Student Loan Scheme Bill

Officials' Report to the Finance and Expenditure Committee on submissions on the Bill

Supplementary Paper

Deferring the application of some parts of the bill
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Threshold below which no penalties for late payment are imposed
Additional deduction rate

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OVERVIEW

This report outlines the changes to the bill that have resulted from Inland Revenue changing its approach to implementing the student loan reforms and supplements information provided in the officials' report of 29 April 2011.

Implementation of the policy and administrative reform package for student loans through a new loan management system has proved more complicated than expected. The complexity is due to extracting and transferring historical student loan data from Inland Revenue's FIRST computer system to the new loan management system, and the integration of the new loan management system with the FIRST system. A high-level review of the project has indicated that attempting to complete the full project by April 2012 in the new system is unachievable. As a result, the legislative changes will now be implemented within the existing FIRST system. Some parts of the bill will need to be deferred until 1 April 2013 to enable the main policy components of the reforms to take effect from 1 April 2012.

The main system changes that need to be deferred until 1 April 2013 are:

- the new interest and penalty rules. However, a reduced late payment penalty rate will continue to apply from 1 April 2012;
- payment priority changes; and
- changes from a period-based debt approach (such as that used for tax with a tax year and taxable periods) to a whole-of-debt approach (similar to a mortgage).

These changes require the bill to be amended to continue the current mechanisms for the imposition of interest and late payment penalties, the priority of how payments are allocated to meet borrower repayment obligations, and retaining a period-based accounting for debt for the 2012–13 tax year. The changes are outlined further in this supplementary report.

DEFERRING THE APPLICATION OF SOME PARTS OF THE BILL AND FURTHER SIMPLIFICATIONS

Issue: Late payment interest and overseas-based interest

Clauses 125, 126, 129, 130 and 131

Submission
(Matter raised by officials)

Changes are required to the way Inland Revenue charges and compounds interest on loan balances and penalties for late payment as a result of the student loan reforms now being implemented in the FIRST system and to ensure the major policy changes can be implemented by 1 April 2012.

The changes relate to:

- the way interest is imposed on borrowers;
- the way interest and penalties for late payment are calculated, charged and compounded in the bill; and
- the need to continue the current interest and penalty regime for the 2012–13 tax year while reducing the current late payment penalty rate that will apply.

The first change is to the way interest is imposed on borrowers. Currently, interest is imposed on the loan balances of all borrowers. Inland Revenue then writes off the interest for New Zealand-based borrowers. This system will continue for the 2012–13 tax year.

However, the bill currently provides that interest on loan balances only be imposed on those borrowers who are subject to interest, namely overseas-based borrowers. This process will reduce administrative costs and is easier for borrowers to understand. Although this change can be implemented in the FIRST system, it cannot be implemented until 1 April 2013. Officials therefore recommend that the bill be amended so that the changes to require interest to be imposed only on overseas-based borrowers apply from 1 April 2013 onwards.

The second change is to the way interest on loan balances and penalties for late payment are calculated, charged and compounded. Currently, interest is calculated daily and charged and compounded annually whereas the late payment penalty is calculated, charged and compounded monthly.

The bill currently changes the calculation and charging method for interest and penalties for late payment. The bill proposes that both interest and penalties for late payment will be calculated daily, charged monthly, and compounded annually. This was based on how officials expected a loan management package would impose interest. However, as the reforms will now be implemented in the FIRST system, officials recommend that interest and penalties for late payment be calculated daily, and charged and compounded monthly. To enable other parts of the reforms to be implemented on time, officials recommend that this proposed change will need to be delayed and apply from 1 April 2013. For the 2012–13 tax year, the current practice of calculating, charging and compounding interest and penalties would remain.

Finally, one of the consequences of continuing the current late payment penalty rules for the 2012–13 tax year is that the current late payment penalty rate of 1.5%, compounding monthly (equivalent to 19.56% per annum) would apply. However, the bill proposed to reduce this rate to an annual penalty of 10.6% with effect from 1 April 2012. To enable borrowers to take advantage of the lower penalty rate proposed in the bill while retaining the current late payment penalty regime, officials recommend that the late payment penalty applying to the 2012–13 tax year be reduced from 1.5% per month to 0.843% per month. This equates to an annual equivalent rate of 10.6%.

These changes will not adversely affect borrowers.

Recommendation

That the submission be accepted.

Issue: Changes to the payment priority rules and period-based debt

Clauses 4 (definition of unpaid amount), 129(1), 136, 187, 188 and 189

Submission

(Matter raised by officials)

The bill introduces changes to the payment priority rules for student loans in order to take a whole-of-debt approach, rather than the period-based approach used for tax. It allocates payments to current obligations first and then any remainder to repay debt. To implement the student loan reforms in the FIRST computer system, changes are required to two aspects to the payment priority rules in the bill.

