

**POLICY AND STRATEGY**

**Tax policy report: Cabinet paper – Draft regulations for the Correction of Errors in Employment Income Information**

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<b>Date:</b>	28 February 2019	<b>Priority:</b>	Medium
<b>Security level:</b>	In Confidence	<b>Report number:</b>	IR2019/006

**Action sought**

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	<b>Action sought</b>	<b>Deadline</b>
Minister of Revenue	<b>Agree</b> to recommendations <b>Authorise</b> the lodgement of the attached Cabinet paper	10 am Thursday 14 March

**Contact for telephone discussion (if required)**

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<b>Name</b>	<b>Position</b>	<b>Telephone</b>
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s 9(2)(a)	Senior Policy Analyst	

28 February 2019

Minister of Revenue

## **Cabinet paper - Draft regulations for the Correction of Errors in Employment Income Information**

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### **Purpose**

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1. This report serves two purposes. It:
  - summarises the feedback from the consultation undertaken on the draft regulations for the Correction of Errors in Employment Income Information; and
  - introduces a paper for you to present to the Cabinet Legislation Committee requesting approval of the regulations.

### **Why the regulations are needed**

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2. 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 to ten working days of each payday (payday reporting). Payday reporting changes will become mandatory for employers from 1 April 2019.
3. The changes will provide Inland Revenue with more timely information on employment income for employees, however it will also reduce the time available to employers to identify and correct any errors in this information before it is sent to Inland Revenue.
4. The regulations support the payday reporting changes by providing for the methods for employers to make adjustments and correct errors in employment income information.
5. 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.
6. The main themes of these submissions are summarised in the body of this report.
7. These regulations have been drafted to bring into effect 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 experienced delays in finalising the draft regulations.
8. A draft copy of the regulations is attached to the draft Cabinet paper, these regulations are still subject to PCO's proof-reading process ahead of certification and lodgement alongside the Cabinet paper.
9. We consider that it is appropriate to seek a waiver in order to allow the regulations to enter into force on 1 April 2019. This will provide the option for employers to use

the additional methods of error correction from the same time that payday reporting become mandatory. The current guidance given to employers is to correct any errors in the original submission of information; this remains an option for all types of errors under the regulations.

### Next steps

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10. The draft regulations will be finalised and submitted to Cabinet Legislation Committee for their meeting on 19 March 2019. Following Cabinet Legislation Committee, the regulations will be submitted to Cabinet for approval, and Executive Council for signing.
11. You may wish to issue a media statement once the regulations have been signed.
12. The regulations will come into force on 1 April 2019.

### Recommended action

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We recommend that you:

- a) **authorise** the lodgement of the attached Cabinet paper with the Cabinet Office by 10 am Thursday 14 March, for the Cabinet Legislation Committee to consider at its meeting on 19 March 2019.

Authorised/Not authorised

- b) **agree** that for the permitted mechanisms for the correction of overpayments of PAYE-related income, the employer may choose to treat an overpaid amount as repaid provided it is repayable to the employer under an agreement between the employer and the employee.

Agreed/Not agreed

- c) **agree** that errors affecting student loans, KiwiSaver or child support deductions that do not follow from an error in the gross PAYE income payment should be amended in the original period.

Agreed/Not agreed

- d) **agree** that officials should review the 10% threshold for when an error may be adjusted in a subsequent pay period when social policy products have been moved into the START computer system.

Agreed/Not agreed

- e) **note** that, before making a recommendation to the Governor-General to make regulations under the empowering provision, the Minister of Revenue must undertake appropriate and reasonable consultation on the proposed regulation that provides for the correction of errors.

Noted

- f) **note** that officials consider that the consultation requirement in the empowering provision for the regulations has been met.

Noted

- g) **note** that a regulatory impact assessment was completed and was attached to the March 2018 Cabinet paper. We have made a minor update to this RIA and this is attached to the Cabinet paper.

Noted

- h) **note** that speaking notes are attached to assist you with support and coalition party consultation.

Noted

- i) **agree** to seek a waiver of the 28-day rule to allow the Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019 to come into force on 1 April 2019.

