The Treasury

Budget 2014 Information Release

Release Document

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Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

THE TREASURY
Kaitohutohu Kaupapa Rawa

Tax policy report: Repeal of cheque duty

Date:	10 February 2014	**Priority:**	**High**
Security Level:		**Report No:**	T2014/163 PAS2014/42

Action sought

	Action Sought	Deadline
Minister of Finance	**Agree** to the recommendations	18 February 2014
Minister of Revenue	**Agree** to the recommendations	18 February 2014

Contact for telephone discussion (if required)

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10 February 2014

Minister of Finance
Minister of Revenue

Repeal of cheque duty

Executive summary

Cheque duty is the one remaining transaction duty. Cheque duty applies to bills of exchange, such as cheques and promissory notes, at a rate of 5 cents per bill of exchange. Cheque use has declined rapidly and cheque duty now only raises about $3 million a year.

The repeal of cheque duty has been raised in previous reviews of the tax system, such as the (McLeod) Tax Review 2001, which recommended that cheque duty be repealed. Ministers expressed an interest in potentially repealing cheque duty in Budget 2014 when it was discussed with them last year, and asked for some further advice. This report provides this further advice.

We do not consider that cheque duty meets the criteria for a good tax. It is easy to avoid, since closely substitutable methods of payment, such as cash or electronic transactions, are not subject to any duty. Cheque duty is therefore an inefficient and distortionary tax.

The repeal of cheque duty would benefit both individuals and businesses that still use cheques as a payment method.

A transitional issue with repealing cheque duty arises due to the fact that cheque duty is usually prepaid and currently a refund can be sought when the cheques have not been used or printed.

We recommend that cheque duty be repealed from 1 April 2016, with no refunds available thereafter for cheques on which cheque duty has been prepaid that have not been used or printed. Refunds would be available up until the date of repeal. The proposed August 2014 taxation bill would be the legislative vehicle for the repeal.

If this proposal is agreed to, it would have estimated fiscal costs, as per the following table:

	$m increase / (decrease)				
Vote Revenue Minister of Revenue	**2013/14**	**2014/15**	**2015/16**	**2016/17**	**2017/18 & out-years**
Tax Revenue	-	(0.500)	(0.500)	(4.000)	(4.000)

Inland Revenue expects that managing the repeal of cheque duty would have minimal administrative impacts, although further work will be undertaken to confirm the administrative costs of repeal. Inland Revenue has a high level of confidence that the repeal can be implemented in the timeframes given.

Repealing cheque duty would reduce compliance costs, particularly for banks and printers of cheques.

Due to our desire to maintain Budget secrecy, the proposal to repeal cheque duty has not been consulted on. If Ministers would prefer to repeal cheque duty immediately, via a Budget night bill, we consider that it would be a virtual imperative for officials to consult with the New Zealand Bankers Association on the compliance implications of this.

Recommended action

We recommend that you:

(a) **Agree** to repeal cheque duty, with announcement in Budget 2014.

Agreed/Not agreed Agreed/Not agreed

(b) **EITHER**

(i) **Agree** that the repeal of cheque duty take effect from 1 April 2016, with no refunds of prepaid cheque duty available thereafter **(officials' recommended option)**.

Agreed/Not agreed Agreed/Not agreed

OR

(ii) **Agree** that the repeal of cheque duty take effect from the date of Royal assent of a Budget night bill, with no refunds of prepaid cheque duty available thereafter.

Agreed/Not agreed Agreed/Not agreed

(c) **Note** that the estimated fiscal costs of repealing cheque duty are up to $4 million per annum, with varying fiscal costs arising in different fiscal years depending on the option agreed to.

Noted Noted

(d) **Note** that the legislative vehicle for the repeal of cheque duty will be either the proposed August 2014 taxation bill (if recommendation (b)(i) is agreed to) or a Budget night bill (if recommendation (b)(ii) is agreed to).

Noted Noted

(e) If you agree to recommendation (b)(ii):

Agree to officials consulting with the New Zealand Bankers Association on the compliance implications of this approach to repealing cheque duty prior to officials preparing any Cabinet paper recommending the repeal.

