Reviewing the tax treatment of employee allowances and other expenditure payments

An officials' issues paper

November 2012

Prepared by the Policy Advice Division of Inland Revenue

First published in November 2012 by the Policy Advice Division of Inland Revenue, PO Box 2198, Wellington 6140.

Reviewing the tax treatment of employee allowances and other expenditure payments – an officials' issues paper.
ISBN 0-478-39206-0

CONTENTS

CHAPTER 1

Introduction

1.1 Over recent years, a number of concerns have arisen around the tax treatment of payments made by employers to or for the benefit of their employees. As a result, the Government has included a review of employee allowances in its tax policy work programme. This issues paper provides officials' initial thinking in this area.

1.2 Although the term "allowance" is commonly used to refer to non-salary or wage cash payments for employees, the review covers a range of payments made by employers to employees, or made on their employees' behalf. There is a spectrum of such payments ranging from payments that reimburse an employee's private expenditure, to payments that are no more than the direct reimbursement of business expenditure incurred for the employer by the employee. In this issues paper we use the term "employee expenditure payment" to refer to all these payments.

1.3 In some cases the generality of the legislation determining the tax treatment of employee expenditure payments can lead to impractical outcomes that may differ from how businesses are applying the rules in practice. We are also aware that in some cases there is a difference between how employers treat employee expenditure payments in practice and Inland Revenue's view of how the legislation operates. Gaps that arise from the general rules may therefore need to be filled with either more detailed legislation or published statements from Inland Revenue.

1.4 Initial discussions with employers and representative groups suggest that the employee expenditure payment rules work well for employers for the most part, but there are some significant interpretive issues that require a policy response.

1.5 Key types of payment requiring some attention are:

- Meal payments – a number of scenarios involving a payment being made to meet the cost of a meal in work-related circumstances and the question of how the payment should be taxed are considered.
- Accommodation payments – situations involving both an employee expenditure payment and the provision of accommodation by the employer when taxing less than the full value of the payment are considered.
- Communication and clothing payments – issues in relation to communication and work clothing payments when it is often difficult to make an apportionment are considered.

1.6 The paper considers these employee expenditure payments and sets out possible options for how to treat these. Later the paper considers the current legislation and how well it works in providing certainty for other employee expenditure payments more generally.

1.7 A boundary between payments that meet a private expense (defined in chapter 2) and those that do not is considered. Payments for a private expense can be seen as a salary substitute. In these circumstances, our starting point is that salary/wages and salary/wage substitutes should be taxed equally. All payments that are salary or wage substitutes should be taxed since all salary and wages are taxed.

1.8 However, to reduce compliance and administrative costs, some payments to meet a private expense should be treated as non-taxable when they are:

- low in value and incidental to the work element;
- low in value and hard to measure; and
- there is little risk of re-characterisation of salary and wages as non-taxable payments.

1.9 Finally, in establishing the taxable amount, valuation is a key concern, including taking into account any employee contribution which reduces the value of any private benefit.

1.10 A summary of the suggested approach and options is set out below and a comparison with the current treatment is provided in the table at Appendix A.

Summary of suggested approach and options

Meals

- We suggest that employee expenditure payments to meet an employee's meal expenses during work travel away from the employee's normal workplace should be exempt from tax, subject to a three-month upper time limit at a particular work location.
- Employee expenditure payments to meet the cost of an employee's working lunches and other working meals/refreshments outside of work travel should not be taxed, provided any payment is not made regularly as an additional payment for the employee's services.

Accommodation

- We suggest that employee expenditure payments to meet an employee's accommodation expenses during work travel away from the employee's normal workplace should be exempt from tax, subject to a 12-month upper time limit at a particular work location, with a power for the Commissioner to extend that time limit in certain exceptional circumstances.
- When an employee is provided with accommodation by their employer at or near their normal workplace, the value of the accommodation should be taxable to the employee based on the market rental value of the property, after taking into account any employee contribution to the cost of the accommodation.

- When an employee has more than one permanent workplace for the same job, one option is not to tax employee expenditure payments to cover accommodation costs at one workplace.
- A valuation method other than market rental value may be needed to establish the taxable amount when the accommodation is in an overseas location – for example, a valuation by reference to comparable New Zealand accommodation.

Communications

- We suggest that employee expenditure payments to meet internet and other electronic communication costs should be taxed in full when meeting mixed work-related and private expenses and there is no separately identifiable work or private element.

Clothing

- We consider that employee expenditure payments to meet clothing costs should be taxed in full except when they relate to uniform, protective or specialist clothing required for the employee's job.

General legislative issues

- Alternative approaches to the current general legislation around the tax treatment of employee expenditure payments are considered, ranging from a fundamental change in approach to leaving the general rules unchanged but introducing a power to exempt particular payments by Commissioner determination – making power for the treatment of payments not addressed by specific rules.
- Changes may be needed to the legislation concerning "expenditure on account of an employee" to remove ambiguities around the application of the general exclusions.

Next steps

1.11 Once the consultation period has closed, officials will report to Government to consider whether any legislative changes are appropriate.

1.12 All legislative references are to the Income Tax Act 2007 except when otherwise stated.

How to make a submission

1.13 You are invited to make a submission on the proposed reforms and points raised in this issues paper. Submissions should be addressed to:

The tax treatment of employee allowances
C/- Deputy Commissioner, Policy
Policy Advice Division
Inland Revenue Department
PO Box 2198
Wellington 6140

1.14 Or email policy.webmaster@ird.govt.nz with "Employee allowances" in the subject line.

1.15 Electronic submissions are encouraged. The closing date for submissions is 1 February 2013.

1.16 Submissions should include a brief summary of major points and recommendations. They should also indicate whether the authors would be happy to be contacted by officials to discuss the points raised, if required.

1.17 Submissions may be the subject of a request under the Official Information Act 1982, which may result in their release. The withholding of particular submissions on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. Those making a submission who consider there is any part of it that should properly be withheld under the Act should clearly indicate this.

CHAPTER 2

Current landscape

Summary of policy principles used in considering the tax treatment of an employee expenditure payment

In considering in this issues paper the appropriate tax treatment of an employee expenditure payment, the following principles have been taken into account:

- When the employee expenditure payment relates solely to a work expense there should be no taxable element*.
- When the employee expenditure payment is for a private expense or a mixed private and work expense, ideally the amount relating to the private element should be taxed.
- Apportionment may not be practical in all cases.
- For compliance and administrative cost reasons, some payments to meet a private expense should be treated as non-taxable when they are:
  - low in value and incidental to the work element;
  - low in value and hard to measure;
  - there is little risk of re-characterisation of salary and wages as non-taxable payments.

* Other than when it relates to a capital expense

2.1 This issues paper builds on the themes of Budget 2010. These included the need to improve the integrity of the tax system and social assistance programmes so that individuals pay their fair share of tax, and social assistance is targeted at those in genuine need. The paper is one of a series of papers over the past two years that focus on these themes and objectives, the others being: *Social assistance integrity; defining family income* and *Recognising salary trade-offs as income*. It also builds on analysis undertaken in the 2007 issues paper, *Tax-free relocation payments and overtime meal allowances*.

2.2 The key focus has been on the taxation of labour income and the recognition of this income and other benefits provided by employers to their employees in exchange for labour services when determining eligibility for social assistance, in as comprehensive a way as practicalities allow.

2.3 This paper does not, however, identify or seek to address any major gaps in the tax base that are giving rise to revenue risks. Rather, it assumes that the main challenge for taxing employee expenditure payments is to provide greater certainty for both taxpayers and Inland Revenue.

2.4 Inland Revenue does not hold detailed information about how much employers pay by way of employee expenditure payments. The observations in this issues paper are, therefore, of necessity based on our discussions with individual businesses and key business representatives that have a range of employers making employee expenditure payments.

2.5 Discussions with employers and representative groups suggest that the employee expenditure payment rules work well for employers for the most part, but there are some significant interpretive issues that mean a policy response is needed. This paper attempts to address these concerns.

Development of employee expenditure payments and their tax treatment

2.6 Over the years there have been a number of changes to the tax legislation applying to employee expenditure payments. Their purpose has been to ensure that any payment for private expenditure is taxed, or are a consequence of changes to other taxing provisions applying to employees.

2.7 A key change was the introduction of the fringe benefit tax (FBT) rules in 1985, which make a clear distinction between monetary payments, that should be taxable to the employee under the income tax rules, and non-cash goods and services that should be taxable to the employer under FBT. The reform included the repeal of the employee deduction rules[1] and introduced the definition of "expenditure on account of an employee".

2.8 Before 1995, the Commissioner of Inland Revenue could determine whether and to what extent any employee expenditure payment constituted a reimbursement of expenditure incurred by the employee in gaining or producing his or her assessable income. The payment was, to the extent determined, exempt from tax.[2]

2.9 Dealing with these requests was, however, a resource-intensive process. The approach also did not fit easily with the move to self-assessment. As a result, the approach was changed through legislation in 1995.[3] Since then, it has been the employer's responsibility to make a judgement on what the correct tax treatment is for an employee expenditure payment.

2.10 The general exemption provision for employee expenditure payments was also changed in 1995. The Commissioner discretion was replaced with a test that makes the expenditure or payment by the employer non-taxable to the extent it relates to expenditure for which the employee would be allowed a deduction but for the employment limitation. These changes meant that certain employee expenditure payments were taxable to the extent that the expenditure they met were private (or domestic) or capital in nature. Rules were also introduced so employers could use a reasonable estimate when determining the expenditure that an employee would be likely to incur.

[1] Previously in the fourth schedule of the Income Tax Act 1976.
[2] Sections 73(2) and 73A of the Income Tax Act 1976 and then sections CB 12(1) and CB 13 of the Income Tax Act 1994.
[3] Changes were made through the Income Tax Act 1994 Amendment (No 2) Act 1995.

2.11 A more detailed summary of the current legislation relating to employee expenditure payments can be found in Appendix B.

Employee expenditure payments in practice

2.12 As a general observation, in recent times Inland Revenue and employers have been looking to simplify and reduce their processing costs, aided by computerisation and new technologies. Historical work practices have been brought up to date and employment practices changed. Nevertheless, employee expenditure payments must still be inputted into the payroll before they can be paid, which gives rise to significant compliance costs.

2.13 There has also been a change in the shape of New Zealand industry[4] over the past 20 years, with a shift towards service industries and away from more traditional forms of employment such as manufacturing. Service industries have experienced the highest levels of employment growth (particularly business and financial services), stimulated in part by technological change.

2.14 As a result of these changes and business pressures, anecdotal evidence shows that there has generally been a significant reduction in the number, nature and variety of employee expenditure payments over the years. Employers have also tried to reduce business costs by making employee expenditure payments simpler. For example, by paying an allowance to meet estimated business travel expenses rather than reimbursing exact expenses or by providing employees with a corporate credit card to pay for business expenses up-front that can then be settled by the employer.

2.15 Working conditions have also changed, with flexible working arrangements, new communication technologies and computerisation leading to an increase in working outside the traditional office environment. Employees may receive payments to reimburse the additional costs.

Employee expenditure payments

2.16 The term "employee expenditure payment" describes a range of payments to reimburse or otherwise meet an employee's expenditure.

2.17 It includes the payment of a cash allowance. In this context, allowances describe a payment to an employee which is in addition to salary and wages, as compensation for expenditure that the employee incurs or is likely to incur in connection with their employment. An allowance can be paid in advance of the employee incurring the expenditure and may be based on a reasonable estimate of the expenditure that the employee is likely to incur.

[4] Department of Labour. *Workforce 2010 – a document to inform public debate on the future of the labour market in New Zealand*: Department of Labour, March 2001.

2.18 An employee expenditure payment also includes a payment to reimburse actual expenditure incurred by the employee or expenditure on account of an employee to settle the employee's liability with a third party. The expenditure may be directly related to the employee's job or may be related to the employer's business. These sorts of payments are normally paid in arrears either directly to the employee or to a third party to settle the employee's liability.

2.19 Types of employee expenditure payments that are commonly made and specifically addressed in this document include meals, accommodation, communication and clothing payments.

2.20 Under the current legislation, when an employee expenditure payment is made, provided it is to meet an expense incurred in earning the employee's employment income, it is not taxable unless there is a private or capital element in the expenditure. In the latter circumstances, the payment may be taxable in part or in full.

Payments that are outside the scope of the review

2.21 Employers may also pay allowances relating to unusual conditions of service. These types of allowances do not relate to the employee incurring expenditure. They might, for example, include allowances to recognise additional skills an employee has to offer their employer in carrying out their employment duties.

2.22 Other examples of these sorts of allowances are payments to compensate for difficult or unpleasant working conditions or for taking on additional responsibilities.

2.23 These sorts of payments are likely to be additional rewards for an employee providing their labour in specific circumstances, reflecting market conditions and the need to pay more in order to get the right person to do the job. As such, they are treated as employment income in the same way as wages or salary. These types of allowance normally present few difficulties in determining the correct tax treatment and are not discussed further in this paper.[5]

2.24 There are a number of other scenarios, when employers make payments to meet additional expenses arising in connection with the employee's job, which are not covered by this review. These include overtime meal allowances, additional sustenance allowances, additional transport costs and certain expenses as part of a work-related relocation package. These payments are already subject to existing tax exemptions[6] and are not discussed further in this paper.

[5] The tax treatment of an additional skills allowance is wholly separate to any consideration of the tax treatment of any payment by the employer to reimburse an employee for costs they have incurred in gaining the particular skills.
[6] Sections CW 17B, 17C and CW 18.

