

Submission

By

Business|NZ

To

**Policy Advice Division,
Inland Revenue Department**

On the

Fringe Benefit Tax Review

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FRINGE BENEFIT TAX REVIEW

SUBMISSION BY BUSINESS NEW ZEALAND

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1. Introduction

- 1.1 Encompassing five regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, Canterbury Manufacturers' Association, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 49-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.
- 1.2 In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.
- 1.3 Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services).
- 1.4 It is widely acknowledged that consistent, sustainable growth well in excess of 4% per year would be required to achieve this goal in the medium term.
- 1.5 The tax system has a critical role to play in attracting investment and fostering a dynamic and innovative economy. Tax rates that are set at high levels, and compliance requirements that are complex and costly for businesses and individuals impose significant costs on the community. These costs include lower investment, output, incomes, and employment as well as distortions in behaviour.
- 1.6 Business New Zealand is pleased that the Government has decided to undertake a review of fringe benefit tax (FBT) and welcomes the opportunity to provide comment for the first step of the FBT Review. It should come as no surprise that many employers regard FBT to be one of the most onerous and frustrating compliance costs they have to face. In Business New Zealand's pre-election survey, 65% of members supported a first-principles review of FBT, and FBT was one of the three top priorities identified by members for tax simplification¹.

¹ *Election 2002 Survey*, Business New Zealand, July 2002.

- 1.7 The 2001 report of the Ministerial Panel on Business Compliance Costs noted that strong concern was expressed to it on the extra work required by moving to a multi-rate regime and new attribution rules. The Panel made the following recommendation in relation to FBT:

“The Government should consider undertaking a first principles review of FBT. The levying of FBT at a single rate and basing FBT on the depreciated cost of motor vehicles should be considered as part of the review.”

- 1.8 The Government has made it clear from the outset that it ‘has no plans to get rid of FBT’. Nor is Business New Zealand suggesting that it should be abolished. Business New Zealand’s submission will instead focus more on ways to meaningfully reduce compliance costs associated with FBT.

2. Summary of Recommendations

- 2.1 Business New Zealand recommends that the FBT Review should consider:

- (a) Whether the liability for the payment of FBT should lie with the employer or the employee;
- (b) The merits of multi-rate FBT versus single rate FBT and what rates should apply;
- (c) Whether FBT should be levied on the depreciated value of motor vehicles;
- (d) The compliance cost implications of proposals to change existing rules on ‘availability for use’, ‘private use’, ‘work related vehicle’, ‘low value vehicles’, and ‘home-to-work’ travel;
- (e) ‘Boundary issues’ to ensure that FBT is applied equitably and with a high degree of understanding and acceptance;
- (f) Whether changes to FBT would be an appropriate way to incentivise the uptake of private health insurance and employer funded superannuation;
- (g) Whether the existing exemption thresholds for free, subsidised, or discounted goods and services should be raised;
- (h) Whether the entertainment tax rules should be repealed; and
- (i) Whether FBT should be incorporated into the PAYE Employer Monthly Schedule as well as other ideas to simplify existing forms and requirements.

3. Background

- 3.1 When FBT was introduced in 1985, it was to close off a number of exemptions and gaps that existed in the income tax base in the early 1980s. At the time, fringe benefits were seen as an attractive way of reducing the tax burden on employee income in the face of very high marginal tax rates (e.g., in 1982 New Zealand had a 66% tax rate for incomes over \$22,000 – around \$51,000 in today's money²), and their use became increasingly common as a result of the 1982-84 wage/price freeze.
- 3.2 FBT raised \$338 million in the 2000/01 year, and it is therefore not a large proportion of total tax revenue (less than 1%). However, it is regarded as having an important role in protecting a significantly higher amount of revenue and thereby assisting in maintaining the existing 'broad-base, low-rate' tax architecture. We note that the 2001 Tax Review said that when FBT was introduced, it plugged a 'major gap' in the income tax base. The Tax Review did not make any recommendations on FBT, which implies that it supported the tax's retention.
- 3.3 These arguments are valid and most people would probably prefer a form of FBT that protects the revenue base if the alternative is to be forced to pay significantly higher income and personal tax rates to make up for 'leakages'. However, notwithstanding this broad acceptance of the need to protect the revenue base, the strong employer feeling about FBT is very real and is largely a reflection of how strongly people in business feel about the complexity, frustration, and costs associated with complying with FBT rules.
- 3.4 We note that the Government has announced that it has 'no plans to get rid of FBT and nor is Business New Zealand saying that FBT should be abolished. However, employers expect the Review to fully explore options that would significantly reduce the onerous compliance burden that FBT currently imposes.
- 3.5 There are several broad issues that Business New Zealand considers should be explored in the Review. These are listed below and discussed further in the following sections:
- Employers paying FBT when the benefits accrue to employees;
 - Multi-rate FBT;
 - Employer-provided motor vehicles;
 - Boundary issues of when FBT does and does not apply;
 - Employer contributions to health insurance and superannuation schemes;
 - Low value fringe benefits; and
 - FBT administrative requirements.

