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Philanthropy & Exemptions Unit
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The Treasury
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3 February 2012

Dear Sir

Submission on the Consultation Paper Fringe Benefits Tax Reform Living-Away-From-Home Benefits

PricewaterhouseCoopers welcomes the opportunity to make a submission in relation to the proposed reforms to the fringe benefits tax (FBT) treatment of Living Away From Home (LAFH) benefits as announced by the Government on 29 November 2011.

Our submission is in three sections:

1. Impact on Australian business
2. Alternative approaches
3. Questions for consultation

In this submission, references to "LAFH benefits" are to LAFH accommodation and food benefits.

The key conditions for an allowance to qualify as a LAFH benefit (including accommodation and food allowances) are:

1. The payment is an allowance paid by the employer to an employee in respect of the employee's employment; and

2. the whole or a part of the allowance is in the nature of compensation to the employee for additional expenses (not being deductible expenses) incurred by the employee and any other additional disadvantages arising to the employee during a period because that the employee is required to live away from the employee's usual place of residence in order to perform the duties of employment.

1. Impact on Australian business

Based on our discussions with clients, other interested parties and on the impact on PwC's own business, the proposed reforms will have a significant impact on Australian business.

LAFH benefits have been and are currently provided to employees to attract people with key skills and experience to Australia either on a short term basis (e.g. a 6 month assignment for a specific customer contract) or on a medium term basis (e.g. a 2-4 year secondment to the Australian business to bring a specific skills set or knowledge to the business). Many of these positions are advertised both within Australia and overseas and are usually filled on a fixed short or medium term basis.

In our experience, LAFH benefits are provided to employees on all types of salaries and not just to executives in senior positions. LAFH benefits are also provided by employers in many industries.

In many sectors in Australia, there is a critical skills shortage and there is therefore a need to attract and retain skilled employees from overseas. In competing for employees, the LAFH benefits are seen to offset the high headline tax rate (46.5%) and cost of living for which Australia is well known internationally. As such, LAFH benefits are a key attraction and retention tool for Australian business and are provided to compensate employees for additional costs because they are in Australia for a short or medium term assignment.

It is also worth noting that some of the employees that come to Australia on a short or medium term basis ultimately decide to apply for permanent residency in Australia. They then contribute to Australia's skills base and contribute to government revenues through paying income tax on a long term basis.

The impacts on Australian business are expected to include:

1. Significantly higher costs to Australian business as additional amounts will need to be paid by employers so as to leave affected employees in the same after tax position once the proposed reforms are introduced – as outlined above, many temporary residents are needed by Australian business to address the skills shortage in Australia and therefore business will need to ensure that the employee is not disadvantaged upon the introduction of the proposed reforms;

2. The higher cost of labour in Australia resulting from the removal of the LAFH benefits for temporary residents may result in:

    a. Contracts and projects being moved offshore to lower labour cost countries either because of cost to the business or because business cannot attract employees to Australia with the necessary skills. If contracts and projects are moved offshore there is likely to be an impact on both the business concerned and on the Australian employees that would have been employed to work on the contracts or projects;
    b. The additional costs being passed onto customers (including consumers and government); and
    c. The profits on current contracts and projects becoming uncommercial and therefore the contract and project being terminated;

3. Where the reforms are implemented there is a real possibility that a large number of temporary residents will leave Australia soon after 1 July 2012 as a result of the increased cost of residing in

Australia, which makes employment offers from overseas companies more attractive and competitive than Australian businesses can offer; and

4. There will also be significantly higher costs for business as a result of the proposed change due to additional payroll tax, superannuation and workers compensation expenses arising because of the move of LAFH accommodation and food benefits moving from being fringe benefits to being salary and wages.

All of the above impacts are likely to result in lower taxable income of Australian businesses and therefore lower corporate taxes being paid.

In summary, the proposed reforms will have a significant negative impact on Australian business and therefore on the Australian economy.

2. Alternative approaches

We believe that retaining the currently LAFH accommodation and food benefits is in the best interest of Australian business and therefore the Australian economy.

That said, we have outlined below alternative approaches that may assist the government in achieving the stated aims of the proposed reforms. The Forward to the Consultation Paper states that: the changes will ensure a level playing field exists between hiring an Australian worker or a temporary resident worker living at home in Australia, in the same place, doing the same job.

We also believe that these alternatives also allow Australia to address the requirements of the non-discrimination articles in its Double Taxation Treaties (this is discussed in more detail in Question 3 of the Questions for Consultation below).

We are happy to discuss these alternatives in more detail.

