13 October 2009

A special report from the
Policy Advice Division of Inland Revenue

Payroll giving – a new tax credit

Legislation introducing a voluntary payroll-giving scheme has been enacted and will take effect from 7 January 2010. The scheme provides a tax credit for gifts of money that are deducted from an employee's pay through his or her employer's payroll. Employees receive an immediate reduction in tax by way of the tax credit each pay-period, eliminating the need to collect and keep receipts to claim the tax relief on gifts of money at the end of the year. To participate in the payroll-giving scheme the recipient organisation, such as a charity or school, must be a donee organisation.

The legislation only provides for the tax administration of the scheme. It does not prescribe the nature of the arrangements or relationships between employers, employees and donee organisations, or how the schemes should be set up in the workplace.

The scheme operates in addition to the current end-of-year donation tax credit claim system. Therefore, employees who do not or are unable to give through a payroll-giving scheme can still claim tax benefits on their donations through the existing end-of-year refund process.

This report is intended to provide timely assistance to employers, employees, donee organisations and their advisors in understanding the tax mechanism for delivering tax credits for payroll donations. It also offers some guidance on how to set up a payroll-giving arrangement based on overseas experience and the current limited New Zealand experience using an after-tax payroll-giving scheme.

Further detailed guidance on payroll giving will be available over the coming weeks on Inland Revenue's website www.ird.govt.nz and in Inland Revenue's publication *Tax Information Bulletin.*

Background

The government first raised the idea of introducing a voluntary payroll-giving scheme to New Zealand in the 2006 discussion document *Tax incentives for giving to charities and other non-profit organisations.* This was followed by a further discussion document in November 2007, *Payroll giving: providing a real-time benefit for charitable giving,* which discussed several options for implementing payroll giving in New Zealand. Submissions made in response to these documents indicated a wide level of public support for introducing a payroll-giving scheme, in particular – for making giving to charitable and philanthropic causes easier.

Other countries, such as Australia and the United Kingdom have introduced payroll giving and their experiences suggested that payroll giving is a simple, convenient and effective way of supporting charitable giving. These countries have also found that payroll giving enables businesses to connect with their communities in ways that achieve tangible and mutual benefits for everyone involved. In particular, payroll giving offers donee organisations the benefit of stable funding that is free of fundraising costs – that is, donee organisations receive donations as a lump sum from each employer and this reduces their costs as donee organisations only process one donation from each employer. Another benefit is that donee organisations are not required to issue receipts to the donors.

The non-prescriptive nature of New Zealand's new payroll-giving scheme is intended to provide flexibility to allow relevant parties to work together to establish schemes that work best for them and to manage the associated costs. A key policy outcome of the payroll-giving scheme is that it has the potential to establish genuine partnerships between businesses and the community, while supporting employees' community activities.

The Finance and Expenditure Committee recommended a number of changes to the payroll giving provisions to better reflect policy intentions and to improve the overall equity of the scheme. The Committee also asked for clarification on a number of matters relating to payroll giving. These issues are covered in this report.

Key features

The rules for the new payroll-giving scheme are largely contained in new sections LD 4 to LD 8 of the Income Tax Act 2007 and in new section 24Q of the Tax Administration Act 1994. Unless otherwise indicated, section references are to the Income Tax Act 2007.

The key features of the scheme are:

- Participation in payroll giving is voluntary for employers and employees.
- Payroll giving is available only to employees whose employers file their employer monthly schedules and PAYE deduction forms electronically, using Inland Revenue's ir-File service, and who choose to offer payroll giving in their workplace.
- Employees who choose to make payroll donations will receive a tax credit on the amount of those donations each payday. The tax credit is calculated on a set rate of 33⅓ percent of the donation made. The tax credit is offset against the PAYE amount calculated on the employee's gross pay, thereby reducing the amount of PAYE payable for that period. The maximum tax credit permitted is limited to the tax portion of the PAYE deduction on the employee's pay each pay period.
- Payroll donations must be made to a donee organisation. A donee organisation is a society, institution, association, organisation, trust or fund as described in section LD 3(2) or an organisation listed in schedule 32.

- Employees are responsible for ensuring that the chosen recipient is in fact a donee organisation and for supplying to the employer relevant details that will enable the transfer of the payroll donations to the donee organisations. A full list of donee organisations can be found at www.ird.govt.nz/donee-organisations.

