

# Regulatory Impact Statement: Fringe benefit tax exemption for public transport

## Coversheet

Purpose of Document	
Decision sought:	Analysis produced for the purpose of informing: final Cabinet decisions on a fringe benefit tax exemption for public transport
Advising agencies:	Inland Revenue
Proposing Ministers:	Minister of Finance, Minister of Revenue
Date finalised:	31 May 2022
Problem Definition	
<p>The current fringe benefit tax (FBT) exemption for on-premise car parking does not align with the general principle that tax should be applied neutrally to avoid biasing economic decision-making. Employers may choose how to remunerate their employees, and the current FBT rules may encourage employers to choose providing their employees with private car parks on their premises over providing them with public transport fringe benefits, thereby creating a bias towards less environmentally friendly modes of transport. The current FBT rules can also encourage the provision of car parking in lieu of a portion of taxable salary and wages.</p>	
Executive Summary	
<p>In principle, anything that an employer provides to an employee that is salary or wages, or is a substitute for salary or wages, should be taxed, subject to the practicality of doing so. To ensure this is the case, most non-cash benefits received because of employment are treated as fringe benefits and are subject to FBT on a broadly comparable basis to salary and wages. FBT should, like taxes in general, be neutral in its application, including its impact on environmental outcomes.</p> <p>Currently, contributions an employer makes to their employees' public transport costs, for example subsidies in the form of a voucher or a loaded electronic ticketing card, will generally trigger FBT.</p> <p>In contrast, when an employer provides free car parking to an employee on the employer's premises FBT does not apply in many instances. This extends to car parks leased from a car park provider. This exemption is not car park specific but rather is part of a general FBT exemption for benefits provided "on-premises", to reduce taxpayer compliance costs.</p> <p>The car park exemption can be a sizeable benefit to employees (currently \$2,500-\$6,000 per annum) where parking charges are material, such as in central Auckland and Wellington. This does not align with the general approach that tax should be applied neutrally to avoid biasing economic decision-making. It can encourage the provision of car parking in lieu of a portion of taxable salary and wages. It may also encourage the use of private cars for transport to workplaces with free car parking over the use of public transport, which can have an environmental impact.</p>	

Applying FBT to valuable on-premise car parking would best improve wider tax and environmental neutrality and achieve a more equitable tax treatment across employees. However, this has been attempted on several occasions, particularly in 2012, and has proved to be problematic, partly because of practical valuation and compliance cost concerns, and therefore did not proceed. These difficulties compromise the feasibility of this option, which the Tax Working Group acknowledged and instead recommended exempting employer subsidised public transport from FBT.<sup>1</sup>

From an environmental neutrality perspective, widening the FBT exemptions to also include a public transport exemption could achieve small environmental improvements. It would remove the current bias towards the environmentally unfriendlier mode of transport by car that employers face when considering how to remunerate their employees. The trade-off being that it would also create a new economic distortion in the FBT rules. Further, tax policy officials consider that such an exemption is unlikely to result in significant behavioural change. Its application would be limited to situations where public transport options are readily available to employers' locations, and by employers' preparedness to offer the benefit to their employees.

The fiscal impact of such an FBT exemption for employer subsidised public transport is an estimated \$9 million<sup>2</sup> reduction in tax revenue per year. This is based on exempting subsidised use of buses, trains and trams, but not air travel.

Feedback from targeted consultation in 2021 indicated that stakeholders largely supported an FBT exemption for employer subsidised public transport and that it would make more employers likely to consider public transport fringe benefits as an option. However, employers who have attempted to provide public transport benefits in the past had encountered significant compliance costs in relation to being billed for employees' use of public transport. Therefore, a simple system for paying the transport provider would be crucial. A number of the larger employers consulted have remote work sites and stated a public transport FBT exemption would not be of much help for their employees.

