Regulatory Impact Statement

Relief of interest on overdue tax (foreign workers here for the earthquakes)

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Inland Revenue.

It provides an analysis of options to relieve interest on overdue tax for foreign workers in New Zealand following the earthquakes in Canterbury (including aftershocks). Some of these workers have not paid tax in New Zealand because they expected their stay to be too short for a tax liability to arise. Further earthquakes have lengthened their stays, however, so that they have become liable for tax. That tax is now overdue.

Two feasible options have been identified. The first is to relieve interest on overdue tax in the circumstances. The second is the status quo. A third option, complete relief from tax for the foreign workers, is not considered on the grounds that its benefits are questionable, its costs are high and it has already been considered twice before.

The analysis in this statement has been limited by the short time available (the issue requires an urgent response) and by incomplete data. It has not been possible to quantify some costs and benefits, owing to the nature of those costs and benefits or to a scarcity of data.

There has been previous consultation with the industry about the general issue of taxation of foreign workers coming to New Zealand following the earthquakes.

However, there has not been time for consultation about the specific proposal to relieve interest on overdue tax. If relief from interest is provided, a legislative amendment will be required and there will be consultation with industry about the detail of that amendment.

The option to relieve interest is not expected to:

- impose additional costs on businesses (reduced tax would exceed any increased compliance costs)
- impair private property rights, restrict market competition, or reduce the incentives on businesses to innovate and invest, or
- override fundamental common law principles.

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STATUS QUO AND PROBLEM DEFINITION

1. Foreign loss adjusters (insurance assessors) have come to New Zealand to assist with insurance assessments in the wake of earthquakes in Canterbury (including aftershocks). If they remain in New Zealand for a sufficient time (often 183 days) the loss adjusters are liable to pay New Zealand tax. This is the case for their employees as well, if they have any.

2. Many loss adjusters organised their affairs to avoid long stays here, so that they would not have to pay tax in New Zealand. On that basis, they have not paid any tax so far. However, stays have been unexpectedly prolonged because of the significant earthquakes in February and June.

3. Loss adjusters who had not paid any tax, on the expectation of a short stay, may now find themselves liable. The liability extends back to their arrival, and the tax is now overdue. This has prompted concerns about interest charged on the unpaid tax and penalties for late payment. We understand from recent correspondence with a Minister's office that these concerns are making it difficult to keep some of the loss adjusters in New Zealand.

4. Inland Revenue has discretion to waive penalties for late payment. However, Inland Revenue currently has no explicit ability to waive interest charged on overdue tax owed by the loss adjusters.

5. This RIS identifies options for addressing concerns about the interest on overdue tax.

OBJECTIVES

6. The government does not wish to impose financial penalties on workers who have come to New Zealand to assist in the aftermath of the earthquakes, if those workers have acted in good faith.

7. The government also does not wish financial penalties to become an undue barrier to retaining foreign workers in New Zealand.

8. At the same time, the government does not wish to incur a high fiscal cost.

9. The analysis in this statement has been triggered by communication from loss adjusting firms that employ foreign contractors. They have expressed a need to make a decision with urgency, given that some loss adjusters are on the cusp of leaving the country to prevent tax liabilities arising. This limits the time available to consider alternative solutions. However, it is noted that related issues of taxation of foreign loss adjusters have been raised, and considered, on two previous occasions. The prior consideration informs this statement.

REGULATORY IMPACT ANALYSIS

10. Two practical options have been identified. These are:

- First option: through legislative change, relieve interest on unpaid tax for foreign workers who have come to New Zealand because of the earthquakes and might have had their stays prolonged by further earthquakes.

- Second option: status quo.

11. Another option – exempting foreign workers from tax altogether – is not considered a feasible option. This option was considered and rejected by the Ministers of Finance and Revenue on two previous occasions, following reports by Treasury and Inland Revenue. The option was rejected on two grounds. The first ground is that tax relief in New Zealand would usually result in additional tax abroad, generally of a matching amount. As such, there would be little advantage for the workers. The second ground is that the fiscal cost for New Zealand could be high.

First option: relieve interest on unpaid tax

12. The case that is causing concern involves people coming to New Zealand expecting a short stay. Because of the intended short stay they have not paid tax. However, they have ended up staying for longer and become liable to tax. The tax liability extends back to the start of their stay. Interest is chargeable on the unpaid tax and this cannot be relieved in most circumstances.

13. The first option would amend legislation to allow for relief of interest on unpaid tax.

14. It is assumed that the relief would apply to any foreign contractor or employee present in New Zealand as a result of the earthquakes. It would not be limited to loss adjusters because there is nothing that identifies loss adjusters as more deserving than any other occupation.

15. It is also assumed that the relief would extend to tax liabilities arising in the first year following the first earthquake. The first year is a proxy for the period during which stays could have been unexpectedly lengthened by the major earthquakes in February and July. It is not desirable to provide relief for people who come later, who can reasonably estimate their length of stay at the outset. If there are further major earthquakes, this assumption may require revision.

16. Finally, it is assumed that interest will begin to accrue again, from a base of nil, once it is clear that the person has become liable to tax (usually 183 days for contractors). There is no desire to allow people to continue to ignore their tax obligations once it is clear that they have them.

17. The first option meets the government's objective (see *Objectives* above) to be fair to foreign workers here to assist following the earthquakes, and contributes to the objective that financial penalties should not be an undue barrier to attracting and retaining such workers. Relieving interest, in combination with discretionary relief that is already able to be given for other penalties, will remove an impediment to retaining specialist staff in New Zealand. However, this is not a quantifiable benefit.

