

# **Submission**

By



To

**Inland Revenue Department**

On the

**Recognising Salary Trade-offs  
as Income Issues Paper**

**8 June 2012**

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**RECOGNISING SALARY TRADE-OFFS AS INCOME ISSUES PAPER**  
**SUBMISSION BY BUSINESSNZ<sup>1</sup>**  
**8 JUNE 2012**

**1. INTRODUCTION**

- 1.1 BusinessNZ welcomes the opportunity to comment on the *'Recognising salary trade-offs as income Issues Paper* (referred to as 'the Paper'). Overall, the Paper represents significant changes that if not properly thought through, could create a number of unintended consequences, both for employers and employees. While there are elements of the Paper that deserve further attention, BusinessNZ is concerned that the Paper's broad policy approach could hamper, rather than help, economic growth.

**2. SUMMARY OF RECOMMENDATIONS**

- 2.1 BusinessNZ **recommends** that:

- a) IRD consider the direct employer-employee relationship when making final decisions on the salary trade-off (p.7);**
- b) In the first instance, IRD look to investigate specific areas of Fringe Benefit Tax policy, rather than taking an all encompassing approach to salary trade-off (p.8); and**
- c) IRD establish a Salary Trade-off External Advisory Panel to assist IRD in understanding all potential unintended consequences and in establishing best policy paths forward (p.9).**

- 2.2 Our submission covers the following areas:

- Setting the scene (p.3)
- Overarching thoughts on the paper (p.3)
- Specific concerns with the paper (p.5)
- An alternative way to deal with the issues (p.6)
- Next steps (p.7)

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<sup>1</sup> Background information on BusinessNZ is attached in the appendix.

### 3. SETTING THE SCENE

#### *Tax Results of BusinessNZ KPMG Compliance Cost Survey*

- 3.1 As tables 1 and 2 show, FBT as a tax compliance cost issue is relatively low, both across all enterprises and by size of enterprise. No doubt this has occurred due to policy work on FBT over the years, as well as to the introduction of exemptions to FBT, where the compliance costs associated with certain forms of fringe benefit have been viewed as compliance cost heavy for employers.

**Table 1: Change in Tax Compliance Cost trend Scores (2007 & 2008)**

Tax Compliance Cost Area	2007	2008	Change	Overall Level (2008)
Tax – PAYE	3.449	3.566	0.117	Modest increase
Tax – Fringe Benefit Tax	3.224	3.175	-0.049	Modest increase
Tax – GST	3.298	3.254	-0.044	Modest increase
Tax – Provisional Tax	3.373	3.429	0.056	Modest increase
Tax – Other deductions	3.469	3.504	0.035	Modest increase
Average, all Tax	3.363	3.386	0.023	Modest increase

**Table 2: Tax Compliance Cost Trend Score by FTE Group (2008)**

Tax Compliance Cost Area	0-5	6-9	10-19	20-49	50-99	100+
Tax – PAYE	3.521	3.595	3.640	3.560	3.467	3.612
Tax – Fringe Benefit Tax	3.104	3.169	3.193	3.169	3.243	3.279
Tax – GST	3.257	3.268	3.276	3.276	3.133	3.194
Tax – Provisional Tax	3.407	3.436	3.497	3.436	3.300	3.438
Tax – Other deductions	3.498	3.393	3.589	3.518	3.500	3.500
Average, all Tax	3.357	3.372	3.439	3.392	3.329	3.404

- 3.2 Therefore, any significant changes to FBT policy need to be mindful of the compliance cost implications of significantly increasing the time and resources spent on compliance. Increased administrative costs because of poor policy decisions are not often just a 'point in time' issue. Poorly drafted legislation, no matter what the lead time, still has significant compliance shockwaves further out beyond the year the changes were formally introduced.

### 4. OVERARCHING THOUGHTS ON THE PAPER

- 4.1 BusinessNZ has previously submitted on discussion documents and Bills relating to FBT, including the Government's major FBT review in 2002, Streamlining the Taxation of Fringe Benefits in 2003, and other proposed FBT changes within omnibus Tax Bills. While we have differed on particular recommendations for FBT policy treatment, the policy process for FBT has generally assisted in steering FBT in the right direction. But this is not to say that further work shouldn't be done where outstanding issues or recently introduced changes have led to unintended consequences.
- 4.2 We appreciate the opportunity to provide comment on the present Paper. However, we consider both the Paper's contents and recommendations to be a mixed bag, to say the least. While in principle we support the idea of improving the integrity of the tax system and social assistance programmes so that individuals pay their fair share of tax and social assistance is targeted at

those in genuine need, the way in which these issues are dealt with is less than desirable.