Agreed/ Not agreed

**Mike Nutsford**  
Policy Manager,  
Policy and Strategy  
28 February 2019

**Hon Stuart Nash**  
Minister of Revenue  
/ /2019

## Background

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13. The Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Act 2018 included changes to the way employers reported employment income information to Inland Revenue.
14. The amendments to the Tax Administration Act 1994 (TAA) include a regulation-making power that enables the Governor-General on the recommendation of the Minister of Revenue, to make regulations to provide for the correction of errors in employment income information, following appropriate consultation. This occurred as part of the release of the officials' issues paper "PAYE error correction and adjustment" in August 2017.
15. We previously reported to you in February 2018 seeking Cabinet approval for the policy settings for the permitted means of error correction for employment income information (IR2018/006 refers). We also sought approval to carry out consultation with a limited group of stakeholders on a draft copy of these regulations.
16. 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, Modernising Tax and Remedial Matters) Bill 2018.
17. The regulations also take into account proposed changes to the treatment of PAYE overpayments contained in the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill (the ARMTARM Bill). Due to the timing of this Bill, these provisions of the regulations were drafted subsequent to the draft version provided for consultation.
18. During drafting we identified a subset of errors which 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. In order 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.
19. The consultation version of the regulations was drafted on this basis. An updated regulatory impact statement is attached to this report.
20. The key changes to the regulations following feedback on consultation is to provide more clarity between which provisions apply for different types of errors. The regulations have been amended to include examples and a flowchart in the explanatory note to assist in the application of the regulations.
21. The empowering provision for regulations Section 23N of the TAA comes into force 1 April 2019, section 11 of the Interpretation Act 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, an enactment into operation". 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 mandatory payday reporting requirements to provide clarity for employers on how to correct errors.
22. A further set of speaking notes has been attached for your use in support and coalition party consultation.

## Feedback from consultation

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23. We sent a copy of the draft regulations to 13 organisations. We received responses from 11, with the points raised generally fitting under one of the below categories:
- clarity between the types of errors;
  - when an error may be reported in a subsequent period;
  - concerns around implementation and application timing; and
  - minor drafting points.
24. The key feedback was: a perceived lack of clarity around what regulations apply to each type of error, whether there was more scope for correction in subsequent returns, and a concern that the proposed application date of 1 April 2019 did not allow enough implementation time.

## Feedback received not resulting in changes

25. Two submitters were concerned that the application date is the same as the move to mandatory payday reporting. One suggested that it would be better for error correction to come into force after the payday reporting changes have bedded in.
26. Two submitters expressed concern around the timing for the regulations to come into effect and the software development that would be required to support them. One submitter raised a concern that there is no allowance for payroll software that does not allow original returns to be amended.
27. The regulations continue the status quo of error correction, allowing all errors to be corrected in the original submission. The ability to include adjustments in subsequent returns (the "netting off" approach) is an option but 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 when software provides for that option.
28. We do not recommend delaying the application date of the regulations, as they are intended to provide clarity to employers and reduce compliance costs.

## *Adjustments in a subsequent period*

29. Three submitters queried the threshold that determines whether an adjustment in a subsequent return is a permitted method of correction in relation to interpretation errors. The rationale for capping the amount of adjustments which may be made in a subsequent period is to draw a distinction between significant errors and small errors which may be corrected in a subsequent return to reduce compliance costs.
30. Two of those submitters suggested revisiting this threshold in two to three years' time to ensure it meets the right balance between reducing compliance costs and ensuring significant errors are allocated to the right period. Officials will monitor this threshold. There is scope to amend the regulations in the future to increase this if the compliance costs are seen to outweigh the impact of correcting larger errors in subsequent returns.
31. Two submitters asked if it would be possible to make adjustments to incorrectly deducted social policy obligations in subsequent periods. Social policy errors 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. However, officials will revisit whether it is

appropriate to allow adjustments in future periods for some circumstances once social policy has been incorporated into Inland Revenue's new computer system.

***Feedback received resulting in changes***

32. The main changes to the regulations following consultation are:
- clarifying which regulations apply to different error types;
  - inclusion of a flowchart and examples in the explanatory notes; and
  - minor drafting clarifications
33. In addition to the changes arising from consultation, we have revised the regulation section regarding when an employer makes an overpayment of PAYE income. This reflects a change proposed in the ARMTARM Bill regarding the status of overpayments of PAYE-related payments.

