Submission 29

The Institute of Chartered Accountants in Australia

13 July 2012

Committee Secretariat
Department of the House of Representatives
PO Box 6021
Parliament House
Canberra ACT 2600

By email: economics.reps@aph.gov.au

Dear Sir/Madam

Tax Laws Amendment (2012 measures No. 4) Bill 2012 – Schedule 1 – Reform of living-away-from-home allowance and benefit rules

The Institute of Chartered Accountants in Australia (**Institute**) welcomes the opportunity to make a submission to the House of Representatives Standing Committee on Economics (**Committee**). This submission is in relation to its inquiry into the Tax Laws Amendment (2012 Measures No. 4) Bill 2012 (**Bill**).

Specifically, the Institute wishes to comment on Schedule 1 of the Bill. Schedule 1 amends the tax arrangements for the living-away-from-home (**LAFH**) allowance paid by employers to employees (**Reform**).

This formal submission to the Committee follows our earlier submissions to Treasury of:

- 15 February 2012 in relation to the November 2011 consultation paper (Attachment A); and
- 1 June 2012 on the exposure draft legislation and the accompanying explanatory materials (Attachment B).

We note that many of the concerns expressed in the earlier submissions as to the impact and scope of the Reform still apply to Schedule 1 of the Bill. We do not repeat those comments here, but attach copies of the submissions so that the Committee is fully cognisant of these matters.

In addition we observe that Schedule 1, as currently drafted, will:

- impose a disproportionate compliance burden on Australian employers as a result of the reform unnecessarily straddling both the income tax and FBT regimes; and
- that further clarification is required on a number of transitional matters.

If you would like to discuss any aspect of this submission or require any further information, please do not hesitate to contact me on 02 9290 5609 at first instance. We would welcome the opportunity to discuss our concerns with the Committee in person.

Yours sincerely

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Comments

1. Inclusion of food amount under both FBT and income tax is impractical

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 the employee 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 the employee fails to provide a declaration, 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 the FBT and income tax regimes 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 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 (thereby forgoing the ability to deduct expenses incurred while 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 the income tax and the PAYG withholding system. From the point of view of minimising cost for employers, the Institute's considers the income tax and the PAYG withholding system to be the preferred option.

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 the additional food costs. However, the tax treatment set out in the Bill presents practical challenges for employers and employees as it potentially gives rise to situations where the first $42 will be subject to FBT (or income tax).

To overcome this practical difficulty we suggest simplifying the tax treatment. This could be achieved by removing 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 are 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 the 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.

2. Scope of variation to employment arrangements

Guidance is given in paragraph 1.81 of the Explanatory Memorandum (EM) to the Bill, as to what constitutes a material variation to an existing employment arrangement. However, in the Institute's view the wording of the EM needs to be amended to make clear that changes to the terms of a LAFH allowance to reflect the impact of this legislation (e.g. alignment with new statutory amounts and reasonable thresholds or changes to the manner in which it is delivered as a reimbursement or an allowance) will not constitute a material variation to the eligible employment arrangement which would deny transitional treatment.

Similarly, the wording of paragraph 1.81 of the EM needs to be varied to specify that changes to terms of employment which have no impact on the requirement to live away from home (e.g. pay rises as a result of an annual salary review, statutory changes such as superannuation, and changes in employer) do not result in a disqualifying variation or renewal of the eligible employment arrangement.

It would also be helpful if the EM included a variety of examples which illustrate which circumstances will, or will not, constitute a change to an eligible employment arrangement.

3. 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 has now created an anomalous outcome for the employees who are relocating and employees who are temporarily living away from their usual place of employment. The latter group will not be able to access the tax free concession from 1 October 2012. In the Institute's view, the Bill should be amended to expand the existing concessional treatment available in the FBT legislation to include those employees who are temporarily living away from their usual place of employment. This will ensure consistency of tax treatment of employer provided accommodation in the initial period for both types of employees.

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.

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The Institute of Chartered Accountants in Australia

1 June 2012

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By email: FBT@treasury.gov.au

Dear Mr Leggett

Exposure draft: Reform of the living-away–from-home allowance and benefit rules

The Institute of Chartered Accountants in Australia (the Institute) welcomes the opportunity to comment on the exposure draft legislation (ED) and the accompanying explanatory materials (EM) of the reform of the living-away-from-home allowance (LAFHA) and benefits. These were released on 15 May 2012 by the Assistant Treasurer, the Hon David Bradbury MP.

On 15 February 2012, the Institute prepared a detailed submission on the November 2011 consultation paper, and we note many of our comments still apply to the current ED. However, in this submission, which is set out in the attachment, we have further concerns that the proposed changes, as currently drafted, will have unintended and adverse consequences for many employers and employees.

