



**MINISTRY OF SOCIAL
DEVELOPMENT**
TE MANATŪ WHAKAHIATO ORA



**TE TAI ŌHANGA
THE TREASURY**



**MINISTRY OF BUSINESS,
INNOVATION & EMPLOYMENT**
HĪKINA WHAKATUTUKI



Inland Revenue
Te Tari Taake

Joint Report: Future of the COVID-19 Wage Subsidy Scheme

Date:	27 November 2020	Report No:	T2020/3581 IR2020/493
		File Number:	SH-3-0-6

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	Agree to the proposals in this report Direct officials to prepare a Cabinet paper as appropriate	Monday 30 November 2020
Minister for Social Development and Employment (Hon Carmel Sepuloni)	Agree to the proposals in this report	Monday 30 November 2020
Minister of Revenue (Hon David Parker)	Note the proposals in this report	Tuesday 1 December 2020
Minister for Small Business (Hon Stuart Nash)	Agree to the proposals in this report	Monday 30 November 2020
Minister for Workplace Relations and Safety (Hon Michael Wood)	Agree to the proposals in this report	Monday 30 November 2020

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Sam Holmes	Principal Adviser, Welfare and Oranga Tamariki	Outside Scope (wk)	N/A (mob) ✓
Keiran Kennedy	Manager, Welfare and Oranga Tamariki	N/A (wk)	Outside Scope (mob)

Minister's Office actions (if required)

Return the signed report to Treasury.

Enclosure: No

RELEASED UNDER THE
OFFICIAL INFORMATION ACT

Joint Report: Future of the COVID-19 Wage Subsidy Scheme

Executive Summary

Available evidence suggests the three COVID-19 wage subsidy schemes were effective at protecting jobs, incomes and firms during temporary periods at elevated alert levels and enabled rapid economic restart when alert levels were lowered.

However, the schemes were implemented rapidly, modified iteratively, and delivered under a high-trust model which involves trade-offs with scheme targeting and integrity. Stakeholder engagement to date has revealed support for rapid payments and simple settings but also concerns about scheme clarity, consistency, fairness and the interaction with employment law. Frequent changes to the scheme have generated confusion and frustration for applicants.

Following the Wage Subsidy Resurgence Scheme in August, Ministers directed officials to provide advice on a more sustainable arrangement for support in the event of future restrictions.

This report proposes clearly signalling the trigger, level and duration for wage subsidy support in advance, as part of the proposed 'resurgence package' to be considered by Cabinet in December. We propose retaining core wage subsidy settings but making some near-term enhancements to update and clarify rules and improve integrity.

Officials can provide advice in February on the scope and timeline for more substantive changes to create an enduring wage subsidy scheme for COVID-19 and the longer term.

Recommended Action

We recommend that you:

- a **note** that the rapidly implemented, high-trust model used by the wage subsidy involved some trade-offs with targeting and integrity;
- b **note** that following the use of the Wage Subsidy Resurgence scheme in August, Ministers directed officials to provide advice on a more sustainable arrangement for support in the event of future restrictions [CAB-20-MIN-0402 refers];
- c **note** that in the event of another COVID-19 outbreak before decisions on changing the scheme, MSD is ready to stand up another Wage Subsidy Resurgence scheme within 5 working days, with no changes to settings;
- d **note** that MSD will be ready to stand up an enhanced scheme with the settings indicated in recommendation g within 5 working days of Cabinet agreement to introduce a further iteration of the scheme;
- e **note** that engagement with stakeholders on enhancements will reduce risks of changing the scheme, and this may not be completed by 14 December;
- f **note** that currently appropriated funding corresponds to at least 2 weeks of funding the wage subsidy based on the settings used in the August Wage Subsidy Resurgence scheme;

For 'resurgence package' Cabinet paper

- g **direct** officials to prepare a Cabinet paper for 14 December seeking Cabinet agreement to the following:

Scheme objectives

- i. agree to the following objectives for the COVID-19 Wage Subsidy scheme:
 - Temporarily support workers' incomes and employment attachment during elevated public health Alert Levels;
 - Provide support for employers to pay wages if they are struggling to do so as a result of elevated Alert Levels;
 - Share the cost of public health alert levels between the government, employers and employees, and across economic sectors;
 - Balance short term labour market attachment with longer term labour reallocation; and
 - Encourage the shift to a COVID-19-resilient economy.

Trigger for COVID-19 wage subsidy

- ii. publicly communicate that the Government intends to introduce a COVID-19 wage subsidy scheme in the event of a period of public health Alert Levels at Level 3 or above, anywhere in New Zealand, for least 7 days, and subject to Cabinet approval;
- iii. if a period of at least 7 days at Alert Level 3 or above appears imminent, the Minister of Finance will bring a proposal to Cabinet to introduce a COVID-19 wage subsidy scheme;
- iv. review this triggering approach 6 months after its introduction;

Duration of support

- v. provide wage subsidy support, if the scheme is triggered, to match the duration spent at Alert Level 3 or above rounded to the nearest fortnight;
- vi. review the availability and settings of an open scheme every 6 weeks;

Scheme settings

- vii. retain core scheme settings including a revenue drop of 40% to qualify, current payment rates, and employee retention obligations;
- viii. adjust the application of the revenue-drop test to address issues of 'shifting baselines', seasonality, and revenue volatility;
- ix. add a requirement for an employer to declare they are '*specifically affected*' by a current escalation of Alert Levels at Level 3 or 4, rather than by COVID-19 and the public health response in general;
- x. continue to make the scheme available on a national basis;
- xi. note that in the case of a very localised elevation in Alert Levels, Cabinet may have the option of introducing a 'manual' scheme which limits subsidies to the geographic area in question;

Other Cabinet recommendations

- xii. publicly communicate the core scheme settings and duration of support in advance;
- xiii. advise on the fiscal implications of these changes;
- xiv. delegate authority to the Ministers of Finance and of Social Development and Employment to make operational changes, and decisions on minor changes and clarifications to scheme settings.

