

Hon Stuart Nash, Minister of Revenue

Information Release

Repeal of child support incremental penalties and simplification of penalty write-off rules

July 2020

Availability

This information release is available on Inland Revenue's Tax Policy website at <https://taxpolicy.ird.govt.nz/publications/2020-ir-cab-leg-20-sub-0093/overview>

Documents in this information release

1. IR2020/290 – Tax policy report: Cabinet paper – Supplementary Order Paper to the Child Support Amendment Bill – repeal of incremental penalties and simplification of the write-off rules (4 June 2020)
2. LEG-20-SUB-0093 – Cabinet paper: Child Support Amendment Bill – Approval for release of Supplementary Order Paper (30 June 2020)
3. LEG-20-SUB-0093 – Supplementary analysis report: Repeal of child support incremental penalties and simplification of penalty write-off rules (4 June 2020)
4. LEG-20-MIN-0093 – Minute: Child Support Amendment Bill: Supplementary Order Paper (30 June 2020)

Additional information

The Cabinet paper was considered by the Cabinet Legislation Committee on 30 June 2020 and confirmed by Cabinet on 6 July 2020.

Two attachments to the Cabinet paper are not included in this information release as they are publicly available:

- Supplementary Order Paper No 538.
- Revised departmental disclosure statement.

Information withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act). Where this is the case, the relevant sections of the Act that would apply are identified. Where information is withheld, no public interest was identified that would outweigh the reasons for withholding it.

Sections of the Act under which information was withheld:

- 9(2)(a) to protect the privacy of natural persons, including deceased people

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POLICY AND STRATEGY

Tax policy report: **Cabinet paper – Supplementary Order Paper to the Child Support Amendment Bill – repeal of incremental penalties and simplification of the write-off rules**

Date:	4 June 2020	Priority:	High
Security level:	Sensitive - Budget	Report number:	IR2020/290

Action sought

	Action sought	Deadline
Minister of Revenue	Agree to recommendations Authorise the lodgement of the attached Cabinet paper	8 June 2020 10 am, Thursday 18 June 2020

Contact for telephone discussion (if required)

Name	Position	Telephone
Samantha Aldridge	Principal Policy Advisor	s 9(2)(a)
s 9(2)(a)	Senior Policy Advisor	

4 June 2020

Minister of Revenue

Cabinet paper – Supplementary Order Paper to the Child Support Amendment Bill – repeal of incremental penalties and simplification of the write-off rules

Purpose

1. This report asks you to approve and lodge the attached Cabinet paper and accompanying revised disclosure statement with the Cabinet Office by 10 am, Thursday 18 June 2020 for consideration at the Cabinet Legislation Committee meeting on Tuesday 23 June 2020.
2. The Cabinet paper seeks approval to introduce a Supplementary Order Paper (SOP) to the Child Support Amendment Bill proposing:
 - 2.1 the repeal of child support incremental penalties, and
 - 2.2 the simplification of the penalty write-off rules in the Child Support Act.
3. In lieu of a regulatory impact analysis (RIA), attached to this report is a supplementary analysis report (SAR) for your information. The SAR will be released with the SOP to improve transparency and understanding of the policy as the amendments go through the legislative process. A RIA is not provided as the temporary suspension of the RIA for COVID-19 policy responses applies to this initiative.

Background

4. The Child Support Amendment Bill was introduced in March 2020 and is currently being considered by the Social Services and Community Committee. The proposal to repeal child support incremental penalties was not included in the Bill due to the fiscal cost of repealing incremental penalties.
5. Cabinet has now approved the repeal of incremental penalties as part of the COVID-19 Response and Recovery Fund Foundation Package (CAB-20-MIN-0219.2 refers).
6. The proposal not to charge incremental penalties also allows for the penalty write-off provisions to be significantly simplified, and these two proposals can be progressed in tandem.
7. You have previously agreed that the child support penalty write-off rules should be simplified to allow for the write-off of penalties when:
 - 7.1 there was a reasonable cause for the late payment;
 - 7.2 the late payment was due to the failure of another person to make a deduction;
 - 7.3 the late payment was due to an honest mistake by the liable parent;
 - 7.4 an error was made by Inland Revenue;
 - 7.5 a person is in serious hardship; or

- 7.6 it is an inefficient use of Inland Revenue's resources to collect the penalty (IR2019/240 and IR2019/334 refer).
8. Further, you have also previously agreed that to ensure parents who are charged penalties on or before 31 March 2021 are not worse off under the new rules, a "fair and reasonable" penalty write-off provision would be retained that would only be used to write off penalties charged on or before 31 March 2021.
 9. The proposed application date for the repeal of incremental penalties and the consequential simplification of the penalty write-off rules should be 1 April 2021, which aligns with the application date for the other penalty proposals in the Child Support Amendment Bill.
 10. The Cabinet Social Wellbeing Committee authorised you to approve minor technical changes (SWC-19-MIN-0110 refers). Officials consider that this authority extends to approving the inclusion of the simplification of the write-off provisions together with the repeal of child support incremental penalties in the SOP to the Child Support Amendment Bill as it is in large part consequential to the repeal.

Approval for an additional amendment

11. You have previously agreed that the child support penalty write-off rules should be simplified to allow for the write-off of penalties when a parent carer has uplifted the debt¹ and a write-off would be fair and reasonable. We recommend that this also apply when a non-parent carer has waived the right to the payment to which the penalty relates, and a write-off would be fair and reasonable. This is consistent with the current write-off provisions.

Example

Rhea is a non-parent carer who provides full time care for her granddaughter Athena. Both of Athena's parents are liable to pay child support for her. Athena's mother, Mere, negotiates a private arrangement with Rhea.

Rhea then seeks a payment waiver so that Mere will no longer be liable to pay child support through Inland Revenue. The waiver applies to the full amount of unpaid child support due to Rhea from Mere, whether future amounts or debt. A waiver can only apply to one parent, and Athena's father is still liable to pay child support.

Six months earlier, Mere had been between jobs and unable to pay her child support for two months. Because of the waiver, Mere is no longer required to pay the child support amounts for these two months. The penalties charged on these amounts remain. However, Mere is eligible to have the penalties written off because of the waiver, if it would be "fair and reasonable".

