

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Legislation Committee

TAXATION (USE OF MONEY INTEREST RATES) AMENDMENT REGULATIONS (NO 3) 2022

Proposal

1. This paper seeks the Cabinet Legislation Committee's agreement to submit an Order in Council amending the Taxation (Use of Money Interest Rates) Regulations 1998 to the Executive Council.
2. It is proposed to amend the regulation so the underpayment use of money interest (UOMI) rate is set at 9.21%, while the overpayment UOMI rate is set at 2.31%.

Policy

3. The UOMI rates play an important role in the tax compliance rules. By moving 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. The rates apply to all revenue and duties.
4. The Tax Administration Act 1994 provides for the UOMI underpayment and overpayment interest rates to be set by Order in Council. Once the rates are set, they remain the prescribed UOMI rates unless subsequently changed by Order in Council.
5. The methodology for calculating the rates is set out in the Taxation (Use of Money Interest Rates Setting Process) Regulations 1997 (the Regulations). The Regulations provide that the interest rate for underpaid tax should be set at the Reserve Bank of 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.
6. The Regulations provide that the interest rate for overpaid tax is set at the latest RBNZ 90-day bank bill rate less 100 basis points, or, if this would produce a negative figure, at 0%. The RBNZ 90-day bank bill rate is the monthly average of the daily standard rates.
7. The current underpayment and overpayment rates are 7.96% and 1.22% respectively. The UOMI rates were last changed by Order in Council with effect from 30 August 2022 and were based on the interest rates for May 2022.
8. The RBNZ interest rates for August 2022 indicate that the 90-day bank bill rate has changed by 109 basis points since the rates were last adjusted. I consider that an

adjustment of the UOMI rates is necessary to avoid a long-term misalignment. I therefore recommend the overpayment rate be increased to 2.31%.

9. The floating first mortgage new customer housing rate has also changed by 125 basis points since the rates were last adjusted. Therefore, I also recommend that the underpayment rate be increased to 9.21%.

Timing

10. I propose to submit the Order in Council giving effect to the change in the UOMI underpayment rate to Cabinet for approval and submission to the Executive Council at its meeting on 28 November 2022. In order to minimise compliance costs, it is proposed that the new rate comes into force on 17 January 2023, the day after the due date for the second standard instalment of provisional tax.

Compliance

11. The regulations comply with the principles, Acts, guidelines, and requirements set out below as follows:
 - 11.1 the principles of the Treaty of Waitangi
 - 11.2 the New Zealand Bill of Rights Act 1990
 - 11.3 the Human Rights Act 1993
 - 11.4 the principles and guidelines set out in the Privacy Act 1993
 - 11.5 relevant international standards and obligations
 - 11.6 the *Legislation Guidelines* (2018 edition), which are maintained by the Legislation Design and Advisory Committee

Regulations Review Committee

12. There are no anticipated grounds for the Regulations Review Committee to draw the Order in Council to the attention of the House under Standing Order 319.

Certification by Parliamentary Counsel

13. The Parliamentary Counsel Office has certified that the attached Order in Council is in order for submission to Cabinet.

Impact Analysis

14. A regulatory impact assessment is not required as the proposal is of a minor and routine nature and does not substantially alter existing arrangements.

Financial Implications

15. The proposal to increase the UOMI rates, with the effective date of 17 January 2023, is estimated to result in net negative revenue of approximately \$84 million over the forecast period. While the change to the underpayment rate will increase revenue over

the forecast period, the increased overpayment rate will reduce revenue over the forecast period at a greater rate.

16. The net tax revenue impact of the change is shown in the table below.

\$ millions increase / (decrease)					
Vote Revenue	2022/23	2023/24	2024/25	2025/26	2026/27 & outyears
Tax Revenue impact of change to Underpayment rate	25.000	56.000	56.000	56.000	56.000
Tax Revenue impact of change to Overpayment rate	(17.000)	(37.000)	(37.000)	(37.000)	(37.000)
Net Tax Revenue Impact	8.000	19.000	19.000	19.000	19.000

17. However, a large part of underpayment debt is typically written off, meaning the cost to revenue is larger than the net revenue impact reported above. To represent this, underpayments are impaired in the Crown accounts to reflect that most UOMI charged is never paid and must be written off. Increasing the underpayment rate thus also increases impairment expenditure.

18. Based on debt repayment for the year ending 30 June 2022, the impairment rate used for this paper is 67.63%. The total fiscal impact and operating expenditure for the forecast period taking this impairment into account are presented in the table below:

\$ millions increase / (decrease)					
Vote Revenue	2022/23	2023/24	2024/25	2025/26	2026/27 & outyears
Crown Revenue and Receipts:	9.000 ¹	19.000	19.000	19.000	19.000
Tax Revenue					
Non-Departmental Other Expense:	17.000	38.000	38.000	38.000	38.000
Impairment of debt and debt write-offs					
Total operating	8.000	19.000	19.000	19.000	19.000

Publicity

19. Inland Revenue will publish an item about these changes in the next available issue of its *Tax Information Bulletin*, the February 2023 issue. However, since the proposed changes will apply from 17 January 2023, a timelier notification method is required. Therefore, Inland Revenue will also publish a special report on the changes once the Order in Council has been made.

Proactive Release

20. I propose to proactively release this Cabinet paper, associated minutes, and key advice papers in whole within 30 working days of Cabinet making final decisions.

Consultation

21. The Treasury, the New Zealand Customs Service, and the Parliamentary Counsel Office have been consulted in the preparation of this paper and agree with its recommendations.

Recommendations

I recommend that the Cabinet Legislation Committee:

1. **agree** that the UOMI underpayment rate increase from 7.96% to 9.21%.
2. **agree** that the UOMI overpayment rate increase from 1.22% to 2.31%.

¹ Note this figure differs from the table above due to rounding differences to ensure the table sums correctly.

3. **agree** that the Taxation (Use of Money Interest Rates) Amendment Regulations (No 3) 2022 give effect to the rates referred to in paragraphs 1 and 2 above.
4. **agree** that the Taxation (Use of Money Interest Rates) Amendment Regulations (No 3) 2022 come into force on 17 January 2023.
5. **note** the following changes as a result of the decision in recommendations 1 and 2 above, with a corresponding impact on the operating balance:

\$ millions increase / (decrease)					
Vote Revenue	2022/23	2023/24	2024/25	2025/26	2026/27 & outyears
Crown Revenue and Receipts:	9.000	19.000	19.000	19.000	19.000
Tax Revenue					
Non-Departmental Other Expense:	17.000	38.000	38.000	38.000	38.000
Impairment of debt and debt write-offs					
Total operating	8.000	19.000	19.000	19.000	19.000

6. **approve** the forecast change in appropriations for Non-Departmental Other Expenses set out in recommendation 5, as a result of the decision in recommendations 1 and 2, with a corresponding impact on the operating balance.
7. **agree** that the proposed change to the Impairment of Debt and Debt Write-offs appropriation for 2022/23 above be included in the 2022/23 Supplementary Estimates and that, in the interim, the increase(s) be met from Imprest Supply:
8. **authorise** the submission to the Executive Council of the Taxation (Use of Money Interest Rates) Amendment Regulations (No 3) 2022.

Authorised for lodgement

Hon David Parker
Minister of Revenue