Tax-free relocation payments and overtime meal allowances

An officials' issues paper on suggested changes to the Income Tax Act

November 2007

Prepared by the Policy Advice Division of Inland Revenue and by the New Zealand Treasury

First published in November 2007 by the Policy Advice Division of Inland Revenue, PO Box 2198, Wellington.

Tax-free relocation payments and overtime meal allowances: an officials' issues paper on suggested changes to the Income Tax Act.
ISBN 978-0-478-27159-1

CONTENTS

Chapter 1

INTRODUCTION

1.1 Over recent years there has been a great deal of uncertainty over the tax treatment of employer payments for relocation and overtime meal allowances, and whether or not they constitute income that is taxable to the employees who receive them.

1.2 As the Ministers of Finance and Revenue announced in a recent media statement, the law relating to these payments needs to be clarified and simplified, so that employers can get on with running their businesses, and not have to devote valuable resources to determining the tax status of these payments. Changing the law accordingly will also reduce the likelihood of employers having to dispute the matter with Inland Revenue, and possibly ending up in court, thus saving time and money for everyone.

1.3 The government has therefore indicated that it will introduce amendments to the Income Tax Act to ensure that relocation payments and overtime meal allowances are clearly exempt from income tax and, where relevant, fringe benefit tax. The changes will be subject to clear limitations to prevent their use for purposes of salary substitution. To further reduce uncertainty, the changes will apply to payments made over the past four years, as well as to future payments.

1.4 The government also announced that an officials' issues paper seeking public feedback on the details of the proposed changes would be published within a few weeks.

1.5 Accordingly, this issues paper outlines officials' suggestions on the detailed application of the exemptions. In particular, it discusses the various requirements that will need to be met for relocation payments and overtime meal allowances to qualify for the exemptions.

1.6 The two employer payments should be non-taxable for the following reasons:

- The element of private benefit involved in these payments is considered to be small.
- The degree of private benefit is hard to measure.
- There is relatively little risk of recharacterisation of taxable salary and wages as non-taxable payments for relocation or as overtime meal allowances.

1.7 The changes will also help employers and employees in making efficient employee relocation decisions by ensuring that tax considerations do not distort their decisions. This is particularly crucial given the mobility of skilled labour.

1.8 To further reduce the risk of recharacterising salary as a relocation payment or overtime meal allowance, limitations have been proposed. In the case of relocation payments, this involves having a list that specifies the types of relocation expenses that would be exempt from income tax and fringe benefit tax. The suggested list is quite broad and would cover relocation expenses that commonly arise. Such an approach would be broadly consistent with overseas practice. In developing this approach, we have been mindful to have clear boundaries to minimise compliance costs.

1.9 In the case of overtime meal allowances, the limitation will involve, amongst other things, clearly delineating between "overtime" and other situations when meal allowances might be paid under an employment contract.

Specific suggestions

Specifically, we suggest with regard to:

Relocation payments:

1) The relocation will need to be as a result of the employee:

   - taking up a new job with a new employer, or
   - taking up new duties at a new location with the existing employer, or
   - continuing the current job, but at a new location.

2) The employee's existing home must not be within reasonable travelling distance of the new work place.

3) The expense will need to be on the list of eligible relocation expenses.

4) The payment must reflect the expenditure incurred.

5) The expenditure must have been incurred within certain time limits.

Overtime meal allowances:

1) The employee's employment contract will need to specify that the employee is eligible for a payment in relation to overtime hours worked.

2) The allowance should reflect expenditure actually incurred by the employee. To reduce compliance costs, verification will be needed only if the allowance exceeds $20. Alternatively, the allowance needs to be a reasonable estimate of the expected costs likely to be incurred.

3) A specific definition of "overtime" in the legislation should distinguish between what is normally considered overtime and other periods of time for which meal allowances may be paid.

Retrospective application:

The legislative amendments will apply from the 2002-03 income year. (Submissions are invited on whether employers rather than employees should receive the tax credit that arises in relation to past relocation payments that were subject to PAYE deductions).

1.10 These suggestions are discussed in the following chapters, and we are seeking public comment on them as part of the Generic Tax Policy Process.

