THE TAX INSTITUTE

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Indirect Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Attn: Ms Raylee O'Neill

By email: fbt@treasury.gov.au

Dear Mr Leggett

Tax Laws Amendment (2012 Measures No. 3) Bill 2012 – Exposure Draft

The Tax Institute is pleased to have the opportunity to make a submission to the Treasury in relation to the exposure draft entitled "Tax Laws Amendment (2012 Measures No. 3) Bill 2012" (**Exposure Draft**) which amends the living-away-from-home benefits and associated Explanatory Materials (**EM**).

The Tax Institute notes the very short timeframe available within which to consult on the Exposure Draft given the intended start date for these measures is 1 July 2012.

Summary

Our submission below addresses many issues arising from both the Exposure Draft and the EM. In particular, we have considered the following aspects:

- the apparent shift in policy as to who is entitled to tax concessions for receiving a living-away-from-home allowance by shifting the concession back into the income tax sphere;
- the elements required to be considered by an employee to determine if they can deduct any expenses for income tax purposes, including the differences to the test of availability for the concessions under the current rules and the need for a broader range of living circumstances to be contemplated than are contemplated by the Exposure Draft;

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- the elements required to be considered by an employee to determine how much they can deduct for income tax purposes, in particular, the difficulties associated with the reasonableness requirement in respect of accommodation expenses and the need for the tax concessions for a food allowance being available independent of whether an employee maintains a home they are living away from;
- employers being required to rely on the "otherwise deductible" rule for the purpose of determining their fringe benefits tax liability upon provision of LAFH allowances;
- the availability of transitional provisions for permanent residents;
- the unavailability of transitional provisions for temporary residents and the need for this to be rectified;
- the need to maintain the availability of the tax concessions for temporary residents under "fly-in fly-out" arrangements; and
- concerns in relation to the process for PAYG withholding variations applicable to the provision of a LAFH allowance.

Discussion

1. Policy Intention

It is understood the purpose of the living-away-from-home (**LAFH**) provisions currently contained in the *Fringe Benefits Tax Assessment Act 1986 (Cth)* (**FBTAA**) was to exempt from fringe benefits tax (**FBT**) a reasonable amount of compensation provided to an employee by an employer who required the employee to live away from home to perform their employment duties. The allowance was to compensate the employee for additional expenses or disadvantages suffered through having to live away from home. However, excessive amounts of allowances were to be subject to FBT. Therefore, the focus of the provision of a LAFH benefit is compensatory in nature for additional private or domestic expenses incurred due to employment purposes.

The reason for removing this type of allowance out of the income tax framework and into the FBT framework was to reflect the fact that these are essentially employment-related costs for the employer arising as a result of resourcing requirements for their business activities (by requiring employees to relocate). The purpose of moving this allowance back into the income tax sphere is to treat this kind of allowance in line with other allowances provided to employees that, broadly, are subject to income tax and rely on the availability of the "otherwise deductible" rule contained in the FBTAA to allow employers providing this type of allowance to reduce the taxable value of the allowance for FBT purposes.

Employers meet these private expenses of their employees for legitimate business reasons (not as a reward for service, but in connection with facilitating the provision of

the services, hence the FBT concession). It is this "business reason" lying behind the provision of the LAFH allowance which seems to have been disregarded under the new policy emanating from the Exposure Draft and EM

To the extent the new income tax provisions and amended FBT provisions extend beyond the bounds of the original policy intention of the LAFH provisions when they were first introduced into the FBT provisions, by extending beyond simply addressing some of the exploitation and misuse of the existing tax concession[1], The Tax Institute is concerned this represents a shift from the original policy intent. If this is the case, this should be clearly expressed in the EM. As a result of this shift in policy, there is concern that other LAFH related concessions and permanent relocation concessions may also be withdrawn over time.

