
A SIMPLIFIED FRINGE BENEFIT TAX REGIME FOR SMALL BUSINESSES

Tax Policy Scholarship Competition 2024 – Final Submission

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4000 Words

*The views expressed in this proposal are my own.

I. INTRODUCTION

New Zealand's fringe benefit tax (**FBT**) regime taxes non-cash benefits provided by employers to their employees in connection with their employment.¹ The purpose of the FBT regime is to provide tax parity between cash and non-cash remuneration.²

The FBT regime can be unintuitive and imposes high compliance costs on employers;³ this has led to the non-compliance of many small businesses.⁴ Inland Revenue has noted that the key areas giving rise to compliance costs are found in the rules regarding:⁵

- motor vehicles available for private use (**AFPU**); and
- free, subsidised, or discounted goods and services (**Unclassified Benefits**).

(Together, the **Current Rules**).

The Current Rules require employers to track the number of days a motor vehicle is AFPU by employees, and the type and quantum of Unclassified Benefits provided to employees.

A small business FBT regime (**SBFBT Regime**) is proposed to simplify the Current Rules by:

- applying a default number of AFPU days to the calculation of the taxable value of a motor vehicle AFPU; and
- amending the current Unclassified Benefits rules to only capture benefits provided to employees which would reasonably be considered as provided in connection with their employment.

II. CURRENT RULES

Motor vehicles AFPU

Employers pay FBT on the taxable value of a motor vehicle AFPU on a quarterly, annual, or income year basis.⁶ For employers who pay on an income year basis, this is calculated as:⁷

$$\text{days} \times \text{schedule 5 amount}^8 \div 365^9$$

In this calculation, "days" is the number of days in the income year on which the vehicle is AFPU.¹⁰

¹ Income Tax Act 2007, s CX 2.

² Streamlining the taxation of fringe benefits – a government discussion document, Policy Advice Division, Inland Revenue (December 2003), at 1.1.

³ Fringe benefit tax: regulatory stewardship review, Policy and Regulatory Stewardship, Inland Revenue (August 2022), at [6].

⁴ At [92].

⁵ At [44].

⁶ Income Tax Act, ss RD 29(2)– (4).

⁷ Income Tax Act, s RD 29(4).

⁸ Income Tax Act, s RD 29(5)(c) and schedule 5.

⁹ Income Tax Act s RD 29(4); ÷ 90 for quarterly filers.

¹⁰ Income Tax Act, s RD 29(5)(b).

Employers must track the number of days a motor vehicle is AFPU to calculate the taxable value. This requires employers to determine whether a motor vehicle is AFPU on any given day; this is a time-consuming and complex exercise, made harder by the need to also assess whether any of the three available exemptions apply to exempt any days from being AFPU.¹¹

Some employers may have policies prohibiting employees from using their motor vehicle for private use. However, to comply with the current motor vehicle AFPU rules, employers must monitor employees' adherence to such policies. In my experience, and from discussions with other professionals, there is doubt over whether most employers do this in practice.

Unclassified Benefits

The Unclassified Benefits rules require employers to monitor both the taxable value of Unclassified Benefits provided to each employee, and the total taxable value of Unclassified Benefits provided to all employees.¹² Section RD 45 of the Income Tax Act 2007 (**ITA 07**) provides that FBT must be paid:¹³

- on Unclassified Benefits provided to an employee, if the total taxable value of all Unclassified Benefits provided in the quarter to the employee is more than \$300 (when employers pay FBT quarterly):
- on Unclassified Benefits provided to an employee, if the total taxable value of all Unclassified Benefits provided in the year to the employee is more than \$1,200 (when employers pay FBT annually or on an income year basis): or
- if the total taxable value of Unclassified Benefits provided to all employees in an annual period is more than \$22,500.

To calculate their Unclassified Benefits FBT liability, employers must classify each Unclassified Benefit provided to employees before considering whether any of the above thresholds apply.

The Unclassified Benefits rules are broad and unintuitive. This leads to an over-reach with the rules taxing Unclassified Benefits that do not have a clear connection to an employees' employment (e.g., bereavement flowers).¹⁴ This is particularly problematic because the purpose of the FBT regime is to provide tax parity between cash and non-cash remuneration.

