

# TOPIC 3

## FRINGE BENEFIT TAX (FBT)

### LEARNING OBJECTIVES

After studying the material for this week you should be able to:

- Describe what Fringe Benefit Tax (FBT) is;
- Explain the rationale for its introduction;
- Define the terms 'employer', 'employee', and 'benefit' in relation to FBT;
- Identify what qualifies as a 'fringe benefit';
- Explain remuneration packages and fringe benefit;
- Analyse the treatment/application of FBT by different employers (including non-resident employers);
- Integrate the concepts of the value & taxable value of a fringe benefit (relating to motor vehicles);
- List the rates and payment dates
- Outline the Goods and Services Tax treatment of fringe benefits.

# Supplementary Readings

## 1. Supplementary Readings in this Study Guide:

	<b>Page:</b>
(a) Carr, S.A & Chan, C. (2004). New Zealand's Fringe Benefit Tax 20 years on: An Empirical Investigation into Employers' Perception. <i>New Zealand Journal of Taxation Law and Policy</i> , Vol. 10, No. 3. pp. 245-270.	13
(b) Richardson, I.L.M. & Congreve, R.L. (1975). <i>Tax Free Fringe Benefits</i> . Rydge Publications Pty Ltd., pp. 3-11.	38
(c) Doolan, J. (24 January, 2007). After Christmas, It's cold turkey. <i>The Independent</i> , p.23.	47

# Additional Readings

## 2. Additional Reading Reference:

Alley, Chan, Dunbar, et al. (2008). *New Zealand Taxation*. [Chap18 (18.1 to 18.6.6, 18.9, 18.10, 18.13)]. Wellington: Thomson Brookers.

# Topic Three Outline

## **Fringe Benefit Tax**

1. What is “Fringe Benefit Tax”?
2. Why was FBT introduced?
3. Remuneration packages and fringe benefits
4. Definitions - employer, employee, employment relationship, fringe benefit.
5. When is FBT imposed (motor vehicle)?
6. Treatment of Fringe Benefits by different employers.
7. Concepts of the value & taxable value of a fringe benefit.
8. Rates, filing and payment of Fringe Benefit Tax.
9. Fringe Benefits and the Goods and Services Tax.

# Explanatory Notes

## FRINGE BENEFIT TAX

### 1. What is Fringe Benefit Tax?

Carmody, G. (1998) [*Fringe Benefit Tax: Time for a rethink*. Research Study No.29, pp.7. Sydney: Australian Tax Research Foundation] describes fringe benefits as having three key features:

- “they are received *as a result of employment*: they represent part of an employee’s remuneration paid in exchange for supplying the employee’s labour to the employer;
- they are a *substitute* for, or additional to, salary or wages paid to an employee;
- they deliver a *private benefit* to the employee, rather than being a work-related expense”.

In New Zealand *Fringe Benefit Tax* (FBT) levied is *payable on* the value of “fringe benefits” provided to employees by an employer, as legislated in the *Income Tax Act 2007*. The tax is a deductible expense, and is payable by the employer on a quarterly basis 30 June, 30 September, 31 December and 31 March, or annually, or on an income year basis. It is required to be paid to the IRD by the 20th of the month following the end of the quarter or such dates stipulated within the FBT rules. A penalty charge is levied for late payment.

This tax is in addition to income tax payable by the employer on profits earned during the year.

### 2. Why was FBT Introduced?

2.1 A number of reasons might be cited for the introduction of fringe benefit tax. Among them were:

- (a) To widen the tax base: The income tax base prior to 1 April 1985 was very narrow with the result that a number of important forms of remuneration escaped taxation. This resulted in the erosion of the (income) tax base.

As early as 1967 the Ross Report [*Taxation in New Zealand: Report of the Taxation Review Committee*. Wellington: R.E. Owens, Government Printers] expressed concern at the growth of fringe benefits and recommended that the Land and Income Tax Act 1954 be amended to include total benefits within the term ‘assessable income’.

- (b) To supply more revenue: The revenue raised from this tax was to facilitate the lowering of other tax rates and/or a reduction in the budget deficit.
- (c) To improve equity: By ensuring **non-cash** benefits provided to employees are subject to tax, equity as between employees working for different employers has been improved. By taxing the total remuneration package, rather than just monetary remuneration, a major distortion has been removed. (Remember that FBT is payable by employers, not employees). Nevertheless, the taxing of fringe benefits has caused employers to think in terms of the gross value (i.e. including the taxation component for both cash and non-cash forms of remuneration).
- (d) To improve resource allocation: Fringe benefit tax was seen by the Government as one way in which resource allocation in the economy could be improved.

[The *Supplementary Readings* in this Study Guide provide you with a further general understanding as to the arguments for the introduction of a fringe benefit tax.]

Even so employers have been crying out for further changes to FBT in terms of general principles and to particular issues, e.g. taxing FBT on 'cost price' rather than on 'book value', high compliance costs, transferring the tax payment to employees, etc. In December 2003 the Government released a Discussion Document, *Streamlining the taxation of fringe benefits* ([www.taxpolicy.ird.govt.nz/publications/index](http://www.taxpolicy.ird.govt.nz/publications/index)) which considered some of these issues (and have since passed into law). The bottom line of this document is that FBT is here to stay for a little longer!

## 2.2 **Why was the Tax Levied on the Employer, Rather Than the Employee?**

The reasons given by the Government were:

- (a) To encourage a shift to remuneration paid in cash: The aim of the legislation was stated to be: the encouragement of employers to change the method of remuneration to payment in cash, rather than the provision of non-cash benefits.
- (b) It permits the taxation of low value benefits: Whereas the cost of taxing low value benefits provided to employees would be high in relation to the revenue collected, certain low value fringe benefits, when aggregated across all employees, may amount to a substantial sum. Administratively, it is easier and cheaper to check on a few employers rather than try to assess and collect the relevant amount of tax from each of the employees concerned.

### 3. Remuneration Packages and Fringe Benefits<sup>1</sup>

When considering the background to the FBT regime it is necessary to establish the different types of remuneration an employer may provide employees to determine where the Fringe Benefit Tax Regime boundaries lie.

#### 3.1 Types of Remuneration

There are essentially two methods an employer may use to remunerate an employee for services rendered, being either cash or non-cash.

The payment of cash 'remuneration' is generally in the nature of salary and wages (including certain allowances) and will be taxable in the hands of the employee. However, the provision of non-cash remuneration will generally be not taxable in the hands of the employee with the employer bearing the tax, eg FBT regime. [Note there is nothing in the FBT regime that prevents its application to cash benefits, however it is normally non-cash benefits that it applies to.]

The Income Tax Act (ITA 2007) provides the following regimes for taxing what some regard as 'remuneration':

- Cash pay (in previous ITAs referred to as monetary/cash remuneration)
- Entertainment
- Fringe Benefit
- Other

Also refer to NZT 18.12.7 for the meaning of *cash pay* as applied to the FBT regime.

#### 3.2 Relationship between the Different Regimes

As can be seen from above there is considerable scope for certain benefits provided to fall within the ambit of either "employment income", "Entertainment" or "Fringe Benefit".

When considering the method of taxation of any benefit provided to an employee it is necessary to consider the following:

- Firstly, is the benefit in monetary form?
- Secondly, is this otherwise included in the employee's gross income?
- Thirdly, is the benefit "entertainment"?
- And finally, is the benefit a fringe benefit?

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<sup>1</sup> Polson Higgs, et al (March, 2001) "The Low-down on FBT" ICANZ paper S.640 pages 4-5.

The above outlines the ordering rules in the Act. However, as a final assurance that any benefit is not double taxed, all regimes ensure there is an exemption if the benefit is taxed in accordance with any of the other regimes.

It is now more important to ensure the correct regime is applied having regard to the increase in top marginal tax rate.

#### 4. Definitions

It is important that the student understand the significance of these technical terms and their relationship.

- Fringe Benefit
- Employment Relationship
- Employer (including third person)
- Employee (including associated person)
- Source deduction payments
- Excluded fringe benefits

Refer to NZT 18.1 to 18.4.

#### 5. When is FBT imposed (motor vehicles)?

Refer to NZT 18.6.1 to 18.6.6.

The requirement to calculate fringe benefit tax on the use of a motor vehicle should be well known to readers. However, it is worthwhile to review when the provision of a vehicle is subject to FBT, and the avenues available to minimise the value of that benefit.

To be subject to FBT, there must be a benefit that consists of:

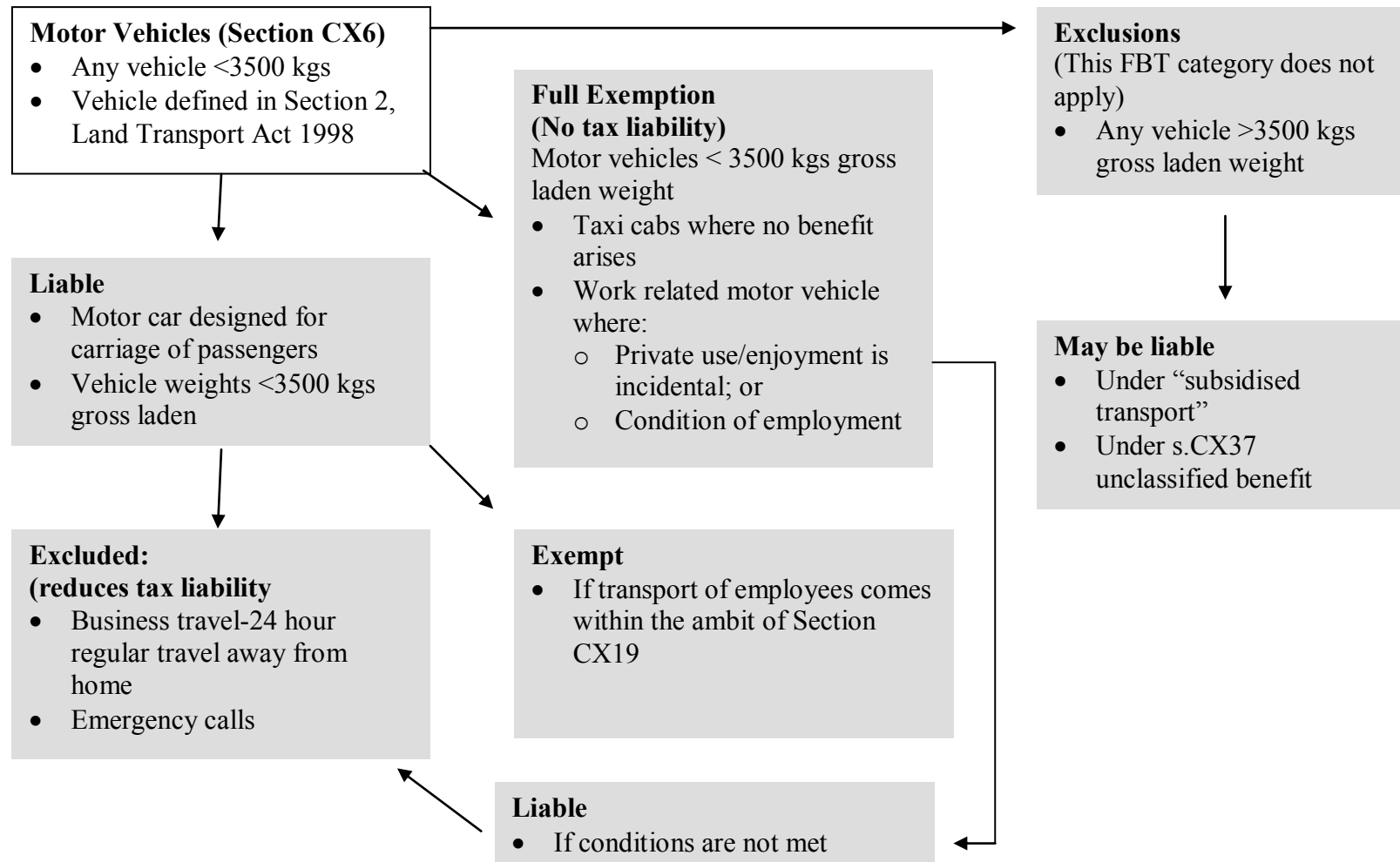
- a motor vehicle,
- private use or enjoyment,
- owned, leased or rented at any time during the period,
- provided by the employee.

