Regulatory Impact Statement

The tax treatment of payments by employers in respect of employee expenditure, and employer-provided accommodation

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by Inland Revenue.

It provides an analysis of options for reforming the rules determining the tax treatment of allowances and other reimbursing payments paid by employers to, or for the benefit of, their employees and the direct provision of accommodation. Inland Revenue has identified a number of issues which have broad implications for the tax treatment of these types of payments. As a result, the Government added the review of this area of tax law to its work programme.

Given that employers and employees do not need to provide separate information to Inland Revenue on these payments, Inland Revenue does not hold detailed information about how much employers pay by way of allowances and other reimbursing payments. We have, however, been advised that businesses generally pay fewer types of allowances than they used to. Nevertheless, there are still a number of payments that are commonly paid by employers, in particular, in relation to accommodation, meals and clothing.

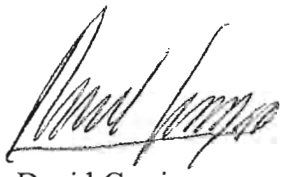
To overcome the lack of comprehensive data in this area and gain a better general understanding of the scope of the issues around employer-provided accommodation, allowances and other reimbursing payments, officials consulted with a wide range of employers, key business representatives and Government agencies, to obtain their views on such payments. There has also been wider public consultation on the options for reform. This consultation has helped to shape the options and our recommendations. Our findings are summarised in this RIS.

The Treasury has worked closely with Inland Revenue in preparing this statement and agrees with the analysis.

A strong message from employers and their representatives has been the desire for certainty over the tax treatment in particular circumstances. This need for certainty has been a key objective in shaping the preferred options.

Although the proposed changes, when broken down into individual issues, may be slightly fiscally positive or negative, the effect of the measures as a whole is likely to be broadly revenue neutral, as originally intended.

Inland Revenue is of the view that there are no significant constraints, caveats and uncertainties concerning the regulatory analysis undertaken, other than as noted above. None of the policy options would restrict market competition, reduce the incentives for businesses to innovate and invest, unduly impair private property rights or override fundamental common law principles.



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EXECUTIVE SUMMARY

There are a number of significant concerns around the tax treatment of employer provided accommodation, accommodation payments and other allowances and payments by employers to cover employee expenditure. The generality of the current tax legislation has led to impractical outcomes that may differ from how employers apply the rules in practice.

Under current tax law when an employee expenditure payment is made, provided it is to cover a work expense, it is not taxable. However, when there is a private element in the linked expense, that element is taxable irrespective of compliance costs. As meals, accommodation and normal clothing are inherently private, the starting position under current tax law is that any employee expenditure payment to cover these sorts of expenses should be taxed. (This is on the basis that the private benefit is a salary substitute and that, just like salary and wages, should be taxed to ensure that there is no incentive to provide remuneration in ways that are not taxed.)

In many instances, however, the private benefit is either incidental to the business objective or is minimal and/or hard to measure. Accordingly, some more practical rules of thumb are needed to determine where to draw the taxable/ non-taxable line, which means that legislative change is required in this area.

The major areas of concern relate to employer-provided accommodation and accommodation payments, particularly when linked to work-related travel and secondments. There has been a lot of confusion in this area, leading to calls from a range of representative bodies, agents and employers for the law in this area to be made more certain and workable.

Legislative change is also required for meal payments, as the current law does not match practice (for example, the amount that an employee saves because an employer pays for their evening meal while working out of town is in theory taxable under current law), and for work-related clothing allowances.

Officials have undertaken extensive consultation over the past two years on these issues. A range of options have been considered and measured against the objectives of limiting compliance costs, fairness and economic efficiency, leading to the recommendations below. There are no environmental or cultural impacts from these recommended changes.

Potentially these changes could impact on a wide range of employees. However, in the vast majority of cases the new rules will largely match existing business practice but with the added advantage of providing greater certainty, so the overall impact on employees and employers should be limited.

The recommended changes are:

Accommodation

- Employer-provided accommodation or an accommodation payment would be tax exempt when an employee is required by their employer to move to a new work location that is not within reasonable daily travelling distance of their home, and either
    i. the move is not project specific but there is a reasonable expectation that the employee's secondment to that work location will be for a period of two years or less, in which case the tax exemption is for up to two years; or
    ii. the move is to work for a period of three years or less on a project of limited duration, in which case the exemption is for up to three years.

There would also be a special exemption of up to five years for employees working on Canterbury earthquake recovery projects (reverting to the three year time limit by 31 March 2019).

- When an employee has to work at more than one workplace on an on-going basis the accommodation or accommodation payment would be tax exempt without an upper time limit.
- The rules for determining the taxable value of an accommodation benefit when it is not tax exempt would be clarified, including in relation to accommodation provided by churches to ministers of religion.

Meals

- The full amount of meal payments linked to work-related travel would be tax exempt, subject to a three month upper time limit at a particular work location.
- The full amount of meal payments and light refreshments outside work-related travel, such as at conferences, would be tax exempt.

Clothing

- There would be a specific exemption for the costs of purchasing and maintaining distinctive work clothing, such as a uniform, to align with the fringe benefit tax approach when the clothing is provided directly by the employer.
- There would be an exemption for plain clothes allowances paid to members of uniformed services who are required to wear ordinary clothing when performing their duties where those allowances were treated as tax-free as at 1 July 2013.

General rule for other payments

- The general rule for determining when an allowance is or is not taxable would be clarified, including by providing the Commissioner of Inland Revenue with the discretion to issue a determination as to what proportion of a class of payment is non-taxable when the private or capital element is hard to measure and/or low in value.

The recommended application date for most of these changes would be 1 April 2015. However, to ease the transition, some of the changes, including the special rule for Canterbury earthquake recovery projects, have earlier start dates. The general accommodation rule would, at the taxpayer's option, apply from 1 January 2011.

STATUS QUO AND PROBLEM DEFINITION

Background

1. This RIS provides an analysis of options for the reform of the rules affecting the tax treatment of allowances and other payments made by employers to, or for the benefit of, their employees and employer provided accommodation. These reforms arise out of the policy review, as outlined in the November 2012 officials' issues paper, *Reviewing the tax treatment of employee allowances and other expenditure payments*.

2. Businesses have a long history of paying their employees allowances, although we understand that there are fewer allowances today than thirty years ago as many have been incorporated into salaries and wages. The legislated tests have also changed over time from a system where all tax-free allowances had to be sanctioned by the Commissioner of Inland Revenue to one of taxpayer self-assessment.

3. Although the term "allowance" is commonly used in this statement, the review covers a wider range of employer payments. An allowance can be categorised as a payment to an employee which is additional to (and in some cases a substitute for) salary and wages, paid in advance and based on estimated expenditure. An employer can also make a payment to reimburse actual expenditure or on account of an employee to settle the employee's expenditure. These sorts of payments are normally paid in arrears either directly to the employee or to a third party. This variety of payments can more generally be described as "employee expenditure payments". The most common employee expenditure payments relate to accommodation and meals. In addition, accommodation provided directly by an employer has been included as part of the review.

The current legislative approach

4. The tax legislation covering these areas consists of some limited specific rules either, as in the case of accommodation, setting out the basis on which it is taxed or, for certain other payments[1], the basis on which they are exempt from tax, with a general rule setting out when other types of payments are tax exempt.

5. Generally, under the legislation, when an employee expenditure payment is made then, provided it is to meet an expense incurred in earning the employee's employment income, it is not taxable. The exception is when there is a private or capital element in the expense being reimbursed. In such circumstances, the payment may be taxable in part or in full. A taxable employee expenditure payment is taxable income of the employee and subject to PAYE. In the case of employer-provided accommodation, the benefit of the accommodation or accommodation allowance is treated as income of the employee and subject to PAYE to the extent of its market value. These taxable benefits are also taken into account when calculating social assistance entitlements.

6. The framework behind the current legislation is that any benefit that is a salary substitute should be taxed, just like salary and wages, to ensure that there is no incentive to provide remuneration in ways that are not taxed.

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[1] Specific exemptions are provided for reimbursement of certain expenses arising from the relocation of employees, for overtime meal payments and for employees' additional transport costs.

Problems with current approach

7. The rule setting out when most types of employer expenditure payments are tax exempt is very general and over the years has been open to a number of different interpretations and practices, leading to taxpayers questioning what is the correct application and intention of the law. Furthermore, there are questions over whether the current law represents the most appropriate policy outcomes. These questions create uncertainty for everyone.

