



COVERSHEET

Minister	Hon Michael Wood	Portfolio	Workplace Relations and Safety
Title of Cabinet paper	Government Response to the Report of the Holidays Act Taskforce	Date to be published	23 February 2021

List of documents that have been proactively released

Date	Title	Author
March 2020	Cabinet Paper: Government Response to the Report of the Holidays Act Taskforce	Office of the Minister for Workplace Relations and Safety
March 2020	Cabinet paper Annex One: Summary of Government response to Holidays Act Taskforce recommendations	MBIE
October 2019	Cabinet paper Annex 2: Holidays Act Taskforce final report (note this documents will also be published separately on the MBIE website when your announcement is made)	Holidays Act Taskforce
March 2020	Regulatory Impact Statement – Improving the Holidays Act 2003	MBIE
11 March 2020	DEV-20-MIN-0035: Government Response to the Report of the Holidays Act Taskforce	Cabinet Office

Information redacted

YES

Any information redacted in this document is redacted in accordance with MBIE's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Some information has been withheld due to the free and frank expression of opinion.

Coversheet: Improving the Holidays Act 2003

Advising agencies	<i>Ministry of Business, Innovation and Employment</i>
Decision sought	<i>Improving the Holidays Act 2003</i>
Proposing Ministers	<i>Minister for Workplace Relations and Safety</i>

Summary: Problem and Proposed Approach

Problem Definition

What problem or opportunity does this proposal seek to address? Why is Government intervention required?

The Holidays Act 2003 (the Act) sets out the minimum entitlements to holidays and leave, and payment for them, that employers are obliged to provide to their employees. Its purpose is to promote balance between work and other aspects of employees’ lives by providing minimum entitlements to annual holidays, public holidays, and sick, bereavement and family violence leave.

A number of issues have been identified with the Act that make it difficult to implement in practice. Chief among these is that there is often a lack of prescription, particularly in how entitlements should be provided and how they are to be paid. For example, the Act does not prescribe how to determine what a ‘week’ is for the purposes of annual holidays or an ‘otherwise working day’ for other forms of leave, and is silent on how to include some types of payments, such as bonuses, in payment calculations. The result is that current provisions generally work for a standard five day, 40 hour week, but pose a number of issues when applied to more diverse working arrangements and variable pay structures.

To help address these concerns, Cabinet agreed in May 2018 to establish a Taskforce to review the legislation and suggest recommendations for change. The tripartite group, comprised of government, union and business representatives, provided the Minister for Workplace Relations and Safety with its final report in October 2019. The proposed approach is an improved status quo, where the existing units of entitlement are retained (weeks for annual holidays, days for other forms of leave) and the focus is on addressing known issues with the existing Act. An alternative approach is to introduce an hours-based accrual system for annual holidays, with other aspects following the Taskforce’s proposals.

Without legislative intervention, many of the issues with the Act will persist.

Summary of Preferred Option or Conclusion (if no preferred option)

How will the agency’s preferred approach work to bring about the desired change? Why is this the preferred option? Why is it feasible? Is the preferred approach likely to be reflected in the Cabinet paper?

The Ministry of Business, Innovation and Employment (MBIE) recommends:

- making changes to the Act that provide greater prescription as recommended by the Holidays Act Taskforce, if *retaining the current units of entitlement* and *protecting employees' entitlements* are prioritised (Option One)
- adopting the majority of the Holidays Act Taskforce proposals but introducing a new system where annual holidays are accrued over time, if *simplicity* for employers and employees is prioritised (Option Two).

Both options provide greater clarity and certainty and will help to ensure that employees receive their correct entitlements and payments for them. They are also implementable in a payroll system, promote the current objectives of the Act, and are applicable to the full range of working and remuneration arrangements in the labour market.

The related Cabinet paper is likely to seek agreement to Option One.

Section B: Summary Impacts: Benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?

The main beneficiaries of changing the Act would be employees and employers. For employees, they would be more likely to receive their correct entitlements and payments, have earlier and greater access to some forms of leave, and may benefit financially from the introduction of new payment methodology. For employers, they would have greater clarity and certainty regarding their obligations and an ability to better systematise rules relating to annual holidays and leave. This should help to reduce costly remediation issues that have occurred as a result of ambiguities with the current Act.

All employers and employees would benefit from legislation that provides greater certainty. However, employees with variable working and pay arrangements would benefit the most as they are the ones most likely to currently receive incorrect entitlements and payments. Similarly, organisations that employ these types of workers would also significantly benefit from greater prescription in how to calculate entitlements and payments for employees with more complex working and payment arrangements.

Where do the costs fall?

Most costs are anticipated to fall to employers. These costs include increased annual holidays and leave payments for some employees due to changes to the 'gross earnings' definition, parental leave provisions, and a new payment methodology. Employees that have variable working arrangements and complex remuneration structures are most likely to receive an increase in annual holidays and leave payments as a result of the proposed changes to the Act. It is estimated that between 60,600 and 580,400¹ employees, or 3 to 27 per cent of all New Zealand employees, fall within these categories and are most likely to work in the 'health care and social assistance', 'accommodation and food services' and 'public administration and safety' sectors.

The majority of employees, particularly those with standard hours and stable earnings, should not see increased payments when compared to the current Act. However, improved clarity and certainty should help address non-compliance issues and many employees may see changes in their holiday and leave pay as a result.

¹ See Section C for a breakdown of the estimated number of employees affected.

Due to data limitations, it is not possible to provide an estimate of the total marginal cost of Option Two. However, it is estimated that the total marginal cost of Option One could be up to \$310.3 million per year. This is comprised of increased costs for the following proposed changes:

- A new annual holidays payment methodology (\$29.7 million per year).
- A new payment methodology for other types of leave (\$186.7 million per year).
- Changing how annual holidays payments are calculated for employees returning from parental leave (\$42 million per year).
- Bereavement, sick and family violence leave being available to employees from day one (\$51.9 million per year).

There are also likely to be some costs for employers to transition to a new or updated payroll system. Amendments to the Act would require a number of changes to payroll systems and it is unclear how much this could cost individual employers or New Zealand more generally. MBIE intends to work with payroll providers and employers during implementation to assist with the transition.

What are the likely risks and unintended impacts? How significant are they and how will they be minimised or mitigated?

Although changes to the Act would provide greater prescription and can be systematised, obligations would remain complex in relation to employees with diverse working arrangements and variable pay structures. This complexity means that the risk of incorrect payments for some employees is not entirely removed. However, greater regulation and support for compliance from MBIE would reduce this risk.

It is also anticipated that small to medium sized enterprises (SMEs) may be more affected than larger businesses by the proposed changes. This is due to SMEs being less likely to have dedicated payroll professionals as part of their staff and less able to absorb increased costs. These impacts could be mitigated by assisting smaller businesses when implementing changes to the Act.

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?

An external professional services company with payroll expertise was contracted to provide independent advice on the implications that the options for change would have if they were implemented across New Zealand. A key part of this testing was to ensure that options were tested against the wide range of working arrangements and employer types that can be found across the New Zealand economy. Using anonymised payroll data from a number of different payroll systems and employers, this testing investigated whether the options were implementable in payroll systems, how options compared to the current Act provisions, and identified any issues with the proposals. The model used in the testing was built with the same underlying functionalities for calculating entitlements and payments as payroll systems in order to generate the same results.

MBIE has confidence in the testing undertaken with regards to implementability, impacts and estimated increased payments for variable workers. However, as the testing was focused on non-standard working arrangements, it did not include a representative sample of all working arrangements and cannot be extrapolated directly to the wider labour force.

As part of the regulatory analysis, MBIE developed estimates of the number of employees impacted by the proposed changes to the Act and which sectors could be most impacted. The estimate for the number of employees with variable working patterns and/or pay, and considered a proxy for those most likely impacted by options one and two, was based on²:

- the number of employees with no usual working pattern (60,600)
- the number of employees that work shifts that vary (226,700)
- the number of employees that worked paid overtime at a higher rate in the last four weeks (277,800)
- the number of employees who do not usually work standard hours (580,400³).

These figures only provide an indication of how many employees may see a change in their holidays and leave payments as a result of options one and two. As proxies have been used, the actual number that may be impacted could differ.

Estimated fiscal impacts have also been developed for a number of Taskforce proposals. Calculations have used a number of estimates and assumptions, such as estimated number of employees and average weekly earnings, so are intended to provide a broad indication of possible costs.

To be completed by quality assurers:

Quality Assurance Reviewing Agency:

The Ministry of Business, Innovation and Employment.

Quality Assurance Assessment:

MBIE's Regulatory Impact Analysis Review Panel has reviewed the attached Impact Statement prepared by MBIE. The Panel considers that the information and analysis summarised in the Impact Statement **partially meets** the criteria necessary for Ministers to make informed decisions on the proposals in this paper.

This is because the second option (accrual-based system for annual holidays) has not been analysed to the same extent as the first option as it was dismissed relatively early by the Taskforce, despite their early consultation indicating wide support for the second option, particularly by employers. There has been limited time for analysis or consultation post-Taskforce to better understand the impacts of the second option and so it is difficult to compare the options on a like-for-like basis.

