Impact Summary: *Student Loans: Limiting Student Loan Scheme rules relating to the 2013 and prior years*

Section 1: General information

Purpose
This analysis and advice informs key policy decisions to be taken by the Minister of Revenue ahead of final decisions by Cabinet on whether to proceed with a policy change to reduce the need to amend pre-2013 student loan obligations after April 2020. Inland Revenue is solely responsible for the analysis and advice set out in this Regulatory Impact Summary.
Key Limitations or Constraints on Analysis
The key limitations on the analysis are as follows. **Time to enact legislation** As part of Inland Revenue's Business Transformation programme, the Student Loan Scheme will be moved to new systems and processes with effect from April 2020. This transfer provides an opportunity to reduce the current complexity of the scheme caused by having to administer rules for previous years that have subsequently been repealed. Any legislative changes that are to apply from 2020 would need to be introduced into Parliament by mid-2019. The timeframe to enact legislation has reduced the time available to develop and analyse the options and to consult with stakeholders. **No consultation with external stakeholders** Inland Revenue has not consulted with affected borrowers as the number of borrowers likely to be impacted by the proposed option is small and the legislative process provides an opportunity for the public to make submissions on the proposals as the Bill progresses through Parliament. **Scale of the problem** The scale of the problem in terms of the impact of the status quo on borrower compliance has not been accurately identified. Research suggests that borrowers do not understand how the student loan rules for previous years impact any changes their loan obligations. **Impact of proposals on the student loan valuation** Proposals that have a material impact on the valuation require a Budget bid and would need to be prioritised alongside other bids for Government funding. In order to proceed with reducing the complexity of changes to prior years' repayment obligations, officials focussed on options that would not materially impact the student loan valuation. None of the limitations materially affect the analysis.
Responsible Manager (signature and date):
  Melody Guy Policy Manager Policy and Strategy Inland Revenue 31 January 2019

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

The underlying problem is the complexity of the student loan rules relating to previous years that no longer feature in the current scheme. This complexity means there is a lack of understanding by borrowers of the rules prior to 1 April 2013.

As part of Inland Revenue's Business Transformation programme, the Student Loan Scheme will move to new systems and processes in April 2020. This transfer process provides an opportunity to make legislative changes to reduce the complexity of the student loan rules prior to April 2013, make it cheaper and easier to make changes to the scheme in the future, reduce compliance costs (by increasing understanding of rules) for borrowers, and increase consistency between tax and student loans. April 2013 has been chosen as this date captures 93% of all changes to student loan obligations for previous years and is the point where the rules are largely the same as apply today.

The Student Loan Scheme was introduced in 1992 and is governed by the Student Loan Scheme Act 2011, and loan contracts between the government and each borrower. A significant number of changes have been made to the Student Loan Scheme since its introduction with changes being made in 21 of the last 26 years. Under current legislation, the importance of accurate borrower's obligations outweighs compliance and administrative costs. For example, either the borrower or Inland Revenue can seek to amend a prior year's loan obligation, regardless of the amount of money involved.

A repayment obligation is changed where an error is identified in the calculation of a borrower's repayment obligation for a year. Unlike income tax, which generally has a period of 4 years from the date a return is filed to make changes to a tax obligation, student loan obligations can be changed back to the date the loan was taken out, which could be as far back as 1992 when the loan scheme was introduced. Therefore, where a student loan obligation for a previous year changes, the rules relating to that year apply. This requirement to retain rules for previous years has increased the complexity of the Student Loan Scheme administration, reduced the overall customer experience by making it difficult for borrowers to understand changes to their loan balance, and increased the administration costs. A significant number of the rules relating to previous years have since been repealed.

Decisions on whether to simplify the Student Loan Scheme are required by March in order for any legislative changes to be enacted in time for an April 2020 application.

2.2 Who is affected and how?

Borrowers affected are those whose obligations prior to 2013 are amended. In the 2018 year, of the 700,000 student loan borrowers, less than 0.2 percent had their repayment obligations prior to April 2013 amended (1,314) resulting in increased repayment obligations of $1.2 million. The number of borrows affected is expected to reduce significantly by 2020 due to Inland Revenue's efforts to reduce the number of outstanding tax returns and to contact non-compliant overseas based borrowers.

2.3 Are there any constraints on the scope for decision making?

The major constraint on our analysis is the time to enact legislation.

Inland Revenue is part way through a multi-year transformation programme to modernise New Zealand's revenue system. Business transformation is enabled by a combination of changes to policy, processes, 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.

Options to simplify the prior years' student loan rules require a legislative change. For legislation to be enacted by April 2020, changes would need to be introduced into Parliament in mid-2019 and therefore Cabinet decisions on policy changes are required in March 2019.

