

Regulatory Impact Statement: Customs and Excise Act Review: Regulations: De minimis threshold for compensatory interest and late payment penalties

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by the New Zealand Customs Service.

It provides an analysis of options to prescribe a de minimis threshold, below which compensatory interest and late payment penalty charges will not be collected.

This RIS is one of three addressing administrative details of Customs' new compensatory interest and late payment penalties regime.

The following are the constraints and limitations on the analysis.

Assumptions

The analysis assumes that the following recommendations, made in two other RIS's, will be implemented:

- the reduced interest rate for shortfall payments made due to an inadvertent error will be pegged to the 90-day bank bill rate, and will be limited to those shortfalls that are voluntarily disclosed and paid in full within the timeframe specified on the payment notice (see *Customs and Excise Act Review: reduced compensatory interest rate for inadvertent errors*)
- compensatory interest incurred between the date a duty payer is notified of the charges and the date they make payment will be cancelled, as long as the duty is paid in full within the timeframe specified on the payment notice (see *Customs and Excise Act Review: compensatory interest incurred between notification of an incorrect payment and payment*).

Data limitations

Data on late and shortfall payments of duty is not complete or reliable. It is also not available in a usable format. For example, late payment data is only available in the form of a monthly snapshot, which does not track individual late payments over time. Furthermore, the available data for both late and shortfall payments includes non-duty charges, which will not be subject to compensatory interest and late payment penalties.

Where possible anecdotal evidence has been used to provide an indication of what percentage of incorrect duty payments would fall above or below a de minimis threshold. However, it has not been possible to calculate the value of duty that would be written off under a particular de minimis threshold.

Effect of interest rates and upgrades to collection systems

The analysis is based on the cost of calculating and charging interest and penalties under Customs' current manual system. It is likely that much of the process will be automated and costs will reduce significantly as a result of a planned upgrade to Customs' financial management system. The de minimis provisions will need to be reviewed when the upgraded system is implemented.

The cost-effective collection point for compensatory interest and late payment penalties has been determined based on current market interest rates. If interest rates were to change significantly, the de minimis provisions will need to be reviewed.

Signed by Anna Cook on 31 July 2017

Anna Cook
Director Policy

31 July 2017

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Executive summary

- 1 This Regulatory Impact Statement is one of three addressing administrative details of Customs' new compensatory interest and late payment penalties regime.
- 2 In some cases, it may not be economical for Customs to calculate and collect compensatory interest and late payment penalties, as the costs of doing so may exceed the revenue collected. The Bill therefore allows for regulations to set a de minimis threshold, below which no compensatory interest or late payment penalties will be collected.
- 3 The recommended option for a de minimis is that no compensatory interest or late payment penalties should be collected if the outstanding core duty is less than \$1000. This would ensure that, in most cases, Customs would only collect interest and penalty charges if the costs of doing so would be recovered. It would also protect duty payers from having to seek remission of interest or penalties, where the cost of providing supporting information would exceed the value of the potential remission.
- 4 As the costs of collecting interest and penalty charges vary depending on the circumstances of the incorrect duty payment, this option would lead to Customs forgoing interest in some cases where the collection costs would have been recovered. Although Customs could capture this interest by prescribing different de minimis thresholds for different circumstances, the single \$1000 threshold is preferred, because it is easier for stakeholders to understand and is more consistent with Inland Revenue's approach.
- 5 The de minimis threshold will need to be reviewed when Customs completes a planned upgrade to its financial management system, as this is expected to lower the costs of collecting interest and penalties. Further review will be required if market interest rates change significantly.

Status quo and problem definition

- 6 Customs duties are charges imposed on goods that are imported into New Zealand and on some domestically manufactured goods. They include tariff duty, excise-equivalent duty and GST on imported goods; and excise duty on domestically produced alcohol, tobacco and fuel.
- 7 There are three ways in which a duty payer might not pay their duty in full by the due date:
 - **late payment:** when some or all of the duty assessed on an import or excise entry is not paid by the due date
 - **shortfall payment:** when an import or excise entry is incorrect, or the goods are not entered, causing a duty payer's duty liability to be under-assessed
 - **incorrect repayment:** when a duty payer provides incorrect information to Customs that results in them receiving a repayment of duty that they are not entitled to. This is similar to a shortfall payment, as both are caused by incorrect or missing information.
- 8 The Bill introduces a system of compensatory interest and late payment penalty charges for people who do not pay their duty in full by the due date (see EGI-17-MIN-

