



POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Use of money interest rates review

Date:	26 January 2023	Priority:	Medium
Security level:	In Confidence	Report number:	IR2023/003

Action sought

	Action sought	Deadline
Minister of Finance	Agree to adjust the use of money interest rates as set out in the report.	02 February 2023
Minister of Revenue	Agree to adjust the use of money interest rates as set out in the report. Sign and refer the attached paper to the Cabinet Office for consideration at the LEG meeting on 23 February 2022.	02 February 2023

Contact for telephone discussion (if required)

Name	Position	Telephone
Paul Fulton	Principal Policy Advisor	s 9(2)(a)
Mila Maxon	Policy Advisor	s 9(2)(a)

26 January 2023

Minister of Finance
Minister of Revenue

Use of money interest rates review

Purpose

1. This report discusses the outcome of the regular review of the use of money interest (UOMI) rates. It seeks your agreement to increase the rates in line with the latest increases in market interest rates.

Context and background

2. The UOMI rates, along with other rates used in the tax system,¹ are reviewed regularly to ensure that they align with market interest rates. The rates are calculated using formulae based on the Reserve Bank of New Zealand (RBNZ) survey of interest rates.
3. 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.

UOMI rates

4. There are two UOMI rates:
 - 4.1 the taxpayer's paying rate (also known as the UOMI underpayment rate), which is charged on underpayments of tax to Inland Revenue;
 - 4.2 the Commissioner's paying rate (also known as the UOMI overpayment rate), which is paid by the Commissioner on money paid to Inland Revenue above a taxpayer's tax liability.
5. The underpayment rate is currently 9.21%, while the overpayment rate is currently 2.31%, based on RBNZ figures from August 2022.

Principles for updating the rates

6. Longstanding administrative principles in setting the rates provide that both UOMI rates should be adjusted if:
 - 6.1 the RBNZ 90-day bank bill rate or the floating first mortgage new customer housing rate moves by 100 basis points or more from the figures used to calculate the last rate change; or
 - 6.2 one of these indexes moves by 20 basis points or more and the UOMI rates haven't been adjusted in the last 12 months.

¹The other rates are the FBT interest rate on employment-related loans and the deemed rate of return on attributing interests in foreign investment funds.

7. When regulations are made altering the UOMI rates, the adjustment is applied from the day after the next standard provisional tax payment date – which, in this case, is 7 May 2023. However, 7 May 2023 falls on a Sunday which makes 8 May 2023 the date that tax payable is due. Therefore, the increased UOMI rates should apply from the next day which is 9 May 2023.
8. The formula for setting the rates is set out in the Taxation (Use of Money Interest Rates Setting Process) Regulations 1997 as follows:
 - 8.1 Section 2 of the Regulations provides that the taxpayer’s paying rate is set at the RBNZ floating first mortgage new customer housing rate plus 250 basis points (or 2.5%);
 - 8.2 Section 3 of the Regulations provides that the Commissioner’s paying rate is set at the RBNZ 90-day bank bill rate less 100 basis points (or 1 percentage point). However, if this calculation would produce a figure lower than 0%, the rate is instead set at 0%, to ensure overpayments do not accrue negative interest.
9. 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 like 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 creditworthiness).
10. 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 a payment of tax to Inland Revenue being used as an investment.

Results of latest RBNZ figure review

11. According to RBNZ figures from December 2022, both the floating first mortgage new customer housing rate and the 90-day bank bill rate have risen more than 100 basis points from their positions at August 2022, which triggers the UOMI rates to be reset.
12. The UOMI underpayment rate should be increased to 10.39%, while the UOMI overpayment rate should be increased to 3.53%.
13. The RBNZ floating first mortgage new customer rate has risen by 118 basis points since August 2022 (the last time the UOMI rates were set). Accordingly, the underpayment rate should be increased by 118 basis points, from 9.21% to 10.39%.
14. The RBNZ 90-day bank bill rate has risen by 122 basis points since August 2022. Accordingly, the overpayment rate should be increased from 2.31% to 3.53%.

Fiscal Impact

15. UOMI applies to both overpayments and underpayments of tax. More is charged by the Commissioner on underpayments than is paid to the taxpayer on overpayments.

In Confidence

However, the charges to underpayments are impaired 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. The rate of impairment reflects the average repayment rate of recent debt, updated in October each year. The impairment rate for the year ended 30 June 2022 is 67.63%.

16. The full year net saving for the 2022/23 fiscal year is estimated to be \$1 million, and \$3 million per annum for 2023/24 and later years. These savings comprise a revenue increase of \$6 million in 2022/23 and \$38 million per annum for 2023/24 and later years, and an increase in impairment expenditure of \$5 million in 2022/23 and \$35 million per annum for 2023/24 and later years. This is shown in the following tables:

\$ millions increase / (decrease)					
Vote Revenue Minister of Revenue	2022/23	2023/24	2024/25	2025/26	2026/27 & outyears
Crown Revenue and Receipts:					
Tax revenue	6.000	38.000	38.000	38.000	38.000
Total Operating	(6.000)	(38.000)	(38.000)	(38.000)	(38.000)

\$ millions increase / (decrease)					
Vote Revenue Minister of Revenue	2022/23	2023/24	2024/25	2025/26	2026/27 & outyears
Non-Departmental Other Expenses:					
Impairment of debt and bad debt write- offs	5.000	35.000	35.000	35.000	35.000
Total Operating	5.000	35.000	35.000	35.000	35.000

