

Recognising salary trade-offs as income

An officials' issues paper

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CHAPTER 1

Introduction

- 1.1 One of the themes of Budget 2010 was the need to improve the integrity of the tax system and social assistance programmes so that individuals pay their fair share of tax and social assistance is targeted at those in genuine need.
- 1.2 Key in this objective is the comprehensive taxation of labour income and other benefits provided by employers to their employees in exchange for labour services, or as comprehensive an approach as practicalities will allow. A second important aspect is the comprehensive recognition of those various cash and non-cash returns to labour when determining eligibility for social assistance.
- 1.3 This issues paper discusses ways in which the current tax rules can be broadened in this regard. Views of employers and employees are sought on the suggested changes presented in this paper.

The suggested approach

- 1.4 Taking as our starting point that salary and salary substitutes should be taxed equally, ideally we would want to tax all material benefits that are salary substitutes. This is largely achieved under current tax legislation with salary and wages being treated as employment income, and subject to PAYE, and most non-cash benefits received as a result of employment treated as fringe benefits, and subject to fringe benefit tax (FBT).¹ There are, however, a few long-standing exceptions.
- 1.5 While these exceptions, in the form of FBT exemptions, can result in employees receiving material untaxed benefits, their removal, based on past experience, would likely be contentious. This is partly because of the resulting valuation and compliance cost issues and partly because of the sensitivities associated with the exemptions themselves. The exemptions that are particularly relevant in this context are car parks and childcare provided on the employer's premises, and benefits received by employees of charitable organisations.
- 1.6 In these circumstances we have decided to focus primarily on those situations where salary substitution is more evident, such as when an amount of salary has been traded off or given up for non-cash benefits (referred to as a salary trade-off). In other words, there is a cash alternative to taking up the benefit. For the purposes of this issues paper, it is suggested that those amounts be made taxable. Implicit trade-offs, when the amount of the salary alternative is not specifically identified but the employee has an enforceable right to the benefit, would also be included to address the behavioural shift that could otherwise potentially arise.

¹ Similarly, employer contributions to an employee's superannuation fund are subject to employer contribution superannuation tax.

- 1.7 Crucially, this focus on salary trade-off situations also helps in achieving the policy objective of enhancing the integrity of key social assistance programmes. The focus in this regard is on Working for Families tax credits, the parental income test for student allowances, some recipients of community services cards (programmes based on “family scheme income”) and child support obligations. Budget 2010 made a number of changes to arrive at a better measure of the economic income available to a family (referred to as “family scheme income”) when determining eligibility for social assistance.² Including salary trade-offs would take this a step further by covering another form of economic income.
- 1.8 Some non-cash benefits, such as employer-provided accommodation, are automatically included in “family scheme income” as they are part of an employee’s taxable income. However, fringe benefits are generally not included because they are taxed in the hands of the employer.³ Including salary trade-offs would mean that these fringe benefits would be included in family scheme income when salary has been traded off for them. Certain benefits that are currently outside the FBT net would also be included to the extent of any salary trade-off.
- 1.9 Limiting change to salary trade-off situations is consistent with the approach outlined in the August 2010 officials’ issues paper, *Social assistance integrity: defining family income*. That approach is that changes should not include (for social assistance purposes) economic income that is not reasonably available to meet family needs. Chapter 3 discusses the definition of “family scheme income”.

Benefits of this approach

- 1.10 Overall, the changes suggested in this issues paper should achieve a more equitable and efficient outcome.
- 1.11 Applying a more neutral treatment between salary and salary trade-offs lessens the likelihood of tax-driven economic behaviour. There are economic efficiency gains from reducing the tax incentive to provide non-cash remuneration and the associated reduction in the attractiveness of activities that lend themselves to high non-cash benefit remuneration.
- 1.12 Neutrality also means greater equity as employees enjoying equivalent remuneration packages pay equivalent tax and, all other things being equal, receive equivalent social assistance, regardless of the package’s composition.

² In addition, the Government’s 2010 discussion document, *Supporting children* canvassed the idea of broadening the definition of income for child support purposes and this has been incorporated in the Child Support Amendment Bill introduced in 2011.

³ Budget 2010 brought attributable fringe benefits provided to shareholder-employees who control a company within the social assistance income net. The officials’ issues paper, *Social assistance integrity: defining family income* released in August 2010, however, noted that there was scope for including an even wider range of fringe benefits.

- 1.13 Focusing on salary trade-offs also addresses a long-standing issue with the current boundary used to determine whether the provision of a car park is or is not a fringe benefit. That boundary has traditionally been whether the car park is on the employer's premises, with "premises" being based on the interpretation of common law so that a leased car park, like one that is owned by the employer, is exempt from FBT whereas a licensed car park is not. There are, however, arguments that some licensed car parks would also qualify for an exemption, which would make the boundary hard to identify. Under the suggested salary trade-off approach, this distinction would be removed. All car parks and childcare benefits would be excluded from the on-premises FBT exemption and instead only be taxable when part of a salary trade-off.

How might a salary trade-off rule be applied?

- 1.14 There are two ways that a salary trade-off rule could be designed. Both are intended to achieve the same overall tax and social assistance result.

Option 1 – PAYE approach

- 1.15 The first option is to apply the approach comprehensively to all salary trade-offs, not just those where the underlying benefit provided by the employer is currently untaxed, and to tax the salary trade-off in the hands of the employee through PAYE. This would mean that all salary trade-offs would automatically count as income when determining eligibility to a range of social assistance programmes. Under this option, to ensure that the amount is not double taxed when the underlying benefit is subject to FBT, the salary trade-off amount (net of PAYE) in relation to those benefits, would also be treated as an employee contribution when assessing the employer's FBT liability.

Option 2 – FBT approach

- 1.16 The second option is to target the salary trade-off rule only to certain currently FBT-exempt benefits, being predominantly car parks and childcare provided on the employer's premises and benefits received by employees of charitable organisations. FBT would be applied to such trade-off amounts.
- 1.17 This approach would then require an employer to advise each employee of the amount of all fringe benefits provided to that employee when there has been a salary trade-off. Employees would then include those amounts in their "family scheme income" calculations.
- 1.18 An appropriate minimum value threshold would be included to ensure that the results are the same whether taxed as salary and wages or under the FBT rules.

- 1.19 This issues paper seeks the views of employers and employees on the relative merits, including compliance costs, of these two options, and whether some combination of the elements of each option could be preferable.

Charitable organisations

- 1.20 Although non-cash benefits provided to employees of charitable organisations currently have a general exemption from FBT, the salary trade-off approach would be applied to such benefits too. This would therefore limit the general exemption rather than replace it.
- 1.21 Additionally, legislative clarification is suggested in relation to the general exemption. Various arrangements are being marketed to charitable organisations, such as the provision of vouchers, which in effect aim to extend the scope of the exemption to cover an employee's normal everyday living expenses. Because these types of arrangements provide such a readily substitutable alternative to salary and wages, and there is argument over whether they are taxable, they could cause a material risk to the tax base. Consequently, a wider response than focussing on salary-trade-offs is suggested in such cases, which is that these types of arrangements be more explicitly excluded from the FBT exemption for benefits provided to employees of charitable organisations.
- 1.22 A change is also suggested to the Goods and Services Tax Act 1985 (the GST Act), to ensure that non-profit bodies, like other employers, pay GST output tax on the fringe benefits they provide. The reason that output tax should be charged is that the benefits amount to private consumption by the employee. Non-profit bodies are already able to claim GST input tax credits on the goods and services acquired to provide such benefits.

