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13 July 2012

House Standing Committee on Economics
House of Representatives
PO Box 6021
Parliament House
Canberra ACT 2600

Sent via email: economics.reps@aph.gov.au

Review of the Tax Laws Amendment (2012 Measures No. 4) Bill 2012

Dear Sir or Madam

Ernst & Young is pleased to provide this submission in respect of the above mentioned inquiry. This submission addresses Schedule 1 of the Tax Laws Amendment (2012 Measures No. 4) Bill 2012 only.

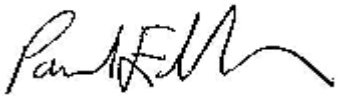
We understand the policy intent of the reforms to the tax treatment of Living Away From Home (LAFH) allowances and benefits is to better target the concessional tax treatment and prevent individuals from exploiting the LAFH concessions and exemptions.

The focus of this submission is to highlight concerns with the legislative reforms as set out in Tax Laws Amendment (2012 Measures No. 4) 2012 Bill ("the Bill") and the accompanying Explanatory Memorandum. In particular, the submission addresses the following areas:

- Appendix One – Major policy considerations, alternatives to prevent exploitation of LAFH concessions and exemptions, and potential unintended consequences of the reforms.
    1. Major policy considerations
    2. Alternatives to mitigate perceived abuses of LAFH allowances and benefits
    3. Unintended consequences of the reforms
- Appendix Two – Tax technical concerns and practical administrative matters in relation to the Bill.
    1. Tax technical concerns
    2. Practical aspects to consider

If you would like to discuss this submission please contact Tanya Ross Jones on 08 9429 2249 or Paul Ellis on 02 8295 6250. Furthermore, we would be pleased to appear before the Committee during the inquiry process to discuss these matters in greater detail.

Yours sincerely



Tanya Ross Jones
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Appendix One

Major policy considerations, alternatives to prevent exploitation of LAFH concessions, and unintended consequences

Following the Mid-Year Economic and Fiscal Outlook (MYEFO) consultation paper released in November 2011 and the exposure draft legislation in May 2012, the Bill was introduced into Parliament on Thursday 28 June 2012. The House of Representatives Selection Committee thereafter referred the Bill to the House Standing Committee on Economics for further inquiry and report.

The reforms will tax LAFH allowances and benefits provided to employees from 1 October 2012, and will apply to existing arrangements. Whilst the reforms are intended to prevent perceived abuse of the LAFH provisions by high-level executives and labour hire companies, they will also adversely impact other sectors of Australia's workforce and the broader population.

We agree that there is a perception that LAFH concessions have been exploited and abused. However, in our view, the reforms go too far and will penalise employers and employees who legitimately utilise these concessions. This will have unintended adverse consequences on employment arrangements and economic competitiveness. Of particular concern is the impact on those subject to industrial agreements and fly-in-fly-out arrangements. These issues are discussed at section 1 below.

We submit that there are alternative mechanisms that could be implemented to help prevent any abuse and exploitation of LAFH benefits, while maintaining the original policy intent behind the provision of these concessions. We have included these alternatives at section 2 below. We strongly recommend that these, or other appropriate actions, be considered by the Committee. In our view they provide an equally effective way to address the primary concern, being the abuse of the concessions, without creating as adverse an economic impact or burden on business. Further, in our view, the Government has significantly underestimated the revenue windfall that the proposed changes will generate. Therefore, these alternative proposals could be implemented without reducing the budgeted savings.

We urge the Committee to consider the impact of these changes on segments of the economy that should not be jeopardised. At a minimum, we recommend a deferred or staged implementation to minimise disruption to existing arrangements. Furthermore, in affecting businesses with global operations, the changes could be construed as posing "country" or sovereign risk that would not be desirable in a broader economic sense, particularly in the current sensitive economic times.

1. Major Policy Considerations

There are a number of major policy considerations that have not been appropriately addressed in the formulation of the Bill implementing the LAFH reforms. It is critical that these are addressed in order to prevent the reforms having unintended consequences.

1.1 Impact on those subject to industrial agreements and awards

It is prevalent in many industries including resources, engineering and construction, for a significant portion of the workforce to be engaged under industrial agreements or awards. These instruments typically contain provisions for LAFH allowances which cannot readily be changed or renegotiated. The Bill as currently drafted would have a significant and potentially highly adverse impact on individuals who are subject to such provisions.

Under the current law, the tax consequences of a LAFH allowance are borne entirely by the employer. Therefore a recipient of a LAFH allowance receives the allowance without any tax being deducted. The individual can then apply the entire allowance to meet the relevant expenses. The Bill proposes a fundamental change in this approach by shifting the taxation of LAFH allowances to the income tax regime.

Several circumstances may arise where an individual would no longer be entitled to receive the allowance free of PAYG withholding, including the following:

- Where the individual does not meet any element of the new requirements e.g. if they do not own or lease a home in Australia that continues to be available to them or do not meet the 12 month or fly-in-fly-out tests;
- If no declaration is provided to their employer before the allowance is paid confirming that they meet the relevant requirements;
- If the predetermined food allowance to which they are entitled exceeds the reasonable food allowance to be stipulated by the ATO and the employee does not demonstrate to the employer that substantiation has or will be maintained in relation to the excess;
- Where the employer requires a PAYG variation to be undertaken by the employee but the individual does not undertake this process;
- Where the employee's expenditure on accommodation is less than the predetermined accommodation allowance amount, or if they do not maintain substantiation.