Feedback

1.11 You are invited to make a submission on the points raised in this issues paper. We would appreciate receiving your comments by 14 December 2007, to enable us time to consider submissions and report to ministers. The aim is to include the resulting legislative changes in the taxation bill planned for introduction in May 2008.

1.12 The proposed legislative changes should be sufficient to deal with uncertainty about the tax treatment of relocation payments and overtime meal allowances. However, people who can make a strong case for introducing legislative certainty for similar reimbursements and allowances, for the reasons outlined in paragraph 1.6, are welcome to put their case by making a submission on this issues paper.

1.13 Submissions should be sent to:

Relocation and Overtime Meal Allowances Project
C/- Deputy Commissioner, Policy
Policy Advice Division
Inland Revenue Department
P O Box 2198
Wellington
New Zealand

1.14 Alternatively, submissions can be made in electronic form, in which case "Relocation and Overtime Meal Allowances Project" should appear in the subject line. The electronic address is:

policy.webmaster@ird.govt.nz

1.15 Please note that submissions may be the subject of a request under the Official Information Act 1982. The withholding of particular submissions on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. If there is any part of your submission that you consider could be properly withheld under that Act (for example, for reasons of privacy), please indicate this clearly in your submission.

Chapter 2

THE CURRENT TAX TREATMENT OF THESE PAYMENTS

2.1 Employers provide payments to employees in a range of situations. In some cases they merely cover costs that employees have incurred as part of carrying out their employment obligations. In other cases the payments are akin to remuneration and should therefore be taxable in the hands of the employees who receive them.

2.2 Payments may be made in several ways. For example, employers may pay employees' monthly telephone accounts or other accounts. Alternatively, employees might seek reimbursement of an amount they have already paid, or the employer might provide them with an allowance to cover the estimated costs they are expecting to incur. Section CW 13 of the Income Tax Act 2004[1] sets out the circumstances when these payments are exempt from income tax.

2.3 These situations differ from those covered by the fringe benefit tax rules (subpart CX of the Act), which cover situations when employers incur the liability directly. Ideally, however, the outcomes should be similar.

2.4 This issues paper focuses on two particular payments:

- when employers make payments to employees to cover the costs of employees relocating their home base as a result of their employment; and
- when employers pay employees an allowance to cover the costs of meals in relation to overtime undertaken by the employee.

Legal interpretative developments

2.5 For many years these two types of payment have been generally treated as non-taxable by both taxpayers and Inland Revenue. Developments over time have, however, complicated the situation.

2.6 Before 1995 taxpayers required approval from Inland Revenue if a particular payment was to be treated as non-taxable, but since then taxpayers have self-assessed whether a payment is taxable or non-taxable.

2.7 In response to a taxpayer enquiry, Inland Revenue released for public consultation in October 2006 an exposure draft (QB0056) on the tax treatment of payments made to new employees to cover their relocation expenses. The draft suggested that the payments (whether made on account of an employee, or by reimbursement, or by way of an allowance based on an estimation of expected expenses) were taxable income of the recipient employee under current law.

[1] The equivalent section in the recently enacted Income Tax Act 2007 is CW17.

2.8 Inland Revenue received around 30 submissions on this draft. They focussed not only on the interpretation itself but also raised concerns about the impact that taxing relocation payments would have on labour mobility and international competitiveness. There was also concern that many businesses, that had genuinely believed these payments to be non-taxable, now faced the risk of retrospective audit activity.

2.9 More recently, Inland Revenue has attempted to identify more generally the circumstances under current tax law (including case law) when amounts paid by employers in relation to employee-related expenses would be exempt from income tax. These circumstances are outlined in draft Interpretation Guideline (IG03162), which was released for public comment on 24 October 2007. The Interpretation Guideline specifically focuses on those situations covered by section CW 13.

2.10 Three criteria[2] that the guideline concludes have to all be met are:

- The employee was performing an obligation under the contract of service at the time the expenditure was incurred.
- The obligation served the purpose of the income-earning process of deriving income from employment.
- The expenditure incurred by the employee was necessary as a practical requirement of the performance of the obligation.

