Inland Revenue
Te Tari Taake

# FREQUENT FLYER SCHEMES PROMOTED BY CREDIT CARD COMPANIES - FRINGE BENEFIT TAX LIABILITY

## PUBLIC RULING - BR Pub 99/5

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 benefits under a "frequent flyer scheme" (FFS) by an employee through the use of a credit card supplied by an employer to the employee of the employer.

The features of the FFS are:

- The employees of the employer hold corporate credit cards.
- The employees use the credit cards for the purchase of goods and services. Depending on the policy of the employer, the purchases may be in respect of employment related expenditure or private expenditure, or both.
- The goods and services purchased by the employees may include airfares arising from employment related travel.
- The employer is not involved in negotiations or discussions with the credit card company as to the amount or level of benefits under the FFS provided to employees. The employer does no more than give permission or consent for employees to join the scheme.
- The employees of the employer join the credit card company's FFS as individual members.
- As members of the FFS, employees accumulate points in respect of goods and services purchased with their corporate credit cards. The employees can exchange the accumulated points for goods and services, including free or discounted air travel, with the credit card company or any other person nominated by the credit card company.

This Ruling will not apply if the employer is the credit card company providing the benefits under the FFS to its own employees.

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**How the Taxation Laws apply to the Arrangement**

The Taxation Laws apply to the Arrangement as follows:

- For the purposes of the FBT rules (as defined in section OZ 1(1)), section CI 2(1) will not apply to the entitlement of benefits received by the employees of the employers under the FFS.

**The period for which this Ruling applies**

This Ruling will apply for the period from 26 July 1999 until 31 July 2002

This Ruling is signed by me on the 26th of July 1999

**Martin Smith**
General Manager (Adjudication & Rulings)

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**COMMENTARY ON PUBLIC RULING BR Pub 99/5**

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 99/5 ("the Ruling").

**Background**

The subject matter covered in the Ruling was previously dealt with in Public Ruling BR Pub 95/6 (*Tax Information Bulletin* Volume Seven, No. 5, November 1995 at page 7 under the heading *"Tax treatment of credit card companies' frequent flyer schemes").* Some formatting changes have been made, and the commentary to the Ruling has been modified to provide further clarification.

The Ruling sets out the tax treatment of frequent flyer schemes promoted by credit card companies. This Ruling will not apply where the employer is the credit card company providing the benefits under the FFS to its own employees.

A policy statement dealing with the tax treatment of FFS promoted by airline companies appeared in *Tax Information Bulletin* Volume Five, No. 6, November 1993 at page 2.

**Legislation**

Section CI 1 states:

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 -

…

(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, -

being, as the case may be, private use or enjoyment, availability for private use or enjoyment, … or 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;…

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. This is not an issue in the Ruling, because the employer is not the person providing the benefit to the employee.

However, under section CI 2(1) an employer can be liable for FBT if the employer enters into an arrangement with another person 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 other 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.

### *Members of a credit card company's FFS*

Some credit card companies give all cardholders the opportunity to join their FFS. These schemes allow cardholders to accumulate points on the scheme as they charge goods and services to their credit cards. These goods and services may be employment related or may be private in nature. Subject to certain conditions (which vary from scheme to scheme), the cardholders can transfer the points to a participating airline FFS. The cardholder can then exchange the points for discounted or free travel or goods or services, depending on the terms of the particular airline FFS.

There will be no FBT liability for the entitlements received if an employee is an individual card holder, even though the employee may charge employment related expenditure to the card that is later reimbursed by the employer. In these instances there is no **arrangement** between the employer and the FFS provider.

### *Employees holding corporate credit cards*

If the employee holds a corporate credit card and is able to charge private as well as employment related expenditure to the card, the question of whether the corporate employer is subject to FBT will depend on whether there is **an arrangement** between the employer and the credit card company. Where such an arrangement exists, and the arrangement between the provider and the employer is for the granting of benefits to the employee, the employer will be liable to FBT on the value of the benefits so received by the employee. Where the entitlement arises as a result of both employment related and private expenditure some adjustment will be necessary to eliminate the portion of benefits arising from the private expenditure.

