

# Regulatory Impact Statement

## Addressing child support legacy debt

### AGENCY DISCLOSURE STATEMENT

This Regulatory Impact Statement has been prepared by Inland Revenue.

The statement provides an analysis of options to strengthen the child support scheme reforms enacted in 2013 (not yet in force) and scheduled for amendment in 2015 to recognise the increased priority of reducing child support legacy debt. Analysis focuses on increasing incentives to pay debt and improving flexibility for the Commissioner of Inland Revenue to negotiate payment arrangements and more pragmatically manage the legacy debt book.


The decision to introduce the child support reforms was accompanied by a Regulatory Impact Statement (RIS) *Child support scheme reform* of 26 July 2011. A review of the child support reforms in the context of benefits, implementation costs, and child support debt reduction was accompanied by a RIS *Review of child support scheme reform* of 4 June 2014. The earlier RIS' contain background information and analysis that is useful to the options considered in this RIS.

There was consultation with a range of Government agencies and significant public consultation on child support issues over a long period of time culminating in the Child Support Amendment Act 2013. There was limited consultation on the subsequent options in the RIS *Review of child support scheme reform* given timing constraints on decision-making and the sensitivity of the decisions being considered. There has been limited consultation on the options in this statement for the same reasons.

Some assumptions have been made on the number of people who may be affected by aspects of the reforms yet to come into force and the likely impact on compliance behaviour, based on existing administrative data. These assumptions affect analysis on the impact on the debt book.

A time constraint exists for the recommended option as the option is designed to support the child support reforms scheduled for amendment through the Taxation (Annual Rates for 2015-16, Research and Development, and Remedial Matters) Bill (the Bill) that was introduced on 26 February 2015. The ability for Inland Revenue to deliver the recommended option relies on the option being reflected in the Bill and the scope, timing and drafting of the option remaining unchanged throughout the legislative process. There are no other significant constraints, caveats and uncertainties concerning the regulatory analysis undertaken.

None of the policy options would restrict market competition, reduce the incentives for businesses to innovate and invest, unduly impair private property rights or override fundamental common law principles.

  
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## STATUS QUO AND PROBLEM DEFINITION

### Background

1. As at 31 December 2014, the New Zealand child support scheme was providing financial support for around 201,500 children. There were 134,500 receiving carers and 133,400 liable parents with current liabilities. There are 42,200 liable parents who have no current liability but have debt. Of the liable parents, 120,600 are in debt.
2. The scheme was established by the Child Support Act 1991, which revised the rules relating to child maintenance when agreement between parents proved difficult or when the receiving carer was a beneficiary. The Child Support Act 1991 sets out the requirements for applying for child support, the means of determining liability, and processes for payments and objections.
3. The child support scheme is administered by Inland Revenue, which is responsible for both assessing contributions and collecting payments. The child support scheme is voluntary for parents unless the caregiver is receiving a sole-parent benefit or Unsupported Child Benefit. The majority of people in the child support scheme are beneficiaries.

### *Reasons for the review of the 1991 scheme*

4. Although the current child support scheme provides a relatively straightforward way of calculating child support liability for the majority of parents, there are some major concerns that seem to be affecting an increasing number of parents (and therefore children).
5. The primary assumption under the current scheme is that the liable parent is the sole income earner and that the receiving carer is the main care provider. The formula assessment is therefore focused on the liable parent and their ability to pay. However, today when parents live apart, there is an increased emphasis on shared parental responsibility and both parents remaining actively involved in their children's lives. Work participation rates of both parents, particularly in part-time work, has also increased since the scheme was introduced, resulting in the principal carer of the children now being more likely to be in paid work or seeking paid work.
6. Escalating levels of accumulated child support debt, relating in particular to child support penalties, is increasingly becoming an issue. Child support debt now exceeds \$3.2 billion, with 78% of the amount being penalties.
7. The scheme is now, in many cases, out of date and out of line with social expectations. This undermines some parents' incentives to meet their child support obligations and therefore detrimental to the wellbeing of their children.