0019). These provisions are broadly consistent with Inland Revenue's approach. They will replace Customs' current additional duty regime, which is outdated and unduly punitive.¹

- 9 Compensatory interest and late payment penalties have distinct purposes – interest is intended to compensate the Crown for loss of use of money, while penalties are intended to punish and deter non-compliant behaviour. The following table outlines how the new compensatory interest and late payment penalty charges will apply to different types of incorrect payments:

Incorrect payment type	Interest and penalty charges
Late payment	<ul style="list-style-type: none"> Compensatory interest of 8.22% per annum², charged for each day the duty is outstanding. A late payment penalty of 1% of any outstanding duty charged on the first day after the due date. A late payment penalty of 4% charged on any duty still outstanding at the end of the seventh day after the due date.
Shortfall payment	<ul style="list-style-type: none"> Compensatory interest of 8.22% per annum, charged for each day the duty is outstanding. Interest will be partially remitted to 2% per annum³, if the shortfall error is voluntarily disclosed, the core debt is paid in full, and the duty payer can demonstrate that the error was inadvertent⁴. Shortfall payments will not attract late payment penalties. However other sanctions, such as administrative penalties or prosecution, may apply.
Incorrect repayment	<ul style="list-style-type: none"> Compensatory interest of 8.22% per annum, charged for each day the duty is outstanding. Incorrect repayments will not attract late payment penalties. However other sanctions, such as prosecution, may apply.

- 10 Customs expects that about \$500,000 of interest and late payment penalties will be payable each year under the new regime. In some cases, it will not be economical to collect the interest and penalties. Customs will use a manual system to calculate and charge compensatory interest and late payment penalties. This process can be time consuming and resource intensive. If a compensatory interest or late payment penalty debt is small, the processing costs are likely to be greater than the amount of revenue collected.

¹ Two RISs were prepared relating to replacing the additional duty regime with compensatory interest and late payment penalties. See *Customs and Excise Act Review: Sanctions for incorrect payments* and *Customs and Excise Act Review: Sanctions for incorrect payments – detailed design of a new regime*.

² This interest rate will be pegged to the floating first mortgage rate, plus 2.5%. Inland Revenue uses the same basis for their use of money interest, and are currently charging 8.22%.

³ This interest rate will be pegged to the 90-day bank bill rate, which, under current market conditions, is about 2% per annum.

⁴ See *Customs and Excise Act Review: reduced compensatory interest rate for inadvertent errors*

- 11 The Bill therefore enables regulations to prescribe a de minimis value, below which the payment of compensatory interest and late payment penalties would not be required. This RIS provides an analysis of options for a de minimis value.

Objectives

- 12 The primary objective in setting a de minimis value is to ensure that compensatory interest and late payment penalties are only collected when the marginal revenue collected is greater than the marginal cost of collection.
- 13 The following objectives have also been taken into consideration when comparing options:

Objective	Indicator
Does not undermine the purpose of compensatory interest and late payment penalties	<ul style="list-style-type: none">• Maintains incentives for duty payers to pay core duty in full.• Crown is compensated for loss of use of money.
Minimise compliance costs for duty payers	<ul style="list-style-type: none">• De minimis provisions are easy to understand and duty payers know whether they will be charged interest and penalties.• Ensures that duty payers are not discouraged from legitimately requesting remission of compensatory interest or late payment penalty, because the cost of doing so is greater than the value of the potential remission.

Options and impact analysis

- 14 A review of Customs' collection systems concluded that the following are the cost-effective collection points for interest and penalties (see Appendix A):
- **late payments:** no interest or penalties to be collected if unpaid duty is less than \$1000
 - [REDACTED]
 - **all other shortfall payments and incorrect repayments:** not interest to be paid if interest accrued is less than \$20.
- 15 Customs has considered the following options for prescribing a de minimis threshold for the collection of compensatory interest and late payment penalties.

Option 1: no de minimis

- 16 Under this option, Customs would collect compensatory interest and late payment penalties on all late payments, shortfall payments, and incorrect repayments.
- 17 No further action is required to implement this option.

Option 2: de minimis thresholds tailored to incorrect payment type

- 18 Under this option, the de minimis provisions would be aligned to the different processing costs for different types of incorrect payment:
- no interest or late payment penalty would be collected on late payments of less than \$1000 core duty
 - [REDACTED]
 - for all other shortfall payments and incorrect repayments, no interest would be collected if the interest owing was less than \$20
 - if a shortfall payment was not settled in full by the date specified on the payment notice, and the core duty outstanding after that date was less than \$1000, no late payment penalty would be collected. However, if the interest owing at the time of notification was greater than \$20, interest would be collected.

