PAYE error correction and adjustment

An officials’ issues paper

August 2017

Prepared by Policy and Strategy, Inland Revenue, and the Treasury
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CHAPTER 1

Background

1.1 Correcting errors and making adjustments to already filed PAYE information is currently a largely manual process, and imposes significant compliance costs on some employers.

1.2 In late 2015 the Government released a discussion document, Making Tax Simpler – Better administration of PAYE and GST, which contained proposals about how modern digital services could be used to improve the administration of PAYE and GST. The objectives outlined included reducing compliance and administrative costs, and improved administration of social policies such as student loans and Working for Families tax credits.

1.3 The discussion document proposed that employers should file PAYE information each payday and that employers using payroll software could do so directly from their payroll systems.

1.4 For those using payroll software, their payroll system could be used to calculate and transmit the information required to correct errors and make adjustments. The discussion document further proposed that the correction and adjustment of PAYE information would require employers to amend the returns in which the error originally occurred.

1.5 Changes to the administration of PAYE are proposed in the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill introduced to Parliament in April 2017. The changes proposed in the Bill are summarised in the Appendix.

1.6 The Bill proposes a regulation-making power for matters relating to the correction of errors in “employment income information”.¹ It further provides that the Governor-General may make these regulations on the advice of the Minister of Revenue, following appropriate consultation.²

Purpose of this consultation

1.7 This consultation is being carried out on behalf of the Minister of Revenue and seeks feedback to help shape the regulations in proposed new section 23M of the Tax Administration Act.

1.8 With the co-operation of providers of payroll software, a largely automated approach to error correction is proposed for employers using payroll software. However it is important that the requirements for error correction...

¹ The Bill uses this term to refer to the information that will be required from employers each payday and information required about new and departing employees.
² Clause 200 proposes to insert new subpart 3C to the Tax Administration Act 1994. This section includes proposed new section 23M, which includes the proposed regulation-making power.
also meet the needs of employers who file through Inland Revenue’s website or on paper. Submissions are also invited from these employers.

Summary of potential solutions

1.9 Several design principles have been identified to reduce the need for rework:

- Where possible, processes for adjustment should be automated and allow employers to make adjustments consistent with their payroll practices.
- Employers who use payroll software should be able to use their software to generate the information they require to amend an already filed return.
- Employers should also have the option of accessing filed returns through myIR and self-correcting incorrect returns.
- A paper error correction form will continue to exist, and employers who only need to make simple corrections will be able to do so by telephone.

1.10 The issues paper identifies a number of types of errors and adjustments. The solutions suggested here apply to PAYE and related deductions such as student loan repayments and KiwiSaver deductions. An important consideration will be current practices and the workability of the suggested solutions proposed in table 1.

Table 1: Summary of potential solutions

<table>
<thead>
<tr>
<th>Type of error or adjustment</th>
<th>Potential solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reporting error: When the return does not reflect what was paid or withheld</td>
<td>Amend the original return.</td>
</tr>
<tr>
<td>Payroll: Underpayment</td>
<td>No correction required as employees are taxed when the underpayment is paid.</td>
</tr>
<tr>
<td>Payroll correction: Overpayment</td>
<td>When the amount is repaid (or there is agreement to repay), this correction can be made either:</td>
</tr>
<tr>
<td></td>
<td>• by amending the original return(s); or</td>
</tr>
<tr>
<td></td>
<td>• by recalculating the pay and tax in the pay periods that require correction, and netting the amounts off the values in a subsequent return.</td>
</tr>
<tr>
<td></td>
<td>If legally able to and with the agreement of the employee, by reducing the gross income in a subsequent pay period and reporting the reduced figures in a subsequent return.</td>
</tr>
<tr>
<td></td>
<td>Inland Revenue will not be able to accept negative values in returns until early 2020 but after that it is proposed that they should be accepted.</td>
</tr>
<tr>
<td></td>
<td>If the overpaid amount is not repaid it should continue to be taxable as PAYE income, no adjustment is required, and there would be no refund of PAYE and related deductions.</td>
</tr>
</tbody>
</table>
If the overpaid amount is **partially repaid**, the sum not repaid remains taxable as PAYE income. If the employer has made an adjustment based on the agreement to repay, a further adjustment would be required to add back the amount not repaid.

**Interpretation errors: When there is a mistake with the tax treatment**

A limited ability to correct the error in a subsequent return is suggested. The error may be corrected in a subsequent return:

- if PAYE on the error is less than 10 percent of the employee’s PAYE in that payday return; and
- subject to a cap of a maximum of $10,000 of upward reassessment by the employer in the tax year.

In other cases the correction should be made by amending the returns that contained the error.

**Errors or corrections that cross tax years**

We are interested to hear what issues would arise if employers were able to correct overpayments and interpretation errors relating to a previous tax year in a subsequent return.

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1.11 Error correction often involves a trade-off between accuracy and cost. The suggested solutions would allow different approaches for reporting errors, overpayments and interpretation errors. An employer concerned about the complexity of distinguishing between different error types could, however, choose to correct reporting errors, overpayments and interpretation errors by amending the returns that contained the errors.

1.12 The issues paper also suggests that employers should report the amount of employer superannuation contribution tax (ESCT) withheld, at an employee level.