### *Original policy problems*

8. The child support scheme was reformed in 2013 to address the main policy problems identified at the time. These included:
  - whether the current child support system accurately reflects the expenditure for raising children in varying family circumstances in New Zealand;
  - whether greater levels of shared care and other regular care should be taken into account when calculating child support;

- whether both parents' income should be taken into account when calculating the child support to be paid;
- whether incentives to make payments can be improved by changing the child support penalty rules and write-off provisions.

9. The main change of the 2013 reforms has been to shift the focus of the child support formula assessment from assessing the liability of the liable parent, to focusing on the level of support that is required from each parent for each qualifying child. In doing so, it considers a greater range of shared care, the income of all parents of the child (including legal step-parents), and the average cost of raising the child (taking into account other children of the parents). At the same time, changes were made to the general administrative processes and rules around payments and debts to improve incentives for liable parents to make timely payments.

10. More information on the background and the reasons for reviewing the 1991 scheme can be found in the earlier RIS *Child support scheme reform* prepared by Inland Revenue for the original reforms, dated 26 July 2011 and released November 2011 (see <http://taxpolicy.ird.govt.nz/publications/type/ris>). The RIS also considered the problems with the 1991 scheme, the consultation undertaken and analysis of the options for addressing the problems.

### ***Child Support Amendment Act 2013***

11. Following consultation on a range of options, the child support scheme was amended by the Child Support Amendment Act 2013 (Amendment Act).

12. The Amendment Act comes into effect from different dates. The application, formula assessment and notification process came into effect from 1 April 2015 (first phase of changes). These changes specifically address the first three bullet points of the original policy problems. The changes to the payment process, penalties and debt come into effect on enactment date or on or after 1 April 2016, along with other policy changes (second phase of changes)<sup>1</sup>. These changes specifically address the last bullet point of the original policy problems.

13. Further detail on the 1991 scheme and the 2013 scheme and the consultation undertaken can be found on Inland Revenue's websites, including the Tax Policy website (see <http://www.ird.govt.nz/childsupport/>) .

### ***Review of child support policy work programme***

14. The child support policy work programme was reviewed in June 2014 and Cabinet agreed to re-focus the child support reforms on reducing the size and growth in child support debt. Key changes in the reform include a fairer assessment formula, reducing penalty rates, and providing measures to better manage the debt book. Further information on the review can be found in the RIS *Review of child support scheme reform*.

15. At that same time, Cabinet also noted that officials would conduct further analysis on the debt book with a view to developing targeted strategies to address the older legacy debt.

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<sup>1</sup> Changes to liabilities for prisoner and long-term hospital patients came into effect on 1 April 2014. These were small changes that required no system changes to implement. There are also transitional provisions that came into effect from date of Royal assent.

## Problem definition

### *Child support debt*

16. Table 1 below summarises the debt book to 31 December 2014 and shows a debtor split between domestic and international (Australia and other countries) debt and the total debt split across assessed debt and penalty (both 10% initial late payment and 2% monthly incremental) debt.

**Table 1: Debt book summary to 31 December 2014**

	<b>Debtors</b>	<b>Assessed Child Support</b> \$	<b>10% Initial Late Payment Penalty</b> \$	<b>2% Monthly Incremental Penalty</b> \$	<b>Total Debt</b> \$
<b>Domestic</b>	91,255	350,281,173	54,427,806	1,053,068,295	1,457,777,274
<b>Australia</b>	19,138	211,258,260	19,523,931	570,073,302	800,855,494
<b>Other International<sup>2</sup></b>	10,160	146,289,712	16,942,411	766,076,600	929,308,723
<b>Total</b>	<b>120,553</b>	<b>707,829,145</b>	<b>90,894,148</b>	<b>2,389,218,198</b>	<b>3,187,941,490</b>

17. Analysis shows that escalating levels of accumulated child support debt, relating particularly to penalties, is increasingly becoming an issue. 78% of the debt is related to penalties and is 97% impaired (not expected to be collected).

18. There are two types of late payment penalties charged to outstanding debt amounts:

- Initial late payment penalties. Imposed on any unpaid balance of assessment immediately following the due date at a rate of 10% (or \$5.00, whichever is greater).
- Incremental late payment penalties. Imposed monthly (following the initial late payment penalty) on any unpaid amounts (inclusive of existing penalties) at a rate of 2%.

The penalty regime creates an effective penalty rate of 37% within the first 18 months.

