QB 18/13  
Income Tax – What is the tax treatment of allowances paid and benefits provided to farm workers?

This Question We’ve Been Asked (QWBA) considers the income tax treatment of allowances or benefits paid or provided to employees in a farming context. This QWBA consolidates, updates and replaces items previously published by the Commissioner. It will be of interest to those paying or receiving allowances in the farming sector.

Question

What is the tax treatment of allowances and benefits paid or provided to farm workers?

Answer

Reimbursing allowances an employer pays for expenses that the employee incurs or is likely to incur in connection with their employment can generally be paid tax-free. However, a reimbursing allowance of a capital or private nature is taxable as employment income to the employee and subject to PAYE.

Benefit allowances an employer pays to an employee are taxable as employment income to the employee and subject to PAYE.

The expenditure an employer incurs on providing reimbursing allowances or benefit allowances is deductible to the employer, provided the employee’s salary or wages are deductible.

Non-cash benefits an employer provides to an employee may be subject to fringe benefit tax payable by the employer. Expenditure incurred in providing non-cash benefits to an employee is deductible to the employer, as is any fringe benefit tax paid.

Key terms

Farm worker:  
an “employee” as defined in s YA 1 of the Income Tax Act 2007. For some purposes this definition includes independent contractors who receive “schedular payments” (that is, contractors subject to withholding tax under Schedule 4).

Reimbursing allowance:  
an amount an employer pays to an employee as a regular or one-off payment that is related to expenditure the employee is likely to incur or has incurred in connection with the employee’s employment or service. These allowances are generally not taxable.

Benefit allowance:  
an amount an employer pays to an employee to compensate the employee for the conditions of their service, such as using a dangerous piece of equipment, working in a dangerous or dirty environment or working in a remote location. These allowances are generally taxable.
Explanation

Scope of this QWBA

1. This QWBA relates to “farm workers” who meet the definition of an “employee” in s YA 1 of the Income Tax Act 2007. An employee is a person who receives, or is entitled to receive, a PAYE income payment. A PAYE income payment includes salary or wages paid to permanent and casual employees.

2. A PAYE income payment also includes a schedular payment subject to withholding tax made to contract workers. A schedular payment is defined in s RD 8 as a payment of a class set out in schedule 4 to the Act. Schedule 4 includes payments made for work or services relating to primary production (see part C of the schedule). Part C includes farming and cultivation contract work, shearing, droving, forestry or bush work and the work described in ss DO 1 and DO 2. Sections DO 1 and DO 2 describe various types of farm-related work including weed and pest destruction, flood or erosion repair, scrub clearing and fencing.

3. A contractor is not an employee in the current context if they hold a Certificate of Exemption issued under s 24M of the Tax Administration Act 1994. This is because the definition of “schedular payment” excludes any payments covered by an exemption certificate. The definition also excludes payments for services a company provides unless the company is an “agricultural, horticultural, or viticultural company”. Such a company is defined in the Act as, effectively, a company involved in supplying labour in orchards, vineyards or market gardens.

4. Accordingly, a “farm worker” in this QWBA includes employees and some contract workers.

5. The term “farm workers” in this QWBA does not include employees with an indirect or direct financial interest in the business of their employer (for example, shareholder-employees or partners in a partnership). This is because additional tax considerations may arise for these types of employees under other provisions of the Act not considered in this QWBA.
What is the tax treatment of allowances paid to employees?

**Meaning of allowance**

6. An allowance is a payment of an agreed amount by an employer to an employee. It is paid 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.

7. The two main types of allowances are reimbursing allowances and benefit allowances.

**Reimbursing allowances**

8. In this context the QWBA is only concerned with “employees” who are subject to the employment limitation. A reimbursing allowance is an allowance an employer pays to an employee for expenses that an employee incurs or is likely to incur in connection with their employment. A reimbursing allowance need not be an exact reimbursement of the employee’s expenses but it should be a reasonable amount.

9. Some reimbursing allowances may be paid tax-free to an employee under s CW 17. For this to apply, the allowance must reimburse the employee for expenses that the employee incurs or is likely to incur in connection with their employment. Under s CW 17(2B), the expenses 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.

10. Further, the expenses must be of a type that the employee could have been allowed a deduction for against their income but for the employment limitation in s DA 2(4). Employees cannot usually deduct expenses incurred in deriving their employment income because of the employment limitation. However, s CW 17(2) suspends the employment limitation for the purpose of determining whether the reimbursing allowance is exempt income of the employee.

