Inland Revenue
Te Tari Taake

THE PROVISION OF BENEFITS BY THIRD PARTIES: FRINGE BENEFIT TAX (FBT) CONSEQUENCES—SECTION CI 2(1)

PUBLIC RULING—BR Pub 04/05

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 section CI 2(1) and the definition of "arrangement" in section OB 1.

The Arrangement to which this Ruling applies

The Arrangement is the receipt of a benefit by an employee from a third party where there is an arrangement between the employer and the third party and where the benefit would be subject to FBT if it had been provided by the employer.

The Arrangement does not include situations where the remuneration given by an employer to an employee is reduced due to a benefit being received from the third party, or otherwise takes the receipt of a benefit provided by a third party into account (including salary sacrifice situations). There cannot be any trade-off between the benefits provided and the remuneration that would otherwise have been received by the employee, or any difference between the remuneration levels of employees who receive benefits and those who do not.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- For the purposes of section CI 2(1), there will be an arrangement for the provision of a benefit to employees where:

  (a) consideration passes from the employer to the third party in respect of the benefit being provided; or

  (b) the employer requests (other than merely initiating contact), instructs, or directs, the third party to provide a benefit; or

  (c) there is negotiation or discussion between the employer and the third party which (explicitly or implicitly) involves the threat or suggestion that the employer would withhold business or other benefits from the third party unless a benefit is provided to the employees; or

(d) the third party and the employer are associated parties, and there is a group policy (whether formal or informal), or any other agreement between the associated parties, that employees of the group will be entitled to receive benefits from the other companies in the group.

- Provided that none of the above exists, there will not be an arrangement for the provision of a benefit to employees for the purposes of section CI 2(1) where:

(a) there is negotiation or discussion between the employer and the third party that results in no more than:
  (i) the employer granting the third party access to the premises or work environment to discuss the benefit with employees; and/or
  (ii) agreement between the parties as to the level of benefit that is to be offered by the third party to employees; and/or
  (iii) the employer agreeing to advertise or make known the availability of the benefit; or

(b) the employer has done no more than initiate contact or discussions with the third party; or

(c) there is no significant contact between the employer and the third party.

The period for which this Ruling applies

This Ruling will apply for the period from 20 May 2004 until 19 May 2007

This Ruling is signed by me on the 20th day of May 2004.

Martin Smith
General Manager (Adjudication & Rulings)

Inland Revenue
Te Tari Taake

COMMENTARY ON PUBLIC RULING BR Pub 04/05

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 04/05 ("the Ruling").

This Ruling relates to an issue arising in the context of Fringe Benefit Tax, and has been under preparation for some time. Fringe Benefit Tax is currently the subject of a Government review. It is not known whether section CI 2(1), as presently enacted, will be amended as a result of this review.

The Commissioner has decided to issue this Ruling at this time, notwithstanding the current review of FBT, as he considers that it is still likely to be of assistance to taxpayers in any event. It is likely to be some time before any resulting legislation is enacted.

The Commissioner notes that if section CI 2(1), or the law in relation to the provision of benefits by third parties, is amended as a result of this review or otherwise this Ruling may cease to apply from the date that legislation is effective.

Background

This Ruling arises from a number of private ruling applications that the Rulings Unit has considered. It considers the scope of section CI 2(1), and what will be an "arrangement" that falls within the scope of the section.

Legislation

Section CI 2(1) states:

For the purposes of the FBT rules, where a benefit is provided for or granted to an employee by a person with whom the employer of the employee has entered into an arrangement for that benefit to be so provided or granted, that benefit shall be deemed to be a benefit provided for or granted to the employee by the employer of the employee.

"Arrangement" is defined in section OB 1 to mean, unless the context otherwise requires:

…any contract, agreement, plan, or understanding (whether enforceable or unenforceable), including all steps and transactions by which it is carried into effect:

Application of the Legislation

Liability for FBT

Under section CI 1, an employer is liable to pay FBT on fringe benefits provided or granted to an employee by the employer. However, under section CI 2(1) an employer can be liable for FBT if the employer enters into an arrangement with

another person (the "third party") for the provision of fringe benefits to the employer's employees.

Section CI 2(1) is an anti-avoidance provision. For it to have any application there must be **an arrangement** between the employer and the third party (the provider of the benefit), and that arrangement must provide for or grant a benefit to the employee of the employer entering into the arrangement.

It is clear that section CI 2(1) applies where any form of consideration passes from the employer to the third party to compensate for, or is otherwise in relation to, the benefit provided by the third party to the employee. The wording of section CI 2(1) is very broad and seems to apply in a range of cases wider than this obvious one. The issue is: where there is no direct or indirect consideration (in any form) provided by the employer to the third party, in what circumstances will the provision apply?

Conclusion on the application of the section

It is concluded that section CI 2(1) will apply, as there will be an arrangement for the provision of a benefit, in each of the following situations:

- Where consideration passes from the employer to the third party in respect of the benefit being provided; or
- Where the employer requests (other than merely initiating contact), instructs, or directs, the third party to provide a benefit; or
- Where there is negotiation or discussion between the employer and the third party which (explicitly or implicitly) involves the threat or suggestion that the employer would withhold business or other benefits from the third party unless a benefit is provided to the employees; or
- Where the third party and the employer are associated parties, and there is a group policy (whether formal or informal), or any other agreement between the associated parties, that employees of the group will be entitled to receive benefits from the other companies in the group.

Provided that none of the above situations exists, it is concluded that there will not be an arrangement for the provision of a benefit, and section CI 2(1) will not apply, in the following situations:

- Where there is negotiation or discussion between the employer and the third party that results in no more than:
    - (i) the employer granting the third party access to the premises or work environment to discuss the benefit with employees; and/or
    - (ii) agreement between the parties as to the level of benefit that is to be offered by the third party to employees; and/or
    - (iii) the employer agreeing to advertise or make known the availability of the benefit; or
- Where the employer has done no more than initiate contact or discussions with the third party; or
- Where there is no significant contact between the employer and the third party.

What is meant by the term "arrangement"?

