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A special report from
Policy and Strategy, Inland Revenue

Employee allowances

This special report provides early information on changes to the tax rules that deal with the taxation of employer-provided accommodation, accommodation payments, and other allowances and payments made by employers to cover employee expenditure. The changes were introduced in the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill enacted on 30 June 2014. Information in this special report precedes full coverage of the new legislation that will be published in the August edition of the *Tax Information Bulletin*.

Sections CE 1, CE 1B, CE 1C, CE 1D, CE 1E, CE 5, CW 16B, CW 16C, CW 16D, CW 16E, CW 16F, CW 17, CW 17CB, CW 17CC, CX 19, CZ 23, CZ 29, CZ 30 and CZ 31 of the Income Tax Act 2007, and section 91AAT of the Tax Administration Act 1994

Changes have been made to the taxation of employer-provided accommodation, accommodation payments, and other allowances and payments made by employers to cover employee expenditure.

From 1 April 2015, a new set of rules in the Income Tax Act 2007 replaces the previous rules applying to accommodation, allowances and payments. The rules can be applied retrospectively in some cases.

These changes are intended to bring greater clarity and cohesion to the rules, making it easier for taxpayers to understand and comply with their obligations.

Key features

The key changes are:

Accommodation

- time limits on when accommodation provided in relation to out-of-town secondments and capital projects is non-taxable (up to two years for secondments and three years for capital projects);

- a special transitional rule for Canterbury earthquake recovery projects;
- a multiple workplace rule that exempts accommodation provided when an employee has to work at more than one workplace on an ongoing basis;
- an exemption for accommodation provided when an employee is required to attend a meeting, training course or conference as part of their job that requires at least an overnight stay;
- confirmation that the taxable value of accommodation provided is the market rental value, less any rent paid by the employee and any adjustment for business use of the accommodation;
- specific exclusions from the definition of “accommodation”;
- a specific valuation rule for accommodation supplied by religious bodies to their ministers (confirming a longstanding administrative practice);
- a specific valuation rule for accommodation provided by the New Zealand Defence Force to personnel, reflecting the specific limitations imposed on these properties; and
- capping the taxable value of employer-funded accommodation as part of an overseas posting at the average or median rental value for accommodation in the vicinity that the employee would live in if in New Zealand.

Meals

- exempting meal payments linked to work travel, subject to a three-month upper time limit at a particular work location;
- exempting without time limit meal payments and light refreshments outside of work-related travel, such as at conferences.

Clothing

- payments provided to cover the cost of distinctive work clothing, such as uniforms, will be exempt (mirroring the treatment under the fringe benefit tax rules);
- payments to meet the costs of plain clothes allowances paid to members of a uniformed service who are required to wear ordinary clothing instead of their uniform will also be exempt, provided certain conditions are met.

Other

- a power allowing the Commissioner of Inland Revenue the discretion to issue a determination in relation to an expenditure payment made to a wide group or class of employees, determining the extent to which the particular type of expense payment is taxable. A determination will be binding on the Commissioner but not the taxpayer, meaning it will act as a safe harbour.

Background

Over recent years there have been some significant concerns around the tax treatment of employer-provided accommodation, accommodation payments, and other allowances, reimbursements and payments by employers to cover employee expenditure (generically referred to as employee expenditure payments). Previous tax legislation could lead to impractical outcomes that may have differed from the way employers applied the rules in practice.

Under the previous rules, when an employee expenditure payment was made, provided it was to cover a work expense, it was not taxable, as long as there was no private, domestic or capital element to the expense. This treatment matched the general deductibility rules in the legislation. However, when there was a private or domestic element in the linked expense, that element was taxable. This was because it was considered to be in effect an alternative to receiving more salary or wages, which would be taxed.

An expense is private or domestic in nature if it is intended to further some personal purpose or provide a private or domestic benefit. As meals, accommodation and normal clothing are inherently private benefits, the starting position under tax law is that any employee expenditure payment to cover these sorts of expenses should be taxed.

In many instances, however, the private aspect is either incidental to the business objective or is minimal or hard to measure, and apportionment between the private and employment purpose is not practical given the compliance costs associated with separating out the relative elements. Accordingly, under the new rules, specific exemption provisions apply the principle that the private amount should be ignored when it is low in value or hard to measure, and is not provided as a substitute for salary or wages.

The new rules were developed after significant consultation, both leading up to the release of the November 2012 issues paper, *Reviewing the tax treatment of employee allowances and other expenditure payments*, and subsequently. A total of 27 submissions were received on the suggestions in the officials' issues paper. Most focussed on the tax treatment of accommodation expenses, and establishing a boundary between private and work-related expenditure.

Subsequently, Inland Revenue officials carried out further consultation with key stakeholders, including the Corporate Taxpayers Group, New Zealand Institute of Chartered Accountants and the Canterbury Earthquake Recovery Authority. The main area of concern was that any new rules should encompass not only work-related secondments but also employee involvement in longer-term projects. Those projects included work on the Canterbury earthquake recovery and projects in other locations throughout New Zealand (for example, the ultra-fast broadband roll-out, dam rebuilds and other major water storage projects, and road building projects). The legislation introduced in the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill took this feedback into account.