Given the importance of this reform, it is also disappointing that more time was not provided (submission due within two weeks from the release of the ED) to enable a thorough review and greater consideration of the taxation treatment of the LAFHA and benefits.

If you have any questions regarding this submission, or would like to discuss any aspect in further detail, please do not hesitate to contact Norman Kang on 02 9290 5718 at first instance.

Yours sincerely

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Comments

1. 12-month period

1.1 12-month period unfairly restrictive

The 12-month period is unfairly restrictive. Given the expense of assignments it is customary for assignments to be for more than 12 months duration. If it is enacted in its current form, the legislation may encourage skilled workers to leave the projects after 12 months or it may discourage them from working and living away from home in the first place, thus making it more costly and difficult for employers to complete projects. The Institute suggests a (minimum) 3-year threshold is much more appropriate.

1.2 Guidance on what constitutes the first 12 months

The proposed section 25-115(1)(e)(i) refers to the 'first 12 months that you live away from that residence.' Guidance is needed on what constitutes the first 12 months. For example, will this be a 365-day rule or a calendar year rule? How are travel days between Australian home and host location treated, and what happens if someone goes home for a weekend?

Also, paragraph 2.3 of the EM states that subject to transitional rules, the amendments will apply from 1 July 2012, however the Institute is unclear as to when the 12-month period will begin for arrangements commencing between 9 May and 30 June 2012, or where existing living away from home arrangements are varied or renewed after 1 July 2012. Does the 12-month period begin at the date of starting to live away from home or does it start from 1 July 2012? The Institute believes it should start from 1 July 2012.

1.3 Pause in 12-month period

In the proposed section 25-115(5), the Institute considers that a pause in the 12-month period should also apply to annual and long service leave at locations other than the usual place of residence, sick leave involving another location (e.g. in case of hospitalisation) and other reasonable circumstances that are more aligned to arrangements that would otherwise occur at the usual place of residence.

1.4 Subsequent periods of living away from home

The proposed section 25-115(5) permits the commencement of a new 12-month period where, at some later time, the employee is required by their employer to live at another location for the purposes of their employment and it would be unreasonable to commute to the new location from a location at which the employee had previously lived away from home.

Presumably the provision, as drafted, is designed to allow deductions for genuine situations of subsequent living away from home and to prevent arrangements whereby employees could circumvent the 12-month rule and obtain extended deductions for the same location. We would question the policy reason, for distinguishing between a person who at a later time is required to again live away from home but at a location that they have not previously been to as compared to an employee who returns home after living away from home and is then genuinely required to again live away from home at the same location.

We accept that there is a need for an anti-avoidance provision to prevent employees artificially structuring their living away from home arrangement to get around the 12-month rule, however we submit that where an employee genuinely is subsequently required to live away from home at a location that they previously had worked at they should not be prevented from obtaining a tax deduction for those costs. For example, an employee living and working in Melbourne is sent by their employer to work in Sydney for 12 months, after which they return home. Having been home in Melbourne for some time the employer again sends the employee to Sydney for a further 6-month period on an unrelated assignment, e.g. for a new project. We submit that in such cases, given a reasonable period of time (for the sake of clarity, the Institute suggests six months) between the periods of living away from home or a clearly identifiable different project, the employee should be entitled to a tax deduction for the costs associated with living away from home for the second 6-month period.

2. Requirement for dwelling in Australia in which the employee has an ownership interest

The Institute believes the requirement for the dwelling to continue to be available is extremely impractical. Rental is prevalent for legitimate reasons of security and maintenance. Under this approach, even having a house sitter, which has no economic benefit, would result in failure of the test. This is extremely punitive and a disincentive for anyone to mobilise, either domestic or outbound Australians. It is also contrary to the government's broader policy to increase or free-up available housing stock in Australia, rather than having it sit idle and unproductive.

The Institute also requests clarification as to what indicators will demonstrate a right to occupy in accordance with the definition in section 118-130 of the *Income Tax Assessment Act 1997* (ITAA 1997). In the Institute's view, formalised arrangements such as boarding in shared accommodation or with family should be allowed to qualify. This is of critical significance to fly-in-fly-out arrangements where it is prevalent for single employees to have accommodation of this nature on 'off' cycles.

3. Income tax deduction for employee

3.1 Compliance burden

It would simplify administration if the requirement that accommodation be reasonable were removed and it were accepted that actual, substantiated expenditure is sufficient, or alternatively that an employee's declaration that the accommodation is reasonable will be sufficient.

Similarly, substantiating food and drink is incredibly onerous as it can involve keeping receipts for all the food and drink they purchase from supermarkets, canteens, cafes, hotels, roadside vans, takeaway shops etc. Such employees where they do not keep all their receipts, file them, add the receipts and summarise them will pay more tax and receive less net pay. The Institute questions whether there will be any discretion as to how to simplify this where food and drink expenses exceed the reasonable levels. In remote locations, given limited supply and high transport costs, actual food and drink costs could well exceed reasonable threshold. This is very relevant to unionised workforce and those covered by industrial agreements containing entitlements to LAFHAs at specified amounts.