² Tax Review Final Report, October 2001, pg 9.

4. Employers Paying FBT

- 4.1 Business New Zealand submits that the taxation of fringe benefits should be included in the PAYE system on the grounds that the benefits accrue to the employee. We understand that this is the case in the United Kingdom and South Africa, although in Australia it is the employer who pays – as in New Zealand. Many employers consider that transferring FBT into the PAYE system would be the biggest single contributor to reducing FBT-related compliance costs.
- 4.2 We accept that the rationale for the introduction of FBT in the first place was for it to act as a disincentive to employers offering non-cash benefits to their employees at a time of very high marginal tax rates and the wage/price freeze. However, circumstances have changed significantly since the mid-1980s, and Business New Zealand submits that it would be appropriate and indeed timely for the FBT Review to consider these matters from a first-principles approach.
- 4.5 *Business New Zealand recommends that the FBT Review should consider whether the liability for the payment of FBT should lie with the employer or the employee.*

5. Multi-Rate FBT

- 5.1 Many employers have expressed concern about the complexity of calculating multi-rate FBT. FBT rates are also set at particularly high levels to act as a disincentive for employers providing fringe benefits. The Compliance Cost Panel's recommendation that the Government should consider reinstating a single rate regime was a reflection of the concern expressed to them by many in the business community.
- 5.2 However, while a return to a single rate of FBT would, on the face of it, assist greatly in reducing compliance costs, a number of employers have reported to us that they have been able to reduce the amount of FBT paid thanks to the lower rates that apply to benefits to employees who are on lower incomes. It is probably fair to say that employer opinion on the merits of multi-rate FBT is divided. Nevertheless, we submit that the Review should look into this issue.
- 5.3 The question of what FBT rates should apply is another important issue. Historically, FBT rates have been set on the basis that fringe benefits are 'net' (i.e., after tax) benefits, so the rates have effectively been 'grossed up' to reflect this. However, concerns have been expressed to us that there is a large risk that the current 63.93% top rate of FBT may in fact overtax employers, unless the employer packages an employee's remuneration so that the gross value of any fringe benefit provided to an employee is factored into account in determining the employee's salary.
- 5.3 We understand that there may also be problems with deductibility for those businesses operating in loss – in those cases the benefit of any FBT deductions available may not be realised for years, if ever.

5.4 Considering the concerns expressed by many in the business community about FBT rates, Business New Zealand submits that it would be worthwhile for the FBT Review to consider the merits of multi-rate versus single rate FBT and whether the 63.93% top rate results in employers being overtaxed in some circumstances.

5.5 *Business New Zealand recommends that the FBT Review should consider the merits of multi-rate FBT versus single rate FBT and what rates should apply.*

6. Employer-Provided Motor Vehicles

6.1 The FBT treatment of employer-provided motor vehicles remains one of the most pressing concerns for employers. Much of this concern relates to FBT being based on the original market value of the vehicle. In practice, this results in FBT being paid as though the vehicle continues to be new, even though it may be several years old and has depreciated significantly in value.

6.2 We understand that the Government has justified the 'market value' policy on two grounds:

- The difference between a new vehicle and one several years old is not material in that it performs the same function and should therefore be of similar 'value' to the employee; and
- As the vehicle gets older, usually more needs to be spent on repairs and maintenance, which as they do not have to be paid for by the employee, makes this a 'benefit' to the employee.

6.3 Business New Zealand finds the arguments listed above to be of dubious merit. Firstly, the pertinent 'value' should be the vehicle's current market value, not the original purchase price and it follows that the FBT cost should reduce in line with the car's market value as it depreciates. Secondly, new cars now perform well for a number of years and require considerably less in the way of repairs and maintenance, so reducing that supposed 'benefit' to employees.

