Impact Summary: Self-employed Levies

Section 1: General information

Purpose
The Ministry of Business, Innovation and Employment (MBIE) is solely responsible for the analysis and advice set out in this Regulatory Impact Summary (RIS), except as otherwise explicitly indicated. This analysis and advice has been produced to inform final policy decisions for Cabinet consideration. It provides an analysis of the potential changes to the way self-employed levies are assessed and collected.

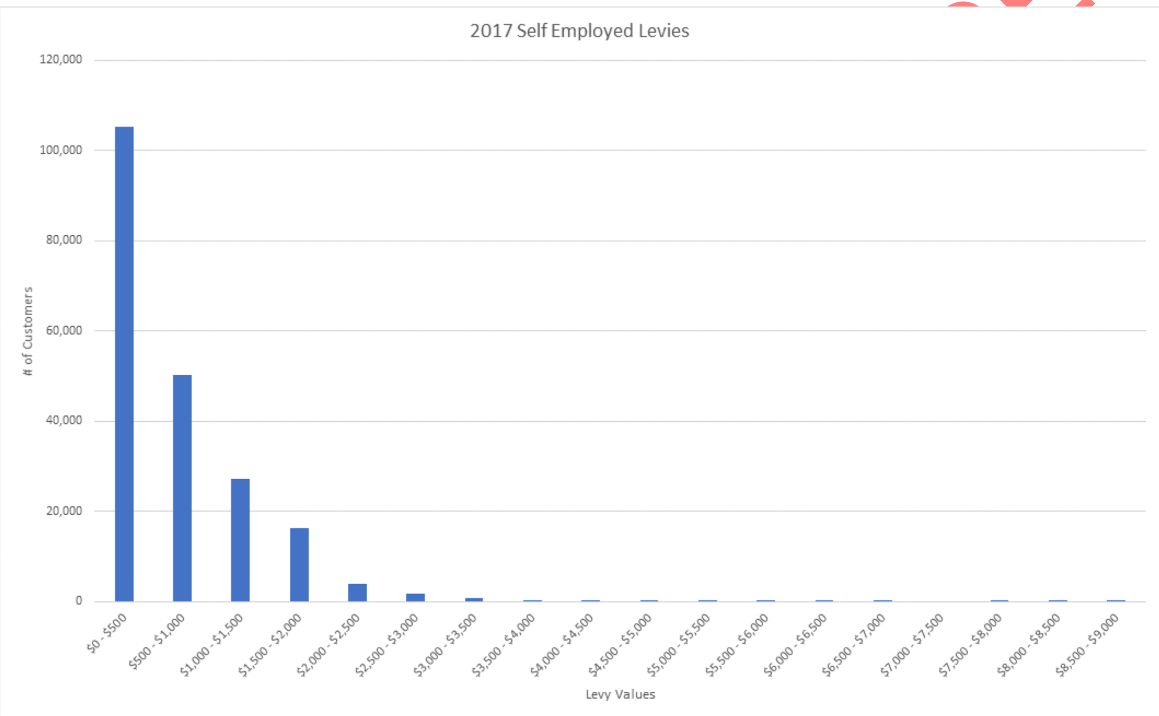
Key Limitations or Constraints on Analysis

The scope of this policy change is limited to minor technical changes to current settings. A wholesale review of the levy approach was not in the scope of this RIS.

As the vehicle for change is the levy round adjustment, options are also limited to:

- Changes that can be made through regulation as part of the levy round (rather than changes to primary legislation).
- Changes that can be implemented and communicated by 1 April 2019 along with other levy changes. (This had implications for the pre-pay option in particular.)

Information on the self-employed group used in the analysis is largely aggregate from information ACC collects for business purposes with general information on number, total levy revenue, and amount of levy paid (eg just over half pay below $500 per annum levy).[1]



An analysis by ACC of the submissions for the 2019/20 and 2020/21 consultations informed this document.

Please note that the attached submissions analysis is not intended as a final document. ACC will produce a public document in early 2019.

[1] CoverPlus Extra customers and customers who ceased business during the year (as these use current year actual earnings rather than previous year) are excluded from this calculation.

Responsible Manager:
Hayden Fenwick Accident Compensation Policy MBIE November 29, 2018

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

The current approach for the self-employed, since the regulations were updated in 2010, sees the income from one tax year (eg 17/18) being used to calculate the ACC levy for the next year (eg 18/19). The levy is charged and paid in the year it applies to (in advance).

