Regulatory Impact Statement

Customs and Excise Act Review: Options for the administrative penalty scheme

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by Customs.

It provides an analysis of options related to improving the administrative penalty scheme in the Customs and Excise Act. To do this, it outlines the advantages and disadvantages of modifying these provisions, compared to retaining the status quo.

The current administrative penalty scheme is not in need of wholesale policy change. However, a number of those making submissions on the review of the Act suggested possible improvements to the administrative penalty scheme (e.g. the need for greater gradation of penalty levels).

The preferred options, therefore, reflect a desire to refine, update and modify (rather than replace) existing provisions in light of stakeholder feedback and the objectives Customs wishes to achieve from these regulatory levers.

There is some uncertainty about the impact of the proposed extension of administrative penalties to all export entries. The volumes of penalties likely to be issued for export entry errors (about 107 per year) are estimates, based on the proportion of penalties issued for equivalent import entry errors. Even if the volumes of export entry penalties are more than double this umber, the additional ongoing cost to Customs associated with this activity is unlikely to exceed a total $50,000 per year.

The proposals discussed in this regulatory impact assessment were subject to public consultation during April to May 2015. Of the 89 parties making submissions, 16 commented on administrative penalties. A view that administrative penalty levels were too high and a call for greater use of non-penalty based interventions were common themes in the submissions. In response, the preferred option discussed in this regulatory impact assessment includes a proposal for sub-limits or caps for lower level administrative offending and makes provision for further work on the use of warnings, support and education for responding to non-compliance.

Signed by Michael Papesch on 14 September 2015

Michael Papesch
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Status quo and problem definition

1. This regulatory impact assessment covers options associated with administrative penalty provisions prescribed in Part 10 of the Act.

2. The purpose of the administrative penalty scheme is to encourage the accurate entry of information required by the Act on imports and exports. Required information in an entry includes the following:

   - the overseas supplier's and importer's identities
   - the identity of the person making the entry
   - the statistical quantity and value of the goods
   - tariff and permit codes.

3. Entries have a number of functions, which include:

   - the provision of information (including the financial value of the goods) for the payment and collection of duty
   - the provision of assurances for trading partners that exported goods are of a certified quality, and meet criteria for applicable tariff concessions (where free trade agreements exist)
   - automatic triggers for regulated goods which have special clearance requirements (e.g. kauri logs, war medals, electronic waste)
   - the provision of trade data for statistical purposes, including the calculation of New Zealand's balance of payments.

4. An incorrect entry code can mean a shortfall in the payment of duty, or the import or export of regulated goods without the correct permits or other safeguards.

5. While Customs conducts regular audits of import and export entries, the millions of import and export transactions each year means that only a relatively small subset of entries can be checked. The integrity of the system relies heavily on those making entries – mainly customs brokers – to provide the correct information.

6. Customs provides comprehensive guidance to brokers on the correct coding of entries. This is supplemented by penalties for 'materially incorrect' administrative errors and omissions. The more serious errors are those resulting in significant shortfalls of duty (e.g. under-declaring the financial value of the goods). Other materially incorrect entries can include those related to the country of origin or the statistical quantity of the goods. Voluntary compliance is encouraged by waiving penalties for self-disclosed errors.

7. The maximum penalty under the administrative penalties scheme is $50,000. The formula for calculating penalties within this limit is provided in the table below:

Table 1: Formula for calculating administrative penalties

For lack of reasonable care	20% of the duty unpaid or undeclared
For gross carelessness	40% of the duty unpaid or undeclared
For an error or omission made knowingly	100% of the duty unpaid or undeclared

8. For example, the penalty for not declaring goods with payable duty of $100,000 (due to a lack of reasonable care) would be $20,000. The penalty for intentionally not declaring goods with payable duty of $100,000 would result in a $50,000 fine (rather than $100,000) due to the maximum penalty being capped at $50,000. Errors or omissions not resulting in duty shortfalls incur a penalty of $200.

