

Streamlining the taxation of fringe benefits

A government discussion document

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CONTENTS

Part one	Introduction	1
Chapter 1	INTRODUCTION	3
	Objectives of the review	3
	The scope of this discussion document	4
	Summary of proposals	5
	Other key decisions	7
	Submissions are invited	8
Part two	Fringe benefit tax	9
Chapter 2	POLICY FRAMEWORK	11
	What should be a taxable benefit?	11
	Valuing benefits	12
Chapter 3	CURRENT FRINGE BENEFIT TAX RULES	15
	Trade-off between accuracy and lower compliance costs	15
	Availability for use versus actual use	16
	Value of benefit to employee	16
Chapter 4	WHO SHOULD PAY THE TAX?	18
Part three	Major issues	21
Chapter 5	VALUATION OF MOTOR VEHICLE BENEFITS	23
	Current treatment	23
	The valuation basis – cost or book value	25
	Proposal	26
	Availability for private use	26
	Leased vehicles	29
	Availability on a daily basis	29
Chapter 6	WORK-RELATED VEHICLES	31
	Current law and problems	31
	Comment	32
	Options	35
	Logo requirement	38
	Emergency call-outs	38
Chapter 7	CAR PARKS	40
	Introduction	40
	Problems with the current law	41
	Policy intent	43
	Proposal	45

Chapter 8	VALUATION OF CAR PARKS	46
	Background	46
	The cost to the employer	46
	Market value to the employee	47
	Options for applying the market value rule	49
	A minimum threshold	51
Chapter 9	MULTI-RATE CALCULATION	52
	Introduction	52
	How the multi-rate calculation works	53
	Problems associated with the calculation	54
	Proposal	54
	How the proposal would work	54
	Low-interest loans	57
	Benefits and risks of the proposal	57
	Other options	57
	Ceasing to employ staff	58
Chapter 10	THE EXEMPTION FOR CHARITIES	59
	Background	59
	Policy arguments	60
	Other issues	61
	Leading conclusion from review	62
	Possible anti-avoidance rule	62
	Tertiary institutions and FBT	63
Chapter 11	LOANS TO EMPLOYEES	64
	Current rules	64
	Policy rationale	65
	Proposal	66
	“Publicly available” interest rates	66
	Comparable to valuation of discounted or free goods and services	67
	Proposal	67
Chapter 12	LOW-VALUE BENEFITS	68
	Reason for catch-all provision	68
	Specific exemption of employer health and safety-related benefits	69
	Policy rationale	69
	Proposal	70
	Minor unspecified benefits	70
	Proposal	71
Chapter 13	PROPOSED EXEMPTIONS – USE OF CERTAIN BUSINESS TOOLS	72
	Use and availability for use of business-related assets	72
	Policy rationale	72
	Proposal	73

Part four	Minor issues	75
Chapter 14	OTHER EXEMPTIONS	77
	Income protection insurance	77
	Third-party provided benefits	78
	On-premises exemption	79
	Travel costs when employee posted overseas	79
	Work-related clothing	80
Chapter 15	OTHER ISSUES	82
	Anti-avoidance rule	82
	Interaction with share option schemes	82
	Value of transport benefits	83
	Policyholder loans	83
	Changes to election provisions in subpart ND	84
Appendix	Motoring costs for petrol-driven vehicles estimated on 14,000km per year, first five years of ownership	85

Part one

Introduction

Chapter 1

INTRODUCTION

- 1.1 Introduced in 1985, fringe benefit tax (FBT) was a response to the growing trend in the 1980s to provide in-kind benefits in lieu of cash remuneration. Non-cash untaxed benefits became popular in the environment of high marginal tax rates that prevailed at that time. By taxing fringe benefits, FBT was intended to buttress the PAYE system so that all forms of remuneration were taxed equally. The initial focus of FBT was on the main fringe benefits at that time – cars, low interest-loans and free, subsidised or discounted goods and services.
- 1.2 Fringe benefits continue to be offered today, albeit perhaps representing a less significant part of packages, and the types of benefits provided by employers have widened,¹ so that FBT continues to play an important role in maintaining the integrity of the tax base.
- 1.3 Although there have been specific changes to the rules to clarify particular areas, such as the use of a test period to establish private use of a motor vehicle, the FBT system has remained substantially unchanged. The most major change was the introduction of the multi-rate system in 2000, which was designed to remove the overtaxation of low and middle-income employees by attributing fringe benefits at the marginal tax rate of the employee.

Objectives of the review

- 1.4 A key step in the process for developing and assessing tax policy – the generic tax policy process – is the undertaking of a review of policy once it has been implemented to see if it is operating as intended and how it can be improved. Several of these reviews have been carried out in various areas of tax policy since the process was introduced in 1994 – for example, the GST review and the accrual rules review. The FBT review is another in this series.
- 1.5 FBT can be considered to have been a relatively effective tax, but questions have arisen over the almost 20 years since it was introduced as to whether its efficiency and equity could be improved. In October last year the government called for taxpayers to identify areas they wished to be addressed in the review. Seventy-eight submissions were received from a cross-section of the public.

¹ A wide variety of subsidised goods and services is provided, either by the employer or by a third party, and paid for by the employer.

- 1.6 The vast majority of submissions considered the fringe benefit tax system to be complex and costly and suggested ways to reduce the cost by simplifying both the process and the rules. There was general concern that some of the rules were unfair, particularly in relation to motor vehicles. Anomalies in a number of areas were also highlighted.
- 1.7 A number of submissions commented on the rationale and scope of the FBT rules – for example, should the FBT rules be limited to benefits that can be readily substituted for salary or key benefits that were offered in lieu of salary? Some submissions suggested employees rather than employers should pay the tax, as part of the PAYE system. Others cautioned against the potential compliance cost increases and wage pressures that this might bring. A range of other issues was also raised.
- 1.8 Inland Revenue surveyed 301 large employers throughout New Zealand on the subject of compliance costs, including those associated with FBT. When businesses and tax agents were asked to name the one thing that could be done to reduce tax-related compliance costs, FBT was rated as the second most important issue for large employers. It was also the second biggest issue for tax agents generally and their most significant technical tax issue. Tax agents identified a number of issues that were considered a waste of their time or added to their clients’ fees, and FBT was one of three general categories of issues.
- 1.9 Several developments in case law and changes in interpretation over time have added to the complexity of the tax, as they have suggested that the policy intent of the legislation is not being achieved in some areas. The different treatment of leased versus licensed car parks and the interpretation of “work-related vehicle” are prime examples.
- 1.10 The purpose of the post-implementation review is, therefore, to assess the operation of FBT and address taxpayers’ concerns about the way the tensions between simplicity, comprehensiveness, and cost and equity are balanced. There are good policy reasons for retaining FBT. The challenge of the review is, therefore, to reduce the difficulty and cost to employers of complying with the FBT rules while essentially maintaining the revenue collected from FBT.²

The scope of this discussion document

- 1.11 This discussion document outlines a number of proposals on which the public is invited to comment. The aim is that any changes the government decides upon from this review would be included in amending tax legislation next year.

² Over \$370m in revenue is expected to be raised from FBT in the current fiscal year, two-thirds of it from motor vehicle related fringe benefits.

- 1.12 The focus of the document is on employment-related fringe benefits. The document, therefore, does not consider the interaction of FBT with other issues such as the deductibility of business entertainment expenditure, or the relative treatment of benefits under different entities such as partnerships.
- 1.13 Because the review has focussed on both the FBT framework and problems with specific benefits, the discussion document looks at, on the one hand, issues such as who should pay the tax and the basis for valuing benefits, and on the other, problems such as how best to value motor vehicles and the extent to which car parks are included as fringe benefits. A range of remedial issues also needs to be addressed.
- 1.14 Part two outlines the conceptual framework and practical issues that provide the foundations for New Zealand's FBT system.
- 1.15 Part three examines the application of the FBT rules in relation to motor vehicles, car parks, loans to employees, the multi-rate, charities, low-value benefits and business tools. These areas address both concerns expressed in submissions and some anomalies that are both conceptually problematic and that provide opportunities to erode the FBT revenue base.
- 1.16 In discussing these issues and suggested solutions, a key point is the need to strike appropriate trade-offs between compliance costs and an accurate and comprehensive system. Often there will be a number of solutions, depending on where the trade-off is made. Accordingly, we are particularly interested in feedback on whether the suggested solutions achieve the best trade-offs.
- 1.17 Part four of the discussion document addresses other exemptions and issues raised by taxpayers or which are of concern to Inland Revenue.

Summary of proposals

- 1.18 The proposed changes are:

Motor vehicles

- Owners would have the choice of calculating the benefit based on the vehicle's book value (with a minimum value) or, as at present, based on its cost.
- The rate applying to either the cost price or book value would be reduced in recognition of lower real motoring costs since the rate was set in the early 1980s. This would reduce the rate from 24% to 20% of cost. (The equivalent rate under the proposed book value option would be 36%.)

- The incentive to use various vehicle leasing structures to reduce FBT liability would be removed by aligning the treatment of leased vehicles with that of owned vehicles. This means that the benefit in respect of a leased vehicle would be based on either cost or book value. Market value (at a rate of 27%) could, however, be used if information on the cost or book value could not be easily obtained.
- To remove the potential for private use within a 24-hour period being treated as two days' private use, each employer would have the option to elect the start time for a day, which would be consistently applied in calculating the motor vehicle fringe benefit.

Car parks

- FBT would be applied to employer-provided car parks that are available for private use, irrespective of their legal form or whether they are on or off the premises, on the basis that any car park provided to an employee for private use is a benefit. Currently, because of the broad application of the "on-premises" exemption, most car parks are not subject to FBT. Various valuation options are suggested, and a minimum value threshold is discussed.

Multi-rate calculation

- Employers who file their fringe benefit returns on-line with Inland Revenue would have access to an on-line electronic calculator that would undertake the end-of-year multi-rate calculation for them.
- Other simplification options are to replace the FBT multi-rate calculation with a simpler calculation that uses the top marginal tax rate on the employee's cash remuneration as a final tax, or to apply a single rate (54%) that produces the same overall revenue outcome.
- Employers who cease to employ staff and do not intend to replace them would have the option of applying the flat rate of 64% in their final return rather than doing the multi-rate calculation.

Low-interest loans

- Employers would have the option of valuing their loans to employees at a publicly available market rate as an alternative to the current prescribed rate of interest.

Minimum thresholds

- The minimum value thresholds that apply to unclassified fringe benefits would be increased. The employee de minimis would be increased from \$75 to \$200 per quarter and the employer de minimis increased from \$450 to \$2,000 per quarter. These increases are expected to remove the need for a number of employers to file FBT returns.

Business tools

- The private use of employer-owned work tools such as cell phones and laptops would be exempt from FBT when provided to employees primarily for business purposes.

Miscellaneous issues

- Payment of income protection insurance premiums by an employer on behalf of an employee would be exempt to the extent that the employee would have received a tax deduction if he or she had paid the premium directly and the income stream would have been taxable.
- Benefits relating to employer health and safety obligations would be exempt from FBT.
- The current law would be clarified to confirm that FBT should not apply to benefits that arise when an employer secures a bulk discount for employees, provided those discounts would be available to other groups on a basis unrelated to employment.
- For the purposes of the on-premises exemption, an employer's premises would include the premises of other companies in the consolidated group.
- The general anti-avoidance rule in section BG 1 would be applied to FBT.
- The legislation treating share options as monetary remuneration would be amended to make it clear that it covers options that are cancelled in exchange for cash.
- The legislation would be clarified so that an election to pay FBT on a quarterly basis is made at the time of filing.
- Employers would be given the option of making their election to pay FBT annually by telephone rather than in writing.

Other key decisions

Who pays the tax?

1.19 FBT would continue to be paid by employers.

Charities exemption

1.20 Following submissions from the review of charities, the current exemption that charities have from FBT would be retained. An anti-avoidance rule is proposed to close off possible opportunities for the exemption to be exploited by charities providing employees with credit cards as a significant proportion of their remuneration.

Submissions are invited

- 1.21 Submissions on any aspect of this paper are welcome. They can be mailed to:

Streamlining the taxation of fringe benefits
C/- the General Manager
Policy Advice Division
Inland Revenue Department
PO Box 2198
WELLINGTON

- 1.22 Alternatively, submissions may be made in electronic form to:

policy.webmaster@ird.govt.nz

Please put “Streamlining the taxation of fringe benefits” in the subject line for electronic submissions.

- 1.23 Submissions should be made by 27 February 2004 and should contain a brief summary of the main points and recommendations. Submissions received by the due date will be acknowledged.
- 1.24 Please note that submissions may be the subject of a request under the Official Information Act 1982. The withholding of particular submissions on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. If you consider that there is any part of your submission that could be properly withheld under the Act, please indicate this clearly in your submission.

Part two

Fringe benefit tax

Chapter 2

POLICY FRAMEWORK

- 2.1 In theory, anything that employers provide to employees that could be considered to be a substitute for salary and wages should be treated as a fringe benefit. Fringe benefits that reduce employees' needs to meet private outgoings from their own resources clearly increase their capacity to spend or save in just the same way as does the payment of additional salary and wages in cash. Given that salary and wages are taxable, it follows that, to ensure neutrality of treatment, fringe benefits should be taxable on an equivalent basis, provided that the economic benefits of doing so are not outweighed by the economic costs.
- 2.2 Applying neutral treatment ensures that economic behaviour is not influenced by the tax outcome and improves economic efficiency. The efficiency gains from FBT result from a reduction in the tax incentive to provide fringe benefit remuneration and the associated reduction in attractiveness of activities that lend themselves to high fringe benefit remuneration.
- 2.3 Neutrality also means greater equality as employees enjoying equivalent remuneration packages pay equivalent tax, regardless of the package's composition.

What should be a taxable benefit?

- 2.4 Because what constitutes a benefit can be very wide, further tests are necessary to identify more specifically the extent of any taxable benefit. Should FBT apply to all benefits that make an employee better off, even if they are not readily substitutable for cash, or should it apply only to those benefits that are easily substitutable for cash or are the non-cash equivalent of a taxable allowance?

Taxing cash substitutes only

- 2.5 The argument for a more limited approach is that it would be more consistent with the position that benefits arise with the use of goods and services that employees would otherwise purchase privately. Anything that an employee could not substitute for cash remuneration would not be a fringe benefit.
- 2.6 Take, for example, the case of employer-provided, non-exchangeable tickets to a weekend sports event. The value of attending will vary greatly depending on whether the employee enjoys the particular sport or the team playing. It is unlikely that an employee not keen on sport could negotiate a cash substitute for such a low-value benefit, particularly if the tickets are part of a sponsorship package. That employee may be able to sell the tickets but there can be costs associated with doing so. On the other hand, if an

employee is a sports fan it is likely that the employer-provided tickets alleviate the cost the employee would otherwise have met from cash remuneration. The cash substitution approach would, to some extent, remove this uncertainty about whether the employee is likely to receive a benefit.