This approach, of using the prior year's income, allows for a potential lag in confirmation of self-employed income until a tax return is filed, by using the last return and assuming similar income levels as the basis for the current year levy.

Issues with current approach

However, this approach has also led to several problems for ACC and self-employed customers.

Firstly, for the first year of self-employment there is no prior year income record to base a levy on.

The current regulations provide a formula for ACC to calculate a minimum levy based on a set amount minus the earnings received as an employee in the prior year. As ACC does not have access to this employee data, they are unable to calculate this amount.

Since March 2017, levies for the first year have not been collected due to difficulties of applying the formula without information on earner income from Inland Revenue. The income from the first year of self-employment (say 18/19) is later used to calculate the levy for the second year of self-employment (19/20), but a levy has not been paid for the 18/19 year.

Using first year income, which may not cover a full 12 month period, to calculate the second year levy that is supposed to represent a full 12 months, can also be seen as an under-estimate of likely income in that year.

Secondly, this low estimated or not collected at all first year levy is never 'caught up' (self-employed don't pay for an extra year after ceasing to be self-employed, or have a reconciliation with estimated and actual income for a year as a provisional tax system does) so that over the lifetime of a self-employment enterprise the levy payer will tend to pay less than their leviable income.

The wrap up phase at the end of enterprise is also administratively complicated. Self-employed customers who cease business will likely be invoiced for a full year based upon their previous year. When they cease, this invoice is cancelled and their levies are adjusted according to their part year income. Once their tax return is filed, their levy invoice is compared to their declared income and a wash-up calculation is made. This means that income from the penultimate year of self-employment is not ever used to calculate a levy.

Together the first and second points mean that ACC is foregoing approximately one year of a levy across the course of an individual's self-employment. The way this works out, the levy amount that can be said to be "underpaid" (compared to other levy accounts) is the same as the income from the penultimate year of self-employment as this income is never used to calculate a levy. For the purposes of this RIS, to estimate this we have taken the average annual income of the self-employed, reduced it by 50% (to allow for waning business), and multiplied it by cohort size (30,000).[2] This gives an approximate levy revenue difference of $10 million per annum.

Finally, starting out self-employed can face a confusing double invoice if ACC discovers their existence once an initial filing is made. They will then receive an invoice for their first year's business (catching up - if this levy is charged) and second year's (paid in advance at same time).

The system is complicated for ACC to administer and for customers to understand.

Opportunity

The opportunity is to identify different options for calculating the levy that allow a first year levy to be charged and collected (as ACC cover is provided for this period), better reflect actual income over the duration of self-employment, and be administratively simpler for ACC and levy payers.

Context

This issue arises within a broader context of long-standing issues with the levying of self-employed. From 2002 to 2009, the regulations included an error which meant that no levies could be raised for self-employed customers in their first year. From 2010 to 2017, as noted above, the levy was collected based on a calculation which relied on information from Inland Revenue that was not available to ACC. This has resulted in ACC subsequently refunding levies collected from the newly self-employed in the 2002-2017 period.

ACC and MBIE have worked together closely in gathering evidence and consulting on how to best address the problem.

2.2 Who is affected and how?

The change is intended to provide a better basis for the levy calculation while addressing administrative issues and levy payer confusion issues. Actual behaviour change should be limited.

There are currently around 210,000 self-employed who would be impacted by the changes.

The change would better align with how employers (in the Work Account) and employees (in the Earners' Account) levies are assessed. It would also increase administrative ease for both ACC and levy payers.

[2] This calculation was provided by ACC and is indicative only.