Timing

12. We recommend that the SOP be introduced on the same day that Cabinet approves it for introduction. This will allow the most time for the Social Services and Community Committee to consider the SOP. To achieve same day introduction,

¹ Uplifting debt means that a payee agrees that Inland Revenue does not pursue a debt. In these cases, the debt becomes directly payable to the receiving carer rather than being paid via Inland Revenue.

support party and caucus consultation will need to occur in advance of Cabinet's final decision.

Consultation

13. The Treasury was informed of this report.

Next steps

14. Officials recommend that you refer the attached Cabinet paper *Child Support Amendment Bill: Approval for release of Supplementary Order Paper* (with any changes that you wish to make to it) to the Cabinet Office by 10 am, Thursday 18 June 2020 so that it may be considered by the Cabinet Legislation Committee at its meeting on Tuesday 23 June 2020.
15. Officials recommend that the attached Cabinet paper be proactively released in full after it has been considered by Cabinet.

Recommended action

We recommend that you:

16. **note** the contents of this report and attached Cabinet paper.
Noted
17. **agree** to progress the repeal of child support incremental penalties and simplification of the child support incremental penalty write-off rules.
Agreed/Not agreed
18. **agree** that the repeal of child support incremental penalties and the simplification of the write-off rules be included in a Supplementary Order Paper to the Child Support Amendment Bill.
Agreed/Not agreed
19. **agree** that the proposed write-off provisions also allow penalties to be written off in relation to debts which the receiving carer has uplifted or has waived their right to payment, and where a write-off would be fair and reasonable.
Agreed/Not agreed
20. **authorise** the lodgement of the attached Cabinet paper (subject to your changes) with the Cabinet Office by 10 am, Thursday 18 June 2020 for the Cabinet Legislation Committee to consider at its meeting on Tuesday 23 June 2020.
Authorised/Not authorised

s 9(2)(a)

Samantha Aldridge
Principal Policy Advisor
Policy and Strategy

Hon Stuart Nash
Minister of Revenue
/ /2020

Sensitive - Budget

Office of the Minister of Revenue

Chair, Cabinet Legislation Committee

CHILD SUPPORT AMENDMENT BILL: APPROVAL FOR RELEASE OF SUPPLEMENTARY ORDER PAPER

Proposal

1. I seek the Cabinet Legislation Committee's agreement to release a Supplementary Order Paper (the SOP) to the Child Support Amendment Bill (the Bill) which amends the Child Support Act 1991.

Policy

2. The Bill was introduced in March 2020 and is currently being considered by the Social Services and Community Committee. The proposals in the SOP were developed alongside the proposals in the Bill but have been progressed separately as funding was required.
3. As part of its five-year Business Transformation (BT) programme, Inland Revenue is modernising its systems and processed to be more flexible and customer-focused. This includes modernising Inland Revenue's functions in collecting and disbursing child support. Almost all areas that are administered by Inland Revenue (including income tax, GST and Working for Families) have already migrated.
4. The administration of child support is the final major area of Inland Revenue that will migrate to the new computer system and processes. Migration is scheduled for the start of the child support year in April 2021 (as BT Release 5).
5. The SOP is necessary because amendments to existing legislation are required to implement the proposed policy changes. The policy changes are listed below:

Policy items with Cabinet approval (CAB-20-MIN-0219.2)

6. Repeal of the child support incremental penalty rules.

Items not requiring Cabinet approval

7. Cabinet has authorised me to approve minor technical changes for inclusion in the Bill (SWC-19-MIN-0110, CAB-19-MIN-0447). I ask Cabinet to note that I have approved:
 - 7.1 the simplification of the child support penalty write-off rules to allow for write-off of child support penalties when:

- 7.1.1 there was a reasonable cause for the late payment;
- 7.1.2 the late payment was due to the failure of another person to make a deduction;
- 7.1.3 the late payment was due to an honest mistake by the liable parent;
- 7.1.4 an error was made by Inland Revenue;
- 7.1.5 a person is in serious hardship;
- 7.1.6 it is an inefficient use of Inland Revenue's resources to collect the penalty;
- 7.1.7 the receiving carer has waived the right to the payment, or uplifted¹ the debt to which the penalty relates, and a write-off would be fair and reasonable; or
- 7.1.8 the penalties were charged on or before 31 March 2021 and it is "fair and reasonable" that the penalty be written off.

Impact analysis

- 8. A regulatory impact assessment was not required due to the temporary suspension of RIA requirements for COVID-19 policy responses. However, a supplementary analysis report has been produced to improve transparency and understanding of the policy as the amendments go through the legislative process.

Compliance

- 9. The SOP complies with:
 - 9.1 the principles of the Treaty of Waitangi;
 - 9.2 the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993;
 - 9.3 the disclosure statement requirements;
 - 9.4 the principles and guidelines set out in the Privacy Act 1993;
 - 9.5 relevant international standards and obligations; and
 - 9.6 the *Legislation Guidelines* (2018 edition), which are maintained by the Legislation Design and Advisory Committee.

¹ In these cases, the debt becomes directly payable to the receiving carer rather than being paid via Inland Revenue.

Consultation

Relevant government departments or other public bodies

10. As part of the Cabinet paper *Business Transformation — Amendments to the Child Support Act 1991*, officials consulted with the Treasury, Ministry of Social Development, Oranga Tamariki — Ministry for Children (as Inland Revenue collects child support for beneficiaries and wards of the State), the Ministry of Justice, and the Department of Prime Minister and Cabinet (Child Poverty Unit). These agencies were consulted on all the proposals relating to debt and penalties in that paper, and generally agreed with the proposals.

Relevant private sector organisations and public consultation processes

11. Although it did not canvass this specific proposal, the 2017 discussion document *Making Tax Simpler: Better administration of social policy* (the discussion document) explored proposals for not penalising people who are trying to comply, and better support early intervention to prevent debt. The discussion document was subject to wider consultation.
12. The discussion document canvassed proposals relating to Working for Families and student loans as well as child support. It generated 37 email submissions, 183 comments on online forums, 374 responses to the surveys and one response to the foreign language surveys. Inland Revenue officials held 17 face-to-face meetings with stakeholders.
13. Submitters generally supported the proposals in the discussion document.

