THE TAX INSTITUTE

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Dear Mr Leggett

Consultation Paper: Fringe Benefits Tax Reform: Living-away-from-home benefits

The Tax Institute is pleased to provide our submission in response to Treasury's Consultation Paper entitled "Fringe Benefits Tax Reform: Living-away-from-home benefits" ("**Consultation Paper**").

In addition to the questions posed in the Consultation Paper, we have also made additional comments in relation to the issues raised in the Consultation Paper and the related Media Release issued by the then Assistant Treasurer on 29 November 2011 ("**Media Release**") as set out below.

Overview

The Tax Institute broadly supports the intention underpinning the current rules governing the Fringe Benefits Tax ("**FBT**") treatment of Living-away-from-home-allowances ("**LAFHA**"), as set out:

- At page 11 of the Explanatory Memorandum to the *Fringe Benefits Tax Assessment Bill 1986* (the "**Bill**"), i.e. to exempt from FBT reasonable compensation to an employee for "additional expenses or disadvantages suffered through the employee (and family) having to live away from home in order to perform duties for his or her employer" ; and

- In the Second Reading Speech to the Bill in which it is noted that "the types of benefits to be taxed include … excessive living away from home allowances …"

We also acknowledge that the implementation of the current rules may have in some circumstances resulted in an inappropriate application of the FBT exemption, owing to either:

1. Non-compliance with the existing rules;

2. Lack of guidance from the ATO; and/or

3. A disconnect between the intention and effect of the legislation.

Our submission below focuses on the extent to which the proposed legislative amendments address the third point. In this regard we note that:

- The scope to bring the application of the FBT exemption for reasonable LAFHA in line with its original intent by addressing points 1 and 2 should also be considered as part of this process; and

- In our view, the effect of the proposed reforms extends beyond addressing point 3. To the extent that the proposed reforms will effect a change of policy in comparison to the original policy intent underpinning the LAFHA rules, such shift in policy should be clearly understood and enunciated.

In particular, we consider the following to be areas where the proposed reforms extend beyond addressing the disconnect between the intention of the existing law and current practices:

- The proposed reforms create discrimination against temporary resident employees as compared to Australian permanent resident employees. Rather than creating a level playing field, the reforms make it more difficult for an employee to cover the costs of a temporary move to Australia (or for an employer to cover the costs associated with such a move) compared to an Australian citizen or permanent resident moving temporarily within Australia. If this is the policy intention underpinning the proposed reforms, the intention should be articulated more clearly in order to provide certainty to taxpayers.

- The reforms apply to all visitors to Australia, including “legitimate” living away from home arrangements, i.e. where the employee would not have moved temporarily to Australia but for the requirement to be located here for work purposes. As noted above, the intention of the existing law was to provide a tax concession in this scenario relating to the additional costs that are incurred.

To the extent that the proposed reforms are intended to create a “level playing field” between Australian residents and temporary residents, regard must also be had to the likely effect of the proposed reforms (in relation to the applicability of the LAFHA rules to temporary residents) on the migration of skilled workers to Australia. This is particularly the case where there are skill shortages and concessions such as those currently available are used to attract workers with the appropriate skills.

As part of this review, we recommend consideration of the possibility of limitation of the LAFHA concessions (for example, for a period of time such as 2 years) or setting a maximum allowable LAFHA amount, either as a dollar value or a percentage of the gross package) rather than the removal of these concessions altogether for temporary resident employees in certain circumstances.

Such a limitation may lessen the impact of the proposed reforms on skilled migration. This would also be consistent with measures implemented offshore. For instance, we understand that:

- The United Kingdom allows a 52 week exemption from National Insurance Contributions;

- The United Kingdom has tax relief called Detached Duty Relief for temporary assignments of less than 2 years; and

- The USA allows a degree of concessional treatment for assignments of less than 12 months).

Question 1. Are there any unintended consequences from the proposed reforms?

The Media Release and Consultation Paper are in our view unclear on what the 'intended' consequences of the proposed reforms are.

In this regard, we understand the intention of the proposed reforms to be:

- To ensure an even playing field between permanent and temporary residents of Australia.
- To eliminate some perceived rorting of the system by way of excessive exempt allowance amount and some "double dipping" by employees in joint living arrangements.

