# Taxation (Beneficiary Income of Minors, Services-related Payments and Remedial Matters) Bill

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*Supplement to the Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill*

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*Prepared by the Policy Advice Division of the Inland Revenue and the Treasury*

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## REMEDIAL CHANGES TO THE MULTI-RATE FRINGE BENEFIT TAX RULES

The multi-rate fringe benefit tax (FBT) rules were enacted as part of the Taxation (FBT, SSCWT and Remedial Matters) Act 2000. These rules provide employers with an option to use progressive FBT rates based on an employee's income (including the value of attributed benefits) to determine the FBT that is payable, instead of applying a flat FBT rate of 64% to the value of all benefits provided.

As a result of these changes, a number of remedial issues have arisen that the Government has asked to be included in this bill. The Committee has sought comment on the following proposals from the Institute of Chartered Accountants of New Zealand (ICANZ), New Zealand Law Society, New Zealand Council of Trade Unions (CTU) and the Employers' Federation:

- Clarification of the subsidised transport exception;
- Remuneration paid to shareholder-employees;
- Clarification of major shareholder-employee's cash remuneration;
- Attribution rule income; and
- Low-interest loans provided by life insurers.

The CTU has provided a submission in broad support of the proposals.

The New Zealand Law Society has provided comments on several technical issues including clarifying when an employer is required to include "attribution rule" income under section GC 14D in the calculation of cash remuneration for a person receiving fringe benefits. The Law Society has also expressed concern at the potential for the proposals to be retrospective in nature should the enactment of the legislation be delayed beyond the time requirement for filing the 2000-01 year final return.

ICANZ has expressed concern at the proposal put forward by officials to deal with the issue of remuneration paid to shareholder-employees. This issue concerns employers who file quarterly and annual FBT returns and provide fringe benefits to shareholder-employees or to persons whom the employer is required to attribute income under the "attribution rule". ICANZ has put forward two alternative options.

Officials recommend that the proposed option for employers to pay 49% for these employees and undertake a square-up in the next year is the most workable solution in the short term. This proposal fits well within the current system without the need for significant systems changes by Inland Revenue and employers. Officials consider that the options put forward by ICANZ should be considered further, including consultation with other interested parties, with a view to including any legislation in a subsequent tax bill.

The Corporate Taxpayer Group has provided a submission on providing an additional option in the multi-rate rules whereby attributed benefits are all taxed at the top FBT rate, while non-attributed benefits are all taxed at 49% (the same rate as under the full multi-rate calculation). ICANZ has expressed its agreement with this proposal.

Officials have also raised several amendments that seek to clarify the application of the multi-rate rules:

- Non-residents and the low-income rebate;
- Clarification of the associates rules (consultation was undertaken with ICANZ); and
- Clarification of category (h) benefits.

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## Issue: Additional option for the multi-rate FBT rules

***New clause***

**Submission**
*(8W – Corporate Taxpayers Group)*

A new option should be added to the multi-rate FBT rules whereby an employer can apply a flat 63.93% rate to all attributed benefits and a flat 49% to all non-attributed benefits. From the employers' perspective this would avoid having to undertake the multi-rate calculations for attributed benefits, while still being able to pool the non-attributed benefits at the lower rate.

**Comment**

Officials agree that complexity is involved in undertaking the full multi-rate calculations for attributed benefits. As a result, employers need to weigh the costs of undertaking the calculation against any potential savings in FBT liability. This option would allow employers to gain some of the advantages of the multi-rate calculation while avoiding some of the more complex steps.

The proposal would see an employer paying the same amount of FBT for non-attributed benefits as under the full multi-rate calculation, and the highest rate of FBT (equivalent to the 39% personal tax rate) for attributed benefits.

While this option would not allow employers with employees on low and middle income levels to take advantage of the progressive FBT rates in the multi-rate calculation, it still allows the benefit of pooling non-attributed benefits at 49%.

Officials support this submission as the practical effect would be to tax non-attributed benefits at the same rate as under the multi-rate rules and all attributed benefits at the top rate.

The revenue impact of this option depends on the employers who would choose to use it. If employers who would otherwise use the flat 64% option for all benefits choose this option, then the effect could be revenue negative. However, if the option was used by employers who would otherwise use the full multi-rate calculation but wished to avoid the extra steps in the calculation, it could be revenue positive.

ICANZ has also been consulted on this option and agrees with the proposal for compliance reasons.

As this proposal is a new option and would not be enacted until late March 2001, officials consider that it should apply from the beginning of the 1 April 2001 year.

**Recommendation**

That the submission be accepted with application from 1 April 2001.

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## Issue: Clarification of subsidised transport exception

***Clause 18B***

**Submission**
*(Matter raised by officials)*

The option under section ND 4, which allows certain fringe benefits in the form of subsidised transport to be pooled, should be amended so that it does not exclude employers who are close companies.

