Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: UOMI rates and FBT prescribed rate of interest review

Date:	24 February 2022	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2022/046

Action sought

	Action sought	Deadline
Minister of Finance	**Indicate** your preferred course of action regarding the use of money interest rates. **Agree** to increase the FBT prescribed rate of interest. **Agree** that the attached papers be lodged with the Cabinet Office for consideration at the LEG meeting on 31 March 2022 (if appropriate).	10am, Thursday 24 March 2022.
Minister of Revenue	**Indicate** your preferred course of action regarding the use of money interest rates. **Agree** to increase the FBT prescribed rate of interest. **Sign** and **refer** the attached papers to the Cabinet Office for consideration at the LEG meeting on 31 March 2022 (if appropriate).	10am, Thursday 24 March 2022.

Contact for telephone discussion (if required)

Name	Position	Telephone
Paul Fulton	Acting Policy Lead	s 9(2)(a)
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In Confidence

22 February 2022

Minister of Finance
Minister of Revenue

UOMI rates and FBT prescribed rate of interest review

Purpose

1. This report brings to your attention the outcome of the regular review of the use of money interest (UOMI) rates and FBT prescribed rate of interest. It seeks a decision on whether to change the UOMI rates now or defer changing the rates because of the current Omicron outbreak. The report also seeks your agreement to increasing the FBT prescribed rate of interest.

Context and background

2. The UOMI rates and FBT prescribed rate of interest 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 underpayment UOMI rate is currently 7.00%, based on RBNZ figures from March 2020, while the overpayment UOMI rate is capped so that it cannot go below zero, where it currently is. The current FBT prescribed rate of interest is 4.50%.

Principles for updating the rates

4. Longstanding administrative principles in setting the rates provide that:

   4.1 Both UOMI rates should be adjusted if:

      4.1.1 the RBNZ 90-day bank bill rate or the floating first mortgage new customer housing rate moves by 1% or more; or

      4.1.2 one of these indexes moves by 0.2% or more and the UOMI rates haven't been adjusted in the last 12 months.

   4.2 The FBT prescribed rate of interest should be adjusted if the floating first mortgage new customer housing rate moves by 0.2% or more.

5. When regulations are made altering the UOMI rates, the adjustment is applied from the next standard provisional tax payment date.

6. When regulations are made declaring the FBT prescribed rate of interest, they apply to quarters starting at least 1 month following the date the regulations were made.[1]

7. Based on RBNZ figures from December 2021, the FBT prescribed rate of interest should be increased to 4.78% and the underpayment UOMI rate to 7.28%. The overpayment UOMI rate would remain below zero on the basis of the formula and so would not change.

[1] Regulations that reduce the prescribed rate may apply to a quarter if made at least one month before the end of that quarter; however, this is not relevant because the proposed change increases the prescribed rate.

UOMI rates

8. The underpayment rate is charged on underpaid tax, while the overpayment rate is paid on money paid to Inland Revenue above their tax liability.

9. Although more is charged on underpayments than is paid on overpayments, underpayments are impaired by 78.7% 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.

10. While the timing and amount of rate change recommendations are determined by formula, they require your agreement so you could elect to defer the increase because of the current Omicron outbreak. Increasing the UOMI underpayment rate during the current Omicron outbreak could be viewed as punitive for taxpayers, even if the Government decides to extend UOMI remission.

11. Officials have therefore included two options for you to consider:

    11.1 Option 1 is increasing the underpayment UOMI rate by following the standard formula. The overpayment UOMI rate would continue to be 0%. The new rates would take effect from 9 May 2022.

    11.2 Option 2 is deferring any change to the UOMI rates for now. Instead, officials would report to you on reviewing the rates in the middle of the year.

Option 1: changing the UOMI rates from 9 May 2022

12. Option 1 will prevent misalignment of the UOMI rates with market rates and maintain continuity of administrative principles. Additionally, most UOMI accrued by taxpayers (78.7%) is impaired, and the Government is considering an extension of COVID-related UOMI remission policies which will increase that amount. The actual impact of raising the underpayment rate on taxpayers may thus be small.

13. Should you proceed with the UOMI rate change, the change to the operating balance for the 2021/22 fiscal year is estimated to be approximately net zero. The 2022/23 and later years are estimated to have a full year net saving of approximately $2 million per annum.

14. These savings comprise a revenue increase of approximately $1 million in 2021/22, $8 million in 2022/23, and $9 million per annum for 2023/24 and later years. As described above, this is partly counteracted by an increase in impairment expenditure of approximately $1 million in 2021/22, and $7 million per annum for 2022/23 and later years. This is shown in the table below:

	$millions - increase/(decrease)				
Vote Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	1.137	8.480	9.000	9.000	9.000
Non-Departmental Other Expense: *Impairment of Debt and Debt Write-offs*	0.895	6.674	7.083	7.083	7.083
Total Operating	**(0.242)**	**(1.806)**	**(1.917)**	**(1.917)**	**(1.917)**

15. The Treasury advises that a decision to proceed with this option would have no impact on allowances, as it would be considered consistent with existing policy, and hence a forecast change. By contrast, a decision to defer changing the rates would have to be charged against an allowance (likely, the Tax Policy Scorecard). Any increase in the *Impairment of Debt and Debt Write-offs* appropriation for 2021/22 would also have to be met from Imprest Supply.

