

Hon Stuart Nash, Minister of Revenue

Information Release

Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019

Tax policy report, Cabinet paper, regulatory impact assessment, and Cabinet minute

April 2019

Availability

This information release is available on Inland Revenue's Tax Policy website at <http://taxpolicy.ird.govt.nz/publications/2019-ir-cab-leg-19-sub-0027/overview>.

Documents in this information release

1. IR2019/006 – Tax policy report: Cabinet paper - Draft regulations for the correction of errors in employment income information (28 February 2019)
2. LEG-19-SUB-0027 – Cabinet paper: Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019
3. Regulatory impact assessment: Modernising the correction of errors in PAYE information (28 February 2019)
4. LEG-19-MIN-0027 – Minute: Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019

Additional information

The Cabinet paper was considered by the Cabinet Legislation Committee on 19 March 2019 and confirmed by Cabinet on 25 March 2019.

One attachment to the Cabinet paper is not included in this information release as it is publicly available:

- Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019

Information withheld

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

Sections of the Act under which information was withheld:

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

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POLICY AND STRATEGY

Tax policy report: **Cabinet paper – Draft regulations for the Correction of Errors in Employment Income Information**

Date:	28 February 2019	Priority:	Medium
Security level:	In Confidence	Report number:	IR2019/006

Action sought

	Action sought	Deadline
Minister of Revenue	Agree to recommendations Authorise the lodgement of the attached Cabinet paper	10 am Thursday 14 March

Contact for telephone discussion (if required)

Name	Position	Telephone
Mike Nutsford	Policy Manager	s 9(2)(a)
s 9(2)(a)	Senior Policy Analyst	

28 February 2019

Minister of Revenue

Cabinet paper - Draft regulations for the Correction of Errors in Employment Income Information

Purpose

1. This report serves two purposes. It:
 - summarises the feedback from the consultation undertaken on the draft regulations for the Correction of Errors in Employment Income Information; and
 - introduces a paper for you to present to the Cabinet Legislation Committee requesting approval of the regulations.

Why the regulations are needed

2. These regulations form part of the recent changes to the provision of PAYE information to Inland Revenue which generally requires employers to submit their employment income information within two to ten working days of each payday (payday reporting). Payday reporting changes will become mandatory for employers from 1 April 2019.
3. The changes will provide Inland Revenue with more timely information on employment income for employees, however it will also reduce the time available to employers to identify and correct any errors in this information before it is sent to Inland Revenue.
4. The regulations support the payday reporting changes by providing for the methods for employers to make adjustments and correct errors in employment income information.
5. A consultative draft version of the regulations was provided to a group of stakeholders for feedback on the workability of the regulations in September 2018.
6. The main themes of these submissions are summarised in the body of this report.
7. These regulations have been drafted to bring into effect related proposed legislation that is included in the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill. To ensure the regulations appropriately reflect the proposed legislation we have had experienced delays in finalising the draft regulations.
8. A draft copy of the regulations is attached to the draft Cabinet paper, these regulations are still subject to PCO's proof-reading process ahead of certification and lodgement alongside the Cabinet paper.
9. We consider that it is appropriate to seek a waiver in order to allow the regulations to enter into force on 1 April 2019. This will provide the option for employers to use

the additional methods of error correction from the same time that payday reporting become mandatory. The current guidance given to employers is to correct any errors in the original submission of information; this remains an option for all types of errors under the regulations.

Next steps

10. The draft regulations will be finalised and submitted to Cabinet Legislation Committee for their meeting on 19 March 2019. Following Cabinet Legislation Committee, the regulations will be submitted to Cabinet for approval, and Executive Council for signing.
11. You may wish to issue a media statement once the regulations have been signed.
12. The regulations will come into force on 1 April 2019.

Recommended action

We recommend that you:

- a) **authorise** the lodgement of the attached Cabinet paper with the Cabinet Office by 10 am Thursday 14 March, for the Cabinet Legislation Committee to consider at its meeting on 19 March 2019.

Authorised/Not authorised

- b) **agree** that for the permitted mechanisms for the correction of overpayments of PAYE-related income, the employer may choose to treat an overpaid amount as repaid provided it is repayable to the employer under an agreement between the employer and the employee.

Agreed/Not agreed

- c) **agree** that errors affecting student loans, KiwiSaver or child support deductions that do not follow from an error in the gross PAYE income payment should be amended in the original period.

Agreed/Not agreed

- d) **agree** that officials should review the 10% threshold for when an error may be adjusted in a subsequent pay period when social policy products have been moved into the START computer system.

Agreed/Not agreed

- e) **note** that, before making a recommendation to the Governor-General to make regulations under the empowering provision, the Minister of Revenue must undertake appropriate and reasonable consultation on the proposed regulation that provides for the correction of errors.

Noted

- f) **note** that officials consider that the consultation requirement in the empowering provision for the regulations has been met.

Noted

- g) **note** that a regulatory impact assessment was completed and was attached to the March 2018 Cabinet paper. We have made a minor update to this RIA and this is attached to the Cabinet paper.

Noted

- h) **note** that speaking notes are attached to assist you with support and coalition party consultation.

Noted

- i) **agree** to seek a waiver of the 28-day rule to allow the Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019 to come into force on 1 April 2019.

Agreed/ Not agreed

Mike Nutsford
Policy Manager,
Policy and Strategy
28 February 2019

Hon Stuart Nash
Minister of Revenue
/ /2019

Background

13. The Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Act 2018 included changes to the way employers reported employment income information to Inland Revenue.
14. The amendments to the Tax Administration Act 1994 (TAA) include a regulation-making power that enables the Governor-General on the recommendation of the Minister of Revenue, to make regulations to provide for the correction of errors in employment income information, following appropriate consultation. This occurred as part of the release of the officials' issues paper "PAYE error correction and adjustment" in August 2017.
15. We previously reported to you in February 2018 seeking Cabinet approval for the policy settings for the permitted means of error correction for employment income information (IR2018/006 refers). We also sought approval to carry out consultation with a limited group of stakeholders on a draft copy of these regulations.
16. The policy principles underlying the error correction regulations were approved by Cabinet in March 2018. The regulations also reflect changes to the taxable status of PAYE overpayments included in the Taxation (Annual Rates, Modernising Tax and Remedial Matters) Bill 2018.
17. The regulations also take into account proposed changes to the treatment of PAYE overpayments contained in the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill (the ARMTARM Bill). Due to the timing of this Bill, these provisions of the regulations were drafted subsequent to the draft version provided for consultation.
18. During drafting we identified a subset of errors which require specific treatment. This is for errors which affect the amount of a student loan repayment obligation, KiwiSaver contributions or child support deductions that have not resulted from an incorrect interpretation and calculation of the gross PAYE income payment. In order to mitigate system errors due to corrections involving social policy deductions, we have restricted the ability to correct in subsequent periods for interpretation errors involving social policy deductions which don't follow from an error in the gross PAYE income payment.
19. The consultation version of the regulations was drafted on this basis. An updated regulatory impact statement is attached to this report.
20. The key changes to the regulations following feedback on consultation is to provide more clarity between which provisions apply for different types of errors. The regulations have been amended to include examples and a flowchart in the explanatory note to assist in the application of the regulations.
21. The empowering provision for regulations Section 23N of the TAA comes into force 1 April 2019, section 11 of the Interpretation Act permits regulations to be made in advance of the power coming into force if the exercise of power is "necessary or desirable to bring, or in connection with bringing, an enactment into operation". To have the regulations in place by 1 April 2019, it is necessary to exercise the power in section 23N ahead of its commencement date. It is desirable to bring the regulations into effect at the same time as mandatory payday reporting requirements to provide clarity for employers on how to correct errors.
22. A further set of speaking notes has been attached for your use in support and coalition party consultation.