An issue has been raised as to a discrepancy between the ED and the EM. The ED contains a table that states, for a child aged under 12, the ordinary weekly food and drink expenses is $44, whereas the EM at paragraph 2.40 states it is $55. Treasury has confirmed that the correct amount should be $55 so the ED will need to be amended. In addition, the statutory food and drink amounts in the table should refer to the 2012-2013 income year rather than the 2011-2012 income year.

3.2 Expenditure incurred by 'you'

The Institute also notes that there seems to be a practical/technical problem with the proposed section 25-115. That is, it refers to 'You can deduct an amount for an ... expense you incur' and makes it clear that the 'you' is the employee. While this works well where the employee shops for him/herself, will the proposed section apply where the partner/ spouse of the employee is the one who actually goes out and buy the food? That is it will be the partner/spouse who incurs the expense and not the employee.

We submit that an amendment is required to allow expenditure incurred by the partner/spouse of an employee to be deductible in either their tax return or the return of the employee where the requirements of the proposed section 25-115 are otherwise met.

3.3 Employer requires you to live away from home

One of the conditions specified in the proposed section 25-115(1) is that 'you incur an expense because **your employer** requires you to live away from your usual place of residence' (emphasis added). This requirement differs from what was previously required in order to be living away from home. Under the existing provisions it was merely a requirement that the person is living away from home for the purposes of their employment, and there was no testing of what the employer required. If this is intended to be a

change in requirement then the EM should clearly state this distinction and provide examples to highlight the matter. If this change is not required then the draft provision should be amended.

The proposed wording also raises a question as to whether an employee could be considered to be living away from home if they seek a job with a new employer and in order to take up that new job they are required to live away from home. In this situation it is arguable as to whether the employer required the employee to live away from home. If the existing wording is to be retained, and such scenarios are intended to satisfy the requirement of living away from home, the EM should contain examples to confirm this intention.

3.4 Nature of deductions

Paragraph 2.45 of the EM provides examples of what documentation could be used to substantiate accommodation costs and lists 'mortgage documents'. Under the existing FBT concessions, the living-away-from-home concessions only applied where the employee's accommodation costs related to a lease or licence of accommodation. This paragraph implies that deductions will be available where the employee purchases a home at their new work location. Assuming that the employee is genuinely living away from home, what costs would be deductible to the employee where they purchase a home rather than rent one? It would be appropriate for the EM to include an example of this situation.

3.5 Connection between food costs and accommodation

If the residence that a person is living away from does not continue to be available for the person's use and enjoyment (whilst they are living away from that residence), the draft provisions deny the person a tax deduction for both accommodation costs and food costs while living away from home.

While there may be some policy basis for denying a tax deduction for the accommodation costs associated with living away from home i.e. where the employee is not maintaining a home at their usual place of residence or is otherwise renting that property, we question the policy basis for denying a tax deduction for the food costs associated with living away from home. As a general proposition a person temporarily living away from home will incur additional food costs as compared to the costs that would be incurred at their usual place of residence. It is submitted that the ability to claim a tax deduction for additional food costs should not be linked to whether or not the usual place of residence continues to be available for that person's use and enjoyment. The deduction for additional food costs should merely be linked back to whether or not the person is truly living away from home.

4. Transitional Rules

4.1 Temporary residents

Treasury has clarified that the transitional relief until 1 July 2014 is only applicable to permanent residents where those benefits are provided under an employment arrangement that was in place before 7.30pm on 8 May 2012.

This has meant that affected businesses and employees have effectively been given only just over a month's notice before an extremely significant change to their tax burden.
There is a need for transitional rules to be available for temporary residents who are benefitting from living away from home arrangements, without the need to have a residence in Australia from which they are living away from, particularly as many are committed to long-term leasing arrangements that they cannot easily extricate themselves from.

4.2 Breaching the non-discrimination articles

The transitional rules (available for permanent residents and not temporary residents) appear to breach the non-discrimination articles in Australian treaties. From an 'in-substance' perspective, the requirement under the new rules to have an Australian home (rather than a home in any location) also appears to breach these articles.

4.3 Employee becoming a permanent resident during the relevant period

The transitional rules are unclear as to when an employee changes his/her resident status during the relevant period. If an employee becomes a permanent resident either before 1 July 2012 or after that date, what happens under the transitional rules?

5. Eligible employment arrangement

The Institute would like confirmation that changes to the terms of a LAFHA to reflect the impact of this legislation e.g. alignment with new statutory amounts and reasonable thresholds or changes to the manner in which it is delivered as a reimbursement or an allowance, will not constitute a variation to the eligible employment arrangement which would deny transitional treatment.