*Clarity on how to apply regulations*

34. Five submitters queried how different regulations would apply to different errors. To clarify the regulations, we have made several changes to help ensure they are easy to follow and apply to different error types.
35. The regulations distinguish error type on the basis of which category of employment income information is affected. The categories which affect which methods are available are whether:
- the PAYE income payment amount is incorrect
  - the PAYE and ACC levy deducted is incorrect
  - student loan repayment, KiwiSaver or Child Support deductions are incorrect, and
  - any of the amounts reported to us in the employment income information do not accurately reflect the amount that was deducted and/or paid to Inland Revenue.
36. If an error includes amounts relating to KiwiSaver, student loan repayments or child support deductions, the original submission must be amended. This is to ensure these deductions are allocated to the appropriate period.
37. We consider there should be more clarity in the regulations by way of a flowchart and key examples in the explanatory note to the regulations. In addition, guidance will be released by Inland Revenue in a *Tax Information Bulletin* once the regulations are made.
38. The legislative changes to the taxable treatment of PAYE overpayments will also have guidance included in the *Tax Information Bulletin*.

*Clarifications to be addressed in further guidance*

39. One submitter also sought clarification on how the regulations would intersect with current penalty provisions in the TAA.
40. The regulations specify that an employer must correct an error as soon as "reasonably practicable". This is intended to provide guidance in the regulations as to when an employer should correct an error without providing a specific deadline. This is because it may be difficult to determine when an error is discovered by the

employer and some errors may take more time to correct than others if they are more complex.

41. If an earlier return is amended to correct for when PAYE was under-withheld, this would count as a voluntary disclosure under section 141G of the TAA. Further guidance and examples about how this will apply will be included in a *Tax Information Bulletin*.
42. New Schedule 3 specifies the record-keeping requirements for employers and PAYE intermediaries. This includes the details of a PAYE income payment and the amount of any tax or other deductions that are withheld.
43. Additional points raised in the feedback included wanting clarification around how the regulations worked with penalties and record-keeping provisions, and queries around the timing provision.
44. Submitters were generally supportive of the use of regulations to provide clarity for how to correct errors.

#### *Minor drafting changes*

45. Following consultation, we have made several minor drafting changes to aid in the clarity of the regulations.

#### **Inclusion of a new overpayments provision**

46. The regulations have been amended to incorporate changes to the taxable treatment of PAYE overpayments included in the ARMTARM bill. This bill amends the Income Tax Act 2007 and the TAA to clarify that overpayments of PAYE income should be subject to PAYE. This bill is currently still going through parliamentary processes, but is expected to be enacted in March 2019.
47. Making PAYE income overpayments subject to PAYE ensures that any overpayments made to employees and not recovered by the employer are subject to tax and any other applicable deductions under PAYE. The proposed amendment leaves the unrepaid amount on the employee's record of income with Inland Revenue, which is used in determining obligations such as the rate of tax on secondary income and entitlements such as Working for Families tax credits. The overpayment would have been taxable if it had been correctly paid and if it is not repaid it remains available to the recipient to spend.
48. The regulations permit the employer to choose one of the following ways to report an overpayment which was treated as a PAYE income payment by:
  - 48.1 amending the original return to record the correct values; or
  - 48.2 adjusting in a subsequent period by netting off the overpayments and any associated deductions against the values in a later payday.
49. The provision also allows for the employer to treat an overpaid amount as repaid, provided it is repayable to the employer under an agreement between the employer and the employee. Where this is the case, the employer may choose which option to correct the error.
50. If the employer wishes to correct the overpayment in one lump sum, for example by correcting the original submission, the regulations permit this approach. However, if the employee subsequently breaches the agreement to repay, the employer must make an additional correction to increase the PAYE income payment by the amount of the remaining unpaid overpayment (an upwards adjustment).

51. The amendments to the TAA and the regulations describe what constitutes a breach of repayment obligations. A breach is considered to be when the employee has breached the agreement (e.g. not complied with the repayment schedule) and not remedied this within two months, or if the employer considers that the employee will not comply with the agreement in the future. This provides flexibility for the employer's discretion as to when it is appropriate to consider the agreement as breached.

### **Consultative requirement**

52. The regulation-making power under section 23N of the TAA provides that appropriate consultation should be undertaken before making a recommendation to make regulations under this provision.
53. Consultation took place in 2017 in the form of the officials' issues paper *PAYE error correction and adjustment*. This consultation helped to inform the policy principles underlying the regulations; these principles were agreed to by Cabinet in March 2018.
54. In addition, subsequent consultation with a small group of stakeholders was undertaken in the last quarter of 2018 to ensure the regulations were able to be used to give effect to the policy decisions.
55. Officials consider that appropriate consultation has taken place to make the regulations under section 23Q of the TAA.