9. While the scheme is generally working well, it can be criticised on two grounds:

- penalties under this scheme are applied inconsistently in the sense that the Act does not permit penalties for errors and omissions related to all export entries. As well as undermining New Zealand's reputation as a reliable trading partner, exports of regulated goods could go undetected. Questions could also be raised about the validity of New Zealand's trade data.

- the penalties for lower levels of non-compliance appear unduly severe. For example, even an unintentional error resulting from a lack of reasonable care can result in the maximum penalty of $50,000. This criticism was raised by a number of stakeholders during the 2015 public consultation process relating to the review of the Act. A number of stakeholders also called for a greater use of warnings and other non-penalty based interventions for the lowest levels of non-compliance.

Objectives

10. Options for considering modifications and updates to the administrative penalty scheme have been assessed against the following objectives. These are listed in order of importance.

- allow a proportionate response to minor offending

- fair, transparent and easily understood

- consistent with approaches used by other regulatory agencies (e.g. Ministry for Primary Industries, the Police)

- procedurally simple and cost effective to administer.

Options for administrative penalties

11. For administrative penalties, two options were considered:

- retaining the administrative penalty scheme in its current form, or
- modifying the administrative penalties scheme to more closely meet the objectives for dealing with offences against the Act (preferred).

12. Modifying the administrative penalty scheme would involve the following changes:

- the extension of administrative penalties to all export entries. Current legislation permits the application of penalties to import entries and to export entries in relation to applications for drawback of duty[1]
- providing for a more proportionate response to lower level administrative errors and omissions. This would involve capped financial penalties, reflecting different levels of culpability, and the greater use of warnings and guidance for those making mistakes at the very lowest levels of culpability.

13. Extending administrative penalties to all export entry errors would involve a change to the Act. Currently, an import entry error involving no shortfall of duty incurs a penalty of $200. The same penalty would also apply to export entry errors involving no shortfall of duty.

14. It should be noted that stakeholders were generally opposed to this proposal on grounds that no duty shortfall is involved and that some export data is unreliable by its very nature (i.e. not completely under the control of entry operators). It is probably the case that many stakeholders do not realise the growing importance of accurate export data for our international trading partnerships. We also believe that concerns over export data inaccuracy can be allayed by consulting with the export industry on details of the proposed change (i.e. on what counts as a material export entry error or omission).

15. About 1.4 million import entries are made each year, with penalties issued for a very small proportion of these. About 281 administrative penalties are issued each year for materially incorrect import entries with no duty owing (out of a total of about 461 penalties). About 0.5 million export entries are made each year.

16. Assuming that export entry penalties will be issued in the same proportion of equivalent import entry penalties, an additional 107 penalties could be issued a year for export entries. Given the large volume of entries made to Customs, the use of administrative penalties is a relatively rare event. The use of administrative

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1 A drawback is a refund of previously paid duty (and sometimes Goods and Services Tax) when goods are exported.

penalties will remain a relatively rare event, even with the addition of export entry penalties.

17. Responsible Customs brokers, and others entering import and export information will already have quality assurance systems covering all or most of their entries. The addition of penalties for export entry errors is unlikely to require any significant or costly change for most operators. No additional reporting requirements will be required as a result of this change.

18. In response to the wide ranging (and deeply held) criticism of the maximum penalty level for an administrative error or omission, the preferred option makes provision for sub-limits or caps within the current maximum fine of $50,000. The caps described in Table 2 (below) will result in halving the maximum penalties currently possible for a lack of reasonable care and gross careless. These levels were adopted because they represent a marked reduction from current levels.

Table 2: Recommended penalty caps within the $50,000 maximum administrative penalty level

Degree of culpability	Percentage applied to duty shortfall	Penalty caps
Lack of reasonable care	20%	$20,000
Gross carelessness	40%	$35,000
Errors or omissions made with knowledge	100%	$50,000 (the current maximum)

19. If the caps described in Table 2 were adopted, the penalty for an error or omission that occurred because the person did not take reasonable care, and involving a duty shortfall of $25,000, would be $5,000 (i.e. 20 percent of $25,000), or half that of the current level.