Inspector-General of Taxation Report – January 2007

If there are concerns in relation to how the LAFH benefits have been administered in the past, we suggest that Recommendation 2 in the *Review of Tax Office's management of complex issues — Case study on living-away-from-home allowances*, a report by the Inspector-General of Taxation to the Minister for Revenue and Assistant Treasurer dated 24 January 2007 is implemented.

We note that this report did not even consider a distinction between temporary and non-temporary residents in relation to how the LAFH provisions should be administered.

Recommendation 1 was that the Commissioner of Taxation reach a conclusion whether the Australian Taxation Office should advise Treasury that a legislative change was needed to the LAFH provisions. Recommendation 2 then stated that:

> In the absence of the Tax Office providing such formal advice to Treasury or any legislative change, then the Tax Office should issue a new public ruling to replace Miscellaneous Taxation Ruling MT 2030. The new public ruling should provide community-wide guidance and certainty on the Tax Office's interpretation, administration and practical application of the LAFHA provisions, and should include clarification of the key technical issues arising from this review such as:

- usual place of residence;
- meaning of the term 'additional';
- factors the Tax Office would take into consideration in determining what was 'reasonable' for the purposes of a LAFHA including guidance on methods which would be acceptable to the Tax Office;
- causation between employment and entitlement to receive a LAFHA, in particular, whether there is a requirement for a pre-existing employee/employer relationship for a LAFHA entitlement.

Requirement to return to a specific home

Where a temporary resident worker is maintaining a home in their home country and also paying for accommodation in Australia, there is not a level playing field between an Australian worker and a temporary resident worker in the same place, doing the same job. The temporary resident worker is incurring additional expenses that the Australian worker is not. This is especially the case for workers in Australia on a short term basis (e.g. a 6 month assignment) where giving up their home in their home country is not practical.

LAFH benefits are the way in which a temporary resident (and any other employee that is LAFH) is compensated for these additional expenses. Given that benefits cannot qualify as LAFH benefits unless they are in the nature of compensation to the employee for additional expenses of and disadvantages arising to the employee during a period because that the employee is required to live away from the employee's usual place of residence in order to perform the duties of employment, by their very nature, LAFH benefits level the playing field where an actual home is maintained by the temporary resident worker.

With the above as background, we believe that the stated aims of the proposed reforms could be achieved through maintaining LAFH benefits for temporary resident workers however, for accommodation benefits, all workers (temporary resident or not) would need to maintain a home in their home location (country or state) rather than only having an intention to return to a specific city or district. The worker would need to substantiate that the property was their home and guidance would be needed from the Australian Taxation Office as to appropriate documentation to substantiate this statement.

Reimbursements only for LAFH accommodation

Another alternative to achieve the stated outcome of a level playing field is to operate the LAFH accommodation benefit on a reimbursement basis only.

Historically, allowances have been paid to employees for administrative simplicity and efficiency rather than to allow employees to "pocket" the excess allowance as tax-free income. Many Australian businesses require employees to show them a copy of a signed lease as evidence of the allowance being reasonable and equivalent to what the employee actually pays in rent.

While paying allowances would still be simpler and more efficient, operating LAFH accommodation allowances on a reimbursement basis only would address the concern in the Consultation Paper that "the concessions currently allow some employees to access large amounts of tax-free remuneration through allowances that are well in excess of the actual costs incurred by the employee".

Again, this change would apply to all workers, not just temporary resident workers.

3. Questions for Consultation

The specific questions for consultation in the paper are:

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

We believe that the significant impacts on business as outlined in Section 1 of this submission are likely to be unintended consequences of the proposed reforms. As a result, we respectfully submit that the alternative approaches in Section 2 should be considered in order to achieve the aims of the proposed reforms as outlined in the Consultation Paper.

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

The practical aspects that need further consideration are outlined below.

Determining whether an employee is a temporary resident

In order to determine who can receive LAFH benefits, employers will need to understand whether the individual is a "temporary resident" as defined. This will also be relevant when an employee requests a PAYG withholding variation (see below).

To determine whether someone is a "temporary resident" as defined is not as simple as just checking whether or not the employee has a section 457 temporary work visa sponsored by the Australian employer. A temporary resident is both a section 457 temporary visa holder lawfully in Australia and a foreign national whose spouse, or former spouse, is not, and has never been, an Australian citizen or permanent resident. Spouse includes both legal and de facto relationships and, from 1 April 2009 de facto relationships include both opposite sex and same-sex relationships. From this definition it can be seen that employers may need to ask questions that employees may not wish to answer from a privacy perspective.