11. Effectively, this means a reimbursing allowance cannot be paid tax-free to an employee if it reimburses the employee for expenses that would not have been deductible for a business taxpayer. The main limitations that might apply to prevent certain expenses from being deductible (and any corresponding reimbursing allowance paid tax-free) are the capital limitation in s DA 2(1) and the private limitation in s DA 2(2).

12. The capital limitation prevents deductions for capital expenses. Therefore, if any reimbursing allowance reimburses the purchase or replacement of a capital asset it cannot be treated as tax-free (for example, an allowance for the purchase of a motor bike rather than for its running expenses). There are two exceptions; firstly, under s CW 17(4), the relevant expenses reimbursed tax-free can include an amount for depreciation. This means if the reimbursing allowance includes an amount for depreciation of an asset, then that amount would be treated as deductible if the asset is used for work purposes. This is because s DA 4 provides that the capital limitation does not apply to an amount of depreciation loss. Secondly, subject to some limitations, the capital costs of low value assets may be deducted in full as depreciation under s EE 38. Items of low value under this provision must have cost $500 or less. This means an allowance could reimburse the capital costs of low value assets tax-free.

13. The private limitation prevents deductions for private or domestic expenses. “Private” expenditure is expenditure that relates to an individual living as a member of society. Examples of private expenditure are food, clothing and shelter. “Domestic” expenditure is
expenditure that relates to the household or family. Examples of this include the cost of a home telephone or an internet connection or other expenditure related to running a household.

14. An example of an allowance subject to the private limitation is one provided to help meet the cost of boarding school-aged children away from the farm. While the expenditure may be prompted by a farm worker's employment in a remote location, the costs associated with the provision of basic needs such as the education of children is expenditure of a private or domestic nature. The employee would not be able to deduct the costs, despite the employment limitation, because of the private limitation.

15. The private limitation may also arise where farm equipment or machinery has both a business use and a private or domestic use. For instance, farm vehicles may be used for work purposes and private purposes. An apportionment is required for any part of the allowance that relates to expenditure incurred for the private or domestic use. In such cases the portion of the allowance relating to the expenditure incurred for business use would be exempt and not taxable. The portion of the allowance relating to the expenditure incurred for the private use would be taxable in the hands of the employee as employment income (and subject to PAYE). However, the allowance may be adjusted to reimburse for only the business use and remain exempt.

16. Contractors are included in the definition of “employee” if they receive a schedular payment. Unlike employees, contractors can (in most cases) deduct expenses. Being able to deduct expenses makes exempt allowances unnecessary. The Commissioner understands that the usual practice is for most employers to pay contractors a single contract price and not to pay separate reimbursement allowances. The outcome is essentially the same as if they were paid an exempt allowance because although they receive a single contract amount subject to withholding tax, the expenses will be deductible to the contractor.

Expenses a reimbursing allowance may cover

17. Examples of the kinds of reimbursing allowances that may be paid to farm workers and the type of expenses they might reimburse are listed in the table at [36]. This is not an exhaustive list, and the items are exempt only to the extent that the capital or private limitations do not apply. In all cases, the onus is on the employer to justify treating the allowance as a tax-free reimbursing allowance.

Estimates of expenses

18. In setting the allowance amount, the employer may estimate the total amount of expenditure an employee is likely to incur. 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. The onus is on the employer to establish the estimate is reasonable.

19. A reasonable estimate is one that has some basis. For example, the estimate might be based on historical data, industry standards 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”.

Benefit allowances

20. A benefit allowance is an allowance an employer pays to compensate an employee for the conditions of their service, such as using a dangerous piece of equipment, working in a
dangerous or dirty environment, or working in a remote location. Another example of a benefit allowance is a cash allowance paid in lieu of the employer providing stores and rations.

21. These types of allowances have been described as “benefit allowances” because they give a financial benefit to the employee rather than to compensate the employee for expenses they incur or are likely to incur in carrying out their employment duties. 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. This is because the benefit allowance does not qualify for an exemption under s CW 17. However, s CW 17CB may exempt a reimbursement allowance for work-related meals where the employee is required to travel for work.

22. 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 that meets s CW 17 can be paid tax-free.

**What is the tax treatment of non-cash benefits provided to employees?**

23. Under s CX 2, a “fringe benefit” is a “benefit” that an “employer” provides to an “employee” (which includes contract workers who receive schedular payments) in connection with their employment and is:
   - a benefit specified in ss CX 6, CX 9, CX 10, or CX 12 to CX 16; or
   - an unclassified benefit under s CX 37.