In our view, the reforms will cause the following, possibly unintended, consequences:

- The intention of rectifying the current uneven playing field referred to in the Consultation Paper implies an equality of treatment between permanent residents and temporary residents in every other respect that is not representative of the current situation. For example:
    - Temporary residents often have higher costs in relation to medical expenses (as they do not qualify for Medicare benefits under their visa, and only some would qualify for any Medicare benefits under a reciprocal health care agreement that Australia may have with their country of origin) or school fees for their children, which may offset any tax savings they may have as a result of receiving LAFHA.
    - Whilst temporary residents receive a number of concessions via the temporary resident rules contained in Subdivision 768-R of the *Income Tax Assessment Act 1997*, they cannot access any social security benefits in Australia as they fail the definition of resident within the meaning of the *Social Security Act 1991*.
    - Temporary residents are subject to the Foreign Investment Review Board restrictions in respect of buying property in Australia.
- A greater compliance burden for employees who will now be required to determine themselves if they are "living away from home" with, in many situations, inadequate knowledge of the complex LAFH criteria (which has troubled tax advisors, the ATO and employers alike). It is unclear to us what remains the employer's responsibility in determining living away from home status and paying a LAFHA under the proposed rules. Specifically, it is unclear to us whether:
    - A LAFHA which is taxable under the income tax provisions will require an employer to obtain a LAFH declaration?
    - Whether a LAFHA needs to be separately disclosed as such on PAYG Payment Summaries (or whether it can just be included as a general allowance)?

    In this regard, tax advisors, employers and taxpayers alike would benefit from clarification of whether the guidance contained in MT 2030 will remain valid in ascertaining whether an individual is living away from home. If so, we recommend that this ruling be updated to provide additional clarity. In this regard, we note the extensive issues in relation to LAFHA raised at the NTLG FBT Sub-committee for clarification.
- There will also be a further compliance burden on employees in terms of substantiating their expenditure.

- A number of other benefits which currently attract concessional tax treatment and which depend on the employee "living away from home", such as children's' education, relocation transport (including immigration costs), removal of household effects, to potentially become taxable fringe benefits for temporary residents. The Consultation Paper is unclear as to whether this is an intended consequence. A list of such benefits is attached at Appendix A for information.

- On-costs (such as salary, superannuation, workcover, payroll tax) to rise as a result of the benefits becoming taxable either under the income tax rules or into the FBT sphere. In particular, WorkCover and payroll tax liability is calculated on a fringe benefits inclusive basis so that such changes to the FBT legislation are likely to fundamentally alter the base on which those liabilities are calculated. And even where a LAFHA subject to income tax is fully offset by substantiated deductions, we understand that WorkCover and payroll tax would apply.

- Employers will need to contribute additional superannuation for employees that will have higher taxable incomes compared to under the existing arrangements. This would then be subject to tax in the superannuation fund and, for temporary residents, a further tax will be levied when the funds are withdrawn on the employee's permanent departure from Australia.

- The requirement to withhold PAYG will become more difficult to manage in relation to knowing whether employees are going to have substantiated offsetting deductions. Employees in receipt of the allowance may begin to unilaterally fill out PAYG variation notices. The possibility of the ATO issuing a blanket variation in relation to all reasonable LAFHAs could warrant examination.

- Under the proposed reforms, accommodation allowances could still be very high and effectively remain tax free where costs up to the amount of the allowance can be substantiated. We understand that a policy driver of the proposed reforms was to curtail the availability of LAFHA concessions for accommodation deemed to be "excessive". It is unclear whether the ability to substantiate expenditure equal to the allowance amount is sufficient to show it is not excessive or whether a dollar or percentage cap is required for this purpose.

- The tax treatment of arrangements whereby an employee has a usual place of residence away from their workplace (potentially even interstate) and another residence they use during their "working week" closer to the workplace appear to be unaffected by the proposed reforms. Clarification of this intention would be helpful.

- Consideration should be given to the loss of income taxation revenue and additional broader revenue considerations should employers cease expatriate arrangements. Further, wage costs and the availability of specialist skills are key considerations in the decision making process of awarding key contracts within Australia or, alternatively, overseas.

Question 2. What practical aspects of the proposed reforms need further consideration?

- The impact on labour mobility, the labour market, the property (i.e. rental) market and the true incidence of the tax cost of these amendments i.e. whether the cost is borne by the employer or passed onto the employee. In particular, the cost to business and employees where a commitment has been made to current arrangements, such as tax equalised employment contracts and residential lease agreements, etc.

- Transitional arrangements in relation to pre-existing contracts or agreements need to be fully considered and not just for the community sector. Please refer to our comments on this issue under Question 6 below.

- The reasonable cap proposed to be set for food costs should take into account that that the costs might be incurred overseas.

- The increased compliance burden on employees, particularly their ability to correctly determine for taxation purposes whether they are "living away from home".

