Australian Government
Australian Taxation Office

# ATO MINUTE

FILE REF: 09/6250

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| TREASURY REF: | HMAU 2009-097 |

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| CATEGORY: | ☒ Pre policy approval<br>☐ Legislative measures development<br>☐ General |

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| ISSUE DATE: | 4 December | RESPONSE DATE: | |

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| SUBJECT: | AFTS proposal - changes to the taxation treatment of fringe benefits |

## 1. Purpose

The purpose of this minute is to provide Treasury with revenue impacts for an AFTS proposal for fringe benefits.

## 2. Proposal

Fringe benefits would be split into two categories:

1. Benefits provided for an employee's private use (for example through salary sacrifice) and whose value can be easily attributed to an individual would be included in an employee's taxable income in

the same way as salary and wages (‘assigned fringe benefits’). The taxable value of these benefits would be reduced by deductions available to the individual (including those related to work-related expenses or their replacement), and through employee contributions (consistent with the current system). Examples might be car parking exclusively for the use of the employee; child care provided on the employer's premises or private use of a motor vehicle.
These benefits would be reportable for the purpose of assessing eligibility for all transfer payments, and would be taxable at the employee’s marginal rate.

2. Benefits incidental to an individual’s employment, or those that are difficult to assign, would be taxable in the hands of the employer at the top marginal tax rate (‘unassigned fringe benefits’). These benefits would not be reportable for the purpose of assessing eligibility for transfer payments. The employer would be taxed where the value of these incidental benefits exceeded a threshold of $300 per employee, on the portion that exceeded that value. For example, a firm with 10 employees that provides $400 of incidental benefits would face a tax liability of $450 [($4,000 - $3,000) x 45%]. The amount of unassigned fringe benefits, plus the fringe benefits tax paid, would represent a deductible expense for the company. In the example cited above, the value of the deduction would be $4,450.
Examples would be pooled car parking, minor benefits, subsidised cafeterias, Christmas parties, pooled use of a gymnasium, etc.
Market value would generally be used to value both assigned and unassigned fringe benefits.
Grossing up would no longer be required.

Most exemptions and concessions would be removed including those provided for members of the Australian Defence Force and not-for-profit and other entities that currently benefit from the FBT cap. These would be replaced by compensating increase in remuneration in the former case and direct outlays in the latter.
The broad definition of fringe benefits in the FBT (Fringe Benefit Tax) law would be reviewed to exclude essential items such as chairs, stationery and toilets. For the purpose of this costing request, these items should be deemed to be excluded.

Concessional treatment would still apply in the following two cases:
• For car fringe benefits, the current statutory formula would be replaced by a single statutory rate of 20 per cent of the value of the vehicle, regardless of the distance travelled. Taxpayers would still have access to the operating cost method.
• Concessions for payments to approved worker entitlement funds would be retained to avoid instances of double taxation.

## 3. Start Date

1 July 2010

## 4. Background

Fringe benefits are taxable in the hands of the employer. Tax is applied to the grossed-up value of the fringe benefit, which reflects the amount of pre-tax income the taxpayer would need to earn to pay for the fringe benefit (assuming they face the top marginal tax rate).
A range of valuation rules are contained in the *Fringe Benefits Tax Assessment Act 1986*, including a large number of exemptions and concessional valuations.
The taxable value of car fringe benefits can be determined using either the statutory formula or operating cost methods.
• The statutory formula applies so that the taxable value of a car fringe benefit falls as total kilometres rise.
• Under the operating cost method, the actual operating costs (for example, all car expenses, depreciation, registration, and insurance) are apportioned between business use and non business use, as determined by the use of a log book over a 12 week period. The non business portion of the operating costs is the value of the car fringe benefit.
Certain not-for-profit organisations are eligible for FBT concessions.
• Public benevolent institutions and health promotion charities receive a $30,000 capped exemption from FBT per employee, and public and not for profit hospitals and public ambulance services receive a $17,000 capped exemption from FBT per employee. Meal entertainment expenses and entertainment facility leasing expenses do not count towards the caps.
• In addition, certain not-for-profit, non-government bodies are eligible for a 48 per cent rebate of FBT

that would otherwise be payable. The rebate applies to up to $30,000 per employee.