Feedback from consultation

23. We sent a copy of the draft regulations to 13 organisations. We received responses from 11, with the points raised generally fitting under one of the below categories:
- clarity between the types of errors;
 - when an error may be reported in a subsequent period;
 - concerns around implementation and application timing; and
 - minor drafting points.
24. The key feedback was: a perceived lack of clarity around what regulations apply to each type of error, whether there was more scope for correction in subsequent returns, and a concern that the proposed application date of 1 April 2019 did not allow enough implementation time.

Feedback received not resulting in changes

25. Two submitters were concerned that the application date is the same as the move to mandatory payday reporting. One suggested that it would be better for error correction to come into force after the payday reporting changes have bedded in.
26. Two submitters expressed concern around the timing for the regulations to come into effect and the software development that would be required to support them. One submitter raised a concern that there is no allowance for payroll software that does not allow original returns to be amended.
27. The regulations continue the status quo of error correction, allowing all errors to be corrected in the original submission. The ability to include adjustments in subsequent returns (the "netting off" approach) is an option but is not required. Employers can continue correcting the original return after 1 April 2019 and use the option to net off adjustments in subsequent returns when software provides for that option.
28. We do not recommend delaying the application date of the regulations, as they are intended to provide clarity to employers and reduce compliance costs.

Adjustments in a subsequent period

29. Three submitters queried the threshold that determines whether an adjustment in a subsequent return is a permitted method of correction in relation to interpretation errors. The rationale for capping the amount of adjustments which may be made in a subsequent period is to draw a distinction between significant errors and small errors which may be corrected in a subsequent return to reduce compliance costs.
30. Two of those submitters suggested revisiting this threshold in two to three years' time to ensure it meets the right balance between reducing compliance costs and ensuring significant errors are allocated to the right period. Officials will monitor this threshold. There is scope to amend the regulations in the future to increase this if the compliance costs are seen to outweigh the impact of correcting larger errors in subsequent returns.
31. Two submitters asked if it would be possible to make adjustments to incorrectly deducted social policy obligations in subsequent periods. Social policy errors should be corrected in the original period to ensure that they are allocated to the right period and that existing rules (for example, significant under or over-deductions for student loans) are not affected. However, officials will revisit whether it is

appropriate to allow adjustments in future periods for some circumstances once social policy has been incorporated into Inland Revenue's new computer system.

Feedback received resulting in changes

32. The main changes to the regulations following consultation are:
- clarifying which regulations apply to different error types;
 - inclusion of a flowchart and examples in the explanatory notes; and
 - minor drafting clarifications
33. In addition to the changes arising from consultation, we have revised the regulation section regarding when an employer makes an overpayment of PAYE income. This reflects a change proposed in the ARMTARM Bill regarding the status of overpayments of PAYE-related payments.

Clarity on how to apply regulations

34. Five submitters queried how different regulations would apply to different errors. To clarify the regulations, we have made several changes to help ensure they are easy to follow and apply to different error types.
35. The regulations distinguish error type on the basis of which category of employment income information is affected. The categories which affect which methods are available are whether:
- the PAYE income payment amount is incorrect
 - the PAYE and ACC levy deducted is incorrect
 - student loan repayment, KiwiSaver or Child Support deductions are incorrect, and
 - any of the amounts reported to us in the employment income information do not accurately reflect the amount that was deducted and/or paid to Inland Revenue.
36. If an error includes amounts relating to KiwiSaver, student loan repayments or child support deductions, the original submission must be amended. This is to ensure these deductions are allocated to the appropriate period.
37. We consider there should be more clarity in the regulations by way of a flowchart and key examples in the explanatory note to the regulations. In addition, guidance will be released by Inland Revenue in a *Tax Information Bulletin* once the regulations are made.
38. The legislative changes to the taxable treatment of PAYE overpayments will also have guidance included in the *Tax Information Bulletin*.

Clarifications to be addressed in further guidance

39. One submitter also sought clarification on how the regulations would intersect with current penalty provisions in the TAA.
40. The regulations specify that an employer must correct an error as soon as "reasonably practicable". This is intended to provide guidance in the regulations as to when an employer should correct an error without providing a specific deadline. This is because it may be difficult to determine when an error is discovered by the

employer and some errors may take more time to correct than others if they are more complex.

41. If an earlier return is amended to correct for when PAYE was under-withheld, this would count as a voluntary disclosure under section 141G of the TAA. Further guidance and examples about how this will apply will be included in a *Tax Information Bulletin*.
42. New Schedule 3 specifies the record-keeping requirements for employers and PAYE intermediaries. This includes the details of a PAYE income payment and the amount of any tax or other deductions that are withheld.
43. Additional points raised in the feedback included wanting clarification around how the regulations worked with penalties and record-keeping provisions, and queries around the timing provision.
44. Submitters were generally supportive of the use of regulations to provide clarity for how to correct errors.

Minor drafting changes

45. Following consultation, we have made several minor drafting changes to aid in the clarity of the regulations.

Inclusion of a new overpayments provision

46. The regulations have been amended to incorporate changes to the taxable treatment of PAYE overpayments included in the ARMTARM bill. This bill amends the Income Tax Act 2007 and the TAA to clarify that overpayments of PAYE income should be subject to PAYE. This bill is currently still going through parliamentary processes, but is expected to be enacted in March 2019.
47. Making PAYE income overpayments subject to PAYE ensures that any overpayments made to employees and not recovered by the employer are subject to tax and any other applicable deductions under PAYE. The proposed amendment leaves the unrepaid amount on the employee's record of income with Inland Revenue, which is used in determining obligations such as the rate of tax on secondary income and entitlements such as Working for Families tax credits. The overpayment would have been taxable if it had been correctly paid and if it is not repaid it remains available to the recipient to spend.
48. The regulations permit the employer to choose one of the following ways to report an overpayment which was treated as a PAYE income payment by:
 - 48.1 amending the original return to record the correct values; or
 - 48.2 adjusting in a subsequent period by netting off the overpayments and any associated deductions against the values in a later payday.
49. The provision also allows for the employer to treat an overpaid amount as repaid, provided it is repayable to the employer under an agreement between the employer and the employee. Where this is the case, the employer may choose which option to correct the error.
50. If the employer wishes to correct the overpayment in one lump sum, for example by correcting the original submission, the regulations permit this approach. However, if the employee subsequently breaches the agreement to repay, the employer must make an additional correction to increase the PAYE income payment by the amount of the remaining unpaid overpayment (an upwards adjustment).

51. The amendments to the TAA and the regulations describe what constitutes a breach of repayment obligations. A breach is considered to be when the employee has breached the agreement (e.g. not complied with the repayment schedule) and not remedied this within two months, or if the employer considers that the employee will not comply with the agreement in the future. This provides flexibility for the employer's discretion as to when it is appropriate to consider the agreement as breached.

Consultative requirement

52. The regulation-making power under section 23N of the TAA provides that appropriate consultation should be undertaken before making a recommendation to make regulations under this provision.
53. Consultation took place in 2017 in the form of the officials' issues paper *PAYE error correction and adjustment*. This consultation helped to inform the policy principles underlying the regulations; these principles were agreed to by Cabinet in March 2018.
54. In addition, subsequent consultation with a small group of stakeholders was undertaken in the last quarter of 2018 to ensure the regulations were able to be used to give effect to the policy decisions.
55. Officials consider that appropriate consultation has taken place to make the regulations under section 23Q of the TAA.

Release of Cabinet paper

56. We recommend releasing the attached Cabinet paper once the Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019 has been gazetted. We also recommend the release of this covering report as additional supporting material. We note that previous policy reports and Cabinet papers on PAYE error correction have been released as part of the information release for the introduction of the ARMTARM Bill.
57. We recommend the documents are released in full, subject to official's contact numbers and the names of junior officials. This is consistent with withholding information under section 9(2)(a) of the Official Information Act to protect the privacy of natural persons.