Binding on the Crown

14. The Child Support Act 1991 is binding on the Crown. The amendments will follow the position of the principal Act.

Creating new agencies or amending law relating to existing agencies

15. The legislation will not create a new agency.
16. The legislation will not amend the existing coverage of the Ombudsman Act 1975, the Official Information Act 1982, or the Local Government Official Information and Meetings Act 1987.

Allocation of decision making powers

17. The draft legislation does not involve the allocation of decision-making powers between the executive, the courts, and tribunals.

Other instruments

18. The SOP does not include any provision empowering the making of other instruments that are deemed to be legislative or disallowable instruments.

Definition of Minister/Department

19. The SOP does not contain a definition of Minister, department, or chief executive.

Commencement of legislation

20. Each provision of the SOP comes into force on 1 April 2021. There will be appropriate transition provisions relating to penalties imposed before 1 April 2021.

Parliamentary stages

21. The Bill was introduced in March 2020 and has been referred to the Social Services and Community Committee
22. I recommend that the SOP be released as soon as possible and referred to the Social Services and Community Committee.

Publicity

23. Inland Revenue will publish a supplementary commentary to the Bill to provide more information on this topic. If enacted, Inland Revenue will include details of the new legislation in a *Tax Information Bulletin*.

Proactive release

24. I propose that proactive release of this Cabinet paper, associated minutes, and key advice papers occur once the SOP is released.

Recommendations

I recommend that the Cabinet Legislation Committee:

1. **note** that the SOP makes substantive, remedial, and technical amendments to the Child Support Act 1991;
2. **note** that the I have approved the following minor or technical changes under delegated Cabinet authority:
 - 2.1 the simplification of the child support penalty write-off rules to allow for write-off of child support penalties when:
 - 2.1.1 there was a reasonable cause for the late payment;
 - 2.1.2 the late payment was due to the failure of another person to make a deduction;
 - 2.1.3 the late payment was due to an honest mistake by the liable parent;
 - 2.1.4 an error was made by Inland Revenue;
 - 2.1.5 a person is in serious hardship;

- 2.1.6 it is an inefficient use of Inland Revenue's resources to collect the penalty;
 - 2.1.7 the receiving carer has uplifted the debt, or waived the right to the payment, to which the penalty relates and a write-off would be fair and reasonable; or
 - 2.1.8 the penalties were charged on or before 31 March 2021 and it is "fair and reasonable" that the penalty be written off.
3. **approve** the release of the Supplementary Order Paper to the Child Support Amendment Bill.

Authorised for lodgement

Hon Stuart Nash
Minister of Revenue

Coversheet: Supplementary Analysis Report — Repeal of child support incremental penalties and simplification of penalty write-off rules

Summary: Problem and Proposed Approach

Problem Definition

What problem or opportunity does this proposal seek to address? Why is Government intervention required?

A key aim of the child support scheme is to support liable parents to meet their child support obligations. To encourage compliance with the scheme, late payment penalties are charged on overdue child support payments.¹ Two types of penalties are applied:

- initial penalties, which are applied in two stages:
 - the greater of 2% of the outstanding amount or \$5 the day after the due date; and
 - a subsequent 8% of the outstanding amount eight days after the due date.
- incremental penalties, which are applied at:
 - 2% of the outstanding amount including penalties from one month after the due date for the next 12 months; and
 - 1% of the outstanding amount including penalties each month from 13 months after the due date.

This Supplementary Analysis Report (SAR) covers three areas where the repeal of incremental penalties offers benefits for both child support customers and Inland Revenue. The proposal offers the benefits of:

- improving liable parent compliance and engagement with the scheme;
- creating simplification opportunities for Business Transformation (BT) Release 5, particularly by enabling simplification of the child support penalty write-off rules; and
- alleviating pressure on Inland Revenue to deliver policy responses to COVID-19 by reducing transactions and customer contacts.

Incremental penalties do not support liable parents to meet their obligations

Research² undertaken by Inland Revenue shows that many customers feel that the current penalty rules are overly punitive and complex. Because incremental penalties compound and create further debt for liable parents, it can lead to them disengaging with the scheme and their debt spiralling. Inland Revenue considers that the policy of charging incremental penalties does not support liable parents to meet their obligations. Inland Revenue considers

¹ Under the Child Support Act, Inland Revenue administers payments of financial support – that is, both child support and domestic maintenance. Domestic maintenance refers to payments made by a person to a former partner under both Court Orders registered in the New Zealand Family Courts and voluntary agreements. Throughout this document the term “child support” is used to refer to financial support for readability purposes.

² *Changing Penalties to Incentivise Child Support Payment*, 2019. The research consisted of 27 one-on-one interviews around the country. The interviewees were a mix of liable parents and receiving carers, and a mix of levels of income including beneficiaries.

that other approaches - including measures to “get it right from the start” - will be more effective.

As at January 2019, the child support debt was \$2.2 billion, of which \$558 million was unpaid child support and \$1.6 billion was penalties. Currently, most penalties can be written off – for example, if the person complies with a payment arrangement for 26 weeks. In the child support year 1 April 2018-31 March 2019, Inland Revenue wrote off \$244 million in child support penalties. This is down from the \$594 million written off in the 2017-2018 child support year, but will increase again in 2020 and 2021 as we focus more on resolving historical debt cases to minimise the impacts of converting data to go into our new system, START. The recovery of debt is challenging and currently 97 percent of child support penalty debt is written down at initial recognition as we do not expect to collect the debt.

Repealing incremental penalties is a key simplification opportunity for Business Transformation Release 5

As part of Inland Revenue’s Business Transformation (BT) programme to modernise the tax system, the child support scheme will move to new systems and processes in 2021 (Release 5). Alongside this process, the Child Support Amendment Bill has been introduced containing proposals to take advantage of the opportunity created by BT to improve and simplify the administration of the child support scheme. The current proposal was developed alongside the proposals in the Child Support Amendment Bill but has been progressed separately as it requires funding; it should be considered alongside the proposals in the Bill.³

As a consequence of repealing incremental penalties, the child support penalty write-off rules can be considerably simplified. The current rules are highly complex, both for customers to understand and Inland Revenue to administer.

