POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Amendments to provisional tax and use of money interest remission**

Date:	9 November 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/428

Action sought

	Action sought	**Deadline**
Minister of Revenue	**Agree** to the recommendations	23 November 2021
Minister of Finance	**Agree** to the recommendations	23 November 2021

Contact for telephone discussion (if required)

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9 November 2021

Minister of Finance
Minister of Revenue

Amendments to provisional tax and use of money interest remission

Purpose

1. This report seeks your agreement to remedial amendments to the safe harbour concession for provisional taxpayers and to use of money interest relief for COVID-19 and emergency events.

Proposed amendments

Safe harbour concession

2. The safe harbour concession for provisional tax is available to standard method provisional taxpayers whose residual income tax (RIT) is less than $60,000, provided they meet the requirements in the Tax Administration Act 1994. To qualify as a safe-harbour taxpayer the person must have paid their provisional tax instalments in full and on time.

3. Qualifying as a safe harbour taxpayer prevents use of money interest (UOMI) being charged for underpaid provisional tax during the income year. A safe harbour taxpayer will only be charged UOMI after the terminal tax due date.[1]

4. In 2017, when incremental late payment penalties were removed from the late payment of income tax (including provisional tax), an amendment was made to the safe harbour concession to require all payments to be paid in full and on time. At the time the change was made the number of taxpayers who pay one or two days late unintentionally was underestimated. Since the change a large number of taxpayers have been caught out by this issue resulting in incurring UOMI, in addition to late payment penalties. In these circumstances the application of UOMI and late payment penalties is not considered to be proportionate to the offence committed.

5. Recently, a change was made to the 'payment in full' requirement to enable flexibility for taxpayers who underpay their provisional tax within $20. This accounted for those who underpaid their tax bill by a small amount. Removing the requirement for taxpayers to pay 'on time' is consistent with this approach, removing the arbitrariness of this requirement.

6. We consider it appropriate to allow taxpayers to retain the safe harbour concession even if they miss a payment, as late payment penalties[2] should be a sufficient penalty to incentivise taxpayers to continue to make their payments on time.

7. This initiative is taxpayer friendly because it removes disproportionate amounts charged as UOMI for minor mistakes of small provisional taxpayers. This change will support small provisional taxpayers who may not be as familiar with their tax obligations, by encouraging them to pay on time without disproportionately penalising them. Instead, late payment penalties will remain operational and be sufficient to encourage taxpayers to pay on time.

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[1] The terminal tax date is generally 7 February (or 7 April if the person has a tax agent) the year following the income year.
[2] Late payment penalties are imposed at 1% of the amount due the day after the due date and 4% 7 days later.

Extending use of money interest relief during COVID-19

8. One of the tax system responses to COVID-19 was to enable Inland Revenue to remit UOMI for taxpayers that were significantly adversely affected by COVID-19 and were unable to pay their tax in full and on time. This power was originally due to expire on 24 March 2022.

9. In June 2021, joint Ministers agreed to extend the UOMI remission scheme for taxpayers in existing instalment arrangements until 31 March 2024 (IR2021/249 refers). This specific group is of concern because, under current settings, those taxpayers whose existing instalment arrangements have not finished when the scheme expires will have their interest charged back to when the original tax became due rather than from when the scheme expires. Officials considered this to be unfair for taxpayers that acted in good faith to arrange to repay their tax and receive the benefit of UOMI remission.

10. At the time those original recommendations were made, officials indicated that a general extension of the scheme for everyone was not warranted due to the positive economic outlook. However, officials now consider that the previously agreed changes should be expanded because of the extended Alert Level restrictions in effect from August 2021 and the effect of those restrictions on smaller businesses in particular.

11. In addition to the previously agreed recommendations, officials consider that UOMI relief should be extended to a wider group of taxpayers due to the uncertainty that smaller taxpayers will encounter in forecasting their income tax liability for the 2021-22 income year.

12. We consider that general UOMI remission of income tax should be allowed for smaller provisional taxpayers that qualify for UOMI remission specifically due to being unable to accurately forecast their RIT because of COVID-19.

