Regulatory Impact Statement

Customs and Excise Act Review: Compensatory interest for provisional value updates

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by the New Zealand Customs Service (Customs).

It provides an analysis of options for how compensatory interest should apply to changes in duty liability due to provisional value updates.

The following are the constraints on the analysis:

- it is not possible to anticipate the impact compensatory interest would have on voluntary disclosures of value changes for imported goods;
- due to complex calculations and gaps in data, it is not possible to accurately estimate Customs' loss of use of money due to value changes in the provisional valuation scheme – this RIS uses broad estimates instead;
- there is uncertainty around the resource costs of calculating compensatory interest, due to the ongoing scoping of an upgrade to Customs' financial management system.

Signed by Michael Papesch on 8 February 2017

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Executive summary

1 Some importers are not able to provide a final value for their goods at the time of import. The Cabinet Economic Growth and Infrastructure Committee (EGI) has approved a process for these importers to declare a provisional value for imported goods and later submit a reassessment to Customs [EGI-15-MIN-0088].

2 The Minister of Customs has directed Customs to consider when compensatory interest should apply to an underpayment or overpayment of duty that is the result of provisional information about the value of goods being different to final information provided to Customs [EGI-16-MIN-0037].

3 This paper recommends that no compensatory interest should apply to provisional value updates. This will incentivise importers to join the provisional valuation scheme, which is beneficial to Customs because it provides a high level of assurance around provisional value updates, without the cost of having to audit importers.

Status quo and problem definition

4 Anyone who imports goods into New Zealand is required to declare the value of the goods to Customs. For goods valued $1,000 or more an import entry is required to be submitted to Customs within 20 working days of import. The import entry contains important information about the goods, including their value and other information used to calculate the amount of duty that is payable.

5 For some importers, it is difficult to accurately assess their duty liability on an import entry, as the value of the goods can change after they have been imported. This includes when goods are sold between divisions of a multinational enterprise (known as transfer pricing) and when royalty payments or commissions need to be included in the value of goods.

6 The value of these goods is more likely to increase after import than decrease. In 2015/16, a total of $57,138 extra import tariff duty, GST, and excise-equivalent duty was payable as a result of value adjustments. It is a small percentage of the total $2.4 billion in duties and $8.5 billion collected on imported goods.

7 A process has been approved by the EGI for these importers to declare a provisional value for imported goods and later submit a reassessment to Customs [EGI-15-MIN-0088]. After submitting the reassessment, the importer will either pay the difference in duty or receive a refund. This is modelled on the U.S. Customs and Border Protection's Reconciliation Programme for post-entry value adjustments.

8 Entry to the scheme is voluntary, but it is beneficial to importers, because it gives them certainty that their value updates will not be treated as errors and will not attract sanctions. However, entry to the scheme is limited to importers who have an Advance Pricing Agreement with Inland Revenue, importers who import goods that are subject

to certain specific changes in value after importation[1], and importers who have been granted approval on a case-by-case basis from Customs.

9 Importers using the scheme must ensure that the provisional value provided is determined in accordance with the method agreed with Customs and is as accurate an estimate of the final value as possible. They must also ensure that all provisional value updates are submitted within the timeframe agreed with Customs. If these obligations are not met, sanctions may apply.

10 The Minister of Customs has directed Customs to consider when compensatory interest should apply to an underpayment or overpayment of duty that is the result of provisional information about the value of goods being different to final information provided to Customs [EGI-16-MIN-0037]. The purpose of compensatory interest is to compensate the Crown or an importer for the cost of not having use of money. Compensatory interest is not a penalty.

11 This RIS contains an analysis of options for how compensatory interest should apply to the difference between provisional and final duty, both where the duty payable has increased (importer compensating Customs) and where the importer is entitled to a refund (Customs compensating importer).

Objectives

12 The objectives are to:

- maximise core duty collected
- minimise financial disadvantage to the Crown and importers as a result of provisional duty liability being different to final duty liability
- minimise administrative costs for Customs
- minimise compliance costs for importers.