16. Separately, however, an extension to UOMI remission policies for businesses impacted by COVID-19 will be considered by Cabinet on 14 March. If Cabinet approves the proposal, it will affect the change to the operating balance as a result of the rate increase. We understand the extension is proposed to go to March 2024.

17. Extending UOMI remission polices will reduce the overall fiscal impact of changing the UOMI underpayment rate, resulting in a lesser increase of revenue and impairment compared to the effect of raising the rate without changes to UOMI remission (as shown in the table in paragraph 14). This reduced effect is shown in the table below:

	$millions - increase/(decrease)				
Vote Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	0.584	6.095	6.819	9.000	9.000
Non-Departmental Other Expense: *Impairment of Debt and Debt Write-offs*	0.460	4.797	5.367	7.083	7.083
Total Operating	**(0.124)**	**(1.298)**	**(1.452)**	**(1.917)**	**(1.917)**

Option 2: deferring changes to the UOMI rates

18. The primary consideration in favour of option 2 is reducing costs for taxpayers already struggling with the potential impact of the Omicron outbreak. While the additional cost to taxpayers if the rates were increased may not be all that high, it is nevertheless an increase in costs at a time when taxpayers may be struggling.

19. Should you defer the UOMI rate changes, leaving the rate unchanged will have no impact on projected future revenue. However, leaving the rates unchanged represents a departure from an existing policy (which is to change the UOMI rates when certain criteria are met). This will have to be charged against an allowance, which would likely be the Tax Policy Scorecard.

20. Officials estimate the impact on the Scorecard would be approximately the reverse of the changes noted in the table in paragraph 14, as represented in the table below. Note that the real effect might be larger or smaller depending on the movement of interest rates and when the eventual decision is made.

In Confidence

	$millions - increase/(decrease)				
Vote Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	(1.137)	(8.480)	(9.000)	(9.000)	(9.000)
Non-Departmental Other Expense: *Impairment of Debt and Debt Write-offs*	(0.895)	(6.674)	(7.083)	(7.083)	(7.083)
Total Operating	**0.242**	**1.806**	**1.917**	**1.917**	**1.917**

21. Additionally, if (as expected) interest rates increase in early 2022, the deferral may result in a higher UOMI underpayment rate at the next review than if you choose option 1. A deferral may also result, however, in the UOMI overpayment rate rising above 0%.

Officials' recommendation

22. Officials recommend Option 1. While a deferral may help some taxpayers, the overall effect is likely to be minimal, especially if COVID-related UOMI remission is extended. Moreover, UOMI plays an important role in incentivising compliance and mitigating the fiscal impacts of late payment. Not updating it would undermine these functions. Proceeding with Option 1 would also have no impact on the Scorecard. Officials have consulted with the Treasury, who concur with this recommendation.

FBT prescribed rate of interest

23. The FBT prescribed rate of interest applies to loans by employers to employees on which the employer is charging a rate of interest that is below the market rate, and taxes the differential between the rate of interest charged and the prescribed rate.

24. Despite the Omicron outbreak, officials recommend that the FBT prescribed rate of interest be increased to 4.78%. While the UOMI rates affect all taxpayers with tax debit or credit, the FBT prescribed rate of interest affects relatively few. Additionally, the purpose of the prescribed rate is to lower the tax advantage of offering employment-related loans at low interest rates; if the rate were to fall too far out of step with market interest rates, its effectiveness may be reduced.

25. The rate increase would come into force on 1 July 2022, the start of the next available quarter.

26. Raising the FBT prescribed rate of interest is projected to have a net positive fiscal impact of approximately $0.59 million per annum, which amounts to $2.36 million over the current forecast period. This net increase consists of an increase of approximately $0.82 million per annum and a decrease in company tax paid of approximately $0.23 million per annum. This is demonstrated in the table below.

In Confidence

	$millions increase/(decrease)				
Vote Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & out years**
Tax Revenue:					
FBT Revenue	0.000	0.820	0.820	0.820	0.820
Company Tax	0.000	(0.230)	(0.230)	(0.230)	(0.230)
Total Operating	**-**	**(0.590)**	**(0.598)**	**(0.590)**	**(0.590)**

Consultation

27. Inland Revenue has consulted with the Treasury, the Parliamentary Counsel Office (PCO), and the New Zealand Customs Service (Customs) on this report. They agree with the recommendations.

28. 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.

29. This increase will in turn have a very small financial impact on Vote Customs. Customs collected $595,752.09 compensatory interest in the 12 months to December 2021. They advise us that an additional 0.28% increase in the UOMI would collect an additional $1,668 compensatory interest.

Next steps

30. Officials have advised PCO that draft Orders in Council changing the rates may need to be prepared depending on your decision.