The definition of "arrangement" in section OB 1 makes it clear that the term "arrangement" is very wide in its application, and that it encompasses not only legally binding contracts, but also even unenforceable understandings. It is clear that what is required for an arrangement to exist is less that that required for a binding contract.

The Concise Oxford English Dictionary (10th Edition, 1999) defines the individual words referred to in the section OB 1 definition as follows:

- "contract" – a written or spoken agreement intended to be enforceable by law.
- "agreement" – a negotiated and typically legally binding arrangement.
- "plan" – a detailed proposal for doing or achieving something.
- "understanding" – an informal or unspoken agreement or arrangement.

The above definitions show that the words used to describe an "arrangement" in section OB 1 form a sequence that descends in formality from a legally enforceable contract to a mere informal, unenforceable "understanding". These words all appear to be slightly differing concepts, each one less strict than the previous term.

The meaning of "arrangement" has been considered by the courts in a number of cases, and generally the cases have found that the term "arrangement" applies in a wide range of situations.

The High Court of Australia in *Bell v Federal Commissioner of Taxation* 87 CLR 548, (1953) 10 ATD 164 considered the meaning of "arrangement" and, at page 573, stated:

…it may be said that the word "arrangement" is the third in a series which as regards comprehensiveness is an ascending series, and that the word extends beyond contracts and agreements so as to embrace all kinds of concerted action by which persons may arrange their affairs for a particular purpose or so as to produce a particular effect.

The Privy Council in *Newton and others v Commissioner of Taxation of the Commonwealth of Australia* [1958] 2 All ER 759 held (at page 763):

Their Lordships are of opinion that the word "arrangement" is apt to describe something less than a binding contract or agreement, something in the nature of an understanding between two or more persons – a plan arranged between them which may not be enforceable at law. But it must in this section comprehend, not only the initial plan but also all the transactions by which it is carried into effect – all the transactions, that is, which have the effect of avoiding taxation, be they conveyances, transfers or anything else.

This passage was quoted and applied by Eichelbaum J in the High Court decision in *Hadlee and Sydney Bridge Nominees Ltd v CIR* (1989) 11 NZTC 6,155. The Court of Appeal subsequently approved this.

The Court of Appeal considered the meaning of the term "arrangement" in *CIR v BNZ Investments* (2001) 20 NZTC 17,103. The majority judgment of Richardson P and Keith and Tipping JJ was delivered by Richardson P. He stated, at page 17,116:

[43]…As did the former s108, s99 bites on an "arrangement made or entered into". It presupposes there are two or more participants who enter into a contract or agreement or plan or understanding. They arrive at an understanding. They reach a consensus.

…

[50]…In short, an arrangement involves a consensus, a meeting of minds between parties involving an expectation on the part of each that the other will act in a particular way. …The essential thread is mutuality as to content. The meeting of minds embodies an expectation as to future conduct. There is consensus as to what is to be done.

A number of other cases in the area of income tax avoidance are consistent with the comments made in the above case law.

Besides income tax cases, some other case authorities on the meaning of "arrangement" in other statutory contexts are considered relevant by the Commissioner.

The Court of Appeal in *Re British Basic Slag Ltd's Agreements* [1963] 2 All ER 807, stated, at page 814:

Though it may not be easy to put it into words, everybody knows what is meant by an arrangement between two or more parties. If the arrangement is intended to be enforceable by legal proceedings, as in the case where it is made for good consideration, it may no doubt properly be described as an agreement. But the statute clearly contemplates that there may be arrangements which are not enforceable by legal proceedings, but which create only moral obligations or obligations binding in honour...For when each of two or more parties intentionally arouses in the others an expectation that he will act in a certain way, it seems to me that he incurs at least a moral obligation to do so. An arrangement as so defined is therefore something "whereby the parties to it accept mutual rights and obligations".

In *Trade Practices Commission v Email Ltd* (1980) 31 ALR 53, the Federal Court of Australia considered whether it was sufficient for an "arrangement" or "understanding" that only one party is under an inhibition in respect of his or her future conduct. The Court stated (at page 66):

Unless there is reciprocity of commitment I do not readily see why the parties would come to an arrangement or understanding. Particularly is this so when it is remembered that the alleged parties to the agreement or understanding in the present case are two large companies. Presumably if they were to reach an understanding or arrangement each would have some commercial objective beneficial to itself in mind. I see no point in an arrangement bare of reciprocity.

Although there is much force in the submissions on behalf of the respondents that it is difficult to imagine a practical example in trade or commerce of a party to an arrangement being subjected to a burden qua the other and that other being under no obligation himself, I incline to the view that there is no necessity for an element of mutual commitment between the parties to an arrangement or understanding such that each accepts an obligation qua the other; although in practice such cases would be rare.

The Privy Council in *New Zealand Apple and Pear Marketing Board v Apple Fields Ltd* [1991] 1 NZLR 257 stated, at page 261:

"Arrangement" is a perfectly ordinary English word and in the context of section 27 [of the Commerce Act 1986] involves no more than a meeting of minds between two or more persons, not amounting to a formal contract, but leading to an agreed course of action.

To summarise, the following principles or characteristics can be extracted from these cases on the meaning of "arrangement" in other statutory contexts than income tax to indicate when an "arrangement" exists:

- A meeting of minds on an agreed course of action for a particular purpose (see *New Zealand Apple and Pear Marketing Board v Apple Fields)*.
- The parties to agree to mutual rights and obligations in respect of the course of action to be undertaken (see *Re British Basic Slag Ltd's Agreements*).
- An arrangement is unlikely to exist when only one party makes a commitment to the proposed course of action (see *Trade Practices Commission v Email Ltd*).

An "arrangement" encompasses various degrees of formality, and the case law in the areas of tax avoidance and competition law reinforces this conclusion. In the context of section CI 2(1), the term "arrangement" will include situations where the employer arranges with the third party to provide a benefit, where the employer agrees to allow the third party to approach the employees, or where the employer agrees to allow an employee to join a scheme promoted by the third party.

In terms of the application to section CI 2(1), for there to be an "arrangement" which is caught under the section, it must be an arrangement "for" a benefit to be "provided" to an employee. This means that not every "arrangement" that exists between an employer and a third party will be caught by section CI 2(1). Similarly, not every instance where a benefit is provided to an employee by a person who is not their employer will be caught by the section.

