

The tax treatment of honoraria and reimbursements paid to volunteers

*An officials' issues paper on clarifying the tax
treatment of payments made to volunteers*

November 2007

Prepared by the Policy Advice Division of Inland Revenue

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Chapter 1

INTRODUCTION

- 1.1 New Zealand's non-profit sector involves around 97,000 organisations whose work makes a significant contribution to almost every aspect of our society – from sports and the arts, to health and social services.
- 1.2 For many of these organisations, their ability to deliver the range and depth of services they do depends on the work of the many thousands of individuals who give their time or expertise as volunteers.¹ While the work of volunteers is, by definition unpaid, there can be certain costs involved in working as a volunteer – such as transport or travel to another location or meal allowances, for example.
- 1.3 One of the long-standing problems for volunteers and the organisations who use their services is that our tax laws are unclear about how reimbursement payments made to volunteers should be taxed. Because volunteers and charitable organisations have often been uncertain about their tax obligations relating to reimbursements, an inconsistent range of administrative practices has developed, often resulting in high compliance costs.
- 1.4 Similar problems relating to tax obligations have arisen over payments of honoraria – particularly if a portion of an honorarium is intended to reimburse the recipient for costs incurred. Uncertainties resulting from the tax laws relating to volunteer reimbursements and honoraria were raised in the 2006 discussion document, *Tax incentives for giving to charities and other non-profit organisations*. In responding to the discussion document, many submissions expressed surprise that there is any tax obligation at all associated with these types of payments. At a time when government is actively encouraging a culture of giving and greater recognition of the contribution to society made by volunteers, failure to remove this tax uncertainty may increasingly be viewed as a disincentive to volunteering.
- 1.5 This issues paper looks at a number of possible solutions to the long-standing problem of taxing reimbursements and honoraria paid to volunteers. Specifically, it seeks feedback on suggestions for clarifying the law and better defining the concept of “volunteer”, and includes a number of options for the tax treatment of volunteer reimbursements and honoraria, to make it easier for volunteers and the charitable sector to comply with their tax obligations.
- 1.6 Feedback on the issues explored in this paper will be considered by the government as part of its policy of further building a culture of charitable giving in New Zealand.

¹ Based on Census Data, Statistics NZ estimated that there were 436,500 volunteers involved in non-profit organisations as at October 2005. However, the Non-profit Institutions Satellite Account, published by Statistics NZ in August 2007 estimates the number may be as great as 1 million.

- 1.7 This paper has been prepared by officials from the Policy Advice Division of the Inland Revenue Department, in consultation with officials from the Treasury.
- 1.8 Submissions on this paper will be taken into account in the development of any recommendations to be made to government, with any resulting legislative changes likely to be included in the next available tax bill.
- 1.9 Submissions should be made by 14 December 2007 and addressed to:
- Taxation of reimbursement payments and honoraria
C/- Deputy Commissioner, Policy
Policy Advice Division
Inland Revenue Department
P O Box 2198
Wellington
New Zealand
- Or email: policy.webmaster@ird.govt.nz with “Taxation of reimbursement payments and honoraria” in the subject line.
- 1.10 Submissions may be the subject of a request under the Official Information Act 1982. The withholding of particular submissions on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. Those who consider there is any part of their submission that could be properly withheld under the Act should indicate this clearly.

SUMMARY OF POSSIBLE APPROACH TO REFORMING THE TAXATION OF VOLUNTEER REIMBURSEMENTS AND HONORARIA

Clarifying the law on volunteer reimbursements

This would include:

- determining the most appropriate tax treatment of reimbursement payments made to volunteers;
- ensuring that the law is clear and simple to apply;
- minimising, as much as possible, the compliance costs associated with return filing for volunteers and the organisations for which they carry out their voluntary activities; and
- proposing a basis on which payments to volunteers characterised as honoraria, which are actually reimbursement for costs incurred, can be removed from the withholding payment tax rules.

Determining an appropriate definition of “volunteer”

- This would be critical to achieving the objective of clarity and simplicity in reforming the taxation of reimbursements and honoraria. The definition would contain three essential features: no financial gain to the individual, the concept of “free will”, but with sufficient flexibility to encompass mahi aroha (the Māori cultural perspective of giving) and other cultural obligations, and benefits to a third party.