Similarly, confirmation is required that changes to terms of employment which have no impact on the requirement to live away from home e.g. pay rises, statutory changes such as superannuation, and changes in employer, do not result in a disqualifying variation or renewal of the eligible employment arrangement, and thus do not jeopardise the transitional treatment.

A further example arises where a project on which an employee, who is living away from home, is working is not completed within the contemplated time frame. In such instances, if the employees LAFHA period is extended (all other employment conditions remaining unchanged), but is still within the transitional time frame, this should not be treated as a change to the eligible employment arrangement.

The EM should be updated with commentary to cover these and as many other examples as possible as to what will or will not constitute a change to an eligible employment arrangement.

6. Interactions with other areas of the tax law that need to be addressed

6.1 Superannuation guarantee

As mentioned in our submission to the November 2011 Consultation Paper, it is still 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 LAFHA paid to a temporary resident, which is intended 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 LAFHAs provided by employers would constitute ordinary time earnings for employees, and any circumstances that affect this classification.

6.2 Otherwise deductible rule

The proposed changes state that where the employer provides the accommodation or food (rather than paying an allowance) they are to rely on the otherwise deductible rule to reduce the value of the relevant benefits. The amendments also state that the employee is entitled to a tax deduction for the accommodation and food and drink costs that relate to his/her spouse and children while they are living away from home with the employee.

However, the Institute requires clarification on the operation of the otherwise deductible rule in the *Fringe Benefits Tax Assessment Act 1986* (FBTAA). For example, in relation to property benefits (this would apply to the provision of food and drink) section 44(1) (k) of the FBTAA states the benefit is deemed to be provided only to the employee as per section 138(3) of the FBTAA, and the amount is calculated in accordance with section 44(5) of the FBTAA to determine the employee's percentage. In the Institute's opinion, if the food and drink is provided to the employee and their associates, the calculation under section 44(5) of the FBTAA can only result in a 50% reduction (although the food was used 100% in producing the employee's assessable income), because the employee only has a 50% interest in the food.

The Institute therefore considers that an amendment is needed to either subsections 44(1) (k) or 44(5) of the FBTAA to prevent this from arising.

6.3 PAYG Withholding

We note that the EM does not address the pay-as-you-go withholding (PAYGW) issues associated with a LAFHA. However, we understand that the Commissioner is considering issuing a class PAYGW variation so employers do not have to withhold where the employee is expected to incur deductible living-away-from-home expenses up to or in excess of the allowance paid.

The EM should contain some discussion of the PAYGW requirements and what evidence an employer would require in order to apply such a variation.

6.4 Other aspects

Again, as noted in our submission on the November 2011 Consultation Paper, it is unclear how the changes will affect temporary accommodation of international assignees e.g. serviced apartment costs for the first six week while they seek long term accommodation. It appears that the operation of section 61C of the FBTAA would not currently operate to make such accommodation costs exempt benefits (through the reduction of taxable value to zero). The Institute believes section 61C of the FBTAA should be expanded to cover the range of residual situations that will now arise if not eligible for concessional treatment under the proposed new rules.

The Institute also believes rental bond and leasing of household goods exemptions should extend to overseas workers if they would qualify for the proposed section 25-115 apart from the requirement to maintain a residence in Australia.

Submission 29

The Institute of Chartered Accountants in Australia

15 February 2012

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By email: FBT@treasury.gov.au

Dear Mr Leggett

Fringe Benefits Tax (FBT) Reform: Living-away–from-home benefits

The Institute of Chartered Accountants in Australia (the Institute) welcomes the opportunity to make a submission on the consultation paper, *Fringe Benefits Tax (FBT) Reform: Living-away-from-home benefits* (the Consultation Paper).

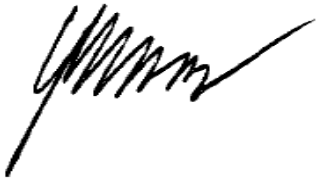
The Consultation Paper follows on from the announcement of the Treasurer, the Hon Wayne Swan MP, in the *2011-12 Mid-Year Economic and Fiscal Outlook* that it would introduce a range of amendments aimed at limiting access to the Living-away-from-home allowance (LAFHA) tax exemption.

While there are a number of concerns held with the overarching rationale for the proposed amendments announced by the government, a key issue which we believe deserves further consideration is transitional arrangements. It appears from the Consultation Paper that, other than in specific cases e.g. the community sector, the government does not envisage putting in place transitional arrangements to move from the existing policy framework to the proposed new one. Given the short time frame between legislation being introduced and the commencement date of 1 July 2012, further consideration should be given to introducing appropriate transitional arrangements in recognition of the fact that tens of thousands of Australian workers will be disadvantaged as a direct result of this change in policy.