However, the arrangements that will be subject to FBT under section CI 2(1) will be limited by the requirement that it must also be "for" the provision of a "benefit" to an employee.

What is the meaning of "for" as used in the section?

The word "for" can have a wide variety of meanings depending on its context. The Court of Appeal in *Wilson & Horton v CIR* (1995) 17 NZTC 12,325 stated (at page 12,330):

> Reference to any standard dictionary brings home the wide variety of senses in which the preposition "for" may be employed. The *Oxford English Dictionary* (2nd ed) identifies 11 separate categories of meaning and many distinct usages within particular categories. The discussion in the text extends over 9 columns in the dictionary. Again the *Tasman Dictionary* which as its name suggests is directed to Australian English and New Zealand English, lists 33 meanings of the word. **The particular meaning intended necessarily hinges on the context in which the word is used and how it is used in that context**.
> (Emphasis added)

The use of the word "for" was interpreted in the case of *Patrick Harrison & Co. v AG for Manitoba* [1967] SCR 274 as imposing a purpose test. In this case, the Court held that "for the extraction of minerals" meant "with the object or purpose of extracting minerals".

In *G v CIR* [1961] NZLR 994, McCarthy J held that the word "for" points to intention, which is similar to looking at a person's purpose. At page 999, McCarthy J stated:

"For" points to intention. …the essential test as to whether a business exists is the intention of the taxpayer as evidenced by his conduct, and that the various tests discussed in the decided cases are merely tests to ascertain the existence of that intention. I think that it conforms with this approach to construe the word "for", when considering a phrase such as "carried on for pecuniary profit" used in relation to an occupation, as importing intention.

These cases show that in a number of statutory contexts the word "for" has been interpreted by the courts to mean "for the purpose" or "with the object of" something. It is noted that in this context, a person's purpose is similar to looking at his or her intention. However, to determine the word's meaning in the current section, it is necessary to look at the section's wording.

Section CI 2(1) states that "…the employer of the employee has entered into an arrangement **for** that benefit to be so provided…". Section CI 2(1) requires there to be an arrangement between the persons for the appropriate benefits to be provided or granted to the employees. The use of the term "for" in this context can only mean that the arrangement entered into is concerned with the provision of these benefits. That is to say that the "arrangement" must have been entered into "for" the provision of a benefit to an employee.

In the Commissioner's opinion, based on the case law and dictionary definitions, the "arrangement" entered into pursuant to section CI 2(1) must be "for the purpose" of providing the appropriate benefit to the employees, or "with the object" of providing the benefit.

Does the section require consideration of the purpose of the "arrangement" or the purpose of a party to the arrangement?

Two possible interpretations of this section result from the conclusion that the word "for" points to purpose. The first is that the section could mean that one, or both, of the parties to the "arrangement" (being the employer and the third party) have the purpose of providing a benefit to the employee. The other interpretation is that the purpose of the "arrangement" that has been entered into is to provide an employee with a benefit. The latter interpretation potentially requires an objective inquiry into the arrangement itself, as opposed to an inquiry as to the purpose of one or more individuals.

The first interpretation above could be considered to be supported by the case law relating to what is now section CD 4, where the word "purpose" has been interpreted by the courts to mean the dominant purpose of the taxpayer (see, for example *CIR v Walker* [1963] NZLR 339).

The second interpretation could be seen as being supported by the interpretation the courts have given to the phrase "tax avoidance arrangement" (as defined in section OB 1) in the context of section BG 1 and earlier corresponding provisions. The courts have held that in this context the test for purpose should be determined by looking at

the intended effect of the arrangement (see, for example, *Newton v FC of T* (1958) 11 ATD 442).

In the context of section CI 2(1), it would appear that the better interpretation is to consider the purpose of the **parties** to the "arrangement" to determine if the "arrangement" was entered into for the provision of a benefit.

The section could not logically be considered to be referring to the purpose of the "arrangement". It would appear to be an unusual interpretation of the section to require consideration of the purpose of the "arrangement", as section CI 2(1) does not actually include the word "purpose". Therefore, the purpose of one or both of the parties needs to be looked at when considering whether the "arrangement" was entered into "for" the benefit to be provided.

It may be argued that, as section CI 2(1) is an anti-avoidance provision, the test for purpose should be the same as that used in the general anti-avoidance provision, section BG 1. However, section CI 2(1) does not refer to the arrangement having a particular purpose or effect, as does the section OB 1 definition of "tax avoidance arrangement". That definition refers to "its" purpose or effect, that is, the arrangement's purpose or effect.

Therefore, the word "for" in section CI 2(1) does not refer to the purpose of the "arrangement" itself, but to the purpose of one or both of the parties who have "entered into" the "arrangement".

This conclusion is reinforced by the use of the phrase "entered into" in section CI 2(1). The section requires that the employer and the third party have "entered into an arrangement for that benefit to be provided". This indicates that the reason the "arrangement" was "entered into" by the parties to it must have been "for" the provision of a benefit. In other words, the parties' "purpose" in entering into the "arrangement" must have been to provide a benefit.

Therefore, the relevant purpose to be determined for the purposes of section CI 2(1) is that of one (or both) of the parties to the "arrangement", and not the purpose of the "arrangement" itself.

Whose "purpose" is relevant for section CI 2(1), the employer's, the third party's, or both?

As previously mentioned, for section CI 2(1) to apply there must be an "arrangement" between the employer and a third party. It is therefore necessary to determine whose purpose must be considered when applying the section.

When a benefit has been provided to an employee by a third party under an "arrangement", section CI 2(1) imposes FBT liability on an employer as if the benefit had been provided by the employer. This implies that the "arrangement" between the employer and the third party must be one where it is appropriate for the employer to be liable for FBT. If the employer does not have the purpose of providing a benefit to the employee, then it would seem unfair, and illogical, to impose FBT liability.

