Inland Revenue
Te Tari Taake

FEDERAL INSURANCE CONTRIBUTIONS ACT (FICA) – FRINGE BENEFIT TAX (FBT) LIABILITY

PUBLIC RULING - BR Pub 01/05

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

All legislative references are to the Income Tax Act 1994 unless otherwise stated.

This Ruling applies in respect of sections CI 1 (e), CI 1(g) and CI 1(h).

The Arrangement to which this Ruling applies

The Arrangement is the deduction of FICA contributions and the paying of these along with the employer contribution, to the United States Federal Government in accordance with the Federal Insurance Contribution Act, by any New Zealand resident employer who is required to do so due to employing a citizen or citizens of the United States of America.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Moneys paid to FICA are not subject to FBT under section CI 1(g), as the contributions are not made to a "superannuation scheme" as defined in section OB 1.

- Moneys paid to FICA are not subject to FBT under section CI 1(h), as no benefit is received by the employee in the quarter or income year within the meaning of the FBT rules.

- Moneys paid to FICA are not subject to FBT under section CI 1(e), as the FICA scheme has not been approved by the Commissioner for the purposes of section CB 5, and FICA is not a "sick, accident or death benefit fund" as defined in section CB 5(2).

The period or income year for which this Ruling applies

This Ruling will apply for the period 1 July 2001 to 30 June 2004.

This Ruling is signed by me on the 11th day of May 2001.

Martin Smith
General Manager (Adjudication & Rulings)

Inland Revenue
Te Tari Taake

COMMENTARY ON PUBLIC RULING BR Pub 01/05

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 01/05 ("the Ruling").

Background

If a United States Citizen is employed in New Zealand, under the Federal Insurance Contributions Act (FICA) of the United States of America, employers and employees may be required to contribute a stated percentage of taxable wages paid to the FICA scheme. The employee portion of the FICA contribution must be withheld and paid from each payment of taxable wages, and in addition the employer must pay the employer portion.

The FICA establishes two funds. The first is old age, survivors, and disability insurance (OASDI). The second is hospital insurance (HI). The current rate of contribution to the FICA scheme is 7.65%, made up of 6.2% for OASDI and 1.45% for the HI portion. This OASDI/HI rate of 7.65% is imposed on both the employer and the employee, so the employer contribution together with the employee's withheld amount result in a combined rate of 15.3%.

Legislation

The relevant meaning of "fringe benefit" is defined in section CI 1 as follows:

> In the FBT rules, "fringe benefit", in relation to an employee and to any quarter or (where fringe benefit tax is payable on an income year basis under section ND 4) income year, means any benefit that consists of –
> …
> (e) In relation to an employer of an employee, any contribution to any sick, accident, or death benefit fund which has been approved by the Commissioner for the purposes of CB 5:
> …
> (g) Any contribution in relation to an employer of an employee, to any superannuation scheme:
> (h) Any benefit of any other kind whatever, received or enjoyed by the employee in the quarter or (where fringe benefit tax is payable on an income year basis under section ND 4) income year, -

The relevant meaning of "superannuation scheme" is defined in section OB 1 as follows:

> "Superannuation scheme" means-
> …
> (c) Any arrangement constituted under an Act of the Parliament of New Zealand, other than the Social Security Act 1964, principally for the purpose of providing retirement benefits to natural persons; or any similar arrangement constituted under the legislation of any country, territory, state, or local authority outside New Zealand;-
> and where the superannuation scheme is a trust, any reference in this Act to a superannuation scheme includes a reference to the trustees of that scheme:

Application of the legislation

The substantive issue is whether the employer is required to pay fringe benefit tax (FBT) on any part of the contributions made to the FICA scheme.

The employee contribution is required to be withheld from the employee's gross income by the employer and is therefore not considered to be a fringe benefit provided by the employer, as it is expenditure on account of the employee.

The employer contribution is required to be paid over and above the employee's gross salary or wages. An issue arises as to whether FBT applies to the employer contribution, as this is a payment by an employer in relation to an employee.

Section CI 1(g)

Section CI 1(g) concerns whether contributions are made to a "superannuation scheme", as defined in section OB 1, and therefore attract FBT.

Under subsection (c) of that definition, "superannuation scheme" includes:

> any arrangement constituted under an Act of the Parliament of New Zealand, other than the Social Security Act 1964, principally for the purpose of providing retirement benefits to natural persons; or any similar arrangement constituted under the legislation of any country, territory, state, or local authority outside New Zealand.

Therefore, to come within the "superannuation scheme" definition, an arrangement constituted under the legislation of any country or state outside New Zealand, such as FICA, must be similar to an arrangement constituted under New Zealand legislation that has the principal purpose of providing retirement benefits.

Two basic or generic types of employee superannuation schemes exist: defined contribution schemes and defined benefit schemes. A defined contribution scheme is one where contributions are defined in advance, usually as a fixed percentage of an employee's salary, and benefits are determined by the amount of accumulated contributions plus income earned on those contributions. In such schemes the principle of allocated funding is employed, where contributions are invested as a common fund, but separate accounts are opened in respect of each member. Given that there is no beneficial entitlement to any particular amount that has been contributed to the FICA scheme (as the FICA scheme pays a statutorily fixed benefit on the basis of eventual eligibility as opposed to contributions made), it is considered that the FICA is not a sufficiently similar arrangement to a defined contribution scheme.