- Paragraph 2.1.3 of the Consultation Paper makes reference to the substantiation requirements contained in Division 900 of the *Income Tax Assessment Act 1997* and notes that these requirements will not be required for food expenses up to an amount considered reasonable by the Commissioner. The Consultation Paper notes that the ATO will produce administrative guidelines in this regard in order to assist taxpayers.

  We note past ATO responses to similar requests for administrative guidelines have been as follows:

  > The Tax Office advised that the information provided by an independent third party that specialises in providing international compensation data for employees working overseas is an objective method of determining the food component of a LAFHA.

  (Source: NTLG FBT Sub-committee minutes of August 2009 meeting, agenda item 6.1)

  Any guidelines will need to be in place by 1 July 2012 as employers and employees will seek to use these guidelines in ascertaining the reasonable food component of the LAFHA to be paid going forward.

- The impact on businesses that will need to revise their systems to cope with these allowances being taxed in the income tax sphere rather than FBT.

Question 3. Are there any interactions with other areas of the tax law that need to be addressed?

Please see our comments above in relation to the likely income tax (including PAYG withholding and PAYG Payment Summary reporting obligations) as well as superannuation guarantee, WorkCover and payroll tax impacts of the proposed reforms.

Consideration may also need to be given to ongoing mismatch issues from recent amendments to section 23AG which still flow through into LAFHA arrangements for permanent residents working overseas. Under current FBT laws, there is no ability for an employer to claim an offset for foreign tax paid by the employee on benefits provided to them in an overseas jurisdiction, against any FBT liability.

Question 4. As the statutory food amount is intended to reflect the ordinary costs incurred by an Australian in 2011, what should the statutory food amount be updated to?

The statutory food amount should be established with reference to a costing of an appropriate basket of goods. There should also be a mechanism for establishing an appropriate value in offshore jurisdictions.

Question 5. Should the statutory food amount be indexed annually to ensure it remains up to date?

Yes, as envisaged in the context of the original legislation. The EM to the Bill notes on page 57 "the statutory food amount for an adult is set at $42 per week. The comparable figure for a child who is less than 12 years of age at the beginning of the relevant year of tax is $21. *It is intended that these amounts be regularly reviewed by reference to movements in the Consumer Price Index.*" (emphasis added).

The total reasonable amount for a food allowance should also be indexed in the same manner as, say, the Housing indexation figures.

Question 6. What transitional arrangements would be appropriate for the community sector?

In our view, transitional arrangements must be fully considered for not only the community sector but for all employers who engage employees who are living away from home and have pre-existing contractual/binding arrangements, e.g. rental agreements.

The proposed reforms will affect the substance of formed bargains between employers and employees (and third parties, e.g. agreements with agents/landlords in relation to accommodation). In most cases, the employee will have already relocated on the basis of the original bargain. Such employees and employers will typically be unable to extract themselves from the bargain already struck.

In the interests of fairness and to prevent adverse outcomes for employees and employers who have entered into employment contracts on the basis of the current law, we recommend that elective transitional measures be made available in respect of **all** employment contracts entered into prior to the date of the announcement of this measure.

If such arrangements cannot be grandfathered indefinitely, we recommend that transitional measures be applied to phase in the changes in relation to existing employment contracts over a number of years, perhaps over the lesser of:

- 4 years (as applicable with respect to the car fringe benefits changes contained in *Tax Laws Amendment (2011 Measures No. 5) Act 2011*); and

- The remainder of the existing visa (which we consider to be a logical period, given that the proposed amendments will primarily affect temporary residents).

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Should you have any queries with respect to any of the matters raised above, please do not hesitate to contact me on (02) 8223 0011 or The Tax Institute's Tax Counsel, Deepti Paton on (02) 8223 0044.

Yours sincerely

Ken Schurgott
President

APPENDIX A

FBT Exemption	**Section reference (*Fringe Benefits Tax Assessment Act 1986*)**
Engagement of relocation consultant	58AA
Removals and storage of household effects as a result of relocation	58B
Exempt benefits – sale or acquisition of dwelling as a result of relocation	58C
Connection or re-connection of certain utilities as a result of relocation	58D
Leasing of household goods while living away from home	58E
Exempt benefits – relocation transport	58F
Reduction of taxable value – overseas employment holiday transport	61A
Reduction of taxable value – temporary accommodation relating to relocation	61C
Reduction of taxable value of temporary accommodation meal fringe benefits	61D
Reduction of taxable value – education of children of overseas employees	65A