

Regulatory Impact Statement

Review of child support scheme reform

AGENCY DISCLOSURE STATEMENT

This Regulatory Impact Statement has been prepared by Inland Revenue.

The statement provides an analysis of options to change the child support scheme reforms, enacted in 2013 but not yet in force, in order to recognise the increased priority of reducing child support debt and to reduce the administrative cost of implementing the reforms.

The statement reviews the child support reforms as enacted and considers whether alternative options could continue to provide the benefits the reforms seek but at a lower implementation cost. Another key consideration in the analysis is whether the reforms, and components of the reforms, reduce child support debt.

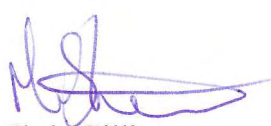
The decision to introduce the child support reforms was accompanied by a Regulatory Impact Statement (RIS) *Child support scheme reform* of 26 July 2011. The earlier RIS contains background information and analysis that is useful to the options considered in this RIS, particularly the status quo.

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. However, there has been limited consultation on the subsequent options in this statement given the timing constraints on decision-making and the sensitivity of the decisions being considered.

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 impact on the analysis on the likely benefits from various options and the impact of different options on the debt book.

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. Some options would reduce costs on some businesses that employ parents who pay child support, although these costs were not thought to be significant and already form part of the existing PAYE processes.


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STATUS QUO AND PROBLEM DEFINITION

Background

1. As at 31 March 2014, the New Zealand child support scheme was providing financial support for around 203,500 children. There were 134,800 receiving carers and 136,000 liable parents with current liabilities. However, there are another 43,800 liable parents who have no current liability but owe arrears. Of the liable parents, 125,000 are in debt. In the 2013/14 tax year there were around 41,000 new child support applications and around 24,000 receiving carers left the child support scheme.
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 parent 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 paying parent is the sole income earner and that the receiving carer is the main care provider. The formula assessment is therefore focused on the paying 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 billion, with 75% 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 paying 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 to make timely payments.

10. More information on the background and the reasons for reviewing the 1991 scheme can be found in the earlier Regulatory Impact Statement (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). However, the reforms are yet to come into effect.

12. The Amendment Act comes into effect from different dates. The application, formula assessment and notification process is due to come 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 from 1 April 2016, along with other policy changes (second phase of changes)¹. These changes specifically address the last bullet point of the original policy problems.

¹ 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.

13. The specific reform changes are to be implemented in two phases and are set out in the box below.

First Phase

The first phase includes the new formula, the new assessment, the reassessment process and the issuing of notices.

It concerns changes that come into effect from 1 April 2015.

The new formula includes:

- the estimated average cost of raising children in New Zealand, which will be annually updated;
- a lower level of minimum shared care, being 28% of nights (down from 40%);
- the child support income of both parents, not just the liable parent;
- recognising where there may be more than two parents (such as legally recognised step-parents);
- recognising where a parent has qualifying children in multiple relationships.

The formula will continue to determine a child support income amount.

The child support income includes:

- a living allowance based on equivalent levels of welfare benefits, but will no longer provide an allowance for a new spouse;
- a dependent child allowance. Children from a new relationship, who are not legally dependent on the parent, will no longer be included in dependent child allowances;
- a multiple relationship allowance to recognise the cost of child support paid for children in other relationships;
- a new simplified process for measuring taxable income if the person only has calendar year income that is withheld at source, for example, wages.

There is an updated process for parents who wish to estimate their taxable income for the year, which will also apply to receiving carers who are parents.

A new assessment and reassessment process is established to collect the new information required for the formula. It also sets out that receiving carers will require care levels of 35% of nights to qualify to receive payments.

There will be greater Commissioner discretion to recognise significant daytime care for shared care purposes, and to rely on parenting orders when establishing care levels.

Notices that are issued will contain additional information reflecting the changes to the formula.

Second Phase

The second phase of the reforms includes the changes to the payment, penalties and debt write-off rules. It also includes other policy changes. The changes in the second phase come into effect from 1 April 2016, or are not required until after the end of the child support year beginning April 2015.

