

## Regulatory Impact Statement

### Review of cheque duty

#### Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Inland Revenue.

The question addressed in this statement is whether cheque duty is a worthwhile tax. Cheque duty is the one remaining transaction duty. Other duties such as estate, gift, stamp and credit card transaction duties have been repealed since 1988, mainly because they had become outmoded and ineffective as revenue raising methods.

Cheque duty applies to bills of exchange (most commonly cheques) at a rate of 5 cents per bill of exchange. The view reached in this RIS is that cheque duty should be repealed. Cheque duty is easy to avoid, since closely substitutable methods of payment, such as cash or electronic transactions, are not subject to any duty. Additionally, revenue from cheque duty has been declining and the current trend suggests that the costs of the duty are likely to outweigh its benefits over time. It is therefore an inefficient and distortionary tax. Previous reviews of the tax system have also examined this question, such as the (McLeod) *Tax Review 2001*, which recommended that cheque duty be repealed for similar reasons.

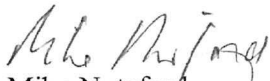
The key objectives of the current review are to improve the overall equity, efficiency and coherency of the tax system.

The class of taxpayers likely to be affected are banks, printers of cheques and cheque users. We note that our preferred option of repealing cheque duty would benefit businesses, non-profit organisations and individuals that still use cheques as a payment method. It would also reduce compliance costs, particularly for banks and printers of cheques.

Due to time constraints and Budget secrecy, limited consultation was undertaken on the proposed options. Inland Revenue consulted the New Zealand Bankers Association (NZBA) on the practical implications of repealing cheque duty. NZBA indicated that there is general support for the repeal. However, some banks asked for some lead-in time - a period of time between announcement and repeal - to adjust their IT systems. Also, some banks expressed a preference for the repeal to take effect from the first day of a quarter, in order to tie-in with current cheque duty return processes. NZBA indicated that a repeal date of 1 July 2014 would be fine. This feedback led to us discarding as an option an implementation approach which would have repealed cheque duty from the date of Royal assent of a Budget day bill.

The Treasury were involved in the policy development of the options discussed in this RIS.

There are no significant constraints, caveats or uncertainties concerning the regulatory analysis undertaken. None of the policy options considered impair private property rights, restrict market competition, or override fundamental common law principles.



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## **STATUS QUO AND PROBLEM DEFINITION**

### **Cheque duty rules and administration**

1. Cheque duty applies to bills of exchange, such as cheques and promissory notes, at a rate of 5 cents per bill of exchange.
2. Cheque duty is usually paid to Inland Revenue by banks and licensed printers, which pass on the cost to their customers. Licensed banks file cheque duty returns and pay cheque duty on a quarterly basis, and licensed printers file cheque duty returns and pay cheque duty on a monthly basis.
3. Additionally, Inland Revenue may grant any person a license authorising the printing of cheques upon application and payment of cheque duty payable. The applicant must nominate a printer and, on the grant of a licence, Inland Revenue issues the nominated printer an authority to print the prepaid cheques to which the licence relates.
4. When cheque duty has not been prepaid on a bill of exchange, it must be duly stamped (by affixing a postage stamp or stamps and cancelling each stamp) by the drawer or maker of the bill. This includes, for example, when an overseas bill of exchange becomes payable in New Zealand. The revenue from postage stamps goes to New Zealand Post rather than directly to the Crown.
5. Inland Revenue may refund cheque duty that has been paid in relation to cheques that have not been used or printed, upon application in writing within 8 years after the date of payment of the duty, but no refunds less than \$1 can be made. Banks receive an effective refund via a deduction from their quarterly payment of cheque duty.
6. Inland Revenue currently administers the collection of cheque duty through its transactional customer services team. Inland Revenue interacts directly with 41 active cheque duty producers and suppliers. There is no interaction between Inland Revenue and the general public in relation to cheque duty.

### **Status quo**

7. Cheque duty is the one remaining transaction duty. No duty applies to alternative methods of payment, such as cash, electronic transactions (for example, EFTPOS or via internet banking), or credit card transactions.
8. Cheque use has been steadily declining; cheque duty raised \$17 million in 1991/92 and \$10 million in 2001/02, but now only raises about \$4 million per annum. Technological advances have led to the introduction of various methods of electronic payments. The increasing popularity of these alternatives to cheques is more likely due to them being more convenient, faster and more secure methods of payment, rather than tax-motivated substitution (given the very low rate of cheque duty).
9. Based on current volumes and resources involved, the administration of cheque duty forms a small percentage of Inland Revenue's processing operations.

