

Commissioner's Statement CS 16/02

Determining "Market Rental Value" of Employer-Provided Accommodation

The purpose of a Commissioner's Statement is to inform taxpayers of the Commissioner's position and the operational approach being adopted on a particular tax matter. The Statement is not a consultative document.

All legislative references are to the Income Tax Act 2007 (the Act).

This Commissioner's Statement replaces any previous operational statements on this issue, with effect from 1 April 2015.

Introduction

1. Changes to the Income Tax Act 2007 that came into force on 1 April 2015 (although some of the changes may have earlier effect) have altered the way in which employer-provided New Zealand accommodation is taxed, including the basis on which the value of such accommodation is determined.
2. This statement provides guidance to assist taxpayers in estimating the likely market rental value of employer-provided accommodation. It is not meant to provide comprehensive guidance on all aspects of the new provisions. If a taxpayer is unsure whether they are properly complying with their tax obligations, or whether the changes apply to the accommodation they are providing, they should consult a tax professional.
3. When an employer provides free, or subsidised, accommodation to employees, the **market rental value** of that accommodation is generally taxed as income of the employee. If the employer is providing accommodation that they have, in turn, rented from a non-associated third party on an arm's-length basis, then the market rental value will be the rent so paid. However, when the accommodation is owned by the employer, or obtained from a third party under anything other than an arm's length arrangement, it is necessary to establish its market rental value.
4. Section CE 1B(1) provides the general rule:

The value of accommodation provided to a person is income of the person when it is provided in relation to their employment or service. The value is an amount equal to the market rental value of the accommodation.
5. Establishing the market rental value necessarily involves a process requiring the estimation of that amount. While the market rental value is inherently a matter of judgment, based on the expertise and experience of the person making the estimate of the value, a number of objective factors can be

used.

6. Absolute accuracy is not expected, but it is expected that a reasonable and appropriate process is followed when estimating the market rental value. It is also expected that the process that is followed, and the factors that were taken into account, will be documented and available for review. Where the process that was followed is able to be demonstrated as reasonable in the circumstances, the actual valuation is unlikely to be questioned and shortfall penalties would not arise.
7. This statement sets out the Commissioner's view on which factors can be taken into account when estimating the market rental value of accommodation provided by an employer to an employee, and those factors that are not relevant.
8. This Commissioner's Statement only applies to the provision of accommodation by an employer to an employee in New Zealand. This includes accommodation owned, or rented, by an employer that is provided to an employee. Separate guidance will be provided for accommodation provided to employees outside New Zealand, as different tax rules apply. Similarly, it is also intended to provide specific guidance for the provision of accommodation that is located within the grounds of a boarding school.
9. As discussed in more detail below, the Commissioner considers that the phrase "market rental value" refers to the amount that would be arrived at by two non-associated parties, on an arm's length basis, for the rental (whether on a periodic or fixed term basis) of the accommodation.
10. When the accommodation is owned by the employer, or is rented by the employer on other than an arm's length basis, a number of factors can be taken into account when determining the market rental value of the accommodation.
11. Employer-provided accommodation can arise in a wide range of circumstances and in a wide range of sectors or industries. It is not possible for this statement to provide specific guidance for accommodation arising from different employment situations. However, it should be noted that only limited exceptions apply and therefore the guidance provided in this statement will broadly apply across those different situations.
12. For example, the same rules apply to accommodation provided by a farmer to a farm worker in rural New Zealand as apply to the provision of a house by a company to an executive in Auckland. The estimated market rental value of the property is taxable income of the employee (the farm worker or the executive) and the employer (the farmer or the company) is required to account for PAYE on the market rental value of the accommodation.
13. New Zealand operates a self-assessment tax system. This means that both the employer and the employee are responsible for meeting their respective tax obligations. However, in the case of employer-provided accommodation, it is the employer's primary responsibility to estimate the market rental value of the accommodation on a reasonable basis and to ensure that tax on the amount is properly accounted for. In the first instance, this means that PAYE must be paid on the market rental value of the accommodation.

14. However, the value of the accommodation will also directly affect the employee. For example, as the value of accommodation will be part of the employee's income, it will be taken into account for child support or Working for Families Tax Credit purposes. It may therefore be good practice for the employer to discuss the basis on which the valuation has been reached with the employee, while recognising that such consultation cannot be for any purpose other than making a reasonable estimate of the market rental value. Deliberately undervaluing accommodation to benefit the employee will not be considered reasonable by the Commissioner.