Options for the tax treatment of reimbursement payments

- Setting a threshold up to which reimbursements would be treated as exempt income.
- Including all reimbursement payments to volunteers in the definition of “exempt income”.

Options for the tax treatment of honoraria paid to volunteers

- All honoraria up to a threshold would be treated as exempt income.
- Honoraria and reimbursements would be required to be paid separately.
- Withholding tax would be deducted from net honoraria paid to volunteers.

Chapter 2

BACKGROUND

What are the problems for volunteers and their organisations?

- 2.1 Volunteers and the organisations they carry out their voluntary activities for are uncertain about how they should manage their tax obligations.
- 2.2 Volunteers are unsure whether they have an obligation to file tax returns and unaware of the likely consequences if they fail to do so.
- 2.3 Organisations are often unsure of the record-keeping requirements for reimbursing payments, whether they have an obligation to withhold tax from those payments or of the likely consequences if they fail to do so.
- 2.4 While the Oxford dictionary defines an honorarium as “a payment for professional services that are rendered nominally without charge”, many organisations combine payments for service with payments that represent a reimbursement of the expenses a volunteer has incurred. There is some anecdotal evidence to suggest that some “honoraria” are, in reality, reimbursement payments only.
- 2.5 Anecdotal evidence also suggests that some organisations may be reluctant to reimburse volunteers for costs incurred because of doubt over the tax consequences. As a result, some volunteers are withdrawing their services.
- 2.6 There is also evidence that some organisations are attempting to obtain a determination on an exemption from tax for reimbursement payments through provisions in the Withholding Payments Regulations.
- 2.7 These problems are not unique to New Zealand. Volunteers who responded to Volunteering Australia’s second annual national survey of volunteering issues saw out-of-pocket expenses as a major concern. Twenty-seven percent of those respondents said expenses had had a direct impact on their volunteering in the past 12 months, while more than half said expenses reduced their ability or desire to volunteer.²

² This was an on-line survey that reached 2,140 volunteers this year.

Chapter 3

FINDING SOLUTIONS

Defining the nature of a “volunteer”

- 3.1 Because of the varied nature of the activities undertaken by volunteers in the non-profit sector, determining what might be an acceptable definition of “volunteer” is a critical factor in approaching any reform of the current tax laws on volunteer reimbursements.
- 3.2 Any definition of “volunteer” would need to be broad enough to ensure that all genuine volunteers are included in the reforms, while ensuring that some distinct boundaries are in place. In our view, any definition of “volunteer” should not be limited to activities carried out for, or on behalf of, registered charities only because that would exclude a significant section of the voluntary sector.
- 3.3 However, a distinction could be made between what could be described as “formal” and “informal” volunteering. “Formal” volunteering could be defined as that carried out for, or on behalf of, an organisation whereas “informal” volunteering could be considered as unpaid help of a more casual nature. This might include, for example, work carried out for a neighbour or someone within the volunteer’s own community.
- 3.4 Limiting the definition of “volunteer” to an individual who is associated with a registered charity could also have the effect of excluding such groups as sports volunteers and volunteers for central government and local authorities, who also make a valuable contribution to New Zealand society. A limitation based on a definition of “formal” volunteering could, however, prevent these groups from being excluded from any potential reform of the tax rules.
- 3.5 Limiting the scope of the proposed provisions to registered charities may also have the effect of excluding those whose voluntary activities are the fulfilment of cultural obligations. This includes the concept of “mahiroha” for Māori and other individuals, such as those from Pacific Island groups, who may feel a cultural obligation to provide their services within their communities.
- 3.6 Taking these factors into account, it is likely that the three essential features that would need to be included in defining a “volunteer” for tax purposes are:
 - that there is no financial gain to the individual involved;
 - that the concept of “free will” is recognised, but with sufficient flexibility to encompass mahiroha and other cultural obligations; and
 - that the act of volunteering results in benefits to a third party.