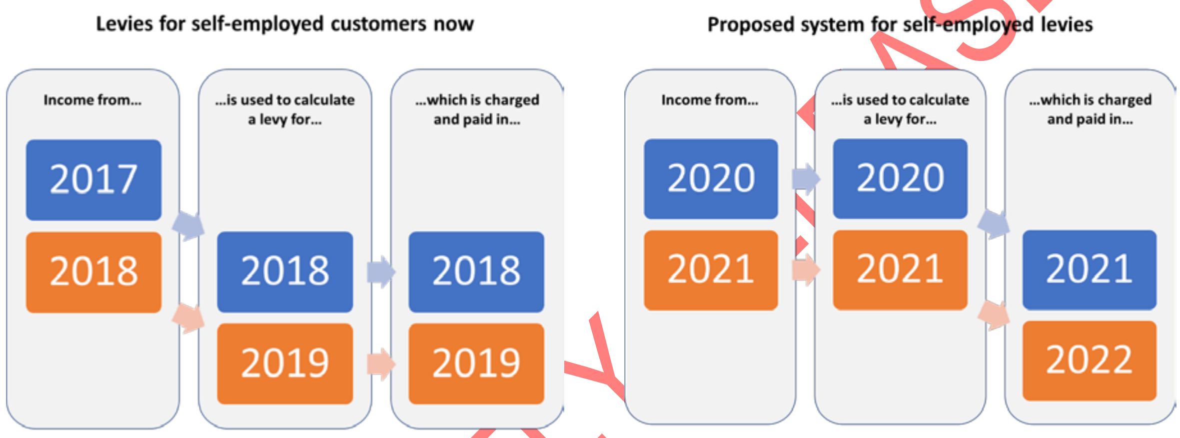
2.3 Are there any constraints on the scope for decision making?
See "key limitations and constraints' – the scope for change is limited to technical calculation changes to regulations that can be implemented for application from April 2019. Levy rates may be updated within the scope of the Minister's regulation making process. MBIE, with ACC support, is undertaking a general regulatory review of the Accident Compensation Act. The way levies work has not been identified as a focus area for policy change. Changes are likely limited to ease of use through application of modern drafting principles. Some auxiliary products for self-employed like CoverPlus Extra (which allows the individual to agree an income amount they are covered for with ACC) may be reviewed, but will not affect the changes proposed in this RIS.

Section 3: Options identification

3.1 What options have been considered?

1. Status Quo – Levies are calculated on previous year's income and collected in advance. This has issues as identified in section 2. Legislative changes to allow ACC to access the missing income data from Inland Revenue will still leave the issue of a minimum levy being paid in the first year rather than being calculated on actual income. This would tend to result in less levy being paid than would be the case if the levy was applied to actual income as in the rest of the Work Account.

2. Option 1 - The income from one tax year is used to calculate the levy for the same tax year and collected in arrears the next year. This is charged and paid for in the following tax year. To implement this transition, levies would not be charged on income on the year ending 31 March 2019 and levies would be collected in the tax year ending 31 March 2020.



This approach would allow the accurate calculation of the first year's levy and allow easier collection of the levy. The current calculation is an estimation in absence of data. It would also simplify the process for both ACC and customers and remove undue confusion. For levy payers there is a change from a levy bill at the start of the year, to one at the end – a change that will need to be tracked for accounting purposes (but is still an annual levy).

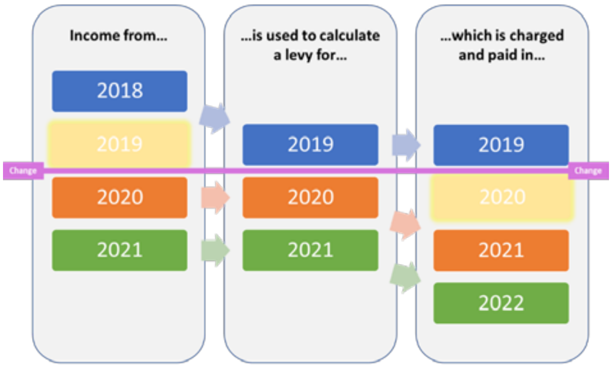
The delay in collection would see an investment income reduction of approximately $5.8m per annum for ACC (ie one year's investment return on the proportion of the levy that would be invested to meet future rehabilitation and compensation costs). This is not a reduction in total levy revenue collected, it's flow-on impact of a timing delay that means ACC cannot realise as much investment return on the revenue collected. This money is instead held by self-employed who could utilise it for an additional 12 months.

This cost to ACC would be offset by the collection of additional levy revenue that is not currently being collected by ACC worth approximately $10 million per annum as noted before in section 2.2.

Collection in arrears may also create a heightened risk of debtor default and non-payment, with businesses folding prior to paying invoices.

There will be no significant issue with a transition period from the current system to the new system under this proposal. A levy is still paid for each year. Levy payers will get a 12 month gap in invoices as a start of year bill becomes an end of year bill. The year ending 2019 won't ever be used to collect a levy. This is illustrated below:

Getting from now to the future



3. Option 2 - Maintaining the status quo but change the calculation for the first year of income.

This would continue to be complex to administer and the penultimate year's income would continue to not be used in levy calculations. The first year calculation would continue to be an estimate and users could continue to receive a double-up of their first and second year's bills.

