

Regulatory Impact Statement

Tax relief for welfare payments by employers – Christchurch earthquake

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Inland Revenue.

It provides an analysis of options to provide tax relief for welfare payments by employers to employees to help them recover from the 4 September 2010 Canterbury earthquake and its aftershock, the 22 February Christchurch earthquake.

The analysis has been undertaken in a very constrained timeframe, due to the urgency of the Government decisions that are required. This has severely limited the depth of research and analysis able to be undertaken. Where fiscal cost estimates have been made there is a significant degree of uncertainty involved due to difficulties in accurately estimating the quantum of employer welfare support and the proportion of that support that would in any case be treated correctly for tax purposes. Also, communicating the issue to employers at this stage is not consistent with the approach that Inland Revenue has taken to the earthquake, given record keeping and other difficulties that taxable treatment might pose.

As a result of the urgency of the Government decisions that need to be made in relation in this problem, consultation has been extremely limited. Consideration has been given to correspondence received by Ministers and officials in connection with the issue. Consultation has been undertaken with the Treasury and the Treasury supports Inland Revenue's conclusions and recommendations.

None of the policy options would impair private property rights, restrict market competition, reduce the incentives for businesses to innovate and invest, or override fundamental common law principles. One of the options selected has the potential to increase compliance costs, but only if employers wish to access tax refunds. This trade-off was necessary for equity purposes.

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STATUS QUO AND PROBLEM DEFINITION

Background

1. Following the Christchurch earthquake on 22 February 2011, many employers provided welfare contributions to their employees who were affected by the earthquake. These welfare contributions have been made in a variety of different ways including pro rata cash payments, the specific provision of goods and services, and the provision of accommodation. Several public calls have been made to Ministers and officials seeking legislation to provide tax relief for employers for these welfare contributions.

2. This analysis is complicated because the welfare contributions, albeit to an apparently significantly lesser extent, were also made as a result of the Canterbury earthquake.

Current law

3. Except to the extent the “on-premises” fringe benefit tax (FBT) exemption or the unclassified benefits de minimis threshold applies to employer provided goods and services, it is Inland Revenue’s considered view that these welfare contributions are subject to either income tax or FBT as appropriate.

The policy problem

4. It is arguable that, except perhaps for donations of sundry goods, according to good tax policy these welfare contributions would be taxed notwithstanding their welfare intent. This is because the payments are made in the context of an employer/employee relationship.

5. However, it is also arguable that the government should encourage employer welfare contributions such as these, even though these employees are perhaps comparatively better off than other employees whose employers cannot support them in a similar fashion.

6. We are aware that employers have adopted different income tax positions in respect of these contributions, even though we believe that the correct approach is clear. This is particularly the case for pro rata cash payments made to, say, all Christchurch staff to alleviate their immediate welfare problems.

7. In the case of fringe benefits, these returns are not due until May and we suspect that, in general, employers will not have turned their minds to the issues here and are unlikely to return to the issues at a later time. It will simply be presumed by employers that the benefits are outside the tax net. Also, communicating the issue to employers at this stage is not consistent with the approach that Inland Revenue has taken to the earthquake, given record keeping and other difficulties that taxable treatment might pose. In addition it is unlikely that Inland Revenue would audit in this space.

OBJECTIVES

8. The desired Government outcomes are to:

- uphold the general direction of tax law;
- encourage (or least not discourage) employers to look after their staff;
- ensure that the revenue base remains sufficiently protected; and
- provide certainty to those employers providing this support to their employees who have been affected by the earthquake.

9. The desired Government outcomes must be achieved within a short timeframe. This is because they are responding to a devastating event that has already occurred. Ideally, people should have certainty as to what the tax treatment will be in respect of certain things they have done or are contemplating doing as soon as practically possible. This is certainly the case where the consequence is an exposure to income tax as larger employers have to finalise their 31 March 2011 payroll by 5 April, and smaller employers have until 20 April.

REGULATORY IMPACT ANALYSIS

10. Several different options (not all mutually exclusive) have been considered to address the problem and achieve the desired Government outcomes.

Option 1: No relief, or relief from FBT for sundry non-cash benefits only

11. The case for no relief was not seriously considered as it was obvious that, at the least, relief needs to be provided for sundry benefits where it was likely that the employer did not know which employees had got what benefits. There was also the risk of the “on-premises” FBT or the unclassified benefits de minimis threshold exemptions applying or not applying depending on the employer’s exact circumstances. While the first issue could be addressed within the confines of existing scheme (and could potentially be FBT charged), the second issue could lead to disparate FBT expenses between employers who had provided similar benefits, but in a different way.