1.13 The solutions suggested relating to overpaid income would require a clarification of the law so that overpaid PAYE income that is not repaid remains taxable as PAYE income. A further clarification is proposed to ensure that the time an employer allows an employee to repay overpaid income does not create a liability for fringe benefit tax on an interest-free loan.

1.14 When “employer” is used in this paper it should generally be read as including “payroll intermediary”.3 The proposals for error correction in employment income information also apply to non-employees such as contractors who are paid schedular payments from which PAYE must be withheld.

1.15 No special rules have been put forward in relation to the correction of errors in employment income information relating to non-resident employees and non-resident contractors. Some specific issues are, however, being worked

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3 Payroll intermediaries already have access to an automated error correction process and are required to file electronically.
through separately, to address specific concerns raised in relation to non-resident employees and non-resident contractors.

**How to make a submission**

1.16 Officials invite submissions on the suggested changes and points raised in this issues paper. Submissions can be sent to policy.webmaster@ird.govt.nz with “PAYE error correction and adjustment” in the subject line.

1.17 Alternatively, submissions can be addressed to:

PAYE error correction and adjustment  
c/- Deputy Commissioner, Policy and Strategy  
Inland Revenue Department  
PO Box 2198  
Wellington 6140

1.18 The closing date for submissions is **15 September 2017.**

1.19 Submissions should include a brief summary of major points and recommendations. They should also indicate whether it would be acceptable for Inland Revenue and Treasury officials to contact those making the submission to discuss the points raised, if required.

1.20 Submissions may be the subject of a request under the Official Information Act 1982, which may result in their release. The withholding of particular submissions, or parts thereof, on the grounds of privacy, or commercial sensitivity, or for any other reason, will be determined in accordance with that Act. Those making a submission who consider that there is any part of it that should properly be withheld under the Act should clearly indicate this.
CHAPTER 2

Environment for PAYE error correction and adjustment

2.1 The following principles have guided the approach in this issues paper:

- Wherever possible, processes for adjustments should be automated and allow employers\(^4\) to make adjustments consistent with their existing payroll practices.

- Processes must, however, be available to accommodate employers that do not use payroll software.

- Income, tax and other deductions withheld should be determined and reported as accurately and quickly as possible. This should enable social assistance entitlements to be calculated more frequently than annually.

- Solutions should be consistent with the principle that employees are taxed when the cash is received; adjustments should follow the flows of money.

- When employer and employee negotiate a correction to pay, as far as possible, tax should follow what is agreed between the parties.

- Solutions should be consistent, with reasonable compliance expectations, and should not create opportunities to correct absence of reasonable care or fraudulent behaviour.

Systems-wide view

2.2 Changes proposed to PAYE in the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill are part of the Government’s transformation of the tax administration system. The proposed changes are intended to make use of digital systems to reduce compliance and administrative costs, and improve the administration of social policies delivered by Inland Revenue.

2.3 In developing the new environment for PAYE reporting, Inland Revenue is committed to an approach that reduces the need for corrections, and minimises the downstream implications of inevitable errors and adjustments. The importance of improving guidance in this area is also acknowledged.

2.4 Planned changes to the PAYE system include the following features, which should reduce the need for rework and/or reduce the downstream impact.

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\(4\) “Employers” includes payroll intermediaries.
Electronic “on-boarding” and early advice of departures

2.5 Inland Revenue’s new system will be able to electronically receive and respond to information about new employees before they are first paid.\(^5\) This will allow employers to submit the relevant fields\(^6\) to Inland Revenue and check the IRD number and the employee profile (proposed tax code and deduction types) before the first salary or wage payment is made. This service should help employers to ensure that the correct deductions are being made, reducing the need for subsequent intervention by Inland Revenue, and rework by employers.

2.6 It will also be possible for an employer to advise Inland Revenue directly from their payroll system that an employee has left the employer. Early advice will break the employee/employer link in Inland Revenue’s system and should ensure that the employer is no longer contacted about that employee.

Resubmit a whole pay

2.7 Employers will have the ability, if necessary, to reverse out and resubmit a whole payday submission (the payday equivalent of an employer monthly schedule).

Speed of processing

2.8 Once migration to Inland Revenue’s new computer system is completed, there will be an increase to the speed of processing, for both original PAYE submissions and adjustments, and employers will be able to readily track the progress of submissions and adjustments.

2.9 In addition, Inland Revenue’s new system is being designed to ensure that errors in employee data only delay the processing of that particular record, not the whole submission.

Multiple submissions

2.10 Some employers pay contractors what are defined as “schedular payments” from which PAYE must be withheld. If these contractors are paid through the accounts payable system, the current limitation that restricts employers to one employer monthly schedule (EMS) per month can cause problems. Officials understand that some employers routinely file contractor PAYE information using an IR344 (EMS amendment form).

2.11 Payday reporting will require employers to file employment income information within two or seven working days from the day on which contractors liable for PAYE are paid. The existing restriction on multiple

\(^5\) While it will be possible to provide this information and get a response before the first payment is made, it will not be a requirement for employers to provide this information before the first payment. The requirement will be that information about new employees comes with or before the first payment of PAYE income.

\(^6\) The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill also proposes to require employers to provide contact details for their employees and date of birth information when this has been provided.
submissions will disappear and it will be possible to file information relating to schedular payments in a standalone submission.

