

EXPOSURE DRAFT FOR COMMENT AND DISCUSSION ONLY

Questions We've Been Asked (ED0118)

All legislative references are to the Income Tax Act 2007, unless otherwise stated.

Reimbursing shareholder-employees for motor vehicle expenses

We have been asked whether an employer who reimburses an employee for the business use of their private motor vehicle is able to use the Commissioner's Mileage Rate as set out in OS 09/01 "*Commissioner's statement of a mileage rate for expenditure incurred for the business use of a motor vehicle*" ("OS 09/01"), published on Tax Information Bulletin Vol. 21, No.3 (May 2009), and to also clarify the "employee criteria" when it comes to reimbursing shareholder-employees. We have also been asked whether the 5,000km limitation on using that mileage rate also applies in these circumstances.

Section CW 17 provides that employers may determine the amount of employee reimbursement that is exempt from tax when employees use their own vehicles for work related purposes.

Employers can reimburse an employee based on actual expenditure incurred by the employee, or by making a reasonable estimate of the amount of expenditure likely to be incurred.

As a reasonable estimation employers may reimburse their staff using the rates published by a reputable independent New Zealand source, such as the New Zealand Automobile Association Inc., provided that the rate represents a reasonable estimate of the expenditure.

Employers may also use the mileage rate issued by the Commissioner as a reasonable estimate. The current mileage rate can be found in OS 09/01. Although the mileage rate is issued pursuant to section DE 12, which requires the Commissioner to set a rate for self-employed taxpayers, Inland Revenue accepts that employers may also use this mileage rate as a reasonable estimate when reimbursing employees.

In regards to reimbursing shareholder-employees, OS 09/01 states "that where a shareholder-employee meets the employee criteria, they may be reimbursed using the mileage rate as a reasonable estimate."

In fact, where a shareholder-employee meets the employee criteria, as defined in section YA 1, they are entitled to tax free reimbursements in the same way as an ordinary employee.

The employee criteria

Section YA 1 defines the term "employee" as a person who receives a PAYE income payment and includes a person to whom section RD 3(2) to (4) applies for the purposes of section CW 17.

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A person comes within section RD 3(2) if they are a shareholder-employee of a close company and they do not receive salary or wages of a regular amount for regular pay periods of one month or less, or where the payments received by the person as an employee total to less than 66% of that person's annual gross income.

“Close company” is defined in section YA 1 and for the purposes of section RD 3(2), it includes a company with 25 or fewer shareholders, and is not a special corporate entity.

Section RD 3(3) and (4) provide that the shareholder-employee referred to in section RD 3(2) may choose that the amount paid to them in the current tax year is not PAYE income payment, and that the amounts paid to them in later tax years are deemed not to be PAYE income payments.

Consequently, shareholder-employees, whether or not they receive a PAYE income payment, may come within the meaning of employee for the purposes of receiving tax free reimbursements. They may also be reimbursed using the mileage rate set by the Commissioner

The 5,000km limitation

The Commissioner's mileage rate is set pursuant to section DE 12, which requires the Commissioner “from time to time to set and publish a mileage rate”. Section DE 12(1) also provides that the mileage rate would only apply where a person's business travel is 5,000km or less in an income year.

It is the Commissioner's view that the 5,000km contained in section DE 12(1) does not extend to employers who elect to use the Commissioner's mileage rate to reimburse employees. However, section CW 17(3) does require the employer to make a reasonable estimate of the expenditure likely to be incurred by the employee, and section CW 17(2) provides that any reimbursement is exempt income only “to the extent to which it reimburses the employee for expenditure for which the employee would be allowed a deduction if the employment limitation did not exist”.

Therefore, while the 5,000km limitation does not extend to reimbursements to employees (including shareholder-employees) it should be remembered that any reimbursement is to be based on a reasonable estimate of the expenditure.

In summary, employers have four options when reimbursing employees (including shareholder-employees) for the business use of a private vehicle:

- Actual expenditure incurred by the employee;
- An employer's own reasonable estimate of expenditure incurred by an employee;
- A mileage rate published by a reputable independent New Zealand source (provided that they represent a reasonable estimate); and
- The mileage rate released by Inland Revenue.

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Further, where an employer chooses to use the Commissioner's mileage rate, although the 5,000km limitation may not apply, any reimbursement must reflect a reasonable estimate of the expenditure actually incurred by the employee.

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