2.11 The draft interpretation guideline reaches the same conclusion as QB0056 in relation to relocation payments, although its coverage is wider as it considers relocating existing as well as new employees.[3]

2.12 Apart from relocations, application of the criteria in Interpretation Guideline IG03162 also has implications for overtime meal allowances as these would be taxable under the preceding criteria, whereas they have traditionally, in practice, been treated as non-taxable.[4]

Policy response

2.13 In response to these various developments, the government has decided that it should, as a simplification initiative and to create greater certainty, amend the Act to specifically exempt relocation payments (for both new and existing employees) and overtime meal allowances from income tax and, where relevant, fringe benefit tax. This was announced in a joint media statement released by the Minister of Finance and the Minister of Revenue on 24 October 2007.

[2] The criteria would not apply to payments that already have their own rules in legislation; for example the rules relating to reimbursement of additional transport costs are already set out in section CW 14 of the Income Tax Act 2004 (or CW 18 of the Income Tax Act 2007).

[3] The one exception when relocation costs of existing employees would not be taxable is when the relocation costs relate to a requirement in the employment contract that the employee transfers at the request of the employer at any time and the employee is relocated to the same job and moves to the new location.

[4] The other examples in the draft (meal allowances or reimbursements for meals taken as part of business situations and clothing allowances or reimbursements), appear to coincide with current practice, but it is likely that there will be specific instances outside of those examples where current practice differs from what the draft interpretation guideline proposes.

2.14 Furthermore, the government announced that, in principle, it believes these amendments should be backdated so that their coverage includes the past four years. By statute, Inland Revenue is generally unable to re-assess an income tax liability beyond four years. (This point is discussed more fully in chapter 5.)

Chapter 3

RELOCATION PAYMENTS – THE DETAILS

3.1 This chapter discusses the detail of the proposed approach to providing an exemption from income tax and fringe benefit tax for relocation payments. Issues discussed include determining what constitutes an employee relocation and what expenses should qualify as "relocation expenses". In developing the requirements in these areas, we have drawn on the experience of other countries.

What legislation needs to be amended?

3.2 Amendments will be needed to subparts CW and CX of the Act. A new section in subpart CW will be added to cover the exemption. Also, subpart CX will need to make it clear that if an employer chooses to directly incur the qualifying costs of relocating an employee, it will not give rise to a fringe benefit.

What will qualify?

3.3 A chain of requirements will need to be met for a payment to be exempt.

Step 1: When does an employee relocation occur?

3.4 The first step would be to determine whether a qualifying work-related relocation has actually occurred.

3.5 In this regard, the relocation will need to be as a result of an employee:

- taking up a new job with a new employer; or
- taking up new duties at a new location with the existing employer; or
- continuing the current job, but at a new location.

3.6 Furthermore, the relocation of the employee's home base (the sole or main residence) must be necessary to carry out the job. If the employee could have commuted to the new job from an existing home base there would appear to be a clear monetary private benefit involved when the employer pays for the relocation costs, and, in principle, this should be taxable.

3.7 This suggests the need for some form of distance requirement before a move could be considered a qualifying relocation. For example, in the United Kingdom the employee's existing home must not be within reasonable daily travelling distance of the new workplace. An alternative would be to have a specific minimum distance test, such as that used in the United States.[5] Either of these requirements does, however, involve some compliance costs. The United Kingdom's approach requires assumptions to be made about what is "reasonable", although reasonableness is a common concept within accounting. The United States' approach is more certain in this regard but is less flexible in handling genuine local relocations, such as within a major city where traffic congestion and transport difficulties may make shorter distance relocations more justifiable.

3.8 A third option would be to leave it to employers to decide whether there has been a home base relocation that they wish to pay for, on the basis that employers will be reluctant to pay for relocations that are not related to work. While this would generally be the case, there could be some instances, particularly for senior appointments, when a salary recharacterisation could be achieved by relocating locally to coincide with taking up a new appointment.