In our view there is little awareness among the affected parts of the workforce of the significance or practical impact of these changes. For those individuals who are not accustomed to maintaining significant tax documentation, it is highly likely that one or more of the above scenarios will arise. This will place the individuals at a significant cash flow disadvantage, in circumstances where their employer withholds tax as they are required by law to do, and the individual must wait until the year-end tax return process to claim deductions and recoup the tax withheld, should they be so entitled. In some cases, the tax cost will be fully borne by the individual. This will cause significant disruption as employers deal with the complaints and concerns of these individuals.

Affected individuals will also likely incur costs in obtaining tax advice and the assistance of a tax agent to lodge their tax returns as the complexity of the provisions is likely to be difficult for most individuals to handle directly. This is contrary to the objective of simplifying the individual income tax return process as previously announced by the Government. There also remains scope for individuals who are not entitled to claim deductions to do so in error, creating a significant risk management issue for the ATO.

In light of the above, we strongly urge the Committee to consider whether the changes in the taxation of LAFHAs are justified and desirable. In our view they are out of proportion to the mischief attempted to be remedied. It is vital that the impact on this segment of the workforce is considered by the Government and appropriately managed.

1.2 Impact on fly-in-fly-out (FIFO) and drive-in-drive-out (DIDO) arrangements

It has been stated at several points throughout the development of this legislation that FIFO arrangements will not be affected. Despite this intent, the Bill will have a significant adverse effect on employees undertaking such arrangements.

Employees on FIFO arrangements who maintain a home in Australia may be eligible for concessional LAFH benefits, for example, food and accommodation provided on-site in connection with the FIFO arrangements. This exception is not broad enough and could significantly penalise the resources sector, the strength of which currently underpins Australia's exports and broader economy.

It is not uncommon for Australian based FIFO employees to live in shared accommodation or reside with family members during "off" cycles. This is often a function of extremely tight rental markets in the capital cities of States where remote sites are prevalent. For example, the current rental vacancy rate in Perth is 1.9% while the median weekly rent has risen by 10.5% in the last 12 months[1]. With the high cost and difficulty of obtaining rental accommodation in Perth, it is not economically feasible to lease a property which may be uninhabited for periods of three to six weeks at a time while the individual works on a remote site. However it remains likely that accommodation expenditure will be incurred both in the capital city and in the remote location.

The accommodation shortage is even more severe in areas such as the Pilbara where rental costs average approximately four times the median rent in Perth[2]. An employee in these circumstances has no choice other than to pay the extreme prices, often for a much lower standard of accommodation than they would otherwise inhabit. Thus it is extremely unfair to suggest that employer assistance with these expenses is a remuneration benefit. Rather it is necessary as an entirely work-related expense.

The Bill as currently drafted does not recognise the unique combination of circumstances arising in FIFO arrangements. It would significantly penalise a very important segment of the workforce and one which employers with remote operations already have difficulties in attracting and retaining. As the Government has made a clear policy statement that FIFO arrangements will not be affected, we strongly urge that the opportunity is taken to remedy this approach.

1.3 Impact on regional areas

In addition to the above, we also highlight the potential implications of the reforms more broadly to regional areas of Australia. That is, whilst FIFO arrangements are commonly understood to be prevalent in the mining, resources and construction industry, such arrangements are also necessary in other sectors, including for example, the provision of health services in remote and regional areas[3]. The strength of the resources sector operating in remote and regional parts of Australia has seen an increase in demand for health services and FIFO arrangements are common and necessary to deliver these services.

[1] Per Real Estate Industry Western Australia March 2012 quarter
[2] Pilbara Housing & Land Snapshot, Residential & Commercial, Quarter Ending March 2012, Pilbara Development Commission
[3] House of Representatives Standing Committee on regional Australia – inquiry into the use of 'fly-in-fly-out' work practices in regional Australia, media release issued 24 May 2012

1.4 Superannuation guarantee

The question of whether employers will be required to calculate superannuation guarantee on LAFH allowances has been raised at various points throughout the consultation processes since the MYEFO paper. This remains unresolved with the release of the Bill. We have addressed a number of tax technical concerns with the interaction of superannuation guarantee and LAFH allowances in detail at 4.2. In light of these concerns, we recommend the appropriate treatment be clearly addressed in the Bill so that employers can be certain of their employment tax obligations in relation to LAFH allowances.

Based on discussions with Treasury and ATO representatives, we understand the preliminary view is that the treatment of LAFH allowances should be determined by reference to prevailing ATO guidance in Superannuation Guarantee Ruling SGR 2009/2. In this ruling, allowances are generally treated as Ordinary Time Earnings ("OTE") unless they are expense allowances, being those allowances paid to an employee with a reasonable expectation that the employee will fully expend the money in the course of providing services. This suggests that an allowance will be subject to superannuation guarantee unless the employer has reason to believe the allowance will be fully expended.

While expenses that relate to employment would usually qualify as deductible costs, the new LAFH allowance regime makes the determination of deductibility far more complex than is the case for any other expense allowance. In our view, it is unsatisfactory and impractical to require employers to determine the reasonableness of deductibility of the LAFH allowance in order to determine the appropriate level of superannuation guarantee support. It would remain the case whether or not the strict tests for deductibility are satisfied that a LAFH allowance is paid to compensate for expenses that arise from employment, and that it is expected to be expended in payment of these expenses.