8. In the past, gaps that have arisen from the general rules had to be subsequently filled with either more detailed legislation or interpretive statements by Inland Revenue. For example, changes were made in 2009 specifically to deal with employee relocation payments and overtime meal payments. Since then a number of further concerns with other types of payments have arisen, in particular in relation to accommodation, meals and clothing. As a result the law needs to be clarified to provide greater certainty and better alignment with business practice.

9. To minimise uncertainty and create consistency in the area, while at the same time ensuring that there is not significant salary substitution, the Government included a review of the tax rules in this area in its work programme, with particular focus on accommodation and meals.

10. Some examples of the problems that need to be addressed are:

- *Accommodation*: It has been common practice for employers to adopt a "net benefit" approach in determining whether employer funded or provided accommodation is taxed. Under this approach, when an employee maintains a home elsewhere for their use, it is argued there is no taxable benefit, whatever the circumstances. Inland Revenue does not agree that this approach is supported in law and the Commissioner of Inland Revenue published an interpretation statement in December 2012[2] clarifying her view about the correct approach. Under the statement, the exemption for employer-provided accommodation and accommodation payments depends on the circumstances in each case (as measured against certain fact-related criteria) with a maximum exempt period of 1 year, and only applies to existing employees. This statement has generated widespread comment amongst employers and their representatives that this interpretation produces an unreasonable outcome that does not match what businesses are doing in practice.
- *Meals*: Arguably when an employer reimburses the cost of a work-related meal then the amount saved by the employee (in other words their normal expenditure on the meal) should be taxed. However, it would not be practically possible to comply with or administer a test that requires such an apportionment to be made.

11. Without change, uncertainty in these areas will continue and is likely to remain a significant issue. A strict interpretation and application of the current law could result in significant additional compliance costs for employers, or even non-compliance. The uncertainty can also result in unfairness and economic efficiency issues to the extent that any payment or employer-provided accommodation provides an untaxed private benefit.

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[2] CS 12/01 Commissioner's Statement: Income tax treatment of accommodation payments, employer-provided accommodation and accommodation allowances.

12. It has not been possible to quantify the impact of the problem because Inland Revenue does not hold detailed information about how much employers pay by way of employee expenditure payments. However, discussions with individual businesses and key business representatives indicate that the issue is likely to be significant for a wide range of employers and, potentially, for many thousands of employees. These employees would be in both the public and private sectors and would include manual workers, technicians, executives and other professionals.

OBJECTIVES

13. Given the concerns outlined above, three key policy objectives were identified for the review:

***Objective 1**: Improve clarity and certainty, thereby improving compliance.*

The first objective has been to explore options for providing greater clarity and certainty in this area for employers and employees, something employers and their representatives have said is important to them particularly in relation to accommodation. Rules that are relatively easy for employers to understand and apply, aid compliance and help to minimise compliance and administration costs.

***Objective 2**: Fairness – ensure individuals pay their fair share of tax and social assistance payments are targeted at those in genuine need.*

When an employee expenditure payment is a substitute for labour income/provides a material private benefit, the second objective is to tax the payment and include it in income when determining eligibility for social assistance. In this regard, the review attempts to identify a workable boundary between payments that confer a private benefit and those that do not.

As outlined in the policy principles set out in the issues paper, when a payment by an employer is to meet an expense incurred by the employee during the course of and directly because of their employment, there should normally be no tax consequences because there will be no or only incidental private benefit, but when the payment is to meet a purely private purpose then it should be taxed in full. When there is a mixed private and employment purpose, ideally the amount relating to the private purpose should be taxed. However, apportionment may not be practical in all cases due to the compliance costs associated with separating out the relative private and employment elements. In such cases the private amount should be ignored when low in value (and incidental to the work purpose) or hard to measure, and the benefit is not provided as a salary substitute. This approach ensures that when there is a private benefit, the tax and social assistance outcomes are the same for employees irrespective of the composition of their remuneration.

***Objective 3**: Economic efficiency – ensure that tax rules in this area are not an impediment to business decision making.*

The law in this area can impact on a broad spectrum of employees who incur expenditure during the course of their work and for which they are reimbursed by their employers. In some cases their employers ultimately bear the additional tax costs. Other than this direct financial implication for the employee or employer, there is the potential for the tax rules to act, where the payment relates to accommodation and meals, as a disincentive to the free movement of labour and, more generally, to normal businesses activities that require travel. To avoid these economic costs, it is crucial to have rules that are clear and that tax only the private benefit element.

REGULATORY IMPACT ANALYSIS

14. The main options for change considered during the review are summarised in the table below and discussed in the paragraphs following the table. They are assessed against the three objectives outlined in the preceding section (compliance, fairness and economic efficiency). A description and fuller analysis of all options considered is provided in the annex. That annex assesses the options against compliance, economic, social and fiscal impacts. The social impact is considered in terms of fairness. There are no cultural or environmental impacts.

Why the status quo is not an option

15. The option of retaining the status quo was also considered for all issues but was rejected because we did not consider it would address the compliance, equity and economic efficiency problems associated with the current rules identified earlier. The status quo option, therefore, is not an option for the long-term.

16. The key options for change are:

Issue	Option	Net impact and whether objectives are met
Employer-provided & funded accommodation linked to work travel and secondments generally	Net benefit approach (see paragraph 19 for further explanation)	- Likely to involve significant compliance and administrative costs. - Equity issues as employee's tax and social assistance outcomes differ depending on personal living circumstances. - Likely to distort behaviour/encourage salary substitution if applied without any time limit, leading to high fiscal risk. *Not preferred option as is high risk and subjective.*
	Series of upper time limits (two years generally, three years for projects with up to five years for Canterbury recovery projects) (see paragraphs 20-26 for further explanation)	- Is the approach adopted in a number of other countries. - Removes uncertainty around where boundary is drawn so should reduce compliance and administration costs. - Extended upper limits for projects and for Canterbury recovery work provide flexibility to avoid equity issues. - This flexibility should also not impede labour movement and normal business activity. *Preferred option as limits risk and provides flexibility without subjectivity.*
	Upper time limit with Commissioner discretion to extend (see paragraph 27 for further explanation)	- Removes some uncertainty around the boundary of what is/is not taxable, upper limit provides a safe harbour, and discretion allows for special circumstances. - Commissioner discretion would involve more compliance and administration costs. - Application of Commissioner discretion may impact on fairness/consistency.

		- Commissioner discretion provides flexibility to avoid impeding labour movement/normal business practice. *Not preferred option as although limits fiscal risk and provides flexibility, may cause inconsistency.*
Valuation of taxable accommodation benefit	Market value	- Compliance and administration costs minimised as is current valuation approach and therefore well understood. - May not be fair where employee provided high priced accommodation that employee would not normally occupy but for the requirements of the job. May impede labour mobility in such cases.
	Market value with standard adjustment	- Compliance costs dependent on nature of the adjustment. - Standard adjustment difficult to determine and application could be too wide, so raises issues of fairness and economic costs.
	Market value with caps for church-supplied property, for those posted overseas (see paragraph 28 for further explanation), and possibly for New Zealand Defence Force housing	- Generally limits compliance and administration costs. - Targets adjustment to specific cases identified as requiring adjustment. *Preferred option for this reason.*
Meals payments during work travel	Upper time limit – tax after 3 months (see paragraphs 29 and 30 for further explanation)	- Removes uncertainty around where boundary is drawn so should reduce compliance and administration costs. - Should be sufficient for vast majority of journeys away from normal workplace so should not impede normal business activity, while recognising extra costs for employee. - Limits fiscal risk associated with alternative option of having no limit. *Preferred option.*
Clothing payments	Distinctive work clothing exemption (see paragraphs 29 to 31 for further explanation)	- By in effect codifying the outcome of case law and mirroring fringe benefit tax treatment when clothing provided by employer instead of an allowance, it provides greater clarity and therefore reduces compliance costs relative to the status quo of relying on general rule. - Plain clothes exemption for uniformed services reflects long-standing practice recognising specific circumstances.
General rule for other payments	Some minor clarifications and a Commissioner determination power to specify proportion of benefit that is taxable (see paragraphs 32 to 34)	- Improves status quo by providing more clarity and flexibility to handle future questions over what is taxable/not taxable while retaining current rules. - Alternative of a substantial revision would lead to greater uncertainty with no guarantee of improvement.