4. Option 2a - Maintaining the status quo but removing the first year payment.

The calculation of the first year levy would be removed to reduce complexity. This would provide a "free" period of cover for the self-employed which would be unfair to other levy payers and result in lost income for ACC. The penultimate year's income would continue to not be used in levy calculations.

A set of sub-options for option 1 were also considered to allow options for those who wanted to pre-pay based on estimated earnings to do so.

As a delay would mean a loss of investment income, MBIE and ACC has considered addressing this by introducing some form of pre-payment, the same way Inland Revenue collects provisional tax during the year in expectation of a final tax liability. There is also scope to develop new products that align with customers' standard business practices – an example of this is the new income tax Accounting Income Method (AIM) which allows businesses to pay tax through their accounting software as they earn.

A key consideration was the administrative burden for ACC when self-employed levy payments are much lower than annual tax payments - the average levy bill is less than $700, whereas the majority of tax bills are over $2,500 – given the likely uptake by levy payers and costs/benefits of a lump sum payment.

Options considered included:

- align to Inland Revenue's $2,500 threshold, which would keep the rule simple but wouldn't impact many levy payers as only 2% of levy payers have a levy bill of more than $2,500

- set a lower threshold, which would mean introducing new, potentially complex rules for relatively small amounts of money and having different obligations than Inland Revenue.

This proposal was included in public consultation to test interest in using a pre-payment function. There was some support, but not significant support and there were concerns raised about the risk of additional confusion by having multiple payment options.

ACC did not engage with Inland Revenue and business service providers specifically on this issue but have had conversations with both previously.

The criteria used to assess the options were:

- Levy paid best reflects income liable for a levy. (in individual years, and over lifetime of self-employment)
- First year levy is paid
- Simple to understand and administer for claimants
- Impact on ACC Scheme
- Implementable by 1 April 2019
- Alignment with Earner's and Work Account. (minor consideration)

	Status Quo	**Option 1: Income from one tax year is used to calculate the levy for the same year.**	**Option 2: Maintaining the status quo but with a change in calculation for the first year of income**	**Option 2a - Maintaining the status quo but removing the first year payment.**
Levy paid reflects income liable for levy	**Neutral (0)**	**Positive (+)**	**Negative (-)**	**Negative (-)**
First year is paid	**Neutral (0)**	**Positive (+)**	**Positive (+)**	**Negative (-)**
Administrative ease	**Neutral (0)**	**Positive (+)**	**Negative (-)**	**Negative (-)**
Impact on ACC	**Neutral (0)**	**Positive (+)**	**Positive (+)**	**Positive (+)**
Implementable by 1 April 2019	**Neutral (0)**	**Positive (+)**	**Positive (+)**	**Positive (+)**
Alignment with other Earner's and Word Account	**Neutral (0)**	**Positive (+)**	**Negative (-)**	**Positive (+)**
Net Impact	**Neutral**	**Positive**	**Mixed**	**Mixed**

3.2 Which of these options is the proposed approach?

The preferred approach to calculating the levy is to change to using the income from one tax year to calculate the levy for the same tax year (Option 1). This will be charged and paid for in the following tax year.

As shown in the table above this option:

- Is the simplest way of addressing the presenting first year levy issue as the levy is now paid on actual income.
- It is administratively simple for both ACC and levy payers, and there was significant support from levy payers for this change through the consultation process.
- The foregone investment costs for ACC are offset by leaving this resource with self-employed for 12 months, and by the additional revenue from more complete levy collection.

It is the best option as it enhances collection, increases alignment and reduces administrative complexity for both customers and levy payers.

There have been no areas of incompatibility identified with the Government's 'Expectations for the design of regulatory systems'.

For the potential option to allow pre-payment for some levy payers, the preferred option is to not include this option at this time. The view is that the benefits of this do not offset the complexity it would add to the system. There was not strong support from the public consultation, and the short time frames to implementation by 1 April 2019 were not conducive to good implementation and communication with levy payers.

Instead ACC and MBIE will continue to work with Inland Revenue, business software companies and self-employed stakeholders to monitor developments in this area, better assess user demand, and consider options and the strength of the case for introducing this flexibility from an ACC and levy payer benefit perspective. If there is a strong case, options will be included in a future levy consultation round. (The extra time may also allow consideration of broader options for example shifting levy collection back to IR if this improves user experience and does not undermine other benefits like levy payer relationships or increase administrative costs.)