Reviewer Comments and Recommendations:

² All figures taken from the Survey of Working Life 2018.

³ Based on the total number of employees (2,166,200) minus the number which 'usually work standard hours' (1,585,800).

Impact Statement: Improving the Holidays Act 2003

Section 1: General information

1.1 Purpose

MBIE is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing key (or in-principle) policy decisions to be taken by Cabinet.

1.2 Key Limitations or Constraints on Analysis

There are a number of limitations and constraints relating to this Regulatory Impact Analysis. These include:

- Only the main annual holidays options developed and tested by the Holidays Act Taskforce are included in the options analysis. Variations from these, or other proposals not considered by the Taskforce (for example, the portability of leave between different employers), have not been considered.
- The issue of remediation of historical underpayments of annual holiday and leave pay was not included in the analysis, but formed part of the problem definition. This is in line with the scope of the Holidays Act Taskforce's work.
- There has not been wide consultation on the Holidays Act Taskforce's recommendations. The lack of comprehensive consultation with stakeholders constrains MBIE's ability to fully understand the impacts and costs of various proposals. Estimates of impacts and costs have been derived from the payroll testing conducted on the options and relevant survey data.
- The payroll testing dataset included, by design, a large overrepresentation of employees with varied and unpredictable working arrangements as these employees are most likely to be impacted by changes to the Act. However, as the data used was disproportionately skewed towards less common working arrangements, it cannot be directly extrapolated to the wider New Zealand workforce. The data was also based on employers from one geographic area (the lower North Island) and, while covering most sectors, did not include all occupations.
- The Taskforce eliminated an accrual-based approach to annual holidays (Option Two) as an option part way through payroll testing because it could leave a small number of employees worse off when compared to the status quo. As a result, it was only tested using an early payment methodology that predates the Taskforce's final recommended payment calculations or the payment calculations outlined in this analysis. MBIE has not had the time to conduct this additional payroll testing.
- There is a lack of New Zealand data on annual holidays and leave entitlements and their use more generally. In combination with how payments can be impacted by when the leave is taken and the uncertain nature of how a new Act could influence behaviour, it is difficult to quantify the status quo and estimate the fiscal impacts of the options.

- Estimated fiscal impacts have also been developed for a number of Taskforce proposals. Calculations have used a number of estimates and assumptions, such as estimated number of employees and average weekly earnings, so are intended to provide a broad indication of possible costs.

1.3 Responsible Manager (signature and date):

Gerard Clark

Employment Standards Policy team

Labour and Immigration Policy branch

Ministry of Business, Innovation and Employment

27 February 2019

Section 2: Problem definition and objectives

2.1 What is the current state within which action is proposed?

The Act sets out the minimum entitlements to holidays and leave, and payment for them, that employers are obliged to provide to their employees. Its purpose is to promote balance between work and other aspects of employees' lives by providing minimum entitlements to annual holidays and other types of leave. It is estimated that there are 153,100 employers and 2,166,200 employees in New Zealand⁴.

Under the Act, all employees are entitled to:

- A minimum of four weeks' paid annual holidays after each 12 months of continuous employment for their employer. Employees can be paid annual holidays on a 'pay-as-you-go' basis if they are on a fixed-term agreement of less than 12 months or work so intermittently or irregularly that it is impractical for the employer to provide them with four weeks' annual holidays.
- Up to 11 public holidays each year, if they are days they would otherwise work.
- An alternative holiday, if they are required to work (or are on call and this impacts on their day) on a public holiday that is an otherwise working day.
- Access to five days' paid sick leave a year, 10 days' paid domestic violence leave a year, and up to 3 days of paid bereavement leave per bereavement:
 - after six months of current continuous employment with the same employer, or
 - after working for the employer for six months for an average of 10 hours per week, and at least one hour in every week, or 40 hours in every month.

Annual holidays are paid at whichever rate is the higher of the employee's ordinary weekly pay (or if this is not possible to calculate, the average weekly earnings in the last four weeks) and the employee's average weekly earnings in the last 12 months. Sick leave, bereavement leave, family violence leave and public holidays are paid at the rate of relevant daily pay, or average daily pay if it is not possible to calculate relevant daily pay or the employee's daily pay varies within the pay period.

The Act also covers a number of other issues. These include annual closedowns for businesses, transferring of public holidays and 'cashing up' one week's holiday.

While an employment agreement cannot provide less leave than is required under the Act, it can provide more, and many employers do in fact set their employee entitlements at levels above the minimum standards set out in the Act. Analysis of collective agreements, for example, indicates that 70 per cent of employees have more annual holidays than the statutory minimum and 43 per cent are entitled to 10 days' sick leave in their first year of employment⁵.

⁴ Survey of Working Life, 2018

⁵ Blumenfeld, Ryall & Kiely (2019). *Employment Agreements: Bargaining Trends and Employment Law Update 2018/2019*.

2.2 What regulatory system(s) are already in place?

Annual holidays and leave is part of the wider employment relations and employment standards regulatory system. The purpose of this system is to promote employment relationships that are productive, flexible and to the benefit of employers and employees.

The core statutory requirements relating to holidays and leave are provided in the Holidays Act 2003. The Act is based on prevailing societal views about just treatment and acknowledges that conditions can arise in labour markets where asymmetries of power and information can exist between employers and employees.

The Act is supported by online tools and guides, a contact centre and problem resolution services established under employment relations statute. These include:

- Mediation Services, where an independent mediator seeks to help an employee and an employer resolve an employment relationship problem in a semi-formal and confidential environment.
- The Employment Relations Authority, an independent body established to consider the facts of an employment relationship problem and make a decision based on the merits of the case.
- The Employment Court, which hears and determines cases relating to employment disputes, including challenges to determinations of the Employment Relations Authority, questions of interpretation of law, and disputes over strikes and lockouts.
- Labour Inspectors, who monitor and enforce compliance with employment standards.

2.3 What is the policy problem or opportunity?

A number of issues have been identified with the Act that make it difficult to implement in practice. Chief among these is that there is often a lack of prescription, particularly in how entitlements should be provided and how they are to be paid. For example, the Act does not prescribe how to determine what a 'week' is for the purposes of annual holidays or an 'otherwise working day' for other forms of leave, and is silent on how to include some types of payments, such as bonuses, in payment calculations. The result is that current provisions generally work for a standard five day, 40 hour week, but pose a number of issues when applied to more diverse working arrangements and variable pay structures.

Another key issue with the legislation is that it can be complex for employers understand and apply. Many employers struggle with the many payment calculations (there are at least 10) and knowing when to use them. A common example is not knowing when to use 'relevant daily pay' and 'average daily pay' when calculating payments for public holidays and sick, bereavement and family violence leave.

There is also a lack of clarity over certain terms used in the Act. For example, it is not entirely clear what 'intermittent or irregular' means in relation to work patterns or what is meant by 'regular' in relation to determining what income should be included in payment calculations.

The effect of the Act's lack of prescription, simplicity and clarity is that:

- Many employees are not receiving their correct entitlements, or payment for their entitlements
- Employers and employees do not have certainty regarding the provision of and payment for entitlements
- Employers, particularly those with large numbers of employees on variable work and pay arrangements, can incur relatively high compliance costs to comply with the Act
- The Act cannot be readily systematised in a payroll system
- Many employers are carrying a liability that cannot be readily quantified (and may change significantly when employees change their work patterns).

These challenges with the Act itself, combined with poor implementation in payroll systems and the business processes that support them, have led to widespread non-compliance with the legislation. Since 2016, every employer engaged by the Labour Inspectorate Payroll team has had a form of non-compliance with the Act, ranging from relatively minor record keeping breaches to full-scale non-compliance with the provision and payment of holidays and leave. It has been estimated that between 194,700 and 763,350 employees could be affected by non-compliance in New Zealand⁶.

Non-compliance issues have often led to underpayments to employees. As at June 2019, arrears had been calculated in respect of 84 of the 155 completed investigations undertaken by the Labour Inspectorate into non-compliance with the Act. In total, around \$90.4 million has been paid to 116,000 employees across numerous organisations. This figure will grow over time – District Health Boards have estimated remediation payments with a cost of \$550-650 million, while the Ministry of Education had \$63 million allocated in Budget 2019 for remediation payments.

In December 2017, the Minister for Workplace Relations and Safety received a joint proposal from Business New Zealand and the New Zealand Council of Trade Unions to review the legislation. A Taskforce was established by Cabinet soon after to review the Act and suggest recommendations for change.

The tripartite group was comprised of BusinessNZ, the New Zealand Council of Trade Unions and government representatives (MBIE, the State Services Commission and Inland Revenue), and was chaired by Professor Gordon Anderson, an employment law specialist from Victoria University. It provided the Minister for Workplace Relations and Safety with its final report in October 2019, and proposed an improved status quo where the existing units of entitlement are retained (weeks for annual holidays, days for other forms of leave) and the focus is on addressing known issues with the existing Act.