The first is how payments are allocated to both current period obligations and debt. The second is determining whether a period-based approach is taken (such as used for tax, using a tax year and taxable periods) or a whole-of-loan approach (similar to a mortgage) is taken to debt. The changes proposed to these two aspects of the payment priority rules are outlined below.

Currently, the bill allocates payments first to meet current repayment obligations. Once these are satisfied, any remainder goes to reduce any outstanding debt. Officials consider that the payment allocation method needs to be modified so the changes can be implemented in the FIRST systems. Officials therefore recommend that the existing practice mainly continue whereby payments first go to repay outstanding debt and any remainder is applied to the borrower's current repayment obligations. This treatment will reduce the borrower's exposure to late payment interest.

However, if a borrower has entered into an instalment arrangement for the repayment of outstanding amounts, payments (other than instalments payments) would be allocated first to meet current liabilities and any remainder goes to reduce outstanding debt. This treatment ensures that the borrower fulfils one of the requirements of their instalment arrangement, of keeping up-to-date with current liabilities.

The bill currently provides for a whole-of-loan approach to be taken to debt. This approach would be more in keeping with the way a mortgage operates. Although this approach could be implemented in the FIRST computer system, it cannot be done in time for 1 April 2012. Officials therefore recommend that this change apply from 1 April 2013 onwards. For the 2012–13 tax year, the current period-based approach to debt (such as that used for tax, with tax years and taxable periods) continue to apply.

Recommendation

That the submission be accepted.

Issue: $20 small balance write-off at time of assessment

Clause 191

Submission
(Matter raised by officials)

The bill and the Student Loan Scheme Act 1992 currently provide for the $20 small balance write-off to occur at 31 March. However this requires the loan account to remain open until 31 March, when the consolidated loan balance is reduced to less than $20 before that date. The borrower should not have to wait until the end of the year for this to occur and for the loan to be closed. This inconveniences both the borrower (in receiving statements) and Inland Revenue (in keeping the loan account open).

To finalise loan accounts on a more timely basis, officials recommend that the Commissioner has discretion to write off small amounts when the loan balance goes below $20, enabling the loan to be closed part-way through the year.

Officials propose that these changes apply with effect from 1 April 2013.

This will provide certainty to the borrower and reduce compliance costs.

The bill allows the Commissioner to reduce the consolidated loan balance to zero if a borrower dies or the Commissioner has reason to believe that the borrower has died. However, there is no date in the legislation on when this has to occur. Officials propose that clauses 191(a) and (b) be amended to ensure that the loan balance is reduced to zero on the date of death or the date the Commissioner considers the borrower died.

These changes will need to come into force on 1 April 2013 as the current payment processing within the FIRST computer system will be retained for a further year.

Recommendation

That the submission be accepted.

Issue: Instalment arrangements

Clauses 130, 146 and 147

Submission
(Matter raised by officials)

Currently, a borrower who enters into an instalment arrangement for the repayment of student loan debt must make all the instalment payments on time before they get the benefit of a late payment penalty remission. This process differs from the way instalment arrangements work for other tax debts.

The bill currently changes the instalment arrangement process to reflect the features of a loan management package. The main change was to cease the instalment arrangement if the borrower failed to pay any two instalments by the due date. With the decision to implement the student loan reforms in the FIRST system, officials now consider that amalgamating the student loan instalment arrangements with those that apply to other tax debts would simplify the process for both borrowers and Inland Revenue. Officials therefore recommend that the bill be amended to remove the requirement to cease instalments if the borrower fails to make two payments over the course of the arrangement. Instead, the process will rely on imposing the higher late payment interest rate on the total amount outstanding for the months when the arrangement is not met.

The proposed change would need to be deferred a year and apply from 1 April 2013 due to the deferral of the interest changes. For the 2012–13 tax year, the current student loan instalment arrangement process will continue to apply.

Recommendation

That the submission be accepted.

Issue: Minor changes as a result of deferring the application of the payment and assessment provisions

Clauses 46, 47, 89 and schedules 3 and 4

Submission
(Matter raised by officials)

As the current payment and assessment provisions will have to be retained for another year, the following two areas also need to be deferred.

6-monthly interim payments

The bill aligns a borrower's student loan interim payments with provisional tax payments. For borrowers who pay provisional tax and GST, 6-monthly student loan payments will also be payable 6-monthly.

With the deferral of the application of the payment and assessment provisions in the bill until 1 April 2013, the proposal to make 6-monthly interim payments must also be deferred. Instead, the current three student loan payment dates will continue for the 2012–13 tax year.

Special assessments

The bill provides that the Commissioner may issue an assessment of salary and wages deductions that should have been made. This provides another mechanism for collecting significant under-deductions. With the deferral of the application of the payment, assessment, and interest and penalties, the special assessment provisions also need to be deferred until 1 April 2013.