Option 3: \$1000 core duty for all incorrect payment types (recommended option)

- 19 Under this option, no late payment penalties or interest would be charged on any incorrect payment less than \$1000.
- 20 This option takes a similar approach to Inland Revenue, who do not charge interest or late payment penalties on unpaid tax of less than \$100. Inland Revenue's cost-effective collection point is lower than Customs'. Inland Revenue's interest and penalty charges are processed by an automated system, which has significantly lower costs than Customs' manual system.

Impact analysis

- 21 The table on the following pages summarises the impacts of each option on the Crown and on duty payers.

	Collection of interest and penalties is cost-effective	Does not undermine purpose of interest and penalties	Minimises compliance costs for duty payers
<p>Option 1: no de minimis</p>	<p>Evaluation against criteria:</p> <p>This option would not ensure that collection of interest and penalties is cost-effective.</p> <p>Impacts:</p> <p>Customs would be responsible for collecting all of the \$500,000 of interest and penalties payable each year under the new regime. However, the net benefit to the Crown would not be maximised, because collection costs would exceed the amount collected in the following situations:</p> <ul style="list-style-type: none"> • where a late payment results in total interest and penalty charges of less than \$50. This is likely to be ten percent, or less, of late payments • [REDACTED] • where any other shortfall payment or incorrect repayment results in an interest charge of less than \$20. It is not clear how many shortfalls and incorrect repayments would fall into this category. 	<p>Evaluation against criteria:</p> <p>This option does not undermine the interest and late payment penalty regime.</p> <p>Impacts:</p> <p>The knowledge that interest and late payment penalties will always be charged gives duty payers strong incentives to pay their duty on time.</p> <p>The Crown will be fully compensated for loss of use of money, as compensatory interest will always be charged.</p>	<p>Evaluation against criteria:</p> <p>This option has the highest compliance costs.</p> <p>Impacts:</p> <p>It would be clear to duty payers that compulsory interest and late payment penalties would be charged on all late payments.</p> <p>[REDACTED]</p> <p>This option could also prevent duty payers from requesting remission of interest and penalties on other grounds, if the amount to be remitted was small compared to the costs of making the remission request and providing supporting evidence.</p>

<p>Option 2: de minimis thresholds tailored to incorrect payment type</p>	<p>Evaluation against criteria: This is the most cost-effective option for the collection of interest and penalties.</p> <p>Impacts: Customs would forgo collection of some of the \$500,000 of interest and penalties payable each year under the new regime, but only where collection costs exceeded the amount collected. This means that the net amount collected by the Crown would be greater than if there was no de minimis threshold.</p> <p>Under this option, there would be a handful of situations in which collection of interest and penalties would not be cost-effective. For example, a late payment above the \$1000 de minimis threshold could result in an uneconomically small amount of interest and penalties being collected, if the outstanding duty was paid in part or in full before the four percent late payment penalty is applied on the seventh day after the due date. However, these scenarios are not common, and, in the vast majority of cases, this option would ensure that the collection of interest and penalties is cost-effective.</p>	<p>Evaluation against criteria: This option could undermine incentives to pay duty on time.</p> <p>Impacts: Protection from interest and penalties on small amounts of unpaid duty would generally weaken incentives for duty payers to ensure that all of their core duty is paid on time. [REDACTED]</p> <p>The Crown will likely be fully compensated for loss of use of money, as most of the compensatory interest charged will be at a considerably higher rate than is necessary to fully compensate the Crown, offsetting the value of the interest forgone.</p>	<p>Evaluation against criteria: Compliance costs under this option are likely to be lower than option 1, but higher than option 3.</p> <p>Impacts: This option will likely be very confusing for duty payers. It will not immediately be clear which de minimis provisions apply in individual circumstances. In particular, it is not likely to be clear to duty payers how their shortfall payment will be treated if it is not paid by the date specified on the payment notice and then becomes liable for late payment penalties.</p> <p>The existence of de minimis thresholds would limit the instances where the costs of providing information to support Customs' remission assessment would exceed the value of the remission.</p>
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<p>Option 3: \$1000 core duty for all incorrect payment types</p> <p>Recommended option</p>	<p>Evaluation against criteria: Collection of interest and penalties under this option is likely to be more cost-effective than having no de minimis threshold, but less cost effective than the bespoke thresholds under option 2.</p> <p>Impacts: Customs would forgo collection of some of the \$500,000 of interest and penalties payable each year under the new regime. For most incorrect payments below the de minimis threshold, it will be cost-effective to forgo the interest and penalties, as collection costs would exceed the amount collected. However, some of the interest forgone on shortfall payments and incorrect repayments will be interest that could have been collected cost-effectively, ie the interest would have been greater than the \$20 collection cost. It is not clear what percentage of shortfall payments and incorrect repayments under the \$1000 threshold will result in interest charges of more than \$20.</p>	<p>Evaluation against criteria: This option is likely to undermine incentives to pay duty on time.</p> <p>Impacts: This option would have a similar effect to option two of weakening incentives for duty payers to ensure their duty is paid on time. [REDACTED]</p> <p>The Crown will likely be fully compensated for loss of use of money, as most of the compensatory interest charged will be at a considerably higher rate than is necessary to fully compensate the Crown, offsetting the value of the interest forgone.</p>	<p>Evaluation against criteria: This option has the lowest compliance costs.</p> <p>Impacts: The simple rule that no interest or late payment penalties would be charged on any incorrect duty payments of less than \$1000 would give certainty to duty payers about how their incorrect payment will be treated. This option would also be easy for duty payers to understand, as it is similar to Inland Revenue's approach of not charging interest or late payment penalties on unpaid tax less than \$100.</p> <p>This option would increase protection for duty payers, across all incorrect payment types, from situations where the cost of providing information to support a remission assessment exceeds the value of the remission.</p>
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Consultation