Consideration should therefore be given to the Australian Taxation Office providing statements in an approved form that employees can give to their employers in relation to their Temporary Resident status and on which the employer can rely.

PAYG variations

Example 1 in Section 2.2 of the Consultation Paper gives an example of Ciara, an employee who is LAFH that intends to claim income tax deductions for her accommodation and food expenses while she is LAFH. The Example states that "Ciara's employer does not have to withhold tax from the LAFHA because she indicates to them that she will be claiming a deduction."

Guidance is requested on how Ciara will "indicate" to her employer that she will be claiming a deduction and what the employer will need to do to approve a PAYG withholding variation in these circumstances.

Substantiation that a unit of accommodation is available

Under the proposed reforms, a temporary resident will only be eligible for LAFH benefits while living away from an Australian home provided that home is available for their personal use and enjoyment at all times. The Consultation Paper makes clear at paragraph 2.1.5 that the unit of accommodation cannot be rented out or sub-let while the temporary resident is LAFH. Under the proposed reforms, temporary residents in this situation will be required to provide documentary evidence to their employers that they are maintaining a home for their own use.

The documentary evidence will be difficult to produce as the evidence will be "proving a negative fact" rather than "proving a positive fact". Guidance should be provided by Treasury or the Australian Taxation Office as to examples of appropriate documentary evidence.

Move from FBT to Income Tax provisions

Moving the LAFH provisions from the *Fringe Benefits Taxation Act 1986* will increase the compliance burden on individual employees in relation to complex provisions. Under the current provisions, this compliance burden sits with the employer who commonly has guidelines and policies on which advice has been sought to ensure compliance with the relevant provisions.

Guidance from the ATO to individual employees would be appreciated as the LAFH provisions can be complex to apply.

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

A key part of Australia's taxation laws are Australia's Double Taxation Treaties. Many of these treaties (for example, the United Kingdom and the United States) have non-discrimination articles. Under a non-discrimination article, nationals of the foreign country cannot be worse off under taxation or connected laws than an Australian national in the same circumstances.

The proposed reforms will result in a temporary resident employee who is LAFH being denied deductions for accommodation and food expenses. An Australian resident employee who is not a temporary resident and who is also LAFH will be able to claim such deductions. This is in clear contradiction to the requirements of the non-discrimination articles in Australia's Double Taxation Treaties.

Another potential contravention of the non-discrimination clause could arise where a foreign national who is a temporary resident (as defined) is LAFH but is denied deductions for accommodation and food benefits whereas another foreign national who has an Australian spouse (and is therefore not a temporary resident as defined) is LAFH and can claim such deductions.

The OECD model convention article and commentary for the non-discrimination article are shown below and the non-discrimination article in the treaties with the United Kingdom and the United States are shown in Appendix 1 to this submission.

Paragraph 1 of Article 24 of the OECD Model Convention states that:-

> Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.

Paragraph15 of the OECD commentary for paragraph 1 of Article 24 states the following:

> Subject to the foregoing observation, the words ". . . shall not be subjected . . . to any taxation or any requirement connected therewith which is other or more burdensome . . ." mean that when a tax is imposed on nationals and foreigners in the same circumstances, it must be in the

same form as regards both the basis of charge and the method of assessment, its rate must be the same and, finally, the formalities connected with the taxation (returns, payment, prescribed times, etc.) must not be more onerous for foreigners than for nationals.

We strongly suggest that the alternative approaches outlined in Section 2 of this submission are considered as we believe that these address the requirements of the non-discrimination articles.

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?

It would be appropriate for the Government to conduct a survey through a reputable information provider to be used as the basis for determining the appropriate statutory food amount.

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

The statutory food amount should be reviewed regularly to ensure that it remains up to date.

The statutory food amount should either:

- be indexed annually and updated with a formal survey through a reputable provider on a regular basis (say every 5 years); or

- be updated with a formal survey through a reputable provider on a more regular basis than the first option (say every 3 years).

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

This question for consultation focuses solely on the community sector. As the implications of the proposed reforms will impact almost all industries in Australia, any transitional arrangements should be for all affected taxpayers and not just those in the community sector.