### **Release of Cabinet paper**

56. We recommend releasing the attached Cabinet paper once the Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019 has been gazetted. We also recommend the release of this covering report as additional supporting material. We note that previous policy reports and Cabinet papers on PAYE error correction have been released as part of the information release for the introduction of the ARMTARM Bill.
57. We recommend the documents are released in full, subject to official's contact numbers and the names of junior officials. This is consistent with withholding information under section 9(2)(a) of the Official Information Act to protect the privacy of natural persons.

## APPENDIX A

The following organisations were sent a copy of the draft regulations in September 2018

- SAP
- ANZ
- EY
- GoFi8ure
- Datacom
- Attache
- Fast Track
- NZ Law Society – Tax Law committee
- CA ANZ
- CTG
- PwC
- KPMG
- Business NZ

## APPENDIX B

Speaking notes  
Coalition and support party consultation  
28 February 2019

### **Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019**

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#### **Context**

- From 1 April 2019, employers will be required to submit their PAYE information to Inland Revenue on a payday basis. The information will generally be required within two or ten days after each payday.
- The Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019 will support the recent change to payday reporting of employment income information by employers.

#### **Issue**

- The more frequent provision of PAYE reporting information will provide Inland Revenue with more timely information on employment income for employees. However, it will also reduce the time available to employers to identify and correct any errors in this information before it is sent to Inland Revenue.
- The regulations will support the move to payday reporting by providing for the methods for employers to make adjustments and correct errors in employment income information.

#### **Proposals**

- The policy principles underlining the error correction regulations were approved by Cabinet in March 2018.
- The regulations also reflect changes to the taxable status of PAYE-related overpayments which are included in the current Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill.
- The permitted methods of error correction allow the employers to continue the current guidance for correction of errors (that is correcting the original period submitted) or make adjustment in subsequent periods subject to restrictions.

#### **Benefits of proposals**

- These regulations provide clarity regarding the methods by which an employer may correct an error in employment income information.

### **Financial implications**

- To the extent that employers will correct minor interpretation errors in a subsequent return, the amount of interest employers pay on re-assessed PAYE will reduce. It is not possible to estimate the magnitude of the change but it is expected to be small.

### **Administrative implications**

- The administrative impacts of the propose changes are consistent with the assumption in the Business Transformation Business Case that the cost of processing PAYE information will reduce. The cost of the changes for Inland Revenue will be met as part of stages 2, 3 and 4 of Inland Revenue's business transformation programme.

## APPENDIX C

Speaking notes  
Cabinet Legislative Committee  
28 February 2019

### Title

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#### Recommended actions

- The paper seeks the committee's authorisation to submit the Tax Administration (Correction of Errors in Employment Information) Regulations 2019.
- It seeks a waiver of the 28-day rule in order to allow the regulations to take effect on 1 April 2019, which coincides with the requirement for employers payday reporting of employment income information.

#### Issue

- The more frequent provision of PAYE reporting information will provide Inland Revenue with more timely information on employment income for employees. However, it will also reduce the time available to employers to identify and correct any errors in this information before it is sent to Inland Revenue.
- The regulations will support the move to payday reporting by providing for the methods for employers to make adjustments and correct errors in employment income information.

#### Proposals

- The policy principles underlining the error correction regulations were approved by Cabinet in March 2018.
- The regulations also reflect changes to the taxable status of PAYE related overpayments which are included in the current Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill.
- The permitted methods of error correction allow the employers to continue the current guidance for correction of errors (that is correcting the original period submitted) or make adjustment in subsequent periods subject to restrictions.

#### Benefits of proposals

- These regulations provide clarity regarding the methods by which an employer may correct an error in employment income information.

### Financial implications

- To the extent that employers will correct minor interpretation errors in a subsequent return, the amount of interest employers pay on re-assessed PAYE will reduce. It is not possible to estimate the magnitude of the change, but it is expected to be small.

### Administrative implications

- The administrative impacts of the propose changes are consistent with the assumption in the Business Transformation Business Case that the cost of processing PAYE information will reduce. The cost of the changes for Inland Revenue will be met as part of stages 2, 3 and 4 of Inland Revenue's business transformation programme.

### Consultation

- The legislative provision enabling the making of regulations to provide for permitted methods of error correction requires the Minister of Revenue to undertake appropriate consultation before making a recommendation.
- Consultation took the form of an officials' issues paper *PAYE error correction and adjustment*, which was released in August 2017, and received 13 submissions.
- In addition, a draft version of the regulations was provided to 13 stakeholders in September 2018 to test the readability and ease-of-use of the regulations.

### Timing considerations

- In order to coincide with the mandatory application date for employers to adopt the recent changes to payday reporting, the regulations should come into effect on 1 April 2019.