

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Legislation Committee

INCOME TAX (FRINGE BENEFIT TAX, INTEREST ON LOANS) AMENDMENT REGULATIONS 2019

Proposal

1. This paper seeks the Cabinet Legislation Committee's agreement to submit an Order in Council amending the Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations 2019 to the Executive Council. The proposal is to lower the FBT prescribed interest rate for low-interest, employment-related loans from 5.77% to 5.26%, in line with a decrease in market interest rates.
2. Changes to the prescribed interest rate are a routine matter and do not involve a change of policy. The methodology used for setting the rate has been applied consistently since the early 1990s.

Policy

3. The fringe benefit tax (FBT) rules tax non-cash benefits provided to employees. Included in the definition of 'fringe benefit' is any employment-related loan on which the employer is charging a rate of interest that is below the market rate. The interest differential is taxable. A prescribed rate set by regulations is used as a proxy for the market rate of interest, to save employers the compliance costs associated with determining the market rate relevant to loans that they have provided to their employees.
4. The Income Tax Act 2007 allows regulations to be made to set the prescribed rate. Once a rate is set, it remains the prescribed rate of interest until changed by a subsequent Order in Council. The current FBT prescribed rate, which has applied from 1 January 2016, is 5.77%.
5. The prescribed rate of interest is based on a Reserve Bank survey of first mortgage housing interest rates on the last day of each month ('floating first mortgage new customer housing rate'). This is calculated as the weighted average interest rate for the surveyed institutions, the weightings being based on each institution's share of total lending for housing purposes. This Reserve Bank series is selected as the benchmark for setting the FBT prescribed rate because it is seen as a good indication of market interest rates.
6. The proposed new FBT rate of 5.26%, despite being 51 basis points lower than the current rate, might still be perceived as a high borrowing rate in the current low-interest environment. However, this figure is consistent with floating rates offered by major banks.

Timing and 28-day rule

7. Lowering the rate is favourable for employers and should apply as soon as possible. I am therefore recommending that the lower rate apply from the beginning of the current quarter, that is, from 1 October 2019. When the prescribed interest rate is reduced, the lower rate is allowed to apply from the start of the quarter in which the change occurs, provided the regulation is made at least a month before the end of that quarter. This means that the new Order in Council has to be made (and be in force) by the end of November.
8. A waiver of the 28-day rule is requested so that the regulation can come into force the day after its notification in the *Gazette* on 28 November 2019. This waiver is requested on the grounds that early commencement is necessary to enable the lower rate to apply from the beginning of this quarter, and early commencement will only confer a benefit on those affected. A waiver of the 28-day rule has been obtained for previous rate changes.

Compliance

9. The regulations comply with each of the following, where applicable:
 - 9.1 the principles of the Treaty of Waitangi Not applicable
 - 9.2 the New Zealand Bill of Rights Act 1990 Not applicable
 - 9.3 the Human Rights Act 1993 Not applicable
 - 9.4 the principles and guidelines set out in the Privacy Act 1993 Not applicable
 - 9.5 relevant international standards and obligations Not applicable
 - 9.6 the Legislation Guidelines (2018 edition), which are maintained by the Legislation Design and Advisory Committee. Complies

Regulations Review Committee

10. Officials consider that there are no grounds for the Regulations Review Committee to draw the Order in Council to the attention of the House under Standing Order 319.

Certification by Parliamentary Counsel

11. The regulations have been certified by Parliamentary Counsel as being in order for submission to Cabinet.

Impact Analysis

12. The proposal is of a minor and mechanical nature and does not substantially alter existing arrangements. Therefore, a regulatory impact statement is not required.
13. The proposal will not increase compliance costs as it is simply a change in the prescribed interest rate.

Publicity

14. I will issue a media statement once the Order in Council is made by the Executive Council.

- Inland Revenue will publish an article about these changes in its *Tax Information Bulletin*.

Proactive Release

- I propose to proactively release this Cabinet paper, associated minutes, and key advice papers in whole within 30 working days of Cabinet making final decisions.

Consultation

- The Treasury has been consulted in the preparation of this paper.

Revenue implications

- Lowering the prescribed interest rate to 5.26% will decrease the amount of FBT that will be collected by approximately \$0.27 million per quarter. This amounts to \$5.16 million over the current forecast period (2018-19 to 2022-23).

Recommendations

I recommend that the Cabinet Legislation Committee:

- note** that the regulations set the prescribed rate of interest for calculating the taxable benefit of low-interest, employment-related loans.
- agree** that, consistent with the latest results of the Reserve Bank’s survey, the FBT prescribed rate of interest should be lowered from 5.77% to 5.26% for the quarter which commenced on 1 October 2019.
- note** that lowering the prescribed rate will have the following impact on Crown Revenue:

	\$m, decrease				
Vote Revenue	2018/19	2019/20	2020/21	2021/22	2022/23 & Outyears
Decreased FBT revenue	(0.82)	(1.09)	(1.09)	(1.09)	(1.09)

- note** that the change is a forecast change and does not have appropriation implications.
- authorise** the submission to the Executive Council of the Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations 2019.
- note** that a waiver of the 28-day rule is sought on the grounds that early commencement is necessary to enable the lower rate to apply from the start of the current quarter, and will only confer benefits on those affected.
- agree** to waive the 28-day rule so that the regulations can come into force on the day after their notification in the *Gazette*.
- note** that I will issue a press statement announcing the decrease once the Order in Council is made.

Authorised for lodgement

Hon Stuart Nash
Minister of Revenue