Market rental value

15. The term "market rental value" is not defined in the Income Tax Act 2007. However, it is a commonly used and understood term that does not have any different, or specific, meaning in a tax context. The Commissioner considers that market rental value refers to the periodic rental that would be paid if similar accommodation in a comparable location, subject to similar restrictions or conditions relating to the tenancy, was rented on an arm's length basis between non-associated parties. The Commissioner also considers that the amount actually paid to a third party as consideration under an arm's length rental arrangement is the "market rental value" of the accommodation.
16. There are a number of factors that the Commissioner considers can be taken into account when estimating the market rental value, but there are also a number of other factors that are not relevant and therefore cannot be taken into account. In particular, those conditions that arise out of, or are peculiar to, the employment relationship itself, as opposed to arising under a lessor/lessee relationship, are irrelevant to estimating what the market rental value of the accommodation would be.

Factors to take into account when determining market rental value

17. In determining the market rental value of accommodation, the aim is to estimate the amount that would be likely to be paid if the specific accommodation was available for rental on an arm's length basis. This will normally be determined on the basis of a comparison with comparable properties (similar location, type of accommodation, condition and amenities). However, that may not always be possible.
18. Relevant matters to take into account in establishing an appropriate market rental value, consistent with the approach taken by registered valuers, include:
 - The location of the accommodation, taking into account aspects such as its desirability, access to amenities (such as transport, shopping etc.), relative building values and security.
 - The specific functional characteristics of the particular accommodation, such as the number of bedrooms, overall size, availability of parking, laundry facilities etc., and the quality of the build.
 - The overall, relative, condition of the accommodation, including whether it is rundown or, conversely, a luxury or high quality dwelling.

- The ease of travel to and from places of work, schools, shopping etc., including the availability of public transport.
 - Restrictions on use of the accommodation, or access to it, where such restrictions substantially inhibit the rights of use that would normally be available to a lessee. The Commissioner considers it unlikely that minor, or reasonable, restrictions, such as in respect of pets or smoking, would have a more than *de minimis* effect on the market rental value of accommodation, if at all.
19. Therefore, it would be expected that accommodation in a sought after urban location will have a higher market rental value than similar accommodation in a less sought after location. However, the actual market rental value will reflect the relevant market – therefore, a higher value might be appropriate on the basis of limited availability of rental accommodation.
20. Accommodation provided within an employer’s place of business and with significant restrictions placed on the times at which persons (particularly visitors) could come and go, might be likely to attract a discount. Similarly, if the premises are not particularly desirable, for example, a house in factory premises, such a lack of relative desirability will be reflected in the likely demand for such a dwelling and therefore its likely market rental value.

Factors that cannot be taken into account:

21. As noted above, the market rental value is the likely rental value of accommodation if it was available on an arm’s length basis.
22. In the case of an employer making accommodation available to an employee, there may be a number of reasons why the employer, or the employee, may consider that a reduced rental value is appropriate. For example, it may be a condition of employment that the employee occupy a specific dwelling, or a reduced rental may be considered appropriate having regard to the level of remuneration received by the employee.
23. However, the Commissioner’s view is that contractual or employment-related matters will not have an effect on the market rental value of the accommodation. Rather, they are personal to the employee and, therefore, such matters would not apply to any arm’s length transaction. As a result, such matters cannot be taken into account when estimating the market rental value of accommodation provided to employees.
24. In addition, it is not relevant, when estimating a market rental value, that there may not be an actual arm’s length market for specific accommodation, for example, where the accommodation that is made available to the employee is not, and never will be, available to members of the general public. This may arise for such reasons as a concern over security, or because the accommodation is intrinsic to the employment relationship.
25. In such cases, the market rental value should be established on the basis of a similar class of accommodation that is available to the general public in the same, or a similar, area.

Market rental value of individual accommodation

26. The Act imposes a tax liability that arises from the specific provision of accommodation to each employee. Where a variety of accommodation is provided to a number of employees, an employer is not permitted to attribute an average market rental value to the accommodation, even though it may be more convenient or cost efficient to the employer. Rather, the estimated market rental value of the actual accommodation provided to each employee must be used, and as such gives rise to the relevant tax liability.

Example 1: An employer owns three different dwellings that are provided to three different employees. A valuation has determined that the dwellings have a likely market rental value of \$100, \$150 and \$200 per week, respectively. These actual market rental values must be used to determine the taxable amount attributable to each employee. It is not possible to attribute an average value of \$150 to each employee.