III. THE ISSUE

Since its introduction in 1985, the FBT regime has remained largely unchanged,¹⁵ despite Inland Revenue undertaking reviews of the regime in 2003 and 2022.¹⁶ Both reviews found that the FBT regime is overly complex, unintuitive, and imposes disproportionately high compliance costs relative to the FBT liability.¹⁷

In the 2022 review, Inland Revenue noted that “[a]necdotally, a number of businesses and employers resent the cost of compliance”, “few taxpayers were keen to incur the costs of advice to ensure fully accurate compliance with the rules” and many taxpayers were therefore taking a “near enough” is “good enough” approach to FBT

¹¹ Income Tax Act, ss CX 6(2) – (4).

¹² Income Tax Act, ss RD 45(2) – (3).

¹³ Sections RD 45(2) – (3).

¹⁴ Inland Revenue above n 3, at [37].

¹⁵ Inland Revenue, above n 2, at 1.3.

¹⁶ Inland Revenue above n 2; Inland Revenue above n 3.

¹⁷ Inland Revenue above n 3, at [6] and [39]; Inland Revenue above n 2, at 3.4.

compliance.¹⁸ Inland Revenue stated that the “*area believed to be the most non-compliant is the small to medium business sector*”.¹⁹ This is unsurprising as such businesses are unlikely to have the processes and resources in place to comply with the Current Rules.

It is difficult to quantify the extent of revenue lost from non-compliance because Inland Revenue has very limited information from taxpayers in respect of FBT.²⁰

In my experience, and from discussions with other professionals, Inland Revenue’s belief that the small business sector is particularly non-compliant is accurate; the unintuitive nature of the Current Rules, and the disproportionate compliance costs required to comply with them, leads to a significant number of small businesses not complying with the FBT regime. It is therefore likely that the total tax revenue lost through this non-compliance would be significant.

Irrespective of the quantum of tax revenue lost, the widespread nature of non-compliance alone merits changes to the FBT regime to maintain the tax system’s integrity.

IV. THE SOLUTION – SBFBT REGIME RULES AND ELIGIBILITY

The SBFBT Regime simplifies the Current Rules to make the rules more intuitive and reduce compliance costs.

Rules

Default Private Use

It is proposed that small businesses should be able to calculate the taxable value of motor vehicles AFPU on the basis of 188 AFPU days, or, for quarterly filers, 47 days in each quarter (**Default Private Use Rule**).

The Default Private Use Rule would replace “days” in the calculation (as set out above) of the taxable value of motor vehicles AFPU.²¹

The Default Private Use Rule is calculated as follows:

Friday, Saturday, and Sunday of each week (52) of the year	156
Annual leave entitlement	20
Public holidays	<u>12</u>
Annual AFPU days:	188
Quarterly AFPU days:	47

The Default Private Use Rule is calculated by treating Friday – Sunday of regular working weeks, the statutory annual leave entitlement, and annual public holidays as AFPU. It is assumed that use on these days would be the most likely to confer a material private benefit to employees than use on Monday – Thursday of regular working weeks, where there are generally less opportunities to make private use of a motor vehicle. This assumes that employees are typically busy with work obligations on Monday – Thursday of regular working weeks, and have limited personal leisure time to make fulsome use of work-supplied motor vehicles.

¹⁸ Inland Revenue above n 3, at [50].

¹⁹ At [92].

²⁰ Letter from Bary Hollow (Principal Policy Advisor) to Simon Watts (Minister of Revenue) regarding Fringe Benefit Tax future policy work (16 February 2024), at [22].

²¹ Income Tax Act, ss RD 29(5)(a) – (b).

Friday is treated differently from other weekdays on the assumption that employees would have relatively more opportunities to use their motor vehicle for private use (e.g., going out for dinner, finishing early on a Friday and completing personal errands, or travelling out of town for the weekend).

The assumptions included in the Default Private Use Rule could lead to an overstated/understated FBT liability than if the current motor vehicle AFPU rules were applied. However, the inclusion of additional rules to mitigate these variances would undermine the goal of avoiding the complexity and disproportionate compliance costs of these rules. Additionally, as the SBFBT Regime will apply on an opt-in basis (discussed further below), small businesses can choose to calculate their FBT liability based on actual AFPU days under the current motor vehicle AFPU rules if they so wish.

Separately, the Default Private Use Rule could also result in a double counting of days AFPU (i.e., if an employee takes annual leave on a Friday). However, it is suggested that such a scenario would only typically arise where an employee takes their annual leave in “blocks” of a week or two at once.

For example, one may consider a scenario where a small business provides an employee with a motor vehicle which is AFPU that has an original cost of \$60,000, and that employee takes all 20 days of their annual leave entitlement across a four-week period. In this scenario, the Default Private Use Rule double counts four Fridays as AFPU and leads to an “overstated” FBT liability for the tax year of \$84, with a corresponding “overstated” GST liability of \$17.²² This overstatement is negligible.