APPENDIX A

The following organisations were sent a copy of the draft regulations in September 2018

- SAP
- ANZ
- EY
- GoFi8ure
- Datacom
- Attache
- Fast Track
- NZ Law Society – Tax Law committee
- CA ANZ
- CTG
- PwC
- KPMG
- Business NZ

APPENDIX B

Speaking notes
Coalition and support party consultation
28 February 2019

Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019

Context

- From 1 April 2019, employers will be required to submit their PAYE information to Inland Revenue on a payday basis. The information will generally be required within two or ten days after each payday.
- The Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019 will support the recent change to payday reporting of employment income information by employers.

Issue

- The more frequent provision of PAYE reporting information will provide Inland Revenue with more timely information on employment income for employees. However, it will also reduce the time available to employers to identify and correct any errors in this information before it is sent to Inland Revenue.
- The regulations will support the move to payday reporting by providing for the methods for employers to make adjustments and correct errors in employment income information.

Proposals

- The policy principles underlining the error correction regulations were approved by Cabinet in March 2018.
- The regulations also reflect changes to the taxable status of PAYE-related overpayments which are included in the current Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill.
- The permitted methods of error correction allow the employers to continue the current guidance for correction of errors (that is correcting the original period submitted) or make adjustment in subsequent periods subject to restrictions.

Benefits of proposals

- These regulations provide clarity regarding the methods by which an employer may correct an error in employment income information.

Financial implications

- To the extent that employers will correct minor interpretation errors in a subsequent return, the amount of interest employers pay on re-assessed PAYE will reduce. It is not possible to estimate the magnitude of the change but it is expected to be small.

Administrative implications

- The administrative impacts of the propose changes are consistent with the assumption in the Business Transformation Business Case that the cost of processing PAYE information will reduce. The cost of the changes for Inland Revenue will be met as part of stages 2, 3 and 4 of Inland Revenue's business transformation programme.

APPENDIX C

Speaking notes
Cabinet Legislative Committee
28 February 2019

Title

Recommended actions

- The paper seeks the committee's authorisation to submit the Tax Administration (Correction of Errors in Employment Information) Regulations 2019.
- It seeks a waiver of the 28-day rule in order to allow the regulations to take effect on 1 April 2019, which coincides with the requirement for employers payday reporting of employment income information.

Issue

- The more frequent provision of PAYE reporting information will provide Inland Revenue with more timely information on employment income for employees. However, it will also reduce the time available to employers to identify and correct any errors in this information before it is sent to Inland Revenue.
- The regulations will support the move to payday reporting by providing for the methods for employers to make adjustments and correct errors in employment income information.

Proposals

- The policy principles underlining the error correction regulations were approved by Cabinet in March 2018.
- The regulations also reflect changes to the taxable status of PAYE related overpayments which are included in the current Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill.
- The permitted methods of error correction allow the employers to continue the current guidance for correction of errors (that is correcting the original period submitted) or make adjustment in subsequent periods subject to restrictions.

Benefits of proposals

- These regulations provide clarity regarding the methods by which an employer may correct an error in employment income information.

Financial implications

- To the extent that employers will correct minor interpretation errors in a subsequent return, the amount of interest employers pay on re-assessed PAYE will reduce. It is not possible to estimate the magnitude of the change, but it is expected to be small.

Administrative implications

- The administrative impacts of the propose changes are consistent with the assumption in the Business Transformation Business Case that the cost of processing PAYE information will reduce. The cost of the changes for Inland Revenue will be met as part of stages 2, 3 and 4 of Inland Revenue's business transformation programme.

Consultation

- The legislative provision enabling the making of regulations to provide for permitted methods of error correction requires the Minister of Revenue to undertake appropriate consultation before making a recommendation.
- Consultation took the form of an officials' issues paper *PAYE error correction and adjustment*, which was released in August 2017, and received 13 submissions.
- In addition, a draft version of the regulations was provided to 13 stakeholders in September 2018 to test the readability and ease-of-use of the regulations.

Timing considerations

- In order to coincide with the mandatory application date for employers to adopt the recent changes to payday reporting, the regulations should come into effect on 1 April 2019.

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Legislation Committee

TAX ADMINISTRATION (CORRECTION OF ERRORS IN EMPLOYMENT INCOME INFORMATION) REGULATIONS 2019

Proposal

1. This paper seeks the Cabinet Legislation Committee's agreement to submit an Order in Council creating the Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019 to the Executive Council.
2. In order to bring these regulations into effect for 1 April 2019, I am seeking a waiver of the 28-day rule on the grounds that its application date should coincide with the mandatory application of payday filing for employers. These regulations have been drafted to accompany related proposed legislation that is included in the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill. To ensure the regulations appropriately reflect the proposed legislation we have had a delayed ability to finalise the draft regulations.

Executive Summary

3. The regulations provide the methods employers may use to correct errors in employment income information submitted to Inland Revenue.
4. These regulations form part of the recent changes to the provision of PAYE information to Inland Revenue which generally requires employers to submit their employment income information within two or ten working days of each payday (payday reporting). Payday reporting changes will become mandatory for employers from 1 April 2019 under changes to the Tax Administration Act.
5. The changes will provide Inland Revenue with more timely information on employment income for employees. However, they will also reduce the time available to employers to identify and correct any errors in this information before it is sent to Inland Revenue.
6. The regulations support the payday reporting changes by specifying the nature and type of errors that are able to be corrected by an employer and the manner in which errors in employment income information may be corrected.
7. The policy principles underlying the error correction regulations were approved by Cabinet in March 2018. The regulations also reflect changes to the taxable status of PAYE overpayments included in the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill.
8. A consultative draft version of the regulations was provided to a group of stakeholders for feedback on the workability of the regulations in September 2018.

9. This paper reports on the feedback received as part of this consultation, the key changes made to the regulations, and seeks approval to submit the Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019 to the Executive Council.

Background

10. The Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Bill amended the filing requirements for employers withholding PAYE. This requires employers to report information on payments made to and PAYE and other deductions withheld from employees (employment income information) on a payday basis. For employers who file PAYE online, this generally means they must report information to within two or ten working days following an employee's payday.
11. These changes modernise the way employers provide PAYE information to Inland Revenue. Under payday reporting, many employers will be providing income information to Inland Revenue more frequently, which aligns more closely with employer's processes. Payday reporting will establish a foundation for more accurate withholding and improved delivery of social policy.
12. The move towards more frequent information provision will also, in turn, reduce the amount of time available to employers to identify and correct information before it is sent to Inland Revenue. To help mitigate the potential administrative and compliance issues associated with error reporting, legislative changes included an empowering provision which gives the Minister of Revenue the ability to make an Order in Council to prescribe how errors in employment income information may be corrected.
13. Legislation has previously been silent on how errors in PAYE information are to be corrected. Inland Revenue's advice to employers has been that all corrections to PAYE information must be made by amending the original returns which contained the error.
14. An officials' issues paper, *PAYE error correction and adjustment*, released in August 2017, which sought feedback from affected parties on what mechanisms should be available for error correction [CAB-17-MIN-0404 refers]. This paper received 13 submissions.
15. The underlying policy principles were approved by Cabinet in March 2018. [CAB-18-MIN-0122]:
 - 15.1 Reporting errors (where the amount actually withheld and/or paid is not accurately reported to Inland Revenue) must be corrected by amending the return that contained the error. Amending the original return is necessary to ensure that the payment can be correctly processed.
 - 15.2 Payroll corrections, which occur where an employee was overpaid, will be able to be made either by amending the original return or by correcting the errors in a subsequent return. Due to the principle that salary and wages are taxed when paid, underpayments do not require correction.

- 15.3 Interpretation errors (where the wrong tax treatment has been applied) may be corrected in a subsequent return if PAYE on the correction is less than a threshold of 10% of the relevant employee's PAYE for the payday. The threshold is required to avoid unfair social policy impacts on the employee.
16. In addition, the legislative proposal to clarify that overpaid PAYE income that is not repaid is taxable as PAYE income was also approved by Cabinet in February 2018. The legislative change is included in the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill. This bill is expected to be enacted in March 2019.
17. An additional subset of errors require specific treatment. This is for errors which affect the amount of a student loan repayment obligation, KiwiSaver contributions or child support deductions that have not resulted from an incorrect interpretation and calculation of the gross PAYE income payment. To mitigate system errors due to corrections involving social policy deductions, we have restricted the ability to correct in subsequent periods for interpretation errors involving social policy deductions which don't follow from an error in the gross PAYE income payment.
18. The consultation version of the regulations that was released in September 2018 was drafted on this basis. Officials have updated the regulatory impact statement; this is attached.

