

Regulatory Impact Statement

Customs and Excise Act Review: Sanctions for incorrect payments – detailed design of a new regime

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by the New Zealand Customs Service (Customs). The analysis has been informed by advice from Inland Revenue (IR) and the Treasury.

This RIS builds on the Preliminary Regulatory Impact Analysis and the Cabinet Economic Growth and Infrastructure Committee's (EGI) subsequent in-principle decisions in March 2016 to introduce a new sanctions regime for incorrect payments [EGI-16-MIN-0037]. It provides an analysis of options for the detailed design of the new regime.

The following are constraints on the analysis:

- It is not possible to anticipate the change in behaviour resulting from the proposals, such as the impact on voluntary disclosure by duty payers of entry errors resulting in a shortfall payment.

The proposals in this RIS assume the following Cabinet and operational decisions will be implemented:

- administrative penalties may be applied to erroneous excise entries, to be concurrent with the implementation of electronic submission of excise entries to Customs;
- enforcement strategy and guidelines to ensure Customs takes a 'fit for purpose' approach to non-compliance.

Signed by Michael Papesch on 8 February 2017

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8 February 2017

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Executive summary

- 1 In March 2016, EGI agreed, in principle, that Customs' additional duty regime should be replaced by a new regime that consists of separate compensation and penalty components. This is fairer and more transparent, because it allows compensation to be pegged to market interest rates, and penalties to be tailored to recognise the different behaviours leading to different types of incorrect payments.
- 2 This RIS provides an analysis of options for the detailed design of compensatory interest and penalties under the new regime. It makes the following recommendations:

Compensation

- that duty payers should pay compensatory interest set at the floating first mortgage rate +250 basis points when they have underpaid duty (IR model);
- that the compensatory interest be partially remitted for shortfall payments and incorrect repayments if the duty payer can demonstrate that the error was inadvertent (based on the Australian Tax Office model);

Penalties

- that a late payment penalty should be imposed at a value of one percent of the unpaid core duty the day after the due date, and four percent of the unpaid core duty the seventh day after the due date (similar to IR's proposed model for income tax, GST and Working for Families tax credit debt);
 - that no new penalties should be introduced for shortfall payments, as Customs' existing range of sanctions is sufficient to deter and punish non-compliance.
- 3 When combined, these recommendations will reduce the effective penalty and compensation rate for a late payment from 33 percent to 13 percent over a year*. For a late payment of \$10,000 outstanding for a year, this would equate to a charge of \$1,325 compared to \$3317. This will still provide incentives to comply, while ensuring that sanctions are proportionate to offending.
 - 4 The recommendations will also reduce the effective interest rate for excise clients who make shortfall payments from 33 percent to 8.27 percent*. However, importers who make shortfall payments will be required to pay compensatory interest, where they currently have no payment obligations. This could result in a drop in voluntary disclosures of shortfall payments, particularly where the importer does not face an administrative penalty.

- 5 Duty payers who provide incorrect information to Customs, resulting in them receiving an incorrect repayment of duty, will be charged compensatory interest of 8.27 percent*, where there currently is no penalty or compensation charged.

Status quo

- 6 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. In 2015/16, Customs collected \$13.180 billion of duty.
- 7 Duty payers are required to correctly self-assess the amount of duty owing on their goods. This information is submitted to Customs on an import or excise entry.¹ Importers often employ customs brokers to make duty assessments and submit import entries on their behalf.
- 8 Duty payers must also pay their duty in full by the due date. For imports, payment is due 20 working days after the import entry is lodged, however most commercial importers use the deferred payment scheme, which allows them to defer payment for three to seven weeks. For excisable goods, payment is due 20 working days after the end of the prescribed timeframe (one, six or twelve months) in which the goods were removed from a Customs Controlled Area for home consumption.
- 9 There are a number of ways that duty might not be paid when it should be:
 - **late payment** – part or all of the assessed duty is not paid by the due date;
 - **shortfall payment** – the amount of duty owing is not calculated correctly. Shortfall payments are usually voluntarily disclosed or discovered through Customs audits, and may remain undiscovered for months or years;
 - **incorrect repayment** – the duty payer provides incorrect information to Customs resulting in them receiving a repayment of duty² that they are not entitled to. This is similar in nature to a shortfall payment.
- 10 Most duty payers meet their obligations and only a small percentage of duty is not paid when it should be:
 - In 2015/16 shortfalls payments totalled \$34,610,903³ – less than one percent of all duty collected;

* Figures based on Inland Revenue compensatory interest rates and Reserve Bank data that was current as at 26 May 2016.