The Finance and Expenditure Committee received 25 written submissions (from 20 submitters) on the employee allowances provisions in the bill. Generally, submitters were supportive of the overall aims of the changes, subject to areas where clarifications or amendments were sought. As with the earlier consultation, the majority of submissions were in relation to the accommodation rules. The Committee recommended the following changes:

- Four exceptions where accommodation provided in connection with employment would not be subject to tax, to allow for situations involving shift work or remote workplaces when it is considered it would be inappropriate to tax accommodation provided in connection with employment. The exceptions cover mobile workplaces such as ships, trucks or oil rigs, a station in Antarctica, lodging provided for shift workers such as fire-fighters, ambulance staff and care-givers, and accommodation provided at remote locations where an employee is expected to “fly in and out”, such as mines in Australia.
- A regulation-making power so other exceptions can be made in future – while the exceptions provided in the legislation are considered reasonably comprehensive, there may be unforeseen situations that arise when it would be inappropriate for work-related accommodation to be taxed.
- Allow uneven apportionment of shared accommodation if the employees involved and their employer agree it is reasonable – for example, to reflect a difference in the size of their rooms.
- Refine and simplify the valuation rule for accommodation provided by churches to ministers of religion.
- Amend the rule regarding accommodation provided in relation to secondments or capital projects to better allow for situations when expectations about the length of secondment change.
- Include snack foods within exempt “light refreshments” and remove the requirement for an employee to work at least seven hours in order to be entitled to exempt light refreshments.
- Allow application of the new work-related meal rules to be backdated to 1 April 2011, provided the employer has not treated the work-related meals as taxable, to allow the status quo to continue without the need to reopen tax positions (provided they fall within the new rules).

Application dates

The majority of the amendments apply from 1 April 2015.

However, employers have the option to backdate the accommodation rules to accommodation provided from 1 January 2011 provided they have not taken a tax position before 6 December 2012 that the accommodation was taxable.

Similarly, employers have the option to apply the work-related meal rules from 1 April 2011, provided they have not already taken a tax position that the expenditure is taxable.

Other exceptions:

- The distinctive work clothing rule, which applies from 1 July 2013.
- The transitional rules for Canterbury earthquake-related accommodation, which are treated as coming into force on 4 September 2010.
- The transitional rule for New Zealand Defence Force-provided accommodation, which is treated as coming into force on 6 December 2012.

Detailed analysis

The main taxing provisions for accommodation remain in section CE 1, which deals with amounts derived in connection with employment. This section includes a definition of “accommodation” which includes board or lodging, and the use of a house or living premises (or part thereof), whether permanent or temporary.

The inclusive aspect of the definition of “accommodation” is unchanged from the previous rules. Ordinarily, “board or lodging” can refer to the provision of the employee’s meals and somewhere to sleep. When an employee is provided with a self-contained living space with most of the facilities necessary for independent living, what is provided is the use of a house or living premises (or part thereof). We expect, in practice, that in most cases what is provided is the use of a house or living premises (or part thereof).

Exclusions from the definition of “accommodation”

Under the new rules the definition of “accommodation” in section CE 1 has been modified by introducing four specific exclusions involving shift work or remote workplaces, namely:

- a berth, room or other lodging provided on a mobile workplace such as a ship, truck or oil rig;
- a station in Antarctica;
- lodging provided for shift workers such as fire-fighters, ambulance staff and care-givers when they are periodically required to sleep at their workplace, and the accommodation is provided only for the duration of the performance of the duties; and
- accommodation provided at remote locations outside New Zealand, such as mines in Australia, where an employee is expected to “fly in and fly out”.

In addition, section CE 1(4) enables the Governor-General, by Order in Council, to make regulations to add to the types of accommodation that are excluded from the definition of “accommodation”. While the exceptions provided are considered reasonably comprehensive, there may be other situations that arise in future when it would also be inappropriate for work-related accommodation to be taxed.

Section CE 1 includes an expanded definition of “employer” to ensure that accommodation provided by an overseas employer is covered. The expanded definition also covers situations when an employee is seconded by their employer (Company A) to another company (Company B), and the accommodation is provided by Company B, but the employee remains employed by and paid by Company A.

“Accommodation” that is tax-exempt

When the accommodation falls within the statutory definition of “accommodation” it may still be exempt from tax. The new rules specifically set out a number of exemptions.

1. Employee accommodation – out-of-town secondments and projects

Employer-provided accommodation or an accommodation payment provided because an employee needs to work at a new work location (and that location is not within reasonable daily travelling distance of their home) is tax exempt provided the following conditions are met:

- there is either a reasonable expectation that the employee’s secondment to that work location will be for a period of two years or less, in which case the payment will be exempt for up to two years; or
- the move is to work on a project of limited duration whose principal purpose is the creation, enhancement or demolition of a capital asset and the employee’s involvement in that project is expected to be for no more than three years, in which case the maximum exemption period is three years.

If the move is to work on Canterbury earthquake recovery projects, the maximum period is extended to five years if the employee starts work in the period commencing on 4 September 2010 and ending on 31 March 2015, and to four years if the employee starts work in the period commencing 1 April 2015 and ending 31 March 2016. The maximum period reverts to three years if the employee starts work on or after 1 April 2016.

Example 1

Adam is an accountant who has worked for his employer in Auckland for 10 years where he lives with his family. He is sent by his employer to New Plymouth for three months to carry out an audit of a large client before returning to the Auckland office. Adam’s employer reimburses his hotel costs in New Plymouth. As Adam’s employer expects him to work in New Plymouth for less than two years, the payment that Adam receives reimbursing him for his accommodation costs in New Plymouth is exempt income.

Example 2

Bill lives in Wellington. His job is moved permanently to Auckland but he chooses not to move his family and commutes on a weekly basis, returning to Wellington at the weekend. Bill’s employer pays him an accommodation allowance towards his Auckland accommodation costs. Bill and his employer expect he will work at the Auckland workplace for more than two years. The accommodation allowance is not tax exempt under the two-year rule.