Our comments on questions posed in the Consultation Paper are set out in the attached submission and we have also listed out a number of issues that require further clarification. In the interest of minimising extensive changes to the tax and superannuation legislation, we have also suggested alternative measures to deal with concerns that the government has with the LAFHA tax exemption.

If you have any questions regarding this submission, or would like to discuss any aspect in further detail, please do not hesitate to contact me on 02 9290 5623 at first instance.

Yours sincerely



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Comments

1. Unintended consequences from the proposed reforms

1.1 Ability to attract skilled migrants

The proposed reforms will impact the ability of Australian businesses to attract skilled migrants or otherwise increase their costs to secure the services of the right skilled migrant.

Australia is experiencing a skills shortage which is only anticipated to become worse in the coming years due to the number of significant projects commencing. With Australia's ageing population leading to a decline in work participation rates, Australian businesses' search for individuals with specific skills is becoming more challenging given the limited pool of Australian individuals who possess the right skills set. Accordingly, employers are increasingly reliant on the ability to recruit individuals from overseas to provide this expertise.

To ensure working in Australia will be attractive to individuals from overseas, employers will have to ensure that potential employees will be adequately compensated to cover any increased cost of living, given Australia's cost of living is relatively high on a global scale. Furthermore, there are additional factors that skilled migrants face such as higher effective tax rates, the availability of less government benefits, additional education costs and cultural familiarisation which will impact the amount of compensation that an Australia employer will need to provide to convince an overseas person to work in Australia.

The proposed reforms will remove tax concessions currently available to temporary residents who are provided with LAFHA fringe benefits, to the extent that they are living away from an overseas home thereby increasing the tax cost of the benefit. This increased cost may be incurred by the employee or employer, depending on how the benefit is provided. However, it is most likely the employer will bear the economic burden of the additional tax cost to secure the skilled overseas person to work in Australia.

Therefore, the proposed reforms will make it even more challenging for employers to attract talent to Australia, as employees will have to fund these additional costs from after–tax income, or employers will have to pay increased remuneration.

The proposed reforms also appear inconsistent with a number of initiatives which have been undertaken or commissioned by the government in regard to Australia's looming skills shortages. Each of these initiatives e.g. National Resource Sector Employment Taskforce and the Australian Financial Centre Forum, recommended the need for skilled migration.

1.2 Flow on impacts on the economy

The proposed reforms may also have other unintended impacts on the Australian economy.

As discussed above, the proposed reforms will increase an employer's cost of employing a temporary resident who is living away from an overseas home (and is not maintaining a home in Australia). As a consequence of this increased cost, employers may decrease their costs in other areas, through decreased spending and redundancies, or pass on the increased costs to the end consumer to avoid the decrease in their profitability and growth potential. Some employers may even decide to move operations offshore as a result of the higher employee costs.

Our members have provided feedback that some temporary residents have indicated they will reconsider working in Australia if the proposed reforms are implemented. Therefore, it is possible that there will be numerous temporary residents departing Australia when the

reforms are implemented, resulting in decreased spending which will flow on to the rest of the economy.

To the extent that temporary residents remain in Australia, the proposed 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.

1.3 Impact on businesses

The proposed 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. Where businesses have employed temporary residents who live away from their overseas home, the proposed reforms will result in additional employee costs. As many of the long term contracts and agreements may not able to be renegotiated, the additional employee costs could result in loss making contracts for businesses.

In addition, 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. Given the short timeframe to potential implementation, it is difficult to estimate, let alone negotiate, the impact of such costs. We understand from our members reimbursable contracts are prevalent in the resources industry.

Further, a business may face increased tax costs and compliance in the form of superannuation guarantee and payroll tax. Currently, an employer is not required to pay superannuation and payroll tax on LAFHAs or other living away from home benefits. These additional taxes may place further burdens on struggling businesses.

Businesses may also need to increase remuneration packages for their temporary resident employees to encourage them to continue working in Australia. 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.

1.4 Unfair advantage to temporary residents is overstated

We understand the proposed reforms are being 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 temporary residents who are receiving LAFHA benefits. The majority of temporary residents receiving LAFHA benefits are individuals who legitimately require assistance with the increased cost of living as a result of coming to Australia.

The proposed changes could severely impact these 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 temporary residents 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.

While a temporary resident in receipt of a tax-free LAFHA benefit may receive higher after-tax remuneration than an equivalent permanent resident, they also incur expenses that a permanent resident 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. 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.

Furthermore, a temporary resident is not afforded the same degree of assistance from the government as a permanent resident. For example, most temporary residents are either not entitled to use or have only limited access to the Medicare system. 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 while in Australia. The additional after tax remuneration received by temporary residents as a result of the treatment of LAFHA benefits helps to offset these additional costs.