A number of non-legislative initiatives have been implemented in recent years to try and address issues with the Act. In addition to proactive audits and investigations, the Labour Inspectorate has conducted extensive industry engagement and developed a suite of tools and guides. However, while these efforts have provided greater clarity and support to employers and employees, it is clear that they are not sufficient to fully mitigate the problems with the Act itself. Without legislative intervention, employers will

⁶ MBIE (2014). *Calculating Payment for Leave: Summary of the compliance issues with the Holidays Act 2003*.

continue to struggle to comply with their obligations and issues with entitlements and payments will persist.

2.4 What do stakeholders think about the problem?

The primary stakeholders are employers and employees. Many employers are struggling to comply with their obligations under the current Act and a large number of employees are not receiving their correct entitlements. Both groups stand to benefit from an improvement to the legislation.

Payroll providers are another interested stakeholder group. They attempt to implement the obligations outlined in the Act in their systems and seek to provide employers with products that are compliant, efficient and effective.

The Holidays Act Taskforce released an issues paper in August 2018 which set out its understanding of the key issues with the Act⁷. It saw these as being that the Act is not prescriptive enough, it is too complex, and there is not enough clarity over certain terms used.

The Taskforce received 87 substantive submissions on the issues paper from employers, payroll providers and individuals. The vast majority of submissions (92%) felt that the issues paper accurately captured the main issues with the Act.

There is general agreement from stakeholders as to what the main issues with the Act are, as well as that legislative change is the best way to address them. This aligns with MBIE's conceptualisation of the problems with the Act.

2.5 What are the objectives sought in relation to the identified problem?

The key objectives of improving the Act are to:

- make the provision of, and payment for, entitlements to holidays and leave simpler and more readily applicable to the range of working arrangements in the labour market
- provide clarity and certainty to employers and employees so that employees receive their correct entitlements, and remuneration for them, and employers' indirect compliance costs are minimised
- aim to protect the overall entitlements for employees
- make obligations easier to systematise and implement in payroll systems.

Section 3: Option identification

3.1 What options are available to address the problem?

The Holidays Act Taskforce considered a range of possible changes to the Act. This included core components of a holidays and leave system such as how entitlements should be calculated and paid, as well as more peripheral issues such as how availability provisions and closedowns should be treated. It focused on regulatory

⁷ <https://www.mbie.govt.nz/assets/Uploads/bbb42c0baf/holidays-act-review-issues-paper.pdf>

options as the group's purpose was to suggest improvements to the legislation, and because a number of non-regulatory initiatives had already been implemented as part of the Labour Inspectorate's payroll strategy.

The Taskforce's options were shaped by research, international comparisons and consultation. For the majority of issues considered, MBIE (as the Taskforce Secretariat) provided detailed policy papers outlining the various options and their relative advantages and disadvantages. In addition, the Taskforce consulted with a small group of payroll providers on some of its recommendations and made some changes in light of the responses received, such as not progressing with a proposal to apportion commission or incentive payments across pay periods.

Option One – The Taskforce's proposals

The Taskforce's proposed approach is an improved status quo, where the existing units of entitlement are retained (weeks for annual holidays, days for other forms of leave) and the focus is on addressing known issues with the existing Act. The group was guided by three key principles when making recommendations: certainty, transparency and practicality. It wanted the recommendations to provide the certainty that employers and employees require, to ensure that employees are fully informed about their leave entitlements, and to work in the real world. It also wanted to ensure that no employee would be worse off under any of its proposals.

With regards to annual holidays, the Taskforce recommended that:

- annual holidays entitlements should be calculated, taken, paid and held in weeks or portions of weeks
- a clear process should be followed to determine how much of an employee's leave entitlement should be used for a period of time away from work (this involves using the days and hours of work that are set out in an employment agreement or roster, or if not available, an averaging approach)
- employees should become entitled to four weeks' leave after 12 months continuous employment, but have the ability to take leave in advance on a pro-rata basis
- annual holidays should be paid at the greater of Ordinary Leave Pay⁸, average weekly pay for the last four or 13 weeks, and average weekly pay for the last 52 weeks
- the following definition of 'gross earnings' should be used for leave payment calculations: *an employee's leave payment should reflect all cash payments received, except direct reimbursements for costs incurred.*

The Taskforce could not agree whether the short-run average weekly pay in the payment calculations should be based on the previous four or 13 weeks, and referred this decision to the Minister for Workplace Relations and Safety. The Minister proposed that the second reference period in the annual holidays payment methodology should be 13 weeks.

The Taskforce's proposals provide greater prescription to areas of ambiguity in the Act. They provide rules for how to calculate a 'week' or 'otherwise working day' for leave purposes, particularly for workers with variable working patterns for whom it is currently difficult to calculate, and clarify which payments must be included in calculations. They

⁸ Base rate plus any scheduled overtime, allowance, commission and incentive payments.

also reduce the number of payment calculations, remove the need for an employer to decide on a specific payment calculation due to the 'greater of' approach for annual holidays and leave, and better define key terms.

This option provides the clarity and certainty that employers and employees are seeking and will help to ensure that employees receive their correct entitlements and remuneration for them. This will reduce future remediation issues, particularly the costly payroll investigations and the need for arrears payments. This option also seeks to protect employees' entitlements and can be implemented in payroll systems.

Option Two – An hours-based accrual system for annual holidays, with other aspects following the Taskforce's proposals

Option Two proposes a fundamentally different approach for how annual holidays entitlements are calculated, taken, paid and held. It departs from the principle that annual holidays entitlements are based on the work pattern at the time the holidays are taken, and introduces a system where entitlements are based on an employee's arrangements at the time they 'earned' them. This option adopts the remaining Taskforce proposals, including holding other forms of leave in days.

Under Option Two, all employees would earn annual holidays in hours at a set percentage rate (7.69% of every hour worked would give employees the equivalent of four weeks annual holidays per year). The employee's annual holidays balance would accrue in hours as they worked and any holidays taken would be calculated and deducted in hours. An accrual system, by definition, means that employees would receive holidays and payments based on their arrangements at the time they 'earned' them (rather than at the time of taking the holidays).

Hours that would accrue annual holidays would be determined as follows:

- For salaried workers, hours that accrue annual holidays are those set out in the employment agreement (i.e. what is usually expected to be worked) plus any additional hours that are agreed and paid separately to the core hours in the employment agreement.
- For workers paid on a daily or hourly rate, hours that accrue annual holidays are any hours that they are paid for (including overtime).

The following process would be used to determine how much annual holidays would need to be taken for a period of time away from work:

- If the number of hours an employee would have worked on a specific day is set in an employment agreement or work roster, then this figure should be used.
- If the number of hours an employee would have worked is not set out in an employment agreement or work roster, then an average working day should be determined by calculating the average daily hours the employee worked on all corresponding calendar days in the previous 13 weeks. For example, if the employee wishes to take holidays on a Monday, then the average hours worked on all Mondays in the 13 week period should be used.
- This process would need to be carried out for each day of holidays the employee wishes to take.

The greater of the following should be paid for the relevant period of annual holidays:

1. Ordinary Leave Pay (base rate plus any scheduled overtime, allowance, commission and incentive payments)
2. Average Leave Pay 13 (average hourly rate in the last 13 weeks⁹ multiplied by the amount of leave being taken in hours)
3. Average Leave Pay 52 (average hourly rate in the last 52 weeks multiplied by the amount of leave being taken in hours)

The proposed new definition of 'gross earnings' would be used for payment calculations. This includes all cash payments received, except direct reimbursements for costs incurred.

The employee would be entitled to take any annual holidays that had accrued to date, but could take leave in advance if agreed to by the employer. There would also be no need for pay-as-you-go provisions, in contrast to Option One.

This option responds to feedback received from many stakeholders for an hours-based accrual system. Many of the submissions received on the Taskforce's issues paper indicated a strong support for an accrual system based on hours and for a simplified system with fewer calculations. Some of the payroll providers the Taskforce engaged with on the draft recommendations also raised concerns with how annual holidays were conceptualised and suggested different accrual approaches.

As with Option One, this approach provides greater prescription for how to calculate entitlements and payments and better defines key terms. It is also simpler than the current Act in respect to the hours-based accrual system for annual holidays and the removal of additional payment calculations.

These changes can be implemented in payroll systems, provide the clarity and certainty that employers and employees are seeking, and are simpler in many respects when compared to the current Act. This will help to ensure that employees receive their correct entitlements and remuneration for them, helping to eliminate remediation issues such as costly payroll investigations and the need for arrears payments. However, a small number of employees could be worse off under an accrual approach when compared with the status quo or Option One, and some employees would likely find the shift from having their entitlements held in weeks to accrued hours confusing.

The specific proposals for options one and two are provided in Table 1.

⁹ E.g. total earnings in the last 13 weeks divided by the total number of hours worked in the last 13 weeks.