- 2.7 Applying the cash substitution approach would mean a comparatively narrower range of benefits would be covered. As such, the approach could have a greater impact on economic decision-making and equity across employees, depending on the extent to which those benefits that were not covered were considered by employees to have value. Furthermore, it could be difficult in many instances to determine whether a fringe benefit is, in fact, substitutable for cash. One approach would list a range of benefits that were considered to be substitutable for cash. Any such list would, however, involve a degree of arbitrariness.

Taxing all non-cash remuneration

- 2.8 Taxing all non-cash remuneration will have a lesser impact on decision-making as it seeks to treat all benefits that flow from the employer to the employee equally for tax purposes. Although this may appear to be too wide to be practicable, the ability to value a benefit will act as a practical limitation and the ultimate test as to whether something has potential value to the employee.
- 2.9 Further practical adjustments can be applied. Some benefits are very difficult to value as there is no readily associated market price. When it is evident in such cases that the cost involved in paying FBT on the benefit clearly outweighs the value of the benefit, exempting the benefit can operate as a useful moderating tool to prevent the FBT rules from applying unreasonably.
- 2.10 When benefits can be more easily measured, instances of when the cost involved in paying FBT outweighs the value of the benefit can be handled by the setting of minimum taxable values, or de minimis thresholds.

Valuing benefits

- 2.11 Two key tests are helpful in valuing benefits:
- if the benefit involves the provision of an asset, whether the asset is available for private use by the employee; and
 - the value of the benefit to the employee.

- 2.12 Consider, for instance, the situation of an employer providing an employee with a motor vehicle. Without the employer-provided car, the employee would have had to purchase a car and incur fixed costs (depreciation, interest, licensing, insurance and warrant of fitness). If the employee uses the vehicle, he or she enjoys further savings in terms of avoiding running costs (maintenance, tyres and possibly oil and petrol if the employer also covers this).
- 2.13 If recognition of the benefit was confined to actual private use – say, on the basis of either kilometres travelled or time, the benefit would be materially undervalued because the fixed costs occur irrespective of whether the vehicle is used. The employee enjoys the economic benefit of avoiding these costs, hence the concept of availability being a fringe benefit.
- 2.14 The other important concept is that the value of the benefit should be the value to the employee rather than, say, the cost to the employer of providing the benefit. In many cases the two values will differ, with the employer having an incentive to provide benefits that have a low marginal cost to them but that are more highly valued by the employee. An example that highlights this disparity is air tickets, which an employer who is in the business of providing air travel may be quite happy to offer to employees at a very low price because the marginal cost of an empty seat at the time of departure is close to zero. In contrast, the benefit of the ticket to the employee is in most instances the price of a normal (standby) fare. The reason the focus needs to be on the value to the employee is because it should measure what the employee is willing to give up in terms of (after tax) salary and wages.

Trade-off between accuracy and compliance costs

- 2.15 Trying to measure all benefits accurately is unrealistic as it would give rise to significant compliance costs for taxpayers and enforcement costs for Inland Revenue. Also, the behavioural effects and revenue implications are minimal from low-value benefits. This means, just as when deciding which benefits should be taxable, that a realistic approach should be taken, with the main emphasis being on the “big ticket” and more frequently occurring benefits. Even in those cases, however, we acknowledge that there is room for flexibility and the need to make trade-offs between accuracy and compliance costs.
- 2.16 Getting the right trade-off is important. The broader the application of tax to fringe benefits, the greater the incentive to switch from fringe benefits to cash remuneration, which then becomes taxable under the personal tax system. At the same time, a reduction in the occurrence of fringe benefit remuneration eases the administration of the tax. However, a relatively onerous tax also increases the incentive for avoidance and evasion and leads to pressure for the granting of concessions or exemptions. A concessionary tax tends to have the opposite results, including making the administration of the tax more difficult through reducing the incentive to switch to cash remuneration.

Categorisation of benefits

- 2.17 Fringe benefits can be categorised into three groups for valuation purposes:
- benefits that are easily quantified and can be assessed by individual valuation – for example, an employer paying for an employee’s holiday;
 - benefits, such as motor vehicles, that would require a more complicated calculation if assessed on an individual basis and should, therefore, be treated as a class to which a standard set of rules applies; and
 - benefits, such as a staff cafeteria in which food is provided at subsidised prices, that are difficult to allocate to individuals largely because, although the benefit might be frequently used, each benefit is small.
- 2.18 The earlier discussion suggests that the FBT rules should focus primarily on the first two categories and that the third is unlikely to be worth taxing and can be addressed by setting minimum values that apply before a benefit is recognised.
- 2.19 When, as in the first category, an employer provides a taxable benefit by paying for a good or service that is supplied by another independent party, the value of the benefit to the employee can be taken for practical reasons as the cost to the employer. In such cases the benefit has a clear market price and the value to the employee should equate to the cost to the employer.
- 2.20 The next chapter discusses how the current rules compare with this framework.

Chapter 3

CURRENT FRINGE BENEFIT TAX RULES

- 3.1 The current fringe benefit tax rules contained in subpart CI of the Income Tax Act 1994 take a wide approach. Although they list specific significant benefits, such as motor vehicles, subsidised travel and loans, they also contain a catch-all provision (section CI 1(h)) that covers “any benefit of any other kind whatever, received or enjoyed by the employee ...whether directly, or indirectly, in relation to, in the course of, or by virtue of the employment of the employee and which is provided or granted by the employer of the employee...”.
- 3.2 The rules then exclude certain benefits, such as a benefit from an employer that is a charitable organisation provided the benefit is not received in the course of carrying on a business, or benefits provided on an employer’s premises.
- 3.3 Minimum value thresholds apply to remove low-value benefits from any FBT impost. Unclassified benefits (those falling within section CI 1(h)) of \$75 or less per quarter (\$300 per year) per employee are excluded and an employer or associated person can provide aggregate unclassified benefits of up to \$450 per quarter before FBT applies.³ Also, discounts of 5% or less are ignored when the goods are of low value.

Trade-off between accuracy and lower compliance costs

- 3.4 The trade-off between accuracy and lower compliance costs has been a major influence on the design of the current rules. Back in 1985 it was noted to be an issue, particularly in relation to the valuation of benefits. Because the value of a benefit is often difficult to determine and may vary considerably among different cases, a system based on case-by-case assessment can involve heavy compliance and administrative costs. It may, however, be more equitable than the alternative of a system of prescribed benefit values which do not permit much case-by-case variation.
- 3.5 No system was considered capable of meeting simultaneously equity and compliance and administrative cost objectives. Hence, the rules developed at that time attempted to achieve a reasonable trade-off between these conflicting objectives. Although their deficiencies were recognised, they were considered to be less than the problems associated with the loss of revenue created by not taxing fringe benefits.

³ There are no equivalent minimum values for those benefits, such as motor vehicles, that are separately listed as benefits in section CI 1.

Availability for use versus actual use

- 3.6 If an asset is provided by an employer to an employee, its fringe benefit value is determined by whether it is available for private use. In the case of motor vehicles, the availability test is applied on a daily basis. Whether a vehicle is available for private use can be determined by keeping a log book for a three-month test period (see section CI 11). If the vehicle is available for private use at any time during the day, such as for home-to-work travel, availability for such use is considered to exist for the whole day.
- 3.7 If the benefit relates to a service rather than the provision of an asset, the benefit is valued according to the actual use of that service, with no value being attributed to having access to the subsidised service. Discounted goods are similarly treated – even though the discount may be available to the employee at all times, goods have to be purchased to trigger the taxable benefit.
- 3.8 Arguably, the availability of a discount or access to services has some value, but it is very difficult to determine and will vary from employee to employee, depending on whether they intend to purchase the goods or services. Given these difficulties, it is sensible to treat the availability aspect as irrelevant and apply “use” as the appropriate test.

Value of benefit to employee

- 3.9 Under the Act, benefits are, in general terms, valued as follows:
- when the employer makes a contribution on behalf of an employee, at the actual amount paid by the employer;
 - when the employer provides a good or service, at the lower of cost or market value; or
 - when the employer provides a good or service for which there is a part charge, such as a low-interest rate on a loan, at the difference between the price to the employee and the market value or market value proxy (for example, a prescribed rate of interest).
- 3.10 Because of the need to strike a balance between accuracy and lower compliance costs, standard rules apply to those types of assets for which identifying and allocating actual individual benefits would be compliance cost intensive.
- 3.11 The prime examples are motor vehicles and subsidised transport. In the latter case the cost is the higher of 25 percent of the highest price that would be charged to the public or non-employees or the price paid by the employer. This proxy is used because of the difficulty in establishing the appropriate cost, since price varies according to the attached conditions. In the absence of this rule, the value of the benefit should be the average cost or the

marginal cost, highlighted by the example used previously regarding airline tickets.

- 3.12 Another example of the difficulty in balancing accuracy and compliance costs arises when ensuring that FBT is accurate by applying the marginal tax rate of the employee. Currently, the rates are 17.65%, 26.58%, 49.25% and 63.93%, to reflect the personal marginal tax rates of 15%, 21%, 33% and 39%. As discussed later in this document, taxpayers are concerned about the complexity that this multi-rate approach entails. Previously, only one rate applied, but taxpayers were concerned that this meant some employee benefits were overtaxed.

Chapter 4

WHO SHOULD PAY THE TAX?

- 4.1 One option that has been raised is that rather than the employer paying the tax, the tax would be paid by the employee. The rationale for this approach is that FBT is a tax on individual benefits, at the individual's marginal tax rates, to bolster PAYE. It is not intended to supplement company tax.
- 4.2 The option of the employee paying FBT would involve attributing benefits to individual employees, who would in some manner pay the tax. The tax would likely be collected by applying the PAYE withholding tax, possibly with an end-of-year square-up through the tax return process.
- 4.3 Requiring individual employees to include benefits as taxable income would effectively leave employees with the same remuneration package while increasing their taxable incomes. Accordingly, it would reduce their entitlements and increase their obligations under the various programmes delivered through the tax system, such as family support, student loan repayments and child support payments. It would align these employees with those who receive all their remuneration as salaries and wages, resulting in more equal treatment. It might also raise employees' awareness of the extent of the benefits they receive. These various outcomes may increase economic efficiency.
- 4.4 Whether the employee or employer pays the tax should not, in theory, affect the incidence of the tax. There may be some implications, however, if the employer does not also pass on to the employee the equivalent amount the employer is paying in FBT. If employees' remuneration is already treated as a package, any fringe benefits and the associated tax will generally be built into that package. In other cases the two parties may have to negotiate over whether the employer passes on to the employee the equivalent amount that the employer is currently paying in FBT.
- 4.5 Because employers would still need to calculate benefits and attribute them to individual employees, changing who pays the tax is unlikely to result in any material compliance savings for employers, although it may obviate their need to undertake the multi-rate calculation. Overall compliance costs would probably increase as there would be additional compliance costs for employees. Furthermore, if benefits could not be attributed, the tax impost would probably remain with the employer. Treating fringe benefits in exactly the same way as salaries and wages would reduce the likelihood of bringing former IR 5 taxpayers back into the end-of-year return filing process, although employees would still need to decide whether they were due a refund.

- 4.6 Alternatively, the employee could be required to pay the tax just on the easily attributable fringe benefits, such as loans, but this might just lead to confusion among the parties as to their relative responsibilities for paying the tax.
- 4.7 On balance, in the context of the objectives of the FBT review there does not seem to be merit in changing who pays the tax. Most of the advantages of integrating FBT into the PAYE system can be achieved without shifting who pays the tax. The government is already working on improvements to the way FBT is returned, including, as discussed in the later chapter on the multi-rate calculation, better access for employers to Inland Revenue's on-line calculation tools.

Part three

Major issues

Chapter 5

VALUATION OF MOTOR VEHICLE BENEFITS

Proposed changes

- Owners would have the choice of calculating the benefit based on the vehicle's book value (with a minimum value) or, as at present, its cost.
- The rate applying to either the cost price or book value would be reduced in recognition of lower real motoring costs since the rate was set, in the early 1980s. This would reduce the rate from 24% to 20% of cost. (The equivalent rate under the proposed book value option would be 36%.)
- The incentive to use various vehicle leasing structures to reduce FBT liability would be removed, by aligning the treatment of leased vehicles with that of owned vehicles. This means that the benefit in respect of a leased vehicle would be based on either cost or book value. Market value (at a rate of 27%) could, however, be used if information on the cost or book value could not be easily obtained.
- Each employer would have the option to elect the start time for a day, which would be consistently applied in calculating the motor vehicle fringe benefit.

- 5.1 The valuation of motor vehicles for FBT purposes was the issue most frequently raised as an area of concern in the comments made in submissions. Submissions considered that the review should reconsider the FBT treatment of motor vehicles in a range of areas.

Current treatment

- 5.2 As noted in chapter 2, motor vehicles are valued for FBT purposes on the basis of their availability for private use rather than actual use, to reflect the full range of fixed and variable costs the employee is saved from incurring by having the use of a vehicle that is owned by someone else, who bears those costs. The FBT value to an employee of a car provided by an employer is, therefore, the sum of the fixed (or standing) costs and variable (running) costs related to private use that the employee would have to bear if he or she owned the car.
- 5.3 Like other fringe benefits, the actual value of an employer-provided vehicle will vary according to individual employees' vehicle preferences and use. However, taking all such factors into account for each relevant employee would significantly increase compliance costs for employers. To avoid this

complexity, a set rate is applied (currently 24% a year⁴). That rate is based on the combined average fixed and variable costs for a vehicle that has an average amount of private use, expressed as a percentage of the cost of an average vehicle. The data source for these costs is the Automobile Association annual survey of motoring costs.⁵ This rate is then applied to the actual price of the vehicle to establish the value of the fringe benefit.

- 5.4 What constitutes the vehicle's actual price depends on whether the employer owns or leases the vehicle. In the case of a vehicle that is owned by the employer, the 24% rate is applied to the original cost of the vehicle. For example, if the cost of the car provided to an employee for unlimited private use is \$30,000, the value of the fringe benefit is \$7,200.
- 5.5 If the vehicle is leased and the lessor and lessee are not associated persons, the 24% rate is applied to the market value of the motor vehicle at the time the lease began. If, however, the leasing parties are associated, the vehicle's cost is used.
- 5.6 In any of these cases, however, the objective should be that the same amount of FBT is payable irrespective of the type of arrangement under which the vehicle is provided. To achieve this objective, the valuation basis for the cost of the car must be either consistent across all arrangements, or the statutory formula must vary to arrive at the same amount of liability.
- 5.7 The relevant formula and rules are contained in sections CI 3 and schedule 2 of the Income Tax Act 1994. Binding ruling (Binding ruling Pub 00/10) sets out what is considered by Inland Revenue to be the "cost price" of a vehicle for FBT purposes.
- 5.8 The formula establishes the maximum taxable benefit. Because it is an average, it will in individual cases result in the actual benefit being either undertaxed or overtaxed, but this is the trade-off for lower compliance costs.
- 5.9 The legislation also provides for the maximum taxable benefit to be reduced by any amounts paid by the employee for the receipt or enjoyment of the fringe benefit (see section CI 4(1)) and any days that the vehicle is not available for private use. The employee, for example, may pay for the petrol or the vehicle may not be available on weekends.

⁴ This means that the average cost of owning a vehicle for five years is 120% of the original purchase price.

⁵ As published in *AA Directions*.

