Ministry of Transport
TE MANATŪ WAKA

BRIEFING

Meeting with the Minister of Revenue on potential tax issues with electric and hybrid vehicles

Reason for this briefing	You will be meeting with the Minister of Revenue on Tuesday 10 November 2015 at 12.30pm to discuss fringe benefit tax and tax depreciation rates for electric and hybrid vehicles. This briefing provides background information for your meeting with the Minister.
Action required	Consider this briefing prior to your meeting with the Minister of Revenue on 10 November 2015.
Deadline	Monday 9 November 2015
Reason for deadline	This deadline will enable you to consider this briefing before your meeting with the Minister of Revenue on 10 November 2015.

Contact for telephone discussion (if required)

Name	Position	Telephone Direct line	Telephone After hours	First contact
[redacted]	Principal Adviser	[redacted]		✓
Erin Wynne	Manager, People and Environment			

MINISTER'S COMMENTS:

Withheld under section 9(2)(a) of the Official Information Act 1982

Date:	9 November 2015	**Briefing number:**	OC03562
Attention:	Hon Simon Bridges (Minister of Transport)	**Security level:**	In-Confidence

Minister of Transport's office actions

☐ *Noted* ☐ *Seen* ☐ *Approved*

☐ *Needs change* ☐ *Referred to*

☐ *Withdrawn* ☐ *Not seen by Minister* ☐ *Overtaken by events*

Purpose of report

1. This briefing provides background information for your meeting with Hon Todd McClay, the Minister of Revenue, on the issues of fringe benefit tax and tax depreciation rates for electric and hybrid vehicles (EVs). The meeting is scheduled for Tuesday 10 November 2015 at 12.30pm.

Fringe benefit tax on EVs

2. Fringe benefit tax is a tax on non-cash benefits that are provided in connection with employment, such as the use of a company car. The tax is the non-cash benefit equivalent of PAYE tax that is applied to salaries and wages.

3. The purpose of fringe benefit tax is to ensure that all forms of remuneration are taxed equally. The tax is intended to leave an employee neutral between receiving a fringe benefit and receiving the equivalent monetary remuneration.

4. The most common type of employment-related fringe benefit is the private use of a company motor vehicle. For an employee, there is significant value in having a company car available for their private use. In monetary terms this value is the fixed and running costs that they would bear if they owned the car.

Why could fringe benefit tax be an issue for EVs?

5. Due to the way fringe benefit tax is calculated EVs attract a higher amount of tax. This is because their purchase prices are higher than those of equivalent conventional vehicles.

6. For the purposes of fringe benefit tax, the annual taxable value of an employee's vehicle benefit is calculated as either 20 percent of a vehicle's cost price, or 36 percent of its book value. These proportions are proxy estimates of the fixed and running costs that the employee would bear if they owned the car themselves. Fringe benefit tax applies to these estimates.

7. The tax regime assumes that these proxy estimates correctly value the fringe benefit of an EV. However, the fixed and running costs of EVs differ from conventional vehicles. The purchase price of EVs is higher, but the running costs tend to be lower than for conventional vehicles. By using the same proportion of cost price, or book value, the proxy estimate ignores these differences.

8. This means that potentially the fringe benefit tax calculation is overvaluing the fringe benefit of EVs and the vehicle owners are paying too much tax.

9. Although we expect the purchase prices of EVs to fall over time, it is unlikely that they will fall below those of conventional vehicles. So this potential for EV owners to be overtaxed is likely to continue into the future.

10. Being overtaxed could in turn distort vehicle choices away from EVs. This result would be inconsistent with New Zealand's tax policy settings, which are designed to deliver a neutral tax system.

11. Little is known about the extent to which fleet purchase decisions are being influenced by fringe benefit tax. In our view, it is more likely that other barriers, such as the higher purchase price, are playing a far greater role in company decisions not to purchase EVs for

their fleets. Also, not all fleet vehicles are subject to fringe benefit tax as often vehicles are used solely for work purposes.