Options and impact analysis

Options

13 The following options have been considered.

Option 1: no compensatory interest

14 Importers using the provisional valuation process would not be charged compensatory interest if the value of their goods increases after import, provided that they finalised

[1] The eligible types of value changes are those due to royalty payments or further proceeds of sale.

the provisional value entry in accordance with the term agreed with Customs (eg updated values are provided within prescribed period). Nor would they be refunded compensatory interest if the value of their goods decreases after import.

Option 2: general compensatory interest provisions

15 This option would apply the same compensatory interest provisions to provisional value updates as are applied to underpayments or overpayments made due to errors. Customs is proposing new compensatory interest provisions in these cases, details of which can be found in the attached Cabinet paper and RISs.

16 This would mean that, when the value of goods increases after import, the importer would be charged compensatory interest at a rate based on the floating first mortgage rate + 2.5 percent. This mirrors Inland Revenue's use of money interest rate for underpayments, which is currently set at 8.27 percent. This would be remitted down to the 90-day bank bill rate (2.39% as at 26 May 2016) if there was no evidence that the importer intended to under-assess their duty.

17 When the value of goods decreases after import, no compensatory interest would be paid out to the importer, because the general compensatory interest provisions only allow for this if the overpayment was due to an error by Customs.

Option 3: compensatory interest charged/paid for all value changes

18 When the value of their goods increases after import, the importer would be charged compensatory interest at a rate based on the 90-day bank bill rate (2.39% as at 26 May 2016). The 90-day bank bill rate reflects the interest rates available on bank deposits.

19 When the value of goods decreases after import, the importer would be paid compensatory interest at the 90-day bank bill rate minus one percent. This mirrors Inland Revenue's use of money interest rate for overpayments, which is currently set at 1.62 percent. This reduced rate would remove the incentive for importers to deliberately declare high provisional values in order to receive compensatory interest.

Option 4: compensatory interest charged/paid for value changes over a threshold

20 This option is the same as option three, except that compensatory interest would only be charged or paid out if the final duty payable is more than five percent different from the provisional duty. Many provisional value updates currently fall within this threshold.

Comparison of options against objectives

21 The following table provides an analysis of the options against the objectives:

Key: ✓✗ partially meets the criteria ✓✓ meets the criteria ✗✗ doesn't meet the criteria

	Maximises core duty collected	Minimises financial disadvantage to Customs/importer	Minimises administrative costs for Customs	Minimises compliance costs for importers	Total
Option 1: no compensatory interest	✓✓ Avoidance of compensatory interest when goods increase in value will incentivise importers to join the provisional valuation scheme, giving Customs greater assurance that value changes will be disclosed.	✗✗ Does not provide fair compensation to either Customs or the importer for loss of use of money when goods change in value. Furthermore, if an importer expects that the final value of the goods will be higher than the provisional value given by the agreed valuation methods, there is no incentive to declare the higher value at the time of import.	✓✓ No administrative costs.	✓✓ No compliance costs for importers.	**6**
Option 2: general compensatory interest provisions	✗✗ Importers may choose to remain outside of the provisional valuation scheme and only disclose changes in values to Customs on an ad hoc basis through voluntary disclosure, ,given that they will have to pay compensatory interest irrespective whether or not they are on the provisional value scheme.	✓✗ When goods increase in value, Customs may be fairly compensated (if interest is remitted) or overcompensated (if interest not remitted). Importers are not compensated when goods decrease in value. However, if an importer expects that the final value of the goods will be higher than the provisional value given by the agreed valuation methods, they have a strong incentive to declare the most accurate value at the time of import.	✓✗ It is estimated that less than one FTE will be required to administer compensatory interest using current manual processes. However, less resource would be required if planned upgrades to Customs' financial management system include automation of interest charges. More resources would be required to provide assurance around importers who do not join the provisional valuation scheme, eg carrying out audits.	✗✗ Interest charges increase the cost of importing goods that may change in value, and make financial planning more complex.	**2**