Means by which errors may be corrected and adjustments made

2.12 Employers who use payroll software will be able to generate the information they require to amend already filed returns as a by-product of correcting their own records. Rather than being required to resubmit a whole return, it is envisaged that payroll software will be able to generate a schedule of corrections that could either be submitted with the payday return or as and when it is available.

2.13 Employers will also have the option of accessing their filed returns through myIR and self-correcting the records that are wrong.

2.14 In addition, a paper error correction form will continue to be available and for the foreseeable future, employers with simple corrections will still be able to make them by telephone.

Question

- Do you have any questions or concerns about any of the issues or principles covered in this Chapter? Please let us know what they are.
CHAPTER 3

Errors and adjustments to employment income information

3.1 Employers have an obligation to provide information to Inland Revenue when they withhold tax and other deductions from PAYE income payments.

3.2 The current obligation is to provide the PAYE information monthly in an “employer monthly schedule”. The Bill\(^7\) refers to the information as “employment income information” and proposes it will be required on a payday basis. Under the proposals in the Bill, employers over the threshold for electronic filing\(^8\) and employers with smaller payrolls who are using payroll software will have two working days following payday to submit employment income information for that payday. Employers not required to file electronically, and who are not using payroll software, will have seven working days following payday to report.

3.3 Payday reporting should result in some errors being identified and corrected more quickly. Because of delayed reporting and slow processing it can currently take three months before an employer who has not made employer KiwiSaver contributions is identified and notified to begin contributions. Payday reporting should see this type of error identified and corrected much more quickly.

3.4 It is recognised, however, that payroll corrections are inevitable and that processes for correction must improve if payday reporting is to result in a reduction in compliance and administrative costs.

Current requirements

3.5 Inland Revenue’s current PAYE guidance states that PAYE errors must be corrected by phoning or by completing a form which amends the original return that was in error. This requires an amendment to be lodged for each return (monthly at present, payday in future) that was wrong.

3.6 However, in some circumstances, Inland Revenue allows employers to make adjustments in a subsequent return. This approach is not available if netting the corrections off against the subsequent return would result in any of the fields (for example, for gross income or PAYE, or KiwiSaver deductions) having a negative value. This constraint arises because of limitations in Inland Revenue’s FIRST computer system, which cannot use negative values. It also limits the size of errors that can be corrected in a subsequent return.


\(^8\) The threshold is currently set at $100,000 of PAYE and ESCT withheld a year. The Bill proposes that it should reduce to $50,000 of PAYE and ESCT a year.
The suggested changes set out below relate to how errors may be corrected once employers are reporting on a payday basis. The Bill proposes that this will become optional from 1 April 2018 and mandatory from 1 April 2019.

Types of errors and adjustments in employment income information

Over 700,000 corrections were made to PAYE information in 2016, based on information from employers. The potential solutions distinguish between a number of different types of errors and reasons for adjustments:

- Reporting errors – when someone was paid and tax and other deductions were withheld correctly but there was a mistake in the reporting to Inland Revenue.
- Payroll corrections – including when someone was wrongly paid due to human error, systems error or receipt of information after the payroll has been run.
- Interpretation errors – for example, when the employer has made a mistake about whether an allowance is taxable.

Officials acknowledge that having to distinguish between different error types adds complexity. However, if one rule is applied to them all it may impose more onerous requirements on some types than is necessary. Submitters have the opportunity to comment on the level of complexity.

For completeness, these sources of error are included but they have their own rules, which this paper does not propose to change:

- Employer non-compliance – for example, deliberate non-withholding or misreporting or failure to take reasonable care. These forms of non-compliance cannot be remedied by “correcting” the resulting “errors” and non-compliant employers will remain subject to existing penalties.
- Employee compliance error – for example, use of an incorrect IRD number or provision of wrong tax code, whether deliberate or inadvertent. The employer’s ability to rely on the information provided by the employee, and to only change employee information following an instruction from the employee or from Inland Revenue, will remain. No requirement to correct previous returns is proposed.

Reporting errors

Reporting errors arise when someone was paid and tax and other deductions were withheld correctly but the information was reported wrongly. There are many reasons why an employer might not accurately report what was paid and/or withheld, for example:

9 Typically student loan repayments and KiwiSaver deductions.
- An employee might have been paid out-of-cycle, and while they have been paid and withheld from correctly, the details have not been included in the return.
- The return might inadvertently have been submitted for the wrong payday.
- A transcription error might have been made in recording an amount or other employee details.

3.12 Reporting errors often give rise to a mismatch with the payment made to Inland Revenue, which will generate contact from Inland Revenue and rework. Resolving the error requires the employer to make the correction in the return in which the error occurred, so that it matches with the payment that includes that return.

3.13 In other circumstances, for example, where information about employee A’s income and deductions has been attributed to employee B and vice versa, the reporting error would not generate a mismatch with total payment. It could, however, have social policy consequences for the employee and may generate processing errors when, for example, a KiwiSaver deduction is reported against an employee who is not a member.

3.14 Employment income information is currently shared with the Ministry of Social Development and Accident Compensation Corporation who use it to help ensure that people get their correct entitlements.