13. Under the existing provisions for this specific group, eligibility is restricted to provisional taxpayers with RIT of less than $1 million. We propose retaining this requirement when assessing the eligibility of taxpayers of this group for general UOMI relief. We propose that provisional taxpayers qualifying from this group for general remission should be able to seek relief until 7 April 2023 (the terminal tax date for the 2021–22 income year).

14. In summary, the COVID-19 interest remission rules would be as follows in **Table 1**:

Table 1: Summary of UOMI relief available due to COVID-19

Taxpayer	**Tax type**	**Expiry for remission under the status quo**	**Expiry for remission if current recommendations agreed to**
Taxpayers in instalment arrangements entered into prior to 24 March 2022	All tax types – deferred payment due to COVID-19 issues	Instalment arrangement must be completed by 31 March 2024 (agreed in June 2021; IR2021/249 refers)	Not affected by current recommendations
Taxpayers who: • have RIT liability less than $1 million; and • COVID-19 has affected their ability to reasonably accurately forecast their RIT liability	Income tax (including provisional tax) – late payment and underpayment due to COVID-19 issues	24 March 2022 (original legislation)	7 April 2023 (including payments for the 2021–22 income year)
All other taxpayers	All tax types – late payment due to COVID-19 issues	24 March 2022 (original legislation)	Not affected by current recommendations

15. As per current legislation, this new recommendation does not limit the Minister of Revenue’s ability to recommend another extension of the scheme, either generally or for a specific group of people. Officials also expect that further consideration will need to be given to the group of taxpayers with instalment arrangements for income tax entered into after 24 March 2022 but extending past the 7 April 2023 expiry date.

Broadening the use of money interest relief available during emergency events

16. The previous amendment describes the ability for UOMI to be remitted when a provisional taxpayer is significantly adversely affected in their ability to reasonably accurately forecast their RIT due to COVID-19. No equivalent provision is currently available in response to an emergency event, such as a flood or an earthquake. Technically, only interest incurred as a result of late payment due to the emergency event can be remitted.

17. Officials therefore recommend a change to the emergency events UOMI remission rules to ensure that UOMI can be remitted if it is charged as a result of a taxpayer being unable to reasonably accurately forecast their income tax due to an emergency event. This will further ensure that the same UOMI provisions available for COVID-19 reasons are also available during emergency events.

18. However, some settings should be changed compared to the relief available for COVID-19. Specifically, officials recommend that:

    18.1 Relief in this situation is not limited to certain income years like the COVID-19 provisions are, so that UOMI remission is fully available for any future emergency event; and

18.2 A taxpayer with any amount of RIT can be eligible for UOMI relief of this sort, subject to meeting the other existing criteria (in the COVID-19 provisions, only taxpayers with RIT of $1 million or less can be eligible for this relief).

Changing the eligibility test for use of money interest relief for emergency events

19. UOMI remission as a response to COVID-19 was largely modelled off UOMI remission available for emergency events. Separate provisions for COVID-19 UOMI remission were required as officials considered that the emergency events UOMI remission rules were not sufficient to be able to provide relief during COVID-19.

20. One of the main reasons for this is that UOMI remission is only available during an emergency event if the event "**physically prevents** the taxpayer from making a payment required by a tax law". This would not deal with situations where a business was financially unable to make a tax payment due to being closed during COVID-19. As a result, eligibility for COVID-19 UOMI remission depends on whether "the taxpayer's ability to make a payment required by a tax law… is **significantly adversely affected** by COVID-19". This allows UOMI remission for a range of reasons during COVID-19, including being physically prevented from paying tax as well as financial hardship.

21. Officials now consider that the same test should be used for emergency events. We therefore recommend that taxpayers should be eligible for emergency events UOMI remission if they are significantly adversely affected by an emergency event as well as meeting the other existing criteria.

