

**Policy report: Debt to Government: Comparing IR and MSD's approaches to writing off debt**

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<b>Date:</b>	27 June 2022	<b>Priority:</b>	Medium
<b>Security level:</b>	In Confidence	<b>Report number:</b>	IR2022/308 REP/22/6/553

**Action sought**

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	<b>Action sought</b>	<b>Deadline</b>
Parliamentary Under-Secretary to the Minister of Revenue	<b>Note</b> the contents of this report. <b>Refer</b> report to Minister for Child Poverty Reduction, Minister for Social Development and Employment, Minister of Revenue, Minister of Justice and Minister of Housing.	N/A

**Contact for telephone discussion (if required)**

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27 June 2022

Parliamentary Under-Secretary to the Minister of Revenue

## **Debt to Government: Comparing IR and MSD's approaches to writing off debt**

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### **Summary**

1. This report provides a comparison of the write-off powers that are available to Inland Revenue (IR) and the Ministry of Social Development (MSD) when dealing with debt caused by the overpayment of Working for Families (WFF) tax credits and benefits, as well as recoverable assistance.
2. IR's write-off powers are generally broader than MSD's. They reflect principles of tax administration including the collection of the highest net revenue over time, given the Commissioner's resources, and the encouragement of voluntary compliance with the tax system. MSD's reflect a stricter obligation to take all reasonably practicable steps to recover debt.

### **Recommended action**

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We recommend that you:

3. **note** the contents of this report that compares the debt write-off powers available to Inland Revenue and the Ministry of Social Development;

Noted

4. **refer** a copy of this report to the Minister for Child Poverty Reduction, Minister for Social Development and Employment, Minister of Revenue, Minister of Justice and Minister of Housing for their information;

Referred/Not referred



**Bede Hogan**

Policy Manager, Income Support  
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**Samantha Aldridge**

Principal Policy Advisor  
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**Dr. Deborah Russell**

Parliamentary Under-Secretary to the Minister of Revenue

/ /2022

## **Purpose and context**

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5. Following your request for information on 13 May, this report compares IR and MSD's approaches to writing off debt. It provides information from each agency on the legislative provisions allowing them to write off debt (in the context of each agency's role and functions) and their operational practices.
6. Information on IR's approach relates to debt created via the overpayment of WFF tax credits.<sup>1</sup> The write-off powers discussed in this paper are not necessarily applicable to other payments administered by Inland Revenue, such as student loans and child support. Information on MSD's approach relates to debt created via the overpayment of benefits and recoverable assistance.

## **Inland Revenue's approach to WFF debt**

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### **The creation of debt**

7. WFF entitlements are calculated as an annual figure according to a customer's income and family circumstances. Customers may receive their entitlement during the year (weekly or fortnightly) or at the end of the tax year.
8. If a customer's income or circumstances change during the year, this will change their entitlement. If they are receiving payments weekly or fortnight, failure to update IR of these changes in a timely manner may result in an overpayment. Customers who receive payments at the end of the year can also be overpaid if their initial entitlement is recalculated (e.g., if additional income is declared after the end of year 'square up' is completed).
9. Not all WFF overpayments result in debt as they only become debt after the repayment is due. The due dates will vary depending on the customer's filing obligations.

### **Legislative provisions**

10. The Tax Administration Act 1994 (the Act) has an overarching provision which requires the Commissioner to collect the highest net revenue over time that is practicable within the law, having regard to the resources available to the Commissioner, the importance of promoting compliance (especially voluntary compliance), and the compliance costs incurred by taxpayers.
11. The Income Tax Act 2007 provides that the Commissioner may recover WFF overpayments from a customer as if the amount was income tax payable by that customer. Therefore, the same powers that apply to the collection of tax also apply to the collection of WFF overpayments.
12. The Act gives the Commissioner powers to provide relief by writing off debt, remitting penalties/interest, or entering into instalment arrangements where this is considered appropriate.
13. A debt, including any shortfall penalties, cannot be written off where the customer is liable to pay a shortfall penalty for either taking an abusive tax position or evasion in relation to the debt. However, late filing penalties, late payment penalties, and use of money interest on the underlying tax can still be written off.

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<sup>1</sup> Although MSD administers the payment of some WFF tax credit components for its customers (Family tax credit and Best Start tax credit payments), all WFF debt is established, managed, and collected by IR.

