

# 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.<sup>1</sup> 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

Research<sup>2</sup> 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

<sup>1</sup> 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.

<sup>2</sup> *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.<sup>3</sup>

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.

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<sup>3</sup> 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, research<sup>4</sup> 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

<sup>4</sup> *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 carers<sup>5</sup> 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.

<sup>5</sup> *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 carers<sup>6</sup> 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

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<sup>6</sup> *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.<sup>7</sup> 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:

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<sup>7</sup> 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  |
|-------------------------------|---------|---------|---------|---------|---------|---------|---------|
| <b>Assessment debt</b>        | \$651m  | \$633m  | \$621m  | \$596m  | \$579m  | \$562m  | \$558m  |
| <b>Penalty debt</b>           | \$2.67b | \$2.59b | \$2.48b | \$2.03b | \$1.80b | \$1.65b | \$1.66b |
| <b>Penalties as % of debt</b> | 80%     | 80%     | 80%     | 77%     | 76%     | 75%     | 75%     |
| <b>Total debt</b>             | \$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.<sup>8</sup> 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.

<sup>8</sup> *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.

Research<sup>9</sup> 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

<sup>9</sup> *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  |
|--|---|--|---|--|---|
| <b>Simpler for customers</b>           | 0   | ++<br>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).   | +<br>Mechanically, this approach would be easier for customers to understand, however carers could struggle to see the rationale for not penalising non-compliance.   | 0<br>Customers would still need to understand the underlying rules, just at different penalty rates.   | -<br>Customers would need to understand the same rules, with increased complexity in knowing when penalties will be applied.  |
| <b>Impact on compliance</b>            | 0   | +<br>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.   | --<br>Penalties play an important role in incentivising timely payment and keeping child support top of mind.   | 0<br>Inland Revenue research <sup>10</sup> 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. | -<br>This approach could decrease compliance as liable parents would have a certain number of times when they could default without being penalised.                  |
| <b>Simpler for R5 IT build</b>         | 0   | ++<br>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.  | ++<br>This approach would mean that no penalty or write-off rules would need to be built for the new system.  | 0<br>Largely similar penalty and write-off rules would need to be built for child support in the new system.   | -<br>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.                  |
| <b>Reduction in child support debt</b> | 0   | ++<br>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. | ++<br>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. | +<br>Because incremental penalties would be applied at lower rates, the amount of penalties charged would be less.   | 0<br>Although fewer penalties would be applied at first, the likelihood that this approach could encourage occasional non-compliance would lessen the impact of that. |
| <b>Overall assessment</b>              | 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

<sup>10</sup> *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.<sup>11</sup>

Research undertaken by Inland Revenue shows that customers felt that penalties are necessary to encourage compliance.<sup>12</sup> 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.<sup>13</sup>

### 5.2 Summary table of costs and benefits of the preferred approach

| Affected parties | Comment: | Impact | Evidence certainty |
|------------------|----------|--------|--------------------|
|------------------|----------|--------|--------------------|

#### 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<br>(Inland Revenue)        | Ongoing – penalties that would have been paid no longer imposed. | \$2m per annum | High |
| Wider government                      | None   | None           | High |

<sup>11</sup> *Changing Penalties to Incentivise Child Support Payment*, 2019.

<sup>12</sup> *Changing Penalties to Incentivise Child Support Payment*, 2019.

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

|                             |         |                |      |
|-----------------------------|---------|----------------|------|
| Other parties               | None    | None           | High |
| <b>Total Monetised Cost</b> | Ongoing | \$2m per annum | High |
| <b>Non-monetised costs</b>  | 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   |
| <b>Total Monetised Benefit</b>                          | None   | None   | High   |
| <b>Non-monetised benefits</b>                           | 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.

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