

## Regulatory Impact Statement

### Customs and Excise Act Review: Flexibility and discretion in making and correcting assessments

#### Agency Disclosure Statement

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

It provides an analysis of regulatory options to address a lack of transparent flexibility in assessing and collecting duty.

The following are constraints on the analysis:

- As little data is available and it is not clear whether a discretion would have been applied to recent cases where businesses failed to make assessments, this analysis is based on qualitative comparisons.

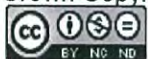


*Signed by Terry Brown on 10 November 2015*

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## Executive summary

1. Businesses self-assess the duty they owe Customs; where clients are non-compliant or assess incorrectly Customs can make or correct assessments. Customs has an implicit discretion to settle or compromise in collecting disputed duty.
2. Customs' discretion in making and correcting assessments is unclear, uncertain and unduly restrictive. In some circumstances it can result in businesses being treated inequitably.
3. Customs' discretion in collecting duty is not explicit and is not subject to explicit constraints; this risks its use being mis-perceived as lacking integrity. Customs cannot compromise or settle in advance of a formal dispute, resulting in lengthier and more costly litigation for all parties.
4. This analysis concludes that the Chief Executive of Customs should have a statutory discretion applying to making or correcting assessments and collecting the duty thereby identified, based on ss.6 and 6A of the Tax Administration Act (TAA) with adjustments to fit the customs context:
  - the Chief Executive shall at all times use his or her best endeavours to protect the integrity of the customs revenue system;
  - the Chief Executive shall be charged with the care and management of the revenue collected under customs legislation;
  - in collecting revenue the Chief Executive shall collect over time the highest net revenue practicable within the law having regard to:
    - other Government objectives in imposing the tax or charge;
    - the importance of promoting compliance, especially voluntary compliance, by all revenue payers;
    - the resources available to the Chief Executive;
    - businesses' compliance costs;
    - the resource needs of Customs' wider border management responsibilities.
5. In line with the TAA, decisions made pursuant to the discretion would be deemed to be correct and any dispute would be referred to the Customs Appeal Authority, in line with the current Act.
6. This discretion would provide flexibility and improve efficiency while still improving certainty and transparency and providing assurance that the integrity of Customs' revenue system would not be undermined.
7. The new customs legislation will need to continue Customs' existing power and discretion under s.61 to amend values in assessments. In addition, Customs' practice, where appropriate, of making bulk corrections, rather than amending each assessment, will also continue.



**Status Quo**

8. Under the Customs and Excise Act 1996<sup>1</sup> Customs collects duty<sup>2</sup> when goods are imported or when goods subject to excise (alcohol, tobacco and fuel) are manufactured and enter the market. Importers and excise-subject businesses are required to self-assess the duty they owe and advise Customs through an entry (assessment).
9. Customs' clients do make assessments and for the most part these are accurate. However, where necessary Customs can amend assessments either to correct value (s.61) or duty (s.89). Customs corrects approximately 16,000<sup>3</sup> entries a year. Where appropriate, Customs has administrative flexibility to make bulk corrections rather than amend each individual assessment. This is more efficient. Customs cannot amend an entry to increase the duty owing more than four years from when the original assessment was made unless the entry was fraudulent or wilfully misleading. Where the entry, contains an error or omission that results in duty being under-paid or the entry being materially incorrect, Customs may impose a penalty, referred to as an administrative penalty.
10. Customs can make an assessment on the rare occasions that a client fails to do so. The table below sets out indicative provisions and associated explicit and specific discretions.

Section	Context in which Customs can make an assessment	Discretions and exceptions
83	Non-compliance with the conditions of an approval to use excise-free alcohol for particular purposes	The Chief Executive must remit or refund the duty if satisfied that the non-compliance was neither intentional nor negligent
84	Reasonable suspicion of non-compliance with the conditions for personal use (excise-free) of beer and wine	
88	There is reasonable cause to suspect an assessment has not been made for dutiable goods.	The Chief Executive may assess the duty at such amount as the Chief Executive thinks proper

11. There is no statutory time limit applying to these sections.

12. 

13. 

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<sup>1</sup> All references to legislation in this document refer to this Act unless otherwise stated

<sup>2</sup> Duty includes excise duty and excise-equivalent duty, tariff duty, safeguard duties, dumping and countervailing duty, GST, the ACC levy and the Petroleum Engine Fuel Monitoring Levy.

<sup>3</sup> Including where values were uncertain at import and the correct duty is collected using Customs' uplift scheme.