The complexity of these rules is reflected in that the incremental penalty and write-off rules are some of the most complex code in Inland Revenue’s FIRST IT system (in which child support is currently administered). With no change, moving child support to Inland Revenue’s new IT system (START) will require us to write and configure bespoke code. This increases the cost and risk profile of Release 5, with increased build and testing effort. In the long run, having bespoke configuration will increase the ongoing administrative cost as Inland Revenue must undertake additional work each time a version upgrade to the system is implemented.

Repealing incremental penalties would simplify the penalty and write-off rules and reduce the complexity they present for the BT Release 5 IT build.

Repealing incremental penalties will reduce transactions and allow Inland Revenue to focus on implementing COVID-19 policy responses

With the advent of COVID-19, the repeal of incremental penalties has been reprioritised along the COVID-19 funding track as it will allow Inland Revenue to focus on implementing other COVID-19 policy responses.

³ Regulatory Impact Assessment for the proposals in the Child Support Amendment Bill:
<http://taxpolicy.ird.govt.nz/sites/default/files/2020-ria-child-support.pdf>

The proposal will do so by reducing the high volume of transactions created for Inland Revenue by the current penalty rules. In the 12-month period to 31 December 2019, 41 million penalty or penalty write-off transactions were applied to the accounts of about 105,000 liable parents with child support debt – an average of 390 transactions per customer per annum. Inland Revenue estimates that we manage around 62,000 customer contacts per annum in relation to child support penalty write offs. As noted above, most penalties are written off.

Repealing incremental penalties would eliminate these transactions and reduce customer contacts. This would alleviate pressure on Inland Revenue to deliver the COVID-19 policy responses which have been agreed to.

Summary of Preferred Option or Conclusion (if no preferred option)

**How will the agency's preferred approach work to bring about the desired change?
Why is this the preferred option? Why is it feasible?**

The preferred option is to repeal incremental penalties from the child support scheme and simplify the write-off rules, alongside other measures in the Child Support Amendment Bill. This is the preferred option because it offers the greatest simplicity, and is the option which will maximise the benefits for customers and Inland Revenue.

Section B: Summary Impacts: Benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?

The parents, carers and children in the scheme are expected to benefit from the proposed change

As at March 2020 the child support customer base was made up of:

- 163,429 liable parents (including 29,067 with debt only);
- 135,617 receiving carers; and
- 182,233 children.

The proposal will make the penalty rules simpler and less punitive, and is therefore expected to improve compliance.

In theory, a benefit to imposing incremental penalties is that it may (even if they are written-off) encourage liable parents to contact Inland Revenue, and Inland Revenue can then help them comply in their circumstances. However, because child support is due each month, if a person is late paying month-after-month there already opportunities to engage with the person when initial penalties are imposed. Therefore, in this respect, no benefits are offered by charging incremental benefits.

Although penalties are intended to discourage non-compliance, research⁴ undertaken by Inland Revenue suggests that they can have the opposite effect. This is because incremental penalties compound causing debt to grow continuously, often resulting in customers

⁴ *Changing Penalties to Incentivise Child Support Payment*, 2019.

disengaging with the scheme. In many cases, the amount of the penalties owed is significantly larger than the unpaid child support. Improved compliance would benefit all those in the scheme; liable parents would be penalised less, and receiving carers could have more certainty and timeliness in receiving payments, which contributes to the welfare of their children.

Inland Revenue would also benefit from the proposed change

Inland Revenue would also benefit from the repeal of incremental penalties as a major simplification measure to support the implementation of child support in BT Release 5.

Implementing the current incremental penalty and write-off rules in the new system presents great complexity for, and therefore greater cost and risk profile to, BT release 5 when compared to the option of repealing incremental penalties and simplifying the write-off rules.

Further, the number of transactions on customers' accounts and customer contacts resulting from penalties represent considerable administrative resources for Inland Revenue. Repealing incremental penalties would reduce transactions for Inland Revenue and alleviate the pressure on Inland Revenue to deliver the COVID-19 responses that have been committed to.

In the long-term, the preferred option would enable version upgrades to the new system to be implemented with less work, and therefore less cost.

Where do the costs fall?

Repealing incremental penalties has a fiscal cost to the Government of \$2m per annum. Simplification of the write-off rules has no fiscal cost.

What are the likely risks and unintended impacts? how significant are they and how will they be minimised or mitigated?

Some liable parents may not respond as expected to the repeal of incremental penalties and levels of compliance could reduce. We do not think this is likely.

If our expectations are incorrect, this can be mitigated by use of customer education, existing enforcement provisions and improved information made available through Inland Revenue's BT programme. Initial penalties will still be charged. These will continue to discourage non-compliance and provide Inland Revenue an opportunity to contact the liable parent to get them back on track.

Certain proposals in the Child Support Amendment Bill, which is also intended to support BT release 5, are intended to improve compliance (for example, the proposed compulsory deductions of child support from payments made by employers to newly liable parents). These proposals would further mitigate any reduction in compliance due to the removal of incremental penalties.

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?

Inland Revenue has a medium–high level of confidence in the evidence base.

The key uncertainty is the impact of repealing incremental penalties on customer behaviour, which cannot easily be modelled. However, literature suggests that measures designed and perceived to be fairer are more likely to lead to better compliance outcomes. Research conducted by Inland Revenue with child support liable parents and receiving carers⁵ indicated that penalties had a role to play in encouraging compliance but that the overly punitive nature of the current penalties and the complexity of the penalty rules acted as a barrier to compliance.

Inland Revenue collects data relating to numbers of liable parents, compliance levels, debt and penalties imposed. This data has been used to estimate the potential direct impacts of removing incremental penalties. Some of the administrative data is manually input and therefore subject to errors. However, their impact should be minor and would not change the “dollar” value of the impacts.

