

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Legislation Committee

## **TAX ADMINISTRATION (CORRECTION OF ERRORS IN EMPLOYMENT INCOME INFORMATION) REGULATIONS 2019**

### **Proposal**

1. This paper seeks the Cabinet Legislation Committee's agreement to submit an Order in Council creating the Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019 to the Executive Council.
2. In order to bring these regulations into effect for 1 April 2019, I am seeking a waiver of the 28-day rule on the grounds that its application date should coincide with the mandatory application of payday filing for employers. These regulations have been drafted to accompany related proposed legislation that is included in the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill. To ensure the regulations appropriately reflect the proposed legislation we have had a delayed ability to finalise the draft regulations.

### **Executive Summary**

3. The regulations provide the methods employers may use to correct errors in employment income information submitted to Inland Revenue.
4. These regulations form part of the recent changes to the provision of PAYE information to Inland Revenue which generally requires employers to submit their employment income information within two or ten working days of each payday (payday reporting). Payday reporting changes will become mandatory for employers from 1 April 2019 under changes to the Tax Administration Act.
5. The changes will provide Inland Revenue with more timely information on employment income for employees. However, they will also reduce the time available to employers to identify and correct any errors in this information before it is sent to Inland Revenue.
6. The regulations support the payday reporting changes by specifying the nature and type of errors that are able to be corrected by an employer and the manner in which errors in employment income information may be corrected.
7. The policy principles underlying the error correction regulations were approved by Cabinet in March 2018. The regulations also reflect changes to the taxable status of PAYE overpayments included in the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill.
8. A consultative draft version of the regulations was provided to a group of stakeholders for feedback on the workability of the regulations in September 2018.

9. This paper reports on the feedback received as part of this consultation, the key changes made to the regulations, and seeks approval to submit the Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019 to the Executive Council.

## Background

10. The Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Bill amended the filing requirements for employers withholding PAYE. This requires employers to report information on payments made to and PAYE and other deductions withheld from employees (employment income information) on a payday basis. For employers who file PAYE online, this generally means they must report information to within two or ten working days following an employee's payday.
11. These changes modernise the way employers provide PAYE information to Inland Revenue. Under payday reporting, many employers will be providing income information to Inland Revenue more frequently, which aligns more closely with employer's processes. Payday reporting will establish a foundation for more accurate withholding and improved delivery of social policy.
12. The move towards more frequent information provision will also, in turn, reduce the amount of time available to employers to identify and correct information before it is sent to Inland Revenue. To help mitigate the potential administrative and compliance issues associated with error reporting, legislative changes included an empowering provision which gives the Minister of Revenue the ability to make an Order in Council to prescribe how errors in employment income information may be corrected.
13. Legislation has previously been silent on how errors in PAYE information are to be corrected. Inland Revenue's advice to employers has been that all corrections to PAYE information must be made by amending the original returns which contained the error.
14. An officials' issues paper, *PAYE error correction and adjustment*, released in August 2017, which sought feedback from affected parties on what mechanisms should be available for error correction [CAB-17-MIN-0404 refers]. This paper received 13 submissions.
15. The underlying policy principles were approved by Cabinet in March 2018. [CAB-18-MIN-0122]:
  - 15.1 Reporting errors (where the amount actually withheld and/or paid is not accurately reported to Inland Revenue) must be corrected by amending the return that contained the error. Amending the original return is necessary to ensure that the payment can be correctly processed.
  - 15.2 Payroll corrections, which occur where an employee was overpaid, will be able to be made either by amending the original return or by correcting the errors in a subsequent return. Due to the principle that salary and wages are taxed when paid, underpayments do not require correction.

- 15.3 Interpretation errors (where the wrong tax treatment has been applied) may be corrected in a subsequent return if PAYE on the correction is less than a threshold of 10% of the relevant employee's PAYE for the payday. The threshold is required to avoid unfair social policy impacts on the employee.
16. In addition, the legislative proposal to clarify that overpaid PAYE income that is not repaid is taxable as PAYE income was also approved by Cabinet in February 2018. The legislative change is included in the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill. This bill is expected to be enacted in March 2019.
17. An additional subset of errors require specific treatment. This is for errors which affect the amount of a student loan repayment obligation, KiwiSaver contributions or child support deductions that have not resulted from an incorrect interpretation and calculation of the gross PAYE income payment. To mitigate system errors due to corrections involving social policy deductions, we have restricted the ability to correct in subsequent periods for interpretation errors involving social policy deductions which don't follow from an error in the gross PAYE income payment.
18. The consultation version of the regulations that was released in September 2018 was drafted on this basis. Officials have updated the regulatory impact statement; this is attached.

#### ***Outcome of consultation***

19. Inland Revenue provided a copy of the draft regulations to 13 stakeholders who were a mix of professional bodies, payroll software providers and intermediaries, and accounting firms.
20. Key messages received during this consultation related to a preference for more ability to make adjustment in subsequent returns, clarity around which provisions relate to which type of errors, and concerns about implementation and timing. Inland Revenue also received some minor drafting points for clarification.