17. More discussion of these points in the context of each area of employee expenditure payment is provided below.

Employee accommodation

18. Employer provided and funded accommodation provides an inherently private benefit to the employee and should generally be taxed, particularly if provided as part of a salary trade-off. However, in some instances there is little benefit to the employee, largely because the accommodation or payments arise from the requirements of the employer or the job. In such cases there should be no tax liability. The key problem is identifying a workable boundary between private and work-related expenditure so only private expenditure is taxed.

Accommodation linked to work travel (and secondments)

Tax exemption when no net benefit

19. To establish this boundary, as noted earlier, many employers have in the past adopted a "net benefit" approach which takes into account whether an employee maintains a home elsewhere for their use and where this is the case, it is then argued that there is no taxable benefit when the employer provides accommodation. This is on the basis that the value of the accommodation related to the work secondment is wholly linked to the employee's job and is extra to the employee's on-going normal home costs. However, such an approach is highly subjective requiring an evaluation of an employee's personal affairs to determine the right tax outcome which may not be possible at the time of payment. It would also be difficult for Inland Revenue to audit and would result in significant administration costs. Whilst in many instances the employee will be incurring extra costs because of the 'temporary' nature of the 'move', the question is the point at which maintaining a home elsewhere is a matter of personal choice for the employee that ought to be recognised as a taxable benefit. The net benefit approach ignores this key issue.

Tax exemption subject to time limits (recommended option)

20. A test or tests based on objective rules may be easier for employers and employees to understand. Some time limit cut-off would be required to establish a suitable boundary and this would also need to take account of fiscal considerations[3].

21. The issues paper suggested a one year bright line test for accommodation linked to work-related secondments of existing employees. However, feedback suggested that a one year limit would be too short for a significant proportion of temporary shifts such as work-related secondments. Consultation indicated that a two year time limit should cover the vast majority of cases in New Zealand. However, there were still concerns in relation to longer-term projects. Options considered for dealing with these concerns included an increased time limit for projects, including the Canterbury earthquake recovery, or alternatively, a power for the Commissioner to agree to an increase in the two year time limit in particular cases. A variant of this alternative option was for the taxpayer to self-assess whether they qualified for a time extension against a set of fact-related criteria.

22. Accordingly, for the general situation, our preference is for a tax exemption linked to a two year upper time limit.

23. Given that increasing any time limit beyond two years for employees in general would not be necessary for most work-related secondments, our preferred option is to allow a limited extension to three years for major projects of limited duration. To qualify the employer will need to have been contracted by an unrelated third party to supply employees to work specifically on such a project for a duration of no more than three years. (While the employee's contracted work cannot exceed a maximum of three years, the duration of the project could be longer.) Both new and existing employees would be potentially eligible in this case.

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[3] An exemption with an upper time limit is the approach used in Australia, Canada, the United Kingdom and the United States. Australia and the United States have a tax exemption with a one-year upper time limit, while Canada and the United Kingdom have a tax exemption with a two-year upper time limit.

24. This extension would be in recognition of the long-term nature of the engagement in these sorts of projects and that some of the projects are often not located where employees might want to relocate permanently. The employees might be employed on a fly in/fly out basis, so would not be relocating, or recruited specifically from overseas with no intention that they ever relocate to New Zealand.

25. Even a three year time limit might not be a long enough period for many of the individual projects that will be undertaken as part of the Canterbury earthquake recovery. Consequently, the package includes a separate transitional rule specific to accommodation provided to employees working on Canterbury earthquake reconstruction projects, over the period 4 September 2010 to 31 March 2019. The recommended maximum tax-free accommodation period is five years for employees arriving in the period 4 September 2010 - 31 March 2015; four years for arrivals in the period 1 April 2015 – 31 March 2016, and three years thereafter. However, Canterbury recovery work will eventually come to an end, at which point the general rules would apply. Consequently, the specific exemption would cease from April 2019.

26. The advantage of the option of a series of upper time limits is that it provides flexibility to handle a wide range of business situations and should not impede labour mobility. At the same time it balances the equity issues associated with ensuring that a pragmatic boundary is drawn to delineate what is a private, and hence taxable, benefit. Since employers and employees can identify the treatment upfront, it aids in limiting compliance and administration costs.

Commissioner discretion to extend

27. The alternative option of giving the Commissioner of Inland Revenue a discretion to extend the two year time period would also provide additional flexibility for particular cases. However, ideally the factors the Commissioner would take into account would be defined in legislation, along with any upper time limit to the extension. There would be additional compliance and administration costs in applying such an approach. Whilst some employers might welcome this discretionary approach, there is scope for inconsistency in how the power is applied and if the factors can be defined in legislation it is questionable whether there would be much to be gained by requiring employers to apply for, and Inland Revenue to consider, an extension of time. The same concerns would apply if the extension was self-assessed by the taxpayer and could lead to more disputes between Inland Revenue and taxpayers. (Consequently, we prefer a series of upper time limits rather than a Commissioner discretion as in the previous option.)

Employees with more than one workplace

28. There are also a number of circumstances in which an employee has to work at more than one workplace on an on-going basis, because of the nature of their duties, and the additional workplaces are beyond reasonable daily travelling distance from their home. This could be the case, for example, for senior managers of large organisations. In these circumstances, because of the on-going nature of the two workplaces and the associated costs, an upper time limit is not appropriate. Accordingly, our recommendation is to introduce an exemption for employer-provided accommodation and accommodation payments in such circumstances, without an upper time limit.

Value of accommodation benefits

29. When employers provide accommodation to their employees, the current approach is to base the taxable value on market rental value. The recommended approach is to leave this well understood approach unchanged, but to make the position clearer in legislation, including recognition of any contribution made by the employee. However, adjustments to this market value rule are recommended for:

- *Ministers of religion:* A longstanding existing administrative practice has capped the benefit of church-supplied accommodation at 10% of stipend. From a policy perspective this accommodation provides a significant private benefit and should be taxed like salary and wages given that no rent is charged. However, removing the existing practice would place a significant additional cost at relatively short notice on individual churches at a time when they have other significant financial obligations, such as making earthquake strengthening repairs. There is a case therefore for continuing the effect of the longstanding practice in a way that is workable, and across the spectrum of churches. This could be by way of a full exemption or by simply including the current practice in legislation. In either case, it would seem more workable to include both rented as well as owned accommodation provided to ministers as they are largely substitutable. A specific valuation rule is recommended for accommodation supplied (whether owned or rented) by religious bodies to their ministers, subject to a reasonableness test that would cap the exempt amount at a reasonable market rental value.

- *Accommodation for employees working overseas:* The recommendation is to cap the benefit value at the rental value of a property that the employee would be expected to occupy in New Zealand. This would be for fairness reasons, to ensure that the attributed tax value does not exceed the perceived benefit from the accommodation.

- *New Zealand Defence Forces (NZDF):* Historically the NZDF had an administrative arrangement allowing for a discount of up to 40% of market value, meaning in effect there was no taxable benefit when personnel paid below market rents. This arrangement was terminated in December 2012 by the Inland Revenue Commissioner's statement on accommodation. The NZDF was moving incrementally towards market values as part of a wider review of terms and conditions, however, this was subsequently suspended in August 2013. Currently, the main differences between market value and the rental charged by the NZDF arise in Auckland (where rents are on average nearly 20% below market) and, to a lesser extent, Christchurch. The NZDF has argued for a continuation of past practice based on the special nature of the armed forces and the housing provided (such as being on base and subject to certain restrictions).

  Generally, following the principles of a broad-base, low-rate tax system, the full market value should be used to determine whether there is any tax liability. The NZDF could gross up the salaries of the affected personnel to cover the tax (and any social assistance) implications of applying full market value. However, there is debate over what is an appropriate market value for NZDF accommodation that sufficiently takes into account the additional restrictions of military life. Arguably, therefore, there is a case for continuing the past practice of discounting the market value and incorporating it into tax legislation, either temporarily through to 1 April 2016, or permanently.

Employee meals

30. Employers typically meet an employee's meal costs when linked to work-related duties. Arguably the amount of normal expenditure saved by the employee is taxable. In these circumstances any private element is likely to be low in value and difficult to measure. The options considered ranged from exempting the full amount of the cost of meals linked to work-related travel without limitation to limiting the exemption either to where there are overnight stays or a three month upper time limit at a particular work location. A limitation was considered to be necessary to limit the fiscal cost of and incentive for salary substitution. A three month time limit was considered preferable to a limitation based on overnight stays because it would better match when an employee incurred additional expenditure as part of work travel and a cut-off that employers might reasonably apply in paying for employee meals.

