

PAYE error correction and adjustment – anonymised summary of feedback

Introduction

A Government discussion document *Making Tax Simpler – Better administration of PAYE and GST* was released in late 2015. It proposed how modern digital systems could be used to modernise the PAYE system. Some of the changes proposed in the discussion document are included in the *Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018* (the Act). The Act includes a requirement that employers generally file PAYE information, referred to in the Act as “employment income information”, within 2–10 days of payday (payday reporting). Currently employers aggregate this information and provide it to Inland Revenue on a monthly basis.

Error correction and adjustment in PAYE information is currently a largely manual process and if Inland Revenue’s business transformation objective of reducing compliance and administrative costs is to be realised, payday reporting necessitates simpler and clearer methods to correct errors and make adjustments in employment income information. The Act includes a regulation making power which provides that the Governor General can, on the recommendation of the Minister of Revenue and following appropriate consultation, make regulations relating to error correction in employment income information.

To contribute to the development of the regulations and to meet the obligation to consult an officials’ issues paper, *PAYE error correction and adjustment* (the issues paper), was released in August 2017. This document summarises the main themes from the submissions on the issues paper. Thirteen submissions were received. Submissions were received from providers of payroll software (some of which also operate as payroll intermediaries), employers including a group of employers, interest groups and accounting firms.

The comments quoted in this summary of feedback are representative of the comments received and are quoted as supplied.

The submissions received were generally supportive of the proposals. However, there was general opposition to the proposed employer threshold. This threshold would only permit an employer to correct ‘interpretation errors’ in a future return if they had not already made \$10,000 of upward adjustments to PAYE in that year.

This summary is organised by issue and error type as set out in the issues paper.

Description and status quo	Proposal	Submissions
<p>Environment for PAYE error correction and adjustment</p>	<p>Although not requiring legislation or regulation a number of design matters were described to illustrate the environment in which the proposed approach to error correction will operate.</p>	<p>A number of submissions commented on aspects of the outlined design.</p> <p>Ability to resubmit a whole pay: <i>“An essential ability. It is not uncommon to process (and submit) a pay run, and before payment is made an error is identified. The pay run is reverted (or re-opened), the correction made, and the pay run re-submitted.”</i> (Software provider)</p> <p>Ability to resubmit a whole pay: <i>“indicates that it will be possible to reverse out and resubmit an entire pay day submission. While that would be useful in situations where the wrong return has been filed, or where a software error means that an entire return is invalid, we also would need the ability to reverse out and resubmit individual line items of a previously submitted payday submission. Section 2.12 implies this, but the mechanism will need to be clearly defined.”</i> (Software provider/intermediary)</p> <p><i>“The document does not make it clear whether resubmissions of data are at employee level or at a schedule level. We feel it’s very important that any adjustments occur at the employee level.”</i> (Software provider)</p>

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<p>Channels for error correction</p> <p>Inland Revenue advises in the “Employer’s Guide” that errors must be corrected by phoning the department (for a small number of errors) or by completing a form that requires the figures originally sent in and what these should be changed to – in this document this process is referred to as “amending the original return”.</p> <p>Payroll intermediaries currently have access to an automated adjustment process.</p>	<p>It was proposed that Inland Revenue should accept:</p> <ul style="list-style-type: none"> • error correction returns generated by employer’s payroll software; • an employer ‘self-correcting’ the return they have filed through Inland Revenue’s secure on-line portal (myIR); • paper error correction returns; and • for small numbers of errors the correction could be advised by telephone. 	<p>Submitters supported the proposed options. One payroll provider expressed concern about the prospect of an employer who uses payroll software self-correcting errors through myIR.</p> <p><i>“Building an automated error correction process into payroll software for minor errors, or errors detected within the next few pay cycles is sensible.”</i> (Interest group)</p> <p><i>“It is especially pleasing to see that there is flexibility in the proposals to allow employers to adjust errors in the manner that works best for their business / systems (and where possible have this as an automated process).”</i> (Interest group)</p> <p>Self-correction through myIR: <i>“I support this, especially for those submitting by manually entering the information via myIR and sending to IR. I have some concerns if manual corrections are made to returns submitted from payroll software. This is likely to result in inconsistencies between the payroll system and the information held by IR. I’d prefer that a return submitted from payroll software was unable to be amended in myIR with any corrections done within the software and submitted to IR as a separate pay return.”</i> (Software provider)</p>
<p>Reporting errors</p> <p>Reporting errors occur when what was paid to and withheld from an employee is incorrectly reported to Inland Revenue.</p>	<p>Reporting errors should be corrected by amending the original return.</p> <p>This proposal continues current practice.</p>	<p>Submitters who responded universally supported the proposed approach.</p> <p><i>“We support the solutions in the paper in relation to reporting errors.”</i> (Accounting firm)</p> <p><i>“Ideally this should never happen with payroll software. If it does it implies there is a bug in the software.”</i> (Software provider)</p>