¹ Imports valued less than \$1000 do not require an import entry. As additional duty does not apply in these cases, these imports are not discussed further in this analysis.

² Repayments include refunds, remissions and drawbacks.

- at the end of June 2016, \$7,789,916.31 of assessed duty was outstanding, ie late paid;⁴
- Customs does not collect separate data on the number or amount of incorrect repayments of duty, but anecdotal evidence indicates these are rare.

- 11 It is important that duty is paid in full by the due date, so that the Crown can meet its planned expenditure. Customs employs a range of sanctions to deter and punish late and shortfall payments, and to ensure that the Crown is compensated for loss of use of money on underpaid duty.
- 12 Customs' current sanctions framework combines penalties and compensation for unpaid duty into a single tool, known as additional duty. An initial charge of five percent of the unpaid duty is automatically imposed under the Act on the duty payer the day after the due date, followed by a monthly incremental charge of two percent of any amount remaining unpaid (including both the original debt and any additional duty already imposed). In 2014/15, a total of \$465,494 of additional duty was assessed by Customs.
- 13 Additional duty is applied to importers using the deferred payment scheme⁵ and all excise clients. For excise clients, additional duty is imposed on both late payments and shortfall payments; however, for importers, it is only imposed on late payments. Additional duty is not imposed on incorrect repayments of duty. This following table summarises the instances in which additional duty applies:

	Importers using deferred payment	Excise clients
Late payment	✓	✓
Shortfall payment	✗	✓
Incorrect repayment	✗	✗

Problem definition

- 14 The additional duty regime has been reviewed as part of the Customs and Excise Act Review. A number of problems have been identified, which are addressed in this RIS:⁶

³ This figure includes a small amount of levies, which are not classified as duty. It excludes legitimate updates to provisional values, and a number of large, atypical fuel excise shortfalls.

⁴ Late payment data is only available in the form of a monthly report, which shows the amount of outstanding duty at a single point in time. It is not possible to give a yearly figure for late paid duty. Data from the 2014/15 financial year was not available, so more recent data was utilised.

⁵ Additional duty does not apply to importers who are on cash payment schemes, because they operate on a 'no pay no go' basis. They do not get their goods until they pay the duty that is owed to Customs.

⁶ Some operational issues were also identified with the additional duty regime. For instance, the remissions policy lacks transparency including whether voluntary disclosure of a shortfall will be taken into account. Furthermore, it is difficult to follow up late payments and apply additional duty promptly due to manual systems. These issues will be addressed through non-regulatory measures.

- The compounding, incremental penalty rates can result in debts that are disproportionate to the offending, when accumulated over long periods;
- The additional duty rates (five percent plus two percent compounding) do not distinguish between compensation to the Crown for loss of use of money and penalties, which are intended to punish and deter non-compliance. This obscures the rationale for the rates and means that the compensation component cannot be benchmarked to market interest rates;
- Shortfall and late payments are treated the same, despite being the result of different non-compliant behaviours. Anecdotal evidence indicates that an entry error resulting in a shortfall of duty is often a one-off mistake, usually unintentional. Late payment can be ongoing and is more likely to be intentional;
- The regime does not treat importers and excise clients consistently, even when they deal in competing goods. For example, domestic alcohol producers receive additional duty if they make a shortfall payment, but alcohol importers do not.

