

In Confidence

Office of the Minister of Education

Office of the Minister of Revenue

Chair, Cabinet Social Wellbeing Committee

## **STUDENT LOAN BUSINESS TRANSFORMATION POLICY CHANGES FOR 2020**

### **Proposal**

1. This paper seeks the Cabinet Social Wellbeing Committee's agreement to changes to the Student Loan Scheme Act 2011 enabled by Inland Revenue's business transformation programme. These changes are largely administrative in nature. They are:
  - 1.1 Limiting student loan scheme rules relating to the 2013 and prior years.
  - 1.2 Renaming the student loan repayment holiday.
  - 1.3 Writing off student loans in cases where borrowers have been able to prove they did not take out the loan.
  - 1.4 Giving Inland Revenue the ability to notify employers when borrowers' loans are close to being fully repaid.
  - 1.5 Treating overseas based borrowers in exceptional circumstances as New Zealand based.

### **Executive Summary**

2. Inland Revenue's multi-year transformation programme is enabled by changes to policy, process, technology, and organisation design. In April 2020, the management of student loans and KiwiSaver will move to new systems and processes.
3. Officials have identified several policy changes that will make it easier for borrowers to meet their obligations and enhance the administration of the student loan scheme (the scheme). Some of these are currently being progressed as part of the Taxation (Annual rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Bill. This paper proposes further changes, being:
  - 3.1 Limiting changes to borrowers' repayment obligations prior to 1 April 2013 to changes in residency status, fraud, or where a tax return has not been filed and it is cost effective to do so. This would reduce the administrative complexity of the system. If this is not progressed, the new systems and processes would need to include a large number of historic changes to policy and legislation, some of which have since been repealed.

- 3.2 Renaming the student loan 'repayment holiday' to 'repayment obligation suspension'. This will make it clearer to borrowers heading overseas that their repayment obligations are only temporarily on hold and they must start making payments again when their repayment obligation suspension ends (or they return to New Zealand).
  - 3.3 Writing off student loans in a small number of cases pre-2000 where borrowers have been able to prove they did not take out the loan, and where the correct borrower cannot be identified. Cases post-2000 are managed by MSD, who already have the power to reverse such loans.
  - 3.4 Giving Inland Revenue the ability to notify employers when borrowers' loans are close to being fully repaid. This would allow employers to make final deductions equal to the remaining loan balance, preventing overpayments and borrowers having to contact Inland Revenue to get a refund.
  - 3.5 Treating overseas based borrowers in exceptional circumstances as New Zealand based. There are a small number of overseas based borrowers living with a serious illness or disability, who are unlikely to repay their loans. Treating these borrowers as New Zealand based would mean the borrower has repayment obligations based on their income, and an interest free loan.
4. We propose progressing the necessary legislative changes in the Taxation (1st 2019 Omnibus Issues, and Remedial Matters) Bill, for introduction in mid-2019. The proposals would apply from 1 April 2020.

## **Background**

5. Inland Revenue's multi-year transformation programme will modernise New Zealand's revenue system. Once complete, customers will spend far less time and effort ensuring they meet their obligations and receive their correct social policy entitlements.
6. Business transformation is enabled by a combination of changes to policy, process, technology and the organisation design of Inland Revenue. It is far more than an upgrade of technology and has provided the opportunity to fundamentally review how the revenue system is administered and consider what changes may be needed.
7. New Zealand's revenue system is being transformed in four broad stages – digital services, tax, social policy, and a final wrap up. Modernisation of the revenue system is now well underway, with the first two releases having been successfully implemented. Release 3, which will move income tax and Working for Families to new systems and processes, is scheduled to go-live on 26 April 2019. Management of the student loan scheme will move to new systems and processes as part of Release 4 in April 2020.
8. Moving student loans to new systems and processes creates opportunities to make it easier for borrowers to meet their obligations and improve the administration of the scheme.
9. Legislation has already been introduced to deduct student loan repayments from schedular, election-day and casual agricultural income, and to not charge loan

interest for New Zealand based borrowers (currently, interest is charged and then written off).

10. The proposed policy changes in this paper seek to:
  - 10.1 Reduce compliance effort and improve the borrower's experience.
  - 10.2 Reduce complexity.
  - 10.3 Reduce administration costs.