Levy payers are already paying a lump sum levy once a year in advance, so there is no practical change from a levy payer perspective (except a one-off 12 month holiday in payments reflecting the timing change from advance to arrears payments).

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties	Comment:	Impact
Additional costs of proposed approach, compared to taking no action		
Regulated parties	Newly self-employed now pay first year levy and more representative levies over lifetime.	$10 million per annum
Regulators	ACC - one-off communication cost to inform levy payers of changes and manage transition. ACC – lost investment return of 12 months due to loss of levy collected from the year ending 31 March 2019. ACC – slightly higher risk of default from self-employed folding before levy paid.	Within BAU $5.8m per annum Low impact on revenue
Wider government	Nil – NB. ACC collects the self-employed levy directly, not via Inland Revenue.	
Other parties	Business software companies (costs of implementation).	Low impact, not quantified
Total Monetised Cost		$15.8 million per annum
Expected benefits of proposed approach, compared to taking no action		
Regulated parties	Self-employed customers – levy collection will be delayed 12 months allowing utilisation of resource Self-employed customers (ongoing; reduced complications and concerns).	$5.8m (equivalent to ACC lost investment return; ACC are likely to get better return than a private investor but we have assumed value to self-employed person is quantified at the same investment return as ACC)
Regulators	ACC (ongoing; comprehensive collection of levy).	$10 million per annum
Total Monetised Benefit		$15.8 million per annum

4.2 What other impacts is this approach likely to have?
Potential risks include: • With levies paid in arrears, there is greater liability in owing money for a longer period, however, this is only an issue if they close their business. This is a similar to the current situation and is therefore a timing issue. The intention to explore prepayment options would help to minimise this issue in the future. There are processes to recover costs. • Confusion from levy payers about transition which will be managed through communications • Awareness of levies and the annual obligation will need to be maintained during the one year gap period.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?
As part of the 2019/20 and 2020/21 levy round, submissions on the proposal were received during consultation. There was strong support for the proposed change, including from major submitters Federated Farmers and Manage Company. This was primarily due to it reducing confusion and complications which exist with the current system. Many respondents also noted the stress placed upon new businesses due to them being charged for the first and second years concurrently. This may have broader impacts on the economy. Federated Farmers is interested in the proposal due to the large number of their members who are self-employed although they noted that the issue had not been raised by members. There were concerns raised about ensuring adequate communication of the changes by ACC to levy payers.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?
The change will be implemented as part of the 2019/20 and 2020/21 levy round process. They will be applied from 1 April, 2019. ACC will communicate the information to customers, although the details of this have not yet been finalised. The primary method will be appending information to existing correspondence. For existing customers this will mean payments will be delayed by 12 months. Invoices are sent after the customer files their tax return – these are mostly due on 7 July (the returns) with a small proportion due 31 March the following year (as they have a tax agent who gets an extension of time). Most customers end up receiving their invoice in September, due in October. It can take up to ten weeks from when the tax return is filed to send out the invoice (4-6 weeks of that is the delay between when Inland Revenue receives the return and when they pass the data to ACC). The timing of the annual invoice process will remain the same under the proposed change.

Section 7: Monitoring, evaluation and review

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

ACC will track the levy revenue and provide direct oversight of the changes.

ACC will undertake further testing on pre-payment options in the next year.

MBIE and Treasury will provide oversight of the changes as part of their stewardship roles.

7.2 When and how will the new arrangements be reviewed?

There is no plan to explicitly review the change in how the levy is calculated. ACC will, however, be monitoring potential issues such as:

- Satisfaction and levy payer feedback.
- Changes in IR or wider businesses processes.
- Levy payment issues.

ACC receives feedback in three ways:

- Formal quarterly customer satisfaction surveys.
- A 'pop-up' feedback form for visitors to the ACC website.
- Heartbeat - an internal tool that ACC uses to gather anecdotal feedback from frontline services.

A review could be instigated if issues were identified.

MBIE is undertaking, with ACC support, a general review of Accident Compensation Regulation from a stewardship perspective. Further issues with the levy arrangements have not been identified at this time.

The policy will not be reviewed specifically. However, monitoring, evaluation and review is built into the biennial review of the ACC levies and the impact may be assessed as part of this process.