Decisions to date

- 15 Earlier in 2016, Customs completed a Preliminary Regulatory Impact Analysis on high-level options for a new sanctions regime for incorrect payments to replace additional duty. The resulting recommendation was to replace additional duty with a regime composed of separate compensation and penalty components, with penalties distinguishing between shortfall errors and late payments.
- 16 This was the preferred option because the separation of compensation and penalties means the rate of compensation will be transparent and can be kept proportionate to market interest rates. It also means that penalties can be tailored to target the different non-compliant behaviours leading to shortfall and late payments.
- 17 In March 2016, EGI agreed to these changes in principle [EGI-16-MIN-0037], subject to approval of the design details of the new regime, including:
 - the nature and level of penalties;
 - the nature and level of the compensatory interest rates .
- 18 This RIS provides an analysis of options for the design of the compensatory interest and penalties components of the new regime for underpayments. Accompanying RISs provide options for compensatory interest in cases of overpayments and provisional valuation updates.

Compensation

Objectives

- 19 Compensatory interest has dual purposes – to compensate the Crown for the cost of not having use of money (due to a late payment, shortfall payment or incorrect repayment), and to incentivise people to pay the right amount of duty at the right time. Compensatory interest is not a penalty.
- 20 The objectives for compensatory interest are to:
 - maximise core duty collected;
 - minimise financial disadvantage to the Crown from underpaid duty;
 - minimise administrative costs for government;
 - remove unnecessary compliance costs for duty payers through consistency with IR, in the treatment of revenue owed to the Crown.

Options

- 21 Normally, when compensatory interest is charged, it would be set at the disadvantaged party's cost of loss of use of money. In the Crown's case, this would be the interest rate that could have been earned if the unpaid duty had been deposited in the bank – two to three percent under current market conditions.
- 22 However, setting the compensatory interest rate at this level would not achieve the objective of maximising core duty collected, because it would be lower than the commercial lending rates available to duty payers. This means that duty payers would have an incentive to defer payment of duty as a cheaper alternative to getting a commercial loan, making the Crown an involuntary lender.
- 23 The population of duty payers includes a wide range of different businesses, some with a higher cost of finance than others. In order to prevent the Crown from becoming an involuntary lender, the compensation rate must reflect the highest cost of finance across the duty payer population. It must also include a margin on top of the cost of finance to take account of the volatility of interest rates and the practical difficulties in changing rates quickly and frequently to accommodate such volatility. The options discussed below take these considerations into account.
- 24 Customs has considered the following options for a compensatory interest rate. Compensatory interest will be charged to importers using the deferred payment scheme and all excise clients when they make a late payment, shortfall payment, or receive an incorrect repayment.

Option 1: floating first mortgage rate + 2.5%

- 25 The rate would be based on the floating first mortgage rate, published by the Reserve Bank of New Zealand (RBNZ) plus 2.5 percent. The floating first mortgage rate is the average of the advertised standard, floating first mortgage interest rates offered by banks to new borrowers for residential property.
- 26 This would mirror IR's Use of Money Interest rate, which is fixed for an indefinite period, but updated when necessary due to changes in market conditions. At 26 May 2016 IR's rate was 8.27%. Customs would reset the rate annually in line with IR.

Option 2: SME overdraft rate

- 27 The rate would be based on the small to medium-sized enterprise (SME) overdraft rate, published by RBNZ. The SME overdraft rate is the base interest rate for new overdraft loans for SME no-farm enterprises. At 26 May 2016 it was 9.27 percent.
- 28 This rate was considered because SMEs generally have the highest cost of finance across the population.
- 29 The rate would be fixed for an indefinite period, but updated when necessary due to changes in market conditions.

Option 3: 90-day bank bill rate + 5.75%

- 30 The rate would be based on the 90-day bank bill rate, published by RBNZ, plus 5.75 percent. The 90-day bank bill rate is a market interest rate that is a common benchmark for many financial products in New Zealand, and reflects the rate of return available on bank deposits. At 26 May 2016, this would have resulted in a total compensatory interest rate of 8.14 percent.
- 31 The 90-day bank bill rate is representative of the Crown's cost of loss of use of money. It has been used previously by IR as a basis for their compensatory interest rate for unpaid tax.
- 32 The rate would be fixed for an indefinite period, but updated when necessary due to changes in market conditions.