20. The penalty for an error or omission that occurred because the person was grossly careless, and involving a $25,000 duty shortfall, would be $10,000 (i.e. 40 percent of $25,000), or half that of the current level. The maximum penalties for lack of reasonable care and gross carelessness would be capped at $20,000 and $35,000 respectively rather than the current level of $50,000.

21. The lowest level penalty (usually applied for errors or omissions involving no duty shortfall) would remain the same at $200. The maximum penalty level for errors or omissions made with knowledge would remain the same (i.e. a maximum of $50,000) because deliberately misrepresenting an entry for financial gain reflects a much higher level of culpability.

22. To provide for further gradation of administrative penalties, the preferred option also includes a response to stakeholder requests for a greater use of warnings and additional guidance for those at the lowest levels of offending.

23. This will require the development of detailed guidelines (for Customs and the public) about the conditions under which non-compliance will attract a warning or other non-penalty based intervention. The development of these guidelines would be included in a broader programme of planned work (which would include the proposed infringement notice scheme) on a Customs compliance strategy and associated enforcement intervention guidelines. Warnings and guidance would form one end of a spectrum of responses, with responses for the most severe offending (e.g. prosecution and imprisonment) sitting at the other extreme.

24. Modifications proposed under the preferred option are likely to be fairer on those making entries because it addresses questions of proportionate responding to various levels of offending. However, they will also make the scheme somewhat more complex and costly to administer.

25. Preliminary estimates suggest additional ongoing costs to Customs of no more than $50,000 per year for extending administrative penalties to all export entry errors (this includes the cost of additional error monitoring, additional warnings and guidance to Customs brokers and others making entries).

26. The proposed compliance strategy will need to include enforcement intervention guidelines for administrative penalties, including those related to export entry errors. Additional staff training and communications will also be needed to ensure that Customs officials and the public understand the implications of the changes. The additional marginal (one-off) cost of implementing changes to the administrative penalty scheme is estimated at about $40,000.

27. In table 3 (below), the two options relating to the administrative penalties scheme (the status quo and modifying the scheme) are ranked from 1 (low) to 3 (high) against each of the objectives listed in paragraph 16. The preferred option ranks more highly against the objectives than does the status quo.

Table 3: Summary of options analysis for administrative penalties

Objectives	Option 1 (status quo): retain the administrative penalty scheme in its current form	Option 2: Modify the administrative penalty scheme
Allow a proportionate response to minor offending	2	3
Fair, transparent and easily understood	2	3
Consistent with approaches used by other regulatory agencies (e.g. Ministry for Primary Industries, the Police)	2	3
Procedurally simple and cost effective to administer	3	2
Total	9	11

Consultation

28. Proposed changes were described in a public discussion document,[2] with an opportunity for public comment provided from April 2015 to May 2015. Of the 89 parties making submissions, 16 commented on administrative penalties. Those commenting on the scheme included the Board of Airline Representatives, Customs Brokers and Freight Forwarders Federation, DHL Global Forwarding (NZ) Ltd, Export New Zealand, Fonterra, and Zespri International Ltd.

29. Submitters indicated general support for the administrative penalties scheme as a means of ensuring compliance. However, a number of criticisms were directed at aspects of the scheme. The main ones were:

   - Concerns that the $50,000 maximum fine is too high. While the lowest fine of $200 was generally seen as appropriate, most of the submitters who commented on fine levels suggested that the maximum was far too high. Of all the issues raised, this is the one which appeared to generate the most concern

   - The need for greater use of non-regulatory interventions, such as training and guidance, to avoid making errors (and incurring penalties) in the first instance, with warnings and support for first offenders, and concessions for those with otherwise good compliance records.