1.5 Inequity and discrimination

Under the proposed reforms, to access the tax concessions, a temporary resident must be living away from a home in Australia (which they continue to maintain). According to the Consultation Paper, this is designed to create a level playing field between an Australian resident worker and a temporary resident working in Australia.

Given 'temporary resident' will have the same meaning as used in the income tax law, there is potential for there to be inequitable treatment between permanent and temporary residents living away from an overseas home under the proposed reforms.

Broadly, the key requirements to be a 'temporary resident' are:

- holding a temporary visa granted under the *Migration Act 1958;* and
- not be an Australian citizen or holder of a permanent visa.

However, an Australian citizen or permanent visa holder who is living overseas (i.e. is not maintaining a home in Australia) could still access the tax concessions if they temporarily move to Australia for an assignment as they would not be considered a 'temporary resident' under the income tax law.

We note this inequitable treatment may also be a cause for concern regarding non-discrimination articles within Australia's relevant international tax conventions.

1.6 Community sector caps

The Consultation Paper advises that the proposed reforms will not affect employees of the community sector organisations who do not use the full extent of the FBT exemption cap. While the intention of this statement has some merit, there are practical implications which require further consideration.

Under the proposed reforms, a benefit provided in the form of a LAFHA will no longer be regarded as a fringe benefit. Instead, LAFHAs will be subject to income tax in the hands of the employee at their marginal tax rate.

Where a tax concession is no longer available (e.g. certain temporary residents), employees will no longer be able to utilise the concessional cap for LAFHAs as it is only applicable to fringe benefits.

Living-away-from-home benefits provided in the form of a fringe benefit, would likely utilise the majority of the concessional cap (if not all of it), particularly given the cost of living and rental prices in Australia.

Accordingly, it is likely that the FBT burden will increase for community sector employers of temporary residents.

1.7 Fly-in fly-out (FIFO) exception

It is proposed that temporary residents who maintain a home in Australia will be eligible for concessional LAFH benefits, for example, benefits provided on-site in connection with 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.

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. There are also many circumstances where FIFO arrangements are not centred around locations that qualify as remote areas for tax purposes, despite having many disadvantages and hardships akin to those experienced in remote areas. Removing the LAFH concessions place projects of this nature at a significant competitive disadvantage.

2. Practical aspects of the proposed reforms requiring further consideration

2.1 Implementation timing

The current LAFHA provisions are utilised by most employers who have temporary resident employees. The time frame between the potential release of legislation and the effective date of 1 July 2012 will be very short and may not provide employers and temporary residents with sufficient time to effectively manage the change.

As a result of the changes, employers would 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 proposed changes depending on how the living-away-from-home benefit is structured, that is, LAFHAs 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.

The short time period until 1 July 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 July 2012.

2.2 Payroll systems

Where a Pay-As-You-Go (PAYG) withholding variation is not applicable, LAFHAs will be subject to PAYG withholding. Employers will be required to make changes to their payroll systems to ensure compliance with PAYG withholding rules. We do not propose any further consideration at this time. However, we wish to bring to the attention of Treasury the wider impact that the proposed reforms will have on employers.

2.3 Interaction with immigration requirements

Employers are required to notify the Department of Immigration and Citizenship of any changes to the guaranteed annual earnings of an employee on a subclass 457 visa. LAFHAs are included in the calculation of guaranteed annual earnings for subclass 457 visa purposes.

As a result of the proposed reforms, employers will need to review the remuneration packages for employees. If an employee's remuneration package is altered by the removal of a LAFHA, the employer would be required to submit to the immigration department a new visa nomination application for that employee. This may result in numerous applications to the immigration department with the consequent associated costs.

An employee's new remuneration package is not able to take effect until the new position nomination has been approved by the immigration department. Accordingly, the short time period between the release of legislation and 1 July 2012 may cause practical difficulties for employers who are trying to adjust remuneration packages for the proposed changes and disadvantage temporary resident employees whose position nominations are submitted before, but not approved until after 30 June 2012.

3 Interactions with other areas of the tax law that need to be addressed

3.1 Personal income tax and PAYG withholding

Under the proposed reforms, the tax treatment of LAFHAs will be governed by the income tax system rather than the FBT system. This will introduce new complexities as employers will be required to withhold tax to the extent the employee is not expected to incur deductible expenses.

Where an employee is expected to incur deductible expenses, we seek confirmation that the PAYG withholding variation made by the Australian Taxation Office (ATO) will automatically apply. Accordingly, employers will not be required to apply on behalf of each individual.