14. If, after considering the taxpayer's circumstances, the Commissioner concludes that relief under the Act is not appropriate, they may either collect the amount owing or apply to have the taxpayer made bankrupt.
15. Relief powers available under the Act are summarised below.

### **Relief powers**

16. An amount of WFF debt may be written off if collecting it:
  - 16.1 would place the taxpayer in "serious hardship"; or
  - 16.2 is considered an inefficient use of IR's resources.
17. The concepts of serious hardship and inefficient use of resources, as they apply to IR administration, are discussed below.
18. The following relief powers are also available to IR:
  - 18.1 Where an amount is considered irrecoverable, the Commissioner may write it off.
  - 18.2 When a taxpayer is made bankrupt, is liquidated, or their estate has been distributed, the Commissioner must write off amounts that cannot be recovered.
  - 18.3 Interest or certain penalties may be remitted if to do so is consistent with the Commissioner's duty to collect the highest net revenue over time through voluntary compliance.
  - 18.4 A remission of penalties/interest may be granted if an event/circumstance beyond the customer's control provides a reasonable justification for not meeting their obligations (for which they were given the penalty), for example, a death or illness of a family member.
  - 18.5 Interest may be remitted when there has been an emergency event declared in an Order in Council which prevented the taxpayer from making the payment.
  - 18.6 The Commissioner will write off outstanding tax/debt when the balance payable after the end of the tax year is \$50 or less i.e., is 'de minimis'<sup>2</sup>.
19. There is no specific provision allowing for the write-off of debt when it arises from IR error. However, IR error will be taken into consideration when determining whether to grant relief on other grounds.

### **Serious hardship**

20. Where a customer is unable to make repayment in full, they may request their debt be written off under the serious hardship provision. Customers may be asked to fill out a hardship relief request form and provide documentation to prove they are in hardship.
21. The Tax Administration Act sets out categories which staff use to determine whether a customer is in serious hardship. A customer may be in serious hardship when:
  - 21.1 they or their dependant has a serious illness;

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<sup>2</sup> For IR3 filers (the self-employed) the balance must be \$20 or less.

- 21.2 they would likely be unable to meet minimum living expenses estimated according to normal community standards of cost and quality;
  - 21.3 they would likely be unable to meet the cost of medical treatment for an illness or injury of the taxpayer, or of their dependant;
  - 21.4 they would likely be unable to meet the cost of education for their dependant; or
  - 21.5 any other factor that the Commissioner thinks relevant would likely arise.
22. If a customer is determined to be in serious hardship, relief options include:
- 22.1 a full or partial write-off (including fully writing off core tax, interest, or penalties);
  - 22.2 an instalment arrangement to pay some or all of the debt; or
  - 22.3 a combination of the two.
23. Customers who enter an instalment arrangement may either make payments themselves or have their weekly/fortnightly WFF entitlement reduced to cover repayments (this option must be initiated and agreed to by the customer).

***Inefficient use of resources***

24. The Act gives the Commissioner the discretion to write off debt where collecting outstanding amounts is expected to be an inefficient use of the Commissioner's limited administrative resources.
25. IR determines which WFF debts to write off automatically under this provision according to the value of the debt and the customer's family scheme income. Customers who have any of the following in place will be excluded from the automatic write-off:
- 25.1 any active account halts
  - 25.2 an open or pending audit case
  - 25.3 legal action underway
  - 25.4 fraud indicators
  - 25.5 a repayment arrangement
26. Precise parameters for the debt value and family scheme income are determined on an annual basis in consideration of factors such as economic conditions in New Zealand and consistency with write-offs for other products (e.g., Income Tax). These parameters are not provided to staff or customers. <sup>s 18(c)(i) OIA</sup>
27. WFF debt may also be written off as an inefficient use of the Commissioner's resources on a case-by-case basis.
28. There will be some instances where the Commissioner will pursue debt even though the cost of collection may be higher than the outstanding tax because of their obligation to ensure the integrity of the tax system and promote taxpayer compliance (e.g., where the debt is connected to fraud).

