TAXATION (FBT, SSCWT & REMEDIAL MATTERS) BILL

Commentary on the Bill

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Policy Issues

SUPERANNUATION FUND WITHDRAWAL TAX

(Clauses 4, 10, 11, 12, 13, 14 and 19)

Summary of proposed amendments

The bill introduces a fund withdrawal tax of 5 percent of an employer's contribution to the amount withdrawn from a qualifying employment superannuation fund. The measure is intended to counter avoidance through the use of superannuation schemes of the already legislated increase in the top personal tax rate, effective from 1 April 2000.

The specified superannuation contribution withholding tax (SSCWT), set at 33 percent, is a tax on employers' monetary contributions to superannuation funds.

Increasing the top personal tax rate to 39 percent and leaving the SSCWT rate unchanged at 33 percent introduced scope for avoidance. Employees earning over $60,000 could negotiate an increase in their employer superannuation contributions, subject to the 33 percent SSCWT rate, with a corresponding reduction in salary and wages subject to tax at 39 percent. They could withdraw the increased employer contributions shortly afterwards, thus avoiding the 39 percent top personal marginal tax rate. The measures in this bill address this concern.

They do not restrict employers contributing to a superannuation fund as a way of remunerating employees. However, their contributions must stay in the superannuation fund until the employee leaves the job or withdraws the money for reasons of significant hardship. Otherwise, a 5 percent fund withdrawal tax will apply.

At 5 percent, the fund withdrawal tax should remove any tax benefit for those earning over $60,000 from substituting employer contributions to a superannuation fund for salary and wages. Furthermore, the tax also applies to any return on employer contribution withdrawn, not just the original amount of employer contribution, if this can be identified.

The following amendments are being made:

- Employers may apply a voluntary 39 percent SSCWT rate for all employees. Only employers whose employees earn over $60,000 a year are likely to use this.
- A withdrawal tax of 5 percent of the amount withdrawn by an employee from a fund is being introduced. This tax will be restricted to the amount of the employer contribution on that employee's behalf if the trustee can identify this.
- The withdrawal tax will not apply when funds are withdrawn after the employee ceases employment or withdraws money on the basis of significant hardship.
- Existing contributions and contributions that continue at current levels will not be subject to the withdrawal tax.

The SSCWT rate will stay at 33 percent for defined benefit funds.

Employers may elect to apply the optional 39 percent SSCWT rate from 1 October 2000. The period from 1 April to 1 October 2000 will allow employers and superannuation funds time to establish necessary systems. If the higher rate is elected the fund withdrawal tax will not apply to any amount withdrawn which has been subject to that higher rate.

These measures minimise the compliance cost impact on employers, employees and superannuation funds as much as possible. They also ensure that current contributions and already determined levels of future contributions will not be affected by the fund withdrawal tax.

Application date

The fund withdrawal tax will apply from the income year beginning 1 April 2000 to contributions made after that date on behalf of:

- employees beginning employment on or after 1 April 2000; and
- existing employees on or after 1 April 2000 if the amount of their contribution has been increased, unless that increase was set before 1 April 2000 according to a superannuation fund trust deed or an employment contract.

Employers may elect the optional 39 percent SSCWT rate from 1 October 2000.

Because the measures are being implemented through the income tax process, superannuation funds will be required to account for any tax levied in their tax return for the 2000-2001 income year and subsequent years.

Background

There are two types of superannuation funds to which employers may contribute, each requiring a different tax solution. The first type is defined contribution funds. These are funds in which the employer contributes a sum to the fund on behalf of an employee that typically vests in the employee after a period of service, although some funds have immediate vesting. Once the sum is vested, the employee may have access to that employer contribution along with any contribution he or she has made in accordance with the fund's rules. Access is normally restricted to retirement or withdrawal on cessation of employment, although funds may be withdrawn when the employee is suffering hardship and sometimes for specific reasons such as meeting Christmas expenses.

The second type of fund consists of defined benefit funds. These funds require the employer to make contributions sufficient to ensure that the employee receives certain defined benefits on retirement, such as a set percentage of pre-retirement salary.