- Employers are responsible for ensuring that payroll donations are transferred to the chosen donee organisations within a specified period. They are also required to disclose certain information and keep adequate records to enable Inland Revenue to determine that payroll donations have in fact been transferred.

- Employees who donate through payroll giving are not eligible for the end-of-year donation refund on their payroll donations.

Application date

The rules of the payroll-giving scheme take effect on 7 January 2010.

Detailed analysis

Establishing payroll-giving schemes in the workplace

In New Zealand, a small number of employers have already established payroll-giving relationships with their employees and individual donee organisations. Under these schemes, donations are made from the after-tax pay of the employee. As long as they keep records, employees can claim the tax benefit of these donations at the end of the year through the current donation tax credit process, like any other charitable donation. The new payroll-giving scheme replaces the end-of-year claim process for employees donating via payroll giving.

As stated earlier, the payroll-giving scheme legislation does not prescribe the nature of the arrangements or relationships between employers, employees and donee organisations, or how the schemes should be set up. Matters that would need to be decided upon by the relevant parties include:

- the process for establishing a scheme that works best for all parties concerned;

- the role of intermediaries;[1]

[1] In overseas jurisdictions, intermediaries are used to receive and distribute payroll donations to donee organisations (payment intermediaries) and/or to help employers establish payroll-giving schemes (facilitating intermediaries).

- the level of employee education about payroll giving that may be needed;
- the process for selecting donee organisations to participate in the scheme;
- the number of donee organisations that can participate in the scheme;
- the level of engagement between donee organisations and employee donors; and
- Any minimum payroll donation threshold.

The examples below illustrate three possible approaches to establishing payroll-giving arrangements based on current New Zealand and overseas experiences.

Example 1

The employer has established a charitable trust to receive its employees' payroll donations and to decide on the ultimate destination of those donations. The charitable trust is itself a donee organisation. Donee organisations apply for grant funding from the trust. As there is employee representation in the grant-making process, employees have the ability to determine the ultimate destination of their payroll donations. Employees receive regular feedback about the impact of their support in the community.

The employer-established charitable trust offers the employer and its employees a flexible payroll-giving programme.

Example 2

The employer and its employees participate in selecting the donee organisations they wish to support. The number of donee organisations is limited to six organisations. Employee peer champions are selected and trained to communicate the benefits of the payroll-giving programme to employees and to facilitate on-going engagement in the workplace. Employees must give at least $2 or more each pay. Employees receive advice detailing the amount donated and to whom each year.

The employer also provides a degree of matching donations. Employees are encouraged to increase their involvement with the selected donee organisations through the giving of volunteer time and expertise (pro bono work).

There is a high level of employer/employee engagement in facilitating the payroll-giving programme. The six donee organisations are also actively involved in the programme.

Example 3

The employer has partnered with a third-party intermediary (which is a donee organisation). The intermediary receives the employee payroll donations from the employer and decides who in the community should benefit. The intermediary ensures that payroll donations go to support certain community activities in the region in which the payroll donations are sourced. Employees have no control over where their payroll donations are applied.

A third-party intermediary offers efficiency gains in time and costs for the employer and its employees.

The new tax credit for payroll donations

Who can participate in the payroll-giving scheme (section LD 4(1))

Participation in payroll giving is voluntary for both employers and employees.

Tax credits for payroll donations are available to any person:

- whose employer chooses to offer payroll giving in the workplace;
- whose employer files its employer monthly schedules and employer deduction forms by electronic means; and
- who chooses to make a payroll donation in a pay-period from their pay.

There is no registration process for payroll giving. An employer simply records any tax credits for payroll donations on the employer monthly schedule and then electronically files this form with Inland Revenue.

Amount of credit (section LD 4(2) and (3))

The credit applies at the rate of 33⅓ percent on the dollar value of all qualifying payroll donations made by the employee in a pay-period.

Maximum credit (section LD 4(4))

The maximum credit is limited to the income tax that the employee has paid in respect of the pay period in which the donation has been deducted.

Non-refundable credit (section LD 4(5))

The tax credit for payroll donations is treated as a non-refundable credit.

No refunds for payroll donations (section LD 4(6))

Payroll donations are not eligible for the end-of-year donation refund.

Definition of "pay" (section LD 4(7))

A new definition of "pay" has been included for the purposes of payroll giving. The definition is intended to ensure that only people who earn income in connection with their employment can participate in the payroll-giving scheme.