	Maximises core duty collected	Minimises financial disadvantage to Customs/importer	Minimises administrative costs for Customs	Minimises compliance costs for importers	Total
Option 3: compensatory interest charged/paid for all value changes	✗✗ Importers may choose to remain outside of the provisional valuation scheme and only disclose changes in values to Customs on an ad hoc basis through voluntary disclosure, given that they will have to pay compensatory interest irrespective whether or not they are on the provisional value scheme.	✓✗ Customs is fairly compensated for loss of use of money when goods increase in value. Importers are undercompensated when goods decrease in value. If an importer expects that the final value of the goods will be higher than the provisional value given by the agreed valuation methods, they have an incentive to declare the most accurate value at the time of import.	✓✗ It is estimated that less than one FTE will be required to administer compensatory interest using current manual processes. However, less resource would be required if planned upgrades to Customs' financial management system include automation of interest charges. More resources would be required to provide assurance around importers who do not join the provisional valuation scheme, eg carrying out audits.	✗✗ Interest charges increase the cost of importing goods that may change in value, and make financial planning more complex.	**2**
Option 4: compensatory interest charged/paid for value changes over a threshold	✓✗ Avoidance of compensatory interest in many cases of value increases will provide an incentive for importers to join the provisional valuation scheme, giving Customs greater assurance that value changes will be disclosed. However, there will not be any benefit for importers to be on the provisional value scheme, if they are likely to have a large difference/fluctuations between provisional and final values given the industry/sector they are in (e.g. the prices of agriculture produce may tend to fluctuate more than 5%).	✓✗ In most cases, does not provide fair compensation to either Customs or the importer for loss of use of money when goods change in value. However, the application of compensatory interest over a threshold provides a stronger incentive for importers to provide a more accurate provisional value if they know their goods are likely to increase in value significantly.	✓✗ It is estimated that less than one FTE will be required to administer compensatory interest using current manual processes. However, less resource would be required if planned upgrades to Customs' financial management system include automation of interest charges. More resources would be required to provide assurance around importers who do not join the provisional valuation scheme, eg carrying out audits.	✓✗ Interest charges increase the cost of importing goods that may change in value, and make financial planning more complex. However, in many cases, no interest would be charged.	**4**

Impact analysis

22 The table below compares the financial impacts for an importer using the provisional valuation mechanism, based on an underpayment or overpayment of $10,000, with a period of twelve months between entering the provisional value and the updated value.

		Overpayment (refund to importer)	Underpayment (charge to importer)
Option 1: no compensatory interest		$0	$0
Option 2: general compensatory interest provisions		$0	$825
Option 3: compensatory interest charged/paid for all value changes		$162	$238
Option 4: compensatory interest charged/paid for value changes over a threshold	Within five percent threshold	$0	$0
	Outside of five percent threshold	$162	$238

Consultation

23 A draft RIS has been circulated to stakeholders, including major accounting firms, importers and excise clients. Stakeholders indicated support for not charging or refunding compensatory interest on provisional value updates.

Conclusions and recommendations

24 Option one is the recommended option. Protection from compensatory interest and associated costs will incentivise importers to join the provisional valuation scheme. This is beneficial to Customs because it provides a high level of assurance around provisional value updates, without the cost of having to audit importers. There is also no resource required to calculate or process compensatory interest. These benefits outweigh the Crown's cost of loss of use of money.

25 Furthermore, the recommended option does not carry significant risks to the collection of core duty, as importers are required to follow agreed valuation methods, which limits their ability to deliberately declare low provisional values to defer duty payment.

Implementation plan

26 The proposals in this paper would be included in the Customs and Excise Bill, which has been referred to select committee. The provisional valuation process will come into force on 1 April 2018 or six months after royal assent, whichever is the later. Transitional provisions will apply in the interim.

27 Operational procedures will be developed to guide consistent application of compensatory interest and administrative penalties in relation to provisional value updates.

28 Customs will assist importers and their brokers to understand their obligations in relation to calculating provisional values using the prescribed methods.

Monitoring, evaluation and review

29 Monitoring will measure the objective of maximising core duty collected. Measures could include the number of importers approved to use the provisional valuation scheme, and the amount of undeclared value increases found through Customs audit.

30 Monitoring against the remaining objectives is not required, as there is certainty around how the recommended option will perform against them.