3.15 Because of the need for reporting to match payment and the potential impacts of reporting errors on an individual’s entitlements and obligations, officials propose that all reporting errors should be corrected by amending the return that was in error.

**Question**

- Do you agree that when reporting does not reflect what was paid and withheld, the error should be corrected by amending the return that was wrong? If you disagree, please explain why.

**Payroll corrections**

3.16 Employment income information can also be incorrect because of the need for payroll adjustments. In this situation tax and other deductions have been calculated correctly but may subsequently require adjustment because the pay needs to be updated. This situation can arise for a variety of reasons, including:

- advice of unpaid leave or other changes received after the payroll has run;
- an allowance or other entitlement did not cease when it should have; or
• paid leave was anticipated and the employer was unable to recover it all from the final pay.

**Underpayments**

3.17 While an underpayment is an error from some perspectives, it is a well-established tax principle that income from wages and salary is derived (taxed) on a cash basis, and is taxed at the rates applying when the cash is actually received.\(^{10}\) Calculating the tax and other deductions when the payment is finally made removes the need for a PAYE correction as the information is simply included in the return when the payment is made.

3.18 If an underpayment spans income years, and tax rates have increased since the income was earned, this can seem unfair to the employee as the underpayment will all be taxed in one year and at the higher tax rate. On the other hand, if tax rates have decreased and/or the employee is on a lower income when the underpayment is corrected, the employee may prefer that the tax is calculated on the rates applying when the payment is made.

3.19 Officials are not proposing any changes to the principle that, when an underpayment is made up, tax and other deductions are calculated at the employee’s rate on the payday when the payment is made. In these circumstances there is no requirement to correct earlier returns.

**Questions**

• Do you agree that tax and other deductions due on underpayments should be calculated at the employee’s current applicable tax rate when the payment is made?

• If the proposal is not how you calculate tax and other deductions on underpayments, please explain how you calculate the tax and what information you provide to Inland Revenue. If you think your approach is preferable, please explain why.

**Overpayments**

3.20 Because of the employment law obligations, employers are usually required to get employee agreement before correcting overpayments.\(^{11}\) Officials understand that once agreement to repay is obtained it is not uncommon for payroll systems to correct overpayments back in the pay period(s) in which the overpayment occurred, and recalculate the tax and other deductions in those periods. As illustrated below, these systems then deduct the correction(s) from the income and deductions payable in the current pay

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\(^{10}\) Hollis v CIR (2010) 24 NZTC 23,967.

\(^{11}\) The Wages Protection Act 1983 identifies limited circumstances in which employee agreement is not required, such as when there has been unauthorised absence or a strike and the process followed meets the legislative requirements.
period. The difference between the net amount owed to the employee for the current pay period and the amount after the agreed overpayment has been deducted is regarded as a loan to the employee, which may be repaid in one amount or over time.

3.21 Despite their own systems recalculating the PAYE and other deductions in the pay period(s) in which the errors occurred, some employers have advised us they would prefer to simply provide Inland Revenue with figures for the current payday, less the overpayments. Because it subtracts the overpayment from the amounts payable in the current pay period, this approach eliminates the need to amend (reverse and replace) earlier returns.

**Option A: Adjustment reported in subsequent payday return**

Jai has a base salary of $900 gross a week but has been paid a $100 weekly allowance that should have ceased at the end of the previous month. It continued for four weeks before it was discovered. In one of the overpaid periods she was paid $200 overtime. Jai has a student loan but is not in KiwiSaver. If the employer corrected the error by reporting it in a subsequent return they would recalculate what was paid (standard text shows what was originally paid) in each of periods 1 to 4 (the figures in italics are the recalculation) and then net the changes off the amounts after tax and other deductions have been calculated for payday 5. The employer would report the bold figures for payday 5.

<table>
<thead>
<tr>
<th>Original</th>
<th>Payday 1</th>
<th>Payday 2</th>
<th>Payday 3</th>
<th>Payday 4</th>
<th>Payday 5 adjusted to net off agreed error</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross income</td>
<td>$1,000 − $100 = $900</td>
<td>$1,200 − $100 = $1,100</td>
<td>$1,000 − $100 = $900</td>
<td>$1,000 − $100 = $900</td>
<td>Correct – adjustment: $900 − ($100 × 4) = $500</td>
</tr>
<tr>
<td>PAYE</td>
<td>$180</td>
<td>$242</td>
<td>$180</td>
<td>$180</td>
<td>Correct – adjustment: $151 − ((29 × 3) + 31) = $33</td>
</tr>
<tr>
<td>Student loan</td>
<td>$76</td>
<td>$100</td>
<td>$76</td>
<td>$76</td>
<td>Correct – adjustment: $64 − (4 × 12) = $16</td>
</tr>
<tr>
<td>Net pay</td>
<td>$744</td>
<td>$858</td>
<td>$744</td>
<td>$744</td>
<td>Correct – adjustment: $685 − (3 × 59) + 57 = $451</td>
</tr>
</tbody>
</table>

**Option B: Amending the earlier returns**

If the employer amended the earlier returns, the record of Jai’s gross income and deductions for paydays 1 to 4 would be amended to show the figures below.