For completeness, it is noted that in 2024, four public holidays occurred on a Friday with only two of these public holidays applying nationwide.²³ Like the risk of double counting in the above scenario, this would only result in a negligible overstatement of a small business’ FBT liability.

Reasonable Substitute

The current Unclassified Benefits rules taxes benefits which would not reasonably be characterised as being a substitute for an employees’ remuneration e.g., personal milestone gifts, bereavement flowers, and news subscriptions.²⁴ The taxation of such benefits is incongruent with the purpose of the FBT regime to provide tax parity between cash and non-cash remuneration.²⁵

Under the SBFBT Regime, an FBT liability would only arise on Unclassified Benefits:

- that have a taxable value of more than \$300 (i.e., the current Unclassified Benefits de minimis threshold); and
- which would reasonably be considered a substitute for an employee’s remuneration.

(The **Reasonable Substitute Rule**).

²² Where the FBT liability is calculated as $[(188 \times (\$60,000 \times 20\%)) / 365] \times 63.93\%$ less $[(184 \times (\$60,000 \times 20\%)) / 365] \times 63.93\%$ equals \$84.07; Where the GST liability is calculated as $[(188 \times (\$60,000 \times 20\%)) / 365] \times (3/23)$ less $[(184 \times (\$60,000 \times 20\%)) / 365] \times (3/23)$ equals \$17.15.

²³ Easter Friday, Matariki, Hawke’s Bay Anniversary and Canterbury Anniversary.

²⁴ Inland Revenue above n 3, at [39].

²⁵ Inland Revenue, above n 2.

In assessing whether an Unclassified Benefit would reasonably be considered a substitute for an employee's remuneration, the following factors should be considered:

- the recurrence of the benefit; and
- whether the benefit is provided directly in response to an employee performing their role.

To reduce the risk of small businesses taking unreasonable positions regarding the taxability of an Unclassified Benefit, and to ensure consistency across taxpayers, Inland Revenue guidance on the above factors should be provided through an interpretation statement. This statement should include illustrative examples of the Unclassified Benefits that Inland Revenue consider to be (and not to be) reasonable substitutes for an employee's remuneration. Additionally, section BG 1 of the ITA 07 would act as a general safeguard against small businesses who seek to take positions that amount to tax avoidance.

This proposal focuses on small businesses who suffer the most from the complexity and disproportionate compliance costs of the Current Rules. However, it would be sound policy for the Reasonable Substitute Rule to be extended to all businesses.

Eligibility

A small business must meet all the following criteria to apply the Default Private Use Rule and the Reasonable Substitute Rule (**New Rules**):

- a) Employ less than 50 full-time-equivalent employees (**Employee Requirement**).
- b) Provide less than 15 motor vehicles to employees which are AFPU (**Motor Vehicles Requirement**).
- c) Have an annual turnover in the preceding 12 months of less than \$30 million, or if unknown, have reasonable grounds for believing that the annual turnover of the current month and the subsequent 11 months will be less than \$30 million (**Turnover Requirement**).

(Collectively, the **Eligibility Criteria**).

The Eligibility Criteria will exclude small businesses who narrowly fall outside of any of the threshold requirements. However, this is a necessary consequence of any threshold, and is required to ensure that larger businesses who have (or should have) the processes and resources in place to comply with the Current Rules do not unduly benefit from the New Rules.

Discussion of Eligibility Criteria

Employee Requirement and Turnover Requirement

Inland Revenue defines "small businesses" as entities with an annual turnover of up to \$30 million and fewer than 50 employees.²⁶ To be consistent with Inland Revenue's position on what amounts to a "small business", these thresholds are adopted in both the Turnover Requirement and Employee Requirement respectively.

²⁶ 2021 study on the time and cost of doing business taxes incurred by NZ small businesses, Inland Revenue (June 2021), p 7. As of 2021 there were 398,111 such "small businesses".

If the annual turnover of the preceding 12 months is unknown (i.e., the business has not traded for a 12-month period), small businesses should consider estimated/budgeted accounts for the current month and the subsequent 11 months. On the assumption that most small businesses regularly prepare estimated/budgeted accounts, small businesses should be able to easily track expected annual turnover.

The Turnover Requirement includes concepts that most small businesses will be familiar with. There is a similar “reasonable grounds” concept in the Goods and Services Act 1985 in respect of when a person becomes liable to be registered for GST, and the wording of the Turnover Requirement is adopted from section 51(b) of that Act.