## 5. Impact analysis – summary details

### 5.1 Revenue impact – (see Appendix 1)

The AFTS panel have asked for a costing based on 'steady state' 2010-11 income year terms, with no timing or transitional impacts.

We have estimated that the impact on revenue would be a gain of approximately $1.7 billion and an increase in government outlays of $200 million, resulting in a $1.5 billion impact on the overall fiscal position.

**5.2 Compliance cost impact –**
not required

**5.3 Departmental impact –**
not required

**Tangamani Kusa for**
**Paul Brodie**
**Acting Assistant Commissioner**
**Revenue Analysis Branch**

## Appendix 1 – Revenue impact

The AFTS panel have asked for a costing based on 'steady state' 2010-11 income year terms, with no timing or transitional impacts.

We have estimated that the impact on revenue would be a gain of approximately $1.7 billion and an increase in government expenses of $200 million, resulting in a net $1.5 billion dollar gain.

### Reliability of estimate

The reliability of the estimate is considered to be low. There is limited data on the size of the currently exempt fringe benefits. Assumptions are used to estimate the cost of the various concessions and exemptions currently available.

### Data

<u>Taxable FBT</u>

- MYEFO 2009-10 estimated cash outcome

<u>Impact of Defence Force exemptions</u>

- *Department of Veterans Affairs Portfolio Budget Statements* 2008/09
- *Exemption for health care benefits provided to members of the Defence Force*
    - Defence data – Portfolio Budget Statements
    - DVA data – direct from the department

<u>Not-for-profit and other entities</u>

- TES 2009 data (2008-09 fringe benefits return data)
- SME business line salary sacrifice report.

<u>20% flat statutory formula for cars</u>

- ATO minute 540-2009

<u>Other concessions and exemptions</u>

- TES 2009 data

### Assumptions

<u>Taxable FBT</u>

- 70% type 1 benefits
- 30% type 2 benefits
- 30.3% marginal tax rate

<u>Impact of Defence Force exemptions</u>

- 35% marginal tax rate
- No change to benefits provided by the Department of Veterans Affairs to former members of the defence force
- extrapolated 2010-11 data based on TES 2009 data

<u>Not-for-profit and other entities</u>

- 35% marginal tax rate

- extrapolated 2010-11 data based on TES 2009 data
- Assumed steady state cost, no compensation
- 48 cent rebate, gross up factor 1.9572 (mix of type 1 and type 2 benefits)

20% flat statutory formula for cars

- See ATO minute 540-2009

Other concessions and exemptions

- Marginal tax rate 35%
- Given that the exemption for minor benefits is retained, we have assumed that employers are already taking advantage of this and all other exemptions are taxed from the first dollar of benefits.
- For the unquantifiable TES, where there is little to no data, we have assumed a 30% mid point of the order of magnitude.
- Concessions for payments to approved worker entitlement funds, arms length transactions, private use of business property and minor benefits are retained.

## Methodology

Taxable FBT

- Gross up 2010-11 year MYEFO cash numbers by the current FBT rate (46.5%) to get the taxable value.
- Un-gross by the gross-up rate to get the market value.
- The cost of the change is equal to
  - the tax on the benefit at individual's marginal rates
  - *plus* the current amount of FBT which is no longer paid by the employer and is now passed on to the individual and taxed at individual's marginal rate
  - *less* the FBT that would have been previously collected in 2010-11 under the current taxation arrangements.

Impact of Defence Force exemptions

- Defence Force personnel would be compensated with higher wages as a result of loosing the benefits they get from the various exemptions available to them.
- For the *Exemption for benefits received by Australian Government employees in receipt of military compensation payments* and *War service loans provided under the Defence Services Homes Act 1918,* the value of payments was grossed up by the individual's marginal tax rate so that they would not be worse off if getting the same benefit from after tax income. The revenue gain to income tax is matched by an equal increase in government expenses.
- For the *Exemption for health care benefits provided to members of the Defence Force,* the majority of the current costs are for benefits provided to former members of the defence force. These benefits are provided through the Department of Veterans Affairs and are not provided by way of salary and wages. We have assumed that there will be no change to how these benefits are provided. The value of payments relating to current defence force members was grossed up by marginal rates.