31. Attached are two papers to the Cabinet Legislation Committee, recommending that it approve the Orders in Council and authorise their submission to Cabinet and the Executive Council. If you decide to increase the UOMI rates and/or the FBT prescribed rate of interest, the papers should be referred to Cabinet Office by 10am, Thursday 24 March 2022. This would enable the Cabinet Legislation Committee to consider the papers on 31 March 2022.

32. The Cabinet paper recommending the increase of the UOMI rates as written assumes that the extension to UOMI remission for businesses impacted by COVID-19 is approved by Cabinet on 14 March. If this extension is not approved by Cabinet, officials will supply you with an alternative Cabinet paper before 24 March.

33. If you decide to defer changing the UOMI rates, officials will continue to monitor the appropriate RBNZ indices and report to you again in the middle of the year.

Recommended action

We recommend that you:

UOMI rates

34. **agree** to EITHER:

34.1 Option 1 – increase the underpayment UOMI rate to 7.28% (from 7.00%) from 9 May 2022. The UOMI overpayment rate remains unchanged. *(Officials' preferred option)*; OR

Agreed/Not agreed		Agreed/Not agreed

34.2 Option 2 – defer changing the rates.

Agreed/Not agreed		Agreed/Not agreed

35. if you select Option 1:

35.1 **note** the following fiscal impacts arising from the decision to increase the UOMI underpayment rate, with a corresponding impact on the operating balance and net core Crown debt:

	$millions - increase/(decrease)				
Vote Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	1.137	8.480	9.000	9.000	9.000
Non-Departmental Other Expense: *Impairment of Debt and Debt Write-offs*	0.895	6.674	7.083	7.083	7.083
Total Operating	**(0.242)**	**(1.806)**	**(1.917)**	**(1.917)**	**(1.917)**

Noted		Noted

35.2 **note** that the fiscal impacts will be treated as a forecast change, and so will have no impact on allowances;

Noted		Noted

35.3 **agree** that the proposed change to the *Impairment of Debt and Debt Write-offs* appropriation for 2021/22 above be included in the 2021/22 Supplementary Estimates and that, in the interim, the increase(s) be met from Imprest Supply;

Agreed/Not agreed		Agreed/Not agreed

35.4 **agree** that PCO draft an Order in Council to adjust the UOMI rates;

Agreed/Not agreed		Agreed/Not agreed

35.5 **agree** that the attached Cabinet paper be lodged with the Cabinet Office by 10am Thursday 24 March 2022 for consideration by Cabinet Legislation Committee at its meeting on 31 March 2022;

Agreed/Not agreed

35.6 **approve** and **lodge** the attached Cabinet paper to the Cabinet Office by 10am Thursday 24 March 2022 for consideration by Cabinet Legislation Committee at its meeting on 31 March 2022;

Approved and lodged/Not approved

36. if you select Option 2:

36.1 **note** the following estimated changes as a result of the decision to defer changing UOMI rates, with a corresponding impact on the operating balance and net core Crown debt:

	$millions - increase/(decrease)				
Vote Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	(1.137)	(8.480)	(9.000)	(9.000)	(9.000)
Non-Departmental Other Expense: *Impairment of Debt and Debt Write-offs*	(0.895)	(6.674)	(7.083)	(7.083)	(7.083)
Total Operating	**0.242**	**1.806**	**1.917**	**1.917**	**1.917**

Noted Noted

36.2 **note** that the real effect might be larger or smaller depending on the movement of interest rates and when the eventual decision is made;

Noted Noted

36.3 **agree** to charge the above operating balance impact against the Tax Policy Scorecard;

Agreed/Not agreed Agreed/Not agreed

36.4 **agree** that the proposed changes to the Impairment of Debt and Debt Write-offs appropriation for 2021/22 above be included in the 2021/22 Supplementary Estimates.

Agreed/Not agreed Agreed/Not agreed

FBT prescribed rate of interest

37. **agree** that the FBT prescribed rate of interest should be increased to 4.78%, effective from 1 July 2022;

Agreed/Not agreed Agreed/Not agreed

38. **note** that increasing the prescribed rate to 4.78% (from 4.50%) will result in an increase in revenue of approximately $0.59 million per annum, which amounts to $2.36 million over the current forecast period (2022-23 to 2025-26);

Noted Noted

39. **agree** that PCO draft an Order in Council to adjust the prescribed rate of interest;

Agreed/Not agreed Agreed/Not agreed

40. **agree** that the attached Cabinet paper be lodged with the Cabinet Office by 10am Thursday 24 March 2022 for consideration by Cabinet Legislation Committee at its meeting on 31 March 2022;

Agreed/Not agreed

41. **approve** and **lodge** the attached Cabinet paper to the Cabinet Office by 10am Thursday 24 March 2022 for consideration by Cabinet Legislation Committee at its meeting on 31 March 2022;

Approved and lodged/Not approved

s 9(2)(a)

Paul Fulton
Acting Policy Lead
Policy and Strategy

Hon Grant Robertson
Minister of Finance
/ /2022

Hon David Parker
Minister of Revenue
/ /2022