Comparison against objectives

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

Key: ✓ x partially meets the criteria ✓✓ meets the criteria xx doesn't meet the criteria

	Maximises core duty collected	Minimises financial disadvantage to the Crown	Minimises administrative costs for Customs	Removes unnecessary compliance costs for duty payers through consistency with IR in the treatment of revenue owed to the Crown	Total
Option 1: floating first mortgage rate + 2.5% (=8.27%)			✓✓ Administrative costs are low. Customs would simply update the compensatory interest rate in line with IR.	✓✓ Rate is consistent with IR. Businesses would not have to understand and operate two separate regimes.	4
Option 2: SME overdraft rate (=9.27%)	All options perform equally against this objective. The rates are all set high enough to discourage duty payers from deferring payment of duty and using the Crown as an involuntary lender.	All options perform equally against this objective. The rates would all result in the Crown being overcompensated for loss of use of money.	✓ x Overall, administrative costs would be low. However, some minimal extra resources would be required to monitor market conditions and determine when a review of the rate is necessary.	xx Rate is not consistent with IR. Businesses would have to understand and operate two separate regimes.	1
Option 3: 90-day bank bill rate + 5.75% (=8.14%)			✓ x Overall, administrative costs would be low. However, some minimal extra resources would be required to monitor market conditions and determine when a review of the rate is necessary.	xx Rate is not consistent with IR. Businesses would have to understand and operate two separate regimes.	1

Impact analysis

- 34 The table below compares the financial impacts of the options based on an underpayment of \$10,000 core duty. The cumulative impact of the compensatory interest imposed on a duty payer is given at seven days overdue through to one year overdue. The difference between options one and three would be small.

	+7 days	+31 days	+93 days	+365 days
Option 1: Floating first mortgage + 2.5% (=8.27%)	\$14	\$68	\$208	\$825
Option 2: SME overdraft (=9.27%)	\$15	\$76	\$234	\$925
Option 3: 90-day bank bill + 5.75% (=8.14%)	\$13	\$67	\$205	\$812

Penalties

Objectives

- 35 The purpose of penalties is to punish and deter the non-compliant behaviour that leads to underpayments of duty. EGI has agreed that penalties will distinguish between late payments and shortfall payments [EGI-16-MIN-0037].
- 36 The objectives for penalties are to:
- maximise core duty collected;
 - minimise administrative costs for Customs;
 - remove unnecessary business compliance costs through consistency with IR, in the treatment of revenue owed to the Crown.

Late payment penalty – options and impact analysis

- 37 The following options have been considered for a penalty to be charged to importers using the deferred payment scheme and all excise clients who make a late payment.

Option 1: 1% + 4%

- 38 This option applies a penalty of one percent of the unpaid duty the day after payment was due, and a further four percent of the duty remaining unpaid on the seventh day after payment was due.
- 39 This mirrors the IR model, except, unlike IR, Customs' penalties would not compound. This is because the difference of 0.04 percent of the total debt is insignificant and would not have any effect on compliance. The difference in revenue may be more significant for IR, given the much larger base of tax payers.

Option 2: 1%

- 40 This option applies a one-off penalty of one percent of the unpaid duty on the day after payment was due. This option was suggested by stakeholders.

Option 3: No penalty

- 41 This option does not apply any penalty. It relies on the rate of compensatory interest for underpayments being set high enough to also act as a penalty for late payment.

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

Key: ✓ **x** partially meets the criteria ✓✓ **meets the criteria** **xx** **doesn't meet the criteria**