To be completed by quality assurers:

Quality Assurance Reviewing Agency:

Inland Revenue

Quality Assurance Assessment:

The Quality Assurance reviewer at Inland Revenue has reviewed the *Repeal of child support incremental penalties* Supplementary Analysis Report prepared by Inland Revenue, and considers that the information and analysis summarised in the Supplementary Analysis Report meets the quality assurance criteria.

Reviewer Comments and Recommendations:

The reviewer’s comments on earlier versions of the Supplementary Analysis Report have been incorporated into the final version. Although this Supplementary Analysis Report will not be presented to Cabinet it has still been reviewed consistent with the quality assurance framework.

⁵ *Changing Penalties to Incentivise Child Support Payment*, 2019.

Impact Statement: Repeal of incremental penalties

Section 1: General information

1.1 Purpose

Inland Revenue is solely responsible for the analysis and advice set out in this Supplementary Analysis Report (SAR), except as otherwise explicitly indicated.

The purpose of this report is to explain the policy rationale and development behind the repeal of incremental penalties and simplification of the write-off provisions as a Regulatory Impact Analysis (RIA) was not required for these proposals. This was because the repeal of incremental penalties was subject to the temporary suspension of RIA requirements for direct COVID-19 responses, and the simplification of the write-off rules is consequential to that proposal.

Inland Revenue has produced this report to improve transparency and understanding of the policy as the amendments go through the legislative process; it has not been used to inform Cabinet's final decisions to proceed with a policy change.

1.2 Key Limitations or Constraints on Analysis

The key uncertainty is the impact of repealing incremental penalties on customer behaviour, which cannot easily be modelled. However, research conducted by Inland Revenue with child support liable parents and receiving carers⁶ indicated that the overly punitive nature of the current penalties and the complexity of the penalty rules acted as a barrier to compliance.

1.3 Responsible Manager (signature and date):



Carolyn Elliott
Policy Lead
Policy and Strategy
Inland Revenue

4 June 2020

⁶ *Changing Penalties to Incentivise Child Support Payment*, 2019.

Section 2: Problem definition and objectives

2.1 What is the current state within which action is proposed?

Inland Revenue's multi-year business transformation (BT) programme is modernising the administration of 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. Child support is part of BT release 5, which provides an opportunity to review how the revenue system is administered and consider what changes may be needed.

The Government is also concerned with improving the welfare of children and minimising the impact of government agency debt on New Zealanders.

Further to these, the Child Support Amendment Bill (the Bill) is currently part way through its first reading. The proposed repeal of incremental penalties relates to the proposals in the Bill aimed at improving compliance; however, the repeal is being progressed separately as it requires funding. Unlike the proposals in the Bill, the repeal of incremental penalties can be implemented in Inland Revenue's current IT system, and its benefits can be realised sooner. Consequently, it is intended for it to be progressed in a different legislative vehicle.

The child support scheme and penalties

The child support scheme works to ensure that children are appropriately supported by both their parents even when they are not living together as a family. Inland Revenue assesses, collects and disburses payments. As part of the assessment process Inland Revenue will identify the liable parent (the parent responsible for making the child support payment) and the receiving carer (the parent (or other carer) entitled to receive the child support payment).

Most liable parents do, or are willing to, comply with their child support obligations, but at times may have trouble meeting their payments. For example, 70 percent of payments are made on time; 81.5 percent of child support payments assessed in a year are paid within that year (which increases to 85 percent if only considering child support payable by parents living in New Zealand). Although some payments are late, it illustrates liable parents are generally trying to comply.

However, when a liable parent does not pay or pay on time they are charged initial late payment penalties and continue to be charged incremental penalties each month until they pay or come to an arrangement to pay the outstanding amount. The financial burden when a liable parent does not pay falls on the receiving carers and their children.

As at January 2019, child support debt was \$2.2 billion, of which \$558 million was core child support debt and \$1.6 billion was penalties. Currently, most penalties can be written off – for example, if the person complies with a payment arrangement for 26 weeks. In the child support year 1 April 2018-31 March 2019, Inland Revenue wrote off \$244 million in child support penalties. This is down from the \$594 million written off in the 2017-2018 child support year, but will increase again in 2020 and 2021 as we focus more on resolving historical debt cases to minimise the impacts of converting data to go into our new system, START. The recovery of debt is challenging and currently 97 percent of child support

penalty debt is written down at initial recognition as Inland Revenue does not expect to collect the debt.

In the 12-month period to 31 December 2019, 41 million penalty or penalty write-off transactions were applied to the accounts of about 105,000 liable parents with child support debt - an average of 390 transactions per customer per annum. Inland Revenue estimates that we manage around 62,000 customer contacts per annum in relation to child support penalty write offs. Incremental penalties are mostly written-off.

Changes introduced to penalties and write-offs in 2015 have slowed the growth of child support debt but primarily through write-offs and reducing penalty charges rather than addressing debt prevention. Write-offs have been successful as an incentive to get some parents to re-engage with the scheme but are not effective at preventing debt.

Some liable parents are concerned that the rules do not encourage them to comply with their child support payments and at times could promote non-compliance. This is because the rules are complex. Receiving carers are most concerned about the non-payment of child support as it impacts on their ability to support their children.

2.2 What regulatory system(s) are already in place?

Child Support Act 1991

The New Zealand administrative child support scheme has been in place since July 1992.

The key feature of the regulatory system is to assess, collect and disburse child support in accordance with the Child Support Act 1991. The key objective of child support is to ensure that children are appropriately supported by both their parents even when they are not living together as a family.

Any parent or carer can make an application for a child support assessment. Using a formula that is legislated for under the Act, Inland Revenue assesses which parent is liable for a child support payment (the liable parent) and which parent will receive child support payments (the receiving carer), and the amount to be paid by the liable parent. This formula includes components such as the income of each parent, the age of the child, and how much care of the child each parent does.

Changes were made in the child support reforms (effective 1 April 2015) to modernise the scheme and improve fairness, primarily through changes to the formula assessment and by assessing the income and other circumstances of both parents (rather than just the liable parent).