3.9 On balance, our preference, backed by preliminary consultation, is to adopt the United Kingdom's approach. In terms of the reasonableness aspect, we note that the reasonable daily travelling distance is not defined in the United Kingdom's legislation. Instead taxpayers are expected to apply common sense and take account of local conditions. The usual time taken to travel a given distance is an indication of whether that distance is reasonable. For example, in the United Kingdom employees living within larger cities commonly travel much greater distances or take longer to travel the same distance to work than do employees elsewhere. In the New Zealand context, transport difficulties in the major cities may make long distance commuting less likely.

3.10 We consider that the small additional compliance costs associated with this requirement are warranted in light of the reduced opportunity for salary recharacterisation.

[5] The United States requires the new main job location to be at least 50 miles (approximately 80 kilometres) further from the employee's former home than from the old main job location. The shortest distance of the most commonly travelled routes must be used. To determine this, employees are required to determine the distance between their former residence and their new job location and then subtract the distance between their former residence and their old job location. If the result is more than 50 miles, the distance test has been met. For example, if the distance from the employee's former residence to the new job is 70 miles, and the distance from the former residence to the old job was five miles, the distance test would be met.

Question for submissions

Would it be workable in New Zealand to have a requirement that the employee's existing home must not be within reasonable daily travelling distance of the new workplace?

Do we need a minimum distance requirement instead? If so, what should the minimum distance be? Would 80 kilometres be appropriate?

What other options would you suggest?

Step 2: What relocation expenses should be eligible?

3.11 Employers can largely be relied upon to confine their reimbursements to reasonable relocation expenses because their natural inclination is to minimise the costs that they incur. Nevertheless, the existence of an exemption for one form of expenditure will naturally create an incentive to recharacterise other forms of expenditure to take advantage of that exemption. Our view is that any payment that, absent an exemption, would have been paid as salary should be taxed as if it was salary.

3.12 Perhaps the most likely form of recharacterisation would be in relation to "additional" expenses, such as temporary accommodation, or an allowance for miscellaneous items. For example, if an employee required two months' temporary accommodation to find a home to buy in the new area, but is offered four months' accommodation, then the value of the additional two months' accommodation should be taxable. The need to minimise recharacterisation provides a justification for limiting the scope of the exemption.

3.13 Allowing only actual expenses to be exempt is an obvious first step in preventing recharacterisation. This is discussed more fully later. Beyond this, two practical ways to limit the scope for recharacterisation are to restrict the eligibility of those types of expenses more likely to be recharacterised or to limit the total amount of the exemption available. In practice, the cost of relocating people will differ depending on their family size, where they are coming from, and so forth. The amount and extent of relocation expenses that an employer is willing to pay will also vary. For highly skilled, mobile workers, for example, a firm is likely to have to pay whatever relocation expenses are required by the employee. Placing limits on the amount of eligible relocation expenses would not adequately recognise these variations and is not therefore an approach we favour.

Having a list of eligible expenses

3.14 Accordingly, the limit we envisage is by way of having a list of eligible expenses. A suggested list is outlined below. The items are generally one-off costs.

3.15 The list would not be included in the Act but, rather, would be included in a determination issued by the Commissioner of Inland Revenue, with the legislation providing for that power. The Commissioner would also be able to issue further determinations extending the list.

3.16 In relation to employees and their immediate families[6] involved in relocation, the list of eligible expenditure should consist of:

- the costs of engaging a relocation consultant or the cost of house hunting trips to the new location;
- the costs of obtaining immigration assistance;
- the costs of obtaining advice on the taxation implications of relocating;
- the costs of health checks and special documentation required as a result of the relocation;
- the costs of selling an existing home and acquiring a new dwelling, including real estate commissions, legal fees and penalty interest charges for breaking a fixed term loan;
- the costs of finding rental accommodation in the new location;
- the costs of removal, transport and storage of household effects;
- the costs to move personal items such as cars, boats or trailers;
- disconnection and connection fees for, respectively, the old and new residences in relation to telephone, power, gas and internet/television;
- transport costs (such as air fares) using a direct route to get to the new location, and any meals and accommodation costs en route;
- costs of replacing or converting (minor) electrical appliances because of voltage differences;
- the costs associated with relocating the employee's pets, including boarding fees;
- the costs of accommodation or value of employer-provided accommodation for up to two months;

[6] "Immediate family" includes the employee's partner, dependent children and any dependent adults that are part of the employee's household. A dependent adult might be a dependent parent of the employee or partner or a disabled relative for whom the employee or the employee's partner is the caregiver.

