

Living away from home benefits

Treasury Consultation Paper –
November 2011

3 February 2012

Contact

Michael Ward +61 2 9921 8540
Michael.Ward@minterellison.com



ADELAIDE
AUCKLAND
BEIJING
BRISBANE
CANBERRA
DARWIN
GOLD COAST
HONG KONG
LONDON
MELBOURNE
PERTH
SHANGHAI
SYDNEY
WELLINGTON

www.minterellison.com

MinterEllison

LAWYERS

Living away from home benefits

Treasury Consultation Paper

Introduction	3
General comments	3
Not for profit sector.....	6
Recommended approach to reform.....	6
Responses to specific consultation questions	9
Consultation Question 1 – Are there any unintended consequences from the proposed reforms?.....	9
Consultation Question 2 – What practical aspects of the proposed reforms need further clarification?	10
Consultation Question 3 – Are there any interactions with other areas of the tax law that need to be addressed?	10
Consultation 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?	10
Consultation Question 5 – Should the statutory food amount be indexed annually to ensure it remains up to date?.....	11
Consultation Question 6 – What transitional arrangements would be appropriate for the community sector?	11
Specific information	12
Firm information.....	12
Contacts.....	12

Introduction

1. Thank you for the opportunity to comment on issues raised in the Treasury Consultation Paper 'Fringe Benefits Tax (**FBT**) Reform Living-away-from-home benefits' (**Consultation Paper**).
2. We provide some general comments and recommendations below, and make specific comments in relation to the consultation questions following.

General comments

3. We agree that there is a need for clarity in relation to the living-away-from-home (**LAFH**) tax concessions.
4. When LAFH concessions were first introduced into Parliament by Ben Chifley in 1945, the stated intention was to allow deductions only where additional necessary expenses were actually incurred. In some cases, the effective deduction would be determined by the Commissioner of Taxation so as to ensure employees did not obtain 'an unintended benefit' (see the Notes to Clause 6 of the Explanatory Memorandum to the *Income Tax Assessment Act 1945 (Cth)*).
5. Amendments to tax legislation in 1986 transferred the LAFH concession to the FBT regime. Together with the broad language of MT 2030, these amendments have allowed some employees to receive a tax free benefit in circumstances where:
 - a. they were not 'required' by an existing employer to leave their home country to live temporarily in Australia, but rather have actively sought employment in Australia with a new employer unrelated to their existing employer;
 - b. the exempt accommodation component is in excess of the 'additional' costs incurred by the employee (where, for example, they relinquish their former foreign residence); and
 - c. the whole amount of the exempt accommodation component is not actually required to be spent on housing (noting the LAFH allowance 'exempt accommodation component' need only be an amount that 'might reasonably be expected to be incurred', not the amount actually incurred).
6. These three situations come together for example where working holiday makers seek out employment opportunities in Australia. For example, in NTLG Minutes dated 10 November 2011, the Australian Taxation Office (**ATO**) noted that 96.3% of working holiday visa holders (type 417) received more than 55% of their total remuneration as tax-free LAFHA payments.

7. There may be good policy reasons to continue the existing LAFH concessions for foreign workers coming to Australia:
 - a. Anecdotal evidence of skills shortages in a number of industry sectors (such as mining), and difficulties in attracting local employees for some jobs (such as seasonal fruit picking, and in some community services areas), mean many businesses are unable to attract staff for some positions;
 - b. A generous LAFH concession allows Australian businesses to procure foreign employees with competitive remuneration packages, sufficient to justify their leaving their home country and travelling to live and work in Australia.
8. However, in the absence of any such policy objective, there would appear to be two areas of potential exploitation under the existing LAFH concession:
 - a. firstly, those persons who do not maintain a former residence are often being over-compensated for the additional costs incurred in residing in Australia rather than at their former location; and
 - b. secondly, those persons who have actively sought out Australian employment are perhaps not properly 'required' to live in Australia, as they have voluntarily sought out employment opportunities in Australia, for a period of their choosing.
9. The proposed changes to the LAFH concessions, which would limit the LAFH concession only to those employees who are living away from an Australian residence, will largely eliminate these risks of further exploitation noted above.
10. However, such a drastic narrowing of the LAFH concession will have serious cost impacts on those persons who are genuinely living away from their **foreign** home:
 - a. The current proposal excludes foreign employees from obtaining any LAFH benefit (as it would be unusual for a foreign employee to be brought to Australia, establish an Australian home and then be required to relocate temporarily to work in another Australia locality, while retaining that Australian home). This seems quite arbitrary and discriminates against foreign employees, as it pays no regard to their existing overseas home which they are required to live away from to carry out their temporary Australian duties.
 - b. It will punish employees who have continuing obligations to pay for housing that they retain in their foreign home location. Were they simply travelling on business and incurring travel costs, they would be entitled to a full deduction for their temporary accommodation costs (see for example paragraph 138 of Taxation Ruling *TR 97/12*). Similarly, an employee who maintains their foreign home receives no 'real' benefit from their Australian accommodation.
 - c. It will nearly double the cost of employee accommodation for employers looking to send senior executives to Australia, where employers agree to bear the cost of the Australian accommodation (which is typically the case where multinational employers send executives to grow their business operations in Australia or to fill a temporary senior employment need).