Table 1: Option One and Option Two proposals

Theme	Option One – Taskforce proposals	Option Two – Hours-based accrual (differences highlighted)
Payment for annual holidays and FBAPS leave	<ul style="list-style-type: none"> • The greater of the following should be paid for the relevant period of annual leave: <ul style="list-style-type: none"> ○ Ordinary Leave Pay (base rate plus any scheduled overtime, allowance, commission and incentive payments) ○ Average weekly pay for the last four or 13 weeks (the Minister for Workplace Relations and Safety subsequently chose a 13-week reference period) ○ Average weekly pay for the last 52 weeks. • Each day (or part-day) of FBAPS leave should be paid based on the greater of: <ul style="list-style-type: none"> ○ Ordinary Leave Pay ○ Average Daily Pay 	<ul style="list-style-type: none"> • The greater of the following should be paid for the relevant period of annual leave: <ul style="list-style-type: none"> ○ Ordinary Leave Pay (base rate plus any scheduled overtime, allowance, commission and incentive payments) ○ Average Leave Pay 13 (average hourly rate in the last 13 weeks multiplied by the amount of leave being taken in hours) ○ Average Leave Pay 52 (average hourly rate in the last 52 weeks multiplied by the amount of leave being taken in hours) • Each day (or part-day) of FBAPS leave should be paid based on the greater of: <ul style="list-style-type: none"> ○ Ordinary Leave Pay ○ Average Daily Pay
Annual holidays entitlement	<ul style="list-style-type: none"> • Annual holidays entitlements should be calculated, taken, paid and held in weeks or portions of weeks. • Employees should become entitled to four weeks' leave after 12 months continuous employment, but have the ability to take leave in advance on a pro-rata basis. • A clear process should be followed to determine how much of an employee's leave entitlement should be used for a period of time away from work. Where an employee's days and hours of work are set out in an employment agreement, shift roster or other document and these are an accurate reflection of the employee's actual working pattern, these agreed days and hours should be used as the basis for determining leave entitlements and deductions. • The 'parental leave override' in the <i>Parental Leave and Employment Protection Act 1987</i> should be removed, to address discrimination against parents who take time off to care for their young children. • The ability for employers to use pay-as-you-go (PAYG) for employees on fixed-term contracts of less than 12 months should be removed and a 	<ul style="list-style-type: none"> • Annual holidays entitlements should be calculated, taken, paid and held in hours. • Employees earn annual holidays at a set percentage rate (7.69%). For salaried workers, hours that accrue leave are those set out in the employment agreement (plus paid overtime); for workers paid a daily or hourly rate, hours that accrue leave are any hours that they are paid for. • A clear process should be followed to determine how much of an employee's leave entitlement should be used for a period of time away from work. Where an employee's days and hours of work are set out in an employment agreement, shift roster or other document and these are an accurate reflection of the employee's actual working pattern, these agreed days and hours should be used as the basis for determining how much leave to deduct. • The 'parental leave override' in the <i>Parental Leave and Employment Protection Act 1987</i> should be removed, to address discrimination against parents who take time off to care for their young children.

	<p>more detailed definition should be provided for when PAYG can be used because a work pattern is 'intermittent or irregular'.</p> <ul style="list-style-type: none"> An employer's ability to require employees to attend work under an availability provision should be suspended from the end of the last shift the employee works before their leave period until the start of the first shift they work on their return from leave. The following definition of 'gross earnings' should be used for leave payment calculations: <i>an employee's leave payment should reflect all cash payments received, except direct reimbursements for costs incurred</i>'. 	<ul style="list-style-type: none"> The ability for employers to use pay-as-you-go (PAYG) for employees should be removed. An employer's ability to require employees to attend work under an availability provision should be suspended from the end of the last shift the employee works before their leave period until the start of the first shift they work on their return from leave. The following definition of 'gross earnings' should be used for leave payment calculations: <i>an employee's leave payment should reflect all cash payments received, except direct reimbursements for costs incurred</i>'.
FBAPS leave entitlement	<ul style="list-style-type: none"> FBAPS leave should continue to be held in days. Eligible employees should be entitled to bereavement leave and family violence leave from the first day of employment. Eligible employees should be entitled to one day of sick leave from their first day of employment, with an additional day per month of employment until the full entitlement of five days is reached after four months. Employees should have the ability to take sick leave and family violence leave in units of less than a day on a proportionate basis for time and pay with a minimum amount of a quarter of a day. There should be a new test for which employees are eligible for sick, bereavement and family violence leave. A new prescriptive methodology should be used to determine whether a day is an Otherwise Working Day for an employee for FBAPS purposes. The list of people for whom bereavement leave applies should be extended to include a more modern understanding of family members. Provisions relating to transferring public holidays should be amended to reduce the chance of employees being disadvantaged by the transfer. 	<ul style="list-style-type: none"> FBAPS leave should continue to be held in days. Eligible employees should be entitled to bereavement leave and family violence leave from the first day of employment. Eligible employees should be entitled to one day of sick leave from their first day of employment, with an additional day per month of employment until the full entitlement of five days is reached after four months. Employees should have the ability to take sick leave and family violence leave in units of less than a day on a proportionate basis for time and pay with a minimum amount of a quarter of a day. There should be a new test for which employees are eligible for sick, bereavement and family violence leave. A new prescriptive methodology should be used to determine whether a day is an Otherwise Working Day for an employee for FBAPS purposes. The list of people for whom bereavement leave applies should be extended to include a more modern understanding of family members. Provisions relating to transferring public holidays should be amended to reduce the chance of employees being disadvantaged by the transfer.

Other proposed changes	<ul style="list-style-type: none"> • The Taskforce was unable to reach a consensus view in relation to establishing an additional public holiday (e.g. for Matariki). • Closedown provisions should be amended to provide greater transparency and certainty for employees. In addition, the requirement that holidays are paid out at 8 per cent and an employee's anniversary date is reset should be removed (although it should still be possible for anniversary dates to be reset by agreement). • On the sale and transfer of a business, employees should have a choice about whether to transfer all of their leave entitlements to the new employer or have them paid out and reset. • Record keeping requirements should be updated to reflect changes to how leave entitlements are held, calculated and paid. • Employers should be required to provide payslips to employees in every pay period. • Issues that cause non-compliance with the current Act should be considered in the design of the compliance and enforcement mechanisms to support any revised Act. • Employers and employees should have the ability to agree to arrangements that are different to those in the Act, providing that it can be demonstrated that these arrangements provide the employee with leave entitlements that, at a minimum, meet the standards set out in the Act. 	<ul style="list-style-type: none"> • The Taskforce was unable to reach a consensus view in relation to establishing an additional public holiday (e.g. for Matariki). • Closedown provisions should be amended to provide greater transparency and certainty for employees. In addition, the requirement that holidays are paid out at 8 per cent and an employee's anniversary date is reset should be removed (although it should still be possible for anniversary dates to be reset by agreement). • On the sale and transfer of a business, employees should have a choice about whether to transfer all of their leave entitlements to the new employer or have them paid out and reset. • Record keeping requirements should be updated to reflect changes to how leave entitlements are held, calculated and paid. • Employers should be required to provide payslips to employees in every pay period. • Issues that cause non-compliance with the current Act should be considered in the design of the compliance and enforcement mechanisms to support any revised Act. • Employers and employees should have the ability to agree to arrangements that are different to those in the Act, providing that it can be demonstrated that these arrangements provide the employee with leave entitlements that, at a minimum, meet the standards set out in the Act.
------------------------	---	---

3.2 What criteria, in addition to monetary costs and benefits have been used to assess the likely impacts of the options under consideration?

The two options have been assessed against the following criteria:

a. It continues to promote the existing purpose of the Holidays Act 2003

Section 3 of the Act sets out the purpose of the Act which is “to promote balance between work and other aspects of employees’ lives” and to provide:

- a. “annual holidays to provide the opportunity for rest and relaxation”
- b. “public holidays for the observance of days of national, religious, or cultural significance”

- c. “sick leave to assist employees who are unable to attend work because they are sick or injured, or because someone who depends on the employee for care is sick or injured”
- d. “bereavement leave to assist employees who are unable to attend work because they have suffered a bereavement”
- e. “domestic violence leave to assist employees to deal with the effects on the employees of being people affected by domestic violence”

b. It provides clarity and certainty for employers and employees so that employees receive their correct entitlements

A major problem identified with the current Act is the difficulty in clearly understanding and expressing entitlements, so an improved Act should be easier to understand and align more with how employers and employees expect the Act to operate.

c. It is simpler than the current Act in relation to provisions of, and payment for, entitlements to holidays and leave

The complexity of the current Act creates issues for employers and employees, so a more simple Act should make it easier to implement.

d. It is readily implementable in a payroll system

Many employers use automated payroll software for the majority of their payroll needs, so the Act should be easily able to be translated into a software system. This would likely involve reducing the number of manual decisions that employers currently need to make about their employees’ entitlements.

e. It minimises perverse incentives on employers and employees

An improved Act should not incentivise employees to take leave on particular days and not others or incentivise employers to arrange rosters in a particular way to minimise entitlements for their employees.

f. It ensures the balance of decision-making between employers and employees when it comes to requests for holidays and leave is appropriately calibrated

An improved Act would ideally not give one party greater bargaining power in relation to the taking of leave, wherever possible.

g. It is readily applicable to the full range of working and remuneration arrangements in the labour market both now and in the future

An improved Act should be ‘future-proofed’ and should apply equally to more traditional working arrangements, as well as being flexible enough to apply to the types of working arrangements that could exist in the future.

h. It aims to protect overall entitlements for employees

An improved Act should, as much as possible, ensure that employees receive at least their current minimum entitlements (four weeks of annual holidays per year, up to 11 public holidays, five days of sick leave, up to three days of bereavement leave per bereavement, and ten days of domestic violence leave).