<table>
<thead>
<tr>
<th>Corrected</th>
<th>Payday 1</th>
<th>Payday 2</th>
<th>Payday 3</th>
<th>Payday 4</th>
<th>Payday 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross income</td>
<td>$900</td>
<td>$1,100</td>
<td>$900</td>
<td>$900</td>
<td>$900</td>
</tr>
<tr>
<td>PAYE</td>
<td>$151</td>
<td>$211</td>
<td>$151</td>
<td>$151</td>
<td>$151</td>
</tr>
<tr>
<td>Student loan</td>
<td>$64</td>
<td>$88</td>
<td>$64</td>
<td>$64</td>
<td>$64</td>
</tr>
<tr>
<td>Net pay</td>
<td>$685</td>
<td>$801</td>
<td>$685</td>
<td>$685</td>
<td>$685</td>
</tr>
</tbody>
</table>

12 Net pay is not reported to Inland Revenue but is included for completeness.
3.22 Option A and Option B, illustrated above, would result in the same overpaid amounts being refunded or credited to the employer. They leave the employee in the same situation both in terms of social policy\textsuperscript{13} and tax. If the employer amended the original returns, Inland Revenue would, however, pay use-of-money interest on overpaid deductions, provided the amount overpaid was more than $100.

3.23 If the correction is made by netting the changes off against a subsequent return (Option A), Inland Revenue’s records for paydays 1 to 4 will not match the employer’s amended records for those paydays. Officials are aware that PAYE-related reconciliation issues cause some employers significant concern. Submitters are invited to comment on whether employers should only be allowed to report an adjustment in a subsequent return if the employer retains both the original and amended records.

3.24 Allowing the employer to net overpayment corrections off in a subsequent return may also make it hard for Inland Revenue to see that appropriate deductions have been made. It is possible that having an indicator, at the employee level, that this return includes an adjustment to previous returns might resolve most cases.

3.25 It is proposed that when agreement is reached with an employee\textsuperscript{14} to repay an overpaid amount, an employer who recalculates the amounts in the pay periods that were wrong could report the change to Inland Revenue either by:

- rolling the changes forward and netting them off the gross income and deductions reported in a subsequent return (Option A). For a discussion about the ability to report negative values please see the next section, “Reporting negative values in a return”; or
- making a correction by amending the returns that required correction (Option B).

3.26 In terms of employment law, and with their employee’s agreement, employers may be able to correct some overpayment errors in other ways – for example, by reducing gross income payable in a subsequent pay period and calculating the tax and other deductions on the reduced gross.

\textsuperscript{13} For discussion of overpayments that cross tax years and the implications of the proposed reductions in assessment periods for some social policies see the section on “errors and adjustments relating to a previous assessment period”.

\textsuperscript{14} Or in the limited circumstances under the Wages Protection Act 1983, where agreement is not required.
**Option C: Reduced gross income**

If the employer is legally able to correct an overpayment by reducing the gross payable in a subsequent period, and has their employee’s agreement, the information reported would be what is shown in bold below. This example assumes the same scenario as in Options A and B, a gross overpayment of $400.

<table>
<thead>
<tr>
<th>Reduced gross</th>
<th>Information reported</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross income</td>
<td>Current pay minus overpayment ($900 – $400)</td>
<td>$500</td>
</tr>
<tr>
<td>PAYE</td>
<td>PAYE on reduced gross</td>
<td>$76</td>
</tr>
<tr>
<td>Student loan</td>
<td>Student loan on reduced gross</td>
<td>$16</td>
</tr>
<tr>
<td>Net pay(^{15})</td>
<td>Net pay</td>
<td>$408</td>
</tr>
</tbody>
</table>

3.27 In this case the situation parallels an underpayment error as the tax and other deductions are calculated on the gross amount in the subsequent pay period. In these circumstances no adjustment or amendment is required.

3.28 The above options (A, B and where possible under employment law, Option C) are intended to meet the design principles of facilitating automation and, as much as possible, allowing employers to make corrections or adjustments consistent with their existing payroll practice. The ability to report negative values and what is required when an error occurred in a previous tax year are considered in the following sections.

**Questions**

- Is the method described in Option A how you or your system calculates the details of an overpayment? If not, how do you do it?
- If you are involved with paying staff, which option (Option A or B) would you adopt to report an error correction to Inland Revenue and why? If your answer would vary depending on the circumstances, please explain why.
- Should employers who adopt Option A be required to keep a record of both the original and corrected pay to enable the records to be reconciled if problems arise?
- If you have concerns about the workability of the options, or would recommend a variation, please elaborate.
- Do you ever recover overpayments by reducing gross income as described in Option C? If you do, can you please describe the circumstances?

**Reporting negative values in a return**

3.29 For employers who pay staff more often than monthly, payday reporting will reduce the values in their returns of employment income information. For

\(^{15}\) Net pay is not reported to Inland Revenue but is included for completeness.
example, an employer who pays weekly will have values in their weekly returns that are approximately one-quarter the size of those reported in the employer monthly schedule. Unless the constraint on filing negative values is relaxed, payday reporting is likely to increase the requirement to correct errors by amending previous returns.

3.30 The current constraint on filing negative values arises largely because Inland Revenue’s FIRST computer system cannot accurately process negative values. Until Inland Revenue completes its transition to the new computer system, it will be managing PAYE and related social policy deductions across two computer systems: FIRST and START. The constraint on filing negative values will remain during this period, which is referred to as “co-existence”.