### **Limiting student loan scheme rules relating to the 2013 and prior years to simplify administration of the Scheme**

11. From time to time, information comes to light that means Inland Revenue needs to change borrowers' historical repayment obligations. Inland Revenue is currently required to maintain rules back to 1992 when the scheme was introduced in cases where either the Commissioner or borrower seek to review a borrower's repayment obligation.
12. Retaining rules going back to 1992 has increased the complexity of the scheme. Compliance costs for borrowers are high, as understanding changes to their loan balance is difficult due to historical rules applying for previous years. Administration costs for Inland Revenue are also high, with little benefit.
13. To simplify the system going forward, we propose incorporating all student loan rules back to 1 April 2013 into the new systems and processes, and a simplified set of rules from 1992 to 1 April 2013. This will reduce compliance costs for borrowers, the administration costs for Inland Revenue, and the time and cost of implementing future changes to the student loan scheme.
14. Incorporating rules back to 1 April 2013 into the new system will capture 93% of all changes to repayment obligations and largely replicate the current scheme. For 1992 to 1 April 2013, we propose a simplified set of rules apply in cases where a borrower's residency status changes, where a borrower has committed fraud, or where a tax return has not been filed and it is cost effective to make changes. These are the situations that have the greatest impact on a borrower's repayment obligations and their loan balance.
15. For example, where a borrower has gone overseas in 2008 but has been treated as New Zealand based, interest would be calculated on the borrower's loan from the date they went overseas in 2008. However, the borrower's repayment obligations would only be changed from 1 April 2013 onwards.
16. Where a borrower has committed fraud or not declared income, a simplified calculation would be applied. Repayment obligations would only be calculated on the adjusted net income figure and the other rules that applied in that year would be disregarded. A one-off penalty would be imposed on the undeclared income in cases of fraud and may be imposed on unfiled returns. Late payment interest would only be imposed on unmet obligations for 1 April 2013 onwards.
17. The number of borrowers expected to be impacted by this change each year is small and reducing over time. In the 2018 year, only 1,314 borrowers had their repayment

obligation for the 2013 or prior years changed. This represents less than 0.2% of the 700,000 student loan borrowers and the repayment obligations involved was \$1.2 million. These figures are expected to reduce further before the introduction of these changes in 2020.

18. This proposal would retain equity between compliant and non-compliant borrowers. These changes could result in slight variations in a limited number of borrowers' loan obligations and repayment period, which could either increase or decrease borrowers' loan obligations.
19. This option reduces the complexity of the scheme, and therefore reduces compliance costs for borrowers and administration costs for Inland Revenue. This option has no material impact on the valuation of the scheme and improves the Government's flexibility to make policy changes in the future.

#### **Renaming the repayment holiday**

20. Currently, borrowers heading overseas can apply for a repayment holiday, which suspends their repayment obligation for up to one year. Interest continues to be charged on the loan.
21. We propose renaming the repayment holiday to repayment obligation suspension. This will make it clearer to borrowers that their obligations are only temporarily on hold and they must start making repayments again when their repayment obligation suspension ends (or they return to New Zealand). It will also remove the potentially positive association with the word 'holiday'.

#### **Writing off loans in cases where borrowers have been able to prove that they did not take out the loan**

22. Inland Revenue is aware of a very small number of cases where borrowers have been able to prove that they did not take out a loan, and it is likely that their identity has been stolen. Inland Revenue manages cases occurring before 2000 and does not have the power to write these loans off if the correct borrower cannot be identified. Cases occurring after 2000 are managed by MSD, who do have the power to reverse loans if they cannot locate the correct borrower.
23. We propose that Inland Revenue should be able to write off loans where borrowers have been able to prove that they did not take out the loan and the correct borrower cannot be identified. This change will make the scheme fairer for borrowers in these situations.

#### **Giving Inland Revenue the ability to notify employers of a borrower's loan balance, when the loan is close to being repaid**

24. Currently, Inland Revenue can tell employers if an employee has a student loan or not, to ensure that they use the correct tax code, but cannot tell employers what the loan balance is. This results in overpayments and delays when loans are repaid, as employers currently make student loan deductions at 12% until they are told to stop.
25. Enabling Inland Revenue to notify employers of a borrower's remaining loan balance, where the loan balance is close to being paid, will mean they can make a final deduction equal to the remaining loan balance. This will improve borrower experience by avoiding overpayments in many situations.

## **Treating overseas based borrowers in exceptional circumstances as New Zealand based**

26. Overseas based borrowers' repayment obligations are based on the size of their loan and they are charged interest on their student loans. Inland Revenue is aware of a few overseas based borrowers who are living with a serious illness or disability and are unlikely to ever be able to make loan repayments.
27. In some circumstances, borrowers can apply to be treated as New Zealand based. We believe it is appropriate to treat the above-mentioned borrowers as New Zealand based. This would seek to align their repayment obligations with their ability to repay and they would not be charged interest. This will also prevent loan balances from increasing due to interest.