- d. Further, even where the employee does not maintain a foreign home, the limited supply and high cost of rental housing in Australian capital cities (especially given the recent and unprecedented revaluation of the \$A) means many foreign employees on Australian assignment (or typically their employers) incur much higher housing costs in Australia, compared to:
- i. their foreign home location¹; or
 - ii. those local employees who have a permanent employment in Australia and therefore can choose to purchase a home in Australia as a long term, CGT-free investment.
- e. More broadly, the full taxation of housing assistance for expatriate employees is out of step with the taxing regimes in alternative regional destinations such as Singapore and Hong Kong, where generally the full cost of accommodation is not taxed. Modern communications provide international businesses with more flexibility in choosing where to locate key employees, and additional costs in Australia would be expected to give pause to foreign employers in choosing a potential destination for their senior executives, costing Australia at least the income tax applicable to the executive's taxable salary and taxable benefits (and GST), and potentially reducing the opportunities for establishing Australia as a regional base. This could result in a net reduction in government revenue.
- f. In addition, even allowing for the current tax free status of LAFH benefits, foreign workers typically make a significant contribution to tax revenue, without any entitlement to government services and support. For example:
- i. Most temporary residents are not entitled to utilise free public education for their children and are not entitled to access Australia's public health system.
 - ii. However, the only tax saving for most foreign employees is an exemption from Medicare Levy (1.5%), which funds less than 15% of Commonwealth health spending².
 - iii. In simple terms, this means nearly 8% of the income tax rate paid by foreign nationals (effectively, 8% of their gross income) goes towards a health system they are not legally permitted to utilise. Further, the employee is required to have private health insurance, at a cost many times that of equivalent cover provided to an Australian citizen. Importantly, there is no LAFH FBT exemption for private health insurance obtained by a foreign employee.

¹ See for example Mercer's *2011 Cost of Living survey highlights – Global* <http://www.mercer.com/costofliving>

² For example, Commonwealth spending on health 2010/11 was approximately \$56bn, while Medicare Levy receipts was \$8.2bn (per 2010/11 Australian Government Budget Outcome http://www.budget.gov.au/2010-11/content/fbo/html/part_1.htm)

If an employee is not sent to Australia, but is sent to another country, the effect is a net reduction in government revenue with no offsetting reduction in government outlays.

Not for profit sector

11. Certain non-profit employers can claim a FBT rebate in respect of certain benefits provided to their employees (up to an annual 'cap' for each employee).
12. However, the effect of the rebate (being 48% of the FBT otherwise payable) has been eroded by the increase in income tax thresholds. For example assume a benefit of \$1000 (not subject to GST) is provided to an employee:
 - a. the FBT (after rebate) would be approximately \$452, bringing the total cost to the employer of providing the benefit to \$1452;
 - b. the tax portion (\$452) is 31% of the employer's cost of the benefit;
 - c. that is, the tax rate is virtually identical to the marginal income tax rate applicable to Australian residents up to taxable income of \$80,000.
13. Therefore, while the rebate is of benefit for higher-income staff, the 48% rebate would appear to be of little practical benefit for many lower income employees of NFP employers.
14. Relevantly, though, this means the removal of the FBT exemption for LAFH benefits provided to many foreign nationals employed by rebateable NFPs could not reasonably be offset by accessing the FBT rebate. Rather, the loss of the exemption would in particular, severely limit the ability of many smaller NFP entities to attract qualified staff, in areas of local skill shortage.
15. For this reason, we consider special rules should be included to protect NFPs from the potentially severe implications (such as the loss of experienced staff) that could occur if the LAFH concessions are arbitrarily restricted in the manner proposed in the Consultation Paper.