24. Also, some benefits are excluded from being fringe benefits by specific provisions in subpart CX. Notably CX 4 prevents a benefit that is assessable income begin taxed again as a fringe benefit.

25. The provision of food (stores and rations) is a non-cash benefit that may be provided to farm workers. The Commissioner’s view is that the provision of food is a “benefit” to the employees. It provides an economic advantage to the employees because it gives them benefits (food) to which they would otherwise not be entitled. Food includes goods produced on the employer’s premises such as eggs, vegetables and meat.

26. The provision of food is not one of the benefits listed in ss CX 6, CX 9, CX 10, and CX 12 to CX 16. However, it may still be an “unclassified benefit” under s CX 37. Section CX 37 applies to benefits that an employer provides to an employee in connection with their employment that are not included or are excluded by a specific provision.

27. The only potentially relevant exclusion is in s CX 23, which deals with benefits the employee uses or consumes on the employer’s premises. Food consumed on the employer’s premises is excluded from being a fringe benefit by s CX 23(1)), so will not be subject to FBT. The meaning of employer’s premises is set out in s CX 23(2). Of relevance to farm workers is that the employer’s premises do not include premises an employee occupies for residential purposes (s CX 23(2)(c)). Whether food provided to employees is consumed on the employer’s premises is a question of fact in each case.

28. This means if the food is provided in connection with an employee’s employment and it is not excluded by a specific provision, then the benefit will be a “fringe benefit” as an unclassified benefit. As a result, the employer may be liable for FBT as calculated under subpart RD.

29. However, s RD 45 limits the employer’s FBT liability when providing unclassified benefits to situations where the taxable value of all unclassified benefits provided exceed certain thresholds.
• Where the employer pays FBT quarterly, the employer is liable for FBT only if:
  o the total taxable value of all unclassified benefits provided in the quarter to the employee is more than $300; or
  o the total taxable value of all unclassified benefits provided in the last four quarters (including the current quarter) to all employees is more than $22,500.

• Where the employer pays FBT annually or on an income year basis, the employer is liable to pay FBT only if:
  o the total taxable value of all unclassified benefits provided in the tax year or income year to the employee is more than $1,200; or
  o the total taxable value of all unclassified benefits provided in the tax year or income year to all employees is more than $22,500.

30. The above figures are based on all unclassified benefits the employer provided in the relevant period, not just the provision of food. The figures are based on the “taxable value” of the fringe benefits provided. Section RD 54 provides that the taxable value of a fringe benefit is its value. For unclassified benefits comprising food, the relevant value of the benefit is that given by s RD 40(1) which applies to goods. The value (and taxable value) of the food will be the:
  • market value where the employer manufactured, produced or processed the goods (which may occur in a farm setting);
  • cost to the employer where the employer acquired the goods when dealing at arm’s length with the supplier.

31. If an employee contributes an amount towards the fringe benefit the taxable value is reduced by the amount of the contribution.

32. In the case of goods produced by the employer, the value may be reduced if the market value is greater than the amount the employer would have received for selling the goods under normal sale conditions to an arm’s length customer (s RD 40(2)).

33. In the case where cost applies, this is the GST-exclusive cost if the employer is a registered person and able to claim an input tax deduction for the goods (s RD 40(3)).

Can the employer deduct allowances or the cost of providing non-cash benefits?

34. A person is allowed a deduction for an amount of expenditure or loss to the extent that it is incurred by them in the course of carrying on a business for the purpose of deriving assessable income (s DA 1). In most cases, salary and wage costs will be deductible because they will satisfy the test in s DA 1 and none of the general limitations will apply. The payment of an allowance or the provision of a benefit in connection with an employee’s employment is a business cost just like the employee’s basic salary or wages. Therefore, provided the costs of an employee’s basic salary or wages are deductible, then, generally, the costs of paying reimbursing or benefit allowances or providing non-cash benefits will also be deductible.

35. The costs incurred in providing a fringe benefit may also be deducted if the general permission is met and none of the general limitations applies. Also, if the employer is liable to pay any FBT, the FBT itself is a deductible expense.

Examples of allowances

36. The following table lists examples of the types of allowances paid to employees. The amounts specified in the withdrawn items listed on the second page of this item no longer apply. The
reimbursement allowances in the table are **exempt only to the extent that they do not reimburse private expenses or capital expenses (subject to the low value asset rule (that is, they are below the $500 limit))**. Employee allowances should be deductible to the employer where the employee’s salary or wages are deductible.