	Maximises core duty collected	Minimises administrative costs for Customs	Remove unnecessary compliance costs for duty payers through consistency with IR, in the treatment of revenue owed to the Crown	Total
Option 1: 1% + 4%	<p>✓✓</p> <p>Provides strong incentives to pay duty on time. The lower penalty on the first day recognises that duty that is outstanding at this stage is more likely to be the result of accidental oversight. For those who are intentionally deferring duty payment, the higher penalty on the seventh day provides an incentive to pay promptly. IR research found that penalties are most effective in the first few weeks after the due date, and have less effect on compliance after that window of opportunity.⁷</p>	<p>✓ x</p> <p>A small amount of resource (less than one FTE) would be required to calculate and notify penalties. However, less resource would be required if planned upgrades to Customs' financial management system include automation of penalty charges.</p>	<p>✓✓</p> <p>Penalty is consistent with IR. Businesses would not have to understand and operate two separate regimes.</p>	5
Option 2: 1%	<p>✓ x</p> <p>Provides some incentive to pay duty on time, and likely to be effective for the majority of duty payers who want to be compliant. However, for those who are at risk of deliberately deferring payment, incentives to comply would likely be insufficient.</p>	<p>✓ x</p> <p>A small amount of resource (less than one FTE) would be required to calculate and notify penalties. However, less resource would be required if planned upgrades to Customs' financial management system include automation of penalty charges.</p>	<p>xx</p> <p>Penalty is inconsistent with IR. Businesses would have to understand and operate two separate regimes.</p>	2
Option 3: no penalty	<p>✓ x</p> <p>There is no incentive to pay on time in the form of penalties. However, the application of compensatory interest means that there is a cost to not paying on time, and this should provide some incentive to comply.</p>	<p>✓✓</p> <p>No resource requirements.</p>	<p>xx</p> <p>Penalty is inconsistent with IR. Businesses would have to comply with two separate regimes.</p>	3

⁷ Inland Revenue (2015). Identifying Sanctions Thresholds Among SME Tax Debtors: An Overview.

- 43 The table below compares the financial impact of the options based on a late payment of \$10,000 core duty. Under option one, the cumulative effect of a penalty imposed on a duty payer seven days after the payment is not paid in full is \$500; for option two it would be \$100. None of the options impose a penalty after day seven of non-payment.

	+ 1 day	+7 days	+31 days
Option 1: 1% + 4%	\$100	\$400	–
Option 2: 1% (one-off)	\$100	–	–
Option 3: Use existing sanctions	–	–	–

- 44 There may also be costs to customs brokers if their insurance does not cover situations where importers seek indemnity from brokers for penalties imposed.

Shortfall payment penalty

- 45 Customs already has a tool to penalise errors made on goods entries, including those leading to a shortfall payment. This is the administrative penalty regime. Administrative penalties are charged at the greater of \$200 or an amount equal to:

- 20 percent of the unpaid duty where the person did not take reasonable care;
- 40 percent of the unpaid duty where the person was grossly careless;
- 100 percent of the unpaid duty where the error was made knowingly.

- 46 Currently, Customs does not apply administrative penalties to excise entries, due to operational considerations. However, Customs intends to start applying administrative penalties to excise entries when excise clients are required to submit entries electronically under the future application of the Joint Border Management System.

- 47 Although there are some situations in which administrative penalties cannot be applied for a shortfall (such as when a customs broker submitted the erroneous import or excise entry, but relied in good faith on information provided by the duty payer), a range of effective non-monetary sanctions are available in these cases. These include prosecution, detention of future imports for a document audit or inspection, and suspension of privileges.

Consultation

- 48 Public consultation was undertaken on the Customs and Excise Act Review discussion paper from March to May 2015 with 16 of the 91 submissions received commenting on additional duty.
- 49 Further consultation was undertaken in early 2016 on high-level options for a penalty and compensatory interest regime. These comments are summarised in the Preliminary Regulatory Impact Analysis accompanying the Cabinet proposals.

- 50 In May 2016, a stakeholder workshop discussed proposals for a detailed design of a penalty and compensatory regime. Comments received included:
- support for a combined compensatory interest and late payment penalty rate that is significantly lower than the current additional duty rate;
 - the recommended underpayment compensatory interest rate (8.27 percent) was considered too punitive by some stakeholders, and seen as a double penalty when combined with a late payment penalty;
 - consistency with IR and certainty of rates were seen as important by some stakeholders;
 - penalties and compensatory interest should not be compounding;
 - when compensatory interest is imposed, any payments should first go towards repaying the principal;
 - any internal policies relating to the application of penalties or compensatory interest should be made public to ensure consistency and transparency.
- 51 A draft RIS has been circulated to stakeholders, including major accountancy firms, importers and excise clients. Feedback from stakeholders was generally supportive of the proposed changes, noting that the proposed regime is fairer and generally consistent with IR.