31. A further recommended option is to exempt reimbursements for working meals and conferences and light refreshments, provided the payments are not a substitute or trade-off for salary. These recommendations are largely consistent with current business practice and should, therefore, have minimal impact on business behaviour and compliance costs.

Distinctive work clothing

32. A specific exemption for payments provided to cover the costs of buying and maintaining distinctive work clothing, such as uniforms, is recommended on the basis that the payments are clearly related to the employee's job. The provision of such clothing is already specifically exempted from fringe benefit tax. Payments in relation to the purchase and maintenance of other clothing would be subject to the general rules for determining when a payment that does not have its own exemption rules is tax-exempt.

33. The alternative option was to just rely on the general rule and existing case law, but the additional certainty of a specific exemption was considered to be preferable. This exemption would be along the lines of the fringe benefit exemption when employers provide distinctive clothing rather than a cash allowance.

34. This distinctive clothing exemption will also cover partly taxable plain clothes allowances that were in place as at 1 July 2013 and paid to uniformed personnel who are required to wear plain clothes in order to carry out their duties. For example, there has been a longstanding expectation that a portion of the plain clothes allowance paid to police officers is non-taxable, based on the specific circumstances involved. Under normal circumstances, however, the provision of ordinary clothing or an allowance to purchase ordinary clothing would be a taxable benefit.

General rule for determining taxable portion of other expenditure payments

35. Our preferred option is to leave the rules that determine what other benefits are provided tax-free largely unchanged. The general rule requires the expenditure in question to be incurred in connection with earning the employee's employment income and exempts the reimbursing payment from tax to the extent that the expenditure is not a private or capital expense. Although this requires a judgement to be made about the nature and extent of any private benefit, any alternative test would require similar judgements to be made. There would, therefore, be significant administrative and compliance costs in moving to any new general rule, without any guarantee of delivering additional clarity.

36. However, an enhancement can be made without a fundamental alteration by clarifying when an expense would be incurred in connection with earning employment income. Under this recommended option several criteria would be added to the general rule, focusing on whether the expenditure was incurred because of the obligations of the job or as a practical requirement of the job.

37. We also recommend adding a Commissioner's determination making power specifying the proportion of any class of payment that would be taxable or exempt. Such a determination would be binding on the Commissioner but optional for the taxpayer. To limit the need to use this power to determine an exempt proportion, the payment involved would need to affect a large group or class of employees, and the Commissioner would need to be of the view that the private or capital benefit involved was low in value and/or hard to measure, and involved no salary re-characterisation (that is the payment was provided mainly for business purposes). This power would provide flexibility in handling future questions over what is the taxable portion of a type of payment and should be a more efficient process than requiring a law change when issues over apportionment arise.

CONSULTATION

38. Following informal consultation with a number of individual businesses and key business representatives, Inland Revenue published an officials' issues paper in November 2012, *Reviewing the tax treatment of employee allowances and other expenditure payments,* setting out the scope of the issues and its initial thinking in this area about the options for resolving them. Submissions on the issues paper led to further refinement of the options suggested in the paper.

39. Twenty-seven submissions were received. In general, submitters welcomed the review as a positive move to clarify the law in this area and supported the policy principles set out in the paper[4]. However, some submitters took the view that the starting position should be that any payment by an employer to cover an employee expense should not be taxable unless it is specifically a reward for services (or similar).

40. Submitters were also positive about any moves to clarify and make the law more certain. In particular, the proposals to exempt the full amount of any meal payment (rather than the excess over the employee's normal day to day costs) for a three month period, working lunches and light refreshments were welcomed.

41. Most submissions focused on the tax treatment of accommodation expenses linked to work-related travel and establishing a boundary between private and work-related expenditure. There was some focus on costs for employers in complying with any new interpretations or rules, particularly when the types of payments likely to be affected are minor and any tax consequences are relatively small.

42. Given the main areas of concern were around the tax treatment of employer-provided or funded accommodation, substantive further consultation was undertaken to discuss this with a range of employer representatives. A number of submissions favoured the net benefit approach to the tax treatment of accommodation payments or, alternatively, a safe harbour

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[4] See objective 2 in paragraph 13 for an outline of those principles.

time period with the ability to extend beyond that time period if certain fact-based criteria were considered to be met. We did not agree that these options were the best approach, for the reasons explained earlier regarding the consistency question and the compliance and administration costs of such approaches.

43. Our view was that a better approach was to focus solely on a simpler test linked to an upper time limit. Consultation then focussed on the length of any time limit for accommodation linked to work-related travel. Those consulted thought a two year time limit should cover the vast majority of work-related secondments, based on anecdotal evidence. Some even commented that a two year limit would be generous in a number of cases.

44. However, there were concerns that this time limit would not be long enough in all cases and that the exemption should also apply to accommodation for new employees in certain situations. In particular, issues were identified about how well a time limited rule might work for longer-term projects – mainly large-scale construction projects that take longer than two years to complete. These include work on the Canterbury earthquake recovery (where there will be a number of major longer term projects with construction workers moving between different projects), projects in other locations throughout New Zealand (for example, the ultra-fast broadband roll-out, dam rebuilds and other major water storage projects, and road building projects such as Transmission Gully), and international secondments (which often last for two to three years). The recommended rules have taken this into account and included new employees in the 3 year test so as to provide the same tax treatment as existing employees.

45. The Treasury has worked closely with Inland Revenue on this review of employee expenditure payments.

CONCLUSIONS AND RECOMMENDATIONS

46. It is recommended that changes be made to the legislation determining the tax treatment of employee expenditure payments and employer-provided accommodation to improve clarity and certainty.

47. In doing so, the proposed approach would result in the following outcomes for accommodation, meals, clothing and the general rule covering other employee payments:

Accommodation
Employer provided/funded accommodation linked to work travel
a) Employer-provided accommodation or an accommodation payment will be tax exempt when: • An employee is required by their employer to move to a new work location and that location is not within reasonable daily travelling distance of their home; and • Either i. the move is not project specific but there is a reasonable expectation that the employee's secondment to that work location will be for a period of 2 years or less, in which case the payment is exempt for up to 2 years; or ii. the move is to work on a project of limited duration for a period of 3 years or less, in which case the time limit is 3 years.

b) The accommodation payment will cease to be tax exempt before the respective maximum period if any of the following occurs:
- The employer makes a tax-free relocation payment to assist an employee buy a property in the new work location (an indication that the shift is more than temporary); or
- The expectation that the employee will be at the new location for, as relevant, a maximum of two years or three years changes.

c) The rules will also be subject to certain conditions to protect against abuse:
- The exemption would not apply if accommodation is provided under a salary trade-off arrangement.
- There would be an anti-avoidance rules to prevent behaviour intended simply to restart the relevant time limit.

d) The above exemptions would apply to accommodation or accommodation payments with existing employers. New employees could also qualify for the three year exemption when they move to work on a particular project of limited duration - for example, when an individual is recruited to work on a project to build a new thermal power station in a remote location. New employees would only qualify for the two year exemption when:
- an employee is recruited to work at a particular work location but is then sent to work at another work location temporarily; or
- an employee working for one employer is seconded to work for another employer on a temporary basis, with the expectation that the employee will return to work for the original employer.

e) The upper time limit for Christchurch recovery projects would be:
- five years if the date of arrival is in the period 4 September 2010 to 31 March 2015;
- four years if the date of arrival is in the period 1 April 2015 to 31 March 2016; and
- three years when the date of arrival is in the period from 1 April 2016 to 31 March 2019.

f) Employers and employees would have the choice of applying these revised rules retrospectively to accommodation arrangements put in place on or after 1 January 2011 (4 September 2010 for Christchurch accommodation). Otherwise, the rules would apply from 1 April 2015.

Accommodation when employee has more than one workplace

There are a number of circumstances when an employee, because of the nature of their duties, has to work at more than one workplace on an on-going basis and these additional workplaces are beyond reasonable daily travelling distance from their home. An exemption for an accommodation payment in such circumstances, without an upper time limit, is recommended.