The valuation basis – cost or book value

- 5.10 Writers of submissions perceived the current valuation formula’s use of the original cost of the vehicle to be unfair as the FBT liability remains constant while the vehicle declines in value over time. Although some appeared not to be aware that the valuation formula includes a depreciation allowance,⁶ others considered that aligning the FBT valuation with the depreciated value used for other tax purposes would result in a compliance cost saving.
- 5.11 The government agrees that there is a perception problem associated with using a vehicle’s cost price as the base for calculating the benefit. Also, because the formula assumes vehicles are held for an average of five years, it results in overtaxation if the vehicle is kept beyond five years.
- 5.12 In 1982 the Task Force on Tax Reform (the McCaw Task Force),⁷ which recommended introducing FBT, considered the alternative option of using a vehicle’s tax book value as the base, but noted a higher rate would be required to produce the same overall result as using cost price as the base. (As the example below illustrates, the equivalent percentage to 24% of the cost price would be 44% of the book value.)

Comparison of rates based on book values and original cost of a vehicle purchased new for \$30,000

Taxable value under the current formula

$\$30,000 \times 24\%^{*1}$	\$7,200	taxable value per year
x 5 years	\$36,000	total taxable value over 5 years

Taxable value based on depreciated value to produce same amount of tax

	<i>Book value of vehicle</i>	<i>Taxable value of fringe benefit</i>
Year 1 (Original Cost)	\$30,000	\$13,200
Year 2	\$20,640	\$9,082
Year 3	\$14,200	\$6,248
Year 4	\$9,770	\$4,299
Year 5	\$6,722	\$2,957
Total over 5 years		<u>\$35,786</u>

The example assumes a vehicle purchased new at \$30,000

FBT rate equivalent is 44%^{*2}

*1 proposed in this chapter to be reduced to 20%.
 *2 36% following the proposed reduction to 20% of cost.

⁶ See appendix.
⁷ See Chapter 6.VI of the *Report of the Task Force on Tax Reform*, April 1982.

- 5.13 Because the rate would be higher, the FBT liability using book value would initially be higher than when using the cost price. Also, because the annual tax depreciation rate on cars is, at over 20%,⁸ higher relative to that used by the Automobile Association, using it in the calculation is likely to exacerbate the rate increase. Consequently, changing the base alone may not address concerns expressed in submissions, although it would align the taxable value of the motor vehicle for fringe benefit purposes with the value of the vehicle for other tax purposes.
- 5.14 An alternative would be to use market value rather than book value, but this would have higher compliance and administrative costs because of the need to verify each car's market value annually. Using some standard values may assist in this regard but could be quite inaccurate.

Minimum value

- 5.15 Because the depreciated tax value declines rapidly over five years, using book value could significantly understate the value of the benefit thereafter. Accordingly, a minimum fringe benefit value would be needed to reflect the benefits that the use of an employer-provided vehicle continues to provide to an employee regardless of the value of the vehicle on the employer's books. The minimum value should cover at least the average cost of warranting, registering, insuring and running private vehicles, assuming an annual distance of 14,000kms,⁹ which equates to around \$3000.

Proposal

- 5.16 The government proposes that tax book value (subject to a minimum value) be used as a method of valuing vehicle fringe benefits, as an alternative to cost price. Having a choice would enable employers to better align the base they use for FBT purposes with the base they use for tax depreciation purposes. Employers would need to elect at the beginning which option they wished to use for each vehicle and that election would continue to apply for the period of ownership of the vehicle, or the first five years, whichever is shorter. If the book value option were adopted, a minimum value of \$3000, reviewed periodically, would apply.

Availability for private use

- 5.17 Submissions considered that the concept of "availability for private use" also needed to be re-examined because a large FBT liability could be incurred if the employer did not prohibit private use, even in circumstances where actual private use was very small.

⁸ For tax purposes, a motor vehicle can be depreciated annually at a rate of either 21.6% of its cost price or 31.2% of its diminishing value. These rates include a 20% loading on the economic rate.

⁹ The assumed average motoring used by the Automobile Association.

- 5.18 As noted earlier, under the current rules, an identification of private versus business use can be made based on a three-month test period in which a log of use is kept. This allocation is, however, on the basis of availability rather than actual use. For the reasons outlined earlier, the government considers availability to be the appropriate approach.
- 5.19 Actual private use of work-provided motor vehicles can be quite variable, ranging typically from occasional home-to-work travel only to regular use outside work. Unfettered use usually arises with vehicles provided to executives, whereas it is more likely that other staff will take home fleet vehicles, perhaps primarily for garaging. In the latter case employers will often place specific limits on private use and require that work use take priority during work time. This “tagging” of the benefit, it is argued, reduces its value. This is a reasonable argument, but by how much is the benefit reduced?
- 5.20 In some instances employees may find the limitations have little practical impact on their ability to use an employer-provided car when they want. For example, an employer may require that a vehicle is used solely for work purposes during work hours but this would not impede an employee from using the car to drive to and from work and on evenings and weekends, so he or she could still have a higher use of the vehicle than is assumed in the standard formula used to calculate the fringe benefit.
- 5.21 This example illustrates the difficulty of trying to identify the impact of particular limitations on the value of any benefit. The impact will depend on the extent of the limitation, the personal circumstances of the employee and how well the limitation is adhered to (which will depend on how sensibly it can be monitored).

The appropriate rate

- 5.22 In 1982 the McCaw Task Force used Automobile Association data to calculate both the fixed and variable costs of motoring, grouping cars according to three categories (small, medium, large) and assuming they travel an average of 16,000kms each year. The aggregate cost was then expressed as a percentage of the cost of the car. On this basis it calculated the percentage benefit to range from 35% for a large vehicle to 43% for a small vehicle. The Task Force considered, however, that a more conservative rate of 24% a year would be more appropriate, to reflect the following factors:
- Many taxpayers’ private motoring travel is less than the benchmark distance of 16,000kms.
 - Some operating costs (such as fuel) may be met by the employee.
 - The vehicle may be superior to that which the employee would have purchased for his or her own use.

- Some restrictions may be placed on the use of a vehicle for private purposes so that it is not wholly available for private running.

5.23 These factors were partially reflected in the final 1985 legislation. Operating costs specifically met by employees reduce the benefit; the availability for private use test is applied to motor vehicles on a daily basis; and the rate calculation of 24% was the cost at that time for employees travelling an average of only 8,000kms per year.

5.24 Applying the methodology used by the McCaw Task Force to current motoring costs and car prices¹⁰ shows that, in real terms, the cost of motoring has declined significantly over the past 20 years, as shown in table 1. Based on 16,000kms, the annual motoring costs as a percentage of the cost price of the vehicles have declined by as much as 20%. The decline is mainly in the variable costs as there is no decline at the 8,000kms level. Arguably, however, 8,000kms per year is too low to reflect average actual travel. The Automobile Association assumes average annual motoring to be 14,000kms, which we consider to be a more reasonable basis for the calculations. It produces a decline in real motoring costs of around 18%.

Table 1: Motoring costs as percentage of cost of vehicle

Year & Source	1982 McCaw*	1981 AA*	1984 MOT*	2003 AA*	% AA change from 1981
at 16,000kms	40.0	35.5	33.4	27.4	-22.8
at 14,000kms	-	32.2	30.7	26.4	-18.0
at 8,000kms	-	22.3	22.9	23.5	+5.4

* Number shown is an average for small, medium and large vehicles.

5.25 This decline over the last 20 years suggests that the valuation of the fringe benefit at a rate of 24% of a vehicle's cost is now overstated, so the rate could be reduced. Continuing to apply a discount to the actual rate will also help reflect any reduction in the benefit's value from the limitations often placed on private use during the day.

Proposal

5.26 Applying an 18% reduction to the 24% discounted rate considered appropriate in the early 1980s and included in the legislation would reduce the rate to 20%. The equivalent percentage using book value as the base would be around 36%. The government proposes, therefore, to introduce revised valuation rates of 20% for cost and 36% for book value.

¹⁰ See appendix for the basic method as applied to motoring costs and prices for 2003.

Leased vehicles

- 5.27 FBT on leased vehicles is assessed on the vehicle's market value at the beginning of the lease. This is intended to produce the same outcome as if the vehicle were owned but removes the need for the employer to ascertain the cost or book value from the owner.
- 5.28 In practice, however, as a number of submissions noted, leasing a vehicle can produce a lower FBT liability. This is because many leases are being structured so that they become renewable each year, resulting in a new market value annually and a commensurate reduction in FBT as the vehicle ages.¹¹ The result is that, effectively, there is a double recognition of depreciation – one being through the market value of the vehicle and the other being incorporated into the rate calculation, as explained earlier.
- 5.29 This situation should be rectified to help ensure both that the FBT base is not undermined and that the choice between leasing and owning is not driven by the tax outcome.

Proposal

- 5.30 The suggested approach is to provide equality of treatment between leased and owned vehicles by allowing lessees the same options that owners have when valuing the fringe benefit. This means that lessees would be able to use either a rate of 20% on the cost price of the vehicle or a rate of 36% on the book value of the vehicle. If lessees cannot obtain the necessary cost price or book value information from the lessor, they would be able to use a market value rate (27%) that produces an equivalent FBT result.
- 5.31 This option would not increase compliance costs for employers who lease vehicles as they could continue the current practice of valuing vehicles each year, with the book value or cost price generally replacing the market valuation.

Availability on a daily basis

- 5.32 A related issue raised by submissions is whether the FBT liability should continue to be calculated on a daily basis. Currently, if a vehicle is available for private use at any time during the day, such as for home-to-work travel, the vehicle is considered to be available for the whole day. Calculating the

¹¹ These types of leases are commonly referred to as 1x1x1 leases. Another common form of leasing arrangement is nine-to-five leases. The latter typically involve an individual (usually a shareholder-employee) buying a vehicle and leasing it back to his or her company for its business use during specified hours in exchange for a market rental. Such agreements are often a means of allowing the individual to enjoy the private use of the vehicle without incurring FBT on that private use. The discussion document does not address the conceptual and technical issues surrounding such leases but consideration is being given to those issues. The leases are a response to the boundary issues between different forms of entity – in particular, the relative treatment of fringe benefits received by shareholder-employees and the self-employed; and technical issues arise, for example, about the appropriateness of the valuations involved, as well as about the general nature of the arrangement.

benefit on, say, an hourly basis would involve a far higher compliance cost and would be more difficult to monitor. Some submissions considered that calculating on a daily basis leads to unfair outcomes when, for example, an employee takes a vehicle home at night because the employee is required to take it to another work site the following morning. In such cases the vehicle is considered to be used privately between the time it is driven home and the time it is driven to work and an FBT liability arises for both days.

- 5.33 We agree that when an employee has no choice but to take a vehicle home so as to get to another work site the following day, such as may occur with a district nurse, that this should be treated as a business use, provided the employee is prohibited from using the vehicle for private use over the period. The recently released exposure draft IS3448, from Inland Revenue's Adjudication and Rulings division, is likely to be helpful in clarifying the FBT treatment in such cases.
- 5.34 The government has also looked at the feasibility of a day being defined as any 24-hour period rather than a calendar day. A reference point would be needed, which could be achieved by employers electing when their day would begin. For example, an employer may elect to begin the day at 6.00pm, in which case any private travel between 6.00pm on a particular calendar day and 6.00pm the following calendar day would be treated as being all within the same day for FBT purposes.
- 5.35 The employer's election would apply for every day thereafter but could be reviewed after three years. The election would also only apply to motor vehicle fringe benefits. Employers should not generally need to maintain more records as a result of this option if the private use of a vehicle follows a regular pattern and can, therefore, be established through a logbook test period. Moreover, it is optional, so that if an employer makes no election, the current treatment of a calendar day would apply.

Proposal

- 5.36 Individual employers would have the option to elect the start time for their day for the purposes of calculating their motor vehicle fringe benefits, and that election would also apply for every day after the election. Employers could review their election after three years. If an employer did not make an election, a day would be a calendar day.

Chapter 6

WORK-RELATED VEHICLES

Proposed changes

There is no specific proposal to change the definition of “work-related vehicle” but some options for simplifying the definition without creating a behavioural change that would significantly erode the tax base are discussed.

The requirement that a work-related vehicle display the employer’s logo would be retained but the Commissioner of Inland Revenue would have the discretion to waive it when an employer could demonstrate that the requirement would seriously compromise the nature of the business.

Current law and problems

- 6.1 Attempts to limit FBT applying to work use have, apart from the use of logbooks to record private versus business use, involved the wholesale exempting of vehicles on the basis of their appearance as “work-related vehicles”.
- 6.2 “Work-related vehicle” is a defined term in section OB 1 of the Income Tax Act. Under the definition, certain private travel in a motor vehicle (not being a car) is exempt from FBT provided it is restricted to:
 - travel between home and work in the course of, and as a condition of, employment; and
 - travel incidental to business travel.
- 6.3 To qualify for the exemption, the employer’s name or logo or equivalent identifier must be prominently and permanently displayed on the vehicle. Any days on which this definition is met are excluded from the FBT calculation.
- 6.4 This exemption dates from the beginning of the FBT legislation in 1985. The first proviso was not designed to cover all travel between home and work but only that travel that had been directed by the employer. This was envisaged to cover those situations when an employer required the vehicle to be taken home at night because, for example, there was no overnight parking at the employer’s premises, or the use of the vehicle was required to carry goods or equipment.

- 6.5 The exemption is not available for many employer-provided vehicles as cars are generally not considered to be acquired for work purposes because they are primarily designed for the carriage of passengers.¹² Court decisions have, however, identified instances when cars can qualify – for example, when passenger seats have been removed – and have generally resulted in a widening of what qualifies as a work-related vehicle.
- 6.6 Submissions considered the current definition to be anomalous and an impediment to normal business practice; a vehicle may be needed, for example, to transport clients or fellow workers between sites as much as goods or equipment. They considered the main problem with the exemption to be that it focuses on the type and appearance of the vehicle rather than the purpose to which it is put. Employers in the same situation can be treated differently, depending on the type of vehicle being used. Ordinary hatch-back cars, for example, are generally “motor cars” and, therefore, not exempt, but hatch-backs modified with removable plywood inserts may meet the exemption criteria.¹³ Furthermore, the definition is relatively inflexible and can fail to keep up with changing work practices.
- 6.7 An additional problem is that the logo requirement can disadvantage businesses with sensitive activities. For example, if organisations who are involved in community health work brand their work vehicles, patients visited at home may be put at risk.

Comment

- 6.8 The problems outlined here do not arise when there is no private benefit element for an employee – that is, when the vehicle is exclusively used for work purposes. Employers can, therefore, avoid any FBT implications by ensuring that no private element arises.
- 6.9 Having said that, however, the government acknowledges that incidental private use of vehicles acquired primarily for business use will inevitably occur from time to time, just as it does for other employer-owned assets, and that FBT should not apply in such cases when the costs outweigh the benefits. This necessitates some form of exclusion mechanism.

¹² Taxi cabs are an obvious exception, given that they are a work vehicle for the specific purpose of carrying passengers.

¹³ *CIR v Rag Doll Fashions (NZ) Ltd* (1995) 17 NZTC 12,104.