Consultation

17. Inland Revenue has consulted with the Treasury and the New Zealand Customs Service (Customs) on this report. They agree with the recommendations.
18. Customs advise that a change in the underpayment UOMI rate will have some small operational and financial impacts. Customs' compensatory interest rate is aligned with the UOMI underpayment rate, and an increase in the underpayment rate will correspondingly result in an increase to the compensatory interest rate.
19. Since the rate change to 7.96% on 30 August 2022, Customs have collected \$116,516.44 in compensatory interest.² If the compensatory interest rate had been 10.39%, they estimate they would have collected \$152,086.16 instead over that period, an increase of \$35,569.72. Customs also estimate that, over the next 12

² As the 9.21% rate only came into effect on 17 January 2023, Customs provided data from the rate change prior to that.

In Confidence

months, they would collect \$375,077.35 in compensatory interest if the rate were set at 10.39%.³

20. Customs note that in the last quarter there were more transactions with compensatory interest than expected and some were of high value.

Next steps

21. Officials have advised PCO that a draft Order in Council changing the rates may need to be prepared depending on your decision.
22. Attached is a paper to the Cabinet Legislation Committee, recommending that it approve the Order in Council and authorise their submission to Cabinet and the Executive Council. If you decide to increase the UOMI rates, the paper should be referred to Cabinet Office by 10am, Thursday 16 February 2023. This would enable the Cabinet Legislation Committee to consider the paper on 23 February 2023.

³ Note that this projected figure excludes compensatory interest that may be collected as a result of Customs' investigation and trade audit activities.

Recommended action

I recommend that you:

Recommendations	Minister of Finance	Minster of Revenue																														
a) agree to increase the UOMI underpayment rate to 10.39% (from 9.21%) and the UOMI overpayment rate to 3.53% (from 2.31%), effective from 9 May 2023.	Agreed Not agreed	Agreed Not agreed																														
b) note the following changes as a result of the decision in recommendation (a) above, with a corresponding impact on the operating balance: <table border="1" data-bbox="204 703 1066 1135"> <thead> <tr> <th colspan="6">\$ millions increase / (decrease)</th> </tr> <tr> <th>Vote Revenue Minister of Revenue</th> <th>2022/23</th> <th>2023/24</th> <th>2024/25</th> <th>2025/26</th> <th>2026/27 & outyears</th> </tr> </thead> <tbody> <tr> <td>Crown Revenue and Receipts:</td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td>Tax revenue</td> <td>6.000</td> <td>38.000</td> <td>38.000</td> <td>38.000</td> <td>38.000</td> </tr> <tr> <td>Total Operating</td> <td>(6.000)</td> <td>(38.000)</td> <td>(38.000)</td> <td>(38.000)</td> <td>(38.000)</td> </tr> </tbody> </table>	\$ millions increase / (decrease)						Vote Revenue Minister of Revenue	2022/23	2023/24	2024/25	2025/26	2026/27 & outyears	Crown Revenue and Receipts:						Tax revenue	6.000	38.000	38.000	38.000	38.000	Total Operating	(6.000)	(38.000)	(38.000)	(38.000)	(38.000)	Noted	Noted
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c) approve the following forecast change in appropriations for Non-Departmental Other Expense as a result of the decision in recommendation (a) above, with a corresponding impact on the operating balance: <table border="1" data-bbox="204 1301 1066 1794"> <thead> <tr> <th colspan="6">\$ millions increase / (decrease)</th> </tr> <tr> <th>Vote Revenue Minister of Revenue</th> <th>2022/23</th> <th>2023/24</th> <th>2024/25</th> <th>2025/26</th> <th>2026/27 & outyears</th> </tr> </thead> <tbody> <tr> <td>Non-Departmental Other Expenses:</td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td>Impairment of debt and bad debt write-offs</td> <td>5.000</td> <td>35.000</td> <td>35.000</td> <td>35.000</td> <td>35.000</td> </tr> <tr> <td>Total Operating</td> <td>5.000</td> <td>35.000</td> <td>35.000</td> <td>35.000</td> <td>35.000</td> </tr> </tbody> </table>	\$ millions increase / (decrease)						Vote Revenue Minister of Revenue	2022/23	2023/24	2024/25	2025/26	2026/27 & outyears	Non-Departmental Other Expenses:						Impairment of debt and bad debt write-offs	5.000	35.000	35.000	35.000	35.000	Total Operating	5.000	35.000	35.000	35.000	35.000	Approved Not approved	Approved Not approved
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d) note that the fiscal impacts will be treated as a forecast change, and so will have no impact on allowances.	Noted	Noted																														
e) agree that the proposed change to the <i>Impairment of Debt and Debt Write-offs</i> 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.	Agreed Not agreed	Agreed Not agreed																														

Recommendations	Minister of Finance	Minster of Revenue
f) agree that PCO draft an Order in Council to adjust the UOMI rates.	Agreed Not agreed	Agreed Not agreed
g) approve and refer the attached Cabinet paper to the Cabinet Office by 10am Thursday 16 February 2023 for consideration by Cabinet Legislation Committee at its meeting on 23 February 2023.	N/A	Approved Not approved

s 9(2)(a)

Paul Fulton

Principal Policy Advisor

Hon Grant Robertson

Minister of Finance

/ /2023

Hon David Parker

Minister of Revenue

/ /2023