Value of taxable accommodation benefits

When employer provided accommodation is not tax exempt, a mechanism is required to determine the taxable value. The current approach is to base the taxable value on market rental value. We recommend continuing this approach but with some clarification around what constitutes 'market value' in certain circumstances:

Accommodation benefits linked to a particular job – A specific valuation rule for church-supplied accommodation provided to ministers of religion is recommended given the specific historical tax treatment in their case of valuing the benefit at 10% of stipend. The tax exempt amount would be limited to the extent that the accommodation is a reasonable amount for the area and the nature of the minister's duties. There is also debate over whether the market rental value test adequately takes into account the additional restrictions applied to personnel who rent New Zealand Defence Force accommodation.

Accommodation for employees working overseas – The value of employer provided accommodation in overseas locations can be particularly high – this issue is of relevance to MFAT staff posted to overseas embassies, for example. To address this issue, we recommend the taxable value should be capped at the value of a property the employee might reasonably be expected to occupy in New Zealand.

Payments to cover meals
Work-related travel meals – We recommend exempting the full amount of meal payments linked to work-related travel, subject to a three month upper time limit at a particular work location. ***Other meals*** – We recommend exempting the full amount of meal payments linked to work-related meals outside of work-related travel and the meal arises because of the nature of the work. This would cover meals at conferences, for example. ***Light refreshments*** – We recommend exempting payments to cover the cost of light refreshments, such as basic tea and coffee, away from the employer's premises when the employer provides refreshments on those premises.
Payments to cover distinctive work clothing
We recommend exempting: • payments to cover the cost of purchasing and maintaining distinctive work clothing, such as uniforms; and • that part of a plain clothes allowance that had previously been treated as non-taxable if: the allowance was in effect as at 1 July 2013; it relates to employees who have been issued with a uniform but, because of the nature of their current duties, are required to wear ordinary clothing; and part of the allowance was previous treated as taxable.
General rule for determining the taxable portion of other expenditure payments
We recommend: • Clarifying the current general rule for determining whether an employer payment is taxable by including several criteria that focus on whether the expenditure was incurred because of the obligations of the job or as a practical requirement of the job. • The Commissioner of Inland Revenue be given a power to determine, by way of binding determination, the proportion of a particular type of payment that is taxable when the private or capital benefit is hard to measure, low in value and not a salary substitute. • A minor technical modification to the general exclusions from the definition of "expenditure on account of an employee" to clarify the way the relevant provisions operate.

IMPLEMENTATION

48. To address issues of uncertainty around applying the current rules, employers and employees will have the choice of applying these revised rules retrospectively to accommodation arrangements put in place on or after 1 January 2011 (4 September 2010 for Christchurch accommodation). Otherwise, the rules would apply from 1 April 2015.

49. Any initial compliance costs arising from gaining familiarity with the new rules can be limited by releasing clear guidance on the operation of these new rules through existing Inland Revenue channels. Inland Revenue customer information products would be updated (for example, guides, booklets, fact sheets and website). Inland Revenue is considering the merits of an on-line tool to help individuals when self-assessing how the new rules will apply in particular circumstances.

50. Consistent with existing tax rules, individual taxpayers would be required to comply with the existing individual tax return (IR3 return) and information obligations. Employers would be required to comply with any new PAYE obligations. Generally, taxable employee expenditure payments and the benefit of employer provided accommodation are taxable income of the employee and therefore subject to PAYE. Employees who receive the benefit of such payments or accommodation will also be required to include them in their social assistance calculations.

51. The administrative impacts of the recommended changes are likely to be small as no system changes will be required.

52. Enforcement of the proposed changes will be managed by Inland Revenue as part of its usual business and no specific enforcement strategy will be required.

MONITORING, EVALUATION AND REVIEW

53. Inland Revenue will monitor the outcomes pursuant to the Generic Tax Policy Process ("GTTP") to confirm that they match the policy objectives. The GTPP is a multi-stage policy process that has been used to design tax policy in New Zealand since 1995.

54. The final step in the process is the implementation and review stage, which involves post-implementation review of legislation, and the identification of remedial issues. Opportunities for external consultation are also built into this stage. Any necessary changes identified as a result of the review would be recommended for addition to the government's tax policy work programme.

Annex – consideration of options

The key objectives identified for the review were as follows:
(C) Compliance *– improve clarity and certainty, thereby improving compliance.*
(F) Fairness *– ensuring individuals pay their fair share of tax and social assistance payments are targeted at those in genuine need.*
(E) Economic efficiency *– ensure that tax rules are not an impediment to business decision making.*

To achieve the objectives outlined above, a number of options were considered as follows:

Impacts				Risks	Net Impact Does option meet objectives?
Compliance	**Economic**	**Social**	**Fiscal impact**		
Issue 1: Tax treatment of employer provided or funded accommodation during work travel					
Option 1: Net Benefit test – make a specific adjustment for costs incurred by an employee when they retain a property elsewhere					
Requires on-going assessment of employee's personal circumstances and judgements about personal benefit and intentions, which may change. A retrospective assessment will often be necessary. An upper time limit or detailed criteria to limit permanent secondments might also be warranted which would bring additional costs. Formalising approach in law would require more rigorous application and compliance by employers, and introduce uncertainty/ more compliance and administration costs.	Reflects approach many employers have been taking so may not impact on business decision making. However, likely to overcompensate/ distort behaviour if applied without any time limit or subjective criteria to preclude permanent moves.	Presents significant fairness and equity issues with employees working side by side and incurring similar expenses having different tax and social assistance outcomes depending on personal circumstances.	Fiscal effect not expected to be significant unless it encourages salary trade-off, particularly for longer terms secondments unless it was combined with a time cap and/or salary trade-off exclusion. Does not recognise private benefit to employee of long-term accommodation.	Formalising net benefit approach in law would require greater compliance costs for employers and administrative costs. Risk of incentivising salary substitution.	**C.** No **F.** No **E.** Partly Overall, likely to require significant compliance and administrative costs. Because it only considers availability of a home elsewhere, does not recognise personal choice element of longer term secondments.

Impacts				Risks	Net Impact Does option meet objectives?
Compliance	**Economic**	**Social**	**Fiscal impact**		
Option 2: Full exemption – no time limit – exempt accommodation payment made when working temporarily away from the employee's normal workplace					
Full exemption would remove valuation issues, such as determining what might constitute "additional accommodation costs".	Recognises that in the majority of cases, accommodation costs are work expenses that are wholly additional to the employee's normal day-to-day household costs. Works against the relocation exemption which provides for a 3 month exemption on relocation. Encourages permanent moves to be dressed up as temporary, in other words distorts behaviour.	Employees who are required to work away from home because of their job would not be subject to tax, for however long they were away. Does not recognise that after a period of time, the new work location becomes a "home" location for the employee and means the significant private benefit would not be recognised for tax purposes and social assistance calculations.	Because this option does not set an upper time limit for making a tax-free payment, it presents a long-term significant fiscal risk in allowing a payment to be traded for salary.	There is a very significant fiscal risk from having an exemption that allows a very significant private benefit to be provided without limit. Places considerable strain on a salary substitution rule.	**C.** Yes **F.** No **E.** Yes Although low compliance and administrative costs, this option presents a significant fiscal risk that an income substitute will go untaxed because the exemption is uncapped. It also fails to recognise the significant private benefit to an employee in the longer term.
Option 3: Full exemption with upper time limits **(recommended option)**					
Provides recognised boundary so that outcome is known in advance. Removes any requirement to compare accommodation costs in different locations so relatively easy to measure any taxable amount. Setting a clear boundary provides a safe harbour and removes the uncertainty under the current approach which is linked to the employee's personal circumstances.	Provided the upper time limit is set at an appropriate period it should not act as a barrier to moving employees to work locations for business reasons. However, some employees will find themselves on the wrong side of the boundary.	Depending on where the time limit is set, would impact on social assistance payments of workers on very long-term secondments. However, for the vast majority of employees this should not be an issue.	This is more generous than the current approach as set out in the Commissioner's interpretation statement, and provides clearer boundaries. The vast majority of travelling employees will be unaffected so unlikely to be a significant fiscal impact.	A time limit creates a cliff edge and some employees will inevitably find themselves on the wrong side of it. If the time limit is set too low, it could act as a barrier to employee mobility and if set too high would create a fiscal risk.	**C.** Yes **F.** Yes **E.** Yes Overall, removes a lot of the uncertainty around the boundary of what is and is not taxable. The taxable amount should be easy to measure and unlikely to lead to salary substitution. The 3 year rule for longer-term projects and further time extension for Canterbury earthquake recovery work mean that there should be fewer employees at the margin.