Accommodation linked to long-term projects of limited duration

The maximum exempt period of three years allowed for involvement in longer-term projects takes into account certain business practices, particularly in the construction industry. The employees might be housed at or near the construction site, might share accommodation and might be employed on a “fly in/fly out” basis so would not be relocating. Employees may be recruited specifically from overseas with no intention that they ever relocate permanently to New Zealand.

Example 3

Eddie is seconded by his employer to work on a dam construction project for a client in a remote area of the North Island. Because of the scale of the project, the number of workers and the remoteness of the location, Eddie’s employer sets up an accommodation facility to house its employees. The dam project is expected to take around five years to complete. However, Eddie’s employer expects him to work on the project for only the first two and a half years.

Eddie is working on a project involving the construction of a capital asset so the three-year upper time limit applies. His employer expects him to be working at the distant work location for less than three years so the value of the accommodation is exempt.

While the projects covered by the three-year maximum exemption will often relate to the construction industry, they may also involve, for example, upgrades of existing infrastructure and information technology development and implementation. The duration of the project can be longer than three years as the test is based on the time the employee is involved in the project, rather than the length of the project.

The project will also have to satisfy the following requirements:

- creation of a capital asset – the principal aim of the project will have to be the creation of a capital asset of some form, whether a new capital asset, a replacement of an existing asset, an upgrade, or refurbishment;
- employment duties specific to the project – the employee will need to be engaged exclusively on project work (bar incidental activities); and
- the project must involve work for a client not related to the employer.

When does the exemption cease?

The payment or the employer-provided accommodation will cease to be tax-exempt before the respective maximum period if any of the following occur:

- the employer pays the employee’s costs associated with buying a house in or near the new work location, as an eligible relocation expense;
- there is a change in the expectation that the employee will be at the new location for, as relevant, a maximum of two years or three years; or
- the employee’s involvement in the secondment or project comes to an end before the maximum time is up.

Example 4

Donna works for an employer in Auckland. Her employer sends her to work in Hamilton for an expected 18-month period. After four months, Donna decides that she wants to relocate permanently to Hamilton and her employer agrees to make her job there permanent. Donna's employer has agreed to pay her an accommodation allowance for the first six months after arrival.

Up to the four-month point, Donna's employer's expectation was that she would not be working in Hamilton for more than two years, and payments to cover accommodation up to that point are exempt under the two-year rule. But given the expectation is now that Donna will be working in Hamilton for more than two years, payments to cover Donna's accommodation after four months would be taxable.

The point in time at which an expectation is treated as having changed is when the employer has a firm expectation that the secondment or role on the project will last longer than initially expected. This may be evidenced by modification in the employee's terms of employment, but in many cases there may not be a written agreement. Instead, there may be other documentation such as board minutes, planning documents, correspondence with the third party for whom the employer is carrying out the capital project, and so on, that will demonstrate that the expectation has changed.

What if the expected period initially exceeds the time limit but subsequently reduces?

If a secondment is initially expected to exceed the relevant two or three years, it will be subject to tax. However, if this expectation changes during the course of the secondment, and the total period will be less than the relevant time limit, the payment or employer-provided accommodation becomes tax-exempt from the date the expectation changes. The payment or employer-provided accommodation up to the date the expectation changes remains taxable (there is no retrospective exemption following the change in expectation).

Example 5

Sam lives in Napier. His employer sends him to Tauranga to set up and manage a new office. The initial expectation is that Sam will be in Tauranga for two years and six months. Sam's employer provides him with accommodation in Tauranga. The accommodation will be taxable as the secondment is expected to exceed two years.

One year into the secondment Sam's employer decides that Sam only needs to stay in Tauranga another six months as the company has found someone to run the office on a permanent basis. As the expectation of the total secondment duration is now less than two years (18 months total), the final six months of the accommodation provided to Sam are exempt from tax. The first 12 months, before the change in expectation, remain taxable.

Residence and reasonable daily travelling distance

To qualify for the accommodation exemptions, an employee must be moving to a workplace that is not within reasonable daily travelling distance of their residence. “Residence” and “reasonable daily travelling distance” are not defined.

In this context (as in section CW 17B, in relation to relocation payments) “residence” refers to the employee’s home immediately before the secondment. The distance test is assessed in relation to that residence.

The concept of “reasonable daily travelling distance” also appears in section CW 17B. Following the introduction of that provision, guidance on the meaning of “reasonable daily travelling distance” was published in *Tax Information Bulletin* Vol 21, No 9 (December 2009), page 6. This guidance is also applicable to the accommodation exemptions.

Relationship with the relocation payments rule

If an employee is not eligible for the secondment or capital project exemption, they may still qualify for an accommodation exemption for up to three months under section CW 17B and Determination 09/04 (provided the relevant criteria are met).

Sections CW 16C(1)(c) and CW 16C(2)(c) provide that eligibility for the section CW 16B exemption ends if an employee receives a relocation payment under section CW 17B in relation to the costs associated with settling the purchase of a new home.

Anti-avoidance rules

The rules are subject to certain conditions to protect against abuse:

- The exemption does not apply if accommodation is provided under an explicit salary trade-off arrangement.
- There is an anti-avoidance rule to prevent behaviour intended simply to restart the respective time limit.

New employees

The exemptions described above apply to accommodation provided to existing employees, and to new employees in specific instances.

New employees qualify for the three-year exemption, subject to the same conditions as existing employees, including that the work is on a project of limited duration and their contract is for a period of three years or less. This ensures there is no disparity between the treatment of new and existing employees working on the same project.