## Limitations and Constraints on Analysis

### Data limitations

Inland Revenue does not hold detailed information on public transport fringe benefits currently provided by employers and the amount of FBT paid on these benefits. In an FBT return, an employer is only required to provide Inland Revenue with the aggregate amount of their fringe benefits provided to its employees. Therefore, Inland Revenue does not have a sense of what proportion of FBT is related to subsidised public transport. There is some limited historical data. Up to 2001 Inland Revenue collected fringe benefit category data, including goods, services and subsidised transport which accounted for 13% of FBT revenue at the time. Anecdotally, much of the FBT returned under this category was from subsidised goods.

Similarly, Inland Revenue does not hold information on car parking benefits currently provided by employers.

While the proposal to exempt employer subsidised public transport benefits from FBT has the potential to result in a small reduction in emissions as compared to the current rules, it

<sup>1</sup> *Future of Tax*, Final Report Volume I, Recommendations, Tax Working Group, Te Awheawhe Tāke, paragraph 126, page 53.

<sup>2</sup> This estimate is based on FBT data for the fiscal year ended 30 June 2021.

is not clear what level of behavioural response would result from such an exemption. It is likely to be relatively small and it is not an impact that can be quantified with ease in terms of carbon reduction.

These data limitations have meant that any fiscal estimates have needed to be very high-level. The financial impact of an FBT exemption for employer subsidised public transport has been made based on the historic New Zealand data, Australian data and feedback from some employer representative groups on public transport fringe benefits. We estimate the fiscal cost of exempting public transport from FBT to be around \$9 million per year. This represents an estimate of the amount currently paid under the status quo rules that would potentially be forgone with an exemption. It does not attempt to model a behavioural shift in the future.

### Option limitations

Given the past difficulties in achieving a change in the tax laws to include more car parks within the FBT net, Ministers indicated that this option should not be further explored. It is however, included in the options discussed later in this paper for comparative purposes.

The scope of the policy project is limited to exploring how the neutrality of the FBT rules could be improved in light of the car parking exemption. It does not extend to similar considerations in relation to direct cash payments that would be covered instead under the pay-as-you-earn (PAYE) tax rules applied to salary and wages. This is because both direct employer payments to cover employee car parking costs and employee public transport use are taxed, so there is not the same non-neutrality issue.

We have not investigated applying the \$9 million annual funding instead to the Government's general subsidisation of public transport.

### Responsible Manager(s) (completed by relevant manager)

Graeme Morrison  
Policy Lead  
Policy and Regulatory Stewardship  
Inland Revenue

s9(2)(a)

31 May 2022

### Quality Assurance (completed by QA panel)

Reviewing Agency:	Inland Revenue RIA Panel
Panel Assessment & Comment:	The Inland Revenue Quality Assurance Panel has reviewed the Regulatory Impact Statement (RIS) <i>Fringe benefit tax exemption for public transport</i> prepared by Inland Revenue and considers the information and analysis summarised in the RIS meets the quality assurance criteria.

## Section 1: Diagnosing the policy problem

### What is the context behind the policy problem and how is the status quo expected to develop?

1. Since the mid-1980s, New Zealand's tax system has been based around a broad-base framework. This means that taxes are applied neutrally with few exemptions and subsidies. In respect of employee income, anything an employer provides to an employee that is salary or wages, or is a substitute for salary or wages, should be taxed, subject to the practicality of doing so. To ensure this is the case, most non-cash benefits received because of employment are treated as fringe benefits and are subject to FBT on a broadly comparable basis to salary and wages.
2. Specifically, the FBT that an employer calculates and pays is designed to equate with the PAYE tax that is applied to salary and wages. This promotes fairness between employees (whether they are paid in cash or in kind) and helps preserve the integrity of the base that taxes income from employment. It reduces incentives for employers to provide employees with non-cash benefits rather than pay them salary and wages.
3. As with the taxation of salary and wages and taxes in general, FBT coverage is intended to be broad with exemptions from FBT being limited to situations where compliance costs make it impracticable to apply FBT. For example, benefits provided on an employer's premises are exempt from FBT. The purpose of this general on-premises exemption is for taxpayer compliance costs reasons.
4. The on-premises concession means that when an employer provides free car parking to an employee on the employer's premises, FBT does not apply in many instances, including car parks leased from a car park provider.
5. In contrast, any contributions an employer makes to their employees' public transport costs, for example in the form of a voucher or a loaded electronic ticketing card, triggers FBT unless they fall below the standard de minimis<sup>3</sup>. Any cash contributions to an employee's public transport costs are taxed like salary and wages under the PAYE rules and do not attract FBT.