Cancellation of the tax credit (sections LD 5 and LD 6)

New section LD 5 extinguishes the tax credit when a calculation or filing error has occurred. This provision also restores the tax credit if the error is subsequently corrected by the employer.

New section LD 6 extinguishes the tax credit when an employer or PAYE intermediary transfers an employee's payroll donation to a recipient that is not a donee organisation. Extinguishing the credit would result in a shortfall in PAYE, and so the employee would have an additional PAYE liability to pay for the relevant pay-period. Ultimately, the employee would be liable to meet any shortfall in PAYE, as provided in section RD 4(1) and section 168 of the Tax Administration Act 1994.

When a donation is returned to an employee (section LD 7)

New section LD 7 extinguishes the tax credit if the donation is returned to the employee. There may be instances when the employee receives a donation back (for example, the employer might have the donation returned if it had been provided to an ineligible donee organisation so the amount can be returned to the employee). The tax credit they previously received for that donation would be cancelled.

Meaning and ranking of payroll donations (section LD 8)

New section LD 8 provides that an employee must meet his or her tax and other obligations in respect of each pay-period before they are able to make payroll donations for a pay-period. In practice, this means that the employer would make the required pay-period tax and social policy deductions (including student loan, child support payments and KiwiSaver obligations) and any other deductions required to be made from an employee's salary and, if there are sufficient funds, make the necessary adjustments for payroll donations.

This provision may affect the amount of payroll donations an employee may make in a pay-period and also the maximum amount of tax credit.

Transferring payroll donations (section 24Q of the Tax Administration Act 1994)

Section 24Q of the Tax Administration Act 1994 is intended to apply when an employer agrees to establish payroll giving in the workplace and an employee asks the employer to transfer an amount of payroll donation from the employee's pay to a donee organisation. The provision provides that:

- Employers must transfer any payroll donations to donee organisations on or before the due date required by sections RA 15 and RD 4 that is nearest to the end of the two-month period from the last day of the pay-period in which the donation was deducted.
- Payroll donations are held in trust for employees until transferred to the donee organisations.
- Employees are responsible for checking that the organisation they are donating to is in fact a "donee organisation" and for supplying their employer with sufficient details of the recipient to enable the payroll donation to be made.

Priority of payroll giving donations

Schedule 7 of the Companies Act 1993 and section 274(2)(aa) of the Insolvency Act 2006 have been amended to confirm that when an employer goes into bankruptcy or liquidation and has not passed on the employee's donations to a donee organisation, those donations will have the same priority for return to the employee in a bankruptcy or liquidation as unpaid wages.

Information disclosure and record-keeping requirements

New section RP 14(ab) requires PAYE intermediaries to transfer any payroll donations to the relevant recipients on or before the due date of the employer's EDF/IR 345 nearest to the expiry of the two-month period that follows the pay period in which the donation was deducted.

New sections RP 8(a)(iii) and (iv) require employers who use PAYE intermediaries to keep a record of the amount of payroll donations and any tax credit for payroll donations and provide this information to the intermediary.

New sections 22(2)(ed) and 22(2)(ke) of the Tax Administration Act 1994 provide that employers must maintain sufficient records to enable Inland Revenue to determine the transfer of an employee's payroll donation to the recipient of that donation.

Penalty and use-of-money interest provisions

Section RD 2(1)(b) provides that the payroll donation tax credit provisions are part of the PAYE rules. Therefore, the normal penalty and use-of-money-interest charges that apply to the determination and payment of PAYE also apply to the tax credit for payroll donations. It would be a question of fact and degree whether the current late payment penalties or any of the shortfall penalties would apply and the application of penalties would be on a case-by-case basis.

The only additional penalty for payroll giving is contained in section 141E(1)(c) of the Tax Administration Act 1994. This provides that employers are liable to pay a shortfall penalty of 150% if they do not transfer the payroll donations to the correct recipient. The penalty is imposed on the tax credit that is extinguished, because the credit would represent the short-paid PAYE.

Inland Revenue support

Employers wishing to learn how to e-file

Any employer with access to a computer and the internet can file electronically using Inland Revenue's secure ir-File service. Inland Revenue provides relevant support and education to employers who choose to file their employer monthly schedules and their deduction forms in this way.

Donee list on Inland Revenue's website

Employees are responsible for checking that the recipients are in fact donee organisations. A full list of donee organisations can be found at: www.ird.govt.nz/donee-organisations.