Outcome of consultation

19. Inland Revenue provided a copy of the draft regulations to 13 stakeholders who were a mix of professional bodies, payroll software providers and intermediaries, and accounting firms.
20. Key messages received during this consultation related to a preference for more ability to make adjustment in subsequent returns, clarity around which provisions relate to which type of errors, and concerns about implementation and timing. Inland Revenue also received some minor drafting points for clarification.

Clarity between types of errors

21. Several submitters considered that there could be improved clarity in the regulations, to help employers and payroll staff apply the regulations to a particular error.
22. Two submitters were concerned that employers and payroll staff would find it difficult to differentiate errors sufficiently in order to apply the right treatment prescribed by the regulations. Another submitter commented that they considered the information provided to be "fairly straightforward and should be sufficient for any payroll specialist to understand and be able to follow when such errors occurred and require amending".
23. The regulations draw a distinction between when it is permitted to make any changes to correct errors in information in a subsequent return (netting off in a subsequent return) and when these changes must be made by correcting the information that was provided (amending the original return). In order to distinguish between what treatment is appropriate, errors have been categorised according to the following types:

- reporting error: when the return does not reflect what was paid or withheld
 - payroll correction: underpayment
 - payroll correction: overpayment, and
 - interpretation errors: when there is a mistake with the tax treatment, and
24. Five submitters raised concerns regarding the distinction between error types and the clarity provided in the regulations as to which section would apply to what type of error. More clarity will be provided in the regulations with a flowchart and key examples included in the regulations. In addition, guidance will be released in Inland Revenue's *Tax Information Bulletin* once the regulations are made.
25. The legislative changes to the taxable treatment of PAYE overpayments will also have guidance included in the *Tax Information Bulletin*.

When an error may be reported in a subsequent period

26. The policy settings previously agreed to by Cabinet provide that employers will have the option of correcting interpretation errors in a subsequent return, subject to the restriction that PAYE on the error is less than 10% of the relevant employee's PAYE for the payday in which the correction would be made.
27. Some submitters queried whether the 10% threshold could be raised. Two submitters suggested that it could, at the minimum be monitored and re-assessed in two or three years' time.
28. Social policy errors that aren't the result of an incorrect calculation of the PAYE income payment, should be corrected in the original period to ensure that they are allocated to the right period and that existing rules (for example, significant under or over-deductions for student loans) are not affected.
29. In addition, the ability to include adjusted values in a subsequent period is limited in the short term, to restrict the filing of negative values. This is due to the inability of Inland Revenue's current computer system to received negative values. This restriction will be lifted once co-existence of Inland Revenue's two systems ends for PAYE, this is expected in April 2020.
30. Officials will monitor and review the 10% threshold once social policy products (student loans, child support and KiwiSaver) are brought into Inland Revenue's new computer system.

Implementation timing and application date

31. Two submitters expressed concern about the timing for the regulations to come into effect, and the software development that would be required to support them.
32. The regulations continue the status quo for error correction, allowing all errors to be corrected in the original submission. The ability to include adjustments in subsequent returns is an option for some types of errors but it is not required. Employers can continue correcting the original return after 1 April 2019 and use the option to net off adjustments in subsequent returns in the future.

33. Delaying the application date of the regulations to provide for the implementation time requested is not recommended as they are intended to provide clarity to employers and reduce compliance costs by introducing additional mechanisms for correction.

Overpayment changes following recent legislation

34. The proposed treatment for overpayments follows that considered by the Finance and Expenditure Committee and set out in the officials' report on the Bill. This aligns with the policy decisions made in the Cabinet paper *PAYE Error Correction Regulations and Legislative Amendments* previously considered by Cabinet on 3 April 2018 [CAB-18-MIN-0122].
35. As drafted, the regulation for overpayments allows employers several options in how to correct these errors when they are not immediately repaid by the employee and instead subject to an agreement to repay over time. Employers may adjust each payday as the overpayment is paid back (that is to make adjustments over several paydays) or they may make a full adjustment of the overpaid amount once agreement to repay has been reached with the employee.
36. However, if the employee breaches the agreement to repay with their employer, the employer must make a second adjustment in relation to the overpaid amount, and add back the outstanding portion of the overpayment and associated PAYE.
37. If the agreement is breached the amount of the overpayment that remains unrepaid is added back to the employee's record of income.

Timing and 28-day rule

38. The regulations are set to come into effect on 1 April 2019. This is required to coincide with the mandatory date set by the Act for employers adopting the new payday reporting requirements for filing their employment income information with Inland Revenue. I am seeking a waiver of the 28-day rule, to ensure the methods of correction under these regulations are available for employers from the commencement of the mandatory payday reporting.

Compliance

39. The regulations comply with the following:
 - 39.1 the principles of the Treaty of Waitangi
 - 39.2 the rights and freedoms contained in the [New Zealand Bill of Rights Act 1990](#) or the [Human Rights Act 1993](#)
 - 39.3 the principles and guidelines set out in the [Privacy Act 1993](#)
 - 39.4 relevant international standards and obligations and
 - 39.5 the [Legislation Guidelines](#) (2018 edition).
40. Section 23N(3) of the Tax Administration Act 1994 allows the making of regulations to provide for error correction. This provision requires that the responsible Minister be satisfied that consultation that is appropriate and reasonable has occurred before recommending the making of an Order in Council under section 23N.

41. This consultation took the form of an officials' issues paper, *PAYE Error Correction and Adjustments*, which was released in August 2017. Thirteen submissions were received. This consultation also included release of a consultative draft version of the regulations in September 2018.
42. The empowering provision for the making of these regulations comes into force on 1 April 2019. Section 11 of the Interpretation Act 1999 permits regulations to be made in advance of the power coming into force if the exercise of power is "necessary of desirable to bring, or in connection with bringing, and enactment into operation".
43. To have the regulations in place by 1 April 2019, it is necessary to exercise the power in section 23N ahead of its commencement date. It is desirable to bring the regulations into effect at the same time as the mandatory adoption of payday reporting in the Act to provide clarity for employers on the methods they may use to correct errors.

Regulations Review Committee

44. Officials do not believe that there are any grounds under Standing Order 319 for the Regulations Review Committee to draw the regulations to the attention of the House of Representatives.

Certification by Parliamentary Counsel

45. The regulations have been certified by the Parliamentary Counsel Office as being in order for submission to Cabinet subject to the enactment of the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill, the consultation requirement, and the waiver of the 28-day rule, as all mentioned above.

Impact Analysis

46. The Quality Assurance reviewer at Inland Revenue has reviewed the *Modernising the correction of errors in PAYE information* RIA prepared by Inland Revenue, and considers that the information and analysis summarised in the RIA meets the quality assurance criteria.
47. This RIA updates an earlier version completed on 7 February 2018 to reflect decisions around social policy obligations for student loan repayments, KiwiSaver employee contributions and child support. Additional information to reflect these decisions has been included in section 2.1 and 3.1 with all other parts substantively unchanged since the original RIA.

Publicity

48. I will issue a media statement once the Order in Council is made by the Executive Council.
49. Inland Revenue will publish an article about these changes in its *Tax Information Bulletin*.

Financial implications

50. The cost of implementing the changes will be met as part of Inland Revenue's business transformation programme.

Proactive Release

51. I propose to proactively release this Cabinet paper, associated minutes, and key advice papers in whole within 30 working days of Cabinet making final decisions.

Consultation

52. Treasury were consulted on this paper. A copy of the draft regulations was provided to ACC and MSD at the same time as external stakeholders.

