

Student Loan Scheme (Repayment Bonus) Amendment Bill

Government Bill

Explanatory note

General policy statement

From 1 April 2009, a 10% bonus will be available for those who make voluntary repayments on their student loans. The student loan voluntary repayment bonus scheme aims to encourage student loan borrowers to make extra repayments so that they repay their student loans sooner.

Voluntary repayments will be any repayments to Inland Revenue in respect of a tax year that exceed the borrower's compulsory repayment obligation for that tax year by \$500 or more. The excess payment may be made in a lump sum or by smaller contributions throughout the year. The bonus will not apply to any excess payment for which a refund is subsequently requested.

New Zealand-based and overseas-based borrowers will be eligible for the bonus if they comply fully with their student loan repayment obligations. Voluntary repayments made to Inland Revenue will attract the bonus, and students will be able to receive the bonus while they are still studying. However, to avoid students borrowing more than is necessary and repaying in the year of borrowing, repayments to the Ministry of Social Development (StudyLink) will not qualify for the bonus.

The bonus will be credited to borrowers' student loan accounts after the end of each tax year. Borrowers who repay their loan in full will receive the bonus at the time of payment if their remaining balance is \$550 or more after any amount payable in the current tax year. However, in the introductory period up to 1 April 2010, the 10% bonus will be credited after that date.

Clause by clause analysis

Clause 1 sets out the Title of the Bill.

Clause 2 is the commencement clause. This Bill is to come into force on the day after the date on which it receives the Royal assent.

Clause 3 states that the Bill amends the Student Loan Scheme Act 1992.

Clause 4 inserts a *new heading* and *new sections 45A to 45F*, all of which concern the payment of a 10% bonus to a borrower who makes repayments to the Commissioner of Inland Revenue in respect of a tax year in excess of the borrower's repayment obligation, and all other amounts that the borrower may be obliged to pay under the principal Act, in respect of that tax year.

New section 45A is an interpretation section. It contains definitions for 2 terms that are used in *new sections 45A to 45F* and cross-refers to the definition of excess repayment in *new section 45B*.

New section 45B(1) defines an excess repayment, in respect of a borrower, as any amount paid to the Commissioner in respect of a tax year in excess of that borrower's repayment obligation for that tax year. *Section 45B(2)* specifies that certain payments are not excess repayments. In particular, any amount paid in respect of a tax year when a repayment obligation, repayment deduction, interim repayment, terminal repayment obligation, or penalty is, or will be, due and payable in respect of that tax year or any prior tax year (a **due amount**) is not an excess repayment except to the extent that the amount paid is in excess of all due amounts. Further, any amount that was paid before 1 April 2009 or in respect of a tax year that ended on or before 31 March 2009 is not an excess repayment.

New section 45B(3) clarifies the manner in which excess repayments may be made. It provides that excess repayments may be made by any means, in 1 or more payments, and when those payments may be made. Generally, all excess repayments need to be made within the

tax year in respect of which they are paid. However, if a borrower must pay a terminal repayment obligation for the tax year in question, excess repayments may be made in respect of that tax year up to and including the day on which that borrower must pay his or her terminal repayment obligation.

New section 45C is the main operative provision. *Subsection (1)* sets out the circumstances in which a borrower is entitled to a 10% bonus. To be entitled to a 10% bonus, a borrower's total excess repayments in respect of a tax year must be \$500 or more and, at the beginning of that tax year, the borrower's IRD loan balance must be \$550 or more. If a borrower is entitled to a 10% bonus under this section, the Commissioner of Inland Revenue must reduce the borrower's IRD loan balance by an amount equal to 10% of the borrower's total excess repayments in respect of the relevant tax year.

New section 45D is similar to *new section 45C* but deals with a situation where the borrower's total excess repayments for a tax year are less than \$500 and the shortfall is because of an under-deduction through the PAYE system and that under-deduction meets 1 or more of 3 criteria. A borrower is only entitled to a 10% bonus under this section if the Commissioner considers that the borrower's total excess repayments for the relevant tax year would have been \$500 or more if the under-deduction had not occurred. If a borrower is entitled to a 10% bonus under this section, the Commissioner of Inland Revenue must reduce the borrower's IRD loan balance by an amount equal to 10% of the borrower's total excess repayments in respect of the relevant tax year that the Commissioner considers would have been made if the under-deduction had not occurred.