- 22 Customs consulted the following government agencies on this RIS: the Treasury, Inland Revenue, and the Ministry of Justice. No issues were raised.
- 23 Customs also undertook targeted consultation with stakeholders who expressed an interest in the compensatory interest and late payment penalty regime. This included major accounting firms, importers and excise stakeholders. Stakeholders support a \$1000 core duty de minimis threshold, viewing it as reasonable and consistent with Inland Revenue's approach.

Conclusions and recommendations

- 24 The recommended option is that no compensatory interest or late payment penalties should be charged if the outstanding core duty is less than \$1000 (option three). This option would ensure that, in the majority of cases, Customs would only calculate and collect interest and penalty charges if the costs of doing so would be recovered.
- 25 This option would also be simple for duty payers to understand, and is broadly consistent with Inland Revenue's approach of not charging penalties and interest on unpaid tax of less than \$100. Inland Revenue's cost-effective collection point is lower than Customs. Inland Revenue's interest and penalty charges are processed by an automated system, which has significantly lower costs than Customs' manual system.
- 26 A de minimis that covers all incorrect payment types also provides the greatest protection to duty payers from situations where the compliance costs associated with an assessment for remission are greater than the value of the potential remission.
- 27 It is expected that less than ten percent of late payments will fall below the \$1000 threshold. It is not clear what percentage of shortfall payments and incorrect repayments will be affected.
- 28 Under this option, there will be some situations in which Customs would either collect or forgo interest, despite it being uneconomical to do so. However, there is not likely to be a reduction in core Crown revenue, because:
- late payment penalties are not core revenue, and
 - most of the compensatory interest charged on incorrect payments over \$1000 will be at a considerably higher rate than is necessary to fully compensate the Crown – this will likely offset the value of the interest forgone.
- 29 Introducing a de minimis will weaken incentives to pay smaller amounts of duty on time. However, this risk can be managed through other enforcement tools. In cases of repeated non-payment of small amounts of duty, Customs may call on a range of effective non-monetary sanctions, including prosecution, detention of future imports for a document audit or inspection, and suspension of privileges. Furthermore, if Customs is aware that duty has not been paid, payment is ultimately enforceable through the courts.

Implementation plan

- 30 The regulations proposed in this RIS will be implemented concurrently with the new compensatory interest and late payment penalty regime, which is included in the Customs and Excise Bill. The Bill is currently awaiting its second reading.
- 31 Customs has developed a comprehensive plan for implementing the Customs and Excise Bill to ensure a seamless transition to the new arrangements
- 32 Guidance material is being developed for both internal and external clients. This material will include operational procedures and practical examples for Customs staff and will assist in consistent application of compensatory interest and late payment penalties in line with the overall policy intent. This guidance material will also form the basis of training packages for Customs staff.
- 33 Prior to implementation, consultation will be undertaken with external stakeholders by way of workshops and feedback on documentation. Following this, external guidance material will be developed to give external clients practical examples on how the compensatory interest, penalties and remissions will be applied. There will be a communications plan associated with the passing of the Bill to publicise the changes.
- 34 There are no implementation risks that require further mitigation.