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<sup>3</sup> Miscellaneous benefits are exempt from FBT when the taxable value provided to each employee is \$300 or less per quarter and the total taxable value of all unclassified benefits provided by the employer to all employees over the past four quarters is \$22,500 or less. There is also a longstanding concessional FBT treatment when an employer who is in the business of providing public transport allows an employee to travel on that transport for less than fares charged to the public, but this covers relatively few employees.



## What is the policy problem or opportunity?

6. The current FBT exemption for on-premise car parking does not align with the general principle that tax should be applied neutrally to avoid biasing economic decision-making. For example, it may encourage the use of private cars for transport to workplaces with free car parking over the use of environmentally friendlier modes of transport, in particular public transport, and can also encourage the provision of car parking in lieu of a portion of taxable salary and wages.
7. A key principle of tax policy is horizontal equity – ideally a tax should apply equally to people on the same effective income. The car park exemption can be a sizeable benefit to employees (\$2,500-\$6,000 per annum) where parking charges are material, such as in central Auckland and Wellington. This gives rise to horizontal equity concerns when the untaxed car parking benefit is provided as a substitute for a portion of the employee's salary and wages. The employee in this case receives a tax saving over other employees who are not able to structure their remuneration package to include this benefit. There may also be, to a lesser extent, some vertical equity considerations, as the car parking exemption is more likely to favour overall high-income earners.
8. In addition, FBT, like other tax rules, should be applied neutrally, including considering its impact on environmental outcomes. Taxes should avoid biasing economic decision-making and should not encourage environmentally damaging behaviour. Current FBT settings may encourage the use of private cars for transport to workplaces with free car parking over the use of public transport, which is likely to have a negative environmental impact.
9. Applying FBT to more on-premises car parking has been considered on several occasions, particularly in 2012. However, the reform proved to be contentious, partly because of valuation and compliance cost concerns, and did not proceed.
10. The Tax Working Group (the Group)<sup>4</sup> identified the environmental neutrality issue around car parking and the practical difficulties associated with applying FBT to a wider range of on-premise car-parking and stated the different FBT treatment of car parks and public transport has the perverse effect of discouraging the use of public transport. The Group recommended in its 2018 final report<sup>5</sup> that the Government consider, for environmental reasons, allowing employers to subsidise their employees' public transport use without incurring FBT given the practical difficulties associated with applying FBT to a wider range of car parks.
11. Stakeholders are employers, employees, public transport providers, and the wider community, particularly those in urban areas. For example, employers have an interest in that they may currently be discouraged from providing public transport fringe benefits to their employees when compared with car parking.
12. Employees have an interest as the FBT rules encourage their take-up of tax free car parking (where available) in lieu of a portion of taxable salary and wages over travel to and from work by public transport. Public transport providers are affected in that the current bias may reduce public transport use. Therefore, the incentive to develop low-cost solutions for employer-subsidised public transport may be reduced.
13. The wider community is affected in that the current FBT rules may encourage behaviour that increases overall emissions and traffic congestion.

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<sup>4</sup> The Tax Working Group was established in November 2017 by the Government at the time to consider the future of tax and provide recommendations to Government that would improve the fairness, balance and structure of the tax system over the next 10 years.

<sup>5</sup> <https://taxworkinggroup.govt.nz/resources/future-tax-final-report.html>

14. Given the lack of data for on-premise car parking and public transport fringe benefits currently provided by employers, it is difficult to determine the scale of the issue.

