Regulatory Impact Statement

Extending pay-period assessments to salaries and wages of all student loan borrowers

Agency Disclosure Statement

Inland Revenue has prepared this Regulatory Impact Statement.

The Statement analyses the problem of whether the pay-period assessment policy should be extended to the salary and wage earnings of all student loan borrowers.

Proposed amendments in the Student Loan Scheme Bill 2010 move certain student loan borrowers from annual assessments to pay-period assessments (with no end-of-year square-ups). The proposed amendments are designed to apply only in cases where there are no business and investment losses that could be used to offset salary and wage earnings and result in a lower student loan repayment obligation. However, the Budget 2011 announcement that losses are to be excluded from repayment calculations means that pay-period assessments can now be extended to all student loan borrowers who earn salary and wages. The main objective is to treat all salary and wage earnings consistently in order to simplify the student loan scheme, improve equity and provide certainty.

Other than set out in this Disclosure Statement, no significant gaps, assumptions, dependencies, constraints, caveats or uncertainties have been identified.

Extensive consultation was undertaken during the development of the wider proposals to transform the student loan administration. This included a discussion document, an online forum and submissions on the Student Loan Scheme Bill 2010. Officials consider that further public consultation on the extension of the pay-period policy to all salary and wage earnings is not necessary given the wide initial consultation.

The recommended policy proposals do not impose additional compliance costs, impair private property rights, reduce market competition, provide disincentives to innovate and invest or override fundamental common law principles.

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STATUS QUO AND PROBLEM DEFINITION

1. The Student Loan Scheme Bill 2010 (the bill) introduces policy changes that improve the overall integrity of the student loan scheme, reduce compliance costs and relieve administrative pressures. The Regulatory Impact Statement *Transforming student loan administration* accompanying that bill provides analysis of those changes.

2. This Regulatory Impact Statement considers the impact of extending one of the policy changes in the bill in light of the Budget 2011 announcement that losses would be excluded from repayment calculations. Specifically, this analysis considers the problem of whether the pay-period assessment policy should be extended to the salary and wage earnings of all student loan borrowers, including those making other income (or losses).

3. Currently, student loan collection is based on an end-of-year square-up where a student's overall repayments are calculated by reference to their annual income. Proposed amendments in the bill provide for a move to a pay-period assessment, where the amount earned in any pay-period is assessed against a weekly, fortnightly or monthly repayment threshold and there is no annual square-up.

4. Under the amendments proposed in the bill, borrowers who earn salary and wages are treated as falling into one of three groups:

Referred to as	Income earned	Repayment obligations
1. Salary and wage borrowers	• Salary and wages • Pre-taxed income[1] less than $1,500 • No other income (including business and rental income)	• All obligations met through pay-period assessments. • No end-of-year square-up required.
2. Pre-taxed income borrowers	• Salary and wages • Pre-taxed income more than $1,500 • No other income (including business and rental income)	• All obligations relating to salary and wage earnings met through pay-period assessments. • Separate end-of-year square-up for pre-taxed income only.
3. Other income borrowers	• May have salary and wages and/or pre-taxed income • Does have other income (including business and rental income)	• End-of-year square-up including all income earned during the year.

5. The other income borrowers (category 3 above) may have had losses from investments or business activity that could be used to offset (reduce) their salary and wage earnings, leading to a reduced student loan repayment obligation. They were excluded from the pay-period assessment policy in the bill in order to reflect their income after losses are taken into account.

[1] Pre-taxed income includes New Zealand-based investment income, casual agricultural earnings, and election day worker earnings.

6. In the 2011 Budget, it was announced that losses from investments or business activity will no longer be included when calculating a borrower's repayment obligation. This removes the need to distinguish between borrowers who receive other income and borrowers who do not. In principle, pay-period assessments can now be extended to all salary and wage earnings.

OBJECTIVES

7. The main objective is to treat all salary and wage earnings consistently in order to simplify the student loan scheme, improve equity and provide certainty to student loan borrowers with salary and wage earnings.

REGULATORY IMPACT ANALYSIS

8. Prior to the 2011 Budget announcements, the end-of-year square-up for other income student loan borrowers was required in order to take into account losses that could reduce student loan repayment obligations. Given that losses are now not taken into account in assessing a student loan borrower's repayment obligations in respect of wages and salary, there is no need to retain the distinction between the salary and wage earnings of a borrower who earns other income and a borrower who does not.