19. Although the Commissioner of Inland Revenue (CIR) has a wide range of debt collection tools to apply across the compliance spectrum within the debt book, the inflationary nature of penalties over time has resulted in high levels of debt. While a penalty regime may be an appropriate part of any compliance model it should not unfairly or unreasonably penalise people. Research suggests that when debt reaches certain levels (\$10,000 or half as much again as the original amount) the debt level becomes a disincentive to pay and people disengage from their debt.

20. The Amendment Act goes some way to addressing the issue of child support legacy debt by providing some incentive for liable parents to enter into instalment arrangements for their debt and comply with those arrangements. In addition, changes to reduce penalty rates and allow for debt write-offs are expected to reduce debt from 2016.

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<sup>2</sup> 'Other International' includes the collection of debts owed by liable parents residing in New Zealand for the Australian Department of Human Services.

21. However, further analysis of the debt book shows that the penalty regime – post-reform – would not be flexible enough to address the legacy debt. This largely results from legislative constraints on incentives for liable parents to pay their assessment debt and on the Commissioner’s ability to negotiate payment arrangements and pragmatically manage the debt book to address legacy debt. Child support legacy debt remains a problem.

22. Further measures are needed to improve flexibility for the CIR to negotiate payment arrangements for child support debt and more pragmatically manage the older legacy debt.

## **OBJECTIVES**

23. The objectives of further measures are to:

- a) Reduce child support legacy debt;
- b) Encourage parents to pay their financial support obligations;
- c) Provide more flexibility for the CIR to negotiate payment arrangements and more pragmatically manage the child support debt book; and
- d) Promote the welfare of the children, in particular by recognising that children are disadvantaged when child support is not paid, or not paid on time.

24. High levels of debt can discourage liable parents from meeting their obligations leading to non-compliance and child support not being paid on time. A more responsive system with a better targeted payment and penalties system would encourage, or at least not discourage, parents to pay their child support, reduce debt and would help improve the well-being of their children.

## **Constraints**

25. A time constraint exists for the recommended option as the option is designed to support the child support reforms scheduled for amendment through the Bill that was introduced on 26 February 2015. The ability for Inland Revenue to deliver the recommended option relies on the option being reflected in the Bill and the scope, timing and drafting of the option remaining unchanged throughout the legislative process. There are no other significant constraints, caveats and uncertainties concerning the regulatory analysis undertaken.

26. This time constraint also impacts on the ability to consult and gather information.

## **REGULATORY IMPACT ANALYSIS**

27. Two options have been considered to meet the objectives and address the policy problem. These options are described and analysed below.

### **Option 1 – Status quo**

28. The status quo continues with the reforms focused on reducing child support debt as amended and detailed in the RIS *Review of child support scheme reform*.

29. Under this option, debt would be reduced through changes to penalty rates, incentivising liable parents to enter into payment arrangements and relaxing the penalty rules to provide the CIR with some flexibility to better manage the debt book.

30. The reforms specifically include:

- A penalty write-off incentive for liable parents to enter into an instalment arrangement covering assessment debt and initial late payment penalties;
- For liable parents who default on their first payment of child support, an initial late payment penalty write-off incentive to enter into and comply with an instalment arrangement (effectively applies to new debt);
- Relaxing the circumstances in which the CIR can write off penalties (but still subject to stringent tests).

31. The status quo only partially meets the objectives and addresses the policy problem as further analysis of the debt book shows that the penalty regime – post-reform – would not be flexible enough to address the legacy debt. This largely results from legislative constraints on incentives for liable parents to pay their assessment debt and on the Commissioner’s ability to negotiate payment arrangements and pragmatically manage the debt book to address legacy debt.

## **Option 2 – Additional measures to address child support legacy debt**

32. Prior to the child support reforms the high, compounding penalty rates for child support debt combined with the low incomes of many liable parents has resulted in penalties that are disproportionate to the originally assessed debt. The measures below aim to permit a fairer treatment of the accumulated penalties faced by liable parents so as to encourage them to focus on repayment of their obligations to pay financial support for their children. The proposals aim to promote the welfare of children by recognising that children are disadvantaged when child support is not paid, or not paid on time.