30. As part of the public consultation process, stakeholders were also asked for their views on extending the administrative penalty scheme to all export entries. There was very little support for this proposal. Those commenting on the proposal noted that there was no revenue loss at stake and that the quality of some of the data entered for exports was not under the control of the person entering it. A response to this risk is provided in paragraph 36. The few that did support the proposal noted the need for consistency and to avoid adverse impacts on international trade.

31. The following government agencies were also consulted on the proposed changes: Ministry for Primary Industries; Ministry for Business, Innovation and Employment; New Zealand Police; Inland Revenue; Ministry of Justice; the Treasury; Crown Law Office; Ministry of Transport; Department of Internal Affairs; Ministry of Foreign Affairs and Trade; Ministry for Primary Industries; Civil Aviation Authority; Maritime New Zealand; Ministry of Defence; New Zealand Defence Force; Ministry of Health; Parliamentary Counsel Office; the New Zealand Security Intelligence Service; and the Office of the Privacy Commissioner. The Department of Prime Minister and Cabinet was informed.

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[2] http://www.customs.govt.nz/news/resources/corporate/documents/ceact1996review-discussionpaper2015.pdf

Conclusions and recommendations

32. While the proposed changes represent relatively minor changes to the existing administrative penalty framework, the review of the Customs and Excise Act provides an opportunity to make improvements of value to stakeholders, and to allow Customs to continue to improve its performance in meeting its regulatory obligations.

33. Public feedback indicates a desire to see the lowering of the maximum administrative penalty and greater use of warnings and other non-regulatory interventions for first offenders and those with good compliance records.

34. The proposed caps or sub-limits within the maximum administrative penalty of $50,000 are intended to achieve this. It is also proposed that Customs develop a robust, publicly available framework for articulating the circumstances under which particular enforcement options would be deployed. This would take the form of a compliance strategy and associated enforcement intervention guidelines and would include operational policy on the use of warnings and other non-penalty based interventions. These changes would be shared with stakeholder reference groups prior to finalisation.

35. Stakeholders were generally opposed to the extension of penalties to all export entries on grounds that duty shortfalls are not usually an issue, and that some information on exports (e.g. monetary values) can be difficult to determine accurately.

36. While these are legitimate concerns, it is also probably the case that many stakeholders have underestimated the growing importance of export entry information for our trading partnerships (and associated international obligations), particularly as it applies to tariff concessions under the growing number of free trade agreements to which New Zealand is party.

37. To address stakeholder concerns about the unreliability of some export information, any application of penalties to export entries must make allowances for export data inaccuracies which cannot reasonably be attributed to those entering information on exports. Section 128 of the Act lists the data fields for which errors or omissions are materially incorrect. This section will need to be revised to include fields relating to materially incorrect export entries.

Implementation plan

38. The Bill is intended to be introduced to the House in mid-2016 with the aim of receiving Royal Assent by the end of 2016. A revised list of import, export and excise data requirements would need to be included when Part 10 of the Act is re-enacted.

39. From an operational perspective Customs will also need to establish:

- operational guidelines (i.e. a compliance strategy and associated enforcement intervention guidelines) to help ensure that Customs officials know the circumstances under which they should issue the range of interventions available to them, including the use of warnings and advice as a response to low level administrative errors. This material would also be publicly available to establish more transparency and accountability with respect to the application of administrative penalties
- a training programme to ensure that Customs officers and other relevant staff are aware of the use and purpose of the changes and can competently issue administrative penalties in accordance with the compliance strategy and associated enforcement intervention guideline.
- a comprehensive plan for ensuring a seamless transition from current provisions to the modified administrative penalty scheme.

Monitoring, evaluation and review

40. A review of the implementation and functioning of the administrative penalties scheme will be conducted after its first full 12-months of operation. The review is likely to cover the following matters:

- the effectiveness of the scheme from the perspective of Customs officers, and other operational staff
- areas of improvement, in terms of the fair and consistent application of administrative penalties
- numbers of reviews, appeals and non-payment (to ensure these are not excessive)
- the actual cost of administering the scheme
- the success of the scheme as a deterrent for non-compliance.

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