Regulatory Impact Statement

Customs and Excise Act Review: Compensatory interest for overpayments of duty

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 overpayments of duty made as a result of an error by Customs.

The financial impacts outlined in this RIS do not take into account possible increases in the number of compensatory interest payments made by Customs to duty payers as a result of the introduction of an internal review process for duty assessments.

Signed by Michael Papesch on 8 February 2017

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Executive summary

1 When Customs issues an incorrect duty assessment, and a duty payer pays too much duty as a result, the duty payer is entitled to a refund of the overpaid duty with compensatory interest for loss of use of money.

2 Compensatory interest is currently paid out at the variable interest rate on Customs' trust account, where duty is held while it is under dispute. This rate is marginally less than duty payers' cost of loss of use of money. It is also inconsistent with Inland Revenue's (IR) approach to setting compensatory interest rates.

3 This paper recommends that Customs should adopt a fixed compensatory interest rate, based on the 90-day bank bill rate, because it fairly compensates duty payers. It also increases transparency and removes unnecessary compliance costs for duty payers as it is in line with IR's approach to setting compensatory interest rates.

Status quo and problem definition

4 Customs duties are charges imposed on goods that are imported into New Zealand and on some domestically manufactured goods. They include tariff duty, excise equivalent duty, and GST on imported goods; and excise duty on domestically produced alcohol, tobacco and fuel.

5 Duty payers are required to assess the amount of duty owing on their goods and declare this to Customs on an import or excise entry. Customs also has the ability to issue duty assessments where the self-assessment is incorrect, or no entry is received.

6 Interest is currently paid out according to the variable interest rate on Customs' trust account, where duty is held while it is under dispute. At the time the financial analysis was undertaken (May 2016), the rate was pegged to the OCR, and was 2.25 percent.

7 This rate does not fairly compensate duty payers, as it is marginally lower than the returns they could have earnt on the overpaid duty if they had deposited it in the bank.

8 Furthermore, pegging the compensatory interest rate to the rate on Customs' trust account is inconsistent with IR's approach to setting compensatory interest rates. IR sets its compensatory interest rate for overpaid tax at a fixed rate, based on the 90-day bank bill rate.[1] The rate is published on IR's website, and updated annually. This inconsistency can reduce transparency for duty payers, as it is not clear why Customs and IR should have different approaches. It also causes unnecessary compliance costs for duty payers, as they need to understand and operate two separate regimes.

[1] IR discounts the 90-day bank bill rate by 100 basis points (one percent), in order to discourage deliberate overpayments. This is necessary, because IR compensates tax payers for all overpayments, regardless of fault. As Customs only pays out compensation when Customs is at fault for the overpayment it is not necessary to discount the rate.

Objectives

9 The objectives are to:

- minimise financial disadvantage to duty payers because of Customs' error, by closely matching returns to duty payers in the market place if the error had not been made;
- remove unnecessary compliance costs for duty payers through consistency with IR in the treatment of revenue owed to duty payers.

Options and impact analysis

Options

10 The following options have been considered.

Option 1: status quo

11 Compensatory interest would be paid out at a rate based on the rate of interest on Customs' trust account. This is a floating rate, which at 26 May 2016 was 2.25 percent.

Option 2: fixed Customs rate based on the 90-day bank bill rate

12 Customs would set a fixed rate based on the 90-day bank bill rate at the time of calculation. The 90-day bank bill rate reflects the interest rates available on bank deposits, and at 26 May 2016 was 2.39 percent. Customs would reset the rate annually, and could also reset it at other tiems if there were significant changes to market conditions.

Comparison of options against objectives

13 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

	Minimises financial disadvantage to duty payer	Removes unnecessary compliance costs for duty payers through consistency with IR in the treatment of revenue owed to duty payers	Total
Option 1: status quo	✓× Rate is marginally lower than the interest a duty payer would earn if they had deposited the overpaid duty in a bank.	×× Inconsistent with IR – this is not transparent for duty payers and requires them to understand and operate two separate regimes.	1
Option 2: fixed Customs rate based on the 90-day bank bill rate	✓✓ Rate is broadly reflective of the interest a duty payer would earn if they had deposited the overpaid duty in a bank.	✓✓ Consistent with IR – this is transparent for duty payers and only requires them to understand and operate one regime.	4

Impact analysis

14 The table below compares the financial impacts of the options on duty payers, based on an overpayment of $10,000 core duty, outstanding for seven days through to one year. The difference between the two options would be small.

	+7 days	+31 days	+93 days	+365 days
Option 1: Status quo	$4	$18	$57	$224
Option 2: fixed Customs rate based on the 90-day bank bill rate	$4	$20	$60	$238

Consultation

15 A draft RIS has been circulated to stakeholders, including major accounting firms, importers and excise clients. Stakeholders indicated their support for an internal review process. One stakeholder indicated a preference for the IR approach to overpayments, where compensatory interest is paid out at a lower rate on all overpayments, regardless of fault. Stakeholders had no comments on the specific rate used.

Conclusions and recommendations

16 Paying interest at a fixed rate based on the 90-day bank bill rate is the preferred option, because it fairly compensates duty payers. It is also in line with IR's approach to setting compensatory interest rates, resulting in greater transparency and lower compliance costs for duty payers.

17 As the 90-day bank bill rate is only marginally higher than the current compensatory interest rate, and there is only a small number of duty refunds paid out due to Customs' error, there will be minimal financial impact on Customs.

Implementation plan

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

19 As part of the implementation stage of the Act review, a client awareness campaign and guidance material on the changes will be developed.

20 Operational procedures will be developed to guide consistent application of the internal review process.

Monitoring, evaluation and review

21 Monitoring will measure the objective of minimising financial disadvantage to duty payers. Desired outcomes will include:

- the interest rate broadly reflects the interest rates for on-call bank deposits
- duty payers understand how much interest they would be refunded.

22 Monitoring will take place as part of wider monitoring, evaluation and review of the new sanctions regime for incorrect payments.