**Comment**

Section CI 1(d) deems that fringe benefits in the form of subsidised transport are subject to FBT. This form of benefit is further defined in section OB 1 as applying only to employers who are involved in the business of transportation themselves. In practice, therefore, the exception to pool these benefits at 49% is limited to a small number of employers such as bus and rail companies and airlines.

The provision as drafted under section ND 4 excluded any close company from the option to pool these benefits at 49%. Officials now recommend that this exclusion be removed to ensure that some employers who could benefit from this option are not excluded by reason only of their close company status.

**Recommendation**

That section ND 4 should be amended so that it applies to all employers, including close companies, who can provide under the Income Tax Act 1994 fringe benefits in the form of subsidised transport.

## REMUNERATION PAID TO SHAREHOLDER-EMPLOYEES

### Issue: Option for next year square-up of liability

***Clause 18C, D, and F***

**Submission**
*(Matter raised by officials)*

An amendment is required to the rules for employers providing fringe benefits to shareholder-employees who receive non-deductible salary and wages or a person receiving attribution income to which the employer is a party to ensure that employers have the necessary remuneration information to perform the multi-rate calculation.

**Comment**

As the multi-rate FBT rules currently apply, there is a timing conflict regarding when an employer needs to determine the remuneration of its employees, and when the employer can calculate the remuneration paid to shareholder-employees that falls outside of the PAYE system.

This timing conflict occurs because employers of shareholder-employees may not know the remuneration of such employees for the year until after the FBT return is due. The same issue applies to amounts under the attribution rule. A clarification is also needed that this rule applies only to an employee deriving amounts under the attribution rule which involve the employer as a party to that amount.

To address this issue, officials recommend the following:

- that attributed fringe benefits provided or granted to a shareholder-employer or a person receiving attribution income to which the employer is a party to in the year be taxed at 49%; and
- employers be subject to the square-up calculation in the subsequent FBT year once they had full information of the remuneration of those concerned in addition to their other FBT obligations.

Furthermore that:

- if any employers were able to obtain this remuneration in the current year they would be able to file completely in that year (that is, the next year's square-up is only an option to ensure that any employers who cannot obtain the necessary information are not subject to penalties); or
- employers have the option to pay 64% on such benefits if they wish to opt out of this rule completely and complete their remaining FBT obligations under either the flat rate or multi-rate options.

All pooled benefits will continue to be calculated in the same year.

ICANZ has been consulted on this issue and argues that it should not be implemented. This is because of the compliance problems in calculating tax a year later and because two records systems may be needed as the employer could do both a square-up for the current year and to adjust payments for the previous year for shareholder-employees and persons receiving attribution income. ICANZ does agree however, that if the proposal is accepted, employers should have the option either to file "normally" or undertake the next year square up.

Officials consider that this system achieves the goal of managing the square-up process for employers with shareholder-employees and persons receiving attribution income. The deferral of potential tax until the next year gives employers use of that money until the square-up is undertaken as the 49% payment rate will in many cases under tax employers.

Officials agree that this proposal needs to be reviewed in the longer term. Furthermore, we recognise that other options exist, such as those suggested by ICANZ to deal with this issue. However, it is not workable to implement these other options by the end of March this year because of Inland Revenue system constraints and the need to provide information to employers and for employers to make their own system changes within that time frame.

The officials' proposal to have a workable solution in place by 1 April to allow employers to meet their FBT obligations fits within the existing FBT framework. We consider that further work should be undertaken to consult on the other longer-term proposals with a view to including any legislation in a subsequent bill, but that this proposal should apply at this time.

**Recommendation**

That an amendment be made to the multi-rate rules for employers providing fringe benefits to shareholder-employees or employees receiving attribution income as proposed in the Minister's letter of 23 November 2000.

That an amendment be made to ensure that the above proposal only applies to employers, who do not have the employee's remuneration details at the time the return is due, are required to undertake the lagged calculation.

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## Issue: ICANZ alternative proposal #1

**Submission**
*(7A – ICANZ)*

Employers should be allowed to pay one-quarter of last year's total FBT liability on the quarterly payment dates without the need for a "return" and to complete a final square-up when the information was available.

**Comment**

ICANZ argues that this proposal has the advantages that it can be applied to all taxpayers, would reduce compliance obligations, and removes double liability of FBT, and employers would pay the liability more accurately. The disadvantages of this proposal would be that employers would still make five payments (four quarterly payments and the final return), and implementing it would require system changes by Inland Revenue.

Officials consider that as a longer-term change this proposal has merit, but as it stands the effect on employers would not substantially change. Employers would still make the same number of payments and would still have to calculate what the payment would be. We are also unsure of the extent of any actual compliance savings involved. Furthermore, the required systems changes, the need to inform employers, and effects on employers in terms of changing their own systems at this time could be significant.