The second phase includes:

- 2.1 a new definition of “adjusted net income”, which includes income adjustments to taxable income, such as income in trusts and companies;
- 2.2 a penalty for receiving carers who are parents and who underestimate their income for the year;
- 2.3 reducing the maximum age of a qualifying child from under 19 to under 18, unless they are 18 and still in full-time secondary education – aligning with Working for Families age limit;
- 2.4 compulsory deduction of child support from employment income, unless there are grounds for an exception such as privacy or cultural reasons;
- 2.5 a two stage late payment penalty with an immediate 2% late penalty, with the remainder of the current 10% penalty only being charged if the debt remains unpaid after seven days;
- 2.6 a reduction in the ongoing monthly penalty rate from 2% to 1% after a year;
- 2.7 the ability to offset current payments against past debts where the liable parent and receiving carer swap roles (that is, where the child moves to live with the other parent);
- 2.8 relaxing the circumstances in which penalties can be written-off, including when a liable parent enters into an instalment arrangement or is in serious hardship, when debt recovery is an inefficient use of Inland Revenue’s resources or when only low levels of penalty debt are outstanding, and allowing Inland Revenue to write off assessed debt owed to the Crown on serious hardship grounds;
- 2.9 recognising re-establishment costs as a grounds for an administrative review;
- 2.10 the discretion to recognise other payments, such as payment of school fees, as qualifying as child support payments where they directly benefit the child.

14. 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/>)

Impact of the reform

15. Analysis from 2011 determined the reforms to the child support formula would have financial implications for some parents.

Parents	Unaffected	Receive more / pay less	Receive less / pay more
Receiving parents	82,230 (60%)	24,505 (18%)	29,776 (22%)
Paying parents	57,823 (42%)	45,997 (34%)	32,691 (24%)

16. Overall, it was estimated that 70,502 parents would be better off under the changes (that is, they will receive more or pay less child support) and 62,467 worse off (that is, they will receive less or pay more).

17. For the majority of parents whose child support will be affected, the change in child support received and paid was estimated as likely to be between plus or minus \$66 per month (plus or minus \$800 per year). That was based on rates and data held at the time and assumptions were made where data was lacking such as the number of dependent children paying parents would have.

18. For a large percentage of receiving and paying parents (60 percent and 42 percent respectively), the changes to the formula would not result in any change in the amounts received or paid. A total of 140,053 parents would be unaffected. This is because many parents would continue to either receive a sole-parent benefit (and therefore not receive child support payments directly) or continue to pay the minimum contribution because their income level is below the minimum level for child support purposes. For those who would be affected, however, the reforms would represent a more transparent and equitable result in a greater number of different circumstances.

19. Parents who qualify for the wider recognition of share care would be most affected, with paying parents likely to pay less in such cases.

Problem Definition

Impact on child support debt

20. The Minister of Revenue has indicated that reducing child support debt is a priority for child support policy. Child support debt is over \$3 billion and growing. 75% of the debt is related to the penalties and the vast majority is over a year old. The penalty rate is approximately 37% a year (in addition to a late penalty payment of 10%), meaning the size of the penalty debt can soon eclipse the size of the child support assessment debt. Liable parents faced with large debt amounts may be discouraged from making further payments, especially if they are on a low income. Of the penalty debt, 97% is impaired (not expected to be collected). A disproportionate amount of debt is owed by parents living overseas.

21. The Amendment Act goes some way to addressing the issue of child support debt by improving the fairness of the scheme (and therefore acceptance by paying parents). In particular, the changes to reduce the penalty rate and allow for debt write-offs will reduce debt from 2016 but are unlikely to be a full solution. Child support debt remains a problem.

Cost of implementation

22. The original 2011 cost estimate for the programme to implement the reforms was \$30 million. As the legislation was developed and greater details on the specific changes were determined and finalised, a business case was prepared in 2012. The business case revised the estimated cost up to \$120 million over the ten year period from 2011-12 to 2021-22 (costs in the latter half of the period cover ongoing depreciation, capital charges and ongoing additional staff costs to administer the modernised scheme). The increase reflected a greater appreciation of the complexity of the changes proposed by the new formula. One of the main assumptions in the business case was that the vast majority of the expenditure would be operating cost.

23. The legislation was amended during the Parliamentary process in response to both changes recommended by officials and matters raised by submitters. For example, the level of shared care at which a receiving carer would qualify for payment was increased to 35%, but 28% of care was kept as the lower threshold for the formula assessment of child support liability. This meant some work already underway had to be significantly altered, increasing the costs and time for delivery.