New employees only qualify for the two-year exemption when:

- the employee is newly recruited to work at a particular work location but is then sent to work at another work location temporarily – for example, an individual is recruited to work in Auckland but is then sent to work in Dunedin for a month before returning to Auckland; or
- an employee working for one employer is seconded to work for another employer on a temporary basis, with the expectation that the employee will return to work for the original employer – for example, an individual working for an Australian accountancy firm is sent to work for an affiliated New Zealand firm in Auckland for 18 months.

A more restrictive approach is taken for new employees under the two-year rule compared with the three-year rule because the scope for behavioural changes to the way new employees are remunerated is considered to be greater when fewer limitations are in place. The existing rules applying to tax-exempt relocation payments will continue to be available to these new employees.

Exceptional circumstances

There is restricted ability to extend the thresholds in exceptional circumstances. Exceptional circumstances are confined to those that are outside the control of the employer and employee, such as a natural disaster or medical emergency, that mean the employee has to stay at the work location beyond the maximum tax-free time threshold. The time limit can be extended for as long as the employee is unable to leave the work location because of the exceptional circumstance.

Accommodation linked to Canterbury earthquake reconstruction work

Given the special nature and scale of the Canterbury earthquake reconstruction work, there is a transitional rule (new section CZ 29) for employer-provided or paid accommodation for employees working on Canterbury earthquake reconstruction projects over the period from 4 September 2010 to 31 March 2019.

- a) When the employment duties of the employee require them to work in greater Christchurch on a project or projects for rebuilding or recovery work arising out of the Canterbury earthquakes, the time limits in the section CW 16B(5) definition of “project of limited duration” are effectively replaced by the following:
- five years when the employee’s date of arrival is in the period from 4 September 2010 to 31 March 2015;
 - four years when the employee’s date of arrival is in the period from 1 April 2015 to 31 March 2016; and
 - three years when the employee’s date of arrival is in the period from 1 April 2016 onwards, for arrivals up to 31 March 2019. The normal three-year rule will apply to Canterbury rebuild and recovery work from 1 April 2019.

- b) When the date of arrival in “greater Christchurch” (as defined in the Canterbury Earthquake Recovery Act 2011) is in the period from 4 September 2010 (the date of the first earthquake) to 31 March 2015, the time limit will be applied by reference to the time the employee works continuously in greater Christchurch rather than to any expectation. For other periods, the time limits apply based on the employer’s expectation.

This approach also applies more generally for out-of-town secondments and projects (see section CZ 30) so that for the period 1 January 2011 to 31 March 2015, the relevant time limit is applied by reference to the time the employee works continuously at the distant location rather than to any expectation. For other periods, the time limits apply based on the employer’s expectation.

2. Employee accommodation – ongoing multiple work places

When an employee has to work at more than one workplace on an ongoing basis the accommodation or accommodation payment is tax-exempt without an upper time limit (section CW 16F).

There are a number of circumstances in which an employee has to work at more than one workplace on an ongoing basis. These may be because of the nature of their duties or because the additional workplaces are beyond reasonable daily travelling distance from their home. This could be the case, for example, for senior managers of large organisations. In these circumstances there is an exemption for employer-provided accommodation and accommodation payments, without an upper time limit, given that there will be genuine ongoing additional costs in such cases. (If the employee has multiple work places for a limited period, the two or three-year time limit-based exemptions may also apply.)

Example 6

Andrew manages two offices, one in Christchurch and one in Dunedin. He works in Christchurch two days a week and in Dunedin for three days a week. His home is in Dunedin. Andrew has more than one ongoing work location. When he works in Christchurch, he is beyond reasonable daily travelling distance from his home in Dunedin. An accommodation payment to cover his hotel costs when staying in Christchurch is not taxable. The Christchurch accommodation is exempt under the multiple workplace rule. The Dunedin accommodation is not tax exempt.

The multiple workplace rule can also apply when an employee is sent on a short-term business trip to another location. In these circumstances the employee will continue to have ongoing duties at their normal place of work while they are working at the other work location during the business trip.

Example 7

Carmen is chief executive of a large group of companies based in Auckland. The company has offices in a number of cities across New Zealand. Each month Carmen visits one of these offices as part of her management duties. Typically these visits can last up to a week and her employer arranges and pays for her accommodation.

When Carmen is visiting the offices away from Auckland she has more than one ongoing workplace for the duration of her visit. The accommodation while working at those offices is exempt under the multiple workplace rule.

3. Employee accommodation – meetings, conferences and training courses

When an employee needs to attend a work-related meeting, conference or training course that requires at least an overnight stay, the accommodation or accommodation payment is tax-exempt without an upper time limit (section CW 16D).

While the need for accommodation would normally arise because the work-related meeting, conference or training course is beyond reasonable daily traveling distance from the employee's home, this need not be the case. Some courses may be held locally but may require employees to stay overnight for reasons such as networking and team-building. Section CW 16D, therefore, covers both local and distant accommodation situations by extending the definition of "period of continuous work" to specifically include a location that is not distant from the employee's regular workplace (see section CW 16D(4)). It is possible, depending on the circumstances, that the multiple workplace exemption or the two or three-year time-based exemption could also apply.

Accommodation for necessary travel in connection with performance of duties

Section CW 16D exempts both accommodation at the location of the conference, training course, or work-related meeting and any accommodation for necessary travel in connection with the performance of the employee's duties in connection with their attendance. This means that if a stopover is required in travelling to or from the location, accommodation at that stopover will also be exempt.

Example 8

Matt is required to travel to London for an international conference. The timing of available flights means it is necessary for Matt to stay in Hong Kong for a night on the way to London between flights. The Hong Kong accommodation will be exempt, along with the accommodation in London for the duration of the conference.