In many areas, including remote sites where demand for accommodation is high and supply is limited, actual costs of both accommodation and food may significantly exceed the general thresholds that would be reasonable in more heavily populated areas. This is likely to result in an extensive need for substantiation of expenditure by Australian employees who continue to be eligible for living-away-from-home concessions. This would be a fundamental change to existing arrangements, and may create considerable difficulty for many employees, including semi-skilled labourers, who are accustomed to receiving such assistance without the need to supply documentation. We submit that further consideration needs to be given to both the substantiation requirements and the setting of reasonable thresholds to cover a variety of situations and areas.

Guidance will need to be given to employers as to the documentation they would be required to obtain from employees to allow them to be satisfied that an employee will expend any LAFHA paid and therefore vary the amount of PAYG withheld. To the extent that individuals will be required to apply for a PAYG withholding variation before an employer is able to alter its withholding requirements, we submit that a process should be

introduced which streamlines the PAYG withholding variation process to ensure individuals receive timely responses to requests. Alternatively, the Commissioner of Taxation should release a legislative instrument clarifying the variation process or make a class order, to overcome the need for a high volume of individual variation applications.

3.2 Superannuation guarantee

Currently, employers are not required to make superannuation guarantee contributions in respect of LAFHAs as they constitute a fringe benefit. However, the position under the new proposals 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. An employer is not required to make superannuation guarantee contributions to the extent an allowance is expected to be fully expended.

Under the proposed reforms, any LAFHAs 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 LAFHAs paid to employees under the proposed reforms, unless the employer is aware that the employee will incur costs equal to the amount of the LAFHA. 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 LAFHA 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 LAFHAs 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 LAFHAs is introduced, as superannuation guarantee shortfalls may otherwise arise in unintended circumstances, creating further costs for employers.

4 Update of the statutory food amount

We recommend that Treasury should update the statutory food amount by way of a formal survey on the average Australian expenditure on food and beverages through a reputable independent information provider or use the data collated by the Australian Bureau of Statistics on food and beverages.

5 Indexation of statutory food amount

Ideally, indexing the statutory food amount annually will ensure the amount will be reflective of ordinary costs incurred by an Australian. However, indexing the statutory food amount each year would increase the administrative burden for employers as it would change the FBT cost to the employer each year, resulting in the employer potentially revising its calculations annually to determine the amount paid to its LAFH employees.

In the interest of minimising the administrative burden, rather than indexing the statutory food amount annually, we suggest that the statutory food amount could be updated on a regular basis, for example, every three years. Further, the statutory food amount provision could be changed so that updating the amount would not require an amendment to legislation thereby avoiding having to go through the parliamentary process.

6 Appropriate transitional arrangements

Based on the Consultation Paper, it appears not enough consideration has been given to transitional issues. The government needs to consider transitional issues on a broader basis rather than focusing on the community sector or specific circumstances. To allow employers, in general, time to adapt and plan for the change in tax treatment of LAFHAs, appropriate transitional arrangements need to be introduced, especially since many employees may be significantly disadvantaged as a direct result of this change in policy.

Moreover, it is unreasonable to expect those on existing multi-year commitments in Australia to bear the additional cost from the start of July 2012 given that many of these commitments may not be able to be changed. In our view, it would be more reasonable to introduce transitional or grandfathering arrangements for arrangements in existence prior to 1 July 2012 that allow workers on existing fixed-period arrangements to continue under the current regime until those contractual periods expire, or are renewed.

7 Further clarity sought

In addition to those items already discussed above, our members have identified a number of issues which require further clarity.

7.1 Remote area housing

The remote area housing concessions in section 58ZC of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) aims to exempt any housing benefit in a remote area for which the circumstances are reasonable. However, in accordance with section 25 of the FBTAA and the definition of 'housing right' in section 136(1), the housing must be the employee's usual place of residence.

Accordingly, for temporary residents living away from their usual place of residence (being their overseas home), the exemption pursuant to section 58ZC of the FBTAA will not apply.

Currently, this is not a concern as temporary residents who are living away from their usual place of residence are entitled to living-away-from-home tax concessions. However, under the proposed reforms, temporary residents will not be eligible for either concession unless they live away from a home they maintain in Australia.

We seek confirmation as to our interpretation of the exemption pursuant to section 58ZC of the FBTAA and propose a review of its application to housing, which is not an employee's usual place of residence, so that it may be applied to attract temporary residents to remote areas where workers are required.

7.2 Application to non-residents

We note that neither the proposed reforms, nor the Consultation Paper, provide commentary regarding non-residents who may be living away from home in order to perform short-term services in Australia.

For example, it is not clear how the changes will affect temporary accommodation costs of international assignees (e.g. serviced apartment costs for the first six weeks while they seek long-term accommodation). It appears that the operation of section 61C of the FBTAA would operate to make such accommodation costs exempt benefits (through the reduction of taxable value to zero).

