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WEEKLY COMMENT: FRIDAY 5 APRIL 2013

1. Two proposals relating to the closure of perceived tax loopholes that were previously discussed in an Issues Paper and a Media Statement are included in the *Supplementary Order Paper No. 167* ("the SOP") of 11 December 2012 to the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill* ("the Bill"). The Bill is due to be reported from the Finance and Expenditure Committee on 29 May 2013.

2. The proposals concern:

   (a) Short-term charge facilities, proposed to come into effect from 1 April 2014; and

   (b) Short-term agreements for sale and purchase under the financial arrangements rules, proposed to take effect from 27 September 2012 (the date of the Minister of Revenue's media statement on the proposed changes) – but see paragraph 15 below for the precise application details.

3. Also relevant in the context of short-term charge facilities is *Revenue Alert RA 13/01 Salary Packaging – reducing income from employment by replacing part of salary or wages with vouchers* ("RA 13/01"), which was issued by Inland Revenue on 22 February 2013. This is discussed in paragraph 23 onwards below.

Short-term charge facilities

4. *Recognising salary trade-offs as income – an officials' issues paper* (the "Issues Paper") was released in April 2012. That document contained a discussion about benefits provided by charitable organisations and the FBT exemption for short-term charge facilities.

5. Section CX 25 of the *Income Tax Act 2007* contains a general exemption from FBT for benefits provided by a charitable organisation to an employee, except in two specified circumstances:

   (a) If the employment relates to a business activity carried on by the organisation outside its charitable purposes; or

   (b) The benefit is provided by way of a short-term charge facility and the value of the benefit from short-term charge facilities for an employee in a tax year exceeds 5% of the employee's salary or wages for the year.

6. A 'short-term charge facility' is defined in s. CX 25(3) as an arrangement that allows an employee of a charitable organisation to buy or hire goods or services that have no connection with the organisation, and to charge an account that the employer is liable to pay.

7. Note that a fringe benefit arises in respect of short-term charge facilities that exceed the 5% threshold even if the employment relates to the organisation's charitable purposes. It is stated in paragraphs 2.46 to 2.48 of the Issues Paper that:

   "When the exemption (from FBT for employees of charitable organisations)was last considered in the 2003–05 review of FBT, the then Government concluded the exemption should not be extended but rather be limited to exclude short-term charge facilities whose value exceeds 5 percent of an employee's salary. The key concern was that such facilities were a close cash-equivalent when they could be used to purchase items that all employees want, such as groceries.

   More recently, there has been further testing of the boundaries of the exemption, with a number of entities marketing schemes to charities that involve offering employees more of their remuneration package in non-taxable benefits. This might be achieved, for example, through the provision of vouchers which cover employees' normal everyday living expenses.

   Arguably, vouchers may be excluded from the exemption on the basis that they are a short-term charge facility but it would be preferable to put this beyond doubt. Our concern is that because these types of arrangements provide such a readily substitutable alternative to salary and wages (and there is argument over whether they are taxable), they could pose a material risk to the tax base."

8. In the Issues Paper, officials indicated that a "voucher" would be defined very widely. It was noted in paragraphs 2.52 – 2.53 that:

   "We would envisage adopting a wide definition of "voucher", similar to that used overseas. In Australia, a "voucher" is defined as a voucher, token, stamp (but not a postage stamp), coupon or similar article, or a prepaid phone card or facility which, in each case, has a stated monetary value and which is redeemable for other supplies in accordance with its terms.

   Likewise, United Kingdom tax legislation adopts a very wide definition of a non-cash voucher. It includes not only conventional retail vouchers but also "any voucher, stamp or similar document or token". This definition may therefore catch documents in letter form as well as plastic discs or tokens inserted into machines. Generally, the voucher needs to be capable of being exchanged for goods and services."

9. However, there is no definition of "voucher" in the SOP. Instead, the meaning of a "short-term charge facility" in s. CX 25(3) is being expanded so as to include "consideration other than money or money's worth" provided by the employer to enable an employee to obtain goods or services having no connection with the employer or its operations.

10. The proposed expanded definition contemplates a wider liability on the part of the employer for "some or all of the payment *or other consideration*" for the goods or services. The value of the benefit under section RD 39(1) is also being amended, by clause 44C of the SOP, so as to include 'an amount paid for or towards consideration, *other than money or money's worth*", including any interest incurred in connection with such non-monetary consideration.

11. The threshold over which a fringe benefit arises is also being tightened. Under the proposal in clauses 13C and 44C of the SOP, a fringe benefit will arise if the value of the benefit from short-term charge facilities exceeds $1,200. The proposed new threshold over which there will be a fringe benefit is the lesser of:

    (a) 5% of the employee's salary or wages; or

    (b) $1,200.

12. A fringe benefit that arises in respect of a short-term charge facility is included in the employee's family scheme income. Under proposed new s. MB 7B(2)(b), the value, for family scheme income purposes, is the value of the fringe benefit itself, plus the FBT.

13. An employer who provides a short-term charge facility has a new compliance obligation under proposed new s. 46F of the *Tax Administration Act 1994*, regardless of whether a fringe benefit arises or not. A statement must be provided to the employee by 20 May including:

    (a) The total value of benefits including FBT from short-term charge faclilites in the previous income year ("the FBT benefit value"); and

    (b) The total value of benefits excluding FBT ("the pre-FBT value"); and

    (c) The relevant threshold amount for the inclusion in family scheme income (either $1,200 or 5% of the employee's salary or wages) ; and

    (d) For each short-term charge facility provided to the employee:

        (i) The type of short-term charge facility;

        (ii) The period during the year that it was available to the employee;

        (iii) The value including FBT of the benefits received from the short-term charge facility.