Section CI 2(1) is an anti-avoidance provision. The prospective liability to tax is the employer's (FBT), which liability the employer is seeking to avoid. The third party is not seeking to avoid tax liability because it has no prospective liability. At most, a third party would be a knowing assister in the employer's avoidance. More likely perhaps, the third party, whatever the employer's motivations, would be seeking to enter into commercial arm's length dealings with an employer and employees ignorant of, or indifferent to, the employer's tax liability. This suggests that, from a policy perspective, it might be expected that the employer's, not the third party's purpose, would be the more relevant.

Also, it is likely that the third party will always have the requisite purpose of providing a benefit to an employee, whether this is determined objectively or subjectively, as the third party is the party that provides the benefit to the employee. If the purpose of the third party alone were considered, all benefits would appear to be caught under the section: an illogical interpretation of the section.

It could be argued that the use of the words "entered into … for" suggests that both parties must have the purpose of providing a benefit, as both parties must have "entered into" the "arrangement". However, this interpretation would not seem entirely sensible, as the third party will most likely have this purpose, and the result would be no different from considering the employer's purpose alone. Therefore, it is not necessary to consider the purpose of both parties, and the purpose of the employer alone should be considered.

Therefore, the party to the "arrangement" whose purpose should be considered in determining whether section CI 2(1) applies, is the employer.

Should the test to determine whether the employer has "entered into an arrangement for that benefit to be so provided" be objective or subjective?

The above conclusions combine to show that for an "arrangement" to be caught under section CI 2(1), the purpose of the employer must have been to provide the employee with a benefit. This part of the commentary considers whether the test to determine if the employer has entered into the arrangement for the purpose of providing a benefit should be a subjective or an objective one.

A subjective approach requires consideration of the intention or motive of the parties in entering into the arrangement. In the current context, a subjective test will look at what the particular employer had in mind when the arrangement with the third party was entered into. An objective approach however may consider what a reasonable person in the position of the employer ought to have had in mind.

Additionally, case law, particularly in the area of GST, indicates that the correct test for determining purpose is a mixed subjective/objective test, considering both subjective and objective factors in reaching a conclusion as to the taxpayer's purpose. In a number of cases the courts have held that the test for purpose is dependent on the statutory context in which it is found (see, for example *CIR v Haenga* (1985) 7 NZTC 5,198).

It is therefore obvious that it is necessary to look closely at the wording of the section. Section CI 2(1) does not contain the word "purpose". Section CI 2(1) requires that the employer and the third party have "entered into an arrangement for that benefit to be so provided".

In the Commissioner's view, section CI 2(1) requires consideration of the reason that the employer "entered into" the "arrangement" with the third party. This means that the test to determine the employer's purpose in entering into the arrangement should be a subjective one, looking at the particular reasons that the employer had in mind. However, objective factors can be taken into account to aid in this interpretation.

This approach could be seen as being supported by McCarthy J in *G v CIR* [1961] NZLR 994 where he held that the word "for" points to intention, clearly indicating a subjective approach. At page 999, McCarthy J stated:

"For" points to intention. …the essential test as to whether a business exists is the intention of the taxpayer as evidenced by his conduct, and that the various tests discussed in the decided cases are merely tests to ascertain the existence of that intention. I think that it conforms with this approach to construe the word "for", when considering a phrase such as "carried on for pecuniary profit" used in relation to an occupation, as importing intention.

Therefore, the test to determine the employer's purpose is a subjective one looking at the intention of the employer, but objective factors should be considered to ensure that the employer's stated purpose is honestly held. That is to say that for section CI 2(1) to apply, the reason that the employer entered into the arrangement must have been to provide a benefit to its employee.

What test should be used to determine the employer's purpose?

This part of the commentary considers the appropriate test to be used in determining the purpose of the employer in entering into the "arrangement" with a third party.

There is a spectrum of tests that could be used to determine the purpose of the employer in entering into the arrangement.

At one end of the spectrum is a sole purpose test, which would require that the sole or only purpose of the employer in entering into the arrangement must be the provision of the benefit. In the Commissioner's opinion, this would be an unduly restrictive test for section CI 2(1), as it would not apply in any situation where there was another purpose, no matter how secondary or minor.

At the other end of the spectrum is the test that the section will apply if *any* of the purposes of the employer in entering into the arrangement is that the employee be provided with a benefit. In the Commissioner's opinion, this is also not an appropriate test in the context of section CI 2(1), as the section would catch all benefits that were provided to employees if the employer had some form of arrangement with the third party, and the fact that the employees were receiving a benefit had crossed the employer's mind when they entered into the arrangement with the third party. If the provision of the benefit is not a part of the arrangement between

the parties, but is truly incidental to the purpose of the employer, then the section should not apply.

Between these two extremes are the dominant purpose test and the more than incidental purpose test.

A dominant purpose test would require that the main reason for the employer entering into the arrangement be the provision of the benefit to the employee. This test would allow the employer to have other purposes in entering into the arrangement, but that, in order for the section to apply, the main purpose of the employer in entering into the "arrangement" needs to be the provision of a benefit. This test would also mean that if the employer had more than one purpose in entering into the "arrangement" and the provision of a benefit to employees was not the most important purpose, then section CI 2(1) would not apply.

There are a number of cases that have determined that the word "purpose" used on its own in statutory language without any apparent qualifier means the dominant purpose of the taxpayer, for example, in relation to the third limb of section CD 4 (and predecessor provisions) and in relation to section 108 of the Land and Income Tax Act 1954 (the former section BG 1).

In the Commissioner's opinion, there is no reason to conclude that section CI 2(1) requires a dominant purpose test. There is no indication on the words of section CI 2(1) that a dominant test is necessary. This can be contrasted with section CD 4, where the section clearly refers to *the* purpose. Therefore, it is the Commissioner's opinion that it would not be appropriate to apply a dominant purpose test in determining whether section CI 2(1) applies.