For purposes of SSCWT, the principal difference is that defined contribution funds allow an employer's contribution to be linked to an individual employee, while under defined benefit funds the employer may make a bulk payment which cannot be attributed at the time of payment to those employees who may benefit from that payment.

Key features

The bill inserts sections CL3 to 9 and NE 2AA into the Income Tax Act 1994, and amends sections NE 2(1) and OB 1 and Schedule 1 of that Act. It also inserts a new section 165 AA into the Tax Administration Act 1994.

Defined contribution funds

Employer contributions to qualifying employment superannuation funds will continue to be subject to a 33 percent SSCWT rate.

A fund withdrawal tax of 5 percent of the amount of employer contribution withdrawn and any return on that employer contribution will apply if this contribution is withdrawn other than on:

- cessation of employment with that employer; and
- significant hardship, which has been defined to include permanent incapacity of the member of the fund.

If a superannuation fund cannot identify whether an amount withdrawn comprises an employer contribution, the withdrawal tax will apply to the full amount withdrawn. "Withdrawal" has been defined to include any return on any employer contribution also withdrawn.

The fund withdrawal tax will not apply to:

- employer contributions made before 1 April 2000; and
- contributions made after 1 April 2000, for the benefit of an existing fund member, if the employer contribution as a percentage of salary does not increase or the increase is according to trust deed or employment contract in existence before 1 April 2000.

A 50 percent or more increase in employer contributions in either of the two years preceding an employee's cessation of employment will result in the withdrawal tax applying to those contributions made after 1 April 2000 on cessation of employment on the employer contribution that is withdrawn. A consequence of this rule is that any contribution on behalf of an employee in the first two years of that employee's employment will trigger this rule, subjecting any withdrawal other than that done on the basis of hardship to the fund withdrawal tax.

Without this measure, employees who were close to leaving their employment and earned over $60,000 a year might choose to have their employer increase their superannuation fund contributions rather than increase their salary. They could then shortly access those funds, with a tax rate of 33 percent effectively applying. This measure minimises this concern.

On the wind-up of a superannuation fund, the 5 percent fund withdrawal tax will apply to employer contributions unless this amount is transferred to a further superannuation fund by the fund that is winding up. On transfer, employer contributions retain their nature.

Unallocated reserves, as at 1 April 2000, can be allocated to an employee to meet the employer's obligation to that employee but will not count as employer contributions and will not be subject to tax on exiting or withdrawal. Reserves after this date may be subject to the fund withdrawal tax if withdrawn.

Defined benefit funds

The current SSCWT rate of 33 percent will continue to apply to employer contributions to existing and new defined benefit funds.

Voluntary increase in SSCWT rate

If all the superannuation fund contributions by an employer are on behalf of employees earning over $60,000 it may be simpler for employers, employees and superannuation funds for the employer to apply a 39 percent SSCWT rate to employer contributions. The withdrawal tax will not apply to these contributions. Employers will be able to elect this rate as an alternative to the 33 percent SSCWT rate from 1 October 2000.

The withdrawal tax will also not apply to employer superannuation contributions made from 1 April to 1 October 2000, even though the 39 percent SSCWT rate does not apply for that period if:

- the amount of employer contribution is not increased, unless that increase was set before 1 April 2000 according to a superannuation fund trust deed or an employment contract; and
- the employer elects the 39 percent SSCWT rate from 1 October 2000.

The 1 October 2000 application date for this election is to allow employers and superannuation funds time to establish necessary systems.

Implementation

The most compliance cost-efficient way to implement the fund withdrawal tax is to place the liability on the superannuation fund rather than the person making the withdrawal. This approach minimises both compliance costs for employees and administrative costs, which eventually have to be borne by taxpayers.

To this effect, 15.15 percent (5 percent divided by the tax rate, rounded to two decimal points) of the amount withdrawn or the employer contribution, if known, will be deemed to be gross income of the superannuation fund for income tax purposes. This requires no new tax processes, minimises compliance and administrative costs and allows prompt introduction of the measure. Trustees will be able to recover the tax from payments to members.