Policy questions

2.25 In determining the appropriate tax treatment for a particular employee expenditure payment, our starting point is that the best approach is to consider all such payments, regardless of the nature of the underlying expenses they are intended to meet. Our preference is, therefore, to include all employee expenditure payments whether they are related specifically to the employee's job or more broadly to the employer's business. Otherwise, there would be boundary issues around what is included and what is excluded.

2.26 To resolve potential areas of uncertainty around borderline issues, our preference is to have clear objective tests to determine what is taxable and what is not for the most common types of payments. For other types of payments not covered by these specific tests, the general approach outlined in this issues paper in chapter 6 would apply (subject to any options for change).

2.27 In considering the appropriate tax treatment for a particular employee expenditure payment, the first question is whether it covers a private expense. Unless it covers a private expense, there will usually be no taxable element. An outgoing is of a private nature if it is exclusively referable to living as an individual member of society or is an ordinary living expense. Examples of expenditure that are often of a private nature include food, clothing and accommodation.

2.28 References in this paper to a private expense include the private element of an expense. However, when the private element is low in value and solely incidental to a work expense or low in value and hard to measure it may be preferable, in order to reduce compliance and administrative costs, to ignore it.

2.29 Salary substitution can arise in a range of instances, although it is more evident when an amount of salary has been traded off or given up for non-cash benefits. By contrast, with the exception of accommodation payments, the employee expenditure payments being considered in this issues paper are unlikely, for the most part, to form part of a salary substitution. However, it will be important to ensure that any changes do not introduce any new incentives for salary substitution.

2.30 When goods or services that are low in value and hard to measure are provided to an employee and fall below a minimum threshold, they are often exempt from fringe benefit tax (FBT).[7] This is for compliance and administrative costs reasons. However, exempting equivalent cash payments in this way would pose a fiscal risk. Therefore, while it would not be practical to tax all low in value and hard to value employee expenditure payments, a different approach is needed.

2.31 Account should also be taken of anything the employee contributes, such as an employee contribution to accommodation costs, which reduces the value they receive from their employer.

[7] Sections CX 37 and RD 45.

2.32 Pragmatic solutions to the main employee expenditure payments that balance the broad salary substitution concerns against the need for workable tax outcomes are considered in this paper. The approach we have taken is illustrated in the flowchart at the end of this chapter.

Other considerations

2.33 There are a number of other considerations that have been taken into account in developing the best options for reform. These are:

- **The tax outcome should not be unduly influenced by the payment mechanism** – While an employer will often pay an allowance in anticipation of an employee incurring expenditure, they might also reimburse actual expenditure that has already been incurred or settle an employee's bill. Alternatively, rather than paying cash they might arrange for goods or services to be provided. Whichever mechanism is chosen, as far as possible, the tax outcome should be the same, without significantly different compliance costs for employers.

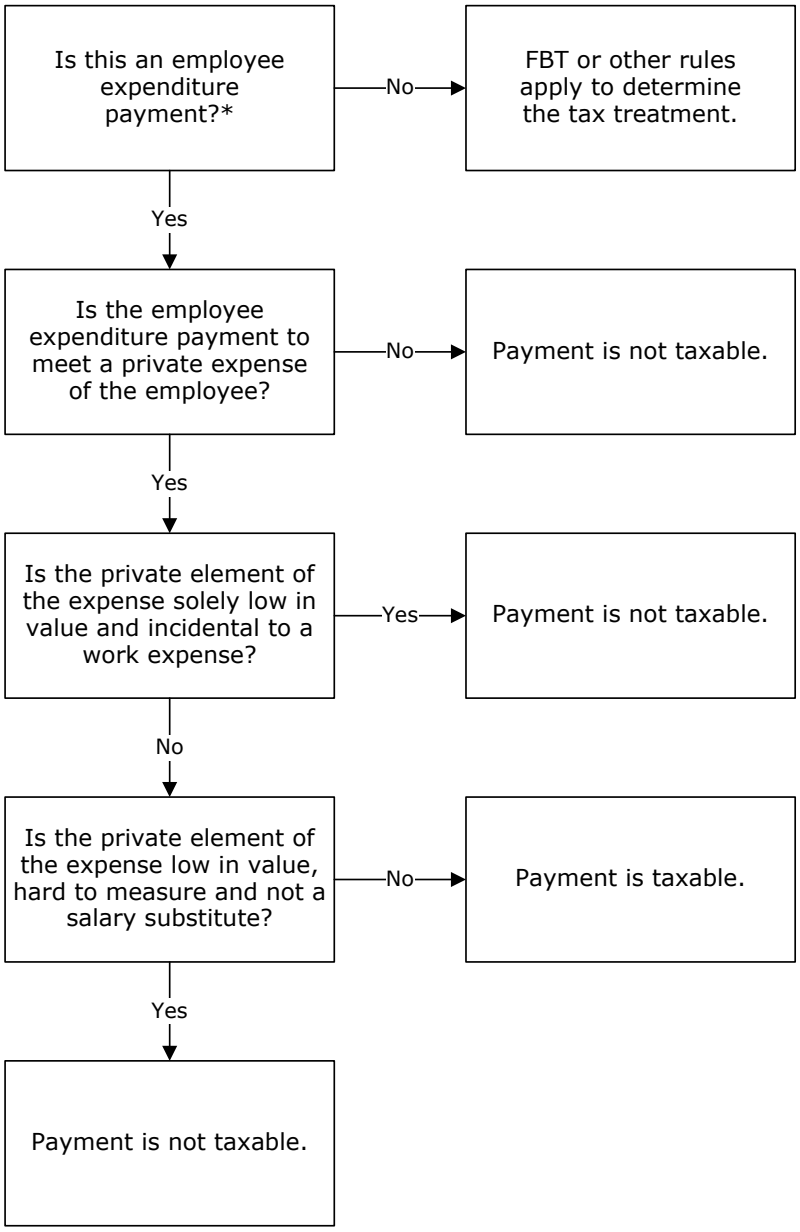
  Rules should be easy to understand and apply – Certainty and simplicity are desirable because employee expenditure payments are mostly dealt with by human resource and payroll staff in larger companies and the wages clerk in smaller companies, who may have little tax expertise. Employers are also reluctant to make judgements about, or delve into, their employees' personal affairs in determining whether a particular payment is taxable.

  However, there is a trade-off between providing certainty (with, for example, an objective "bright line" test to determine what is taxable and what is not), against fairness and flexibility with a more subjective test (for example, by reference to what is reasonable).

- **The impact of any changes to the current rules on employer/ employee agreements and the time needed to adapt these** – Many payments are the subject of historical employment agreements negotiated between employers, employees and their trade unions. These agreements may take time to change and, therefore, transitional issues might need to be considered in implementing any changes that arise as an outcome of this review.

- **The outcome of the review should be revenue-neutral** –While the outcome of the review is not intended to raise revenue, it must be recognised that there is limited scope for relaxing the current legislation.

Policy principles for reviewing employee expenditure payments



Note:

The terms used in this flowchart are generic and are not based on current legislation or case law definitions.

The flowchart reflects the general policy principles, which should apply so that an employee expenditure payment should not be taxed in the hands of the employee, provided any private expense is low in value and incidental to any work expense or hard to measure and not a salary substitute.

These principles are likely to be relevant to all types of employee expenditure payment, although initially focused on the main types identified in this paper.

*"Employee expenditure payment" covers all payments, whether related to the employee's job or more broadly to the employer's business, and includes allowances to cover future estimated expenditure, actual reimbursement and expenditure on account of an employee payments.

CHAPTER 3

Meal payments

Meal payments – suggested approach

- We suggest that employee expenditure payments to meet an employee's meal expenses during work travel away from the employee's normal workplace should be exempt from tax, subject to a three-month upper time limit at a particular work location.
- Employee expenditure payments to meet the cost of an employee's working lunches and other working meals/ refreshments outside of work travel should not be taxed, provided any payment is not made regularly as an additional payment for the employee's services.

3.1 Our general proposition is that when an employer makes a payment to meet an employee expense, the payment should not be taxable to the employee unless it is also to meet the employee's private expense. Then, the private element of the employee expenditure payment should be taxed.

3.2 However, difficulties can arise in determining whether a particular payment is to meet a private expense. This chapter considers this issue, with particular reference to payments for meal expenses and how the boundary should be drawn between work expenses and private expenses.

The general approach

3.3 Businesses usually seek to maximise profits and minimise costs. They do not usually make a payment to or for the benefit of an employee that is not for a business purpose. Similar issues arise, whatever the employer's business, and when public or not-for-profit sector employers make such payments they will also be conscious of the need to minimise costs. Therefore, when an employer incurs an expense it is likely to be a work expense.

3.4 When an employer makes a payment that is a work expense in its hands, to or for the benefit of an employee, it does not determine the nature of the payment in the employee's hands. For example, a non-cash benefit will almost always be deductible by the employer as a work expense, but may be of private benefit to the employee (and subject to FBT). Salary and wages can likewise be characterised as a private benefit. The New Zealand courts have stressed that whether a receipt is income depends on its quality in the hands of the recipient (for example, *Reid v CIR* which concerned the tax treatment of a student teacher allowance).[8]

[8] *Reid v CIR* (1985) 7 NZTC 5,176.

3.5 We therefore need to consider the nature of the underlying expense from the employee's perspective to determine whether it (or any part of it) is a private expense of the employee and, if so, then determine the tax treatment of the employee expenditure payment.

3.6 What do we mean by a private expense? There is no statutory definition to draw on, but the courts have considered the meaning of "private or domestic expenditure". In *CIR v Haenga*[9] (which considered whether payments to a welfare fund were of a private or domestic nature) , Richardson J in the Court of Appeal commented:

> "An outgoing is of a private nature if it is exclusively referable to living as an individual member of society and domestic expenses are those relating to the household or family unit …"

3.7 The case, therefore, tells us that a private outgoing relates to an individual living as a member of society – for example, food and drink. A domestic expense is one that relates to the household or family unit – for example, a home telephone. Private and domestic expenses are intended, at least in part, to further some personal purpose.

3.8 In principle, the general approach should be that an employee expenditure payment that is for a private (or domestic) expense of the employee should be taxed.

Exceptions to the general approach

3.9 The next question to consider is in what circumstances we might move away from a full taxation approach. In doing so, we would tend to discount more fact-based considerations, such as the degree of nexus with employment and focus instead, in the interests of simplicity and certainty, on more practical considerations.

3.10 In the next part of this chapter, we consider a number of scenarios involving a payment being made to meet the cost of a meal and the question of how the payment should be taxed. Matters we have taken into account in considering the question are:

- whether any private element is low in value and incidental to the work expense, or low in value and hard to measure;
- whether not taxing the payment would encourage salary substitution; and
- whether not taxing the payment is consistent with the approach taken under the FBT rules when the goods or services are provided directly by the employer.

[9] *C of IR v Haenga* (1985) 7 NZTC 5,198.

Employee meals in general

3.11 The New Zealand courts have not given much further general guidance than Richardson J's comments in Haenga on the meaning of "private expenditure", but have considered particular types of expenditure, including food and drink. In *Case E80*,[10] which considered the nature of out of town meal expenses for a removal van driver, Barber J found that the expenditure did not have the necessary relationship with the earning of the taxpayer's income:

> "In my view there is no necessary relationship between the expenditure by O on meals and the earning of O's income. The meals were purchased by O in order to live and not to perform O's job. The expenditure was not incidental and relevant to the earning of income but was incidental and relevant to O's physical sustenance."

3.12 Barber J did acknowledge that, when the requirements of the taxpayer's job mean that extra cost is incurred on meals and there is clear evidence of that, then there may be a sufficient nexus between the expense and earning the income from the employment. An example would be when the employee is required by his or her job to work out of town and, therefore, has to spend more on their meals than usual.

3.13 Nevertheless, food and drink are more commonly private expenditure since any meals purchased are to provide the employee with personal sustenance in order to live. They are not generally part of performing an employee's job. Whether an employer pays an employee wages so they can buy food and drink or some form of meal payment, the outcome is the same and, at least in principle, the meal payment should be taxable.

3.14 It is certainly arguable that when an employee incurs extra meal costs during a work journey, then that additional cost is not private expenditure. However, the amount saved on the employee's normal day-to-day expenditure remains private expenditure. The question is whether this argument can be reflected adequately in the options proposed in this chapter, given that, for many employers, it will not be practically possible to comply with or administer a test that requires an apportionment to be made. Identifying the private part of the expenditure would require consideration on an employee-by-employee basis of their meal consumption which could change from day to day.

3.15 There is a range of circumstances in which an employee might be provided with some form of meal payment by their employer. The most common appear to relate to:

- work travel – when an employee has extra meal costs because they have had to work away from their normal place of work over a meal period;

[10] *Case E80* (1982) 5 NZTC 59,421.

- non-work travel related:
  - working lunches (and other working meals) – when the needs of the job mean an employee has to work through a meal period;
  - conference meals – when an employee attends a work-related conference that extends through a meal period;
  - light refreshments, such as tea and coffee – when employees work away from their employers' premises and cannot use tea and coffee ordinarily provided to on-premises based staff.

Employee meals during work travel

3.16 Commonly, employers make payments to meet employee meal costs when their employees are travelling away from their normal place of work on work-related duties through a meal period. This may be for a specific journey of short duration, or for a longer period such as a secondment.

3.17 Employers recognise that their employees may have to spend more on their food and drink than they usually would when travelling away from home for work. Therefore, they will normally meet their employees' meal expenses in such circumstances, to a varying extent. This recognises the fact that employees may be reluctant to travel if it means they are likely to be out of pocket for work-related costs. However, employers will also want to control costs on what can be a substantial work expense. For example, some employers may limit meal reimbursement payments to work journeys when an overnight stay is required, and make or set a daily payment, or an amount based on a monetary limit – either with a fixed upper limit or by reference to what is a "reasonable" amount.