- utility and maintenance costs for the old residence up to one year if, despite reasonable efforts, it cannot be sold, and provided the property is not rented;
- when new school uniforms are required, the cost of such uniforms up to $500 per child; and
- private school application fees if an employee's children were enrolled in private schools in the previous location.

Question for submissions

Are there other items that should be on an inclusive list?

Are there items that should be removed from the list?

Step 3: Requirement that expenditure has to be incurred

3.17 The exemption will apply only to actual expenditure incurred. Hence, paying an employee a relocation allowance would not generally qualify unless it could be shown that the allowance covers costs that were actually incurred. Similarly, any amount paid by the employer in excess of the actual amount incurred will be taxable, even though a particular expense is on the list. Otherwise, general allowances bearing no semblance to actual expenditure could be paid as salary substitutes.

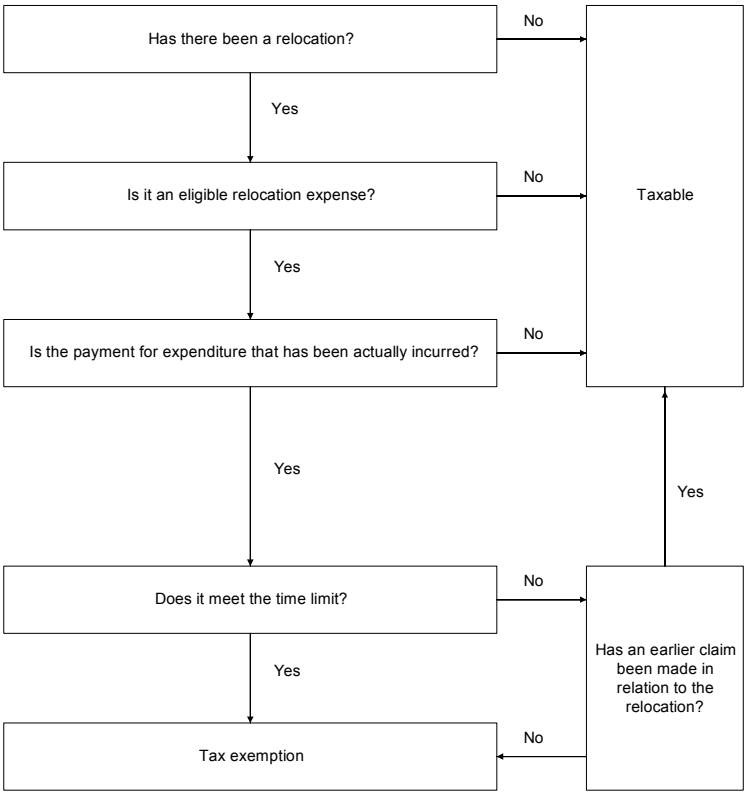
Step 4: Time limit for incurring expenditure

3.18 We envisage that the expenditure for a particular relocation must be incurred, or the benefit provided, before the end of the income year following the one in which the employee starts the new job or moves to the new location. The purpose of this requirement is to avoid expenditure some years later being attributed to the relocation when that expenditure would have no bearing on the employee's decision to relocate. In practice, most relocation costs will be incurred close to the time of relocation.

3.19 The one proviso would be when an employee has temporarily moved to a new location for, say, a couple of years and then decides to relocate permanently but continues to do the same job. Provided no earlier claim has been made in relation to the relocation, it would be treated as having been made at the later date. The earlier, temporary move would not be considered to have been a relocation, as such, in those circumstances.

3.20 These steps are summarised in figure 1.

FIGURE 1: ESTABLISHING WHETHER A RELOCATION PAYMENT IS TAX-EXEMPT



3.21 Consequently, provided these various tests are met, the relocation payment will be exempt from income tax and fringe benefit tax, irrespective of how the employer makes the payment.