Impacts				Risks	Net Impact Does option meet objectives?
Compliance	**Economic**	**Social**	**Fiscal impact**		
Option 4: Full exemption – upper time limit with power to extend in certain circumstances					
Removes any requirement to compare accommodation costs in different locations so relatively easy to measure any taxable amount. Setting a clear boundary provides a safe harbour and removes the uncertainty under the current approach which is linked to the employee's personal circumstances. Compliance and administration costs associated with any application to Commissioner for an extension of time.	Provided the upper time limit is set at an appropriate period to reflect the upper time limit in most cases, it should not act as a significant additional barrier to moving employees to long-term work locations. A power to extend the time limit would bring additional flexibility allowing the rule to cater for non-standard circumstances where a fixed limit might not be sufficient.	Provides a boundary to recognise the point at which long-term accommodation should be treated as providing a private benefit that should be taken into account in income calculations. Depending on where the time limit is set, would impact on social assistance payments of workers on long-term secondments. However, for the vast majority of employees this would not be an issue. Power to extend provides some additional flexibility around the margins. There would be fairness issues depending on how this was applied.	This broadly reflects the current approach as set out in the Commissioner's interpretation statement, although with a clearer boundary. Therefore, depending on where the upper time limit is set, unlikely to be a significant fiscal impact. Administration costs if leads to significant number of requests for extension. Need to identify criteria for extension in which case why not include in legislation?	A time limit creates a cliff edge and some employees will inevitably find themselves on the wrong side of it. If the time limit is set too low, it could act as a fiscal barrier to employee mobility and if set too high provide a fiscal risk.	**C.** Partly **F.** Yes **E.** Yes Removes some uncertainty around the boundary of what is and is not taxable. Taxable amount should be easy to measure. Having a power to extend the time limit overcomes some of the borderline issues with a fixed upper time limit. However, unless CIR power narrowly drawn, it introduces administrative costs, uncertainty and potential fairness issues if there is an inconsistent approach to applying any extension power.
Issue 2: Tax treatment of employer provided or funded accommodation at or near normal work location (e.g. caretaker)					
Option 1: Tax full market rental value, adjusted for a range of factors					
Difficult to establish adjustment as requires a subjective assessment to be made about a range of factors personal to the employee that will vary on an individual basis; for example perceptions about the drawbacks to living at or near the job.	Would remove or substantially reduce disincentives to labour mobility since if accurate would ensure the employee was only taxed on the perceived benefit rather the market rental value which may not always be reflective of the benefit when the employee would choose to live in cheaper location.	Would mean the employee was only taxed on the perceived benefit, resulting in neither over nor under taxation. However, it is unlikely that an accurate and fair figure could be established as perception of the effect of the factors would vary substantially.	Since the current approach is to tax market rental value, there should be a fiscal cost. However, the value of this is unclear since it is not certain that employers are currently always taxing full market rental value.	Would be likely to lead to significant additional administrative costs in Inland Revenue agreeing taxable values and additional compliance costs for employers in establishing the discounted value.	**C.** No **F.** Partly **E.** Yes Overall, whilst theoretically this option results in the correct value being taxed, this is unlikely to be the case. It would be very difficult to quantify accurately the discounted value which would also depend on the particular factors.

Impacts				Risks	Net Impact Does option meet objectives?
Compliance	**Economic**	**Social**	**Fiscal impact**		
Option 2: Full exemption if employee required to occupy property in order to do job					
Significant issues would arise in identifying the circumstances in which a particular property should be exempt. There would be on-going compliance issues in policing the boundary with self –assessment by an employer being subject to subsequent scrutiny under Inland Revenue audit.	Runs counter to principle that the tax system should be neutral in economic decision making, and broad based with few exemptions.	An employee required to occupy a particular property would not have their social assistance entitlements and obligations affected. However, there would be fairness issues relative to other employees.	Whilst there may be significant drawbacks to "living on the job", an employee will still enjoy a substantial private benefit from employer provided accommodation which would not be taxed or taken into account for social assistance calculations. Once exempted, difficult to change at a later date because of the impact on individual employees and their families.	Introducing a general exemption would introduce significant compliance and administration issues in identifying and policing the boundary. Potentially, it could lead to salary substitution because of the substantial tax-free benefit that would arise and calls for extension of the exemption.	**C.** No **F.** No **E.** No Overall, a general exemption would bring new compliance issues in identifying which housing should be exempt, fairness issues in deciding which employees should have their housing treated as exempt and economic efficiency concerns that those employees were not being taxed on a valuable private benefit.
Option 3: Tax full market rental value, but subject to a specific exemption or cap on value for church-owned accommodation supplied to ministers of religion **(recommended option)**					
This more or less reflects the current position and allows the use of well understood market rental values. Is a simpler rule of thumb than trying to adjust for perceived disadvantages in particular circumstances. By carrying forward an established practice, compliance costs should be kept down. Exemption or valuation cap for church owned properties recognises longstanding administrative practice. Not intended as general tax exemption for ministers of religion. Some argument for capping the value in relation to	Market rental value should broadly reflect the value of a particular property without the need for further complex adjustments. In most cases, it should result in the correct amount being taxed. However, employees are likely to be less willing to move to areas with high property values where they would otherwise rent in a cheaper location but for the job requiring them to be at that location.	Employees required to work in areas with high property values are likely to be less willing to move there given tax and social assistance implications of high rental values. However, high costs of living are often factored into salary and wages (which are taxable) in the alternative scenario of a purely cash package.	Fiscal cost associated with exemption/valuation cap for ministers of religion and for NZDF personnel. Otherwise, fiscal cost should be neutral since this option largely reflects the current position.	Because this approach carries the current practice forward, risks should be low. Potential impact on movement of labour to areas with high property values.	**C.** Yes **F.** Partly **E.** Partly Overall, this reflects the option with the lowest compliance costs and that best reflects the taxable value to the employee given the trade-off between accuracy and simplicity.

Impacts				Risks	Net Impact Does option meet objectives?
Compliance	**Economic**	**Social**	**Fiscal impact**		
accommodation provided by NZDF to its personnel given the historic practice of discounting market value to reflect the restrictions of military life.					
Option 4: Tax market rental value, but cap at a benchmark value					
Would mix two approaches but market rental value approach is well understood. Comparison with a capped value could be relatively straightforward if benchmarks identified.	This would have to be a fairly broad brush approach but, depending on where the cap is set could overcome the barriers to employee mobility that might arise with a link solely to rental values.	An advantage of this approach is that it avoids large tax charges arising when an employee is obliged to live in a particularly expensive location, where they might not otherwise live, because of the needs of the job.	Depending where the cap is set, the full private value to the employee may not be recognised, which could lead to under taxation and a fiscal cost.	The full private value to the employee may not be recognised, which could lead to under taxation and an incentive for salary substitution.	**C.** No **F.** Yes **E.** Yes A fairly broad brush approach which, because it would have to cater for the whole of the working population, would lead to under-taxation for a group of the population.
Option 5: Tax market rental value, but cap at a proportion of salary					
Would mix two approaches but market rental value approach is well understood. Capping at a proportion of salary could be more complex depending on how this is defined.	Depending on where the cap is set could overcome the barriers to employee mobility that might arise with a link solely to rental values. Linking to salary would be more flexible and provides a better link to taxable income than using a benchmark value.	Avoids large tax charges when an employee is obliged to live in a particularly expensive location where they might not otherwise choose to live.	The full private value to the employee in some cases will not be recognised, leading to under taxation and a fiscal cost.	The full private value to the employee in some cases will not be recognised, which could lead to under taxation and an incentive for salary substitution.	**C.** Partly **F.** No **E.** Yes A fairly broad brush approach which, because it would have to cater for the whole of the working population, would lead overall to more under-taxation of the accommodation benefit.
Issue 3: Tax treatment of accommodation when more than one permanent workplace					
Option 1: Exemption based on employee nomination of which is the permanent workplace					
Potentially low compliance costs if employee simply has to tell employer which accommodation payment should be tax exempt.	Employer can provide tax-free accommodation without there being a barrier to employee mobility.	Avoids tax charges when an employee has to work in multiple work locations away from home and social assistance implications.	Likely to be some fiscal cost because it would allow employees to pick that location that produced the exemption.	Allowing employee nomination could mean selection of the most tax advantageous location to be exempt which could be employee's home.	**C.** Yes **F.** No **E.** Yes Although there are low compliance costs with this option, allowing choice as to which accommodation should be exempt provides significant fiscal risk.