- 6.10 Intuitively, from a compliance perspective, exempting a range of obviously work-related vehicles is preferable to requiring all motor vehicles to have to keep logs of business and private use or, alternatively, applying a minimum taxable value to motor vehicles. But a range of boundary problems arise with this exemption, the solutions for which are not straightforward.
- 6.11 The key problem in designing a better, and preferably simpler, solution is that it needs to be sufficiently robust, from both an economic and administrative perspective, while not creating additional compliance costs.

Economic implications

- 6.12 Arguably, the current exemption gives rise to its own economic distortions since it potentially enables some employees to receive material fringe benefits that are not taxed. The benefit arising from the ability to use a vehicle for home-to-work travel is in many cases not incidental if the vehicle is used in this way each day. Even though the employer may require the vehicle to be taken home for good commercial reasons, employees may still receive a material private benefit in terms of reducing their transport costs between home and work.
- 6.13 For example, travelling just 30kms between work and home on each working day of the year (240 days) amounts to 7,200kms, which is half the assumed average travel of a vehicle that is available for unlimited private use, the big difference being that in the latter case home-to-work travel is subject to FBT. The magnitude of this imputed “concession” means that if the definition of a work-related vehicle was extended to include cars there would be a significant incentive to try to characterise cars as work-related vehicles, irrespective of whether they should in principle be regarded as such.¹⁴
- 6.14 There are also the distortions, as highlighted by submissions, that arise from the definition influencing decisions at the margin as to which vehicles to buy. Were an employer to purchase a car and make it available for private use on the same limited basis as permitted under the definition of work-related vehicle, the employer would incur compliance costs from having to keep a log book for a test period to verify the limited use and, more importantly, would have to pay FBT on the private benefit. This means that there is a strong incentive to purchase a vehicle that meets the work-related vehicle definition, irrespective of whether it is the optimal vehicle for the job. Although, undeniably, distortions arise in this situation, they are a trade-off for the compliance cost reductions provided by the exemption.

¹⁴ There will be questions about whether the benefit is of the same value. Does a truck used to transport a concrete mixer and other equipment and materials have the same private benefit to an employee as a sedan? If the employee does not see the vehicle as a substitute and retains his or her own vehicle, the benefit is arguably just the saving in running costs or some equivalent transport cost.

- 6.15 If, by extending the definition, the behavioural changes were only at the margin, the current distortions might be reduced and the change would, therefore, be worth making. But if there were significantly higher behavioural change, more economic distortions would likely be created. For example, the policy objectives of FBT would be completely undermined if those cars on which FBT is currently payable because of their being fully available for private use became “redefined” as work-related vehicles.

Revenue implications

- 6.16 Apart from the economic implications, the government is also concerned that this potential for significant behavioural change could lead to a material erosion of the FBT revenue base.
- 6.17 The definition is already difficult to administer in terms of identifying whether a vehicle is actually being used for more than the private purposes allowed by the definition. Consequently, any further liberalisation could lead to relatively free private use under the guise of employer letters prohibiting wide scale private use¹⁵ and/or vehicles being called “work vehicles” because they might be used for client visits. The current rules at least serve as an impediment to this abuse.

Simplifying the definition

- 6.18 Given the economic and fiscal implications, the government needs to be convinced that the risk of widespread behavioural change is low. At present, the government does not have sufficient information on which to make an informed decision on this point. Accordingly, the government invites submissions on ways in which the definition could be simplified without resulting in widespread avoidance. The rest of this chapter discusses possible options for achieving this objective. The government is not committed to any of these options but, rather, raises them to assist submissions in this area.
- 6.19 The options discussed are:
- extending the current exemption by widening the definition of “work-related vehicle”, subject to certain safeguards;
 - replacing the exemption with a minimum taxable value that also covers cars;
 - replacing the exemption with a charge for per-kilometre private use for vehicles that meet a widened definition of “work-related vehicle”;

¹⁵ Technically, a vehicle is not available for private use if an employer has prohibited its use, even though it may actually be used. The operation of the exemption, therefore, becomes dependent on employers’ enforcement and Inland Revenue audit. The record-keeping requirements necessary to establish that a vehicle is not available for private use are set out in *Tax Information Bulletin* Volume 4, No 8 (April 1993).

- supplementing the current definition by applying any changes only to vehicles that would qualify for the definition of “work-related vehicle” but for the fact they are cars;
- replacing the exemption with a charge for per-kilometre private use for vehicles that meet the current definition of “work-related vehicle”.

Options

Option 1: Widening the definition of “work-related vehicle” subject to certain safeguards

- 6.20 The definition of “work-related vehicle” could be widened to include any vehicle, provided that at all times during a quarter any private benefits are only incidental and/or limited to travel between home and work as directed by the employer, and the vehicle clearly displays the organisation’s name, logo or similar identifier.
- 6.21 Widespread behavioural change could be mitigated by all or any of the following:
- Employees would use logbooks to identify the nature of the travel for those vehicles that do not meet the current definition but that meet the widened definition. This would provide a record for audit purposes to establish whether private use was confined to travel between home and work and/or incidental use. Employers could weigh up the compliance costs of keeping logbooks against the benefits of having their cars that are used for work purposes designated as work-related vehicles. Unlike the current provision that enables a logbook to be kept for a test period to establish private use,¹⁶ this approach would require a log to be kept permanently. It would focus on both actual use as well as availability for private use. A key problem with logbooks is that their effectiveness is reliant in the first instance on the employer providing a check on what the employee has recorded; otherwise verification can be problematic.
 - A vehicle would have to meet the requirements of a widened definition at all times. This means that just one day’s use unrelated to business or home-to-work travel during the quarter would result in that quarter being subject to full FBT in relation to the vehicle.
 - Situations when the employee and employer are associated persons would be excluded from the widened definition. The current definition would continue to apply in such cases. The presumption is that employer limitations on private use are less likely to be enforced or monitored when the employer is associated with the employee, so the scope for behavioural change is larger.

¹⁶ This current log book provision records the days of private use and enjoyment of a vehicle during the three-month test period. The results of the test period apply for three years. Private use includes any availability for private use.

Option 2: A minimum taxable value

- 6.22 An alternative option to widening the work-related vehicle exemption would be to replace it with a minimum taxable value (in tax terms, a de minimis) for motor vehicle fringe benefits. It would be quite separate from other minimum taxable values applying to other low-value benefits. A minimum taxable value applies to vehicle fringe benefits in the United States, for example, for administrative and compliance reasons.
- 6.23 It could be applied in either of two ways – as a threshold which, once crossed, would mean that all the fringe benefit would be taxed, or as a threshold above which the maximum exemption would begin to be abated.
- 6.24 The advantage of this option is that it need not be confined to particular vehicle types, so that low-value private use of cars would be exempt from FBT. The trade-off is that it would mean a tightening up for some taxpayers as their travel between home and work would no longer be automatically exempt.
- 6.25 Overall compliance costs would likely increase given that it would mean having to keep a record of actual benefits for all those road vehicles that are currently exempt as work-related vehicles.¹⁷ A significant number of employers could, therefore, be affected. For those employers who pay FBT on a quarterly basis, the minimum taxable value would need to be applied on a quarterly basis, which could produce a different tax outcome from application on an annual basis if the benefits arose unevenly during the year.
- 6.26 But the main problem with a minimum taxable value if applied to all vehicles would be that it would not be sufficiently targeted to identify minor availability for private use. If, for example, a second-hand vehicle was purchased, its value could be quite low, so that applying a minimum taxable value in such instances could allow a significant proportion of private use before FBT applied. The de minimis might, therefore, need to be limited to vehicles that are less than five years old. Also, since the system determines private availability on a daily basis, incidental use of just a few minutes would mean that the whole day would be considered to be private use, which could severely limit the usefulness of the measure. Alternatively, if it were expressed in terms of days, it would enable unlimited private travel to be undertaken on those days, which would not be the objective.

Option 3: Valuing private travel at running costs

- 6.27 Under this option, vehicles predominantly used for work purposes would be charged FBT on private use by adopting a standard running cost rather than the full costs of motoring. To qualify, the vehicle would have to meet the equivalent of the work-related vehicle exemption, except that cars would also

¹⁷ There would be no additional compliance costs for those vehicles that are already doing this because they do not currently qualify for the exemption.

be included. Given that some private use may be difficult to measure, the test would likely focus on charging FBT on travel between home and work.

6.28 A justification for this approach is that if employees do not see the vehicle involved as a substitute and retain their own vehicles, the benefit is arguably just the saving in running costs or some equivalent transport cost. This approach is used in Canada for motor vehicles other than automobiles that are essential to an employer's business operation, when the only personal use is to provide transportation between an employee's home and work. In such cases the benefit can be computed on a cents-per-kilometre basis for equivalent automobile transportation.

6.29 The key advantage of this option is that it would apply uniformly across all vehicle types and reduce the difference in tax treatment between vehicles that qualify and those that do not.

6.30 Problems with the option are:

- There would still be some tax advantage between a vehicle that qualifies and one that does not, so there would still be an incentive to characterise a vehicle as complying with the requirements, which may be difficult to address.
- More generally, the private benefits may be undervalued because a per-kilometre charge would measure actual use rather than availability for use.
- Those employers that are currently exempt would be faced with paying FBT as well as the additional compliance costs from having to keep logbooks that measure the kilometres travelled by employees between their home and work.

Option 4: Applying option 3 just to vehicles that do not meet the current "work-related vehicle" definition only because they are cars

6.31 This option would supplement rather than replace the work-related vehicle exemption by enabling vehicles that would meet the definition of work-related vehicle were they not excluded because they are motor cars, to qualify for a lower FBT impost based on a per-kilometre running cost.

6.32 An advantage of applying this approach to just the additional vehicles is that there would be no extra compliance costs for those that are currently exempt. Also, many employers who would be able to use the supplement are likely to have already established private use for their vehicles through keeping a log book for a trial period. In the case of the per-kilometre charge, however, actual use would need to be recorded on an ongoing basis.

- 6.33 This option would involve a revenue loss for the government. Moreover, behavioural and enforcement issues would still arise, given that there would be an increased incentive to characterise cars as meeting the new requirements, as FBT for those vehicles that qualify would be based on a per-kilometre running cost and actual private use rather than the full costs of motoring and availability for private use.

Option 5: Applying a per-kilometre running charge to vehicles that currently meet the “work-related vehicle” definition

- 6.34 This option would involve no extension of coverage but would mean that the work-related vehicle exemption would be replaced by a charge per kilometre that reflected running costs.
- 6.35 The advantage of replacing the exemption with a charge per kilometre of private use would be that it reduces the tax effects at the margin between vehicles that do and do not qualify, thereby reducing the significance of where the definition boundary is drawn. Because it would not involve an extension of the definition, the behavioural change and enforcement issues would be less likely to be of concern than under option 3.
- 6.36 As with option 3, however, employers with work-related vehicles would still be faced with a new FBT liability and greater compliance costs.

Logo requirement

- 6.37 We considered the merits of continuing to require the employer’s identifier on a work-related vehicle and concluded that the requirement should be generally retained. Its purpose is both to deter widespread private use and to help in monitoring that the definition is being adhered to. For this reason, the identifier needs to be permanently affixed to the vehicle.
- 6.38 It is proposed, however, that the Commissioner of Inland Revenue be given the discretion to waive the identifier requirement when an employer can demonstrate that the requirement would seriously compromise the nature of the business.

Emergency call-outs

- 6.39 Another key exception that applies to motor vehicle fringe benefits is the exemption of those days on which emergency call-outs are made. The trigger for the exemption is that the vehicle leaves the employee’s home to make an emergency call (as defined). Any private use or enjoyment during that day is ignored. Unlike the definition of “work-related vehicle”, the definition of “emergency call” does not confine the private use or enjoyment to incidental benefits or travelling between home and work.

- 6.40 The definition is somewhat of a misnomer as it does not always require an emergency or breakdown situation to occur before it applies. “Emergency call” not only covers visits by emergency services such as the fire or ambulance services but also other visits such as those involving an employee carrying out services that are essential to the operation of any plant or machinery of the employer or their customer.
- 6.41 Several queries have been raised about various terms within the definition relative to the original policy intent. If the definition of “work-related vehicle” were broadened to include cars under one of the options discussed earlier in this chapter, revising or even removing the definition of “emergency call” would be considered. Otherwise the definition would not be changed.

Chapter 7

CAR PARKS

Proposed change

The private use and availability for private use of a car park would be included in the list of benefits that are subject to FBT, with the “on-premises” exemption for car parks being removed. Consequently, significantly more employee-provided car parks would be subject to FBT, irrespective of their legal form or whether they are on or off-premises. Various methods for valuing car parks are discussed, including a minimum value threshold under which using car parks would remain untaxed (see next chapter). Organisations such as schools and hospitals should not be affected by the change.

Introduction

- 7.1 Car parks provided to employees that are situated within the employer’s place of work or leased to the employer are not subject to FBT as they fall within the exemption for benefits provided on the employer’s premises. A leased car park may, however, be far removed from the physical premises of the employer. In contrast, licensed car parks provided to an employee are subject to FBT even though they may be right alongside the leased parks.
- 7.2 Submissions noted that this distinction is arbitrary and generally recommended exempting all car parks to ensure consistent treatment. About two-thirds of employer-provided car parks are estimated to be exempt at present.
- 7.3 The government agrees that the distinction is arbitrary. Given that an employer-provided car park has an economic benefit to employees as it saves employees from having to pay for a park themselves, the government considers that FBT should apply to all employer-provided car parks that are available for private use, irrespective of legal form. This means excluding car parks from the current “on-premises” exemption.
- 7.4 This chapter discusses the policy rationale for the change and the next chapter discusses a range of options for valuing car parking benefits. Ideally, the benefits should be valued at the market value of equivalent car parks, but in some cases establishing the market value may be difficult. Under this approach, a sizeable number of parks would still not give rise to a benefit because, for example, comparable free parking would be available on the street. Also discussed is a minimum value threshold that might further limit the application of the proposed change.

Problems with the current law

“On-premises” exemption

- 7.5 Car parks are included within the scope of the FBT rules through the catch-all provision in section CI 1(h), which incorporates “(a)ny benefit of any other kind... enjoyed by the employee”.
- 7.6 However, car parks that are located on the premises of the employer are exempt from FBT under section CI 1(q), which more generally exempts a wide range of benefits provided by employers on their premises.¹⁸

Leases and licences

- 7.7 In 1999 Inland Revenue issued Public Ruling (BR Pub 99/6) on car park fringe benefits. In relation to car parks, the ruling defined the premises of the employer as being car parks that the employer enjoyed an exclusive right to occupy.
- 7.8 Following this interpretation, the “on-premises” exemption extends to car parks that are leased or rented by the employer. This is because a lease is considered to convey an exclusive right to occupy the property being leased as well as a legal interest in it and is, therefore, part of the employer’s premises. However, employers who hold a licence in relation to an employer-provided car park are liable for FBT on the basis that a licence does not provide an exclusive right of occupancy.