## **Problem definition**

10. Inland Revenue considers that cheque duty is now no longer a worthwhile tax. Cheque duty is easy to avoid, since closely substitutable methods of payment, such as cash or electronic transactions, are not subject to any duty. Additionally, revenue from cheque duty has been declining and the current trend in cheque use suggests that the costs of the duty are likely to outweigh the revenue generated over time. It is therefore an inefficient and distortionary tax. That said, the very low rate of cheque duty (5 cents per transaction) suggests that its distortionary effect is likely to be small.

11. Cheque duty is the one remaining transaction duty. Other duties such as estate, gift, stamp and credit card transaction duties have been repealed since 1988, mainly because they had become outmoded and ineffective as revenue raising methods.

12. The Government-appointed but independent (McLeod) *Tax Review 2001* recommended that cheque duty be repealed, citing the fact that cheque duty is easily avoided by using alternative methods of payment and that, at the time of the review, cheque duty only raised about \$10 million per annum. At that time, repeal of cheque duty was not considered a priority for fiscal reasons. The case for repeal is stronger today.

## **OBJECTIVES**

13. The objectives of the review of cheque duty are to:

- a) Improve the overall efficiency of the tax system by ensuring that the economic, administrative and compliance costs associated with a tax are kept to a minimum.
- b) Improve the overall fairness of the tax system by ensuring that similarly situated taxpayers are taxed in the same way.
- c) Ensure that the benefits of cheque duty outweigh its associated costs going forward.
- d) Ensure coherency of the tax system.

14. We note that there may need to be a trade-off between the objective of improving overall efficiency of the tax system, which is about keeping to an absolute minimum the costs imposed by the tax system, and improving the overall fairness of the tax system. For example, broadening the base on which a duty applies may improve equity amongst similarly situated taxpayers, but it may also reduce the overall efficiency of the tax system.

## **REGULATORY IMPACT ANALYSIS**

15. Three options have been considered for addressing the problems and achieving the stated objectives. These options are:

- *Option one:* Retain the status quo.
- *Option two:* Repeal cheque duty.

- *Option three:* Broaden the base by applying a duty to a broader range of transaction types.

**TABLE 1: IMPACTS OF OPTION ONE**

Option	Meets objectives?	Impacts				Net impact
		Economic and fiscal impacts	Administrative and compliance impacts	Equity and risks		
One <i>Retain the status quo</i>	No	Tax system	Cheque duty imposes minor administration costs on Inland Revenue	Unfair because it imposes a transaction tax on one particular method of payment (cheques) and other payment methods (credit card, EFTPOS or cash) are easily substitutable	Does not address the problem definition or achieve any of the stated objectives	
		Banks, printers and cheque users	Cheque duty imposes minor compliance costs on banks and printers of cheques			Given the trend of declining cheque use, the costs of the duty are likely to become disproportionately high relative to the revenue raised going forward

**TABLE 2: IMPACTS OF OPTION TWO**

Option	Meets objectives?	Impacts				Net impact
		Economic and fiscal impacts	Administrative and compliance impacts	Equity and risks		
Two <i>Repeal cheque duty</i>  (preferred option)	a, b, c and d	Tax system	Improvement in efficiency due to the removal of the distortion created by the duty	Small decrease in administrative costs. Inland Revenue would not have to administer the duty in future years	More equitable, as no transaction types would be subject to a duty	Addresses the problem definition and achieves all of the stated objectives
			Estimated fiscal cost of \$4 million per annum	Repealing the duty would result in a very small one-off cost for Inland Revenue, which would be met within existing baselines		
		Banks, printers and cheque users	Extinguishes future duty costs for cheque users	Small decrease in compliance costs, as banks and printers would no longer incur the compliance costs imposed by the duty		

**TABLE 3: IMPACTS OF OPTION THREE**

Option	Meets objectives?	Impacts				Net impact
		Economic and fiscal impacts	Administrative and compliance impacts	Equity and risks		
<b>Three</b> <i>Broaden the base by applying a duty to a wider range of transaction types</i>	b and c	Tax system	Unquantified increase in administrative costs associated with implementing and administering duties on a wider range of transaction types	Improvement in equity, as a broader range of transaction types would be subject to a duty  Inconsistent with the general approach of removing inefficient and distortionary transaction taxes	Does not address the problem definition and only achieves some of the objectives	
		Potential fiscal gain – cannot be quantified, as it depends on what transactions are subject to the duty and the rate of the duty  Increase in duty costs associated with a wider range of transactions subject to a duty	Unquantified but potentially significant increase in compliance costs for duty payers, as they will need to make systems changes and to administer the wider range of duties			
		Banks, printers and cheque users				