12. Nevertheless, the potential for the tax regime to overvalue the fringe benefit of EVs could be an issue that adds to the barriers that are limiting the appeal of EVs to businesses.

The tax calculation used to value the fringe benefit of EVs could be reviewed

13. In our view there would be merit in addressing this potential tax issue. Discussions with tax officials suggest that the best way to do this would be to review the basis for calculating the taxable value of the fringe benefit for EVs. The point of the review would be to ensure that the lower running costs of these vehicles are adequately recognised in the tax calculation.

14. In this way, a review would remove any perception that the fringe benefit tax regime is influencing companies to favour conventional vehicles. It would also strengthen the existing policy settings of the fringe benefit tax regime.

15. Tax officials have said that this review would have to be prioritised against other items on the Government's tax policy work programme.

16. An alternative to a review would be to exempt EVs from fringe benefit tax. We do not support this option as it would:

    16.1. be inconsistent with New Zealand's broad based tax system, which ensures all earnings and non-cash benefits across the economy are taxable

    16.2. compromise the fairness of the tax system by affording a tax advantage to those companies and employees where an EV company car is made available for private use

    16.3. be inconsistent with the Government's revenue strategy which generally avoids tax concessions. Instead, it advocates that if the Government wishes to encourage a particular economic activity, then it should do so in a transparent way through direct funding rather than through the tax system.

17. Moreover, the current road user charges (RUC) exemption already provides a financial concession to encourage the purchase of EVs. Someone purchasing an EV today will benefit from a subsidy that is worth around $2,800[1].

Tax depreciation rates for EVs

18. Currently EVs are depreciated for tax purposes at the same rate as conventional vehicles. The depreciation rates are either 30 percent (diminishing value), or 21 percent (straight line).

Why could the depreciation rates be an issue for EVs?

19. Some stakeholders have suggested having a higher, or accelerated, tax depreciation rate for EVs. This is because fleet buyers perceive that the total cost of ownership over a 5-year period will be higher for EVs than for fuel efficient conventional vehicles. They suggest that EVs can be expected to have a higher depreciation rate than is currently allowed for income tax purposes.

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[1] This is based on the existing RUC rate of $62 per 1,000 kilometres (GST inclusive) and an average distance travelled of 10,000 kilometres. It reflects existing policy that the RUC exemption will end on 30 June 2020.

20. The evidence we have that EVs are depreciating at a faster rate comes from companies that calculate residual vehicle values. These companies are making lower estimates for EVs than for similar conventional vehicles. This is the case even though the original purchase prices of the EVs are higher. The lower estimates reflect the uncertainty around the rate at which EVs will depreciate as they are new to the market.

21. If tax depreciation rates are too low, then this can act as a further disincentive to fleet buyers by increasing their fleet vehicle costs. This is because EV owners would not be receiving the correct amount of depreciation deductions over the period that the vehicle is used by the business. This can result in over taxation of annual income.

22. However, the concern identified by these stakeholders is a question about the timing and value of depreciation deductions rather than a permanent tax effect. When a vehicle is disposed of, the Income Tax Act 2007 requires a wash-up to calculate if the relevant tax depreciation rate has correctly spread the cost of the vehicle over its economic life.

23. If a vehicle is disposed of at a value lower than its tax book value, then the company effectively receives a tax credit to account for that loss. If a vehicle is sold for more than its tax book value, the company effectively is credited with an amount of taxable income.

There would be merit in looking at whether the standard depreciation rates are appropriate for EVs

24. Nevertheless, the policy principle behind depreciation is that deductions should broadly match an asset's expected decline in value. If EVs are expected to depreciate differently to conventional vehicles, there is merit in investigating whether EVs warrant an alternative tax depreciation rate.

25. For simplicity the tax system applies average rates of depreciation across all cars. Average rates bring the risk that there will be 'winners and losers' in terms of tax liability in the early years of owning a company vehicle. However, the early years matter here because businesses tend to turn vehicles over every four years.