As an alternative, we recommend that the legislation be amended to replicate the treatment currently applicable to LAFH allowances. That is, SGR 2009/2 states that allowances that are fringe benefits under the FBT legislation are not OTE and are not salary and wages for the purposes of the superannuation guarantee. Furthermore, as SGR 2009/2 presents the Commissioners' view on what items of compensation constitute OTE, we urge the Committee to ensure this tax treatment is explicitly stated in law to avoid the need for interpretative guidance from the ATO.

Accordingly, we strongly recommend that LAFH allowances be excluded from the definition of OTE for superannuation purposes.

1.5 Requirement to maintain a home

Employees who are required to live away from their usual place of residence will be entitled to claim deductions for expenses incurred only where the employee maintains a home that is available for his/her use and enjoyment at all times. We submit that the requirement to maintain a home is both restrictive and impractical, and will act as a disincentive for labour force mobility. Renting a property during an extended period of absence is a legitimate and common practice to ensure the property is secure and maintained during the absence.

Whilst we appreciate the need for qualifying conditions to maintain the integrity of the tax concessions, it is our view that this could equally be achieved by the imposition of appropriate time limits, rather than imposing the requirement to maintain a home.

1.6 Temporary accommodation

As outlined at 1.5 in Appendix Two, the Bill is silent on the tax treatment on employer provided temporary accommodation provided to employees who are not eligible for the LAFH concessions but who have nonetheless taken up a temporary work assignment with their employer. This creates inconsistency and tension between the treatment of such accommodation benefits provided to employees who have permanently relocated. Furthermore, the distinction will inevitably create interpretative confusion with employers who will be required to make a determination as to whether the employee has relocated to the new work location on a temporary or permanent basis. If the former, temporary accommodation provided by the employer would be taxable in the absence of a legislative amendment. If the latter, the accommodation could be tax free.

To reflect the position that temporary accommodation is a legitimate, work-related entitlement in relation to both temporary and permanent relocations and to minimise the risk for employers of incorrectly interpreting the this distinction, we recommend the FBT legislation be amended to extend the existing concession in section 61C to ensure it covers all employee relocations.

2. Alternatives to mitigate perceived abuse of LAFH allowances and benefits

> The perceived abuse of LAFH benefits can be addressed without creating the adverse consequences described below. The reforms outlined in the Bill go well beyond what is necessary to address these concerns.

The intention behind the reforms is to prevent individuals from exploiting the living away from home concessions and exemptions. However, there are alternative measures that could be introduced to achieve the same result but without the unintended economic consequences discussed below. We submit consideration should be given to the following alternatives.

2.1 Foreign employees who are overseas when engaged or remain with the same employer

International companies often transfer employees between operations in different countries. Due to the temporary nature of the assignment, employers will often be required to provide employees with compensation for the additional cost of living in the host location. In addition, any tax cost incurred by the employee in the host country is usually borne by the employer. The LAFH tax concessions assist employers in managing the cost of the international assignment and enhance Australia's international competitiveness.

One of the main areas of perceived abuse is in situations where individuals do not genuinely relocate for work purposes. The consultation paper released in November 2011 that first announced the LAFH tax reforms refers to an example, also referred to extensively in the Inspector-General's review of the ATO's management of LAFH cases, of backpackers on working holidays who may receive concessionally taxed remuneration. It is acknowledged that this situation is not within the intent of the law.

To address this situation, the existing LAFH provisions could be modified to make it clear that an employee from overseas can qualify as LAFH only if they relocate at the employer's instigation. This would impose a similar condition on all LAFH arrangements as set out in the Bill. Similar conditions are imposed in relation to other FBT concessions for home sale and purchase costs provided in relation to permanent relocations. This would ensure that an individual who is already in Australia at their own instigation cannot obtain the benefit of the LAFH concessions. Furthermore, an individual who changes employer while working on a subclass 457 visa would cease to be eligible to be treated as LAFH after the employment for which they relocated has ceased.

The changes could also include provisions excluding individuals working for labour hire agencies.

Generally, international assignments are for fixed periods of time and once the employee has completed their time in Australia they will return home. As in this circumstance the individual is genuinely LAFH, it would be appropriate to consider allowing the LAFH concessions to apply to temporary residents in this situation.

The LAFH concessions could be structured to only apply to temporary residents who are on fixed term assignments, are working for the same group employer and will return to their home country at the end of the assignment. This will assist in ensuring that LAFH benefits are only provided to temporary residents who have an intention to return to their home location at the end of the assignment.

2.2 Introduction of appropriate time limits

Introducing a time limit on the number of years an individual could be considered LAFH would reduce the claimed exploitation of LAFH benefits by individuals who have remained on assignment in Australia for an extended period of time. However in recognition that LAFH assistance may be provided in a number of different circumstances, the time limit should vary depending on the arrangement in question (e.g. temporary resident, permanent resident on domestic assignment or permanent resident on overseas assignment).

We note that in 1995, the Government attempted to introduce legislation specifying time limits for which a person could be LAFH. However, this legislation did not proceed due to concerns raised by business and industry groups. We consider these concerns remain valid.

The Bill stipulates that from 1 October 2012, the LAFH the tax concessions will be available for a maximum period of 12 months in respect of an individual employee for a particular work location. In our view, 12 months is far too restrictive and does not adequately reflect commercial considerations of work assignments. In many cases, employers require skilled workers to be involved in projects which can run for two to three years. If the 12 month limit is imposed, it may discourage employees from accepting longer term assignments and/or increase project costs as employers will likely be required to compensate employees for the additional tax burden and therefore will bear the additional cost to ensure the employee remains committed to the project.