FBT is then calculated based on the number of days where the benefit was provided.

The legislation does not require a vehicle to have been actually used privately during the quarter; **it need only have been available** for private use or enjoyment.

A flowchart summarising, in general, the FBT liability on motor vehicles is attached on the following page of the Explanatory Notes.

# “Motor Vehicles” and Liability to FBT





## 6. Treatment of Fringe Benefits by different employers

Fringe benefit tax is levied on fringe benefits provided, directly or indirectly to employees of an employer by the employer as part of the employment “package”.

6.1 In terms of specific employees the treatment for FBT is as follows:

- (a) By virtue that a *sole trader* cannot be an employee as well as an employer at the same time any fringe benefit provided by the sole trader for own use will not be liable for FBT; employer-employee relationship is non-existent. However, if the sole trader provided such benefits to an arms-length employee then FBT is liable.
- (b) A *working partner* (in the case of a *partnership* and under the PAYE source deduction regime) can be treated as an employee. But, in terms of FBT rules under the 2007 ITA these partners are specifically excluded from the definition of an “employee” – s YA1 “employee” para. (c)(i). Therefore, fringe benefits provided to *working partners* were not liable for FBT; FBT liability, in a partnership situation, arose only when fringe benefits were provided to **arms-length** employees.
- (c) Where a *company* is concerned the shareholder are considered separate entities from the company. Shareholders may hold positions within the company and receive remunerations as employees. Fringe benefits provided to shareholder-employees or associated persons are liable for FBT, similar to if such benefits are provided to arms-length employees.

However, the **exception** applies where fringe benefits are provided to *non-executive directors* and shareholders. These “in-kind” benefits are taxable to these persons as income [i.e. dividends] even though the benefits are non-cash.

Also, Section CX 17(2) allows the employer of a *close* company to *elect* to pay FBT or income tax for non-cash benefits derived by shareholder-employees.

- (d) FBT and non-resident employers: refer to Inland Revenue Department’s TIB Vol. 7, No. 6 if students are interested in the practical details.

6.2 In terms of “arms-length” employees the multi-rate FBT system allows the employee to either pay FBT at the 64% rate, or **attribute** certain benefits to **individual** employees and pay FBT based upon their marginal tax rates. Where attribution of a benefit to a principal user is

not possible then the benefit must be pooled and taxed at 49% (non-major shareholder/employees) or 64% (major shareholder/employees).

**Please note:** Only the basic concepts, application of concepts and rationale of the FBT system are examinable; technical details and mechanics are not required.

## 7. Concepts of the Value & Taxable Value of a fringe benefit

Although the following concepts are not examinable, students are still required to have a *general knowledge* of the principles in these areas.

Under subpart RD the legislation provide the necessary formulas to be applied in calculating the value of a fringe benefit and the reductions available in determining the taxable value of a fringe benefit. It is upon the taxable value on which the rate of tax is levied.

The taxable value of a fringe benefit is required to be calculated and payable as described in NZT 18.10 and 18.12.

## 8. Rates, Filing and Payment of Fringe Benefit Tax

Since its introduction several different rates had been applied in calculating FBT liability. For a number of years the rate remained at 49%. However, in 2000 the government increased the rate to 64% (refer to pp 17-19, Supplementary Reading) and also introduced a multi-rate option to address equity issues. Present practice is for employer to calculate FBT liability, for the first three-quarters, using either the 49% or 64% irrespective of whether the fringe benefits are attributed or not, and applying the multi-rate in the fourth quarter. Refer to NZT 18.1.1 and 18.11. These rates are not examinable but a *general awareness* of the concept is necessary.

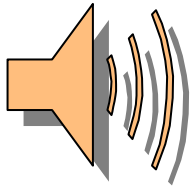
There are three alternate ways of filing and paying FBT. A FBT election form is available for employers to apply to the IRD as to the method they wish to adopt. Refer to NZT 18.13.

## 9. Fringe Benefits and Goods and Services Tax

Refer to NZT 18.1.1, p835.

Where a fringe benefit is provided to an employee Section 10(7) of the *Goods and Services Tax Act 1985* deems a supply to have taken place for GST purposes. GST has to be accounted for only on supply of goods or services which are *taxable*. Therefore, when considering the implication of GST on fringe benefit, it is necessary to identify whether the benefit falls within the GST ambit of a taxable (including *zero-rated*) supply

# Work Preparation



**Read and study the material required for this week.**

**Review the following questions.**

1.
  - (a) What is fringe benefit tax?
  - (b) What types of benefits are liable to the tax?
  - (c) What essential characteristics must be in evidence before a liability for fringe benefit tax exists?
  - (d) Why is the tax levied on employers and not the employees?
  - (e) Are any cash allowances subject to fringe benefit tax? Why?
  
2. Are the following statements true or false? Explain your answers:
  - (a) If an employer provides a benefit to anyone other than an employee, the benefit cannot be a “fringe benefit”.
  - (b) If anyone other than an employer provides a benefit to an employee, a fringe benefit does not arise.
  - (c) If an employer is taxable as a result of the provision to an employee of a particular fringe benefit, it is nevertheless possible for the employee to be assessable in respect of the benefit.
  - (d) A taxicab will always be exempt from FBT under the “Motor Vehicle” category of Fringe Benefits
  
3. Refer to **NZT 2009** Chapter 18, Review Question 4.
  
4. A & B are two self-employed mechanics operating in premises next to each other. After two years of competing for customers they decided

to form a company, AB Ltd., which then employs them as manager and employee respectively.

As part of the employee package AB Ltd. provides A the manager with a car. It is used for private and business purposes. From the car's log book it is ascertained that the car is used 80% of the time for private purposes.

B on the other hand, is provided with a van which is mainly used for business.

- (i) Is the company liable for FBT on the car and van used by A and B respectively?
- (ii) Explain why the company is/is not liable for FBT.
- (iii) Would they be liable for FBT if A and B, as self-employed persons, were provided the respective vehicles by their businesses? Why?
- (iv) If A and B are in a partnership and A is a "working partner" is the partnership liable for FBT on the car used by A? Why?
- (v) Is GST liable on any of the above scenarios? Why?

Carr, S.A & Chan, C. (2004). *New Zealand's Fringe Benefit Tax 20 years on: An Empirical Investigation into Employers' Perception*. *New Zealand Journal of Taxation Law and Policy*, Vol. 10, No. 3, pp. 245-270.

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## **New Zealand's Fringe Benefit Tax 20 Years On: An Empirical Investigation into Employers' Perceptions**

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*When the New Zealand (NZ) Government introduced a fringe benefit tax (FBT) in April 1985, unlike other OECD countries, it levied the tax on employers. The tax has subsequently been widely criticised for its complexity and for the associated compliance costs employers face. This article examines NZ's FBT from the perspective of good tax policy principles and provides the results of an investigation into the fringe benefit provision practices of NZ employers, and the employers' perceptions of the fringe benefit tax regime. The findings suggest fringe benefit tax policies do not have a great influence on employers' remuneration practices. Further, there is no apparent way of resolving the simplicity and efficiency issues of FBT that would be acceptable to both parties; compromises are all that can be expected. The article should interest those concerned with researching and developing tax policy.*

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### **1.0 INTRODUCTION**

Prior to the introduction of New Zealand's (NZ) fringe benefit tax (FBT), there was widespread use of untaxed fringe benefits in employee remuneration packages.<sup>3</sup> In addition to cash, employers were reportedly providing some employees with two motor vehicles for private use, subsidising their home financing, as well as paying for private expenses such as their family's school fees, clothing, child care and annual holidays. The system, by default, was compromising the basic tax principles of vertical and horizontal equity, and economic neutrality. However, when NZ introduced a FBT in April 1985 it did not follow other OECD countries. It levied the tax on employers; an approach also adopted by Australia when a separate FBT system was introduced in that country 15 months later.

Ostensibly a FBT levied on employers encourages them to remunerate employees in cash rather than in kind and thereby reduces the adverse effect of fringe benefits on economic neutrality. The simplicity of assessing one employer rather than many employees also has certain administrative advantages for a tax collection agency. However, without evidence of a move to more cash based remuneration packages, NZ's

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<sup>2</sup> The authors acknowledge with thanks the helpful comments provided on an earlier draft of this article by delegates at the Sixth International Conference on Tax Administration, Sydney (April 2004), and from colleagues in NZ. Grateful thanks are also extended to the School of Accountancy at Massey University for the financial support of this project, and Mary Rossiter and Sim Loo for their valuable research assistance.

<sup>3</sup> Task Force on Tax Reform, *Report of the Task Force on Tax Reform*, (Wellington, April 1982).

FBT has been widely criticised for its complexity and substantial compliance costs for employers.

This article examines NZ's FBT from the perspective of good tax policy principles and provides the results of an investigation into employers' perceptions of the fringe benefit tax regime. The findings suggest the arguments for imposing FBT on employers were based on tenuous assumptions, because despite it being a complex and high compliance cost tax, most employers have not moved to cash based remuneration packages and are not likely to do so. Further, attempts to address inequities in the FBT system have led to an alignment of this employer tax with employees' personal income tax, thereby effectively aligning it with an employee based FBT system. The article should be of interest to all those concerned with researching and developing tax policy.

## 2.0 BACKGROUND

During the late 1970s and early 1980s there was an increasing use of fringe benefits in NZ employees' remuneration packages.<sup>4</sup> The very high marginal tax rates (in 1981 the statutory rate of tax was 60 percent for incomes over \$22,000,<sup>5</sup> which is equivalent to approximately \$51,000 in today's dollar values) and the imposition of a wage / price freeze (between 1982 and 1984) certainly exacerbated the situation.

Prima facie, s 65(2)(b)<sup>6</sup> Income Tax Act 1976 (NZ) provides a general provision to include employee benefits as a form of taxable income in the hands of the taxpayer. However, its effect with regard to fringe benefits was rendered nugatory by the court's narrow interpretation of the term "allowances".<sup>7</sup> Attempts to include fringe benefits as part of employees' assessable income were similarly ineffective in Australia. As Collins observed, "... the taxation of fringe benefits in the hand of the recipient has not been, and is not likely to be successful".<sup>8</sup>

The need for a FBT in NZ was acknowledged by the Taxation Review Committee<sup>9</sup> (the Ross Report) and by the Task Force on Tax Reform<sup>10</sup> (the McCaw Report). In the McCaw Report, it was argued that non-taxed benefits were a significant factor in tax

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4 See n 1, see also Sheffield Consulting Group, *Fringe Benefit Survey 1978*, (Wellington, 1978); T Van Zijl, "Is There Anything Good to Say About the Perks Tax?", (1985) Vol 64:<sup>[1]</sup> *Chartered Accountants Journal* 30; New Zealand Society of Accountants, "Fringe benefits - The Society's submissions", (1985) Vol 64:<sup>[2]</sup> *Chartered Accountants Journal* 31; MP Rigby, "The Taxation of Fringe Benefits", (1985) Vol 15:5 *Victoria University of Wellington Law Review* 301; C Sandford, "New Zealand Under Labour", (1987) Vol 100:1127 *Accountancy* 98; R Braddell, "Cashing up the Perks", (1987) Vol 66:<sup>[4]</sup> *Chartered Accountants Journal* 20; RJ Stephens, "New Zealand Tax Reform", in JG Head (Ed), *Australian Tax Reform in Retrospect and Prospect*, (Sydney, Australian Tax Research Foundation 1989), pp 65-98.

5 McLeod Committee, *Tax Review 2001: Final Report*, (Wellington, October 2001), p 9.

6 This refers to the general provision to include within assessable income all "allowances (whether in cash or otherwise)".

7 MP Rigby, "The Taxation of Fringe Benefits", (1985) Vol 15:5 *Victoria University of Wellington Law Review* 301.

8 DJ Collins, "Taxation of fringe benefits", in JG Head (Ed), *Australian Tax Reform in Retrospect and Prospect*, (Sydney, Australian Tax Research Foundation, 1989), p 119.