The Government Actuary will monitor the use of defined benefit funds and, specifically, withdrawals from these funds.

MULTI-RATE FRINGE BENEFIT TAX

(Clauses 7-9, 13 and 17)

Summary of proposed amendments

The introduction of a three-tier fringe benefit tax (FBT) will allow fringe benefits that can be attributed to an employee to be subject to FBT at a rate based on the employee's marginal tax rate. Those fringe benefits that are not attributed to individual employees will be subject to FBT at the 49 percent rate.

These amendments to the FBT rules will reduce the effect of the increase in the FBT rate to 64 percent for fringe benefits provided or granted on or after 1 April 2000, which was enacted in December 1999. The FBT rate was increased to equate with the top personal tax rate of 39 percent to prevent high-income earners substituting salary or wages for fringe benefits to avoid the increase in the top personal tax rate. Without these changes, the 64 percent rate would further exacerbate the over-taxation of low-income employees and would overtax middle-income employees subject to a 33 percent personal tax rate.

The amendments will generally allow employers to choose to apply a FBT rate based on the remuneration they pay to the employee receiving the fringe benefit. Employers will continue to pay FBT on the value of benefits provided or granted to employees. The new rules will apply as follows:

- Certain benefits (motor vehicles other than pooled vehicles, low-interest loans and other benefits with a taxable value exceeding $1,000 per category per year) must be attributed to the individual employee receiving them. Such benefits will be taxed at a FBT rate based on the employee's marginal tax rate.
- Employers will be able to attribute other individual fringe benefits with a value of $1,000 or less, per category per year, if they so wish. Again, such benefits will be taxed at one of three FBT rates based on the employee's marginal tax rate.
- Fringe benefits not attributed to an individual employee and pooled fringe benefits (such as pool motor vehicles) will be subject to FBT at 49 percent.
- Employers will continue to pay FBT tax on a quarterly basis at either 64 percent or 49 percent. FBT will be subject to adjustment in the fourth quarter, when the liability for attributed benefits will be calculated using a FBT rate based on the marginal tax rate of the employee to whom benefits have been attributed.

Application date

The new rules will apply to fringe benefits provided or granted on or after 1 April 2000. For administrative reasons, all employers will be required to pay 64 percent on benefits provided or granted during the first quarter (1 April 2000 to 30 June 2000). Any overpayment of FBT in this first quarter can be recovered through the square-up process in the last quarter.

For employers who pay FBT on fringe benefits provided to shareholder-employees on an income year basis, the new rules will apply to benefits provided or granted during the 2000-01 income year.

Background

The FBT rate will increase to 64 percent from 1 April 2000, to prevent high-income employees substituting fringe benefits for monetary remuneration to avoid the increase in the top personal tax rate to 39 percent, also from 1 April. Since their introduction in 1985, the FBT rules have overtaxed low-income employees. The Government announced late last year, when the FBT rate was increased to 64 percent, that it would look at this issue with a view to introducing legislation early this year to lower the tax rate on fringe benefits provided to lower-income employees. These proposed amendments are in response to that undertaking and provide a workable solution to this issue while minimising any increase in compliance costs.

Key features

The bill amends sections ND 1 and ND 2 of the Income Tax Act 1994 and inserts new sections ND 1A to 1F and ND 2A. A new definition is being added to section OB 1 of that Act. Also amended is section 120 C of the Tax Administration Act 1994 in relation to the payment of interest on FBT refunds.

Multi-rate FBT system

Employers will have the choice of whether to pay FBT at 64 percent on all the benefits they provide or use the multi-rate fringe benefit system. Using the flat 64 percent rate would be appropriate for employers who provide fringe benefits predominantly to high-income employees, as they would avoid any compliance costs associated with the multi-rate fringe benefit rules, such as attributing and tracking benefits and calculating the individual employee's FBT rate.