### **What objectives are sought in relation to the policy problem?**

15. The objectives are to:
  - a. Enhance neutrality of the wider tax system, particularly removing or reducing the bias towards the use of private cars.
  - b. Improve equity as taxpayers with similar levels of income should pay similar levels of tax (horizontal equity) and that taxpayers on higher incomes should pay higher levels of income tax in a way that reflects the Government's objectives of increasing the progressivity of the tax system (vertical equity).
  - c. Improve environmental neutrality of the FBT rules, in particular reduce the current bias towards the environmentally unfriendlier mode of transport by car employers face when considering how to remunerate their employees.
  - d. Minimise compliance costs on employers.

## **Section 2: Deciding upon an option to address the policy problem**

### **What criteria will be used to compare options to the status quo?**

16. The options will be assessed against the objectives previously stated. As stated in the limitations, they only consider changes to FBT, not PAYE or government expenditure options.
17. In addition, consideration is given to the Government's climate change priority and to its commitment to reduce New Zealand's greenhouse gas emissions to net zero by 2050.

### **What options are being considered?**

#### **Option One – Status Quo**

18. Under the status quo, employer-provided on-premise car parking is exempt from FBT, whereas other more environmentally friendly modes of transport, such as employer subsidised public transport, attract FBT.
19. Pros:
  - a. Maintains consistency and neutrality between public transport and other fringe benefits.
  - b. Maintains lower compliance costs for employers providing car parking for their employees compared with option two.
20. Cons:
  - a. Car parks are subsidised when provided by employers which encourages salary substitution.
  - b. Car park subsidy encourages travel to and from work in private cars rather than other modes of transport, in particular public transport.
  - c. Current negative environmental bias is maintained.

#### **Option Two – Apply FBT to (more) on-premise car-parking**

21. Under this option FBT would be applied to all or more (for example in areas where the benefit is greatest) employer-provided car parks on the employers' premises.
22. Pros:
  - a. Improves wider tax neutrality and horizontal equity.
  - b. Improves environmental neutrality by removing the incentive to use private cars over other modes of transport for travel between home and work, in particular public transport.
23. Cons:
  - a. Increases administrative complexity for Inland Revenue and employers and increases compliance complexity and costs for employers providing car parking to employees.
  - b. Given previous experience, it is unlikely that this option will be able to proceed and be implemented.

### **Option Three – Exempting employer subsidised public transport from FBT**

24. Under this option FBT would not apply when employers subsidise employees' use of public transport for the purposes of travel between home and work, for example by providing a voucher or loaded electronic ticketing card. Public transport would cover buses, trains and trams.
25. Pros:
  - a. Provides a more balanced treatment between the use of private cars and car parking and public transport. It improves horizontal equity.
  - b. Improves, in principle, the environmental neutrality of the FBT rules by removing the incentive to use private cars over public transport. Some employers are likely to shift to providing subsidised public transport benefits. However, tax officials believe that uptake will likely not be significant enough to materially change employees' behaviour in respect of their between work and home travel.
26. Cons:
  - a. Does not remove overall tax distortion.
  - b. Creates an additional economic distortion relative to other fringe benefits.
  - c. An exemption would in practice be limited to situations where public transport fringe benefits are relevant to employers' location (urban areas with sufficient public transport infrastructure) and employers' preparedness to offer such benefits to their employees (administrative complexity and compliance costs for employers of providing vouchers or topping up electronic ticketing cards may limit uptake by employers).
  - d. Could incentivise calls for other FBT exemptions, adding further distortion and undermining the integrity of the tax system.

### **Consultation**

27. Officials undertook targeted consultation through meetings, emails, and surveys in 2021 with three public transport providers, one public transport planner and employers through two representative Groups. It suggested that there are very few employers currently providing public transport fringe benefits. They noted the challenges were the differing circumstances of employees which meant it may or may not be a useful benefit and consideration of whether other fringe benefits, such as health insurance, might be of equal or more value to employees.
28. Stakeholders largely supported an FBT exemption for employer subsidised public transport and stated that it would make more employers likely to consider public

transport fringe benefits as an option. Those members who have attempted providing public transport benefits in the past had encountered significant compliance costs in setting up and operating processes that enabled them to top up employees' electronic travel cards or be billed directly by public transport providers. Accordingly, they stated that for an exemption to be successful, public transport providers will need to have some type of simple approach that employers can use. A number of the larger employers consulted have remote work sites and stated a public transport FBT exemption would not be of much help for their employees.