- 4.3 First, the Paper itself sets out a considerable number of views and recommendations that when looked at in their entirety, result in a complex, and for want of a better term, 'knotty' policy process that is difficult to understand. While we acknowledge that IRD is attempting to address a number of interrelated issues, we believe the complex, overlapping and often understated nature of what is being proposed could produce adverse outcomes when a Bill is drafted. In short, the Paper bites off more than it could possibly ever chew.
- 4.4 Second, the way in which the Paper is presented gives an impression that various departments within IRD have amalgamated current projects into one Paper. This has created at times a confusing document, where statements made in one part do not take into account statements elsewhere, making it hard to envisage what proposed changes will look like.

#### *Lack of quantitative analysis*

- 4.5 Aside from the two broad observations above, given the issues examined we would expect IRD to undertake some rigorous quantitative analysis in the Regulatory Impact Statement (RIS) of the associated Bill of the future costs and benefits of the options presented. However, we believe it would have been useful to include in the Paper some preliminary quantitative analysis to assist in weighing up the options outlined. Or, at the very least, some base numbers so that submitters can appreciate likely fiscal costs.
- 4.6 For instance, we know that an NZTA report on FBT relating to cars and car parks early this year<sup>2</sup> found that the lack of FBT on car parks provided for company cars could represent around \$177m of forgone tax revenue. Equally, IRD's updated Tax Compliance Cost Survey (2009) showed that the average annual compliance cost associated with FBT per enterprise was \$126, up 41.6% from 2004. However, the overall average increase was affected by a large reduction in the FBT population, given FBT changes in recent years to remove or limit FBT for the smallest businesses.
- 4.7 Also, while the Paper has included some examples comparing suggested approaches, these could have been used more extensively, particularly in relation to effects on social assistance income. For example, how would broadening the definition of social assistance income affect a worker's Working for Families entitlement, if the worker was provided with a car park and had three children? Again, such information would be useful in weighing up the additional compliance costs for employers compared with the scale of social assistance.
- 4.8 Information as suggested above would help to provide some context when trying to establish whether the problem outlined is significant. On the face of it, changes may seem to make sense in terms of improving integrity and

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<sup>2</sup> Company cars and fringe benefit tax – understanding the impacts on strategic transport targets (February 2012).

equity, but if the monetary amounts from the changes are relatively small, while associated compliance costs are high, there is every likelihood changes could end up as wealth destroying for the economy.

## **5. SPECIFIC CONCERNS WITH THE PAPER**

- 5.1 As indicated above, our overarching concerns with the Paper do not mean that no FBT issues should be examined where there are legitimate concerns that the integrity of the tax system is at issue. If the Paper was separated out and some issues examined separately, we might agree that in some cases a re-examination of current policy needs to take place. This may be because of interpretation issues, or because what is proposed does not properly fit within the broad scope of taxation policy. Yet, the Paper as it stands has a number of specific impediments which put into question whether the broad policy approach will be the most advantageous. These include (in no particular order):

### *Understanding compliance cost implications for employers*

- 5.2 While the Paper does mention the issue of compliance costs for employers at various points throughout the document, from our perspective it is difficult to get a good handle on the extent and level of additional compliance costs that may be put on employers because of both the overlapping nature of the changes, or the unintended consequences that may result. Therefore, providing a definitive view of the extent to which compliance costs would increase for employers is tricky at best, and in broad terms BusinessNZ only has two comments to make.
- 5.3 First, the current FBT exemptions for car parks and for childcare provided on an employer's premises were essentially structured that way because of the excessive compliance costs that would otherwise be associated with FBT on these benefits. While how these benefits will be taxed is yet to be decided, either way there will undoubtedly be costs for employers.
- 5.4 Second, as a general remark, the Paper's broad position seems to be that an employer's decision to provide fringe benefits is driven by tax reasons. In reality, the reasons for fringe benefits are wide and varied. While some employers may go down a tax optimisation route, others may use fringe benefits for efficiency reasons, or even some form of 'feel good'/motivational reason for their staff. Applying a more neutral treatment between salary and salary trade-offs could lessen the likelihood of some tax-driven economic behaviour, but misses other positive benefits for the employer-employee relationship. Therefore, the trade-off between the tax integrity and compliance costs is misleading given the other factors at play when businesses consider providing benefits to their employees.