If employers opt into the multi-rate fringe benefit rules, they will be required to attribute the following fringe benefits to the individual employee who receives the benefit: motor vehicles (other than pooled vehicles), low-interest loans, and other benefits that have a taxable value of over $1,000 per category per year. For example, if an employer provides or grants fringe benefits of the type covered by paragraph (f) of section CI 1 of the Income Tax Act, the $1,000 will be calculated by reference to the total taxable value of all benefits covered by that provision. That is, the total value of premiums paid for life insurance, pension insurance, personal accident or sickness insurance and contributions to a friendly society insurance fund will be added together to calculate whether an individual has gained a fringe benefit in excess of $1,000. Attributed benefits will be taxed at a FBT rate based on the employee's marginal tax rate as shown in table 1.

TABLE 1:
FRINGE BENEFIT TAX RATES FOR BENEFITS ATTRIBUTED TO EMPLOYEES ON THE BASIS OF THEIR MARGINAL TAX RATE

Employee's cash remuneration from employer	*Employee's marginal tax rate*	*FBT rate applicable to employee*[1]
$0 -$38,000	21%	27%
$38,001 - $60,000	33%	49%
Over $60,000	39%	64%

Employers will be able to attribute fringe benefits with a taxable value of $1,000 or less provided to individual employees, if they so wish. An employer who chooses to attribute a category of fringe benefits with a taxable value of $1,000 or less must attribute all the benefits provided in that category that can be attributed to individual employees.

All benefits not attributed to an individual employee, including pooled benefits such as pooled motor vehicles, will be subject to FBT at 49 percent. Benefits provided to previous employees and low-interest loans provided by life insurers to policyholders or associates will be treated as non-attributed benefits and subject to FBT at 49 percent. The benefits provided to previous employees or provided to policyholders or associates will be treated as non-attributed benefits because previous employers or life insurers will not have access to income information of the recipient of the benefit.

A benefit will be attributable to an individual if the asset or the benefit is principally assigned, used or available for use by that employee. This is despite the fact that it may not have been used solely by that employee. For example, an employee has a car specifically provided for her use, which includes private use for which fringe benefit tax is payable. However, from time to time other employees use this car for their private use, while the first employee uses another vehicle temporarily. The total fringe benefit from making the car available for private use is attributable to the first employee, to whom it has been principally assigned, and will be taxed at the FBT rate appropriate to her. This rule will ensure that benefits are taxed only once, while reducing compliance costs, and provides guidance in determining whether a benefit can be attributed or is pooled and non-attributable. If a benefit cannot be attributed to an individual employee, as there is no principal user, it becomes a pooled benefit and is taxed at the non-attributable rate of 49 percent.

Return filing requirements and FBT rates

Employers who file FBT returns on a quarterly basis will be able to elect whether to pay FBT on the taxable value of all attributable or non-attributable fringe benefits at either 49 percent or 64 percent for the first three quarters of an income year. In the fourth quarter return, the employer will be required to undertake an end-of-year square-up whereby the taxable value of benefits attributed to individual employees

[1] The FBT rate is calculated using the formula (t / 1-t) where t is the marginal tax rate of the employee. For example, if the marginal tax rate of the employee is 39% the FBT rate is 64% (0.39 / 1-0.39).

during that year will be subject to FBT at a rate based the employee's marginal tax rate. As part of this square-up process, a credit will be given for the FBT paid in the previous three quarters. This square-up process may result in employers underpaying or overpaying their FBT liability during the year. If FBT has been overpaid during the year, the employer will be entitled to a refund. Table 2 shows the return filing obligations for those employers filing quarterly FBT returns.

TABLE 2:
RETURN FILING OBLIGATIONS FOR EMPLOYERS FILING QUARTERLY FBT RETURNS

Period	*Employer's obligation*
Quarter 1	Apply either the 49% or 64% rate to benefits provided or granted (both attributed and non-attributed benefits) during that quarter.
Quarter 2	Apply either the 49% or 64% rate to benefits provided or granted (both attributed and non-attributed benefits) during that quarter.
Quarter 3	Apply either the 49% or 64% rate to benefits provided or granted (both attributed and non-attributed benefits) during that quarter.
Quarter 4 (square-up return)	If the employer has applied the 49% rate in any quarter, the employer must undertake an end-of-year square-up; OR if the employer has applied the 64% rate in the previous three quarters, the employer can either: (a) pay 64% for Quarter 4 and avoid this square-up and attribution process; or (b) use the square-up process.

