



Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

Tax policy report: Use of money interest rates review

Date:	6 June 2019	Priority:	High
Security level:	In Confidence	Report number:	IR2019/280

Action sought

	Action sought	Deadline
Minister of Revenue	Agree to the recommendations. Sign and refer attached paper to Cabinet Office for consideration at LEG meeting on 25 June 2019. Refer a copy of this report to the Minister of Finance.	10am, Thursday 20 June 2019.

Contact for telephone discussion (if required)

Name	Position	Telephone
Jess Rowe	Team Lead	s 9(2)(a)
s 9(2)(a)	Policy Analyst	

6 June 2019

Minister of Revenue

Use of money interest rates review

Executive summary

1. This report seeks your agreement to adjust the use of money interest rates (UOMI) as part of the regular review of the UOMI rates.
2. The UOMI rates are reviewed regularly to ensure that they align with market interest rates. The UOMI rates are calculated using formulae based on the results of the Reserve Bank (RBNZ) survey of interest rates. These formulae are set down in regulations.
3. The current underpayment UOMI rate is 8.22% and the overpayment UOMI rate is 1.02%. We recommend that the underpayment rate be increased to 8.35%, and that the overpayment rate be reduced to 0.81%, in line with movements in market rates. Your approval is sought to make these rate changes, and for the Parliamentary Counsel Office to draft an Order in Council to set the new rates.
4. If you agree, the new rates will come into force on 29 August 2019, the day after the due date for the first standard instalment of provisional tax. We confirm that this complies with the 28-day rule.
5. In anticipation of your approval, officials have advised the Parliamentary Counsel Office that a draft Order in Council changing the rates will need to be prepared.
6. Attached is a paper to the Cabinet Legislation Committee recommending that it approve the Order in Council and authorise its submission to Cabinet and the Executive Council. For the paper to be considered by the Cabinet Legislation Committee at its meeting on 25 June 2019, it should be referred to Cabinet Office by 10am, Thursday 20 June 2019.
7. A draft press statement will be forwarded for your consideration once the Order in Council has been made.
8. The Treasury has been consulted and agrees with the recommendations in this report. A copy should be referred to the Minister of Finance for his information.

Recommended action

We recommend that you:

- (a) **Agree** that the UOMI underpayment and overpayment interest rates be changed to 8.35% (from 8.22%) and 0.81% (from 1.02%) respectively.

Agreed/Not agreed

- (b) **Agree** that the new UOMI rates come into force on 29 August 2019.

Agreed/Not agreed

- (c) **Note** that agreeing to recommendations (a) and (b) is expected to have the following impact on tax revenue and impairment expenditure with an overall net increase in the operating balance of around \$6 million in the 2019/20 fiscal year with the effective date of 29 August 2019, and an operating balance increase of \$7 million for 2020/21 and later years:

		\$ millions increase / (decrease)			
Vote Revenue Minister of Revenue	2018/19	2019/20	2020/21	2021/22	2022/23 & Outyears
Crown Revenue and Receipts: Tax Revenue	-	9.000	10.000	10.000	10.000
Total Operating	-	9.000	10.000	10.000	10.000

		\$ millions increase / (decrease)			
Vote Revenue Minister of Revenue	2018/19	2019/20	2020/21	2021/22	2022/23 & Outyears
Non-Departmental Other Expense: Impairment of debt and debt write-offs (funded by Revenue Crown)	-	3.000	3.000	3.000	3.000
Total Operating	-	3.000	3.000	3.000	3.000

Noted

- (d) **Agree** that the Parliamentary Counsel Office draft an Order in Council to adjust the UOMI rates.

Agreed/Not agreed

- (e) **Sign** and **refer** the attached paper to the Cabinet Office by 10am Thursday 20 June 2019 for consideration by Cabinet Legislation Committee at its meeting on 25 June 2019.

Signed and referred

- (f) **Refer** a copy of this report to the Minister of Finance.

Referred

Jess Rowe
Team Lead
Policy and Strategy

Hon Stuart Nash
Minister of Revenue
/ /2019

Background

9. The UOMI rates are an important component of the tax compliance rules. By changing in line with underlying market rates, the UOMI rates provide taxpayers with the incentive to pay the right amount of tax at the right time. They apply to all revenue and duties.
10. The UOMI rates are set according to the Taxation (Use of Money Interest Rates Setting Process) Regulations 1997. The Regulations provide that the methodology for setting the interest rate for underpaid tax is the latest Reserve Bank New Zealand (RBNZ) floating first mortgage new customer housing rate plus 250 basis points. The floating first mortgage new customer housing rate reflects the variable interest rate offered by surveyed institutions to new borrowers for residential property, weighted by each surveyed institution's total lending outstanding for housing purposes.
11. The floating first mortgage new customer housing rate is a proxy for a debt that a taxpayer might prioritise over their tax obligations. In the absence of a UOMI charge, a taxpayer wanting to borrow money could simply underpay their tax and use Inland Revenue as a bank rather than borrow from a bank at a commercial interest rate. A conservative margin of 250 basis points is added to the mortgage rate in calculating the underpayment UOMI rate because the Commissioner does not have information about the likelihood of any individual taxpayer paying the UOMI charged to them (i.e. the taxpayer's credit-worthiness).
12. The Regulations provide that the methodology for setting the interest rate for overpaid tax is the latest RBNZ 90-day bank bill rate less 100 basis points. The RBNZ 90-day bank bill rate is the monthly average of the daily standard rates, and approximates the return a taxpayer might expect on a low-risk investment in the New Zealand Government. Ensuring that the Commissioner pays less interest to the taxpayer on overpaid tax than the taxpayer would receive as a return from a low-risk bond aims to prevent Inland Revenue being used as an investment.
13. Because the two UOMI rates are based on two different Reserve Bank interest rate measures that can move independently of each other, the underpayment rate can increase while the overpayment rate decreases, as is the case in this rates review.
14. The current underpayment rate is 8.22% and the current overpayment rate is 1.02%.