Recommendations

I recommend that the Cabinet Legislation Committee:

1. **note** that on 21 March 2018 the Cabinet Economic Development Committee agreed to the following decisions on which methods should be available to employers in the regulations:
 - 1.1 Employers should continue to be required to correct reporting errors by amending the original returns
 - 1.2 Employers should be able to correct overpayment errors by:
 - 1.2.1 Amending the original returns in which the error occurred; or
 - 1.2.2 Recalculating the original pays by netting off the changes against the values in a subsequent return. This option will be subject to a restriction preventing employers from lodging negative values until PAYE is entirely managed within Inland Revenue's new computer system.
 - 1.3 Employers should have an option to correct interpretation errors in a subsequent period provided PAYE on the error is less than 10% of the relevant employee's PAYE for the payday in which the correction is made.
 - 1.4 Employers should have the option to correct overpayment and interpretation errors (subject to the employee threshold) from a previous tax year in a subsequent year.
2. **note** that on 21 March 2018, the Cabinet Economic Development Committee also agreed to the amendment to primary legislation providing that overpaid PAYE income that is not repaid remains taxable as PAYE income should be included in the next taxation omnibus bill [CAB-18-MIN-0122];
3. **note** that the Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019 will give effect to the decisions referred to in paragraph 1 above, and provides methods of correction to support the decision referred to in paragraph 2;
4. **note** that the regulations include guidance material in the explanatory note to assist in the application of the provisions to relevant errors.
5. **note** that section 23N(3) of the Tax Administration Act 1994 requires that the responsible Minister be satisfied that consultation that is appropriate and reasonable has occurred before recommending the making of an Order in Council under section 23N;

6. **note** the advice of the Minister of Revenue that this requirement has been met.
7. **note** that regulatory impact analysis has been prepared by Inland Revenue and is attached to this Cabinet paper.
8. **authorise** the submission to the [Executive Council](#) of the Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019;
9. **note** that a waiver of the 28-day rule is sought:
 - 9.1 so that the regulations can come into force on 1 April 2019 coinciding with the requirement for payday reporting of employment income information and the commencement date of the provisions relating to the taxable status of overpayments of PAYE income payments in the Tax Administration Act 1994 and the Income Tax Act 2007.
 - 9.2 on the grounds that it continues the status quo for how employers correct errors in employment income information, and provides additional options to reduce compliance costs.
10. **agree** to waive the 28-day rule so that the regulations can come into force on 1 April 2019;

Authorised for lodgement

Hon Stuart Nash
Minister of Revenue

Impact Summary: Modernising the correction of errors in PAYE information

Section 1: General information

Purpose

Inland Revenue is solely responsible for the analysis and advice set out in this Impact Summary, except as otherwise explicitly indicated.

This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by Cabinet.

This Regulatory Impact Assessment (RIA) updates an earlier version completed on 7 February 2018 to reflect decisions around social policy obligations for student loan repayments, KiwiSaver employee contributions and child support. Additional information to reflect these decisions has been included in sections 2.1 and 3.1 with all other parts substantively unchanged since the original RIA.

Key Limitations or Constraints on Analysis

The key limitations on the analysis that follows are:

- *Consultation and testing:* Although there has been consultation with employers and payroll providers, employers with small payrolls who do not use payroll software were underrepresented in submissions.
- *Quality of data used for impact analysis:* We have been unable to accurately estimate the monetary value of expected changes in administrative costs for Inland Revenue and compliance costs for employers and payroll software developers.

Neither limitation materially affects the analysis.

Responsible Manager

Mike Nutsford
Policy and Strategy
Inland Revenue

28 February 2019

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

PAYE error correction

“PAYE error correction” describes the process by which employers advise Inland Revenue of changes to income, PAYE and other deductions, such as KiwiSaver when an error has been made in, or an adjustment is required to, the information originally filed with Inland Revenue.

For many reasons, including human error and late receipt of information, payroll errors¹ are inevitable.

There are three types of errors that require amendment to PAYE information:

1. **Reporting errors** arise when the employee(s) were paid and taxed correctly but reporting to Inland Revenue does not accurately reflect what was paid and/or withheld.
2. **Payroll overpayment errors** arise when an employee is overpaid, correcting the overpayment requires consequential change to the amounts withheld for PAYE and related deductions such as KiwiSaver.
3. **Interpretation errors** arise when the employee receives the correct pay but an incorrect tax treatment is applied, for example a benefit is treated as tax free when it should have been subject to PAYE.

Because salary and wage earners are taxed when they are paid underpayments are taxed when they are paid and so there is no requirement to correct the information already provided to Inland Revenue.

The current PAYE error correction process is set out in operational guidance from Inland Revenue and is largely manual.

The current PAYE error correction guidelines require all errors to be corrected by filing an amendment to the original return. This requirement imposes considerable compliance costs on employers and administrative costs on Inland Revenue.

The guidelines would need to be updated to reflect the changes proposed in the *Taxation (Annual rates for 2017-18, Employment and Investment Income, and Remedial Matters) Bill* (The Bill).

This Bill introduces “payday reporting”². In general, payday reporting would require employers to file “employment income information” with Inland Revenue within 2 to 10 working days of payday. This information is currently provided to Inland Revenue on a monthly basis. Payday reporting will allow some errors to be identified and corrected more

¹ Payroll staff often distinguish between “errors” and “adjustments” with the latter category arising from timing events such as the late receipt of information. For simplicity these are all referred to in this document as errors.

² This Bill is currently before the Finance and Expenditure Committee and the proposed changes are due to be mandatory from April 2019, employers can voluntarily adopt payday filing from April 2018..

quickly but it will reduce the amount of time available to employers to correct information before it is sent to Inland Revenue and, when an error has continued for several pay periods, it will require more returns to be amended. Therefore, in the absence of any other changes, payday reporting will increase the overall number of errors reported to Inland Revenue. This is the status quo position.

Inland Revenue's business transformation programme provides an opportunity to reduce compliance costs for employers and administrative costs for Inland Revenue by modernising the PAYE error correction process using employers' payroll software and taking advantage of the capabilities in Inland Revenue's new computer system. This could be achieved by revising some of Inland Revenue's requirements and coding PAYE error correction requirements into payroll software and Inland Revenue's system.

To achieve this outcome the requirements would need to provide certainty and must be accessible to employers and developers of payroll software. The requirements must also cater for those organisations which do not use payroll software. We note that the Bill proposes that the requirements for PAYE error correction can be set out in regulations.

The PAYE system is also used to help administer social policy obligations.

- Student loan repayments: employees with a student loan have repayment deductions made from PAYE income over the student loan threshold amount. Additional student repayment rates may also apply if they have requested by the employee or required by the Commissioner of Inland Revenue.
- KiwiSaver: for employees enrolled in KiwiSaver, employers must make deductions from the employee's PAYE income for employee contributions, pay employer contributions and withhold and pay ESCT on that amount.
- Child support: in some cases, child support obligations are administered via deductions from PAYE income which is then paid to Inland Revenue.

We have identified a subset of interpretation errors which require alternate treatment. This is for errors which affect the amount of a student loan repayment obligation, KiwiSaver contributions or child support deductions that have not resulted from an incorrect interpretation and calculation of the gross PAYE income payment.

Other problems with PAYE error correction

In addition, a matter affecting PAYE error correction has arisen which relates to the definition of PAYE income in the Income Tax Act 2007. The objective of providing certainty in relation to the requirements for PAYE error correction requires that this issue should be resolved as soon as possible so that it can be included in advice to providers of payroll software and employers.

The problem concerns the taxable status of overpaid PAYE income which is not repaid. Inland Revenue's legal position is that an overpayment which is not repaid is not taxable unless it has been obtained fraudulently or has become a bonus or salary advance.