Agreed/Not agreed Agreed/Not agreed

(f) **Note** that officials will prepare a submission for Cabinet to be included in the Budget 2014 process.

Noted Noted

Andrea Black
Principal Advisor
Tax Strategy
The Treasury

Charles Ngaki
Senior Policy Advisor
Policy and Strategy
Inland Revenue

Hon Bill English
Minister of Finance

Hon Todd McClay
Minister of Revenue

Background

1. Cheque duty applies to bills of exchange, such as cheques and promissory notes, at a rate of 5 cents per bill of exchange. The Annex sets out the current tax law relating to cheque duty.

2. Cheque duty is the one remaining transaction duty. No duty applies to alternative methods of payment, such as cash, electronic transactions (e.g., EFTPOS or via internet banking), or credit card transactions (repealed with effect from 1 April 1998). It is therefore an inefficient and distortionary tax.

3. Cheque use has been declining rapidly; cheque duty raised $17 million in 1991/92 and $10 million in 2001/02, but now only raises about $3 million a year. Technological advances have led to the introduction of various methods of electronic payments. The increasing popularity of these alternatives to cheques is more likely due to them being more convenient, faster and more secure methods of payment, rather than tax-motivated substitution (given the very low rate of cheque duty).

4. The repeal of cheque duty has been raised in previous reviews of the tax system, such as the (McLeod) Tax Review 2001, which recommended that cheque duty be repealed. Ministers expressed an interest in potentially repealing cheque duty in Budget 2014 when it was discussed with them last year, and asked for some further advice. This report provides this further advice.

Proposed repeal

5. We do not consider that cheque duty meets the criteria for a good tax. It is easy to avoid, since closely substitutable types of transactions (such as cash, EFTPOS, internet banking and credit card transactions) are not subject to any duty. This makes it an ineffective way of raising revenue and is distortionary. That said, the very low rate of cheque duty (5 cents per transaction) suggests that its distortionary effect is likely to be small.

6. The distortion could be addressed by broadening the base (by applying a duty to a broader range of transactions) or repealing cheque duty. Transaction duties are a relic of the time before GST was introduced in 1986. As the trend since the late 1980s has been to repeal transaction duties, we consider repealing cheque duty to be preferable to broadening the base by applying a duty to a broader range of transactions.

7. The repeal of cheque duty would benefit both individuals and businesses that still use cheques as a payment method.

8. A transitional issue with repealing cheque duty arises due to the fact that cheque duty is usually prepaid and currently a refund can be sought when the cheques have not been used or printed. If refunds are available after the effective date of repeal and/or in between

announcement of the impending repeal and the effective date of repeal, it is likely that there will be a revenue impact beyond the cheque duty revenue forgone.

Policy options

9. There are three key issues to be considered in repealing cheque duty:

- the effective date of repeal;
- the availability of refunds; and
- the legislative vehicle to be used.

10. Trade-offs will need to be made in making decisions in relation to these issues. They include:

- As the effective date of repeal moves away from the date of announcement, affected parties will have more lead-in time, enabling them to better manage their transition to the new environment. However, this will also enable these groups to seek refunds for their surplus prepaid cheques, which increases the uncertainty surrounding the fiscal cost.
- The availability of refunds beyond the effective date of repeal would also have a fiscal cost.
- The choice of legislative vehicle will determine the level of consultation that can be undertaken with affected parties on the practical implications of the repeal of cheque duty and this could influence the public reaction to the change.

11. On the basis of these potential trade-offs, we consider that the two best approaches to repealing cheque duty are as outlined below.

Announcement in Budget 2014 with repeal in April 2016 – Option 1

12. Officials' preferred option is to repeal cheque duty from 1 April 2016, with no refunds available thereafter for cheques for which cheque duty has been prepaid that have not been used or printed. Refunds would be available up until the date of repeal. The legislative vehicle would be the proposed August 2014 taxation bill. This option has the following advantages:

- It allows a reasonable lead-in time, which would enable all affected parties (banks and their customers, licensed printers and their customers, temporary licensees, and Inland Revenue) to better manage the transition.
- The availability of refunds of prepaid cheque duty over the period in between Budget 2014 and 1 April 2016 would mitigate the potential public perception of unfairness that may be caused by not giving or significantly restricting the availability of refunds.