Requiring an end-of-year square-up ensures that an employee's FBT rate for attributed benefits is calculated on the actual cash remuneration paid during that year.

If an employer ceases to employ staff and does not intend to re-employ staff during that income year, the square-up process must be undertaken in the quarter in which staff employment stopped. In such cases, the quarter's return and payment will be due on the last day of the second month following the end of that quarter. For example, if an employer ceased employing staff during the second quarter and did not recommence employing staff during that income year, the return and payment of any FBT would be due on 30 November.

The FBT returns and the tax payable for the first three quarters will continue to be due on the 20th of the month following the end of the quarter. The return and any tax payable for the fourth quarter will be due on 31 May following the end of that quarter. This additional time will allow employers to undertake the end-of year square-up process. If an employer decides to pay FBT at 64 percent in the last quarter, the tax and return will continue to be due on 20 April.

Employers who file annual FBT returns or income year returns can use the square-up process to determine the appropriate FBT rates to apply to attributable and non-attributable benefits, or apply the 64 percent rate to all benefits and avoid the square-up process. For annual FBT payers, the return and any tax payable will continue to be due on 31 May following the end of the income year. For income year FBT payers, the return and any tax payable will continue to be due on the terminal tax date of the employer.

As a transitional measure to allow Inland Revenue to implement system changes related to these rules all employers will be required to use the 64 percent rate for the first quarter (1 April 2000 to 30 June 2000). Any overpayment of FBT can be recovered through the square-up process in the last quarter.

Calculation of annual income of employees

The cash remuneration paid to an employee by his or her employer during the income year will be used to calculate the appropriate FBT rate to be applied to benefits that can be attributed to an individual. This will include salary or wages, withholding payments, extra emoluments, payments to specified office holders, and any salary, wages or other gross income to which section OB 2(2) applies, such as salary or wages paid to shareholder-employees of close companies. It will not include the taxable value of fringe benefits provided by that employer or the value of employer superannuation contributions subject to specified superannuation contribution withholding tax.

For employees who receive secondary employment income, their FBT rate for attributed benefits provided by the primary employer will be calculated on the basis of the cash remuneration paid by the primary employer only. The FBT rate for any attributed benefits provided by the secondary employer will be calculated on the basis of the cash remuneration paid by the secondary employer only. Employers will not be required to determine how much income an employee receives from other sources (unless the other source is a division or branch of the employer).

In determining an employee’s annual income, employers will be required to take into account all cash remuneration paid by any division or branch of the employer if that division or branch is treated as a separate employer or associated person of the employer.

If an employee starts or ceases work during the year or is a part-year employee, the employer will be required to annualise the cash remuneration paid during the income year to determine the employee’s annual cash remuneration for the purposes of calculating that employee’s FBT rate. This rule will not apply to part-time, full-year employees.

Shareholder-employees and their associates

Because shareholder-employees may have control of remuneration decisions of the employing company, the amendments include specific rules to deal with major shareholders who are also employees. A "major shareholder", in relation to a close company, is a person who owns, has the power to control (whether directly or indirectly) or has the right to acquire 10 percent or more of the ordinary shares or voting rights of the company.

In calculating the annual income of a major shareholder-employee for the purposes of determining the employee's individual FBT rate for attributed benefits, the employer will be required to include dividends and any interest paid or payable for that income year, in addition to cash remuneration paid or payable. This FBT rate will also be used to calculate the FBT payable on attributable fringe benefits provided or granted to an associate of a major shareholder-employee that are subject to FBT. This rule will not apply if those benefits are received by that associated person in an employment capacity with that employer.