18. The first option also meets the government's objective not to incur high fiscal cost. It is estimated that relief of interest on loss adjusters would cost the government $170,000. This is based on an estimate of 400 loss adjusters earning $160,000 per annum. This estimate is likely to be biased upwards (for example, not all the loss adjusters will be here for long stays). Doubling the estimate to take into account other specialists such as engineers increases the cost to $350,000. The ability to produce an accurate cost estimate is limited by incomplete data, but even if the assumptions are varied significantly the cost should not exceed $1 million.

19. Interest relief, in principle, should reduce the amount paid by foreign workers to the New Zealand government. However in some cases, contracts may have specified that tax would be paid by the person hiring the foreign worker, in which case the relief would reduce the amount paid by the hirer to the government. In that case, there would be a windfall gain for the hirer with little effect on the incentive for foreign workers to come to or remain in the country.

20. The first option imposes a new compliance cost. In order to relieve the interest, Inland Revenue will need to know that the person is eligible for relief. This will require, at least in the default case, an application to be made by the taxpayer (see *Implementation* below for ways in which this will be dealt with).

21. Administrative costs are expected to be minimal and would be met within existing resources.

Second option: status quo

22. The status quo would not meet the government's objectives for fairness to earthquake-related workers and may be inconsistent with the desire to remove undue impediments to retaining such workers.

23. At least some foreign workers who came here for the earthquakes paid no tax because they did not expect to be here long enough to incur any liability. Following further large earthquakes, their services were required for a longer period and they became liable to tax from the first day of their stay. If they had have been aware that they would be here for so long, they would have paid tax from the outset and avoided interest charges. It seems unfair to impose tax on these people, given that the further earthquakes are extremely unusual events that it would have been impractical to anticipate.

24. To avoid interest charges, foreign workers may decide to leave the country before their stay exceeds the relevant time limit. This could put pressure on the supply of workers to assist with the recovery from the earthquakes. This effect is not quantifiable. The effect may be reduced to the extent to which firms are earning high margins for earthquake-related work and so can afford to pay foreign workers more to compensate for any penalties they incur.

25. The status quo would meet the objective of having low fiscal cost. Its direct cost would be nil.

CONSULTATION

26. The Treasury has been consulted about the proposal to relieve interest on unpaid tax. There has been no consultation with industry about the specific proposal to relieve use of money interest because of the short time frame for making decisions. However, it is anticipated that the detailed design of a legislative amendment would involve contributions from industry.

27. There has been consultation, following the first earthquake and again after the February earthquake, with loss adjusting firms and large accounting firms about the general issue of taxation of loss adjusters. These firms have requested a general tax exemption, which officials have opposed (on the grounds outlined above).

CONCLUSIONS AND RECOMMENDATIONS

28. Foreign workers in New Zealand because of the Canterbury earthquakes may become subject to New Zealand tax if they are here for long enough, and may be liable for interest charges once the tax liability arises. This may make it difficult to retain foreign workers.

29. Two options have been considered for responding to the problem, with the first being preferred.

30. The first option is to relieve interest on unpaid tax when foreign workers are in New Zealand within a year of the first earthquake, by a change to legislation. This would remove an impediment to retaining foreign workers in earthquake-related occupations, and can be seen to be fairer than the status quo. This benefit is difficult to quantify.

31. The fiscal cost of the preferred option is estimated, with considerable uncertainty, to be $350,000. It is unlikely to be more than $1 million. A small additional compliance cost, to apply for the interest relief, would be introduced.

32. The second option is to maintain the status quo. This may lead to some foreign workers leaving New Zealand prematurely to avoid interest charges arising and could be seen as unfair. It would not have any direct fiscal cost.

IMPLEMENTATION

33. The first option would require a legislative change. It is intended that the detail of the change would be finalised in consultation with industry, to reduce the chance of unintended omissions.

34. At an operational level, Inland Revenue can already use its computer systems to remit interest charges. This is a manual process but is straightforward and not time consuming, particularly given the relatively small number of people who are likely to be claiming relief.

35. In some cases in which the identity of affected taxpayers is known, it might be possible to put manual blocks on accounts so that interest will be manually remitted before any demands are sent to taxpayers. However, this is a manually intensive process.

36. In general, however, it is not possible to identify all the people who would be eligible for relief.

37. Interest would therefore be charged by default, and the taxpayer would need to apply for the relief. To reduce compliance costs as much as possible, Inland Revenue would communicate to tax agents, particularly those known to be dealing with foreign workers here after the earthquakes, to advise them that relief is available and to tell them how to apply. The Inland Revenue team that is the main point of contact for non-resident contractors would also be able to advise taxpayers of the relief in the general course of its work.

38. The alternative option of the status quo would not require any implementation. Existing legislation and processes would be employed.

MONITORING, EVALUATION AND REVIEW

39. The cost of the first option (interest relief) is relatively small, and the option applies only for a short period (approximately a year).

40. At the same time, the benefits of the option are difficult to quantify. A foreign worker will take many factors into account when deciding whether to come to or remain in New Zealand, and tax is just one of those. It would be very difficult to distinguish cases in which a person stays because of interest relief from cases in which a person would have stayed anyway. People might also leave for a variety of reasons, including dislike of ongoing aftershocks.

41. Because of the relatively low fiscal cost, the temporary nature of the option, and the difficulty of assessing benefits, we do not propose any explicit monitoring or post-implementation review process for the first option.

42. Inland Revenue and Treasury officials will, however, continue to make themselves available for discussion with industry should any further difficulties arise.