Hon Robertson	Agree/Disagree
Hon Sepuloni	Agree/Disagree
Hon Nash	Agree/Disagree
Hon Wood	Agree/Disagree

- h **note** that the proposal to match wage subsidy support to the duration spent at Alert Level 3 or above rounded to the nearest fortnight (recommendation g.v) may result in support being rounded up or down, leading to support being between one week shorter and one week longer than the period at Alert Level 3 or 4;

Other near-term changes

Regional scheme

- i **indicate** if you would like officials to explore a 'higher-scrutiny' regional scheme to be ready by mid-February, noting it is not yet clear if this would be viable;

Hon Robertson	Yes/No
Hon Sepuloni	Yes/No
Hon Nash	Yes/No
Hon Wood	Yes/No

Scheme integrity

- j **note** that significant integrity improvements are not possible in the short term because this requires investment in new systems and processes;

k **note** that MSD is concurrently updating the Minister for Social Development and Employment on the progress and ongoing refinements to MSD’s audit and integrity approach for the COVID-19 wage subsidy schemes;

l **note** that officials will progress the following, minor, short term improvements to scheme integrity:

- i. explore increasing visibility and publicity around audit, enforcement and repayments, including through ministerial communications;
- ii. improve guidance for applicants to reduce error rates and improve automation rates;

m **indicate** if you would like MSD to engage with the Offices for the Minister of Finance and the Minister for Social Development and Employment to raise public visibility of audit, enforcement and repayment information;

Hon Robertson	Yes/No
Hon Sepuloni	Yes/No
Hon Nash	Yes/No
Hon Wood	Yes/No

n **note** that work on the integrity improvements described in recommendation l may not be ready in the event of an outbreak in the near future (e.g. prior to Christmas);

Employment law interface

o **agree** to maintain the current direction to make ‘best endeavours to pay 80% of ordinary wages’, while making it clearer through guidance that employers must meet their obligations to consult and agree to any changes to their employees’ terms and conditions;

Hon Robertson	Agree/Disagree
Hon Sepuloni	Agree/Disagree
Hon Nash	Agree/Disagree
Hon Wood	Agree/Disagree

p **agree** to continue to allow employers to use the wage subsidy to pay for annual holidays, including where they direct employees to take annual leave and for a business closedown period;

Hon Robertson	Agree/Disagree
Hon Sepuloni	Agree/Disagree
Hon Nash	Agree/Disagree
Hon Wood	Agree/Disagree

q **note** that this could result in deadweight costs if the wage subsidy is available over the Christmas period;

r **note** officials will prepare clearer guidance on how employers need to consider what ‘normal income’ is for the purposes of the scheme;

Clarify and update other scheme rules

s **note** officials will clarify the drafting of rules under the scheme, including a definition of 'revenue' and eligibility of company groups;

t **note** that work on the improvements described in recommendations o to s may not be ready in the event of an outbreak in the near future (e.g. prior to Christmas);

Stakeholder engagement

u **agree** to targeted stakeholder engagement in November and December on operational and drafting options for the proposed adjustment to the revenue drop and 'specifically affected' tests (recommendations g.viii, iv);

Hon Robertson	Agree/Disagree
Hon Sepuloni	Agree/Disagree
Hon Nash	Agree/Disagree
Hon Wood	Agree/Disagree

v **note** that officials will align the revenue-drop test as far as possible in terms of definitions and comparator periods across the wage subsidy scheme and any new Business Support Grants Scheme;

More substantive changes

w **direct** officials to report back to Joint Ministers in February 2021, with advice on the scope and timeline for longer term changes to the Wage Subsidy Scheme as described in Annex 2.

Hon Robertson	Agree/Disagree
Hon Sepuloni	Agree/Disagree
Hon Nash	Agree/Disagree
Hon Wood	Agree/Disagree

Outside Scope



Keiran Kennedy
**Manager, Welfare and Oranga Tamariki
 The Treasury**

Outside Scope



Inland Revenue

Outside Scope



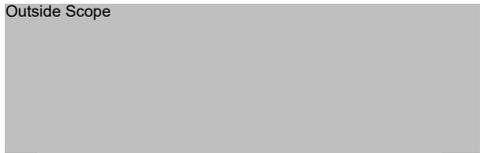
Megan Beecroft
Policy Manager
Employment and Housing Policy
Ministry of Social Development

Outside Scope



Tracy Mears
Manager, Employment Standards Policy
Ministry of Business, Innovation and
Employment

Outside Scope



Kate Challis
Policy Manager
Small Business Team, Ministry of
Business, Innovation and
Employment

Hon Grant Robertson
Minister of Finance

Hon Carmel Sepuloni
Minister for Social Development and
Employment

Hon David Parker
Minister of Revenue

Hon Stuart Nash
Minister for Small Business

Hon Michael Wood
Minister of Workplace Relations and Safety

Joint Report: Future of the COVID-19 Wage Subsidy Scheme

Purpose of Report

1. The purpose of this report is to:
 - a Report back on stakeholder views of the COVID-19 wage subsidy (the subsidy);
 - b Revisit the role and objectives of the subsidy in the context of a changed operating environment;
 - c Seek agreement to near-term changes to subsidy settings and to signal the criteria for introducing the subsidy going forward; and
 - d Understand if you would like to explore substantive changes required to create a higher-integrity and more enduring subsidy.

Background

The COVID-19 Wage Subsidy has been a core part of the COVID-19 economic response

2. The Government introduced the COVID-19 Wage Subsidy scheme during the early public health response to COVID-19 in March. There have been three main iterations of the scheme: the 12-week Wage Subsidy Scheme (WSS) opening in March, a further eight week extension (Wage Subsidy Extension, WSX) opening in June, and the 2-week Wage Subsidy Resurgence Scheme (WSR) available during the August outbreak of COVID-19 in Auckland.
3. The subsidy is intended to support employment attachment when elevated public health Alert Levels (ALs) disrupt economic activity. Available evidence suggests that it has contributed to maintaining employment levels, incomes and economic activity during and after the first lockdown.
4. Employers¹ that experienced a COVID-19-related drop in revenue (30% for the WSS, and 40% for the WSX and WSR) were able to claim a subsidy of \$585.80 per week for each full-time employee (20 hours or more) or \$350 for part-time (less than 20 hours). Employers were obliged to retain for the duration of the subsidy, staff for whom they claimed the subsidy (or repay it), and to pay at least the value of the subsidy to those staff (or their normal wages if less).
5. A total of \$14b has been paid out across the three schemes, in respect of 1.8m unique jobs. Progressively less support was paid out through each scheme iteration: \$10.9b for the WSS, \$2.6b for the WSX, and \$0.3b for the WSR.
6. Following the Auckland August outbreak, the last Government directed officials to report back on a more sustainable, longer term wage subsidy scheme and to engage with stakeholders on the details of a revised scheme [CAB-20-MIN-0402 refers];. Ministers also agreed in principle that the WSR would be reintroduced in the case of a return to Alert Level 3 or 4 in the short term.

¹ 'Employers' includes self-employed people and sole-traders for the purposes of this report. These entities are all eligible for the scheme.

The role of the COVID-19 Wage Subsidy is changing

7. There continues to be a role for Government in providing wage subsidies when public health measures impact otherwise viable incomes, jobs, and firms.
8. Subsidies incentivise employers to adjust by reducing aggregate hours worked instead of reducing the number of staff employed. This prevents unnecessary 'hiring and firing' for employers, as well time as time spent out of work for employees.
9. Going forward the role of the subsidy will change, as New Zealand spends less time at elevated ALs, and businesses adapt to the prospect of further lockdowns and adjust to the changed operating environment². The wage subsidy has a weaker justification on purely economic grounds going forward as intermittent lockdowns may become the 'new normal'.
10. To reflect these changes in the economic context, we suggest adding the objective of '*support for the costs of lockdown*' and emphasising the temporary nature of support, so that the objectives of the scheme are to:
 - a Temporarily support workers' incomes and employment attachment during elevated public health ALs;
 - b Provide support for employers to pay wages if they are struggling to do so as a result of elevated ALs;
 - c Share the cost of public health alert levels between the government, employers and employees, and across economic sectors;
 - d Balance short term labour market attachment with longer term labour reallocation; and
 - e Encourage the shift to a COVID-19-resilient economy.