If a major shareholder-employee receives or is entitled to receive any benefits that have been included in the pool of non-attributed benefits, the taxable value of the non-attributed benefits for all employees will be subject to FBT at 64 percent.

Information requirements

Employers will need to ensure that their systems can provide the information necessary to undertake the end-of-year square-up process, including:

- details of the fringe benefits and their taxable value attributed to individual employee each quarter; and
- the annual cash remuneration of employees who receive attributed fringe benefits.

Because these changes apply with effect from 1 April 2000, it is important that employers start to identify what information needs to be maintained and develop appropriate systems as soon as possible.

How the multi-rate system will operate

EXAMPLE:
FRINGE BENEFITS RECEIVED BY EMPLOYEES (QUARTERLY FILING EMPLOYER)

	Annual "income" from employer $	Taxable value ($) of fringe benefits received PER QUARTER				
		Motor vehicles	Super-annuation[1]	Medical insurance[2]	Cards and flowers[3]	Discounted goods[4]
CEO	$80,000	$1,800*	$750	$200		$50
Manager 1	$65,000			$200		$50
Manager 2	$50,000	$1,800*		$200	$100	$50
Employee 1	$40,000			$200		$50
Employee 2	$40,000			$200		$50
Employee 3	$30,000			$200		$50
Employee 4	$30,000			$200	$50	$50
Employee 5	$30,000			$200		$50
Employee 6	$30,000			$200	$50	$50
Employee 7	$15,000			$200		$50
Total/benefit		$3,600	$750	$2,000	$200	$500
					Total value all benefits	$7,050

* based on a $30,000 vehicle used every day in the quarter (90 days)

1 The contributions to a superannuation scheme are covered by paragraph (g) of section CI 1 and therefore is a category of benefits.

2 The medical insurance premiums are covered by paragraph (f) of section CI 1 and therefore is a category of benefits.

3/4 The cards and flowers and discounted goods are covered by paragraph (h) of section CI 1 and therefore are a category of fringe benefits.

FBT obligations for the first three quarters

An employer would aggregate the taxable value of all fringe benefits provided in a quarter and then apply either the 49 percent or 64 percent flat rate to this total. In this example the total value of the fringe benefits provided in the quarter is $7,050. An employer who chose to apply the 49 percent rate would be liable for $3454.50 in FBT for that quarter.

For the purposes of this example, we will assume that this liability is constant over the first three quarters of the year, meaning that the employer will have paid $10,363.50 in FBT at the end of the third quarter. The same benefits are provided in the fourth quarter. Furthermore, this example ignores the transitional requirement to pay 64 percent in the first quarter during the 2000-01 year.

An employer who chooses to apply the 49 percent rate in any quarter must undertake the square-up process in the fourth quarter. Alternatively, if the 64 percent rate was applied in every quarter, the employer has the option in the fourth quarter of undertaking a square-up, or simply applying the flat 64 percent rate again.

Over the first three quarters employers should maintain accurate records relating to the value and type of fringe benefits provided, as well as who the employee recipient was.

The fourth quarter square-up

STEP 1 – Attributable fringe benefits

Employers would need to identify which of the fringe benefits they had provided over the year had to be attributable. Under these rules, all motor vehicles, low-interest loans, and fringe benefits with a taxable value of over $1,000 per category per year must be attributed in the square-up process. This $1,000 value applies to an entire category of fringe benefits. Section CI 1 sets out the types of fringe benefits covered by the FBT rules, and the benefits included in paragraphs (a) to (h) will be treated as separate categories.

In the example above, the following fringe benefits must be attributed, and therefore taxed at a FBT rate based on the employee's "income" (see Table 1):

- The CEO's motor vehicle. As the income received in this case is over $60,000, the appropriate FBT rate to apply is 64 percent. ($1,800 x 4 quarters) x 64% = $4,608.
- Manager 2's motor vehicle. As the income received in this case is between $38,000 and $60,000, the appropriate FBT rate to apply is 49 percent. ($1,800 x 4 quarters) x 49% = $3,528.
- The CEO's superannuation scheme as it exceeds $1,000 as a single category benefit over the year. ($750 x 4 quarters) x 64% = $1,920.