3.18 Employers meet their employee meal expenses in different ways, depending on their internal procedures and sensitivity to administrative costs. This might be by settling the bill directly (for example, through the employee using a company credit card), by reimbursing actual expenses (for example, on receipt of a claim by the employee), or by paying an allowance (for example, based on an estimate of restaurant costs for a particular location).

Low in value, incidental to earning employment income and hard to value

3.19 Any comparison between meal costs when travelling on a work journey and normal day-to-day meal costs is likely to be between the cost of dining out and self-catering (at least for short-term business journeys rather than longer term secondments). An employee usually stays in a hotel, or similar accommodation, without self-catering facilities and therefore has to buy catered food. In these circumstances, the amounts saved by the employee are likely to be variable and very difficult to measure. When short-term work travel is concerned, the private element of any meal costs is also incidental to the need to travel.

3.20 When an employee undertakes a longer journey or secondment, this is likely to change after a period of time. An employer is likely to be reluctant to fund restaurant meals on a long-term basis and the employee will often move to self-catering accommodation. At that point the meal costs are not likely to be significantly greater than the normal day-to-day costs at home and the case for allowing tax-free treatment becomes more questionable.

Salary substitution

3.21 Reimbursing an employee's meal costs is unlikely to lead to significant salary substitution when the employee is travelling on a short-term work journey because the cost of meals is generally ancillary to the cost of the travel. Employees would normally expect to have their expenses reimbursed on top of salary and not see it substituted. However, there could be salary substitution risks if allowances are paid and the employee does not have to account for matching expenses.

Match with FBT

3.22 When the employer provides a meal while the employee is travelling (for example by booking and paying for the meal, along with other expenses, centrally), then the meal is exempt from FBT to the extent that an allowance to meet the cost would be exempt.[11] The FBT rules, therefore, follow the approach used with allowances.

3.23 Meals provided off the employer's premises are normally treated as entertainment expenditure and the employer's tax deduction is limited to 50 percent of the expenditure as a proxy tax impost with no tax charge for the employee. Meals consumed in the course of business travel are normally excluded from this treatment.

Options

3.24 We have identified a number of options for determining the tax treatment of meals during work travel.[12] In arriving at these, we have already concluded that the practical difficulties in apportioning expenditure on meals between normal and additional meal costs while travelling for work reasons mean that apportionment is not a realistic option.

3.25 The options we have identified are:

- **Exempt from tax payments to meet meal costs** – Employers and employees would not need to apportion any payments once they establish that meal expenses have been incurred on a work journey to a location other than the employee's normal work location. The advantage for employers is obvious, particularly since our understanding is that, in practice, employers do not apportion expenditure. However, a disadvantage is that the option may not adequately address the possible incentive to make tax-free payments when an employee is sent to work at a particular location for a longer period of time, when their meal costs are likely to reduce and become more in line with their normal day-to-day expenditure.

[11] Sections CX 5 and CX 19.
[12] Work travel does not include commuting between the employee's home and normal place of work.

- **Exempt from tax payments to meet meal costs, but limit to overnight journeys** – This would assume that when a work journey does not involve an overnight stay the employee does not incur significant additional meal costs. This is an approach Australia follows.[13] However, this approach would not recognise that some employees may incur additional costs even when an overnight stay is not required.

- **Set an upper time limit for making tax-free meal payments** – This is a variant on the first option and recognises that when an employee is away from their normal work location for a limited period of time they are likely to have to incur significantly higher meal costs. However, after a reasonable period of time in a particular location, they and their employers are likely to make arrangements to reduce the additional meal costs – for example, by the employee moving into self-catering accommodation. After an appropriate period, therefore, any employee expenditure payments should become taxable.

  This option has the advantages of the first option in resolving the apportionment issue but also seeks to recognise the potential reward element of reimbursing meal costs for longer trips to a particular location. However, an upper time limit would have to be a one size fits all approach. Any limit would act as a cliff edge, which inevitably means that some employees will find themselves on the wrong side of it.

- **Exempt from tax a fixed portion of any payment to meet meal costs** – Under this option, whatever amount is reimbursed or paid by the employer, a fixed proportion would remain taxable. This would recognise that the employee is receiving a tangible benefit when their employer pays for their meals but overcomes the practical difficulties in identifying the amount saved by making a round sum adjustment. Such an approach is adopted by the United States of America and Canada which only give a tax deduction to the employee for 50 percent of expenditure on meals when travelling overnight on a business journey. However, it is a fairly arbitrary adjustment that has no regard to particular circumstances and would over- or under-tax in many instances.

- **Set a maximum amount that can, with certainty, be paid tax-free** – This would provide a threshold below which the employer could reimburse the full amount tax-free. The benefit of this approach would depend on the amount it is set at. If set too low, it would be of little value to an employer who would still have to make an adjustment. If set too high, it could provide an incentive for salary substitution. Either way, there may be a need for criteria to be set by Inland Revenue to allow the exemption to continue if the cap is exceeded – for example, if the meal expense is incurred in a particularly expensive part of the world. There may be some value to employers in this approach, however, if the capped amount could be used more broadly as a daily amount that employers could pay without having to check employee records in detail (similar to the approach in the United Kingdom).

[13] See Appendix C for summary of approach in other countries.

Preferred option

3.26 On balance, our preference is to fully exempt the payment, subject to an upper time limit for this treatment at any given temporary work location. This would mean that an employer would not have to worry about identifying the notional private/work split of any meal payment – it would either be not taxable at all, or taxable in full.

3.27 Setting an upper time limit for tax-free treatment would recognise the significant additional meal expenses normally incurred during work travel. However, it would also recognise that a meal payment is inherently private and that after an appropriate period of time the additional costs are likely to reduce and any meal payment will be more in line with an employee's normal day-to-day spending on meals.

3.28 Setting an upper time limit would provide a clear boundary that should be easy to understand and apply. It would provide employers with certainty and resolve many of the problems around identifying when a work location should be treated as temporary for the purposes of making a meal payment. It would also leave it to employers to determine what amount they consider is appropriate to pay their employees by way of a meal allowance in different circumstances.

3.29 A time limit does provide a cliff edge though and where that limit is set would be important. Data about the length of business trips is not available. However, it is likely that most visits by an employee to a particular location (other than their normal work location) are for a relatively short period of time, usually days or weeks rather than months. As already noted, when meal payments are concerned, we would anticipate that when a trip runs into months, employers and employees will make arrangements to reduce spending on meals.

3.30 On this basis, an upper time limit of three months before a meal payment becomes taxable in full, would set an appropriate margin. However, we are interested in feedback on the pattern and duration of work trips to particular locations and what employers do in practice.

Employee meals in other circumstances – working lunches and other working meals/ refreshments outside of work travel

3.31 An employee may have to work through lunch or some other meal time because of the needs of the job. For example, it may be more effective to carry on a meeting without breaking for lunch, or to conduct business at a lunch-time meeting or hold an early morning meeting over breakfast. Often, any food and drink will be provided or paid for directly by the employer – for example, by arranging and paying for the catering directly. However, there will be occasions when the employee has to pay for and claim reimbursement for any costs – an allowance in this situation would be less likely. It may also be unclear how much of the cost relates to the employee and how much to guests.

3.32 One variation is when the employee attends a work conference. Normally an employer will fund and pay for conference costs (including meals) directly. However, there may be occasions when the employee pays for meals and claims reimbursement for the costs from their employer.

3.33 Finally, some employers pay modest tea and coffee allowances to members of staff who routinely work out in the field away from their employer's premises and cannot use the refreshments the employer provides on the premises.

Low in value, incidental to earning employment income and hard to value

3.34 The cost of a working lunch or conference meal is usually reimbursed by the employer only when there is a particular work need. Working meals are not generally provided as a reward so the effective value to the employee is the saving they make over their normal day to day expenditure. This private element is likely to be low in value, incidental to earning the employee's income and difficult to measure.

3.35 Tea and coffee payments related to the employee's inability to obtain tea and coffee on the employer's premises because they are working off site, are likely to be modest.

Salary substitution

3.36 Working meals (outside of work travel) are likely to be intermittent, relatively modest and only provided when there is a work need. With these assumptions in mind, exempting payments to meet the cost of working lunches seems unlikely to encourage a material behavioural response towards salary substitution.

3.37 However, it might be necessary to prevent regular meal payments that are effectively rewards from being treated as non-taxable. For example, tea and coffee payments might need to be broadly linked to the value of tax-free refreshments the employer provides at the workplace and provided because the employee cannot access on-premises refreshments.

Match with FBT and entertainment regime

3.38 A further matter to consider is whether exempting an employee expenditure payment on food and drink is consistent with other taxing provisions. Working lunches provided by an employer on their premises are already exempted from being treated as fringe benefits although entertainment tax may apply in some instances to limit the employer's deduction to 50 percent of the expenditure. In certain circumstances, when food and drink is provided away from the employer's premises the entertainment expenditure rules also remove any potential FBT charge but limit the employer's tax deduction to 50 percent of the expenditure. Working lunches are currently being taxed through the entertainment limitation.

3.39 Exempting modest off-site tea and coffee payments when provided because the employee cannot access on-premises refreshments would align with the FBT exemption that applies when light refreshments are provided to an employee on the employer's premises.

Options

3.40 The following two options have been considered:

- **Exempt from tax any payments to meet working meal/ light refreshment costs, subject to an upper monetary limit** – A key advantage of this approach is that it provides a clear and easily understood boundary that would provide an exemption for reasonable amounts. However, one disadvantage of this approach is that it would introduce a cliff edge which could result in employers having an incentive to pay up to the boundary, but no more. This would require maintenance to keep it up-to-date. There might also be problems in allocating expenditure to particular employees and for employers ensuring spending fits the cap. It would also introduce an inconsistency with the FBT and entertainment rules.

  One variation on this option would be to define the upper limit in terms of "reasonable" expenditure on meals. However, while it could provide a more flexible boundary it would introduce a new subjective test and further uncertainty around what is meant by "reasonable".

- **Exempt from tax any payments to meet working meal/ light refreshment costs** – This approach would exempt employee expenditure payments to meet the cost of working meals or light refreshments, but not provide particular limits.

  This approach leaves judgements about when and how much to fund working lunches to employers who would not have to worry unduly about tax consequences. It would not be inconsistent with the FBT rules which provide that food and drink provided off the employer's premises is not taxed as a fringe benefit when subject to the 50 percent deduction limitation under the entertainment expenditure tax rules.

  The disadvantage of this approach is the small risk that working meals and refreshments could become a vehicle for salary substitution or simply a means to provide an additional tax-free reward. The circumstances in which the exemption would apply would need to be clarified and require, for example, that it is not provided to a particular employee on a frequent basis or as a reward for services.

Preferred option

3.41 Overall, when a meal payment is provided in work circumstances and is not intended to reward its employees, our preference is to exempt the payment. When the meal is provided as part of entertainment, any payment will already be taxed through the employer's business under the entertainment rules by restricting the employer's tax deduction.

3.42 The rule would have to be carefully crafted to make it clear that this does not extend to circumstances when the payment is made on a regular basis for the employee providing his or her services. Additionally, when light refreshments are concerned, any payment might have to be linked to what the employer provides to its staff, tax-free, on its premises more generally, limited to relatively modest amounts and only to situations when the employee has to work regularly on site away from the employer's premises.

CHAPTER 4

Accommodation payments

- We suggest that employee expenditure payments to meet an employee's accommodation expenses during work travel away from the employee's normal workplace should be exempt from tax, subject to a 12-month upper time limit at a particular work location, with a power for the Commissioner to extend that time limit in certain exceptional circumstances.
- When an employee is provided with accommodation by their employer at or near their normal workplace, the value of the accommodation should be taxable to the employee based on the market rental value of the property, after taking into account any employee contribution to the cost of the accommodation.
- When an employee has more than one permanent workplace for the same job, one option is not to tax employee expenditure payments to cover accommodation costs at one workplace.
- A valuation method other than market rental value may be needed to establish the taxable amount when the accommodation is in an overseas location – for example, a valuation by reference to comparable New Zealand accommodation.

4.1 Once the private element of an employee expenditure payment is identified, a key issue is to determine the value which should be taxed.

4.2 Identifying the taxable value will often be straightforward. For example, when the entire expense the payment meets is private, the whole of the employee expenditure payment should be taxed. However, problems arise around identifying the taxable value when the payment is not wholly to meet a private expense and there is also a work element.

4.3 This chapter considers issues around how the private element of accommodation payments or payments to meet housing costs should be valued. It includes payments to meet the employee's accommodation costs, both at their normal place of work and when on a work journey. It also looks at issues that arise when, rather than making an accommodation payment, the employer provides the accommodation to the employee directly.

Policy issues in considering accommodation payments

4.4 Accommodation is a fundamental human and personal need and will normally be "private or domestic expenditure" as defined in *CIR v Haenga*.[14] Employees need accommodation of some form to provide them with the necessary shelter and facilities for eating, washing and sleeping as part of their normal day-to-day living. Expenditure on employee accommodation is not usually incurred in the income-earning process. Instead, it merely puts an employee in the position to be earning income. See, for example, *Case G57*[15] when the court held that the lodging costs of a mussel farmer were not deductible because they were to put him in a position to tend his mussel farm for the production of income and were not incurred in gaining or producing the income from the farm.[16]

4.5 Consequently, when an accommodation payment is provided to meet an employee's accommodation costs, it could be expected that the full amount of the payment would be taxed. Alternatively, if the employer provides the accommodation, the starting point ought to be that the accommodation benefit is taxed when the employee does not pay full value for using it. The taxable amount can generally be considered to be the market value of the accommodation less any contribution from the employee. Market value is usually regarded as equal to the market rental value of the property.