### *Scope of capture*

- 5.5 The Paper has predominantly identified three key exemptions from FBT that require a policy change, namely:

- Car parks;
- Childcare provided on the employer's premises; and
- Benefits received by employees of charitable organisations

These three areas are specifically mentioned in the Paper's summary of suggested changes and also in the associated media release. However, from the Paper itself, it is difficult to ascertain what may or may not be included. For instance, paragraph 1.16 discusses option 2 – the FBT approach, stating that *'the second option is to target the salary trade-off rule only to certain currently FBT-exempt benefits, being predominantly car parks and childcare provided on....'* However, the full range of exclusions and limitations for FBT, according to the 2007 Income Tax Act (CX19-CX33), also applies to elements of:

- Business tools
- Benefits to non-executive directors
- Benefits provided on premises
- Benefits relating to health and safety
- Non-liaable payments
- Assistance with tax returns
- Accommodation
- Entertainment
- Distinctive work clothing
- Contributions to income protection insurance
- Services provided to superannuation fund, and
- Goods provided at discount by third parties

While we would presume that the three FBT exempt areas that the Paper has focussed on would be important from a fiscal point of view, we should not lose sight of the fact that these other exemptions may be far more common in the business community, which would mean any significant changes could affect a large number of businesses, especially from the point of view of the relationship and communication between employers and employees.

#### *Associated effects of salary trade-offs included in family scheme income*

- 5.6 Given salary trade-offs may be included in 'family scheme income', the Paper has focussed on the possible effects this will have on social assistance schemes, with Working for Families being the predominant discussion point. However, the full range of schemes would also include student allowances, student loan repayment obligations, the community services card and various types of child support.
- 5.7 One other area not mentioned at all is KiwiSaver, which now has in excess of 1.9 million members. While the drafting of the Bill for salary trade-offs may look to ensure there is no effect on KiwiSaver, one could equally consider that silence on this policy indicates some sort of readjustment might take place where fringe benefits fall within the scope of an employee's gross income, thus causing employees' (and in many cases employers') monetary contribution to increase.

### *How to define salary trade-offs*

5.8 Paragraph 2.26 outlines a definition for salary trade-off, along with examples of explicit and implicit trade-offs. In many respects, the explicit trade-off is simple to determine given the direct trade-off presented to the employee would invariably be included in an employment agreement. Larger businesses would generally have this option in an agreement so that the procedure for complying with the trade-off changes would be fairly clear-cut.

5.9 However, implicit trade-offs, especially in relation to the SME sector of the economy, present a much greater challenge. First, as the third part of the 'salary trade-off' definition in paragraph 2.26 states:

*Any attributed or currently untaxed benefit for FBT purposes that is offered to a group or class of employees not involving an explicit trade-off for salary or wages, where the employee has an enforceable right to the benefit and has taken up the benefit.*

The definition of 'enforceable right' will be critical in determining whether or not a benefit is or is not an implicit salary trade-off.

5.10 Ensuring an appropriate picture of implicit salary trade-offs and in particular 'enforceable rights' will only come about if the Government is fully aware of the forms and levels of benefits out in the business community. Despite best intentions with the current round of consultation, BusinessNZ cannot be sure that the Government will have a complete picture of these when it comes to drafting the Bill. Indeed, within our own channels of communication with our members, creating an accurate picture of the situation would take longer than the submission deadline allows.

5.11 Following on from the issue of how to define 'enforceable rights' is the valuation issue employers will have to deal with. Paragraphs 2.29 and 2.30 of the Paper discuss the issue relating to the value of trade-off, stating that *'the employer would need to ascribe a value to that trade-off for those employees who had chosen to take up the offer. We acknowledge that valuing the benefit may be more readily achievable in some cases than others'*. While paragraph 2.30 goes on to provide an example, as well as to briefly mention the possibility a standard value to alleviate compliance costs, trying to establish a correct value for various benefits, including the right value for the same benefit in different parts of the country, could present significant compliance problems for employers. Despite this, the issue is hardly touched upon in the Paper.

### *Communication between employers and employees*

5.12 While any changes made will be introduced in April 2014, employers will have to understand how these will affect their business operations before that time. One aspect that officials may not consider is how the communication of the changes between employers and employees will play out, considering some employees may experience a decrease in take-home pay or to their social assistance entitlements, depending on what final option is chosen.

- 5.13 Unlike changes to, say, personal income tax rates or ACC levies, the connection between take-home pay/social assistance and FBT has a stronger employer element linked to the end outcome. As stated above, instances where benefits previously viewed as not having a formal salary sacrifice element to them suddenly become captured may lead to employee disagreement and/or resentment of the employer. Therefore, the Government needs to be fully aware of how this may play out in informal agreements at one end, through to formal employment agreements at the other.