Therefore the total FBT that should have been paid on attributable fringe benefits is $10,056.

STEP 2 – Non-attributable and low-value fringe benefits

The next step for the employer is either to:

(a) Simply add the value of all other fringe benefits provided over the year and multiply this amount by the flat non-attributable FBT rate of 49 percent.

    - The medical insurance. ($200 x 4 quarters) x 10 employee recipients = $8,000.
    - The cards and flowers. ($200 x 4 quarters) = $800.
    - The discounted goods. ($50 x 4 quarters) x 10 employees = $2000
    - This equals a total of $10,800 in non-attributable fringe benefits, which results in $5,292 in FBT liability. ($10,800 x 49% = $5,292).

OR:

(b) Attribute a category(s) of low-value fringe benefits (value less than $1,000) and apply 49 percent to non-attributable fringe benefits. This option may be relevant to an employer with a large number of low-income employees receiving fringe benefits. The choice of attributing low-value benefits such as these rests on the employer weighing the additional compliance costs against any tax saving.

If an employer chooses to attribute a low-value fringe benefit to an employee, all the benefits in that category must be attributed to all the individual employees receiving the fringe benefit.

This example will assume the employer would only wish to attribute the medical insurance provided, with the flat 49 percent pooled rate applying to the cards, flowers and discounted goods category.

- To attribute the medical insurance, the employer must apply the correct FBT rates as follows:

  Employees at the 64% rate: (2 x ($200 x 4 quarters)) x 64% = $1,024
  Employees at the 49% rate: (3 x ($200 x 4 quarters)) x 49% = $1,176
  Employees at the 27% rate: (5 x ($200 x 4 quarters)) x 27% = $1,080
  TOTAL FBT Liability = $3,280

- As above, the FBT liability of the cards and flowers is $800, and $2,000 for the discounted goods. This results in $1,372 of FBT liability for non-attributable fringe benefits ($2,800 x 49% = $1,372), plus $3,280 in FBT liability from attributing the medical insurance. Therefore this employer would save $640 in total FBT liability by attributing the medical insurance ((a) $5,292 – (b) $4,652 = $640).

<u>STEP 3</u> – Reconciliation

The final step for the employer is to add the FBT liability over the year for attributable and non-attributable benefits. The FBT paid over the first three quarters is subtracted from this amount, leaving the total final FBT payment for the year.

	Using method (a) for non-attributed benefits	*Using method (b) for non-attributed benefits*
Total FBT liability on attributable benefits	$10,056.00	$10,056.00
Total FBT liability on non-attributed benefits	$5,292.00	$4,652.00
	$15,348.00	$14,708.00
Subtract the amount of FBT already paid during the year	($10,363.50)	($10,363.50)
Total FBT due as a result of the square-up	$4,984.50	$4,344.50

Therefore, in this case, the employer is liable to pay either $4,984.50 or $4,344.50 in the fourth quarter tax return due on 31 May. The reason this amount is higher than the payments over the first three quarters is that this employer opted to use the 49 percent rate, when a significant amount of the fringe benefits provided (in terms of value), went to employees subject to the 64 percent rate.

USE-OF-MONEY INTEREST ON FRINGE BENEFIT TAX

(Clauses 16 and 18)

Summary of proposed amendment

Use-of-money interest on fringe benefit tax paid either on an annual basis or an income year basis is to be removed. This is a simplification measure designed to reduce compliance costs for those who pay small amounts of the tax, by reducing the number of returns and payments they make.

Application date

The amendment applies to the 2001-2002 and subsequent income years.

Background

The discussion document *Less Taxing Tax*, released in September last year, considered a number of tax simplification proposals aimed at small businesses. The proposals in the discussion document received wide support, and a number are expected to be enacted this year, of which this is the first.