**Factors to consider for discretionary relief**

29. All the Commissioner’s powers to provide relief are discretionary, excepting where a taxpayer is made bankrupt, is liquidated, or their estate has been distributed. In addition to the legislative criteria, when deciding whether to grant discretionary relief the Commissioner may consider the following, more general, factors:
- A. Taxpayer’s financial position:
  - B. Options available to the Commissioner
  - C. Integrity of the tax system
  - D. Resources available to the Commissioner
  - E. Importance of promoting compliance
  - F. Taxpayer’s reasons for failure to pay
  - G. Taxpayer’s compliance history
  - H. The taxpayer’s co-operation
  - I. Steps taken to avoid similar situation in future
30. These are not listed in order of importance; the factors that apply and the weighting they are given will depend on the particular case. Some factors may not apply to certain forms of relief.
31. Inland Revenue’s Standard Practice Statement SPS 18/04 provides more detail on these factors and on the application of all the relief options described above.

**Data on IR write-offs**

32. As at July 2021, IR held \$198 million in WFF debt. During the 2020/21 fiscal year IR wrote off just over \$40 million in WFF debt.<sup>3</sup>
33. As at July 2021, 44,066 families owed WFF debt to IR with an average debt of \$3,242. The median debt was \$1,666.
34. Figure One shows the amount of WFF debt written off by IR during the 2020/21 fiscal year by reason for the write off:

**Figure One:** Amount of WFF debt written off by reason in the 2020/21 fiscal year:

Fiscal year	Volume or percentage of debt	Reason				Total
		Serious hardship	Inefficient	Covid-19	All other reasons	
2020/21	V	\$19,828,893	\$10,778,976	\$6,313	\$10,228,066	\$40,842,250
	P	48%	26%	0.01%	25%	100%

<sup>3</sup> The debt held does not include what was written off during the year.

## **The Ministry of Social Development's approach to Recoverable Hardship Assistance and benefit overpayment debt**

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### **Recoverable Hardship Assistance and Overpayment debt**

35. As at 31 March 2022, there was more than 578,000 people with debts to MSD, which average \$3,498 per person.<sup>4</sup> In the 2021/22 full year to 31 March 2022, MSD has written off around \$16.3 million in debt or approximately 0.76 percent of the total debt of \$2.133 billion (as at 31 March 2022). \$1.3 billion is attributed to current clients (62 percent).

*Recoverable Hardship Assistance debt is established to help the client meet an immediate and essential need*

36. Hardship assistance is the third tier<sup>5</sup> of assistance in the welfare system. It provides discretionary assistance and is generally one-off. It consists of Special Needs Grants (SNG), of which some are recoverable, and Advance Payments of Benefits (Advances) and Recoverable Assistance Payments (RAPs), which are always recoverable.<sup>6</sup>
37. Hardship Assistance is relatively unique in that hardship is the driver for granting recoverable assistance. Eligibility for hardship assistance is targeted at those with limited cash and assets who have immediate and specific needs that cannot be met by their own resources. For recipients of recoverable hardship assistance, debt occurs when clients contact MSD and request support to meet their immediate and essential needs.

*Overpayment debt can occur when a client's personal or financial circumstances change*

38. Overpayment debt can occur when a clients' circumstances change and MSD does not receive this information in time to update their payments accordingly. Clients are required to notify MSD of any change in their circumstances, including income they receive that affects their benefit entitlement.
39. A few examples include debts created when a client is late in declaring a change in income which would lead to a reduction in MSD payments, or as the result of data matching with other agencies or following a fraud investigation.

### **Legislative provisions to write off and recover debt**

40. The Social Security Act 2018 (the Act) imposes a legislative duty on MSD to take all reasonably practicable steps to recover debt and empowers MSD to recover debts to the Crown.<sup>7</sup> This is reflected in MSD's current recovery and write-off provisions.<sup>8</sup>
41. Section 362 of the Social Security Act 2018 establishes MSD's duty to recover debts. It recognises that welfare assistance is a major form of public expenditure and that the public is entitled to expect that MSD will effectively recover welfare debts. This is also part of MSD's obligations to manage public money responsibly under the Public Finance Act 1989.

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<sup>4</sup> Note that this figure includes all types of debts, including recoverable assistance, overpayments, social housing debt, Student Allowance debt, and fraudulent debt.

<sup>5</sup> The first tier of support in the welfare system is main benefits, the second tier is supplementary assistance.

<sup>6</sup> The third tier also includes on-going support in the form of Temporary Additional Support (TAS) which is a supplementary limited time payment for those who cannot meet their regular essential living costs from chargeable income and other resources, and Emergency Housing Special Needs Grants (EHSNGs) and Housing Support Products (HSPs) which are both recoverable.