In our view, a 24 month time limit would be more commercially appropriate for domestic assignments and 36 – 48 months would be appropriate for overseas assignments. These time limits are closely aligned with existing LAFH practices which would minimise disruption to employer policies and practices administering LAFH allowances and benefits. Imposing strict time limits on the length of work assignments which may qualify for concessional tax treatment under the LAFH rules would provide clear parameters for employers and employees for administering LAFH benefits.

3. Unintended consequences of the reforms

The perceived unfair advantage to temporary residents under the current rules is overstated and the economic consequences of the reforms seeking to address this situation could be severe for Australia.

3.1 Global labour market competitiveness

The reforms will have unintended adverse consequences on Australia's economy, including its global labour market competitiveness.

Australia already has an aging workforce and is currently experiencing a skills shortage which is only anticipated to become worse in the coming years due to the number of significant projects commencing. Businesses are seeking individuals with specific skills to meet their needs. Increasingly, given the specific nature of the skills required, there is a limited pool of Australian individuals who possess these abilities. Accordingly, employers are required to look to individuals from overseas to provide this expertise.

The reforms will increase the cost of attracting international labour to Australia. International experience suggests that if Australia is unable to respond to this to match the international pricing of labour, decreased international competitiveness and an associated productivity decline will result. This may manifest itself in a number of ways, some examples of which are discussed below, starting from 3.2.

The reforms also appear inconsistent with the Government's intention of attracting skilled labour to Australia. The immigration legislation, administered by the Department of Immigration and Citizenship, recognises the need for employers to pay LAFH allowances to employees to attract them to work in Australia through the inclusion of LAFH allowances in the calculation of a subclass 457 visa holder's "guaranteed annual earnings". In granting an individual a temporary residence visa there is an assumption that the employee's presence in Australia is required as their skills are not otherwise available in Australia and that their presence will benefit the Australian economy as a result. Therefore, the LAFH allowance provisions are not a mechanism that alters the level playing field by providing foreign workers with an unfair competitive advantage that will take jobs from local workers.

Due to the high cost of living in Australia compared to overseas locations, it can be difficult for employers to attract talent to Australia. The LAFH concessions assist employers in attracting employees to Australia as they provide a cost effective mechanism for employers to give employees compensation for the additional costs that they incur as a result of living in Australia. This is consistent with the intent behind the introduction of the LAFH concessions, being to promote labour market mobility and increase national productivity.

The reforms will make it even more challenging for employers to attract talent to Australia as employees will either have to fund these additional costs from after-tax income or employers will have to pay increased remuneration. Either way, these increased costs may prove prohibitive to attracting skilled temporary residents to Australia.

The changes will also impact on Australia's competitiveness in the global economy. Many of Australia's trading partners and neighbours including China, the United States of America, Canada, Malaysia and the United Kingdom have tax concessions for accommodation where an individual is on a temporary assignment in the location. Global companies operating in these locations would also be looking for individuals with specific expertise to meet their requirements. The changes will make Australia less attractive to individuals if they have a choice between Australia and a location that does provide assistance for temporary residents. In addition, employers will be required to incur additional costs in order to attract talent, the implications of which are discussed below.

Australia's ability to be a talent hub in the Asia Pacific region may be hampered by the reforms as the ability to attract talent is hindered. Many of Australia's neighbours in the Asia Pacific region either provide tax concessions for cost of living assistance or have significantly lower personal income tax rates than Australia and much lower living costs. Accordingly, these locations are prima facie more attractive for individuals in comparison.

In addition, many global employers are responsible for the tax payable by their employees when they send them to work in overseas jurisdictions as a result of tax equalisation arrangements with employees. For example, a global employer sending employees to Australia would generally be responsible for any tax arising on the individual's Australian salary and fringe benefits, including LAFH allowances. If the reforms are implemented, global employers will likely be responsible for the additional tax cost on the LAFH allowance or accommodation assistance. As a result it may be more attractive for employers to establish operations in locations with lower tax rates or where there is concessional tax treatment of temporary assignees.

To the extent that individuals choose other jurisdictions over Australia and employers move their operations to overseas locations, this will result in flow-on effects to the economy, including less spending and investment in Australia. This may be detrimental to sectors of the economy, including real estate and retail, which are already experiencing difficulties.

3.2 Lost social dividend

In our view, the existing rules provide a significant social dividend that justifies their ongoing retention (albeit potentially in a modified form as discussed above).

The international labour market also brings intangible benefits to Australia, providing Australia with the ability to up-skill its workforce and obtain knowledge from other jurisdictions which can ultimately benefit Australia's productivity. If the reforms are implemented it would become increasingly difficult for Australian employers to attract talent. It follows that Australia may start to experience a decline in the intangible benefits it receives from international talent, including a decrease in the skilled labour base. In addition, Australian employees may be required to move overseas in order to receive training in desired skills.

3.3 Other flow-on impacts on the economy

The reforms may have other unintended impacts on the Australian economy. Apart from the flow-on effects resulting from fewer temporary residents coming to Australia and employers moving operations offshore, there may be further implications for Australia's economy. In addition to the issues discussed above in relation to temporary residents, the impact on domestic mobility is likely to be significant. In relation to industries such as mining , resources and construction which are experiencing extreme skills shortages, imposing impediments on domestic mobility is directly contrary to the objective of making the most of the stimulating effect on the economy that these industries have.