Suggested transition arrangements could include:

- employees currently receiving LAFH benefits could continue to receive the full LAFH benefit for the period of their fixed term employment contract where this period is of no more than 4 years (say) in total;

- employees currently receiving LAFH benefits to receive a capped LAFH benefit for a period of their fixed term employment contract where this period no more than 4 years (say) in total. The cap could be determined by the ATO and could either a specified percentage of the employee's total remuneration package (including salary, superannuation and other fringe benefits) or a specified amount. If an amount was specified, we suggest that a survey is conducted through a reputable provider on the appropriate amount for relevant cities; or

- for all affected taxpayers who, as at 29 November 2011, were LAFH, were claiming accommodation benefits under the LAFH provisions and who were in a fixed term lease, where the fixed term for this lease ends after the proposed implementation date of the reforms of 30 June 2012, transitional rules should permit these taxpayers to continue to claim accommodation benefits under the LAFH provisions until the end of the fixed term lease. This transitional approach would be consistent with the recent transitional

arrangements for motor vehicles and the changes to the *Fringe Benefits Taxation Act 1986*.

Without such transitional rules there will be significant financial hardship for individual taxpayers who made the decision to enter into the fixed term lease or employment contract based on the taxation laws that existed (and had existed since 1945) at the time that the decision was made.

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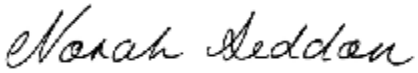
PricewaterhouseCoopers would welcome the opportunity to discuss this submission with Treasury. Please contact Jim Lijeski on 02 8266 8298 or Norah Seddon on 02 8266 5864 with any queries in relation to the contents of this submission.

Yours sincerely



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APPENDIX 1

United Kingdom

ARTICLE 25
Non-discrimination

1 Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected.

2 The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities in similar circumstances.

3 Except where the provisions of paragraph 1 of Article 9, paragraph 8 or 9 of Article 11, paragraph 6 or 7 of Article 12, or paragraph 4 or 5 of Article 20 of this Convention apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State.

4 Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State in similar circumstances are or may be subjected.

5 Nothing contained in this Article shall be construed as obliging a Contracting State to grant to individuals who are residents of the other Contracting State any of the personal allowances, reliefs and reductions for tax purposes which are granted to individuals so resident.

6 This Article shall not apply to any provision of the laws of a Contracting State which:

(a) is designed to prevent the avoidance or evasion of taxes;

(b) does not permit the deferral of tax arising on the transfer of an asset where the subsequent transfer of the asset by the transferee would be beyond the taxing jurisdiction of the Contracting State under its laws;

(c) provides for consolidation of group entities for treatment as a single entity for tax purposes provided that Australian resident companies that are owned directly or indirectly by residents of the United Kingdom can access such consolidation treatment on the same terms and conditions as other Australian resident companies;

(d) provides deductions to eligible taxpayers for expenditure on research and development; or

(e) is otherwise agreed to be unaffected by this Article in an Exchange of Notes between the Government of Australia and the Government of the United Kingdom.

7 The provisions of this Article shall apply to the taxes which are the subject of this Convention.

United States

ARTICLE 23
Non-discrimination

(1) Each Contracting State in enacting tax measures shall ensure that:

(a) citizens of a Contracting State who are residents of the other Contracting State shall not be subjected in that other State to any taxation or any requirement connected therewith which is more burdensome than the taxation or connected requirements to which citizens of that other State who are residents of that other State in the same circumstances are or may be subjected;

(b) except where the provisions of paragraph (1) of Article 9 (Associated enterprises), paragraph (4) of Article 11 (Interest) or paragraph (5) of Article 12 (Royalties) apply, interest, royalties and other disbursements paid by a resident of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of the resident of the first-mentioned State, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State;

(c) a corporation of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is more burdensome than the taxation or connected requirements to which other similar corporations of the first-mentioned State in the same circumstances are or may be subjected; and

(d) the taxation on a permanent establishment which a resident of a Contracting State has in the other Contracting State shall not be less favorably levied in that other State than the taxation levied on residents of that other State that carry on the same activities in the same circumstances.

(2) Nothing in this Article relates to any provision of the taxation laws of a Contracting State:

(a) in force on the date of signature of this Convention;

(b) adopted after the date of signature of this Convention but which is substantially similar in general purpose or intent to a provision covered by sub-paragraph (a); or

(c) reasonably designed to prevent the avoidance or evasion of taxes;

provided that, with respect to provisions covered by sub-paragraphs (b) or (c), such provisions (other than provisions in international agreements) do not discriminate between citizens or residents of the other Contracting State and those of any third State.

(3) Without limiting by implication the interpretation of this Article, it is hereby declared that, except to the extent expressly so provided, nothing in the Article prevents a Contracting State from distinguishing in its taxation laws between residents and non-residents solely on the ground of their residence.

(4) Where one of the Contracting States considers that the taxation measures of the other Contracting State infringe the principles set forth in this Article the Contracting States shall consult together in an endeavor to resolve the matter.

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