6.4 The fact that FBT is calculated on the un-depreciated value also causes problems to those employers who provide vehicles as part of a remuneration package but also want to manage a fleet efficiently. This is because when the FBT cost is passed onto the employee (as it often is, say through a lower salary), the employee will be reluctant to accept an older car from within the fleet (particularly if this 'cost' is based on the value of the vehicle when new).

6.4 However, the most important single reason for basing FBT on the vehicle's original market value is simply that it maximises the tax payable, which has a two-fold effect. Firstly, it acts as a disincentive for the employer to provide the fringe benefit, and secondly it maximises revenue to the Crown – we understand that the bulk of the \$338 million FBT revenue in 2000/01 was sourced from FBT on motor vehicles.

6.5 It is also important to note that different treatments for motor vehicle FBT can result in further anomalies – for example, 1+1+1 leases get the benefit of the

decrease in market value through depreciation, while this is not available for those vehicles that are owned.

- 6.6 Business New Zealand considers that many of the concerns associated with FBT on motor vehicles could be overcome by allowing FBT to be levied on the depreciated value of the vehicle, based on either the IRD's own depreciation rates or perhaps on a set depreciated value (e.g., applying a single 'average' rate to the original cost-price of the vehicle).
- 6.7 *Business New Zealand recommends that the Review should consider whether FBT should be levied on the depreciated value of motor vehicles.*
- 6.8 There are a number of second-tier issues surrounding FBT for motor vehicles that could also be explored in the Review, although we note that some of them could actually increase compliance costs by requiring a higher degree of record keeping, for example. Examples would include:
- Could the 'availability for use' test be changed to one of 'actual use'?
 - Could a threshold be introduced for 'private use' that would see kilometres driven below such a threshold being exempt from FBT?
 - Could the definition of 'work related vehicle' be relaxed (e.g., by allowing vehicles to qualify provided they are clearly marked with the employer's name or logo and are required to be used for the purpose of employment)?
 - Could vehicles valued below a certain threshold be made exempt from FBT altogether?
 - Could there be more flexibility for 'home-to-work' travel for employees whose place of work varies (e.g., builders, real estate agents, etc)?
- 6.9 The trade-off between increased accuracy and additional complexity is critical. Clearly, proposals that would increase compliance costs but potentially reduce FBT-payable would need to be subject to rigorous cost-benefit analysis and extensive consultation with employers and other interested parties.
- 6.10 *Business New Zealand recommends that the FBT Review should consider the compliance cost implications of proposals to change existing rules on 'availability for use', 'private use', 'work related vehicle', 'low value vehicles', and 'home-to-work' travel.*

7. Boundary Issues

- 7.1 There have been a number of concerns expressed about IRD's interpretation and enforcement of 'boundary issues'. For example, IRD has ruled that there is a distinction between car parks leased or owned by an employer (which are not subject to FBT) and car parks held on license (which are subject to FBT). It is hard for employers to understand what the practical difference is between these types of car parks.
- 7.2 There is also the rather bizarre and worrisome example of employer-funded eye tests for those who work with personal computers for extended periods of time. The Health and Safety in Employment Act 1992 obligates employers to

provide a safe workplace for their employees, yet we understand that there is a distinction between eye tests provided in the workplace (which are not subject to FBT) and eye tests carried out by the employee's regular optometrist (which are subject to FBT). Again, this anomaly is difficult to understand and it does not help employers in their efforts to comply with the HSE Act, which is being made even more onerous under new legislation.

7.3 These anomalies are not only unfair, but they result in considerable confusion and frustration for employers and employees. There is considerable uncertainty over when FBT applies and when it does not and Business New Zealand considers that the Review must explore these issues.

7.4 *Business New Zealand recommends that the FBT Review should consider 'boundary issues' to ensure that FBT is applied equitably and with a high degree of understanding and acceptance.*

8. Employer Contributions to Health Insurance and Superannuation Schemes.

8.1 Any contributions made by employers to employees for funds, insurance, and non-SSCWT superannuation schemes are subject to FBT.

8.2 Increasingly, employers are expected to be 'good employers', with the Government's more recent policy and legislative initiatives more often than not adding to this expectation. Employers have often responded by providing non-wage benefits to their employees, yet find they are penalised for doing so through FBT. This is unfair.

8.3 There are also arguments that in the case of health insurance and superannuation, for example, that employers should be encouraged rather than penalised for providing such contributions, on the grounds that doing so relieves the Government of its own obligations and therefore reduces demand on already stretched publicly funded health and superannuation.