27. However, if a group of employees are provided with shared accommodation in one property, then the market rental value of the entire property can be apportioned between the employees to determine the market rental value of the individual accommodation. Any reasonable basis of apportionment will be acceptable, as long as it is agreed to by the affected employees. If all the employees do not agree to a basis of apportionment, then it must be apportioned equally (as required by section CE 1B(4) of the Act).

Example 2: A three-bedroom dwelling is shared by three employees. The market rental value of the accommodation is \$450 per week. As there is no substantial difference between the rooms occupied by each employee, the amount attributed as income for each employee is \$150 per week.

Example 3: Three employees share a three-bedroom house. One of the employees also has sole use of the attached garage. The market rental value of the accommodation is \$500 per week. As there is no substantial difference between the rooms occupied by each employee, all of the employees agree that the amount attributed as income to the two employees who do not have use of the garage is \$150 per week, and the amount attributed to the employee who has the use of the garage is \$200 per week.

Market rental valuation methods

28. The Act does not specify how to determine the market rental value of accommodation an employer provides, or how often it is necessary to obtain an updated valuation. Rather, the Act simply imposes a tax liability in respect of the accommodation and as a consequence an obligation on the employer to establish the market rental value of such accommodation and account for tax (generally PAYE) accordingly.
29. Therefore, it is open to the employer to adopt any reasonable basis for determining the market rental value of the accommodation. For example, the possible basis for a market rental value might include (but isn't necessarily limited to):
- a valuation from a registered valuer;

- an estimate of the market rental value from a real estate agent, property manager, or other suitably experienced person;
 - a review of comparable properties on internet sites that advertise rental properties, for example, Trade Me;
 - any other reasonable basis that takes into account the features of the accommodation being provided and compares it with similar accommodation.
30. Inland Revenue does not have a preference for any particular basis of determining the market rental value of accommodation. However, as with any other tax position taken by a taxpayer, it is expected that a taxpayer will take reasonable steps, and exercise reasonable care, in reaching a view on the appropriate market rental value. For example, if a valuation or estimate is sought from a registered valuer, real estate agent, or property manager, such a person would need to be suitably experienced and qualified. Similarly, if the market rental value is determined by using the values of other properties on Trade Me, it will be necessary to use a comparison with similar accommodation.
31. In all cases, it is necessary to document the basis on which the market rental value was reached. In the case of a valuation provided by a valuer, real estate agent or property manager, this could be a letter that sets out the valuation, how it was reached, and the factors and information taken into account.

Example 4: *Bruce has hired a new mechanic, Rob, for his garage. Rob has moved to Wellington from Hawera and hasn't found anywhere to live, so Bruce has agreed to let Rob live in the house in Karori that he recently inherited, while Rob gets himself settled. As the house has never been rented (it was owned by Bruce's mother for 62 years) Bruce has no idea how much the market rental value of the property is. However, Bruce knows that there is a strong rental market in Karori so he asked a local property manager, Felicity (who Bob is going to use to manage the property once Rob moves out), to estimate the likely rental that he will get once the house is put on the rental market.*

Felicity inspected the house and, on the basis of a comparison with similar houses (facilities, condition, location) that she manages, she has advised that a weekly rental of \$500 is appropriate. Felicity backed this up with a letter confirming the amount and setting out the basis for the amount.

32. When an employer reaches their own estimate of the market rental value, for example, by using Trade Me, it is important to ensure that a fair and appropriate sample is used for comparison and as the basis for the valuation.

Example 5: *Margaret runs a French restaurant in Tawa. The restaurant is very busy, but Margaret has difficulty finding waiting staff with the right experience.*

Following a trip to Paris, Margaret was successful in employing a waiter, Jean-Claude, but found it necessary to include the provision of accommodation in his salary package. Margaret found it economical to purchase a three-bedroom ex-State house to provide to Jean-Claude.

However, Margaret wants to keep her costs down so she looked on Trade Me to see what similar houses in the area are renting for. The house she bought is conveniently located near a commuter train station, so she limited her comparison to other three-bedroom houses with similar public transport connections. She found four houses that were comparable, and found that the rent being sought ranged from \$350 to \$400 per week, with the average being \$380 per week. There were a number of cheaper houses available, but as they were not of the same quality, she excluded them. She also excluded the more expensive new build houses. However, as Margaret had her house redecorated and insulated before making it available to Jean-Claude, she decided that it would be more appropriate to estimate the market rental value at \$400 per week.