Motor Vehicles Requirement

The Default Private Use Rule could reduce the revenue integrity of the tax system through an understated FBT liability for some small businesses. This impact may compound as more motor vehicles AFPU are provided to employees. Limiting the New Rules to small businesses that provide less than 15 motor vehicles to employees which are AFPU will mitigate this possibility.

General administration

A business’ eligibility to apply the New Rules will be assessed as of 1 April (i.e., the first day of the tax year).²⁷ For ease of administration for both small businesses and Inland Revenue, a small business that meets the Eligibility Criteria as at this date will be eligible to apply the New Rules for the entire tax year, even if they fail to meet the Eligibility Criteria during the tax year.

As noted above, the New Rules will be optional. To minimise the administrative burden on Inland Revenue, small businesses who wish to opt-in to the New Rules should only be allowed to do so through their FBT return/s, which should be amended to include a “tick-box” question which asks whether the New Rules have been applied during the relevant tax year or quarter (for quarterly filers).

V. ANALYSIS AGAINST RELEVANT JUDGING CRITERIA

Impact on simplicity of tax system

The New Rules simplify the FBT regime for small businesses by removing the requirements to count the days motor vehicles are AFPU, and limiting the range of Unclassified Benefits required to be tracked through only capturing benefits that would reasonably be considered a substitute for an employee’s remuneration.

The tax system will become more complex following the introduction of the New Rules as these will apply alongside the Current Rules (which will continue to apply to larger businesses and small businesses who do not opt-in to the New Rules). Consequently, Inland Revenue would need to administer two different sets of FBT rules. However, this is a well-accepted consequence of the various simplified regimes in New Zealand’s tax system.²⁸

Incidentally, the complexity of the New Rules and the Current Rules applying concurrently would be reduced if the Reasonable Substitute Rule applied to all businesses.

Ease of administration by taxpayers and Inland Revenue and impact on compliance costs

²⁷ Income Tax Act, s YA 1.

²⁸ Income Tax Act, ss GC 20(3), EB 23(1), and EW 57(1)-(2) (not exhaustive).

The Default Private Use Rule will increase the ease of administration for small businesses (and reduce compliance costs) by removing the requirements to count the days motor vehicles are AFPU.

Additionally, under the Default Private Use Rule, small businesses with private use prohibition policies would not be required to monitor compliance with such policies. The FBT liability for these small businesses would increase under the Default Private Use Rule as the FBT liability would be calculated on the basis that motor vehicles provided are AFPU (compared to no AFPU days when a private use prohibition policy is in place).

However, the Default Private Use Rule provides small businesses with the opportunity to eliminate any compliance costs incurred to monitor private use prohibition policies.

The Default Private Use Rule will be easier for Inland Revenue to administer compared to the current motor vehicle AFPU rules which requires it, when enforcing compliance, to check the accuracy of an employer's calculation of AFPU days. The Reasonable Substitute Rule will also increase the ease of administration for small businesses and reduce compliance costs through limiting the range of Unclassified Benefits small businesses are required to track.

While the Reasonable Substitute Rule limits the range of tracking required by small businesses, this will not increase the ease of administration for small businesses and Inland Revenue to the same extent as the Default Private Use Rule. This is because small businesses will need to track and assess Unclassified Benefits which are reasonable substitutes for an employee's remuneration; Inland Revenue would need to check this information when enforcing compliance. However, this additional administrative burden would be lightened for small businesses through the publication of Inland Revenue's interpretation statement.

Further, it can be reasonably expected that any additional administrative costs will be set-off by a reduced FBT liability due to a smaller range of Unclassified Benefits being taxed compared to what is taxed under the current Unclassified Benefits rules.

The Eligibility Criteria is simple for both small businesses and Inland Revenue to apply. Additionally, in assessing eligibility, it is expected that small businesses would not need to obtain any information that is not already available to them.

The New Rules' only procedural requirement for small businesses is to opt-in. As discussed above, this will be done through a "tick-box" included in the small business' FBT return/s.

Feasibility of introduction and acceptance

As the New Rules draw on existing FBT (and general tax) concepts, the introduction and acceptance of the New Rules would be very feasible; small business owners will be saving on compliance costs without having to upskill on new tax concepts.

As evidenced by the complaints noted in Inland Revenue's 2022 review of the FBT regime, the Current Rules are perceived as overly complex, unintuitive, and as imposing disproportionately high compliance costs on businesses.²⁹ As the New Rules address these complaints, the New Rules should be publicly and politically acceptable.

