



POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Increase in FBT prescribed rate of interest

Date:	29 September 2022	Priority:	Medium
Security level:	In Confidence	Report number:	IR2022/454

Action sought

	Action sought	Deadline
Minister of Revenue	<p>Agree to adjust the FBT prescribed rate of interest 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 10 November 2022.</p>	3 November 2022

Contact for telephone discussion (if required)

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

29 September 2022

Minister of Revenue

Increase in FBT prescribed rate of interest

Purpose

1. This report seeks your agreement to raise the prescribed interest rate used to calculate fringe benefit tax (FBT) on low-interest loans provided by employers to employees from 4.78% to 6.71%. This change is required to align the rate with current market interest rates. The new rate should apply from the beginning of January 2023.
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 raise 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. PCO can provide the Order in Council directly to Cabinet Office.

Background

3. The 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 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.
5. The prescribed interest rate was last changed from 4.50% to 4.78%, effective from the quarter beginning 1 July 2022.

Determination of appropriate prescribed rate

6. 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.
7. The floating first mortgage new customer housing rate of 6.71% for August 2022 indicates that the current FBT prescribed rate of 4.78% is lower than the prevailing market rate.
8. 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 to ensure that there is no long-term misalignment.

Process issues

9. 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.
10. The Order in Council should be referred to the Cabinet Office by 3 November 2022, so that it can be considered by the Cabinet Legislation Committee on 10 November 2022. PCO has arranged for the Order in Council to be provided directly to the Cabinet Office.
11. 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 3 November 2022.

Revenue implications

12. Raising the FBT prescribed interest rate to 6.71% will increase the amount of FBT that will be collected over 2022/23 by approximately \$1.83 million. This amount is estimated to increase to \$3.66 million per year over the current forecast period (2023/24 to 2025/26).

Vote Revenue	2022/23	2023/24	\$millions increase/(decrease)		
			2024/25	2025/26	2026/27 & out years
FBT revenue	2.54	5.08	5.08	5.08	5.08
Company tax	(0.71)	(1.42)	(1.42)	(1.42)	(1.42)
Net Revenue	1.83	3.66	3.66	3.66	3.66
Impact on Operating balance	1.83	3.66	3.66	3.66	3.66

13. A forecasting adjustment will be necessary to account for the increase in expected FBT revenue. It will not affect the balance of the tax policy work programme scorecard.

Consultation

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

Recommended action

We recommend that you:

- a. **agree** that the FBT prescribed rate of interest for low-interest employment-related loans should be raised to 6.71%, effective from 1 January 2022.

Agreed/Not agreed

- b. **note** that increasing the prescribed rate to 6.71% will result in an increase in revenue of approximately \$1.83 million over the 2022/23 year and \$3.66 million per year over the remaining forecast period.

Noted

- c. **agree** that the Parliamentary Counsel Office should be instructed to draft an Order in Council to implement the proposed rate change.

Agreed/Not agreed

- d. **approve** and **lodge** the attached Cabinet paper to the Cabinet Office by 10am Thursday 3 November 2022 for consideration by Cabinet Legislation Committee at its meeting on 10 August 2022.

Agreed/Not agreed

Paul Fulton

Principal Policy Advisor
Policy and Strategy

Hon David Parker

Minister of Revenue
/ /2022