A more than incidental purpose test would be similar to the test contained in section BG 1, where, as long as the purpose of providing a benefit is more than incidental to any other purpose of the employer in entering into the "arrangement", the section will apply. In the context of section CI 2(1), this means that if the provision of the benefit is incidental to other purposes of the "arrangement", such as the provision of credit cards to employees, or obtaining a good package deal for the employer, then the section would not apply. The use of this test could be seen as being supported by the fact that section CI 2(1) is an anti-avoidance provision, and that it is appropriate to have a similar test as in other avoidance contexts. Alternatively, it could be argued that a more than incidental test is not appropriate, as the language of section BG 1 explicitly provides for the test of more than merely incidental in the legislation itself, whereas section CI 2(1) does not.

Overall, it is the Commissioner's opinion that this is the appropriate test to be adopted in interpreting section CI 2(1). This approach would mean that if the purpose of providing a benefit to the employees is no more than incidental to some other purpose of the employer in entering into the arrangement, the arrangement would not be caught within the section. A more than incidental test means that the purpose of the employer must be significant in order for the benefit to be caught within the section, but does not need to be the most important (or dominant) reason or purpose of the employer in entering into the "arrangement".

In the Commissioner's opinion, if an employer has more than one purpose when they enter into the "arrangement" with the third party, it is considered appropriate to exclude incidental purposes from section CI 2(1), but there is no reason why an employer with a significant, but not dominant, purpose of providing a benefit to employees should not be caught by the section.

Therefore, to establish if section CI 2(1) applies, it is necessary to look at what the arrangement between the employer and the third party is for, and whether the provision of the benefit to employees is incidental to another purpose of the employer, or whether it is a separate, significant, purpose in its own right. If the provision of a benefit is no more than incidental to some other purpose of the employer in entering into the arrangement with the third party, then section CI 2(1) will not apply.

It is noted that the relevant consideration is whether the purpose of the employer of providing a benefit to employees is incidental to another purpose of the employer, not whether the benefit received is incidental to the arrangement entered into. It is the purpose of the employer that is relevant, not the purpose of the arrangement.

If the employer does not have a purpose of providing a benefit to employees (or the purpose is not more than incidental), section CI 2(1) will not apply to any benefit that may be provided by a third party.

Which "arrangement" must be the one "for" the benefit?

In most cases where a benefit is provided to an employee by a third party, there will be an "arrangement" between the employee and the third party that is "for" that benefit to be provided. It could be argued that because the arrangement between the third party and the employee may be "for" the benefit to be provided, then no matter what degree of negotiation or other interaction occurs, the third party/employer arrangement will not also be "for" the provision of a benefit unless consideration is provided to the third party by the employer.

This argument focuses on which arrangement actually provides for the benefit to be provided. If the "arrangement" between the employer and the third party is not <u>for</u> a benefit, then section CI 2(1) will not apply. Any arrangement that may exist between the third party and the employee will be "for" a benefit, as it is the third party that must provide a benefit to the employee for the purposes of the section.

Section CI 2(1) requires that the third party must be a person "with whom the employer of the employee has entered into an arrangement for that benefit to be so provided". This does not require consideration of any arrangement that may exist between the third party and the employee. The fact there is an arrangement between the third party and the employee which is "for" the provision of a benefit, does not mean that it is not also possible for the employer to be party to that or another such arrangement.

For there to be an "arrangement" between the employer and the third party "for" the provision of a benefit, in the Commissioner's view, as a minimum, the employer

must request or instruct a third party to provide a benefit. When this has occurred, it is the Commissioner's opinion that the subjective purpose of the employer in entering into the arrangement is to provide a benefit, and therefore the arrangement is "for" the provision of a benefit, as required by the section. The employer's activity in requesting or instructing is, in the Commissioner's view, a sufficient level of involvement or activity by the employer to make the employer/third party arrangement an arrangement that is "for" the benefit to be provided. The arrangement will obviously also be "for" the benefit to be provided where consideration passes between the employer and the third party.

There appears to be no reason to conclude that merely because the arrangement between the third party and the employee is for the provision of a benefit, that it is not also possible for the employer to be party to that or another such arrangement.

What is required for there to be a benefit to the employees?

Under section CI 1, the definition of what amounts to a fringe benefit is very broad, and is intended to include all non-cash payments made by an employer to an employee in respect of their employment. However, it is not clear whether, given that section CI 2(1) is an anti-avoidance provision, what the employee receives from the third party needs to be a benefit that the employee would not usually be able to receive or if something else is needed. The issue arises of whether a benefit under section CI 2(1) must be something that the general public are unable to receive.

In *Case M9* (1990) 12 NZTC 2,069, Bathgate DJ held that the provision of the motor vehicle was subject to FBT and stated (at page 2,073) that:

A benefit is often regarded as being given voluntarily, rather than compulsorily. A benefit may however be given under compulsion in some circumstances – *Yates v Starkey* [1951] 1 All ER 732…"Fringe benefits" are defined in s 336N(1) of that Act as the benefits "received or enjoyed", in the sense that it is from the employee's view they are to be considered a benefit, which is the object and purpose of such.

In *Case M59* (1990) 12 NZTC 2,339 Bathgate DJ stated (at page 2,343):

Only the receipt or enjoyment occurred after FBT was imposed, but that was not sufficient, as that is only a part of a fringe benefit, and not the whole fringe benefit. By 31 March 1985 the objector had provided a benefit, although it was not enjoyed by B and C until after that date. That enjoyment however was not for the purposes of the Act a fringe benefit. Although the objectors would be taxable in that period after 1 April 1985, they were not subject to the tax because when the benefit was provided by them it was not chargeable to FBT.

This means that there are two separate elements that must exist in order for there to be a "benefit" for FBT purposes: provision to the employee and enjoyment by that employee. Accordingly, for a benefit to exist under section CI 2(1), there must be both the provision of something by a third party who has entered into an arrangement with the employer to provide that benefit, and enjoyment by the employee.

Accordingly, on the basis of the above cases, all that is necessary for there to be a benefit to an employee under section CI 2(1) is for the employee to receive, or be provided something by a third party, and to enjoy, or take advantage of, that thing.

There is no requirement that a fringe benefit must be something that the employee could not receive on his or her own account, or that the general public cannot receive provided that the requirements of the definition in section CI 1 are met and the benefit is provided in respect of the employment of the employee.