26. In a policy environment where we are trying to encourage businesses to purchase EVs, it would be desirable if the tax system helped to provide certainty. This would happen if businesses who purchase EVs could deduct depreciation in line with a vehicle's expected decline in value. Where this happens, the Crown would not inadvertently be benefiting from the market uncertainty around the rate at which EVs decline in value through use and time.

27. Tax policy officials advise that there is an existing process that can be used to review the depreciation rates. This is for the relevant companies to ask the Commissioner of Inland Revenue to review the case for having different depreciation rates for EVs. If such a review occurred, the companies would be expected to prepare an economic case and support their arguments for a different rate of depreciation.

28. You could prompt such a review by inviting relevant industry participants, for example the Sustainable Business Council and Mighty River Power, to make a request to the Commissioner of Inland Revenue.

Views of stakeholders

29. Earlier this year, stakeholders advocated using the tax system to encourage the purchase of EVs. Specifically, the Sustainable Business Council expressed the view that removing fringe benefit tax, or offering a 'tax holiday', would contribute substantially to the business case for EVs. A copy of the memo that the Sustainable Business Council gave you in January 2015 is attached.

30. Similarly, Mighty River Power and Zero Emission Vehicles Limited suggested that government could consider having accelerated depreciation rates for EVs.

31. These tax issues were discussed at a 12 October 2015 meeting that was held with the Sustainable Business Council and local and central government officials, including officials from Inland Revenue. Following the discussion, stakeholders appeared to understand the high thresholds involved in attempting to change the tax system to advantage EVs.

32. The 12 October 2015 meeting went on to workshop other solutions to encourage the uptake of EVs. As we have advised you, this discussion resulted in the three elements of the proposed EVs government-industry package. These elements are: enabling bulk procurement, having a contestable fund, and providing coordination initiatives, such as, an information and promotion campaign.

The key risk with the reviews is that they may generate results that stakeholders do not want

33. The key risk with doing the reviews is that the results may not benefit the stakeholders who have advocated for tax reform. In particular, higher depreciation rates could have a knock-on effect for fringe benefit tax. Higher depreciation rates imply that an employee would be getting the benefit of a vehicle that has greater costs. Therefore, the value of the vehicle benefit would be higher. This suggests that a higher amount of fringe benefit tax should apply on the private use of these vehicles.

34. This risk would be mitigated by giving stakeholders the choice as to whether or not they wish to pursue a review. The interrelationship between depreciation rates and fringe benefit tax was explained to stakeholders at the meeting of 12 October 2015.

Suggested talking points to raise with the Minister of Revenue

35. We suggest that you raise the following points with the Minister of Revenue:

35.1. There is the potential that the fringe benefit tax regime could be overvaluing, and thus overtaxing, the fringe benefit of EVs. This is because the regime assumes that the estimates that work for conventional vehicles, correctly value the fringe benefit of EVs. However, while the purchase prices may be higher, EVs can have lower running costs than conventional vehicles.

35.2. A review could be done on the basis for calculating the value of the fringe benefit of EVs. The point of the review would be to ensure that the lower running costs of EVs are adequately recognised in the tax calculation.

35.3. The standard tax depreciation rates for motor vehicles may not be appropriate for EVs. This is because the market seems to be depreciating EVs at a faster rate than for conventional vehicles.

35.4. Companies could perceive the standard depreciation rates as an additional reason not to purchase EVs for their fleets. If they did, they would not be able to deduct the tax on the additional cost of an EV's depreciation from their annual taxable earnings prior to the vehicle being disposed of.

35.5. There could be merit in the Commissioner of Inland Revenue reviewing the tax depreciation rates for EVs.

Recommendations

36. The recommendations are that you:

(a) **note** the background material in this briefing to assist you in your meeting with the Minister of Revenue on Tuesday 10 November 2015 at 12.30pm

(b) **note** our advice that you raise with the Minister of Revenue the possibility of Inland Revenue conducting a review of the:

1. basis for calculating the value of the fringe benefit of EVs
2. tax depreciation rates for EVs.

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[redacted]
Principal Adviser

Erin Wynne
Manager, People and Environment

MINISTER'S SIGNATURE:

DATE: 16/11/15