In particular, while the original purpose of the LAFH provisions was consistent across all tax residents and foreign residents of Australia, the new provisions provide a clear advantage to permanent Australian residents as compared to temporary residents and non-residents. While related announcements prior to the release of the Exposure Draft mention creating a level playing field, this would appear to be comparing permanent residents who are not living away from home with temporary and foreign residents who are living away from home. The effect of the Exposure Draft as it stands will be to give a significant advantage to permanent residents living away from home, so if this is the policy intent, it should be clearly stated.

2. Exposure Draft Aspects

a) Income tax deduction – when you can deduct

There are five elements that an employee must satisfy under draft section 25-115(1) before they are able to claim a deduction for income tax purposes for accommodation, food and drink expenses incurred while living away from home. Each aspect is considered individually below:

i) *The expense is incurred because "your employer requires you to live away from your usual place of residence for the purposes of your employment"*

This test differs from the existing test in section 30 FBTAA which includes a passive requirement that an employee is required to live away from their usual place of residence in order to perform the duties of their employment. New section 25-115(1)(a) is active in nature and requires an employer to require the employee to live away from their usual place of residence for the purpose of their employment. Is this distinction intended? If so, perhaps the EM should include a statement to this effect and explain the difference.

[1] As noted in the Assistant Treasurer's press release of 15 May 2012

Both employees and employers will also need to know how to ascertain whether this test has been met or not. For instance, does this test now require that an employee be employed with a particular employer before that employer then requires them to live away from home in order to qualify for the tax concessions? Or can an employer recruit a new employee for a temporary role who lives far enough away that it will be necessary for them to live away from home? This is currently not clear from the EM and its examples.

Also, how far away does the employee need to live before it can be said that the employer requires them to live away from home? Under the previous test, the requirement to live away from home could be decided based on the practical difficulties or time required to commute, and it might be the employee's choice as to whether they bear some of the additional hardships of a long commute or whether they arrange a second place of accommodation where they live away from home. If the employer allows the employee to choose in this way, would this mean the employer has not actually required them to live away from home? Further clarification on this in the EM would be helpful.

Example 2.2 in the EM illustrates how a permanent resident choosing to relocate within Australia before then looking for a job would be prevented from accessing the LAFH concessions. As temporary residents moving to Australia are also not intended to be entitled to access the concession, we suggest an example clarifying this position should be included in the EM. The comments in paragraph 2.19 of the EM could also be expanded to reflect this.

In addition, as there does not seem to be any requirement that only employees relocating within Australia are able to access the LAFH concession, an example where an Australian employee is required by their employer to relocate overseas for the purpose of their employment should be included, if it is intended that such an employee is intended to access the LAFH concession (subject to them continuing to be an Australian tax resident).

ii) *The residence is a dwelling in which there is an ownership interest and the residence continues to be available "for your use and enjoyment" during the period the employee is required to live away from home*

Ownership Interest

In relation to the requirement the employee must have an ownership interest, the exclusion from accessing the LAFH concession which applies to various scenarios outlined below, where a person does not have an "ownership interest" in their residence, appears to be an unfair penalty for this class of person, particularly where their individual circumstances may be such that they contribute to the household expenditure (eg utility bills, food expenses etc). Persons in this

circumstance who would generally not be entitled to an “ownership interest” in the property as such might include adult children living in the family home, older adults living with elderly parents, employees that share rented accommodation without having their name on the lease and employees granted life tenancies under wills.

As provision of a LAFH allowance and access to the associated tax concessions is compensatory in nature, providing access to such a benefit where none is needed would create an undue windfall to the affected employee, However, arguably, denying this class of person access to the concession would be unjust in the absence of knowing the real circumstances of the individual.

In our view, where “double costs” are incurred (for keeping an existing home and incurring a second set of costs while living away from the original home), concessional treatment should apply to the second set of costs. However, with regards to the circumstances discussed above, there is potential for duplicate costs to be incurred for this class of person and no tax relief provided.

“For your use and enjoyment”

The availability of the dwelling for the employee’s “use and enjoyment” seems to be a critical element of this sub-section. The EM says a person can continue to have a boarder who rents a room in the person’s home that they are required to live away from. However, for security reasons, a person who is relocated for work may have a house sitter (eg friend, relative) occupy their home so that their property does not remain unoccupied for an extended period of time. On the basis that this person could be easily displaced and therefore could vacate the property at momentary notice making it “available” to the individual, such an example could also be included in the EM.

