliance costs by eliminating the need for incorrectly enrolled members who have yet to turn 19 to apply under the Minors' Contract Act 1969 if they wish to exit the scheme.

27. The disadvantages of this option are:

- Does not prevent the incorrect enrolment of minors.

- Members who have been incorrectly enrolled and who wish to exit the scheme but have turned 19 would still have to apply under the Minors' Contract Act 1969.

- May encourage members to annul their membership when it is not in their long term interests to do so.

28. This last disadvantage is less relevant for this option as the members do not qualify for Crown contributions until they turn 18 and so at most would have a years' worth of Crown contributions that could be forgone.

Summary of impact analysis

29. The table below summarises our analysis of the options (including the status quo).

Option	*Meets objectives a, b, c, d or e?*	*Impacts*			*Net impact*
		Economic / revenue impact	*Administrative impact*	*Compliance impact*	
Option 1 (Status quo): KiwiSaver members who were enrolled as minors cannot annul their membership without applying to the courts under the Minors' Contract Act 1969	Does not meet (a), (b) or (c). Fully meets (d) and (e).	No impact	No impact	Members and providers would incur costs should an incorrectly enrolled member wish to exit the scheme via the Minors' Contract Act 1969. As no cases have been taken as yet it is not possible to estimate the costs.	Does not address the problem definition and fully meets only one of the four objectives
Option 2: Inland Revenue sends additional communications to employers and KiwiSaver providers stressing that minors cannot be enrolled through their employer	Does not meet (a). Partially meets (b) and (c). Fully meets (d) and (e).	No impact	Developing and releasing additional communication material. This is expected to be incorporated in business as usual activities and promotions at marginal cost.	Members and providers would incur costs should an incorrectly enrolled member wish to exit the scheme via the Minors' Contract Act 1969 however the incidence of this would be reduced in the future	Does not address the problem definition and fully meets only one of the four objectives
Option 3: Inland Revenue develops a system to automatically check employer enrolments received to ensure they are for adults only and reject enrolments for minors	Does not meet (a). Partially meets (b) and (c). Fully meets (d) and (e).	No impact	Investment in new application based on legacy systems required. This has not been costed.	Members and providers would still incur costs should an incorrectly enrolled member wish to exit the scheme via the Minors' Contract Act 1969 however the incidence of this would be reduced in the future.	Addresses the problem definition partially, going forward, and fully meets only one of the four objectives
Option 4: A new opt-out provision is introduced so that members who have been enrolled incorrectly can end their membership	Does not meet (c) or (e). Fully meets (a), (b) and (d).	No impact	No impact	Compliance costs arising from reliance on the Minors' Contact Act 1969 would be eliminated.	Addresses the problem definition and fully meets three of the four objectives.
Option 5: A new opt-out provision is introduced so that members who have been enrolled incorrectly can end their membership up until their 19th birthday	Does not meet (c). Partially meets (b). Fully meets (a) and (d) and (e).	No impact	No impact	Compliance costs arising from reliance on the Minors' Contact Act 1969 would be reduced.	Addresses the problem definition and fully meets three of the four objectives.

Other impacts

30. The options have no social, cultural or environmental impacts.

CONSULTATION

31. Workplace Savings NZ, who represent most KiwiSaver providers, were consulted. Comments received from providers both through Workplace Savings NZ and directly emphasised the need for Inland Revenue to play a more active role in policing the age requirements for employer enrolments.

32. The Treasury and the Ministry of Building, Innovation and Employment were consulted and supported the recommended options.

CONCLUSIONS AND RECOMMENDATIONS

33. We support option 5. This would address to some extent the number of incorrect enrolments being made and provides a clear but limited ability for incorrectly enrolled members to easily exit the scheme. In the short term we also recommend option 2 be adopted – that is, Inland Revenue should send additional communications to employers and KiwiSaver providers stressing that minors cannot be enrolled through their employer. In the longer term, as part of Inland Revenue's Business Transformation programme of systemic change, we recommend that option 3 should be explored as a priority.

IMPLEMENTATION

34. Options 1 and 2 do not require legislation to implement. Legislative change is required to implement options 3, 4 and 5.

35. Any legislative amendments can be included in the proposed Taxation (Business Transformation and Simplification) Bill, which is scheduled for introduction in June 2015, and could be implemented from the date of enactment. Additional communications to employers and providers highlighting the current enrolment rules will be made later this year.