As discussed above, many employers bear the cost of a temporary resident's taxes in Australia. Employers may be required as a result of the reforms to increase employees' remuneration packages to compensate them for the additional tax that would be payable on LAFH allowances. This would increase the cost of business for many employers and result in an unintended consequence of employers decreasing their costs in other areas, including through decreased spending and redundancies.

The reforms could also impact on employers who legitimately rely on the concessions in order to attract and engage staff (both foreign and domestic) in a difficult market, especially small and medium sized companies. Organisations which rely on mobile talent may find it difficult to continue operating or may have to scale back on growth plans, due to the inability to find talent or the increased costs to attract talent to diverse locations as a result of compensating employees for increased tax and cost of living amounts.

Critical to the analysis is that the proposals will affect a subset of the labour market that is mobile and highly skilled. As a result, it is likely that the impact of the changes will fall on the consumers of labour, without any offsetting productivity increase. Increased costs incurred by businesses as a result of the reforms would likely ultimately increase costs for the end consumer. This effectively results in a deadweight loss to the economy.

Temporary residents have indicated they will reconsider working in Australia if the reforms are implemented. Already some temporary residents have begun preparations for departing Australia as a result of the reforms. This will result in decreased spending which will flow on to the rest of the economy. Similarly, in a domestic context, the restriction that would prevent individuals from renting out their homes while undertaking a domestic assignment provides a strong disincentive to take up such arrangements.

To the extent that temporary residents remain in Australia, the reforms may also have an unintended consequence on the rental market. The provision of accommodation assistance to temporary residents has assisted in creating demand for medium to high end rental properties. Without this assistance, there may be a decrease in demand in that sector. This will potentially result in corresponding increase in demand for medium and low end rental properties. This would put increased pressure on a sector that is already struggling to meet demand. This may have flow-on effects to Australian citizens and permanent residents.

3.4 Impact on businesses

In addition to the above, the reforms may have other significant unintended consequences on businesses.

Many businesses have entered into long term contracts and agreements with clients where the pricing has been determined based on employee cost at the time contracts or agreements were entered into. The reforms will result in additional employee costs for many employers which will impact on their profitability. In many cases, these contracts are not able to be renegotiated. For some employers this could result in loss making contracts.

Alternatively, for businesses which have entered into contracts with suppliers on a reimbursable basis, there may be a significant unbudgeted increase in costs charged to them if their suppliers bear either additional FBT or additional costs of remuneration and on-charge those costs. Reimbursable contracts are prevalent in the resources industry. Given the short time frame to potential implementation, it is difficult to estimate, let alone negotiate, the impact of such costs.

Further, an employer may face increased tax costs in the form of superannuation guarantee and payroll tax. Currently an employer is not required to pay superannuation and payroll tax on LAFH allowances or other LAFH benefits. These additional taxes may place further burdens on struggling businesses.

Businesses may also need to increase remuneration packages for their mobile employees to enable them to continue an existing assignment or accept a future assignment. Some businesses will not be able to increase remuneration packages and this may result in employees moving between employers, causing instability in the labour market.

3.5 Unfair advantage to LAFHA recipients is overstated

The reforms were introduced as there is a perception of unfair advantage and abuse by certain sectors of the economy, including highly paid executives. However, highly paid executives only account for a small proportion of individuals who receive LAFH benefits. The majority of individuals receiving LAFH benefits legitimately require assistance with the increased cost of living as a result of undertaking a domestic or international assignment for work purposes.

The changes could severely impact individuals who have entered into their current living arrangements based on a certain remuneration package and expected after tax earnings. If the reforms are implemented, many assignees could find themselves living beyond their means and in financial difficulties. This is particularly relevant to accommodation arrangements, many of which are long-term in nature and involve substantial penalties for early termination.

Whilst an individual in receipt of a tax-free LAFH allowance may receive higher after-tax remuneration than an equivalent individual based permanently at that location, they also incur expenses that a permanent worker does not incur. As well as the costs of accommodation, which may be in addition to the cost of maintaining a residence in their home location, there are a range of costs that arise purely as a consequence of their assignment.

These issues are particularly notable for temporary residents. Temporary residents are discouraged from purchasing residential homes as they are required to sell the property within a certain time period once they depart Australia. A temporary resident is not afforded the same degree of State assistance as a permanent resident. For example, most temporary residents are either not entitled to use or have only limited access to the Medicare system. Accordingly, they are required to pay medical costs in addition to those paid by permanent residents either by bearing all actual health costs incurred or through higher health insurance premiums. Temporary residents are also not entitled to receive many of the rebates and government assistance for which permanent residents are eligible, for example, child care rebate and baby bonus.

Temporary residents also incur high education costs for their children in both the private and public school system and potentially for tertiary education. Even in the public school system, temporary residents are required to pay substantial fees that are not levied on ordinary Australian residents.

These burdens are emphasised as usually only one member of the family is employed whilst in Australia. The additional after tax remuneration received by temporary residents as a result of the treatment of LAFH allowances helps to offset these additional costs.

Similar issues arise for domestic assignees, or Australian residents working overseas. Affording tax concessional treatment to LAFH allowances and benefits is an appropriate way of recognising the intrinsically work-related nature of assignment expenses. Provided the fundamental requirements are met that the individual is living away from home and genuinely incurs a reasonable level of expenditure, it is entirely appropriate as a matter of policy that employer-provided assistance is not subject to further taxation.