Not many people would leave their house unattended for a whole year while they are required to live away from home for the purpose of their employment and for security reasons would want to rent it out or have it occupied. In our view, an amendment should also be made to the Exposure Draft, in the form of a limited exception, allowing people who wished to have their homes occupied for security reasons can still qualify for the LAFH concessions, but only to the extent the cost of their other accommodation exceeded what they were earning from renting out their home. The rental income would be assessable and only the excess costs deductible, so parity is maintained (this would only apply in the case where the person had an “ownership interest” in their home and in the case where the person could easily displace the person renting the accommodation).

We note that this may cause an issue as to whether the property is no longer available for the employee’s “use and enjoyment”. This would only be the case if

at law renting out the property in this limited capacity as suggested excluded the employee from being able to obtain the “use and enjoyment” of the property.

iii) *It is reasonable to expect the employee will resume living in the residence after they are no longer required to live away from home*

If it is up to the individual to self-assess whether they are likely to return to their original residence after the period for which they are required to live away ends, guidance should be provided to an individual as to what factors they should consider and how they should make this determination/decision. As MT 2030 is the existing guidance from the ATO on this issue, it will need to be confirmed that this ruling will continue to apply once these new rules are introduced, or the ruling will need to be updated to reflect the new rules.

The EM could perhaps include a reference to there being no specific declarations etc. required in this regard, if this is the case.

iv) *The expense is for accommodation, food and drink for the individual and includes their spouse and their children if the spouse and children are living away with the individual.*

A person may be required to live away from home. However their spouse and children might remain in the original residence, but may come to visit the individual during school holidays. No explanation is provided in the EM as to when an individual’s spouse and children will be regarded as living with them away from the family’s original residence. A couple of examples should be included in the EM to clarify when expenditure incurred by an individual in relation to food and accommodation for their spouse and children will be deductible under section 25-115(1) and when this expenditure will not be deductible.

v) *The expense relates to the all or part of the 12 months the individual is required to live away from home by their employer*

We consider there should be provision within the legislation for a subsequent secondment to the same location for an employee of a particular employer. This could be limited to scenarios where the subsequent secondment is unrelated to any previous secondment and perhaps has a minimum time lag in between the secondments.

The EM should also make clear that an employee can claim deductions relating to a subsequent secondment in the same location but with a different, unconnected employer. It might not be clear to an individual that the use of the wording “your employer” in s.25-115(1)(a) means that new claims can arise with new employers.

b) Income tax deduction – how much you can deduct

i) *Accommodation component*

Section 25-115(2) provides that an individual can deduct so much of the expense for accommodation that is reasonable. This wording is similar in nature to the definition of "exempt accommodation component" in section 136 of the FBTAA.

There are difficulties with the current FBT law in determining what is a reasonable amount of "accommodation expenses" that should be exempt from FBT. It seems that these difficulties will be inherited by the income tax law where similar wording is used to apply to determine what will be a reasonable amount that an individual can deduct for income tax purposes with respect to accommodation expenses. Paragraph 2.35 of the EM confirms that the same principles as currently apply for FBT purposes will also apply for income tax purposes.

One particular issue that arises in this regard is where accommodation costs are significantly higher in the initial short term period while the employee looks for more suitable temporary accommodation.

No explanation or assistance is proffered in the EM to assist an individual to determine what will be reasonable accommodation expenses.

One of the perceived exploitations of the current LAFH concession was excessively expensive accommodation being provided to employees living away from home. If part of the intention of the provisions in the Exposure Draft is to address this concern, then it is not evident how this issue has been addressed given the lack of guidance in the EM.

ii) *Food*

Section 25-115(3) appears to operate such that an individual can deduct expenses incurred for food and drink that are "reasonable" and which exceed the statutory amount of $110 which applies to a 7 day period (increased for an accompanying spouse and children).