4.6 If the accommodation payment is simply paid as part of an employee's remuneration package, the taxable amount should be the full amount of the payment. There is little difference between salary which can be used by an employee to pay his or her rent or mortgage and a cash payment to do the same. Therefore, no adjustment should generally be made to the gross amount of the payment. Similar considerations apply if the accommodation is provided by an employer.

4.7 The following paragraphs consider how the taxable amount might vary in different circumstances and what adjustments might need to be made – both when provided by way of an accommodation payment to meet an employee's costs, or by an employer providing the accommodation.

4.8 Consistent with the approach adopted in relation to meal payments, our suggestions about the amount to be taxed take into account the following considerations:

- any variation in treatment, including to help identify the overall private element, should be easy to measure; and
- not taxing the full payment should not encourage salary substitution.

[14] *C of IR v Haenga* (1985) 7 NZTC 5,199, see paragraph 3.6 of Chapter 3.
[15] *Case G57* (1985) 7 NZTC 1,251.
[16] Although this case concerned whether an employee could claim a tax deduction, something an employee can no longer do, the principles are still relevant to considerations of the tax treatment of employee expenditure payments linked to accommodation costs.

4.9 We have identified a number of situations when it seems appropriate to tax less than the full value. These are:

- **Accommodation during temporary work travel** – When the employee is temporarily working away from his or her normal place of work. An example of this is when an employee who lives and works in Wellington is required to stay overnight in Auckland in the course of his or her job. A further example is when an employee who lives and works in Auckland is required to work in Christchurch for a month and is reimbursed the cost of his or her motel room.
- **Accommodation provided because of the needs of the job** – When the needs of the job mean an employee is required to live in a particular property in order to carry out his or her work duties. An example of this is an on-site caretaker or school hostel warden required to live in a particular property because he or she is on call out of working hours and needs to respond immediately.
- **Other circumstances** – There are also a limited number of other circumstances that do not fit easily within any general rule and which may warrant separate consideration. Examples include employees with more than one permanent workplace for the same job and employees working in countries outside New Zealand.

Accommodation during temporary work travel

4.10 "Temporary" means that something is only expected to last for a limited period of time. So, temporary work travel concerns travel an employee undertakes because of the needs of the job that is only expected to last for a limited time, usually for a relatively short period. When an overnight stay is required, the travel costs include the cost of the employee's accommodation.

4.11 A payment to meet accommodation costs incurred when an employee is required to stay in temporary accommodation because of work requirements may be for an overnight stay on a work trip away from the employee's normal workplace. Alternatively it could be for a more substantial temporary secondment to a workplace in another city. The costs will usually be additional to the employee's normal day-to-day accommodation costs, assuming the employee is staying temporarily away from the place where he or she lives.

Salary substitution

4.12 Meeting an employee's accommodation costs is unlikely to lead to salary substitution when the employee is travelling temporarily on a work journey, as long as the payment is closely linked to the amount of the expense. Even if the employee has not retained a property at the normal place of work, there is unlikely to be salary substitution.

4.13 However, there may be salary substitution when an employee can be paid a tax-free employee expenditure payment rather than salary or wages. A recent illustration of the risks in this area can be seen with the Australian "Living Away From Home allowance" (LAFHA)[17] tax rules which the Australian Treasury reports have been used by employees to substitute large tax-free allowances in excess of actual expenditure on accommodation and food for taxable salary.

4.14 The LAFHA rules have been changed to address this by making the qualifying criteria more stringent and by setting an upper time limit for paying the allowance at a particular workplace.[18]

Options

4.15 We have identified several options for establishing the taxable value of accommodation payments when an employee has to travel temporarily away from his or her normal place of work requiring an overnight stay.

4.16 Making a specific adjustment for costs incurred by an employee when they retain a property elsewhere is not a practical option. This approach would present uncertainty and very significant administrative and compliance issues for employers, employees and Inland Revenue. Employers would have to make an on-going assessment of an employee's personal circumstances, because these might change, and make subjective judgements about personal benefit and intentions. Employees would have to be prepared to subject their personal circumstances to scrutiny on an on-going basis in order to justify the tax-free treatment of business travel expenses. Inland Revenue would also have to administer and apply the law taking into account the individual circumstances of employees and make judgements which could appear to be arbitrary or inconsistent.

4.17 This approach would also present significant fairness or equity issues within the tax system. Employees working side by side who are incurring similar business travel expenses could find themselves with different tax outcomes depending on their personal circumstances and how those are assessed in determining the taxable element of any accommodation payments. Ultimately, there is a private benefit involved and the longer the payment continues the less tenable the argument that the retention of the other property is an extra cost created by the secondment and the more it is likely to be a personal choice of the employee.

[17] LAFHA is an allowance paid by an employer to an employee to compensate for additional expenses incurred and any disadvantages suffered because the employee is required to live away from their usual place of residence in order to perform their employment duties. The part of LAFHA that is taxed is usually minimal as the taxable element is reduced by any reasonable amounts paid in compensation for accommodation and increased expenditure on food.

[18] www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/Fringe-Benefits-Tax-FBT-Reform-living-away-from-home-benefits

4.18 With these factors in mind, the options we are considering are:

- **Exempt an accommodation payment made when working temporarily away from the employee's normal workplace** – This option recognises that in the majority of cases, temporary accommodation costs are work expenses that are wholly additional to the employee's normal day-to-day household costs. Full exemption would remove valuation issues, such as determining what might constitute "additional costs".

  However, because this option does not set an upper time limit for making a tax-free payment, it presents a significant fiscal risk in allowing an allowance payment to be substituted for salary, especially if it becomes common to treat relocations as temporary in the first instance. In the longer term, an employee is likely to want to "normalise" their lifestyle in the new location and reduce their accommodation costs. Under this option, an employee who has been permanently relocated could receive an unlimited tax-free payment that would not take account of this and the very real private benefit he or she would enjoy.

- **Exempt an accommodation payment made when working temporarily away from the employee's normal workplace, but subject to an upper time limit** – Another option would be to cap the exemption by reference to an upper time limit. This would have the advantage of removing any requirement to compare accommodation costs in the temporary and normal workplaces yet ensure the exemption covers only temporary changes in workplace. This is the approach adopted by the United States of America when the employee is working away from their "tax home", in Australia when an employee is paid a LAFHA (both with a 12-month time limit) and the United Kingdom when an employee has to work at a "temporary workplace" (with a 24-month time limit).

  In the case of meals, employees may adjust their spending at the new workplace relatively quickly to minimise their additional expenses. However, it will take longer for them to regularise their accommodation costs, which may continue to be additional to their day-to-day expenses at their normal workplace. It would, therefore, be appropriate to set an upper limit for accommodation payments that is longer than for a meal payment. There is a three-month time limit for tax exempt accommodation payments provided for under the relocation exemption.[19] However, if the employee is not permanently relocating, a 12-month period would appear reasonable. As already noted, this is the time limit adopted by the United States of America and Australia for similar payments.

  One drawback with this approach is that a time limit creates a "cliff edge". Under the option, any time limit would also have to be linked to an intention that the employee is temporarily away from their normal workplace. Without this test, all employees could receive a tax free accommodation payment within the upper time limit, whatever the circumstances.

[19] Section CW 17B.

- **Exempt an accommodation payment made when working temporarily away from the employee's normal workplace, subject to an upper time limit and a power to extend the limit in certain circumstances** – A variation on the previous option would be to give the Commissioner powers to increase the tax-exempt time period in prescribed circumstances – for example, when the employee is required to continue working at the temporary workplace for a longer period due to exceptional circumstances.

  This would provide employers and employees with a safe harbour while allowing additional flexibility in limited circumstances when the temporary accommodation costs continue to be additional to normal day-to-day expenditure. The Commissioner's discretion would need to be restricted to well-defined and limited circumstances.

  Further consideration would need to be given to these circumstances, but initial thoughts are that they might encompass extraordinary events outside the control of the employer and employee that arise after the employee has started working at the new work location. These might include circumstances when a contract originally scheduled to finish within the upper time limit overruns because of changes made by the customer or an unforeseen event for example, a fire or natural disaster, that requires the employee to continue working at a particular work location beyond the upper time limit.

Preferred option

4.19 On balance, our preferred option is to exempt from tax any accommodation payments when an employee has to work temporarily away from their normal workplace overnight, subject to an upper time limit of 12 months, with a Commissioner power to extend that limit in exceptional circumstances. This would satisfy the criteria that the taxable amount should be easy to measure and be unlikely to lead to salary substitution. Any changes to the tax treatment would also apply to situations when the employer provides the accommodation, rather than makes an accommodation payment, to ensure consistency of treatment.

Accommodation provided because of the needs of the job

4.20 A further scenario involving an accommodation payment or provision of accommodation by the employer is when an employee is required to live in a particular property because of the needs of the job. This is not just because it might be more convenient for the employee to live in that location, but because the job cannot be performed effectively without the employee living in the particular property. Very few employees will be in this position.

4.21 When the employer makes an accommodation payment to meet an employee's accommodation costs, it is unlikely that the needs of the job mean the employee has to occupy a particular property. The fact that the employee has arranged their own accommodation means that they are likely to have had a choice about where they can live. However, rather than paying an allowance, the employer may provide the employee with accommodation – either a property the employer owns, or one that it rents for the employee to use. The following discussions are, therefore, more relevant to that scenario.

4.22 Modern communications mean there are likely to be very few jobs that require an employee to occupy a particular property even if an employer chooses to provide one. When on call, most employees can use cell phones to cover out-of-hours duties and a car means they can travel where they are needed relatively quickly. However, there are a small number of occupations when the needs of the job mean an employee must live in a particular property. For example, a farm worker who has to live on the farm in case livestock need attending to at night.

4.23 There will also be other occupations when the employer will expect the employee to occupy a particular house so they are better able to undertake their duties. For example, a rural police officer who is required to live adjacent to the police station, or a diplomat who occupies a particular property in an overseas location in order to undertake official functions.

4.24 In these circumstances the employee might be occupying accommodation they would not otherwise choose to live in. This might be a particular location or particular property. The property might be in a more expensive suburb (issues around accommodation provided when working overseas are considered separately later in this chapter) or to meet work needs might require much larger or more lavish accommodation than the employee would normally live in.

4.25 In most cases, using market value should not cause a problem because this should broadly reflect the value of the private benefit to the employee. However, some large tax charges can potentially arise. There can also be an impact on the employee's entitlement to social assistance, such as Working for Families, and their liability for child support, or student loan repayments.

Options

4.26 While there may be some significant drawbacks to "living on the job", an employee for whom the premises are their permanent residence will still obtain a substantial private benefit even if there is a work need for him or her to live in the property. With this in mind, we have ruled out introducing a full exemption in these circumstances.

4.27 Instead, we have identified the following options:

- **Tax the full value of any accommodation payment or employer provided accommodation, adjusted for a range of factors** – This option would mean the taxable value of any accommodation payment made by the employer to meet the accommodation costs or market value of the employer-provided property would be adjusted down depending on a range of factors. These factors might be linked to the property, such as location and state of repair, or factors linked to the job, such as the inconvenience the employee suffers from having to live in employer-provided accommodation.

  If market value is based on the market rental value of the property, then this is likely to adjust automatically for factors linked to the property. For example, a property in a remote area is likely to have a significantly lower value than a similar property in a city suburb. Similarly, a property located in a particular work location may also affect the rental value. The quality of the property is also likely to be reflected in the market value.

There are also valuation factors linked to the employee and his or her job. These might reflect the obligation on the employee to live in a particular property he or she might not otherwise want to live in or a requirement to live close to the job. These factors are unlikely to be reflected in the value of the property because they can vary between individuals, depending on their perceptions and personal circumstances. However, when taking up employment with provided accommodation, an employee will often take this into account in his or her decision to take the job. An employer will often factor this in when setting the overall remuneration package.

One of the policy criteria is that the overall private benefit to the employee is recognised. Assuming market rental value reflects the value of the particular property and the wider remuneration package reflects any disadvantages particular to the employee, arguably, no further adjustment should be made to the market value of the property or to the taxable amount of any accommodation payment.

- **Cap the taxable element of any accommodation payment or provided accommodation at a benchmark value** – This option would link the taxable amount to standard values: for example, the market rent for a typical house or flat in a particular reference location. If the rent in the work location is greater than in the reference location, the taxable value would be capped at the reference amount.

  An advantage of this approach is that it avoids large tax charges arising when an employee is obliged to live in particularly expensive locations where they would not otherwise live, but for the needs of the job.

  However, this option would require reference properties to be identified, which would be problematic. This would have to be a fairly broad brush approach that would not recognise differences between particular properties, other than at a high level (for example, number of bedrooms). A further disadvantage is that it would mean the full private value might not be recognised which could provide an incentive for salary substitution at the margin.

- **Cap the taxable element of any accommodation payment or provided accommodation at a proportion of salary** – The taxable amount could be capped at a proportion of the employee's salary or wages. Consideration would need to be given to what that proportion might be. However, it could, for example, be linked to the average ratio of rental values to income, which might be around 25 percent of gross income.

  An advantage of this approach is that it avoids large tax charges arising when the employee has to live in a property with a value out of all proportion to the costs they would normally otherwise incur and which distorts the value of their remuneration package. It would ensure that any tax charges outside the control of the employee remain affordable and do not distort their income for Working for Families, and other social assistance and liability purposes. It would also ensure that in most cases the private benefit element continues to be recognised.