Other changes to family scheme income

- 1.23 There is a strong argument for extending the definition of "family scheme income" to include all near-cash equivalent fringe benefits received by employees, not just when those benefits are part of a salary trade-off. Such facilities provide a very ready means by which a family can meet its living expenses. Accordingly, one of the suggested changes in this issues paper is to include all employer-provided short-term charge facilities and vouchers in "family scheme income".

Summary of suggested changes

Tax

- When an amount of salary has been traded off for non-cash benefits that are not currently taxable, the amount traded off would be made taxable.
- Views are sought on two possible mechanisms for achieving this that also have regard to the objective of expanding “income” for social assistance purposes to include traded-off benefits:
 1. taxing all salary trade-offs in the hands of the employee through applying PAYE to the trade-off amounts. To ensure that the amount is not double-taxed when the underlying benefit is already subject to FBT, the salary trade-off amount net of PAYE would be treated as an employee contribution when assessing the employer’s FBT liability; or
 2. targeting the salary trade-off rule only to certain currently FBT-exempt benefits, being predominantly car parks and childcare provided on the employer’s premises and benefits received by employees of charitable organisations. FBT would be applied to such trade-off amounts.
- Changes to the FBT rules would be made to:
 1. consequently exclude all car parks and childcare benefits from the on-premises FBT exemption and instead separately subject the benefits to either PAYE or FBT but only to the extent that they are part of a salary trade-off; and
 2. make it clear that the benefit of arrangements involving vouchers are excluded from the FBT exemption that charitable organisations have for non-cash benefits provided to their employees.
- Changes to the GST rules would be made to ensure that non-profit bodies pay GST output tax on the fringe benefits they provide.

Social assistance

- Salary trade-offs would be included in “family scheme income”. Depending on the mechanism chosen to achieve the tax changes, this would be largely achieved by either including all salary trade-off amounts in the employee’s taxable income, or would require an extension of the definition of “family scheme income” to include all salary trade-off amounts attributed to them under the FBT rules.
- The definition of “family scheme income” would be extended to include all employer-provided short-term charge facilities and vouchers, not just when those benefits are part of a salary trade-off or received by an employee of a charitable organisation.

Application date

- 1.24 The above tax changes would apply from 1 April 2014, with the changes being included in a tax bill later this year. Any changes to the parental income test for student allowances would be given effect by amending the Student Allowances Regulations 1998.

How to make a submission

- 1.25 Submissions on this paper should be made by 31 May 2012 and can be addressed to:

Recognising salary trade-offs as income
C/- Deputy Commissioner
Policy Advice Division
Inland Revenue Department
P O Box 2198
Wellington 6140

- 1.26 Or email: policy.webmaster@ird.govt.nz with “Recognising salary trade-offs as income” in the subject line.
- 1.27 Submissions should include a brief summary of major points and recommendations. They should also indicate whether it would be acceptable for officials from Inland Revenue and the Treasury to contact those making submissions and to discuss their submission, if required.
- 1.28 Submissions may be the subject of a request under the Official Information Act 1982, which may result in their publication. The withholding of particular submissions on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. Those making a submission who consider there is any part of it that should properly be withheld under the Act should clearly indicate this.

CHAPTER 2

Tax changes

- 2.1 This chapter considers whether salary-substituted amounts that are currently untaxed should be subject to tax so that, after taking into account necessary compliance and administration cost trade-offs, the same amount of tax is paid on a salary package irrespective of how it is composed. It suggests, subject to certain provisos, that such amounts should be taxed if they are part of a salary trade-off. Two options are discussed on how this might be achieved.
- 2.2 Changes to the FBT rules are also considered that would:
- exclude all car park and childcare benefits from the on-premises FBT exemption and instead, depending on the mechanism chosen, separately subject these benefits to either PAYE or FBT when they are part of a salary trade-off; and
 - remove the benefit of arrangements involving vouchers from the FBT exemption that may be available to charitable organisations in respect of non-cash benefits provided to their employees.

Current issues

- 2.3 Conceptually, anything that an employer provides to an employee that could be considered to be a substitute for salary and wages ought to be made taxable when it is of material value. We appreciate, however, that there are practical limitations. Based on past experience, the wholesale removal of certain FBT exemptions (such as that for on-premises car parks) would likely be contentious, partly because of resulting valuation and compliance cost concerns and partly because of the sensitivities associated with the exemptions themselves.
- 2.4 In these circumstances we have decided to focus primarily on situations of evident salary substitution, such as when the employee has been given a cash alternative to the benefit and equivalent situations. When salary has effectively been forgone, the tax treatment of those amounts should be aligned as much as possible with the tax treatment of salary and wages.
- 2.5 Currently, salary and wages are treated as employment income, and subject to PAYE, while most non-cash benefits received as a result of employment are treated as fringe benefits, and subject to FBT.⁴ This means that although amounts that are included in a salary trade-off may not be directly taxed as salary and wages, they are in many instances indirectly taxed through the tax treatment that applies to the benefits received.

⁴ A brief outline of the FBT rules is provided in the Appendix.

- 2.6 There are, however, instances when some salary substitutes, or the equivalent amount of salary or wages that has been traded off, are not taxed. Examples include the salary traded off for an employer-provided car park or childcare benefits when these benefits are provided on the employer's premises,⁵ and benefits provided to employees of charitable organisations as part of a salary trade-off.⁶ Another example could be an employer payment in respect of a group life insurance policy, when part of a salary trade-off.
- 2.7 It is difficult to justify these trade-off situations being tax exempt on tax policy grounds when it is considered that the amounts would be taxed if provided as cash remuneration.
- 2.8 The exemption gives rise to equity and efficiency issues. A key principle of tax policy is horizontal equity: ideally a tax should apply equally to people on the same effective income. By being untaxed on the salary trade-off, and therefore choosing to receive part of their remuneration in kind, the employee receives a tax saving over other employees who may receive the same overall salary package but are fully taxed on their total remuneration through either, or a combination of, the PAYE system or the FBT system. This is not equitable.
- 2.9 In practice, the benefits of this subsidy or tax incentive that the Government is in effect providing are likely to be shared between the employer and the employee. To the extent that the employer pays less for their labour because of the tax exemption, it changes the relative price of labour and encourages the employer to over-invest in labour and under-invest in capital equipment. This is economically inefficient.
- 2.10 A more equitable and economically efficient outcome, including a lower likelihood of behavioural distortions, can be achieved by reducing this uneven tax treatment. This would enhance the integrity of the tax system.