***Recommendation: That IRD consider the direct employer-employee relationship when making final decisions on salary trade-offs.***

## **6. AN ALTERNATIVE WAY TO DEAL WITH THE ISSUES**

- 6.1 As discussed above, the shortcomings of the paper in its entirety should not preclude the examination of certain issues. BusinessNZ believes that in this instance, choosing selected issues instead of spreading the focus wide would assist not only in improving policy for those issues examined, but would provide a steer for improving other issues further down the track. Two such examples are:

### *Concentration on explicit trade-offs*

- 6.2 Rather than attempting to boil the ocean by examining all explicit and implicit salary trade-offs, a better path would be to concentrate only on those explicit areas where there is a clear and defined instance in an employment agreement.
- 6.3 As stated above, while explicit salary trade-offs are to a large extent self selecting because of the formal nature of the trade-off, implicit salary trade-offs provide a much broader scope for subjectivity. In particular, in determining whether a benefit will fall under the new taxation rules, whether an employee has an 'enforceable right' to the benefit will obviously be a crucial factor for an implicit salary trade-off.
- 6.4 While an examination of implicit trade-offs might well occur in the future, for now, exploring explicit trade-offs would provide a solid base from which to begin.

### *Car park lease/license boundary issues*

- 6.5 Paragraph 2.36 states that the lease/licence boundary associated with car parking has, in IRD's view, become increasingly difficult to sustain. This has primarily been due to the interpretation of the current tax provision which suggests the boundary is not as clear cut as first thought.
- 6.6 BusinessNZ agrees that there is certainly scope for a review of car park fringe benefit policy in light of the boundary issue, especially when considering the urban versus rural availability of car parks.



***Recommendation: In the first instance, IRD look to investigate specific areas of Fringe Benefit Tax policy, rather than an all encompassing approach to salary trade-off.***

## **7. NEXT STEPS**

- 7.1 Given our concerns outlined above, the step from an issues paper to the first legislative draft will be crucial. We are concerned that the full ramifications of what is being proposed will not be fully understood, or that employers will in some cases not even be aware of the issues, until the draft Bill is released. There is every possibility that rather than simply refining the legislation to ensure it is successful in meeting all the criteria for good legislation, considerable impediments and issues will arise which could stifle the draft Bill's progression and cause problems during the submission process.

### ***Establishment of a Salary Trade-off External Advisory Panel***

- 7.2 Therefore, given that the intention is that the legislation be enacted for the start of the 2014 tax year, BusinessNZ believes IRD needs to establish a Salary Trade-off External Advisory Panel (STEAP) soon after submissions on the Paper have closed.
- 7.3 We envision STEAP would be relatively similar to the establishment of the GST Panel in 2010, which was set up to help businesses and the Government implement the GST rate increase to 15%, announced in Budget 2010.
- 7.4 The GST Panel consisted of five private sector GST experts from various elements of the business community, who considered submissions and acted as a conduit between businesses and the Government. It monitored how businesses dealt with the changes so that the Government was aware of particular issues faced in recording and charging GST at the new rate. The Panel also advised the Government on more general concerns for particular industries, activities or types of transactions related to the GST rate increase.
- 7.5 Given BusinessNZ was on the GST Panel, we saw first hand how the Panel interacted between business and the Government to ensure any and all issues were considered and dealt with. Its success was shown in the fact that the increase in GST on 1 October 2010 went very smoothly, as almost all issues had been considered, with guidelines published or decisions made.
- 7.6 Similarly, STEAP could provide guidance to IRD as a follow-up to the Paper in three primary ways:
- a) Consideration and possible elaboration of submissions received that highlight examples of enforceable rights and instances where no formal contract has been agreed upon;
  - b) A clean sheet start for other situations that may likely arise; and

- c) Recommendations to IRD outlining how such situations should be handled, which would also provide a basis for an overall recommendation on the best policy options to proceed with.
- 7.7 Obviously, those invited to be on STEAP would have an expert knowledge of FBT from various angles, including size of business and sector type. Ideally, like the GST Panel, some on STEAP should also be able to tap into the membership of the organisations they represent to ensure various issues are presented and feedback sought.
- 7.8 For transparency purposes, we would like to point out that our recommendation for this Panel should not in any way be taken to indicate self-interest on BusinessNZ's part. We are not expecting that a representative of BusinessNZ will necessarily sit on such a Panel. BusinessNZ is willing to assist in any form, so long as a Panel is established, thereby avoiding considerable problems once the legislation is drafted.

***Recommendation: That IRD establish a Salary Trade-off External Advisory Panel to assist IRD in understanding all potential unintended consequences and in establishing best policy paths forward.***

## **APPENDIX**

### **8. About BusinessNZ**

- 8.1 Encompassing four regional business organisations (Employers' & Manufacturers' Association, Employers Chamber of Commerce Central, Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), its 78 member Major Companies Group comprising New Zealand's largest businesses, and its 76-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, BusinessNZ is New Zealand's largest business advocacy body. BusinessNZ 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.
- 8.2 In addition to advocacy on behalf of enterprise, BusinessNZ 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.
- 8.3 BusinessNZ'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). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per capita per year would be required to achieve this goal in the medium term.