In making a claim for a deduction, an individual is entitled to claim the amount that exceeds $110 per each 7 day period. It should be specified in the EM that the first $110 of each 7 day period is private expenditure that is not able to be claimed by the individual as a deduction.

There is no need to substantiate the amount of expenditure on food and drink unless the expenditure exceeds a specific amount as determined by the Commissioner in a legislative instrument per draft section 900-97(2).

We consider that employees should be able to claim food expenses regardless of whether they are maintaining a home they are living away from and that the Exposure Draft should be amended in this regard. This is due to the fact there is no cost differential for food expenses, such as there might be for accommodation, whether or not a home is maintained.

From an administrative perspective, it should also be made clear that employers should seek declarations from their employees about the employee's ability to deduct food (and accommodation) expenses so that the employer can apply the "otherwise deductible" rule when reimbursing employees or paying directly for such costs. Further clarification in paragraph 2.17 and example 2.1 in the EM may be required so there is clear guidance on this issue.

c) Application of FBT to employers – reliance on "otherwise deductible" rule

A statement in the EM regarding when employers still need to obtain LAFH declarations from their employees would be helpful, as this is a commonly raised question. Will this be at year end as consistent with the current position? Is an employer allowed to "reasonably assume" an employee is living away from home when they begin to pay such benefits at the start of the year?

3. Other issues

a) Transitional Provisions – Permanent residents

We would like further clarification on what is an "employment arrangement". The EM refers to an "employment contract", but often the contract may be silent on LAFH allowances and benefits. For example, this may be covered by company policy and documented by letter or email. Would the offer of such benefits by letter or email, without documentation in a written employment agreement, still satisfy the transitional provisions if this "arrangement" for LAFH allowances and benefits has not changed since 7.30pm (AEST) on 8 May 2012?

In addition, when rates of payments to employees are updated, does this trigger a "variation"? And is the answer different depending on whether such a rate change is contemplated in a written contract?

b) Transitional Provisions – Temporary residents

In our view, the announcements by the Government prior to release of the Exposure Draft suggested there would be transitional arrangements for temporary residents, but the effect of the transitional provisions in the Exposure Draft for temporary and foreign residents is such that they will generally not apply, that is because those individuals would rarely be maintaining a usual place of residence in Australia. This has meant that affected businesses and employees have effectively been given only 1 ½ months' notice before an extremely significant change to their tax burden is imposed.

It is unreasonable to suggest that temporary residents have had time to prepare for such changes, as the likelihood of grandfathering restrictions or transitional relief would have prevented many temporary residents and employers adjusting their affairs prior to confirmation of such transitional relief requirements.

There is still a need for transitional rules to be available for temporary residents who are benefitting from LAFH arrangements, but who do not have a residence in Australia from which they are living away.

c) "Fly-in Fly-Out" arrangements – Temporary Residents

The Tax Institute considers that temporary residents flying in and out of remote localities with their home bases outside of Australia should continue to be able to access LAFH concessions. Allowing overseas employees to access the LAFH concessions when flying to remote localities assists with reducing the skills shortage issue in these areas, particularly for Western Australia and Queensland. This would appear consistent with the policy intent surrounding assistance for "fly-in fly-out" arrangements. Therefore, the Exposure Draft should be amended to reflect this.

d) PAYG Withholding variation

We also have some concerns in relation to arrangements regarding PAYG withholding variations. In particular:

- How can an employer anticipate/monitor whether an employee is likely to incur expenses up to the amount of the allowance and therefore work out what amount of the allowance they should withhold from for PAYGW purposes? This seems impracticable.

- To avoid significant administrative difficulties in this regard, perhaps employers could be permitted to vary withholding to nil in all cases and for the employees to bear the tax liability of any excess unsubstantiated costs at year end.

If you would like to discuss any of the above, please contact me or The Tax Institute's Tax Counsel, Stephanie Caredes, on 02 8223 0011.

Yours sincerely

Ken Schurgott
President