9 Taxation Review Committee, *Taxation in New Zealand*, (Wellington, October 1967).

10 Task Force on Tax Reform, *Report of the Task Force on Tax Reform*, (Wellington, April 1982).

inequities reaching serious proportions, and were encouraging the development of a tax avoidance climate in NZ. The NZ body of professional accountants supported this view.<sup>11</sup> The failure to tax fringe benefits was perceived to be undermining taxpayers' confidence in the government's ability to fairly distribute the tax burden; reducing the social stigma associated with tax avoidance; and, promoting the growth and adoption of avoidance practices.<sup>12</sup> In addition, untaxed fringe benefits were narrowing the tax base and encouraging employees to accept services or resources they did not really require or would not normally avail themselves of in a neutral system.<sup>13</sup>

In 1984 the NZ Government announced it was introducing a FBT, and the tax came into effect from 1 April 1985. A similar tax was introduced in Australia 15 months later.

### 3.0 LEGISLATING FOR FRINGE BENEFITS

Equity is one of Adam Smith's tax policy maxims<sup>14</sup> and has been cited as one of the ten guiding principles of good tax policy.<sup>15</sup> Clearly, the two generally accepted notions of equity, namely horizontal equity (that taxpayers with the same abilities should pay exactly the same tax) and vertical equity (that taxpayers with a greater ability to pay should pay more tax),<sup>16</sup> are compromised when fringe benefits are not taxable. Employees receiving the same monetary remuneration have the same tax liability, but some could be receiving non-taxed fringe benefits as well. In addition, employees at different (higher) levels of remuneration are able to erode the progressivity of the tax scales by receiving a large portion of their remuneration in the form of non-cash benefits that escape the tax net.

A further principle of good tax policy is neutrality.<sup>17</sup> Whilst acknowledging taxes reduce the overall income of the taxpayer, the effect of a tax on a taxpayer's business and personal decisions should be minimised.<sup>18</sup> Thus it has been argued<sup>19</sup> that if a tax system encourages the use of non-taxed fringe benefits then that tax system (by default)

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11 New Zealand Society of Accountants, "Fringe Benefits - The Society's Submissions", (1985) Vol 64:<sup>[2]</sup> *Chartered Accountants Journal* 31.

12 See for example, J Elmgreen, *Reform of Fringe Benefits Taxation*, (Sydney, Australian Tax Research Foundation, 1986); C Emerson, "The Hidden Economy", in DJ Collins (Ed), *Tax Avoidance and the Economy*, (Sydney, Australian Tax Research Foundation, 1984), pp 5-22; Task Force on Tax Reform, *Report of the Task Force on Tax Reform*, (Wellington, April 1982); R Albon, "Australia's Personal Direct Tax Base: Hybrid Aspects", in JG Head (Ed), *Changing the Tax Mix*, (Sydney, Australian Tax Research Foundation, 1986), pp 315-324; JW Nevile, "Macro-economic Effects of Tax Avoidance", in DJ Collins (Ed), *Tax Avoidance and the Economy*, (Sydney, Australian Tax Research Foundation, 1984), pp 39-45.

13 See J Elmgreen, n 11; and DJ Collins, n 11, p 119.

14 A Smith, "An Inquiry into the Nature and Causes of the Wealth of Nations" (1776) in E Cannan (Ed), *University Paperbacks*, (London, Methuen, 1961), Book 5, Ch 2, pp 341-399.

15 American Institute of Certified Public Accountants (AICPA) Tax Division, *Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals*, (New York, AICPA Inc, 2001).

16 See n 14.

17 See n 14.

18 LN Ross, *Taxation – Principles, Purpose and Incidence*, (Wellington, New Zealand Society of Accountants, 1973).

19 See J Elmgreen, n 11.

is not economically neutral because it allows the economic choice regarding disposable income to be taken away from the taxpayer.

Carmody<sup>20</sup> describes fringe benefits as having three key features:

“They are received *as a result of employment*: they represent part of an employee’s remuneration paid in exchange for supplying the employee’s labour to the employer;

They are a *substitute* for, or additional to, salary or wages paid to an employee;

They deliver a *private benefit* to the employee, rather than being a work-related expense.” (Emphasis added.)

The Ross Report and the McCaw Report both recommended that such benefits be taxed in the hands of the employees. However, the legislation that was introduced in 1985 imposed the tax on the employers; an approach Australia also adopted with their FBT. This method, described by Sandford and Hasseldine<sup>21</sup> as ‘unusual’, is in contrast to all other OECD countries. The other countries typically tax employees at their marginal tax rate for the value of the fringe benefits received, thereby aligning the benefits with the cash remunerations of the employee for tax purposes.

FBT in NZ was levied on employers rather than employees for two reasons.<sup>22</sup> First, it was to encourage employers to move away from the use of fringe benefits in remuneration packages. Presumably, this was to enhance the neutrality of the system with employees having the freedom to choose how to dispose of their income. Given that cash remunerations were a desired outcome of levying FBT on employers, it is not surprising that the flat FBT rate was set at a level that would negate any tax advantage in providing employees with fringe benefits instead of cash.

Certainly, Inland Revenue highlighted this point by providing examples in their Fringe Benefit Tax Guides. For example, a scenario was described<sup>23</sup> where an employer has to increase an employee’s gross salary by \$2,985 in order to increase their net salary by \$2,000 and cover the \$985 income tax due on the \$2985 (the highest personal marginal tax rate was 33 percent). It was then pointed out that if the employer provided a fringe benefit with a taxable value of \$2,000 instead, approximately the same amount of tax is payable because  $\$2,000 \times 0.49 = \$980$  (FBT was a flat rate of 49 percent). Examples like these were supposed to persuade employers to adopt cash payments because they would then avoid the compliance costs associated with fringe benefits. However, this argument is based on an assumption that tax is the prime, if not only, consideration in such a decision, and that employers are otherwise indifferent as to whether they supply fringe benefits or cash.

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20 G Carmody, *Research Study No 29 - Fringe Benefits Tax: Time for a Rethink*, (Sydney, Australian Tax Research Foundation, 1998), p 7.

21 C Sandford and J Hasseldine, *The Compliance Costs of Business Taxes in New Zealand*, (Wellington, Institute of Policy Studies, Victoria University, 1992).

22 See *New Zealand Master Tax Guide*, (Auckland, CCH New Zealand, 2004) and *Tax Practitioner*, (Wellington, Butterworths, 1995).

23 Inland Revenue, *Fringe Benefit Tax Guide*, ([June] 1992), p [7].



Secondly, the tax was imposed on employers to simplify the administration of the tax for Inland Revenue. Assessing one employer was considered a more attractive option than assessing a number of employees. The taxation authorities in both NZ and Australia believed that imposing FBT on employers would reduce the administrative costs, make the tax easier to collect, and thereby reduce the opportunities for avoidance. The Australian Government<sup>24</sup> argued that placing the incidence of FBT on employers rather than employees would give the advantage of relative simplicity both from the viewpoint of official administration and taxpayer compliance.

## 4.0 THE RULES

The rules relating to FBT are included in Part CI of the Income Tax Act 1994 (ITA 94). Although the initial focus of FBT was on cars, loans, and goods and services provided to employees free, or at subsidised or discounted rates, s CI 1(h) ITA 94 has provided the means to extend over time the FBT net. This provision states:<sup>25</sup>

“any benefit of any other kind whatever, received or enjoyed by the employee.... whether directly, or indirectly, in relation to, in the course of, or by virtue of the employment of the employee and which is provided or granted by the employer of the employee....”.

The legislation also specifically excludes some benefits and provides minimum value thresholds for FBT impost for others, in recognition that the cost of collecting FBT on some of the more minor and less common fringe benefits is higher than the potential revenue from taxing them.

Initially, the tax on fringe benefits in NZ was 45 percent and not deductible to the employer in calculating income for tax purposes. The rate increased to 48 percent one year later and, for a short period after that, specific fringe benefits were taxed at varying rates.

From 1989, the rate went to 49 percent and FBT became deductible. The tax deductible rate of 49 percent was equivalent to the (then) top personal marginal tax rate in NZ of 33 percent and applying a flat tax set on this basis resulted in an over-taxation of some employers. Furthermore, had the proportional tax been imposed directly on employees, vertical equity would have been breached for those at lower income levels. The generally held notion that fringe benefits were the prerogative of the highly paid probably allayed any initial concerns in this area. Indeed, it may have been a deliberate attempt by the Government to stem the offering of fringe benefits to employees at different levels of income. Nonetheless, inequities in the system existed and became more pervasive as fringe benefits were extended to employees on lower marginal tax rates.

In 2000, the FBT flat rate increased to 64 percent. The increase was in response to the top personal tax rate being raised to 39 percent. However, at the same time the

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<sup>24</sup> Australian Government, *Reform of the Australian Tax System: Draft White Paper*, (Canberra, 1985).

<sup>25</sup> Under the new Income Tax Act 2004, these benefits are referred to in s CX 31 as “unclassified benefits”.

Government introduced a multi-rate FBT based on the marginal tax rate of the employee (see Table 1). This amendment gave employers the option of paying FBT at the rate of 64 percent on **all** fringe benefits or applying the multi-rates to attributed benefits.

**Table 1: Multi-Rates and Associated Personal Marginal Tax Rates<sup>26</sup>**

Equivalent Gross Remuneration (\$)	Fringe Benefit - Inclusive Net Cash Remuneration (\$)	Personal Marginal Tax Rates (%)	FBT Multi-Rate (%)
0 - 9,500	0 - 8,075	15	17.65
9,501 - 38,000	8,076 - 30,590	21	26.58
38,001 - 60,000	30,591 - 45,330	33	49.25
60,001 and above	More than 45,330	39	63.93
	Unattributed fringe benefits which do not benefit a major shareholder		49.00
	Unattributed fringe benefits - any of which benefits a major shareholder		64.00

Concerns that cash remunerations may be set just below a marginal tax rate threshold and then ‘topped up’ with fringe benefits, prompted the use of the “net remuneration” method which imposes FBT on the basis of the total remuneration package - salary and wages plus attributed fringe benefits. Hence, although the tax is still levied on employers, multi-rates have brought the tax more in line with a Pay As You Earn (PAYE) type system. The rules for applying the multi-rates are not straight forward though. They vary according to what the benefit is, ie whether the benefits can be attributed to an employee or whether they have to be pooled; whether the employer is filing quarterly returns or paying on an annual or income year basis; and whether the recipient of the fringe benefit(s) is a major shareholder employee. Furthermore, irrespective of whether an employer pays FBT at the rate of 64 percent for the full year or 49 percent for the first three quarters, multi-rate calculations are undertaken in the fourth quarter<sup>27</sup> return and need end-of-year reconciliation with the FBT that has already been paid.

Undoubtedly, from the employers’ perspective, using multi-rates would address any equity concerns they may have regarding lower income employees and their FBT liability should reduce as a result. However, any gains in this area are at the expense of simplicity, and some employers argue that a single rate is preferable for compliance cost reasons. Indeed, the Government acknowledges that the multi-rate calculations increase the complexity of the tax, increase the likelihood of errors and leave the employers exposed to a higher risk of penalties and use-of-money interest as a result. Furthermore,

<sup>26</sup> Institute of Chartered Accountants of New Zealand, *The Low-down on FBT*, Professional Development Course Paper No S640, p 41.

<sup>27</sup> FBT returns are typically filed quarterly. Only employers with PAYE and specified superannuation contribution withholding tax deductions less than \$100,000 per annum have the option of filing annually or on an income year basis.

it is suggested that “[t]he high compliance costs associated with the calculations may also result in increased non-compliance”.<sup>28</sup>

The multi-rates, as applied by employers, also do not address vertical equity issues at the employee level. It is just the cash portion of an employee’s remuneration package that determines their personal marginal tax rate for income tax purposes. Thus, in extreme cases, an employee’s cash income may be sufficiently low enough to make them eligible for social welfare benefits and subsidised education for their families, whilst receiving a significant portion of their remuneration in the form of fringe benefits.