Treatment of reimbursement payments

- 3.7 One of government's commitments in its 2002 document, *Policy on volunteering*, was "reducing barriers associated with volunteering in legislation, policy and practice".
- 3.8 At that time, there was an expectation by government that this commitment would be met through work to be undertaken by Inland Revenue to determine the circumstances when honoraria might be treated as the reimbursement of expenses and therefore treated as tax-free.³
- 3.9 Feedback on this issue raised in the 2006 discussion document, *Tax incentives for giving to charities and other non-profit organisations*, clearly demonstrates that the taxation of reimbursement payments or honoraria has become an increasingly significant barrier to volunteering as more individuals and organisations become aware of their tax obligations.
- 3.10 There are several possible options that could be explored to resolve the current uncertainty that organisations and volunteers face in terms of tax compliance and reimbursement payments.

Retaining the status quo

- 3.11 Under this option, if changes to the law were considered unnecessary or inappropriate, as a means of resolving uncertainties surrounding reimbursements government could:
- require Inland Revenue to issue administrative guidelines to codify its interpretation of current law; or
 - require each agency or organisation that makes reimbursement payments to volunteers to obtain a determination from Inland Revenue for the tax treatment of each type of payment made.
- 3.12 We feel that neither of these options is likely to achieve the objective of eliminating or reducing the compliance costs associated with filing returns for volunteers and the organisations for which they carry out their voluntary activities. Rather, it is more likely that the two options would increase compliance costs for some organisations and volunteers.

Set a threshold up to which reimbursements would be treated as exempt income

- 3.13 Under this option, a threshold would be set that represents a "reasonable" amount for the reimbursement of any actual costs incurred. Reimbursement payments up to that level would be treated as exempt income and volunteers would not be required to include those payments in their income tax returns.

³ CAB Min (02) 31/5B refers.

- 3.14 If payments exceeded the threshold, the full amount would not be treated as exempt income. Instead, it would be included in the volunteer's income tax return and claimed expenses would have to be supported by documentary evidence of costs incurred before they would be allowed as a deduction.
- 3.15 The exempt income amount would cover reimbursement payments for actual costs incurred as well as flat-rate payments based on an estimation of costs.
- 3.16 While we believe that a threshold would achieve the objective of minimising compliance costs for some individuals and organisations, it would not be effective for others. It would also be hard to justify a different tax treatment of payments that have similar features purely on the basis of their cumulative monetary value over a tax year.

Include all reimbursement payments to volunteers in the definition of "exempt income"

- 3.17 Under this option, all reimbursement payments to volunteers (as defined earlier in this paper) would be treated as exempt from tax according to the exempt income provisions in the Income Tax Act 2004.
- 3.18 This exemption could be applied to all reimbursements for actual costs incurred. This approach could, however, become problematic if reimbursement payments are made at a flat rate, based on an estimation of costs. The provision could also be inappropriately used as a mechanism to avoid withholding tax from payments that are similar in quality to income. If this option were to be adopted, it would be necessary to set a cap on flat rate payments that fall within the exemption.
- 3.19 Under current law, the exempt income limitation would act to prevent the expenses that had been incurred being claimed as a deduction against other income received by the volunteer. It would therefore be unnecessary to make any changes to the exempt income limitation rules.
- 3.20 We believe that the option of including all reimbursement costs to volunteers in the definition of "exempt income" in the Income Tax Act would achieve the purpose of:
- determining the most appropriate tax treatment of reimbursement payments made to volunteers;
 - ensuring that the law is clear and simple to apply; and
 - minimising, as much as possible, the compliance costs associated with return filing for volunteers and the organisations for which they carry out their voluntary activities.

Treatment of honoraria paid to volunteers

3.21 It is generally accepted that honoraria, when paid as a nominal fee for services provided, are similar in quality to income and should be subject to income tax. However, a difficulty arises when payments also contain an element of reimbursement for actual or reasonable costs incurred by the recipient. This problem is further explored in the context of the following options for possible tax treatment of honoraria paid to volunteers.

All honoraria paid to volunteers up to a threshold are treated as exempt income

3.22 The assumption underlying this option would be that all honoraria paid to volunteers contain an element of reimbursement for costs incurred by the volunteer. Only honoraria over the threshold would be subject to withholding tax.