<sup>7</sup> Defined at regulation 206 of the Social Security Regulations 2018.

<sup>8</sup> Social Security Act 2018, section 362.

42. MSD must determine a rate or method<sup>9</sup> of debt recovery, but MSD has discretion about what this can be, including the option to defer (suspend) recovery, and these can be amended as clients' circumstances change.<sup>10</sup>
43. MSD does not enforce penalties on debt except in cases of fraud, but this is only used in a small number of circumstances.
44. The Act also provides for exceptions to the duty to recover debt made in the Social Security Regulations 2018 (the Social Security Regulations) and Ministerial Directions.<sup>11</sup> There are currently four main exceptions to MSD's duty to recover debt:
  - 44.1 if the debt was caused by error;
  - 44.2 if exceptions are provided for in the Social Security Regulations;
  - 44.3 if the debt is uneconomic to recover; or
  - 44.4 if the Ministers of Finance and Social Development and Employment have agreed to exceptions for public finance reasons.
45. These exceptions are explained further below.

*Social Security regulations provide for how to test debts to determine whether the debt was caused by MSD error*

46. Social Security Regulations provide for new debts, including recoverable assistance and overpayment debts, to be tested to determine if that debt was created by MSD error to establish whether it should be recovered.<sup>12</sup>
47. Debt caused by MSD error must meet all of the following five criteria to be considered non-recoverable:
  - 47.1 the debt is a result of an error by MSD;
  - 47.2 the client did not intentionally contribute to the error – i.e., whether the client intentionally or deliberately took some action, or failed to take action, or delayed action which resulted in an overpayment;
  - 47.3 the client changed their position – i.e., when a client makes different financial decisions with the overpayment received than they would have without that additional money;
  - 47.4 the client received the money in good faith – i.e., the client received the money without any knowledge of their lack of entitlement to it; and
  - 47.5 it would be inequitable to recover the debt – this requires full consideration of their current circumstances, including their financial position, whether they have the resources to repay the debt, and the degree of any error made by Work and Income.

*The Minister for Social Development and Employment and the Minister of Finance have jointly given an authorisation about some debts that can be written off<sup>13</sup>*

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<sup>9</sup> Including court proceedings and deductions from benefits and other sources.

<sup>10</sup> Clause 4 of the Ministerial Direction states MSD must give consideration to certain matters in relation to rate and method of recovery.

<sup>11</sup> Ministerial Direction on Debt Recovery Amendment 2016 and Delegation from the Minister of Finance and the Minister for Social Development and Employment to the Chief Executive of the Ministry of Social Development to Write-off Crown Assets 2020.

<sup>12</sup> Social Security Regulations 2018, regulation 208

<sup>13</sup> Social Security Regulations 2017, regulation 207(3)



48. The Minister of Finance and the Minister for Social Development and Employment can also use the ability in Social Security Regulations<sup>14</sup> to specify certain types of debt which can be written off and delegate, pursuant to the Public Service Act 2020, the authority to write off debts under a specific set of circumstances to the Chief Executive of MSD. An authorisation to this effect has been given, and specified circumstances include when:
- 48.1 the proceeds of the sale of assets seized by Court order are paid to the Crown;
  - 48.2 the debt or identity of the debtor cannot be proven;
  - 48.3 the debtor is insolvent;
  - 48.4 the agent is insolvent;
  - 48.5 the debtor is deceased;
  - 48.6 the debt is due to foreign exchange balances (due to agreement of payment amount in foreign currency and fluctuations of exchange rates);
  - 48.7 all economic avenues of collection have been exhausted and the debt is \$50 or less;
  - 48.8 the debt cannot be recovered due to estoppel in accordance with the Property Act 2007 (this is in relation to student debt);
  - 48.9 the debtor is a participant in a Witness Protection or Relocation Programme;
  - 48.10 the debt cannot be proven to the Court's satisfaction; or
  - 48.11 the debt established cannot be recovered in accordance with debts caused wholly or partly by errors to which debtors did not intentionally contribute (regulation 208 of the Social Security Regulations<sup>15</sup>).