#### 4.1 Impact of the Rules

Van Zijl<sup>29</sup> predicted FBT would result in substantial collection costs for Inland Revenue as well as substantial compliance costs for employers. A study conducted by Sandford and Hasseldine<sup>30</sup> found that employers’ compliance with FBT requirements was both time consuming and difficult. The employers in the study estimated that external fees for FBT as a proportion of total compliance costs were more than twice those for PAYE (the system that would apply if FBT had been imposed on the employee).<sup>31</sup>

**Table 2: Fringe Benefit Tax and Total Income Tax Receipts<sup>32</sup>**

Fiscal Year	Fringe Benefit Tax (\$m)	Total Income Tax (\$m)	FBT as a Percentage of Total Income Tax (%)
March 1986	104	10,568	0.98
March 1987	167	12,432	1.34
March 1988	213	13,800	1.54
March 1989	521	14,978	3.48
June 1990	483	16,814	2.9
June 1991	485	16,370	3.0
June 1992	446	15,421	2.9
June 1993	390	16,100	2.4
June 1994	313	17,952	1.7
June 1995	296	19,692	1.5
June 1996	322	21,378	1.5
June 1997	331	20,505	1.6

28 Inland Revenue, *Streamlining the Taxation of Fringe Benefits* (Wellington, December 2003), A Government Discussion Document, p 54.

29 T Van Zijl, “Is There Anything Good to Say About the Perks Tax?” (1985) Vol 64:<sup>[1]</sup> *Chartered Accountants Journal* 30.

30 C Sandford and J Hasseldine, *The Compliance Costs of Business Taxes in New Zealand*, (Wellington, Institute of Policy Studies, Victoria University of Wellington, 1992).

31 Since the introduction of FBT in NZ, three main categories of taxes apply to employment related benefits: PAYE on monetary remunerations; entertainment tax (50 percent deduction) on certain specified entertainment expenses; and FBT.

32 Figures obtained from Inland Revenue’s *Annual Report* for the years 1986 to 2003.

June 1998	341	21,369	1.6
June 1999	329	20,509	1.6
June 2000	306	21,410	1.4
June 2001	338	23,603	1.4
June 2002	356	24,734	1.4
June 2003	374	26,812	1.4

**Figure 1: Fringe Benefit Tax Receipts 1986 - 2003**

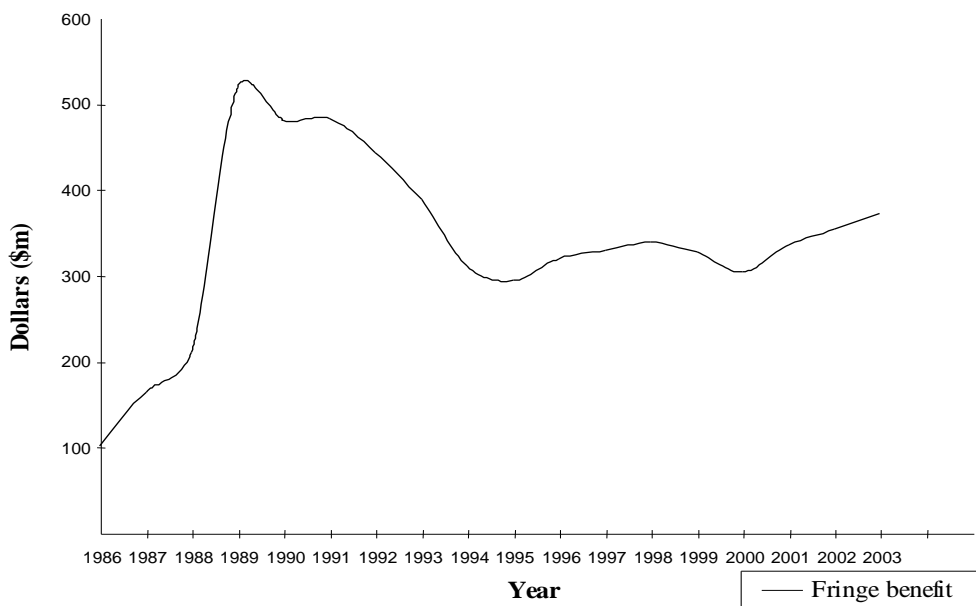


Table 2 shows the annual FBT collected over the years 1986-2003. During the period 1986-1989, the range of taxable benefits increased (see Figure 1), the rate of tax moved from 45 percent to 49 percent, and there was a general upward trend in the amount collected from FBT. Although this was followed by a decline in the amount of FBT collected, it is not possible to attribute this downturn to employers shifting to cash only remunerations, notwithstanding indications in the Sandford and Hasseldine<sup>34</sup> study that some employers avoided providing fringe benefits so they would not be liable for the tax. A number of other factors contributed to the decline. First, the employer contributions to specified superannuation schemes, which had previously been taxed, were removed from the FBT net, and FBT values which had previously been considered GST exclusive were treated as GST inclusive. In addition, some employers were finding ways of avoiding the tax on the fringe benefits they continued to provide.

Nearly twenty years after the introduction of FBT in NZ, Inland Revenue has stated: “A recent review of FBT returns has shown a number of employers are either paying too

33 Based on figures obtained from Inland Revenue’s *Annual Report* for the years 1986 to 2003.

34 C Sandford and J Hasseldine, *The Compliance Costs of Business Taxes in New Zealand*, (Wellington, Institute of Policy Studies, Victoria University of Wellington, 1992).

much or not enough FBT”.<sup>35</sup> Their explanation of how the wrong values are still being used to calculate GST payable on FBT implicitly acknowledges that FBT is not a simple tax. Furthermore, an Inland Revenue investigation into NZ tax compliance costs in general found that tax agents rated FBT as their most significant technical tax issue.<sup>36</sup> In this same study, FBT was rated as the second most important item for reducing the tax-related compliance costs of large employers. The Government also acknowledged these concerns in its objectives for reviewing the taxation of fringe benefits:<sup>37</sup>

“The purpose of the post-implementation review is, therefore, to assess the operation of FBT and address taxpayers’ concerns about the way the tensions between simplicity, comprehensiveness, and cost and equity are balanced.”

Interestingly, Australia’s FBT experiences have been similar to NZ’s and the tax has been subjected to the same general criticisms. The Ralph Report,<sup>38</sup> which had the support of the tax professionals, argued that fringe benefits should be taxed in the hands of employees with the income received as fringe benefits taxed at the same personal marginal tax rate as any other form of employee remuneration. Employers’ responsibility would be to collect the tax through the PAYE system. This stance was justified on the grounds that the main aims of tax reform are to improve equity and simplicity and with FBT this would be achieved by levying the tax on the employee. In 1998 the Technical Director of the Taxation Institute of Australia stated:<sup>39</sup>

“Fringe benefits tax is without doubt the most unpopular tax introduced in the last 20 years. It also has unreasonably high costs of compliance, representing 10.5 percent of revenue collected from the tax”.

One year later, the President of the Taxation Institute of Australia<sup>40</sup> described the FBT system as a complicated and costly piece of legislation that had equity issues needing addressing and compliance costs needing reducing.

## 5.0 GOVERNMENT DISCUSSION DOCUMENT

In 2002, the Associate Minister of Revenue announced<sup>41</sup> the NZ Government was seeking employers’ views as the first step in a major review of fringe benefit tax, the first since it was introduced. It was stated that the Government had no intention of

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35 Inland Revenue, *FBTnews*, Issue 05 (December 2003).

36 Inland Revenue, *Streamlining the Taxation of Fringe Benefits* (Wellington, December 2003), A Government Discussion Document, p 4.

37 See n 35.

38 Review of Business Taxation, *A Tax System Redesigned: More Certain, Equitable and Durable*, (Canberra, July 1999).

39 Taxation Institute of Australia, *Abolish ‘Hated’ Fringe Benefits Tax and Restore Small Business Confidence* (1998), p 1, available at <<http://www.taxinstitute.com.au/CDA/Stories/Individual/1,1030,5553,00.html>> (as at 14 May 2004).

40 Taxation Institute of Australia, *Government Missed Opportunity with Fringe Benefits Tax* (1999), available at <<http://www.taxinstitute.com.au/CDA/Stories/Individual/1,1030,5303,00.html>> (as at 22 February 2004).

41 Hon P Swain, “Government seeks employers’ views on Fringe Benefit Tax”, *Ministerial Media Statement* (30 October 2002), available at <<http://www.taxpolicy.ird.govt.nz>> (as at 1 September 2004).

getting rid of the tax, “[h]owever there is scope for improving its effectiveness, simplifying it and reducing the associated compliance costs”.<sup>42</sup> The review, though focusing on reducing the difficulty and cost to employers, would also be “... ensuring the revenue base is maintained”.<sup>43</sup>

A Government Discussion Document has subsequently been published,<sup>44</sup> and commentators<sup>45</sup> have suggested any potential for employer savings may be countered by the proposal to bring into the FBT net more, previously exempt, benefits. Certainly, it has been the situation in NZ that some benefits are not included under s CI 1(h) ITA 9446 because of the difficulty and associated costs of monitoring and valuing them. Examples of items the Government proposes to keep as FBT exempt are the private use of mobile phones and laptops, if they are provided to the employee primarily for business use. The Document’s silence regarding printers and modems is perhaps alarming in view of an Australian case where a salesman using a laptop, printer and modem for his work on the road, found his printer and modem were subject to FBT even though the laptop was exempt.<sup>47</sup>

Possibly the more significant changes proposed relate to the taxing of motor vehicles as an employee fringe benefit. Motor vehicles are currently valued for FBT purposes on their original cost price at a rate of 24 percent a year. However, the Government is proposing to give employers the option of either calculating the benefit on the vehicle’s tax book value (with a minimum fringe benefit value of \$3,000), or, as at present, on its original cost price.<sup>48</sup> It also proposes that the rates of 20 percent per annum of cost, or 36 percent per annum of book value, should be adopted for calculating the taxable value of the benefit under the respective options. These proposals would make the taxable value of the fringe benefit higher under the depreciated value option for the first two years. However, over five years the total taxable value would be basically the same.

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42 See n 40.

43 See n 40.

44 Inland Revenue, *Streamlining the Taxation of Fringe Benefits* (Wellington, December 2003), A Government Discussion Document, p 4.

45 See for example, PricewaterhouseCoopers, “Fringe benefit tax changes proposed”, *Tax Tips Special*, Issue 22/2003 (12 December 2003); ICANZ, *Fringe Benefit Tax - Implications of the Government Review on Small and Medium-sized Businesses*, (2003), available at <[http://www.icanz.co.nz/StaticContent/AGS/Tax\\_Article.cfm?NewsID=818.html](http://www.icanz.co.nz/StaticContent/AGS/Tax_Article.cfm?NewsID=818.html)> (as at 22 February 2004); Deloitte, *Last-minute fringe benefits tax change to confuse business, says Deloitte*, (2003), available at <[http://www.deloitte.com/dtt/press\\_release/0,2309,sid%253D5527%2526cid%253D14272,00.html](http://www.deloitte.com/dtt/press_release/0,2309,sid%253D5527%2526cid%253D14272,00.html)> (as at 22 February 2004).

46 Under s 336N(1) Income Tax Act 1976, the four major categories of taxable fringe benefits are: motor vehicles; low interest loans; free, subsidized or discounted goods and services; employer contributions to sick, accident or death benefit funds, superannuation schemes and specified insurance policies.

47 Taxation Institute of Australia, *Abolish ‘Hated’ Fringe Benefits Tax and Restore Small Business Confidence*, (1998), p 1, available at <<http://www.taxinstitute.com.au/CDA/Stories/Individual/1,1030,5553,00.html>> (as at 22 February 2004).

48 Inland Revenue, *Streamlining the Taxation of Fringe Benefits* (Wellington, December 2003), A Government Discussion Document, p 23.