Appendix Two

Tax technical concerns and practical administrative matters

1. Tax technical concerns

Urgent clarification is required on the exception for fly-in-fly-out arrangements, along with interaction of the LAFH rules with other areas of tax law which remain unresolved from the exposure draft legislation.

1.1 Fly-in-fly-out (FIFO) exception

Employees on FIFO arrangements who maintain a home in Australia will be eligible for concessional LAFH benefits, for example, benefits provided on-site in connection with the FIFO arrangements. It is submitted that this exception is not broad enough and could significantly penalise the resources sector, the strength of which currently underpins Australia's exports and broader economy.

It is not uncommon for Australian based FIFO employees to live in shared accommodation or live with family members during the off cycles. For these reasons, many FIFO employees will be unable to benefit from the concessional tax treatment outlined in the Bill as they do not have an ownership interest in a residence that is maintained for their use and enjoyment.

If the reforms are implemented as outlined in the Bill such that FIFO workers are required to maintain a home whilst completing their rostered "on "cycle, this will put significant cost pressures on the resource industry as many FIFO workers will be unable to meet the qualifying conditions as set out in the Bill to access the concessional tax treatment.

In addition, FIFO arrangements often extend to overseas employees. In many circumstances, it is more cost effective to fly an individual directly in and out of their overseas home location, as opposed to accommodating them in an Australian city during "off" cycles.

It is therefore considered that at a minimum, the exception for temporary residents who maintain a residence should not be limited to those who maintain a home in Australia, but should include those who maintain a residence anywhere in the world. Furthermore, we propose a relaxation of the requirement for Australian based FIFO workers to maintain a home in which they have an ownership interest. In our view, a more practical position may be to stipulate that provided the FIFO worker is able to substantiate ongoing home accommodation costs (for example by way of bank statements), he/she would be entitled to claim a deduction for the additional accommodation costs incurred.

Several technical issues also arise as a result of the precondition for the FIFO exception relying on eligibility for the FBT exemption for FIFO transport costs. The FIFO transport exemption only applies if the employer arranges and provides the relevant transport (i.e. it is not a reimbursement of expenses, or another category of benefit such as a car expense) and the employer also directly provides accommodation, as opposed to providing an allowance to assist with accommodation expenses.

While FIFO arrangements that meet these strict requirements are prevalent in the relevant industries, this is not the case across the board. For example, it is increasingly common for employees to make their own travel arrangements either due to living in locations other than the capital city of the state in question, or because the site permits alternative approaches such as DIDO. It is also becoming more common for employers to pay allowances to cover the accommodation costs, rather than providing the accommodation onsite. It does not appear to be the policy intent to penalise employees who are working on rotational arrangements solely because their employer chooses to allow different approaches to travel, or the nature of the site is conducive to other forms of travel, or the employer provides accommodation support by way of an allowance. However, making the concessional LAFH treatment contingent on the eligibility for exempt travel assistance has this effect. To address this issue we recommend that the FIFO exclusion be reworded to remove the requirements to satisfy subsections 47(7)(b) and (d).

1.2 Superannuation guarantee

Currently employers are not required to make superannuation guarantee contributions in respect of LAFH allowances as they constitute a fringe benefit. However, the position under the Bill is unclear.

Generally an employer is required to make superannuation guarantee contributions on amounts paid to an employee, unless the amount is in respect of the employee working overtime hours, or the allowance is expected to be fully expended.

Under the Bill, any LAFH allowances paid will be taxable to the employee. However, the employee (other than temporary residents) would be able to claim an income tax deduction for the actual costs they have incurred, provided substantiation is available. Nonetheless, it is likely that the employer could be required to make superannuation guarantee contributions on LAFH allowances paid to employees under the reforms, unless the employer is aware that the employee will incur costs equal to the amount of the LAFH allowance. This could result in additional superannuation compliance and administration costs to employers.

Further, it is not clear how the superannuation guarantee concept of an allowance that is intended to be expended interacts with the income tax deductibility provisions. That is, it is not clear whether a non-deductible LAFH allowance paid to a temporary resident, which is expected to be expended, should still be classified as an expense allowance which would fall outside the scope of ordinary time earnings. It should be clarified whether LAFH allowances provided by employers would constitute ordinary time earnings for employees, and any circumstances that affect this classification. This guidance would be required at the same time as any legislation amending the treatment of LAFH allowances is introduced, as superannuation guarantee shortfalls may otherwise arise in unintended circumstances, creating further costs for employers.

As discussed above at 1.4 in Appendix One, we submit that it is unsatisfactory and impractical to require employers to have to determine the reasonableness of deductibility of the LAFH allowance in order to be able to assess their superannuation obligations. We request confirmation by way of legislative amendment that LAFH allowances be excluded from the definition of OTE.

1.3 Payroll tax

Currently state payroll tax does not apply to LAFH allowances or benefits that have a nil taxable value as determined under the FBT legislation. The proposed changes will have inequitable outcomes from a payroll tax perspective as an economically equivalent benefit will be taxed in a different way for payroll tax purposes.

Generally, allowances are subject to payroll tax with the exception of travelling or accommodation allowances which do not exceed the prescribed rates. The Bill does not prescribe any such limits other than to set out the ordinary food and drink expenses amount. Accordingly, on current interpretation, it is likely that LAFH allowances will be subject to payroll tax , irrespective of whether the allowance is fully expended on accommodation and food expenses whilst LAFH.