Officials recommend that the application of the provisions dealing with 6-monthly interim repayments and the issuing of special assessments be deferred until 1 April 2013.

Recommendation

That the submission be accepted.

Issue: Consequential changes to other provisions as a result of the deferment of interest, penalties and payment priority rules

Submission
(Matter raised by officials)

A number of other provisions require the application to be deferred as a result of the deferral of the overseas-based interest and late payment interest provisions in the bill. For example, relief from the late payment penalty and the removal of the 30-day grace period.

A number of transitional provisions also need to be added to the bill as a result of the deferred application date for some provisions. These transitional changes fall into two types.

- the continuation of certain sections of the Student Loan Scheme Act 1992 for another year until 31 March 2013; and

- the changes to enable the sections of the Student Loan Scheme Act 1992 to operate within the framework of the bill.

These changes will be identified as part of drafting the revised version of the bill. Officials recommend that the Committee authorise these consequential and transitional changes to the bill.

Recommendation

That the submission be accepted.

Issue: Confirming whether information provided by StudyLink is correct

Clauses 9 and 10

Submission
(Matter raised by officials)

The bill enables the transfer of an applicant's name, date of birth and IRD number from StudyLink to Inland Revenue in order to confirm that this information matches the information held by Inland Revenue. However, when the information transferred does not match with the information that Inland Revenue holds, the only message that can be advised to StudyLink is that the match failed. This results in StudyLink having to go back to the borrower and find out where the error has occurred. This imposes compliance costs on borrowers and administration costs on StudyLink.

To reduce these costs officials recommend that the bill be amended to enable Inland Revenue to confirm to StudyLink the fields in which an error has occurred – for example, the match failed because the date of birth is wrong. It would be impractical not to identify what part of the data was in error as it would lead to delays and increased costs for agencies and the borrower. The Office of the Privacy Commissioner has been consulted and confirms that there are no significant privacy implications with the proposed amendment. Officials propose this measure apply from 1 January 2012 onwards.

Recommendation

That the submission be accepted.

Issue: Period within which a borrower can claim a refund

Clauses 61(3) and (4), 123(2) and (3)

Submission
(Matter raised by officials)

The period within which a borrower can elect to receive a refund varies depending on the residence status of the borrower – two months for overseas-based borrowers and six months for New Zealand-based borrowers. However, to administer the refund time-period effectively when a borrower changes their residence status part-way through the time period, Inland Revenue has generally provided borrowers with a six-month time-period. Officials recommend that the bill be amended to legislate for this practice and align the time-periods for all borrowers to six months, and that the amendment applies from 1 April 2012.

Recommendation

That the submission be accepted.

Issue: Administering the pay-period threshold

Clause 57

Submission
(Matter raised by officials)

Clause 57 of the bill provides that a borrower's repayment obligation on salary or wage income is satisfied by the student loan deductions made from that income each pay-period. In determining whether a borrower's repayment obligation has been satisfied, the bill requires the Commissioner to determine what is a significant over- or under-deduction for the purposes of administering the pay-period basis of assessment for salary and wage payments. When an over- or under-payment occurs and the amount exceeds the threshold, the Commissioner applies the over-payment to the loan balance and makes it available for refund or collects the under-payment through increased deductions from future salary and wage payments. If an over- or under-payment does not exceed the thresholds, no action is taken.

As currently drafted in the bill, the Commissioner determines the pay-period threshold for over- or under-payments for the year. However, as only monthly information (from the Employer Monthly Schedule) is readily available to the Commissioner, and to avoid imposing more compliance costs on employers, it is proposed that the significant over- or under-deduction threshold be set based on this monthly information. If the monthly information indicates that a significant over- or under-deduction has occurred, and the Commissioner considers more information is needed, this information can be requested from the employer or the employee to determine whether an over- or under-deduction has occurred.

To allow this process to occur, officials recommend that the bill be amended to enable the Commissioner to take account of other relevant information available (including Employer Monthly Schedule information) in setting the significant over- or under-deduction threshold.

Recommendation

That the submission be accepted.

EXCESS REPAYMENT BONUS

Clause 118(2)

Submission
(Matter raised by officials)

The excess repayment bonus is currently credited on 1 April, following the date the excess repayment was made. However, this may not be appropriate in all cases – for example, if the loan is repaid part-way through the year or the borrower dies or becomes bankrupt. Officials therefore recommend that the bill be amended to enable the bonus to be credited during the year in these circumstances. Amendments are also required to clearly define a borrower's repayment obligation for calculating a finalising bonus when the loan is repaid during the year.