Broader policy context

11. The Minister of Finance has commissioned advice on the key elements of a resurgence package. The Treasury has advised the Minister of Finance that the Government's economic response to outbreaks should be substantial and linked to public health restrictions. A package of support at higher ALs, clearly signalled in advance, is critical to minimise the impact of restrictions on employment and incomes, deliver equitable outcomes in the face of very short and severe economic shocks, and maintain social license for public health restrictions.
12. Core components of the resurgence package should be support for firms' wage costs to allow them to retain staff, and support for fixed costs. Going forward the Treasury recommends a clearer link between support and health restrictions, and a sustainable solution to fixed and transition costs beyond the Small Business Cashflow Scheme.
13. This report proposes near-term changes to the wage subsidy to form part of this resurgence package, with further options for more substantive work on an enduring wage subsidy scheme.

² Data reveals a mixed picture of changes in business resilience. Reserve Bank data show business deposits have grown 17.5% overall in the year to September, and both businesses and households have shifted funds from term deposits to call accounts. This may indicate a greater buffer against future COVID-19 outbreaks. However survey data (Better for Business: Business Health Survey) suggests limited resilience for some businesses. 20% of businesses surveyed in September and October state they have no financial reserves, 29% have reserves to continue operating for only a few weeks, and 44% have reserves for a number of months.

Stakeholder engagement

14. Officials engaged on the subsidy scheme in September and October with stakeholders including Business New Zealand, the Council of Trade Unions, other business groups and professional services firms.
15. Stakeholders indicated they appreciated the opportunity to engage with officials and would value input on any proposed future changes. We consequently recommend targeted stakeholder engagement on the recommended enhancements in November and December.
16. Key conclusions are summarised below and Annex 1 provides more detail:
 - a **Simplicity and speed:** Stakeholders emphasised a key factor in the scheme's success was the certainty and confidence for employers provided by rapid, lump-sum payments, and a simple, high-trust application process;
 - b **Employment law:** Clarifying the interaction with employment law would help determine the relative rights, obligations and outcomes for employers and employees under the scheme;
 - c **Clarity of rules:** Stakeholders were frustrated by unclear and changing rules and guidelines;
 - d **Integrity:** Stakeholders were open to scheme changes to improve integrity. They acknowledged that changes would need to be balanced with simplicity and the speed of pay-outs; and
 - e **Targeting:** Stakeholders acknowledged further targeting of the scheme might be appropriate, in light of changed economic and public health conditions and other supports.

Priority enhancement issues that can be addressed at pace

17. Near-term changes that can be made to improve the Wage Subsidy Scheme's integrity and efficiency while retaining the main, current scheme settings and delivery model are outlined in Table 1 and below with estimated implementation dates. Officials can include proposals as indicated in the proposed resurgence package Cabinet paper.
18. In February we can provide you with further advice on more substantive changes to the scheme, as outlined in Annex 2 of this report.

Table 1

Issue	Recommendation	Implementation Timeframe
For 'resurgence package' Cabinet paper		
Trigger for the COVID-19 wage subsidy	Government communicates it intends to introduce the subsidy in the event of a period of public health Alert Levels at Level 3 or above, anywhere in New Zealand, for least 7 days	Enhanced scheme can be ready within 5 days of Cabinet decisions to introduce a scheme
Duration of support	Match wage subsidy support to duration spent at Alert Level 3 or above, rounded to the nearest fortnight	
Scheme settings	Retain core scheme settings (rate, 40% revenue drop, employee retention obligations)	
	Adjust the application of the revenue-drop test to address issues of 'shifting baselines', seasonality and natural revenue volatility	
	Add a requirement that an employer must have been <i>specifically affected</i> by the current Alert Level escalation	
	Retain a national scheme	
Other near-term changes		
[OPTIONAL] Higher-scrutiny regional scheme	[OPTIONAL] Further operational work to develop automatic processing of applications by businesses within a defined regional boundary and manual processing for other businesses	Mid-February 2021
Scheme integrity	Short term improvements to scheme integrity	
Employment law interface	Clearer guidance on making <i>best-endeavours</i> to pay 80 percent of usual wages where employers consider a reduction is necessary.	January-February 2021
	Clearer guidance on how employers determine 'normal income'	
	Continue allowing use of subsidy for annual leave	N/A
Clarify and update other scheme rules	Officials begin work to clarify the drafting of scheme rules, including a definition of 'revenue' and eligibility of company groups	January-February 2021

Trigger for the COVID-19 wage subsidy

19. The Government has not explicitly committed to re-introduce the scheme in the event of future outbreaks, nor signalled the triggers for doing so, or the particular settings that would apply. To date, scheme settings have been changed at short notice with each new iteration of the scheme.
20. It is important for business confidence to minimise uncertainty in the Government response to COVID-19. Although resurgences cannot be predicted, clarity about the public health response and the economic support that will be available will help business planning and decisions. Although businesses may already expect the same support in future resurgences, the Government can do more to clarify the details of support in advance and reduce uncertainty about the settings that will apply.

21. To support this, we propose publicly communicating the trigger for a decision on opening the scheme, the core scheme settings and the duration of support in advance, subject to review points by Ministers in case of a prolonged outbreak.
22. We recommend that the Government signals now that it intends to introduce a COVID-19 wage subsidy resurgence scheme if public health ALs are at level 3 or higher, anywhere in New Zealand, for at least 7 days, subject to any other factors relevant at the time. If this public health scenario appears imminent, the Minister of Finance should seek a Cabinet decision to introduce a wage subsidy.
23. Signalling scheme settings in advance limits Ministers' flexibility and discretion at the time of an outbreak and creates a risk of pre-committing to expenditure. To mitigate this risk, we suggest highlighting that wage subsidy support will still be subject to Cabinet decisions at the time it is introduced. We also recommend regular review points of scheme availability and settings between uses (every 6 months), and while the scheme is open (every 6 weeks). We believe this approach supports businesses' certainty without binding Cabinet decision-making in a way that may not be suitable for future circumstances.