Taxing benefits that form part of a salary trade-off

- 2.11 The suggested solution is, therefore, to tax amounts that are currently not taxed when they are part of a salary trade-off (which, as discussed later in this chapter, includes both explicit and implicit trade-offs).
- 2.12 This could be achieved by either:
- including the amount of salary traded off in the employee's income and applying PAYE. This would be through a general rule covering all salary trade-offs, even those where the underlying benefits are already subject to FBT. To avoid double taxation, employers would be able when calculating their FBT liability, to treat those salary trade-off amounts (net of PAYE), to the extent that the underlying benefits are

⁵ See section CX 23 of the Income Tax Act 2007 under which benefits provided on the premises of the employer are specifically excluded from FBT. Premises of a person include premises that a person owns or leases.

⁶ FBT applies only when the employment consists of the carrying on by the charitable organisation of a business whose activity is outside its benevolent, charitable, cultural, or philanthropic purposes.

subject to FBT, as a contribution paid by the employee.⁷ This would reduce and in many cases remove the relevant FBT liability; or

- through a rule confined just to salary trade-offs involving specific currently FBT-exempt benefits, being car parks or childcare provided on the employer's premises, and certain fringe benefits provided to employees of charitable organisations. FBT would be applied to the salary trade-off amounts.⁸

2.13 Either option could be set up to largely achieve the same overall tax results, with appropriate minimum value thresholds to ensure this. Consequently, key in deciding which option is preferable, is which one imposes the least compliance cost while achieving the other key objective of ensuring that the amounts are taken into account when determining eligibility for various social assistance programmes. Submissions on which option is preferred would be welcomed.

Option 1 – PAYE approach

2.14 While some may argue that an approach that subjected all salary trade-offs to PAYE would be too comprehensive, in practice it would, like the targeted approach, only affect those FBT-exempt benefits where an employee has been prepared to trade off salary and, therefore, are presumed to have some value to the employee. This is because of the square-up that would offset salary trade-off amounts when the underlying benefits are already subject to FBT, against the employer's FBT liability in relation to those benefits.

2.15 There would be an additional compliance cost on employers through their having to do this square-up, which would need to be done for each FBT return-period.

2.16 On the other hand, since the salary trade-offs would be income to the employee and therefore automatically included in their social assistance income calculations, the employer would not need to separately advise employees, for social assistance calculation purposes, of the value of the underlying attributed fringe benefits and associated fringe benefit tax included in the salary trade-offs. This aspect is discussed more fully in chapter 3.

Option 2 – FBT approach

2.17 The second option would require only certain currently FBT-exempt benefits to be brought within the FBT net, when they are part of a salary trade-off.

⁷ In accordance with section RD 54(2) of the Income Tax Act 2007. An adjustment to the rules that already treat some non-cash benefits, such as employer-provided accommodation, as income of the employee may also be necessary to clarify that the same amount is not taxed again when a salary trade-off is involved.

⁸ An alternative would be to tax such specific amounts (on a grossed-up basis) as employment income and subject to PAYE.

- 2.18 Under this option, employers would need to advise employees of all the fringe benefits that have been attributed to them as part of the salary trade-off (together with the associated FBT) so that if applicable, they can include the amount in their social assistance calculations. This should be able to be obtained from the information that employers currently compile for the purposes of attributing fringe benefits to the relevant employees. This information would be particularly crucial in the case of implicit salary trade-offs (discussed below) as employees may not have information on what value their employers have ascribed to such trade-offs.
- 2.19 The Tax Credits Registration form – FS 1 – that employees complete when applying for Working for Families tax credits would need to be expanded to include these fringe benefits, as it currently only covers fringe benefits provided to shareholder-employees who hold voting interests of 50 percent or more in their respective companies. Employees would also need to obtain information from employers at year-end, or even during the year, if the value of the fringe benefits received differs from that expected when the employee completed the FS 1 form at the beginning of the year.
- 2.20 Providing the extra information to employees would be an additional compliance cost relative to the PAYE option. On the other hand, there would not be a need to square-up salary trade-offs with FBT liabilities under this option, given that the benefits being targeted would not be subject to FBT.
- 2.21 The FBT approach may be easier to apply to salary trade-offs provided by charitable organisations given the range of exemptions in the FBT rules which would need to be reflected in the minimum value thresholds in the PAYE approach as discussed below. In the case of charitable organisations, this FBT option would involve a narrowing of the current FBT exemption for benefits provided to their employees. On the other hand, the tax would be imposed directly on charitable organisations which would have to put FBT systems in place rather than just extend their use of PAYE systems.

Minimum values

- 2.22 Under the PAYE option it may be appropriate to have a minimum value threshold specific to aggregate salary trade-offs involving what would be unclassified or other exempt benefits under the FBT rules. A suggested threshold is \$1,800 per annum (equivalent to that in the FBT rules, after including tax,⁹ for low-value unclassified benefits). This would be to avoid these amounts being taxed under the PAYE rules when they have been exempted from FBT. The threshold would be limited to implicit salary trade-off situations on the basis that if an employee has accepted an explicit trade-off, it is assumed that the employee has decided that the benefits are of sufficient value to them and, therefore, the amount of salary traded off (irrespective of the trade-off value) should be taxable. We are seeking the public's views on whether this approach is appropriate, and whether the minimum value threshold should be extended to explicit salary trade-off situations.

⁹ The FBT threshold is \$1,200 per annum, with the maximum FBT rate being 49.25%.

Example comparing PAYE and FBT approaches

Employee A, is offered a salary trade-off involving the following non-cash benefits:

	<i>Salary traded off</i>	<i>Equivalent benefit value</i>
• car	\$14,925	\$10,000
• car park	\$ 3,731	\$ 2,500
• childcare	\$ 7,462	\$ 5,000
• health insurance	\$ 2,985	\$ 2,000
• low interest loan	<u>\$ 4,478</u>	<u>\$ 3,000</u>
	\$33,581	\$22,500

His salary is \$80,000 in cash plus the above benefits.¹⁰

Under the PAYE approach

Salary trade-offs total \$33,581, which would be treated as income of employee A. The trade-offs for a car park would be included as the salary traded off of \$3,731 (equivalent benefit value of the trade-off being \$2,500) is more than the \$1,800 minimum value (which is equivalent to an underlying benefit of \$1,200).

PAYE on the additional income is: $\$33,581 \times 0.33 = \$11,081$.

The \$33,581 in additional income would automatically count as “family scheme income” for social assistance purposes.

FBT adjustment

The car park and childcare benefit are exempt from FBT under this approach so the amounts of salary traded off for them would not be included in the FBT adjustment. Salary traded off where underlying benefit subject to FBT = $\$14,925 + 2,985 + 4,478 = \$22,388$.

Fringe benefits as calculated under the FBT rules = \$10,000 (car) + \$2,000 (health insurance) + \$3,000 (low interest loan) = \$15,000.

(In this example the equivalent benefit value matches the value of the fringe benefit under the FBT rules.)

Value of employee’s contribution for FBT purposes is \$22,388 (this is the sum of the amount of salary traded off for the car, health insurance and low-interest loan).

$\$22,388 \text{ less tax} = \$22,388 \times 0.67 = \$15,000$.