24. During 2013 Inland Revenue re-assessed the time and costs associated with the programme and the assumptions underlying the business case. It became clear that the work could not be implemented, to the level of quality and certainty required, by the original legislative deadline. More time was required. Also, the assumption that the majority of development costs would be operating and not capital expenditure was proving to be incorrect as the reform was implemented. Capital expenditure comes with associated depreciation costs and capital charges leading to a higher overall cost for the reforms. If the correct assumption had been made in the business case, the cost of the reforms would have been much higher than \$120 million. In early 2014, the legislative deadlines were delayed a year to allow time to complete the first phase to the standards required. The revised estimate of the project, including costs from the delay and the higher ratio of capital expenditure, is now \$210 million for the ten year period from 2011/12 to 2020/21. The majority of the higher cost is the depreciation and capital charge associated with the capital expenditure.

25. The higher estimated cost mean the implied benefit:cost ratio for implementing the reform has changed from when the Government originally made its decision. As a result, the Minister of Revenue requested a review of the reforms in light of the revised cost estimate. The Minister also requested a greater focus on reducing the child support debt book.

Assessment of Status Quo

26. The status quo option is to implement the reforms as set out in the Amendment Act. The status quo meets the original objectives and policy problems and is expected to deliver the original non-quantified benefits considered in the earlier RIS of improved fairness, a modern scheme, and greater incentives to make timely payments. Implementing the status quo will require a higher cost than anticipated – meaning a lower value for money return to the Government.

27. The estimated cost of implementing the whole reform is estimated at \$210 million over the ten year period. While the benefits of the reform are generally intangible, it is questionable whether the Government would have agreed to implement all of the reform components at the revised total cost.

28. The overarching fiscal objective of the Government has been to restrain the growth in government spending, reduce deficits and return to surplus. The additional cost of implementing the status quo will impact on the Government's operating balance meaning less spending elsewhere (where the value for money proposition may be higher), greater debt or lower surplus.

29. As the reform is made up of a number of components, the value for money of individual components will vary. Most of the reform elements are expected to have a positive impact on timely payments and reducing the growth of new debt, especially the changes to penalty and debt write-off provisions. Other elements of the reform will have a small or no impact on debt. In terms of reducing debt further, other non-legislative options may have a greater impact than elements of the child support reforms, especially as non-legislative options generally only require operating costs and no capital expenditure.

30. While the status quo addresses the original policy problem and will mostly meet the priority of reducing child support debt, it does so at a higher than expected cost, and therefore represents less value for money than originally anticipated. Consequently, the status quo is no longer supported.

OBJECTIVES

31. The objectives are to:

- a) reduce child support debt (or at least slow the growth);
- b) reduce the implementation cost of the reforms;
- c) improve the fairness of the child support scheme so that it reflects social and legal changes which have occurred since its introduction in 1992;
- 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.

32. High levels of debt can discourage paying 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. The cost of implementing changes to make the system more responsive should be commensurate with the likely and intended benefit.

33. Reducing the implementation cost would mean not delivering some of the changes that meet the other objectives. For example, not proceeding with the changes to the penalty rates would reduce the implementation costs but would not reduce child support debt, may be considered unfair and have a negative impact on compliance, ultimately resulting in disadvantage to the child of the parent.

Constraints

34. The Government has previously approved funding for \$120 million and authorised the department to use a further \$10 million of its capital reserves. There are significant constraints on additional funding over the next few years, particularly in the 2014/15 fiscal year. The Government is unlikely to authorise new funding to meet the \$210 million cost of the status quo.

35. As legislation is already in place, any further changes to legislation should be enacted before the existing provisions come into force, to avoid the prospect of retrospective application. Legislative changes that impact on child support assessments are required to be in place by February for a 1 April year as notices are sent out to parents in advance. Changes to the Inland Revenue's FIRST system take time to be implemented and checked, with the minimum time dependent on the complexity and type of change.

36. Parliament is dissolved for the election period from Thursday 14 August 2014 until after the election on Saturday 20 September 2014. Parliament also tends to rise over January. The first phase of changes applies from 1 April 2015. Therefore, to avoid retrospective application, any legislation affecting the formula assessment on the first phase of the reforms would require urgency through at least some stages of Parliament. A higher threshold is required to be met for urgent legislation. This constrains the options that affect the first phase of the reforms.