Duration of support

24. Our understanding is that periods at Alert Level 3 are likely to vary from a few days of 'precautionary use' up to several weeks. Longer periods at Alert Level 3, and elevation to Alert Level 4, are plausible but unlikely under current policy settings (e.g. effective border-controls, and testing and tracing systems). The Government has typically signalled changes in Alert Level settings in advance, to give businesses and households as much time as possible to prepare.
25. We do not recommend opening the wage subsidy scheme unless there is a period of at least 7 days at Alert Level 3. It takes MSD 5 business days to open the scheme with current operational arrangements and around a week after the start of lockdown for support to begin flowing to most employers. We consider it is reasonable for employers and employees to manage the effects of a lockdown shorter than one week without wage subsidy support.
26. If the 7 day 'trigger' is met for opening the scheme, then the subsidy duration should match the duration at Alert Level 3 or 4. There are choices about how this is achieved as described below.
27. Under current settings, the wage subsidy is provided in 2-week lump-sum payments. As a result, if Alert Level 3 or 4 lasts for an odd number of weeks, employers may experience either an 'overhang' or a 'shortfall' versus days at elevated ALs. The decision to extend the wage subsidy or not is made at the time by Cabinet which reduces certainty for business. This also exposes Ministers to lobbying which may reduce the ability to make a considered decision at the time.
28. This issue can be addressed by deciding in advance how the subsidy duration will be matched to lockdown duration. This requires a permanent trade-off between 'overpaying' or 'underpaying' for all subsidised employers³ as shown in Options A1 and A2 below.
 - a [RECOMMENDED] Option A1 ('Round to nearest fortnight')
 - i Subsidy payments in two-week lump sums

³ The trade-off between overpaying and underpaying could be reduced by system changes that allow weekly payments. However this would require policy and operational investment, and changes could not be made at pace. We therefore have not explored this option in the paper.

- ii Subsidy payments are available to cover the period at Alert Level 3 or higher rounded to the nearest fortnight
- iii Note: Support could exceed or fall short of lockdown duration by up to 1 week
- b Option A2 (**'Round up** to nearest fortnight')
 - i Subsidy payments in two-week lump sums
 - ii Subsidy payments are available to cover the period at Alert Level 3 or higher **rounded up** to the next fortnight
 - iii Note: Support would never be shorter than lockdown duration, but could exceed it by up to 13 days

29. Table 2 shows how options A1 and A2 would work.

Table 2

Duration of AL 3 or 4	Option	Duration of support	Description
6 days	A1	-	<ul style="list-style-type: none"> • Scheme is not opened
	A2	-	<ul style="list-style-type: none"> • Scheme is not opened
10 days	A1	2 weeks	<ul style="list-style-type: none"> • 2 weeks of support triggered after 7 days of AL 3 or 4, covering the period from the beginning of AL 3 or 4.
	A2	2 weeks	<ul style="list-style-type: none"> • 2 weeks of support triggered after 7 days of AL 3 or 4, covering the period from the beginning of AL 3 or 4.
20 days	A1	2 weeks	<ul style="list-style-type: none"> • 20 days is rounded-down to nearest fortnight (14 days) • Support is 6 days shorter than AL 3 or 4
	A2	4 weeks	<ul style="list-style-type: none"> • 20 days is rounded-up to next fortnight (28 days) • Support exceeds AL 3 or 4 by 8 days

- 30. Under either option, the scheme would not open at all unless at least 7 days had passed at Alert Level 3. Once open, subsidy payments would cover at least the first two weeks of Alert Level 3 or 4
- 31. Employers would be required to reapply for each payment. This ensures that employers can choose not to reapply if they are no longer eligible and means their obligations under the scheme are extended (e.g. they must continue to retain and pay their staff).
- 32. We recommend **Option A1 ('Round to nearest fortnight')**. This avoids the potential situation (under Option A2) of providing a two-week payment to cover a single day of Alert Level 3, while at the same time ensuring that employers will be without support for no more than one week.
- 33. The recommended Option A1 puts more cost onto employers (and potentially employees) than Option A2 particularly where the Alert Level 3 or 4 period lasts longer. However, we consider this is appropriate given the objective of sharing costs between

Government, employers and employees, and encouraging the shift to a COVID-19-resilient economy.

Scheme settings

Retain core scheme settings

34. We recommend retaining core settings of the scheme for the resurgence package. Employers and employees are familiar with the core settings of the scheme, including the 40% revenue drop eligibility test, payment rates, and employee retention obligations.
35. Stakeholder engagement indicated that changing scheme settings creates confusion and this is likely to reduce business confidence. The scheme appears successful at supporting employment and incomes to date so any changes to core settings would need a strong justification.

Revenue-drop test

36. The key eligibility test for the scheme is that an employer has experienced a minimum reduction in revenue when compared to a similar period last year, and that the revenue loss is attributable to effects of the COVID-19 outbreak. High-growth and new businesses are allowed to use more recent comparator periods.
37. The revenue-drop test is a weak proxy for business need for support to retain staff. This means it is likely to provide too much support for some employers, including non-viable firms, and too little for others. It also creates a risk of gaming ^{s 9(2)(k)}

However, there are no available options to improve on the revenue-drop test in the near-term while maintaining a simple, rapid model.

38. Although we recommend retaining the core setting of a '40% drop in revenue', there is an opportunity to adjust the application of this rule.
39. Three key issues with the existing revenue-drop test in its current form:
 - a. the proportion of small businesses meeting the revenue test due to '**natural revenue volatility**';⁴ and
 - b. it is becoming progressively less accurate at selecting firms in need of support due to a '**shifting baseline**' effect as the economy adjusts to COVID-19;
 - c. some businesses have very **seasonal** revenue.
40. To address the issue of 'natural revenue volatility' we recommend introducing an extra eligibility requirement for an employer to have been *specifically affected* by a current elevation in ALs to 3 or above, rather than COVID-19 in general. The requirement ensures there is a nexus to the current Alert Level elevation. This could be a standalone test and required to be the main factor leading to the decline in revenue.
41. The test would be implemented in a high-trust manner, meaning declarations made would not generally be verified prior to payment, but could be checked in subsequent audits. A broad range of potential ways in which the employer is affected would be

⁴ Data analysis by Xero suggests that in an average month in 2019 about 20% of small businesses experienced at least a 40% revenue drop vs the prior year. This is not much smaller than the estimated 30% of Auckland small businesses that experienced at least a 40% revenue drop during the Auckland lockdown in the last two weeks of August.

allowed, including, but not limited to, business operations being impeded, difficulty accessing premises, and suppliers or customers being affected.

42. There are several options to address the shifting baseline issue in the revenue test, including a more recent comparator period or a revenue/FTE drop test. The test will also need to address businesses that have very seasonal revenues, so that a recent comparator will not always be suitable either.
43. It is not clear what the best option is at this stage and we recommend rapid engagement with stakeholders before final decisions are made on the form of the revenue test for the wage subsidy and the proposed Business Support Grants Scheme. This will mitigate the risk of creating unexpected problems and the need for repeated changes which could lead to employer confusion and reduced confidence about eligibility.
44. Officials will include advice in the proposed 'resurgence package' Cabinet paper on the likely effect on scheme uptake and financial implications of proposed changes to the revenue test and the new 'specifically affected' test.
45. Even after making changes to the revenue-drop test, there may still be trade-offs between targeting and fiscal cost, and support for firms that might not be viable.