Conclusions and recommendations

Compensation

- 52 The recommended option for a compensatory interest rate in the new sanctions regime is the floating first mortgage rate plus 2.5 percent. This rate is high enough to remove incentives for duty payers to use the Crown as an involuntary lender. It also reduces compliance costs for duty payers, as it mirrors IR's Use of Money Interest.
- 53 Customs also intends to provide for compensatory interest to be adjusted down to a rate reflecting the Crown's loss of use of money for shortfall payments and incorrect repayments if the duty payer can demonstrate that the error was inadvertent.
-
- 54 This is because anecdotal evidence indicates that the majority of shortfall payments and incorrect repayments are made due to an unintentional error that was not known to the duty payer at the time. In these cases, the duty payer has not had the opportunity to make a deliberate decision to use the Crown as an involuntary lender, removing the need to increase the interest rate above the Crown's cost of loss of use of money.

Penalties

- 55 The recommended option for a late payment penalty in the new sanctions regime is one percent of the unpaid duty the day after payment was due, and a further four percent of the duty remaining unpaid on the seventh day after payment was due. This will provide strong incentives for duty payer to pay promptly, within the timeframe that penalties are most effective. It also reduces compliance costs for duty payers, as it mirrors IR's proposed late payment penalty for income tax, GST and Working for Families tax credit debt.
- 56 It is also recommended that the Act include a grace period for late payment penalties to recognise that even duty payers with good payment records make occasional genuine mistakes. This would apply to duty payers who have not made any late payment in the past two years, and would allow them to avoid the late payment penalty if the outstanding duty is paid in full by a month after the original due date. This is consistent with IR's policy.
- 57 Customs has not considered any options for a new shortfall payment penalty because administrative penalties are an effective and fit for purpose tool to discourage shortfall payments.

Summary of proposed regime

- 58 The proposed regime will address the problems identified in paragraph 14 by:
- Reducing the combined compensation and penalty rates to a level that is more proportionate to offending and more manageable for businesses.
 - Clearly distinguishing between compensation to the Crown for loss of use of money and penalties to punish and deter non-compliance.
 - Distinguishing between late and shortfall payments through different penalty regimes, ie late payment penalty for late payments and administrative penalties for shortfall payments.
 - Applying compensation and penalties consistently across both importers and excise clients.
- 59 The way that the proposed compensation and penalties will impact duty payers when they make late payments, shortfall payments and receive incorrect repayments is outlined below.

Late payments

- 60 When a duty payer makes a late payment, they will receive a late payment penalty of one percent of the unpaid duty the day after payment was due, and a further four percent of the duty remaining unpaid on the seventh day after payment was due. They will also be charged compensatory interest for each day that the duty remains unpaid, set at the floating first mortgage rate plus 2.5 percent.

- 61 This means that duty payers will face an effective combined penalty and interest rate of 13 percent*, as opposed to 33 percent under additional duty.
- 62 The following table shows a comparison of the financial impact of the proposed regime and the additional duty regime based on a late payment of \$10,000 core duty.

	+1 day	+7 days	+31 days	+93 days	+365 days
Additional duty	\$500	\$500	\$924	\$1147	\$3317
Proposed regime	\$100	\$514	\$638	\$708	\$1325

Shortfall payments

- 63 When a duty payer makes a shortfall payment, the person who made the shortfall error on the goods entry may receive an administrative penalty of 20, 40 or 100 percent of the duty shortfall, depending on culpability. The duty payer will also be charged compensatory interest for each day that the duty was unpaid. This will be set at the floating first mortgage rate plus 2.5 percent, but partially remitted if the duty payer can demonstrate that the error was inadvertent.
- 64 This means that excise clients will face a charge of 8.27 percent* (prior to any remission) over a year and a possible administrative penalty, as opposed to a 33 percent charge under additional duty⁸. However, for importers this means imposing a cost of 8.27 percent where previously no additional duty was applied.
- 65 The following table shows a comparison of the financial impact of the proposed regime and the additional duty regime based on a shortfall payment of \$10,000 core duty.

