

Impact Summary: Lowering the student loan repayment threshold for non-salary and wage income and repealing withholding changes for student loan income

Section 1: General information

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| Purpose |
| Inland Revenue is responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice have been produced for the purpose of informing key (or in-principle) policy decisions to be taken by Cabinet. |
| Key Limitations or Constraints on Analysis |
| <p>The key limitations on the analysis are as follows.</p> <p>Threshold changes</p> <p>In preparation for the transition of Student Loans repayments to IRD’s new systems and process, an issue has been discovered. If not addressed, the issue would affect the integrity of the system and introduce inequity. The administration of Student Loans is due to go live as of April 2020, so it is necessary to address this issue immediately. This urgency has imposed a limitation on analysis.</p> <p>No consultation with external stakeholders</p> <p>The timing around the identification of this issue has meant that no consultation has occurred with borrowers or representative groups. However, only approximately 25 borrowers per year are expected to be affected.</p> <p>Scale of the problem and impact on borrowers</p> <p>The scale of the problem is low. The proposal is limited to borrowers whose total income is above the \$19,760 repayment threshold and who have between \$500 and \$1500 of non-salary and wage income. From information Inland Revenue holds, the total number of borrowers who earned over the loan repayment threshold and had non-salary and wage income between \$500 and \$1500 was 25 borrowers for the 2018 income year.</p> <p>In terms of the impact on borrowers, the maximum increase in repayment obligations will be \$179 per annum. If borrowers pay this amount, then the time it will take them to repay their loan will be reduced slightly. If borrowers do not pay, then the amount will be capitalised back onto their loan and the loan balance and term of the loan will remain the same. No penalties will be imposed for non-payment.</p> <p>Impact of proposals on the student loan valuation</p> <p>The benefits from the proposal will not have a material impact on the student loan valuation</p> <p>None of the limitations materially affect the analysis.</p> |

Withholding changes

In the process of consultation on the implementation of changes previously passed into law, officials have been made aware that the change to require student loan repayments to be withheld from schedular, casual agricultural, and election day income earned by borrowers would impose significant compliance costs on employers. These issues were not raised previously in public consultations on the policy proposals or in submissions to select committee.

This urgency does not materially affect the analysis.

Responsible Manager (signature and date):

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Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

Threshold changes

The student loan scheme currently has a \$1500 threshold for non-salary and wage income for New Zealand-based borrowers, above the annual repayment threshold. Borrowers who earn \$1500 or less of non-salary and wage income (including schedular, casual agricultural, and election day income) in a year are not required to notify Inland Revenue of this income for student loan purposes and do not have to make student loan repayments on it. If a borrower earns more than \$1500 of non-salary and wage income, they are required to make repayments on the full amount.

This threshold was introduced when most salary and wage earners were not required to file a tax return and recognised the additional compliance costs associated with borrowers advising Inland Revenue of their income for student loan purposes only.

However, from 1 April 2019, legislative changes were made to the administration of individual's income tax. Now all taxpayers either file a return or have their income tax automatically squared up at the end of the tax year based on information from third parties reported during the year or information provided for tax purposes at the end of the year. As a result, there is no longer a significant compliance cost for borrowers in advising Inland Revenue of their non-salary and wage income. Therefore, the current threshold is set at a level that is higher than the compliance costs involved in providing this information to Inland Revenue.

Inland Revenue's Business Transformation programme is now moving the repayment of student loans into the new computer systems and processes. This process has highlighted the issue of the \$1500 threshold being set at a level that does not reflect the compliance costs involved in providing information to Inland Revenue. It is also an opportune time to reduce the threshold and any changes to the threshold would be included in this transformation process.

Withholding changes

Legislation currently enacted and due to take effect from 1 April 2020 would require Student loan deductions to be made from schedular, casual agricultural, and election day income each pay day. This change would affect approximately 33,000 borrowers and approximately 11,000 employers.

These changes were intended to address non-compliance by some borrowers earning this income. They would impose compliance costs on employers and potentially reduce compliance costs on borrowers. The changes do not affect the borrower's overall student loan repayment obligations but would have changed the way that these are met. Rather than make two interim payments and have an end-of-year square-up, borrowers would instead have deductions made from their income with an end-of-year square-up.

Consultation as part of Inland Revenue's business transformation programme has indicated that this change would impose significant, unforeseen, compliance costs on employers. These costs vary depending on the size of the employer and the complexity of their systems, but consultation has indicated that these costs are typically relatively large, both initially and on an ongoing basis.

2.2 Who is affected and how?

Threshold changes

The proposal is to reduce the threshold would affect borrowers with non-salary and wage income of between \$500 and \$1500 above the \$19,760 repayment threshold. The number of borrowers likely to be affected is 25 borrowers per year.

The maximum additional repayment amount resulting from lowering the threshold would be \$179 per annum per borrower payable with their end of year tax return. Those borrowers with non-salary and wage income either above \$1500 or below \$500 would not experience a change in their current treatment.

Retaining the current threshold level increases inequity between borrowers with salary and wage income (who make repayments on all income above the repayment threshold) and those with non-salary and wage income (who have an additional \$1500 above the \$19,760 repayment threshold before repayments apply).