New section 45E sets out the time at which a 10% bonus must be credited to a borrower's IRD loan balance. If, after a 10% bonus has been provided, a borrower's IRD loan balance will be fully repaid, the 10% bonus must be credited to that borrower's IRD loan balance as at the date on which the final excess repayment was made. If, after a 10% bonus has been provided, a borrower's IRD loan balance will not be fully repaid, the 10% bonus must be credited to that borrower's IRD loan balance as at 1 April in the tax year that follows the tax year in respect of which the excess repayments were made. However, if a borrower is a borrower who must pay a terminal repayment obligation and his or her IRD loan balance will not be fully repaid as a result of it being reduced by a 10% bonus, that bonus must be

credited to that borrower's IRD loan balance as at the day after the date on which that borrower must pay his or her terminal repayment obligation for the tax year in respect of which the excess repayments were made.

New section 45E also provides that the total amount of a 10% bonus that may be provided to a borrower must not exceed an amount equal to one-eleventh of that borrower's IRD loan balance on the date on which the 10% bonus is provided. This is to ensure that a borrower cannot actually end up with a positive IRD loan balance as a result of a 10% bonus.

New section 45F sets out what must occur if a borrower who has received a 10% bonus subsequently seeks a refund under section 56 or 57 of the principal Act of any excess repayment that was made. If this occurs, the 10% bonus that was provided to the borrower must be reduced to an amount equal to 10% of the remaining excess repayment (if any) in respect of the tax year that is equal to or more than \$500.

Regulatory impact statement

Executive summary

The Government has made a manifesto commitment to introduce a bonus scheme that will offer a 10% bonus to borrowers who make voluntary repayments of \$500 or more on their student loan. A bonus scheme is proposed that aims to help borrowers repay their loans more quickly and lower the costs to the Government of the scheme. The issue is twofold. First, there is a public perception that student loan balances are very high and that it takes many years for borrowers to repay them. Secondly, since student loans became interest free from 1 April 2006, there has been a downward trend in student loan repayments received directly from borrowers and in the number of people fully repaying their loan each year. These trends are concerning because the longer borrowers take to repay their loans, the more expensive the borrowing is to the Crown.

The bonus scheme is expected to reduce repayment times of borrowers who take up the offer by 1.5 years.

The bonus will be credited to borrowers' student loan accounts after 1 April 2010, and that will mean that the bonus will be credited retrospectively for those repaying in full between 1 April 2009 and

1 April 2010 (ie, those repaying in full before the legislative and systems changes have been made).

Adequacy statement

The Ministry of Education confirms that the principles of the Code of Good Regulatory Practice and the regulatory impact analysis requirements, including the consultation regulatory impact analysis requirements, have been complied with. A regulatory impact statement was prepared and the Ministry of Education considers it to be adequate. The final regulatory impact statement was circulated with the Cabinet paper for departmental consultation.

Status quo and problem

There is a public perception that student loan balances are very high and that it takes many years for borrowers to repay them. The Student Loan Scheme Annual Report for 2008 indicates that—

- as at 30 June 2008, the median loan balance payable by borrowers (ie, excluding accrued interest) was \$10,883; and
- the median repayment time for those who finished study in 1999 was forecast to be 9 years. The median repayment time for those who finished study in 2005 is expected to be 7 years.

Before the interest-free student loan policy, the key incentive for early repayment of loans was the interest rate. Following the introduction of the interest-free student loan policy,—

- the proportion of repayments that Inland Revenue receives directly from borrowers continues to decrease (Inland Revenue does not specifically identify or monitor voluntary repayments; it does categorise repayments made directly to it by borrowers and those made through the PAYE system): from 46.9% in 2005, to 35.5% in 2006, to 29.92% in 2007, and to 28.3% in 2008; and
- the number of people who fully repay their student loan each year is decreasing: from 25 600 in 2005, to 21 448 in 2006, and to 19 779 in 2007; and
- the upfront cost of new lending has increased: the cost is now 39.15 cents for every dollar lent (up from 23 cents for every dollar in 2002).

The repayment trends are concerning because the longer borrowers take to repay their loans, the more expensive the borrowing is to the Crown. Therefore encouraging voluntary repayments may help reduce the cost of the scheme to the Crown.

Objectives

The primary objective of the proposed policy is to help borrowers to pay back their student loan debt more quickly. A secondary objective is to lower the costs to the Government of the student loan scheme.

Alternative options

A number of policy design options were considered for the bonus scheme but were largely rejected because of the associated level of administrative complexity and cost.

It would be difficult for Inland Revenue to implement a bonus scheme if it were applied at the time the payment is made (except for final payments) instead of at the end of the tax year or if the bonus applied to single lump sum repayments only. This is because Inland Revenue does not have the ability to classify individual student loan payments from borrowers as voluntary or otherwise.

If the policy was restricted to New Zealand based-borrowers, Inland Revenue would need to develop systems to match borrowers' time in New Zealand to their repayments in the tax year. Similarly, if the policy was offered just to graduates, Inland Revenue would need to make significant systems changes to establish which portion of each borrower's loan balance was generated by study that resulted in graduation.