3.31 Once Inland Revenue manages all aspects of employment income information in its new computer system, it is proposed that employers will be able to file adjustments with negative values. It is not possible to definitively indicate when the system will be able to accept negative values but it will not be before early 2020. Officials are seeking to explore and understand any reconciliation or systems issues that might arise if this change is introduced.

Questions

- If you run a payroll and make adjustments by netting off the change against a subsequent return, approximately how many times a year does the constraint on filing negative values require you to amend earlier returns?
- Do you support the proposal to allow employers to file negative values in their returns of employment income information?
- If you have concerns about the proposal to allow employers to report negative values, or if there are issues that implementation must address, please explain them.

Interpretation errors

3.32 Another type of error occurs when an employer misinterprets the law – for example, wrongly treating a taxable allowance or provision as non-taxable. These errors are similar to other interpretation errors the employer might make in other aspects of their tax affairs, and it is proposed that similar principles should apply. When a taxpayer discovers an interpretation error, the general rule is that the error must be corrected by making a voluntary disclosure proposing a reassessment of the incorrect return.\(^{16}\) Interest and penalties may apply.

\(^{16}\) When an employer amends an earlier employer monthly schedule revising the amount of tax to pay upwards it is regarded as a voluntary disclosure.
Some of those who responded to the discussion document, *Making Tax Simpler – Better administration of PAYE and GST*, supported the proposal that there should be an ability to correct genuine PAYE errors in a subsequent return, up to a threshold or cap. A provision exists in section 113A of the Tax Administration Act 1994 whereby taxpayers can correct genuine errors, occurring in certain other tax types in a subsequent return, up to a cap of $1,000 per return.

A limit or cap of $1,000 per payday return for a large employer with several payrolls could amount to a very significant total in a year and could obscure systematic problems in the employer’s tax treatment of payroll.

In addition, the possibility of shorter assessment periods for some social policy entitlements and obligations has been raised. If those proposals go ahead, a non-trivial tax treatment error could detrimentally affect an employee’s social policy entitlements and obligations if it was all reported in a subsequent payday return.

**Example**

Since starting a new job in April, Phil and his family have lived in a house supplied by his employer at a rent $150 a week below the market rent. The employer has not included the $150 in his gross income. After six months the error is picked up by the tax agent, at which time $3,900 in gross income has gone unreported. At Phil’s salary the PAYE owing is $1,224.18

If the assessment period for Working for Families tax credits and child support reduces from a year to a shorter period, reporting the whole amount in a single payday return could materially reduce Phil’s entitlements or obligations without his available income changing.

Entitlements and obligations would be similarly affected if instead of his employer having made an interpretation error the employer had underpaid Phil $150 gross over the six-month period. However, in that case, when the underpayment is corrected, Phil would receive a cash lump sum and it is appropriate that his obligations and entitlements should reflect that.

Ideally, a threshold for interpretation errors would allow small errors to be corrected in a subsequent return while requiring other errors to be corrected by amending previous returns.

Officials propose that an employer who makes an interpretation error can correct it in a subsequent return provided PAYE on the discrepancy is less than 10 percent of the employee’s total PAYE in that payday return.

In addition, to ensure that frequent or widespread interpretation errors have visibility, we suggest that employers can only correct interpretation errors in a subsequent return up to an annual threshold of $10,000 a year of PAYE.

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18 Including ACC levy.
discrepancy for that employer. No threshold is proposed for correcting other error types. The $10,000 is proposed as a limit on upward reassessments arising from interpretation errors, not as a net threshold that allows upward and downward reassessments to be netted off.

3.40 A number of issues relating to PAYE information concerning non-resident employees and non-resident contractors were raised in feedback on *Making Tax Simpler – A Government green paper on tax administration*, and in response to *Making Tax Simpler – Better administration of PAYE and GST*.

3.41 This issues paper does not put forward any special rules in relation to the correction of errors in employment income information relating to these taxpayers. To the extent that the suggested changes would allow more flexibility around error correction, the employers of non-resident employees and contractors should also benefit. A number of specific issues are, however, being worked through separately in an effort to address specific concerns that have been raised relating to non-resident employees and non-resident contractors.

3.42 As with other tax types, interest on interpretation errors corrected by amending previous returns, would continue to apply, as would exposure to late payment and, if warranted, shortfall penalties.

### Questions

- In your experience what issues most often give rise to interpretation errors?
- How do you or your payroll system, currently correct interpretation errors?
- If you consider that thresholds for allowing interpretation errors in a subsequent return should be set at different values or on a different basis to that suggested here, please tell us your alternative and explain your reasons.

### Errors and adjustments relating to a previous assessment period

3.43 The majority of PAYE errors and adjustments are identified and rectified relatively quickly. However, some will inevitably cross tax years, raising the question of whether special rules are required for error correction when the error occurred in a previous tax year. In addition, as noted above, the prospect of shorter assessment periods for social policy also needs to be considered.

3.44 As set out earlier in this chapter, underpayments are reported and taxed when they are paid, regardless of the tax year in which the underpayment occurred.