33. The additional measures would strengthen the second phase of the child support reforms currently being developed, require minimal systems changes and additional resource, and would be funded internally by Inland Revenue.

34. The measures proposed are :

- Extension of the mandatory write-off of monthly incremental penalties for payment arrangements subject to 26 week review to payment arrangements where a liable person has not explicitly agreed to the arrangement;
- Amendment to the discretionary penalty write-off tests to adopt a more pragmatic test based on “fair and reasonable”.

35. The key principle of these proposals is that if the liable parent takes action to repay their assessment debt then the Commissioner can relieve them on their existing penalty burden.

### *Extension of mandatory write-off of incremental penalties*

36. Currently, when a repayment arrangement for debt is negotiated and agreed between the CIR and a liable parent an automatic write-off of monthly incremental late payment penalties is considered at each 26-week period (or at the completion of an arrangement).

Liabile parents who remain fully compliant with their negotiated repayment arrangement receive an automatic write-off (mandated in child support legislation) of monthly incremental late payment penalties.

37. Repayment arrangements where explicit agreement with the liable parent has not been received do not currently qualify for write-off of monthly incremental late payment penalties as above. The manner in which the repayment is being made, and the rate of repayment, can be the same as an arrangement negotiated with a liable parent, the only difference being no explicit agreement.

38. Currently, there are 27,500 liable parents with child support debt amounts totalling \$423 million under payment arrangements that do not qualify for monthly incremental penalty write-off. If this proposal is approved, the debt to be collected under these plans could reduce by \$123m. In addition, aligning treatment across arrangements regardless of the liable parent's agreement would increase equity across liable parents.

39. *For example:* A liable parent with income from a benefit has child support debt of \$52,139 (\$17,577 unpaid core assessments, \$1,775 initial late payment penalties and \$32,787 monthly incremental penalties). As the main source of income is a benefit, the legislation requires Inland Revenue to impose automatic deductions from the benefit income to repay current obligations and debt amounts. The beneficiary is not asked whether they agree with child support being paid in this manner. The automatic deductions continue to be made as expected, and at the conclusion of each 26-week period until full repayment, monthly incremental penalties are automatically written off. If the liable parent does not comply with the arrangement (moving off a benefit for example), Inland Revenue ceases the arrangement and the monthly incremental penalties will begin to accumulate from that point on. Inland Revenue also has the discretion to decline any future payment agreements if the liable parent is non-compliant. Without the proposed extension of the mandatory write-off, the liable parent would be required to pay the monthly incremental penalties of \$32,787 even while on a benefit.

#### *A pragmatic test for discretionary penalty relief*

40. Child support legislation (both current and anticipated reform) contains penalty relief discretions designed to increase flexibility to manage the debt book effectively. The discretions cover both initial late payment and monthly incremental penalties across a range of circumstances where penalty write-off would be appropriate, such as incentivising arrangements and promoting and rewarding positive compliance behaviour.

41. To qualify for penalty relief, some discretions (the upfront monthly penalty write-off and residual penalties write-off) require a liable parent to be in serious hardship or for continued collection to represent an inefficient use of the Commissioner's resources. In both of these circumstances, write-off is subject to further tests in which the Commissioner must have regard to maintaining the integrity of the tax system, promoting compliance, the rights and responsibilities of taxpayers and Inland Revenue, and her duty to maximise revenue within practical boundaries. While the tests were legislated to ensure appropriate consideration is given to debt write-off and that checks and balances are in place, they provide less discretion than originally envisaged.

42. As a consequence, the debt book is inflated with penalties that are unlikely to be collected and unable to be written off. In many cases, the high value of penalty debt (often a result of the inflationary penalty rates over time) implies that the debt value is sufficient to

warrant collection. Adopting a “fair and reasonable” test would enable penalty relief to be applied in circumstances where it makes sense to do so but where the “inefficient use of resources” based test would not allow relief.

43. *For example:* A liable parent receiving NZ Superannuation from the Ministry of Social Development owes \$136,958 in penalties for child support. He has paid all his core assessment debt, all his late payment penalties and \$943 towards his incremental late payment penalty debt. He is repaying his penalty debt at \$25 per week. He will be 89 years old at the conclusion of the arrangement in 2037. As his debt is currently under arrangement, he does not qualify for any penalty write-off. This proposal would allow for the write-off of some or all of the incremental late payment penalty debt.