This interpretation is supported by the scheme of the FBT rules. Section CI 1 defines the term "fringe benefit" very broadly. It is not necessary for the purposes of the FBT rules for the benefit to be something that the employee could not otherwise be able to receive or that the public is unable to receive. All that is required is that something needs to be provided to the employee that falls within the definition of "fringe benefit" in section CI 1. In the Commissioner's opinion, this applies equally to section CI 2(1). If something is provided to the employee by a third party that would have been a fringe benefit had it been provided by the employer, it will be subject to FBT by virtue of section CI 2(1).

Therefore, for there to be a benefit under section CI 2(1) all that is required is that a "fringe benefit" (as defined in section CI 1) is provided to the employee by a third party (in addition to regular salary or wages) pursuant to an arrangement between the employer and the third party for the provision of that thing, and the employee must take advantage of or use that thing.

Meaning of "Provision"

Another requirement of section CI 2(1) is that the arrangement be for the benefit to be so "provided". For a benefit to be caught under section CI 2(1) it must have been provided to the employee by the third party. It is not sufficient that there is an "arrangement" between the parties that is merely for access to premises, the "arrangement" must be "for" the provision of a benefit for section CI 2(1) to apply.

The *Oxford English Dictionary* (10th Edition, 1999) defines the term "provide" as "make available for use; supply". There have been a number of cases that discuss the meaning of the word "provide".

These cases show that the meaning of "provide" depends on the facts and circumstances of each case. For example, in *Ginty v Belmont Building Supplies Ltd* [1959] 1 All ER 414, Pearson J stated, at page 422:

> I do not think that there is any hard and fast meaning of the word "provided"; it must depend on the circumstances of the case as to what is "provided" and how what is "provided" is going to be used.

In *Norris v Syndi Manufacturing Co Ltd* [1952] 1 All ER 935, an employee had removed the safety guard from a machine in order to carry out tests. His employer was aware that the employee took the guard off to test the machine, and had told him to replace it "after testing and before operation". The employee inadvertently injured himself while working without the guard one day. The Court of Appeal found that the guard had been "provided" by the employer, and that the duty to provide the guard did not require that the employer should have to order the workmen to use it. Romer LJ stated, at page 940:

The primary meaning of the word "provide" is to "furnish" or "supply", and accordingly, on the plain, ordinary interpretation of s. 119 (1), a workman's statutory obligation is to use safety devices which are furnished or supplied for his use by his employers.

The meaning of "provide" has been considered by the Employment Court of New Zealand in *Tranz Rail Ltd (T/A Interisland Line) v New Zealand Seafarers' Union* [1996] 1 ERNZ 216. In that case, the issue was whether a statutory requirement that the employer provide food and water to the seafarers meant that the employer had to provide them with free food and water, or just ensure facilities were available for the employees to have access to food and water. Colgan J, at page 227, stated:

The applicant's principal argument is that the plain words of the statute allow an employer of seafarers either to agree to provide food and water without cost to an employee or to do otherwise whether by negotiation as part of a collective employment contract or by the imposition of charges for such provisions. Ms Dyhrberg submitted that to achieve an interpretation as sought by the respondents, the Court would be required to add to the statutory words a phrase such as "without cost to such employees" or the like. Ms Dyhrberg submitted that the word "provide" means make available but no more. Counsel conceded that this interpretation would mean that an employer of seafarers would be entitled to charge an employee for water consumed, although stressed that such an outcome would be unlikely in any event.

Ms Dyhrberg submitted that to "provide" is to provide the opportunity of having the appropriate supplies of food and water. I find however that in this context the natural and ordinary meaning of the word "provide" in relation to food and water on ships is to supply without cost to the recipient seafarer.

The Australian Administrative Appeals Tribunal in *Pierce v FCT* 98 ATC 2240, considered whether a car had been provided to an employee. At page 2247, the Tribunal stated:

There is no reason why "provides" should not be given its ordinary English meaning, namely "to furnish or supply" (Macquarie Dictionary).

In order for something to have been "provided" to an employee by a third party in the context of section CI 2(1), it must be supplied, furnished or made available to that employee.

Conclusion on the scope of section CI 2(1)

For an "arrangement" to fall within section CI 2(1), it is not necessary that consideration passes from the employer to the third party. The section will apply and FBT be payable where less has occurred. However, if consideration does pass between the employer and the third party in respect of the benefit, then the section will apply.

For section CI 2(1) to apply, the "arrangement" between the employer and the third party must have been entered into by the employer "**for**" the benefit to be provided to the employee. The term "arrangement" is very wide in its application. The word "for" means that the relevant consideration is the subjective purpose of the employer in entering into the "arrangement", and that the purpose of providing a benefit to employees must be more than incidental to some other purpose of the employer. The word "provide" means to supply, furnish or make available.

It is concluded that these requirements will be fulfilled, and that section CI 2(1) will apply in the following situations:

- Where consideration passes from the employer to the third party in respect of the benefit being provided.
- Where the employer requests (other than merely initiating contact), instructs or directs, the third party to provide a benefit.
- Where there is negotiation or discussion between the employer and the third party which (explicitly or implicitly) involves the threat or suggestion that the employer would withhold business or other benefits from the third party unless a benefit is provided to the employees.
- Where the third party and the employer are associated parties, and there is a group policy (whether formal or informal), or any other agreement between the associated parties, that employees of the group will be entitled to receive benefits from the other companies in the group.

It is noted that the Commissioner does not consider that all situations involving associated persons will necessarily fall within section CI 2(1). It is only in those situations where there is a group policy, or any other agreement between the associated parties, regarding the provision of benefits that the Commissioner considers that the section will apply.

Provided that none of the above situations exists, it is concluded that section CI 2(1) will not apply in the following situations:

- Where there is negotiation or discussion between the employer and the third party that results in no more than:
    (i) the employer granting the third party access to the premises or work environment to discuss the benefit with employees; and/or
    (ii) agreement between the parties as to the level of benefit that is to be offered by the third party to employees; and/or
    (iii) the employer agreeing to advertise or make known the availability of the benefit.
- Where the employer has done no more that initiate contact or discussions with the third party.
- Where there is no significant contact or arrangement between the employer and the third party.