Fringe benefit value less value of employee’s contribution = $\$15,000 - \$15,000 = \$0$.

¹⁰ This example does not take into account ACC earner premium on salary and wages.

Under the FBT approach

Under this approach, the value of the underlying benefits in the salary traded off for the car park and childcare would be treated as a fringe benefit and subject to FBT. If the value of the benefit has not been identified in an explicit trade-off, then the underlying benefit value will be calculated from the amount of salary traded off, by deducting the tax at the employee's marginal tax rate. In the above example the assumed underlying values are $\$2,500 + \$5,000 = \$7,500$.

This would be added to the other fringe benefits (car, health insurance and low-interest loan), which total \$15,000.

Total fringe benefits = \$22,500.

FBT on those fringe benefits = $\$22,500 \times 0.4925 = \$11,081$.

This FBT liability is the same as the additional PAYE under the PAYE approach.

The employer will need to advise employee A of the fringe benefits and FBT that have been attributed to him as part of the salary trade-off, so that employee A can include the amount in any social assistance calculations. Employee A would, therefore, include \$33,581 ($\$22,500 + \$11,081$) in his "family scheme income".

Implication for the FBT rules

2.23 The focus on salary trade-off situations is not a signal of a more general change of approach to the taxing of fringe benefits. As noted in chapter 1, this approach is being adopted in recognition of the contentious nature of past suggestions in relation to the currently untaxed key benefits, and the proposal in effect represents a compromise approach to obtaining certainty in these areas and a more equitable and efficient approach overall.

2.24 Although it is recognised that FBT gives rise to its own compliance costs, particularly for employers, it is still considered to be an effective tax for buttressing the taxation of salary and wages by reducing the incentive to provide remuneration through benefits rather than cash. This review is not intending to change the current general approach to determining what constitutes a fringe benefit, and fringe benefits will continue to be taxed under the FBT rules.

Salary trade-off defined

2.25 The risk with focussing on pure salary trade-offs involving the sacrifice of a specific amount of salary for a specific benefit, rather than on all material situations when the underlying benefits are provided, is that economic decision-making could be affected – for example, contracts could be altered over time to provide benefits outside of explicit salary trade-offs. Some employees could still receive the benefits on an untaxed basis. To some extent, employment relationships may reduce these risks, particularly if an employer has a large number of employees. These risks can be further ameliorated through the way in which a "salary trade-off" is defined.

- 2.26 We envisage a “salary trade-off” being defined to include:
- an amount of salary or wages that is traded off for a non-cash benefit;
 - any other income related to employment and payable in money that is traded off for a non-cash benefit; and
 - any attributed or currently untaxed benefit for FBT purposes that is offered to a group or class of employees not involving an explicit trade-off for salary or wages, where the employee has an enforceable right to the benefit and has taken up the benefit. The benefit must also be available to the employee. We refer to this as an implicit salary or wage trade-off.
- 2.27 This broader definition recognises that not all salary trade-offs involve the employee actively choosing to forgo an amount of salary in exchange for the benefits. A group or class of employees may be offered non-cash benefits outside of an explicit salary trade-off, similar to those offered under a salary trade-off but with no cash alternative being offered to those that do not wish to take up the benefit. For equity and base-protection reasons, we consider that the proposed new rule needs to cover these implicit salary trade-off situations provided the employee has an enforceable right to the benefit and has taken up the benefit.
- 2.28 The requirement that the employee has an enforceable right means that the benefit will have been either specified in an employment agreement or in documentation¹¹ associated with an employment agreement rather than being provided by the employer as an incidental perk or on a casual basis. Limiting the requirement this way is intended to reflect that the employee is more likely to consider it to be of value, particularly if the employee has taken up the option. The agreement may even ascribe a value to it. Likewise, the requirement that the benefit has to have been taken up is to ensure that employees are not taxed on terms in their employment agreements that they do not take up, presumably on the basis that there is minimal value to them. The requirement that the benefit has to be available for use ensures that the employee is not affected if the benefit is unable to be provided by the employer as might be the case for a car park in the central business district red zone in Christchurch.

Value of trade-off

- 2.29 The value of the salary trade-off would, in most cases, be the amount of employment income traded off for the benefit.
- 2.30 If there was an implicit salary trade-off, the employer would need to ascribe a value to that trade-off for those employees who had chosen to take up the offer. We acknowledge that valuing the benefit may be more readily achievable in some cases than in others – for example, it may be the amount paid by the employer to a third-party providing the benefit but in other cases another valuation mechanism will be needed. A standard value could be considered to ease compliance costs in such cases.

¹¹ Which could include material on employers’ internal electronic websites.

- 2.31 Given these valuation issues, submissions are also sought on alternative ways in which the risks and costs associated with implicit salary trade-offs might be mitigated.

Salary trade-off examples

Example 1: Explicit salary trade-off

Business Co offers all of its senior executives one of the following salary packages, either:

- \$85,000 cash salary and a car-parking space for private car-parking; or
- \$90,000 cash salary.

Senior executives are given the choice between a cash salary or trading off some of that salary for a non-cash benefit. This is an example of an explicit salary trade-off. The value of the salary traded off car park would be \$5,000.

Example 2: Implicit salary trade-off

Office Co has 10 car-parking spaces in the basement of its building. Although the car-parking spaces are unallocated, the spaces are offered to the 10 managers working for Office Co for private parking their motor vehicles. The car park is available for the managers to use at any time, and each manager is guaranteed a parking space. In other words, they have an enforceable right to the benefit. This example would be covered under the suggested salary trade-off rule.

Example 3: Not a salary trade-off situation

Hammer and Nails hardware store has a car park on its business premises. The car park is available for general customer parking. However, employees of Hammer and Nails can use this car park for their own private parking, on a “first-in, first-served” basis if there is a parking space available. This example would not be covered under the suggested rule change as the employees would not have an enforceable right to the benefit.

Similarly, teachers at Midtown secondary school are able to park their cars on the netball courts in the school grounds. However, the netball courts are only available for use as a car park on the days that the school does not use the courts for physical education activities – typically one or two days per week. The school grounds are open from 8am to 5pm during the school term, and are closed at all times during the weekends and school holidays. In this situation, the teachers would not have an enforceable right to a car-parking benefit. This is because car-parking spaces for teachers’ cars are only available at specific times, and on certain days during the year. Moreover, when car-parking is available, a space is not guaranteed to them.

Example 4: Employees of charitable organisations

Megan is an employee at Charitable Org, earning \$70,000 cash salary per annum. On top of this cash salary, Charitable Org offers Megan the following benefits as part of her salary package:

	<i>Equivalent benefit value</i>	<i>Salary traded off</i>
Credit/debit card	\$5,000	\$7,463
Car park	\$2,000	\$2,985
Childcare benefit	\$2,500	\$3,731
Total	\$9,500	\$14,179

Current approach

Under the current rules, only the provision of the credit card to Megan would be taxable under the FBT rules.

FBT on this benefit would be: $5,000 \times 0.4925 = \$2,463$.

The provision of the car park and childcare facility (whether it is on- or off- premises) would fall under the general FBT exemption for benefits provided by a charitable organisation to its employees.