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19 Where employers file under different numbers – for example, at different locations each number would be regarded as an employer.
3.45 If overpayments in a previous tax year are adjusted in an employment income information return relating to a subsequent year, the individual’s record of income with Inland Revenue will reflect the reduction in income in the later year and it will be taxed at that year’s rates. A case can be made that this is appropriate. The employee was taxed on the income they had in the previous year and it is in the current year when they repay the overpayment that they experience the reduction in income.

3.46 When tax rates, thresholds or the individual’s circumstances have changed in the time between when an overpayment occurred and when repayment was agreed, adjusting in a subsequent period can seem unfair.

3.47 Requiring errors which span tax years to be corrected by amending the original returns would, however, not solve the problem. If the assessment for a prior year has been finalised, an employer amending employment income information returns for that year does not automatically prompt a reassessment for the individual. It would be up to the individual to either make the adjustment in a subsequent IR3 or to contact Inland Revenue to discuss their options. This would include requesting the Commissioner to make amendment. Permitting the employer to report and adjust for a payroll error in a subsequent year would at least ensure that the change factors into an assessment.

3.48 If proposals for shorter assessment periods for some social policies are adopted, entitlements and obligations could be based on income in the prior assessment period. In this environment, reporting an overpayment when repayment is agreed will ensure that the change in income feeds through to social policy entitlements and obligations in the following period. This is appropriate as it is when the available (net) income is reduced by the requirement to make repayment(s).

3.49 If the employer chooses to correct an overpayment error by amending earlier returns, some of the reduction in income may fall outside the social policy assessment period. It is intended, however, that there will be a mechanism whereby material changes affecting prior assessment periods are checked to see if a consequent reassessment of social policy calculations is needed. It is also proposed that an employee adversely affected by error correction in an earlier assessment period could seek to have their social policy entitlement or obligation reconsidered.

3.50 Officials suggest that employers should be permitted to report payroll overpayment errors relating to a previous tax year in a subsequent return.

3.51 If employers are permitted to correct overpayment errors relating to a previous tax year in a subsequent return, there does not appear to be good reason why they should not be allowed to remedy interpretation errors up to the relevant thresholds, in the same way.
Questions

- Can you estimate how often you correct overpayments or interpretation errors relating to a prior tax year? How do you report them?
- Do you agree with the proposal that employers should be able to report overpayment and interpretation errors\(^\text{20}\) relating to a previous tax year in a current-year payday return?
- If you have issues or concerns with the above proposal for an employee or an employer please tell us about them.

Employee compliance errors

3.52 The suggested changes in this issues paper will not change an employer’s obligations if an employee has made an error in the information they have provided to their employer. For example, under payday reporting, the Bill proposes that the employer will only be required to action tax code changes from the next time they run the payroll. There is no obligation on the employer to go back and “correct” earlier periods.

Reporting employer superannuation contribution tax (ESCT)

3.53 Under payday reporting, it is intended that a separate IR345 (“employer deduction form” or EDF) would no longer be required to accompany payment of PAYE. This change would not be introduced until the processing of PAYE and related social policy administration occurs completely within Inland Revenue’s new computer system, which will not be before early 2020. This change would require that information about total ESCT, which is currently reported on the EDF, is added to the employment income information that is reported each payday.

3.54 Officials are aware that the current aggregated reporting of ESCT creates problems. For example, when an employer is due a refund of PAYE, the associated ESCT needs to be separately calculated and notified to Inland Revenue. In addition, because Inland Revenue cannot see the amount of ESCT withheld for each employee, it can be difficult to monitor that the employer is making appropriate KiwiSaver contributions.

3.55 To alleviate these problems, officials suggest that employers should be required to report the amount of ESCT withheld for each employee in their payday returns of employment income information.

\(^{20}\) Up to the thresholds.
Question

- Do you support the proposal that instead of reporting total ESCT in the EDF (IR345) the amount of ESCT withheld is reported in the payday reports of employment income information at the employee level?

3.56 Inland Revenue’s new computer system, and the redesign of PAYE processes, provide an opportunity to eliminate other reasons for contact from Inland Revenue. If employers could notify Inland Revenue, using a checkbox or drop-down menu when something unusual was happening, it should reduce unnecessary contacts. For example, for some employees the employer’s KiwiSaver contribution is subject to PAYE not ESCT and it would help if the employer could indicate this. Only one notification should be required per employee.

Question

- Do you support the greater use of one-off notifications, such as the one discussed above relating to KiwiSaver being subject to PAYE, to reduce contact from Inland Revenue?

Complexity

3.57 Error correction often involves a trade-off between accuracy and cost. The changes suggested in this chapter would allow different approaches for reporting errors, overpayment errors and interpretation errors. An employer concerned about the complexity of distinguishing between different error types could, however, choose to correct all of these errors by amending the previous returns.

Question

- Would you find the proposed changes unduly complex? If so, how would you simplify them?
CHAPTER 4

PAYE income and payroll corrections

4.1 Stakeholder feedback suggests that the law around the taxation of overpaid PAYE income requires clarification. It is Inland Revenue’s current view that overpaid wages and salary are not PAYE income and are generally not taxable in the hands of the employee. This view has not been widely promulgated or included in Inland Revenue’s guidance to employers.

