



MINISTRY OF FINANCE AND ECONOMIC MANAGEMENT
GOVERNMENT OF THE COOK ISLANDS

COLLECTOR'S RULING 2013/02

SUBJECT: Taxable/Non Taxable Allowances

Background

Frequently employers offer employee benefits and allowances as part of their employment. Whether or not they are taxable depends on the type of benefit or allowance, and the reason an employee receives it. The Collector has become aware of the inconsistent treatment of allowances and other employee benefits by taxpayers and this ruling provides his view.

Tax Laws

All legislative references are to the *Income Tax Act 1997* unless otherwise stated.

Section 2 "Source deduction payment" means a payment by way of salary or wages, an extra emolument, or a withholding payment.

"Salary or wages", in relation to any person, means salary, wages, or allowances (whether in cash or otherwise), including all sums received or receivable by way of overtime pay, bonus, gratuity, extra salary, commission, or remuneration of any kind, in respect of or in relation to the employment of that person; and includes the value of any benefits of the kinds referred to in section 46(2) (b), determined in case of dispute as provided in that section; and also includes a periodic payment by way of superannuation, pension, retiring allowance, or other allowance or annuity in respect of or in relation to the past employment of that person or of any person of whom that person is or has been the spouse or a child or dependent; but does not include -
(a) a payment of exempt income, or an extra emolument, or a withholding payment; or
(b) any payment which is declared by regulations under this Act not to be salary or wages.
(emphasis added)

Section 46 Items included in assessable income

(1)(b) all salaries, wages or allowances (whether in cash or otherwise), and all sums receivable by way of bonus, gratuity, extra salary, or emolument of any kind in respect of or in relation to the employment or service of the taxpayer; (emphasis added)

(2) For the purposes of paragraph (b) of subsection (1) -

(b) without limiting the meaning of the term "allowances" as used in that paragraph the said term shall be deemed to include (in the case of a taxpayer who in any income year has been provided in respect of any office or position held by the taxpayer with board or lodging, or the use of house or quarters, or has been paid an allowance in lieu of being so provided with board or lodging or with the use of a house or quarters) the value of such benefits, such value to be determined in case of dispute by the Collector;

(c) the Collector may from time to time determine whether and to what extent any allowance in respect of or in relation to the employment or service of any person constitutes a reimbursement of expenditure exclusively incurred by that person in the production of assessable income, and the allowance, to the extent so determined, shall be exempt from income tax.

Section 145 Tax deductions to be made by employers –
*(1) For the purpose of enabling the collection of income tax from employees by instalments, where an employee receives a **source deduction payment** from an employer, the employer or other person by whom the payment is made shall, at the time of making the payment, make a tax deduction therefrom in accordance with this Part and by reference to the basic tax deductions set out in the Second Schedule (emphasis added)*

Section 147 Benefits and superannuation and other payments deemed to be salary or wages
*Where in respect of employment an employee receives or enjoys a benefit referred to in section 46(2)(b), or **any other benefit in kind** which is included in salary or wages, or receives a payment by way of superannuation, pension, retiring allowance, or other allowances, or annuity which is included in salary or wages as defined in section 2, the value of the benefit (whether in money or otherwise) or, as the case be, the amount of the payment shall be deemed to accrue from day to day, and accordingly in each case the amount, so accrued for any days in a pay period of the employee shall be deemed to be that employee's salary or wages for the pay period, or, as the case may be, part of that employee's salary or wages for the pay period. (emphasis added)*

Ruling

Allowances Generally

The taxing provision of allowances is contained in section 46 (1) (b) and states that allowances paid “... in respect of or in relation to employment ...” are assessable income.

The term allowance is not defined in the *Income Tax Act 1997*; however the Oxford Dictionary definition is “a sum of money paid regularly to a person to meet needs or expenses”

The payment of allowances fall under the tax deduction provisions requiring PAYE to be deducted.

Non Taxable (Reimbursing) Allowances

Instead of reimbursing actual expenditure incurred by an employee for business purposes an allowance may be paid to the employee in anticipation of expenses incurred in relation to the employer's business activity. In certain circumstances such allowances can be tax-free to the employee. Employers can base a tax-free allowance on a reasonable estimate of the work-related expenditure likely to be incurred by an employee or group of employees.

Example 1 Anton Hore is paid an allowance in respect of expenses incurred when travelling on the employer's business. This would be treated as a non taxable (reimbursable) allowance.

Example 2 Bruce Shelford is paid a modest tool allowance, as he is required to provide his own tools for his employment. This would be treated as a non taxable (reimbursable) allowance.

Whether or not an allowance is taxable depends on the basis for which the allowance is paid. In cases where the allowance is simply reimbursing an employee for expenditure that would meet the general deductibility principles for the employer it may be classified as tax free, i.e., not private or capital expenditure. Refer section 46(2)(c).

Taxable Allowances

Where the allowance is in respect of private, domestic or capital expenditure they are not tax free.

Example 3 Sally Braid receives a net vehicle allowance of \$10,000/annum paid with her monthly pay. Sally is on the highest tax rate. This amount should be grossed up to \$14,285 and have PAYE of \$4,285 deducted. Each month the employer needs to include Gross (\$1,190) and PAYE (\$357) from the allowance in their VAT/PAYE return.

Example 4 Kurai Carter's employer pays for Kurai's children's school fees in New Zealand of \$5,000 annually. The payment of the school fees is an allowance and the amount of the school fees should be grossed up in order to calculate the PAYE. Kurai is on the highest tax rate. The amount of school fees paid should be grossed up to \$7,142.86, and then have PAYE of \$2,142.86 deducted. If the school fees are paid each semester then the PAYE should be deducted and paid when the school fees are paid.

Other examples include telephone, internet, electricity, housing and air travel allowances.

Grossing Up

Where the amount of either the cash or benefit is a net amount it will need to be grossed up to calculate the correct PAYE.

Example 7 Michelle Melamu's employer pays her an allowance of \$250/month towards her private electricity account. Michelle is on the highest tax rate. The \$250 is a net amount and needs to be grossed up to \$357.14, with PAYE deducted and paid of \$107.14.

Who to contact with any questions

Please contact the staff at Revenue Management on telephone number 29365 if you have any questions in relation to this Ruling.

Please note that this Ruling is the Collector's view only and is non-binding.

This ruling is signed by me on the *21st* day of *March* 2013.



Andrew Haigh
Collector of Inland Revenue