Suggested new approach

Under the PAYE approach

Under the PAYE approach, the \$14,179 in salary trade-offs would be included in Megan's income, and this amount would be automatically treated as "family scheme income" for Megan's social assistance purposes.

PAYE on the traded off salary would be: $\$14,179 \times 0.33 = \mathbf{\$4,679}$.

FBT adjustment

An FBT adjustment would be required to ensure that the amount is not double-taxed when the underlying benefit is already subject to FBT. The adjustment would work by treating the salary traded off amount (net of PAYE) as an employee contribution when assessing the employer's liability for FBT.

This means that the credit/debit card benefit provided to Megan will need to be included in the FBT adjustment. The salary traded off for the car park and the childcare benefit would not be included as they would be exempt from FBT.

The FBT value of the debit/credit card benefit is: **\$5,000**.

The value of the employee contribution for FBT purposes would therefore be the salary traded off when the underlying benefit is subject to FBT: **\$7,463** (credit/debit card).

\$7,463 less tax would be: $\$7,463 \times 0.67 = \mathbf{\$5,000}$.

The FBT value less value of employee contribution would be: $\$5,000 - \$5,000 = \mathbf{\$0}$.

Under the FBT approach

This approach targets non-cash benefits that form part of a salary trade-off and are currently FBT-exempt. For Megan, this approach would treat the value of her employer-provided car park and childcare benefit as a fringe benefit and subject to FBT, because it forms part of her salary trade-off.

The underlying value of Megan's car-parking and childcare benefits is:
 $\$2,000 + \$2,500 = \$4,500$.

An FBT adjustment, like the one undertaken under the PAYE approach, would not be needed given that the only benefits being targeted under this approach are currently FBT-exempt.

Megan's car-parking and childcare benefit would then be added to other salary traded-off attributable fringe benefits in her package:

$\$4,500$ (car-parking and childcare) + $\$5,000$ (credit/debit card) = **$\$9,500$** .

Total fringe benefits = **$\$9,500$** .

FBT on fringe benefits: $\$9,500 \times 0.4925 = \$4,679$.

The total FBT collected on Megan's salary traded-off benefits under the FBT approach is the same as the PAYE collected under the PAYE approach.

Megan's employer would need to advise her of the fringe benefits and FBT that have been attributed to her as part of her salary trade-off. This is so Megan can include the amount in her social assistance calculations.

Implications for on-premises exemption – car parks and childcare

- 2.32 The changes we are suggesting would also provide an important opportunity to address a long-standing issue with the current boundary used to determine whether the provision of a car park is a fringe benefit.
- 2.33 One of the key determinants of whether an employer-provided car park is a fringe benefit is whether the benefit is enjoyed on the premises of the employer. What constitutes "premises" of the employer is based on the common law distinction between a lease and a licence – the former being exempt and the latter being taxable on the basis that a lease, like ownership, provides an exclusive right of possession. Therefore, a car-parking benefit provided to an employee as part of his or her remuneration is taxable if the benefit is provided on licensed premises of the employer, but is exempt if provided on the employer's leased premises.
- 2.34 The same test applies to employer-provided childcare facilities. Some employers offer or arrange childcare facilities for their employees to assist their participation in the workforce. Whether FBT applies to these benefits is determined by whether they are provided on the employer's premises.

- 2.35 Regardless of their legal character, from a policy perspective, the tax treatment of these benefits should be the same when it provides the employee with the same private benefit.
- 2.36 Furthermore, the lease/licence boundary has become increasingly difficult to sustain in relation to car parks, with some interpretations of the current tax provision tending to suggest that the boundary is not so clear-cut, and that conceivably some types of licensed car parks that provide substantially exclusive possession also qualify for the exemption.
- 2.37 Accordingly, it is suggested that this distinction be removed so that car parks and childcare benefits be excluded from the on-premises FBT exemption. Instead, the boundary would be based on the more general approach of whether there had been a salary trade-off for the benefit(s). If so, the amount of salary traded off would be taxable either in the hands of the employee, through the deduction of PAYE, or in the hands of the employer, through applying FBT. If the benefit is not salary traded off, it would be excluded from the fringe benefit tax rules.

Implications for charitable organisations

- 2.38 The suggested approach would potentially affect charitable organisations and their employees as, like other employers, charitable organisations may offer their staff some form of non-cash benefit. This may, either implicitly or explicitly, involve a salary trade-off.¹²
- 2.39 Currently, these benefits are generally tax-exempt. They are exempt from income tax, and FBT does not apply other than when the employees are employed in the organisation's business activities – for example, when a charity operates a manufacturing or retail business. For the purposes of the FBT exemption, charitable organisations are defined widely to include entities and funds set up for benevolent, charitable, cultural or philanthropic purposes. This definition, however, specifically excludes local and public authorities, and universities. A salary trade-off rule would in effect narrow this general exemption, but the benefits provided outside of a salary trade-off would still be tax exempt.¹³
- 2.40 In addition to applying a salary trade-off rule, a legislative clarification to the FBT exemption should in our view be made to remove any doubt that vouchers are excluded from the exemption, for the reasons explained below.

¹² Recent survey data indicates that the most common form of non-cash benefit provided by not for profit bodies involves some provision of a motor vehicle, with 8 percent of the employees of the survey respondents being provided with that benefit. This benefit could range from provision for pure private use to provision for home to work travel. Other non-cash benefits noted in the survey included employer provided or paid club/professional fees (received by 3 percent of employees in the survey), medical insurance (2 percent) and car parks (2 percent).

¹³ The exemption would be directly narrowed if the FBT approach were adopted as the charitable organisation would pay FBT on the salary traded-off benefits whereas under the PAYE approach the exemption would not be altered but the employee would pay the tax, which would indirectly narrow the exemption. However, irrespective of whether the tax is paid by way of FBT or PAYE, who ultimately bears the tax will depend on the circumstances and each party's bargaining power.

- 2.41 These suggested changes would not affect the FBT treatment of benefits provided to employees of charitable organisations who do not qualify for the current exemption, in other words, those employees who are employed in a business whose activities are outside the charitable organisation's benevolent, charitable, cultural, or philanthropic purposes. Their benefits would remain fully subject to FBT.

Charities and the FBT exemption

- 2.42 Successive governments have provided a range of financial assistance measures to charitable organisations. This assistance has increased in recent years through, for example, the removal of the cap on the donations rebate.¹⁴ These forms of government support are based on the concept that the services that charitable organisations provide are complementary to the programmes that the Government provides as part of its social objectives, and assist in furthering those objectives. This form of assistance can also result in a better targeting of resources compared with simply increasing state provision in these areas, as the donations people make to a charitable organisation are an indicator of the causes that people feel need their support. Subsidising charities through the income tax exemption ensures that those members of society who do not donate to charitable organisations but who nevertheless benefit indirectly from them contribute through their general tax payments.¹⁵ Hence there are good reasons for the Government providing some form of tax assistance to charitable organisations.
- 2.43 However, unlike the expanded rebate for donations and the income tax exemption for charities, providing additional assistance through an FBT exemption can give rise to the efficiency and equity issues referred to earlier. For example, because other entities do not have such a broad FBT exemption, it may provide a charitable organisation with a competitive advantage both in terms of attracting employees and when competing with other entities to provide services. To the extent that the FBT exemption attracts employees away from other organisations, it may be economically inefficient as it can enable the tax-exempt entity to expand at the expense of non-exempt entities.¹⁶
- 2.44 While there may be debate about the size of the equity and efficiency losses and the extent to which the offsetting benefits provided by charities should be taken into account, the distortions have the potential to grow as there will always be an incentive for further fringe benefits to be substituted for cash remuneration, increasing the relative tax advantage. Any further salary substitution also reduces the tax base.

