



POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Use of money interest rates review

Date:	5 July 2022	Priority:	Medium
Security level:	In Confidence	Report number:	IR2022/347

Action sought

	Action sought	Deadline
Minister of Revenue	<p>Agree to adjust the use of money interest rates as set out in the report.</p> <p>Sign and refer the attached paper to the Cabinet Office for consideration at the LEG meeting on 4 August 2022.</p>	18 July 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Paul Fulton	Principal Policy Advisor	s 9(2)(a)
Bradd Forster	Policy Advisor	

5 July 2022

Minister of Revenue

Use of money interest rates review

Purpose

1. This report brings to your attention the outcome of the regular review of the use of money interest (UOMI) rates. It seeks your agreement to increasing 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 7.28%, based on RBNZ figures from December 2021, while the overpayment rate is capped so that it cannot go below zero, where it currently is.

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.

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

In Confidence

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 is 28 August 2022. However, 28 August falls on a Sunday which makes 29 August 2022 the date that tax payable is due. Therefore, the increased UOMI rates start applying from the next day which is 30 August 2022.
8. The next Executive Council meeting is scheduled on 8 August 2022. To minimise compliance costs the new rates should apply from 30 August 2022. To meet this deadline, a waiver of the 28-day rule is required. This is recommended due to the possibility for the UOMI rates to become seriously misaligned with market interest rates if the change is delayed until the next possible date to update the UOMI rates.
9. The formula for setting the rates is set out in the Taxation (Use of Money Interest Rates Setting Process) Regulations 1997 as follows:
 - 9.1 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%);
 - 9.2 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.
10. 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).
11. 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

12. According to RBNZ figures from May 2022, the 90-day bank bill rate has risen more than 100 basis points from its position at December 2021, which triggers the UOMI rates to be reset.
13. The UOMI underpayment rate should be increased to 7.96%, while the UOMI overpayment rate should be increased to 1.22%.
14. The RBNZ floating first mortgage new customer rate has risen by 68 basis points since December 2021 (the last time the UOMI rates were set). Accordingly, the underpayment rate should be increased by 68 basis points, from 7.28% to 7.96%.
15. The overpayment rate should be increased by 122 basis points, from 0% to 1.22%, due to the 90-day bank bill rate rising 131 basis points between December 2021 and May 2022. This discrepancy is due to the overpayment rate previously being set at the lower limit of 0%.

Fiscal Impact

16. The change to the underpayment rate will increase revenue over the forecast period. At the same time, the increased overpayment rate will reduce revenue over the forecast period.
17. Overall, it is estimated that the net tax revenue impact will be negative, as the cost of increasing the overpayment rate is expected to exceed the revenue from increasing the underpayment rate.

\$ millions increase / (decrease)					
Vote Revenue	2021/22	2022/23	2023/24	2024/25	2025/26 and outyears
Tax Revenue impact of change to Underpayment rate	-	17.000	21.000	21.000	21.000
Tax Revenue impact of change to Overpayment rate	-	(29.000)	(35.000)	(35.000)	(35.000)
Net Tax Revenue Impact	-	(12.000)	(14.000)	(14.000)	(14.000)

18. A large part of underpayment debt is typically written off, meaning the cost to revenue is larger than the net revenue impact reported above. To represent this, 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. The total fiscal impact and operating expenditure for the forecast period taking this impairment into account are presented below.

\$ millions increase / (decrease)					
Vote Revenue	2021/22	2022/23	2023/24	2024/25	2025/26 and outyears
Crown Revenue and Receipts:					
Tax Revenue	-	(12.000)	(14.000)	(14.000)	(14.000)
Non-Departmental Other Expense:					
Impairment of debt and debt write-offs	-	14.000	17.000	17.000	17.000
Total operating	-	26.000	31.000	31.000	31.000

Consultation

19. 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.

In Confidence

20. 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.
21. This increase will in turn have a very small financial impact on Vote Customs. Customs collected \$342,397.82 compensatory interest in the 12 months to 30 June 2022. They advise us that an additional 68 basis point increase in the UOMI would collect an additional \$31,982.221 compensatory interest.

Next steps

22. Officials have advised PCO that a draft Order in Council changing the rates may need to be prepared depending on your decision.
23. 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 28 July 2022. This would enable the Cabinet Legislation Committee to consider the paper on 4 August 2022.

Recommended action

We recommend that you:

- a. **agree** to increase the UOMI underpayment rate to 7.96% (from 7.28%) and the UOMI overpayment rate to 1.22% (from 0%), effective from 30 August 2022.

Agreed/Not agreed

- b. **note** that agreeing to a commencement date of 30 August 2022 will require you to seek a waiver of the 28-day rule in the paper to be taken to cabinet on 4 August 2022;

Noted

- c. **note** the following fiscal impacts arising from the decision to change the 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 and outyears
Crown Revenue and Receipts:	-	(12.000)	(14.000)	(14.000)	(14.000)
Tax Revenue					
Non-Departmental Other Expense:	-	14.000	17.000	17.000	17.000
Impairment of debt and debt write-offs					
Total operating	-	26.000	31.000	31.000	31.000

Noted

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

Noted

- e. **agree** that the proposed change to the *Impairment of Debt and Debt Write-offs* 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

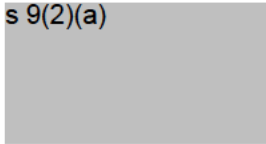
- f. **agree** that PCO draft an Order in Council to adjust the UOMI rates;

Agreed/Not agreed

- g. **approve** and **lodge** the attached Cabinet paper to the Cabinet Office by 10am Thursday 28 July 2022 for consideration by Cabinet Legislation Committee at its meeting on 4 August 2022.

Agreed/Not agreed

s 9(2)(a)



Paul Fulton

Principal Policy Advisor

Hon David Parker

Minister of Revenue

/ /2022