Not-for-profit and other entities

- The concessions for the not-for-profit sector would be removed and the sector would be compensated through direct outlays in the short term. We have costed this proposal in the steady state, after all compensation would have ceased.
- The value of the benefits from the *Capped exemption for public and not-for-profit hospitals, Capped exemption for public benevolent institutions, Capped exemption for charities promoting the prevention or control of disease in human beings, Fringe benefits provided to employees of religious institutions* and *Meal entertainment* Tax Expenditure Statements were "cashed out" at the individuals marginal tax rate.

- The effect of removing the Partial rebate for certain not-for-profit, non government bodies was estimated as follows:
  - The amount of rebate was grossed up by 48%
  - Gross tax was extrapolated using the following equation (rebate = .48 * (gross tax - non rebatable amt))
  - The Grossed up value and taxable value were calculated.
  - Net FBT was calculated.
  - The gain to revenue was calculated as the sum of taxable value of the benefits plus the net FBT that would have previously been payable by the employer (now passed on to the individual) *multiplied* by the individual's marginal tax rate *less* the net FBT foregone.

<u>20% flat statutory formula for cars</u>

- The gain to revenue from replacing the current statutory rate to a flat 20 per cent rate regardless of distance travelled was sourced from a previous costing, ATO Minute 540-2009. The out year number was used to reflect a steady state gain to revenue, once the current lease arrangements have run out.

<u>Other concession and exemptions</u>

- The various concessions were divided between those that are provided for an individual's private use and those that are incidental to an individual's employment.

**Private use**

*Quantifiable TES*

- For the following quantifiable TES, the taxable value was multiplied by the individual's marginal tax rate to calculate the gain to revenue.

D18 Discounted Valuation of stand-by travel for airline employees and travel agents
D33 Discounted valuation for car parking fringe benefits
D26 Exemption for small business employee car parking

*Unquantifiable TES*

- For the unquantifiable TES, where there is little to no data, we have assumed a 30% mid point of the order of magnitude in the TES publication to estimate the cost.

D11 Exemption for employer contributions to secure childcare places in certain centres
D35 Exemption for airline employees on stand by flights
D36 Exemption of benefits in relation to compassionate travel
D5 Reduction in taxable value for education costs of children of employees posted overseas
D31 Concession for holiday transport for employees and their families posted overseas or to Australia
D47 Reduction in taxable value for remote area holiday benefits
D25 Exemption for certain loan benefits
D39 Exemption for employer-provided motor vehicle parking
D40 Exemption for engagement of a relocation consultant
D46 Exemptions for employees living away from home

**Incidental use**

*Quantifiable TES*

- For the following TES, the taxable value was multiplied by the new FBT rate. The gain was reduced by the deductible expense for the company.

D16 Exemption for free or discounted commuter travel for employees of public transport providers

D17 Exemption for free or discounted travel to and from duty by police officers on public transport
D38 exemption for eligible work-related items
D32 Discounted valuation for board meals
D27 Record keeping exemption

Unquantifiable TES

- For the unquantifiable TES, where there is little to no data, we have assumed a 30% mid point of the order of magnitude.

D1 Exemption for benefits provided by certain international organisations
D9 Exemption for accommodation, fuel and meals for live-in employees caring for the elderly or disadvantaged
D7 Exemption for travel costs of employees and their families associated with overseas medical treatment
D10 Exemption for emergency assistance
D13 Exemption for safety award benefits up to $200 per year per employee
D15 Exemption for employee taxi travel arriving at or leaving from place of work
D19 Exemption for certain long service awards for more than 15 years of service
D20 Exemption for certain relocation and recruitment expenses
D21 Exemption for compensation-related benefits, occupational health and counselling services and some training
D29 Exemption for certain benefits provided to live-in employees who provide domestic services and are employed by religious institutions or religious practitioners
D42 Exemption for minor private use of a company motor vehicle
D44 Exemption for the provision of food and drink in certain circumstances
D45 Exemption for transport for oil rig and remote area employees in certain circumstances
D22 Reduction in taxable value for reimbursements of car expenses incurred for occupational health and counselling services and some training courses
D23 Reduction in taxable value of certain relocation and recruitment expenses

**Mix of both**

- The following unquantifiable TES contains a mix of private and incidental benefits. We have assumed a cost of $30 million.

D12 Exemption for recreational or childcare facilities on an employer's business premises

## Further Information

[Attachment]