¹⁴ A recent study commissioned by Philanthropy NZ and undertaken by BERL, indicates that charitable giving, particularly by individuals, has increased significantly over the past five years. As regards the income tax exemption this is estimated, based on Charities Commission data, to be worth at least \$300 million per annum.

¹⁵ For further discussion on this point see *Tax and charities*, a government discussion document, June 2001 (available on www.taxpolicy.ird.govt.nz).

¹⁶ Possible examples of this could be teachers in private schools that are charities receiving untaxed non-cash benefits. Those same benefits, if provided to teachers in state schools, would be subject to FBT. Likewise, benefits provided to university staff are specifically not exempt but benefits provided to staff of other tertiary institutions may face the legal uncertainty over whether polytechnics, colleges of education and wananga are public authorities.

- 2.45 The general suggestion to tax salary trade-offs provides a step towards achieving an overall more equitable and efficient outcome across the variety of returns to labour services. However, we consider that it is necessary to go a step further in the case of the charitable organisations' FBT exemption.
- 2.46 When the exemption was last considered in the 2003–05 review of FBT, the then Government concluded the exemption should not be extended¹⁷ but rather be limited to exclude short-term charge facilities¹⁸ whose value exceeds 5 percent of an employee's salary. The key concern was that such facilities were a close cash-equivalent when they could be used to purchase items that all employees want, such as groceries.
- 2.47 More recently, there has been further testing of the boundaries of the exemption, with a number of entities marketing schemes to charities that involve offering employees more of their remuneration package in non-taxable benefits. This might be achieved, for example, through the provision of vouchers which cover employees' normal everyday living expenses.
- 2.48 Arguably, vouchers may be excluded from the exemption on the basis that they are a short-term charge facility but it would be preferable to put this beyond doubt. Our concern is that because these types of arrangements provide such a readily substitutable alternative to salary and wages (and there is argument over whether they are taxable), they could pose a material risk to the tax base.
- 2.49 The Concise Oxford Dictionary defines a voucher as "a document which can be exchanged for goods or services as a token of payment made or promised by the holder or another". Hence, like money, a voucher is a store of wealth and, although it may not always be transferable to others, is a medium of exchange.

Suggested change to exemption in relation to vouchers

- 2.50 In the case of vouchers, we are suggesting a legislative clarification to confirm these types of arrangements are clearly excluded from the FBT exemption. FBT would therefore explicitly apply to the provision of arrangements involving vouchers consistent with the current exclusion of short-term charge facilities.

¹⁷ The exemption has been part of the FBT rules since their inception in 1985, although it was removed for a brief period in 1990. Since then, various reviews have considered the exemption's merits and whether it should be retained.

¹⁸ Defined in section CX 25 of the Income Tax Act to be an arrangement that –

- (a) enables an employee of a charitable organisation to obtain goods and services that have no connection with the organisation or its operations by buying or hiring the goods or services or charging the cost of the goods or services to an account; and
- (b) places the liability for some or all of the payment for the goods or services on the organisation; and
- (c) is not a fringe benefit that is an employment-related loan.

- 2.51 If such an arrangement also involved a salary trade-off and the PAYE approach becomes the mechanism for implementing the salary trade-off rule, the amount of salary traded off would be treated as income of the employee (and subject to income tax), with the employer treating the net of tax amount as an employee payment,¹⁹ to reduce or even eliminate the fringe benefit and associated FBT liability.

Defining “voucher”

- 2.52 We would envisage adopting a wide definition of “voucher”, similar to that used overseas. In Australia, a “voucher” is defined as a voucher, token, stamp (but not a postage stamp), coupon or similar article, or a prepaid phone card or facility which, in each case, has a stated monetary value and which is redeemable for other supplies in accordance with its terms.
- 2.53 Likewise, United Kingdom tax legislation adopts a very wide definition of a non-cash voucher. It includes not only conventional retail vouchers but also “any voucher, stamp or similar document or token”. This definition may therefore catch documents in letter form as well as plastic discs or tokens inserted into machines. Generally, the voucher needs to be capable of being exchanged for goods and services.

GST and non-profit bodies

- 2.54 Normally for an entity to receive a GST input tax credit or deduction it must be providing taxable supplies. An exception to this taxable supply requirement is provided for non-profit bodies so that GST-registered non-profit bodies (including charities) receive GST input tax credits in relation to all of their activities, other than the making of exempt supplies (such as the sale of donated goods at a stall operated by a charity).
- 2.55 This means non-profit bodies can claim input tax credits on any asset that they purchase (such as a car) even if it involves providing private benefits to their employees. Other entities are generally required to pay output tax on the provision of the private benefit as fringe benefits are generally subject to output tax. The rationale for this is that the employee is in effect the final consumer in such cases. In the car example, the value of the car’s services will be consumed by the employee over a number of years, with a corresponding gradual reduction in the residual value of the vehicle.
- 2.56 Not applying GST output tax to the private benefit provided by a non-profit body to its employees is inconsistent with the general intent of the GST rules. Accordingly, we would suggest an amendment to the GST Act to ensure output tax applies in such cases as if a fringe benefit had been provided. In other words section CX 25 of the Income Tax Act 2007 which excludes a private benefit provided to an employee of a charitable organisation from being a fringe benefit would be ignored when determining output tax. This would not affect non-profit bodies’ ability to claim input tax credits.

¹⁹ In accordance with section RD 54(2) of the Income Tax Act 2007.

Application date

- 2.57 The tax changes suggested in this chapter would apply from 1 April 2014, with the changes being included in a tax bill later this year.

CHAPTER 3

Recognising a wider range of fringe benefits in social assistance income

- 3.1 This chapter considers whether the definition of “family scheme income” needs to be widened to improve the integrity of various social assistance programmes. It concludes that fringe benefits that are part of a salary trade-off should be included in “family scheme income” as they are economic income available to meet a family’s needs. Depending on the tax mechanism adopted to apply the salary trade-off rule, these salary trade-offs would either be included automatically because they would be taxable income or employees would need to separately include them in their social assistance calculations.
- 3.2 There is a strong argument for extending the definition of “family scheme income” to also include all those near-cash equivalent fringe benefits received by employees, not just when those benefits are part of a salary trade-off. Accordingly, it is proposed to include employer-provided short-term charge facilities and vouchers in “family scheme income”. Such facilities provide a very ready means by which a family can meet its living expenses.