The majority of the criteria do not conflict with one another. However, there appears to be some trade-off between simplicity and protecting overall entitlements for employees (criteria c and h).

Under the current Act, annual holidays entitlements are in weeks and a ‘week’ needs to reflect the work pattern at the time the leave is taken. For example, if an employee was

previously working 20 hours a week but recently increased their hours to 40 a week, a 'week' for them would be 40 hours. Under an hours-based accrual system, however, an employee would build up a bank of leave in hours and this does not need to be converted into a week as part of annual holidays calculations (i.e. they determine how many hours they want off and deduct that from their balance).

The tension between simplicity and protecting overall entitlements for employees arises when comparing an accrual-based system with the current Act or with Option One. Some employees could be worse off under an accrual approach if they increase their hours, as they would have accrued leave based on what they have worked and it would not be converted to match their current working pattern. These employees would miss out on annual holidays (i.e. time off) and payments compared to the status quo they would never be able to claw back. However, it should be noted that employees would be better off compared to the current Act if they have recently reduced their hours as they would have more in the 'bank'. In essence, some options may be significantly simpler and meet all other criteria, but may have impacts on some employees' annual holidays entitlements under certain circumstances.

3.3 What other options have been ruled out of scope, or not considered, and why?

Only the two main annual holidays options developed and tested by the Holidays Act Taskforce are included in the options analysis. Variations from these, or other proposals not considered by the Taskforce (for example, the portability of leave between different employers), have not been considered. In addition, while the estimated impacts of the Taskforce's full recommendations are included in this analysis (section 5.3), the various options for the remaining recommendations have not been examined. This is because:

- the Taskforce's options for annual holidays cover the main, feasible alternatives
- how annual holidays are treated is of significant interest to stakeholders, with most supporting one or the other of the two main options presented in this analysis
- all recommendations were considered in-depth by the Taskforce (e.g. for the issue of what happens to annual holiday and leave entitlements when a business is sold, the Taskforce received two supporting papers from the Secretariat, considered five main options, and discussed the relative advantages and disadvantages of each option over a number of meetings before making a decision)
- the recommendations were developed and negotiated between employer, employee and government representatives, and are assumed to balance the varying perspectives of the different groups.

Section 4: Impact Analysis

Table 2 – Marginal impact: How does each of the options identified in section 3.1 compare with taking no action under each of the criteria set out in section 3.2?

	No action	Option One – Taskforce proposals	Option Two – Accrual system
Promotes purpose	0	+ Better promotes work/life balance due to earlier and better access to leave	+ Better promotes work/life balance due to earlier and better access to leave
Clarity and certainty	0	+ Provides better prescription (e.g. how to determine a ‘week’ and ‘otherwise working day’) and clarifies certain terms (e.g. ‘gross earnings’, ‘intermittent or irregular’), but may remain hard for some employers and employees to understand entitlements	++ Provides better prescription (e.g. how to determine a ‘week’ and ‘otherwise working day’) and clarifies certain terms (e.g. ‘gross earnings’, ‘intermittent or irregular’)
Simpler	0	0 Provisions remain complex for employees with variable hours and/or remuneration	+ Annual holidays entitlements much simpler to calculate
Implementable	0	+ Greater prescription and rules improve implementability; requires less upfront changes to payroll systems as it is an improved status quo, but annual holidays may be more difficult to calculate and compliance costs may be higher over time when compared to Option Two	+ Greater prescription and rules improve implementability; requires more upfront changes to payroll systems, but annual holidays easier to calculate and compliance costs may be lower over time when compared to Option One
Perverse incentives	0	+ Removes perverse incentives around forms of payment (e.g. discretionary bonuses) and payment calculations (e.g. RDP vs. ADP); minimises incentives for employees to take holidays and leave on particular days (i.e. payments and deductions are well calibrated so employees are not incentivised to take time off on	+ Removes perverse incentives around forms of payment (e.g. discretionary bonuses) and payment calculations (e.g. RDP vs. ADP); minimises incentives for employees to take holidays and leave on particular days (i.e. payments and deductions are well calibrated so employees are not incentivised to take time off on

		specific days); minimises incentives for employers to arrange rosters in certain ways (except permanent arrangements to minimise public holidays costs)	specific days); minimises incentives for employers to arrange rosters in certain ways (except permanent arrangements to minimise public holidays costs)
Balance of decision-making between employers and employees	0	+ Retains existing approach where annual holidays is 'by agreement', but formalises the widespread practise of employers' agreeing to the use of annual holidays during the first year of employment by explicitly allowing leave to be taken in advance on a pro-rata basis; making sick, bereavement and family violence leave available from day one removes the need for employers to agree for employees to take leave in the first six months	+ Retains existing approach where annual holidays is 'by agreement', but employees have the right to take the annual holidays that they have accrued; making sick, bereavement and family violence leave available from day one removes the need for employers to agree for employees to take leave in the first six months
Applicable to diverse working arrangements	0	+ Prescribed rules apply to diverse working arrangements, but annual holidays provisions may not be as future proofed as Option Two due to a rigid and complex approach	++ Prescribed rules apply to diverse working arrangements; annual holidays provisions more easily applied to all types of working arrangements when compared to Option One
Aims to protect employee entitlements	0	++ Vast majority of employees better off	+ Most employees better off, except those who increase their hours and want to take annual holidays soon after
Overall assessment	0	Preferred option if protecting employees' entitlements is prioritised	Preferred option simplicity is prioritised

Key:

- ++** much better than doing nothing/the status quo
- +** better than doing nothing/the status quo
- 0** about the same as doing nothing/the status quo
- worse than doing nothing/the status quo
- much worse than doing nothing/the status quo

Section 5: Conclusions

5.1 What option, or combination of options is likely to best address the problem, meet the policy objectives and deliver the highest net benefits?

MBIE recommends making changes to the Act that provide greater prescription as recommended by the Holidays Act Taskforce, if *retaining the current units of entitlement* and *protecting employees' entitlements* are prioritised (Option One). This approach keeps annual holidays entitlements in weeks and retains the requirement that a 'week' must reflect the current working pattern, thereby largely protecting employees' annual holidays entitlements when compared to the status quo. It should also have less of an impact on payroll systems as it seeks to improve, rather than fundamentally change, holidays and leave entitlements.

Alternatively, MBIE recommends adopting the majority of the Holidays Act Taskforce proposals but introducing a new system where annual holidays are accrued over time, if *simplicity* for employers and employees is prioritised (Option Two). An hours-based accrual system for annual holidays makes it significantly easier to calculate entitlements and removes the need for complicated pay-as-you-go provisions. This should make it easier for employees to understand their entitlements and reduce compliance costs for employers.

More generally, both options provide greater clarity and certainty and will ensure that employees receive their correct entitlements and payments for them. This should help to eliminate remediation issues and the need for costly payroll investigations and arrears payments. Both options are also implementable in a payroll system, promote the current objectives of the Act, and are applicable to the full range of working and remuneration arrangements in the labour market.

These recommendations need to be viewed in light of data and consultation limitations. As previously outlined, while MBIE has confidence in the assumptions and evidence on the type of employees that are likely to be impacted and how, a lack of data on the annual holidays and leave system and the purpose of the payroll testing make it difficult to estimate fiscal impacts at the New Zealand level. With regards to consultation, the Taskforce only publicly consulted on an issues paper and with a small group of payroll providers on a subset of draft recommendations. MBIE intends to conduct further consultation on detailed policy and implementation issues with relevant stakeholders after Cabinet agreement.

The consultation that has taken place to date indicates that there will be a mixed response to the Taskforce's recommendations (Option One). While it has the support of key stakeholders, such as Business New Zealand and the New Zealand Council of Trade Unions, it is expected that others (particularly some payroll providers and employers) would see them as overly complex and would prefer an accrual-based option more in line with Option Two. On the other hand, it is expected that most unions will oppose Option Two as some employees could be worse off when compared to the status quo.