Consultation with employers suggests that at least some employers treat this income as

taxable and that any change to their approach would incur additional compliance costs and could reduce the likelihood of the employee agreeing to repay the net amount overpaid. Some employers who treat overpaid income which is not repaid as subject to PAYE seek a refund of PAYE and other deductions, when they obtain agreement from the employee that the net amount will be repaid³, others wait until the net amount is fully repaid.

³ If the employee subsequently defaults on the repayment these employers submit a further error correction to reinstate the outstanding amount as income and pay PAYE on it.

2.2 Who is affected and how?

Employers would be most affected by the current situation and those who responded to consultation generally supported the proposed changes on the basis that they would help to reduce their compliance costs.

Payroll software developers would also be affected by the proposals for PAYE error correction. They generally support the proposed changes because they would provide certainty and would simplify reporting.

Employees could be potentially affected. If the requirements for PAYE error correction are unclear or too complex employers could ignore them and adopt approaches which could be unfair for employees whose records of income and deductions might be affected.

Some tax professionals do not support the proposed change to the status of overpaid PAYE income which is not repaid because it would tax an amount which is not currently defined as PAYE income and denies the employer the refund of PAYE that is currently available. The individual employers who responded to consultation on this point nevertheless supported the proposed change.

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

The common law principle that wage and salary earners are taxed when they are paid is a constraint. This principle means that underpayments are taxed when they are paid; there is therefore no "error" from a tax perspective and no requirement on the employer to amend earlier tax returns. No change is proposed and this issue is not analysed further in this impact summary.

The Bill's changes to PAYE reporting are a constraint as they require more frequent filing of PAYE information. These changes form part of Inland Revenue's business transformation programme. One objective of this programme is to, as much as possible; integrate tax obligations with normal business processes by using business software to automate processes.

Automation requires the rules to be set out clearly and centrally so that they can be coded. The proposed changes would be consistent with a largely automated approach to error correction. In most cases, this would allow an employer using payroll software to generate the information required by Inland Revenue as a consequence of updating their own records.

Because a significant group of employers do not use payroll software the requirements for PAYE error correction should also cater for employers who would manually correct their PAYE information.

Section 3: Options identification

3.1 What options have been considered?

Modernising PAYE error correction

Criteria

- Minimise compliance costs to the extent possible for employers and payroll software developers:
- Minimise administrative costs for Inland Revenue, including consistency with the objectives of Inland Revenue's business transformation.
- Maintain the equity of the tax system. This means allowable approaches to PAYE error correction should not disadvantage employees to whom the income and deductions belong.
- Maintain the integrity of the tax system.

Options for error correction

- Option 1: All corrections would be made by amending the original return (status quo).
- Option 2: Employers would be able to make corrections by either; amending the original return or reporting the correction in a subsequent return. The ability to amend in a subsequent return would exist even if the error occurred in a previous tax year. Additional sub-options have been considered for interpretation errors and these are discussed below.

Analysis of options for each error type against the stated criteria

1. Reporting errors

Option 1 is preferred over option 2 for dealing with reporting errors. If reporting errors were not corrected in the original return there could be a mismatch in the reported information and the amount paid. This would give rise to reconciliation problems which give rise to compliance costs and administrative costs. Amending the original return would also ensure that employees would not be disadvantaged by the income or deductions actually received being reported in a later period.

Option 2 does not address the problem.

2. Overpayment errors

Option 1 would involve higher compliance costs for users of payroll software, compared with option 2. This is particularly true in the context of payday reporting - that is, if an error has continued for more than one payday, an employer who pays more often than monthly would have more returns to correct.

Option 2 would involve a reduction in compliance costs for employers using payroll software, compared with option 1. These reductions would arise because employers would be able to report overpayment errors in a subsequent return which would

eliminate the requirement for a separate error correction return. Because it provides choices option 2 would also cater for employers who do not use payroll software and who prefer to make corrections by amending the original return. Option 2 would not give rise to integrity concerns.

If the overpayment error occurred in a previous tax year option 2 would more often ensure that the reduction in an employee's income feeds through into their annual assessment and social policy position. For this reason option 2 is also preferred on equity grounds as fewer employees would need to seek a reassessment to ensure the reduction in their income feeds through to an assessment.

Option 2 would not be fully available to employers until Inland Revenue's new computer system takes over the full processing of PAYE; this is not expected until 2020. Until then employers would only report overpayment errors in a subsequent return if the net amount reported were a positive number.

3. *Interpretation errors*

Option 1

Requiring all interpretation errors to be corrected by amending the original return (the status quo) would impose higher compliance and administrative costs than option 2. There would not be equity or integrity of the tax system concerns with this option.

Option 2

Allowing the employer to choose to correct the error either by amending the original return or by including the correction in a subsequent return would have lower compliance and administrative costs than option 1.

However if the ability to correct interpretation errors in a subsequent return is unconstrained employees could be disadvantaged by having a significant increase in their income reported in a single payday return when they have not had an increase in available cash⁴. This concern led to consideration of sub option 2a below.

In addition, concern for the integrity of the tax system led to consideration of a further sub option as set out in sub option 2b below.

Option 2a

This sub option would permit employers to choose to correct small interpretation errors in a subsequent return up to a threshold of PAYE on the error being less than 10% of the employee's PAYE in the payday return. Larger interpretation errors would need to be corrected by amending the original return(s).

Option 2a would mitigate the risk of disadvantaging employees but it would impose higher compliance and administrative costs than option 2.

⁴ This situation could arise if a taxable benefit such as subsidised accommodation had been treated as tax free, if the value of this benefit is all reported in one payday return the employee has higher income reported but no more cash.

Option 2b

In addition to the 10% threshold proposed in sub option 2a concern for the integrity of the tax system lead to a further proposal: that an employer could only correct interpretation errors in a subsequent return if they had made less than \$10,000 of upward reassessments in that tax year.

This sub option would have significantly higher compliance costs than options 2 and 2a but it has the advantage of reducing the likelihood that the correcting interpretation errors in a subsequent return could conceal widespread non-compliance.

4. Interpretation errors which affect student loans, KiwiSaver or child support

Option 1

Requiring all interpretation errors to be corrected by amending the original return (the status quo) would impose higher compliance and administrative costs than option 2.

Option 2

Allowing the employer to choose to correct the error either by amending the original return or by including the correction in a subsequent return would have lower compliance and administrative costs than option 1.

Option 2 would permit employers to choose to correct small interpretation errors in a subsequent return up to a threshold of PAYE on the error being less than 10% of the employee's PAYE in the payday return. Larger interpretation errors would need to be corrected by amending the original return(s).

Option 2 would mitigate the risk of disadvantaging employees, however it still requires employers to distinguish between whether PAYE on an error exceeds 10% of the PAYE on the employee's PAYE for the subsequent payday.

When an error is corrected by netting off the relevant values in a subsequent period, Inland Revenue won't be aware that it includes a portion which relates to a previous period. Given that there are system rules which are linked to the gross PAYE income amount, there is a concern that if a subsequent return included social policy deductions which related to a previous period, these would cause errors and might not be accepted by Inland Revenue's system.

This problem is less likely to occur if the PAYE income is also corrected as proportionality in deductions will be preserved.

Options for amending definition of PAYE income

Three options are considered using the criteria set out at the beginning of this section.

- Option 1: no amendment to the Income Tax Act 2007. This is the status quo option.
- Option 2: no amendment to the Income Tax Act and a significant investment by Inland Revenue in employer education in an effort to change employer behaviour.
- Option 3: amend the Income Tax Act 2007 so that overpaid PAYE income that is not

repaid remains subject to PAYE.

Analysis of options

Option 1

This option retains the current definition of PAYE income. Some employer submissions indicated that this option would be inconsistent with current employer practice and with how their payroll software is currently configured.

Continuing with the status quo may undermine the objective of automating error correction through software and is likely to result in continuing non-compliance which undermines the integrity of the tax system.

This option could also be seen as inequitable because it treats an employee who repays overpaid PAYE income as having the same income as an employee who does not repay it.