Once Inland Revenue has determined who the liable parent is, the liable parent must make the child support payment to Inland Revenue. Child support payments are due to Inland Revenue monthly. Inland Revenue then passes the payment on to the receiving parent.

When payments are not made, or not made on time, the financial burden generally falls on carers and their children.⁷ Penalties and other tools (such as contact by Inland Revenue and compulsory deductions for defaulting liable parents) are used by Inland Revenue to encourage compliance.

Initial late payment penalties apply if a payment is not paid on time. In addition to the initial late payment penalties, for each subsequent month that the child support remains outstanding (with no repayment arrangement in place), compounding incremental penalties are also applied (initially at 2 percent, but reduced to 1 percent after 12 months).

International agreements

There is a reciprocal agreement with Australia which allows for the enforcement of payments when a liable parent moves to Australia or a parent liable under the Australian child support scheme moves to New Zealand. Further, the Family Proceeding Act 1980 details the rules for recognition of overseas maintenance orders made in Commonwealth countries as well as countries that are parties to the United Nations Convention on the Recovery Abroad of Maintenance (UNCRAM). Finally, New Zealand signed the Hague Convention on the International Recovery of Child Support and other forms of Domestic Maintenance on 27 November 2019. Generally, a child support assessment is raised under the jurisdiction of the country in which the receiving carer resides; when Inland Revenue administers the child support assessment, initial and incremental penalties are applied to overdue payments.

Why is Government regulation preferable?

Government regulation in the form of the Child Support Act is preferable because parents may not be able to come to agreement between themselves regarding the support of their children.

Because the existing penalty rules are imposed by legislation, they require legislation to be repealed.

2.3 What is the policy problem or opportunity?

On balance, the New Zealand child support scheme has been very successful in collecting assessed child support debt. Since the scheme's introduction in 1992, Inland Revenue has collected 89 percent of all the child support payments assessed by Inland Revenue. This rate compares very favourably internationally.

However, the child support debt remains substantial. The table below illustrates the value of overall child support debt and the proportion made up of penalties:

⁷ If the receiving carer is a sole parent beneficiary or in receipt of an Unsupported Child's Benefit, their child support is retained by the Crown to offset the cost of their benefit. Therefore, in these cases the impact is on Government revenue.

	Mar 16	Sept 16	Mar 17	Sept 17	Mar 18	Sept 18	Mar 19
Assessment debt	\$651m	\$633m	\$621m	\$596m	\$579m	\$562m	\$558m
Penalty debt	\$2.67b	\$2.59b	\$2.48b	\$2.03b	\$1.80b	\$1.65b	\$1.66b
Penalties as % of debt	80%	80%	80%	77%	76%	75%	75%
Total debt	\$3.3b	\$3.2b	\$3.1b	\$2.6b	\$2.4b	\$2.2b	\$2.2b

Further, the current penalty rules are perceived to be overly harsh. The imposition of penalties means that some people stop interacting with Inland Revenue and do nothing, resulting in spiralling debt and further disengagement.

Finally, the current penalty and write-off rules present considerable complexity for the move of child support to the new system. The system load of the high volume of transactions (41 million per annum) created on customers' accounts currently caused by, and the high number of customer contacts (around 62,000 per annum), regarding penalties and write-offs, represent considerable administrative resource for Inland Revenue.

2.4 What do stakeholders think about the problem?

The main stakeholders are parents and carers who are in the child support scheme.

Inland Revenue has undertaken research to determine what interventions would encourage customers to comply with their child support obligations and why currently compliant customers comply.⁸ The options canvassed ranged from removing all penalties through to removing incremental penalties and changes to initial penalties.

This research showed that customers felt that penalties are necessary to encourage compliance. There were concerns that if no penalties were applied when child support is not paid on time, people would stop complying – that is, penalties are needed as an incentive to keep child support “top of mind”. However, customers felt that Inland Revenue was too quick to penalise customers and the penalties imposed are too high. Many customers did not understand the rules and therefore did not understand how to “fix things”. Customers felt that the rules need to provide “clarity, flexibility and the perception that Inland Revenue is working with customers.”

The discussion document *Making Tax Simpler: Better administration of social policy* was released in July 2017, and contained proposed approaches to social policy debt management that included no longer charging penalties and interest in certain situations and supported an early intervention approach aimed at debt prevention. However, it did not canvass the specific proposal to repeal incremental penalties put forward here. Submitters broadly agreed with the proposals, and supported Inland Revenue working proactively with customers to manage debt.

⁸ *Changing Penalties to Incentivise Child Support Payment, 2019.*

2.5 What are the objectives sought in relation to the identified problem?

The key objectives are to encourage engagement and compliance with the scheme, simplify the rules, and make them fairer. And further, to realise fully the benefits made available by the opportunity offered in the move of the child support scheme to Inland Revenue's new system as part of BT release 5.

Section 3: Option identification

3.1 What options are available to address the problem?

Option 1: Maintain the status quo with some operational improvements offered by BT Release 5 including better education, improved statements and better online content.

Option 2: Charge no incremental penalties.

This option would help prevent debt increasing to levels which cause customers not to engage with Inland Revenue on managing that debt as they feel it is unmanageable. It would also slow the growth of the debt book. Further, it would allow for simplification of the write-off rules.

Initial penalties would still be charged, and would continue to discourage non-compliance and provide Inland Revenue an opportunity to contact the liable parent to get them back on track.

Option 3: Charge neither initial nor incremental penalties.

This option would slow the escalation of the debt book due to the accumulation of penalty growth but could increase the value of assessment debt. It would also mean no penalty or write-off rules would need to be built for the new system. It could mean some liable parents stop paying altogether.

Research⁹ conducted showed penalties do play a part in incentivising compliance by keeping child support "front of mind". Charging no penalties may reduce compliance with the scheme.

Option 3: Lowering the rate at which incremental penalties are charged.

This option would slow the escalation of the debt book, but is unlikely to have much impact on preventing debt in the first instance and improving compliance behaviours and would have no impact on simplifying the write-off rules.

Option 4: Do not apply penalties by default and start applying penalties if the customer falls into arrears more than a certain number of times per year.