5.2 Table 3: Summary of costs and benefits of Option One

Affected parties (<i>identify</i>)	Comment: <i>nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks</i>	Impact <i>\$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts</i>	Evidence certainty <i>(High, medium or low)</i>
---	--	---	---

Additional costs of proposed approach compared to taking no action

Regulated parties <i>(employers and employees)</i>	<p>Increased ongoing costs for some employers due to:</p> <ul style="list-style-type: none"> • 'gross earnings' definition • new payment methodologies • removal of the 'paid parental leave override' • earlier availability for some types of leave • new bereavement leave definition • updated record keeping and payslips requirements <p>One-off costs for many employers to upgrade to a new payroll system.</p>	\$310.3 per year for Option One	Low
Regulators <i>(Labour Inspectorate)</i>	One-off costs to operationalise the new requirements and upskill staff, provide initial education services, update guidance and tools and respond to questions after implementation. Possible on-going costs related to increased enforcement and compliance activity.	Approx. \$10.5 million (2021/22 to 2024/25) for Option One.	Medium
Wider government	Estimated costs to government as an employer included in the 'Regulated parties' estimates		Low
Other parties	One-off costs to payroll providers to upgrade their systems. This is expected to be greater for Option Two, but cannot be estimated at this time.		Low

Total Monetised Cost		Approx. \$312.9 million per year for Option One	
Non-monetised costs			

Expected benefits of proposed approach compared to taking no action

Regulated parties <i>(employers and employees)</i>	Employers will have greater clarity and certainty, be better able to systematise rules, and reduce the likelihood and impact of remediation projects. Employees more likely to receive their correct entitlements and payments and have earlier and greater access to some forms of leave.	Medium	
Regulators <i>(Labour Inspectorate)</i>	Greater clarity and prescription should make it easier to identify non-compliance.	Low	
Wider government	Some benefits as regulated parties.	Medium	
Total Monetised Benefit			
Non-monetised benefits		Medium	

5.3 What other impacts is this approach likely to have?

Option One – Impacts of the Taskforce’s recommendations for the entitlement and payment for annual holidays

The Taskforce proposals reflect an improvement on the current annual holidays provisions. They provide clear rules for how to calculate a ‘week’, clarify what payments are to be included in payment calculations, and give employees the ability to take leave in advance on a pro-rata basis (at present, employees can only take annual holidays in advance at an employer’s discretion). The entitlements and payment calculations also minimise incentives for employees to take holidays on particular days (i.e. payments and deductions are well-calibrated) or for employers to arrange rosters in certain ways. However, the annual holidays recommendations increase the number of payment calculations from two (greater of Ordinary Weekly Pay and average weekly earnings over the last 12 months) to three, and do not fully address concerns regarding complexity and being easily understood by regulated parties.

Payroll testing and our analysis indicates that:

- **The annual holidays proposals under Option One result in higher annual holiday payments (on average) than the status quo.** Results show that around 34 per cent of employees were better off and annual holidays payments

increase on average by 0.32% for the sample tested. This is largely due to entitlements being held and paid in 'weeks', the 'greater of three' approach to payment calculations and the new 'gross earnings' definition.

- **Employees with variable hours and/or pay are most likely to be impacted.** It is estimated that approximately 60,600 and 580,400 employees, or between three and 27 per cent of all New Zealand employees, work variable hours or receive variable pay. These employees are primarily from the 'health care and social assistance', 'accommodation and food services' and 'public administration and safety' sectors.
- **Most employees' annual holidays pay is unchanged.** The majority of employees should not see increased payments when compared to the current Act. Around 55 per cent of the employees included in the payroll testing did not receive an increase in pay. However, there could be a marginal change for those employees that are not currently receiving their correct entitlements or payments.
- **A small number of employees could be disadvantaged.** Workers who take annual holidays immediately after a period in which their average hours over the last four weeks are higher than their average hours over the last 13 weeks could be worse off, relative to the status quo.

Table 4 provides an overview of the results of the payroll testing.

Table 4: Impact of the Taskforce's proposals on the annual holidays payment model

		Annual holidays payments – Option One		
Percentage of employees from testing dataset affected	Worse off (compared to status quo)	10.35%	Worse by more than 15%	3.33%
			Worse by 5-15%	3.45%
			Worse by 0-5%	3.57%
	No change	55.16%		
	Better off (compared to status quo)	34.48%	Better by 0-5%	27.59%
			Better by 5-15%	6.90%
Better by more than 15%			0.00%	
Average impact on employees from the testing dataset (\$)	Average payment for four weeks' leave (under proposed option)	\$5,691.29 (compared to \$5,673.22 under the status quo)		
	Average % variance per employee	+ 0.32%		
	Average \$ variance per employee	+ \$18.07		

The percentages set out in the table above need to be treated with caution as they are not directly applicable to the wider New Zealand working population. The percentages represent the portion of employees from the testing dataset who would be impacted by the Taskforce's proposals. By design, however, the testing dataset includes a large overrepresentation of employees with varied and unpredictable working arrangements as these employees are most likely to not be receiving the correct entitlements now and because it is important to capture as many varied working arrangements and leave scenarios as possible. Therefore, the 10 per cent figure of employees from the testing dataset who would be negatively impacted is almost certainly a significant overstatement of the percentage of New Zealand employees who would actually be negatively impacted. Similarly, the dollar figures in the table should be treated with caution as they are based on salaries of employees in the testing dataset rather than average salaries from across the New Zealand economy.

Using the payroll testing data, it is estimated that annual holidays payments could increase across the New Zealand economy by up to \$29.7 million per year. However, in light of the caveats mentioned above, MBIE considers that this is an overestimation.

Option Two – Impacts of an accrual-based annual holidays system

As detailed in section 3.1, the alternative option for annual holidays is an accrual-based system where entitlements are calculated, taken, paid and held in hours. Payment would be based on the greater of:

- Ordinary Leave Pay (base rate plus any scheduled overtime, allowance, commission and incentive payments)
- Average Leave Pay 13 (average hourly rate in the last 13 weeks multiplied by the amount of leave being taken in hours)
- Average Leave Pay 52 (average hourly rate in the last 52 weeks multiplied by the amount of leave being taken in hours)

As with Option One, these proposals reflect an improvement on the current annual holidays provisions. They provide clear rules for how to calculate entitlements and payments, give employees the ability to take leave as they earn it, and minimise incentives for employees to take holidays on particular days (i.e. payments and deductions are well-calibrated) or for employers to arrange rosters in particular ways. It is also simpler than the current Act in respect to the hours-based accrual system for annual holidays and the removal of complex pay-as-you-go provisions.

Payroll testing indicates that many employees would not be negatively impacted or would be better off under Option Two when compared to the status quo. Employees with stable hours and pay, have recently decreased their hours, or work variable hours and take leave during quieter periods would be better off than under the current Act. However, those who have recently increased their hours or work variable hours and take leave during busy periods would be worse off than under the current Act.

For example, if an employee has recently increased their hours permanently and wishes to take annual holidays, they would not have accrued as much leave as they would currently be entitled to. These employees would miss out on annual holidays (i.e. time off) and payments compared to the status quo they would never be able to claw back. Conversely, if they took annual holidays shortly after permanently decreasing their

hours, they would likely have accrued more leave than they would have been entitled to under the current Act.

Employees could also be slightly disadvantaged if they were to leave within the first 12 months of employment. Under the current Act, employees receive their annual holidays entitlement after 12 months and if they leave before this time they get paid 8% of their gross earnings in lieu of annual holidays (unless they have taken them in advance). Under Option Two, they would be paid what they had accrued at 7.69%, so could be slightly financially worse off.

It is estimated that Option Two could impact between 60,600 and 580,400 employees, or three to 27 per cent of all New Zealand employees. These would typically be those working highly variable hours in the 'health care and social assistance', 'accommodation and food services' and 'public administration and safety' sectors.

The Taskforce eliminated an accrual-based approach to annual holidays as an option part way through payroll testing because it could leave a small number of employees worse off when compared to the status quo. As a result, it was only tested against an early payment methodology that predates the payment calculations provided in this analysis or the Taskforce's final recommended payment calculations. MBIE has not had the time to conduct this additional payroll testing. However, as the majority of payroll systems already calculate annual holidays based on an accrual system, it is expected that there not be a large cost to the payroll sector to implement this option.

Impacts of other recommendations

The Taskforce made a number of additional main recommendations that are common to both options one and two. The estimated impacts of these recommendations are provided below.

Payment calculations for other forms of leave

Under the current Act, payment for family violence leave, bereavement leave, alternative holidays, public holidays and sick leave (FBAPS leave) is calculated using relevant daily pay or average daily pay. Relevant daily pay is what an employee would have received if they were at work on that day, and includes payments such as regular (taxable) allowances, productivity or incentive-based payments and overtime payments if the employee would have received them on the relevant day. If it is not possible to calculate relevant daily pay or the employee's daily pay varies within the pay period, an employer can use average daily pay. This is the daily average of an employee's gross earnings over the previous 52 weeks.

The Taskforce recommended that each day (or part-day) of FBAPS leave should be paid based on the greater of:

- Ordinary Leave Pay (base rate plus any scheduled overtime, allowance, commission and incentive payments)
- Average Daily Pay (average hourly rate multiplied by the amount of leave being taken in hours).

This methodology is more prescriptive and can be implemented in payroll systems. It also removes the need for some employers to decide which payment calculation to

adopt, which can be a source of confusion or could be done in a way to financially advantage the employer.