Fiscal impacts

Safe harbour concession

22. The fiscal impact of removing the requirement to pay in full, from the safe harbour concession is approximately -$2.7 million per year over the forecast period. This is represented by the gross interest charge of -$13.7 million per year and the corresponding saving in no longer having to impair this UOMI amount of $11 million per year leaving a net cost of -$2.7 million per year.

23. The fiscal impact is likely to depend upon taxpayer behaviour. There is sufficient space on the Tax Policy Scorecard to absorb this cost.

24. The Tax Policy Scorecard has historically been used only to manage the revenue impact of tax policy changes. By contrast, the Scorecard has not been used to manage the fiscal impacts of changes to appropriations. However, officials recommend that the positive impact on the impairment appropriation [Impairment of Debt and Write-Offs] in this instance should be managed through the Scorecard, as it is a direct consequence of the policy change. This is consistent with the Scorecard's purpose, which is to enable tax policy changes to be managed outside the allowance framework.

Extending use of money interest relief during COVID-19

25. The fiscal impact of extending COVID-19 UOMI relief to the additional group of provisional taxpayers (with RIT of less than $1 million) has a gross interest charge of -$700,000 that is impaired by $550,000, leaving a net fiscal cost of approximately -$150,000.

26. This fiscal impact is based on remission of income tax interest charges for small taxpayers relating to the 2021–22 year and assumes that any new arrangements are set up to finish by 7 April 2023 so they get the benefit of the proposed remission.

The fiscal costing is further based on assumption of reduced demand for COVID-19 UOMI relief due to reduced likelihood over time of lockdowns impeding trading.

27. The Treasury has advised that this amendment meets the Minister of Finance's criteria for charging the cost against the COVID-19 Response and Recovery Fund.

Use of money interest relief for emergency events

28. For emergency events, the amendments relating to both broadening UOMI relief available to help provisional taxpayers and changing the eligibility test for UOMI relief have a nil fiscal impact. They will both increase the relief provided during each emergency event, which will lead to a negative but unquantifiable effect on revenue. However, any such amount is offset against the positive UOMI amounts resulting from the emergency event causing taxpayers to be unable to pay their tax, none of which is in baseline forecasts.

Legislative implications

29. Legislative provisions relating to the extension of UOMI relief during COVID-19 have already been included in the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill, which is currently being considered by the Finance and Expenditure Committee. The revised recommendations in this report will not affect what has already been included in the Bill.[3]

30. If you agree to the expanded COVID-19 UOMI remission recommendations, some of these will be reflected in the Order in Council extending the scheme to be made in March 2022. You have previously approved officials to issue drafting instructions to the Parliamentary Counsel Office to make this Order for the original extension (IR2021/249 refers). Some of the changes in this report, if agreed to, will be contained in the drafting instructions for the Parliamentary Counsel Office.

31. The remaining amendments in this report (the change to the safe harbour concession, part of the changes for COVID-19 UOMI relief for provisional taxpayers, and both the emergency events UOMI remission changes) can be included in the same Bill by way of inclusion in the officials' report, which will be presented to the Finance and Expenditure Committee's in early 2022.

32. As the proposals are all taxpayer friendly, we do not anticipate any issues with including these amendments in the Bill at this stage of the legislative process.

Consultation

33. The Treasury has been consulted on this report. Chartered Accountants Australia and New Zealand have been consulted on the proposed amendments and is supportive of the changes.

Next steps

34. As these are remedial amendments to legislation, your approval of the changes is sufficient for them to be progressed without requiring consideration by Cabinet.

35. Subject to your agreement to the amendments, officials will issue drafting instructions to prepare legislation giving effect to these changes. This will be considered by the Finance and Expenditure Committee prior to the Bill being reported back to the House.

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[3] The current provisions in the Bill will allow any future extension of the scheme to be targeted at a specific group of people; currently, the scheme can only be extended for everyone.