In 2001, it was ruled that yearly leasing arrangements for vehicles were acceptable for tax purposes.<sup>49</sup> However, this ruling has allowed taxpayers to mitigate their FBT costs by using various annual vehicle leasing arrangements (often with closely associated parties). These arrangements have allowed them to calculate FBT on vehicle costs that are adjusted to market values annually. The Government is now proposing to treat leased vehicles the same as owned vehicles with the same cost or book value options. Further, where a lessee does not know the cost price or book value of the leased motor vehicle, there will be an option to calculate the value of the benefit on the basis of 27 percent of market value.<sup>50</sup>

According to the Discussion Document, the Government intends to continue levying the tax on the employer. However, the document does not really address the issues of simplicity and equity from the employers' perspective. The only explicit concession in this area is:<sup>51</sup>

“The government is already working on improvements to the way FBT is returned, including, as discussed in the later chapter on the multi-rate calculation, better access for employers to Inland Revenue's online calculation tools.”

There are also indications that the FBT net is likely to be extended. In particular, there is a proposal to treat all car parks the same whereas currently they are treated differently depending on whether they are on or off the employer's premises. Introducing on-premise car parks into the FBT net will raise further valuation and threshold issues that will have to be built into the rules.

It is perhaps significant that Inland Revenue's earlier objective to discourage the use of fringe benefits in remuneration packages was reinforced in the Discussion Document:<sup>52</sup>

“The efficiency gains from FBT result from a reduction in the tax incentive to provide fringe benefit remuneration and the associated reduction in attractiveness of activities that lend themselves to high fringe benefit remuneration”.

The purpose of this research is twofold. First, it seeks to better clarify the fringe benefit provision practices of NZ employers, as well as the impact FBT has had on these practices. Second, it seeks to assess employers' perceptions of NZ's FBT regime as it currently operates. Using the data obtained from a survey, the article intends to build a fairly comprehensive picture of the provision and taxing of fringe benefits from the perspective of NZ employers. In doing so, it may be possible to assess whether fringe benefit tax policies influence employers' remuneration practice and how employers' concerns might be addressed. The next section of the article explains the research method and discusses the findings.

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49 See, for example, Product Rulings provided to Esanda (Product Ruling BR Prd 01/15 in TIB Vol 13:7 (July 2001)), Custom Fleet Ltd (Product Rulings BR Prd 01/28 and BR Prd 01/29 in TIB Vol 13:11 (November 2001)), and Hertz Fleet Lease (Product Rulings BR Prd 01/35, BR Prd 01/36 and BR Prd 01/37 in TIB Vol 14:3 (March 2002)).

50 See n 47.

51 See n 47, p 19.

52 See n 47, p 11.

## 6.0 RESEARCH METHOD

### 6.1 Participants

The organisations surveyed were selected on the basis that they had an annual turnover of \$10 million or greater. The 760 organisations meeting this criterion were drawn from a commercially held NZ database and the names and addresses were provided as an Excel spreadsheet.

Sixteen of the 760 instruments that were mailed to the Financial Controllers of the organisations, were returned undeliverable. Of the 744 instruments delivered, 280 usable responses were received representing a response rate of 38 percent. Nonresponse bias can result from a low response rate and / or the missing responses affecting the conclusions about the variables being examined in the study. The anonymity of the survey responses combined with the limited data received initially about the sample population (from the commercially held database), made testing for nonresponse error difficult. However, it has been reported that mail surveys are not the most effective response generators<sup>53</sup> and further, “[a]s a rule of thumb, a response rate of about 30 percent is generally regarded as satisfactory”.<sup>54</sup> Thus taking these points into consideration as well as the nature of the subject matter of this study, 38 percent is a reasonable response rate. Several companies that did not return a completed questionnaire wrote and explained that it was either a company policy not to respond to surveys, or time constraints prevented them from responding on this occasion; suggesting it was not a matter of them being indifferent to the focus of the study or the survey questions.

### 6.2 Instrument

A survey instrument was developed to examine NZ employers’ perceptions of FBT. In particular, information regarding the fringe benefit provision practices of NZ employers, the impact FBT has had on these practices, employers’ perceptions of the FBT regime as it currently operates, and the profile of the responding organisation, was solicited. A copy of the questionnaire appears in the Appendix to this article.

In Section A, participants were asked to indicate whether any of their employees received fringe benefits and, if fringe benefits were not provided, whether their organisation would provide fringe benefits if the tax liability was removed or was imposed on the employee not the employer. Participants who did not provide fringe benefits then went straight to Section C, the demographic questions.

In Section B, respondents who provided fringe benefits were asked to indicate whether it was top management, middle management and / or ‘other’ employees who received benefit(s), and which benefits they received. This group of respondents was also asked to indicate the level of influence various factors had on whether their organisation

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53 J Yu and HA Cooper, “Quantitative Review of Research Design Effects on Response Rates to Questionnaires”, (1983) Vol XX:[February] *Journal of Marketing Research* 36.

54 B Tran-Nam, C Evans, M Walpole and K Ritchie, “Tax Compliance Costs: Research Methodology and Empirical Evidence from Australia”, (2000) Vol 53:2 *National Tax Journal* 229, p 244.



offered private use of motor vehicle(s), zero or low interest loans, discounted goods / services, contribution to super funds / health insurance, and / or other fringe benefit(s). The respondents were required to indicate the level of influence of each factor by placing “1” for the greatest influence, “2” for the next greatest, and so on, with the opportunity to assign the same weighting of influence to more than one factor.

The respondents, already identified as providers of fringe benefits, were then asked to estimate what proportion of their total tax compliance costs could be attributed to FBT compliance. They were also asked whether the introduction of FBT had caused their organisation to change remuneration packages, or make changes in any other area(s). The respondents also had to indicate whether they applied the flat rate of 64 percent on **all** fringe benefits, or whether they used the multiple tax rates introduced in 2001 for attributed benefits. This was followed by questions on whether the tax rates chosen had impacted on their FBT compliance costs and their FBT liability. Section B concluded with three general questions on what they would like to happen to FBT; whether they considered the current FBT scheme was equitable for (i) employees and (ii) employers; and an open ended question asking for any further comments.

Section C questions, answered by all participants in the survey, identified the industry grouping of the responding organisation, the size of the organisation, whether it was an international firm and if so, which country the head office was located in. Finally, respondents had to indicate the nature of the organisation, ie whether it was a company, partnership, public sector, State Owned Enterprise (SOE), or ‘other’.

## 7.0 RESULTS, ANALYSIS AND DISCUSSION, AND LIMITATIONS

### 7.1 Results

Thirty one of the 280 respondents (or 11 percent) did not provide fringe benefits to their employees. However, 16 of the 31 (52 percent) said they would provide benefits if FBT was removed and four of these 16 respondents (25 percent) also acknowledged they would provide fringe benefits if the tax was levied on the employee rather than the employer.

**Table 3: Responses of employers not currently offering fringe benefits**

Question	Yes	No	No Response	Total
Type of firm?				
Local firm	18			
International firm	10		3	31
Would benefits be offered if FBT was removed?	16	11	4	31
Would benefits be offered if FBT was imposed on employees?	4	20	7	31

Of the 280 employers who completed the questionnaire, 89 percent provided fringe benefits to one or more of their employees, with an average of 83 percent of their top

management, 71 percent of their middle management and 61 percent of their ‘other employees’ receiving some form of fringe benefit as part of their remuneration package. Salesmen / sales representatives, support / clerical / general / administrative staff, and long service employees were some of the identified “other” employee groups. Notably, two respondents indicated all staff received some form of fringe benefit.

Table 4 provides insight into the types of fringe benefits that are provided to each of these groups of employees. The private use of motor vehicles and employer contributions to superannuation funds and / or health insurance were the most frequently provided benefits. Further, with the exception of motor vehicles, it appears that if a benefit is provided by an employer it is typically provided to employees in each of the employee groups.

**Table 4: Provision of Fringe Benefits to Three Employee Groups**

Benefits	Top Management		Middle Management		Other employees	
	Frequency*	Percent	Frequency*	Percent	Frequency*	Percent
Private use of motor vehicles	195	(69.6)	162	(57.9)	68	(24.3)
Contributions to super funds / health insurance	160	(57)	146	(52)	128	(46)
Discounted goods / services	33	(12)	34	(12)	30	(11)
Zero or low interest loans	13	(4.6)	7	(2.5)	12	(4.3)
Other	60	(21)	55	(20)	54	(19)

\* Number (percentage) of respondent employers who provide the benefit to the different employee groups.

When employers were asked to assess the level of influence various factors had on decisions to provide particular types of fringe benefits or not, it was found that “Head office / corporate policy on the benefit(s)” was not only chosen by most employers but was also the factor with the greatest overall influence on whether a fringe benefit was provided (see Table 5). The exception was motor vehicles where the most influential factor was ‘Industry expectations’. Because only a small number of employers chose ‘Other factors’, these mean responses have been discounted, although it is noteworthy that the ‘Other factor’ frequently cited as having an influence on the provision of a motor vehicle was that a vehicle was required for the job and this had led on to home use.

**Table 5: Factors Influencing\* An Organisation's Decision to Provide a Fringe Benefit**

Factors	Private use of motor vehicle		Zero or low interest loans		Goods / services		Superannuation funds / health insurance		Other factor(s)	
	Frequency factor selected	Average rating	Frequency factor selected	Average rating	Frequency factor selected	Average rating	Frequency factor selected	Average rating	Frequency factor selected	Average rating
Corporate tax planning	94	4.5	36	4.2	39	4.2	67	4.6	34	4.8
Employee's request for a particular benefit(s)	133	2.9	49	3.3	46	3.6	102	2.7	40	3.7
Flexibility to minimise liability on the benefit(s)	96	3.8	36	3.9	43	3.7	67	4.2	34	4.5
Head office / corporate policy on the benefit(s)	147	2.4	<b>56</b>	<b>2.1</b>	<b>63</b>	<b>1.9</b>	<b>128</b>	<b>2.0</b>	<b>58</b>	<b>2.1</b>
Industry expectations to receive certain benefit(s)	<b>160</b>	<b>2.2</b>	40	3.8	49	3.3	100	2.6	41	3.2
Internal equity issues with cash payments	96	4.1	36	4.2	39	4.3	66	4.7	33	4.8
Means of attracting new staff	156	2.5	43	3.8	52	3.5	128	2.1	47	3.4
Tax bracket of employee receiving benefit(s)	97	4.9	37	4.8	41	4.9	76	4.6	33	5.2
The FBT tax rate(s)	107	3.8	43	3.5	44	4.1	74	4.1	39	3.8
Other factor(s)	<b>20</b>	<b>2.0</b>	4	2.8	4	2.8	<b>11</b>	<b>1.5</b>	7	1.7

\* Influence is measured by the number of respondents who selected the factor as having an influence and the average of the respondents' ratings (with '1' representing the greatest influence and '10' the least influence).

The percentage of the respondent's total tax compliance costs that could be attributed to FBT compliance ranged from 0.5 percent to 100 percent with an average of 14.9 percent. There were 227 responses. Notably, the respondent who indicated 100 percent of their compliance costs could be attributed to FBT qualified their response with the comments that it was "excluding PAYE and GST" and that they "do not pay company tax". Despite acknowledgement in the literature that the multi-rates introduced in April 2001 (refer Table 1) have further complicated FBT calculations, the survey findings indicate that 148 of the participants (59 percent) who provided fringe benefits apply the multi rates. Furthermore, 79 of the 148 respondents indicated that applying these tax rates had increased their FBT compliance costs by an average of 38 percent. The FBT liability had increased for only 18 of the 148 respondents (12 percent) though, with an average increase in liability of 14 percent over these 18 respondents.

**Table 6: Tax Rates Applied**

<b>Tax rate applied for FBT calculation</b>	<b><u>Frequency</u>*</b>	<b><u>Percent</u></b>
Multi-rates for attributed fringe benefits	148	(59)
Flat rate of 64 percent on all fringe benefits	96	(39)
No response*	5	(2)
Total	249	(100)

\* Excludes the 31 respondents who do not provide fringe benefits.

Employers indicated that removing the tax completely and allowing depreciated asset figures to be used were the two options for FBT they preferred most, with averaged weightings of 1.6 and 1.7 respectively. Interestingly, imposing the tax on the employee rather than the employer was not rated very highly, with an averaged weighting of 3.6.