Impacts				Risks	Net Impact Does option meet objectives?
Compliance	**Economic**	**Social**	**Fiscal impact**		
Option 2: Exemption base on main place of work					
Requires a factual assessment to be made of the employee's main place of work – for example, the workplace the employee works from for most of the time. This would require a judgement to be made and reviewed on an on-going basis with some compliance costs for the employer.	Assuming the employee's home is near their main place of work, this approach would mean there was no accommodation barrier to the employee working away on an on-going basis.	Assuming the employee's home is near their main place of work, this approach would mean there was no accommodation barrier to the employee working away on an on-going basis.	Likely to be fiscally neutral.	Relies on an accurate assessment being made of the employee's main place of work. This may not be clear in some cases and require careful consideration. Alternatively it would be difficult to challenge any assessment.	**C.** Partly **F.** Yes **E.** Yes Reduces the fiscal risk that would arise under self-nomination. However, has slightly higher compliance costs in assessing the main place of work.
Option 3: Exemption if type of accommodation is considered temporary, for example a hotel room					
Employer would have to monitor the work accommodation being used to determine the tax treatment.	Subjective judgement on type of accommodation could be incorrect leading to under or over-taxation that drives decisions about form of accommodation offered. Could act as a barrier to the mobility of labour/impede business activity if employer or employee is unable to find the right type of accommodation.	Social assistance implications could be determined by something outside of the control of the employee – the type of accommodation. There are fairness issues around employees doing the same job having different tax treatment just because one employer placed their employee in different type of accommodation.	If limits accommodation options, then could be fiscally positive, but not an objective of the review.	That this could act as a barrier to mobility of labour or distort business behaviour.	**C.** No **F.** No **E.** No Likely to have additional compliance costs since the employer would need to monitor the nature of the accommodation costs being reimbursed and would result in some work-related accommodation being taxed and others under taxed with social assistance consequences.
Option 4: Distance from home **(recommended option) -** This option focuses only on the accommodation being beyond reasonable daily travelling distance from the employee's home (and therefore beyond the usual workplace).					
This should already be a consideration in the employer's decision to pay for accommodation and so should not bring significant additional compliance costs.	Exempts accommodation away from the employee's home so should not act as a barrier to the mobility of labour.	Exempts accommodation costs necessarily incurred from the job so should not bring any excess tax charges.	Should be broadly revenue neutral.	No particular issues identified.	**C.** Yes **F.** Yes **E.** Yes Introduces relatively low compliance costs and broadly exempts additional accommodation costs necessarily incurred because of the job.

Impacts				Risks	Net Impact Does option meet objectives?
Compliance	**Economic**	**Social**	**Fiscal impact**		
Issue 4: Tax treatment of accommodation when posted overseas					
Option 1: Tax market rental value					
Is practical. Assuming the rental market in the overseas location is well developed, it should be relatively easy to identify the taxable value.	Follows the normal model for taxing accommodation. However, since many overseas work locations are in particularly expensive cities and the accommodation may incorporate a work-purpose (e.g. embassy). If taxed to the employee there can be significant over taxation and therefore a disincentive to work overseas when remaining New Zealand tax resident, for example government employees.	If working in a particularly expensive overseas location but retaining NZ residency, this could have a significant impact on social assistance payments.	Reflects the current law so no material cost implications likely.	Can act as a barrier to mobility of labour.	**C.** Yes **F.** Partly **E.** No Maintains the current position of taxing in full.
Option 2: Tax market rental value but cap at a proportion of salary					
Is practical. Assuming the rental market in the overseas location is well developed, it should be relatively easy to identify the taxable value. Ease of compliance determined by identifying correct salary entitlement.	Reduces the addition to taxable income to an amount commensurate with the employee's salary so it is affordable and not a disincentive to working overseas. In some cases it provides a subsidy to employees, depending on salary level chosen.	Reduces the addition to taxable income to an amount commensurate with the employee's salary so it is affordable and this carries across to social assistance implications.	The numbers are likely to be small so unlikely to be significant cost implications.	The numbers are likely to be small so risks are likely to be small.	**C.** Yes **F.** Partly **E.** Yes Caps the taxable amount at a level in line with the employee's remuneration package.
Option 3: Tax market rental value but cap at benchmark New Zealand property value **(recommended option)**					
As above for previous option – but requires knowledge of employee's circumstances in New Zealand.	As above for previous option.	As above for previous option.	As above for previous option.	As above for previous option.	**C.** Yes **F.** Partly **E.** Yes Caps the taxable amount at a level in line with what a NZ employee might expect to pay.

Impacts				Risks	Net Impact Does option meet objectives?
Compliance	**Economic**	**Social**	**Fiscal impact**		
Issue 5: Whether to tax accommodation benefits under income tax or fringe benefit tax (FBT)					
Option 1: Tax under FBT, with inclusion of fringe benefit in income for social assistance/obligation calculation					
Aligns with other fringe benefits but there are compliance costs associated with the change. However, the employer is already currently involved in collecting tax, through PAYE.	Would not alter who ultimately bears the cost of the tax. Would need to ensure benefit continued to be included in income for social assistance purposes. Otherwise, would encourage provision of accommodation benefits.	Neutral, provided benefit included in social assistance calculations.	Potential fiscal gain as would be taxed to employer at a higher rate.	Risk that benefit may not be included when calculating income for social assistance purposes.	**C.** Yes **F.** Yes **E.** Yes This approach would align with other fringe benefits and be taxed to the employer. However, without special rules, it would result in a very significant fundamental benefit being excluded from social assistance considerations.
Option 2: Tax under income tax **(recommended option)**					
Continues the current approach so no new rules for the employer to be concerned about.	Continues the current approach so no new incentives/ barriers to employee mobility.	Ensures that a very substantial personal benefit is taken into account for social assistance purposes.	No costs anticipated.	No particular risks identified.	**C.** Yes **F.** Yes **E.** Yes This option maintains the current approach which has been established for a long time.
Issue 6: Tax treatment of meal payments during work travel					
Option 1: Full exemption – no upper time limit					
Employers and employees would not need to apportion any payments once they establish that meal expenses have been incurred on a work journey which would avoid significant compliance costs.	Ensures no barrier to employee mobility for work purposes.	The additional cost the employee spends on meals linked to work travel is not taxed nor taken into account for social assistance purposes.	There may be a cost if the employee swaps taxable salary for a meal payment since it covers a significant private benefit.	Risk of salary trade-off for meal payments over a prolonged period.	**C.** Yes **F.** No **E.** Yes Over time, could encourage higher allowances and salary substitution.

Impacts				Risks	Net Impact Does option meet objectives?
Compliance	**Economic**	**Social**	**Fiscal impact**		
Option 2: Full exemption – limit to overnight stays					
As above for option 1. However, employers would need to distinguish whether overnight stay involved with employee travel.	Would not recognise that some employees may incur additional costs even when overnight stay is not required.	More limiting than current practice. The additional cost the employee spends on meals linked to work travel without an overnight stay is not taxed nor taken into account for social assistance purposes. May lead to some currently untaxed payments affecting social assistance.	There may be a cost if the employee swaps taxable salary for a meal payment since it covers a significant private benefit.	Risk of salary trade-off for meal payments over a prolonged period, but limited significantly by employee needing to be away.	**C.** Yes **F.** Partly **E.** No Assumes that when a work journey does not involve an overnight stay the employee does not incur significant additional meal costs.
Option 3: Full exemption – subject to upper time limit of three months **(recommended option)**					
As for option 1. However, there would be an upper time limit that employers would have to comply with, although this would set a clear non-taxable/taxable boundary for employers.	Any time limit would need to be sufficiently long so that it covered the vast majority of work journeys away from the normal place of work so it does not act as a barrier to the mobility of labour. Three months is considered appropriate in this context.	The option would mean work related meal expenses would be excluded from an employee's income calculation. Any time limit would inevitably mean some employees find themselves on the wrong side of it, which could result in some employees being taxed on some expenses.	No significant costs anticipated since employers normally only reimburse work-related meals.	Risk of salary trade-off for meal payments, but limited by three month cut-off.	**C.** Yes **F.** Yes **E.** Yes The employer would not have to worry about identifying the notional private/ work split of a meal payment – it would be not taxable at all, or taxable in full. Setting an upper time limit would recognise the additional expenses linked to work-related travel, and that these costs are normalised after a period of time.
Option 4: Exempt amount saved, in other words, the amount taxable under current law					
There would be a significant compliance cost from the employer having to identify the employee's normal meal expenses. This would be very difficult, if not impossible, to do.	There would be an impediment to normal business activity if employers and employees had to undertake complex exercises to identify the taxable element of a meal expense.	The value of the amount saved would need to be taken into account in income for social assistance purposes. Given the relatively small individual amounts this would be difficult to identify and monitor.	Potentially, a small fiscal positive since the amount save is not currently taxed. However, this would be so difficult to identify employers would be reluctant to undertake the calculations.	The calculation required to identify the amount saved could prove to be near impossible to undertake.	**C.** No **F.** Yes **E.** Yes Because of the likely difficulties in identifying the amount saved and hence the taxable amount, this option is not seen as a realistic outcome.