44. Key risks associated with providing further flexibility for penalty relief include interpretation concerns (for example, misunderstanding could lead to inappropriate penalty relief), potential for inconsistency in treatment of liable parents in similar situations, unintended behavioral change with liable parents not paying assessment on time, and loss of consistent debt treatment across legislation Inland Revenue is responsible for.

45. These risks can be mitigated through development of robust internal guidelines for considering “fair and reasonable”, appropriate training for staff, education for customers, and acknowledgement that child support customers can be differentiated from customers associated with other Inland Revenue Acts. These risks can be further mitigated by ensuring appropriate levels of delegated authority are set to apply this penalty relief.

### **Impact analysis of the options**

46. The key impacts of the options, and whether they meet the objectives in paragraph 23, are summarised in Table 2.

47. Both options would continue with changes to debt and penalties as part of the second phase of the child support reforms. Around 120,600 liable parents are in debt, about 70% of liable parents. The total debt exceeds \$3.2 billion, an average of \$26,550 per person. Around 78% of the debt is the penalty component. Of the penalty debt, about 3% relates to the late payment penalty, with the rest relates to the 2% monthly penalty rate. However, the average debt is not a good indicator of the spread of the impact of the changes. Around half of the 120,600 liable parents have a debt where the penalties are greater than the value of the assessment debt. The older the debt, the higher the proportion of penalties.

48. To the extent that the debt and penalty changes improve the timeliness of payments, and the payment of assessment debt by liable parents, there would be a corresponding impact on the receiving carers and their children. However, receiving carers do not receive penalty payments (78% of all debt), and receiving carers who are beneficiaries do not receive assessment debt as this is retained by the Crown. Around 25% of domestic assessed debt and around 50% of the international assessed debt is owed to receiving carers, the rest is owed to the Crown.



**Table 2: Summary of the impacts of the options**

<i>Option</i>	<i>Meets objectives</i>	<i>Impacts</i>					<i>Recommendation and net impact</i>
		<i>Economic/ Revenue impact</i>	<i>Administrative implications</i>	<i>Compliance implications</i>	<i>Social implications</i>	<i>Risks</i>	
<b>One</b> <i>Status quo</i>	Partially A, B, C & D	<p>The revenue cost of the current reform changes to penalty and debt rules is estimated at around \$10 million per annum.</p> <p>Estimated that a 1% increase in the amount of child support paid to the Crown would have a positive fiscal impact of around \$2m per annum.<sup>3</sup></p>	The administrative impacts of this option are an integral part of the wider child support reform programme.	<p>Compliance costs for liable parents are expected to decrease as payment arrangements are made and interactions with Inland Revenue decrease.</p> <p>An increase in positive compliance behaviour is anticipated as a result of incentives to enter into payment arrangements.</p>	<p>Increases in positive compliance behaviour will have flow-on effects for receiving carers and their children to the extent that payments are due to carers not the Crown.</p> <p>Improved perception of Inland Revenue and the child support system through a less punitive penalty regime</p>	<p>Debt may continue to escalate to unmanageable levels if incentives to negotiate and enter payment arrangements are insufficient.</p> <p>Liable parents are discouraged from paying child support as a result of inflationary penalties over time.</p> <p>Parents who have paid penalties may perceive inequity where other parents are relieved of penalties owed.</p> <p>Other demands on income prevent the repayment of child support debt resulting in less financial support for children.</p> <p>Delays in the legislative process delay implementation of the reforms.</p>	<p>Not recommended.</p> <p>This option addresses the problem definition but only partially meets the policy objectives.</p> <p>The risks to continued debt levels and non-payment of financial support are significant.</p>