37. These time constraints also impact on the ability to consult and gather information.

REGULATORY IMPACT ANALYSIS

38. Four major options have been considered to reduce the cost of implementing the child support reforms and slowing the growth of child support debt while continuing to address the objectives of the reform. These range from repealing the reforms and returning to the 1991 child support scheme to scaling back the scope of the child support reform package. These options are described below:

Option 1 – Defer the child support reforms until Inland Revenue's Transformation programme has been completed

39. Under this option the reforms would be further amended to either delay the commencement dates by several years or to repeal the legislation and re-introduce the reforms at a later date once the Inland Revenue Business Transformation programme is completed. The Business Transformation programme is looking to improve the processes supporting the administration of the tax system, including the technology and computer systems. Part of the implementation of the child support reform underway now will be in the department's legacy FIRST system, which is expected to be replaced as part of the Transformation programme.

Option 2 – Repeal the child support reforms and return to the 1991 scheme on child support

40. Under this option, the reforms would be repealed entirely, with no expectation of re-introducing the reforms at a later date. Some small improvements may continue to be made to the scheme through the usual remedial programme or through the Budget process, as funds and resources allow.

Option 3 – Implement the first phase of the reforms and repeal the second phase of the reforms

41. Under this option, the second phase of the reforms in the Amendment Act would be repealed, but the first phase will remain and be implemented. This would mean most of the change to the formula assessment and associated processes would continue but the penalty, debt write-off and payment changes would no longer proceed.

Option 4 – Implement the first phase and part of the second phase of the reforms

42. This option is the closest to the status quo. Under this option, parts of the reforms would be repealed. All of the first phase will remain and be implemented and some parts of the second phase that meet the objective of debt reduction would also be implemented. This would mean most of the change to the formula assessment and associated processes would continue as well as the penalty, and debt write-off provisions but the changes to payment options, the wider definition of income and the underestimation penalty would no longer proceed.

Impact analysis of the options

43. The impacts of options one to four and the status quo option, and whether they meet the objectives in paragraph 31, are summarised in Table 1.

44. In 2011 it was determined that 60% of receiving carers and 42% of paying parents would be unaffected by the reforms in the amount of child support they are liable to pay or expect to receive. It is expected that a similar proportion of the current and future child support parents would be unaffected by the options on whether to delay, stop or proceed with the first phase of the reforms. For liable parents this is because they are on a low income and therefore are required to only pay the minimum amount of child support, whether under the old or new formula. For receiving carers who are on a welfare benefit, any child support paid is retained by the Crown to offset the cost of the benefit payments and is not passed on. The options considered in the RIS around the first phase would impact only on the remaining 40% of receiving carers and 58% of paying parents.

45. Option 1, to defer the reforms, would likewise defer the expected impact of the reforms mentioned earlier. Option 2, to repeal the reforms, would undo the expected impact on families discussed above. That is, those expecting to be better off would no longer be, and those expected to be worse off would presumably continue to receive their current levels of support. This would depend on whether the repeal alters the compliance behaviour of paying parents. It is possible that the repeal could result in some paying parents ceasing to be compliant due to perceptions of unfairness, leading to receiving carers being worse off.

46. The status quo, options 3 and 4 would continue to implement the first phase of the reforms including the change to shared care and the formula calculation. The expected impact on families from the 2011 RIS would continue to apply.

47. Option 4 and the status quo are the options that propose to proceed with changes to debt and penalties in the second phase. Options 1, 2 and 3 would defer or repeal the second phase, and therefore the debt and penalty provisions. Around 125,000 paying parents are in debt, about 70% of paying parents. The total debt just exceeds \$3 billion, an average of \$24,250 per person. Around 75% of the debt is the penalty component. Of the penalty debt, about 4% 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. Nearly half of the 125,000 paying parents have a debt where the penalties are greater than the value of the assessment debt; 44% or 55,000 people. The older the debt, the higher the proportion of penalties. This smaller group will receive the greatest impact from the penalty write-off and penalty rate reductions proposed under the status quo and option 4. For example, a \$1,000 missed payment after 2 years grows to \$1,768 under the current rules. Under the proposed changes in the second phase, the same debt after 2 years would be \$1,571, a reduction of \$197 or nearly 20% of the original missed payment.

48. For some debtors the issue is the inability to make payments over and above current liabilities. Around 67% of domestic debtors have low incomes, around 63,500 people. Penalty debt write-offs will have a particularly positive impact on this group.