Such a proposal should be considered for all employers after consultation with interested parties.

**Recommendation**

That the submission be declined.

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## Issue: ICANZ alternative proposal #2

**Submission**
*(7A – ICANZ)*

All employers providing fringe benefits to shareholder-employees or person receiving attribution income should be able to file on an income year basis for those employees.

**Comment**

ICANZ submits that the advantages of this system are that Inland Revenue would not have to develop new systems and that employers would have to complete only one return and make one payment for these employees. Against this, ICANZ recognises that a number of further law changes would be needed to the multi-rate rules to allow employers to elect retrospectively into the income year rules and overcome the current monetary limit of $100,000 and limitation of the rule to close companies that would exclude many employers. Furthermore, employers would still be required to file for its other employees and for the 2000-01 income year such employers would be subject to use-of-money interest.

Officials acknowledge that this proposal has merit as a longer-term initiative. As with the comment for option 1, officials consider that such a change could not be implemented at this time.

**Recommendation**

That the submission be declined.

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## Issue: Drafting issue #1

**Submission**
*(7A – ICANZ)*

The proposed treatment of employers with shareholder-employees and persons with attribution income should not apply to employers filing on an income year basis as such employers have until their terminal tax date to file their FBT return and as such would have the necessary remuneration information by this date.

**Comment**

Officials agree as this proposal was intended to apply only to quarterly and annual FBT filers and therefore the draft amendment should be changed to reflect this.

**Recommendation**

That the submission be accepted.

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## Issue: Drafting issue #2

***Clause 18B***

**Submission**
*(7A – New Zealand Law Society)*

In clause 18B the reference to section ND 3(1) has been partially omitted and should therefore be corrected.

**Comment**

Officials agree that the reference should be corrected.

**Recommendation**

That the section be amended to correct the section reference.

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## Issue: Clarification of major shareholder employee's cash remuneration

***Clause 18E***

**Submission**
*(Matter raised by officials)*

An amendment should be made to section ND 7(2) to clarify when interest and dividends should be included in the cash remuneration of a major shareholder-employee for the purpose of the multi-rate FBT rules.

**Comment**

A concern has been raised that section ND 7(2) can be interpreted as requiring major-shareholder employees to include interest and dividends from all sources in their calculation of remuneration.

The policy intent behind this section was always to limit the calculation of remuneration to the compensation received from the employer concerned whether that remuneration was in the form of salary and wages or substitutes such as interest or dividends. Furthermore, interest or dividends from a related employer should also be taken into account if remuneration such as salary or wages is also received from that related employer.

**Recommendation**

That an amendment be made to clarify when interest and dividends are required to be included in the cash remuneration of major-shareholder employees.

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## Issue: Attributed income

***Clause 18D***

**Submission**
*(Matter raised by officials, 13W – New Zealand Law Society)*

The definition of "remuneration" used to calculate tax liability under the multi-rate FBT rules should be amended to include any amount distributed under the attribution rules contained in sections GC 14B to GC 14E (attribution income) to which the employer is a party.

**Comment**

This submission, to include any amount of "attribution rule" income in calculating the total remuneration of an employee under the multi-rate FBT rules, was raised as part

of the Committee's consideration of the Taxation (GST and Miscellaneous Provisions) Bill last year. At the time, however, the multi-rate fringe benefit changes had not been enacted by Parliament, so no amendments could be made at that time.

With both the multi-rate FBT rules and the attribution rule enacted, officials recommend that this change be undertaken as part of the current bill.

The New Zealand Law Society has made a submission that the requirement to include attribution rule income should apply only in instances where the employer concerned knows (or should reasonably know) that a distribution has been made subject to the attribution rule.

This rule should apply only in the situation where the employer is required to attribute income to an "employee" under the "attribution income" rule.

**Recommendation**

That the FBT rules be amended so the total remuneration provided by an employer includes any amount of income attributed under the attribution rules by that employer to an employee.

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## Issue: Low-interest loans provided by life insurers

***Clause 18A***

**Submission**
*(Matter raised by officials)*

An addition should be made to section ND 3 to state that subsection (1)(a) does not apply to low-interest loans by life insurers, and instead that such loans be treated as non-attributed or pooled benefits subject to a flat 49% rate. This would clarify the legislation regarding the treatment of low-interest loans from life-insurers to policy holders or their associates.

**Comment**

Low-interest loans are treated under the multi-rate FBT rules as attributed benefits. An exception to this rule are low-interest loans provided by life insurers to policy holders which are deemed to be non-attributed benefits and taxed at a flat rate of 49%. This is because the loans are not provided in an "employment relationship", and as such the life insurer would not have any knowledge of the recipient's income details.

An amendment would clarify any confusion over the treatment of this class of low-interest loan as against all other low-interest loans.