**Table 7: Employers' Preferences for Fringe Benefit Tax Changes**

<b>Would like FBT to:</b>	<b><u>Frequency</u>*</b>	<b><u>Averaged preference rating</u>**</b>
Allow depreciated asset figures to be used	171	1.7
Be removed completely	165	1.6
Impose lower rates of tax	137	2.1
Stay as it is	105	3.6
Be imposed on the employee, not the employer	103	3.6
“Other”	23	1.6

\* The number of respondents (excluding the 31 who do not provide fringe benefits) who selected the change.

\*\* The average of the respondents ratings for the change ( “1” represented respondents’ first preference, “2” second preference and so on).

Nonetheless, 58 percent of the employers considered the current FBT scheme inequitable for employers whilst 62 percent considered it equitable for employees. These findings are endorsed by some of the comments on who should pay the tax and the perceived impact of FBT on employees (see qualitative comments below).

**Table 8: Employers' perceptions of the equity of FBT**

FBT scheme is:	YES		NO	
	<u>Frequency*</u>	<u>Percent</u>	<u>Frequency*</u>	<u>Percent</u>
Equitable for employees?	154	(62)	91	(37)
Equitable for employers?	69	(28)	145	(58)
No response*	26	(10)	13	(5)
Total	249	(100)	249	(100)

\* Excludes the 31 respondents who do not provide fringe benefits.

In terms of the impact the introduction of FBT had on remuneration packages, 44 percent of the respondents said it had no effect while 31 percent said some benefits had been removed but with a compensating increase in the cash component, and 16 percent said some fringe benefits had simply been removed. Notably, none of the employers who were currently providing benefits had removed all their fringe benefits in response to the introduction of FBT. Four percent did not respond but a number of these made the comment that their organisation did not exist prior to the introduction of FBT.

**Table 9: Impact of Introduction of FBT on Remuneration Packages**

Organisational response	<u>Frequency*</u>	<u>Percent</u>
Remuneration packages did not change	110	(44)
Some fringe benefits were removed with compensating increase in cash	76	(31)
Some fringe benefits were removed	39	(16)
All fringe benefits were removed with compensating increases in cash	8	(3)
Fringe benefits increased with compensating decreases in cash	5	(2)
Fringe benefits increased	1	(0.4)
All fringe benefits were removed	0	(0)
No response* (Some didn't exist prior to 1985)	10	(4)
Total *	249	(100)

\* Excludes the 31 respondents who do not provide fringe benefits.

Fifty nine percent of the responding organisations were domestic and 40 percent international, with most of the international organisations having their head office in NZ, USA or Australia.

**Table 10: Number of Domestic and International Organisations**

Type of company	Frequency	Frequency	Percent
Domestic		164	(59)
International		112	(40)
Head Office:			
NZ	31		
USA	24		
Australia	20		
Japan	9		
France	3		
UK	2		
Finland	2		
Germany	2		
Singapore	2		
Sweden	2		
Holland	2		
Other European countries	3		
Not disclosed	10		
No response		4	(1)
Total		280	(100)

The participating employers' general views on FBT were also sought. Because of the recurring nature of many of the opinions expressed, they are discussed under the headings: motor vehicles; taxable values; medical insurance and superannuation subsidies; complexity of the tax and associated compliance costs; management issues; and more general comments.

### 7.1.1 Motor vehicles

The motor vehicle comments mainly took the form of criticisms of the allocation of private and work-related use of vehicles. In particular it was considered unfair that FBT on motor vehicles is triggered when such vehicles are available for private use as opposed to actual private use, and prompted comments such as: “[It is] wrong that a motor vehicle used mainly for business is deemed available for private use”. One participant proposed that the reverse approach should be adopted: “... To my mind it should be the other way, ie if the car is actually used for work activities for that day it should be exempt for FBT.” Many participants made the point that: “... incidental use is usually a requirement of being on standby. Need to recognise that business is a 24-7 operation not 9-5 Monday to Friday.”

### 7.1.2 Taxable values

Motor vehicles were also frequently referred to in comments about the tax values used for FBT calculations. Having to base the value of motor vehicles on cost price over the full life of the vehicle was widely criticised. In addition, the economic neutrality of such

an approach was implicitly questioned in the comment: “Requirement to use cost price is inequitable if you would keep vehicles for 10 years except for FBT penalty”.

The current anomaly in respect of owned versus leased motor vehicles was also raised with comments such as: “Market values on motor vehicles not taken into account when purchased outright as opposed to leasing”; and “Forced to lease vehicles rather than buy them”. Indeed, several commented that current market value, not cost, should be used for all goods and services provided.

Another recurring concern of the respondents was fringe benefits are calculated using GST inclusive values. There was a perception that FBT on GST inclusive figures was “a tax on a tax” and they were effectively being double-taxed.

### **7.1.3 Medical insurance and superannuation subsidies**

Comments in this area tended to focus on the “greater social good” of these particular benefits and the short term focus of the Government to include them in the FBT net. Two fairly representative comments are: “By contributing to health insurance, [one is] saving [the] Government on public health, [and the Government] should recognise this”; and “[It] discourages health and super schemes being funded by employers with long term implications on savings and dependence on social security payments”.

### **7.1.4 Complexity of the tax and associated compliance costs**

Many respondents expressed concern that the administrative costs to the employer were often higher than the value of the benefits for the employee and the revenue for the Government. For example: “Admin costs can be higher than benefit and some benefits are captured by FBT that really aren’t related to remuneration, that is, Christmas and leaving gifts”; and “Quarterly returns for such a small payment are too time consuming”. On the grounds that FBT was: “Complex and time consuming to administer”, one respondent suggested: “Could look at lower rates in conjunction with capped levels per employee to minimise abuse”.

Some comments related specifically to the complexities and associated costs of applying the multi-rates: “The recent change has dramatically increased compliance cost, they are just one more example of how the Government is reducing business efficiency and productivity for what seems purely political reasons. How much extra revenue has been collected?”; and “Time consuming process with vehicles on car less days etc and performing calculation at year end for employees on different marginal rates”.

### **7.1.5 Management issues**

Most of these comments were linked to human resourcing issues. For example: “High FBT rates discourage employers from providing benefits but these benefits often form an important part of employee satisfaction / happiness / sense of value”; and “Due to skill shortage [it is] imperative that benefits [are] provided”. Other examples include: “This tax regime impedes negotiations between employers and employees for packages

that will best fit both parties”. The negative impact on business efficiency was also frequently commented on, with the suggestions that employers were “subsidising the cost of tax gathering for the Government”; and “It would be good if you could elect your FBT year end date rather than having to use 31 March”.

### **7.1.6 More general comments**

Comments relating to s CI 1(h) ITA 94 included: “Bigger allowances for small FBT items like movie tickets, meals etc”; and “Too broad - applies to expenses which aren’t fringe benefits!” A number of respondents suggested it should be the employee who pays the tax with comments such as: “Employers [are] effectively having to pay employee’s tax”; and “Employees generally have no idea of the FBT being paid on their behalf”.

Positive comments on the objectives of the tax were made: “Provides level playing field in terms of remuneration”; “FBT regime needs to stay to prevent abuse”; and “[the] principle [is] good”. However, these were often qualified with comments such as “[the] method of implementation needs rethinking”; “whatever is decided it must be simple”; or “[the] cost should be on [the] employee to be equitable”.

Some comments were of a more political nature. For example: “People on the dole get something for nothing, why shouldn’t people that work hard get a ‘benefit’ for nothing”. Two participants expounded their theory as to why the tax had been introduced: “... it would seem FBT has simply been introduced because the civil servant was jealous at their not receiving perceived benefits”; and “Revenue gathering device developed zealously by envious civil servants”.

## **7.2 Analysis and Discussion**

The literature suggests the introduction of the multi-rate structure to the FBT regime has added further complexities and increased employers’ compliance costs. The application of the multi-rates, cynically described as a “copybook exercise in tax simplification” has been outlined by Kerr as follows:<sup>55</sup>

“The FBT procedures require employers to work out the cash income of the employee, deduct the notional tax liability, add the value of attributed fringe benefits, calculate a notional fringe benefit tax liability on this total, and then subtract the notional cash tax liability to work out the actual fringe benefit tax liability.”

Despite the complexities, this survey found that 59 percent of the participants who provided fringe benefits applied the multi-rates, and for 79 of these 148 respondents using the multi-rates, FBT compliance costs had increased by an average of 38 percent.

Relevant to this discussion is the distinction between ‘legal’ and ‘economic’ simplicity:

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<sup>55</sup> R Kerr, *The Quagmire of Regulation*, (Speech to Otaki Rotary Club, Otaki, 12 October 2000), p 2.



“Legal simplicity refers to the ease with which tax legislation can be comprehended and applied. Economic simplicity refers to the cost of complying with tax legislation. The two concepts may or may not be consistent.”<sup>56</sup>

The suggestion is that a tax law may be legally simple but compliance costly because it affects a large number of taxpayers. Some employers would argue that NZ’s FBT legislation is not simple. Comments offered in this survey suggest there are circumstances when the employer does not know which tax regime to apply. For example, if entertainment (such as the movie tickets commented on by one of the respondents), is at the discretion of the employee then it becomes taxable as a fringe benefit otherwise it is liable for entertainment tax. In addition, the finding from Inland Revenue’s review of FBT returns, that employers were still paying too little or too much tax,<sup>57</sup> is indicative that the legislation is not easy to follow; a view that was clearly supported by the tax agents who rated FBT as their most significant technical tax issue.<sup>58</sup>

It could also be argued that for employers who provide fringe benefits to their employees, the tax is not economically simple because their costs of complying with the legislation are high. However, FBT is voluntary in that employers can simply avoid the tax by not providing fringe benefits. Thus, arguably, FBT has the ultimate economic simplicity of zero compliance costs. The question then arises whether fringe benefits are a business necessity or not, ie do employers really have a choice as to whether they provide fringe benefits? The comments made by the participants in this study would suggest that in today’s competitive environment they do not have much choice. However, when the factors influencing the provision of fringe benefits are analysed (refer Table 5), it is evident “Head office / corporate policy” is the most influential factor on all benefits except motor vehicles, where “Industry expectations” have greater influence. It also appears that being able to offer superannuation / health insurance subsidies is quite important when trying to attract new staff.

These findings suggest tax considerations are not the prime or only consideration when an employer decides whether to provide a fringe benefit or not. They also raise the question as to whether fringe benefits are provided because they have a low marginal cost to the employer but are known to have a higher value in the hands of the employee, or whether some fringe benefits are simply seen as adding economic value to the business. An area for further research would be to examine what influences the making of the “Head office / corporate policy”. Nonetheless, whatever the reason(s), attempts by Inland Revenue to influence remuneration behaviour through the taxation of fringe benefits will be ineffective if “Head office / corporate policy” has the most influence on such decisions.

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56 B Tran-Nam and J Glover, “Tax Reform in Australia: Impacts of Tax Compliance Costs on Small Business”, (2002) *Submission No 68 to Senate Inquiry Into Small Business Employment Issues in Australia*, p 4, available at <[http://www.aph.gov.au/senate/committee/eet\\_ctte/smallbus\\_employ/submissions/sub068.pdf](http://www.aph.gov.au/senate/committee/eet_ctte/smallbus_employ/submissions/sub068.pdf)> (as at 14 May 2004).

57 Inland Revenue, *FBTnews*, Issue 05 (December 2003), p 1.

58 Inland Revenue, *Streamlining the Taxation of Fringe Benefits* (Wellington, December 2003), A Government Discussion Document, p 4.

Historically, the bulk of the fringe benefit revenue has been sourced from motor vehicles.<sup>59</sup> Sandford and Hasseldine<sup>60</sup> also found that “motor vehicles account for 78 percent of the internal compliance costs and may well account for a similar proportion of external costs.” Further, it has been predicted that two thirds of the FBT revenue will come from motor vehicle related fringe benefits in the 2003 fiscal year.<sup>61</sup> Certainly, responses to this survey indicate private use of motor vehicles and contributions to superannuation funds and / or health insurance are the benefits most frequently provided to employees.