12. The case for offering limited relief for sundry non-cash benefits is a mixture of pragmatism and the acknowledgement of the potential horizontal equity position between employers.

13. This option has been agreed to by Ministers.

Option 2: Provide complete relief from tax for all employer welfare contributions

14. An option is to totally tax exempt all employer welfare contributions made to employees. This could be open-ended both as to when the welfare was provided, and how much was provided. That is, this option would not be limited to welfare provided following the Christchurch earthquake. Given the policy position that, except perhaps for donations of sundry goods, it is good tax policy to tax welfare contributions made in the context of an employer/employee relationship and the potential fiscal risk, this option was not considered to be appropriate.

Option 3: Provide a wider limited relief

15. Ministers asked us to consider whether widely targeted and fiscally responsible relief could be offered. Ministers decided that such relief could be loosely based on the MSD grant to individuals called “earthquake job loss cover”. This grant is \$400 a week per person and is payable for 6 weeks after the earthquake. Accordingly, we developed a proposal that could apply to cash payments to employees and to goods provided to specific employees.

16. The major features of this proposed relief are that the cash and/or benefits are:

- capped at \$2,400 per each employee with amounts over this being taxable;
- paid or provided in the six weeks after the Christchurch earthquake;

- not in lieu of salary or increments thereto (to help ensure appropriate targeting);
- not targeted on seniority of employee (again to help ensure appropriate targeting); and
- not available to persons associated with the owners of the employer, except where the benefit is of the type that has been provided to all non-associated employees (again to help ensure appropriate targeting).

17. From a compliance cost perspective, this is easy to comply with where the welfare contribution is of items that would otherwise be subject to FBT (because this is not calculated until later in May), and of cash contributions which have not been subject to income tax (in the form of PAYE). However, where income tax been accounted for, there are significantly higher compliance and administration costs, which can be partially mitigated by making the announcement as soon as is possible. Steps are under way to meet this objective if this option is adopted.

18. The compliance and administration cost risk has been considered and while there are difficulties for both Inland Revenue and employers if the adjustments cannot be completed before the 2010–11 tax year payroll can be finalised, we will seek to put in place further mechanisms to mitigate the risk in the circumstances.

19. This option has been agreed to by Ministers.

Option 4: Provide a tax exemption for employer provided accommodation

20. A number of employers are providing or meeting the cost of employee accommodation (generally short term) when the employees' houses are unusable or where the employee needs a respite from Christchurch. If employers did not provide this assistance, frequently the state would at least have to contribute to this cost.

21. This option would potentially be subject to abuse and so the same general rules that would apply for option 3 would also apply for this option, except that there would be no cap. Further, if this is adopted, it would likely be announced on 29 March, and in relation to the Christchurch earthquake, the six week period expires on the 5th of April, which also helps mitigate the fiscal risk.

22. Again, this option has been agreed to by Ministers.

CONSULTATION

25. The urgency of the Government decisions that need to be made in relation to this problem has meant that consultation has been extremely limited. Consideration has been given to correspondence received by Ministers and officials in connection with the issue. Consultation has been undertaken with the Treasury and the Treasury accepts the preferred options.

23. However, there will be a period for public feedback after the announcement on 29 March, and we propose to consult on the draft legislation with two taxpayer representative organisations before the legislation is finalised.

CONCLUSIONS AND RECOMMENDATIONS

24. Officials have considered the options outlined above. Officials consider that implementing options 1, 3 and 4 are appropriate and best address the problem in a way that meets the desired Government outcomes. This solution limits the potential cost and risks associated with providing tax relief. It provides a more publicly acceptable tax treatment for employers that are supporting the relief effort than the status quo, whilst providing the necessary degree of protection to the revenue base.

25. Further, it has been agreed by Ministers that, for equity reasons, these options would also apply to the 4 September 2010 Canterbury earthquake.

IMPLEMENTATION

26. The proposed options will be given effect by amendments to the Income Tax Act. The amendments will apply retrospectively. The legislative vehicle for these amendments is a special omnibus earthquake related tax bill expected to be introduced and enacted in May 2011.

MONITORING, EVALUATION AND REVIEW

27. In general, Inland Revenue monitoring, evaluation and review of new legislation takes place under the Generic Tax Policy Process (“GTPP”). The GTPP is a multi-stage tax policy process that has been used to design tax policy in New Zealand since 1995. The final stage in the GTPP is the implementation and review stage, which involves post-implementation review of the legislation, and the identification of any remedial issues. Opportunities for external consultation are also built into this stage. In practice, any changes identified as necessary for the new legislation to have its intended effect would generally be added to the Tax Policy Work Programme, and proposals would go through the GTPP.