**Recommendation**

That section ND 3(1) be amended.

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## Issue: Non-residents and the low-income rebate

***New clause***

**Submission**
*(Matter raised by officials)*

An amendment should be made to section ND 5 to clarify that employers should use the full income rebate available to residents under section KC 1. This is irrespective of the tax residence of any employees concerned.

**Comment**

The multi-rate fringe benefit tax rules require employers to calculate the total remuneration of an employee. This total remuneration calculation includes both the cash income received such as salary, wages and extra-emoluments along with the total taxable value of attributed benefits (as defined in the multi-rate rules). The FBT payable for each employee concerned is determined by calculating the "total tax" that would be payable on that remuneration and subtracting a deemed amount of tax payable on that remuneration. This is similar to subtracting the PAYE that would have been paid on the cash component of the remuneration.

The concern is that the low-income rebate under section KC 1 is used to determine this deemed tax already payable, and that rebate is determined by reference to the residency of the employee concerned. The intent of the multi-rate calculation under section ND 5 was never to distinguish between resident and non-resident employees as the tax amount determined is a deemed rather than actual tax paid amount. Furthermore, requiring employers to determine the eligibility of each employee to the low-income rebate would add unintended complexity to the rules.

Section ND 5 should therefore be amended to state that for all employees receiving attributed fringe benefits, the calculation should include any rebate of tax allowed under section KC 1 as if each employee concerned was a full resident for the purposes of that section.

**Recommendation**

That section ND 5 be amended to ensure that the full rebate under KC 1 applies in all circumstances.

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## Issue: Clarification of the associates rules

***New clause***

**Submission**
*(Matter raised by officials)*

Currently there is an inconsistency between the general FBT rules and the optional multi-rate FBT rules in how to treat an associate of an employee who receives fringe benefits. Officials therefore submit that this treatment should be clarified to remove any potential inconsistency.

**Comment**

Section GC 15 outlines the general FBT rules for associates of employees who receive fringe benefits. In certain circumstances the section deems that either the associate, by virtue of receiving the benefits, is an employee in his/her own right, or that the benefits are deemed to have actually been received by the employee and not the associate.

Under the current multi-rate rules, the taxable value of any benefits provided to an associate of a major shareholder employee is required to be added to the total attributed fringe benefits of the major shareholder employee. The intent of this section was that it would apply to all associates, irrespective of whether they were shareholders themselves, unless they had their own genuine employment relationship with the employer. As section GC 15 deems some associates by virtue of receiving fringe benefits to be employees in their own right, such benefits are not taxed on the basis of the remuneration of the shareholder-employee (the principal).

ICANZ has made a submission on this issue and agrees that a legislative change is required to ensure the benefits provided to an associate are taxed in the hands of the employee rather than the associate.

Officials agree with the submission by ICANZ that an amendment should be made to section GC 15 to achieve this intent.

**Recommendation**

That an amendment be made to clarify the treatment of associates under the multi-rate rules who receive attributed fringe benefits.

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## Issue: Clarification of category (h) benefits

***New clause***

**Submission**
*(Matter raised by officials)*

Section ND 3(1)(c) should be clarified to ensure that the threshold for fringe benefits to which section CI 1(h) applies is $2,000 or more in total and not $2,000 or more per type of benefit.

**Comment**

Section ND 3 outlines, for the purpose of the multi-rate FBT calculations only, the thresholds at which certain fringe benefits defined under section CI 1 must be attributed to the employee receiving them. This means that, if the taxable value of fringe benefits within a prescribed category breaches the threshold, that entire category must be attributed to the employee concerned. The employer then uses this remuneration information for each employee concerned to calculate the FBT payable.

The issue requiring amendment concerns section ND 3(1)(c), which requires attribution for a benefit with a taxable value of $2,000 or more per year to which section CI 1(h) applies. Put simply, CI 1(h) covers all "other" fringe benefits that are not covered by any other category. These benefits can sometimes be in the form of very low value benefits such as discounted goods.

The underlying policy was that if the entire group of benefits that section CI 1(h) applies to had a combined taxable value of $2,000 to a particular employee, that category of benefits would be required to be attributed.

Officials are concerned that the provision may be interpreted to mean that each "type" of benefit that could be subject to section CI 1(h) needs to have a taxable value of $2,000 or more before being required to be attributed. For example, an employer could provide a club membership with a taxable value of $1,500 and discounted goods with a taxable value of $1,000. With an amendment, it can be clarified that these two types of benefit are required to be combined to constitute a total taxable value of $2,500, and thus would be required to be attributed.

**Recommendation**

That an amendment be made to the multi-rate FBT rules to ensure that the $2,000 threshold for benefits to which section CI 1(h) applies is interpreted on a full category rather than a per benefit type basis.

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