Fringe benefit tax is generally paid on a quarterly basis, although some taxpayers have the option to pay it once a year. Use-of-money interest is applied to yearly payments to compensate the Government for the tax deferral. Removing interest is intended to increase the incentive for taxpayers to make one payment and therefore file one return each year, rather than four returns and payments.

Key features

Section 120S of the Tax Administration Act 1994, which imposes the interest on those paying fringe benefit tax on an annual or income year basis, is being repealed.

Remedial Issues

THE FIF RULES AND COMPANY MIGRATION

(Clauses 4 and 5)

Summary of proposed amendments

Amendments are being made to clarify how the foreign investment fund rules apply when a resident entity migrates from New Zealand.

- The market value of the holding on the date of migration will be used for assessing the threshold as to whether the rules apply, as well as the value on entry to the rules themselves.
- Holders on revenue account will be treated as if they had sold their holding immediately before the change in residence and repurchased it immediately after. This will crystallise for tax purposes any gain or loss without having to sell the entity.
- The entity will not need to prepare separate audited financial statements for the periods before and after migration in the year of transition if its shareholders are to use the accounting profits method for that year.

Application date

The amendments apply retrospectively to the 1999-2000 and subsequent income years.

Background

The foreign investment fund rules are part of New Zealand's international tax rules, which are designed to reduce distortions in the investment decisions of our residents. They do this by ensuring that as far as practicable, the worldwide income of New Zealand residents is taxed as it accrues.

The rules were enacted in 1992, but it was only in 1993 that company law was amended to allow for transfers of incorporation, so clarification of the rules to cater for this is necessary.

Amendments are being made to clarify that the market value on the date of migration is to be used in assessing the threshold for entry to the rules, as well as the opening value of the entity when calculating income. This is consistent with the policy intent that entry into and exit from the foreign investment fund rules should be at market value.

A further amendment is being made to make it easier to use the accounting profits method in the year of migration. The lack of separate audited accounts for the period from the change in residence to the end of the entity's accounting period will not preclude its use by its shareholders.

Key features

- Under new subsection CG 14(1)(ca) of the Income Tax Act 1994, the cost or expenditure of the holding is to be the market value on the date of the change of residence.
- Under new subsections CG 23(7A) to (7C), the shares are considered to have been sold and reacquired on the date of the change in residence. One consequence of this is that gains and losses will be crystallised at that date for tax purposes for holders of shares on revenue account.
- New subsection CG 23(7D) removes the requirement for separate financial accounts to be prepared for an entity up to the date of migration if the accounting profits method is to be used in that year by its shareholders.

SSCWT CONTRIBUTIONS TREATED AS SALARY OR WAGES

(Clause 12)

Summary of proposed amendment

The amendment removes a technical problem in the legislation relating to the specified superannuation contribution withholding tax (SSCWT) rules. It will ensure that the payment of PAYE deducted from an employer's contribution to a superannuation fund, if the employee and the employer have agreed to treat the employer's contributions as salary or wages, will satisfy the employer's obligation to pay the contribution to the superannuation fund.

Application date

The amendment will apply retrospectively from 26 November 1998 to coincide with the enactment date of the rules that allow an employee and employer to agree to treat employer contributions to a superannuation fund as salary or wages of the employee.

Background

The SSCWT rules were amended by the Taxation (Tax Credits, Trading Stock, and Other Remedial Matters) Act 1998 to allow an employee and employer to agree to have specified superannuation contributions treated as salary or wages and therefore made subject to PAYE rather than SSCWT. However, the legislation does not allow the PAYE deducted and paid from the employer's superannuation contribution to be treated as satisfying the employer's obligation to pay contributions to the superannuation fund. Such a provision exists for SSCWT deducted from contributions.

Key features

Section NE 6 of the Income Tax Act 1994 is being amended to allow the PAYE deducted and paid to satisfy an employer's obligation to pay contributions to the superannuation fund, if the employee and employer have agreed to treat the superannuation contribution as salary or wages. The proposed amendment will ensure that the legislation reflects the original policy intent and is consistent with the current treatment afforded to contributions subject to SSCWT.