8.4 Generally speaking, health insurance is regarded as a private benefit to the insured person. However, a number of employers pay medical insurance for their full-time staff, so that in the event that the employee is unwell immediate treatment can be received. For example, an employer has advised us that having private health insurance recently enabled a staff member to have replacement surgery on both knees and enabled him to quickly return to work, whereas without insurance he would have been placed on a long public waiting list and been off work and on a sickness benefit. To these employers, paying for health insurance is seen as a way to protect and improve workplace productivity as well as provide a 'social good'.

8.5 This is clearly a wider policy issue, but if incentives were to be considered to encourage the uptake of private health insurance and employer funded superannuation, then changes to the FBT regime might be an appropriate way to provide such an incentive.

8.6 *Business New Zealand recommends that the FBT Review should consider whether changes to FBT would be an appropriate way to incentivise the uptake of private health insurance and employer funded superannuation.*

9. Low Value Fringe Benefits

9.1 The most common benefits subject to FBT are for motor vehicles, car parks, low interest loans, and subsidised transport. These can be of high value. However, there are a raft of other items covered in the 'catch-all' provision that are relatively minor in comparison, such as many examples of free, subsidised or discounted goods and services. Some examples include:

- Goods that are produced for sale but given away to employees (e.g., a soft drink producer provides free soft drink for employees to take home)
- Subsidised clothing that is provided for work purposes, but is not 'distinctive' to the business;
- Gifts (e.g., flowers sent to bereaved employees) and prizes (e.g., air tickets won in a raffle); and
- Entertainment, when employees can choose to enjoy the benefit or if the benefit is not enjoyed in the course of employment (e.g., Christmas lunches).

9.2 These goods and services are subject to the following exemptions:

- \$75 per employee per quarter (general exemption); and
- A maximum per employer of \$450 per quarter.

Or...(if the employer files annual or income year returns):

- \$300 per employee per annum; and
- A maximum per employer of \$1,800 per annum.

9.3 If any of these thresholds are broken, then the employer must pay FBT on the *total* value of the goods and services benefits.

9.4 FBT is intended to combat the substitution of salary and wages for fringe benefits. However, in Business New Zealand's view it is stretching the realm of credibility to justify flowers, chocolates, or Christmas lunches as 'substitutes for income'. As a result, many employers (and employees) quite rightly regard the rules for benefits that are of low monetary value as being mean-spirited and petty, not to mention a nuisance in imposing onerous business compliance costs for what must be little revenue gain to the IRD (a pertinent question is how much revenue is actually collected from such benefits?).

9.5 As a result there is undoubtedly a high degree of non-compliance, particularly among small businesses. It is appropriate therefore to consider whether the time has come to at least revisit the exemption thresholds, with a view to increasing them to a more appropriate and fair level.

- 9.6 *Business New Zealand recommends that the FBT Review should consider whether the existing exemption thresholds for free, subsidised, or discounted goods and services should be raised.*
- 9.7 In this context, we also submit that it would also be appropriate for the Review to consider the issues around Entertainment Tax and whether the time has not come to repeal it – it is very difficult, in our view, to find any policy merits in retaining what many regard to be a nuisance tax.
- 9.8 *Business New Zealand recommends that the FBT Review should consider whether the entertainment tax rules should be repealed.*

10. FBT Administrative Requirements

- 10.1 The issues here relate mainly to the form and timing of FBT returns. For example, IRD is considering whether FBT could be simplified by including it in the PAYE Employer Monthly Schedule. Under this idea, most of the associated calculations, particularly for motor vehicles, could also be shifted to IRD. Such a move may make FBT simpler but it would also require employers to file returns (and make payments) more frequently than with the current quarterly or annual FBT returns. Some businesses may prefer to file and pay FBT quarterly or annually rather than monthly.
- 10.2 It would be appropriate, however, to explore and test these issues further and for the FBT Review to put a firm proposal to employers at the discussion paper stage. The Review should also explore other ideas to simplify the existing forms and requirements.
- 10.3 *Business New Zealand recommends that the FBT Review should consider whether FBT should be incorporated into the PAYE Employer Monthly Schedule as well as other ideas to simplify existing forms and requirements.*

11. Conclusion

- 11.1 Business New Zealand welcomes the opportunity to provide IRD with employer views on the scope of the FBT Review and we look forward to submitting further on the release of the subsequent discussion document, which is to be released for public comment in 2003.