9. The preferred option is therefore to extend pay-period assessments to all salary and wage earnings. The key features of this option for other income borrowers (category 3 in the table above) are:

Feature	Status quo	Preferred option
End-of-year square-up	• All income including salary and wage earnings is squared up.	• Other income and pre-taxed income is squared up. • Salary and wage earnings are not.
Under deductions	• Significant under deductions are collected in the PAYE system. • Smaller amounts are collected in the end-of-year square-up.	• Significant under deductions are collected in the PAYE system. • Smaller amounts are ignored.
Over deductions	• Significant over deductions are credited in the end-of-year square-up. • Smaller amounts are credited in the end-of-year square-up.	• Significant over deductions can be refunded during the year. • Smaller amounts are ignored.
Secondary employment	• Borrowers may face a higher repayment rate and must wait for the end-of-year square-up to receive any over deductions.	• Borrowers can apply for a reduced repayment rate and have the correct amount deducted.
Full time study	• Borrowers cannot apply for the full time study exemption and must wait for the end-of-year square-up to receive any over-deductions.	• Borrowers can apply for the exemption and receive immediate relief from deductions.

10. Consequently, the effects that the preferred option has on other income borrowers (category 3) in respect of their repayment obligations are:

- all obligations relating to salary and wage earnings are met through pay-period assessments; and
- there is a separate end-of-year square-up for pre-taxed income and other income only.

11. The proposed changes would increase student loan repayments by approximately $5 million per year from the 2012-13 tax year.[2]

12. We have not identified any other options that would have the benefit of treating salary and wage earnings consistently.

Benefits of the preferred option

13. The benefits are that other income borrowers would:

- be treated consistently;
- face the same repayment obligations with the same salary and wage earnings;
- receive fairer treatment in cases of significant over deductions, secondary employment and full time study; and
- have certainty that their salary and wage repayment obligations were being met through their deductions.

Costs of the preferred option

14. Student loan borrowers who earn salary or wages for part of the year, or whose earnings are irregular, would continue to have the same amount of repayment deductions withheld each pay period. However, they would no longer be able to have their salary and wage earnings squared up, which spreads their income over the whole year and could lower their repayment obligation. In effect, these student loan borrowers would be forced into repaying their student loans more quickly.

15. This change would affect approximately 62,000 borrowers and for two thirds of the affected borrowers the increased obligation would be less than $100 per year. However, as already noted, these borrowers would ultimately benefit from the increased obligation as their loans would be repaid faster.

16. No social, environmental or cultural costs were identified.

CONSULTATION

17. Extensive consultation was undertaken during the development of the wider proposals to transform student loan administration. This included a discussion document, an online forum and submissions to the bill. The following departments were consulted during the

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[2] Note that any change that gives rise to an increased repayment obligation results in a borrower repaying their loan more quickly with the borrower retaining the benefit of each payment.

bill's development: the Ministry of Education, the Treasury, the Ministry of Social Development (including StudyLink), the Ministry of Justice, the Ministry of Consumer Affairs, the Commerce Commission and the Privacy Commissioner.

18. Submitters saw the move to a pay-period assessment as a positive step for borrowers who have completed their study. This and related issues were dealt with in the Regulatory Impact Statement *Transforming student loan administration* that went with the bill.

19. Given the extensive consultation and the positive feedback noted above, Officials consider that the extension of the pay-period assessment policy does not require further public consultation.

20. We have undertaken further consultation with the Ministry of Education, the Treasury, and the Ministry of Social Development (including StudyLink) in regards to the extension of the pay-period assessment policy. Their views have been incorporated into the paper and they are supportive of the extension of the pay-period assessment policy.

CONCLUSION AND RECOMMENDATION

21. As noted, the recommended option is to extend the pay-period assessment policy to the salary and wage earnings of all student loan borrowers. This would:

- remove a distinction between student loan borrowers that is now unnecessary as a result of the Budget 2011 announcements; and
- provide consistent treatment of all salary and wage earnings which would simplify the student loan scheme, improve equity and provide certainly to borrowers with salary and wage earnings.

IMPLEMENTATION

22. These changes would be undertaken by Inland Revenue as part of the wider project to implement the changes under the Student Loan Scheme Bill. As these changes simplify the student loan scheme, implementing them would help to relieve pressure from Inland Revenue's efforts in this area. It would be easier to implement the preferred option than to retain the status quo.

23. Systems are being developed to support the bill that will ensure other income borrower's obligations are met. These systems will check that correct student loan deductions are made from salary and wage earnings.

MONITORING, EVALUATION AND REVIEW

24. In general, the monitoring, evaluation and review of these proposals would take place under the Generic Tax Policy Process (GTPP). The GTPP is a multi-stage policy process that has been used to design tax policy in New Zealand since 1995. The final step in the process is the implementation and review stage, which involves a post-implementation review of legislation, and the identification of remedial issues. Opportunities for external consultation are also built into this stage. In practice, this would mean that these proposals would be reviewed at a time after the policy has had some time to work. Any changes that are needed to give the legislation its intended effect would be added to the tax policy work programme, and proposals would go through the GTPP.