29. Some, mainly large, employers also provided details of car parks they have available and stated that, as a generalisation, other than remote sites, the provision of car parks is often restricted to being available for employees who need to park work vehicles in them or need to have a vehicle available for work related travel.
30. The public transport providers and the planner confirmed that they have been involved with only a few employers who were providing, or looking to provide, public transport benefits. One transport provider had been running a small-scale pilot scheme with a few employers for partially subsidising employees' transport costs. At the time of consultation, this pilot was not ready or intended to be scaled up.



## How do the options compare to the status quo?

	Option One – Status Quo	Option Two – <i>Apply FBT to (more) on-premise car-parking</i>	Option Three - <i>Exempting employer subsidised public transport from FBT</i>
Enhance neutrality of the wider tax system	0	<p>+</p> <p><i>Reduces an economic distortion in the tax system.</i></p>	<p>-</p> <p><i>Creates an additional economic distortion relative to other fringe benefits.</i></p>
Equity	0	<p>+</p> <p><i>Employees provided with on-premise car parking no longer receive a tax free benefit means more equitable treatment across employees receiving fringe benefits.</i></p>	<p>+</p> <p><i>Provides a more balanced treatment between private cars/car parking and public transport. Employers are not biased in their choice of whether to provide public transport to their employees relative to car-parking.</i></p> <p>-</p> <p><i>Less equitable in relation to employees receiving other fringe benefits that are taxed or cash subsidies/reimbursements.</i></p>
Improve environmental neutrality of the FBT rules	0	<p>++</p> <p><i>Removes the bias towards employers providing car-parking and therefore employees using private cars for between home and work travel. This creates neutrality across all modes of travel between home and work.</i></p>	<p>+</p> <p><i>Removes the bias towards employers providing car-parking over subsidised public transport.</i></p>

<b>Minimise compliance costs</b>	0	<p>-</p> <p><i>Employers providing on-premise car-parking to their employees have increased compliance complexity and costs, but employers may have option of not providing such parking.</i></p>	<p>-</p> <p><i>Providing public transport benefits may increase employers' compliance costs depending on billing/administrative arrangements. However, providing the benefit is voluntary.</i></p> <p>+</p> <p><i>Compliance costs of those employers already providing public transport fringe benefits are reduced because they no longer need to calculate and pay FBT on these benefits.</i></p>
<b>Overall assessment</b>	0	++	0

**Example key for qualitative judgements:**

- ++ much better than doing nothing/the status quo/counterfactual
- + better than doing nothing/the status quo/counterfactual
- 0 about the same as doing nothing/the status quo/counterfactual
- worse than doing nothing/the status quo/counterfactual
- much worse than doing nothing/the status quo/counterfactual

**What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?**

31. From a pure tax policy perspective, option two – apply FBT to (more) on-premise car parking would be officials' preferred option, as it would improve wider tax neutrality and horizontal equity as well as environmental neutrality. However, this option would increase complexity and compliance costs for employers providing on-premise car parking. Earlier attempts pointed to stakeholders raising practical difficulties which could not be readily resolved at the time. It is unlikely that perceptions have changed.
32. Our view is that the status quo would be preferable to exempting employer-subsidised public transport fringe benefits from FBT. While an exemption would improve environmental neutrality in relation to private cars, it creates an additional economic distortion relative to other fringe benefits, including other modes of travel such as employer-provided e-bikes. Officials believe that an exemption would result in limited behavioural change. Its application would be restricted to situations where employers are located near public transport routes that their employees can readily access, including the availability of those services when the employees need them, and employers' preparedness to offer the benefit to their employees. We also note that with exemptions there is an incentive to salary sacrifice and associated costs that come with that choice.
33. Environmental neutrality is a priority given the Government's emissions reduction commitments. In that context, widening the FBT exemptions to also include a public transport exemption would potentially achieve an improvement despite creating an additional economic distortion in the FBT rules. The current bias towards the environmentally unfriendlier mode of transport by car employers face when considering how to remunerate their employees is removed. Limiting the exemption to between home and work travel would best achieve removing the existing bias between car-parking on the employer's premises and public transport. However, this may be practically difficult (for example, when an employee uses a monthly train pass), so an exemption would need to focus on situations where the subsidy is provided primarily for that purpose and accept that some incidental other private travel would likely be subsidised too.

