

QUESTION WE'VE BEEN ASKED QB 15/08

INCOME TAX – TAX TREATMENT OF ALLOWANCES PAID TO CHAINSAW OPERATORS

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

This Question We've Been Asked is about ss CE 1 and CW 17.

This item replaces the items "Allowances for Chain Saw Operators" (*Public Information Bulletin* No 89, January 1977) and "Chainsaw Reimbursing Allowances" (*Public Information Bulletin* No 175, July 1988). They were identified as being out of date and needing to be replaced during a review of *Public Information Bulletins* and *Tax Information Bulletins* published before 1996. For more information about the review, see "Review of Public Information Bulletins" *Tax Information Bulletin* Vol 23, No 1 (February 2011), at 116.

Question

1. Can an employer pay a tax-free allowance to an employee for using a chainsaw in their work?

Answer

2. Yes, but only to the extent that the allowance is a reimbursing allowance for expenses the employee incurs or is likely to incur in using their own or their employer's chainsaw for work. Any amount paid to the employee over the reimbursing allowance is taxable to the employee as employment income and subject to PAYE.

Explanation

What is an allowance?

3. An allowance is a payment of an agreed amount by an employer to an employee. It is paid either on a regular basis (such as daily or weekly) or when certain events happen. It is taxable to the employee as employment income under s CE 1(1)(a) unless an exemption applies.
4. There are two main types of allowances, namely benefit allowances and reimbursing allowances. Benefit allowances are taxable to the employee as employment income under s CE 1(1)(a) and subject to PAYE. However, reimbursing allowances may be exempt from income tax under the general exemption in s CW 17.

What is a reimbursing allowance?

5. A reimbursing allowance is an allowance paid by an employer to an employee for operating expenses that an employee incurs or is likely to incur in connection with their employment.
6. A reimbursing allowance is not an exact reimbursement of expenditure. Operating expenses are expenses that the employee would be allowed a deduction for if the employment limitation did not exist (s CW 17(2)). Under s CW 17(2B) the expenditure will be treated as incurred in connection with an employee's employment if it is a necessary expense incurred in doing the job from which they earn income.

7. For a chainsaw reimbursing allowance to be paid tax-free to an employee under s CW 17(2), the employee must incur, in connection with their employment, operating expenses on a chainsaw:
 - owned and operated by the employee in their work; or
 - owned by the employer and operated by the employee in their work.

The Commissioner acknowledges that it is unlikely that an employee will incur operating expenses on their employer's chainsaw in practice. Where the employee does not incur operating expenses on their employer's chainsaw, they cannot receive a chainsaw reimbursing allowance tax-free.

What is a benefit allowance?

8. A benefit allowance is an allowance paid by an employer to compensate an employee for the conditions of their service, such as using a dangerous piece of equipment or working in a dangerous or dirty environment or in a remote location. Unlike a reimbursing allowance, a benefit allowance is taxable to the employee as employment income under s CE 1(1)(a) and subject to PAYE.
9. If the allowance paid is a mixture of a reimbursing allowance and a benefit allowance, then only that part of the total allowance that is a reimbursing allowance can be paid tax-free.

What types of expenses can a chainsaw reimbursing allowance cover?

10. A chainsaw reimbursing allowance can cover operating expenses such as interest, insurance, repairs and maintenance costs (including labour and parts), bars and consumables (such as chains, petrol, two-stroke oil and chain oil).
11. In setting the allowance amount, the employer can estimate the total amount of expenditure an employee is likely to incur in using their chainsaw at work. Section CW 17(3) allows employers to make a "reasonable estimate" of the amount of expenditure likely to be incurred by an employee or a group of employees.
12. A reasonable estimate is one that has some basis. For example, the estimate might be based on actual historical data, industry standard information or employee survey information. Employers must retain sufficient information about how the estimate was calculated to substantiate the allowance amount. Employers should review their estimates periodically to ensure they remain "reasonable".