Imposing a time limit on entitlement to the bonus payment would mean that Inland Revenue would need to track borrowers' repayment progress and possibly their movements in and out of study.

Accepting qualifying repayments to the Ministry of Social Development as well as to Inland Revenue would require an extra layer of administrative complexity and cost.

The policy recommends that borrowers who are overseas have the same eligibility for the bonus scheme as those based in New Zealand. This gives priority to reducing the costs of the scheme to the Crown over maintaining consistency with the interest-free loan policy (which provides more favourable provisions for those

living in New Zealand in order to retain borrowers to contribute to our economy and society). This is because the bonus scheme may encourage faster repayments from borrowers based overseas, who take longer to repay their loans, and increased compliance.

Preferred option

The preferred design of the bonus scheme is as follows:

- voluntary repayments will be defined as additional repayments to Inland Revenue in a tax year, over and above a borrower's compulsory repayment obligation, that sum to be not less than \$500 after any refund which has been sought (in specified circumstances the Commissioner of Inland Revenue will have discretion to accept a smaller amount):
- the bonus will be credited to the borrower's student loan account after the end of the tax year. For those who are repaying their student loans in full, the bonus will be provided at the time of final payment:
- borrowers will be able to make extra repayments progressively throughout the tax year and if these repayments total \$500 or more, they will qualify for the bonus:
- all borrowers (this refers to both New Zealand-based and overseas-based borrowers, and graduate and non-graduate borrowers) will be eligible for the bonus if they are fully compliant with their student loan obligations:
- voluntary repayments made to the Ministry of Social Development will not attract the bonus. This means that borrowers must have a loan with Inland Revenue to be eligible for the bonus:
- there will be no time limit placed on entitlement to the bonus scheme.

The advantages of this policy design are that: it is easier to administer than the alternatives; it provides incentives for borrowers who are unable to make lump-sum payments toward their loan to make smaller, more frequent payments; and it has no time limit on entitlement which offers the bonus to borrowers who might be in a better position to make extra repayments later in their working life.

The disadvantage of providing the bonus after the end of the tax year is that borrowers may expect to receive their bonus at the time they

reach the \$500 threshold for voluntary repayment (via a lump sum or cumulatively). In addition, some borrowers may expect to make repayments to the Ministry of Social Development. These risks could be mitigated with a clear communication strategy.

It is estimated that the policy will reduce repayment times of borrowers who take up the offer by 1.5 years and decrease the upfront cost of new lending from 39.15 cents for every dollar lent to 38.49 cents. The bonus scheme is estimated to have the following financial impact:

	2008/09	2009/10	2010/11	2011/12	2012/13 & outyears
Net operating impact (\$M)	(77.493)	(5.382)	(5.915)	(6.831)	(7.757)
Net debt impact (\$M)	(2.602)	11.001	2.547	1.915	1.134

Implementation and review

The bonus will be credited to borrowers' student loan accounts after 1 April 2010, and that will mean that the bonus will be credited retrospectively for those repaying in full between 1 April 2009 and 1 April 2010 because in those circumstances the borrowers will be repaying in full before the legislative and systems changes have been made.

Relatively minor amendments to the Student Loan Scheme Act 1992 will be required.

Inland Revenue and the Ministry of Education will continue to monitor repayment trends over the next few years to assess the impact of the voluntary repayment bonus policy. The student loan integrated data set will enable officials to get an understanding of the debt, income, and demographic characteristics of those making additional student loan repayments. It will take several years, however, for a sufficient time-series to emerge to enable good outcome data to be collected.

Consultation

The Ministry of Social Development, Inland Revenue, the Ministry of Women's Affairs, the Ministry of Pacific Island Affairs, Te Puni

Kōkiri, the Ministry of Youth Development, the Ministry of Justice, the Department of the Prime Minister and Cabinet, and the Treasury were consulted in the preparation of this paper.

Hon Peter Dunne

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The Parliament of New Zealand enacts as follows:

- 1 Title**
This Act is the Student Loan Scheme (Repayment Bonus) Amendment Act **2009**.