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<p>Underpayments</p> <p>Underpayments typically occur in an employment context when:</p> <ul style="list-style-type: none"> • the wage or salary has been incorrectly calculated; or • information was not received in time to be included in pay. <p>Because wages and salaries are taxed on a cash basis, tax is calculated at the time the cash is paid.</p>	<p>Tax and other deductions should be calculated at the time payment is made.</p> <p>This proposal continues current practice.</p>	<p>Submitters agreed that this was the correct approach although one noted that in their experience many employers worked out the changes back in the original periods. One submitter drew attention to the unfairness that recipients of large multi-year back payments for example from ACC can experience if the money is all taxed in one year.</p> <p><i>“Agree, the group agreed that all tax and other deductions particularly KiwiSaver should be calculated on the employee’s current rate and should not be retrospectively calculated on prior year or previous tax rates as they are receiving the funds now and not in the past. This would also enable clear and correct reporting as the impact of the underpayment would be realised in the current period.”</i> (Employer group)</p> <p><i>“While we agree with this principle, we note that many employers do not differentiate between an underpayment made in a previous period from an over payment in a previous period, and approach the correction in the same way, which is to correct the payment data in the pay period that it relates to.”</i> (Software provider)</p> <p><i>“Payment can be received in a lump sum in a different income year from the year or years to which the compensation relates. As the payment is taxed in the year it is received, many taxpayers are taxed at a higher marginal tax rate by virtue of the resulting aggregation of income. Taxpayers who receive ACC loss of earnings compensation should have the option of having it taxed in the year to which it relates or taxed in the year it is paid. We acknowledge that these options would need legislative change.”</i> (Interest group)</p>

Description and status quo	Proposal	Submissions
<p>Overpayments</p> <p>Overpayments typically occur:</p> <ul style="list-style-type: none"> • if information was not received in time to be included in pay; or • if an employee was able to ‘anticipate’ certain benefits such as leave and resigned before it was earned. <p>Inland Revenue’s published advice is that all errors must be corrected by filing an amendment to the original return (Option B next column).</p>	<p>Submissions were sought on three options:</p> <p>Option A: Recalculate amounts and tax in the period(s) in which the error(s) occurred, but net the change off the values in a current return. Employers will not be able to file negative values until PAYE is being fully processed in Inland Revenue’s new computer system, estimated as during 2020.</p> <p>Option B: Recalculate amounts and tax in the period(s) in which the error(s) occurred and file an amendment for the return(s) that contained the error.</p> <p>Option C: If the employer is legally able to do so and corrects the error(s) through an agreed reduction to gross income in a future period(s), no correction is required by Inland Revenue.</p>	<p>The employers who commented on this question universally expressed a preference for option A as did the majority of software providers. However, one software provider commented that many small employers use Option C.</p> <p><i>“Option A would be the preference for the group as this would reduce any need for manual intervention, once all functionality updates are completed by Inland Revenue.”</i> (Employer group)</p> <p><i>“Our approach for overpayments is recalculating the pay and tax in the periods that require correction, and netting the differences off the values in a subsequent return [Option A]. The amount that the employee is to repay is calculated in the reversing and adjustment process. This also results in any overpaid deductions being offset against any existing deductions to be paid in the current payment period.”</i> (Software provider)</p> <p><i>“By default this [Option A] is the way that our system will recover overpayments but it should be noted that the system can be changed by customers so there may be some customers who have slight variations on this.”</i> (Software provider)</p> <p><i>“For small businesses Option C is the most commonly used method for processing overpayments, and is also recommended under payday reporting.”</i> (Software provider)</p> <p><i>“Wherever possible, employers should be allowed to correct prior period errors in subsequent returns [Option A].”</i> (Employer)</p>