The payroll testing suggests that:

- **No employees would be worse off.** When compared to the current Act, no employee would be worse off under the FBAPS payment methodology.
- **Most employees would be better off.** While some employees would not see a change in their FBAPS leave pay (28%), results show that the majority (72%) would receive more under the Taskforce's proposals than when compared to the status quo. The average daily FBAPS leave payment increased by 7.1 per cent.

As with the testing for annual holidays payments, the results need to be treated with caution as they are not directly applicable to the wider New Zealand working population. Therefore, it is expected that the proportion of employees that are paid more than the status quo and the average size of the increase is an overestimation.

Using the payroll testing data, it is estimated that FBAPS payments could increase across the New Zealand economy by up to \$487.8 million per year. However, in light of the caveats mentioned above, MBIE considers that this is an overestimation and provides a maximum estimate for a range.

A more reasonable estimate is \$186.7 million per year. This assumes that the increase in FBAPS leave payments is largely confined to workers with variable hours and/or pay.

Removing the 'parental leave override'

Section 42 of the *Parental Leave and Employment Protection Act 1987* overrides section 21 of the *Holidays Act 2003*, so that employees who became entitled to annual holidays while they were on parental leave or in the 12 months after returning to work are paid differently. These employees are only entitled to be paid at a rate based on the average weekly earnings over the last 12 months, rather than the greater of this amount and their Ordinary Weekly Pay. Because the employee's average weekly earnings during parental leave will be \$0, and parental leave periods can be up to 52 weeks long, this means that some employees are entitled to be paid \$0 per week for annual holidays when they return from parental leave.

Removing section 42(2) of the *Parental Leave and Employment Protection Act 1987* would mean that employees who take leave after returning from parental leave are paid at their full rate (greater of Ordinary Weekly Pay and their average weekly earnings over the last 12 months), removing discrimination issues. It also simplifies payroll complexity and aligns with broader Government goals of supporting families and working parents.

However, it could lead to behavioural change, such as employers becoming more reluctant to employ parents (despite being in breach of legislation), and may disadvantage employers if employees resign immediately after 12 months of parental leave and are paid at their full rate for the annual holidays entitlement. It would also likely increase costs for employers.

It is difficult to estimate the marginal cost of removing the override due to lack of data on the status quo. For example, there is limited information on the duration of parental leave (paid and unpaid), how many employees return to work following parental leave, and whether they return full- or part-time. We also do not know how much these types of

employees earn and how they use annual holidays once they return to work (e.g. do they wait until their annual holidays are worth more before using them or take them earlier when they are needed).

In light of these caveats, a range of estimates have been calculated:

- A low estimate would be a negligible marginal increase for employers across New Zealand. This assumes that employees currently returning to work wait until their annual holidays are worth their full rate or close to their full rate.
- A mid-range estimate would be approximately \$42 million per year for employers across New Zealand. This estimate tries to account for some employees not returning to work, and for those that do, returning at reduced hours. It also assumes that returning employees are earning the average wage and only take half of their annual holidays entitlement at a reduced rate.
- A high-range estimate would be approximately \$137.7 million per year for employers across New Zealand. This assumes that all employees return to work but at reduced hours, are earning the average wage, and wish to take all of their entitled leave immediately upon return.

MBIE considers that the mid-range estimate is likely to be the most accurate, although these calculations are based on limited data and a number of assumptions and are only provided to give a sense of possible marginal costs.

Availability of bereavement, sick and family violence leave

Under the Act, all employees are entitled to five days' paid sick leave a year, 10 days' family violence leave a year and bereavement leave of either three days or one day per bereavement depending on the nature of the relationship with the deceased. Although an employer and employee can agree to take sick leave, family violence leave or bereavement leave in advance, there is no obligation on the employer to provide them before six months' employment.

The Taskforce recommended that eligible employees should be entitled to bereavement leave and family violence leave from the first day of employment. It recommended that eligible employees should be entitled to one day of sick leave from their first day of employment, with an additional day per month of employment until the full entitlement of five days is reached after four months (the entitlement of five days for the second and subsequent years of employment should apply from the anniversary of their employment).

This recommendation provides a number of benefits. Employees have little control over when they may need these forms of leave, and would benefit by having protections in place in the first six months. Other workers, such as those who frequently change jobs or work for a business which has been sold, are also disadvantaged by not having immediate access to leave. It also aligns with the purpose of the Act and encourages employees to stay home when sick.

The gradual increase of sick leave over the first four months may be more difficult for employees to understand and for employers to implement than the status quo. However, this approach tries to balance the needs of employees to take sick leave within the first six months and increased costs to employers.

It is estimated that making bereavement, sick and family violence leave available from day one will increase costs across the New Zealand economy by \$51.9 million per year. This figure accounts for tenure and turnover rates in New Zealand and is based on assumptions on the amount of leave likely to be taken within the first six months of employment.

Eligibility for bereavement, sick and family violence leave

An employee is currently eligible for bereavement, sick and family violence leave if:

- they have six months' current continuous employment with the same employer, or
- they have worked for the employer for six months for an average of 10 hours per week, and at least one hour in every week, or 40 hours in every month.

In light of the Taskforce's recommendation that these forms of leave are available from the first day of employment, it proposed a new eligibility test:

- All employees with agreed hours and an expectation of continuous employment should be eligible for family violence leave and bereavement leave from the first day of employment.
- All employees with agreed hours and an expectation of continuous employment should be eligible for sick leave from the first day of employment. Sick leave days should build up from one day on the first day of employment to a full entitlement of 5 days after 4 months.
- 'Agreed hours' refers to the hours that the employer and employee have agreed that the employee will work, as outlined in the employment agreement. 'Expectations of continuous employment' refers to the expectation that the employee will not have any periods of unpaid leave that are longer than one week.
- Employees with no agreed hours or who are not expected to work continuously should be subject to an 'hours test' applied after 13 weeks. This test requires that the employee works on average at least 10 hours a week over the preceding 13 weeks. If the employee meets this threshold, they become eligible for sick leave, family violence leave and bereavement leave. If they do not meet this test, it is repeated after 13 weeks to see if they meet the hours requirement or have been working continuously.
- All employees should be eligible for sick leave, family violence leave and bereavement leave after six months of continuous employment.

This proposal provides clarity for employers and employees and should be relatively straightforward for the majority of employees. While it will remain somewhat complex for variable workers, it should not be any more so than the status quo. As it is analogous to the current eligibility requirements and likely to apply to a similar number of employees, it is anticipated that it would not increase costs.

Pay-as-you-go annual holidays

Under the current Act, employers can regularly pay annual holiday pay with an employee's pay if the employee works on a basis that is so intermittent or irregular that it is impracticable for the employer to provide the employee with four weeks' annual

holidays. Also known as pay-as-you-go (PAYG), this type of arrangement must be specified in an employment agreement at a rate of not less than eight per cent.

The Taskforce recommended that PAYG should not be available to employees on fixed-term contracts of less than 12 months and a more detailed definition should be provided for when PAYG can be used because a work pattern is 'intermittent or irregular'. It also developed a range of enabling parameters to support the new 'intermittent or irregular' definition, such as a recurring 13 week review period.

The Taskforce's proposals provide clarity as to what 'intermittent or irregular' and should reduce the incidence of some employees incorrectly receiving PAYG as opposed to annual holidays. However, it could incentivise employers to offer more or less casual work or to structure work to fit the defined thresholds. The Taskforce intentionally sought to increase the general threshold of eligibility for PAYG, and it is likely that the proposed provisions would reduce the number receiving PAYG.

The introduction of a review period may increase compliance costs for employers, but it is estimated that the overall costs of the Taskforce's PAYG recommendations would be negligible. Even if the percentage of employees receiving PAYG alters, the costs should be the same as an 8% loading on top of employees' earnings and four weeks' paid annual holidays are equivalent.

Taking sick leave and family violence leave in smaller units

The Act considers sick leave and family violence leave in days and does not explicitly allow for these types of leave to be taken in units of less than a day. Although many employers allow their employees to take sick and family violence leave in part days, it is possible that an employee could be deducted a full day's leave when they were only away for a few hours.

The Taskforce recommended that employees should have the ability to take sick leave and family violence leave in units of less than a day on a proportionate basis for time and pay with a minimum amount of a quarter of a day. This would provide greater clarity on the matter of partial sick and family violence leave, protect employees' entitlements, and ensure that the usage and deduction of sick and family violence leave entitlements would more closely align.

However, it may increase payroll complexity and lead to increased costs for employers that:

- currently treat part sick leave and family violence leave days as whole days; and
- have employees that use their full entitlement and need more time off; and
- require employees who have used their full entitlement to take annual or unpaid leave.

MBIE considers that very few employees would use their full family violence leave entitlements as a result of not being granted part days and needing to take unpaid leave each year. While this number would be higher for sick leave, it is not possible to provide an estimate of increased costs. It is expected that the fiscal impacts would likely be negligible at the New Zealand economy level.

Otherwise working day test

Section 12(3) of the Act provides a list of factors to be taken into account by the employer and employee when determining whether a day is an Otherwise Working Day for FBAPS purposes. However, as these factors are not ranked and there is no guidance about the weighting that should be attached to each factor, there are often difficulties determining whether an employee is eligible or not for a day of FBAPS leave.