<sup>3</sup> RIS – Child Support Scheme Reform, 26 July 2011

<i>Option</i>	<i>Meets objectives</i>	<i>Impacts</i>					<i>Recommendation and net impact</i>
		<i>Economic/ Revenue impact</i>	<i>Administrative implications</i>	<i>Compliance implications</i>	<i>Social implications</i>	<i>Risks</i>	
<p><b>Two</b></p> <p><i>Addressing child support legacy debt</i></p>	A, B, C & D	<p>Modelling shows a high response to debt repayment incentives and approach to penalty write-off would result in net reductions to the Crown Operating Balance of \$1.2 million in 2015/16, \$8.3 million in 2016/17, and \$14.9m in 2017/18, and \$22.7 million in 2018/19.</p> <p>The positive fiscal impact of the changes as a result of increased child support paid to the Crown is estimated at \$0.9 million for the 2015/16 year which increases to \$1.8 million in the 2017/18 year.</p> <p>The changes are expected to cost \$500,000 which will be funded internally by Inland Revenue.</p>	<p>Administratively, this option closely aligns with the wider child support reform programme.</p> <p>In addition to option 1, a minor increase in administration cost is anticipated relating to training, operational processes and communications.</p> <p>Partial offset of administration cost from shorter term payment arrangements as fewer penalties charges and collected.</p> <p>Increased capacity for Inland Revenue to achieve greater coverage across the debt book.</p>	<p>Compliance costs for liable parents are expected to decrease as payment arrangements are made and interactions with Inland Revenue decrease.</p> <p>An increase in positive compliance behaviour is anticipated as a result of incentives to enter into payment arrangements.</p> <p>The expected decrease in compliance cost and increase in positive compliance behaviour are anticipated to be greater than option 1 as a result of stronger incentives to repay debt.</p>	<p>Greater increases in positive compliance behaviour (than under option 1) will have flow-on effects for receiving carers and their children to the extent that payments are due to carers not the Crown.</p> <p>Greater improved perception of Inland Revenue and the child support system through a less punitive penalty regime than under option 1.</p>	<p>Debt may continue to escalate to unmanageable levels if incentives to negotiate and enter payment arrangements are insufficient.</p> <p>Parents who have paid penalties may perceive inequity where other parents are relieved of penalties owed.</p> <p>Other demands on income prevent the repayment of child support debt resulting in less financial support for children.</p> <p>Delays in the legislative process delay implementation of the reforms.</p>	<p>Recommended.</p> <p>This option addresses the problem definition and meets the policy objectives.</p> <p>In addition to promoting positive compliance behaviour for legacy debt, this option is expected to have positive impacts on future compliance behaviour as debt becomes more manageable.</p>

### *Economic/Revenue impacts*

49. The financial implications of additional measures to address child support legacy debt would depend on debt repayment levels by liable parents and the timing of any penalty relief granted.

50. The proposed Commissioner discretions are expected to result in higher repayments of core assessment debt by liable parents. The ability to relieve penalties will encourage some parents to repay their assessment debt when previously they would not have. The higher repayment of assessment debt will be to both the Crown (where the custodial parent is on a benefit) and directly to custodial parents to help support the children.

51. A high write-off estimate puts the additional core assessment paid (payable to the Crown and receiving carers) as a result of these proposals at \$1.5 million in the 2015/16 year increasing to \$2.9 million by 2018/19. An additional benefit of the proposals is the ability of the Commissioner to address situations where the penalties faced by liable parents are clearly disproportionate to their original assessment. In addition to the repayment of assessment debt the changes would enable administrative efficiencies for Inland Revenue enabling stronger focus on further collection of assessment debt.

52. Table 3 below shows the expected increase in repayments of Crown assessment debt and repayments directly from the liable parent to the custodial parent.

**Table 3: Increase in repayments of assessment debt by liable parents**

<b>Financial year</b>	<b>Increase in Crown assessment debt \$m</b>	<b>Increase in assessment debt direct to custodial parent \$m</b>	<b>Total \$m</b>
2014/15	-	-	-
2015/16	0.9	0.6	1.5
2016/17	1.5	0.9	2.4
2017/18	1.8	1.1	2.9
2018/19	1.8	1.1	2.9

53. In the Crown accounts the imposition of child support penalties is recognised as revenue when imposed. Any unpaid penalties are treated as a receivable i.e. an asset. From an accounting perspective Inland Revenue is required to impair this receivable. Based on historical information we impair this receivable at 97%, reflecting the low collectability of penalties.