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<p>Negative values</p> <p>Negative values would occur when an employer nets off a large overpayment and resulting over-deductions against a current return where the current value(s) is smaller than the overpaid/over-deducted value(s).</p> <p>Consistent with the approach to general overpayment errors employers are required to amend the original return.</p>	<p>Inland Revenue’s existing computer system cannot accurately process negative values.</p> <p>Once PAYE processing is fully managed from Inland Revenue’s new computer system, estimated to be in 2020, employers will be able to file returns containing negative values. Until 2020 employers will be required to correct overpayments which would give rise to negative values by amending the earlier return(s).</p> <p>Employers will still have the option of correcting these errors by amending a previous return.</p>	<p>Submitters universally supported the proposal although one noted that complex cases sometimes required careful reconstruction across filing and payment periods.</p> <p>Two submitters expressed significant concern that it would not be possible to file negative values from the beginning of payday reporting in April 2019.</p> <p><i>[We] “support the proposal to allow employers to file negative values in their returns of employment income information”. (Employer)</i></p> <p><i>“Yes, the group agreed that this would reduce the amount of manual intervention required and is fully supported.” (Employer group)</i></p> <p><i>“We support the proposal to accept negative values in returns but question why payday reporting will become mandatory from 1 April 2019 when Inland Revenue’s system will not be able to accept these until 2020. We submit that the implementation date for payday reporting should be aligned to the date when the START system will be in operation for PAYE reporting”. (Employer)</i></p> <p><i>“IR should accept negatives into START and figure out how to manage them in FIRST if more info is required to do that let us know and we will see what we can do.” (Software provider)</i></p>

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<p>Interpretation errors</p> <p>Interpretation errors occur where the wrong tax treatment is applied. For example:</p> <ul style="list-style-type: none"> • A benefit, such as accommodation allowance, that should be subject to PAYE may be treated as tax free. • New legislation may be incorrectly applied. <p>Inland Revenue’s published advice is that all errors must be corrected by filing an amendment to the original return.</p>	<p>The employer has the option of correcting interpretation errors in a subsequent return provided that:</p> <ul style="list-style-type: none"> • PAYE on the error is less than 10% of the relevant employee’s PAYE for the pay period in which the correction is made; and • subject to a cap of \$10,000 of upward revisions per employer per year. <p>Larger errors should be corrected by amending the original return (a voluntary disclosure). If they choose to, employers can also amend small interpretation errors in this way.</p>	<p>Respondents almost universally opposed the \$10,000 a year employer level cap on upward revisions of PAYE on the basis that it was too low for large employers and would have to be manually tracked. Several respondents also suggested that the 10% of employee’s PAYE threshold was too low.</p> <p><i>“The cap of \$10,000 per year does not seem appropriate for large organisations.”</i> (Software provider)</p> <p><i>“The group is largely supportive of such an approach as it will work to reduce compliance costs and allows for the fact that there will be errors, especially as more information is required to be pushed to Inland Revenue. However, a ten percent threshold can be easily exceeded if, for example, an interpretation error is discovered which has occurred over multiple paydays. There should be some additional flexibility to deal with matters. It is additionally proposed that there should be an annual threshold of \$10,000 worth of upwards reassessments from interpretation errors in an income year. The group does not support this proposal”.</i> (Interest group)</p> <p><i>“The \$10,000 per annum threshold for employers is not appropriate or practical for all situations. Setting an annual dollar based threshold would also require employers to identify and specifically track interpretation errors to ensure the threshold is not exceeded. This would result in additional compliance costs for employers”.</i> (Employer)</p> <p><i>“It would also be extremely difficult for a software system to check a per annum threshold for the payroll as a whole”.</i> (Software provider)</p> <p><i>“We support the proposal to allow small and other interpretation errors, subject to a threshold, to be able to be corrected in a subsequent return. We submit that the employers overall eligibility threshold should be extended so as not to exclude mid-size employers.”</i> (Interest group)</p>