33. When a taxpayer estimates the market rental value of accommodation on the basis of a comparison with other properties, for example, by using Trade Me information, it is important to ensure that the process that was followed, and the information relied on, is documented. This may include printing out the listings of the properties that were used as a comparison, recording the rental being sought for those properties, and recording why they were considered to be valid comparisons.
34. The Commissioner's view is that it is necessary to establish an initial estimate of the market rental value of the accommodation (as at the time the arrangement commenced) and to then review that valuation from time to time, as appropriate, to ensure that the rental value, and therefore the taxable income, is as accurate as possible. How often this will be needed will depend on whether there has been a shift in the market rental value of accommodation for the particular area. However, it is suggested that the value of the accommodation should be reviewed at least every three years and adjusted accordingly. If the likely market rental value has declined, then the taxable income of the employee can also be reduced. A review of the market rental value will require a similar process as followed to reach the initial estimate of the market rental value.

Employee contribution

35. When an employee contributes to the cost of employer-provided accommodation, the amount paid by the employee will reduce the income attributed to the employee.

Example 6: *The market rental value of employer-provided accommodation is \$200 per week. The employee pays to the employer (whether by way of payment, or deduction from salary or wages) \$150 per week. The amount of income derived by the employee will be \$50.*

Employee obligations

36. The market rental value of accommodation provided by an employer to an employee is taxable income of the employee. As such, it will be taken into account for such things as child support, student loans and Working for Families Tax Credits.
37. The employee, therefore, has an interest in the accommodation being properly, and correctly, valued. For example, if the accommodation is not correctly valued, the employee may be subject to too much or too little

income tax, or it may result in an incorrect calculation of a student loan repayment obligation or child support entitlements or liability.

38. It is therefore suggested that the employer discusses the method adopted to value the accommodation with their employee. Alternatively, an employee may wish to discuss with their employer the basis on which the estimate of the market rental value of their accommodation was reached.

Further examples

39. The following examples are intended to illustrate particular circumstances. They are not intended to reflect all possible circumstances.

Example 7: *Farmer Brown supplies a cottage each to three live-in farm workers. While the farm workers could live in the nearest town, it is more convenient for Farmer Brown to have the workers living on-site, as they are readily available to respond to stock-related emergencies more quickly.*

As the farm workers are required to deal with such emergencies when they arise, and because the cottages are quite rundown, Farmer Brown doesn't charge the farm workers for the accommodation. In addition, as the cottages are located in the heart of a working farm, there is little privacy, no peace and quiet, and no practical opportunity for the farm workers to have guests or visitors.

Farmer Brown considers that, as he would never make the cottages available for rental, they would not have a market rental value.

Furthermore, the nearest town does not have an established rental accommodation market, so even if it was convenient, the farm workers would not be able to live in town unless they bought or built a house.

Answer:

The market rental value of the cottage is taxable income of the employee. It is accepted that it will be difficult for Farmer Brown to establish the market rental value of the cottage, as there is no relevant nearby market to use as a comparison. A number of options are available to Farmer Brown. He could hire a valuation professional to assist him, or he could look on the internet to see if similar cottages are available for rental in other similar locations.

Ultimately, Farmer Brown could reach a view, having regard to his experience, on what a reasonable estimate of the market rental value would be. Whichever option is adopted, it is important to ensure that the process followed, and the factors taken into account, are documented.

The employment arrangement that gives rise to the supply of the accommodation does not affect the market rental value. The market rental value reflects the amount that would be charged in the absence of such an employment arrangement. The fact that the employees are expected to deal with emergencies does not give rise to any reduction in the value of the accommodation, but rather is a matter addressed by the employment arrangement (and in this case has given rise to Farmer Brown not charging rent). The rundown nature of the accommodation

will likely be reflected in the market rental value, and environmental factors, such as excessive noise, would similarly be taken into account.

*It is similarly not relevant that Farmer Brown would not make the cottages available to non-employees. It is necessary to establish the likely market rental value **if** the properties were put on the open market.*

Farmer Brown can also not attribute an average value to each dwelling. It is necessary to attribute the correct income to each employee, on the basis of the accommodation actually supplied to them.

Example 8: *Mike has recently returned to New Zealand from a few years overseas and has decided to train as an electrician. He was lucky enough to be taken on as an apprentice. As he has been unable to find somewhere to live, his employer, John, has agreed to let him live rent free in John's luxury penthouse in central Auckland for six months. Before Mike moved in, the penthouse had been rented to members of the public for \$1,500 per week (and the market has not moved significantly in the meantime).*

Answer:

The market rental value of the apartment is \$1,500 per week, as this is the amount of the previous arm's length rental. Mike's taxable income is increased accordingly.