This option may slow the escalation of the debt book, however it could encourage occasional non-compliance as liable parents would have a certain number of instances

⁹ *Changing Penalties to Incentivise Child Support Payment*, 2019.

they could default without being penalised. As such, it may reduce compliance and have a negative impact on receiving carers. Further, it would have no impact on simplifying the write-off rules.

3.2 What criteria, in addition to monetary costs and benefits have been used to assess the likely impacts of the options under consideration?

The following criteria have been used to assess the likely impact of the options under consideration:

Simpler for customers – the option should make the rules simpler for customers to understand.

Impact on compliance – the option should have a positive impact on compliance with the child support scheme and incentivise timely payment.

Administration costs – the option should result in simpler penalty and write-off rules which will be easier to build for the Inland Revenue's new system.

Effectiveness – the option should lead to a reduction in the child support debt.

The balance between having penalties to incentivise timely payment and not having overly punitive rules presents a trade-off. While research does suggest that overly punitive penalty rules discourage compliance and engagement with the scheme, too lenient rules could reduce compliance with the scheme.

While simplification of the penalty and write-off rules presents significant benefits for BT release 5, and to slow the escalation of the debt book, this is secondary to the primary purpose of having penalties: to encourage compliance with the scheme.

3.3 What other options have been ruled out of scope, or not considered, and why?

Several other changes to the penalty rules canvassed in the research document *Changing Penalties to Incentivise Child Support Payment* and the discussion document *Making Tax Simpler: Better administration of social policy* are being progressed separately in the Child Support Amendment Bill. This is because they did not require funding, whereas the proposal to repeal incremental penalties does. Simplification of the write-off rules was also not progressed alongside the proposals in the Child Support Amendment Bill because it is consequential to, and dependent on, the repeal of incremental penalties.

Section 4: Impact Analysis

Marginal impact: How does each of the options identified in section 3.1 compare with taking no action under each of the criteria set out in section 3.2?

	Status quo	Repeal incremental penalties	Repeal all penalties	Apply incremental penalties at a lower rate	Allowing a number of defaults before penalties are applied
Simpler for customers	0	++ This approach would greatly reduce the complexity of the existing penalty rules for customers as they will only need to understand one set of penalty rules (initial penalties).	+ Mechanically, this approach would be easier for customers to understand, however carers could struggle to see the rationale for not penalising non-compliance.	0 Customers would still need to understand the underlying rules, just at different penalty rates.	- Customers would need to understand the same rules, with increased complexity in knowing when penalties will be applied.
Impact on compliance	0	+ Repeal of incremental penalties is expected to improve compliance. However, it is possible that it could remove a further incentive for some parents to comply.	-- Penalties play an important role in incentivising timely payment and keeping child support top of mind.	0 Inland Revenue research ¹⁰ notes that child support customers find it hard to quantify percentages and prefer thinking in dollar figures; the difference between (for instance) 2 percent and 1 percent might not be meaningful enough to customers to change their attitudes.	- This approach could decrease compliance as liable parents would have a certain number of times when they could default without being penalised.
Simpler for R5 IT build	0	++ This approach would mean that the current, complex incremental penalty rules will not need to be built for the new system, and will enable simplification of the write-off rules.	++ This approach would mean that no penalty or write-off rules would need to be built for the new system.	0 Largely similar penalty and write-off rules would need to be built for child support in the new system.	- The current penalty and write-off rules would need to be built for the new system, as well as additional rules to know when to apply penalties.
Reduction in child support debt	0	++ This approach would have a significant impact on penalty debt as the amount of penalties charged would be greatly reduced. The expected positive impact on compliance would also help lessen overdue child support payments.	++ This approach would greatly slow the growth of penalty debt as no new penalties would be charged. However, the likely negative impact on compliance would likely increase the amount of unpaid child support.	+ Because incremental penalties would be applied at lower rates, the amount of penalties charged would be less.	0 Although fewer penalties would be applied at first, the likelihood that this approach could encourage occasional non-compliance would lessen the impact of that.
Overall assessment	This option would be unlikely to deliver significant improvements on current state.	This option is able to realise the benefits of simpler penalty and write-off rules for both customers and Inland Revenue, while also likely having a positive impact on compliance.	The likely negative impact on compliance by removing all penalties outweighs any benefits of this proposal.	This option would slow the escalation of the debt book, but is unlikely to have much impact on preventing debt in the first instance and improving compliance behaviours. Further, it would not address the concerns of simplicity for customers and BT release 5.	This option would add complexity to the current rules, while not offering improvements to compliance.

Key:

++ much better than doing nothing/the status quo

+ better than doing nothing/the status quo

0 about the same as doing nothing/the status quo

- worse than doing nothing/the status quo

-- much worse than doing nothing/the status quo

¹⁰ *Changing Penalties to Incentivise Child Support Payment*, 2019, pg 13: "It's a common theme that customers found it hard to quantify percentages. They prefer to work with dollar figures."

Section 5: Conclusions

5.1 What option, or combination of options is likely to best address the problem, meet the policy objectives and deliver the highest net benefits?

On the basis of the above analysis, the preferred option is to repeal incremental penalties from the child support scheme (Option 2). This option is best able to meet policy objectives and deliver the highest net benefits. That is, the benefits of simpler penalty rules for both customers and Inland Revenue, particularly in allowing for simpler write-off rules, and improvements in compliance with the scheme.

Inland Revenue has high confidence that the rules will be simpler for customers to understand, and for child support to be implemented in the new system, if incremental penalties are repealed. Research suggests that removing incremental penalties will improve compliance.¹¹

Research undertaken by Inland Revenue shows that customers felt that penalties are necessary to encourage compliance.¹² There were concerns that if no penalties were applied when child support is not paid on time, people would stop complying – that is, penalties are needed as an incentive to keep child support “top of mind”. However, customers felt that Inland Revenue was too quick to penalise customers and the penalties imposed are too high. Many customers did not understand the rules and therefore did not understand how to “fix things”. Customers felt that the rules need to provide “clarity, flexibility and the perception that Inland Revenue is working with customers.”