Example 9

Sophie works in Auckland. Her employer requires her to attend a meeting in Canberra that starts early in the morning. No direct flights are available from Auckland to Canberra and the first flight from Auckland on the day of the meeting would not reach Sydney in time to catch the necessary connecting flight to Canberra. Sophie could either:

- a) fly to Canberra the day before (in which case the accommodation would be exempt under section CW 16D(1)(c)(i) or (ii)); or
- b) fly to Sydney and stay the night then take the first morning flight from Sydney to Canberra (in which case the Sydney accommodation would be exempt under section CW 16D(1)(c)(iii)).

Accommodation for necessary travel in connection with secondments and capital projects

As with meetings, conferences and training courses, accommodation for necessary travel to and from a distant workplace in relation to secondments and capital projects is also exempt (see section CW 16B(1)(c)(iii)).

Taxable employee accommodation – determining its value

When employer-provided accommodation, accommodation allowances and other payments for accommodation are taxable, the amendments to sections CE 1 and CE 1B, and new sections CE 1C, CE 1D and CE 1E specify how to determine their taxable value.

The taxable value of the accommodation continues to be linked to market rental value but will be subject to certain adjustments and exceptions as follows:

- The taxable value is confirmed as market rental value when accommodation is provided by the employer, less any rent paid by the employee and any adjustment for business/work use of the premises. There is also an adjustment when employees share accommodation, to avoid over-taxation.
- The taxable value of employer-funded accommodation provided to employees as part of an overseas posting is capped at the average or median rental value for accommodation in the vicinity where the employee would live if in New Zealand (section CE 1C). This cap, which is of significance to employees who remain tax-resident in New Zealand, recognises that the market rental value of accommodation in overseas locations can be disproportionately high compared with that which an employee might occupy if working in New Zealand.
- There is a specific rule to confirm that the market value is discounted in the case of accommodation provided to New Zealand Defence Force (NZDF) personnel to reflect the specific limitations imposed on these properties (section CE 1D).

- There is also a specific valuation rule for accommodation supplied by religious bodies to their ministers (section CE 1E). A long-standing administrative practice has capped the benefit of church supplied accommodation at 10% of ministers' stipends. This longstanding practice has been incorporated into the legislation, subject to the amount to which this treatment applies being capped at a reasonable rental value that is commensurate with the duties of the minister and the location in which the minister performs his or her duties. This rule is intended to apply across a wide variety of churches.

Apportionment of taxable value between employees when accommodation is shared

Generally, when more than one employee shares the accommodation provided by their employer, the taxable amount is either:

- apportioned equally between the employees; or
- if the employer and employees agree, apportioned between the employees on some other reasonable basis such as one employee having a larger room.

Separate rules apply for ministers of religion.

Example 10

Two employees share a house provided by their employer, with a weekly rental value of \$300. They are each taxed on \$150.

Example 11

Three employees share a house with a weekly rental of \$400. One employee has a much smaller room than the others and they all agree with their employer that the employee with the smaller room will be taxed on \$100 and the other two employees will be taxed on \$150 each.

Work use of accommodation

The deduction from the taxable amount when part of the accommodation is used for work purposes reflects current practice and the amendment is merely intended to clarify and confirm that approach. To qualify, a clearly identifiable part of the accommodation needs to be used “wholly or mainly” for work purposes related to the employee’s employment or service. The accommodation does not need to be used solely for work purposes to meet the “wholly or mainly” test, but it must at least be used predominantly for work purposes, and its primary purpose must be work-related. Any non-work-related use must be temporary or sporadic, or otherwise minor (such as using an office for checking personal emails or a family member occasionally using it for personal projects). The deduction is determined by apportioning between the business and private use.

Example 12

An employer provides an employee with accommodation with a market rental value of \$500 a week. The employee has set up one of the bedrooms as an office, and it is usually only used as an office. However, the office has a couch that is also a fold-out bed. On occasion, when the employee has house guests, the office is also temporarily used as a place for the house guest to sleep. As the office is one-tenth of the total floor area of the accommodation, \$50 is deducted from the weekly taxable amount.

Accommodation for employees working overseas

The exception to the general valuation rules allowing the use of a New Zealand-based value rather than the market value of the overseas accommodation applies not only to employer-provided accommodation but also when the employer makes an accommodation payment for the employee's accommodation costs at the overseas location.

In establishing the value of the comparable New Zealand property, regard must be had to the location where the employee would be likely to be working for the employer, the equivalent accommodation the person would be likely to occupy if living in New Zealand, and the average or median market rental values at or near that New Zealand work location.

Example 13

Zoe is seconded by her employer to Brussels for three years and is provided with a flat for the duration of her secondment. The rent paid by the employer is equivalent to \$50,000 a year. Zoe would normally work in central Wellington if working in New Zealand, and would be likely to be living in a two-bedroom house in Thorndon where an average annual rental value would be \$24,000. Zoe is taxed on an accommodation value of \$24,000 per year.

When there is more than one location in New Zealand where the employee could work for the employer, a New Zealand-wide valuation can be used. There is a choice of using either the average market rental value or the median market rental value for the whole of New Zealand.

There is a range of sources available to help determine average or median market rental values; for example, the Ministry of Business, Innovation and Employment website <http://www.dbh.govt.nz/market-rent> provides market rental statistics based on bonds lodged with its Building and Housing Group.

Accommodation provided to Defence Force personnel

The valuation rule for accommodation provided to NZDF personnel is that, up to 31 March 2015, the rent currently being paid is treated as the market rental value (section CZ 31) and, after that date, the market rental value is the lesser of (i) the market rental value for the accommodation and (ii) the market rent for the national NZDF benchmark property of that type less a discount (section CE 1D).