Example

- Employer A, who holds a licence to occupy a car park in a building next to its premises, is required to return FBT on the car park if it is provided to an employee.
- Employer B, who leases a car park in a parking building five blocks away from the employer’s offices, is not required to return FBT on the car park because the employer has an exclusive right to occupy the park. That car park is treated as part of the employer’s premises, despite the car park’s geographical separation from the employer’s business activities.

- 7.9 In this example, the “on-premises” exemption results in different tax treatments according to the legal characterisation of the car park, despite the same benefit (not having to pay for private parking) being enjoyed by the employees in both situations.

¹⁸ All benefits other than the use or enjoyment of free, discounted or subsidised travel, accommodation, or clothing.

7.10 In principle, the legal rights enjoyed by the employer regarding the car park should not be relevant to whether a car park provided to an employee confers a private benefit on the employee.

Business premises

7.11 Restricting the definition of the “premises of the employer” to locations on which the employer’s business is carried on would remove the lease/licence distinction. However, there is no policy rationale for exempting from the FBT rules car parks that are situated on the employer’s business premises. The location of the car park on the employer’s premises does not change the private benefit associated with the car park.

7.12 This approach would also cause uncertainty about what the employer’s business includes and how close to the business activities the car park would need to be to form part of the same premises.

Minor benefits

7.13 The original intent of the “on-premises” exemption was to exclude minor benefits enjoyed on the employer’s premises that were generally costly to value and monitor relative to the FBT value of the benefits. The provision of alcohol at a company function that includes clients and some employees is an example of the type of minor benefits that were intended to be covered by the exemption.

7.14 In contrast, the value of car parks, at least those provided in urban centres, can be very high, as illustrated in table 2:

Table 2: Regional variations in monthly car park charges

Location (% weight)*		Park type (% weight)*	Approx cost \$*	Adjusted regional cost \$	Adjusted average cost \$
Auckland	(44)	Reserved (17.5)	310	217	153
		Daily (82.5)	200	140	
Wellington	(11)	Reserved (31.0)	300	210	181
		Daily (69.0)	240	168	
Other North Island	(29)	Reserved (11.0)	80	40	76
		Daily (89.0)	160	80	
Christchurch	(7)	Reserved (12.0)	170	119	101
		Daily (88.0)	140	98	
Dunedin	(2)	Reserved (70.0)	80	56	73
		Daily (30.0)	160	112	
Other South Island	(7)	Reserved (12.0)	50	25	38
		Daily (88.0)	80	40	

* Council data of central city parking charges. Location weightings are from a survey of firms. The adjusted regional cost is the approximate cost reduced by either 30% or 50% to reflect lower costs in suburban areas. The adjusted average regional cost is the adjusted regional cost weighted according to the proportion of reserved and daily parking. “Other North Island” daily charge is higher than the reserved parking charge because Hamilton has only a council charge for street parking.

Policy intent

- 7.15 When a car park is provided to an employee by an employer for private car parking the employee enjoys an economic benefit from not incurring car parking expenses that would have to be paid from salary or wages.
- 7.16 In most situations the nature of car parking benefits is determined by the nature of the travel that necessitates the car park. Generally, whenever an employee travels from home-to-work, or another location, the travel will be of a private nature, because the travel facilitates employment but is not the employment task itself. Hence, the use of an employee-provided car park is also private in nature. An exception to this general approach may be appropriate when the employee is an “itinerant” worker, such as a travelling salesperson.
- 7.17 In contrast, if a vehicle meets the definition of “work-related vehicle”, there should be no fringe benefit because both the vehicle and its parking during work hours are work-related. Such situations should be specifically exempted.

Example 1

Bruce is a manager who drives his own car to work and is provided with a car park as part of his remuneration package. During business hours he is not required to use his car for business purposes.

Example 2

Alison works for a company that makes curtains and blinds. She drives a van, which is a work-related vehicle, to and from work. She is allocated a car park by her employer because she is required to make frequent visits to customers during business hours.

Example 3

Carol is a human resources adviser who lives close to and walks to and from work. Sometimes she is required to visit clients during business hours. At these times Carol uses the company car that is available to all staff for business purposes. The vehicle is normally parked on the company’s premises.

- 7.18 Of the three examples, only in example 1 could the car park be considered to remove the need for the employee to purchase car parking facilities during business hours. Only in that instance should FBT be payable. In example 2 the employee does not have any vehicle that is available for private use once it is at work as it is a work vehicle.

- 7.19 In example 3 the employee receives no private benefit as she does not require a car park for private travel, not even between home and work. The vehicle is solely for business purposes. FBT is not relevant.

Home as a work base

- 7.20 Car parks located at an employee's private residence when the residence is also a place of work would not be covered by the FBT rules because the car parks would not generally be provided by the employer. If the residence were owned by a company that employed the occupier of the residence, any rental paid by the occupier would normally include the parking. To the extent that the employer subsidised the rent, the benefit would be treated as monetary remuneration rather than subject to FBT.

Availability for use

- 7.21 In addition to the actual use of a car park, the availability of a car park is an advantage to an employee. Irrespective of whether or not an employee chooses to use the car park on any given day, the ability to use the car park whenever it is needed is a benefit enjoyed by the employee. Although car parks are treated as the provision of a service under section CI 3(10), arguably a car park is an asset and, as noted earlier, assets should, in theory, be valued according to their availability.
- 7.22 Compliance costs would increase significantly if employers were required to determine the exact extent to which a car park was privately used. This would involve monitoring employees' actual use of employer-provided car parks and the cost of each car park for each period of actual use. It would also be inconsistent with the way that many car park charges are structured, given that they are usually payable on a monthly basis and provide for 24-hour use.
- 7.23 In practice, there may not be a significant difference between valuing a car park on the basis of actual use versus its availability, given that in many cases an employee may not place much value on a car park being available overnight if there is little or no need to use it outside work hours. Any relatively lower demand for car parking outside of work hours would normally be reflected in car park charges.

Other issues

- 7.24 The government considers that there may be a case for excluding car parks provided to employees of entities such as hospitals and schools that are required to operate in central business districts and other affected areas to serve the needs of the community in those areas.¹⁹ The government welcomes submissions on how best to address this issue.

¹⁹ Some of these entities, as charities, may be exempt from FBT anyway, as discussed in chapter 10.

Proposal

- 7.25 The government proposes to include, as a listed fringe benefit, employer-provided car parks that are used for private purposes or available for the private use of an employee.
- 7.26 Car parks would, therefore, be specifically excluded from the “on-premises” exemption.

Chapter 8

VALUATION OF CAR PARKS

Background

- 8.1 If a car park were valued on the basis of its actual benefit to the employee the value would be the amount that the employee was willing to pay to have the use of the car park whenever it was needed. This amount would include the cost of having the car park available so that it could be used when it was needed.
- 8.2 In practice, it would be difficult to ascertain accurately the value that each employee places on the benefit as the circumstances of each employee will vary. Even if it were possible to arrive at an accurate valuation, the compliance costs involved in correctly valuing, monitoring and recording the benefit to each employee would be extremely high.
- 8.3 As with other parts of the FBT rules, therefore, the current valuation rules were intended to be a compromise between accuracy and simplicity, to prevent high compliance costs relative to the tax returned.
- 8.4 Under section CI 3(10),²⁰ the value of a fringe benefit that involves the provision of a car park is:
- the open market value if the employer is normally providing car parking as part of the business; or
 - the amount paid or liable to be paid by the employer if the employer is not in the car parking business;
 - the open market value if neither (a) nor (b) apply.
- 8.5 In practice, the application of these rules is limited, given the “on-premises” exemption and the interpretation that it includes leased car parks. However, with the proposed removal of the “on-premises” exemption for car parks, the application of the rules needs to be reviewed.

The cost to the employer

- 8.6 As noted earlier, the cost of an employer-provided car park can be a reasonable estimate of the private benefit enjoyed by the employee when the car park is leased or licensed to the employer at market value. In other circumstances, this valuation method can be complex and lead to incorrect outcomes.

²⁰ Section CI 3(10) determines the value of fringe benefits that involve a service.

Example 1

The car park is leased to the employer from a car parking company at market value.

Example 2

The car park is owned by the employer, who purchased it some years ago.

Example 3

The car park is leased to the employer as part of the employer's business premises but has no specific value assigned to it under the lease.

- 8.7 In example 1 the cost to the employer approximates the cost to the employee as this is the price the employee would have had to pay for the car park if it were not provided by the employer.
- 8.8 In example 2 difficulties arise from the different benefits enjoyed by the employer and employee in relation to the car park. The original cost of the car park represents the historic value to the employer rather than the current value. Unless the employer's opportunity cost²¹ is used, cost may bear no relationship to the value of ongoing use or availability of the car park enjoyed by the employee.
- 8.9 In example 3 the car park has a current value, but because the car park is not separately priced in the contract, as it is attached to the location of the actual business premises, it may be difficult to identify the cost attributable to providing the car park.

Market value to the employee

- 8.10 Except when the car park is leased or licensed to the employer at market value, the value of the fringe benefit is best based on identifying the cost of the alternative parking that the employee would have had to obtain if the employer had not provided the car park. (In this document this is described as an alternative market value.) In areas where free or inexpensive alternative car parking is available, FBT on the employer-provided car park would be nil or very low. The value of car parking fringe benefits would be higher in areas where car parking is more expensive.

²¹ For example, what employers could receive if car parks were let out to the public.

Example 1

A car park is provided to an employee at an inner city business. The price of parking on the street outside the business is \$1 per hour between 8am and 6pm on weekdays. Outside those hours there is no charge for the car park.

The market value of the car park provided to the employee is \$1 x 10 hours x 5 days, or \$50 per week.

Example 2

A car park is provided to an employee located in a rural area. Visitors to the business generally park along the road in front of the business. There is no charge for parking along the roadside.

The market value of the car park in this example is nil.

What is an equivalent car park?

- 8.11 A key part of applying the market value rule involves determining what is an equivalent car park. An equivalent car park would provide identical or similar benefits to the employer-provided car park.
- 8.12 The market value of an equivalent car park would be readily ascertainable when an identical car park is available to the general public, particularly if it is provided by the employer. For example, a business may contract a parking company to manage visitors' car parks, which staff may also be able to use free of charge.
- 8.13 The market value is more difficult to ascertain when a range of similar but not identical car parking options is available at different prices.²² In this situation it is reasonable to assume that the employee would use the lowest cost equivalent alternative. The value of the fringe benefit should, therefore, be equal to the least expensive equivalent park.
- 8.14 Generally, an equivalent car park would:
- be available to the general public for the same period of time as the employer-provided car park; and
 - provide the same or similar level of assurance of available car parking; and
 - be located in the same or similar vicinity as the employer-provided car park.

²² For example, off-street parking on a weekly basis and on-street parking on an hourly basis.

Options for applying the market value rule

8.15 In the absence of a third party, market-based charge to the employer, an alternative market value rule is the best approximation of the cost to the employee. There is a range of options, however, for applying the rule that should assist in reducing compliance costs. The government invites feedback on which of these options would achieve the best balance between the appropriate policy outcome and the need to minimise costs.

Option 1

Use the market rate of the equivalent car park within a specified radius (say, 0.5km) of the employer-provided car park

This option aims for reasonable precision as to the location of equivalent car parks. The assumption is that equivalent surrounding car parks will have a relatively uniform value.

If there were no equivalent car park within the specified radius, the closest comparable park would have to be used.

The onus would be on the employer to provide corroborating evidence. To reduce compliance costs, the identified value could be valid for a specified period of time – for example, five years. This period of time, although essentially arbitrary, would provide certainty for the employer while retaining a reasonably current approximation of the value of the car park.

To further reduce compliance costs, this approach could be applied just to the central business districts (CBD), or comparable council zoning, so that if a car park were outside of the CBD it would not be subject to FBT. At the margin, however, this would mean that FBT would be payable on car parks on one particular street but not the neighbouring street.

Option 2

Use local council or similar charges for equivalent car parks

This option would provide a specific benchmark that may be less open to argument than having reference to all possible equivalent car parks. It should, however, link to the closest equivalent car park as council charges can vary across a city.

It would mean that valuations would be subject to the policies of councils; for example, a council may introduce a particular pricing policy that is not necessarily reflective of market rates. Also, in some areas, councils may not provide equivalent car parks.

Again, this option could be limited to car parks in CBDs.

Option 3

Apply standard values that reflect regional differences

This option would save employers having to identify equivalent car parks and market rates. The use of standard values to reduce compliance costs is used elsewhere in the tax legislation.

Periodic surveys – say, every five years – could be undertaken to establish regional values, and local authority zoning could be used to specify the CBD or commercial areas that would be covered. One rate for New Zealand would considerably simplify the application but would be inequitable as car park charges vary significantly from region to region (see table 2). A variant would be to apply the standard rate just to the main centres such as the Auckland and Wellington CBDs.

Although this option seems simple, it does raise boundary issues. To reduce the incentive for car parking to be developed just outside of the zone, the Commissioner of Inland Revenue could be given discretion to set and alter the area covered for tax purposes.

Option 4

Apply a set value related to the value of the land on which the car park is sited

This option would overcome regional boundary problems and result in a valuation that reflected the circumstance of each car park. But it would be relatively complicated to apply and would require some work on the part of the employer, plus the possible costs of any valuation.

It would involve taking the rateable land value, assuming the car park is a vacant lot, and determining the value per square metre by dividing the valuation by the number of square metres. The square metres would then be linked to a set value for FBT purposes.

Option 5

Combination of the four preceding options

If the employer is charging third parties for equivalent car parks or is paying a third party for the use of car parks, this could be the value attributed for FBT purposes. Otherwise, a standard regional value would apply.

A minimum threshold

- 8.16 Regardless of any other limitations, such as specifically limiting the benefit to CBD areas, a minimum threshold could be set per park to exclude small benefits. This would in itself exclude many car parks outside of the main centres – for example, the average value of a car park in the South Island outside of Christchurch and Dunedin is \$38 per month.
- 8.17 Employers would have reasonable certainty about whether a benefit was likely to arise as the annual value of most car park benefits would be known in advance and so could be compared against the minimum threshold. But with those cases near the threshold, employers would have to keep track of benefits to ensure they did not exceed the threshold.
- 8.18 The government also welcomes submissions as to how a rule of this nature can best be implemented.

Chapter 9

MULTI-RATE CALCULATION

Proposed changes

- Employers who file their fringe benefit returns on-line with Inland Revenue would have access to an on-line electronic calculator that would undertake the end-of-year multi-rate calculation for them. Employers would not be subject to penalties if they filed returns electronically and the calculations produced a wrong answer, provided they had supplied correct information. They would be subject to use-of-money interest.
- Other simplification options are to replace the FBT multi-rate calculation with a simpler calculation, or apply a single rate (54%) that produces the same overall revenue outcome.
- Employers who cease to employ staff and do not intend to replace them would have the option of applying the flat rate of 64% in their final return rather than doing the multi-rate calculation.