<table>
<thead>
<tr>
<th>Category</th>
<th>Payment or benefit provided</th>
<th>Type of allowance</th>
<th>Tax treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Working dogs</strong></td>
<td>Allowance for food, registration or vet bills</td>
<td>Reimbursing allowance</td>
<td>Exempt</td>
</tr>
<tr>
<td><strong>Horses</strong></td>
<td>Allowance for food, saddlery and accessories (less than $500), saddlery repairs, vet or farrier’s bills</td>
<td>Reimbursing allowance</td>
<td>Exempt</td>
</tr>
<tr>
<td><strong>Motor bikes and quad bikes</strong></td>
<td>Allowance for depreciation, interest, fuel, tyres (less than $500), servicing or repairs</td>
<td>Reimbursing allowance</td>
<td>Exempt</td>
</tr>
<tr>
<td><strong>Protective clothing</strong></td>
<td>Allowance for purchase (less than $500) of protective clothing such as boots, chaps, leggings, gloves, and hearing or eye protection</td>
<td>Reimbursing allowance</td>
<td>Exempt</td>
</tr>
<tr>
<td><strong>Wet weather gear</strong></td>
<td>Allowance for purchase (less than $500) of wet weather gear, such as waterproof coats, hats and leggings</td>
<td>Reimbursing allowance</td>
<td>Exempt</td>
</tr>
<tr>
<td><strong>Shearing equipment</strong></td>
<td>Allowance for acquisition (less than $500) of hand-pieces or shearing equipment, repairs and maintenance and depreciation of equipment</td>
<td>Reimbursing allowance</td>
<td>Exempt</td>
</tr>
<tr>
<td><strong>Boarding school fees</strong></td>
<td>School boarding away allowance</td>
<td>Benefit allowance</td>
<td>Taxable</td>
</tr>
<tr>
<td><strong>Travel costs</strong></td>
<td>Reimbursement of work travel</td>
<td>Reimbursing allowance</td>
<td>Exempt</td>
</tr>
<tr>
<td><strong>Rations and stores</strong></td>
<td>Provisions of stores and rations, meat or farm produce</td>
<td>Non-cash benefit</td>
<td>Not assessable</td>
</tr>
<tr>
<td></td>
<td>Payment in lieu of stores and rations</td>
<td>Benefit allowance</td>
<td>Taxable</td>
</tr>
<tr>
<td><strong>Remote location</strong></td>
<td>Allowance for working in a remote location</td>
<td>Benefit allowance</td>
<td>Taxable</td>
</tr>
<tr>
<td><strong>Dangerous or dirty conditions</strong></td>
<td>Allowance for working in a dangerous or dirty environment</td>
<td>Benefit allowance</td>
<td>Taxable</td>
</tr>
</tbody>
</table>

37. The following example uses sheep farming as its basis because this relates the most closely to the allowances in the items now withdrawn. It is included solely to assist in explaining the
application of the law as set out above. The same principles would apply to farm workers on other types of farms or other primary production sectors.

**Example**

Frank is a sheep farmer in a remote area. The following people work at various times on Frank’s farm:
- Mike, the farm manager;
- Pete and Jake, full-time live-in farm hands;
- a shearing gang employed by Sharp Shearing Services Ltd with which Frank has a contract for the provision of shearing services. The shearing gang is from another district and because of the distance and remoteness of the farm they stay in the shearers’ quarters for the duration of the job.

Mike, his partner and their two children live in the manager’s house on the farm. Because of the remote location of the farm, the children attend boarding school. Frank pays Mike an allowance every term to assist with boarding school costs.

Mike is also paid the following amounts regularly as part of his salary:
- an allowance to reimburse Mike for the costs (depreciation, interest, fuel, tyres, and servicing and repairs) he is likely to incur in using his own quad bike;
- an allowance for Mike to provide his own wet weather gear;
- a remote living allowance of $50 per week.

Pete and Jake live on the farm in separate staff quarters provided by Frank. On work days, Frank provides them breakfast that has been prepared and is consumed in Frank’s kitchen. From time to time, Frank gives them meat for the freezer that they store and consume in their own quarters.

Sharp Shearing Services Ltd pays each employee an allowance to reimburse them for the costs they are likely to incur in using their shearing gear for work depending on the job they do. The allowances cover repairs and maintenance of hand-pieces, and the replacement of combs and cutters and for the employees to provide their own protective clothing. Sharp Shearing Services also pays its employees a daily allowance in lieu of providing stores or rations when the employees are on site.