The timeframe to enact legislation has reduced the time available to consult with stakeholders. Inland Revenue does not intend to consult separately with affected borrowers. However, mitigating factors are that the number of borrowers likely to be impacted by the preferred option is small and public submissions can be made on the proposals at the Select Committee stage as the Bill progresses though Parliament.

Another constraint is the impact on the student loan valuation. Options that have an impact on the valuation would require a Budget bid as part of Budget 2019. These options would have to be prioritised together with other Government initiatives. Officials do not propose pursuing options that materially impact on the student loan valuation.

Section 3: Options identification

3.1 What options have been considered?

Transferring the Student Loan Scheme to the new systems and processes provides an opportunity to reduce the administrative complexity of the Student Loan Scheme. Reducing the complexity of the Student Loan Scheme can only be resolved through legislative changes. Officials have considered non-legislative options, such as manually undertaking changes to prior year obligations, but these options may reduce but will not resolve the complexity issue. Therefore, the options proposed to simplify the Student Loan Scheme are legislative only.

The options considered are retaining the status quo and two options to simplify the Student Loan Scheme rules relating to the 2013 and prior years.

The policy objective is to implement the Student Loan Scheme into the new systems and processes within the timeline (April 2020) and reduce the complexity of the scheme, whilst ensuring equity among borrowers, and no material impact on the student loan valuation.

In considering the options, officials evaluated the options against the following criteria:

- equity between borrowers (current versus past borrowers, compliant versus non-compliant borrowers, and New Zealand based versus overseas based borrowers);
- the impact of the complexity of the scheme on both the compliance costs of borrowers and administrative costs for Inland Revenue;

- the impact of the options on the valuation of the Student Loan Scheme; and
- the cost and time to make policy changes in the future.

Option One: Status quo – implement the rules back to 1992
This option involves implementing all the prior years' student loan rules back to 1992 into new systems and processes. However, as student loans repayments for New Zealand based borrows are based on income for tax purposes, and as income tax generally has a period of 4 years for making changes to tax obligations, there will be no income generated student loan changes prior to 2013. Changes to loan obligations prior to 2013 would be those where fraud or non-filing of tax returns is involved and it is cost effective to do so, changes in residence status, or changes due to other student loan rules such as repayment holiday entitlement, or entitlement to the voluntary repayment bonus.

This option would have no material impact on the student loan valuation and retains the current equity among borrowers. However, it retains the current complex rules prior to April 2013 which would need to be built into new systems and processes. This complexity imposes administration costs on the government and would impact very few borrowers.. Also, future policy changes should still accommodate the rules prior to 1 April 2013.

This option is not preferred by officials.

Option Two: No new changes to repayment obligations prior to April 2013
Under this option the student loan rules would only be incorporated into new systems and processes back to 1 April 2013. This date was chosen as it captures almost all changes to student loan repayment obligations and the rules applying from April 2013 are largely the same as apply today. The rules relating to policy changes prior to 2013 will not be built into new systems and processes. Changes to repayment obligations prior to this date would only occur in exceptional circumstances such as cases of tax or student loan fraud or non-filing of tax returns showing a significant liability. These cases would be processed manually.

This option simplifies the current rules, removes the need to build the rules prior to 1 April 2013 into the new systems and processes, and reduces both compliance and administrative costs. However, there are instances where equity between compliant and non-compliant borrowers would not be retained, such as where a borrower who Inland Revenue considers is New Zealand based is found to have gone overseas prior to April 2013 without notifying Inland Revenue as required in their loan contract. Under this option the borrower would only have interest imposed back to 1 April 2013 not the earlier date when they became overseas based.

This option would reduce the cost and time to implement policy changes in the future as changes would not have to accommodate rules prior to April 2013. However, it would also have a material impact on the student loan valuation and for this reason is not preferred by officials.

Option Three: Limited changes to loan obligations in relation to the 2013 and prior years (preferred option)
This option would incorporate the student loan rules into new systems and processes back to 1 April 2013. For periods prior to 1 April 2013, changes to repayment obligations would only occur where a borrower changes their residence status, for example, Inland Revenue receive new information that a borrower had gone overseas, or in cases of unfiled returns where it is cost effective to do so, or fraud.

Where a borrower's residency status changes, interest would be calculated on their loan balance from the date the borrower's status changed at the interest rates that applied in the relevant years. Changes in the borrower's repayment obligation for the period up to 1

April 2013 would be ignored. However, changes to obligations from 1 April 2013 onwards would be assessed as they are now.

In cases of fraud, or unfiled tax returns where the obligation is material, a simplified calculation would be used by applying the student loan repayment rate to the amended income figure. A one-off penalty may also apply to penalise the non-compliant action. Late payment interest will only be imposed on adjusted repayment obligations from 1 April 2013 onwards.