The proposal to repeal incremental penalties was mentioned at a high level in the Regulatory Impact Assessment for proposals in the Child Support Amendment Bill.¹³

5.2 Summary table of costs and benefits of the preferred approach

Affected parties	Comment:	Impact	Evidence certainty
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Additional costs of proposed approach compared to taking no action

Regulated parties	Liabe parents	None	High
(Receiving carers and liable parents)	Receiving carers	None	High
Regulators (Inland Revenue)	Ongoing – penalties that would have been paid no longer imposed.	\$2m per annum	High
Wider government	None	None	High

¹¹ *Changing Penalties to Incentivise Child Support Payment*, 2019.

¹² *Changing Penalties to Incentivise Child Support Payment*, 2019.

¹³ *Regulatory Impact Assessment: Child Support Business Transformation*, pp 17-8.

Other parties	None	None	High
Total Monetised Cost	Ongoing	\$2m per annum	High
Non-monetised costs	None	None	High

Expected benefits of proposed approach compared to taking no action

Regulated parties (liable parents and receiving carers)	Liable parents – these customers will be subject to rules that are perceived as fairer.	High	High
	Receiving carers – if compliance increases as expected, carers will have more certainty and timeliness in receiving payments, which will improve wellbeing outcomes for their children.	Medium	Medium
Regulators (Inland Revenue)	Simpler penalty and write-off rules will allow for child support to be built more easily for the new system, reduce transactions for Inland Revenue and make it easier to deliver the COVID-19 policy responses that have been committed to.	High	High
Wider government	None	None	High
Other parties	None	None	High
Total Monetised Benefit	None	None	High
Non-monetised benefits	The proposal to repeal incremental penalties will benefit both liable parents and receiving carers with rules that encourage compliance. It will also benefit Inland Revenue by allowing for the write-off rules to be simplified and child support to be built more easily for the new system; and by reducing transactions, making it easier to deliver the COVID-19 policy responses that have been committed to.	High	High

5.3 What other impacts is this approach likely to have?

A potential risk is that liable parents may not respond as expected to the repeal of incremental penalties and levels of compliance could reduce. We do not think this is likely. If our expectations are incorrect, this can be mitigated by use of customer education, existing enforcement provisions and improved information made available through Inland Revenue's BT programme. Initial penalties will still be charged, which will continue to discourage non-compliance and provide Inland Revenue an opportunity to contact the liable parent to get them back on track.

Certain proposals in the Child Support Amendment Bill, which is also intended to support BT release 5, are intended to improve compliance (for example, the proposed compulsory deductions of child support from payments made by employers to newly liable parents). These proposals would further mitigate any reduction in compliance due to the removal of incremental penalties.

Section 6: Implementation and operation

6.1 How will the new arrangements work in practice?

The proposal would require amendment to the Child Support Act 1991. It is intended that the preferred option be included in a Supplementary Order Paper to the Child Support Amendment Bill.

The proposed changes would apply from April 2021, which aligns with the application date for the proposals in the Child Support Amendment Bill and also the go-live date of BT Release 5.

Inland Revenue will be responsible for the operation of these options and they will form part of its business as usual function. Although not the key driver, the preferred option will reduce the implementation risks associated with transferring the child support scheme from the current computer platform to the new systems and processes.

Incremental penalties charged before the application date of the repeal would remain.

6.2 What are the implementation risks?

The implementation will be done by Inland Revenue only. No issues concerning implementation were raised during internal consultation and Inland Revenue considers that repealing incremental penalties will reduce implementation risks for BT Release 5.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

Inland Revenue already monitors timeliness of child support payments, obligations paid on time (including for newly liable parents), amounts collected and dispersed (including amounts collected through employers).

Inland Revenue is currently building a monitoring and evaluation framework for child support. These tools will be used to monitor and evaluate the proposals when they are implemented.

Inland Revenue will monitor the effectiveness of the proposed legislation when implemented. If we identify any evidence that suggests the legislation is not operating as intended, we will consider options for addressing the issues raised.

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.

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

Inland Revenue is currently building a monitoring and evaluation framework for child support. These tools will be used to monitor and evaluate the proposals when they are implemented.



Cabinet Legislation Committee

Minute of Decision

This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.

Child Support Amendment Bill: Supplementary Order Paper

Portfolio **Revenue**

On 30 June 2020, the Cabinet Legislation Committee:

- 1 **noted** that the Supplementary Order Paper (SOP) to the Child Support Amendment Bill (the Bill) makes substantive, remedial, and technical amendments to the Child Support Act 1991;
- 2 **noted** that in August 2019, the Cabinet Social Wellbeing Committee authorised the Minister of Revenue to approve technical changes relating to the decisions for inclusion in the Bill [SWC-19-MIN-0110];
- 3 **noted** that the Minister of Revenue has approved the following minor or technical changes:
 - 3.1 the simplification of the child support penalty write-off rules to allow for write-off of child support penalties when:
 - 3.1.1 there was a reasonable cause for the late payment;
 - 3.1.2 the late payment was due to the failure of another person to make a deduction;
 - 3.1.3 the late payment was due to an honest mistake by the liable parent;
 - 3.1.4 an error was made by Inland Revenue;
 - 3.1.5 a person is in serious hardship;
 - 3.1.6 it is an inefficient use of Inland Revenue's resources to collect the penalty;
 - 3.1.7 the receiving carer has uplifted the debt, or waived the right to the payment, to which the penalty relates and a write-off would be fair and reasonable; or
 - 3.1.8 the penalties were charged on or before 31 March 2021 and it is "fair and reasonable" that the penalty be written off;

4 **approved** the release of the Supplementary Order Paper to the Child Support Amendment Bill [PCO 22406-1/5.0].

Gerrard Carter
Committee Secretary

Present:

Hon Chris Hipkins (Chair)
Hon Andrew Little
Hon David Parker
Hon Stuart Nash
Hon Iain Lees-Galloway
Hon Tracey Martin
Hon Eugenie Sage
Michael Wood MP (Senior Government Whip)

Officials present from:

Office of the Prime Minister
Officials Committee for LEG