  When the employee has a variable reward structure (for example, because they are rewarded in part through overtime or performance pay) it might mean there would have to be an end-of-year adjustment to the taxable amount if a cap has operated during the year.

Preferred option

4.28 Our preferred option for job accommodation is to continue to base the taxable amount on the full market value of the property or accommodation payment. If linked to market rental value for a particular property this would broadly ensure that the private benefit to the employee, which forms part of his or her overall remuneration package, is properly recognised, without introducing new complicated calculations and exemptions which would be hard to apply or create inequitable or inconsistent outcomes.

4.29 Any circumstances particular to the property – for example, remote location or poor quality of the housing stock would be recognised in this approach. Additionally, particular features of the property – for example, when it is located within the employer's premises – might also be reflected in the market value.

Other circumstances

4.30 This part of the chapter considers the appropriate tax treatment of accommodation payments and employer provided accommodation in certain other circumstances.

Home workers

4.31 In addition to the limited number of employees who must live in a particular property because of the needs of the job, more commonly, employees may work from home either from personal choice or because their employer wants them to do so. For example, an office-based employee may choose to work from home to avoid a long daily commute, or an employer may prefer to reimburse an employee's home office costs rather than pay for additional commercial office space.

4.32 As a matter of principle, if someone uses part of their home in their work, it is appropriate to adjust the taxable value of any employee expenditure payment to reflect any additional work costs. The extent of that adjustment should reflect the particular circumstances. When a separately identifiable part of the home is used wholly for work purposes, it may be appropriate to base the apportionment on the area used. When there is mixed use, some other basis for apportionment may be appropriate. For example, by treating an accommodation employee expenditure payment as tax-free to the extent that it meets additional heat and lighting costs.

4.33 Generally, our consultations to date suggest that this approach does not raise significant issues. Apportionment issues are considered more generally in the next chapter.

More than one permanent workplace

4.34 Work requirements may mean the employee has more than one permanent regular workplace for the same employer. For example, when an employee is required to work permanently in Auckland for two days a week and in New Plymouth for three days a week with substantive duties in each city requiring overnight accommodation in both locations. This is distinct from the situation of an employee with a permanent workplace some distance from their home who chooses not to relocate

but is able to work locally from personal preference or an employee with two separate jobs.

4.35 In the ordinary course of events any accommodation payment made to meet accommodation costs in either location would be taxable, even if rules were introduced to exempt accommodation at temporary workplaces – neither workplace is temporary and any upper time limit would be exceeded. However, in certain circumstances, it might be appropriate not to tax the accommodation costs in one location, recognising that the employee has to incur additional costs because of the requirements of the job to work in more than one location.

4.36 Under this scenario, it could be a requirement of the job that the employee had to work for a reasonable period of time each working week at the alternative work location and not just a matter of personal preference for the employee. For example, an employee may be responsible for day-to-day management of factories in two geographically separate locations.

4.37 If we were to consider this further, there would need to be a mechanism for identifying the non-taxable work location. We have identified the following options:

- **Employee nomination** – Under this approach an employee who satisfies multiple permanent workplace criteria would nominate a particular workplace as their main workplace. An accommodation payment made in relation to accommodation at the other workplace could then be paid tax-free. The advantage of this approach is that once any qualifying criteria had been satisfied, no further judgements would need to be made and the employee would make a nomination to the employer.
- **Main place of work** – This approach would require a factual assessment to be made about which workplace is the principal place of work – for example, the workplace where the employee works for most of his or her time. That would be treated as the main workplace for tax purposes and an accommodation payment made to meet costs at the other workplace could be made tax-free. This would require a subjective judgement to be made which might change as circumstances change.
- **Quality of accommodation** – The first two options consider the position from the perspective of the workplace. They take no account of the nature of the accommodation – that is, whether it constitutes lodging or living accommodation. The particular concern is about employees who are required to live in temporary accommodation because of the demands of the job – normally for part of the week. Therefore, a further option is to exempt only accommodation payments made to meet short-term accommodation costs, such as hotel rooms or short-term lodgings – that is, accommodation without the means for independent living (in other words without cooking facilities). This option has the advantage of focusing on temporary arrangements that are not otherwise recognised by the more general rules discussed previously.

4.38 If rules were to be introduced to cater for the situation when an employee has more than one permanent and regular workplace, our preference would be for the second option under which the tax treatment of any employee expenditure payment is determined by the main place of work. Employee expenditure payments to meet accommodation costs at the secondary workplace could then be paid tax-free.

4.39 While this does not provide a "bright line" test, and requires a judgement to be made about the main place of work, this approach avoids the fiscal risk that might arise if the tax treatment was simply determined by reference to employee choice, rather than on the basis of the particular facts.

Overseas temporary transfers

4.40 In some cases, the market value of the property the employer requires the employee to occupy because of the needs of the job is disproportionately expensive compared with the rest of the employee's remuneration package. The focus is on employer-provided accommodation, but there may also be issues when an employee expenditure payment is paid.

4.41 We have in mind the scenario of an employee who is transferred to an overseas work location – for example, an employee who must live in the middle of Tokyo, where accommodation costs are particularly expensive compared with New Zealand. This is not an issue when the employee is no longer tax-resident in New Zealand. However, when the employee remains a New Zealand tax-resident, there can be some very high tax charges and social assistance entitlements or obligations implications.

4.42 Options for addressing this concern are similar to those identified earlier when an employee is required to occupy particular accommodation because of the requirements of the job. Our initial view is that, for the most part, market value will be appropriate as the employer should build any tax effect into the overall remuneration package.

4.43 However, it might be appropriate to cap the measure of the private value by reference to a percentage of salary or a standard property in New Zealand as outlined in the options discussed earlier. For example, one possible approach would be for the taxable value to be based upon the average market rental value of a similar property with the same number of bedrooms in Wellington or Auckland.

Relationship with other tax rules

Fringe benefit rules

4.44 As previously discussed, when an employer makes a taxable accommodation employee expenditure payment, the taxable value should normally be the amount of the payment. When the employer provides the accommodation, the taxable amount should normally be based on the market value, or rental value. These alternative approaches produce broadly the same tax outcome since the employee expenditure payment will normally be to meet the employee's rent (or be a contribution to the rent).

4.45 In these circumstances, the market value is taxed as employment income rather than as a fringe benefit. One of the reasons for this particular treatment is historical, in that employer-provided accommodation was subject to income tax before FBT was introduced.

4.46 Employer-provided accommodation delivers a very significant benefit to an employee because it replaces a very significant part of his or her personal household costs. By treating the value of such a benefit as employment income, this ensures that it is taken into account in establishing the employee's entitlement to tax credits such as Working for Families payments, as well as liabilities such as Child Support. Changing the rules so the benefit is subject to FBT would be more consistent with the treatment of major non-cash benefits and would tax the non-cash accommodation benefit at a more appropriate rate.[20] However, it would significantly distort the social assistance outcomes as fringe benefits are generally not included in income calculations for social assistance purposes.

4.47 It would, of course, be possible to change the law so employer-provided accommodation taxed as a fringe benefit is taken into account in determining social assistance entitlements and obligations. More general work is underway on the extent to which salary trade-offs should be included in social assistance calculations. In principle this would be a better, more consistent approach. However, this would create some additional compliance costs and increase the risk that the amounts are not included in practice.

4.48 On this basis, we prefer at this stage to continue to treat the taxable value of employer-provided accommodation as employment income for tax purposes.

Relationship with relocation rules

4.49 There is a legislative exemption for relocation payments[21] to allow an employer to reimburse tax-free certain expenses incurred by the employee when moving their home as a result of a job move, or taking up new employment.

4.50 The relocation exemption allows expenses incurred up to the end of the tax year following that in which the relocation occurs to be reimbursed tax-free. The expenses that can be paid tax-free are provided in a Commissioner's determination, *Determination* DET 09/04. DET 09/04 provides for accommodation, or the value of employer-provided accommodation once the employee has arrived in the new location, for up to three months after arrival, to be paid tax-free.

4.51 This exemption stands independently of any other tax rules.

4.52 We have considered whether we should link the accommodation time limit for the relocation exemption to any new rules affecting meal and accommodation allowances. However, we do not think this will be necessary if the 12-month time limit for paying a tax free accommodation allowance when temporarily working away from the employee's normal workplace were clearly expressed as an upper limit.

[20] Currently, a $1,000 non-cash accommodation benefit is taxed at a maximum of $330. To pay $1,000 in rent, the employee would need to earn $1,500, i.e. pay $500 in tax, not $330.
[21] Section CW 17B.

4.53 Our preference is that both time limits should be linked to the employee's initial arrival at the new workplace. Provided this is the same, the relocation exemption time limit would expire well within the temporary workplace time limit. When an employee takes advantage of the relocation exemption, this should also be an indication that he or she views the new workplace as permanent and the suggested longer time limit for temporary work travel would not apply.

CHAPTER 5

Communications and clothing payments

- We suggest that employee expenditure payments to meet internet and other electronic communication costs should be taxed in full when meeting mixed work-related and private expenses and there is no separately identifiable work or private element.
- We consider that employee expenditure payments to meet clothing costs should be taxed in full except when they relate to uniform, protective or specialist clothing required for the employee's job.

5.1 In many instances when there is a mixed private and work expense, making an apportionment in order to arrive at the private or work element of any employee expenditure payment might be relatively straightforward, based, for example, on respective use. However, in some instances there is no separately identifiable private or work element.

5.2 In these cases, how should an apportionment be made? When the work or private element is likely to be low in value and hard to measure so that the administrative and compliance costs of making an apportionment would be disproportionate to determining the exemption or tax liability, should that element be disregarded?

5.3 This chapter considers these issues principally by reference to communication and clothing payments. Communication payments are those made to meet expenditure, typically when an employee is working away from the employer's premises, such as the employee's phone and other electronic communication costs. Clothing payments are payments for buying and maintaining clothing for use while carrying out employment duties.

Policy considerations

5.4 The first issue to consider is how to make an apportionment between a mixed private and work expense.

5.5 The starting point is based on assumptions that:

- When the private element is incidental, an apportionment should not be made.
- When the private element is low in value and hard to measure, an apportionment should also not be made.
- Apportionment, or no apportionment, of the expense should not provide an incentive for salary substitution.

5.6 "Incidental" is a commonly used term in tax legislation, but is not specifically defined. However, it is generally taken to mean something that occurs sometimes by chance as a minor accompaniment to something else, whether an expense or event.

5.7 So, if the private purpose is not independent of the work purpose, but is carried out in order to fulfil that work purpose, it will be incidental to the employment purpose. Similar considerations apply when the work purpose is subordinate to the private purpose.

5.8 However, there will be occasions when the private element of an expense is more than incidental, such as travel costs of a spouse when accompanying an employee on a work journey.

5.9 Often, it will be clear what the respective private and work elements are and the appropriate amounts to be attributed to each. This may be because there is a distinct private/work element or because the relative proportions are clear. In the example in the previous paragraph, the spouse's travel costs are private and the employee expenditure payment that meets them should be taxable. Alternatively, when an employee works from home and sets aside a distinct part of the house for carrying out work duties, then any employee expenditure payments for the household costs may be apportioned by reference to floor area between the work and private elements.

5.10 However, in other circumstances, the private element may not be so clearly identifiable. If so, and the private element is low in value and hard to measure, an apportionment should not be made.

5.11 In considering these apportionment issues, the scenarios considered are:

- **Communication payments** – The employer meets the employee's home telephone, personal cellphone (or other electronic communications device) or internet costs, and there is mixed employment-related and private use, and part of the cost relates to private use and part to work use but overall apportionment is difficult.
- **Clothing costs** – The employer meets the costs relating to the employee's clothing worn while at work.

Communication payment

5.12 The term "communication payment" in this chapter describes an employee expenditure payment to meet an employee's phone, other electronic device or internet costs.

5.13 Working away from the employer's premises has become increasingly common with the development of communications technology and flexible working arrangements. In many cases, the employer will provide the employee with a cell phone or other electronic communications device in the employer's own name. If so, then the benefit is covered by a specific exemption from FBT and may not be taxed if it satisfies the criteria to be classed as a work tool including that it has been provided mainly for business use.

5.14 As an alternative, the employer may meet all, or a portion, of an employee's costs, including the employee's internet costs. Whatever sort of expense, the electronic communication facility is often to meet both private and work expenses with a single bill meeting the combined expense.

5.15 Part of the underlying expense may be specific to the private or work element (for example, individual calls), but part may be common (for example, line rental or a broadband facility). There may be a bundled package including mixed private and business elements to which no particular expense can be attributed. For example, when a phone package provides free calls as part of a single monthly fee.

5.16 If the employer meets the cost of a dedicated work phone line or internet facility with no, or only incidental private use, no apportionment should be required in order to tax the private element. When the employer meets the cost of what is effectively a private line with only incidental work use, an apportionment should also not be required in order to tax the payment. However, when there is mixed use that is more than just incidental, arguably an apportionment between the taxable and non-taxable elements should be made.

5.17 Whether and how this apportionment should be made is discussed below.

Options

5.18 Technology developments mean that phone and internet access are now integral to most people's private lives. On occasions, an employee may install a dedicated work line or buy a cell phone (or other electronic device) for exclusive use in their job. However, in such circumstances, it is more likely that the employer will make the necessary arrangements – for example, by providing a cell phone package. The FBT business tools exemption provides an incentive for the employer to do so. With this in mind, our starting proposition is that for the vast majority of people, personal phone and internet access will be primarily a private expense and any work benefit will be incidental.