Regional scheme

46. We recommend continuing to provide the scheme on a national basis going forward, even in the case of regionally elevated alert levels.
47. It is not straightforward to accurately target support to the disruption from regional ALs. A regional Alert Level escalation is likely to disrupt the economy both within and outside the region. The economy is geographically connected via businesses with multiple locations, movement of workers, and goods and services through supply chains. A national scheme was used in the Auckland August outbreak, with around 40% of supported jobs outside the Auckland region.
48. As well as poor targeting, a regional scheme is also likely to lead to a large volume of queries around eligibility, and to cause confusion due to required scheme changes if the affected region expands.
49. The recommended approach is to retain a national wage subsidy scheme but rely on the proposed '*specifically affected*' eligibility rule (paragraph 40) to target those firms that are facing disruption from elevated ALs, regardless of their location. If the geographic extent of ALs changes this approach 'adapts' targeting without the need to change the scheme.
50. However, this approach creates a risk to social license, if it is perceived that many firms outside the affected region are making incorrect claims. This issue is exacerbated in the case of localised outbreaks. If a national scheme were used then the vast majority of potential applicants will be outside the region and probably not economically affected by the elevated Alert Levels.

'Higher-scrutiny' regional scheme

51. If you would prefer a higher degree of scrutiny for a regional outbreak, MSD and IR can explore an approach which uses IR or other business location data to identify employers outside of the region for high-trust manual processing.
52. The high trust manual process would involve an MSD representative contacting applicants outside the region. Experience with the COVID-19 Leave Support Scheme suggests this will reduce the number of incorrect applications from businesses outside

of the affected region. This would remain a high-trust model in that MSD staff would not verify information or determine eligibility.

53. It is not certain yet if this option is viable or cost-effective. If you are interested in this option officials can do further work on the quality of location data, data sharing arrangements, and feasibility of handling the forecast call volumes. MSD currently estimates it could stand-up such a scheme by February.
54. In the case of a very localised Alert Level escalation, such as for a few thousand people, MSD could provide support through a bespoke 'manual' scheme rather than the existing COVID-19 Wage Subsidy mechanism to limit subsidies to the geographic area in question. Manual processing mitigates much of the integrity risk of a national scheme in this scenario by allowing employer claims to be scrutinised.

Scheme integrity

55. Ministers agreed that the COVID-19 Wage Subsidy would be implemented with a 'high-trust' model. This approach accepted some increased risks to scheme integrity in order to rapidly build the scheme, process applications and make payments. The scheme began approving applications and paying out within days, which provided certainty and rapid cash-flow to employers.
56. Characteristics of this high-trust model are:
 - a Implementation using a simple, pre-existing MSD application system;
 - b No new legislative basis created;
 - c Heavy reliance on voluntary compliance by applicants;
 - d Limited pre-payment verification of information provided by applicants;
 - e Some discretion by MSD staff in applying rules that include an element of subjectivity; and
 - f Post-payment audit and enforcement activity with targeting supported by cross-government data sharing.
57. The previous iterations of the scheme have included integrity features at various stages of the process:
 - a **Pre-application:** Communications to ensure potential applicants understand the eligibility rules;
 - b **Between applications and payment:** Automated checks of application details with data provided by IR; higher degree of scrutiny of high-risk groups, large claims and exceptions to automated data-matching; and
 - c **Post-payment checks:** Random and targeted audits using a risk-based approach, and in response to complaints, leading to possible investigations and possible (future) prosecutions. Publication of names of subsidised employers.
58. Further details of MSD's integrity approach are covered in concurrent advice MSD has prepared for the Minister for Social Development and Employment.
59. We recommend further steps to reduce errors and incentivise voluntary compliance within the high-trust model:
 - a Increase visibility and publicity around audit and enforcement activity including through ministerial communications; and

- b Communicate requirements of applications better so that employers can fill out applications more accurately – this will help automation rates by reducing errors.
60. MSD regularly updates the Minister for Social Development and Employment on the number of allegations received, investigations underway, investigations resolved, refunds and referrals for prosecution. Some of this information has been made public through Official Information Act and media requests. If Ministers would like this information to be more visible to the public and regularly updated, MSD can engage with the Offices for the Minister of Finance and the Minister for Social Development and Employment to determine how this could be best achieved.

Employment law interface

61. There have been a number of queries and concerns raised by stakeholders about the interface of the scheme with employment law requirements relating to pay and statutory leave.
62. As summarised below, we recommend retaining the status quo for how the conditions in the declaration of the scheme interface with employment law requirements but updating guidance and communications to clarify these obligations and entitlements. Annex 3 discusses the issues and options considered in more detail.

'Best endeavours' direction

63. We recommend maintaining the current direction to make 'best endeavours to pay 80% of normal wages', while emphasising through guidance that employers must meet their obligations to consult and agree to any changes to their employees' terms and conditions. This approach provides an 'anchoring point' or signal of Government expectations for what levels of agreed pay reductions are acceptable but would not be a binding constraint. Agreed changes below the 80% level would continue to be permitted, subject to the minimum payment of the wage subsidy amount or normal wages if less than the subsidy.

Calculating 'normal income'

64. Employers provided feedback that they were unclear about what 'normal income' meant, such as for employees on variable hours. 'Normal income' is referred to in the scheme when determining what to pay employees while they are receiving a subsidy,
65. We propose developing guidance for applicants on this issue. The alternative is a more prescriptive approach to the calculation. This is not recommended as the appropriate method is likely to be specific to the particular employment situation

Use of wage subsidy to pay for annual holidays.

66. We recommend retaining the current setting of allowing use of the wage subsidy to pay for annual holidays. While we consider that, from a principled perspective, employers should not be able to use the wage subsidy to pay for annual holidays during a closedown period, we consider that the compliance and administrative issues are too high to warrant recommending this approach. For example, the subsidy period is unlikely to match the closedown period exactly leading to a large number of repayment requests and queries.
67. We note that retaining the current approach may result in some deadweight cost in the scheme if there is an elevation in Alert Levels over the Christmas period and the scheme is available over that period.

Clarify and update other scheme rules

68. Rules were drafted at pace in March, with minor changes made since. This has led to some rules being ambiguous and subjective, and guidance that is sometimes inconsistent. These issues have led to confusion among employers and employees, higher administration costs, lower enforcement ability and disputes.
69. Rules could be clarified in several areas including those noted below:
- a Defining the term '**revenue**' and allowable methodologies to calculate a **revenue drop** to qualify for the scheme; and
 - b The eligibility of **groups of related companies** – in part or whole.
70. We recommend officials begin work on re-drafting these rules now, so that clearer rules are available if and when a further scheme is introduced. It will be important to ensure alignment of definitions across the Small Business Cashflow Scheme, wage subsidy and any new business grants scheme as far as possible to avoid confusion among applicants.