It is also unclear as to how the changes will affect the accommodation requirements of staff on temporary project-based assignments (generally 1 – 9 months duration). It is very common for such projects to be planned as likely to have certain duration e.g. 3 months, but project scope can change or project delays may occur necessitating an extension of the employee's stay.

We recognise that treaty income tax exemptions apply to certain employees. However, for those who are not exempt, we seek clarification as to the application of the proposed changes.

We would expect that based on the proposed reforms as discussed in the Consultation Paper, non-resident workers who are not treaty exempt would not be subject to the conditions applicable to temporary residents and would continue to be eligible to receive living-away-from-home benefit concessions.

While we believe that the concession should apply to non-residents in this regard, we seek confirmation as to how the concessions are intended to apply to non-resident employees.

7.3 Other overseas employee concessions

The Consultation Paper comments that employees receiving FBT education expenses concessions for their children when living away from home for work will not be affected by the proposed reforms.

In this regard we seek confirmation regarding the continued application of these and other concessions currently available to overseas employees. As mentioned previously, the requirement for temporary residents to maintain a home in Australia does not appear to require the Australian home to be their usual place of residence. We summarise the application of the following concessions on this basis and seek confirmation accordingly regarding:

- **Overseas employment holiday transport (section 61A of the FBTAA) and Education of children of overseas employees (section 65A of the FBTAA)**
  Under sections 61A and 65A, there will be no requirement for a temporary resident employee to maintain a home in Australia as required under the proposed reforms.

- **Connection of utilities (section 58D of the FBTAA)**
  The concession under section 58D will allow an exemption for the connection or re-connection of certain utilities required because the employee is required to live away from their usual place of residence.

  For temporary residents who are living away from their usual place of residence and who also maintain a home in Australia from which they are living away from, the concession will apply only to the residence for which they are required to maintain. A concession will not apply to the home for which a tax concession is available for living-away-from-home benefits

- **Leasing of household goods (section 58E of the FBTAA)**
  For temporary residents who are living away from their usual place of residence and who also maintain a home in Australia from which they are living away from, the concession will apply only to the residence for which an exemption is allowed. The concession will not apply to the home they are required to maintain.

- **Relocation transport (sections 58F and 61B of the FBTAA)**
  The concession under section 58F allows an exemption for relocation transport required because the employee is required to live away from their usual place of residence. We note, however, that where a temporary resident is living away from a home they maintain, it will not be their usual place of residence and therefore the exemption will not apply to transport between these homes, which is inconsistent with the application of living-away-from-home concessions for temporary residents.

  We note that the proposed reforms appear to result in the inconsistent application of these concessions.

7.4 Living-away-from-home vs. travel benefits

Given Treasury's proposed LAFHA reforms and the interaction between LAFHA and travel benefits, we suggest Treasury review and clarify the distinction between where an employee is travelling on business and when they are living away from home.

This distinction remains a significant area of confusion for employers, as well as a significant area of risk. In particular, the difference between 'reasonable' allowances for travel and LAFH purposes has the potential to result in a significant tax liability.

We suggest Treasury have specific regard to the 21-day rule, which the ATO has determined should apply in circumstances where a distinction is not clear.

8 Alternative measures

Rather than introducing the proposed reforms, which could result in problematic interactions with other tax laws and practical issues for Australian employers, we suggest that changes could be made to the current treatment of LAFH benefits which could assist taxpayers in determining the correct tax treatment of these benefits also reduce the unintended misuse of these concessions. Based on our members' feedback, some suggested changes are:

- **Maximum time limit**
  The introduction of a time limit for which an employee is eligible to receive living-away-from-home concessions. This would continue to encourage short-term skilled migration where it is needed, while removing any longer-term cost to revenue.

- **Substantiation of costs**
  Substantiation requirements would ensure that there is no incentive for employees to salary sacrifice living costs in excess of costs actually incurred.

- **Introduction of accommodation value limits**
  Consideration could be given to introducing accommodation value limits rather than abolishing LAFHA benefits for temporary residents.

- **Foreign employees who are overseas when engaged**
  To deal with situations where individuals do not genuinely relocate for work purposes, the existing LAFHA provisions could be modified to make it clear that an employee from overseas can qualify as living away from home only if they relocate at the employer's instigation.

- **Temporary residents on fixed term assignments with same employer**
  As these individuals are genuinely living away from home for work purposes, the LAFH concessions should continue to apply in this situation. Therefore, consideration should be given to structuring the LAFH concessions so that they 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.

- **Employee has to return to a specific home**
  LAFHA effectively compensates the employee for maintaining two homes - one in Australia and one that they are living away from overseas. Having this requirement provides a level playing field between an Australian resident worker (not living away from home) and a temporary resident worker in the same place, doing the same job as the temporary resident worker actually has another home to maintain whereas an Australian resident worker does not.