- 2 Commencement**
This Act comes into force on the day after the date on which it receives the Royal assent.
- 3 Principal Act amended**
This Act amends the Student Loan Scheme Act 1992. 5
- 4 New heading and new sections 45A to 45F inserted**
The following heading and sections are inserted after section 45:
“Ten percent bonus for excess repayments
- “45A Interpretation** 10
In this section and **sections 45B to 45F**, unless the context otherwise requires,—
“10% bonus means the bonus specified in, as appropriate, **section 45C(2)** or **45D(2)**
“excess repayment has the meaning set out in **section 45B** 15
“final excess repayment means an excess repayment that, when combined with the resulting 10% bonus, results in the borrower’s IRD loan balance being fully repaid.
- “45B Meaning of excess repayment**
“(1) For the purposes of this Act, an **excess repayment**, in respect of a borrower, is any amount paid to the Commissioner in respect of a tax year in excess of that borrower’s repayment obligation for that tax year. 20
“(2) However, the following are not excess repayments:
“(a) any amount paid in respect of a tax year when a repayment obligation, repayment deduction, interim repayment, terminal repayment obligation, or penalty is, or will be, due and payable in respect of that tax year or any prior tax year (the **due amount**), except to the extent that the amount paid is in excess of all due amounts: 25
“(b) any amount that was paid before 1 April 2009: 30
“(c) any amount that is paid in respect of a tax year that ended on or before 31 March 2009.
“(3) Excess repayments may be made—

- “(a) by any means, including repayment deductions, interim repayments, and voluntary payments; and
- “(b) in 1 or more payments in respect of a tax year; and
- “(c) in respect of a tax year, at any time during that tax year and, if the borrower is a borrower to whom section 30 applies, at any time up to and including the date (determined in accordance with section 30) on which that borrower must pay his or her terminal repayment obligation for that tax year. 5

“45C Borrower’s entitlement to 10% bonus for total excess repayments of \$500 or more 10

- “(1) **Subsection (2)** applies to a borrower if—
 - “(a) the borrower’s total excess repayments in respect of a tax year are \$500 or more; and
 - “(b) at the beginning of the tax year in respect of which the excess repayments were made, the borrower’s IRD loan balance was \$550 or more. 15
- “(2) If this subsection applies to a borrower, the Commissioner must reduce the borrower’s IRD loan balance by an amount equal to 10% of the borrower’s total excess repayments in respect of the relevant tax year. 20

“45D Borrower may be entitled to 10% bonus if under-deduction is due to PAYE system

- “(1) **Subsection (2)** applies to a borrower if—
 - “(a) the borrower’s total excess repayments in respect of a tax year are less than \$500; and 25
 - “(b) the difference between the borrower’s total excess repayments in respect of that tax year and \$500 (the **shortfall**) is because of an under-deduction through the PAYE system; and 30
 - “(c) the shortfall meets 1 or more of the following criteria:
 - “(i) it is less than \$20;
 - “(ii) it is due to the borrower commencing or ceasing employment;
 - “(iii) it is due to an action or an omission of the borrower’s employer; and 35

- “(d) the Commissioner considers that the borrower’s total excess repayments in respect of that tax year would have been \$500 or more if the under-deduction referred to in **paragraph (b)** had not occurred; and
- “(e) at the beginning of the tax year in respect of which the excess repayments were made, the borrower’s IRD loan balance was \$550 or more. 5
- “(2) If this subsection applies to a borrower, the Commissioner must reduce the borrower’s IRD loan balance by an amount equal to 10% of the borrower’s total excess repayments in respect of the relevant tax year that the Commissioner considers would have been made if the under-deduction referred to in **subsection (1)(b)** had not occurred. 10
- “45E Manner in which 10% bonus is to be provided and restriction on amount of 10% bonus 15**
- “(1) If a borrower’s IRD loan balance will be fully repaid as a result of it being reduced by a 10% bonus, that bonus must be credited to that borrower’s IRD loan balance as at the date on which the final excess repayment was made.
- “(2) If a borrower’s IRD loan balance will not be fully repaid as a result of it being reduced by a 10% bonus, that bonus must be credited to that borrower’s IRD loan balance as at 1 April in the tax year that follows the tax year in respect of which the excess repayments were made. 20
- “(3) However, if a borrower is a borrower to whom section 30 applies and his or her IRD loan balance will not be fully repaid as a result of it being reduced by a 10% bonus, that bonus must be credited to that borrower’s IRD loan balance as at the day after the date (determined in accordance with section 30) on which that borrower must pay his or her terminal repayment obligation for the tax year in respect of which the excess repayments were made. 30
- “(4) The total amount of a 10% bonus that may be provided to a borrower must not exceed an amount equal to one-eleventh of that borrower’s IRD loan balance on the date on which the 10% bonus is provided. 35

“45F Consequences of refund

“(1) If a borrower elects that the whole or part of an excess repayment in respect of a tax year be refunded, any 10% bonus that was provided to that borrower must be reduced to an amount equal to 10% of the remaining excess repayment (if any) in respect of the tax year that is \$500 or more. 5

“(2) If the 10% bonus was provided under **section 45D(2)**, then the remaining excess repayment (if any) in respect of the tax year that is \$500 or more must be determined by reference to the borrower’s total excess repayments in respect of the relevant tax year that the Commissioner considered (under **section 45D**) would have been made if the under-deduction referred to in **section 45D(1)(b)** had not occurred.” 10