Other options

3.22 As mentioned earlier, we also considered the merits of having a cap and/or a list of ineligible expenditure but concluded against these for various reasons.

3.23 The United States' test, for example, focuses on what are the reasonable expenses of moving the employee's household goods and personal effects and of travelling from the old to the new home. It includes a list of non-deductible expenses, which has the effect of significantly limiting what qualifies. The United Kingdom also has a list of ineligible items.

3.24 Obvious items for an ineligible list would be any capital gains provided to employees, such as compensation for having to pay more for a house in the new location than in the old location. Also, "expenditures" that were in effect lump-sum allowances unrelated to actual expenditure would also be ineligible.

3.25 A list of eligible expenses provides greater control over the expenses that would be tax-exempt than the converse approach of allowing any expenses other than those on an ineligible list.

3.26 A concern with placing a cap on the amount of exempt expenses is that it could preclude some socially optimal relocations because it would not recognise variations in employees' costs, which can be significant depending on factors such as an employee's family size.

Questions for submissions

Should there be a cap?

Would having an exclusive list be a better approach than having an inclusive list of expenses?

Chapter 4

OVERTIME MEAL ALLOWANCES – THE DETAILS

4.1 Meal costs are generally considered to be of a private or domestic nature. They are a normal part of living, irrespective of whether someone is in paid work or not. For example, if an employer pays employees a meal allowance for them to buy their lunch, in the course of their normal working day, the allowance is generally considered taxable to the employees. In this case there is a clear private benefit. If the employer had not paid for the meal, the employees would have had to. The payment of a meal allowance in these circumstances is equivalent to the employees being paid salary or wages and purchasing the meal out of those wages.

4.2 There are, however, a number of situations when meals are considered to be necessarily incurred in deriving income, and are consequently non-taxable. For example, when an employer pays for meals taken as part of business or work meetings, as part of the entertainment of business clients, or in relation to a business trip to attend a meeting or conference that involves accommodation overnight, the payments are not taxable. Inland Revenue's draft Interpretation Guideline will generally not affect these situations.

4.3 As an alternative to an allowance, employees may instead be provided with meals through a cafeteria on the employer's premises. In such cases, fringe benefit tax does not apply because of the exemption for benefits provided on the employer's premises.

4.4 Meal allowances are often paid to employees who work overtime. These payments have not been generally considered taxable, either by taxpayers or by Inland Revenue. However, the draft Interpretation Guideline concludes that these payments are, in fact, taxable under current law, and if that guideline is finalised in its current form, will result in Inland Revenue treating them accordingly.

4.5 With an overtime meal allowance, however, it is arguable whether the entire payment provides a private benefit. If the employees concerned had not worked overtime they could have eaten at home at a comparatively cheaper cost than they incurred by purchasing a meal while working overtime. An apportionment exercise could be entered into to estimate the likely cost of a meal at home, but this is likely to be difficult and would create significant compliance costs relative to the revenue likely to be generated. As with relocation payments, the private benefit involved is likely to be very small.[7] As such, rather than attempting to apportion private and business elements, the proposed approach, as announced in the media statement by ministers, is to exempt overtime meal allowances, subject to the limitations set out in the following sections. This will create more certainty.

[7] For example, if an employee were to receive fifty overtime payments of $10 in a year and those payments were taxed, the maximum tax involved would be $195.

What legislation needs to be amended?

4.6 Amendments to subparts CW of the Act will be needed. As with relocation payments, overtime meal allowances will need to be separated out of section CW 13, and the specific rules relating to the overtime meal allowances exemption included in a new section. No changes are envisaged for the fringe benefit tax rules because fringe benefits arising outside of on-premises meals seem unlikely. If they do arise, however, they may get the benefit of section CX 5(3). That section states that to the extent to which a benefit that an employer provides to employees in connection with their employment would have been exempt income if it had been paid in cash, the benefit is not a fringe benefit.

Limitations

4.7 The possibility of recharacterisation is again an issue. To minimise this likelihood, we are suggesting an exemption for meal allowances paid during overtime work when it is specified in the employee's contract that the employee is eligible for a payment in relation to overtime hours worked. This would be irrespective of whether the employee can be required to work overtime. Eligibility for payment would be sufficient.