Financial Implications

71. Both the Wage Subsidy Extension and Resurgence Wage Subsidy had lower uptake than originally forecast. This has resulted in an underspend in the 2020/21 fiscal year of approximately \$1.3 billion in the *Business Support Subsidy Covid-19* appropriation. If another wage subsidy were to be established, we would recommend that it be funded (in full or in part) from the underspend in the appropriation.
72. The Ministry of Social Development estimates (assuming current settings through a national scheme) another wage subsidy for a national Alert Level 3 would cost between \$770 - \$1,155 million for a two-week period (\$385 - \$580 million per week). Therefore, appropriated funding corresponds to at least 2 weeks of wage subsidy.
73. If further funding is required beyond the amount of the underspend or beyond the current fiscal year, consideration would need to be given to the source of this funding. Note that approximately \$13.2 billion remains in the COVID-19 Response and Recovery Fund as of 25 November.

More substantive changes to the scheme

74. Annex 2 details key areas for more substantive improvements to the scheme. This includes changes to improve targeting and increase integrity.
75. A new implementation system would likely need to be built to deliver an improved scheme, and Ministers may wish to put the scheme in a legislative framework. This could form the basis of a more enduring "emergency wage subsidy" payment for future use.
76. These changes would require additional policy and operational resources from a number of departments and potentially time to pass legislation in the House to implement a legal framework to support an enduring scheme. There may also be implications for the timing and delivery of other work programmes, such as flexi-wage and the welfare reform programme, which are delivered by the same agencies working on the COVID-19 wage subsidy.

77. Investment in an enduring scheme needs to be weighed against uncertainty in the pandemic's length and frequency of resurgences. There is the risk that by the time an improved payment is built there is no longer a need for wage subsidy scheme for COVID-19, especially if legislation is required. Introducing multiple sets of changes to the scheme increases the risk of confusion for applicants. This is balanced against the potential degradation in social licence if the current scheme shows up inappropriate spending or inconsistent application among businesses.
78. However, it is plausible that the scheme will be used several times over the next year and investment to build a more robust scheme is likely to be worthwhile in this scenario. Investment now also contributes to an enduring scheme that can contribute to New Zealand's long-term resilience to economic shocks.
79. We recommend officials provide further advice on the scope and timeline for these more substantive changes so that Ministers can make an informed decision on progressing them.

Next Steps

80. Officials will include the agreed proposals for near-term enhancements in a Cabinet paper on the resurgence package.
81. If you indicate you are interested in further advice on substantive changes, then officials will prepare a more detailed scope and timeline for advice and implementation to inform further decisions.

Annexes

Annex 1: Themes from stakeholder engagement

Annex 2: Key areas for substantive changes to the scheme

Annex 3: Wage Subsidy interaction with employment law

Annex 1 – Themes from stakeholder engagement: Business New Zealand, the Council of Trade Unions, other business groups and professional services firms.

Payments were rapid but changing rules and guidance caused confusion

1. The COVID-19 wage subsidy schemes were well-received by businesses, and widely thought of as being quick, effective at enabling rapid cash-flow (which was especially important for small businesses), and effective at maintaining work-place connections in the face of significant uncertainty due to COVID-19.
2. Two features that stakeholders cited as critical to the success of the scheme were the lump sum payments, and the speed at which employers received pay-outs after applying. According to stakeholders, this provided certainty and enabled businesses to plan their wage costs for the duration of lockdown.
3. Stakeholders noted that while the scheme's 'high-trust model' supported rapid-cash flow, it reduced scheme integrity, and led to more downstream issues as applicants tried to clarify rules with MSD. These issues were exacerbated by slow, changeable and inconsistent messaging around scheme eligibility and obligations on employers.
4. Frequent changes to rules and changes in guidance and across schemes, also caused significant confusion and frustration. At times the information on different agencies' websites was inconsistent.

Some scheme rules are unclear

5. Stakeholders highlighted a number of scheme rules that are unclear. This created higher costs for employers in terms of the application process and professional advice, and reduced certainty about entitlements and obligations for both employers and employees.
6. Rules that created particular difficulties are:
 - a **The revenue test:** how to calculate, revenue and a revenue drop; and the changes made between scheme iterations to allow a predicted and/or actual revenue drop to qualify.
 - b **Cross-over and interaction between schemes** which were open at the same time; for example this led to a sense of inequity for firms that missed out on the WSR because they were covered by the WSX for example.
 - c The requirement to "**take active steps**" to mitigate the financial impact of COVID-19 before applying
 - d Calculating the **number of full and part time staff** and **average earnings**, especially with regards to employees who worked variable hours.
 - e **Repayment requirements.** Government communications have not been consistent about the circumstances under which repayment is necessary, or the allowable uses for 'leftover' subsidy. There has also been media discussion about legal or 'moral' obligations on firms to repay the subsidy after downsizing, closing, experiencing a bounce-back in revenue or profits or paying dividends.

7. Smaller businesses in particular faced difficulties with this lack of clarity and had fewer resources available to help navigate the system. In general, larger businesses, and small business with access to legal and accounting resources, were more confident in navigating the scheme. However, we also understand that some large businesses may have chosen not to apply due to the risks created by unclear scheme obligations, including around repayment.

There was tension between the rights of employees and employers

8. Applications for the wage subsidy are made at the discretion of employers (or sole traders) for some or all staff. There are obligations to retain those staff on the subsidy (or repay it if not), to pass on at least the value of the subsidy (or to pay their normal wages if less), and to make 'best endeavours' to pay at least 80% of normal wages. This arrangement created some questions for stakeholders about whether the purpose of the scheme was 'business support' or 'employee support'.
9. The Council of Trade Unions (CTU) raised concerns that some employees missed out on the subsidy because their employers did not apply, even though they may have been eligible.
10. There was confusion around how the schemes interacted with employment law, including annual and sick leave entitlements, the minimum wage, and 'good faith' engagement processes on changes to employment conditions. There was particular confusion about the interpretation of the requirement to make "best endeavours" to pay 80% of normal wages.
11. Some employers struggled to carry out, or possibly chose not to engage in, "good faith" wage negotiations, due to limited time available to make staffing decisions and apply to the scheme. The WSR scheme was only open for two weeks, and firms that took the time to carry out thorough employee consultation processes may have been unable to apply in time as a result. Employees with different employers may have faced different outcomes depending on how well the employer complied with the 'good faith' engagement requirement.
12. The CTU reported that unions undertook significant representation work for both members and non-members around the schemes, and that many employees did not understand, or were not able to ensure, their employment law rights. Given unions' limited resources, they suggested an independent advocacy function for non-union employees would be useful.