49. To the extent that the debt and penalty changes improve the timeliness of payments, and the payment of assessment debt by paying parents, there would be a corresponding impact on the receiving carers and their children. However, receiving carers do not receive penalty payments (75% 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 owned to the Crown. The number of receiving carers expected to be impacted by the penalty and debt write-off changes is therefore expected to be much less than 70% of the total carers.

Table 1: Summary of the impacts of the options and the status quo.

<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>Risks</i>	
<p>Status Quo</p> <p><i>Implement the whole reform – phases 1 & 2</i></p>	A, C & D	<p>The revenue cost of the reforms is estimated at \$115 million over the 10-year forecast period (2011/12 to 2020/21).</p>	<p>The cost of implementing the reforms is approx. \$210 million over the 10-year forecast period (2011/12 to 2020/21). This includes one-off set up costs and ongoing costs of administering the reforms.</p> <p>There will be additional costs of migrating the reforms to the new “transformed” environment.</p>	<p>Compliance costs would increase for businesses and individuals due to the additional compliance requirements imposed under the reforms. For further details see comment “compliance impact” below.</p>	<p>There is a small risk to the timing of delivery of the whole reform if unexpected issues arise during implementation.</p>	<p>Not recommended.</p> <p>This option fails as it does not reduce the implementation costs of the reforms.</p>
<p>One</p> <p><i>Defer implementation of the whole reform until Transformation project completed</i></p>	<p>B</p> <p>A, C & D are delayed for up to 10 years</p>	<p>The revenue implications of this option are unknown but are expected to be favourable on a net present basis, as the revenue cost of the reforms will not be incurred in the deferral period.</p>	<p>The cost of deferring the reforms has not been quantified but is expected to be favourable on a net present value basis compared with the status quo.</p> <p>There would be a cost of approx. \$2 million of undoing changes to date to the FIRST system to return to the 1991 scheme.</p> <p>Less staff would be required to administer child support during the deferral period requiring redundancies at a cost of approx. \$5m</p> <p>A full assessment of the administrative implications of reintroducing the child support reforms in the “transformed” environment would need to be undertaken as part of the transformation project.</p>	<p>Compliance costs would decrease for businesses and individuals during the deferral period.</p> <p>Compliance behaviour may decrease as the 1991 child support scheme is perceived as unfair, increasing debt and impacting child outcomes.</p> <p>A full assessment of the compliance implications of reintroducing the child support reforms in the “transformed” environment will need to be undertaken, as part of the transformation project.</p>	<p>Benefits of the reforms will be delayed up to 10 years until the new “transformed” environment is delivered.</p> <p>Debt may escalate to unmanageable levels under old penalty rules.</p> <p>Urgent legislation is required to defer the reform.</p>	<p>Not recommended.</p> <p>This option reduces the cost of implementation but does not address the problem of escalating child support debt or achieve the majority of objectives in the short-term.</p>

<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>Risks</i>	
Two <i>Repeal the whole reform</i>	B	There will be revenue savings of \$115 million over the 10-year forecast period (2011/12 to 2020/21).	<p>This option has the highest administrative savings, as spending on the implementation would cease at the time of decision. The amount is not quantified as it is dependent on a number of variables.</p> <p>There would be a cost of approx. \$2 million of undoing changes to date to the FIRST system to return to the 1991 scheme.</p> <p>Less staff would be required to administer child support requiring redundancies at a cost of approx. \$5m</p>	<p>Compliance costs would decrease for businesses and individuals.</p> <p>Compliance behaviour may decrease as the 1991 child support scheme is perceived as unfair, increasing debt and impacting child outcomes.</p>	<p>Debt may escalate to unmanageable levels under old penalty rules.</p> <p>Urgent legislation is required to repeal the reform.</p>	<p>Not recommended.</p> <p>This option would not achieve any of the objectives besides reducing costs. It may worsen compliance behaviour, making child outcomes worse.</p>
Three <i>Implement the first phase of the reforms and repeal the second phase</i>	B & C A (partially)	There will be a revenue cost of \$42.5 million over the 10-year forecast period. This cost is based on the new child support formula recognising shared care at 28% (original proposal).	<p>The cost of implementing phase 1 of the reforms is estimated at \$145 million over the forecast period.</p> <p>There will be an additional cost of migrating the reforms to the new “transformed” environment.</p>	Compliance costs would increase for some parents from the removal of payment options.	Debt may escalate to unmanageable levels under old penalty rules.	<p>Not recommended.</p> <p>While this option addresses the problem definition it does so by preferring cost savings over debt reduction.</p>
Four <i>Implement the first phase and part of the second phase of the reforms</i>	A, B, C D (partially)	The revenue cost of the reforms is estimated at \$115 million over the 10-year forecast period (2011/12 to 2020/21) – same as status quo.	<p>The cost of implementing phase 1 and part of phase 2 of the reforms is estimated at \$163 million.</p> <p>There will be an additional cost of migrating the reforms to the new “transformed” environment.</p>	Compliance costs would increase for some parents from removal of payment options.		<p>Recommended.</p> <p>This option addresses the problem definition and achieves the best balance between the objectives while minimising the impact on families.</p>