5.19 For these reasons, exempting employee expenditure payments from tax when the associated expenditure is mainly a work expense, but the private element is more than incidental is not a workable option despite its alignment with the FBT exemption. This approach would ignore the potentially significant private value which might accrue and provide an incentive for salary substitution.

5.20 The options considered are:

- **Apportion between private and work elements on a "reasonable" basis** – This broadly reflects the current approach that seeks to provide a split between private and work elements across all expenses. It would achieve a broadly equitable result, but requires an analysis of the underlying expense with associated compliance costs for employer and employee who would both have to monitor expenditure. Calls may not necessarily reflect the appropriate work element of the line rental. For example, the communications device may have been provided so the employee can be available when on call, or otherwise available to be contacted by the employer, but all calls made from the communications device are unlikely to reflect business use. Additionally, when there is no separately identifiable private or work element, such as call charges, any apportionment may be difficult to establish.

- **Tax a fixed ratio** – Under this approach, a standard ratio, such as 50 percent of expenses, might be used to apportion expenditure. Many employers already adopt this approach as a rule of thumb. This option would recognise the intention to establish broadly the correct amount to tax in relation to the administrative and compliance costs, and likely revenue implications.

  In many instances, a fixed apportionment may produce a broadly reasonable result. However, it is, of necessity, arbitrary. It would require a set apportionment without regard to particular underlying facts and could over- or under-tax depending on the employee's circumstances.

- **Tax any employee expenditure payment when there is mixed work and private use** – Under this option, any reimbursing payment to meet expenditure with mixed use would be taxed in full. This is on the assumption that when private use is more than incidental, the employer has the ability to take advantage of the FBT business tools exemption and provide access to electronic communication devices tax-free as business tools. Such an approach would avoid the need to make arbitrary or complex apportionments of mixed expenditure.

  An employee expenditure payment would not, however, be taxed when there is a dedicated work facility or other separately identifiable and exclusive business cost being reimbursed.

Preferred option

5.21 Overall, our preference is for the third option that would tax any communication employee expenditure payment when there is a mixed work and private expense that is more than incidental private use.

5.22 One of the aims of this review is to provide certainty by establishing clear boundaries between taxable and non-taxable payments that are easy to understand and apply. This approach would avoid the need to make arbitrary judgements about apportioning mixed-use expenditure. It would also recognise that the expense is mainly a private expense. When an employee has a significant on-going need to be contacted or to work away from their office, the employer is likely to provide the facilities in its own name – for example, by providing an electronic communications device or dedicated home office facilities. In these circumstances, the FBT rules will apply to exempt any benefit when work tools are provided mainly for use in the employee's job.

Clothing payments

The current approach

5.23 The New Zealand courts have considered the tax treatment of clothing on a number of occasions and concluded that expenditure incurred on the purchase and maintenance of clothing is normally a private expense.[22] Any employee expenditure payment to meet a clothing expense should therefore normally be taxable in full.

5.24 The general proposition that expenditure on clothing and its maintenance is normally a private expense was summarised in *Case E51*[23] which concerned clothing worn by a police officer. Judge Barber stated "Broadly, the authorities say that expenditure on clothing and maintenance is generally of a private nature and non-deductible". Expenditure on conventional clothing (which might broadly be considered to be clothing reasonably suitable for private use) is a private expense, even when the employee is required to wear that particular clothing as part of a uniform (for example, see *Case F45*[24] which concerned conventional clothing worn by a ferry steward) and irrespective of whether the clothing is worn outside of the employment situation.

5.25 There is an exception to this general approach when the nature of the employee's occupation means that "abnormal expenditure on conventional clothing" is required. In *Case F9*[25], Judge Barber allowed a deduction to hotel managers for an amount representing the extra clothing (and dry cleaning) that was required because of the nature of their employment. In particular, it was observed that the taxpayer's employment required them to maintain a larger stock of clothes and to clean and replace clothes more often.

5.26 An employee expenditure payment to meet clothing costs is also not taxable when the particular clothing is "necessary and peculiar" to the employee's occupation (see, for example, *Case F45*, referred to above). This includes a uniform, or specialist clothing that is not reasonably suitable for private use. Examples include uniforms worn by nursing staff or members of the armed forces. However, ordinary clothing of a particular style or colour which could reasonably be worn outside the job would not be treated as a uniform. Specialist clothing might include overalls and protective boots worn in an industrial plant.

5.27 If the costs of particular articles of clothing are treated as exempt, any payments to meet the costs of cleaning and otherwise maintaining them should be likewise exempt – for example, when the employer pays a laundry or dry cleaning allowance that meets those costs.

[22] Although these were decided under the deduction rules set out in the Fourth Schedule of the Income Tax Act 1976 which were repealed with effect from 1 April 1988, the principles derived from them are still relevant in determining the tax treatment of employee expenditure payments covering clothing expenditure today because they focused on the private nature of clothing.
[23] *Case E51* (1982) 6 NZTC 59,786.
[24] *Case F45* (1983) 6 NZTC 59,786.
[25] *Case F9* (1983) 6 NZTC 59,606.

Policy considerations

5.28 In the majority of cases the position is clear. When an employee wears ordinary clothing to work, the cost of maintaining and replacing that clothing is a private expense and any employee expenditure payment should be taxed.

5.29 However, uncertainty can arise around whether something is a uniform, or whether a particular employee or an employee in a particular occupation is required to buy and maintain extra clothing beyond what might be expected for an ordinary employee. Apart from identifying situations when this might apply, there are questions around identifying the additional expense.

5.30 When the employee is provided with what is essentially ordinary clothing, there is a very substantial private value that goes beyond being merely incidental to the work purpose. An employee may be required to wear something that they might not otherwise choose to wear. However, alongside meals and accommodation, clothing should be treated as being inherently private. This also means it is difficult to apportion ordinary clothing expenses between private and work elements, or even to make a judgement about a broad apportionment. Therefore, the primary approach should be to tax all or none of any employee expenditure payment to meet personal clothing costs.

Abnormal expenditure

5.31 The principle in *Case F9* was that when the nature and duties of the employment required the employee to spend more on buying and maintaining clothing than would be the case for an "ordinary" employee, extra costs were deductible. The case concerned hotel workers, but the principle applies more generally.

5.32 The previous chapters discussed the difficulties of taking account of an employee's personal circumstances when working away from their normal place of work temporarily, in the context of meal and accommodation allowances. Similar considerations arise with clothing allowances. Questions around whether a particular clothing expense is excessive compared with other employees or occupations are difficult to resolve and not generally something that the tax system should have to make judgements about.

5.33 This paper has tried to focus on rules that provide clear "bright lines" between what is and what is not taxable. When possible, there should be clear rules that do not have excessively moveable boundaries. Rules that have to take account of personal judgements about what is and what is not ordinary clothing are not consistent with this approach. Therefore, in our view, while exemptions should be maintained for uniforms and other specialist clothing which might be subject to particularly arduous use resulting in excessive wear and tear, there is less justification for exempting payments for similar treatment for ordinary clothing.

5.34 This approach would be consistent with the FBT rules that apply when the employer provides the clothing or meets any maintenance and cleaning costs. There are specific FBT exemptions for "distinctive work clothing"[26] which cover uniforms and for protective clothing which are generally covered by the health and safety exemption.[27]

Preferred option

5.35 Ordinary clothing worn at work is often indistinguishable from or interchangeable with clothing the employee might wear outside of work. In these circumstances, any employee expenditure payment is simply meeting a private expense. Therefore, our preference is to move away from the position that an employee expenditure payment in respect of personal clothing is to meet a private expense only in specific circumstances.

5.36 These specific circumstances are when the clothing in question is specific to the job in question and not something that is readily useable outside of work. A uniform, protective or specialist clothing that is not reasonably suitable for private use would fall within this category. Judgements about the tax treatment of clothing allowances that fall short of this standard lead to subjective questions about what an employee might be expected to wear at work in "normal" circumstances. These are questions that are impossible to answer with any certainty.

5.37 It is suggested that the law in this area be made more certain by making it clear that payments to meet clothing costs are taxable unless they concern expenditure on uniforms, protective clothing and other specialist work clothing that is not reasonably suitable for use outside work. They are taxable if they meet expenditure on ordinary clothing that can reasonably be worn outside the job, irrespective of the quantity of clothing or maintenance required.

5.38 This may result in some allowances becoming taxable – for example, hosiery allowances, but these allowances have already been built into pay in most cases.

[26] Section CX 30.
[27] Section CX 24.

CHAPTER 6

Current legislation, interpretation and delivery options

- Alternative approaches to the current general legislation around the tax treatment of employee expenditure payments are considered, ranging from a fundamental change in approach to leaving the general rules unchanged but introducing a power to exempt particular payments by Commissioner determination-making power for the treatment of payments not addressed by specific rules.
- Changes may be needed to the legislation concerning "expenditure on account of an employee" to remove ambiguities around the application of the general exclusions.

6.1 This chapter considers how well the existing legislation works for employee expenditure payments in general, beyond the most common payments considered in the previous chapters. The intended scope of the current legislation as well as its advantages and disadvantages are therefore examined and options discussed.

6.2 We also consider whether the mechanism within which any outcomes are delivered needs to be legislated so that employers, employees, their advisers and Inland Revenue can then apply them in practice.

The current legislation

6.3 Section CE 1(1) treats any amounts derived by employees from their employment as employment income. This can take a variety of forms beyond salary or wages, and the definition of employment income is drawn widely. It includes amounts paid by way of an allowance, expenditure on account of the employee, and any other benefit in money.

Allowances

6.4 The term "allowance" is not defined in the Income Tax Act 2007 but case law[28] suggests that to be an allowance, an amount paid must have the following characteristics:

- the amount must be paid in money to the employee;
- the amount must be paid periodically or on the occurrence of certain events; and
- the amount must be an entitlement, rather than a discretionary payment.

[28] *Stagg v CIR* [1959] NZLR 1252 (SC), *CIR v Parson* (No 2) [1968] NZLR 574 (CA), *Sixton v CIR* (1982) 5 NZTC 61,285 (HC) and *Mutual Acceptance Co Ltd v FCT* (1944) 69 CLR 389.

6.5 Case law has suggested that allowances only include payments for expenditure yet to be incurred by the employee and do not include payments relating to expenditure already incurred. In the case of *M76*,[29] Judge Bathgate stated that:

> "As a verb, the word [allowance] is said to mean "the action of allowing: a thing allowed". By paying an allowance an employer pays to the credit of the employee, on account of the employee's expenses to be incurred, a payment for such expenses. An allowance is not apt to cover the situation of an employer paying a debt owed to the employee, rather it is a payment for or to meet expenditure of the employee, yet to be incurred by the employee, for or on behalf of the employer."

6.6 Adopting this interpretation, an allowance is not a payment for expenditure already incurred by the employee on behalf of the employer. The amount of the allowance can also be based on a reasonable estimate of the expected expenditure, rather than be an exact reimbursement of expenditure.

6.7 For example, in accordance with company policy to pay an allowance when it sends an employee on a business trip, an employer pays an amount of $300 to an employee before their departure to meet the employee's estimated travel expenses on an overnight trip to Auckland.

Expenditure on account of an employee

6.8 The second type of employee expenditure payment that is treated as employment income is "expenditure on account of an employee". This is defined in legislation[30] in very broad terms as a payment made by an employer relating to expenditure incurred by an employee. If a payment satisfies these requirements it is expenditure on account of an employee and treated as employment income for tax purposes, unless it is covered by one of the statutory exclusions.[31] If one of the statutory exclusions applies, the payment is not expenditure on account of an employee and the employee expenditure payment is unlikely to be employment income of the employee.

6.9 Within the statutory exclusions to expenditure on account of an employee, there are two general exclusions.[32] These cover:

- expenditure for the benefit of the employee, or a payment made to reimburse an employee for expenditure to the extent that the employee would be entitled to a deduction if they incurred the expenditure and the "employment limitation" did not exist (this exclusion applies section CW 17 to the expenditure); and

[29] *M76* (1990) 12NZTC2469.
[30] Section CE 5(1).
[31] Section CE 5(3).
[32] Section CE 5(3)(a) and (c).

- expenditure committed to by the employer, paid for by the employee and reimbursed by the employer – for example, the employer orders and is invoiced for stationery, the employee pays for the stationery on the employer's behalf and the employer reimburses the employee for the cost. It is important to note that, in these circumstances, nothing is really provided to the employee. The employee is acting as agent of the employer. From a policy perspective, such payments should be excluded from being expenditure on account of an employee.

Is the amount exempt income under section CW 17?

6.10 Section CW 17 provides an exemption from tax for certain employee expenditure payments in whole or in part. The expenditure in question must be in connection with the employee's employment and the provision exempts the income from tax to the extent to which the employee would be entitled to a deduction if the "employment limitation" did not exist. The employment limitation in section DA 2(4) denies employees a deduction for expenditure to the extent that it is incurred in earning income from their employment.

6.11 In determining the exempt portion of the income in question, an apportionment may have to be made between the deductible and non-deductible elements of the expenditure under consideration. The apportionment methodology is not defined, but depends on the employee's circumstances and the particular requirements of the employee's job.

6.12 The general deductibility provision in section DA 1(1)(a) requires there to be a sufficient relationship or nexus between the expenditure and the income-earning process of the individual claiming the deduction.

6.13 To be exempt using the guidance of the general deductibility provision, the expenditure under consideration must be incurred in the course of the employee earning their employment income. It is not sufficient that the expenditure puts the employee in a position to earn income. So, an employee expenditure payment to reimburse an employee's travel costs between home and work is taxable since the linked expenditure is to put the employee in a position to earn their employment income rather than in the course of doing so.