54. Any reversal or relief from child support penalties is treated as a reduction in revenue i.e. a reduction in the Crown operating balance. When a penalty is written off, revenue will decrease and impairment expense will decrease by 97% of the revenue reduction. This results in a net reduction to the Crown operating balance of 3% of the write-off amount.

55. A reduction in administrative costs is anticipated due to payment arrangements being set for lower values and subsequently, shorter durations. Further administrative efficiencies would be achieved if the CIR had ability to take a fair and reasonable approach to penalty

only debt. Where liable parents qualify, their debts could be written off and their case exited from the scheme, reducing on-going administration and compliance costs.

56. Table 4 below shows the impact on the Crown operating balance of the proposals assuming a high response to debt repayment incentives and approach to penalty write-off. These impacts are in addition to the status quo as the proposals are designed to complement the already agreed child support reforms.

**Table 4: Net impact on Crown Operating Balance**

Vote Revenue	\$m increase/(decrease)				
	2014/15	2015/16	2016/17	2017/18	2018/19
<b>Non- Tax Revenue:</b> Child Support Collections	-	(67.7)	(326.0)	(553.8)	(816.8)
<b>Non-Departmental Other Expenses:</b> Impairment of Debt Relating to Child Support	-	65.6	316.2	537.1	792.3
Increase in Revenue from child support assessment receipts to the Crown	-	0.9	1.5	1.8	1.8
<b>Net impact on Crown Operating Balance</b>	-	<b>(1.2)</b>	<b>(8.3)</b>	<b>(14.9)</b>	<b>(22.7)</b>

57. To implement these measures some changes will be required to Inland Revenue's operational processes which will also be supported by internal communication, guidelines and training. The changes are expected to cost around \$500,000 which would be funded internally by Inland Revenue.

#### *Administrative impacts*

58. Both options have comparable staff and associated administrative costs required for implementation. As phase two of the child support reforms is in the development stage and the timing of some of the penalty and debt changes is anticipated for later in 2015, the administrative impacts to move from option 1 to option 2 would be relatively minor.

59. An increase in administrative costs is anticipated for the development and implementation of internal interpretation guidelines for amended penalty rules under option 2 but these costs are expected to be mitigated by more efficient use of Inland Revenue resources resulting from the new rules.

60. A reduction in administrative costs is anticipated due to payment arrangements being set for lower values and subsequently, shorter durations. This is due to penalties accumulating at a slower rate (through child support reforms changes), the proposal for the Commissioner to have greater flexibility to write off penalty debt where it is "fair and reasonable" (rather than pursuing collection), and all eligible liable parents who enter into a payment arrangement qualifying for incremental penalty write off whether the arrangement is agreed to or otherwise made.

61. Further administrative efficiencies would be achieved if the CIR had ability to take a fair and reasonable approach to penalty only debt. Where liable parents qualify, their debts could be written off and their case exited from the scheme, reducing on-going administration and compliance costs.

62. Under both options, administrative efficiencies gained could be reinvested to pursue the collection of more liable parent assessment debt, increasing payments to receiving carers and enabling them to financially support the children in their care.

### ***Compliance impacts***

63. Both options are designed to encourage payment arrangements, support liable parents to get their child support debt under control and meet their child support obligations.

64. Under both options it is anticipated that compliance costs would decrease for liable parents as payment arrangements were made and the number of and need for interactions with Inland Revenue would decline. Based on greater flexibility to negotiate arrangements and determine penalty levels under option 2, compliance costs are expected to be less than option 1.

65. Positive compliance behaviour is expected to result from both options 1 and 2 but is anticipated to be greater under option 2 given greater incentives for liable parents to repay debt.

### ***Social, environmental or cultural impacts***

66. There are no environmental or cultural impacts associated with the options considered above. There are social impacts from the options as they are anticipated to impact on the levels of financial support available to families with children, the timeliness of payments, and the level of debt.

67. Under option 2, there will be greater increases in positive compliance behaviour with flow-on effects for receiving carers and their children to the extent that payments are due to carers not the Crown, than under option 1.

68. Option 2 presents a greater opportunity for improved perception of Inland Revenue and the child support system through a less punitive penalty regime than option 1.