Impacts				Risks	Net Impact Does option meet objectives?
Compliance	**Economic**	**Social**	**Fiscal impact**		
Option 5: Exempt a fixed portion or a capped amount					
A broad brush approach that should have relatively low compliance costs. The approach is already adopted by the USA and Canada which exempt 50% of any expenses. However, employers would have to change their processes to tax in part payments that are currently being paid tax-free.	Ensures that a significant element of any meal payment is tax exempt. However, the level of the cap will determine the extent of any impediment to normal business activity and labour mobility.	The taxable portion will be taken into account in income used for social assistance purposes. When an employee works away on a regular basis this could be a material amount. However, it should recognise the significant private benefit to the employee when the employer covers their meal costs.	This option would be fiscally positive since the amount saved by the employee is not currently being taxed. There is little information on the scale here and the amount would be determined by the deemed taxable element.	That the cap is set too high and acts as a barrier to normal business activity.	**C.** Yes **F.** No **E.** Partly Employers would have to change their processes to tax meal payments in part and account for this through PAYE.
Issue 7: Tax treatment of working lunches/ light refreshments					
Option 1: Exempt full amount – subject to upper monetary limit					
It provides a clear boundary. However, would introduce a cliff edge which employers would have to monitor and potentially allocate expenditure between employees, bringing significant compliance costs for relatively small amounts.	The boundary approach could result in employers paying up to the limit and no more. The boundary would require monitoring to maintain the real value or it could start to distort decisions.	No particular issues identified.	Unlikely to be a fiscal cost.	That the compliance costs would impact on business decisions and behaviour.	**C.** No **F.** Yes **E.** No Employers would have to monitor employee expenditure to ensure monetary limits are not exceeded and any excess is taxed. Depending on where the cut-off was set, could curtail normal business behaviour.
Option 2: Exempt full amount **(recommended option)**					
Employers would need to ensure that they satisfy any criteria for making tax-free payments, but otherwise no compliance costs.	No impacts.	No impacts.	No impacts.	Potential for private meal benefits to be paid by way of salary trade-off or otherwise as a tax-free – salary substitution rule for this.	**C.** Yes **F.** Yes **E.** Yes This option would reflect current practice so net impact likely to be minimal.

Impacts				Risks	Net Impact Does option meet objectives?
Compliance	**Economic**	**Social**	**Fiscal impact**		
Issue 8: Tax treatment of clothing payments					
Option 1: Tax in full					
A simple outcome since employers would tax all clothing payments.	Would also cover uniforms and specialist clothing that employees require to do their job, pushing up costs and distorting business decisions.	Assuming employers continue to make such payments, there would be an additional taxable income that would flow through into social assistance entitlements.	Would result in additional revenue since employers would have to continue to provide and service clothing for certain jobs.	That business decisions will be distorted towards providing clothing directly.	**C.** Yes **F.** No **E.** No There would be significant additional tax consequences for uniform and specialist clothing.
Option 2: Exempt distinctive clothing – including police plain clothes allowance **(recommended option)**					
Substantially maintains the current approach for employers. Issues would remain around employers identifying what clothing is covered by the definition of uniform or specialist clothing and is therefore tax exempt.	For the vast majority of employers, there should be no impact on business decision making. Consistent with fringe benefit tax treatment of distinctive clothing.	No significant impacts other than for the few employees who consider they have significant abnormal use of ordinary clothing.	Broadly revenue neutral.	None identified.	**C.** Yes **F.** Yes **E.** Yes Payments relating to uniform and specialist clothing would continue not to be taxed – however, a plain clothes allowance paid to an employee who had been issued with a uniform but was required to wear ordinary clothing because of the nature of their duties would be exempt.
Option 3: Exempt distinctive clothing and abnormal use of ordinary clothing					
Different from current position with respect to abnormal use of ordinary clothing.	Incentive to try to include ordinary clothing tax-free.	Incentive to try to include ordinary clothing tax-free.	Fiscal cost if interpreted to enable more ordinary clothing to be tax-free.	By enshrining law the tax position for ordinary clothing, this could result in additional pressure to widen the very limited current scope.	**C.** Yes **F.** Partly **E.** Partly By enshrining law the tax position for ordinary clothing, this could result in additional pressure to widen the very limited current scope.
Option 4: Apply general rule to clothing					
Retains the existing position in effect.	Retains the existing position in effect.	Retains the existing position in effect.	Retains the existing position in effect.	Retains the existing position in effect.	**C.** Yes **F.** Yes **E.** Yes Retains the existing position in effect.

Impacts				Risks	Net Impact Does option meet objectives?
Compliance	**Economic**	**Social**	**Fiscal impact**		
Issue 9: Clarifying the definition of "expenditure on account of an employee"					
Option: Amend general exclusions to make a clearer distinction between when they should apply **(recommended option)**					
Retains status quo so minimal compliance impact.	Retains the current position.	Retains the current position.	Retains the current position.	That re-drafting the exclusions will have unintended consequence that will not deliver the policy intent.	**C.** Yes **F.** Yes **E.** Yes Retaining the existing position is simpler approach than consolidating the two provisions. Other options also considered but would have either left a gap in the law (if repealed general provision) or lead to a more confused outcome if merged the two exclusions.
Issue 10: Enhancing the general rule that determines taxable/non-taxable portions of other allowances					
Option 1: Amend general rule to reflect policy principles					
Re-writing of the general rules would result in significant compliance costs as employers and their advisers have to come to grips with them and how they should be interpreted and applied. There would be corresponding administrative costs.	Potentially would make it simpler for employers to pay work-related expenses.	Potentially would make it simpler for employees to be refunded work-related expenses.	Potential significant fiscal cost if the change in approach results in a relaxation of the current approach.	That the change in approach merely complicates the existing rules.	**C.** No **F.** Yes **E.** Yes Uncertain whether it would allow employers to make additional payments tax-free in a range of work-related scenarios.
Option 2: Clarify general rule by including general criteria that focus on whether expenditure is incurred because of obligations of the job or as a practical requirement of the job					
Involves minor re-writing of the general rules that should reduce compliance costs over time through providing greater clarity.	No significant economic implications.	No significant social implications.	No significant cost implications.	Limited risk that the revised rules deliver an unintended outcome and create some uncertainty or a relaxation having some fiscal impact.	**C.** Yes **F.** Yes **E.** Yes Limited impact expected.

Impacts				Risks	Net Impact Does option meet objectives?
Compliance	**Economic**	**Social**	**Fiscal impact**		
Option 3: Apply the above change and provide the Commissioner of Inland Revenue with power to determine the proportion of a class of payment that is not taxable when private or capital benefit is hard to measure or low in value and not a salary substitute **(recommended option)**					
Commissioner determination making power is expected to lead to some additional administrative costs. But a determination would reduce compliance costs for employers.	Determination power should make it easier to deal with grey areas that are an impediment to business decisions.	Determination power should make it easier to deal with issues that have an impact on employees.	Fiscal costs should be low since any discretion would be focused on low value apportionment aspects that are currently hard to measure or low in value.	That the determination power is applied inconsistently or too widely, but have public rulings to limit this.	**C.** Yes **F.** Yes **E.** Yes Enables specific apportionment issues to be addressed in a more streamlined way than having to legislate for each case.