Administrative impacts

50. The status quo of implementing the whole reforms have a higher level of ongoing administrative costs than the 1991 scheme, mostly as a result of the new, more detailed, formula assessment in the first phase of the reform. It is expected that the new formula will result in additional contacts from parents to discuss the assessment and update details. Likewise, customer calls are expected to be longer. Other aspects, such as the change in qualifying age and compulsory wage deductions, will also increase administrative costs. At the same time, some of the changes in the first and second phase are expected to reduce the level of administration through the automation of manual processes or ability to rely on existing information and call recording. The overall result for the status quo is an increase in administrative costs. This is mainly through costs associated with an increase in staff numbers.

51. Options 1 and 2 reduce the administrative costs compared to status quo as a repeal or significant delay in the new formula assessment would be expected to reduce the need for the additional staff in the near future. The positions have been filled so there would be some additional costs associated with a redundancy process. There would be some relatively small costs associated with rolling the systems back to the 1991 scheme and communicating the changes to parents. Overall Options 1 and 2 are expected to have administrative savings.

52. Option 1 seeks to defer the changes until a new business process and computer system is in place. It is intended that the new system will mean that implementation costs of changes are reduced, and the ongoing administrative costs are reduced. As a new technological solution has not yet been chosen it is not possible to determine the extent of any future administrative savings for delaying the child support reforms.

53. Options 3 and 4 retain the new formula assessment, and therefore the additional staff and associated administrative costs.

Compliance impacts

54. The status quo of implementing the whole reforms have a higher level of compliance costs than the 1991 scheme, mostly as a result of the new, more detailed, formula assessment in the first phase of the reform. The formula assessment will now require additional information from the receiving carers, so most of the compliance costs fall on this group. Other aspects of the reforms may reduce compliance costs through providing a wider range of options for liable parents to make payments, such as qualifying payments or debt offsetting. However, the reforms will also introduce compulsory wage deductions for liable parents who have employment income. This will increase the compliance costs for employers who will be required to administer deduction notices.

55. Options 1 and 2 would reduce the compliance costs for receiving carers by removing or significantly delaying the requirement for them to provide additional information or set up compulsory wage deductions.

56. Options 3 and 4 retain the new formula assessment and therefore the additional compliance on receiving carers. They also will repeal some of the payment options proposed for liable parents. This could result in a small increase in compliance costs to make payments.

Option 3 will reduce the compliance costs for employers by removing the requirement for compulsory wage deductions and not replacing it with an alternative. Option 4 includes a voluntary wage deduction process, which will have compliance costs on employers if their staff request to have child support deducted from their wages. This option has lower compliance costs than the status quo, as the status quo includes a compulsory wage deduction process. A voluntary process is expected to impact on a smaller number of employers.

Social, environmental or cultural impacts

57. There are no environmental or cultural impacts associated with any of the options considered above. There are social impacts from the options as they will potentially impact on the levels of financial support available to families with children, the timeliness of payments, and the level of debt. Some families have made financial decisions or shared care decisions on the basis of the reforms being implemented.

Other risks

58. There is a risk around the timing of options 1 and 2. These will seek to repeal or change the parts of the Child Support Amendment Act that come into effect from 1 April 2015. Inland Revenue will need to amend various systems to roll back to the 1991 scheme in time for notices of assessment in February 2014. Ideally legislative change would need to be enacted 8 months to a year before the change is required to allow time to amend and test systems. However, Parliament will be dissolved between August and October 2014 and usually rises over January. Implementing these options would likely require urgent legislation and for Inland Revenue to begin system changes before the legislation has been enacted. There is a risk that either the legislation will not be enacted in time, making it retrospective, or that Inland Revenue would be unable to change systems in time, leading to incorrect assessments.