36. Inland Revenue will communicate any legislative changes to members, employers and providers through its existing channels, such as *www.kiwisaver.govt.nz*, the Tax Information Bulletin and by updating its guides

MONITORING, EVALUATION AND REVIEW

37. There are no specific plans to monitor, evaluate and review any of the policy proposals in this analysis. The number of incorrectly enrolled minors will continue to be measured and the impact of any additional communications to employers and providers will be monitored. If any detailed concerns are raised in relation to these changes, Inland Revenue will determine whether there are substantive grounds for review under the Generic Tax Policy Process (GTPP).

Regulatory Impact Statement

Allowing additional deductions to be made from salary or wages

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Inland Revenue.

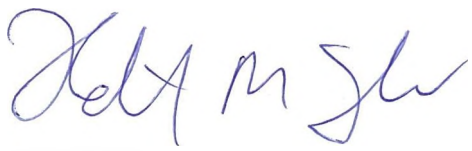
The question addressed in this statement is how can Inland Revenue more efficiently use information it already holds about the employment of a defaulter in order to recover outstanding payments of tax, child support, gaming duty or student loan repayment obligations.

Requiring an employer to make deductions from wages or salary is one of the most efficient means of debt collection available to Inland Revenue. If deductions are imposed soon after a default is detected, they ensure early recovery of the debt and limit the growth of late payment interest or penalties. However, when Inland Revenue issues a deduction notice to an employer, it is required to issue a notice to the defaulter at the same time. If Inland Revenue does not hold a valid address for the defaulter, it cannot send notification to them and therefore cannot send a deduction notice to the employer.

Inland Revenue has considered a range of options for requiring an employer to make additional deductions from a defaulting employee's salary or wages when there is no valid address held for the employee.

Because of time constraints, Inland Revenue has not consulted with employers on any of the options. Even so, we do not consider that our analysis of the issues is impaired by the lack of external consultation with employers and employees. We note that only a small number of taxpayers are affected (approximately 700 at any time). The Treasury was consulted on the policy proposal.

None of the options identified would impair private property rights or reduce market competition. However, two of the options involve some impairment of the common law principle of natural justice by reducing employees' opportunity to challenge the basis on which the decision to increase wage or salary deductions is made, or to make alternative arrangements to redress any shortfall in PAYE, child support, gaming duty or student loan repayment obligations. We also note that some of the options (not the preferred option) would impose additional costs on business.



Keith Taylor
Policy Manager, Policy and Strategy
Inland Revenue
3 June 2015

STATUS QUO AND PROBLEM DEFINITION

1. Automatic deductions from salary or wages are one of the most efficient means of debt collection available to Inland Revenue. They help to minimise administrative costs for Inland Revenue and compliance costs for taxpayers in a debt situation. If the automatic deductions are imposed soon after a default is detected, they limit the growth of late payment penalties or interest and ensure early recovery of the debt. These deductions are additional to standard PAYE, ACC, child support contributions or student loan repayments.

2. Under current law, Inland Revenue is required to advise a defaulting taxpayer, liable parent, gaming machine operator or student loan borrower of its intention to make automatic additional deductions from salary or wages in order to recover unpaid tax, child support, duty, or student loan repayments. Notification is sent to the individual at the same time as the deduction notice is sent to the employer, giving them a short time (until their next pay day) during which they can contact Inland revenue to challenge the decision or make alternative arrangements to address the debt.

3. The release of the deduction notice to the employer is prevented if a valid address is not held for the defaulter. The system has been designed to protect the right of the employee to be notified of the intended deductions so they can exercise their right to challenge the decision or make alternative arrangements.

4. As at 11 March 2015, the lack of a valid address is preventing recovery of $718,044 from 545 taxpayers, across all tax types. In addition 170 student loan borrowers have additional repayment obligations that could be met through increased wage or salary deductions if we had valid addresses. The rate of growth as penalties are applied will vary across tax types so that numbers and amounts owed will vary from time to time. The rate of recovery through additional deductions is limited by law to 20% of the wages or salary payable to an individual.

5. The current practice in these situations involves administrative costs for Inland Revenue and for employers, as manual intervention is required. This may include an initial phone call to the employer, followed, if necessary, by a written demand to provide the address details. Address records must then be updated before the deduction notice can be issued to the employer and copied to the defaulting employee.