#### ***Clarity between types of errors***

21. Several submitters considered that there could be improved clarity in the regulations, to help employers and payroll staff apply the regulations to a particular error.
22. Two submitters were concerned that employers and payroll staff would find it difficult to differentiate errors sufficiently in order to apply the right treatment prescribed by the regulations. Another submitter commented that they considered the information provided to be "fairly straightforward and should be sufficient for any payroll specialist to understand and be able to follow when such errors occurred and require amending".
23. The regulations draw a distinction between when it is permitted to make any changes to correct errors in information in a subsequent return (netting off in a subsequent return) and when these changes must be made by correcting the information that was provided (amending the original return). In order to distinguish between what treatment is appropriate, errors have been categorised according to the following types:

- reporting error: when the return does not reflect what was paid or withheld
  - payroll correction: underpayment
  - payroll correction: overpayment, and
  - interpretation errors: when there is a mistake with the tax treatment, and
24. Five submitters raised concerns regarding the distinction between error types and the clarity provided in the regulations as to which section would apply to what type of error. More clarity will be provided in the regulations with a flowchart and key examples included in the regulations. In addition, guidance will be released in Inland Revenue's *Tax Information Bulletin* once the regulations are made.
25. The legislative changes to the taxable treatment of PAYE overpayments will also have guidance included in the *Tax Information Bulletin*.

***When an error may be reported in a subsequent period***

26. The policy settings previously agreed to by Cabinet provide that employers will have the option of correcting interpretation errors in a subsequent return, subject to the restriction that PAYE on the error is less than 10% of the relevant employee's PAYE for the payday in which the correction would be made.
27. Some submitters queried whether the 10% threshold could be raised. Two submitters suggested that it could, at the minimum be monitored and re-assessed in two or three years' time.
28. Social policy errors that aren't the result of an incorrect calculation of the PAYE income payment, should be corrected in the original period to ensure that they are allocated to the right period and that existing rules (for example, significant under or over-deductions for student loans) are not affected.
29. In addition, the ability to include adjusted values in a subsequent period is limited in the short term, to restrict the filing of negative values. This is due to the inability of Inland Revenue's current computer system to received negative values. This restriction will be lifted once co-existence of Inland Revenue's two systems ends for PAYE, this is expected in April 2020.
30. Officials will monitor and review the 10% threshold once social policy products (student loans, child support and KiwiSaver) are brought into Inland Revenue's new computer system.

***Implementation timing and application date***

31. Two submitters expressed concern about the timing for the regulations to come into effect, and the software development that would be required to support them.
32. The regulations continue the status quo for error correction, allowing all errors to be corrected in the original submission. The ability to include adjustments in subsequent returns is an option for some types of errors but it is not required. Employers can continue correcting the original return after 1 April 2019 and use the option to net off adjustments in subsequent returns in the future.

33. Delaying the application date of the regulations to provide for the implementation time requested is not recommended as they are intended to provide clarity to employers and reduce compliance costs by introducing additional mechanisms for correction.

### **Overpayment changes following recent legislation**

34. The proposed treatment for overpayments follows that considered by the Finance and Expenditure Committee and set out in the officials' report on the Bill. This aligns with the policy decisions made in the Cabinet paper *PAYE Error Correction Regulations and Legislative Amendments* previously considered by Cabinet on 3 April 2018 [CAB-18-MIN-0122].
35. As drafted, the regulation for overpayments allows employers several options in how to correct these errors when they are not immediately repaid by the employee and instead subject to an agreement to repay over time. Employers may adjust each payday as the overpayment is paid back (that is to make adjustments over several paydays) or they may make a full adjustment of the overpaid amount once agreement to repay has been reached with the employee.
36. However, if the employee breaches the agreement to repay with their employer, the employer must make a second adjustment in relation to the overpaid amount, and add back the outstanding portion of the overpayment and associated PAYE.
37. If the agreement is breached the amount of the overpayment that remains unrepaid is added back to the employee's record of income.

### **Timing and 28-day rule**

38. The regulations are set to come into effect on 1 April 2019. This is required to coincide with the mandatory date set by the Act for employers adopting the new payday reporting requirements for filing their employment income information with Inland Revenue. I am seeking a waiver of the 28-day rule, to ensure the methods of correction under these regulations are available for employers from the commencement of the mandatory payday reporting.

### **Compliance**

39. The regulations comply with the following:
  - 39.1 the principles of the Treaty of Waitangi
  - 39.2 the rights and freedoms contained in the [New Zealand Bill of Rights Act 1990](#) or the [Human Rights Act 1993](#)
  - 39.3 the principles and guidelines set out in the [Privacy Act 1993](#)
  - 39.4 relevant international standards and obligations and
  - 39.5 the [Legislation Guidelines](#) (2018 edition).
40. Section 23N(3) of the Tax Administration Act 1994 allows the making of regulations to provide for error correction. This provision requires that the responsible Minister be satisfied that consultation that is appropriate and reasonable has occurred before recommending the making of an Order in Council under section 23N.