Monitoring, evaluation and review

- 35 The Financial Management Information System (FMIS) that Customs uses to administer duties is to be upgraded. The ability to automatically calculate penalties and interest will be scoped as part of this upgrade. An automated system could significantly reduce the costs of calculating and charging interest and penalties. As such, the de minimis provisions will need to be reviewed when FMIS is upgraded. It is not yet clear when the upgrade is likely to be implemented, as the tender process is still underway.
- 36 Once the new compensatory interest and late payment penalty regime is implemented, Customs will set up a programme to collect the following data:
 - the value of all incorrect duty payments, and the time period the duty is outstanding for
 - the percentage of shortfall payments that are voluntarily disclosed, and the percentage that are granted partial remission of compensatory interest
 - the value of late payment penalties and compensatory interest that is written off under the de minimis provisions.
- 37 This data will be used to inform the review of the de minimis provisions following the FMIS upgrade.
- 38 Customs will also monitor the number of incorrect payments where the underpaid duty is less than \$1000. A significant increase would indicate that there are insufficient incentives to pay duty in full in the absence of compensatory interest and late payment penalties.

Appendix A: Determining an appropriate de minimis value

- 1 A de minimis threshold should be set so that the value of the interest and penalty charges is equal to the marginal cost of processing those charges.
- 2 Appropriate de minimis thresholds have been considered separately for different incorrect payment types, as late payments are very different types of debts to shortfall payments and incorrect payments, with different calculation and collection processes.

Late payments

- 3 Late payments will attract both late payment penalties and compensatory interest. Most late payments are not outstanding for more than a few weeks, meaning that the majority of the resulting charges are made up of the 1 percent and 4 percent late payment penalty, with smaller amounts of interest.
- 4 Late payments are processed by Customs' Revenue Management team. Staff-driven costs for Revenue Management are \$40.34 an hour.
- 5 The costs to Customs of processing compensatory interest and late payment penalties will primarily be the costs of calculating the amount of interest and penalty. There will also be a small amount of resource required to generate and send a payment notice to the duty payer.
- 6 It is expected that the process of calculating interest and late payment penalties will be similar to the process used to calculate additional duty under the current regime. This process involves manually printing an invoice, isolating duty charges, deducting any payments already made, calculating the amount of additional duty that has accrued on the balance, and entering the charges into Customs' financial management system. It can take an officer between 30 minutes and two hours to calculate additional duty on a late payment. A calculation in the middle of this range would cost about \$50 to complete (1.25 hours at \$40.34 an hour).
- 7 **An appropriate de minimis value for late payments would be \$1000 of core duty.** A late payment of \$1000, outstanding for between a week and a month, would attract interest and penalties roughly equal to the \$50 cost of calculating those charges (total late payment penalty of \$50, plus compensatory interest of between \$1.58 and \$6.98).
- 8 The de minimis threshold must be based on a value of core duty, as opposed to the value of interest and late payment penalties, in order to eliminate the costs of calculating the interest and penalty charges.

Shortfall payments and incorrect repayments

- 9 Shortfall payments and incorrect repayments will attract compensatory interest, but no late payment penalty. The interest will be partly remitted for voluntarily disclosed shortfalls, if the duty is paid in full by the date specified on the payment notice, and the duty payer can demonstrate that the error was inadvertent. It is expected that this remission will be routinely granted for voluntary disclosures.⁵

⁵ See *Customs and Excise Act Review: reduced compensatory interest rate for inadvertent errors*

- 10 Shortfall payments are processed by Customs' Trade Assurance team. Staff-driven costs for Trade Assurance are \$45.56 an hour.

Standard shortfall payments and incorrect repayments

- 11 The cost of calculating compensatory interest on shortfall payments and incorrect repayments will be lower than for late payments, as the calculation process is simpler. In addition to the fact that there is no late payment penalty to calculate, some of the steps, such as isolating duty charges from non-duty charges, will already be completed as part of an audit report or other investigation of the error. Furthermore, as the unpaid duty is identified retrospectively, there are generally no part payments to deduct.
- 12 In addition to a small amount of time spent calculating the interest, there will also be some costs to produce and send out an assessment notice and supporting documentation. These processes could take up to 30 minutes, at a cost of up to \$23 (0.5 hours at \$45.56 an hour). Therefore, **an appropriate de minimis value for most shortfall payments and incorrect repayments would be \$20 of interest.**
- 13 In this case (unlike late payments), it is appropriate that the de minimis threshold be based on a value of interest, as opposed to a value of core duty, as the costs associated with making the interest calculation are small.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]