A defined benefit scheme is one that provides benefits based on a predetermined formula, usually relating the benefit level to the number of years of service and, in some cases, the average or recent levels of pay. Such schemes employ unallocated funding, and the employer contribution rate varies in order to meet the cost of providing the defined benefit. While FICA may prima facie appear similar to such a scheme in that it also employs unallocated funding and members contribute a fixed percentage of salary, it is considered the FICA is not sufficiently similar to a generic defined benefit scheme, as the employer's contribution and employee's contribution are matched and the rate is contained in statute. This statutorily

imposed rate is fixed by the Federal Government of the United States, is involuntary, and an employer who fails to contribute the full amount as set down in statute may be liable for civil or criminal penalties.

It is therefore considered that FICA is not a sufficiently similar arrangement to either of these generic schemes (constituted under an Act of the Parliament of New Zealand principally for providing retirement benefits) to be regarded as a superannuation scheme as defined in section OB 1.

It is further concluded that the FICA is more similar to the New Zealand Social Security Act 1964, which is explicitly excluded from the definition of "superannuation scheme" as (on the words of the section) are similar arrangements constituted under the legislation of another country. Both schemes are tax funded and are the main government-provided retirement benefit schemes in the respective countries. In addition, both schemes form the basis of the social security systems in the respective countries, providing additional benefits such as those for sickness and disability. This conclusion takes FICA outside the definition of "superannuation scheme", so contributions to the FICA are not caught by section CI 1(h) as being liable to FBT.

Furthermore, contributions to FICA are more like a tax than a contribution to any superannuation scheme, as supported by the words of the Federal Insurance Contributions Act referring to the contributions as an "excise tax" (section 3111(a) and 3111(b)) and the penalties payable for non-payment of contributions that are the same as those for non-payment of federal income tax under the Internal Revenue Code. This view is also supported by an Australian decision, *Case 20* CTBR (NS) Vol. 7, 91 that by a majority held *employee* contributions under the FICA to be in the nature of an income tax, implying that the compulsory employer contribution is likewise more in the nature of a tax.

Section CI 1(h)

Section CI 1(h) includes as a fringe benefit "any benefit of any other kind whatever".

In addition, a fringe benefit under section CI 1(h) must be a benefit that is:

> used, enjoyed, or received, whether directly or indirectly, in relation to, in the course of, or by virtue of the employment of the employee… and which is provided or granted by the employer of the employee.

The Commissioner considers that the withholding of amounts from employees' wages or salaries provides no benefit. As to the employer's contribution, it is considered that in the absence of a beneficial entitlement to a matched contractual amount, no benefit is provided either.

It cannot be said that the employee receives a benefit at the point in time the employer makes a contribution to FICA, because it is a compulsory tax, goes into the Federal Government tax pool, and no beneficial sum is "belonging" to the employee. In addition, any eventual benefits from the FICA scheme do not satisfy the combination of requirements in section CI 1(h) to attract FBT liability.

It is a contingency whether the taxpayer ever receives any payment back from the Federal Government, as any benefit received depends on an individual meeting the eligibility requirements (entitlement to the old age benefit is based on reaching the age of 62 and being *fully* insured).

If an individual does receive a payment under the FICA scheme (paid as a monthly benefit), the person does so because of his or her United States citizenship and meeting the eligibility criteria etc. The person receives the government mandated amount, as opposed to a sum based on actual contributions made to the scheme.

So whilst eligibility in part is due to previous contributions made to FICA (and some of these are made by the employer), and this may be considered, "indirectly, in relation to, in the course of, or by virtue of the employment of the employee", if these words are of the widest import, overall, it is considered the nexus or connection between any eventual benefit and the employment of the employee is too remote (especially given that the only nexus is to eligibility at all, and not in any way connected to the quantum of any eventual benefit received).

Principally, the reason the benefit is received by the employee is not by virtue of the employee's employment, but because the employee is a United States citizen. Contributions to the scheme are not made voluntarily, but are compulsorily imposed by the Federal Government of the United States, and are not part of any employment contract or remuneration package.

Any amounts received by a United States Citizen from FICA will be received from the Federal Government and not in the course of, or by virtue of, the employment relationship. Such a conclusion is consistent with the outcome of *Constable v FC of T* (1952) 86 CLR 402, where the High Court of Australia concluded that Constable only became entitled to payments under his scheme as a result of contingencies that had become absolute in the year in question, but that such an event did not give rise to an "allowance, gratuity, compensation, benefit […]" to the employee "in respect of, or for or in relation" to his employment.

Accordingly, no benefit is "received by the employee in the quarter or income year" when the employee is being paid, and no sufficient nexus exists between the employer's requirement to pay funds to the Federal Government of the United States and the ultimate benefit the employee may eventually receive from the government at a later date, if eligible under statute.

Section CI 1(e)

Section CI 1(e) includes as a fringe benefit:

> In relation to an employer of an employee, any contribution to any sick, accident, or death benefit fund which has been approved by the Commissioner for the purposes of section CB 5:

The Commissioner has not approved the FICA scheme for the purposes of section CB 5.

The term "sick, accident, or death benefit fund" is not defined for the purpose of section CI 1(e), but is defined in section CB 5(2) for the purpose of that section. Section CI (1)(e) and section CB 5(2) are interlinked, as section CI (1)(e) requires that a "sick, accident or death

benefit fund" be approved by the Commissioner for the purposes of section CB 5. To be approved under section CB 5 such a fund must satisfy the section CB 5(2) definition

The FICA scheme is not a "sick, accident, or death benefit fund" as that term is defined in section CB 5(2), as the FICA scheme is not established for the "benefit of the employees of any employer" as required by that definition. FICA is the funding scheme for the provision of United States social security benefits and there is no sufficient nexus between the employer's requirement to pay funds to FICA and any benefit the employee may eventually receive from the government at a later date, if eligible under statute.

Accordingly, any payments made to the FICA scheme are not considered to be subject to fringe benefit tax under section CI (1)(e).