Can an amount for depreciation be paid as part of a chainsaw reimbursing allowance?

13. An employee who buys their own chainsaw cannot be reimbursed tax-free for the purchase price of the chainsaw because the expenditure is of a capital nature. However, under s CW 17(4), a chainsaw reimbursing allowance can include an amount for the depreciation of the chainsaw where the employee owns the chainsaw. The depreciation amount included in a chainsaw reimbursing allowance is not meant to be an exact reimbursement of the cost of the chainsaw. It is supposed to be a reasonable estimate of the depreciation loss likely to be suffered by an employee from using their chainsaw at work. Employers can therefore factor into the chainsaw reimbursing allowance paid to their employees an estimated amount representing the depreciation loss likely to be suffered by the employees using their own chainsaws in their employer's business. This estimated amount should be based on the depreciation rates for chainsaws set by the Commissioner.

14. The depreciation rate for chainsaws of professional loggers (such as cross-cutters) is 100%. This means that the full cost of the chainsaw can be written off as depreciation and factored into the amount of the chainsaw reimbursing allowance for professional loggers annually.
15. The Commissioner understands that the forestry industry is far more mechanised today than in the past. The industry is increasingly using mechanised harvesters, static de-limbers and the like. This means that the use of chainsaws has become less prevalent, and the number of professional loggers has decreased as a result. The depreciation rate for chainsaws of forestry workers other than professional loggers, as well as of arborists and other employees using their chainsaws for work, is 67% (for both the straight line and diminishing value calculations). This means that a proportion (up to 67%) of the cost of the chainsaw can annually be factored into the chainsaw reimbursing allowance paid to such workers to compensate for the depreciation of the chainsaw.
16. An amount for the depreciation of a chainsaw can be included in the chainsaw reimbursing allowance because depreciation is an operating charge that employees are likely to incur in connection with their employment in using their chainsaws at work. To the extent that any amount paid for depreciation of a chainsaw exceeds the amount allowed under the Act, it cannot be paid tax-free under s CW 17. This is because it will be reimbursing expenditure of a capital nature. It is therefore subject to the capital limitation and would not be deductible to the employee.

What happens when the employee only uses the chainsaw some of the time or not at all?

17. For a chainsaw reimbursing allowance to be tax-free under s CW 17, it must be a reasonable estimate of the operating costs an employee is likely to incur in using their chainsaw for work. For professional loggers, such as cross-cutters, those costs are likely to be greater than for other employees who use their chainsaws at work, such as arborists. These other employees might also incur some operating costs, although these costs are expected to be less than professional loggers' costs. In the case of those employees who are required to bring a chainsaw to work but do not use it regularly (or do not use it at all), such as machine operators, the level of costs that can be legitimately reimbursed with a chainsaw reimbursing allowance will be much less. This is because, apart from depreciation, these employees are likely to incur minimal expenses (if any) in using their chainsaw at work.
18. If all these employees (eg, cross-cutter, arborist, machine operator) are paid the same level of chainsaw reimbursing allowance, the whole allowance may be tax-free to the cross-cutter, but will be split between a reimbursing allowance (tax-free) and a benefit allowance (taxable to the employee as employment income) for the others.
19. Any chainsaw allowance paid to an employee who neither owns nor uses a chainsaw at work at all is taxable to the employee as employment income and subject to PAYE. This is because the exemption in s CW 17 does not apply.

What about other reimbursing allowances paid to forestry workers?

20. The principles discussed above relating to the tax treatment of allowances also apply to other allowances that might be paid in the forestry sector.