The Taskforce recommended that a day should be considered an Otherwise Working Day for an employee for FBAPS purposes if:

- the employee was expected to work on the day in question according to a work pattern that has previously been agreed between the employee and employer, or
- the employee has worked on 50% or more of the corresponding days in either the previous 4 weeks or the previous 13 weeks.

This approach provides prescription and certainty as to whether a particular calendar day is an Otherwise Working Day for an employee, ensuring that employees receive their correct entitlements. However, although it minimises incentives for employers to make short-term changes to rosters in order to avoid obligations, it does not remove the incentive to set permanent working arrangements in a way that reduces costs relating to public holidays. For example, MBIE has received feedback from a number of workers that their employers have placed them on a Tuesday to Saturday roster in order to avoid having to pay them for the public holidays that fall on a Monday.

It is possible that more employees will receive FBAPS leave than under the current Act, although it could be argued that these employees should already be receiving them. It is expected that the new Otherwise Working Day test will result in a negligible marginal cost.

New bereavement leave definition

Employees can take three days' bereavement leave on the death of their partner, parent, child, sibling, grandparent, grandchild or partner's parent. Bereavement leave can be taken at any time and for any purpose relating to the death, and does not have to be taken straight away or on consecutive days.

A separate provision enables an employee to take one day's bereavement leave on the death of any other person. However, this is only on recognition by the employer that the employee has suffered bereavement by taking into account: closeness of relationship; any responsibility for ceremonies around death; and/or cultural responsibilities.

The Taskforce recommended that section 69(2)(a) of the Act, regarding people on whose death the employee may take three days of bereavement leave, should be extended to include:

- stepfamily
- family-by-marriage not already included (siblings-in-law and children-in-law)
- cultural family groups (e.g. whāngai relationships)
- aunts, uncles, nieces and nephews
- miscarriage.

This would recognise the importance of a greater set of relationships and circumstances, provide greater certainty to employees about when they can take bereavement leave and better supports the purposes of the Act. It also better supports cultural practices and varied family arrangements.

This proposal is likely to have cost implications for employers. However, it is not possible to estimate the marginal fiscal impact of the extended bereavement leave definition as bereavement leave is not finite, there are no reliable statistics on the number of days currently taken each year, and no reliable way to estimate how much employees would use after a change in legislation.

For comparison purposes, if the number of bereavement leave days taken each year by employees increased on average from half a day to one, costs would increase from \$232.3 million a year to \$464.6 million a year.

Closedown provisions

The Act allows employers to have one period per year where they customarily close operations and require employees to use some or all of their annual holiday entitlements. Businesses can have additional closedowns throughout the year if employees agree, but employers cannot require the use of holiday entitlements for these additional closedowns.

The Taskforce proposed a number of changes to the Act to provide greater transparency and certainty for employees. It also recommended that the requirements that holidays are paid out at 8% and an employee's anniversary date must be reset during a closedown should be removed.

These recommendations better protect employees' entitlements, align with the purpose of the Act and provide greater certainty for employees. As they do not alter the level of entitlement (just whether it is taken as leave or as a lump sum payment), it would not increase costs for employers.

Sale and transfer of a business

Under the current Act, employees' outstanding holidays and leave entitlements cannot be transferred from an outgoing employer to a new employer in the event that a business is sold. This is because, in these situations, existing employment agreements come to an end and the Act requires that outstanding annual holidays entitlements are to be paid out. The exception to this requirement is when vulnerable workers are involved and section 69J of Part 6A of the Employment Relations Act 2000 applies.

Anecdotally, MBIE is aware that in many instances these entitlements are in fact transferred from one employer to a new employer. In some cases, this may occur with the agreement of employees while in other cases it may occur without employees being given a choice.

The Taskforce recommended that on the sale and transfer of a business, employees should have a choice about whether to transfer all of their leave entitlements or have them paid out and reset. This benefits employees who have accumulated entitlements and wish to retain them. For example, if they have carried over 15 days' paid sick leave in recent years and have accumulated annual holidays in preparation for an upcoming

trip. However, it also provides the option to have their annual holidays paid out for those employees that would prefer a lump sum payment.

The Taskforce proposals imply that the employer that is selling would be responsible for paying out entitlements for the employees that wished to reset them, but this is not made explicit. This issue, as well as concerns around inheriting incorrect holidays and leave records and liabilities, will be examined as part of the next phase of the Holidays Act Review.

This proposal has some potential disadvantages:

- The ability for employees to be paid out for accumulated annual and alternative holidays is contrary to the policy objective of giving employees time away from work.
- It is unclear whether it has the potential to lead to behavioural change, such as incoming employers deciding to start fresh with new staff rather than retaining existing employees, offering incentives one way or another, or only offering employment to employees who take a pay out.
- It could also have implications for a business's ability to sell, particularly if a new employer would be inheriting large leave liabilities and incomplete wage, time and leave records.

In light of the Taskforce's recommendations that annual holidays can be taken in advance on a pro-rata basis and that sick leave, bereavement leave and family violence leave are available from day one, it is expected that this recommendation would not have a significant marginal cost for employers.

Record keeping and payslips requirements

Under the current Act, employers must keep the information necessary to demonstrate that they have complied with minimum entitlement provisions. The Taskforce agreed with this general approach and recommended that record-keeping requirements should be updated to reflect changes to how leave and entitlements are held, calculated and paid. It also recommended that employers should be required to retain all holiday and leave records for six years and to make these available to employees on request.

As there is currently no legal requirement for employers to provide payslips to employees, the Taskforce recommended that employers should be required to provide payslips to employees in every pay period. It was proposed that payslips could be in a digital or physical format, but employees should be able to request that their payslip be provided in a specific format.

These recommendations help to ensure that employers hold the information needed to calculate pay and leave entitlements, address any queries from employees and support any investigation into correct payment or miscalculation. They also provide a clear way for employees to have regular access to information regarding their leave entitlements, increase transparency, and allow employees to better understand and track their holidays and leave entitlements.

The proposed requirements may necessitate changes to payroll systems and result in direct costs to payroll providers and indirect costs to employers. The payslips requirement may also increase compliance costs for employers. It is unclear how much these recommendations may cost individual employers or New Zealand more generally,

but MBIE intends to work with payroll providers and employers during implementation to assist with the transition.

Section 6: Implementation and operation

6.1 How will the new arrangements work in practice?

The implementation of options one or two would require legislative change via a Holidays Amendment Bill. It is anticipated that an amended Act would come into effect 12 to 18 months after royal assent in order to provide payroll providers the time to develop new systems and for employers to adopt them. Transitional provisions would likely be needed, and although the details of these still need to be worked through, it is expected that they would be relatively complex and detailed in order to minimise costs and unintentional non-compliance for employers.

The Better Rules approach would be used in the drafting process in order to help develop the detailed policy and implementation specifications. It involves creating a clear concept model, decision trees and rules statements that can then be translated into both written legislation and computer code. This should result in legislation that is clear and workable for computerised payroll systems. The Better Rules approach seeks to involve important stakeholders into the process – in this case, it could include employer and employee representatives, payroll providers and Parliamentary Counsel Office.

Once implemented, MBIE would be the agency responsible for the legislation. The Labour Inspectorate, as the regulator for the employment relations and standards regulatory system, would be responsible for enforcing and monitoring the new arrangements.

It is especially important that sufficient support is provided to employers, employees and payroll providers during the implementation period. For the Labour Inspectorate, this could include:

- increasing its resourcing in order to determine how to operationalise the new requirements, develop new training resources, and enforce the new requirements
- engaging with relevant stakeholders (e.g. roadshows with payroll providers and payroll professionals)
- updating approximately 90 per cent of the existing guidance and products relating to holidays legislation.

6.2 What are the implementation risks?

As part of the Taskforce's consultation process, payroll providers indicated that they would require at least 12 months to update their systems in order to comply with a new Act. There were also some concerns that the Taskforce's recommendations remain complex in some areas and employers who do not use payroll systems or have dedicated payroll functions, particularly SMEs, may have difficulty complying with a new Act.

These issues could be mitigated by including payroll providers and employers in the Better Rules process focusing on implementation and delaying the date at which new requirements come into effect by 12 to 18 months. Plenty of support, guidance and tools would also be developed to help comply with a new Act, with a particular focus on SMEs.

Section 7: Monitoring, evaluation and review

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

MBIE will track the number and types of queries to the MBIE contact centre, the Labour Inspectorate and our websites (business.govt.nz and employment.govt.nz) in relation to the Holidays Act. The number and types of breaches resulting from Labour Inspectorate activities, as well as Employment Relations Authority and Employment Court cases, will also be monitored.

The details of the monitoring and evaluation framework will be developed by MBIE as part of the next phase of work.

7.2 When and how will the new arrangements be reviewed?

The new arrangements would be reviewed by MBIE as part of ongoing monitoring and compliance activities. A comprehensive review of the legislation would be initiated if serious issues were identified as part of this work.