Given the requirement for NZDF personnel to accept a posting anywhere in New Zealand, the NZDF has historically considered it appropriate to take a national approach to considering market rental value of NZDF accommodation. The deployment of personnel is concentrated around the central North Island, and therefore national benchmark properties have previously been assessed by reference to accommodation in the area of Linton Camp. Linton also offers a representative range of NZDF housing stock, reasonable access to amenities and a stable basis for rental comparison purposes.

The benchmark properties, their market value and the discount will be determined by the Commissioner of Inland Revenue and the Chief of Defence Force in consultation with a registered valuer. The determination of these matters must be reviewed every three years, at the instigation of either the Commissioner of Inland Revenue or the Chief of the Defence Force.

Accommodation provided by religious bodies to ministers of religion

The specific rule for accommodation provided to ministers of religion is given by the following formula:

$$\text{remuneration} \times (1 - \text{adjustment}) + \text{excess rental}$$

where:

remuneration is the amount that equals 10% of the remuneration that the minister receives for the income year for the performance of their duties as a minister;

adjustment is the part of the value of the accommodation that is apportioned to work-related use, expressed as a decimal fraction of the total value of the accommodation. To be eligible for apportionment, the minister needs to use the relevant part of the accommodation wholly or mainly for work purposes. If more than one minister of religion lives in the accommodation, the adjustment is apportioned equally between them;

excess rental is the amount (that is not less than zero) that is the difference between the accommodation's market rental value for the income year and the market rental value for the income year of accommodation that is reasonably commensurate with the duties of the person as a minister and for the location in which they perform their duties.

A "minister of religion" is defined "as a person who is ordained, commissioned, appointed or otherwise holds an office or position, regardless of their title or designation, as a minister of a religious denomination or community that meets the charitable purpose of the advancement or religion and whose duties are related mainly to the practice, study, teaching or advancement of religious beliefs; and whose accommodation is an integral part of performing their duties".

The definition specifically excludes a member of a religious society or order who is covered by the exemption in section CW 25. That exemption relates to board and lodging provided to members of religious societies and orders whose sole occupation is service in a society or order and who are not paid for their service. The specific valuation rule for accommodation provided to ministers of religion therefore supplements, rather than replaces, the existing exemption in section CW 25.

The requirement that a minister's church-provided accommodation is used as an integral part of performing the minister's duties refers to the expectation underlying a minister's pastoral duties that some parishioners might visit their home, irrespective of whether this happens in practice. There is no intention that ministers need to measure such use.

If the accommodation is provided for only part of the year, the calculations of the value are done with reference to that part of the year.

Further guidance on determining taxable value

During submissions to the Finance and Expenditure Committee, some submitters raised questions about how market rental value would be ascertained, particularly in relation to specific situations when accommodation is provided at the place of work, such as accommodation provided to staff at boarding schools. To assist employers, Inland Revenue will be issuing operational guidance on the valuation of employer-provided accommodation.

Payments to cover employee meals

Employers typically meet an employee's meal costs when linked to work-related duties. This recognises that these meals may be more expensive for the employee than normal meal costs at home.

Under previous rules, when an employer reimbursed the cost of a work-related meal, the amount saved by the employee (their normal expenditure on the meal) was arguably taxable.¹ However, it would not be practical to carry out an apportionment each time a meal payment is made, so a more practical approach that better matches business practice was needed, given that these meal payments are generally not provided as a substitute for taxable salary.

Section CW 17CB introduces two specific exemptions:

- An exemption of up to three months for meal payments if the employee is required to work away from their normal work location because they are travelling on business. This may be for a specific short-term, work-related journey or for a longer period such as a secondment to a distant work location.

¹ However, see application dates for new rules set out earlier.

- Payments to cover working meals and light refreshments when working off the employer's premises are exempt without any upper time limit.

In both circumstances, when the exemption applies, the full amount of any meal payment will be exempt. The exemption includes reimbursement payments and meal allowances.

These rules do not affect the existing exemptions in section CW 17C that apply to overtime meal payments and sustenance allowances. Likewise, the direct provision of a meal by an employer remains subject to the fringe benefit tax rules (including any "on premises" exemption) rather than the new rules. The rules that limit employers' deductions of entertainment expenses also continue to apply.

Calculating the three-month time limit

The three-month time limit runs from the date the employee starts working at the workplace and extends for as long as the employee works continuously at that location.

Example 14

Vernon normally works in Christchurch but is sent by his employer to work in the employer's Nelson office for a period of six months. Vernon's employer pays him a meal allowance for the duration of the secondment. The meal allowance is exempt for the first three months and taxable for the remainder of the secondment.

If the employee is sent away from their normal workplace and for the period they are away does not have a fixed work base, but instead works at a variety of locations and works out of an accommodation base (a single accommodation location, away from their normal residence, from which they travel to the various workplaces), then the time limit will apply from the date at which they arrive at the accommodation base.

Example 15

Bruce normally lives in Napier. He is sent by his employer to work on an infrastructure project that requires him to work in a variety of locations around the Waikato. Rather than moving to each location, Bruce rents a house to use as a base from which he can travel to those locations each day as required. The three-month time limit applies from the date Bruce moves to the rented accommodation.

In determining whether the employee is working continuously at a particular location, periods when away from the location for personal reasons such as leave and weekend breaks and short breaks that are required for work purposes will be disregarded.

The payment will not be exempt when it is paid by way of a salary trade-off.

Working meals and light refreshments at or near the employee's normal work location

Payments to cover meal expenses for a working meal near the employee's work location will be exempt in certain circumstances. For example, this will include lunches at conferences or training courses near their normal work location.

The expense will only be exempt if the employee attends the meal because of the nature of the duties of the job. The meal expense will not be exempt if it is provided as a salary trade-off.