## **Consultation**

28. The Ministry of Education and Inland Revenue have consulted with the following agencies in preparing this paper: The Treasury, the Ministry of Social Development, and the Office for Disability Issues. The Office of the Privacy Commissioner has also been consulted.

## **Financial Implications**

29. The costs of making these changes are included as part of Inland Revenue's business transformation programme, and no additional funding is sought. The impact of the changes on the future cash flows of the scheme has been considered and there are no material impacts on the valuation.

## **Legislative Implications**

30. Implementing these proposals requires changes to the Student Loan Scheme Act 2011.
31. If approved, we propose that the changes be included in the Taxation (1st 2019 Omnibus Issues, and Remedial Matters) Bill, scheduled for introduction in mid-2019. The proposals would apply from 1 April 2020 for the 2020/21 tax year. This aligns with the transition of the management of student loans to the new systems and processes as part of Inland Revenue's business transformation.

## **Impact Analysis**

32. The Quality Assurance Team at Inland Revenue has reviewed the *Student Loans: Back-year reassessments prior to 2013* regulatory impact assessment prepared by Inland Revenue and:
  - 32.1 Considers that the information and analysis summarised in the regulatory impact analysis **partially meets** the quality assurance criteria.
  - 32.2 In light of the time constraints on the policy development process that are identified in the Key Limitations or Constraints on Analysis section, the reviewer considers that the information in the RIA is as complete as could be expected and identifies the main risks and uncertainties.
  - 32.3 However, the time constraint has meant that public consultation particularly with affected parties has not been carried out. Consequently, the reviewer cannot be sure that the full range of impacts have been identified or that the preferred

options are the best options to address the problem and achieve the desired objectives.

33. The Regulatory Quality Team at the Treasury has determined that the remaining decisions sought in this paper are exempt from the requirement to provide a Regulatory Impact Assessment as they have no or minor impacts on businesses, individuals or not for profit entities.

### **Human Rights**

34. This paper does not have any significant human rights implications. The proposal to notify an employer of a borrower's remaining loan balance has minor privacy implications.

### **Gender Implications**

35. The proposals in this paper are generally administrative in nature. Officials are not aware of any significant gender implications arising from these proposals.

### **Disability Perspective**

36. Treating overseas based borrowers with serious illnesses or disabilities as New Zealand based will provide relief to borrowers who are unlikely to be able to repay their loans. It will better align their repayment obligation with their ability to repay, and their loans would be interest free. This will be beneficial for these borrowers.

### **Publicity**

37. An announcement on the contents of the Bill, including these proposals, will be made when the Taxation (1st 2019 Omnibus Issues, and Remedial Matters) Bill is introduced. A commentary on the Bill will also be released at this time. Inland Revenue will include details of the new legislation in a *Tax Information Bulletin* after the Bill is enacted.
38. The proposals are unlikely to be controversial as they largely seek to make it easier for borrowers to repay their loans and to improve the administration of the scheme.

### **Proactive Release**

39. We propose to delay the release of the attached Cabinet paper in full and associated minutes until the proposed Taxation (1st 2019 Omnibus Issues, and Remedial Matters) Bill containing legislative amendments to give effect to the recommendations in this paper is introduced.

### **Recommendations**

The Minister of Education and Minister of Revenue recommend that the Cabinet Social Wellbeing Committee:

1. **note** that Inland Revenue is planning to move the student loan scheme to new systems and processes in April 2020;
2. **note** that there are several policy changes requiring legislative change that can make it easier for borrowers to meet their obligations and improve the administration of the student loan scheme;

3. **agree** that changes to borrower's repayment obligations prior to 1 April 2013 be limited to changes in residency status, where fraud is involved, or where a tax return has not been filed and it is cost effective to make changes;
4. **agree** to rename the student loan repayment holiday to student loan obligation suspension;
5. **agree** that Inland Revenue have the ability to write-off student loans taken out before 2000, in cases where borrowers have been able to prove that they did not take out the loan;
6. **agree** that Inland Revenue have the ability to notify a borrower's employer when the borrower's student loan is close to being fully repaid;
7. **agree** that overseas based borrowers with serious illness or disabilities should be treated as New Zealand based;
8. **agree** that recommendations 3-7, if agreed, will apply from 1 April 2020; and
9. **invite** the Minister of Revenue to instruct Parliamentary Counsel Office to draft the necessary amendments to give effect to the changes recommended in this paper.

Authorised for lodgement

Hon Chris Hipkins  
Minister of Education

Hon Stuart Nash  
Minister of Revenue