### *Social, environmental or cultural impacts*

16. There are no social, environmental or cultural impacts associated with any of the options considered above.

### *Net impact of all options*

17. The preferred option to repeal cheque duty (option two) addresses the problem by removing an outmoded and inefficient means of raising revenue. It also achieves all of the objectives – that is, it ensures the overall equity, efficiency and coherency of the tax system.

18. Inland Revenue does not support options one and three because they do not address the problem and fail to achieve some or all of the objectives.

## **CONSULTATION**

19. Given time constraints and the fact this matter was being progressed as part of Budget 2014, only limited consultation was undertaken. Inland Revenue consulted the New Zealand Bankers Association (NZBA) on the practical implications of repealing cheque duty. NZBA sought feedback on this matter from several banks. While all banks canvassed by NZBA are supportive of the repeal, some banks said that they have legacy IT systems, and that the repeal becoming effective on the date of Royal assent may cause problems for them. Those banks expressed a preference for cheque duty to be repealed with effect from a set date in the future, to allow them some lead-in time to manage the transition from a systems perspective. Also, some banks expressed a preference for the repeal to take effect from the first day of a quarter, in order to tie-in with current cheque duty return processes. NZBA indicated that a repeal date of 1 July 2014 (the first day of the next quarter following Budget 2014) would allow banks sufficient lead-in time to manage the transition.

20. The Treasury was consulted and agrees with our conclusions and recommendations.

## **CONCLUSIONS AND RECOMMENDATIONS**

21. Inland Revenue recommends that cheque duty be repealed, as:

- the duty no longer raises substantial revenue and the revenue raised is in decline; and
- cheque duty is easy to avoid, since closely substitutable transaction types (such as cash, EFTPOS, internet banking and credit card transactions) are not subject to any duty. It is therefore inefficient and has a small distortionary effect.

22. Transaction duties are a relic of the time before GST was introduced in 1986. As the trend since the late 1980s has been to repeal transaction duties, we consider the repeal of cheque duty to be preferable to broadening the base by applying a duty to a broader range of transaction types. Furthermore, repealing cheque duty would reduce administrative and compliance costs. Introducing other duties would have the opposite effect.

23. Based on Ministers' desire to consider any repeal as part of Budget 2014 with an announcement on Budget day, Inland Revenue's preference is that the repeal is announced on Budget day with an application date for repeal of 1 April 2016.

## **IMPLEMENTATION**

24. The status quo would not require legislation to implement. Option two and option three would require changes to the Stamp and Cheque Duties Act 1971 and the Tax Administration Act 1994. Shortly after the bill giving effect to the repeal of cheque duty receives Royal assent, Inland Revenue will issue a *Special Report* explaining the effect of the amendments.

### **Approaches to implementing the repeal of cheque duty considered**

25. Based on Ministers' desire to announce any repeal of cheque duty at Budget 2014, we considered various approaches to implementing the repeal of cheque duty. This required consideration of three key issues:

- the effective date of repeal;
- the availability of refunds of prepaid cheque duty; and
- the legislative vehicle for the repeal.

26. We were mindful of the potential trade-offs in making decisions in relation to these issues. They included:

- The longer the period between announcement and repeal, affected parties will have more lead-in time, enabling them to better manage their transition to the new environment. However, this will also enable these groups to seek refunds for their surplus prepaid cheques, which increases the uncertainty surrounding the fiscal cost.
- The availability of refunds beyond the effective date of repeal arguably improves fairness but would also have a fiscal cost, administrative resource implications, and impose compliance costs on banks.
- The choice of legislative vehicle between a Budget day bill and the next available taxation bill after Budget 2014 involves trading-off certainty about the repeal against the level of on-going consultation that can be undertaken with affected parties on the practical implications of the repeal of cheque duty and the opportunity for parliamentary consideration. This choice could influence the public reaction to the change.