### ***Other risks***

69. There is a risk around the timing with respect to both options as they are designed to support the child support reforms scheduled for amendment through the Taxation (Annual Rates for 2015-16, Research and Development, and Remedial Matters) Bill (the Bill) introduced on 26 February 2015. The ability for Inland Revenue to deliver either option relies on the option being reflected in the Bill and the scope, timing and drafting of the option remaining unchanged throughout the legislative process.

70. Option 1 will continue to limit incentives for parents to pay debt and Inland Revenue's ability to manage the debt book, meaning debt will continue to climb. Experience indicates that compliance levels fall as debt accumulates and ages, especially when penalty debt begins

to exceed the core assessment. This is a risk that debt becomes unmanageable, impacting on perceptions of the child support scheme and ultimately the welfare of associated children.

71. Under both options, but more particularly option 2 with greater payment incentives, there is a risk that receiving carers perceive the changes as inequitable. This perception would be related to any penalty write-off for parents who had not been meeting their child support obligations. However, if penalties have been written off this should be as a result of positive compliance behaviour and increased payments of child support. In all cases, receiving carers do not receive penalty payments as these are payable to the Crown under the child support scheme.

72. Under both options, but greater under option 2 with wider penalty relief, there is a risk that liable parents who have paid penalties in the past perceive that new write off provisions are unfair.

## **CONSULTATION**

73. A significant level of public consultation was undertaken on the original options for potential child support reform. There had also been consultation with a range of Government agencies on child support issues over several years. Feedback from these agencies had, wherever possible, been incorporated into the formulation of the original policy options and subsequent legislation. There was a general recognition from these agencies that the various issues with the child support scheme need to be addressed.

74. There was less opportunity to consult on the options in the June 2014 RIS and this RIS given the timing constraints on decision-making and the sensitivity of the changes. Treasury were consulted and their feedback is incorporated in the options considered.

## **CONCLUSIONS AND RECOMMENDATIONS**

75. Inland Revenue supports option 2. This option will encourage and facilitate parents to make timely child support payments for the benefit of their children, and to reduce debt. While this option has an implementation cost, the cost is expected to be partially offset by shorter term payment arrangements as fewer penalties charges and collected and increased capacity for Inland Revenue to focus on collectible debt.

76. The pragmatic approach for penalty consideration based on “fair and reasonable” enables more flexible negotiation with liable parents, opportunity for liable parents to get debt under control, the CIR to better focus resources on collecting outstanding financial support rather than penalties that are unlikely to be collected and are 97% impaired.

77. Overall, option 2 is recommended as it strengthens the expected benefits to be delivered by the child support reforms. The benefits of option 2 are anticipated to address the older legacy debt through strong incentives for liable parents to repay debt and providing the CIR with additional negotiation levers for making payment arrangements and ability to pragmatically manage the child support debt book.

## **IMPLEMENTATION**

78. To enable appropriate processes to be in place and required administrative measures to take place before external communications with child support parents can commence the legislative amendments would need to be considered as part of the Bill that was introduced on 26 February 2015.

79. Once implemented, Inland Revenue will enforce the new legislation as part of its usual business operations.

80. Communications will be prepared for child support families and key stakeholders to ensure they understand the changes. Inland Revenue websites will be updated, and an article included in a *Tax Information Bulletin*.

## **MONITORING, EVALUATION AND REVIEW**

81. A programme governance group will oversee the implementation of the changes to ensure the legislative changes are delivered correctly. The changes, once implemented, will be monitored by senior managers to ensure they achieve the objectives. Any issues will be raised through Inland Revenue's internal processes. Complaints and correspondence will also be analysed to identify any issues with the new legislation or the implementation.

82. In accordance with the Generic Tax Policy Process (GTTP), the legislation will be reviewed and remedial changes may be included on a future tax policy work programme, subject to resources and priority.

83. In general, Inland Revenue's monitoring, evaluation and review of new legislation takes place under the GTTP: a multi-stage tax policy process that has been used to design tax policy in New Zealand since 1995. The final stage in the GTTP contemplates the implementation and review stage, which can involve post-implementation review of the legislation, and the identification of any remedial issues. Opportunities for external consultation are also built into this stage. In practice, any changes identified as necessary for the new legislation to have its intended effect would generally be added to the Tax Policy Work Programme, and proposals would go through the GTTP.