Introduction

- 9.1 Since its introduction, FBT has been criticised for the complexity of its calculations. The recent introduction of the multi-rate calculations has increased these concerns, which have been reflected both in the consultation with businesses and in the research undertaken.²³
- 9.2 The FBT multi-rate system was introduced in April 2000 in response to the increase in the top personal tax rate to 39%, which raised the FBT rate to 64%. By better reflecting employees' personal marginal tax rates, the multi-rate calculation is intended to increase the accuracy of the tax system. This is done by reducing the rate of FBT applying to those who earn less than \$60,000, while removing any incentive for high-income employees to substitute fringe benefits for monetary remuneration to avoid the 39% tax rate. Hence there are good conceptual reasons for retaining the multi-rate. The government recognises, however, that these gains have been at the expense of simplification and, accordingly, has been considering ways in which the rules could be made less complex.

²³ See appendix.

How the multi-rate calculation works

- 9.3 Employers may file FBT returns quarterly,²⁴ annually or on an income year basis. Employers can file returns on an annual or income year basis only if their PAYE and specified superannuation contribution withholding tax deductions are less than \$100,000 a year.
- 9.4 In general terms, employers that file quarterly FBT returns can either:
- pay FBT on all fringe benefits at the rate of 64% for the full year, in which case their use of the multi-rate calculation in the fourth quarter is optional; or
 - pay FBT at 49% for the first three quarters and undertake the multi-rate calculation in the fourth quarter.
- 9.5 Employers paying on an annual or income year basis similarly have the choice of paying 64% on all fringe benefits or applying the multi-rate calculation.
- 9.6 The rules vary, depending on whether the benefits can be attributed to individual employees or have to be pooled as non-attributed benefits, the type of benefits and whether the employees are also major shareholders in the business. Special rules apply if insufficient information is available to undertake the multi-rate calculation at the time of filing the fourth quarter return.
- 9.7 Specifically, employers undertaking the multi-rate calculation must:
- determine the value of fringe benefits provided to each employee for the year;
 - determine each employee's cash remuneration for the year;
 - calculate the tax on that cash remuneration and determine the net cash remuneration;
 - add the value of the attributed fringe benefits to the net cash remuneration for each employee to determine his or her fringe benefit-inclusive cash remuneration; and
 - calculate the tax on the fringe benefit-inclusive cash remuneration.
- 9.8 The FBT liability is the difference between the tax on the fringe benefit-inclusive cash remuneration and the tax on cash remuneration. The FBT already paid during the year is deducted from this amount to get the final FBT that is payable or refundable.

²⁴ On the 20th of July, October and January, with the final quarter due on 31 May.

Problems associated with the calculation

- 9.9 The multi-rate calculation provides an accurate assessment of an employer's FBT liability. However, it also increases the complexity and, therefore, compliance costs faced by employers because it requires additional calculations and the use of tax rates and thresholds specific to the calculation, instead of using the ordinary marginal tax rate scale.
- 9.10 This complexity increases the likelihood of errors, which in turn exposes employers to a higher risk of penalties and use-of-money interest. The high compliance costs associated with the calculations may also result in increased non-compliance.

Proposal

- 9.11 Advances in information technology make it possible to reconsider how FBT calculations are performed, who performs them, and where the responsibilities for each part of the process should lie. Specifically, the government proposes that Inland Revenue provide an on-line FBT calculator for optional use by employers who file their returns electronically.²⁵ Under this approach, employers could supply all the information required and the calculator would do the FBT calculations for them, as well as the multi-rate calculation at the end of the year. The calculation would become the basis of their FBT return. This would reduce compliance costs and give users results they could rely upon to be correct provided the information they supplied was correct.
- 9.12 This would be a complex system for Inland Revenue to design and deliver, so the application date of this proposal, if implemented, would depend on the changes required to Inland Revenue's systems and procedures. The earliest likely application date would probably be 1 April 2006.

How the proposal would work

- 9.13 Employers who filed quarterly would pay their FBT liability each quarter based on the current 49% or 64% rates. Each quarter they would also supply additional information electronically, to enable their current quarterly FBT liability to be determined and to carry out their end-of-year multi-rate calculation. At the end of the year they would be able to access the information previously provided to Inland Revenue and then would have to enter their employees' cash remuneration for the year. The FBT multi-rate calculation would be carried out by the calculator. If the employer was satisfied with the information provided, the resulting FBT calculations would form the final quarter's return and the amount due would become the

²⁵ A survey undertaken by Inland Revenue suggested reasonable support among employers for this type of option.

employer's FBT assessment. Payment of the amount due would be required by the due date and could be made either electronically or manually.

- 9.14 Income year or annual filers would supply information at the end of the year or annually, and the calculator would perform the multi-rate calculation annually.
- 9.15 This proposal would not change the self-assessment system on which New Zealand's tax system is based, since the fundamental determination of the facts and the application of tax law to their own circumstances would remain with the taxpayer. Penalties could be imposed if taxpayers applied those laws incorrectly.
- 9.16 If, however, there were an error in the FBT assessed and it was attributable to an incorrect calculation, it would be the responsibility of Inland Revenue, not the employer. In that case, shortfall penalties would not be imposed on the employer. If the employer had, as a result of such an error, underpaid tax a new due date for payment would be set. Although no penalties would apply, use-of-money interest would. If there were an error in the FBT assessment attributable to incorrect information provided by the employer, it would be the responsibility of the employer. The normal penalty rules and use-of-money interest would apply to such errors.
- 9.17 Although the proposal should reduce errors in final computation, there might still be errors in the underlying data which employers would want to correct. A simple way to achieve this would be to allow the information to be updated in the following quarter, with the employer having a mechanism to indicate which quarter the correction relates to.

Information required

- 9.18 Employers using the calculator would be required to supply certain general information in relation to their employees. Specific information would also be required for each class of fringe benefit, to enable the FBT liability to be determined. The information requirements and the frequency of provision are shown in table 3.

**Table 3: Provision of information by quarterly
FBT filers under the proposed system²⁶**

Information	Frequency of provision
<i>Employee-specific information</i>	
Employee's name	Only when the employer starts to provide benefit
An FBT rate election (49%, 64%, or whether shareholder employee)	Annually
Employee's remuneration	Annually
<i>Vehicle</i>	
Vehicle identifier	Once/only when vehicle changes
Cost of the vehicle	Once/only when vehicle changes
Number of days available for private use	Quarterly
Employee contribution	Quarterly
<i>Low-interest loans</i>	
Year the loan was granted (if non-reviewable)	Once
Highest interest rate applying to loan for month	Quarterly
Lowest loan balance in period	Quarterly
<i>Discounted goods/services</i>	
Value of discounted goods	Quarterly
Value of subsidised transport	Quarterly
Value of employer contributions to fund	Quarterly
Employee contribution towards cost of fringe benefit	Quarterly

Example of how the electronic calculator would be used

An employer provides a motor vehicle to a new employee. The employee's income exceeds \$60,000 and the employer decides to pay fringe benefit tax each quarter based on the 49% rate. The employer will provide to Inland Revenue, on the first FBT return, the employee's name, the FBT rate chosen, the vehicle identifier, and the cost of the vehicle. This information will be required only once, unless circumstances change. Each quarter, the employer will also supply the calculator with the number of days the car was available for private use and the amount of any contributions the employee makes.

The information would be retained in the calculator, along with other information provided on the employer monthly schedule and used at the end of the year to undertake the end-of-year square-up.

The employer would be able to access the information on-line, confirm it and deduct the FBT paid during the year and pay any remaining FBT by the due date.

²⁶ Based on current FBT requirements.

Low-interest loans

- 9.19 At present, the calculation of the FBT liability on low-interest loans for a given period requires an employer to determine the daily loan balance during the period. This imposes compliance costs on the employer, who must keep and undertake calculations. To simplify the amount of information that has to be supplied to the calculator, it is proposed that the employer provide the lowest loan balance for the period to Inland Revenue. This is likely to be the latest loan balance.
- 9.20 When another fringe benefit is provided to an employee or an employee begins to receive a fringe benefit, the information would be supplied when the employer makes the next quarter's FBT payment.

Benefits and risks of the proposal

- 9.21 The proposal's principal benefits lie in reducing employers' risks of making calculation errors, their spending less time on revising numbers, a reduced likelihood of penalties being applied, and a probable reduction in stress.
- 9.22 Since the FBT multi-rate system has been introduced relatively recently, some of the concerns about its compliance costs may reflect the transition to the new rules rather than permanent compliance costs. Therefore the expected benefit of the proposal may be less than anticipated.
- 9.23 Although there could be a reduction in compliance costs associated with the calculations, there would be an increase in compliance costs in providing information more frequently, even though the process had been simplified.

Other options

Use employee's top marginal tax rate instead

- 9.24 An alternative proposal is to simplify the FBT calculation and thereby do away with the multi-rate calculation. The proposal would replace the multi-rate calculation and tax the fringe benefit at the FBT equivalent rate of each employee's top marginal tax rate. The calculation would involve:
- determining the fringe benefits provided to each employee for the quarter;
 - determining the employee's likely gross cash remuneration for the year;
 - determining the highest marginal tax rate that applies to the cash remuneration of the employee; and
 - taxing the fringe benefit at the FBT rate equivalent to the employee's highest marginal tax rate.

- 9.25 This calculation would be undertaken each quarter by the employer. Simplifying the calculation could enable the FBT calculation to be a full and final payment of the employer's liability.
- 9.26 This alternative proposal would reduce compliance costs for employers, especially those who do not have access to on-line or computerised FBT calculation tools. The calculation would be less accurate, however, and might increase an employer's FBT liability.
- 9.27 The government would also need to introduce anti-avoidance measures to ensure that there was no additional incentive to provide remuneration in the form of fringe benefits when an employee's marginal tax rate was less than the top rate.

A single average rate

- 9.28 Many submissions advocated a return to a single rate system as one of their most preferred simplification measures. Generally, submissions advocated a rate below 64% to ensure that low and middle-income earners would not be disadvantaged. The government considers that there are strong conceptual reasons for retaining some form of multi-rate and notes that employers have the option of using the single rate of 64% for all fringe benefits. As a possible alternative means of simplification it seeks comment on whether a flat rate that produces the same overall revenue as at present would be preferred to the other options raised here. That rate would be around 54%. This approach would trade off accuracy for simplicity, while achieving the same overall revenue result.

Ceasing to employ staff

- 9.29 Employers who cease to employ staff and do not intend to replace them during the year are still required to undertake the multi-rate calculation in their final return. It is proposed to reduce compliance costs by amending section ND 8(1) so that employers also have the option of applying the flat rate of 64% in their final return.

Chapter 10

THE EXEMPTION FOR CHARITIES

Proposed changes

- The current exemption that charities have from FBT would be retained.
- An anti-avoidance rule is proposed, to close off possible opportunities for the exemption to be exploited by charities providing employees with credit cards as a significant proportion of their remuneration.

Background

- 10.1 Benefits provided to employees of charitable organisations are exempt from FBT, other than when they are employed in businesses carried on by charities. This exemption has been in the FBT rules since 1985, although it was removed for a brief period in 1990.
- 10.2 The government discussion document *Tax and Charities*, issued in June 2001, proposed that the FBT exemption for charities be removed on the basis that, in principle, employees of charities should be treated in the same way as other employees. A similar recommendation had been made by the Committee of Experts on Tax Compliance in its December 1998 report. Most of the submissions received in response to the discussion document, many of which were from charities, opposed the abolition of the exemption on various grounds, including compliance costs. As a result, the issue, including whether it would be feasible to limit the exemption, was referred for consideration in the wider context of this review.
- 10.3 There was a divided response from those who provided comments for the purposes of this review as to whether the exemption should be retained. Some commented that the FBT review needed to reconsider the application of the exemption as they considered that it applied inequitably – universities, for example, must pay FBT, while polytechnics and other tertiary institutions may be exempt. Some also considered that it was unfair to exempt charities but not other local or public bodies that performed a similar function. Charities reiterated their earlier arguments against removing the exemption, that:
- having to pay FBT would reduce the amount of funds they have available for charitable purposes;

- employees of charities are paid less than market salaries, and fringe benefits partly redress this;
- the compliance costs would be particularly severe on small charities, which do not have the resources to pay a tax accountant to calculate any FBT liability; and
- bigger charities may undertake less efficient practices in order to reduce their FBT liability.

10.4 It would appear that while, like other employers, charities may offer their staff a wide range of fringe benefits, the main form of fringe benefit is motor vehicles.

Policy arguments

10.5 FBT relates to income earned by the employee rather than the income of the employer, even though the tax is paid by the employer. The current FBT exemption for charities, therefore, advantages employees of charities because they pay less tax than other employees on the same total remuneration.

10.6 There is no tax policy reason why one set of employees should be treated differently from any other purely because of who they work for or because the remuneration is paid in kind. Given that the true value of the benefit normally accrues to the employee rather than the employer, the fact that the employer is exempt from income tax is not a relevant consideration. The contrast is more obvious when it is considered that employees of charities are taxed on their cash remuneration through the PAYE system in the same way as other employees.

10.7 Apart from equity issues, the main concern with any FBT exemption is the flow-on distortions that are created from having some form of remuneration that is not taxable. For example, the exemption provides an incentive for further fringe benefits to be substituted for cash remuneration, increasing the relative tax advantage.

Compliance costs

10.8 Although removing the exemption for charities would remove any distortions that the exemption creates, it would increase compliance costs for charities. Charities would have to pay tax on benefits, which could mean higher costs or lower cash payments to employees. Alternatively, charities might decide to alter the relative value of fringe benefits and instead pay more cash, to reduce compliance costs.

Possible limitations

- 10.9 Consideration was given to various options for limiting the exemption, some of which are outlined below. The government's conclusion was that the limitations in these options would be either too narrow or too wide to be meaningful or effective. Furthermore, any limitation, such as apportionment between charitable and private use, would likely result in more compliance costs than if the exemption was either retained or removed in full.

Examples of possible limitations and their problems

Example 1

One option would be to limit the exemption to vehicle-related benefits provided the vehicles are available for charitable purposes at all times. This would remove any small private benefits that might arise when a vehicle is provided to carry out charitable purposes. It would go beyond the current exemptions for incidental benefits, emergency calls, or work-related vehicles. But, in fact, it would not preclude wide private use because a vehicle could still be concurrently available for charitable purposes, and the exemption would, therefore, be very broad in its application.

Example 2

A limit could be related directly to the employee's circumstances. An exemption may be more justified, for example, when the person's only remuneration is to cover necessities, such remuneration being exempt from income tax. Arguably, the provision of a fringe benefit is neither a deciding factor in determining employment decisions nor a substitute for cash remuneration in such cases. An example would be those who join certain religious orders. But such an exemption would be extremely narrow.

Example 3

Options that would allow more private use of motor vehicles would likely focus on maintaining records of actual use. To avoid the significant compliance costs arising from having to keep logbooks, or otherwise having to apportion business and private use, the fringe benefit could be a set percentage – say, 50 percent – of the usual value. But there would be no sound basis on which to base any such percentage.

Other issues

- 10.10 A number of other issues were also considered in determining the FBT treatment of charities:
- Many charities do not provide fringe benefits and would, therefore, not be affected by whether the exemption was removed or retained.²⁷

²⁷ In a survey conducted by Watson Wyatt, *Remuneration Report for the Voluntary Welfare Sector* (April 2001), more than half the participants did not provide fringe benefits to employees.