## Problems

### *The need for discretion*

14. In principle, Customs should assess and collect all duty payable, treating all taxpayers consistently, providing a level playing field for businesses and encouraging voluntary compliance. However, on rare occasions making and correcting an assessment and collecting the duty thereby identified would not be desirable; ie where:
  - Customs suspects that a class of businesses have failed to correctly assess but considers it more productive to agree a basis for future payment than audit each business to identify any additional past revenue owing.
  - The cost would exceed the revenue gained, including future revenue.
  - The integrity of Customs' revenue system would be called into question or
  - Making an assessment would unduly impact on businesses' compliance costs, Customs' resources or wider border management responsibilities.
15. Customs' revenue system must be perceived as having integrity; it relies on voluntary compliance. This is more likely where processes are reasonable and do not impose unnecessary compliance costs.

### *Problems with existing discretions*

16. The customs legislation is being modernised; this is an opportunity to address the following problems.

#### **The legislation is not transparent and is uncertain**

17.



#### **The extent of the discretion is insufficient**

18.



#### **The restrictive nature of the discretions is not efficient**

19. Customs cannot exercise its implicit discretion to compromise and settle in collecting duty in advance of a formal dispute. This may mean that differences over duty may have to advance to formal litigation processes, resulting in lengthier and



more costly litigation for both parties. It can also damage relationships, discouraging voluntary compliance.

**Customs' existing discretion over collecting duty is not explicit and clearly constrained**

20. Customs' discretion over collection is implicit and consequently not subject to clear statutory duties and constraints. Its use could result in mis-perceptions that the revenue system and Customs lack integrity.

*Contrast with the Tax Administration Act*

21. In contrast ss.6 and 6A of the TAA provide Inland Revenue with an explicit but bounded discretion over the tax system which can be viewed as operationalising New Zealand's tax principles as applied to discretion. (See annex for full text.) Those sections provide for maximising net revenue over time subject to resources, promotion of voluntary compliance and compliance costs. This discretion operates in conjunction with duties to protect the integrity of the tax system and take care of and manage the revenue.

## Objective

22. The objective is for Customs to have clear and transparent flexibility and discretion in making and correcting assessments and collecting the revenue identified so that it can administer the revenue system efficiently and take account of differing situations. However, that flexibility and discretion needs to be provided in a way that gives assurance that it cannot be mis-used to undermine the integrity of Customs' revenue system.
23. Customs applied the following criteria to assess the options:
  - **Transparency:** The law must be transparent, easily understood and predictable.
  - **Certainty:** Both Customs and clients need certainty over their respective obligations and the extent of any discretion. Certainty is fundamental to the integrity of Customs' revenue system. Improving the transparency of the law and explicit constraints on discretion both contribute to certainty.
  - **Efficiency:** Customs needs to be able to administer its revenue system efficiently so as to keep administrative and compliance costs within reasonable levels.
  - **Flexibility:** Customs needs flexibility to be able to respond to a range of occasional or unforeseen situations.
  - **Provides assurance over integrity:** Discretion needs to be provided in a way that recognises Parliament's control over taxation, aligns with tax principles, and provides assurance that the integrity of Customs' revenue system is not being undermined.



*Discussion of criteria:*

24. Tax collection must be lawful. Customs cannot ignore the law, nor in the absence of a clear discretion, fail to make or correct an assessment.
25. There are tensions within the criterion of fairness: using discretion in collecting duty from a business which acted in good faith may be thought fair by the business but not by competitor businesses. The balance of fairness to individuals versus fairness to taxpayers as a whole, needs to be weighed-up in the context of the particular instance, hence the need for flexibility.
26. There are trade-offs between the flexibility and other criteria. This tension can be mitigated by making Customs' discretion explicit and bounded by explicit duties and considerations.

## **Options and impact analysis**

27. Customs considered the three options below.

*Options:*

1. Option One - Status quo
2. Option two - A bounded discretion in making and correcting assessments and collecting the duty identified
3. Option three - Unbounded discretion in making and correcting assessments and collecting the duty identified.

*Options not included in this analysis*

28. Some options have been excluded from this analysis for the following reasons:
  - A general discretion over the revenue collection system as a whole was not included as the need for such a wide discretion has not been demonstrated.
  - A four year time limit on making assessments could have been gamed so as to undermine the integrity of the revenue system.
  - Separate discretions could be provided for making assessments, correcting assessments, and collecting duty, however, there is no rationale for applying different criteria to the discretions.