		+7 days	+31 days	+93 days	+365 days	Administrative penalty
Additional duty	Importers	-	-	-	-	May be applied - \$2000-10,000
	Excise clients	\$500	\$924	\$1147	\$3317	Currently not applied
Proposed regime	Both importers and excise clients	\$14	\$68	\$208	\$825	May be applied - \$2000-10,000

- 66 Introducing compensatory interest for importers where there previously was none may result in a decrease in voluntary disclosures. It is not possible to identify the volume of shortfall payments that are voluntarily disclosed on imports, however it will be less than the total volume of shortfall payments on imported goods, which in 2015/16 was \$30,413,905.⁹

* Figures based on Inland Revenue compensatory interest rates and Reserve Bank data that was current as at 26 May 2016.

⁸ Note that the planned introduction of administrative penalties for export entries is happening independently of any changes proposed in this paper.

⁹ This figure includes a small amount of levies, which are not classified as duty. It excludes legitimate updates to provisional values.

Incorrect repayments

- 67 When a duty payer receives an incorrect repayment of duty, they will be charged compensatory interest for each day that the duty was unpaid. This will be set at the floating first mortgage rate plus 2.5 percent, but partially remitted if the duty payer can demonstrate that the error was inadvertent.
- 68 This means that duty payers will face a charge of 8.27* percent (prior to any remission) over a year, where previously no additional duty was applied.
- 69 The following table shows a comparison of the financial impact of the proposed regime and the additional duty regime based on an incorrect repayment of \$10,000 core duty.

	+7 days	+31 days	+93 days	+365 days
Additional duty	-	-	-	-
Proposed regime	\$14	\$68	\$208	\$825

Implementation plan

- 70 The proposals in this paper would be included in the Customs and Excise Bill, which is currently before the Foreign Affairs, Defence and Trade Committee. The changes 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.
- 71 The Financial Management Information System (FMIS) that Customs uses to administer duties is to be upgraded and the ability to automatically calculate penalties and interest will be scoped as part of this upgrade. The cost of configuring this is being scoped.
- 72 As part of the FMIS system upgrade scoping, timely notification of penalties and compensation will be explored, including options for communicating with clients electronically.
- 73 Guidelines will be developed, setting out the detail of how remissions policy for compensatory interest and late payment penalties should be applied. These guidelines will be made publicly available.
- 74 The minimum personnel costs for implementation and operational delivery for the period 2017/18 to 2019/20 are \$956,000, to be covered through baseline funding. These estimated costs will apply regardless of which compensatory interest and penalty options are chosen. They cover:
- two FTEs for six months to review data to establish baseline data
 - programme management and overhead funding of the operational delivery

* Figures based on Inland Revenue compensatory interest rates and Reserve Bank data that was current as at 26 May 2016.

- client awareness campaign and guidance material on the changes
- operational guidance and training for Customs staff
- one extra FTE to manage the ongoing administration of the new regime.

75 An enforcement strategy and guidelines will also be established to guide Customs staff to select an enforcement response that reflects the culpability and the seriousness and pattern of non-compliance. Enforcement responses include warnings, penalties and prosecution.

Monitoring, evaluation and review

76 Monitoring would measure the objective of *maximise core duty collected* and that the new regime is addressing the legislative and policy problems that were identified. Desired outcomes will include:

- duty payers understand penalties and compensation will apply if they fail to comply
- the volume of duty exposed to penalties and compensation reduces over time
- the average period of debt reduces over time
- non-compliance is addressed in accordance with the enforcement strategy and guidance.

77 Specific measures and any new data required to monitor and evaluate the new regime are still to be identified. These could include:

- the volume of voluntary disclosure of errors by duty payers
- minimum percentage of revenue that is collected by the due date (the current standard is 98%, which will be reported against in Customs' annual report for 2016/17).