It is noted that a consequence of this conclusion may be that the employer is required to put into place systems to enable them to obtain the relevant information required to fulfil their FBT obligations. In the Commissioner's opinion, where the employer is involved in the types of arrangement contemplated by the first four of the bullet points set out above, the employer will generally be in a sufficient relationship with the third party to obtain the information they require to fulfil their obligations. The onus is on employers who are involved in arrangements for the provision of benefits in any of these ways to ensure that they can do so (for example, by requiring this of the third party).

Salary Sacrifice Situations

This Ruling does not consider or rule on the taxation implications of salary sacrifice situations. In the context of the Ruling, this would include situations where the remuneration given by an employer to an employee is reduced due to a benefit being received by the employee from the third party (or due to the possibility of a benefit being received), or where the remuneration of the employee otherwise takes the receipt of a benefit provided by a third party into account.

It is considered that different considerations may apply to the tax treatment of such situations, for example, the benefit may have been provided by the employer in such a situation, or there may be other relevant aspects of the arrangement, and this Ruling has not considered the taxation implications of salary sacrifice situations.

COMMENTS ON TECHNICAL SUBMISSIONS RECEIVED

Submissions were received from a number of commentators that the conclusion reached in the previous draft ruling would lead to enforceability or workability problems in practice. These matters have been given serious consideration. It is the Commissioner's opinion that the conclusions reached in this draft ruling should not generally give rise to unworkable or unenforceable results. If the circumstances referred to in the first four bullet points referred to in the draft ruling exist, it is considered that the employer will be in a sufficient position to require that systems be put into place to ensure that they have access to the relevant information required to fulfil their FBT obligations. Therefore, it is considered that the conclusions will not give rise to unworkable or unenforceable results. As noted previously, the onus is on employers who are involved in arrangements for the provision of benefits in any of these ways to ensure that they can obtain the necessary information (for example, by requiring this of the third party).

One submission was received regarding the use of the FBT prescribed rate of interest in the examples. It was considered that this would mean that there would technically often be a benefit to employees, even if the interest rate offered was what was considered to be a market rate. This submission has also been given serious consideration. It is considered that this result is a consequence of the normal way in which the FBT rules operate, by prescribing a rate of interest to be used in determining the value of the benefit, and is not due to the conclusions reached in the draft ruling.

We also received a number of comments regarding the interaction between section CI 2(1) and the FBT valuation provisions. However, these issues are outside the scope of this Ruling.

EXAMPLES

The following examples are included to assist in explaining the application of the law. These examples all assume that there has been no sacrifice of salary by the employee receiving the benefit.

Example 1

ABC Bank wishes to offer the employees of XYZ Ltd a low interest loan facility. ABC approaches XYZ, who agrees to ABC's offer, and also agrees to pay ABC the difference between the interest rate offered to employees, and the current market interest rate.

This is clearly subject to section CI 2(1), and FBT will be payable on the difference between the rate paid by XYZ's employees and the FBT prescribed rate of interest. An "arrangement for" exists between ABC and XYZ, and the purpose of the employer is to allow the provision of a benefit to XYZ's employees. This is evidenced by the fact that consideration has been passed between the employer and the third party in respect of the benefit being provided.

Example 2

A credit card company approaches the manager of BCE, and asks whether BCE would allow them to approach BCE's employees to offer them credit cards (for the employees' personal use). The credit card company proposes that all staff members who choose to receive cards will be allowed to join the credit card company's loyalty scheme (which has no joining fee, but is only available to selected cardholders). BCE agrees to this request, but suggests that the credit card company might wish to provide a slightly discounted interest rate to the employees, so that the offer does not waste the employees' time. The credit card company agrees to this change. BCE provides no consideration to the credit card company. The credit card company is keen to secure BCE employees as customers and is happy to agree to offer the employees the additional benefits.

Here, there is an "arrangement" between the employer and the third party. There is a meeting of minds, and that meeting of minds extends to future action. However, section CI 2(1) will not apply in this situation. The meeting of minds does not include the provision of a benefit, but merely allows the credit card company access to BCE's employees to offer them a benefit. The main purpose of the employer in entering into the arrangement is to allow the credit card company to offer a benefit to their employees which will be of potential interest to the employees. The provision of a benefit, if it is a purpose of the employer, will be incidental to this. Therefore section CI 2(1) will not apply and no FBT will be payable on any benefit received by the employee from the credit card company.

Example 3

A local retailer approaches MNO Ltd, and asks permission to display advertising brochures on MNO's premises, and for MNO to place an advertisement on the company's intranet. MNO agrees, after only a cursory inspection of the brochures and advertisement. MNO also agrees to allow the retailer to email interested staff with updated specials (staff are given the opportunity not to receive the email updates). The brochures, and subsequent emails, invite the employees to join a loyalty programme, which gives them the possibility of receiving rewards.

As above, there will be an "arrangement" between the employer and the third party, as there is consensus as to future action. However, the arrangement will not be "for" the provision of a benefit. The employer has only agreed to allow the third party access to its employees, and this is their main purpose in entering into the arrangement. Any purpose the employer may have of benefiting their employees is incidental to this purpose. The "arrangement" is "for" access to the employer's premises or to allow the third party to communicate with the employees directly or by electronic means, not to provide a benefit to employees. Hence, section CI 2(1) will not apply, and no FBT will be payable on any reward received by an employee under the loyalty programme.

Example 4

BB Ltd is a large company with a number of high net worth employees. BB contacts its Bank and requests that the Bank offer a low interest mortgage facility to the employees of BB, which also permits an employee to obtain a mortgage with a smaller deposit than would normally be required. BB believes that the Bank will agree to this request as BB has a lot of business with the Bank. Additionally, it is expected that the Bank will get a great deal of business from the employees of BB, as BB have told the Bank that they are aware of a reasonable number of staff members who would be interested in such a facility. The Bank is attracted by the level of business it may achieve with the employees, and is also keen to maintain the good relationship it has with BB, so puts together a proposal which it presents to BB. BB considers that the proposal is worthwhile, so asks the Bank to make the facility available to employees. BB also agrees to help promote the facility by putting up posters and making brochures available in the workplace, and also by sending an email to staff informing them of the facility.