6.14 When the expense is private, the general deductibility rule will not be satisfied.

6.15 An employee is also denied a deduction for the expenditure that the employee expenditure payment relates to if the expenditure is capital in nature. Section CW 17, however, ensures that this does not prohibit a payment including a depreciation element from being treated as non-taxable.

6.16 A more detailed summary of the relevant legislation is set out in Appendix B.

Alternative approaches to current legislation

Applying the "nexus" test to employee expenditure payments in general

6.17 The previous chapters considered options for making it easier to identify the taxable amount when employee expenditure payments are made to meet the more common types of work expenditure. However, they do not cover every circumstance and a general rule is still needed.

6.18 The treatment of the specific payments would be legislated for in those cases and treated as if they satisfied the general rule or were a proxy for the general rule.

6.19 The question is whether, for the general rule, the current nexus test is the best approach, or whether there is another approach that could better achieve the necessary differentiation between an employee expenditure payment linked to a wholly work expense, a private expense and a mixed work/ private expense.

6.20 The current test does allow an employee expenditure payment in respect of expenditure incurred in earning the employee's employment income to be exempted for tax purposes, but for anything which includes a private element to be taxed. This is consistent with the general aims of the tax system.

6.21 However, the current test does have some disadvantages:

- The statutory tests require an assessment to be made concerning the deductibility of the employee's expenditure in applying three hypothetical deduction tests that override the "employment limitation": is the expenditure incurred in earning the employee's employment income, to what extent is it private or domestic, and to what extent is it capital? Employees have not been able to claim deductions from their taxable income for over 25 years and applying a hypothetical deduction rule to amounts that could never be deductible may be seen by some as confusing.
- A judgement must be made about the expenditure in question and its purpose. This may be relatively simple when it is or is not clearly a private expense, but this is not always the case – for example, study courses undertaken by an employee may have a benefit in the employer's business, but also a private benefit to the employee in enhancing their human capital. The general rule provides no clarity in this case.

6.22 We have, therefore, considered some alternative approaches.

Options

6.23 To address these issues, we have suggested the following approaches:

- **Incorporating into a general rule, the principles outlined in chapter 2 and followed in this paper in relation to specific payments** – Being predominantly an exemption for low-in-value and incidental or hard-to-measure private elements. The benefits of this approach would be greater coherence and consistency in treatment across the range of payments. The disadvantage would be the potential for low-in-value and hard-to-measure items becoming more commonplace to take advantage of the exemption. An

assessment would continue to have to be made about the quality of the employee expenditure.

- **Simplify the current exemption rule for determining the taxable amount** – It is arguable that the private and capital limitations are not a necessary element of the current approach since such an expense is not incurred in earning the employment income. Therefore, a further option is to abolish the existing deductibility test and replace it with a simpler exception test focused on the linked expenditure having been incurred by the employee in earning the income from the employment.

  Changing the approach could remove the need to apply the hypothetical deduction test and the private and capital limitations. However, this is essentially the approach taken by the courts in interpreting the relevant legislation in any case and identification and apportionment issues around distinguishing employment and whether there was a private benefit would still arise.

  This option would require new rules for establishing the tax treatment of an employee expenditure payment. However, these might reflect a simplification of the current rules without a radical change in approach. And a significant change in the wording of the exemption rule might give rise to unintended consequences and a shift in interpretation by Inland Revenue, taxpayers and the courts.

- **Continue to apply the current exemption rule but introduce a power to exempt or otherwise specify the tax treatment of particular payments by Commissioner determination** – This approach would leave the existing rules unchanged. However, in the event that issues are identified around the tax treatment of particular types of payment in defined circumstances, further rules would be introduced. This approach would provide a practical solution for employee expenditure payments that were sufficiently common or widespread to warrant a specific determination.

Feedback on preferred option

6.24 We have not expressed a preference for how the general rule should operate but would be interested in obtaining views on the options as well as any not considered in this section.

Expenditure on account of an employee

6.25 The statutory definition of "expenditure on account of an employee" is very widely drawn, so there is a comprehensive list of exclusions from this definition. Although most of the exclusions in this list cover specific types of payment, there are two general exclusions set out in section CE 5(3)(a) and (c). These are important exclusions because they cover employee expenditure payments in general.

6.26 There have been a number of significant changes to this legislation since it was first introduced in 1985.[33] The changes have reflected major and minor reform of the tax treatment of employee expenditure payments. As a result of these changes, the general exclusions have been amended and expanded and it is no longer clear how the exclusions should apply, particularly in relation to each other. The general exclusion in section CE 5(3)(a) which only covered the payment of an allowance when first introduced now has wider coverage so, arguably, it now covers a wider range of employee expenditure payments.

Options

6.27 Removing the ambiguity around the interpretation of the exclusions from expenditure on account of an employee would improve certainty around the tax treatment of employee expenditure payments.

6.28 This would require legislative change to the two general exclusions, either by:

- **amending both general exclusions to make a clearer distinction between when they should apply**. A distinction would need to be made between reimbursing allowances, expenses incurred by employees and expenses incurred on behalf of their employers. This would require the way in which an employee expenditure payment is made to be considered in applying the tax rules;
- **replacing both exclusions with a single general exclusion**. This would consolidate the general exclusions into a single exclusion. Since there would only be a single such exception, the way in which an employee expenditure payment is made would not need to be considered; or.
- **repeal of paragraph (c) in section CE 5(3)**. This would leave the paragraph (a) exception unchanged as the only general exclusion.

Preferred option

6.29 The best option will be determined by the shape of the overall legislation relating to employee expenditure payments and a decision on the preferred option will not be apparent until that is clear.

Capital limitation

6.30 An employee is denied a deduction for expenditure that is capital in nature. However, section CW 17(4) allows for a payment to include an amount of depreciation loss. The depreciation rules also allow low value assets (costing $500 or less) to be deducted in the year of acquisition.

[33] Income Tax Amendment (No. 2) Act 1985 – see *Public Information Bulletin* No. 136 Part 3 February 1986.

6.31 In practice, this issue might arise when an employee is reimbursed for expenditure relating to the purchase of a capital item. An example includes purchase of a laptop computer for work purposes and the employer reimburses the employee for the cost of the laptop. Another example is a mileage allowance that includes a component for depreciation of the employee's motor car when it is used for work purposes. The capital limitation would also be relevant to expenditure relating to a capital item, such as reimbursement of expenses relating to the cost of converting a room into a home office when an employee works from home. It is useful to bear in mind that often this type of expenditure will also have a private or domestic element to it.

6.32 To the extent that capital expenditure is incurred in acquiring an asset for use in the employee's job, it would seem reasonable to continue to allow a deduction for an amount of depreciation loss.

Estimated expenditure of employees

6.33 When an employee incurs expenditure for which he or she expects to be compensated, the employee will often itemise the amount of each expense. This will be the case when the employer makes a payment on account or reimburses particular expenses. However, many employers prefer to reduce administrative costs by paying an up-front allowance with the tax-free element supported by an estimate of the underlying allowable expense.

6.34 This approach is allowed by section CW 17(3). This section provides for the amount incurred for a relevant period to be based on a relevant estimate of the expenditure likely to be incurred by the employee or a group of employees. The legislation is fairly broad and does not provide any further guidance or direction on how the estimate should be made, except that the estimate must be reasonable.

6.35 While many employers base their employee expenditure payments on the actual expenditure incurred (for example, setting a maximum amount the employee can spend on meals and accommodation and then reimbursing up to that amount) others, prefer to pay an allowance based on a daily rate. These daily amounts based on an estimated cost of hotel accommodation and meal costs, with different rates depending on location or the meals in question.

6.36 The advantage to employers of paying a daily amount is that they do not have to check individual expense claims for particular journeys. There is a saving on administrative costs in checking claims when the amount they pay out under either approach is broadly similar.

6.37 Provided a daily amount is supported by evidence to show that the employer has taken reasonable steps to establish that the amounts reasonably reflect the expenses their employees incur, this would satisfy the requirements of section CW 17(3). However, we would expect employers to monitor the level of expenditure and remain satisfied that the amounts are reasonable in the particular circumstances.

6.38 Framing the legislation in this way allows employers considerable flexibility in how they go about making an estimate, provided it is reasonable. We are not aware of particular problems in applying the rule and, therefore, are not proposing to make any changes to it.

Delivery mechanisms

6.39 The proposals in this document will require changes to the Income Tax Act 2007. However, supporting rules may be better addressed through other mechanisms. These supporting rules may include, for example, how the Commissioner would propose to exercise the discretion to extend the 12-month period under which accommodation payments may be made tax-free. Importantly, they may also serve to provide clarity on the treatment of allowances not previously considered, including those where exemption is warranted because the amounts involved are low in value and incidental or hard to measure.

Commissioner determinations

6.40 The Commissioner may issue binding determinations about various tax issues. These determinations generally represent statutory discretions exercised by the Commissioner relating to a specific tax issue. The determinations may, for example, set rates, values or types of deductible expenditure.

6.41 An example of a binding Commissioner's determination is the power to provide, extend and modify the list of eligible relocation expenses under section CW 17B(6).

6.42 One of the options considered in this paper is an upper time limit for treating a visit to a particular workplace as temporary for the purposes of determining whether an accommodation payment can be made tax-free. Our preferred option is to set an upper time limit of 12 months but subject to a power to extend that in certain exceptional circumstances. We have suggested that those circumstances might include when a contract originally scheduled to finish within the upper time limit overruns because of some unforeseen event. It might be appropriate to introduce a power to set those circumstances by way of a Commissioner's determination.

6.43 The taxability or exemption issues relating to particular allowances that are not covered by specific rules could also be dealt with through a determination process. We would expect these to be fairly limited and only made when the payment in question was widespread and its treatment demonstrably in need of identification.

APPENDIX A

Comparison of current and suggested treatment of key employee expenditure payments

Type of payment	Current treatment	Suggested
Payment for employee's meal expenses during work travel	The amount the employee saves on day-to-day meal costs during work travel may be taxable because meal costs are generally treated as private expenditure. In practice, employers do not tax payments regardless of duration of travel.	Payment tax-free if duration of travel to particular work location is no more than 3 months. Taxable in full for longer trips.
Payment for work-related meals outside of work travel	As for work travel, the amount the employee saves on their meal costs is taxable because it is private expenditure. In practice, employers do not tax these payments.	Payment tax-free if not regular payment for employee services.
Payment for employee's accommodation expenses during work travel	While generally not taxable, there may be circumstances when the expenditure is of a private nature and therefore taxable. In practice, employers do not tax these payments.	Payment tax-free if duration of work travel to particular work location is no more than 12 months. Taxable in full for longer trips.
Payment for accommodation costs outside of work travel	The payment is taxable because accommodation is a private cost.	No change, the payment would be taxable.
Employer provides accommodation at or near work place	The market value of accommodation is taxable. In practice this is interpreted to mean rental value and can take into account any contribution from the employee.	Confirm the legislation to ensure taxable value is rental value, subject to any employee contribution.
Payment for accommodation costs where more than one permanent work place	In some circumstances the payment may be taxable because accommodation is a private cost.	Special rules to ensure that a payment to meet accommodation costs at one location is not taxable in certain circumstances.
Payment for accommodation costs for employees seconded overseas who remain NZ tax resident	The payment is taxable, at a value based on market rent in the overseas location.	Special rules to limit tax value – for example, NZ equivalent rent.
Payment for communications (including telephone and internet)	The value of any private expenditure is taxable and in practice this will mean an apportionment is required according to the private/work-related split.	Taxable in full except where private/work element able to be separately identified.
Payment for work-related clothing	The payment is not taxable if the payment is for work uniform/specialist clothing.	Confirm not taxable only when payment is for a work uniform/specialist clothing.

APPENDIX B

Summary of current legislation and its interpretation

The legislation for determining the tax treatment of payments to or on behalf of employees is set out in the Income Tax Act.[34]

In order for a payment to be taxable as employment income, it must be income within Part C of the Income Tax Act 2007 and, more specifically, employment income within section CE 1. Provided a payment is employment income, section CW 17 then sets out the circumstances in which it is exempt income so that it is not assessable. There are also a number of specific exemptions in sections CW 16 to CW 26.

These arrangements are different from circumstances when the employer incurs the liability directly and provides goods or services to the employee for their private benefit. In those circumstances the fringe benefit rules in subpart CX apply. Fringe benefit tax is then payable by the employer on the cost or value of any private benefit rather than income tax payable by the employee.

The current statutory framework covering circumstances when payments are made directly to the employee or paid on their behalf is summarised in more detail in the following paragraphs. They consider, first of all, the general position before going on to consider certain specific circumstances.

Payments made to or for the benefit of an employee

Any amount derived by an employee in connection with their employment or service will be income to that employee under sections CE 1(1)(a) and (b) if that amount is either an allowance or is expenditure on account of an employee.

Expenditure on account of an employee is defined in section CE 5(1) as meaning a payment made by an employer relating to expenditure incurred by an employee. A payment made by an employer in the section CE 5(1) definition includes both payments by an employer to a third party on an employee's behalf and payments to an employee.

Section CE 5(3) exclusions

Section CE 5(3) contains exclusions from the definition of "expenditure on account of an employee". If a payment satisfies the requirements of the definition of expenditure on account of an employee in section CE 5(1) but is excluded from the definition by one of the exclusions in section CE 5(3), the payment will not be employment income of the employee. The two exclusions most likely to apply to payments made to or on behalf of employees for their expenditure are contained in section CE 5(3)(a) and (c).

[34] All statutory references are to the Income Tax Act 2007.