4.8 This exemption would not extend to amounts paid for overtime meals that have been incorporated into an employee's normal salary and wages.

4.9 Ideally, the allowance should also reflect the expenditure incurred, although this raises some compliance concerns, such as the cost of verification. One option in these circumstances would be to require receipt verification only if the allowance is above a certain amount, as is done in Australia. An appropriate amount could be $20. (The Australian threshold is around this amount.[8]) Even though verification would not be required in these circumstances, the allowance would still need to be fully expended on purchasing a meal. Alternatively, the allowance should be a reasonable estimate of the expected costs likely to be incurred by the employee or a group of employees for which reimbursement is payable (that is, the equivalent of the section CW13(3) requirement). The estimated amount would then be treated as if it were the amount incurred.

4.10 Combined, these features would substantially reduce any possibility of recharacterisation occurring.

[8] Currently $21.90. See appendix for more detail.

Defining "overtime"

4.11 Furthermore, we suggest that the definition of "overtime" that is used in the legislation distinguish what is normally considered overtime from other periods of time for which meal allowances may be paid. "Overtime" is not commonly defined in statute, either in New Zealand or overseas, but there is a common understanding in everyday English usage. The Concise Oxford Dictionary, for example, defines "overtime" as "the time during which a person works at a job in addition to the regular hours". The concept is therefore of something beyond normal hours.

4.12 This implies that if someone agreed to work four ten-hour days each week, for example, the last two hours of each day would not be considered overtime because they are part of the employee's normal working hours. There would appear to be no difference between receiving a meal allowance during the last two hours in this example and receiving a lunchtime meal allowance.

4.13 The definition should encompass genuine overtime arrangements without providing opportunities to restructure contracts to provide for multiple overtime meal allowances by extending the number of overtime hours through significantly limiting the hours covered by basic pay.

Possible definition

4.14 In these circumstances, a definition of overtime (and overtime payment) could be:

> **Overtime,** for a person, means time worked for an employer —
>
> (a) beyond the person's normal hours of work as set out in the employment agreement; and
>
> (b) on a day, —
>
> (i) beyond a minimum requirement of eight hours; or
>
> (ii) for which the person is eligible to be paid under the employment agreement at a rate that is at least 1.5 times their rate of pay for normal hours.
>
> **Overtime payment** means an amount paid by an employer to a person for working overtime, and includes an overtime meal allowance paid or reimbursed under the person's employment agreement.

Questions for submissions

Would it be a useful option to have a $20 threshold below which verification of actual expenditure would not be required?

Does the definition of "overtime" suggested in this chapter encapsulate the concept of overtime as you understand it?

Should the definition also require that overtime does not include time worked outside someone's normal hours when the minimum requirements for the employee for the week as set out in the employment agreement have not been met? Under such a requirement, an employee who worked an additional four hours on one day of the week but who worked only 36 of the required 40 normal hours for the week would not be considered to have worked any overtime.

Is there a need, in practice, also to amend the fringe benefit tax rules to accommodate tax-free employer payments for overtime meals?

Chapter 5

RETROSPECTIVE APPLICATION

5.1 The government has signalled its intention that the two legislative changes will have retrospective effect, so their coverage includes the past four years. Consequently, changes will need to be made not only to the Income Tax Act 2007 but also to the Income Tax Act 2004 and the Income Tax Act 1994.

5.2 Making retrospective amendments to tax legislation is generally not desirable as it can create uncertainty for taxpayers. In this instance, however, it will remove taxpayer uncertainty about what to do about past payments for relocation and overtime meal allowances in light of the conclusions reached in Inland Revenue's draft Interpretation Guideline.

5.3 Specifically, the four-year period was intended to close off the possibility that past positions taken by taxpayers who had genuinely considered the amounts to be tax-free might be subsequently revised by Inland Revenue. By statute, Inland Revenue is generally[9] unable to re-assess a tax position beyond four years from the time of the end of the year in which the notice of original assessment was issued. (See section 108 of the Tax Administration Act 1994.) Similarly, for taxpayers who have not filed a tax return, Inland Revenue is generally unable to issue an income statement beyond four years from the time of the end of the year in which the notice of original assessment was issued.