Principles to be applied in resetting UOMI rates

15. In 2010 the Minister of Revenue agreed that the following principles be applied in setting new UOMI rates (PAD 2010/287 refers):
 - adjust both UOMI rates where there has been a 1% increase or 1% decrease (since the time the rates were last set) in the RBNZ 90-day bank bill rate or the floating first mortgage new customer housing rate;
 - adjust both UOMI rates every 12 months where there has been an increase or decrease in the Reserve Bank 90-day bank bill rate or the floating first mortgage new customer housing rate of 20 basis points or more (since the time the rates were last set), if the previous 12-month movement has not been sufficient to trigger a change, in order to avoid long-term misalignment of the rates; and
 - apply the adjustment from the next standard provisional tax payment date.

16. Inland Revenue officials are responsible for monitoring the RBNZ 90-day bank bill rate and the floating first mortgage new customer housing rate throughout the year.
17. The UOMI rates were last changed by Order in Council with effect from 8 May 2017 and were based on the interest rates for February 2017.

Annual review of UOMI rates

18. The Reserve Bank's survey results for the relevant market interest rates in February 2017 and April 2019 are below:

Month ended	Floating first mortgage new customer housing rate (%)	90-day bank bill rate (%)
February 2017	5.72	2.02
April 2019	5.85	1.81

Note: add 250 basis points to the floating first mortgage new customer housing rate to get the UOMI under-payment interest rate and subtract 100 basis points from the 90-day bank bill rate to get the UOMI overpayment rate.

19. The results for April 2019 indicate that, since the rates were last set, the floating mortgage new customer housing rate has increased by 13 basis points, and the 90-day bank bill rate has decreased by 21 basis points. To avoid a long-term misalignment, officials consider an adjustment to the UOMI rates is necessary.
20. Officials recommend that the underpayment and overpayment rates be changed to 8.35% and 0.81% respectively.

Approval for drafting

21. The UOMI rates are set at regular intervals by Order in Council and it has become a routine matter to amend them. Paragraph 7.91(d) of the Cabinet Office Manual provides that where the making of an Order in Council will not involve any further policy considerations, the Minister may authorise drafting without reference to Cabinet.
22. Your approval is sufficient for the Parliamentary Counsel Office to draft the Order in Council.

Financial implications

23. UOMI applies to both overpayments and underpayments of tax. Although more is charged by the Commissioner on underpayments than is paid to the taxpayer on overpayments, the charges to underpayments are impaired by 80% in the Crown accounts to reflect that most UOMI charged is never paid, and therefore must be written-off. This means that an increase in the underpayment rate also produces an increase in impairment expenditure.

24. The full year net saving for the 2019/20 fiscal year is estimated to be \$6 million, and \$7 million per annum for 2020/21 and later years. These savings comprise a revenue increase of \$9 million in 2019/20 and \$10 million per annum for 2020/21 and later years, and an increase in impairment expenditure of \$3 million per annum. This is shown in the following tables:

		\$ millions increase / (decrease)			
Vote Revenue Minister of Revenue	2018/19	2019/20	2020/21	2021/22	2022/23 & Outyears
Crown Revenue and Receipts: Tax Revenue	-	9.000	10.000	10.000	10.000
Total Operating	-	9.000	10.000	10.000	10.000

		\$ millions increase / (decrease)			
Vote Revenue Minister of Revenue	2018/19	2019/20	2020/21	2021/22	2022/23 & Outyears
Non-Departmental Other Expense: Impairment of debt and debt write-offs (funded by Revenue Crown)	-	3.000	3.000	3.000	3.000
Total Operating	-	3.000	3.000	3.000	3.000

25. We note that these revenue implications are a forecasting change only as they result from an existing policy; therefore there is no impact on the scorecard from the proposed adjustment to the UOMI rates.

Consultation

26. The Treasury has been consulted in the preparation of this report and agrees with its contents.

Next steps

27. To enable the UOMI rates to come into force on 29 August 2019 it is proposed that the Order in Council be submitted to Cabinet Office by 10am, Thursday 20 June 2019 for the Cabinet Legislation Committee meeting on Tuesday 25 June 2019 and to Cabinet and the Executive Council for approval on Monday 1 July 2019.