27. On the basis of the potential trade-offs, we considered three main approaches to repealing cheque duty. They were:

- Repeal cheque duty immediately – approach 1.
- Repeal cheque duty from 1 July 2014 – approach 2.
- Repeal cheque duty from 1 April 2016 – approach 3.

### **Repeal immediately – approach 1**

28. This approach repeals cheque duty with effect from the date of Royal assent of a Budget day bill, with no refunds available from then on for cheques for which cheque duty has been prepaid that have not been used or printed.

29. The main advantages of this approach are that it is clean and certain that cheque duty is being repealed and it provides cheque users with immediate relief from the duty.

30. The main downsides of this approach are:

- The potential for there to be a negative public reaction to not giving refunds.
- Possible transitional issues (for example, for banks in adjusting systems) due to the lack of lead-in time.
- Higher fiscal costs would arise from the 2014/15 fiscal year as this option features an earlier repeal date.
- Limited consultation on the impacts of repealing cheque duty and a truncated parliamentary process.

### **Repeal from 1 July 2014 – approach 2**

31. This approach repeals cheque duty with effect from 1 July 2014, with no refunds available from then on for cheques for which cheque duty has been prepaid that have not been used or printed. Refunds would be available up until 30 June 2014. The legislative vehicle would be a Budget day bill.

32. The main advantages of this approach are:

- Banks will have some lead-in time to adjust their IT systems.
- The 1 July repeal date allows banks and licensed printers to complete a full cycle for their final cheque duty return.
- Cheque users will receive relief from cheque duty relatively promptly.
- The use of a Budget day bill and the short period of time before the repeal takes effect provide certainty about the repeal.

33. The main disadvantages are:

- The potential for there to be a negative public reaction to not giving refunds from 1 July 2014.
- Limited consultation on the impacts of repealing cheque duty and a truncated parliamentary process.

### **Repeal from 1 April 2016 – approach 3**

34. Under this approach, cheque duty would be repealed from 1 April 2016, with no refunds available from then on for cheques for which cheque duty has been prepaid that have not been used or printed. Refunds would be available up until 31 March 2016. The legislative vehicle would be the next available taxation bill after Budget 2014.

35. This approach has the following advantages:

- It allows a reasonable lead-in time, which would enable all affected parties (banks and their customers, licensed printers and their customers, temporary licensees, and Inland Revenue) to better manage the transition.
- The availability of refunds of prepaid cheque duty over the period in between Budget 2014 and 1 April 2016 would mitigate the potential public perception of unfairness that may be caused by not giving or significantly restricting the availability of refunds.
- The use of the next available taxation bill after Budget 2014 would enable the proposal to go through the full parliamentary process, including the select committee stage. Any issues with the proposed approach could be raised in public submissions.

36. Given the relatively long time period between announcement and legislative repeal, the main downsides to this approach are:

- Cheque users will continue to incur the cost of the duty for significantly longer.
- A potential perception that the Government is not serious about repealing the duty.

### **Potential variations to main approaches**

37. We also considered but discounted two potential variations to these main approaches around the availability of refunds of prepaid cheque duty on cheques that have not been used or printed.

#### ***Removing refundability prior to repeal date – variation 1***

38. We considered removing the ability to seek refunds in between the date of Royal assent and the date of repeal (applicable to approaches 2 and 3). This would have the following advantages:

- It would reduce uncertainty about the fiscal cost of the repeal as a consequence of the lack of empirical data on the number of cheques for which cheque duty has been prepaid that have not been used or printed.
- It would avoid compliance costs for banks associated with any increase in customers seeking a refund of prepaid cheque duty on unused cheques, which they may otherwise temporarily experience.

39. The main disadvantage of doing this is that, because cheque duty is in economic substance a tax on transactions using a particular type of instrument, not refunding prepaid duty when no dutiable transaction has taken place has the potential to create a perception of unfairness.

40. We consider that the fairness reasons for continuing to allow refunds up until the date of repeal outweigh the advantages of removing the ability to seek refunds in between the date of Royal assent and the date of repeal.

### *Allowing a fixed refund period – variation 2*

41. We also considered continuing to allow refunds of prepaid cheque duty to be sought for a fixed period (for example, six months) after cheque duty is repealed.

42. The advantage of doing this is that it improves fairness as it seems fair for prepaid cheque duty to be refunded where no dutiable transaction has taken place.

43. The disadvantages of doing this are as follows:

- It would be likely to increase the fiscal cost and uncertainty around the fiscal cost.
- It would necessitate Inland Revenue committing resources to administering cheque duty for a longer period.
- It would impose additional compliance costs on banks associated with customers seeking a refund of prepaid cheque duty on unused cheques.