As such, to avoid inequities, we submit that the state payroll tax legislation will need to be amended to ensure payroll tax does not apply to LAFH allowances which are deductible to the employee. An exemption from payroll tax could be provided on the basis that the allowance is paid by the employer with the expectation that the allowance will be expended by the employee on accommodation and food and drink expense whilst LAFH. Such an exemption would ensure consistent treatment for employer provided LAFH benefits that have a nil taxable value under the otherwise deductible rule in the FBT legislation.

While payroll tax is not a matter for Federal Parliament, there should be recognition that each State and Territory would need to amend its payroll tax legislation to effect this change as a direct consequence of changes made at the Federal level. It would be preferred if an equitable treatment of economically equivalent benefits could be achieved without requiring this degree of flow-on legislative change.

1.4 Ordinary food and drink expenses amount

Under the Bill, a portion of a LAFH food allowance representing the ordinary food and drink expenses of an employee may be subject to FBT in the hands of the employer and the excess may be subject to income tax in the hands of the employee. More specifically, where an employer pays an allowance to compensate for food and drink expenses, the allowance includes an amount for ordinary food and drink expenses, and the employee provides a declaration stating that he/she will meet the new tests for deductibility and incur the relevant expenses, the first $42 will be taxed to the employer under the FBT rules. Where no declaration is provided, the first $42 is instead treated as taxable income to the employee and subject to Pay As You Go ("PAYG") withholding.

Splitting the tax treatment of the food allowance between FBT and income tax will create unnecessary complexity and add to the administrative burden for employers. At a minimum, it would require employers to request declarations at the start of the LAFH arrangement to ensure the correct FBT or PAYG withholding treatment is adopted. However this may not even be sufficient to safeguard an employer from employment tax shortfalls that may arise due to a subsequent change in circumstances.

For example, the employee provides the relevant declaration at the commencement of the arrangement but later rents out his/her home and forgoes the ability to deduct expenses incurred whilst LAFH. To minimise the compliance burden and manage the employment tax shortfall risk for employers, we submit that the tax treatment of a LAFH food allowance should be managed either wholly in the FBT regime or wholly in income tax and the PAYG withholding system.

As stated above, the ordinary food and drink expenses amount is intended to represent the employee's stay-at-home food costs and ensure that an income tax deduction is available only for the expenses exceeding this amount. We agree with the broad objective of ensuring the employee's deduction is limited to only the additional food costs. However, the tax treatment set out in the Bill presents significant practical challenges for employers and employees as it gives rise to situations where the first $42 may be subject to either FBT or income tax, which must be assessed on a case by case basis.

Irrespective of whether the tax on a LAFH food allowance falls in the FBT or PAYG regime, we suggest simplifying the tax treatment. This could be achieved by deducting the ordinary food amount from the reasonable food amounts published by the ATO on an annual basis. That is, the ATO publishes only the amount which it considers reasonable costs over and above the stay-at-home costs. Where the employer pays only the reasonable amount, there would be no need to consider the tax treatment of the first $42. Where the employer pays an allowance greater than the reasonable amount published by the ATO, the excess over the reasonable amount should be taxable, subject to the employee's eligibility to claim a tax deduction for substantiated expenses.

To maintain integrity of the tax deductions available to employees who meet the qualifying conditions, the ordinary food and drink expenses amount could be retained for the purposes of determining the deductible amount where substantiated expenses exceed the reasonable amount published by the ATO. This would be similar to the $250 reduction of allowable expenses for self education costs. For example, assume the reasonable food amount for a single adult is $208 per week but the employee has incurred substantiated expenses of $300 per week. Should the individual wish to claim a tax deduction for the actual additional food and drink expenses incurred in excess of the stay-at-home expenditure, his/her deduction would be calculated as $300 less the $42 ordinary food amount.

1.5 Temporary accommodation benefits

Subject to certain time limitations, employers are currently able to provide tax free temporary accommodation assistance to employees who have relocated to a new usual place of employment. Similar treatment is currently also provided to employees who are temporarily living away from their usual place of employment via the LAFH concessions. The Bill does not address the position of temporary accommodation benefits provided to employees who temporarily relocate for work purposes on or after 1 October 2012.

We submit that the existing concessional treatment available in the FBT legislation should be expanded to include employer provided temporary accommodation benefits relating to employees who are required to temporarily relocate for work purposes but who are not eligible for concessional tax treatment from 1 October 2012. This will ensure consistency of treatment of employer provided accommodation in the initial relocation period for employees who are relocating to a new usual place of employment, and those who are temporarily living away from their ongoing usual place of employment. Assistance of this nature is imperative to support mobility arrangements and avoid penalising employees who incur expenses that are genuinely work-related, albeit private in nature.

1.6 Pauses in the 12 month period

Employees who meet the qualifying conditions to claim an income tax deduction for eligible expenditure are limited to claiming that tax deduction for a maximum period of 12 months, commencing the first day the employee begins to live away from home. The Bill sets out that the 12 month period will pause if the employee temporarily resumes living in their usual place of residence. By way of example, the Explanatory Memorandum suggests the 12 month period will pause if the employee temporarily returns to their usual place of residence to take a month of leave or perform employment duties at their former work location. Presumably the 12 month period would also be paused if the employee returned to their usual place of residence for weekend visits.

However, in contrast, the 12 month period would not be paused if the employee chooses to spend his/her annual leave at a destination other than their usual place of residence. Similarly, the 12 month period would not be paused if the employee was required to be hospitalised in a location other than their usual place of residence.