4.2 An employer only has an obligation to deduct PAYE from PAYE income. If an employee agrees to repay an overpaid amount that was originally paid as PAYE income, the parties have agreed that it was not PAYE income. The employer therefore did not have an obligation to withhold from it, and once notified of the error, Inland Revenue should refund the overpaid deductions to the employer.

4.3 In some cases a repayment schedule may be agreed which spreads the employee’s obligation to repay over a number of pay periods. To reduce compliance and administrative costs, it is proposed that the reduction in income could be adjusted in one payday return following agreement to repay, rather than being matched to each repayment from the employee. Alternatively, it could be reported when the sum had been fully repaid. An employer could choose which option best suited the circumstances.

4.4 Not all overpayments result in repayment. Occasionally an employer will agree to leave the overpayment with the employee. Following this decision, the amount might be regarded as a “bonus” and subject to PAYE, or alternatively, taxable as debt remission income.

4.5 Sometimes an employee refuses to repay the employer or leaves the employer with no forwarding address before the overpayment is repaid. Officials understand that when overpaid income is not repaid, it is often treated as if it remains taxable as salary or wages. As a consequence, employers do not adjust the employment income information filed with Inland Revenue.

4.6 It is proposed that the legislation should be amended to make it clear that where an overpayment is not repaid, it is PAYE income and no error correction or adjustment should be made.

4.7 This approach would remove the need to distinguish between when an employer has agreed to leave the amount with the employee and when they have simply been unable to recover it. It would, however, mean that when the employee does not repay the net amount, the employer is unable to recover the PAYE and other deductions from Inland Revenue.

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21 “PAYE where income is received fraudulently or in error”, Tax Information Bulletin Vol 16, No 11.
22 Or, in the limited circumstances under the Wages Protection Act 1983, where agreement is not required.
23 If the employee subsequently defaulted on the repayment there would be an obligation on the employer to advise of a further adjustment which added the amount not repaid back into the employment income information.
Table 2: Summary of proposals for overpayments

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<thead>
<tr>
<th>Type of overpayment</th>
<th>Proposal</th>
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| Overpayment repaid        | When the amount is **repaid** (or there is agreement to repay) this error type can be corrected either:  
                          | • by amending the original return(s) that contained the error; or  
                          | • by recalculating the pay and tax in the pay periods that contained the error, and netting the amounts off the values in a subsequent return.  
                          | If legally able to and with the agreement of the employee, by reducing the gross income in a subsequent pay period and reporting the reduced figures in a subsequent return.  
                          | Inland Revenue will not be able to accept negative values in returns at least until after the end of 2019, but after that, it is proposed that negative values should be accepted. |
| Overpayment not repaid    | When the overpaid amount is **not repaid**, it continues to be taxable as PAYE income; no error correction is required and there would be no refund of PAYE and related deductions. |
| Overpayment partially repaid | If the amount is **partially repaid**, the sum not repaid remains taxable as PAYE income. If the employer has made an adjustment based on the agreement to repay, a further adjustment would be required to add back the amount not repaid. |

**Question**

- Do you support the proposal that the law should be amended to make it clear that overpaid income not repaid remains taxable in the hands of the employee as PAYE income? If not, please explain your reasons.

**Fringe benefit tax**

4.8 If the employer and employee agree that the overpaid net income should be repaid over a period of time, it is possible that the overpayment could be regarded as an interest-free loan, which should attract fringe benefit tax. The legislation currently excludes a loan provided as an advance against future salary from fringe benefit tax, provided the loan amount does not exceed $2,000 during the fringe benefit tax period, and it is not a term of the employment contract.
4.9 Because the amount to be repaid could exceed $2,000, it is proposed that an amendment to the Tax Administration Act 1994 be made, to clarify that time allowed to an employee to repay overpaid income does not create a liability for fringe benefit tax.

**Question**

- If you have any concerns with this approach, can you please tell us why?
APPENDIX

Proposed PAYE changes

The key changes proposed in The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill currently before Parliament are:

- Employers and payroll intermediaries\(^{24}\) will no longer be required to file an employer monthly schedule; instead they would file employment income information on a payday basis from 1 April 2019.
- Employers using payroll software will be able to file their information directly from their payroll system.
- Employers will not be required to use payroll software but would have to file their PAYE information on a payday basis.\(^{25}\)
- Employers with the smallest payrolls will still be able to file their PAYE information on paper if they choose to do so. The threshold for electronic filing of PAYE information will reduce from $100,000 a year of PAYE and Employer Superannuation Contribution Tax (ESCT) deductions to $50,000 a year.
- The Government is not proposing to change the dates by which PAYE and related deductions must be paid to Inland Revenue. However, employers will be able to make these payments on payday if they choose to.
- To improve the workability of the rules, minor changes will be made from 1 April 2018 to the PAYE rules for holiday pay paid in advance, and to align when rate changes come into effect.
- The payroll subsidy, which subsidises employers to outsource their PAYE obligations to listed payroll intermediaries, will cease from 1 April 2018.

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\(^{24}\) References to employers should generally be read as including payroll intermediaries.

\(^{25}\) For payroll intermediaries, employers above the electronic filing threshold and for those below the threshold using payroll software, the due date would be two working days after payday. For employers below the electronic filing threshold not using payroll software, the due date would be seven working days after payday.