Here, there is an "arrangement" between BB and the Bank which is "for" the provision of a benefit to employees. There is a meeting of minds between the parties that extends to the provision of a benefit to employees. BB has not simply entered into the arrangement with the purpose of allowing the Bank access to the employees. Rather, BB has entered into the arrangement with a more than incidental purpose of providing employees with a benefit. This is evidenced by the fact that BB has an expectation that the Bank would comply with their request and because they are aware of a number of staff members who would be interested in the facility. Therefore section CI 2(1) will apply, and FBT will be payable on the difference between the interest rate paid by employees and the FBT prescribed rate of interest.

Example 5

STU and VWX are both companies in the same group of companies. The group has a widely understood policy that all companies in the group will provide discounted products or services to all employees of companies in the group, although this policy has never been put into writing. STU therefore provides interested employees of VWX with discounts on their products.

Here, there will an “arrangement” for the provision of a benefit, and VWX will be liable to FBT on any benefits received by its employees from STU. There is a group policy that each company will provide the employees of the other companies in the group with benefits. Therefore, there is an understanding between the employer and the third party that each will act in a particular way, that understanding extending to the provision of a benefit, and the purpose of the policy is to allow employees to be provided with benefits by a third party. Therefore section CI 2(1) will apply.

Example 6

DFG, a travel agent, employs a number of staff, and enters into a scheme with YTR, an airline, to strengthen their relationship. The scheme involves YTR agreeing to give a certain number of free domestic flights per year to employees of DFG who excel in promoting and selling YTR flights. In return, DFG agrees to have their employees promote YTR flights, and convert flights to YTR wherever possible. In order to determine which employees are entitled to free flights, DFG awards its staff with points for outstanding customer service. Once a staff member has accumulated the required number of points, they are entitled to a free flight from YTR. There is no cost to DFG for those flights.

Here, section CI 2(1) will apply. There is an "arrangement" between the parties, as there is a consensus between DFG and YTR that involves the provision of a benefit to employees. One of the main purposes of DFG in entering into the arrangement is to provide the staff with free flights. Although DFG have another significant purpose in entering into the arrangement, which is to strengthen their relationship, the purpose of providing a benefit to employees is not incidental to that purpose. Therefore, FBT will be payable by DFG on the value of the flights.

Example 7

HJK is a large nationwide employer with a large number of staff. A Senior Manager of HJK approaches LMN, a nationwide chain of retail stores, and suggests that they may like to consider offering a discount to employees of HJK. LMN agree to consider this idea, and later decide to allow a 10% discount to all staff of HJK at all of their stores (this is achieved by providing all employees with a discount card). HJK does not give any consideration for this, has made no suggestion that they will do business with LMN themselves if a discount is permitted, and have not been involved in discussions as to the level of the discount, or any other details of the offer. LMN has decided to offer the employees the discount as they believe they will obtain a substantial amount of business.

Section CI 2(1) would not apply in this situation. There is no "arrangement" between the parties that encompasses the provision of the benefit, as the only consensus as to future action is that LMN agreed to consider the idea. HJK has done no more than initiate discussions with LMN, and the decision to offer a benefit to employees was made unilaterally by LMN. Although the purpose of HJK could be argued to be the provision of a benefit, there is no "arrangement" with LMN that is "for" such provision.

Example 8

An employee works for a company. She obtains a personal credit card and joins its associated points reward scheme. Under that scheme she can accumulate points as goods and services are charged on the credit card. After the employee accumulates 10,000 points, she can transfer those points, at her option, to any one of a number of airlines' Frequent Flyer Schemes affiliated to the credit card company's points reward

scheme. Once she accumulates a specified number of points on the airline Frequent Flyer Scheme, she can exchange them for free or discounted travel.

In the course of her work she incurs a number of employment related charges on the credit card as well as private expenditure. The employee accumulates points on the credit card points reward scheme for both types of expenditure. She very soon reaches the specified threshold of points, and transfers them to a particular airline's Frequent Flyer Scheme, exchanging them for a free trip to Fiji.

The company does not have an FBT liability, as section CI 2(1) will not apply. The receipt of the points under the credit card company's points reward scheme is because of the contractual arrangement between the credit card company and the employee. No arrangement exists between the employer and the credit card company to provide the employee with entitlements under its points reward scheme or the associated airline's Frequent Flyer Scheme. It does not matter that some of the points that give the entitlement result from employment related expenditure.

Example 9

The following year the employee obtains promotion in the company and receives a corporate charge card on which she is specified as the cardholder. The charge card is from a different company to that which issued her personal cards. This particular charge card company also allows cardholders to join in its points reward scheme. The employee joins as an individual member and pays the membership fee personally. The employee's employer is not involved in encouraging the employee to join the scheme. This scheme also allows an accumulation of points as goods and services are charged on the card and a transfer of points, subject to certain conditions, to a participating airline Frequent Flyer Scheme.

Section CI 2(1) will not apply to this example and the employer does not have an FBT liability on any entitlement received by the employee under the credit card company's points reward scheme. There is no arrangement between the employer and the credit card company to provide entitlements to the employee under the points reward scheme. The employee receives those entitlements because of her contractual relationship with the credit card company.

Example 10

QRS is an employer, and wants to purchase a number of motor vehicles for use in their business. The company approaches a motor vehicle dealer and negotiates a discount on the vehicles it purchases. QRS tells the dealer that it has a substantial number of employees who would like to purchase vehicles, and who it expects would be induced to buy them from the dealer if they were offered the same discount. The dealer agrees that it will offer the employees the same discount if they wish to buy vehicles from it.

Here, the employer has requested that the dealer provide their employees with a discount on any vehicles purchased. There is an arrangement between the third party and the employer that is for the provision of a benefit. Although the dominant

purpose of the employer may be to obtain a benefit for themselves, the purpose of the employer in asking the dealer to offer the same discount to their employees could not be said to flow from this purpose. Therefore a more than incidental purpose of the employer in entering into the Arrangement is the provision of a benefit, and the section will apply.