- The use of the proposed August 2014 taxation bill would enable the proposal to go through the full parliamentary process, including the select committee stage. Any issues with the proposed approach could be raised in public submissions.

13. The main downside to this option is the perception that the Government is not serious about repealing this duty, given the long time period between announcement and legislative repeal.

Announcement in Budget 2014 with immediate repeal – Option 2

14. This option is to repeal cheque duty with effect from the date of Royal assent of a Budget night bill, with no refunds available thereafter for cheques for which cheque duty has been prepaid that have not been used or printed.

15. The main advantage of this option is that it is clean and certain that cheque duty is being repealed.

16. The main downsides of this option are the potential for there to be a negative public reaction to not giving refunds, and possible transitional issues (e.g., for banks in adjusting processes) due to the lack of lead-in time. Additionally, as this option features an earlier repeal date, higher fiscal costs would arise from the 2014/15 fiscal year.

Fiscal implications

17. This section sets out the fiscal implications of these options over the five-year forecast period from the 2013/14 fiscal year to the 2017/18 fiscal year. In assessing the fiscal implications of the options, we have conservatively estimated the revenue forgone as a result of repealing cheque duty at $4 million per annum.

Announcement in Budget 2014 with repeal in April 2016 – Option 1

18. Officials' preferred option, under which cheque duty is repealed from 1 April 2016, with no refunds available thereafter, would have estimated fiscal costs, as per the following table:

	$m increase / (decrease)				
Vote Revenue Minister of Revenue	**2013/14**	**2014/15**	**2015/16**	**2016/17**	**2017/18 & out-years**
Tax Revenue	-	(0.500)	(0.500)	(4.000)	(4.000)

19. Because refunds would be available between announcement and 1 April 2016, there is likely to be an increase beyond usual levels in refunds being sought during this period. However, as cheque duty would still be required to be prepaid on cheques used during this period, it would be expected that people would only seek refunds if they estimate that they will not use all of their prepaid cheques before the date of repeal. Although these refunds could be claimed in either the 2014/15 or 2015/16 fiscal year, this estimate assumes that half are claimed in each year. As we have no empirical data on the number of cheques for which cheque duty has been prepaid that have not been used or printed, the estimate of the fiscal cost arising in the 2014/15 and 2015/16 fiscal years due to refunds of prepaid duty has been based on broad assumptions. There is therefore a significant degree of uncertainty around the fiscal cost arising in these years, with the potential for it to be higher than estimated.

Announcement in Budget 2014 with immediate repeal – Option 2

20. If cheque duty is repealed from the date of Royal assent of a Budget night bill, and no refunds are available thereafter, there would be estimated fiscal costs, as per the following table:

	$m increase / (decrease)				
Vote Revenue Minister of Revenue	**2013/14**	**2014/15**	**2015/16**	**2016/17**	**2017/18 & out-years**
Tax Revenue	-	(3.500)	(4.000)	(4.000)	(4.000)

21. As this option features an earlier repeal date, higher fiscal costs would be expected to arise earlier.

Administrative implications

22. Inland Revenue currently administers the collection of cheque duty through its transactional customer services team. Inland Revenue interacts directly with 41 active cheque duty producers/suppliers. There is no interaction between Inland Revenue and the general public.

23. Based on current volumes and resources involved, the administration of cheque duty forms a small percentage of Inland Revenue's processing operations.

24. Although Inland Revenue does not know the current level of pre-prepared cheque books held by banks, this would not affect the number of returns filed post-repeal.

What would need to happen if cheque duty was repealed?