*Option one: Status quo*

29. The discretions in making and correcting assessments are unclear, uncertain and narrow. The discretion is therefore difficult to use and businesses with good long-term records may be penalised relative to others.
30. The administrative and compliance costs of the status-quo are not known. But it clearly could incur avoidable litigation costs for both Customs and businesses as they cannot settle prior to entering into a formal dispute, even where they know they intend to. Businesses' litigation costs are unknown but are expected to be



## **IN-CONFIDENCE Unclassified**

significant. Customs external costs for the last completed litigation over the making of an assessment were \$370,000. Internal costs would also have been significant.

31. The implicit discretion over collection is governed by the purposes of the Act. What this means in practice is not clear to lay readers. As it is implicit, the discretion lacks statutory duties and constraints which could give assurance that its use would not undermine the integrity of the revenue system.

*Option two: A bounded discretion in making and correcting assessments and collecting the duty identified (preferred)*

### **Form of discretion**

32. The Act could be amended to give Customs explicit discretion in collecting the revenue identified in making and correcting assessments, constrained by statutory duties and considerations:
  - a duty to care for and manage the revenue collected by Customs, including collecting over time the highest net revenue practicable within the law;
  - a duty to use best endeavours to protect the integrity of Customs' revenue system, so that it is seen as cost-effective in collecting revenue and fair, requiring all clients to pay the revenue owing except in limited and predictable circumstances;
  - a requirement to take into account: other Government objectives in imposing the tax or charge, the resources available, the importance of promoting compliance, compliance costs and the resource needs of Customs' wider border management responsibilities.
33. This discretion is based on ss.6 and 6A of the TAA with two additions: Government's objectives in imposing the tax and the resource needs of wider border management. Some of the revenues Customs collects have a purpose additional to revenue-raising; eg excise can reduce social harm. Also, it is not intended to give revenue collection priority over Customs' wider border management functions. The relative priority between revenue collection and other functions will fluctuate according to changing events and risks.

### **Transparent and certain flexibility**

34. This option would provide a clear and certain discretion. Not only is the discretion and its associated constraints explicit, ss.6 and 6A of the TAA have existed for some time and have associated case law.
35. While Customs would continue to be required to make assessments where there was clear evidence that a business had failed to do so and that the revenue to be gained would exceed costs; it would still have flexibility not to make or correct assessments where there was insufficient information or the costs would exceed revenue. In addition Customs could:
  - better respond to occasional and unforeseen situations;



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- limit the numbers of years for which it made or corrected assessments avoiding individual businesses being treated differently on account of their record-keeping;
- opt not to make or correct assessments where it suspected that a class of businesses had failed to correctly assess but Customs considered it more productive to agree a basis for future payment than audit each business to identify any additional past revenue owing;
- distinguish between clients whose failure or error was a genuine mistake and those acting in bad faith, so as to encourage future voluntary compliance;
- settle prior to entering into a formal dispute, avoiding unnecessary litigation costs for it and the business involved.

### Improved assurance over integrity

36. This option best provides assurance over the integrity of Customs' revenue system through the incorporation of statutory duties and constraints. Further, it is proposed that any disputes over the use of the discretion could be referred to the Customs Appeal Authority in line with the current Act. The right to appeal is an additional integrity safeguard.

### Improved efficiency

37. Customs' day to day administrative costs will not change significantly. Customs rarely makes assessments and already has discretion not to where there is insufficient information or the costs would exceed the revenue gained. Customs would be able to avoid litigation costs in instances where it and the business both intend to settle.
38. Businesses tax liability will not change, nor will their day to day compliance costs. Like Customs they could avoid litigation costs.

### Impact on level of revenue collected

39. It is difficult to predict the level of core duty involved. The past is an unreliable guide as Customs so rarely makes assessments. In any case, it is not clear whether Customs would have used discretion in those cases. The level of revenue collected would not necessarily fall. Exercise of the discretion would be bounded by statutory duties and considerations, meaning it would likely be exercised sparingly. Customs already has discretion over collecting revenue.

### *Option three: Unbounded discretion in making and correcting assessments and collecting the duty identified*

40. This option would improve flexibility and efficiency as in option two. However, the scope of the discretion would be less clear and certain as it would lack statutory duties and constraints so its application would not be informed by the case law applying to ss.6 and 6A of the TAA.
41. In addition, the lack of statutory duties and constraints would not provide assurance that the discretion could not be mis-used to undermine the integrity of the revenue system.



*Summary of options*

42. The table below summarises the comparison of the options.

- Key: ✓✓ Meets the criterion  
 ✓✗ Partially meets the criterion.  
 ✗✗ Does not meet the criterion.