This change would mean that approximately 25 affected borrowers each year would be required to make repayments and if payments are made, these would reduce the term of their loans. If the affected borrowers do not make payments, provisions in the Student Loan Scheme Act 2011 allow unpaid amounts of less than \$334 to be capitalised back onto the loan balance, so no borrowers whose total non-salary and wage income is between \$500 and \$1,500 will be subject to penalties if they do not make repayments and the debt to the Government will not increase.

Withholding changes

The change to student loan deductions on schedular, casual agricultural, and election day income would impose compliance costs on employers and seeks to reduce non-compliance by recipients of these payments. Repealing these provisions would avoid these compliance costs being imposed.

2.3 Are there any constraints on the scope for decision making?

The need for a quick response to this issue and the integrity issues mean that only three options are available for consideration – retaining the current \$1500 threshold (the status quo), lowering the threshold to zero, or lowering the threshold to \$500 (which is the option preferred by officials).

Section 3: Options identification

3.1 What options have been considered?

Threshold changes

There were three options considered, namely: to retain the current threshold; to reduce the threshold to zero; or to reduce the threshold to a lower amount of \$500.

The following criteria have been used to assess the options:

- Efficiency
- Equity between borrowers
- Compliance costs
- Economic (maintaining the value of the loan asset)

Retaining the existing threshold

This option would:

Pros

- Not result in any change for borrowers or Inland Revenue or require any legislative change

Cons

- gives an unintended financial benefit to borrowers with non-salary and wage income under the \$1500 threshold as they are not required to make loan repayments on this income
- treat borrowers under the \$1500 threshold differently to other borrowers
- the student loan scheme becomes inconsistent with how other taxes are administered
- the term of borrowers' loans would be longer than necessary
- the government would carry this student loan debt for longer.

Reducing the threshold to zero.

These borrowers would pay the increased obligation as part of their end-of-year assessment process. This option would:

Pros

- remove the financial benefit to borrowers with non-salary and wage income compared to other borrowers
- improves loan repayments/reduces the term of the loan
- reduces the period the government carries the debt

Cons

- this option would introduce another inequity as the threshold would be set at a level that is lower than similar compliance cost reduction thresholds used for the administration of income tax (where outstanding amounts of less than \$50 are not pursued).
- Compliance costs would be incurred by affected borrowers in understanding the changes and making repayments, but these would be similar to the costs incurred by other borrowers with repayment obligations.
- Consultation has not occurred with affected borrowers.
- Legislative changes are required to give effect to this proposal

Reducing the threshold from \$1500 to \$500 (The preferred option)

Reducing the threshold to \$500 would equate to \$60 of loan repayments. This is very close to the \$50 threshold for income tax owed from an automated assessment, where amounts less than \$50 owed are written off.

These borrowers would pay the increased obligation as part of their end of year assessment process. This option would:

Pros

- Set the threshold at a level that is similar to other thresholds used to administer income tax (where outstanding amounts are not pursued).
- remove the financial benefit to borrowers under the threshold compared to other borrowers
- improve equity among borrowers (between those with non-salary and wage income of \$1500 or less and other borrowers)
- increased equity increases the integrity of the loan scheme.
- improve loan repayments/reduce the term of the loan
- reduce the period the government carries the debt

Cons

- Compliance costs would be incurred by affected borrowers in understanding the changes and making repayments, but these would not be material as they would be incurred in complying with their income tax obligations.
- Consultation has not occurred with affected borrowers.
- Legislative change is required

Withholding changes

For the changes to the student loan withholding requirements, the option that has been considered is to repeal the provisions, so that these changes do not come into force and that the current arrangements continue.

Options briefly considered and rejected were to defer the application date or to make the changes optional for employers. Making the changes optional would create greater complexity and uncertainty for borrowers, employers and Inland Revenue. Deferring the application date would give employers more time to implement the changes but is unlikely to reduce the compliance costs.

3.2 Which of these options is the proposed approach?

Threshold changes

The preferred option is to reduce the threshold level to \$500. This would increase equity among borrowers and reflect the original intent that borrowers who are not subject to high compliance costs should make loan repayments.

Withholding changes

For the changes to the student loan withholding requirements, the preferred option is to repeal the provisions as this minimises compliance costs.

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

| Affected parties (<i>identify</i>) | Comment: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks | Impact <i>\$m present value, for monetised impacts; high, medium or low for non-monetised impacts</i> |
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Threshold changes

| Additional costs of proposed approach, compared to taking no action | | |
|--|--|----------------------------------|
| Regulated parties (borrowers with non-salary and wage income between \$500 and \$1500) | <p>Compliance costs: The ongoing compliance costs are not expected to be material as they would be incurred in complying with income tax obligations.</p> <p>One-off cost may be incurred in understanding the changes. These would be short lived.</p> <p>Financial Impact: The maximum financial impact on the affected borrowers (approximately 25 borrowers per year) is increased repayments of \$179 per annum for borrowers who are over the \$19,760 repayment threshold. If a borrower is under the repayment threshold, they would not have to make any repayments.</p> <p>As the repayment obligation is based on the borrower's income, we expect that most would be able to make the additional repayment.</p> <p>If borrowers are unable to make the additional repayments, they would not be subject to any penalties and so would not be made worse off.</p> | <p>Nil</p> <p>Low</p> <p>Low</p> |
| Regulators (Inland Revenue) | The costs of implementing this change will form part of Inland Revenue's Business Transformation programme and additional costs (above those already funded by Business Transformation) will not be incurred. | Nil |
| Wider government | N/A | Nil |
| Other parties (Student Unions and other representative bodies) | One-off cost. There will be costs for representative bodies in updating informational material on this change for students. However, this change would be included with other student loan | Low |