Targeting, auditing, and integrity:

13. Stakeholders understood the rationale for establishing the scheme on a 'high-trust' basis, with limited upfront verification and relatively high discretion for MSD staff processing applications. Stakeholders acknowledged the trade-off between scheme integrity against payment speed and simplicity. They suggested more visible auditing and enforcement, and increased transparency as some key features to support a higher integrity scheme.
14. Stakeholders indicated that some employers and firms accessed the scheme when they did not need it, and that some people – including consultants – claimed multiple subsidies under different employers. Both the high-trust model and the eligibility criteria more generally were cited as contributing factors.
15. The search function on MSD's website was specifically cited as being useful for incentivising compliance by enabling independent confirmation of applicants and

subsidy amounts. Suggestions were made to further increase transparency in this way to boost scheme integrity and to help employees and unions uphold employment rights.

16. Stakeholders were supportive of making changes more generally to improve integrity and targeting. They specifically suggested differential treatment of different types and sizes of employer; reducing windfalls; and targeting viable jobs.

Broader context and support landscape

17. Stakeholders noted that although many firms had successfully navigated the first lockdown with Government support, the ongoing uncertainty and 'stop-start' dynamics of the public health response was harmful to business confidence. They noted this was discouraging smaller firms from taking on debt and investing, in spite of Government loan schemes (Small Business Cashflow Scheme and Business Finance Grant).
18. Stakeholders also raised the need for other grant support beyond the wage subsidy – for non-wage costs and for the costs faced by a subset of firms at Alert Level 2 (including hospitality and events).

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Annex 2 – Key areas for more substantive changes in the longer term

1. The wage subsidy has largely the same high-trust delivery model as when it was built 'at pace' in March 2020. There remain significant limitations to integrity processes and the ability to target support. More substantive changes as described below could address these issues for use in a COVID-19 resurgence scheme and also lead to a more enduring scheme to improve New Zealand's long-term resilience to future emergencies.

Introducing a higher-integrity model

2. Integrity improvements under a high-trust model generally involve a trade-off with compliance cost or simplicity. Areas where more resource investment could improve integrity while limiting the trade-off with compliance costs include:
 - a Introducing a formal, transparent process for handling fraud-related complaints and for creating 'rulings' on issues that can then be consistently applied;
 - b Differential treatment of high-risk groups (including sole traders, new firms and trusts) including greater evidence of income or revenue; and
 - c Linking the subsidy to compliance with tax obligations – either historic or future, although we note that this will need further clarification.

Establishing a new legal framework for the scheme

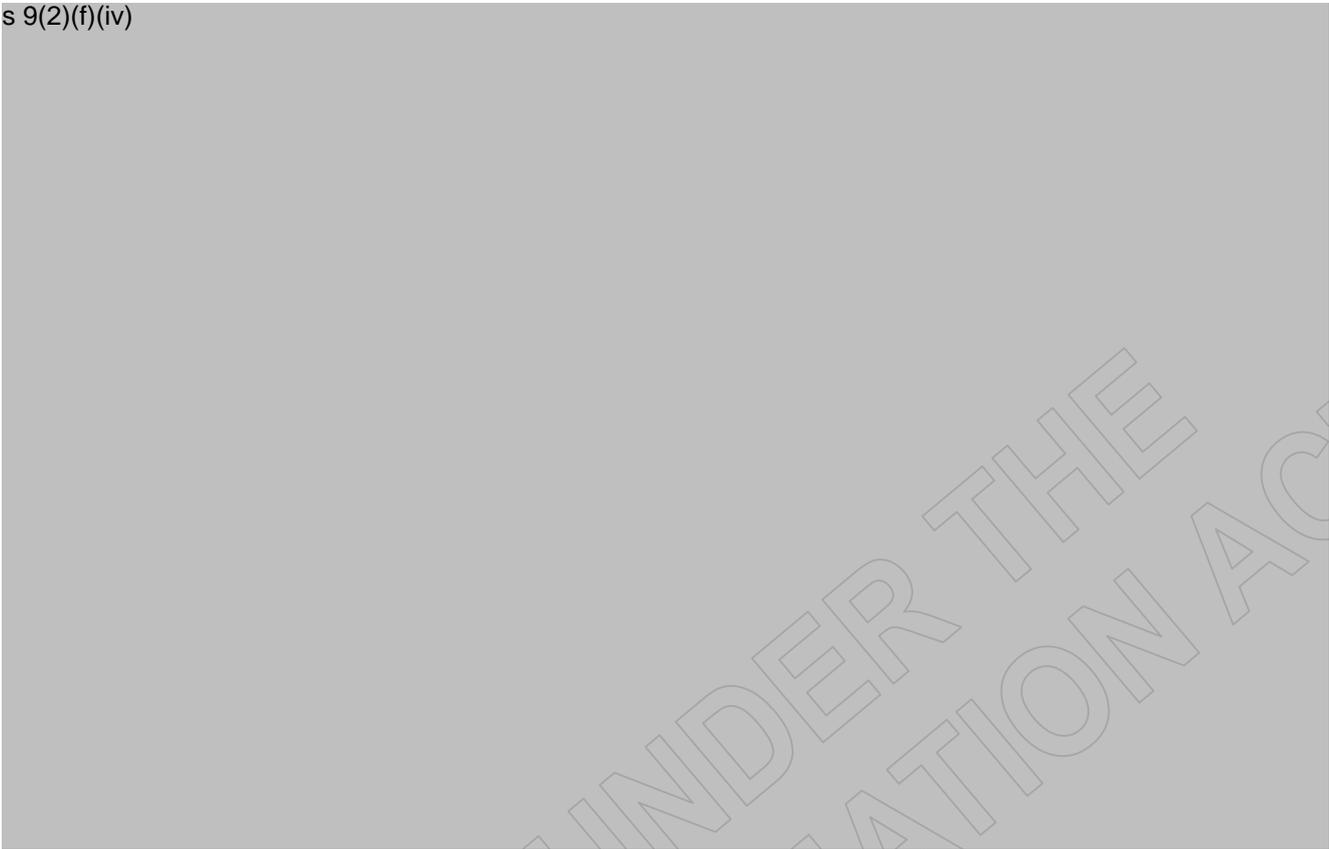
3. Establishing a legal framework for the scheme would create a clearer statutory basis for Government decision making and for the obligations, rights and entitlements of scheme applicants. Scheme rules would be less subject to interpretation in court and case law could be drawn on. Specific powers could be created to support investigations and enforcement, such as debt collection, information production and offences and penalties. This would increase the efficiency of these activities and contribute to scheme integrity.
4. A new legal framework could also provide the basis for an enduring 'off the shelf' Emergency Wage Subsidy. This could contribute to New Zealand's long-term resilience by decreasing the risks of a slow or poorly designed economic response to natural disasters or other economic shocks.