	<b>Option 1: status quo</b>	<b>Option 2: bounded discretion (preferred option)</b>	<b>Option 3: unbounded discretion</b>
<b>Transparency</b>	✗✗ Discretion is unclear or implicit	✓✓ A transparent discretion with stated constraints.	✓✗ A transparent discretion with implicit constraints.
<b>Certainty</b>	✗✗ Some discretions are uncertain	✓✓ Certainty would be maximised.	✓✗ The discretion would be certain but not its application.
<b>Efficiency</b>	✗✗ Customs incurs unnecessary administrative costs.	✓✓ Reduced administrative costs: Customs need not assess for all years and can avoid litigation. Businesses could avoid litigation; otherwise their compliance costs would be unchanged.	✓✓ Reduced administrative costs: Customs need not assess for all years and can avoid litigation. Businesses could avoid litigation; otherwise their compliance costs would be unchanged.
<b>Flexibility</b>	✗✗ Customs discretion in making assessments is difficult to exercise. Businesses may be treated inequitably.	✓✓ Customs would have flexibility.	✓✓ Customs would have flexibility.
<b>Assurance over integrity</b>	✗✗ Poor transparency and no explicit constraints risk misperceptions that integrity is being undermined.	✓✓ An explicit discretion with statutory constraints would give assurance that the discretion could not be misused.	✗✗ The discretion would not be subject to explicit statutory duties and constraints.
<b>Conclusion</b>	Does not meet the criteria.	Meets the criteria. This is the preferred option.	Meets some criteria.

43. Both options for additional discretion would improve flexibility and efficiency but a bounded discretion is preferred as it gives greater transparency and certainty and provides more visible assurance that the discretion will not undermine the integrity of Customs' revenue system.

*Avoiding unintended consequences*

44. It is important that granting Customs explicit discretion over making and correcting assessments and collecting duty not affect Customs' ability to make bulk corrections; it will not.

45. Also, s.61 will continue to need a separate discretion. Government has approved a regime whereby certain importers, in certain circumstances, can enter provisional values and later adjust the values when they become certain [EGI-15-MIN-0088]. To ensure this flexibility is not abused and all due revenue is collected, Customs needs the ability to refuse to adjust valuations, which do not meet the criteria for the adjustment regime.



*Applying the discretion*

46. It is not intended that the discretion should operate to provide an additional or alternative avenue to challenge the correctness or validity of assessments. In line with the TAA, it is proposed that the Act confirm that any assessments made pursuant to the discretion be deemed to be correct and any disputes arising in relation to the discretion be referred to the Customs Appeal Authority in line with the current Act.

*Impacts*

47. The preferred option would have the following impacts on revenue clients and Customs as compared to the status quo.

<b>Impact on:</b>	<b>Comment</b>	<b>Scale of impact</b>
<b>Customs: administration costs</b>	<i>Better:</i> Customs would have clear flexibility not to make assessments where it will not be cost-effective	Minor: assessments are rarely made
<b>Business: tax liability</b>	<i>Neutral:</i> The tax will still be owed and Customs already has discretion in collecting duty in formal disputes	None
<b>Business and Customs: litigation costs</b>	<i>Better:</i> Litigation can be avoided where both parties intend to settle	Customs: \$370,000 <sup>4</sup> Business: unknown but positive
<b>Business: compliance costs</b>	<i>Neutral:</i> The requirement for businesses to self-assess duty will remain.	None
<b>Customs and the Crown: Revenue collected</b>	<i>Neutral:</i> The level of Crown revenue collected would not necessarily fall. The exercise of the discretion would be bounded by statutory duties and considerations, meaning it would likely be exercised sparingly. Customs already has discretion over collection.	None
<b>Public: Confidence in integrity of revenue system</b>	<i>Better:</i> Customs discretion is better understood and the duties and considerations to which it is subject will provide assurance	Public acceptance and compliance with the revenue system is vital to its operation.