Consideration for short-term agreements treated as financial arrangements

14. On 27 September 2012 the Minister of Revenue , the Hon Peter Dunne, announced that the Government would move swiftly to address an unintended consequence of allowing taxpayers to elect to treat short-term agreements for the sale and purchase of property as financial arrangements.

15. The unintended consequence he referred to is the ability to claim a deduction for either the cost of acquiring agreements, or any losses on disposal of those agreements. These represent deductions for what are capital amounts.

16. The proposed changes are contained in new s. EW 32B set out in clause 33B of the SOP. The changes apply to all short-term agreements for sale and purchase, unless a tax position is taken relying on the rules before the proposed amendment:

    (a) In a tax return received by the Commissioner before 27 September 2012; or

    (b) Under a determination or binding ruling made by the Commissioner before 27 September 2012.

17. The effect of the proposed amendment is that any consideration for the transfer or defeasance of a short-term agreement is ignored, for the purposes of the financial arrangements rules, to the extent it exceeds the consideration for the sale or purchase before the transfer or defeasance.

18. The rules apply to:

    (a) A transfer, or a legal defeasance, of an interest in a short-term agreement for sale and purchase; and

    (b) A transferor and/or a transferee who chooses under s. EW 8 to treat the agreement (which would otherwise be an excepted financial arrangement under s. EW 5(22)) as a financial arrangement.

19. The amendment was explained in "Questions and Answers" that accompanied the Minister's media statement on 27 September 2012 as follows:

    "Where a vendor or purchaser of a short-term agreement for sale and purchase elects to treat the agreement as a financial arrangement, the amount of consideration that will be taken into account for the purposes of spreading or undertaking a base price adjustment will be limited to debts outstanding under the agreement. This will mean that the taxpayer will not be able to claim a deduction under the financial arrangements rules for either the cost of acquiring the agreement or any losses on disposal of the agreement. …

    An example will help to illustrate the problem:

    A company acquires the assets of another company, which includes profitable contracts for the provision of certain services. The purchase price for the contracts is $5 million. Electing that the service contracts be financial arrangements and then applying the financial arrangements rules, a tax deduction of $5 million is available to the purchaser over the life of the contracts, resulting in tax savings of $1.4 million. If the contracts were treated as excepted financial arrangements (as conceptually they should be) the general deductibility rules would treat the amounts as capital (non-deductible) expenditure, just as the income to the vendor would be capital and therefore non-assessable."

20. The same example is provided on page 38 of the Commentary to the SOP.

21. The original intention, as stated in the media statement, was that the amendment should apply from the start of the 2008-09 income year. The reason given for the retrospective application in the media statement was as follows:

    "There is a high hurdle for tax legislation to be applied retrospectively.

    In this particular case, the Government is concerned about the possibility that past transactions might be post-facto re-characterised with a potentially significant fiscal effect. This is because of the length of time that some financial arrangements can cover and to prevent exploitation of that loophole over the remaining term of an arrangement."

22. However, as noted in paragraph 15 above, clause 33B(2) of the SOP makes the proposed change apply only to existing short-term agreements for which an election had not been made in a tax return filed before 27 September 2012, or to which a determination or binding ruling made before 27 September 2012 applies.

Revenue alert on salary packaging using vouchers

23. Revenue Alert RA 13/01 concerns reducing income from employment by replacing part of salary or wages with vouchers. Inland Revenue claims that PAYE tax is not being correctly withheld, and that GST input deductions are being claimed without the GST output tax being correctly returned. Inland Revenue considers that the arrangements may be tax avoidance in terms of s. BG 1 and potentially s. GB 44.

24. Inland Revenue states that:

    "Inland Revenue is aware of arrangements being entered into by some employers where an employee selects an amount of salary or wage that is substituted for vouchers (for example, supermarket and petrol vouchers) which are very similar to the cash equivalent of the salary or wage. A "voucher" in this context may take many forms but includes paper vouchers and electronic vouchers on stored value cards. …

Under this "repackaging" the vouchers are not being treated as income of the employee and no PAYE is deducted by the employer. The employee's income is treated as being reduced by the amount of the salary substituted with vouchers. As well as paying less income tax, employees who seek to reduce their income in this way pay less child support; decrease their student loan repayment obligation; reduce their KiwiSaver contributions and may claim a larger entitlement to Working for Families Tax Credit (WfFTC) than they should. In addition, repackaging in this way has the effect of reducing the contribution that their employer is required to make to the employee's KiwiSaver scheme.

Usually, the employer also does not treat the provision of the vouchers as a fringe benefit subject to FBT. *For instance, many of the employers offering this arrangement are charities who treat the provision of the vouchers as being exempt for FBT purposes under section CX 25* …

In addition, some employers are claiming GST input tax credits on the purchase of the vouchers that they provide to employees, but are not returning output tax when the vouchers are provided to the employees.

In some cases, the salary packaging scheme is administered by a third party provider who runs the scheme and provides the vouchers and administration services such as invoicing, in return for a fee."

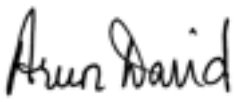
(emphasis added)

25. Inland Revenue's view is that:

    (a) Vouchers are essentially a substitute for salary and wages and PAYE tax should be withheld on the value of the vouchers; and

    (b) The provision of the vouchers is a supply in relation to which the employer should return GST output tax.

26. Some examples are provided in RA 13/01. Inland Revenue states that it has commenced investigations into a number of taxpayers who have entered into salary packaging schemes involving the use of vouchers.



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