Recommended action

We recommend that you:

1. **agree** to remove the requirement that taxpayers must pay "in full and on time" to retain the safe harbour concession;

   Agreed/Not agreed Agreed/Not agreed

2. **note** that the net operating balance impact of the decision in recommendation 1 is $13.5 million over the forecast period ($2.7 million per year), caused by a reduction in net tax revenue and partly offset by a reduction in impairment, as shown below in recommendations 3 and 4;

   Noted Noted

3. **note** the following change to forecast tax revenue to give effect to the decision in recommendation 1, with a corresponding impact on the operating balance and net core Crown debt;

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Tax Revenue	(13.700)	(13.700)	(13.700)	(13.700)	(13.700)
Operating Balance and Net Core Crown Debt Impact	**13.700**	**13.700**	**13.700**	**13.700**	**13.700**

   Noted Noted

4. **agree** to the following change to appropriations to give effect to the decision in recommendation 1, with a corresponding impact on the operating balance only;

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Impairment of Debt and Debt Write-Offs	(11.000)	(11.000)	(11.000)	(11.000)	(11.000)
Operating Balance Only Impact	**(11.000)**	**(11.000)**	**(11.000)**	**(11.000)**	**(11.000)**

   Agreed/Not agreed Agreed/Not agreed

5. **agree** that the proposed change to appropriations for 2021/22 above be included in the 2021/22 Supplementary Estimates and that, in the interim, the increase be met from Imprest Supply;

   Agreed/Not agreed Agreed/Not agreed

6. **note** that, because impairment is appropriated, it is not usually accounted for through the Tax Policy Scorecard;

Noted Noted

7. **agree,** notwithstanding the above, to charge the net cost of the policy change (including the positive impact of a reduction in impairment) described in recommendation 2 to the Tax Policy Scorecard;

Agreed/Not agreed Agreed/Not agreed

8. **agree** to expand UOMI remission to 7 April 2023 for provisional taxpayers with residual income tax (RIT) of less than $1 million whose ability to reasonably accurately forecast their RIT has been affected by COVID-19;

Agreed/Not agreed Agreed/Not agreed

9. **note** that the net operating balance impact of the decision in recommendation 8 is $0.15 million over the forecast period, caused by a reduction in net tax revenue and partly offset by a reduction in impairment, as shown below in recommendations 10 and 11;

Noted Noted

10. **note** the following change to forecast tax revenue to give effect to the decision in recommendation 8, with a corresponding impact on the operating balance and net core Crown debt;

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Tax Revenue	(0.170)	(0.520)	-	-	-
Operating Balance and Net Core Crown Debt Impact	**0.170**	**0.520**	**-**	**-**	**-**

Noted Noted

11. **agree** to the following change to appropriations to give effect to the decision in recommendation 8, with a corresponding impact on the operating balance only;

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Impairment of Debt and Debt Write-Offs	(0.140)	(0.410)	-	-	-
Operating Balance Only Impact	**(0.140)**	**(0.410)**	**-**	**-**	**-**

Agreed/Not agreed Agreed/Not agreed

12. **agree** to charge the net operating balance impact described in recommendation 9 to the COVID-19 Response and Recovery Fund, established as part of Budget 2020;

Agreed/Not agreed   Agreed/Not agreed

13. **agree** to the following changes relating to UOMI remission for emergency events to better align the rules with those developed for COVID-19:

13.1 Allow remission for all provisional taxpayers who are significantly adversely affected in their ability to forecast their income due to an emergency event;

Agreed/Not agreed   Agreed/Not agreed

13.2 Change the test for remission from a taxpayer being "physically prevented" from paying their tax to being "significantly adversely affected" in their ability to pay tax;

Agreed/Not agreed   Agreed/Not agreed

14. **note** that the two amendments relating to emergency events UOMI remission have a nil fiscal impact, as the negative revenue effect of remitting the interest in these cases is offset by the positive revenue effect of UOMI being collected relating to unexpected emergency events that are not in existing forecasts;

Noted   Noted

15. **agree** that all the new amendments agreed to are to be included in the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill and in the officials' report to be presented to the Finance and Expenditure Committee.

Agreed/Not agreed   Agreed/Not agreed

s 9(2)(a)

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Hon David Parker
Minister of Revenue
/ /2021

Hon Grant Robertson
Minister of Finance
/ /2021