### *Is there an arrangement?*

There have been a substantial number of cases in which the courts have considered the application and meaning of the definition of "arrangement". Briefly, the major cases are:

The High Court of Australia in *Bell v Federal Commissioner of Taxation* 87 CLR 548 considered that an arrangement:

…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 took a similar line when it concluded 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 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 approved 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 Privy Council considered the meaning of arrangement in the context of the New Zealand Apple and Pear Marketing Act 1971 in *New Zealand Apple and Pear Marketing Board v Apple Fields Ltd* [1991] 1 NZLR 257. It concluded that:

Arrangement is a perfectly ordinary English word and in the context of section 27 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.

The English Court of Appeal in *Re British Basic Slag Ltd's Agreements* [1963] 2 All ER 807 considered the ordinary meaning of arrangement. It concluded:

Though it may not be easy to put 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 be properly 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..... When each of two or more parties intentionally arouses in the others 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 is so defined is therefore something whereby the parties to it accept mutual rights and obligations.

In *Trade Practices Commission v Email Ltd* 31 ALR 53, the Court considered whether an arrangement could exist when there was a commitment by one party only. It concluded that it would be rare that an arrangement could exist without reciprocity of commitment from the parties to achieve a commercial objective beneficial to each party.

To summarise, the courts have identified the following characteristics that indicate the existence of an arrangement:

- 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 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* 31 ALR 53).

The recurring theme in these characteristics is that the parties agree to make a combined effort for a common goal. It is arguable that an agreement for the granting of permission to recruit employees into the FFS, between the credit card company and the employer client, is an arrangement under section OB 1. It is clear that where each party agrees to certain actions there is a "meeting of the minds" (*New Zealand Apple and Pear Marketing Board v Apple Fields)* and this is sufficient for there to be an arrangement.

However, before section CI 2(1) has any application, the "arrangement" between the credit card company and the employer must be "for" the provision of a benefit by the employer to the employee.

***Is the arrangement "for" the provision of a benefit to the employee?***

The use of the word "for" in section CI 2(1) is the critical feature of this component. It 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".

This component limits the arrangements that will fall within the ambit of section CI 2(1) by linking the arrangement to the purpose of providing a benefit to the employees. Accordingly, for section CI 2(1) to apply in this situation there must be an arrangement between the credit card company and the corporate employer to provide a benefit to the employees.

In this Ruling's Arrangement the corporate employer has not entered into any contract or other understanding with the credit card company so that employees receive entitlements under the FFS.

If the employees obtain a benefit or an advantage from joining the FFS, it is from the contractual agreement between the credit card company and themselves rather than from any arrangement between the company and the corporate employer.

It is concluded that any benefit arising from an individual employee's membership of an FFS is not a "benefit" provided or granted by the employer, nor is it provided by way of an "arrangement" entered into by the employer and the credit card company.

However, if there is any form of arrangement between the credit card company and the corporate employer where the benefits pass to employees as a result of that arrangement, there is clearly a provision of a fringe benefit and, accordingly, section CI 2(1) will apply.

**Examples**

***Example 1***

An employee works for a company. She obtains a personal credit card and joins its associated FFS. 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' FFS affiliated to the credit card company's FFS. Once she accumulates a specified number of points on the airline FFS, 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 FFS for both types of expenditure. She very soon reaches the specified threshold of points, and transfers them to a particular airline FFS, exchanging them for a free trip to Fiji.

The company does not have an FBT liability. The receipt of the entitlement under the credit card company's FFS 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 FFS. It does not matter that some of the points that give the entitlement result from employment related expenditure.

***Example 2***

The following year the employee obtains promotion in the company and receives a corporate credit card on which she is specified as the cardholder. The credit card is from a different company to that which issued her personal card. This particular credit card company allows cardholders to participate in its FFS. 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 FFS.

The employer does not have an FBT liability on any entitlement received by the employee under the credit card company's FFS. There is no arrangement between the employer and the credit card company to provide entitlements to the employee under the FFS. The employee receives those entitlements because of her contractual relationship with the credit card company.

*NOTE: The draft ruling and commentary issued for consultative purposes late last year (PU0042) contained* Example 3 *which described a situation where the Commissioner could decide that there was an arrangement between an employer and a credit card company in respect of an FFS. It has been decided to remove this example as it raises issues beyond the scope of the "arrangement" to this Ruling which is to rule that there is no liability for FBT where there is no arrangement between the respective parties.*