

**POLICY AND STRATEGY**

**Tax policy report: Decrease in FBT prescribed rate of interest**

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<b>Date:</b>	21 October 2019	<b>Priority:</b>	Medium
<b>Security level:</b>	In Confidence	<b>Report number:</b>	IR2019/575

**Action sought**

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	<b>Action sought</b>	<b>Deadline</b>
Minister of Revenue	<b>Agree</b> to recommendations <b>Note</b> the contents of this report	10am, Thursday 14 November

**Contact for telephone discussion (if required)**

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<b>Name</b>	<b>Position</b>	<b>Telephone</b>
Paul Fulton	Principal Policy Advisor	s 9(2)(a)
s 9(2)(a)	Policy Advisor	

21 October 2019

Minister of Revenue

## **Decrease in FBT prescribed rate of interest**

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### **Purpose**

1. This report seeks your agreement to lower the prescribed interest rate used to calculate fringe benefit tax (FBT) on low-interest loans provided by employers to employees from 5.77% to 5.26%. This change is required to align the rate with current market interest rates. Based on longstanding practice, the new rate – being taxpayer favourable – should apply from the beginning of the current quarter (1 October 2019).
2. An Order in Council is required to make this change. Therefore, this report also seeks your approval for the Parliamentary Counsel Office (PCO) to draft an Order in Council to lower the rate. As changes to the FBT prescribed interest rate have become a routine matter, we consider that your approval is sufficient for PCO to draft the Order.
3. To enable the new rate to apply from 1 October 2019, the Order in Council must be made – and be in force – by the end of November. PCO can provide the Order in Council directly to Cabinet Office.

### **Background**

4. 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.
5. The Income Tax Act 2007 permits the making of regulations by Order in Council to set a prescribed rate of interest for the purpose of calculating FBT on low-interest loans. Once a rate is set, it remains the prescribed rate until changed by a subsequent Order in Council.
6. The prescribed interest rate was last changed from 5.99% to 5.77% from the quarter beginning 1 January 2016, following a review of the rate in February 2016.

### **Determination of appropriate prescribed rate**

7. The Reserve Bank conducts a survey of first mortgage housing interest rates on the last day of each month, producing a 'floating first mortgage new customer housing rate'. The rate 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 a suitable indication of general market interest rates, and is therefore used as the benchmark for setting the FBT prescribed rate.
8. The floating first mortgage new customer housing rate of 5.26% for August and September 2019 indicates that the current FBT prescribed rate of 5.77% is higher than the prevailing market rate. 5.26% could still be perceived as a high borrowing

rate in the context of the current low-interest environment, but this figure is consistent with floating rates offered by major banks.

9. Longstanding administrative policy has been to adjust the FBT prescribed interest rate when there has been a change in the floating first mortgage new customer housing rate of 20 basis points or more. We recommend that the rate be adjusted this quarter to ensure that there is no long-term misalignment.
10. If you agree that the prescribed interest rate should be decreased, the change should take effect from the start of the current quarter (1 October 2019).
11. The overall effect of the proposed change in the prescribed interest rate is that the rate for the quarter beginning 1 October 2019 will decrease from 5.77% to 5.26%.

### Process issues

12. When regulations are made declaring the rate of interest applying to employment-related loans, they apply to quarters starting from a date at least 1 month following the date the regulations were made. However, regulations that reduce the prescribed rate may apply to a quarter if made at least 1 month before the end of that quarter. If the prescribed interest rate is to be lowered from the start of the current quarter (1 October 2019), an Order in Council will therefore need to be made before 1 December 2019.
13. To meet this timetable, the Order in Council should be referred to the Cabinet Office by 10am on Thursday 14 November, so that it can be considered by Cabinet Legislation Committee on 19 November 2019. PCO has arranged for the Order in Council to be provided directly to the Cabinet Office.
14. A Cabinet paper recommending that Cabinet approve the Order in Council and authorise its submission to the Executive Council is attached. We recommend that you lodge the Cabinet paper with the Cabinet Office by 10am on Thursday 14 November 2019.
15. 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.

### Revenue implications

16. Lowering the FBT 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 (2019-20 to 2023-24).
17. A forecasting adjustment will be necessary, to account for the decrease in expected FBT revenue. It will not affect the balance of the tax policy work programme scorecard.

### Consultation

18. The Treasury has been consulted in the preparation of this report and the attached Cabinet paper.

## Recommended action

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We recommend that you:

19. **agree** that the FBT prescribed rate of interest for low-interest employment-related loans should be lowered to 5.26%, effective from 1 October 2019.

Agreed/Not agreed

20. **note** that decreasing the prescribed rate to 5.26% will result in a decrease in revenue of approximately \$0.27 million per quarter (\$1.08 million per annum), which amounts to \$5.16 million over the current forecast period (2019-20 to 2023-24).

Noted

21. **agree** that the Parliamentary Counsel Office should be instructed to draft an Order in Council to this effect.

Agreed/Not referred

### Paul Fulton

Principal Policy Advisor  
Policy and Strategy

### Hon Stuart Nash

Minister of Revenue  
/ /2019