*Recommended options:*

48. From the above analysis, Customs concludes that the preferred option should have the following elements:

- Customs should have explicit and clear discretion in exercising its power to amend valuations under section 61;
- the Chief Executive of Customs should have an explicit statutory discretion applying to making and correcting assessments and collecting the duty thereby identified and the discretion be based on section 6 and 6A of the TAA adjusted to fit the customs context as indicated below:

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- the Chief Executive shall at all times use his or her best endeavours to protect the integrity of the tax system;
- the Chief Executive shall be charged with the care and management of the revenue collected under customs legislation;
- in collecting revenue the chief executive shall collect over time the highest net revenue practicable within the law having regard to:
  - other Government objectives in imposing the tax or charge;
  - the importance of promoting compliance, especially voluntary compliance, by all revenue payers;
  - the resources available to the Chief Executive;
  - businesses' compliance costs;
  - the resource needs of Customs' wider border management responsibilities;
- that decisions made by the Chief Executive pursuant to the discretion are deemed to be correct and that any dispute arising in relation to the correctness or validity of the decision will be referred to the Customs Appeal Authority in accordance with the current provisions of the Act;
- should not affect Customs' ability to make bulk corrections rather than amend each individual assessment.

## **Consultation**

49. The public was consulted on question: "Do you think managerial discretion should be explicitly added to the Customs and Excise Act, similar to that provided for in the Tax Administration Act 1994?" Eighteen stakeholders commented and all but three indicated support although some sought a more extensive discretion to reduce the amount of revenue owing and to make decisions "right in circumstance, even if wrong in law". An industry stakeholder workshop on 26 June 2015 supported Customs' having a general discretion in order to promote economic growth and facilitate trade, but did not consider it a priority. Customs also consulted a Senior Officials Advisory Group and a Stakeholder Reference Group on the proposal for a general Chief Executive's discretion<sup>5</sup>. More recently the Customs Brokers and Freight Forwarders Federation of NZ confirmed that they support discretion subject to guidance making its operation transparent.

## **Implementation**

50. Legislative changes will be given effect through the new, modernised customs legislation already approved by Cabinet [EGI-15-MIN-0092 refers].

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<sup>5</sup> Members of the Senior Officials Advisory Group include: the Ministry for Primary Industries, the Ministry of Business, Innovation, and Employment, New Zealand Police, the Ministry of Transport, Inland Revenue and the Department of the Prime Minister and Cabinet. The Stakeholder Reference Group included representatives from the Importers' Institute, NZ Shippers' Council, Port CEO Forum, New Zealand Airports Association, Business New Zealand / Export New Zealand, Board of Airline Representatives NZ, International Container Lines Committee, Customs Brokers and Freight Forwarders Federation of NZ, the Conference of Asia Pacific Express Carriers, and Shipping New Zealand.



51. If Parliament grants greater discretion over the making and correcting of assessments and the collection of duty identified, Customs will develop a process to explicitly apply the relevant duties and considerations to its decision-making. Exercise of the discretion would be restricted to the Chief Executive.
52. Legislative changes would be communicated to stakeholders as part of a wider communication plan for the re-drafted Act and wider Customs and Excise Act Review amendments.

### **Monitoring, evaluation and review**

53. Customs would undertake five yearly evaluations of the Chief Executive's use of the discretion in making and correcting assessments and collecting the duty identified. Customs rarely makes assessments so a longer, five year evaluation period has a better chance of identifying any trends than a shorter three year period.



## Annex: Sections 6 and 6A of the Tax Administration Act

### 6 Responsibility on Ministers and officials to protect integrity of tax system

(1) Every Minister and every officer of any government agency having responsibilities under this Act or any other Act in relation to the collection of taxes and other functions under the Inland Revenue Acts are at all times to use their best endeavours to protect the integrity of the tax system.

(2) Without limiting its meaning, **the integrity of the tax system** includes—

- (a) taxpayer perceptions of that integrity; and
- (b) the rights of taxpayers to have their liability determined fairly, impartially, and according to law; and
- (c) the rights of taxpayers to have their individual affairs kept confidential and treated with no greater or lesser favour than the tax affairs of other taxpayers; and
- (d) the responsibilities of taxpayers to comply with the law; and
- (e) the responsibilities of those administering the law to maintain the confidentiality of the affairs of taxpayers; and
- (f) the responsibilities of those administering the law to do so fairly, impartially, and according to law.

### 6A Commissioner of Inland Revenue

(1) The person appointed as chief executive of the department under the [State Sector Act 1988](#) is designated the Commissioner of Inland Revenue.

(2) The Commissioner is charged with the care and management of the taxes covered by the Inland Revenue Acts and with such other functions as may be conferred on the Commissioner.

(3) In collecting the taxes committed to the Commissioner's charge, and notwithstanding anything in the Inland Revenue Acts, it is the duty of the Commissioner to collect over time the highest net revenue that is practicable within the law having regard to—

- (a) the resources available to the Commissioner; and
- (b) the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and
- (c) the compliance costs incurred by taxpayers.