Current issues

- 3.3 The Government provides or funds a wide range of social assistance programmes. There are various broad approaches that could be used to determine a household’s entitlement to these social assistance programmes, and the actual approach used varies across the range of programmes.²⁰
- 3.4 Entitlements and liabilities for a number of the programmes are principally based on taxable income and, as a result, the programmes are delivered through the tax system. These programmes are Working for Families, child support and student loans. A number of social assistance programmes not administered by Inland Revenue, such as student allowances and community services cards, also use taxable income as a basis for assessing entitlement.
- 3.5 In a number of these cases, taxable income is subject to various adjustments. The definition of “family scheme income” is an example. “Family scheme income” is used for determining a family’s entitlement to Working for Families tax credits, the parental income test for student loan purposes, and in relation to some community services card recipients. The objective of adjusting taxable income is to reflect the amount that is available to assist the family in meeting its day-to-day living expenses. Generally, the types of adjustments were relatively minor until the changes made as part of Budget 2010.

²⁰ A number of benefits, for example, focus only on cash amounts received.

- 3.6 A social assistance programme has integrity if people receive the same level of assistance or incur the same level of liability regardless of how they structure their financial affairs. Budget 2010 highlighted that the perceived integrity of various programmes was being undermined by not taking into account all the types of income that a family might receive, so that how economic income was structured was having an important and unfair impact on social assistance entitlements.
- 3.7 To address these integrity concerns, Budget 2010 emphasised the need to include in family scheme income different types of economic income that had previously not been counted, with changes being made in late 2010 to broaden the definition of income for the purposes of calculating entitlements to Working for Families in particular. These changes were explained in the August 2010 officials' issues paper, *Social assistance integrity: defining family income*, and were followed by legislative changes that were included in the Taxation (GST and Remedial Matters) Act 2010.
- 3.8 In addition, the Government's 2010 discussion document, *Supporting children* canvassed the idea of broadening the definition of income for child support purposes.

Widening the definition further

- 3.9 One aspect that was set aside at the time of last year's social assistance integrity review was whether a wider range of fringe benefits and FBT-exempt benefits should be included in social assistance income calculations. Currently, only attributable fringe benefits provided to shareholder-employees who control a closely held company are included.
- 3.10 Fringe benefits provided to other employees do not automatically count as income for social assistance purposes as the benefits are taxed in the hands of the employer. In principle, fringe benefits should be included in income for social assistance purposes if they are easily substitutable for cash or household expenditure. The availability of an employer-provided motor vehicle, for example, can save an employee substantial costs through not having to own and operate a vehicle. Some submissions on the officials' issues paper, *Social assistance integrity: defining family income* supported the inclusion of fringe benefits in family scheme income.
- 3.11 Likewise, other material in-kind benefits, such as the provision of on-premises car parks and childcare, and benefits provided to employees of charitable organisations, that are exempt from FBT should arguably also be included in income for social assistance purposes on the basis that they contribute towards a household's living expenses.
- 3.12 The exclusion of benefits from family scheme income means that employees on similar remuneration packages can receive significantly different amounts of social assistance depending on how their remuneration is structured. This not only creates inequities but also provides an incentive to receive non-cash benefits rather than salary, promoting behaviour that reduces economic efficiency.

- 3.13 There are several options for how the currently taxed and untaxed benefit amounts might be included in “family scheme income”.

Option 1: Including all fringe benefits and material FBT-exempt benefits

- 3.14 The first option involves including in “family scheme income” all fringe benefits and material FBT-exempt benefits provided to an employee. It is the most comprehensive option.
- 3.15 Including all fringe benefits would impose high compliance costs, particularly on employers. The value of all benefits would need to be attributed to each employee so that the employee has the information available when applying for social assistance. This is more than is required from employers under the FBT rules. For example, pooled or lower value benefits are not required to be attributed because of the complexity of doing so.
- 3.16 There is also a potential equity issue if the ascribed benefits do not truly reflect contributions towards meeting a family’s day-to-day living expenses. The FBT rules endeavour to reasonably value the likely benefit that an employee derives but some employees may consider the benefit to be of less value to them than that ascribed under the FBT rules. They may not have a choice over whether they receive the fringe benefit²¹ and may not be able to forgo it, yet their social assistance entitlements could be materially affected by including the benefit in their income calculation.
- 3.17 As with option 2 below, employers would be required to advise employees of the value of the benefits they have received (and the FBT that has been paid on those benefits) so that they could include them in their relevant social assistance income calculations.

Option 2: Including only attributed benefits and material FBT-exempt benefits

- 3.18 A second option is to include only those benefits that are attributable to individual employees under the fringe benefit tax rules when applying the FBT multi-rate calculations, plus any material FBT-exempt benefits (car parks and childcare provided on the employer’s premises and benefits received by employees of charitable organisations).
- 3.19 Table 1 illustrates the rules that apply to different categories of fringe benefits, including the respective minimum values below which attribution is not required.

²¹ This was the reason given for including in the 2010 changes only attributable fringe benefits received by shareholder-employees who, together with associates, hold 50 percent or more of the voting interests (or market value interests if a market value circumstance exists) of the company. A major shareholder is able to arrange for a substantial proportion of their remuneration to be paid as fringe benefits instead of wages. Usually, employees who do not have a controlling interest in the company have less influence over the composition of their remuneration.

Table 1: Fringe benefit categories and attribution

Benefit category	Threshold	Attribute	Pool
Motor vehicles	None	Yes except if pooled	If no employee has the principal use, enjoyment or availability of the benefit
Low-interest loans	None	Yes except if it is a low-interest loan by a life insurer to policyholders	Loans by life insurers to insurance policyholders
Subsidised transport (for employers in the public transport business only)	Yes	Attribute if annual taxable value for the employee is \$1,000 or more except if all employees have the same or a similar entitlement to the benefit*	Can be pooled if all employees have the same or a similar entitlement to the benefit
Employer contributions to sick, accident or death fund	Yes	Attribute if the annual taxable value for the employee is \$1,000 or more*	
Employer contributions to specified insurance funds of friendly societies	Yes	Attribute if the annual taxable value for the employee is \$1,000 or more*	
Employer contributions to any superannuation scheme where employer superannuation contribution tax (ESCT) does not apply	Yes	Attribute if the annual taxable value for the employee is \$1,000 or more*	
Unclassified benefits	Yes	Attribute if annual benefits for the employee are in aggregate \$2,000 or more*	

*Note: Employers can choose to attribute all benefits within a category regardless of the category thresholds.

- 3.20 This would be a workable solution as it would be relatively comprehensive.
- 3.21 In this regard, option 2 could be seen as an extension of the approach used for major shareholder-employees where attributed fringe benefits are included in “family scheme income” because such shareholders are regarded as having influence over the composition of their remuneration. However, as with option 1, there is a potential equity issue if the ascribed benefits do not truly reflect contributions towards meeting a family’s day-to-day living expenses – for example, if an employee has an employer-provided car but also has their own car that they could just as easily be using.
- 3.22 Information on attribution would be available to the employer as it is required to be calculated already for FBT purposes.²² As with option 1, there would be an additional compliance cost for the employer in providing this information (and information on the FBT that has been paid on those benefits) to employees so that they can include it in their relevant social assistance income calculations.