Description and status quo	Proposal	Submissions
<p>Errors relating to a previous tax year</p> <p>Inland Revenue’s published advice is that all errors must be corrected by filing an amendment to the original return.</p>	<p>Errors relating to a previous tax year should be able to be corrected in the current year. The employer could, however, choose to correct the error by amending the original return.</p> <p>The limitations relating to negative values and thresholds for interpretation errors would constrain the ability to correct errors in a subsequent year in the same way as they apply to corrections made within the same tax year.</p>	<p>Employers and payroll providers who responded to this question supported the proposal. One submitter proposed that there should be a materiality threshold before a previous year’s assessment is reopened and another submitted that Inland Revenue needed to issue clear guidance for employees.</p> <p><i>“Yes, this would be helpful.”</i> (Software provider)</p> <p><i>(We) “support the view that employers should be able to report overpayment and interpretation errors relating to a previous tax year in a current year payday return. This is the simplest approach to correct errors, and significantly reduces compliance costs for employers.”</i> (Employer)</p> <p><i>“We recommend that a materiality level be set before back years are reopened. The implications of reopening a back year should be taken into account.”</i> (Interest group)</p> <p><i>“If employers are able to report overpayment and interpretation errors relating to previous tax years, in a current-year pay day return, we strongly urge Inland Revenue to issue clear guidance about the implications on the employees. For example, if the tax position of the employee has crystallised, what are the impacts, if any?”</i> (Accounting firm)</p>

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<p>Employer superannuation contribution tax (ESCT)</p> <p>Information about the amount of ESCT paid by the employer is currently provided at an aggregate level which shows the total paid by the employer for the month.</p> <p>Aggregate reporting complicates error correction and precludes Inland Revenue from proactively refunding ESCT for example, when an employee opts out of KiwiSaver.</p>	<p>Inland Revenue should obtain ESCT information at an individual employee level.</p>	<p>Employers, accounting firms and payroll software providers supported this proposal. One submitter expressed the view that it should only occur if Inland Revenue uses the data to refund ESCT when employees opt out.</p> <p><i>“Fully support this and it will aid reconciliation.”</i> (Software provider)</p> <p><i>“We strongly support the proposal that ESCT reporting is done at employee level.”</i> (Accounting firm)</p> <p><i>“Yes please. Very much in favour of this. It is always calculated on a per employee per pay basis any way.”</i> (Software provider)</p> <p><i>“If an employee opts out the KiwiSaver contributions are refunded but as the IRD do not have ESCT details at an individual employee level, they do not refund ESCT unless specifically requested. It would be useful if this problem is rectified as part of this proposal”.</i> (Interest group)</p>