The amendments will also introduce an exemption for payments for light refreshments (in the form of snack food such as biscuits and fruit, or liquid refreshments such as tea or coffee), when the following criteria are met:

- the nature of an employee's employment duties mean they have to be away from the employer's premises for most of the day;
- the employer would normally provide the refreshments to the employee on the day; and
- it is not practicable for the employer to provide the refreshments on the day.

Example 16

Jane normally works in an office where her employer provides tea and coffee for employees while working. Jane is required to spend two days out of the office staffing a recruitment stand for her employer at a local employment expo. During her attendance at the expo, it is not practical for Jane's employer to provide her with tea or coffee. A payment made by Jane's employer to cover tea or coffee in these circumstances will be exempt.

Application of new rules to past periods

As noted earlier, employers can apply the new accommodation and meal rules to periods before 1 April 2015 in certain circumstances. In the case of accommodation, the rules can be backdated for accommodation provided or expenditure incurred from 1 January 2011 provided the employer has not taken a tax position before 6 December 2012 that the accommodation or accommodation payment is taxable. Similarly, employers have the option to apply the work-related meal rules from 1 April 2011, provided they have not already taken a tax position that the expenditure is taxable.

This means in some situations amounts that were treated as taxable income will become exempt income, resulting in a refund to the employee.²

² If the employee owes tax, the amount that would be refunded will first be used to offset the tax owing.

Example 17

Anna lives and works in Hamilton. In January 2013 she was sent on a 15-month secondment to Blenheim. The secondment was expected to last 15 months, and did, in fact, last 15 months. Her employer paid for her accommodation in Blenheim and treated these payments as taxable. Under the new rules the accommodation would be exempt from tax. Anna's employer may now elect to backdate the application of the new rules to exempt the payments, meaning a refund of the tax paid on the accommodation can be claimed.

Example 18

Grace lives and works in Invercargill. In February 2011 her employer sent her on secondment to New Plymouth to assist with setting up a new site. The secondment was expected to last 18 months, but in fact lasted 20 months as the new site progressed slightly behind schedule. Grace's employer provided her with an accommodation allowance which was treated as taxable, with PAYE deducted. Grace's employer is unable to backdate the new provisions because although the accommodation allowance would be exempt under the new rules and was provided after 1 January 2011, it was treated as taxable before 6 December 2012.

Backdating can be applied on an employee-by-employee basis. Accordingly, when the employer agrees to backdate the new rules, the employer should indicate to Inland Revenue which employees and which tax years they have chosen to apply this option to, and the employees' new gross earnings and the tax-exempt amounts. They should also provide each employee with a letter confirming they have chosen this treatment, setting out the new gross earnings details and the amount that is now tax-exempt for each tax year.

The employee will then need to make a request to Inland Revenue to amend their IR3 return or personal tax summary assessment or, if necessary, request a personal tax summary.

Employees should note that the income adjustments described above will affect their social assistance entitlements and obligations (such as Working for Families, child support and student loan repayments). For example, if as a result of the adjustment it is found that the employee's student loan repayments have been too high, the employee should indicate whether they want the repayments refunded to them or treated as voluntary repayments.

Example 19

Jon was on an out-of-town secondment for two years with accommodation provided Monday to Friday at a cost of \$300 per week. Jon's employer had originally treated the accommodation as tax exempt as Jon returned home every weekend to his family. Jon's employer provided a voluntary disclosure and treated the accommodation for the last 12 months as taxable income. Jon's salary was \$75,000 on top of which his employer paid the additional PAYE of \$150 per week, being the grossed up amount of the accommodation, increasing his earnings by a total of \$450 per week.

Jon's employer agrees to apply the new rules to his accommodation making the cost of the accommodation – \$300 per week – tax exempt.

Jon's employer provides him with a letter confirming the details to amend his return. Jon sends a copy of the letter and requests that the Commissioner amends his return to reduce his taxable income and issue a refund of the overpaid tax.

Any requests for amendments, voluntary disclosures or case-specific queries can be sent to: accommodation@ird.govt.nz

Payments to cover “distinctive clothing”

Under the previous general rules used to determine whether a payment or allowance is taxable, expenditure incurred on the purchase and maintenance of clothing is normally a private expense. Case law has confirmed that there is an exception to this general approach when the particular clothing is “necessary and peculiar” to the employee’s occupation. This has been taken to include a uniform, or specialist clothing that is not reasonably suitable for private use. Examples include uniforms worn by nursing staff, members of the armed forces and police officers. However, ordinary clothing of a particular style or colour which could reasonably be worn outside the job would not be treated as a uniform. Specialist clothing might include overalls and protective clothing worn for health and safety reasons.

When an employer directly provides and/or maintains work-related clothing instead of paying an allowance, rather than relying on case law, the fringe benefit tax rules specifically include a distinctive work clothing exemption (see section CX 30). Applying this same approach to clothing allowances will provide consistency in this area.

New section CW 17CC makes it clear that an allowance to cover the cost of buying and maintaining distinctive work clothing is not taxable income. “Distinctive work clothing” is defined drawing on the fringe benefit tax definition in section CX 30(2) to mean a single item of clothing, that:

- is worn by an employee as, or as part of, a uniform that can be identified with the employer:
 - through the permanent and prominent display of a name, logo, or other identification that the employer regularly uses in carrying on their activity or undertaking; or
 - because of the colour scheme, pattern, or style is readily associated with the employer; and
- is worn in the course of, or as an incident, of employment; and
- is not clothing that employees would normally wear for private purposes.