Recommended approach to reform

16. We consider any reform of this area should meet the long established tests for tax policy and legislation, by providing:
 - a. equity – by limiting the opportunity for exploitation and minimising hardship on persons who are genuinely incurring additional costs as a result of a decision by their employer to send them to work in a new location for a limited period.
 - b. simplicity – by ensuring the requirements for the concessions are clear and free from doubt; and

c. efficiency – by minimising the impact on tax revenue and the resources needed by the ATO to enforce the new rules.

17. To this end, we would suggest the following reforms to the LAFH concession:

- a. The ability to claim a deduction for LAFH costs should not depend on whether the employee receives a specific allowance, but should be allowable where the employee is living away from their usual residence for work purposes (this approach is consistent with the tax treatment of other allowances, such as car allowances, where the receipt of an allowance is not a prerequisite to being entitled to claim a deductible expense).
- b. In principle, the LAFH concession for temporary residents should not differ from that applicable to Australian citizens and permanent residents. That is, the proposed reforms should apply equally to employees who are required to live away from their Australian home or their foreign home.
- c. However, if the Government has determined, for policy reasons, to provide a different LAFH concession for temporary residents who are required to live away from their foreign home for work purposes, then we consider:
 - i. in general, the LAFH concession should be available to holders of 457 visas who are seconded to Australia by their foreign employer;
 - ii. where the employee retains a foreign residence - an income tax deduction should be allowed for the full cost of their temporary Australian accommodation; and
 - iii. where the employee did not retain a foreign residence - an income tax deduction should be allowed for reasonable additional housing costs in Australia, having regard to their personal circumstances and the requirements of their position, but only to the extent those reasonable housing costs exceeded 30% of the employee's gross income³.

This approach seeks to ensure temporary residents are neither punished for retaining a foreign residence, nor given a 'free ride' on their housing costs if they do not.

- d. Further, the Government should consider, as a first step towards the implementation of Recommendation 9 of the Henry Review, treating as assessable income any other fringe benefits provided to holders of type 457 visas, with the assessable amount of the benefit being equal to what the FBT taxable value of that benefit would otherwise have been, and with employers required to pay PAYG instead of FBT in relation thereto. This would have the effect of partly offsetting the cost

³ This 30% 'threshold' reflects a reasonable cost of accommodation for the employee in Australia. that the employee should be expected to bear on an after-tax basis (on the basis that the average cost of housing for households is between 20% and 30% of gross income - see for example ABS 13381DO004_201012 NSW State and Regional Indicators, Dec 2010).

of the increased taxation on LAFH benefits where employees are able to claim a foreign tax credit in their home jurisdiction for Australian income tax but not FBT (e.g., USA), including where these additional costs are borne by employers under tax equalisation/protection agreements with their expatriate employees.

- e. For persons employed by the not-for-profit (**NFP**) sector, we recommend:
 - i. the entitlement to LAFH concessions should be extended to include persons who are hired directly by the NFP, whether on 457 or 417 visas, recognising that most NFP entities by their nature do not have foreign operations and therefore would not be 'seconding' foreign employees to Australia from those foreign operations; and
 - ii. the nature of the LAFH concession for employees of NFP entities should be **a 50% deduction** for rental housing costs, with the deduction capped at 15% of gross income for a maximum of 4 years, recognising the special needs of the NFP sector in attracting and retaining staff.

18. As a transitional measure:

- a. employees holding type 457 visas should retain their existing concessions until the expiration of their current 457 visa; and
- b. employees holding type 417 visas should retain their existing concessions until the end of their existing employment (that is, for a maximum 6 months).

We would be pleased to meet with you to discuss our submission, as required.

The authors of this report and their contact details are as follows:

Garry Beath	Partner	+61 2 9921 4906	Garry.Beath@minterellison.com
Michael Ward	Special Counsel	+61 2 9921 8540	Michael.Ward@minterellison.com

Responses to specific consultation questions

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

The proposed reforms will operate to sweep away more than 60 years of tax policy, whereby any employee who maintains a home and is required by their employer to reside away from that home for a significant but not indefinite period is entitled to tax relief for all or part of the additional costs incurred in maintain two residences.