3.23 This treatment would be consistent with determinations that have already been made under the Withholding Payments Regulations, for selected organisations. If this option were to proceed, honoraria recipients would be required to file income tax returns only if the reimbursement portion of their honoraria exceeds the threshold.

3.24 This option would reduce compliance costs for many volunteer recipients and for payers of honoraria that are below the threshold, but not for others. It could also provide an incentive for organisations to characterise their employees as “volunteers” to claim the exemption.

Honoraria and reimbursements to be separate payments for volunteers

3.25 Under this option, organisations would be required to pay honoraria and reimbursements to volunteers as separate payments so that the reimbursement element could be treated in a consistent manner with other reimbursement payments to volunteers. The fee for the service element – the true honoraria – would continue to attract withholding tax.

3.26 While this option would eliminate compliance costs for payers and recipients of honoraria that are wholly reimbursement payments, it would marginally increase compliance costs for some payers who are currently making payments that contain elements of both types of payment. This group would be required to separate the payments.

Withholding tax deducted from net honoraria paid to volunteers

3.27 Under this option the payer would be required, on an individual basis, to calculate the portion of an honorarium that represents expenses that have been, or will be, incurred. The payer would be required to deduct withholding tax only from the net amount.

3.28 This option would require payers to know in advance what expenses are going to be incurred so they can correctly calculate the taxable portion of the honorarium, and the amount of withholding tax. This would significantly increase up-front compliance costs for payers of honoraria to volunteers.

- 3.29 On the other hand, this option is likely to eliminate compliance costs for many volunteer recipients of honoraria because they would no longer need to file an income tax return solely to claim a deduction for their expenses.

SUBMISSION POINTS

Defining the nature of a “volunteer”

- Are there other groups of volunteers who may be excluded from a definition that has the features described?
- Are there distinctive features in cultures other than Māori and Pacific Island groups that would need to be accommodated within a definition of “volunteer”?
- Would a limitation based on a definition of “formal” volunteering create a sufficiently distinct boundary?
- Is a definition of “voluntary activity” also needed, to create a clear distinction from work or employment?

Treatment of reimbursement payments

- If reimbursements were to be treated as exempt income up to a threshold, what factors should determine where the threshold is set?
- Should the level of a threshold be reviewed at timed intervals, or should other factors prompt a review?
- What would be the risks if all reimbursement payments were to be treated as exempt income?
- If all reimbursement payments were to be treated as exempt income, what would be a reasonable cap to set for payments based on an estimation of costs to be incurred, rather than actual costs incurred by the volunteer?
- What compliance costs, in addition to those already incurred for organisational accounting, would be incurred under each of the options?
- Should a tax exemption be available for reimbursements relating to:
 - volunteering only for registered charities; or
 - volunteering only for, or on behalf of, recognised organisations (“formal” volunteering); or
 - for all forms of volunteering?

Treatment of honoraria paid to volunteers

- Would there be new compliance costs associated with separating reimbursements from true honoraria for organisations that currently make combined payments or would the costs merely replace costs that already exist?
- Would those costs differ from the costs to be incurred if payers were required to calculate and withhold tax from the portion of honoraria that represents a fee for service – that is, after the deduction of reimbursements?

Other matters

- Should an exemption for the reimbursement of transport costs extend to costs incurred by a volunteer in getting from their home to the place where they carry out their voluntary activities? For example, it can be argued that the private benefit arguments that are raised in support of the employment limitation⁴ do not flow through to volunteers because they do not derive a private benefit in the same way that a waged or salaried employee does.
- Should there be a different form of tax code declaration for volunteers to complete if they are subject to withholding tax so they are not erroneously characterised as “employees”? Volunteers are currently required to complete the tax code declaration IR 330.⁵
- What would need to be done to ensure that any changes to the tax law on volunteer reimbursements and honoraria have the desired impact? How could the changes best be communicated to those who would be affected?

⁴ Under the employment limitation in section DA 2(4) of the ITA, a person who is an employee is denied a deduction for an amount of expenditure or loss to the extent to which it is incurred in deriving income from employment.

⁵ A “form for employees to complete when starting their job or changing their tax code”.