²² Specifically this would mean just those benefits that the employer attributes to an employee for the purposes of the fringe benefit tax rules in sections RD 47 to RD 49 of the Income Tax Act 2007.

Option 3: Including only those benefits that form part of a salary trade-off

- 3.23 Confining coverage to those benefits that are included in a salary trade-off would help to limit arguments about the true value of a benefit to a particular employee as it is more likely to reflect situations when an employee acknowledges the value of the benefit and is willing to explicitly trade off salary for it.²³
- 3.24 This would be similar to the Australian approach of recognising “salary sacrifices” when determining eligibility for social assistance programmes.²⁴

Interaction with proposed tax changes

- 3.25 The compliance costs for employees associated with implementing this option could be lower when it is combined with the option in chapter 2 of including all material salary trade-offs in taxable income (the PAYE option). As we have noted, the PAYE option would mean that trade-off amounts are automatically included in income for social assistance purposes, saving the employer the need to separately advise the employee of the value of the underlying attributed fringe benefits included in the salary trade-off (which would be necessary under the FBT option).

Conclusion

- 3.26 Option 3 is our preferred approach as it best meets the objective of including benefits that meet the family’s living expenses. The question is then whether this should be achieved through the PAYE option or the FBT option, a key determinant being the overall impact on compliance costs.

Extending this approach

- 3.27 Another tax change suggested in chapter 2 was the need for legislative clarification with regard to the exclusion of arrangements involving vouchers from the FBT exemption for charitable organisations’ employees. The key concern here is the close equivalence of vouchers and cash when vouchers can be used to purchase items that all employees are likely to want, such as groceries. A broad exclusion already applies to short-term charge facilities provided to employees of charitable organisations and arguably vouchers may come within that exclusion. However, the matter should be put beyond doubt by specifically excluding vouchers.

²³ It may also reflect when the employee has explicit control over whether they receive the benefits although “control” in this context can be very subjective as employees who agree to a salary trade-off arrangement may not always have control over the make-up of their total remuneration package. Control was a reason given for including fringe benefits received by shareholder-employees of closely held companies in the 2010 changes to the definition of “income”.

²⁴ Under the Australian approach, the grossed-up (at the top marginal tax rate) taxable value of fringe benefits is included in the employee’s annual payment summary when the benefits exceed \$2,000 in aggregate. This reportable fringe benefit amount is required to be included in the employee’s tax return and is taken into account when determining eligibility for a range of social assistance programmes, including certain income-tested government benefits and child support obligations. The sacrificed amount is not, however, subject to FBT unless the benefit would normally be subject to the FBT rules. This means, for example, health promotion charities and public hospitals are not liable to FBT on benefits provided to their employees (unless the relevant thresholds are exceeded) irrespective of whether the employee has salary sacrificed in exchange for the benefit.

- 3.28 There is a strong argument for including all short-term charge and vouchers facilities in “family scheme income”, not merely when they involve a trade-off of salary, and not merely in relation to employees of charitable organisations, as they clearly provide a very ready means by which a family can meet its living expenses. A facility that enables payment of an employee’s family’s grocery bill is clearly going to be of wide appeal irrespective of whether it is explicitly included in a salary trade-off.
- 3.29 Accordingly, this issues paper suggests including employer-provided short-term charge and voucher facilities in “family scheme income”. This would mean that employers would need to advise their employees of those fringe benefits (and the associated FBT) arising in relation to such arrangements so that they can include them in their “family scheme income” calculations. The Tax Credits Registration form – FS 1 – that employees complete when applying for Working for Families tax credits would be expanded to include these fringe benefits. In such cases the fringe benefit would be the net amount after taking into account any “contribution” from the employee through salary that has been traded off.

Which programmes would these changes apply to?

- 3.30 The social assistance programmes that these changes might apply to depends on whether the PAYE or the FBT option is implemented. Under the PAYE option the changes would apply automatically, through the employee’s taxable income incorporating the various non-cash benefits that form part of a salary trade-off, whereas under the FBT option the changes would require specific inclusion.
- 3.31 If the PAYE option is implemented, the changes would apply to any social assistance programmes that used taxable or net income as a basis and would include:
- Working for Families
 - Student allowances (parental income test)
 - Student loans repayment obligations
 - Community services card (entitlements for superannuitants and families with children, other than beneficiary families)
 - Child support.
- 3.32 If the FBT option is implemented and the definition of family scheme income is amended to include salary traded off amounts, these changes would apply to Working for Families tax credits, the parental income test for student loans, community services card entitlements for families with children (other than beneficiary families) and child support calculations²⁵.

²⁵ Proposed in the Child Support Amendment Bill 2011.

Application date for social assistance changes

- 3.33 As noted in chapter 2, any changes to taxable income and the relevant FBT provisions would apply from 1 April 2014. The change to include employer-provided short-term charge facilities and vouchers in “family scheme income” would also apply from that date. Further consideration will be given to the implications for those social assistance programmes, such as student allowances, that have a calculation year other than 1 April to 31 March.

APPENDIX

Currently taxed benefits

Employee benefits that are subject to FBT are listed in the Income Tax Act 2007, along with valuation rules for a number of the benefits, most notably motor vehicles. The five main types of benefits are:

- motor vehicles;
- low-interest loans other than low-interest loans provided by life insurance companies to policyholders;
- free, subsidised or discounted goods and services, including subsidised transport for employees in the public transport business;
- employer contributions to sick, accident or death benefit funds, superannuation schemes and specified insurance policies;
- a catch-all category – “unclassified benefits” received by an employee in connection with his or her employment.

The catch-all provision can include any benefit of any kind received by an employee, including employment-related gifts and prizes and free, subsidised or discounted goods. A de minimis exemption may apply to fringe benefits provided in this category.

In the case of unclassified benefits, minimum value thresholds apply to remove low-value benefits from any FBT impost. If the value of the unclassified benefits provided to an employee is no more than \$300 in the quarter (if FBT is returned quarterly) or \$1,200 (if FBT is returned annually) and total unclassified benefits provided by the employer to all employees in the year is no more than \$22,500, then FBT does not apply. If the value of the benefits exceeds the thresholds, then FBT will be payable on the total value of the benefits, including any amount below the threshold.

Attributed versus pooled benefits

Initially there was a single rate of FBT but since April 2000 a range of rates (commonly referred to as multi-rates) has applied. Employers elect the rate of FBT to use depending on the type of return they file, the classification of the fringe benefits they provide and the marginal tax rates of the relevant employees. Applying the marginal tax rate equivalent is designed to replicate the outcome as if the benefits had been taxed directly in the hands of the employee. To achieve this most benefits are required to be attributed to an employee.

In general, a fringe benefit does not need to be attributed to an employee when:

- the value of the benefits falls below the threshold relevant to that type of benefit (there are no minimum value thresholds for employer-provided motor vehicles and low-interest loans); or
- are required to be pooled because the benefit is shared by a number of employees and the employer cannot determine which employee mainly uses or receives the benefit.