*MSD may defer (provisionally write off) debts of less than \$20,000*

49. MSD defines uneconomic to recover<sup>16</sup> to be when the cost of recovery outweighs the expected return of debt. MSD currently automatically writes off debts of \$50 or less of non-current clients after 70 days of non-payment.
50. This threshold is based on analysis from 2015 that found that the average cost of collection is \$59.80 per debt. At the time, increasing the write-off limit to \$50 aligned MSD with other agencies' write-off powers and was appropriately balanced with the risk of changing client repayment behaviours.
51. This approach was reaffirmed through the 2020 Delegation from the Minister of Finance and the Minister for Social Development to the Chief Executive of the Ministry of Social Development to Write-off Crown Assets (discussed above).
52. Debts of higher amounts can also be assessed to determine whether collection of that debt is appropriate if:<sup>17</sup>
- 52.1 the debt is less than \$200 and there have been no repayments during the previous six months;
  - 52.2 the debt is less than \$1000 and there have been no repayments during the previous 12 months;
  - 52.3 the debt is less than \$2000 and there have been no repayments during the last 2 years; or

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<sup>14</sup> Social Security Regulations 2018, regulation 207(1)(d)

<sup>15</sup> Previously section 86(9A) Social Security Act 1964.

<sup>16</sup> Social Security Regulations 2018, regulation 207(1)(c).

<sup>17</sup> These timeframes only apply in cases where fraud is not a factor i.e., there are separate conditions for cases of fraud. Some values of debt also require other conditions regarding client identification to be met.

- 52.4 the debt is more than \$2000 but less than \$20,000 and there has been no ability to gain repayment or communicate with the debtor for at least six years.
53. Debts written off under these grounds can be reactivated once the client accesses social security (including superannuation) again, as recovery is once again feasible. This approach aligns with MSD's duty to recover debt.

*Debt recovery is written off according to conditions in the Social Security Regulations*

54. The Act empowers regulations to be made permitting changes to debt write-off settings.<sup>18</sup> However, since the changes to primary legislation in 2014 which clarified MSD's duty to recover debt, no further debt recovery regulation changes have been made by Government.
55. When making new or amending existing regulations to permit any methods of write-off, the Minister for Social Development and Employment must be satisfied that these changes are likely to:
- 55.1 prevent accumulation of debt by any category of beneficiary and assist those beneficiaries to reduce their levels of debt while on a benefit;
  - 55.2 assist any category of beneficiary to move from dependence on a benefit to self-support through employment by ensuring that those beneficiaries do not face increasing benefit debt repayments when they enter the workforce;
  - 55.3 provide a positive incentive for beneficiaries to enter employment or stay in employment; or
  - 55.4 achieve more than one of these objectives.
56. Any changes to current settings would have fiscal and operational implications.

### **Comparing IR and MSD's approaches to writing off debt**

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#### **Agency functions**

57. Under the Tax Administration Act 1994, the Commissioner of IR is charged with the care and management of the tax system, which includes WFF tax credits. This includes a duty to collect the highest net revenue over time that is practicable within the law, having regard to the resources available to the Commissioner, the importance of promoting compliance (especially voluntary compliance), and the compliance costs incurred by taxpayers. IR's write-off powers reflect these responsibilities.
58. By contrast, MSD's debt recovery and write-off powers are primarily focused on its legislative duty to recover debt. Section 362 of the Social Security Act 2018, establishing MSD's duty to recover debts, recognises that welfare assistance is a major form of public expenditure and that the public is entitled to expect that MSD will effectively recover welfare debts.

#### **Legislative provisions**

59. There are two significant differences between IR and MSD's powers to write off debt.
60. First, IR may do so where a customer is considered to be in serious hardship. Although MSD may take a customer's circumstances into account when determining

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<sup>18</sup> Social Security Act 2018, ss 444 and 448. Regulation 207(1)(b), subpart 11, Social Security Regulations 2018.

repayment arrangements (or any subsequent amendments to existing arrangements), they may not write off debt because a customer is in hardship.

61. Second, IR's power to write off debt as an inefficient use of the Commissioner's resources is much broader than MSD's power to write off debt as uneconomic to recover. IR has discretion to determine annual parameters for writing off debt as part of an automatic process at the end of the year (in addition to the automatic \$50 de minimis write-off). <sup>s 18(c)(i) OIA</sup>

█ In comparison, MSD's power has a much narrower scope. MSD writes off up to \$50 in debt for non-current clients after 70 days of non-payment, but for amounts in excess of \$50, collection is prioritised, or deferred if MSD is unable to get into contact with the person.

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