Mike considers that this is excessive, as he would only ever pay up to \$300 per week for rent. While that may be true, section CE 1B(1) of the Act includes in his taxable income the market rental value of the accommodation provided to him by his employer, not the amount that he is saving by being given free accommodation.

Example 9: *Vanessa is employed (she is not an IR56 taxpayer) as a nanny by Mr and Mrs Wells to look after their three children, Anita (2), Jenny (4) and Laura (5). Vanessa works long hours looking after the children, but is provided with a room within the Wells' household. Vanessa is regarded as a full member of the household, has access to all parts of the house, joins the family for meals, and often watches television, once the children are in bed, with Mr and Mrs Wells.*

As part of her duties, Vanessa is expected to attend to the children if they wake up in the night. She is only "off duty" when the children are asleep or she is on her day off. Even on her day off, the children will usually want to play with her and she is usually woken up by the children each morning.

The Wells family, and Vanessa, live in a six-bedroom house. To obtain an appropriate market rental valuation of the accommodation provided to Vanessa, Mr and Mrs Wells' accountant has engaged a registered valuer to provide them with a valuation.

Answer:

The accommodation provided to Vanessa is one bedroom in a six-bedroom house. If Vanessa did in fact have unrestricted use of the house, such as in a flatting environment, an appropriate basis on which

to calculate the market rental value of that one bedroom would be on the basis of one-sixth of the market rental value of the entire house.

However, in many cases Vanessa's actual entitlement to the use of the house would be likely to be far more restricted, recognising the reality that she is an employee. The extent of the restrictions might be explicit, such as being required to eat her meals or watch television in her own room, or a less explicit expectation that she recognise her employer's privacy. In such cases, a lesser value, reflecting the actual extent of the private use that she has of the house, would be appropriate.

No adjustment is made on the basis of the duties that Vanessa is expected to perform and the relative lack of privacy that she experiences. Such matters are appropriately addressed by the remuneration that Vanessa receives (which includes the market rental value of the accommodation).

No specific adjustment needs to be made in respect of any lack of privacy, which is considered an inherent feature of shared accommodation.

Example 10: Vanessa's friend, Karen, is also a nanny. Karen is also provided with accommodation, but in a separate "granny flat". In Karen's case, the market rental value of the separate granny flat can be established and will be the amount that is treated as taxable income.

Example 11: Martin is employed as the manager of a motel complex. Martin is provided with a separate, three bedroom house for his use. The house is located within the motel complex, but separate from the motel units.

Answer:

The starting point for establishing the market rental value of the house should be similar houses in the vicinity. It may also be relevant to take into account other houses with similar levels of noise, or foot and vehicle traffic. However, no adjustment should be made for matters related to Martin's employment, such as the likelihood of being disturbed by guests wanting to check in late, or a guest needing something repaired in their motel unit.

Example 12: Kat is a barista in a popular holiday town. While the café that Kat works in is busy all year round, in summer the town becomes very busy and accommodation is eagerly sought after by holiday-makers, to the extent that many residents rent out their houses. As a rule, rental accommodation can attract up to three-times as much in summer as it can the rest of the year.

Kat is fortunate to be provided with a small house by her employer. Kat and her employer have entered into a long term rental arrangement and Kat pays the "winter rate" all year long.

Answer:

While it is accepted that for most of the year Kat pays a market rental amount, during summer she pays a lot less than her employer would be able to rent the house out for. However, the rent that Kat pays is

appropriate when it is taken into account that she has entered into a long term rental agreement.

Example 13: *Kat's friend, Simon, is employed at the café as a barman over the busy summer period. Simon is provided with a house similar to Kat's, and he is charged the same rent as Kat.*

Answer: As Simon is only renting the accommodation over the summer period, the higher "summer rate" is the appropriate market rental value. Taxable income arises to the extent that the summer rate exceeds the rent being paid by Simon.

Application

40. This statement provides general guidance to assist taxpayers in meeting their tax obligations. This approach can be used by taxpayers for, and will be applied by the Commissioner to, periods commencing on or after 1 April 2015, which was the commencement date of the new legislation.
41. Specific guidance should be sought from appropriately qualified tax professionals.
42. If you have any concerns about compliance with the tax obligations discussed in this Commissioner's Statement, you should discuss the matter with a tax professional or Inland Revenue.

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Date of Issue: 24 November 2016