



WEEKLY COMMENT: FRIDAY 22 FEBRUARY 2013

1. *Reviewing the tax treatment of employee allowances and other expenditure payments - An officials issues paper* ("the Issues Paper") was released in November 2012. (Submissions closed on 1 February 2013.) Last week I looked at the proposals for accommodation payments. This week I look at the proposals for meal payments and communications and clothing expenses.
2. Officials have suggested that supporting rules should be covered by Commissioner discretion. I am not opposed to Inland Revenue statements of operating practice, which I find very helpful. However, law changes need to be legislated, in my view, because simply providing the Commissioner with the discretion to decide the appropriate tax treatment eliminates the taxpayers' alternative of challenging that position.

Meal payments

3. The New Zealand courts have considered the tax treatment of expenditure on food and drink. In *Case E80* (1982) 5 NZTC 59,421, the out-of-town meal expenses of a removal van driver were held to be private because they related to his living, and not to his performing the job.
4. The judge in that case acknowledged that, when the requirements of the taxpayer's job meant that extra cost is incurred on meals and there is clear evidence of that, there may be a sufficient nexus with earning income. For example, when the employee is required to work out of town and therefore has to spend more on meals than usual. However, officials maintain that in such a case it will not be practically possible to comply with or administer an apportionment test.
5. The discussion in the Issues Paper is focused on the suggested tax treatment for two types of meal payments:
 - (a) Meal payments for work travel; and
 - (b) Non-travel related working lunches, conference meals, and payments for light refreshments such as tea and coffee.

Meal payments during work travel

6. The factors considered in arriving at a suggested tax treatment for meal payments during work travel are that:
 - (a) The private element of any meal costs in relation to short-term work travel is incidental to the need to travel;

- (b) Reimbursing meal costs during a short-term work journey is unlikely to lead to significant salary substitution;
 - (c) Employer-provided meals while the employee is traveling are exempt from FBT to the extent that an allowance to meet such costs would be exempt; meals provided off the employer's premises are normally treated as entertainment expenditure which is 50% non-deductible it, but meals consumed in the course of business travel are normally excluded from being entertainment expenditure; and
 - (d) There are practical difficulties in apportioning expenditure on meals between normal and additional meal costs while traveling.
7. The alternative tax treatments discussed for work travel-related meal payments are:
- (a) Exempt from tax all payments to meet meal costs; the disadvantage identified is a possible incentive to make tax-free payments even when an employee is sent to work at a particular location for a longer period of time;
 - (b) Limit the exemption for meal payments to overnight journeys – the approach followed in Australia;
 - (c) Set an upper limit for making tax free meal payments;
 - (d) Exempt from tax a fixed portion of any payments to meet meal costs; for example, 50% of expenditure on meals is tax-deductible in the US and Canada; or
 - (e) Set a maximum amount that can, with certainty, be paid tax-free – similar to the UK approach.

Meal expenses during work travel: Proposed v current

8. Officials' preferred option is to fully exempt work travel-related meal payments subject to an upper time limit for the exemption at any given temporary work location. An upper time limit of 3 months before a meal payment becomes taxable in full has been proposed.
9. Currently, there may theoretically be a tax liability in relation to the amount saved by the employee on daily meal costs while travelling, but in practice employers do not treat any amount as taxable, and they do not adhere to any upper limit. The proposed time limit of 3 months will, therefore, result in some meal payments that are currently treated as tax-free becoming taxable.

Meal payments not related to work travel

10. For meal payments not related to work travel, officials' consider that:
- (a) The private element in a working lunch or conference meal is likely to be low in value, incidental to earning the employee's income and difficult to measure;
 - (b) Exempting payments to meet the cost of working lunches is unlikely to encourage salary substitution; but it might be necessary to link the value of refreshments provided to refreshments provided at the workplace;
 - (c) There are FBT exemptions that currently apply although entertainment tax may apply to limit the employer's deduction; modest coffee and tea payments are exempt from FBT if provided on the employer's premises.
11. The alternative tax treatments discussed for meal payments not related to work travel are:

- (a) Exempt from tax any payments to meet working meal or light refreshment costs, subject to an upper limit; or
- (b) Exempt from tax any payments to meet working meal or light refreshment costs.

Meal payments not relate to work travel: proposed v current

12. The preferred approach is to make non-travel related meal payments completely exempt from tax with no upper limit. If the meal is provided as part of entertainment, the expenditure is already 50% nondeductible. However, the rule would have to be carefully crafted to make it clear that:
- (a) The exemption does not extend to circumstances where the payment is made on a regular basis for the employee providing his or her services; and
 - (b) The payment is linked to what the employer provides on its premises and limited to relatively modest amounts; and
 - (c) The payment is only provided in situations when the employee has to work regularly on site away from the employer's premises.
13. Currently, there may theoretically be a tax liability in relation to the amount saved by the employee on daily meal costs while travelling, but in practice employers do not treat any amount as taxable. The proposed limitation to the exemption will result in some meal payments that are currently treated as tax-free becoming taxable.