5.4 Because the four-year period begins from the assessment notice rather than from when the income was earned, the proposed exemption will likely apply retrospectively for five years. For example, an assessment made in August 2003 in relation to income earned in the 2002-03 income year could be amended up until 31 March 2008. In these circumstances, we suggest that the amendments apply from the 2002-03 income year.

Credit for over-paid tax

5.5 Assuming that the legislation is passed, taxpayers who have been treating the payments as taxable will be eligible to receive a credit for any over-paid tax.[10] At that point, they can request that their relevant assessments be amended, which the Commissioner can do under section 113 of the Tax Administration Act 1994, and receive an adjustment for the overpaid tax and any associated penalties.

5.6 The past payments would still need to meet the proposed criteria set out earlier in this issues paper, such as being an eligible relocation expense, to qualify for the exemption and any tax adjustment.

[9] There is an exception when the return in question is, in the opinion of the Commissioner, fraudulent or wilfully misleading or omits all mention of income which is of a particular nature or was derived from a particular source.
[10] If no other tax is owed, this would result in a refund.

Who should get the credit?

5.7 Normally, the employee would receive the credit if the original payment is considered to have been part of the employee's income. However, when in relation to a relocation payment an employer has deducted PAYE and has grossed up the payment to reflect the tax liability, there are strong grounds for giving the tax credit to the employer rather than the employee.[11] In such cases, the employee has been fully reimbursed for the relocation costs and the tax has, in effect, been borne by the employer. Consequently, we are interested in receiving feedback on whether it would be more appropriate for the employer to receive the tax credit adjustment. A special legislative mechanism may be required to achieve this in all cases. Employers would then be required to include the credits in their income because they would have treated the PAYE deduction as a cost of business.

5.8 This approach could also be administratively simpler as it would avoid having to adjust, where relevant, an employee's liabilities for student loans and child support and entitlement to family tax credits.

Questions for submissions

Should the employer rather than the employee receive the tax credit that will arise in relation to the deduction of PAYE from past relocation payments?

[11] This is not a problem if the employer has paid fringe benefit tax on the payment because the employer will automatically receive the credit.

Appendix

TREATMENT OF RELOCATION AND MEAL ALLOWANCES IN OTHER JURISDICTIONS

Table 1 shows the key features of the tax treatments of relocation and overtime meal allowances in four "similar" jurisdictions.

Canada, the United States, the United Kingdom and Australia all provide a tax exemption for certain relocation expenses. This is achieved through lists of what is eligible, and in the United States the test is also what is "reasonable" in the circumstances. Common features of the lists are the cost of travelling to the new home and transporting belongings, with the countries other than the United States also including the costs of selling an existing home and acquiring a new home. The United States and United Kingdom also have lists of ineligible expenditure. The United Kingdom is the only country to place a cap on the level of the concession, set at £8,000.

Meal allowances are generally taxable in all four countries, with an exemption for meals during business travel in all four, and an exemption for overtime meals in all but the United Kingdom.[12]

In Canada, if the employee works three or more hours of overtime right after his or her scheduled hours of work and the overtime is infrequent and occasional in nature (less than three times a week), then it is not taxable. If more frequent, the allowance is seen as taking on the characteristics of additional remuneration. The United States takes a similar approach for an overtime meal allowance provided on an occasional basis. In Australia, an overtime meal allowance may be tax-free if paid under an industrial law, award or agreement. If the allowance is no more than $21.90, there is an exemption from the need for verifying documentation but the amount must still be fully expended.

TABLE 1

	Relocation				**Overtime meals**
	Tax-free	**List of eligible expenses**	**List of ineligible expenses**	**Cap**	**Exemption**
Canada	Yes	Yes	No	No	Yes
United States	Yes	Yes	Yes	No	Yes
United Kingdom	Yes	Yes	Yes	Yes	No
Australia	Yes	Yes	No	No	Yes

[12] The UK has an exception for lorry and coach drivers whose duties oblige them to take meals away from home and their permanent workplace.