Furthermore, although superannuation / health insurance contributions are fairly evenly spread across all levels of employment, motor vehicles are more often provided to top management than to the lower levels in the organisation (refer Table 4). The survey responses show 69.6 percent of the participating employers provide employees with a motor vehicle. The high incidence may explain why this particular benefit is the biggest FBT revenue generator for the Government and a liability issue of prime concern to the survey respondents. However, the respondents’ comments suggest the real reason is because FBT on motor vehicles is triggered when the vehicle is available for private use rather than on the vehicle’s actual use. Their complaint is that no allowance is made for situations where a vehicle has to be readily available at all times for work reasons.

The requirement to value motor vehicles at cost price for the life of the vehicle prompted further comments by the respondents. Certainly being allowed to use depreciated asset figures was the change sought by most (171) employers (see Table 8). The principle of economic neutrality is also involved as it is evident employers have sought tax avoidance schemes to get round this motor vehicle valuation issue. The survey comments indicate a number of employers have been encouraged to move to a leasing arrangement for their vehicles to take advantage of the reducing value that comes with the roll over of an annual lease. These arrangements undermine the tax base and encourage taxpayers to make economic decisions on the basis of their tax outcome. The Government’s proposal to remove this FBT tax advantage<sup>62</sup> is an obvious response to the issue.

The Government’s Discussion Document<sup>63</sup> suggests that if FBT was levied on the employee, some employers may not pass on to employees an amount equivalent to what they are currently paying in FBT. Concerns that moving FBT into the PAYE system may lead to industrial relation issues as well as higher employer remuneration costs, were also expressed in Australia when they reconsidered the ‘who should pay’ question.<sup>64</sup> Certainly grossing up an employee’s wage or salary to cover FBT is an issue employers would have to address. However, the survey finding that only 16

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59 C Sandford and J Hasseldine, *The Compliance Costs of Business Taxes in New Zealand*, (Wellington, Institute of Policy Studies, Victoria University of Wellington, 1992); Business NZ, *Submission to Policy Advice Division, IRD, on the Fringe Benefit Tax Review*, (Wellington, 2002).

60 See C Sandford and J Hasseldine, n 58, p 54.

61 See n 57, p 23.

62 See generally Inland Revenue, *Streamlining the Taxation of Fringe Benefits* (Wellington, December 2003), A Government Discussion Document.

63 See generally n 61.

64 CPA Australia, *Tax Reform, The Road Ahead: A Framework Paper on Road Rules and a Road Map for Better Tax Policy*, (Melbourne, CPA Australia, 2002).

percent of employers simply removed some of the fringe benefits without a compensating increase in the cash portion of the remuneration package when FBT was introduced, should alleviate some of the Government's concerns in this area.

Moreover, employer comments made in the survey suggest that fringe benefits are frequently provided to recognise special circumstances such as long service or special / scarce skills, whilst other fringe benefits have been an outcome of business needs (eg, a sales representative's motor vehicle). In these situations, it is unlikely that an employer would jeopardise a special relationship by effectively lowering an employee's real income. Interestingly, 58 percent of the participants in this study perceived FBT to be inequitable for employers. Yet in terms of what they would like to happen to FBT, imposing the tax on the employee was not a highly ranked option. As it happens, the Government is unlikely to reverse their original 'employer pays' policy as it is proposed in the Discussion Document that "FBT would continue to be paid by employers".<sup>65</sup>

### **7.3 Limitations**

The study has several limitations. First, the questions asking for responses according to whether top management, middle management and / or 'other' employees were involved, did not define these terms. Thus, the participants' answers to these questions were based on their perception of what constituted "top management" and "middle management" in their organisations. This gives rise to a potential inconsistency in how respondents distinguished between the two management groupings. However, the size of the organisations suggests that any inconsistencies at the margins of the categories, would not impact on the overall trends of the results.

Secondly, when participants were asked to indicate whether contributions to super funds / health insurance were fringe benefits they provided to each of these groups of employees, the question did not explicitly exclude monetary contributions to superannuation schemes which are subject to Specified Superannuation Contribution Withholding Tax (SSCWT) and not FBT. Thus although some respondents made it clear they had made the distinction, it is not possible to determine whether all respondents had responded on the basis of super contributions that were subject to FBT only.

Thirdly, regarding the question as to which factors influence decisions to provide a fringe benefit or not, respondents distinguished between "Head office / corporate policy on the benefit" and the other factors listed in the questionnaire. The "Head office / corporate policy" factor is fundamentally different from the other factors listed though. Indeed, its more generic nature means it may be determined by the other factors listed albeit by people at a higher level in the organisation. A subsequent study could investigate top management decision making on tax matters and in particular, what influences the making of "Head office / corporate policy" on the provision of fringe benefits.

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65 See n 61, p 7.

## 8.0 CONCLUSIONS

Without abolishing FBT, it appears there are three key ways of addressing the concerns expressed by the participants in this study and in the literature. First, the employee rather than the employer could pay the tax. However, according to Dr Cullen,<sup>66</sup> this would still require the employer to calculate benefits and attribute them to individual employees, which would be unlikely to reduce (and may even increase) compliance costs. Without supporting evidence, this argument appears flawed because it disregards the relative legal simplicity of the PAYE system compared to FBT. In addition, applying more complex rules is often associated with higher compliance costs.

Furthermore, without providing supporting evidence Dr Cullen<sup>67</sup> also speculates that employers would not preserve their employees' real income if payment of FBT was shifted to the employee. It is perhaps ironic that Inland Revenue's attempts to address inequities have aligned FBT more closely with a PAYE / employee-based system. Nonetheless, while this study's findings showed some employer support for FBT to be levied on employees, the employers did not rate it as highly as other options for change. It also appears the Government is unlikely to reverse their original 'employer pays' policy.<sup>68</sup>

Secondly, FBT is a voluntary tax and employers can simply choose not to provide employees with fringe benefits. However, nearly 50 percent of the respondents did not change their remuneration packages at all when FBT was introduced. Furthermore, the evidence provided by this survey suggests employers are not indifferent as to whether they provide fringe benefits or cash, and many in-kind benefits are provided for business reasons which are not necessarily tax related.

The third option is the one being promoted in the Government's Discussion Document, namely to strike appropriate trade-offs between compliance costs and an accurate and comprehensive FBT system.<sup>69</sup> However, the proposals to make more options available to the employer with regard to taxable values and tax rates do not address, indeed conceivably add to, the complexity of FBT and its compliance costs. In addition, the proposed widening of the FBT net may introduce further complexities to the rules and calculations. It is also apparent that employers do not perceive Inland Revenue's prior attempts to address concerns have led to greater simplicity from either a legal or economic perspective. The Government has to be cognisant of the need for businesses to invest their scarce resources (both time and money) into productive activities for the good of society as a whole.

The findings of this survey support the claims that FBT is complex and the costs of compliance are high. Nonetheless, it appears employers do not anticipate any major revamp of the FBT legislation as a result of the Government review. As with the Ralph

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66 Inland Revenue, *Streamlining the Taxation of Fringe Benefits* (Wellington, December 2003), A Government Discussion Document.

67 See n 65.

68 See n 65.

69 See n 65, p 15.

Review in Australia,<sup>70</sup> any changes will fall short of a reform and be more consistent with the “streamlining” promised in the title of the Discussion Document. Just how the simplicity and efficiency objectives of streamlining are to be achieved is not obvious from the Discussion Document.

Irrespective of what changes are finally made to the FBT rules and processes, the bottom line is clearly to maintain the revenue collected from FBT.<sup>71</sup> Unfortunately, the revenue may once again be collected at the expense of the employers’ compliance costs. However, with the taxation of fringe benefits, employers already have available the ultimate solution in terms of economic simplicity, but perhaps this is just the view of two more “envious civil servants”.

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<sup>70</sup> Review of Business Taxation, *A Tax System Redesigned: More Certain, Equitable and Durable*, (Canberra, July 1999).

<sup>71</sup> Over \$370 million in revenue is expected to be raised from FBT in the current fiscal year, two thirds of it from motor vehicle related fringe benefits. See also Inland Revenue, *Streamlining the Taxation of Fringe Benefits* (Wellington, December 2003), A Government Discussion Document, p 7.

Richardson, I.L.M. & Congreve, R.L. (1975) "*Tax Free Fringe Benefits*". Rydge Publications Pty Ltd., pp.3-11.

Note:

Section 88 referred to in article is the precedent to Section 65 ITA 1976

Richardson, et al

"Tax Free Fringe Benefits"

## **1. Introduction**

To most people the expression "fringe benefits" brings to mind cigar smoking executives eating expensive lunches or enjoying the comforts of company owned or subsidised cars and yachts. The view is also widely held that fringe benefits are tax "loopholes" carefully created and exploited by the tax advisers of the rich to the cost of the taxpaying community as a whole. Like many popular conceptions these views have an element of truth which has become distorted. Some fringe benefits are little more than tax "loopholes" (although that perjorative may suggest more than is justified) and it is true that traditionally they have been used to benefit employees on high incomes, but that tells only part of what they are or how they can be used.

In its widest sense the term "fringe benefits" means any benefits or advantages, other than the payment of wages and salaries, passing from employer to employee and arising out of the employment. Fringe benefits are usually paid in kind rather than in cash and include a wide range of goods, services and other employee benefits. Although the higher rates of tax paid by "executives" make the use of fringe benefits particularly appropriate at these levels, there are tax advantages to be obtained at all in-

come levels. It is in the very nature of things that the fringe benefits passed to the managing director are likely to be more valuable (both absolutely and in terms of tax savings) and possibly more flamboyant than those passed to the office boy. But the office boy, too, may have fringe benefits at a level proportionate to his salary and importance. Subsidised meals, access to low interest finance or the use of sports facilities are just as much fringe benefits as entertainment allowances and limousines.

## **2. Conditions of employment**

In order to attract and keep employees an employer must, of course, pay them wages and salaries. He may also make the conditions of employment as attractive as possible by providing, for example, air conditioning, recorded music or, at the executive level, luxurious surroundings and facilities in excess of those strictly needed by the employee to carry out his job satisfactorily. Benefits of this kind do, in a sense, help to compensate the employee for his work and it cannot be disputed that an employee who works in cool and comfort in attractive surroundings is better off than one who, while on the same wage, works in hot, dirty or unpleasant conditions. Although these conditions of employment benefit the employee and may even be provided in order to attract him, they do not constitute "income" in the normal sense and it is not suggested that the Revenue would ever seriously consider treating as income amenities of the type mentioned above. Quite apart from the difficulties involved in attempting to value such benefits, they would not be taxable in New Zealand because they are not allowances realisable in the hands of the employee.

Conditions of employment of this sort are obviously not going to allow employers to pass huge tax-free benefits to their employees. Again, the boundary line between advantages, conditions and fringe benefits is not easy to draw. It is worth emphasising, however, that pleasant and comfortable surroundings are a benefit that all employers can pass tax free. For the man who spends one third of his life at work that can be very attractive.

### **3. Why fringe benefits?**

Fringe benefits are usually associated with income tax avoidance, and it is the major concern of this book to discuss the tax implications of various types of benefit. However, although income tax is almost always one of the considerations behind the granting of fringe benefits, and often a most important consideration, it is possible to over emphasise this element and lose sight of other reasons and objectives which may be involved.

In many cases fringe benefits are not paid solely as an alternative to wages and salaries at all — it may not be clear that the regular income of an employee would be increased if he were not granted a fringe benefit. For example, the employer who allows an employee to use a company car at nights and over weekends might not be prepared to pay an extra salary if the business no longer required the employee to use the car and it was sold. The particular form of fringe benefit which an employer adopts often reflects the nature of his own business and the fringe benefit itself is granted only because it is convenient and appropriate for the employer to do so. Consequently, the retailer gives his employees discount buying privileges, those who provide services give them free or at a cut rate, those who have access to finance give low interest loans and so on. This does not mean that such fringe benefits are granted in ignorance of their possible tax advantages, but it does mean that in different circumstances the employer might not necessarily commute the benefit into additional wages or salaries. Often these benefits are granted because they cost the employer nothing: the airline which allows employees to fly cheaply on a stand-by basis or the small retailer who gives away produce which would otherwise go bad. In these cases there is clearly a reason, other than employee tax advantages, for the giving of benefits in kind.