Imposing late payment interest on repayment obligations for the period 1992 to 2013 can disproportionately increase the debt owed to Inland Revenue to the point where the borrower cannot repay the debt and disengages with the Student Loan Scheme.

Adjustments to residency status and the associated interest impact together with situations where under-declared income or fraud is involved have the greatest impact on the loan balance and time to repay the loan. This option incorporates these situations.

This option simplifies the calculation of repayment obligations prior to April 2013, removes the need to build these rules into the new systems and processes, reduces the complexity of the scheme and therefore reduces both compliance costs and administrative costs.

As this option takes account of residency changes and applies the historical loan interest rates, equity between compliant and non-compliant overseas-based borrowers would be preserved. Also, the inclusion of borrowers who fail to file returns of a material value or commit fraud also retains equity between compliant and non-compliant borrowers.

This option has no material impact on the student loan valuation and reduces the time and cost of making policy changes in the future as changes would not have to accommodate rules prior to April 2013. This option is preferred by officials.

How each option would work

The following examples illustrate the differences in treatment of a borrower under each option.

<u>Example 1</u>

A borrower went overseas in 2008, did not advise Inland Revenue and was not picked up through the passenger movement match with NZ Customs. The borrower has been treated as New Zealand-based and therefore not charged loan interest. In 2021 the borrower returns to New Zealand. Inland Revenue identifies that the borrower has been overseas for the preceding years and updates the borrower’s residency status for the time they were away.

Under Option One, the borrower’s residency status will be changed with effect from the date they went overseas in 2008 and loan interest, repayment obligations and late payment interest would be imposed from that date.

Under Option Three, the borrower’s residency status will be changed with effect from the date they went overseas in 2008 and loan interest will be imposed from that date. However, repayment obligations and late payment interest would only be imposed from 1 April 2013 onwards.

Under Option Two no changes would be made to the borrower’s residency status prior to April 2013 but loan interest, repayment obligations, and late payment interest would be imposed from 1 April 2013 onwards.

Example 2

In 2009 the voluntary repayment bonus feature was introduced which rewarded borrowers for making voluntary repayments above what they were required to repay. The bonus applied for 5 years (2009-2013) before being repealed.

In 2020 a borrower identifies an error in the calculation of their voluntary repayment bonus for the 2010 year although their income remains unchanged. They apply to have the voluntary repayment bonus recalculated for the 2010 year. Under Option One, the borrower would be able to receive the bonus but under Options Two and Three, they would not. We do not expect lack of retrospective entitlement to the voluntary repayment bonus to be a significant issue, given that few people took it up and there has been a long period during which any affected borrowers could have sought a recalculation of their entitlement.

Example 3

A taxpayer has committed fraud through not declaring a large source of income for the 2008 year. This has implications for both their income tax and student loan obligations. The four-year period for making changes to an income tax obligation after a return is filed does not apply where fraud is involved. Therefore, the Commissioner amends the taxpayer's income tax liability for the 2008 year. Under Options One, Two, and Three, the student loan repayment obligation would also be changed. Under Options One and Two, the student loan repayment obligation would be calculated on both the adjusted income for the year and the relevant student loan rules for that year. Under Option Three, the repayment obligation would only be calculated on the adjusted income and late payment interest would only apply from 1 April 2013 onwards.

3.2 Which of these options is the proposed approach?

Officials consider Option Three to be the preferred option. This option addresses the policy problem set out in 2.1 and has advantages in terms of ensuring equity between compliant borrowers and non-compliant overseas borrowers, those who under declare income, or those who commit fraud. It also reduces the complexity of the scheme and therefore makes it easier for borrowers to understand their loan obligations and reduces the administration costs for Inland Revenue over the status quo. This option has no material impact on the student loan valuation and reduces the time and cost of making policy changes in the future.

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties *(identify)*	**Comment**: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks	**Impact** *$m present value, for monetised impacts; high, medium or low for non-monetised impacts*
Additional costs of proposed approach, compared to taking no action		

Regulated parties (*affected borrowers)*[1]	The cost to borrowers in reduced accuracy of prior years' obligations may increase or decrease a borrower's repayment liability and reduce or increase the time period to repay the loan accordingly. Changes to repayment obligations by Inland Revenue would tend to increase a borrower's repayment liability. Borrowers not being able to receive the voluntary repayment that they may have been entitled to prior to this change (pre-April 2020).	The extent of the impact is dependent on the amount of the assessed obligation, but any impact on a borrower's repayment time period is expected to be low. Low
Regulators (*Inland Revenue)*	None	None
Wider government	None	None
Other parties	None	None
Total Monetised Cost	Financial impact for borrowers	Borrowers face either an increased or decreased repayment obligation
Non-monetised costs	Compliance costs for borrowers	*Low*