25. Managing the repeal of cheque duty would have minimal administrative impacts. Regardless of the policy option chosen, Inland Revenue would need to undertake the following:

- *Maintaining current processes*. In the initial period after repeal, Inland Revenue would need to maintain its current processes in order to process final returns (and any refunds, if applicable). As part of managing the repeal, Inland Revenue would make minor changes to internal procedures and communicate with affected parties.
- *Decommissioning*. Cheque duty is managed via a standalone purpose-built application. This is outside of Inland Revenue's FIRST mainframe system and, as such, decommissioning the duty would be a straight-forward procedure. Relevant cheque duty forms would need to be discontinued at the appropriate times.
- *Preserving data.* Inland Revenue would need to preserve return data in accordance with the Public Records Act 2005. This means determining the amount of data to be retained and the appropriate storage method to be used.

26. Further work will be undertaken to confirm the administrative costs of repeal. However, Inland Revenue has a high level of confidence that the repeal can be implemented in the timeframes given.

Compliance costs

27. Repealing cheque duty would reduce compliance costs for banks, printers of cheques and the printers' customers, as they would no longer have to apply to Inland Revenue for licences authorising the printing or supply of bill of exchange forms prepaid with cheque duty, or make payments of cheque duty to Inland Revenue. Additionally, banks and printers would no longer have to complete and file the quarterly/monthly returns that accompany their payments of cheque duty to Inland Revenue.

28. However, under option 1, in the short-term (that is, between announcement and the date of repeal) banks may temporarily experience an increase in customers seeking a refund of prepaid cheque duty on unused cheques.

Consultation

29. Due to our desire to maintain Budget secrecy, the proposal to repeal cheque duty has not been consulted on. Therefore, we have a limited understanding of the nature of the compliance implications of repeal on banks and licensed printers, such as how long it will take banks to adjust their processes. If Ministers wish to repeal cheque duty with effect from Budget night or shortly thereafter, we consider that it would be a virtual imperative for officials to consult with the New Zealand Bankers Association (NZBA) prior to officials preparing any Cabinet paper recommending the repeal.

30. If Ministers wish to repeal cheque duty from 1 April 2016 via the proposed August 2014 taxation bill, we do not consider that it would be necessary for officials to consult with the NZBA prior to the Budget announcement. Consultation could instead be undertaken after the Budget announcement.

Next steps

31. If Ministers agree with the recommended action, officials will prepare a submission for Cabinet seeking its approval to the repeal of cheque duty. We are aiming to provide this paper to Ministers by the end of February.

Annex

Current law – cheque duty

Generally, cheque duty is payable on every bill of exchange (at a rate of 5 cents per bill of exchange). There are various exemptions from cheque duty (e.g., a person acting on behalf of the Crown).

Licensed banks pay cheque duty on a quarterly basis. A licensed bank must pay to Inland Revenue, within 21 days of the expiry of each quarter, the amount of cheque duty payable for the quarter, less the amount paid for unused prepaid cheques that have been destroyed by the bank during the quarter.

Licensed printers pay cheque duty on a monthly basis. A licensed printer must pay to Inland Revenue, within 21 days of the last day of each month, the amount of cheque duty payable (if any) for the month.

Additionally, Inland Revenue may grant any person a license authorising the printing of cheques upon application and payment of cheque duty payable. The applicant must nominate a printer, and, on the grant of a licence, Inland Revenue issues the nominated printer an authority to print the prepaid cheques to which the licence relates.

When cheque duty has not been prepaid on a bill of exchange, it must be duly stamped (by affixing a postage stamp or stamps and cancelling each stamp) by the drawer or maker of the bill. The revenue from postage stamps goes to New Zealand Post rather than directly to the Crown.

Inland Revenue may refund cheque duty that has been paid, upon application in writing within 8 years after the date of payment of the duty, but no refunds less than $1 can be made. Banks receive an effective refund via a deduction from their quarterly payment of cheque duty.

The penalties regime in Part 9 of the Tax Administration Act 1994 is applicable to cheque duty. As well as the usual civil penalties (i.e., the late payment penalty and shortfall penalties) and use of money interest, there are several criminal penalties that relate specifically to non-compliance with certain provisions of the Stamp and Cheque Duties Act 1971. Maximum fines range from $12,000 to $20,000.