Even where fringe benefits can be more clearly seen as an alternative to an employee's usual income, there may be good reasons, other than tax reasons, why they should be made. Over-reaction to the more transparent tax avoidance devices should not lead to the conclusion that legitimate non-tax reasons are never behind their creation — the employer may provide housing to enable his



executives to entertain company guests; it may be felt that an executive will be assisted on a business trip by the presence of his wife. Again, it may simply be more appropriate and convenient for the employer to grant a benefit in kind rather than additional income. For example, if the employer is able to provide funds for low interest employee housing loans it may be convenient for all concerned, quite apart from the income tax consequences, to make such loans in lieu of additional salary which would have to be spent on the same purpose.

Finally, there are other advantages to employers in granting fringe benefits. They may tie an employee more closely to his employer, ensuring that he stays longer in that employment and is loyal to his employer. An employee who has share option benefits conditional upon his remaining in office is not as likely to wander as one who has already been paid a greater salary.

The use of fringe benefits may, then, be justified on the simple grounds that they are the most appropriate or convenient form of benefit, or on the grounds that they have advantages to the employer over the payment of wages and salaries.

#### **4. Tax avoidance and the wage and salary earner**

This book is, at least in part, about income tax planning for the wage and salary earner. For those who have no experience of tax planning and its implications, both personal and to the tax paying community, there may occur some doubts as to the propriety of tax avoidance of the sort described here. It is as well, therefore, to begin by putting those doubts in their proper perspective by showing them in the context of tax planning generally.

Lord Clyde's statement, made in 1929 in *Ayrshire Pullman Motor Services v. I.R.C.* (1929) 14 T.C. T54, 763 that:

“ . . . no man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores.”

would now be regarded as an overstatement of the individual's right to avoid income tax. There is general agreement that widespread tax avoidance on a large scale is not acceptable and both the Legislature and the Courts have increasingly been concerned over recent years with anti-avoidance measures.

But it is the responsibility of the legislature to specify the limits of what is acceptable planning and it cannot expect taxpayers to do more than the law requires of them.

For the non-wage and salary earner there are a number of opportunities for such tax planning recognised, and sometimes even encouraged, by both the revenue authorities and the legislation. For the wage and salary earner, on the other hand, the opportunities for tax planning are comparatively limited. He has no income earning asset which he can assign to a family trust or to someone for whom he wishes to provide. He cannot easily deal with his income before it is derived by him and taxable in his hands. He does not have the tax planning opportunities available to those who derive their income from a business. He must always meet the needs of today and provide for the future from tax-paid income.

## **5. The tax advantages of fringe benefits**

The one major opportunity for the wage and salary earner to lessen his income tax burden is for him to take advantage of the fact that not every benefit or advantage passing from employer to employee is regarded as "income" for the purposes of income tax. Fringe benefits are benefits which are passed to an employee but which are not taxable in his hands. The advantages of such benefits to the employee are clear. If the fringe benefit provides some advantage, or relieves the taxpayer of an expense he would otherwise have to bear, it is as good as income in his hands. Tax-free income. As the taxpayer's marginal rate of tax increases, so the value to him of these tax free benefits increases. There are also advantages to the employer. With the same outlay he can offer a greater inducement to present or prospective employees with a combination of salary and fringe benefits than by paying a salary

alone. By commuting only part of what would otherwise have been paid by way of salary into fringe benefits, both employer and employee can share in the tax advantage.

There is one danger to the employer which must be avoided. Wages, salaries and taxable allowances, taxable in the employee's hands, are of course always deductible by the employer when his taxable income is assessed. The advantages of fringe benefits to the employer are lost if they are not deductible by him. If the employer's marginal rate of tax were higher than that of the employee the Revenue would actually benefit from payment of a non-taxable but non-deductible fringe benefit. Unfortunately, some of the very factors which suggest that a fringe benefit is not taxable in the hands of the employee might also be used by the Revenue in an argument that the cost incurred is not deductible by the employer.

Fringe benefits are unlikely to be used solely to obtain employee tax advantages.

The advantages to the employer of fringe benefits have already been mentioned (in para. 2). They can be designed to make the employee more efficient and can lock him into the employment. Even when tax avoidance is a consideration the use of fringe benefits is not necessarily the exploitation of tax "loopholes" which can be justified only in terms of expediency.

## **6. The scheme of the taxing legislation**

The expression tax "loopholes" suggests the exploitation of some deficiency in the taxing legislation. Many fringe benefits, far from taking advantage of weaknesses in the Act, merely use taxation "benefits" which the Act itself offers. For example, s.88C, while bringing the benefits derived from certain share option schemes within the tax net, explicitly excludes other schemes where the benefit is deferred for a minimum period. Similarly, s.90 specifically exempts from taxation certain allowances that would otherwise be assessable.

On a more general level, there is no duty on any taxpayer to go out of his way to maximise his assessable income. The employer

who pays the travelling expenses of an employee's wife, who is accompanying him on a trip, has the alternative of paying the husband extra salary and making him meet his wife's expenses. The fact that the former course of action has tax advantages is not a "loophole" in the Act. It arises from the very scheme of the Act itself and the fact that only "income" is taxed. The notion of income may be changed from time to time to accommodate new practices or simply to protect the Revenue, but at present in New Zealand it does not include many types of fringe benefits.

## **7. Legislative acceptance**

Quite apart from those areas in which the legislature has provided specific tax advantages, there is more to fringe benefits than the exposure of tax "loopholes" providing unintentional tax benefits due to nothing other than bad draftsmanship. It may not always be true that the legislature says exactly what it intends or that it intends exactly what it says, but failure to remedy "weaknesses" which have been discovered in the tax net must imply acceptance of the situation and not merely ignorance on the part of the legislature.

Possibly for the reasons outlined above (in para. 2), the New Zealand legislature has made only a few moves to deal with specific types of fringe benefit and has done nothing to amend general provisions in the Act which have been found wanting when used by the Commissioner as the basis of assessment. As interpreted by the Courts, the word "allowances" in s.88(1) (b) may not have fulfilled the expectations of those who originally drafted the section. However, given the decisions limiting the scope of that word, and given the legislative inaction in the years since those decisions, it must be accepted that taxpayers who receive tax-free "allowances" are not escaping through a "loophole" but merely taking advantage of a tax "benefit" which the legislature itself has recognised.

In Parson's case the word "allowance" was given a limited meaning (as will be noted in para. 15). Parliament moved quickly and enacted special legislation the very same year but that legisla-

tion applied only to share options and it must be accepted that the legislature deliberately decided not to extend the definition of allowances to cover other types of fringe benefit which Parson's case had shown were not within the legislation.

## **8. Horizontal and vertical equity**

Most tax systems claim as a desirable objective equity both "horizontal" (i.e. among taxpayers on the same income level) and "vertical" (i.e. in the rates of taxation at the various income levels). The tax planning opportunities of the non-wage and salary earner place him at a distinct advantage over his salaried equivalent. It might even be argued that, in the absence of completely effective anti-avoidance measures, horizontal equity can only be maintained by permitting a degree of tax "planning" by wage and salary earners.

In our tax system vertical equity is based on the idea that those on higher incomes should pay a greater proportion of their incomes in tax. This is reflected in the graduated rates of tax. What is not clear is whether high income earners are in fact paying tax at the appropriate rate on their "true" incomes. As a result of tax planning the taxpayer's taxable income may be less than the aggregate of all the income-type benefits which he derives; consequently the proportion of tax to "income" and rates of tax applicable are less than they would have been without tax planning. The wage and salary earner who has no tax planning opportunities, on the other hand, does pay a "true" rate of tax in accordance with the prevailing rates. At the higher income levels the disparity between salaried employees and those who derive their incomes from profession, business or property, becomes even greater.

Of course, arguments based on the need for income tax to be imposed "equitably" can be taken too far. They assume that all taxpayers are taking advantage of available tax planning opportunities. The point which can be made, however, is that while there are recognised and common tax avoidance opportunities open to one sector of the tax paying community it is not entirely

equitable to deny those opportunities to another sector. The use of fringe benefits, far from placing employees in an unfairly advantageous position, provides the one limited opportunity for bringing their real tax burdens more in line with other income earners.

Doolan, J. (24 January, 2007). After Christmas, It's cold turkey. *The Independent*, p.23.

## TAX & LAW

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*"I was pretty shocked and angry when they demanded tax on the turkeys. I just could not believe how mean spirited they were behaving."*

Martin Weeks, founder and director of British engineering firm Mitutoyo.

# After Christmas, it's cold turkey

**T**HE CHRISTMAS party hang-over is a distant memory and you are back at work bright eyed and ready to focus on 2007.

A melody still hums in the background: *Hark, the IRD is Stinging*. A timely reminder to sort out the tax status of your Christmas festivities if you do not want the taxman to spoil your season of goodwill.

British business owner Martin Weeks' Christmas spirit turned into a cold turkey experience thanks to the taxman.



**TAXING TIMES**

JO DOOLAN

For 23 years Martin gave his employees a turkey for Christmas; all was sweet until the mean-spirited taxman slapped him with a tax assessment for £6,000.

Outraged at this attack on the Christmas spirit Martin told the tax office where to put their tax assessment, claiming the whole experience felt like an erosion of traditional British values.

There is a misconception that Christmas parties are not taxable. The reality is they are no different to any sort of entertainment, and you need to grapple with the entertainment limitation rules. Even if you manage to escape them, you must consider whether that other nasty, fringe benefit tax (FBT), applies.

Whether you are the type of employer who prefers to throw a party, on your business premises or off-premises, expenditure on food and drink is only 50% deductible under the entertainment expenditure regime. Incidental expenditure such as hiring crockery, cutlery, waiting staff, Santa Claus or a DJ will also be 50% non-deductible.

If the expenditure is not subject to the entertainment regime, it may be subject to FBT. Consider this one with a clear head; the rule is FBT will apply if the employee:

- Doesn't receive or use the benefit in the course of employment (or as a necessary consequence of their employment);
- And either may choose when to receive or use the benefit;
- Or enjoys the entertainment outside New Zealand.

Hosting a morning tea is a good one because if it is on your business premises, the 50% deductibility limitation will not apply (since the 50% limitation rule does not apply to light refreshments such as morning tea). So you can smugly munch away as the cost is fully deductible for tax. Added to this feeling of euphoria is the knowledge FBT will not apply as there is an exemption for benefits provided on an employer's premises.

Gifts such as the bottle of wine or food hamper are the sort that will be in the FBT camp unless you dictate when the employee can enjoy the gift. Providing a straw with the bottle of wine and insisting they drink the wine on your work premises at a set

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time is one way to try to avoid the taxman's greedy hand snatching extra tax from you.

It's not all doom and gloom, because certain fringe benefits which fall under a minimum threshold are exempt from FBT. While we may be still waiting for our inflation adjustments to tax rates, the FBT exemption thresholds increased from April Fools' Day last year.

This means if the benefits provided to your employees are less than \$200 an employee per FBT quarter (and if you provide benefits of less than \$15,000 annually for all employees for the current and previous three FBT quarters) you are not liable for FBT.

Gifts (other than food and wine) to clients or business contacts, are generally fully-deductible for tax purposes.

If, on the other hand, the gift you are giving is food or drink related, the expenditure will be 50% non-deductible.

The cost of taking a client out for a lunch or dinner will also generally be 50% non-deductible.

Without wanting to start the year on a negative note, doesn't this really illustrate the absurdity of how dictatorial our tax rules are. Given most business owners would not spend money without considering what the return is to the business in the form of increased client income, or increases in staff productivity, why should the taxman discriminate against these sort of expenses?

The reality is your effective tax rate on entertainment is at least 50% higher than other types of expenses.

The puritans in the 17th Century banned anything that sounded like fun so entertainment tax and fringe benefit tax must just be a modern-day variation on this theme.

While we contemplate whether the Human Rights Commission should be asked to investigate this blatant discrimination, be assured, if you mess up the tax status of your Christmas entertainment the taxman is unlikely to adopt a spirit of goodwill when dealing with you.

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