Expected benefits of proposed approach, compared to taking no action		
Regulated parties *(affected borrowers)*	Ongoing compliance costs savings for borrowers affected by a prior year's repayment obligation. The proposal reduces the need for affected borrowers to understand how the old rules impact their student loan liability. By way of example, borrowers with changes to prior year's obligations will no longer be required to understand the impact of the voluntary repayment bonus or 3-year repayment holiday on their loan balance. However, they may have had a higher loan balance through not receiving the voluntary repayment bonus. Borrowers who may have been required to pay late payment interest due to a changed repayment obligation prior to 1 April 2013 would not be required to pay this after this change (April 2020)	Low/Medium depending on the extent of the changes to repayment obligations and number of years involved Low

1 In the 2018 year, of the 700,000 student loan borrowers, less than two percent had their repayment obligations prior to April 2013 amended (1,314). This number is expected to reduce significantly by 2020 due to Inland Revenue's efforts in recent years to reduce the number of outstanding student loan returns and to contact non-compliant overseas based borrowers.

Regulators *(Inland Revenue)*	Reduced implementation costs for IR. Reduced ongoing costs of changing prior years' obligations, training staff and retaining administrative processes. These costs will form part of the savings from Inland Revenue's Business Transformation Programme.	Low/Medium
Wider government	None	None
Other parties	None	None
Total Monetised Benefit	None	None
Non-monetised benefits	Reduced compliance costs for borrowers and administrative benefits for Inland Revenue	*Low/Medium*

4.2 What other impacts is this approach likely to have?

Two different borrowers may be treated differently in the same situation, depending on when the change is identified. For example, assuming no fraud or non-filing of a material amount is involved, a change in a borrower's income that occurred prior to April 2013 would be included in the borrower's repayment obligation if the change was identified last year but would not occur if the change was identified after April 2020. The amended repayment obligation would result in the time to repay the loan being varied slightly either earlier (if the repayment obligation increases) or later (if the repayment obligation reduces). The greater the adjustment in repayment obligation the greater the impact on the loan repayment period. Most changes to borrowers' obligations occur in the first 3-4 years following the tax year. After that the number of changes falls dramatically. In the 2018 year the number of borrowers who had changes to their repayment obligations for the 2013 or prior years was 1,314, and the total increased repayments obligations was $1.2 million (although the amount expected to be collected is less than this). These figures are expected to reduce significantly by 2020 due to Inland Revenue's continued efforts to reduce the number of outstanding tax returns and to contact non-compliant overseas based borrowers.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?
The timeframe to enact legislation and implement student loans into the new systems and processes has limited Inland Revenue's ability to consult with those borrowers affected by the preferred option. This means that the problem identification, options identification, and impacts have been generated by officials based on the information available. It is recognised that consultation with those affected by a change is an important part of the Generic Tax Policy Process. However, mitigating factors are that the number of borrowers likely to be impacted in future by the preferred option is small and expected to reduce in future. Also, there will be an opportunity for the public to submit on the measure during the Select Committee process and feedback will be considered at that point. The Ministry of Education have been consulted in developing the options and agree with the recommended proposal.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?
It is intended that the preferred option be included in the next available taxation bill which is expected to be introduced into Parliament later in the year. Inland Revenue will be responsible for the operation of this preferred option and this will form part of its business as usual function. The preferred option will reduce the implementation risks associated with transferring the Student Loan Scheme from the current computer platform to the new systems and processes. It is proposed that legislation apply to limit changes in repayment obligations for the 2013 or prior years where the change occurs on or after April 2020. This will enable sufficient preparation time for Inland Revenue to implement the changes. The proposed approach will be included in the commentary on the taxation bill and consultation by select committee is expected to provide an opportunity for interested parties to express their views on this proposed change.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?
Inland Revenue would monitor the effectiveness of the proposed legislation in the first 12 months of operation. If we identify anything that suggests the legislation is not operating as intended, then we will undertake a review.

Inland Revenue currently have metrics to monitor the administration of the Student Loan Scheme. Work is progressing on designing the new system and processes and although work on the metrics to enable ongoing monitoring of volumes of changes to repayment obligations prior to 2013 has not commenced yet, officials expect the new systems and processes to replicate the existing metrics.

7.2 When and how will the new arrangements be reviewed?

The final step in the Generic Tax Policy Process is the implementation and review stage, which involves post implementation review of legislation, and the identification of remedial issues. Post implementation review is expected to occur around 12 months after implementation. Opportunities for external consultation are built into this stage.

Any necessary changes identified from the review would be recommended for addition to the Government's tax policy work programme.