- Even without the exemption, many of the fringe benefits provided by charities might not be subject to FBT. Charities would need to be sufficiently large to have employees (rather than volunteers) and have systems that are capable of making source deduction payments. They would not have to pay FBT on incidental private benefits on vehicles available for emergency calls, or on work-related vehicles. The government's proposed changes, particularly those in relation to the valuation of motor vehicles, low-interest loans and increasing the minimum thresholds would, in many instances, further reduce any FBT liability.
- More importantly, at present, little information is available on the value of current benefits, so that neither the impact on the sector of removing the exemption nor how it fits within the government's assistance to the sector can be determined.²⁸

Leading conclusion from review

10.11 The government's view, after weighing up the various factors, is that the exemption for employees of charitable organisations should be retained. But given the policy reasons that militate against the exemption, the government is not in favour of extending it to other groups that may be similar but who are not charities. Although this may give rise to distortions, any extension would likely lead to greater distortions, as well as erode the tax base.

Possible anti-avoidance rule

10.12 Although the government has decided to retain the exemption, it is concerned to minimise the potential for the exemption to be exploited by providing a significant proportion of employees' remuneration in the form of fringe benefits. This is more likely the more readily substitutable a benefit is for cash. Credit cards are perhaps the closest cash substitute as a wide range of goods and services can be purchased with them.

10.13 There has been some suggestion that credit cards are being used to provide significant untaxed fringe benefits to some employees of charities. The government considers this to be inconsistent with its policy objectives and wishes to close off such opportunities. This will be achieved either through including a specific anti-avoidance rule targeted at credit cards and other short-term credit facilities or by specifically excluding such activities from the exemption.

²⁸ One of the benefits from the proposed registration and reporting system for charities should be a better indication of the aggregate value of the government's various forms of assistance to the sector.

Tertiary institutions and FBT

- 10.14 Some submissions were concerned that universities are subject to FBT, on the basis that they are specifically excluded from the definition of “charitable organisation”, while other tertiary institutions may not be. The government has set out its reasons for not altering the current exemption but it is worth noting that there is some debate over whether polytechnics, colleges of education and wananga are subject to FBT. Public authorities are subject to FBT and one argument is that at least some of these tertiary institutions are public authorities.

Chapter 11

LOANS TO EMPLOYEES

Proposed changes

- The benefit received from loans would be valued with reference to either the prescribed rate of interest or a publicly available market rate. Employers would elect which method to use, and that election would be binding for five years and apply to all their loans to employees.
- “Publicly available market rate” would be defined to include discounted rates available to employees other than by reason of their employment.

Current rules

- 11.1 FBT applies when an employer provides a loan to an employee. An employee loan would also be subject to FBT if the employer has entered into an arrangement for the loan to be provided by a third party.
- 11.2 The value of a fringe benefit arising from an employee loan is the amount by which interest calculated according to the FBT prescribed rate of interest exceeds actual interest paid. The prescribed rate generally differs from the lowest publicly available market rate.

The prescribed rate of interest

- 11.3 The FBT prescribed rate of interest is set by Order in Council and is reviewed before the start of each quarter. In order to allow for the various reporting requirements and the actual making of the regulations, the new rate must be determined two months before the start of the new quarter. The rate can, therefore, be out of date before the new quarter begins, as well as during the quarter itself.
- 11.4 The prescribed rate is based on the weighted average of first home mortgage interest rates for eight major providers of housing finance, using each institution’s total lending outstanding for housing purposes. For the quarter beginning on 1 October 2003, the prescribed rate is 7.08%.
- 11.5 This method of setting the prescribed rate generally results in the rate being higher or lower than the lowest market rate by the time the rate is applied. This difference may fluctuate during the quarter, given that market rates can move while the prescribed rate is fixed. The prescribed rate may also be less than the actual market rate if the security for the loan is not a house. Credit card loans, for example, are unsecured and carry a commensurately higher interest rate.

Policy rationale

- 11.6 The value of the benefit of an employer-provided loan to an employee is the difference between the interest rate of that loan and the lowest market interest rate that would otherwise be available to the employee.
- 11.7 If the prescribed rate of interest is higher than the market rate of interest the FBT rules overtax the benefit of the loan, but if the prescribed rate is lower than the market rate, the fringe benefit is undervalued. The prescribed rate will be higher than the lowest available market rate when interest rates are declining, as they have been over the past few years. The fringe benefit from employee loans will be undervalued when market interest rates start increasing.
- 11.8 In this context, the prescribed rate of interest method for valuing employee loans is a compromise between accuracy and compliance costs. It was designed to approximate market rates while saving employers the cost of having to track market rates. These costs could be significant for many employers. Accordingly, employers should be able to continue to use the prescribed rate to value employee loans if they wish.
- 11.9 On the other hand, employers who have sufficient information to make a more accurate calculation of the benefit of the loan according to market interest rates should be able to do so.
- 11.10 To reflect the benefit to the employee accurately, the value of the fringe benefit would need to be calculated with reference to a market rate that would be available for the type and length of loan that the employee had received from the employer.

Example

An employer lends employee A \$10,000, unsecured, at 5% over five years to buy a vehicle. The lowest publicly available unsecured personal loan rate is 10%.

An employer lends employee B \$10,000 for a house deposit. The loan is secured against the house and set at 5% over five years. The lowest publicly available fixed five-year interest rate is 6.5%.

The prescribed rate of interest at the time is 7.5%.

The benefit of the employer-provided loan to employee A is much larger than the benefit to employee B in this example as employee A would have had to pay a higher interest rate than employee B if the employer had not provided the loans.

Accordingly, if the employer had elected to value the loans according to the difference between the market rates and the actual rates applied, the FBT on employee A's loan would be much higher than the FBT on employee B's loan.

However, the difference between the prescribed rate and the actual interest rate applied to both the employee loans is 2.5%. The employer would be able to use this rate when calculating FBT on the loans. The prescribed rate would undervalue the loan to employee A and overvalue employee B's loan.

Proposal

- 11.11 The government proposes that employers be able to elect to value employee loans for FBT purposes according to the difference between the rate charged on the loan and either the prescribed rate of interest or a relevant publicly available market rate.
- 11.12 Providing for two methods allows employers to strike the balance between accuracy and compliance cost in the way that best suits their particular business. However, there would need to be legislative guidelines on making an election, to prevent employers changing the valuation method each quarter according to which method resulted in the lowest FBT. The election should apply for five years and cover all loans to employees.

“Publicly available” interest rates

- 11.13 Generally, the publicly available rate would be a carded rate offered by a member of the New Zealand Banker’s Association. This restriction would limit the potential for interest rates that are used to defeat the FBT rules.
- 11.14 Sometimes, however, special reduced rates are offered to particular groups. If an employee would qualify for a special reduced interest rate for reasons other than his or her employment, no private benefit would arise from an employer-provided loan at that rate.
- 11.15 On the other hand, when the reduced rate applies to a class to which the employee does not belong, FBT would apply if the employer provided a loan to the employee at that rate. Clearly, in this situation the employee receives a benefit that he or she would not have received if the employer had not provided the loan.

Example

An employer is a financial institution that is promoting a special interest rate for members of the local tennis club. Employee A is a member of the local tennis club but employee B is not.

No FBT would arise if the employer offered a loan to employee A at the special interest rate because employee A qualifies for the discount by being a tennis club member.

If the employer provided employee B with a loan at the special interest rate, FBT would be triggered because the special interest rate is a private benefit arising out of the employment situation.

Comparable to valuation of discounted or free goods and services

- 11.16 This proposed approach is consistent with the general valuation rules applicable to discounted goods and services that are also provided by the employer to the public.
- 11.17 Goods that are manufactured, produced or processed by the employer are valued at the price charged for identical goods to arm's length purchasers. Services provided by the employer's business must be valued at the price charged to the general public.

Proposal

- 11.18 The government proposes that "publicly available market rates" be defined to include reduced interest rates that would be available to employees other than by reason of their employment.

Chapter 12

LOW-VALUE BENEFITS

Proposed changes

- The employee-related threshold for minor fringe benefits would be raised from \$75 to \$200 per quarter.
- The employer-related threshold would be raised from \$450 to \$2000 per quarter.
- Benefits that arise in relation to employer health and safety obligations would be exempt from FBT.

12.1 The catch-all provision in section CI 1 (h) applies FBT to all unspecified private benefits derived by an employee from his or her employment, subject to a few exceptions. The main general exceptions relevant to unclassified benefits are:

- benefits provided on the employer's premises;
- benefits that remove the need for the payment of an allowance if that allowance would have been exempt income under section CB 12 of the Income Tax Act 1994 (reimbursement of expenditure on account of an employee); and
- minor unclassified benefits totalling \$75 or less, per quarter, per employee, provided all such benefits provided by an employer to all employees does not exceed \$450 per quarter. (Annual and Income year filers have corresponding thresholds.)

Reason for catch-all provision

12.2 Some submissions have argued that this catch-all approach has extended the FBT rules beyond the scope of remuneration by including all private benefits arising from employment.

12.3 Generally, a taxable fringe benefit arises when there is a clear nexus between the provision of labour by the employee and a benefit provided as compensation. This may come in the form of an employee accepting a lower salary on the condition that a car, for example, is made available to the employee for private use. A taxable fringe benefit also arises when an employee's salary is supplemented, such as when an employee receives vouchers.

- 12.4 The FBT rules should cover both these circumstances. However, the rules arguably extend beyond these to tax any private benefit arising from employment, regardless of whether it is in the nature of remuneration. The example of flowers given to an employee upon the death of a relative has been cited as a common instance when a private benefit may arise from employment but does not have the nature of remuneration.
- 12.5 In addition, the catch-all provision imposes significant compliance cost on employers as it requires the recording and monitoring of all benefits.

Specific exemption of employer health and safety-related benefits

- 12.6 Benefits that might arise as a result of an employer meeting health and safety obligations can fall within the scope of FBT. Such benefits include free vaccinations, subsidised health checks and counselling services. The FBT treatment of these benefits depends on the location of their provision. If this occurs on the premises of the employer, the benefit will be exempt. This treatment is appropriate since the on-premises exemption was introduced to reduce compliance costs stemming from valuing a myriad of small benefits which are available to employees on their employer's premises.
- 12.7 If, however, the vaccination, counselling or health check is performed away from the employer's premises, FBT applies.

Policy rationale

- 12.8 There seems to be no good policy rationale for exempting these activities on the basis of location, given that any benefit that arises would be the same whether performed at the employer's premises or at the doctor's surgery, or elsewhere. In this instance the exemption only creates an arbitrary division between taxable and non-taxable fringe benefits of the same type.
- 12.9 Furthermore, difficulties with valuation is not a rationale for the current exemption. Vaccinations, health checks, and counselling are all available to the general public and can be valued at the open market value.
- 12.10 In principle, the fact that a fringe benefit may also benefit the employer or society in general should not mean that tax should not be charged on the benefit to the employee if it is in the nature of remuneration. The link to remuneration, however, is more difficult to establish in the case of these types of benefits. Would employees have purchased the benefit themselves had the employer not provided it? If not, then it is difficult to argue that the employees have been saved a cost that they would otherwise have incurred out of their remuneration.

Proposal

- 12.11 The specific exemptions from FBT would be extended to cover such items as flu injections and eye tests on the basis of their being part of employer health and safety obligations. Those obligations may arise from the Health and Safety in Employment Act 1992 or the State Sector Act 1988.
- 12.12 This proposal would not extend to a more general exemption of employer-paid health insurance premiums or childcare facilities, where the employee can be regarded as clearly receiving a subsidy from the employer for activities for which the employee would normally bear a cost.

Minor unspecified benefits

- 12.13 Section CI 5 creates an exemption from FBT for unspecified benefits when the aggregate taxable value of those benefits provided to the employee during the quarter amounts to \$75 or less, and the aggregate taxable value of all benefits provided by the employer to all employees during the quarter does not exceed \$450.
- 12.14 The provisions were intended to act as a buffer, excluding small benefits that are not in the nature of remuneration and benefits that are so low in value that the cost of paying FBT on them is unreasonably high relative to the value of the benefit.
- 12.15 The provisions have not been adjusted for over ten years²⁹ and are now generally seen as too low for the current commercial climate. In particular, the \$450 cap for all benefits provided to employees is seen as disadvantaging larger employers.
- 12.16 Many submissions on the issues for inclusion in the FBT review advocated an increase in the threshold and/or the removal of the \$450 cap on the basis that too many benefits that were not within the intended scope of FBT were being caught by the rules.
- 12.17 Raising the thresholds would remove FBT on some benefits that should not be subject to FBT, although it would be a blunt instrument to achieve this purpose because it would also remove FBT on benefits of low value that should, in principle, fall within the FBT rules because they have the character of remuneration.

²⁹ The threshold was set at \$50 when FBT was introduced in 1985 and was subsequently increased to \$75 in 1992. The current structure of having both an employee and employer threshold was introduced in 1993.

12.18 Moreover, the minimum thresholds do not necessarily offer a trade-off between accuracy and cost because in order to use the provisions an employer must track all unclassified benefits to establish whether the thresholds have been exceeded. The provisions are, therefore, unsuitable for fringe benefits that are difficult to monitor or value. In such cases specific exemptions are more effective. From a policy perspective, therefore, minimum thresholds are a useful adjunct to specific exemptions in relation to small measurable benefits. Their main benefit, from an employer's perspective, is in lowering overall FBT liability.

Proposal

12.19 The government proposes to:

- increase the employee-related minimum threshold from \$75 to \$200 per quarter; and
- increase the employer-related threshold from \$450 to \$2000 per quarter.

Chapter 13

PROPOSED EXEMPTIONS – USE OF CERTAIN BUSINESS TOOLS

Proposed changes

The private use (and availability for private use) of employer-owned business tools such as cell phones and laptops would be exempt from FBT if the tools are provided to the employee primarily for business purposes.

Use and availability for use of business-related assets

- 13.1 The private use or availability for private use of business-related equipment such as cell phones and laptops is currently subject to FBT under the catch-all provision in section CI 1(h), unless the private use is only on the employer's premises.
- 13.2 The FBT valuation rules do not directly address the use or availability for use of such assets owned by the employer and, consequently, cause uncertainty about the value of the benefit.
- 13.3 In theory, the rental value or similar annual cost of the equipment could be an appropriate basis for the valuation of the benefit. However, rental values may overvalue the benefit if the employer places restrictions on the use of the equipment, such as an international calling bar on a cell phone, that would not generally apply if the employees had hired the equipment themselves.

Policy rationale

- 13.4 The government agrees with submissions that argued that it is difficult and, therefore, costly to monitor and value the private use of small items such as laptops and cell phones when they are provided by employers primarily as business tools. As they are primarily for business use, any private benefit would likely be incidental.
- 13.5 In the absence of an express condition granting use of the equipment in a salary package, these benefits may also be difficult to characterise as remuneration. When the equipment is provided to facilitate the employee's job, such as when a cell phone is given to an employee who is on call and when a laptop is provided to an employee to complete work assignments at home, the benefit to the employee may be seen as merely incidental. The ability to surf the internet at home after having completed the work

assignment may benefit the employee but does not have the character of remuneration for the work done.