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| | changes that will be occurring from 1 April 2020. | |
| Total Monetised Cost | | Low |
| Non-monetised costs | | Low |

| Expected benefits of proposed approach, compared to taking no action | | |
|--|---|-----|
| Regulated parties (borrowers with non-salary and wage income between \$500 and \$1500) | <p>Borrowers who pay the increased repayment will slightly reduce the term of the loan.</p> <p>Borrowers who do not pay will have the amount added back to their loan. They will not incur any penalties for non-payment and the term of their loan will remain same.</p> <p>Increased equity between borrowers with non-salary and wage income and other borrowers which increases the integrity of the loan scheme.</p> | Low |
| Regulators (Inland Revenue) | Consistency of loan scheme with way income tax is administered. | Low |
| Wider government | N/A | N/A |
| Other parties | N/A | N/A |
| Total Monetised Benefit | | |
| Non-monetised benefits | | Low |

Withholding changes

| Additional costs of proposed approach, compared to taking no action | | |
|---|---|-----------------------|
| Regulated parties (borrowers earning these types of income and their employers) | <p>Compliance costs: The changes proposed to be repealed would have imposed compliance costs on employers and potentially reduced compliance costs for borrowers. Repealing these changes would lower compliance costs overall.</p> <p>Financial Impact: As the change preserves current arrangements, there is not expected to be any financial impact</p> | <p>Low</p> <p>Nil</p> |
| Regulators (Inland Revenue) | As the change preserves current arrangements there should not be significant additional costs to repealing the change. | Low |
| Wider government | N/A | Nil |
| Other parties | N/A | Nil |
| Total Monetised Cost | | Low |

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| Non-monetised costs | | Low |
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| Expected benefits of proposed approach, compared to taking no action | | |
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| Regulated parties (borrowers earning these types of income and their employers) | Employers have indicated that there are significant compliance costs to implement the changes, so repealing these changes will mean that they do not face these costs. | Medium |
| Regulators (Inland Revenue) | N/A | N/A |
| Wider government | N/A | N/A |
| Other parties | N/A | N/A |
| Total Monetised Benefit | | Low |
| Non-monetised benefits | | Medium |

4.2 What other impacts is this approach likely to have?

Threshold changes

Officials have not identified other impacts as a result of the proposal.

There is uncertainty around borrower behaviour towards these loan repayments and the extent to which these amounts will be repaid. Some borrowers will pay, some will have their loan repayments amalgamated with other tax obligations, and others will not pay.

Withholding changes

Removing the withholding requirements is likely to mean that compliance rate for the borrowers effected may remain lower than the wider population of student loan borrowers. Inland Revenue are considering ways that this can be addressed operationally.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?

Threshold changes

Consultation with representative groups has not occurred to date. Consultation will occur with representative groups as part of Business Transformation stakeholder engagement activities in implementing the changes.

Withholding changes

The proposal to repeal the earlier withholding changes is a direct response to concerns raised by employers during recent consultation that they would face significant and unforeseen compliance costs unless the previous law changes were repealed before the take effect on 1 April 2020.

These issues were not previously identified in earlier public consultation on the policy proposals or in submissions to select committee.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?

Threshold changes

Lowering the threshold requires a legislative change to the Student Loan Scheme Act 2011. It is intended that this change be included at the Select Committee stage of the Taxation (Kiwisaver, Student Loans, and Remedial Matters) Bill. The change will apply from 1 April 2020, which is the same date that other student loan changes apply from.

Inland Revenue will be responsible for the ongoing operation of this threshold. The change will be implemented as part of Inland Revenue’s Business Transformation Release 4 changes which incorporate the repayment of Student Loans into the new systems and processes. The risks associated with this proposal are being managed as part of the wider risks to do with the Transformation programme.

Information on the change will be incorporated with other communications to affected borrowers once the legislation is enacted.

Withholding changes

Repealing the withholding changes will not require any implementation as this maintains current arrangements. As part of educating employers before release 4, Inland Revenue would ensure that it is clear that these provisions are intended to be repealed so that no employers make changes to their systems to comply with the repealed provisions.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

Inland Revenue will monitor whether there are any issues arising with the enacted legislation. If officials identify anything that suggests the legislation is not operating as intended, then we will undertake a review and report to Ministers on legislative changes to address the issues.

7.2 When and how will the new arrangements be reviewed?

As described above in 7.1 above