The proposed reforms retain this approach for Australian homes, but not for employees who are brought to Australia by their foreign employer to assist in developing their Australian and regional businesses or to temporarily fill an Australian position, and who maintain, but are required to live away from, their foreign residence while they are in Australia on a temporary work visa (such as type 457 work visas typically held by foreign nationals).

The proposed reforms:

- a. penalise foreign nationals who retain a foreign residence;
- b. penalise employers who seek to develop their Australian operations by seconding staff from their foreign affiliate; and
- c. reduce Australia's attractiveness as a potential work destination for foreign workers.

In principle, the LAFH concession for temporary residents should not differ from that applicable to Australian citizens and permanent residents.

However, if different outcomes are considered appropriate for temporary residents compared with Australian citizens and permanent residents, then we recommend the following approach should apply to temporary residents:

- a. seconded employees who retain a foreign residence should be able to deduct the cost of their Australian housing (consistent with the proposal for Australian citizens);
- b. other seconded employees should be able to deduct the cost of their Australian housing, to the extent it exceeds a 'reasonable' cost of housing (30%) to ensure they bear a 'reasonable' cost of housing on an 'after-tax' basis; and

- c. special rules should be implemented for the NFP sector, recognising that cost pressures limit their ability to offer competitive remuneration packages or to pass-on rapid cost increases (see Question 6 below).

Consultation Question 2 – What practical aspects of the proposed reforms need further clarification?

The proposed LAFH deduction would appear to depend on the employee receiving a specific LAFH allowance.

Given the allowance is now to be treated as any other allowance, similarly the availability of a deduction for LAFH housing cost should not depend on the receipt of an allowance, only that the employee is LAFH.

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

Treating some benefits as assessable income of the employee (and taxable at progressive marginal tax rates), while other LAFH benefits are taxed as fringe benefits taxable to the employer (at a 'flat' highest tax rate) gives rise to double tax where a foreign employee remains taxable in their 'home' foreign jurisdiction and is unable to claim FBT as a foreign tax credit to reduce their home country tax liability.

For simplicity (consistently with Recommendation 9 of the Henry Review) and to reduce the incidence of 'double tax', all LAFH benefits paid to expats should be treated as income (assessable or otherwise) and not as fringe benefits. This would reduce the effective cost of the assignment where the employee remains taxable in their home country and their actual tax burden is met by their employer under a tax equalisation or tax protection arrangement.

Consultation 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?

Consistently with its purpose of providing compensation for the additional reasonable cost of food in Australia, the 'statutory food amount' (being the amount that is taxable in Australia) should reflect the cost of food in the foreign employee's home country.

Implementation of this 'pure' approach might require setting 'standard' amounts for each major foreign country. However, this approach may be difficult in practice for the ATO to deal with. Therefore, we agree that the current approach should be maintained (subject to Question 5).

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

See Question 4. Ideally, the SFA should be reviewed and revised each year to reflect changes in food costs in each country, as well as changes in exchange rates. However, if a 'flat' rate is used, then the amounts should be indexed each year based on the movement in an appropriate 'weighted' index (representing movements in average food costs in a 'basket' of major foreign countries).

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

The NFP sector has particular cost pressures that limit their ability to offer competitive remuneration packages. As a result, they have relied heavily on the current operation of the LAFH concessions to allow them to better achieve their community objectives.

Many NFPs by their nature are unable to absorb rapid increases in costs, as they are typically unable to 'pass on' such costs to their 'clients'.

Therefore, for persons employed by the NFP sector, we recommend:

- a. the entitlement to LAFH concessions should be extended to include persons who are hired directly by the NFP, recognising that most NFP entities by their nature do not have foreign operations and therefore would not be 'seconding' foreign employees to Australia from those foreign operations; and
- b. the nature of the LAFH concession for employees of NFP entities should be a 50% deduction for rental housing costs, with the deduction capped at 15% of gross income for a maximum of 4 years, recognising the special needs of the NFP sector in attracting and retaining staff.

Specific information

Firm information

Firm Name	Minter Ellison
Firm address	88 Philip Street, Sydney 2000
Contact number	+61 2 9921 8888
Facsimile number	+61 2 9921 8123

Contacts

Principal contact name	Michael Ward
Position / title	Special Counsel
Postal address	88 Philip Street, Sydney 2000
Contact details	Landline: +61 2 9921 8540
	Mobile: 040 114 3692
	Fax: +61 2 99218233
	Email: Michael.Ward@minterellison.com