Officials have earlier recommended that when a borrower dies or becomes bankrupt, the Commissioner should be given the discretion to apply the excess repayment bonus on a date other than 1 April. In the case of the death of a borrower, the excess repayment bonus would be credited on the date of death, or if the person is missing and presumed dead, on the date that the Commissioner reasonably believes the person to be dead.

In the case of a bankrupt borrower, the excess repayment bonus should be credited on the date the borrower becomes bankrupt, which will enable the loan to be finalised following the crediting of any bonus.

The discretion to apply the bonus at a date other than 1 April should apply from the date of assent of the bill.

The second change recommended relates to which compulsory repayments should be taken into account in calculating the bonus if the loan is finalised part-way through the year. Officials recommend that only compulsory repayments that are due on or before the date the loan is paid off should be included in the excess repayment bonus calculation.

The final change recommended relates to the adjustment once the finalising bonus has been applied to the loan. If the loan has been repaid and the finalising bonus applied for that year, any subsequent assessments or reassessments, or other information becoming available should not affect the finalising bonus. This will provide certainty for borrowers that their loan will not be reopened. However, to protect the revenue, there are two exceptions. The first is that the bonus calculation would be reopened if the borrower has purposefully withheld information or if fraud is involved. The second is when a loan is paid off part-way through the year but a borrower has a drawdown during the year, or when the Commissioner considers there is a risk that the borrower may have a drawdown before the end of the year. Officials recommend that the calculation of the bonus, and the closing of the loan account, be delayed until the end of the year.

These changes will provide certainty to borrowers and reduce compliance costs. However, if at the end of the year the borrower has a reduced repayment obligation, they could notify the Commissioner and have their repayment obligation and bonus recalculated, based on their actual repayments due before the final payment or on an annual basis.

Officials recommend that these amendments be made to the bill and apply with effect from 1 April 2012.

Recommendation

That the submission be accepted.

TRANSITIONAL RULE FOR INTERIM PAYMENTS

New clause

Submission
(Matter raised by officials)

Borrowers with other income or pre-taxed income (for example, interest and dividends) are required to make interim payments during the year if their repayment obligation for the previous year is $1,000 or more. However, in the 2012–13 tax year the borrower's previous year's student loan repayment obligation will have been determined under the Student Loan Scheme Act 1992, using different terminology. For example, the current Act refers to "residual repayment obligations" rather than "other income repayment obligations" in the bill.

To allow a smooth transition for borrowers from the 1992 Act to the bill, officials recommend that for the 2012–13 tax year, the bill be amended to provide that borrowers be required to make interim repayments if they meet the qualifying criteria under the terminology used in the Student Loan Scheme Act 1992.

Recommendation

That the submission be accepted

THRESHOLD BELOW WHICH NO PENALTIES FOR LATE PAYMENT ARE IMPOSED

New clause

Submission
(Matter raised by officials)

As a result of the application of the new interest and penalty rules being delayed until 1 April 2013, the interest and penalty rules under the Student Loan Scheme Act 1992 will continue to apply for another year. Under the Act, borrowers are not subject to penalties for late payment if the unpaid amount is less than $334, which equates to no penalty being imposed if the penalty is $5 or less. This reduces the administrative and compliance costs in imposing and collecting small amounts.

With the delay in the application of the new interest and penalties rules, officials have previously recommended in this report that the penalty for late payment be reduced from 1.5%, compounding monthly to 0.843%. One of the consequences of this change is that if the $5 threshold remains, no penalties will be imposed on outstanding amounts less than $593 ($5 / 0.00843) rather than $334 as intended. Officials therefore recommend that the references to the $5 threshold be removed and instead provide that penalties are not imposed on unpaid amounts less than $334 and that the change applies with effect from 1 April 2012.

Recommendation

That the submission be accepted.

ADDITIONAL DEDUCTION RATE

Clause 33

Submission
(Matter raised by officials)

The bill currently provides for a special deduction rate to be imposed on the salary and wage payments of borrowers to recoup either a significant under-payment, repay outstanding amounts, or make additional payments to repay the loan (and thereby qualify for the excess repayment bonus). The bill provides that the special deduction rate is administered by way of a special tax code of "SLADR".

To more easily identify what the special deduction rate is for, officials recommend that the rate be split in two and have a special code for borrower-instigated special deductions (SLBOR) and a special code for Commissioner-instigated special deductions (SLCIR).

This will enable the Commissioner to apply more easily the payment priority rules, which differ between borrower and Commissioner-instigated deductions.[1]

Officials recommend that this change applies with effect from 1 April 2012.

Recommendation

That the submission be accepted.

[1] Borrower-instigated deductions are first applied to repay any outstanding debt and any remainder goes to repay the loan. Commissioner-instigated deductions are usually tagged to specific repayments or debts and the payment is applied to this liability first and any remainder goes to repay other debts.