6. Even so, the current practice seeks to preserve the rights of the employee to be informed about the decision and be able to challenge it or choose how they will redress their non-compliance.

7. Inland Revenue should be able to use information it already holds about a defaulter's employment to recover debt more efficiently when a defaulter has not only failed to meet payment obligations, but also failed to advise a change of address to Inland Revenue.

8. The question addressed in this RIS is how can Inland Revenue more efficiently use information it already holds about employment of a defaulter in order to recover outstanding debt.

OBJECTIVES

9. The key objectives are:
   (a) minimise administrative costs for Inland Revenue
   (b) minimise compliance costs for defaulters and employers
   (c) reduce or limit the growth of late payment interest or penalties and effect full recovery in the shortest possible time
   (d) ensure that defaulters' rights to object or make alternative arrangements to redress their default are maintained (fairness).

10. Trade-offs will need to be made across the various objectives. For example, options that seek to minimise administrative costs for Inland Revenue and compliance costs for employers may impair defaulters' rights to object or make alternative arrangements to redress their default.

11. An additional constraint faced by Inland Revenue is its inability to make significant system changes in advance of the relevant stage of development of its Business Transformation.

REGULATORY IMPACT ANALYSIS

12. One administrative and two legislative solutions were considered as alternatives to the status quo. The options are:

- Option 1: Inland Revenue obtains contact details for the defaulter from their employer (status quo).
- Option 2: Inland Revenue issues notice to the last known address of the defaulter.
- Option 3: Inland Revenue issues notice to the employer for pass on to the defaulter.
- Option 4: Inland Revenue dispenses with requirement to issue notice to the defaulter when it holds details of the defaulter's employer (preferred option).

Option 1 – status quo

13. Under the status quo:

- Inland Revenue contacts the employer and requests that the employer provide the defaulter's address details.
- Inland Revenue then updates the address details of the defaulter in its system.
- Inland Revenue issues a deduction notice to the employer and a copy to the defaulter.

14. The current practice creates additional compliance costs for Inland Revenue and for employers and an additional step in the recovery process, slowing the commencement of recovery, but preserves the rights of the defaulter (for a very limited time) to challenge the decision or choose how they will redress their non-compliance before any action is taken.

Option 2 – Issue notice to the last known address of defaulter

15. Under this option, Inland Revenue issues a deduction notice to the employer and a copy to the defaulter's last known "invalid" address.

16. The main advantage of this option is that it avoids imposing additional compliance costs on employers (compared with the status quo), as they are not required to provide Inland Revenue with updated address details for defaulters.

17. There are several disadvantages with this option, including:
- The defaulter is unlikely to receive the notice so does not have the opportunity to challenge the decision or choose how they will redress their non-compliance.
- The address held for the defaulter remains invalid.
- There is potential for a breach of tax secrecy, as someone other than the intended recipient may open the mail (even though it is an offence under the Postal Services Act 1998 for a person to open mail addressed to another).
- It could generate complaints from residents who have sent back previous pieces of correspondence, creating resource implications through additional work for call centres.
- It would create extra work for Inland Revenue through manual activity in what is intended to be an automated process, with further resource implications.
- Employers would be required to bear the compliance cost of dealing with employees who complain about reduction in pay.
- There would be some delay in the commencement of debt recovery.
- There may also be an increase in contacts to Inland Revenue call centres of complaints about the unexpected deduction from pay.

Option 3 – Issue notice to employer for pass on to defaulter

18. Under this option, Inland Revenue takes manual action to issue the notice to the employer and a copy of the notice for the employer to pass on to the defaulter.

19. The main advantage of this option over the status quo is that it would limit growth of late payment interest and penalties and contribute to the earliest possible recovery of debt. In addition, the defaulter would retain the limited right to challenge the decision or choose how they will redress their non-compliance before any action is taken.

20. The main disadvantages are:
- It would impose additional compliance cost on employers.
- There would be systems implications, which may be significant and could not be implemented until Inland Revenue's Business Transformation reaches the relevant stage of development. Until then, manual intervention would be needed.
- The address details of the defaulter remain invalid unless the defaulter contacts Inland Revenue and updates them.