44. We consider that there are reasonable grounds for not continuing to allow refunds of prepaid cheque duty for a fixed period following repeal under each of approaches 1 to 3, for the reasons outlined below:

- *Approach 1:* In addition to the disadvantages outlined in paragraph 43, continuing to allow refunds after the date of repeal could create practical difficulties in the case of cheque duty being repealed immediately. This is because banks may not have had time to have ordered and had printed cheque books containing cheques without an inscription indicating that the cheque duty has been paid. Consequently, in the short-term following repeal, banks may not be in a position to supply customers with cheque books containing cheques without an inscription indicating that the cheque duty has been paid.
- *Approach 2:* We consider that, on balance, the disadvantages of continuing to allow refunds after the date of repeal outweigh the advantages under approach 2, especially since this approach allows a month and a half for refunds to be sought between announcement and the date of repeal. This should be enough time for those most inequitably affected by the repeal to seek a refund. Although this is a significantly shorter period of time between announcement and repeal than under approach 3, cheque users receive the benefit of earlier relief from cheque duty under approach 2.
- *Approach 3:* We consider that, on balance, the disadvantages of continuing to allow refunds after the date of repeal outweigh the advantages under approach 3, as there would be more than sufficient time for refunds to be sought prior to the date of repeal.

### **Preferred approach - conclusion**

45. Managing the repeal of cheque duty would have minimal administrative impacts for Inland Revenue. Cheque duty is managed via a standalone purpose-built application. This

sits outside of Inland Revenue's FIRST mainframe system and, as such, decommissioning the application would be a straight-forward procedure.

46. Inland Revenue and the Treasury prefer approach 3 (that is, repealing cheque duty from 1 April 2016, via the next available taxation bill after Budget 2014, with no refunds of prepaid cheque duty available from the date of repeal). Our preference is for the effective date of repeal to be a sufficiently long time after announcement so as to give ample time for all affected parties to seamlessly manage the transition. Furthermore, we prefer to allow refunds to be continued to be sought in relation to prepaid cheque duty up until the date of repeal. Refunds can currently be sought for cheque duty that has been paid in relation to cheques that have not been used or printed, within 8 years after the date of payment of the duty. Cheque duty is in economic substance a tax on transactions using a particular type of instrument. If no dutiable transaction takes place, refunding the prepaid duty makes sense. There is the potential for there to be a perception of unfairness if the current availability of refunds was suddenly removed or significantly restricted. The case for having a period for refunds beyond the date of repeal is weaker under approach 3, as there is more than sufficient time for refunds to be sought prior to the repeal date.

47. We consider using the next available taxation bill after Budget 2014 as the legislative vehicle for repeal to be preferable to a Budget day bill, as it would enable the proposal to go through the full parliamentary process, including the select committee stage. Any issues with the proposed approach could be raised in public submissions.

48. The proposed repeal of cheque duty would reduce compliance costs for banks, printers of cheques and the printers' customers, as they would no longer have to apply to Inland Revenue for licences authorising the printing or supply of bill of exchange forms prepaid with cheque duty, or make payments of cheque duty to Inland Revenue. Additionally, banks and printers of cheques would no longer have to complete and file the quarterly/monthly returns that accompany their payments of cheque duty to Inland Revenue.

49. However, under our preferred approach, in the short-term (that is, between announcement and the date of repeal) banks may temporarily experience an increase in customers seeking a refund of prepaid cheque duty on unused cheques.

## **MONITORING, EVALUATION AND REVIEW**

50. There are no specific plans to monitor, evaluate and review the repeal of cheque duty. If any detailed concerns are raised in relation to the repeal, Inland Revenue will determine whether there are substantive grounds for review under the Generic Tax Policy Process.

51. In general, Inland Revenue's monitoring, evaluation and review of new legislation takes place under the Generic Tax Policy Process (GTPP). The GTPP is a multi-stage tax policy process that has been used to design tax policy in New Zealand since 1995. The final stage in the GTPP contemplates the implementation and review stage, which can involve post-implementation review of the legislation, and the identification of any remedial issues. Opportunities for external consultation are also built into this stage. In practice, any changes identified as necessary for the new legislation to have its intended effect would generally be added to the Tax Policy Work Programme, and proposals would go through the GTPP.