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<p>Complexity</p> <p>Inland Revenue’s published advice is that all errors must be corrected by filing an amendment to the original return.</p>	<p>The issues paper asked whether the proposed approach with three different ‘error types’ is overly complex. The paper did note that an employer concerned about the complexity of different error types could, however, choose to correct all of the error types by amending the original return (status quo).</p>	<p>Most of those who responded support allowing choice, but one submitter expressed concern that it would cause confusion.</p> <p><i>“We acknowledge the need to distinguish between the types of errors identified in the issues paper and agree that having different rules to deal with these error types is appropriate.” (Interest group)</i></p> <p><i>“No, the Group does not find the proposed changes unduly complex; however, we would require clear and concise guidance and working examples to assist system vendors and employers to implement these changes. Clear guidance would also assist employers to deal with the day-to-day queries from employees.” (Employer group)</i></p> <p><i>“We support the ability of employers to choose to amend the original return rather than applying one of the other methods proposed in the paper.” (Accounting firm)</i></p> <p><i>“It is especially pleasing to see that there is flexibility in the proposals to allow employers to adjust errors in the manner that works best for their business / systems (and where possible have this as an automated process). This is in line with Inland Revenue’s customer centric approach and takes into account the fact that businesses vary significantly in the way that they operate.” (Interest group)</i></p> <p><i>“The issues paper categorises the types of errors and adjustments encountered in payroll, and proposes different rules based on these types of errors and adjustments. It is our opinion that this approach is unlikely to work. Firstly, the difference between error types is not sufficiently clear for employers to be able to determine the correct approach to take.” (Software provider/Intermediary)</i></p>

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<p>The tax status of overpaid PAYE income not repaid</p> <p>Inland Revenue’s view is that PAYE income not repaid is generally not subject to PAYE. It would be subject to PAYE if:</p> <ul style="list-style-type: none"> • repayment was not required by the employer; • the employee did not have claim of right to the income; or • it became debt remittance income. <p>This view has not been widely communicated and many employers are known to treat overpaid PAYE income not repaid as subject to PAYE.</p>	<p>Overpaid PAYE income not repaid is subject to PAYE.</p>	<p>Most submitters supported the proposed approach but some did not.</p> <p><i>“Yes, the group fully support this proposal.”</i> (Employer group)</p> <p><i>“We strongly support this proposal. However, we urge Inland Revenue to release clear guidance around what constitutes an agreement to repay so employers can be clear on this.”</i> (Accounting firm)</p> <p><i>“Yes, we support the proposal that the law should be amended to make it clear that overpaid income not repaid remains taxable in the hands of the employee as PAYE income. However, the law should also make it clear that overpaid salary/wages that is repaid (or where there is an agreement to repay) is not taxable in the hands of the employee as PAYE income.”</i> (Accounting firm)</p> <p><i>“No we do not. We believe that as soon as the amount is agreed to be repaid then the employer should be able to correct the overpayment and request the overpaid PAYE and related deductions be refunded. Having to subsequently make amendments if the total amount is not repaid introduces unnecessary complexity and in practise is unlikely to be adhered to resulting in non-compliance should the law be clarified”.</i> (Software provider)</p> <p><i>“Inland Revenue should widely disseminate and include in its guidance to employers that an overpayment of wages or salaries is not PAYE income. Once Inland Revenue has been notified of an overpayment error they should be able to amend their records and repay the PAYE to the employer... The recovery of the amount paid to the employee is a separate exercise from the refund of the PAYE from Inland Revenue. It is an agreement between the employer and the employee and does not involve Inland Revenue unless there is debt remission.”</i> (Interest group)</p> <p><i>“The Group disagrees with this proposed treatment of overpayments of PAYE income and does not consider that Inland Revenue has given sufficient justification for this change. The Group considers that this treatment effectively taxes an amount which cannot in any sense be considered employment income. This proposed approach disadvantages employers by effectively taxing an amount that is not income.”</i> (Interest group)</p>

Description and status quo	Proposal	Submissions
<p>Fringe benefit tax on an interest free loan</p> <p>If an employer has made a large overpayment it is common for an employee to be allowed time to repay the overpayment with an agreed amount being repaid each pay period.</p> <p>Technically this could be regarded as an interest free loan which should be subject to fringe benefit tax.</p>	<p>FBT does not arise when time is allowed to repay an overpayment of employment income.</p>	<p>All those who submitted on this proposal supported it.</p> <p><i>"[We] agree that the Act should be amended to clarify that time allowed to an employee to repay overpaid income is excluded from fringe benefit tax."</i> (Employer)</p> <p><i>"We support this clarification"</i> (Accounting firm)</p> <p><i>"The group agrees that salary overpayments should be excluded from the fringe benefit tax rules."</i> (Interest group)</p>