Repayment rules

5. Some firms faced criticism in the media due to paying dividends or reporting profits after claiming the subsidy. Greater targeting to employer need could be achieved by requiring large firms to repay the wage subsidy under some such circumstances. Small firms, however, are unlikely to take a wage subsidy with repayment conditions attached however. Some stakeholders also indicated that they would prefer rules-based repayment over moral appeals in the media experienced to date, which has resulted in different outcomes for different businesses.
6. We could provide more advice on creating repayment obligations for firms that experience a bounce-back in revenue or profits.

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Annex 3 Wage Subsidy interface with employment law requirements

1. The Wage Subsidy Scheme (WSS) interfaces with employment law requirements in three key ways (this section considers options for each of these):
 - Should the scheme continue to require that employers make best endeavours to pay their employees at least 80 percent of their usual wages?
 - Should employers be able to use the WSS to pay for annual holiday entitlements (to prevent employers 'double dipping', that is, receiving the WSS and reducing leave balances)?
 - Should 'normal income' be prescribed to provide employers with more certainty about what to pay employees for the period of the wage subsidy?

Should the scheme continue to require that employers make best endeavours to pay their employees at least 80 percent of their usual wages?

2. We have considered the following three options:
 - A Remove the WSS requirement to use 'best endeavours to pay 80 percent'. This option would instead emphasise that:
 - employers need to comply with their employment obligations (including for the pay and hours in the employment agreement); and
 - employers need to follow a proper process to change employees' terms and conditions.
 - B (recommended) Maintain the current best endeavours requirement while making it clearer through guidance that employers must meet their obligations to consult and agree to any changes to their employees' terms and conditions.
 - Compared to the status quo, this option would clarify in guidance that for employers to meet employment obligations they must reach agreement with employees to any changes to employees' terms and conditions. This would mean employers must meet their existing obligations (for pay and hours) in the employment agreement (or those arising from custom and practice) until a change to those obligations has been agreed.
 - If an employer considers a reduction in pay necessary and follows a proper process to change an employee's terms and conditions, employers would still need to use best endeavours to pay their employees at least 80 percent of their usual wages. This would provide an anchoring point or signal of Government expectations for what levels of agreed pay reductions are acceptable, but would not be a binding constraint, that is, agreed changes below this level would continue to be permitted, subject to the minimum payment of the WSS amount.
 - C Require employers to pay at least 80 percent of usual wages to be eligible for the wage subsidy.

3. We recommend option B for the following reasons:
 - Health strategy papers indicate that alert level 4 will only be used in very rare circumstances. Data also indicates that most businesses can operate to some extent under alert level 3 which means that most employees are likely to be working.
 - This option may mean that employees' wages/hours would not decrease as much compared with removing the current requirement altogether (although it would still be possible to agree to less than 80%). The Government's expectations would be clearer so we would expect that fewer employers would be passing on the wage subsidy only.
4. We do not recommend option A as it may mean that in some circumstances, such as a return to level 4, employers may apply pressure on their employees to accept a reduction of hours to beyond that which was necessary. Option B maintains some encouragement by the Government that employers should endeavour to pay a particular proportion of their employees' usual wages during the period they are unable to work their normal hours, while improving clarity on what is needed if wages or hours are proposed to be changed.
5. We do not recommend option C as we consider it would reduce flexibility for employers to manage their wage costs and may mean that some employers who may need the WSS to keep on employees may decide not to apply for it and result in redundancies.

Should employers be able to use the WSS to pay for annual holiday entitlements (to prevent employers 'double dipping', i.e. receive the WSS and reduce leave balances)?

6. We have considered the following four options:
 - A (recommended) Status quo – Allow employers to use the wage subsidy to pay for annual holidays.
 - B Prevent employers from using the wage subsidy to pay for annual holiday entitlements, including where employees ask to take annual leave
 - C Prevent employers from using the wage subsidy if they have directed employees to take annual holidays, while still allowing for employees to ask for, or agree, to take annual leave.
 - D Prevent employers from using the wage subsidy if they have directed employees to take annual holidays during a business closedown period only.
7. We recommend option A. While we consider that, from a principled perspective, employers should not be able to use the wage subsidy to pay for annual holidays during a closedown period (option D), we consider that the compliance and administrative issues are too high to warrant recommending this approach. This may result in a risk of some deadweight cost in the WSS if there is a lock down over the Christmas period and the WSS is available over that period.
8. We do not support option B as this could provide an incentive for employers to restrict employees' ability to take holidays and could result in employees taking significant cuts to their income, without being able to use holiday balances to manage this. We do not support option C as this could disrupt the business use of directing that employees take

leave as part of usual business practice. Both options are likely to have administrative costs for MSD and compliance costs for employers.

Should 'normal income' be prescribed to provide employers with more certainty about what to pay employees for the period of the wage subsidy?

9. Employers provided feedback that they were unclear about what 'normal income' meant for the purposes of the wage subsidy. We propose that guidance for the wage subsidy scheme could specify:
- If an employee works regular hours that are specified in their employment agreement, then an employer must pay what the agreement requires.
 - If an employee would normally work variable hours, or more than their minimum contracted hours, then their normal income may be considered to be based on the hours that they normally work, rather than what is specified in their employment agreement. This will depend on the facts of the case, for example:
 - If an employee regularly and predictably works more hours than what is stated in their employment agreement, then this could be considered to be their 'new normal' hours of work based on custom and practice. If an employer wanted to make any changes to these hours to reflect custom and practice, they would need to go through a proper process with the employee and gain their agreement to change their hours.
 - If an employee sometimes works more hours in a particular week, for example if a specific job has come in that requires more workers for a limited time, then this is not likely to override the hours specified in their employment agreement.
 - If an employee performs seasonal work and a lock down period coincides with a downturn for that work, an employer should check whether the employment agreement is clear on what the hours would have been. If this is unclear, the employer should look to provide evidence from previous years that there would normally be a downturn for the same period in order to reduce an employee's hours.
10. Guidance could specify:
- For employees who work variable hours, or more hours than what is stated in their employment agreement, their employer must work out what their normal hours are for the purposes of the wage subsidy and whether they need to follow a proper process and gain their employee's agreement to change those hours.
 - Employers should calculate pay as though the person is taking annual leave, according to the requirements of the agreement. This would take into account the hours that the employee would normally work outside of lockdown.
 - Employers need to pay employees for any work they complete and all other employment obligations, such as Holidays Act obligations apply.
11. We also considered the following options (but do not recommend them):
- No change to the status quo – this is not recommended as employers would continue to be unclear about the approach to 'normal income' and may risk breaching their employment obligations if they do not follow proper processes.

- Prescribe an approach to 'normal income' that employers must apply – this is not recommended as the approach to what should be considered to be 'normal income' is likely to be specific to the particular employment situation (as the above examples illustrate).

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