41. This consultation took the form of an officials' issues paper, *PAYE Error Correction and Adjustments*, which was released in August 2017. Thirteen submissions were received. This consultation also included release of a consultative draft version of the regulations in September 2018.
42. The empowering provision for the making of these regulations comes into force on 1 April 2019. Section 11 of the Interpretation Act 1999 permits regulations to be made in advance of the power coming into force if the exercise of power is "necessary or desirable to bring, or in connection with bringing, and enactment into operation".
43. To have the regulations in place by 1 April 2019, it is necessary to exercise the power in section 23N ahead of its commencement date. It is desirable to bring the regulations into effect at the same time as the mandatory adoption of payday reporting in the Act to provide clarity for employers on the methods they may use to correct errors.

#### **Regulations Review Committee**

44. Officials do not believe that there are any grounds under Standing Order 319 for the Regulations Review Committee to draw the regulations to the attention of the House of Representatives.

#### **Certification by Parliamentary Counsel**

45. The regulations have been certified by the Parliamentary Counsel Office as being in order for submission to Cabinet subject to the enactment of the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill, the consultation requirement, and the waiver of the 28-day rule, as all mentioned above.

#### **Impact Analysis**

46. The Quality Assurance reviewer at Inland Revenue has reviewed the *Modernising the correction of errors in PAYE information* RIA prepared by Inland Revenue, and considers that the information and analysis summarised in the RIA meets the quality assurance criteria.
47. This RIA updates an earlier version completed on 7 February 2018 to reflect decisions around social policy obligations for student loan repayments, KiwiSaver employee contributions and child support. Additional information to reflect these decisions has been included in section 2.1 and 3.1 with all other parts substantively unchanged since the original RIA.

#### **Publicity**

48. I will issue a media statement once the Order in Council is made by the Executive Council.
49. Inland Revenue will publish an article about these changes in its *Tax Information Bulletin*.

#### **Financial implications**

50. The cost of implementing the changes will be met as part of Inland Revenue's business transformation programme.

## Proactive Release

51. I propose to proactively release this Cabinet paper, associated minutes, and key advice papers in whole within 30 working days of Cabinet making final decisions.

## Consultation

52. Treasury were consulted on this paper. A copy of the draft regulations was provided to ACC and MSD at the same time as external stakeholders.

## Recommendations

I recommend that the Cabinet Legislation Committee:

1. **note** that on 21 March 2018 the Cabinet Economic Development Committee agreed to the following decisions on which methods should be available to employers in the regulations:
  - 1.1 Employers should continue to be required to correct reporting errors by amending the original returns
  - 1.2 Employers should be able to correct overpayment errors by:
    - 1.2.1 Amending the original returns in which the error occurred; or
    - 1.2.2 Recalculating the original pays by netting off the changes against the values in a subsequent return. This option will be subject to a restriction preventing employers from lodging negative values until PAYE is entirely managed within Inland Revenue's new computer system.
  - 1.3 Employers should have an option to correct interpretation errors in a subsequent period provided PAYE on the error is less than 10% of the relevant employee's PAYE for the payday in which the correction is made.
  - 1.4 Employers should have the option to correct overpayment and interpretation errors (subject to the employee threshold) from a previous tax year in a subsequent year.
2. **note** that on 21 March 2018, the Cabinet Economic Development Committee also agreed to the amendment to primary legislation providing that overpaid PAYE income that is not repaid remains taxable as PAYE income should be included in the next taxation omnibus bill [CAB-18-MIN-0122];
3. **note** that the Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019 will give effect to the decisions referred to in paragraph 1 above, and provides methods of correction to support the decision referred to in paragraph 2;
4. **note** that the regulations include guidance material in the explanatory note to assist in the application of the provisions to relevant errors.
5. **note** that section 23N(3) of the Tax Administration Act 1994 requires that the responsible Minister be satisfied that consultation that is appropriate and reasonable has occurred before recommending the making of an Order in Council under section 23N;

6. **note** the advice of the Minister of Revenue that this requirement has been met.
7. **note** that regulatory impact analysis has been prepared by Inland Revenue and is attached to this Cabinet paper.
8. **authorise** the submission to the [Executive Council](#) of the Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019;
9. **note** that a waiver of the 28-day rule is sought:
  - 9.1 so that the regulations can come into force on 1 April 2019 coinciding with the requirement for payday reporting of employment income information and the commencement date of the provisions relating to the taxable status of overpayments of PAYE income payments in the Tax Administration Act 1994 and the Income Tax Act 2007.
  - 9.2 on the grounds that it continues the status quo for how employers correct errors in employment income information, and provides additional options to reduce compliance costs.
10. **agree** to waive the 28-day rule so that the regulations can come into force on 1 April 2019;

Authorised for lodgement

Hon Stuart Nash  
Minister of Revenue