We submit that a pause in the 12 month period should also apply to temporary absences where the employee takes annual leave, long service leave or sick leave in locations other than their usual place of residence. In our view, it is not necessary or reasonable to create a distinction between temporary absences taken at the employees' usual place of residence and an alternative destination. Furthermore, it would be difficult for the ATO to audit such absences in the event the employee makes a claim that the 12 month period was paused and therefore he/she is entitled to claim deductions for a period beyond 12 months.

A more practical approach may be to recognise a pause in the 12 month period where the employee is temporarily absent, for whatever reason, and the absence is for a minimum time period. For example, the 12 month period may be paused for temporary absences exceeding 5 working days.

1.7 Subsequent periods of living away from home

The Bill provides for the commencement of a new 12 month period where the employer later requires the employee to live at another location and it would be unreasonable to expect the employee to commute to the new location from an earlier location. This clearly permits employees to claim deductions for expenses incurred for the first 12 months in an initial work location, and then claim deductions for expenses incurred for the next 12 months in a new work location, provided the qualifying conditions continue to be met. In this situation, the employee is not required to resume living in their usual place of residence prior to transferring to the new work location. We agree with this provision as it allows deductions for genuine sequential periods of living away from home.

However we question the policy rationale of limiting the deductibility of expenses to a maximum period of 12 months per work location. This effectively discriminates against employees who are required to undertake subsequent work assignments to the same location after having resumed living in their usual place of residence. In this scenario, the employee is denied a deduction for expenses incurred during the later work assignment. We submit that the requirement that a subsequent assignment must be to a different work location is unnecessarily restrictive.

In our view, the employee should be entitled to claim deductions for the second work assignment provided genuine commercial reasons exist as to the reason why the employee is deployed to the same work location on separate occasions. For example, an employee living in Sydney is required to live in Brisbane for 12 months to oversee a particular transaction or acquisition. After the 12 months, the employee returns to Sydney and resumes living in their usual place of residence. At some time in the future, the employee is required to again live in Brisbane for a period of 3-6 months whilst working on a different project, unrelated to the initial project.

We agree the legislation needs controls which will restrict the ability of employees to artificially circumvent the 12 month limit and claim deductions which are outside the policy intent of the legislation. We also agree the employee should not be entitled to deductions relating to a work location which is merely extended beyond the initial term. However, we recommend the concessional tax treatment be extended to employees who are deployed to the same work location on separate assignments provided genuine commercial reasons exist and the employee has returned to their usual place of residence in the intervening period.

2. Practical aspects to consider

There is a short time period to the effective date of 1 October 2012 for businesses to adjust to the changes. There should be a deferral of the effective date or a longer transition period allowed.

Few employees are likely to benefit for the full term of the transitional measures outlined in the Bill due to stringent limitations imposed by the accompanying Explanatory Memorandum of what constitutes a material variation to an eligible employment arrangement.

2.1 Implementation timing

The current LAFH concession provisions are utilised by most employers who have temporary resident employees. The time frame between the release of the Bill and the effective date of 1 October 2012 is very short and may not provide employers and temporary residents with sufficient time to effectively manage the change. While this date represents a deferral from the initial proposed date of 1 July 2012, the number of unresolved issues and the likely time frame for further guidance to be released mean that most employers still face extreme difficulties in fully implementing the changes in time.

Employers will need to review the remuneration packages for temporary resident employees and determine whether there are going to be changes to the remuneration packages.

We submit that it is inequitable to impose what will effectively be a retrospective change, if it applies to existing employment contracts that cannot readily be altered due to their nature and the time frame involved. There are also different tax implications as a result of the changes depending on how the LAFH benefit is structured, that is, LAFH allowances will be taxable to temporary residents and the reimbursement or provision of accommodation would be subject to FBT and affect employers.

In most instances where there is a significant change in law, there is scope for contracts entered into prior to any announcement of change to be quarantined from the impact. At a minimum, contracts which were negotiated prior to the announcement of the proposals should be outside the scope of the new provisions. Transitional arrangements are considered in more detail below.

The short time period until 1 October 2012 may also provide difficulties for temporary residents as many would be locked into lease agreements which they may no longer be able to afford from 1 October 2012.

2.2 Transitional arrangements

As outlined in the Bill, transitional rules will apply to certain employees with a contract existing at 8 May 2012 until the earlier of (1) 30 June 2014 (2) when that contract ends or (3) the contract is varied or renewed. By way of clarification, Explanatory Material accompanying the legislation suggests that the phrase "varied or renewed" is to be interpreted as meaning any material variation to an existing employment arrangement would trigger the commencement of the new arrangements. By way of example, the Explanatory Memorandum suggests a material variation would include an extension of time, a pay rise or change in working hours. Presumably a promotion would also trigger cancellation of the transitional rules.

Furthermore, any material variation to an award or industrial agreement covering multiple employees will cancel the transitional rules for all employees covered under that award or agreement.

As currently drafted as per the Explanatory Memorandum commentary, this will mean that very few LAFH arrangements would be able to benefit from the transitional rules for the full period provided. A pay rise in July or September 2012, for example, could cancel the transitional rules even before the new rules start on 1 October 2012. Further clarification on what constitutes a material variation to an eligible employment arrangement will be necessary in order to ensure the transitional measures operate as intended. We recommend that clarification should be provided to ensure that modifications in employment terms that are customary in the industry in question do not preclude eligibility for transitional treatment.