## What are the marginal costs and benefits of the option?

Affected groups	Comment	Impact	Evidence Certainty <i>High, medium, or low, and explain reasoning in comment column.</i>
<b>Additional costs of option three compared to taking no action</b>			
Regulated groups (employers)	Taxpayer friendly and voluntary.	No cost	High
Regulators (Inland Revenue)	This change will bring a small administrative cost to Inland Revenue for providing guidance to employers about the new rules to raise awareness and understanding, and to promote compliance.	Low	High
Wider government	Exempting employer subsidised public transport benefits from FBT will result in a lower FBT take for the Government.  There may also be some salary substitution which would mean a decrease in PAYE.	Around \$9 million forgone revenue per year	Low, given the lack of FBT specific detailed data.
Others (employees – if receiving public transport benefits)	Not applicable	Not applicable	Not applicable
<b>Total monetised costs</b>	Fiscal cost	Around \$ 9 million forgone revenue per year	Low
<b>Non-monetised costs</b>		Low	
<b>Additional benefits of option three compared to taking no action</b>			
Regulated groups (employers)	Employers are able to provide public transport fringe benefits without attracting FBT.	Medium	High
Employees	There is likely to be an increase in employees receiving employer subsidised public transport benefits.	Low	Medium
Regulators	N/A	N/A	N/A

Wider government	Some behavioural change towards using public transport between home and work, which should reduce overall emissions and traffic congestion.	Low	Medium
<b>Total monetised benefits</b>	N/A	N/A	N/A
<b>Non-monetised benefits</b>		Low	Low

34. An FBT exemption for public transport would generally apply to all employers. However, in practice it would largely be relevant for employers with workplaces in urban areas with sufficient public transport networks. The level of uptake will also depend on the availability of low compliance cost options for employers.

## Section 3: Delivering an option

### How will the new arrangements be implemented?

35. Should the Government decide to proceed with an exemption, it will require an amendment to the Income Tax Act 2007. The proposed legislative amendments would take effect from 1 April after the proposed bill receives Royal Assent. There is already a public transport provision in the FBT rules but that relates only to valuing the benefit where it has been provided by an employer who is a public transport provider.
36. Inland Revenue would be responsible for the implementation and ongoing administration of the new rules. Inland Revenue will publish guidance material to raise awareness and explain how the exemption works. This would include producing a relevant Tax Information Bulletin item and updating guidance on Inland Revenue's website. Overall, Inland Revenue expects that only very minor alterations to systems and operations will be needed.



## How will the new arrangements be monitored, evaluated, and reviewed?

37. **Monitoring:** Should the Government decide to proceed with an FBT exemption for employer subsidised public transport fringe benefits, the proposal is taxpayer friendly, uptake will be voluntary, and enforcement and extensive monitoring is not necessary. In practice, it will be difficult to evaluate the effect the proposed measure will have on employers' and employees' behaviour. A reduction in FBT collected may indicate the level at which public transport benefits are currently provided.
38. **Review:** Should the Government proceed with an exemption for public transport, there are no plans for a specific review of this change, as it is taxpayer friendly.
39. Inland Revenue regularly reviews tax settings on an ongoing basis and provides advice and updates to the Government accordingly. Policy officials maintain strong communication channels with stakeholders in the tax advisory community, including through the generic tax policy process, and these stakeholders will be able to correspond with officials about the operation of the new rules at any time. If problems emerge, they will be dealt with either operationally, or by way of legislative amendment if agreed by Parliament.