Communications payments

14. The communication payments considered are: an employee's home telephone, personal cell phone and internet costs.
15. Officials consider that where an employer meets the cost of a dedicated work phone line or internet facility with no, or only incidental private use, or meets the cost of what is effectively a private line, with only incidental business use, apportionment should not be required in either case: the payments will be tax-free, and fully taxable, respectively.
16. The question of apportionment arises where there is mixed-use that is more than just incidental. Officials are of the view that where an employer requires an employee to have a dedicated work line or requires the employee to have a cell phone for exclusive use in a job, it is more likely that the employer will make the necessary arrangements – for example, by providing a cell phone package. Therefore the starting proposition is that an allowance or expenditure on account for personal phone and internet access will be primarily a private expense and any work benefit will be incidental.
17. The alternative tax treatments discussed are to:
- (a) Apportion the payment between private and work elements on a “reasonable” basis; this will be difficult if there is no separately identifiable private or work element.
 - (b) Tax a fixed ratio, such as 50% of expenses, but this is arbitrary.
 - (c) Tax any employee expenditure payment when there is mixed work and private use; the payment would be taxed in full, except where there is a dedicated work facility or other separately identifiable and exclusive business costs being reimbursed.

Communications payments: proposed v current

18. Officials prefer taxing and employee expenditure payment in full when there is mixed work and private use. The basis for this is that:
 - (a) It would avoid the need to make arbitrary judgments;
 - (b) The expense is mainly at private expense; and
 - (c) If the employee or requires significant facilities, the employer is likely to provide the facilities in its own name and take advantage of the FBT exemption for work tools.
19. At present, the business-related portion of such payments is treated as not taxable. There will be a significant increase in taxable payments if this proposed change is adopted.
20. The proposed change is likely to promote a move away from allowances and towards employer provided business tools. Take, for example, this extract from *FBT News Issue 20* September 2007:

“Private use of laptop computers and cellphones

Do you know that the private use of business tools you provide your employees with may be exempt from FBT? This includes items such as laptops and cellphones used mainly for business and which, individually, cost \$5,000 or less.

Example

Extreme Dirt Design provide all their mobile design consultants with laptop notebooks and a cellphone. The notebooks cost around \$3,000 and the cellphones around \$900 each. From time to time Regan uses his laptop for private use. This private benefit is exempt from FBT because the notebook was provided mainly for work purposes. Regan uses his cellphone for both business and private calls, as he doesn't want to manage two cellphones. As the cost of the cellphone is less than \$5,000 the private use is also exempt from FBT.”

Clothing payments

21. Officials note that the New Zealand courts have considered the tax treatment of clothing on a number of occasions and concluded that expenditure incurred on the purchase and maintenance of clothing is normally a private expense and should be taxable in full: *Case E51* (1982) 6 NZTC 59,786.
22. Expenditure on conventional clothing is a private expense, even when the employee is required to wear that particular clothing as part of a uniform: *Case F45* (1983) 6 NZTC 59,786, which concerned conventional clothing worn by ferry steward.
23. However, in *Case F9* (1983) 6 NZTC 59,606, a deduction was allowed for “abnormal expenditure on conventional clothing to hotel managers for an amount representing the extra clothing (and dry cleaning) required because of the nature of their employment.
24. *Case F45* also held that expenditure to meet clothing costs is not taxable when the particular clothing is “necessary and peculiar” to the employee’s occupation: this includes a uniform, overalls and protective boots, but excludes ordinary clothing which could reasonably be worn outside the job.
25. If the cost of particular articles of clothing is treated as exempt, payments to meet the cost of cleaning and otherwise maintaining them should also be exempt.

Clothing payments: proposed v current

26. The preferred option is to move away from the position that an employee expenditure payment in respect of personal clothing is to meet a private expense only in specific circumstances. Officials suggest that the law in this area be made more certain by making it clear that payments to meet clothing costs are taxable unless they concern expenditure on uniforms, protective clothing and other specialist with clothing that is not reasonably suitable for outside work for use outside work. Payments should be taxable if they meet expenditure on ordinary clothing that can reasonably be worn outside the job irrespective of the quantity of clothing or maintenance required. (This would overrule *Case F9* regarding abnormal expenditure.)
27. At present the payment is generally not taxable if it covers work uniforms or specialist clothing. There may be some ambiguity: *Case F9*, for example. Some payments currently treated as tax-free will become taxable.

Proposed delivery options

28. It is noted that the proposals in the document will require changes to the *Income Tax Act 2007*. However officials are of the view that supporting rules may be better addressed through other mechanisms such as, for example, Commissioner's discretion.
29. Appendix A to the Issues Paper contains a comparison of current and suggested treatment of key employee expenditure payments.
30. Appendix B contains a summary of current legislation and its interpretation.
31. Appendix C compares the approach in other countries for general allowances, meal payments and accommodation payments.



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