Option 4 – Dispense with requirement to issue notice to the defaulter

21. Under this option, Inland Revenue would issue the notice to employer when there has been a default on payment obligations, even though it is not possible to issue a copy of the notice to the defaulter. Ultimately, the defaulter can regain the right to challenge the

decision or choose how they will redress their non-compliance by re-engaging with Inland Revenue and updating their address records.

22. The main advantages of this option are:
    - It ensures that growth in late payment interest or penalties is limited by early intervention.
    - It contributes to the earliest possible recovery of outstanding debt.
    - It will ultimately retain the automation of the process when systems changes are possible.
    - In the interim, it can be implemented manually on a case-by-case basis with no additional administrative resources over the status quo.

23. The main disadvantages are:
    - By removing the requirement for formal notification to the employee it further limits the defaulter's opportunity to dispute the outstanding amounts or make other arrangements for repayment.
    - Employers would be required to bear the compliance cost of dealing with those employees who complain about the unexpected reduction in their pay.
    - There may also be an increase in contacts to Inland Revenue call centres of complaints about the unexpected deduction from pay.

24. This is officials' preferred option.

Summary of impact analysis

25. The table below summarises our analysis of the options (including the status quo).

Table: Summary of analysis

Option	*Meets objectives a, b, c, or d?*	*Impacts*				*Net impact*
		Economic / revenue impact	*Administrative impact*	*Compliance impact*	*Fairness*	
1. Inland Revenue obtains contact details for the defaulters from their employers (status quo)	Meets (d). Partially meets (c) but not (a) or (b).	None	Inland Revenue must obtain valid address details of defaulters, which slows the debt recovery process	Employers must provide address details for defaulters	Right of defaulters to be informed is preserved	Does not address the problem definition and fully meets only one of the four objectives
2. Inland Revenue issues notice to the last known "invalid" address of defaulters	Meets (c). Partially meets (b). Does not meet (a) or (d).	None	Inland Revenue must manually over-ride its system to issue the notices, deal with returned mail and handle additional complaints to call centres.	Employers may have to deal with employee complaints about reduction in pay	Defaulters are unaware of intention to deduct	Does not address the problem definition and fully meets only one of the four objectives
3. Inland Revenue issues notice to the employers for passing on to the defaulters	Meets (d). Partially meets (c). Does not meet (a) or (b).	None	Inland Revenue must manually over-ride its system to issue the notices	Employers have to pass on notice to defaulters	Right of defaulters to be informed is preserved	Addresses the problem definition but fully meets only one of the four objectives
4. Inland Revenue dispenses with notices to the defaulters (preferred option)	Meets (a) and (c). Partially meets (b). Does not meet (d).	None	An administrative saving compared with the status quo.	Employers may have to deal with employee complaints about reduction in pay	Defaulters are unaware of intention to deduct	Addresses the problem definition and fully meets two of the four objectives

OTHER IMPACTS

26. There are no social, cultural or environmental impacts.

CONSULTATION AND IMPACT

27. Inland Revenue has not consulted with employers due to time constraints and the preferred option would reduce compliance costs over the status quo for the small number likely to be affected (approximately 700 in March 2015). The Treasury was consulted on the policy proposal.

CONCLUSIONS AND RECOMMENDATIONS

28. We recommend Option 4 because it offers the biggest administrative cost reduction for Inland Revenue while offering improvements in efficiency of debt recovery and a reduction in compliance costs for employers. We consider these efficiency gains outweigh the impairment in the defaulters' right to natural justice because that impairment can be redressed by the defaulters taking action to update their address records.

IMPLEMENTATION

29. Options 1 and 2 do not require legislation to implement. Legislative change is required to implement options 3 and 4.

30. Amendments will be included in the proposed Taxation (Business Transformation and Simplification) Bill, which is scheduled for introduction in June 2015, and could be implemented from the date of enactment.

31. The preferred option would be automated when Inland Revenue's system changes are at a suitable stage of development. In the interim, it could be implemented manually on a case-by-case basis.

32. Inland Revenue will communicate any legislative changes to employers through its existing channels, such as its guides and the Tax Information Bulletin.

MONITORING, EVALUATION AND REVIEW

33. There are no specific plans to monitor, evaluate and review the changes to give effect to additional recovery of outstanding payments of tax, child support, gaming duty or student loan repayment obligations. If any detailed concerns are raised in relation to these changes, Inland Revenue will determine whether there are substantive grounds for review under the Generic Tax Policy Process.