- 13.6 Even in situations where the benefit can be characterised as remuneration, such as when the cell phone provided by the employer alleviates the need to purchase private telephone services, the compliance costs involved may be so high that they outweigh the benefit of imposing FBT.
- 13.7 Although this boundary is difficult to judge, the complexity in valuing business-related equipment and the difficulty in monitoring the uptake of these benefits indicates that these benefits give rise to particularly high compliance costs.
- 13.8 The valuation of the private use or availability for use of laptops and cell phones contrasts with the relatively straightforward calculation when ownership of a laptop or cell phone is transferred to an employee. In that situation the value of the laptop or cell phone is its market value less any contribution by the employee.
- 13.9 The extent to which the use of business-related assets such as cell phones and laptops are substituted for cash remuneration is unknown. Only limited potential for substitution exists as the employee is unlikely to require more than one laptop or cell phone at any one time.
- 13.10 The difficulty in regularly measuring any private benefits that do arise effectively precludes them from being encompassed in the minimum thresholds, so the better solution is to exempt them. As one submission noted, this would be consistent with the government's initiatives for promoting a knowledge economy.

Proposal

- 13.11 The private use of employer-owned work tools such as laptops, cell phones and other business-related assets would be exempt from FBT when these assets have been provided to the employee primarily for business purposes. This exemption is on the assumption that the private use would be incidental, which could be verified by periodic audit.
- 13.12 This proposal represents a trade-off between accuracy and simplicity. As such it recognises that the high level of cost and complexity associated with valuing and monitoring private benefits that arise from the use of work tools such as laptops and cell phones will generally outweigh the advantages of taxing these fringe benefits.
- 13.13 Cell phones and laptops that are provided by an employer but are either owned by the employee or are not required to be brought to work would continue to be subject to FBT, as would land line telephones.

Part four

Minor issues

Chapter 14

OTHER EXEMPTIONS

Proposed changes

- Payment of income protection insurance premiums by an employer on behalf of an employee would be exempt to the extent that the employee would have received a tax deduction if he or she had paid the premium directly and the income stream would have been taxable.
- The current law would be clarified to confirm that FBT should not apply to benefits that arise when an employer secures a bulk discount for employees, provided those discounts would be available to other groups on a basis unrelated to employment.
- For the purposes of the on-premises exemption, an employer's premises would include the premises of other companies in the consolidated group.

Income protection insurance

- 14.1 In principle, the FBT treatment of income protection insurance policies should put the employee in the same position as if the employer had paid the employee a cash amount and the employee had then paid the premium directly. This is not the case currently because employees who pay the premium directly can be eligible for a deduction for the premium paid, on the basis that it is to ensure future income. Employees do not, however, receive a deduction when the employer pays the premium on their behalf.

Example

Scenario 1: An employer pays a \$100 premium on an income protection insurance policy for an employee. Given that the marginal tax rate of the employee is 33 cents, the FBT liability is \$49.

Scenario 2: The employer pays the employee the \$149 in cash and the employer deducts PAYE of \$49. The employee then pays the \$100 premium and can claim a deduction against income of \$100, which reduces the tax liability by \$33.

Under scenario 2 the employee is \$33 better off.

Proposal

- 14.2 The government's proposed solution for rectifying this difference is that the premiums paid by the employer would be exempt from FBT if the employee would have received a tax deduction had he or she paid the premium directly, and if any claim under the policy would be subject to tax in the employee's hands. This means that those premiums relating to personal sickness or accident policy insurance (which is treated as exempt income under section CB 5(1)(h)) would not qualify for the exemption.

Third-party provided benefits

Incidental benefits

- 14.3 When an employer enters into an arrangement for a third party to provide employees with benefits, the employer is still regarded as having provided the benefits and is liable for the FBT on them.
- 14.4 There is an argument that FBT should not apply to benefits that arise when an employer has secured a bulk discount for its staff from a third party merely because they represent a significant group. The crucial criterion in these circumstances should be whether such a discount would be available to the employees were they members of some other group unrelated to their employment. If the third party generally provides a bulk discount to large groups to attract their custom then, from a policy perspective, it is difficult to consider the discount to be a fringe benefit.
- 14.5 The employer may not have provided any consideration for the discount, although this need not be an indication that the benefit is not really employment-related, particularly if the parties are associated persons.

Proposal

- 14.6 It is proposed that the current law be clarified to confirm that FBT should not apply to benefits that arise in instances such as when an employer secures a bulk discount for its employees, provided those discounts would be available to other groups on a basis unrelated to employment. This treatment is conceptually the same as that proposed for low-interest loans, outlined in chapter 11.

Third party pays the FBT

- 14.7 Another issue raised in submissions was whether the third party providing the benefit to the employee should have the option to meet the FBT liability. There may be good practical reasons for this, such as the third party having the information to calculate the value of the benefit, or the third party may consider the information on cost to be commercially sensitive.

14.8 The third party may also have chosen to provide the benefit to the employee in return for services provided by the employee to the third party through the employer. In such cases the third party is bearing the cost of the fringe benefit, and it seems appropriate that it, rather than the employer, be able to elect to pay the FBT. The employer would in these circumstances be exempt from FBT on the relevant fringe benefit.

14.9 This could, however, give rise to some complexities:

- because the third party would not have access to the salary details necessary to identify the employee's marginal tax rate, the 64% tax rate may need to be applied to the benefit; and
- to reduce the opportunity to use this treatment to take undue advantage of the minimum value threshold, the employer and the third party should not be associated persons and no payment should be made by the employer to the third party in respect of the benefit.

14.10 The government seeks comment on the practicalities of this treatment.

On-premises exemption

14.11 As discussed earlier, benefits provided on an employer's premises are excluded from FBT. This exemption does not, however, extend to the premises of another member of a group of companies, which can produce inconsistent outcomes. An employee may, for example, be employed by one member of the group of companies but receive a benefit while at the premises of another member – say, on a visit as part of his or her employment duties. It seems logical, therefore, that the on-premises exemption be able to be applied on a consolidated group basis or when companies are 100 percent commonly owned.

Proposal

14.12 For the purposes of the on-premises exemption, an employer's premises would include the premises of other companies in the consolidated group or when the companies are 100 percent commonly owned.

Travel costs when employee posted overseas

14.13 Although a number of submissions raised the issue of the FBT treatment of spousal travel, the government is not proposing to alter that treatment. In general terms, having the spouse or partner of an employee accompany the employee on a business trip cannot be considered to be for work purposes. This is because of the difficulty in establishing a clear nexus between the spouse's or partner's role during the trip and the generation of income for the employer's business. Therefore if an employer pays for an employee's

spouse or partner's travel costs in such cases, the payment should be treated as a fringe benefit and subject to FBT.

14.14 One issue that has arisen in the FBT review, however, is the appropriate FBT treatment of family visits to employees working overseas that are paid for by the employer. If the employer pays for the employee to return home to visit his or her family, this cost may currently be exempt from FBT on the basis that it removes a need to pay the employee a reimbursement allowance for travel costs the employee would have incurred in travelling between the employee's home and place of work for the purposes of their employment. If, in the alternative, the employer incurs the cost of the family visiting the employee, the FBT outcome should arguably be the same – that is, any benefit should be exempt.

14.15 In principle, the government agrees that there are grounds for considering an exemption if:

- it can be shown that the travel by the family is required as part of the employee's employment;
- the business purposes that would have been met by the employee making the trip continue to be achieved by the family visiting the employee; and
- the exemption for family visits is limited to the amount that would have been exempt from FBT if the employee had made the visit.

14.16 The government invites comment on this point.

Work-related clothing

14.17 No changes are proposed to the FBT rules on work-related clothing. Distinctive work clothing provided to employees by their employer is exempt from FBT provided it meets the definition of "distinctive work clothing". This is defined as clothing that is worn for work purposes and would not be normally worn for private purposes, and can be identified with the employer by virtue of:

- a name, logo, or other similar identifier being prominently and permanently displayed on the clothes at all times; or
- the uniform's pattern, colour scheme or style being readily identifiable with the employer.

14.18 Given that some concerns were raised in submissions about the practical application of these requirements – in particular, what is meant by “readily identifiable” and “prominently displayed”, the requirements were reviewed. While acknowledging that any definition creates interpretation issues and, therefore, compliance costs, this is part of the trade-off for having an exemption. The conclusion is that changing the definition would create more problems than it would resolve and that, therefore, no change should be made.

Chapter 15

OTHER ISSUES

- The general anti-avoidance rule in section BG 1 would be applied to FBT.
- Section CH 2, relating to share options, would be amended to make it clear that it covers options that are cancelled in exchange for cash.
- The legislation would be clarified so that an election to pay FBT on a quarterly basis is made at the time of filing.
- Employers would have the option of making their election to pay FBT annually by telephone rather than in writing.

Anti-avoidance rule

- 15.1 Although FBT has its own anti-avoidance provision in part G of the Income Tax Act 1994,³⁰ unlike many of the specific anti-avoidance rules in part G, it is not also bolstered by the general anti-avoidance rule in part B, which enables a tax avoidance arrangement to be voided and any associated tax advantage to be counteracted. This omission arises because of the wording in section BG 1, when read in conjunction with sections OB 6 and OZ 1. The omission in this legislation and its predecessor, the Income Tax Act 1976, does not appear to have been deliberate. In the circumstances, the general anti-avoidance rule should apply to FBT and the government proposes to make a remedial change to achieve this.
- 15.2 This change would apply as a back-stop measure to bolster other specific anti-avoidance rules, including the specific rule proposed in this document in relation to charities.

Interaction with share option schemes

- 15.3 Under section CH 2 of the Income Tax Act 1994, exercised share options provided to an employee by an employer are treated as monetary remuneration, with the value of the benefit being the difference between the value of the shares on the date of acquisition and the amount paid by the employee for them. To avoid double taxation, the FBT rules specifically exclude benefits that arise under section CH 2.

³⁰ See section GC 17.

- 15.4 An issue has arisen as to the treatment of options that are cancelled in exchange for cash rather than converted into shares. In these circumstances the option holder still receives a benefit so that if section CH 2 were not to apply, then FBT should apply in theory, although there is confusion as to whether it does in fact apply. This confusion creates compliance costs for taxpayers.
- 15.5 To avoid these compliance costs, the government proposes to clarify section CH 2 to ensure that, as intended, any benefits in relation to share options are covered by that provision rather than the FBT rules.

Value of transport benefits

- 15.6 Transport-related fringe benefits provided by an employer are generally valued at 25% of the highest amount charged by the employer to members of the public. This means, for example, that an airline that provides its staff with free air travel for their private use generally pays FBT at the rate of 25% of the highest fare charged to a member of the public for a comparable flight. This discount was intended to represent a stand-by type of fare, given that employees may not be guaranteed a seat until shortly before departure.
- 15.7 Some submissions questioned whether the rate of 25% is still appropriate, given the range of discounted fares that are now available to the public. This should be able to be established empirically. Accordingly, the government invites submissions on this point. In considering the rate, the government would need to take into account the full range of transport options to which the rate applies.

Policyholder loans

- 15.8 Section CI 2(8) of the Income Tax Act 1994 applies the FBT rules to loans provided by a life insurer to a policyholder. This is done by treating the relationship between the policyholder and the life insurer as an employment relationship. The purpose of the provision is to capture the benefits of low-interest loans to policyholders in the same way that such benefits, when provided to shareholders of a company, are treated as dividends.
- 15.9 Over recent years many life insurers have demutualised but because there is an exemption in the dividend rules for amounts subject to FBT, the FBT rules continue to apply to low-interest loans to policyholders even when the life insurer is now a company.

- 15.10 Because some life insurers have not demutualised, section CI 2(8) needs to be retained. But the government invites submissions on whether loans to shareholders in life insurance companies should be subject to the dividend rules rather than the FBT rules. One aspect to consider is the implications of changing who pays the tax. At present, the life insurer pays the FBT, whereas if the benefit were treated as a dividend, the shareholder would pay the tax, which would likely increase compliance and administrative costs.

Changes to election provisions in subpart ND

- 15.11 Some technical issues have been raised with the election requirements in subpart ND. Subpart ND sets out the specific tax rules, such as the multi-rate, in relation to the fringe benefits identified in subpart CI. The proposed changes are:

- Section ND 2(3) provides that an employer elects to pay FBT on a quarterly basis by filing a return and paying tax at the rate selected. Since not all taxpayers pay when they file, the proposal is that the section be amended so that an election is made at the time of filing.
- Employers can elect to pay FBT on an annual rather than a quarterly basis if they meet certain criteria. The election must be in writing. In practice this means that employers complete an Inland Revenue form. It is proposed that sections ND 13, 14 and 15 be amended to provide employers the option of making their election by telephone. An advantage of making a telephone election is that the employer can discuss such detail as whether they meet the annual filing criteria and when the change of filing will apply from.

Appendix

MOTORING COSTS FOR PETROL-DRIVEN VEHICLES ESTIMATED ON 14,000KM PER YEAR, FIRST FIVE YEARS OF OWNERSHIP

Engine capacity	Up to 1300cc	1301 – 1600cc	1602 – 2000cc	Over 2000cc
Average Price of a New Car Including Registration	\$19,662	\$28,065	\$36,936	\$42,356
A – FIXED COSTS				
Average Value at Start of Third Year	\$14,441	\$20,612	\$27,128	\$31,108
Annual Relicensing	\$217	\$217	\$217	\$217
Insurance – Comprehensive, No Claim	\$540	\$665	\$805	\$825
Warrant of Fitness Annually at \$34 for the First 6 Years	\$34	\$34	\$34	\$34
Total Outlay	\$15,232	\$21,529	\$28,184	\$32,185
Interest on Outlay at 8.2%	\$1,249	\$1,765	\$2,311	\$2,639
Capital Cost (Outlay + Interest)	\$16,481	\$23,294	\$30,495	\$34,824
Depreciation (at 14.3% from Average Value) at 3 rd Year	\$2,065	\$2,948	\$3,879	\$4,449
Depreciated Value	\$12,376	\$17,665	\$23,248	\$26,660
TOTAL FIXED COSTS	\$4,105	\$5,629	\$7,247	\$8,164
B – RUNNING COSTS				
Petrol – Litres Used per 100km	6.9	7.2	8.6	10.8
Litres Used over 14,000km	966	1009	1204	1512
Cost at \$1.09 per Litre (January 2003)	\$1,056.80	\$1,103.85	\$1,317.18	\$1,654.13
Oil at \$7.82 per Litre – 1 Litre per 2,500km = 5.6 Litres Used	\$43.74	\$43.74	\$43.74	\$43.74
Tyres Estimated Life of 40,000km – Cost per Year	\$157.78	\$182.65	\$224.99	\$229.83
Repairs & Maintenance (Incl. Service Oil Changes) to Maintain Car in Reliable Operating Condition	\$732.95	\$724.90	\$777.97	\$879.21
TOTAL RUNNING COSTS	\$1,991.27	\$2,055.13	\$2,363.87	\$2,806.91
Running Cost per Kilometre	14.2c	14.7c	16.9c	20.0c
FIXED COSTS PLUS RUNNING COSTS	\$6,097	\$7,684	\$9,611	\$10,971
TOTAL MOTORING COSTS AS % OF CAR COST	31.0	27.4	26.0	25.9

Source: AA Directions