The distinctive clothing exemption also covers plain clothes allowances that were in place on 1 July 2013 and paid to uniformed personnel who are required to wear plain clothes in order to carry out their duties. This is in line with a longstanding expectation that a portion of the plain clothes allowance paid to police officers is non-taxable, based on the specific circumstances involved. This exemption applies only when:

- the employer provides a uniform to its employees to wear when performing the duties of their employment;

- despite the fact that the employee has been provided with a uniform, it is a requirement of their current job with the same employer that they do not wear that uniform but instead need to wear plain clothes;
- the plain clothes allowance was in place at 1 July 2013;
- historically, the plain clothes allowance was part of a larger plain clothes amount the employer paid to employees, the balance being a taxable amount that was subsequently included in the taxable salary of employees receiving the plain clothes amount, under the employer's general terms and conditions; and
- the employer's general terms and conditions of employment continue to provide for the payment of a plain clothes allowance.

Payments in relation to the purchase and maintenance of other clothing continue to be subject to the general rules for determining when a payment that does not have its own exemption rules is tax-exempt.

General rule for determining taxable portion of other expenditure payments

For the most part, beyond the specific payments discussed earlier in relation to accommodation and meals and distinctive clothing where the need for particular rules have been identified, the previous general rule for establishing the taxable part of an employee expenditure payment has worked satisfactorily. However, some further clarity around what the rule involves was merited. Furthermore, there is still a possibility that at some time in the future the general rule may not be able to provide an appropriate outcome for another particular type of payment. There are advantages in having a mechanism to handle this other than through specific legislative amendment.

Nexus test – clarification of the approach

Under the general approach set out in section CW 17, the expenditure being paid to or on behalf of the employee is exempt income of the employee provided it is incurred in connection with the employee's employment or service and the employee would be allowed a deduction in respect of that amount if the limitation on employees claiming deductions (the employment limitation) did not exist. This is often referred to as the "nexus test". It effectively means that a payment is exempt provided it is not of a private, domestic or capital nature. This is not confined to actual expenditure. Section CW 17 allows an employer to make a reasonable estimate of the expenditure likely to be incurred.

These rules generally satisfactorily deal with the vast majority of expenses that do not have their own rule. The changes are simply aimed at providing greater clarity about what the nexus test involves by providing further detail of what is considered expenditure incurred, or an amount paid, in connection with an employee's employment or service.

New section CW 17(2B) provides that to qualify as expenditure that is incurred in connection with an employee's employment or service, it has to be incurred because the employee is performing an obligation required by their employment or service, and the employee earns income through the performance of the obligation, and the expenditure is necessary in the performance of the obligation. This does not remove the requirement to consider whether the employee would have received a deduction for the amount but for the employment limitation, which necessarily incorporates consideration of whether the capital or private limitations apply.

Commissioner determination power

A new power enables the Commissioner of Inland Revenue to issue a determination (under section 91AAT of the Tax Administration Act 1994) in respect of a payment made to a wide group or class of employees. This does not dispense with the general requirements of section CW 17 but rather, in situations where it is hard to measure the precise private or capital portion of the expense, the Commissioner may determine the extent to which on average the amount is exempt income by setting a percentage that represents the extent to which the payment for the particular type of expense, based on a reasonable estimate, is taxable.

This determination-making power is discretionary. Before deciding to issue a determination, the Commissioner needs to be satisfied that the payment not only affects a large group or class of employees but also that the average private or capital benefit likely to be received is hard to measure, and that the payment is not paid as a substitute for salary or wages (see section CW 17(2C)). The power is only available in respect of payments made to a wide group of employees to ensure that the cases in which the Commissioner issues a determination are of sufficient importance to the wider business community. This is likely to mean an employee expenditure payment that is commonly provided across a wide spectrum of businesses. It may include an employee expenditure payment provided in a specific industry if it covers many employees.

Any determination issued will be binding on the Commissioner but not the taxpayer, which means that it will act as a safe harbour. If the employer or employee has evidence to demonstrate that in their particular circumstance some other apportionment is appropriate under the section CW 17 general rule, the taxpayer will still be able to apply that apportionment.

Expenditure on account of an employee

When an employer reimburses or otherwise meets a specific employee expense, this is an employee expenditure payment known as "expenditure on account of an employee". The statutory definition is very widely drawn, so there is a comprehensive list of exclusions from the definition. These include two general exclusions that covered employee expenditure payments in general.

The first general exclusion (section CE 5(3)(a) – which remains unchanged) excludes payments to third parties or to employees for expenditure incurred by those employees in deriving their employment income. The second general exclusion (section CE 5(3)(c)) excluded payments made by employers to employees for expenses that an employee had incurred and paid for on their employer’s behalf, when the expenses were the employer’s liability. An example would be when the employee buys a box of photocopying paper on the employer’s behalf on the basis that the employer will reimburse them.

There have been a number of significant changes to the definition of “expenditure on account of an employee” since it was first introduced in 1985. As a result, the general exclusions have been amended and expanded and it was no longer clear how the two exclusions should apply in relation to each other. Arguably, there was some overlap, which the amended provision is designed to remove.

The general exclusion in section CE 5(3)(c) has been amended so that it excludes expenditure from being “expenditure on account of an employee” when:

- the particular payment does not already fall within the section CE 5(3)(a) exclusion (this ensures the section CE 5(3)(a) exclusion takes priority);
- the expense covered by the payment is incurred by or on behalf of the employee’s employer; and
- the expense has been paid for by the employee on their employer’s behalf.

Other matters

A number of minor technical amendments have been made to support the wider changes to the rules governing the tax treatment of employer-provided accommodation, accommodation payments, and other allowances and payments by employers to cover employee expenditure.

The amendments cover changes to definitions, headings and cross-references to ensure compatibility with other taxing rules.