Option 2

Under this option there would be no change to the definition of PAYE income in the Income Tax Act 2007 and Inland Revenue would widely publicise its view of the law in an effort to change employer practice and how payroll software is configured. The objective would be to enable payroll software to be used to report such errors to Inland Revenue and recover overpaid PAYE and other deductions as soon as an overpayment is identified and regardless of whether it is repaid or not.

This option would have significant one-off educational costs for Inland Revenue and might not be successful. Those employers consulted view the status of overpaid PAYE income as wages or salary subject to PAYE. In addition, employers have reasons under employment law for not coding the amount as an overpayment in their payroll system until agreement to repay has been reached.

If this option resulted in a change in employer behaviour employers would benefit by being able to recover PAYE and other deductions from Inland Revenue regardless of whether they had recovered the net amount from the employee.

Option 3

This option would expand the definition of PAYE income so that overpaid PAYE income not repaid would be subject to PAYE. This option would have lower compliance and administrative costs than the alternatives as it accords with how (some) employers currently treat such income and with how their software is configured.

This option supports the integrity of the tax system as overpayments not repaid may become taxable as debt remittance income. However, because employees would be unlikely to be aware of this obligation it is unlikely that tax would be paid on such income.

Option 3 would expand the definition of PAYE income and could be seen as unfair for employers because it denies employers refunds of PAYE and related deductions that they are currently entitled to.

It could also be seen as unfair to employees who have been overpaid because the overpaid amount would be taxed. As noted above, there are countervailing equity arguments that suggest that Option 3 is preferable on equity grounds because for social policy purposes it would recognise an employer who repaid overpaid income as on a lower income than someone who received an equivalent overpayment but did not repay it.

3.2 Which of these options is the proposed approach?

Error Correction

1. **Reporting errors:** Option 1 (all corrections to be made by amending the original return) is the proposed approach as it is preferable on all criteria.
2. **Overpayment errors:** Option 2 (allowing the employer the choice between amending the original return and correcting in a subsequent period) is the proposed approach as it reduces compliance and administrative costs and is preferable on equity grounds.
3. **Interpretation errors:** Option 2a (allowing the employer the choice between amending the original return and correcting in a subsequent period subject to PAYE on the correction being less than 10 percent of the employee's PAYE in the return) is the preferred approach. This option represents the best trade-off between reducing compliance costs for employers and administrative costs for Inland Revenue without the possibility of unfair impacts on employees.
4. **Social policy errors which do not result from an error in gross taxable income:** Option 1 (all corrections to be made by amending the original return) is the preferred option as it ensures these errors won't cause an exception in the information submitted to Inland Revenue. This should be re-considered once student loans, KiwiSaver and child support has been moved into Inland Revenue's new computer system. (Student loans and KiwiSaver are planned for 2020, child support is planned for 2021).

If an amount is in error due to an incorrectly calculated PAYE income payment then it is appropriate to allow corrections in a subsequent period, subject to the 10% threshold restriction outlined in option 2a for interpretation errors.

Definition of PAYE income

The taxable status of overpaid PAYE income which is not repaid: Option 3 (amending the definition of PAYE income so that overpaid PAYE income which is not repaid remains subject to PAYE) is the preferred approach as it is preferable on all criteria.

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

PAYE Error correction: the error correction items are considered together as costs are principally driven by the requirement to amend original returns. When there is a continuing requirement to correct errors by amending the original return employers who use software should experience reduced compliance costs owing to automation.

Employers who do not use payroll software but who have internet connectivity would be able to access their already filed and processed returns through myIR and self-correct earlier returns; this should reduce costs for this segment. Employers who report PAYE on paper would continue to have access to a paper form for PAYE error corrections and for simple corrections should be able to make them over the telephone.

Additional costs of proposed approach, compared to taking no action

Regulated parties	<p>Providers of payroll software would need to upgrade their products to support the electronic submission of error corrections in line with the proposed methods for error correction. Software providers could integrate this change into the regular update cycle. Work to create an automated channel for the status quo position is already underway in advance of the proposed regulations, as part of business transformation changes. These are transitional costs.</p> <p>Employers would have transitional costs of understanding the new approach in order to take advantage of it.</p>	<p>Very low</p> <p>Very low</p>
Regulators	<p>Inland Revenue would need to ensure that employers and payroll providers are provided with appropriate education and support and that its new computer system is effectively set up and tested in order to receive negative values from 2020. These are transitional costs.</p>	Very low
Wider government	NA	NA
Other parties	NA	NA
Total Monetised Cost	NA	NA
Non-monetised costs		Very low
Expected benefits of proposed approach, compared to taking no action		
Regulated parties	<p>Providers of payroll software: Have additional certainty that their payroll offerings are compliant with requirements.</p> <p>Employers (including payroll intermediaries). Once it becomes possible in 2020 for employers</p>	<p>Very low</p> <p>Medium</p>

	to file negative values to correct overpayment errors in a subsequent return, compliance costs to correct overpayment errors, are expected to materially reduce. The ability to correct small interpretation errors in a subsequent return should reduce costs of reporting these errors. These benefits are ongoing.	
Regulators	Inland Revenue once the new system has bedded in and employers can use their payroll systems to correct overpayment errors and minor interpretation errors in a subsequent return, including those showing negative values the cost of administering the PAYE system should reduce.	Low
Wider government	Government employers are expected to have the same experience as private sector employers. The changes are also expected to benefit the Ministry of Social Development and the Accident Compensation Corporation which pay PAYE income to beneficiaries and to recipients of New Zealand superannuation and accident compensation.	Medium
Other parties	NA	NA
Total Monetised Benefit	NA	NA
Non-monetised benefits	.	Low/medium

Overpaid PAYE income subject to PAYE		
Additional costs of proposed approach, compared to taking no action		
Regulated parties	<p>Software providers would have no costs as we understand their systems currently support the proposed approach.</p> <p>Employers: we understand that what is proposed aligns with how (some) employers currently treat this income and reflects how their systems work. Even though the proposed change would preclude employers from receiving a refund of PAYE on the overpaid income (some) employers are not currently claiming this refund. Unless this practice changed the increased cost would be theoretical, rather than real.</p> <p>Further, employers argue that continuing to treat overpaid income as subject to PAYE would make it more likely that the employee would repay the employer because repayment would be the only way their record of income for social policy purposes is corrected. To the extent this view is valid the theoretical increase in costs</p>	

	identified below would reduce. Employer costs have been estimated as very low; this reflects the fact that the situation is not a common one and assumes that some employers do seek a refund of PAYE on overpaid PAYE income that is not repaid.	Very low
Regulators	Inland Revenue: the proposal reflects the way the system is currently operating so no additional costs would be incurred.	No change
Wider government	NA	NA
Other parties	NA	NA
Total Monetised Cost	NA	NA
Non-monetised costs	As noted above (some) employers have advised us that what is proposed is how they currently operate. For these employers there would be no increase in costs. The costs have been entered as very low on the assumption that some employers are recovering PAYE on overpaid income not repaid.	Very low

Expected benefits of proposed approach, compared to taking no action		
Regulated parties	Payroll providers will have certainty that their systems could be used as currently configured to seek a refund of overpaid income when repayment is agreed or made. Employers would have certainty that the widespread current approach, that treats this income as subject to PAYE, is consistent with the law. Employees would be freed of any obligation to pay tax on the overpaid PAYE income when and if it becomes debt remittance income.	Low
Regulators	Inland Revenue would no longer have to deal with ambiguity around the current position.	Low
Wider government	NA	NA
Other parties	NA	NA
Total Monetised Benefit		
Non-monetised benefits	The primary benefit is increased certainty around how this income should be treated for tax purposes.	Low

4.2 What other impacts is this approach likely to have?

The proposed legislative change to deem overpaid PAYE that is not repaid as subject to PAYE would improve equity between overpaid employees. Under existing law two employees who are overpaid the same amount of PAYE income would be treated as having the same income for social policy purposes (for example working for families payments, student loan repayments and child support payments) despite one employee having repaid the money and the other not having done so.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?