It is accepted that any reimbursement allowances are paid in connection with the relevant employee’s employment and, with the exception of Mike’s remote living allowance, has been based on an amount incurred or a reasonable estimate. The $50 per week remote living allowance was negotiated as a condition of Mike’s employment.

**Implications for Mike**

The reimbursing allowances paid to Mike to reimburse him for the costs he is likely to incur in using his quad bike for work and for providing wet weather gear are exempt from tax under s CW 17(2). This exemption is because these expenses are expenses that would have been deductible to Mike if the employment limitation did not exist. In the case of the wet weather gear, the conclusion that s CW 17 applies to treat this allowance as exempt income assumes that if any part of the allowance was for the capital cost to acquire the gear, the acquisition costs would have been deductible as a depreciation allowance under the low value asset provision s EE 38.

The allowance paid to assist Mike with the costs of his children attending boarding school is a benefit allowance because it provides Mike with a benefit in reducing the boarding school costs paid by him. Expenditure on boarding
school fees for his children is of a private or domestic nature. It is taxable to Mike as employment income under s CE 1(1)(a) and subject to PAYE.

The remote living allowance paid to Mike is also a benefit allowance because it provides him with a benefit by reducing his private or domestic expenditure. Therefore, it is taxable as employment income under s CE 1(1)(a) and subject to PAYE.

**Implications for Pete and Jake**

The food Frank provides Pete and Jake for breakfast is not a fringe benefit because the exclusion for benefits provided on an employer’s premises applies (s CX 23).

The meat for the freezer is a fringe benefit and the exclusion in s CX 23 does not apply. The taxable value can be worked out using s RD 40(1) and will be the meat’s market value.

**Implications for the shearing gang**

The reimbursing allowance paid to each member of the shearing gang to reimburse them for the costs of providing their own shearing gear is exempt from tax under s CW 17. This exemption is because these expenses are expenses that would have been deductible to them if the employment limitation did not exist. In the case of protective clothing, the conclusion that s CW 17 applies to treat these allowances as exempt income assumes that if any part of the allowance was for the capital cost to acquire the clothing, the acquisition costs would have been deductible as a depreciation allowance under the low value asset provision s EE 38. The allowance in lieu of rations paid to the gang is also exempt from tax. Generally such allowances would not satisfy s CW 17(2) because of the private limitation. However, s CW 17CB(1) allows exempt meal allowances to be paid for short periods where the employment duties of an employee require them to travel and work away. In this case the shearers are working away in another district and staying in shearers’ quarters so can be paid an exempt meal allowance to the extent that they receive an allowance rather than food.

**Implications for Frank**

Frank is not liable for FBT for the food he provides to Pete and Jake.

All the allowances paid to Mike and the costs of providing food to Pete and Jake are deductible to Frank because they are paid in connection with their respective employment. They are business expenses that satisfy the test in s DA 1.

**Sharp Shearing Services**

The reimbursing allowances paid to the shearing gang are all deductible to Sharp Shearing Services because they are paid in connection with the employment of the company’s employees. Accordingly, they are business expenses that satisfy the nexus test in s DA 1.
# References

## Subject references
- Allowances
- Benefit allowance
- Certificate of exemption
- Employee
- Farm worker
- Fringe Benefit
- Reimbursing allowance

## Legislative references
- Income Tax Act 2007: ss CE 1, CW 2, CX 6, CX 9, CX 10, CX 12 to CX 16, CX 23, CX 37, DA 1, DA 2, DO 1, DO 2, EE 38, subpart RD, RD 8, RD 40, RD 45, RD 54, YA 1 ("agricultural, horticultural, or viticultural company", "employee", "PAYE income payment", "scheduler payment"), Sch 4
- Tax Administration Act 1994: s 24M, 91AAT

## Other references
- "Allowances – shearers and shed hands", *Public Information Bulletin* No 92 (December 1977): 2
- "Allowances for shepherds, musterers and drovers", *Public Information Bulletin* No 40 (May/June 1967): 8
- "Cost of keep of farm employees", *Public Information Bulletin* No 171 (March 1988): 1
- "CS 16/02: Determining ‘market rental value’ of employer-provided accommodation", *Commissioner’s Statement* (24 November 2016)
- "CS 12/01: "Income tax treatment of accommodation payments, employer-provided accommodation and accommodation allowances", *Commissioner’s Statement* (6 December 2012)
- "Farming supplement 'No 2' – allowances to farm employees – tax position explained", *Public Information Bulletin* No 25 (August 1965): 7
- "Some farm employees living in remote areas not to pay tax on school boarding allowances", *Public Information Bulletin* No 25 (August 1965): 11