Public acceptability

²⁹ Inland Revenue above n 3.

Coherence is a fundamental principle of tax policy design.³⁰ The complaints of interview participants recorded in Inland Revenue's 2022 review demonstrates that the Current Rules are perceived to be incoherent. The New Rules are simple, intuitive, and understandable, and therefore would be welcomed by the public.

Compliance costs are a "necessary evil" towards doing business compared to costs incurred in revenue generating activities. In a survey conducted by BusinessNZ in 2023, 64% of New Zealand businesses stated that their tax compliance costs had increased over the last three years.³¹ As such, the reduced compliance costs through the application of the New Rules would be particularly welcomed.

Political acceptability

Minimal work has been done to remedy the unintuitive nature of the FBT regime and the disproportionate compliance costs imposed by its rules. To date, these issues have not featured on Inland Revenue's tax policy work programme.³² However, the appetite for reform is growing.

The Minister of Revenue (**Minister**) has publicly expressed his view that the FBT rules are an area where he would like to see substantive changes made in 2025.³³

Inland Revenue policy officials have clearly acknowledged the Minister's intentions. In a letter to the Minister dated 16 February 2024, Inland Revenue set out various approaches to FBT reform. The New Rules would align with Inland Revenue's recommended approach of redesigning the rules around motor vehicles and "other" benefits.³⁴

In view of both the Minister's intentions, and Inland Revenue's recommendations, the New Rules would be politically welcomed.

Revenue integrity

The Default Private Use Rule

As the actual number of AFPU days will vary for every small business, the Default Private Use Rule may, in certain cases, lead to an understated FBT liability than if the current motor vehicle AFPU rules were applied. The negative impact of such understatement on the revenue integrity of the tax system would increase with every additional motor vehicle which is AFPU. As discussed above, limiting the New Rules to small businesses that provide less than 15 motor vehicles to employees which are AFPU mitigates the potential impact on the revenue integrity of the tax system.

The Reasonable Substitute Rule

The Reasonable Substitute Rule may result in reduced tax revenue through the removal of some of the Unclassified Benefits which presently attract an FBT liability under the current Unclassified Benefits rules. However, the extent of this loss would depend on the proportion of small businesses that presently comply with these rules. On the

³⁰ Future of Tax Recommendations, the Tax Working Group (February 2019), p 28.

³¹ The Deloitte and Chapman Tripp Election Survey, conducted by BusinessNZ (September 2023), p 15.

³² Bary Hollow above n 20, at [29].

³³ Brent Edwards "Revenue Minister keen to reduce tax burden and compliance costs" (25 March 2024) NBR <www.nbr.co.nz>.

³⁴ Bary Hollow above n 20, at [18].

basis that many small businesses are non-compliant, it could be assumed that the total revenue lost from limiting the range of Unclassified Benefits subject to FBT would not be particularly significant.³⁵

Separately, given that the purpose of the FBT regime is to provide tax parity between cash and non-cash remuneration connected with an employee's employment, it is arguable that some of the FBT revenue collected under the current Unclassified Benefits rules does not belong in New Zealand's tax base. As such, while revenue integrity may reduce through limiting the types of Unclassified Benefits taxed under the FBT regime, this limitation increases the coherence of the tax system by aligning the taxability of Unclassified Benefits with the FBT regime's purpose.

Overall impact on revenue integrity

Any potential loss of tax revenue through the New Rules would be mitigated (or potentially set-off entirely) through more small businesses complying with the New Rules than the Current Rules.

Impact on the New Zealand economy and business growth

The New Rules will result in lower compliance costs. As such, the New Rules should have a positive impact on the New Zealand economy and business growth; small businesses will be able to put their compliance cost savings towards revenue generating activities.

The Eligibility Criteria will exclude some small businesses who fall outside of any of the threshold requirements. It is theoretically possible that an employer could refrain from hiring additional employees or increasing turnover to meet the Eligibility Criteria. However, the prospect of a small business taking such steps in practice would seem very unlikely.

VI. CONCLUSION

By remedying the unintuitive nature of the Current Rules and reducing the disproportionately high compliance costs to comply with these rules, the New Rules will enable more small businesses to comply with their FBT obligations.

With the FBT regime remaining largely unchanged since its introduction, and with increasing political appetite of the need for change to the FBT rules, the SFBFT Regime is ripe for introduction.

³⁵ Inland Revenue above n 3, at [92].