Inland Revenue consulted with a number of providers of payroll software and employers and with the Corporate Taxpayers Group and Chartered Accountants Australia and New Zealand prior to releasing an official issues paper in August 2017.

An officials' issues paper, *PAYE error correction and adjustment*, was released through Inland Revenue's normal channels and in addition was sent to the members of the Payroll Practitioner's Association, to providers of payroll software and to representatives of more than thirty employers who had indicated interest in the subject.

Thirteen submitters responded some representing more than one employer. Submitters generally agreed with the problem analysis and the proposed regulatory approach with the exception of the original proposal for an employer level threshold for interpretation errors.

Submitters argued that the employer level threshold could not be automated and that manual tracking would involve disproportionate compliance costs. In response to feedback the employer level threshold has been dropped.

Concern was also expressed by some respondents that the 10% threshold for interpretation errors at the employee level was unduly low. This threshold has been retained at 10% because the amount could be material for someone on a low income.

One respondent felt that the proposals were unduly complex. However an employer who wishes to minimise complexity will have the option to correct all errors by amending the original returns. No change has been made in response to this submission.

Most respondents agreed with the proposed amendment to the Income Tax Act 2007, deeming overpaid PAYE income not repaid as subject to PAYE. The Corporate Taxpayers Group and Chartered Accountants Australia and New Zealand however disagreed. The Corporate Taxpayers Group considered that the proposal would disadvantage employers by taxing an amount that is not employment income. Chartered Accountants Australia and New Zealand submitted that whether the net amount was recovered or not was a private matter between the employer and employee and the amount should not be taxed unless it became debt remittance income.

In addition, one software provider submitted that if an employer had made an adjustment when agreement to repay the overpaid amount was repaid they should not be required to make a further adjustment if the employee subsequently defaulted on the repayment.

No changes were made in response to the submissions received on the proposal to amend the definition of PAYE income so that overpaid income not repaid is subject to PAYE.

A number of technical questions were raised by payroll software providers and these will be considered in the process of developing the technical specifications.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?

The proposals relating to reporting errors, overpayment errors and interpretation errors would be given effect through regulations.

Clause 235C of the Taxation (*Annual Rates 2017 -18, Employment and Investment Income and Remedial Matters*) Bill proposes that the Governor General may, by Order-in-Council on the recommendation of the Minister of Revenue and following appropriate consultation, make regulations for the correction of errors in employment income information. The proposed timing provides adequate time for employers to understand the proposed changes and become familiar with the new options.

In general the proposed regulations introduce additional options, with continuing to file amendments on the current basis being one option. Having options provides a means of managing implementation risk including risks that arise from a relative lack of engagement with employers with small payrolls.

Inland Revenue's systems are being upgraded to accept automatic error correction schedules from 1 April 2018. Issues relating to the effectiveness of the automated process should be resolved by the time the regulations, which permit a greater number of errors to be correcting in a subsequent return, come into effect on 1 April 2019.

The proposal relating to the tax status of overpaid PAYE income not repaid will be managed through a proposed amendment to the Income Tax Act 2007. It is intended that the amendment will be included in the next available taxation omnibus bill with a proposed effective date of 1 April 2019.

Consultation by select committee is expected to provide a further opportunity for interested parties to express their views on this proposed change. The proposed change to the legislation reflects how many employers are understood to currently treat such income, implementation risks are not therefore considered to be material.

Section 7: Monitoring, evaluation and review

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

Information on the number of errors and adjustments to employment income information that are corrected at the employer's request is currently available. There is no way to deconstruct the totals into different error types.

Once the systems changes are made and the regulations are in place Inland Revenue will know how many automated error correction schedules are filed and the number of changes made. If the system is working as intended the number of changes that are made by amending earlier returns should reduce after it becomes possible for employers to file returns which include negative values (estimated as 2020).

Inland Revenue will not know how many employers exercise the option of correcting overpayment and small interpretation errors in a subsequent return as this option eliminates the need to separately file error correction information.

Implementation and operational issues will be identified through feedback from payroll software providers and through our call centres, account managers and specialised units such as those established to support large enterprises.

7.2 When and how will the new arrangements be reviewed?

The arrangements will be reviewed as part of the post implementation review of phases three and four of Inland Revenue's business transformation.

In addition if monitoring shows unanticipated spikes in the numbers of error corrections being made to employment income information Inland Revenue will investigate the reasons and consider whether the issue:

- is insufficient education;
- reflects a problem with the specifications for payroll software or with Inland Revenue's processing of error correction information;
- stems from the regulations.

Employers will have the opportunity to raise any concerns with our call centres and account managers and payroll software providers can do so through Inland Revenue's Software Liaison Unit.

If employees consider that they are unfairly affected by the actions of employers pursuant to the proposed regulations or legislative change they will be able to make their concerns known through our call centres or by asking the Commissioner to reassess their income.



Cabinet Legislation Committee

Minute of Decision

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

Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019

Portfolio **Revenue**

On 19 March 2019, the Cabinet Legislation Committee:

- 1 **noted** that on 28 March 2018, the Cabinet Economic Development Committee (DEV) agreed to the following decisions on which methods should be available to employers in the regulations:
 - 1.1 employers should continue to be required to correct reporting errors by amending the original returns;
 - 1.2 employers should be able to correct overpayment errors by:
 - 1.2.1 amending the original returns in which the error occurred; or
 - 1.2.2 recalculating the original pays by netting off the changes against the values in a subsequent return. This option will be subject to a restriction preventing employers from lodging negative values until PAYE is entirely managed within Inland Revenue's new computer system;
 - 1.3 employers should have an option to correct interpretation errors in a subsequent period provided PAYE on the error is less than 10 percent of the relevant employee's PAYE for the payday in which the correction is made;
 - 1.4 employers should have the option to correct overpayment and interpretation errors (subject to the employee threshold) from a previous tax year in a subsequent year;
- 2 **noted** that on 28 March 2018, the Cabinet Economic Development Committee also agreed to the amendment to primary legislation providing that overpaid PAYE income that is not repaid remains taxable as PAYE income should be included in the next taxation omnibus bill;

[DEV-18-MIN-0030]
- 3 **noted** that the Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019 will give effect to the decisions referred to in paragraph 1 above, and provides methods of correction to support the decision referred to in paragraph 2;
- 4 **noted** that the regulations include guidance material in the explanatory note to assist in the application of the provisions to relevant errors;

- 5 **noted** that section 23N(3) of the Tax Administration Act 1994 requires that the responsible Minister be satisfied that consultation that is appropriate and reasonable has occurred before recommending the making of an Order in Council under section 23N;
- 6 **noted** the advice of the Minister of Revenue that this requirement has been met;
- 7 **noted** that regulatory impact analysis has been prepared by Inland Revenue and is attached to the paper under LEG-19-SUB-0027;
- 8 **authorised** the submission to the Executive Council of the Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019 [PCO 21535/6.0];
- 9 **noted** that a waiver of the 28-day rule is sought:
- 9.1 so that the regulations can come into force on 1 April 2019 coinciding with the requirement for payday reporting of employment income information and the commencement date of the provisions relating to the taxable status of overpayments of PAYE income payments in the Tax Administration Act 1994 and the Income Tax Act 2007;
- 9.2 on the grounds that it continues the status quo for how employers correct errors in employment income information, and provides additional options to reduce compliance costs;
- 10 **agreed** to a waiver of the 28-day rule so that the regulations can come into force on 1 April 2019.

Vivien Meek
Committee Secretary

Present:

Rt Hon Winston Peters
Hon Chris Hipkins (Chair)
Hon David Parker
Hon Stuart Nash
Hon Iain Lees-Galloway
Hon Tracey Martin
Hon Kris Faafoi
Hon Aupito William Sio
Hon Eugenie Sage
Hon Ruth Dyson (Senior Government Whip)

Officials present from:

Officials Committee for LEG

Hard-copy distribution:

Minister of Revenue