59. The current penalty rules impose a 2% a month compounding rate on defaults. This means that overall debt quickly escalates. Nearly half of all liable parents in debt have penalties higher than the assessment debt. The reforms will reduce the penalty rate to 1% after a year in default. Options 1, 2 and 3 will delay or repeal this change, 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 scheme and ultimately the welfare of the children.

Further analysis relating to Option 4 - completing the first phase and part of the second phase

60. In option 4 some, but not all, of the second phase would be implemented. This option would incorporate those aspects that have the greatest impact on debt, or which can be delivered at low cost in comparison to the other benefits expected to arise. Components that have limited benefits and significant costs or have a small impact on debt would not proceed.

61. A similar impact analysis is required on the different components of the second phase of the reforms to determine if they should form part of Option 4. The analysis is contained in the following table.

<i>Option</i>	<i>Meets objectives</i>	<i>Impacts</i>			<i>Recommendation and net impact</i>
		<i>Advantages</i>	<i>Disadvantages</i>	<i>Risks/Size</i>	
<i>2.1 Keep wider income definition</i>	A & C	A fairer income measure. Reduces need for an administrative review.	Higher compliance costs and administration costs High implementation cost.	Parents may not understand new definition Very limited numbers of parents actually impacted, less than 0.5% of possible parents	Not recommended. Very limited impact on outcomes does not justify cost.
<i>2.4 Keep compulsory wage deductions with limited exemptions</i>	A & D	More liable parents making payments on time.	Higher compliance costs and administration costs Requires policies for exemptions (eg privacy).	Parents may assume wage deductions meet all liabilities when it doesn't. Impacts on large number of employers	Not recommended. Compulsion relatively expensive and creates own problems.
<i>2.4 Introduce voluntary wage deductions</i>	A, B & D	More liable parents making payments on time. Compliance behaviour improves. No need for exemptions.	Higher compliance costs and administration costs	Impacts on smaller number of employers than compulsory deductions.	Recommended. Parents can choose best method of payment
<i>2.10 Keep qualifying payments</i>	C & D	Flexibility in payments Payments directly benefit the child	High compliance and administrative costs Requires agreement of both parents.	Very few people expected to meet criteria, less than 0.2% of possible parents	Not Recommended. Very limited impact on outcomes does not justify cost.
<i>2.7 Keep offsetting of debt</i>	A & C	Reducing debt Fairer. May encourage compliance.	Higher administration cost Receiving carer may receive insufficient income	Impacts a limited number of parents, less than 1% of possible parents	Not recommended. Very limited impact on outcomes does not justify cost.

<i>Option</i>	<i>Meets objectives</i>	<i>Impacts</i>			<i>Recommendation and net impact</i>
		<i>Advantages</i>	<i>Disadvantages</i>	<i>Risks/Size</i>	
<i>2.5 & 2.6 Keep penalty rate changes – ongoing and late payment</i>	A, C & D	Reduces new debt. Fairer.	Significant implementation cost but lower administration cost	Impacts a large number of parents	Recommended. Will make a significant impact on new debt.
<i>2.8 Keep debt and penalty write-off provisions</i>	A, C & D	Reduces new debt. Fairer. Improves incentives to re-comply. Lower admin costs/ better use of resources.	Significant implementation cost	Impacts a large number of parents	Recommended. Will make a significant impact on legacy debt.
<i>2.3 Keep reduction in qualifying age</i>	A & C	Matches international law and age limits in other social policies. Fairer. Reduces debt	Higher administration costs to determine if in school.	Impacts a reasonable number of parents and children.	Recommended. On balance, is value for money.
<i>2.9 Keep re-establishment ground for administrative review</i>	C & D	Recognises additional costs incurred for child's benefit. Very small implementation cost.		Unknown impact but expected to be small	Recommended. On balance, is value for money.
<i>2.2 Keep underestimation penalty for receiving carers</i>	D	Encourages receiving carers to provide their best estimate of current income.	Carers may be penalised even when they have provided best estimate.	Limited evidence that a penalty would improve compliance behaviour. Small numbers of people affected.	Not recommended. Unclear impact on outcomes does not justify cost.

CONSULTATION

62. 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.

63. There was less opportunity to consult on the options in this RIS given the timing constraints on decision-making and the sensitivity of the changes. Treasury, the State Services Commission and the Department of Internal Affairs (in regards to the Government Chief Information Officer) were consulted. Their feedback is incorporated in the options considered.