Examples

21. The following examples are included to assist in explaining how the law applies.

Example 1 – Chainsaw reimbursing allowance

22. Ian is employed by Big Trees Logging Ltd as a cross-cutter. Ian provides his own chainsaw that he uses for work purposes on a daily basis. Big Trees Logging Ltd pays Ian a daily chainsaw allowance for the use of his chainsaw at work. In arriving at the amount of the allowance, Big Trees Logging Ltd estimates the GST inclusive amount of expenditure likely to be incurred by its cross-cutters, including reasonable estimates of:
- depreciation (using a depreciation rate of 100%);
 - interest;
 - insurance;
 - repairs and maintenance (labour and parts);
 - bars and chains; and
 - consumables.
23. The reasonable estimates of these items of expenditure take into account the size and expected usage of Ian's chainsaw, and are in line with industry standard costings. This daily chainsaw allowance is exempt and not taxable to Ian because it reimburses Ian for expenditure that would be deductible to him if the employment limitation did not exist.
24. If Ian is required to provide a spare chainsaw, Big Trees Logging Ltd can also pay Ian a daily chainsaw allowance for providing the spare chainsaw. However, the reasonable estimate of expenditure Ian is likely to incur for the spare chainsaw will be much less than for Ian's first chainsaw. This is because Ian's expenses on the second chainsaw are likely to be minimal.

Example 2 – Chainsaw not used for work

25. Todd is also employed by Big Trees Logging Ltd as a machine operator. He is required to bring his chainsaw to work every day but, unlike Ian, Todd seldom uses the chainsaw for his work. Big Trees Logging Ltd pays Todd the same daily chainsaw allowance as that paid to Ian in example 1.
26. Todd cannot be paid the same allowance as Ian tax-free as it is not a reasonable estimate of the costs Todd is likely to incur for the use of his chainsaw. Any amount paid to Todd over a reasonable reimbursement amount will be taxable to Todd as employment income and subject to PAYE.

Example 3 – Chainsaw not owned by employee

27. Graham is employed as an arborist. He is required to use a chainsaw on a daily basis for his work. His employer supplies the chainsaw and pays for all consumables and outgoings, including spare parts and repairs and maintenance costs for the chainsaw.
28. Any chainsaw allowance paid to Graham is not an allowance paid to reimburse Graham for any expenditure because he is not likely to incur any expenditure for the use of the chainsaw. It is therefore taxable to Graham as employment income and subject to PAYE because the exemption in s CW 17 does not apply.

Example 4 – Chainsaw owned by employee but employer pays for some outgoings

29. Chris is employed as a tree-feller. She is required to use her own chainsaw for work on a daily basis, but her employer pays for the fuel, two-stroke oil and chain oil for the chainsaw.

30. In setting the level of the chainsaw allowance, Chris's employer needs to consider what expenses Chris is likely to incur for the use of her chainsaw. If her employer includes the cost of the fuel and chain oil in the allowance paid to Chris, the amount representing these costs is a benefit allowance, as Chris will not incur these expenses in using her chainsaw. To the extent that the allowance provides a benefit to Chris, the allowance will be taxable to her as employment income and subject to PAYE.

Example 5 – Chainsaw reimbursing and benefit allowance

31. Nikau is employed as a cross-cutter and uses his chainsaw for work in his employer's business on a daily basis. In addition to his salary, Nikau's employer pays Nikau a daily chainsaw allowance. The amount of the allowance includes a reasonable estimate of the operating costs Nikau is likely to incur in using his chainsaw at work, a depreciation amount using a depreciation rate of 100% and an amount to compensate Nikau for working in a dangerous outside environment.
32. The part of the total daily allowance paid to compensate Nikau for working in a dangerous outside environment is a benefit allowance. It is not an allowance paid to reimburse Nikau for any expenditure. It is therefore taxable to Nikau as employment income and his employer should deduct PAYE from that amount. The balance of the allowance paid to Nikau, being a reimbursement allowance, is exempt and not taxable to Nikau.

References

Related rulings/statements

"Allowances for Chain Saw Operators" (*Public Information Bulletin* No 89, January 1977)
"Chainsaw Reimbursing Allowances" (*Public Information Bulletin* No 175, July 1988)

Subject references

Allowance, chainsaw

Legislative references

Income Tax Act 2007 – ss CE 1(1)(a) and CW 17