The section CE 5(3)(a) exclusion covers expenditure on account payments that would be exempted under section CW 17. If section CW 17 applies, the payment is excluded from the definition of "expenditure on account of an employee" and is not income.

As the section CE 5(3)(a) exclusion is aimed at payments intended to be exempted under section CW 17, the two types of expenditure on account payments it applies to are:

- expenditure that is committed to by the employee but paid for by the employer (for example, the employer pays the employee's phone bill on behalf of the employee); and
- expenditure that is committed to and paid for by the employee and reimbursed by the employer (for example, the employer reimburses the employee for the cost of the employee's phone bill).

The exclusion in section CE 5(3)(c) applies to expenditure that is committed to by the employer, paid for by the employee, and reimbursed by the employer (for example, the employer orders and is invoiced for stationery, the employee pays for the stationery on the employer's behalf, and the employer reimburses the employee for the cost of the stationery).

The section CE 5(3)(a) exclusion covers reimbursements for expenditure incurred by employees in deriving their employment income while the section CE 5(3)(c) exclusion applies to reimbursements for expenditure paid for by employee's on their employer's behalf. These exclusions are mutually exclusive, so if a payment is for expenditure incurred by an employee in deriving their employment income, it is the subject of the section CE 5(3)(a) exclusion and will not be within the scope of the section CE 5(3)(c) exclusion.

Exempt income under section CW 17

Section CW 17(1) provides an exemption from tax for payments made by an employer to a third party on behalf of an employee for expenditure that the employee has incurred when the employee would be able to deduct the expenditure (or part of it) if the employment limitation in section DA 2(4) did not exist. The expenditure must be in connection with the employee's employment or service and the employee must have incurred the expenditure in the sense of being legally liable for that expenditure.

Section CW 17(2) provides an exemption from tax for payments made by an employer to an employee in connection with that employee's employment or service to reimburse the employee for expenditure they would have got a deduction for if the employment limitation did not exist.

Under section CW 17(1) and (2), an apportionment may have to be made between the deductible and non-deductible elements of the expenditure under consideration. This apportionment is a question of fact.

Section CW 17(3) provides that, for a relevant period, the employer may make a reasonable estimate of the amount of expenditure likely to be incurred by an employee or a group of employees for which a reimbursement is payable. In practice, these types of reimbursement will be paid in the form of an allowance.

Deductions – general rules

The deduction rules are set out in Part D with the general deduction rules in subpart DA. Section DA 1(1)(a) permits a deduction for an amount of expenditure to the extent that it is incurred in deriving assessable income. However, to qualify for a deduction, the expenditure in question must bear a sufficient relationship, or nexus, with the income.[35]

The general deductibility permission in section DA 1(1)(a) requires there to be a sufficient relationship between the expenditure and the income-earning process of the individual claiming the deduction. The expenditure under consideration must be incurred in the course of the employee deriving their employment income. It is not sufficient that the expenditure puts the employee in a position to earn income.

Section DA 2 denies a deduction "to the extent to which" the expenditure falls within a number of general limitations The words "to the extent to which" provide that there may be an apportionment when part of the expenditure falls within one of the general limitations. The general limitations relevant to section CW 17 include:

- The "capital limitation" in section DA 2(1). The capital limitation denies a deduction for any expenditure to the extent that the expenditure is capital in nature. However, the capital limitation will not apply to an amount of depreciation loss (see section DA 4).
- The "private limitation" section DA 2(2). The private limitation denies a deduction for expenditure to the extent that the expenditure is of a private or domestic nature.
- The "employment limitation" in section DA 2(4). The employment limitation denies a deduction for an amount of expenditure to the extent that expenditure is incurred in deriving income from employment.

An outgoing is of a private nature if it is exclusively referable to living as an individual member of society, and domestic expenses are those relating to the household or family unit.[36] Examples of expenditure that are often of a private nature include food, clothing and accommodation. Examples of expenditure that are often domestic in nature include a home telephone, an internet connection and furniture.

When a benefit of a private or domestic nature accrues to the recipient, but this benefit is incidental to the income-earning or business activity of the payer, the deduction is not prohibited. When the private or domestic benefit accrues from a purpose of the taxpayer distinct from the employment purpose, apportionment is necessary.

Accommodation allowances

Section CE 1(1B) provides that the market value of accommodation, or an accommodation allowance, provided to a person in relation to their job is treated as his or her employment income.

[35] The leading New Zealand cases on the deductibility of expenditure are *CIR v Banks* [1978] 2 NZLR 472 and *Buckley & Young Ltd v CIR* [1978] 2 NZLR 485. These cases are authority for the proposition that there must be a sufficient nexus between the expenditure and the income earning process for the expenditure to be deductible.

[36] *CIR v Haenga* [1985] 7 NZTC 5198, in which Richardson J commented on the meanings of "private" and "domestic" (at p5, 207): *"An outgoing is of a private nature if it is exclusively referable to living as an individual member of society and domestic expenses are those relating to the household or family unit…".*

When the employer provides their employee with actual accommodation, rather than an allowance or reimbursement, this differs from most other circumstances when an employer provides their employee with a non-cash benefit. The value of the accommodation is not a fringe benefit.

When the property is owned by the employer, market value is the market rent that the property would otherwise fetch on the open market. If the property is rented by the employer, the market value is the rent paid by the employer. In both circumstances, the taxable value is adjusted for anything made good by the employee.

Section CE 1(2) defines accommodation as meaning board or lodging, or the use of a house or living premises, or the use of part of a house or living premises. Accommodation benefits are taxed under PAYE.

There are also two specific circumstances when the provision of accommodation or an accommodation payment is exempt from tax:

- Section CW 25 provides an exemption for the value of personal board and lodging for members of religious orders or societies in certain narrowly defined circumstances. There is no general legislative provision, though, for a concessionary treatment for valuing accommodation benefits provided to a minister of religion.
- Section CW 17B provides that relocation payments are tax-free provided certain criteria are met. When the employee is entitled to the relocation exemption, the provision of accommodation benefits is not taxed for up to three months after moving to the new location.[37]

Other allowances

Section CW 17C provides an exemption for payments for overtime meals and sustenance allowances. The exemptions set out certain criteria that have to be satisfied before payments can be treated as exempt income.

Section CW 18 provides an exemption for payments by an employer to meet above normal transport costs that an employee has incurred in travelling between their home and place of work. A payment is exempt to the extent that the employee incurs the additional transport costs in connection with their employment for the employer's benefit and convenience.

The effect of sections CW 31 and CX 12 is that the payment of allowances to members of Parliament under the Civil List Act 1979 is taxed by way of fringe benefit tax, rather than under income tax.

[37] See Determination DET 09/04.

APPENDIX C

Approach in other countries

The payment of allowances and reimbursement of employee expenses is a common feature of businesses across the world. The rules to cater for these sorts of payments are, therefore, also common features of other countries' tax systems.

The core features of the approaches adopted by the USA, UK, Australia and Canada are summarised in the tables below. These cover their approach to employee expenditure payments in general, meal payments and accommodation payments.

In general, countries tax monetary payments to or for the benefit of an employee as income or as a cash benefit but reduce the taxable amount to the extent that the underlying expense the payment intended to meet is incurred for employment purposes. The common aim is to tax only payments to meet private or non-employment related expenses. Therefore, many countries also provide administrative easements so that payments that are matched by clearly allowable employment expenses are not reported.

Common features in the USA, UK, Australia and Canada are:

- The full amount of any payment to meet employee employment-related expenditure is taxable.
- Deductions are allowed from the taxable amount when the underlying expense is to meet allowable business or employment-related expenditure incurred while performing employment duties.
- Administrative easements apply so employers and employees do not need to report payments matched by clearly allowable employment expenses.
- Statutory and non-statutory scale rates that can be paid without detailed checking of amounts are provided either by way of administrative practices or in legislation.

However, there are variations around the world on the detail of how this approach is applied to payments in general and in particular circumstances.

A significant difference from the New Zealand rules is that all these countries allow employees to claim deductions for employment-related expenses.

General allowances

USA	UK	Australia	Canada
All compensation for personal services must be included in gross income. Includes allowances and reimbursed income.	Allowances and payments to reimburse expenses are taxed as income.	An allowance received by an employee is taxable as income.	An allowance or reimbursed personal or living expenses are treated as taxable income.
The amount of any ordinary and necessary business-related expense is deducted from income.	Expenses incurred wholly, exclusively and necessarily in the performance of the duties of the employment are deducted from income.	Expenses incidental and relative to the employment are deducted from income.	Employees may claim a deduction for certain employment expenses.
Under an "accountable plan", neither the amount reimbursed nor the matching expense are reported.	When "dispensation" issued, neither the amount reimbursed nor the matching expense are reported.	Reimbursed expenses give rise to a fringe benefit (expense payment benefit) on which employer pays fringe benefit tax.	Reimbursement of out-of-pocket business expenses which is proved by vouchers does not have to be reported.
Under a "non-accountable plan", the reimbursement is included within gross income and the expense can be deducted. Claims for expenses are subject to a floor set at 2% of gross income. Claims for meal and entertainment expenses are set at 50% limit.	"Benchmark" rates set in certain circumstances to allow tax-free amounts to be paid without detailed checking of receipts.	Exemptions if no private use declaration for reimbursement of employment-related expenses.	Exemptions when "reasonable" allowances are paid for travel and motor vehicle expenses.

Meal payments

USA	UK	Australia	Canada
The cost of meals is deductible from a payment if employee temporarily away from general area of tax home for substantially longer than an ordinary day's work and the employee needs to sleep or rest to meet the demands of their work while away from home	Meal expenses are deductible if there is a material change in the journey to work and the employee is required to travel to a temporary workplace.	A meal payment is not taxable if it is paid to meet travel expenses incurred in earning assessable income. Applies when the employee travels away from their ordinary residence in the course of their duties. ATO interprets this as requiring a sleep away from home.	Meal allowances are taxable unless they are received by the employee for travelling away from the area where the employee normally works or reports in order to carry out their job.
"Tax home" is employee's regular place of business or post of duty (if more than one then main place, if none the place where the employee regularly lives).	A temporary workplace is somewhere the employee has to travel to as part of their job for a temporary purpose or for task of limited duration.	Allowable travel expenses cover travel to an alternative workplace.	Travel has to be away from the municipality and metropolitan area where the employer's establishment is located and the employee ordinarily works or reports.
Temporarily means employee expects to work there for 12 months or less.	Temporary means employee expects to work there for two years or less.	12-month time limit for Living Away From Home Allowance from 1 October 2012.	There is no set time limit for travel.
Allowance not taxable if "accountable plan" - business expenses accounted for in full to employer, any excess over is taxable. Otherwise full allowance taxable. Employee may claim deduction for itemised meal expenses to 50% limit.	The additional cost of meals is allowed in full. In practice provided some expense is incurred, HMRC will also allow deduction for the amount saved from not eating at home.	ATO sets "reasonable travel allowance rates" each year. Provided the allowance is paid at or below those rates PAYG does not have to be operated on the allowance and it does not have to be returned. If employee spends more than the allowance they must keep detailed records if they want to claim the excess.	The meal allowance has to be reasonable. The Canadian Revenue Authority sets very broad guidelines about what it considers reasonable. As at 6 December 2011 it considered a meal allowance of $17 is reasonable.
"Standard meal allowance" method can be applied rather than actual costs but subject to 50% limit.	HMRC sets tax-free rates which can be paid if employees do not want to keep detailed records.	If LAFHA paid, exempt amount is excess over standard weekly amount.	Claims for meal expenses are set at 50% limit.
Meals cannot be lavish/ extravagant.	May challenge if meals are lavish/extravagant.		

Accommodation payments

USA	UK	Australia	Canada
The value of accommodation or an accommodation allowance provided to an employee will usually be taxed as part of the employee's compensation package. The taxable value is the fair market value (market rent), reduced by anything made good by the employee. Exemption for accommodation provided by an employer to an employee for the employer's convenience on the employer's premises if the employee is required to accept the lodging as a condition of employment. There are also specific exemptions for campus lodging, ministers of religion and lodging when temporarily away from the normal tax home (up to 12 months).	The cash equivalent of employer provided accommodation is taxable. Taxable value is the rent paid by the employer less any amount made good by the employee. Special rules if owned by the employer, linked to rateable value of property and interest rates. Exemption if accommodation necessary for proper performance or better performance (and customary) of the employment duties. Exemption for accommodation at a temporary workplace (up to two years). But if private use, for example by family or lavish, then adjustment made to reduce tax free element. If part of accommodation necessarily used exclusively for employment purposes deduction may be given for appropriate proportion of expenditure.	The market value of the right to occupy accommodation is taxable as a fringe benefit when the unit is the employee's normal place of residence. The taxable value is effectively the market rental value of the unit, reduced by anything made good by the employee. Exemption when the employee is living away from their usual place of residence in order to carry out their employment duties, or travelling in the performance of those duties (up to 12 months from 1 October 2012). Special exemption for accommodation provided in remote areas. Payment of a LAFHA is a LAFHA fringe benefit. Taxable value is allowance paid less any exempt component. The exempt accommodation component is the additional accommodation expenses the employee could reasonably be expected to incur at the alternate location (depends on facts and circumstances) .	The fair market value of employer provided board and lodging must be added to the employee's salary, less any amount the employee paid to the employer. Exemption if the employee performs duties temporarily in an area where, because of the distance of the areas, they are not expected to return daily to their principal place of residence. Special exceptions for sports teams, members of the clergy and remote work locations. If the employee has to occupy accommodation larger than he or she needs, the taxable value can be reduced to the value of the accommodation the employee needs. If the employee's privacy or quiet enjoyment is impaired because of the nature of the accommodation, the taxable value may be reduced.