CONCLUSIONS AND RECOMMENDATIONS

64. Inland Revenue supports option 4 (implement phase and part of phase 2 of the reforms). Proceeding with the first phase would provide more equitable financial support for children in a variety of circumstances. It would also better reflect many of the social and legal changes that have occurred since the introduction of the current scheme in 1991, in particular the greater emphasis on separated parents sharing the care of and financial responsibility for their children.

65. Inland Revenue supports some aspects of the second phase continue as enacted but that other aspects not proceed; aspects that were designed to provide general improvements to the operation of the child support scheme, particularly in regards to payments.

66. The aspects we support proceeding include the changes to the imposition of penalties, and the writing-off of penalties and debt, and a new voluntary wage deduction process to replace the proposed compulsory wage deduction process. These will encourage and facilitate parents to make timely child support payments for the benefit of their children, and to reduce debt. While these components have an implementation cost, the impact on debt across a significant number of child support parents justify the cost.

67. The associated cost of implementation is considered to exceed the expected benefits for the components we do not support proceeding. In most cases the benefits from these changes are now expected to impact on a much smaller group of parents than anticipated, and alternative existing process may exist to achieve the desired outcome, although at a higher compliance cost to those involved.

68. Overall, option 4 is recommended as it is close to the status quo in terms of the expected benefits to be delivered by the reforms, especially in relation to debt reduction, but at a significantly reduced implementation cost.

Summary of changes that are proceeding or not proceeding

First Phase

All aspects to proceed as enacted.

Second Phase

It is recommended that the following aspects continue:

- 2.3 reducing the maximum age of a qualifying child from under 19 to under 18, unless they are 18 and still in full-time secondary education – aligning with Working for Families age limit;
- 2.5 a two stage late payment penalty with an immediate 2% late penalty, with the remainder of the current 10% penalty only being charged if the debt remains unpaid after seven days;
- 2.6 a reduction in the ongoing monthly penalty rate from 2% to 1% after a year;
- 2.8 relaxing the circumstances in which penalties can be written-off, including when a liable parent enters into an instalment arrangement or is in serious hardship, when debt recovery is an inefficient use of Inland Revenue's resources or when only low levels of penalty debt are outstanding, and allowing Inland Revenue to write off assessed debt owed to the Crown on serious hardship grounds;
- 2.9 recognising re-establishment costs as a grounds for an administrative review;

It is recommended that a new voluntary wage deduction be introduced.

It is recommended that the following aspects no longer proceed:

- 2.1 a new definition of "adjusted net income", which includes income adjustments to taxable income, such as income in trusts and companies;
- 2.2 a penalty for receiving carers who are parents and who underestimate their income for the year;
- 2.4 compulsory deduction of child support from employment income, unless there are grounds for an exception such as privacy or cultural reasons;
- 2.7 the ability to offset current payments against past debts where the liable parent and receiving carer swap roles (that is, where the child moves to live with the other parent);
- 2.10 the discretion to recognise other payments, such as payment of school fees, as qualifying as child support payments where they directly benefit the child.

69. The total implementation cost of the recommended option is estimated at \$163 million over the ten year period.

70. The components that do not proceed could be reconsidered in the future if the implementation costs can be reduced as part of, or following, the Business Transformation programme.

IMPLEMENTATION

71. Changes to the child support reform programme would require amendments to the Child Support Amendment Act 2013 and to any consequential provisions in other legislation. These amendments would be required before 1 April 2016, when the second phase comes into effect, and ideally before January 2016 as notices of assessments and communication with child support parents are usually issued in February each year.

72. The legislative amendments could be introduced as a stand-alone bill or may form part of a taxation omnibus bill. The next taxation bill is expected to be introduced after the 2014 election is concluded.

73. The scope of the child support reform implementation programme will be amended in accordance with Cabinet decisions and legislation. The programme will re-plan delivery of the remaining aspects of the reform accordingly, including any new performance indicators required. The child support reform implementation programme was subject to an independent review to determine why it was unable to deliver to the original timeframes. The recommendations of the review have been accepted and are being incorporated into the programme management to ensure the implementation of the revised reforms can be delivered on time.

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

75. There is a risk that child support families will be confused about what the revised reforms mean for them. 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

76. 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.

77. 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.

78. 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.