Joint Committee of Public Accounts and Audit ("JCPAA")

Inquiry reviewing a range of taxation issues within Australia

Part B – Fringe Benefits Tax ("FBT") regime

Submission to correct the anomaly in FBT legislation that discriminates against government owned organisations in the National Tax Equivalents Regime (NTER) and their employees

1. Introduction

We wish to draw to your attention, and ask Parliament to rectify, an anomaly in the FBT legislation which can disadvantage State and Territory owned corporations and commercialised business units and their employees, compared to their corporate taxpayer counterparts (that is, employers participating in the Federal income tax regime).

FBT is payable by State and Territory owned corporations on a range of low value fringe benefits provided on an infrequent and irregular basis which are normally exempt for other corporate taxpayers - for example, cinema tickets given to employees as a reward for service and team building activities undertaken to improve cooperation and leadership skills. These benefits are also reportable fringe benefits which impact on employees' Family Tax Benefit entitlements, HECS repayment obligations and child support payments.

Compliance with the tax law means that our members are required to put infrequent and irregular low value (that is, less than $100) rewards and team building events of an entertainment nature on employees' payment summaries. Importantly, in our opinion, these benefits are not akin to income paid to our employees as a reward for their services. Additionally, as outlined below, benefits of this nature fall outside of the stated policy intent of the reportable fringe benefits measures.

Apart from the impact on the employee, in order to comply with the FBT legislation, the State or Territory owned corporation is required to:

- identify low value benefits, less than $100, that are provided in conjunction with team building and reward schemes that are provided on an infrequent and irregular basis;
- value each individual benefit;
- identify every employee recipient;
- calculate, report and pay the resulting FBT; and
- calculate and disclose the associated reportable fringe benefit amount for every employee who receives reportable fringe benefits exceeding $1,000.

A corporate taxpayer providing identical benefits is not required to undertake this administrative process, as they can simply treat the benefit as exempt from FBT and non-deductible.

We believe this is a potential oversight which, in our opinion, can easily be rectified with only a marginal cost revenue. One possible option would be to update the FBT legislation to recognise the introduction of the NTER - now applying to government owned organisations - such that infrequent and irregular minor entertainment benefits provided to employees of NTER participants are exempt from FBT similar to other corporate taxpayers. Alternatively another, yet less desirable, option would be to exclude benefits of this nature provided to employees of NTER participants from the operation of the reportable fringe benefits measures.

There is no apparent policy rationale for maintaining this difference in treatment and the issue could be resolved by a minor amendment to the FBT legislation. We do not consider that an administrative solution with the Australian Taxation Office ("ATO") is available given the clear language of the legislation.

We have intentionally avoided providing a detailed discussion in this submission. ***Our hope is that the JCPAA will agree with and endorse our proposal, in-principle, and direct the matter to the the Department of the Treasury to carry through the process of legislative amendment.*** We would be happy to liaise with Treasury in this regard.

2. Summary

Our concerns, explained in more detail below, are broadly as follows:

a) There are FBT exemptions, for ad hoc minor entertainment benefits, resulting in significant administrative savings and less tax being paid by employers who are corporate taxpayers. Because the benefit is exempt from FBT, it is not a "reportable fringe benefit" for the employee receiving it (the significance of this is explained below) and hence no double taxation applies as a result of the operation of the latter measures.

These concessions are not available for "tax exempt body entertainment fringe benefits". Instead, when a tax exempt body provides ad hoc and minor entertainment to employees, more onerous FBT rules apply. This affects both "traditional" tax exempt bodies, such as charities, as well as Government Owned Corporations and commercialised business units (for brevity referred to here as "GOCs").

b) The FBT legislation has not been updated to recognise the introduction of the NTER, under which State and Territory GOCs are subjected to the same income tax imposts, administrative burdens and ATO scrutiny as corporate taxpayers. Nor does the FBT legislation properly address the additional compliance difficulties facing tax exempt bodies which have resulted from the introduction of the reportable fringe benefit rules.

The NTER arose out of the competition policy framework endorsed by the Commonwealth and State and Territory Governments, which agreed to promote "competitive neutrality" between State and Territory owned enterprises and their privately owned/corporate taxpayer counterparts, including through uniform application of income tax laws.

c) Even though NTER entities operate in the same business and tax environment as corporate taxpayers, the FBT legislation still treats them as tax exempt and their FBT compliance burden is significantly greater as a consequence.

Both NTER entities and their employees are paying additional tax compared to their corporate taxpayer counterparts.

From a policy perspective, we assume this is an oversight (the FBT rules for tax exempt body entertainment were in place before the NTER was agreed). However, we can see no apparent policy reason for maintaining this difference in treatment. In the context of competitive neutrality, it potentially amounts to 'reverse discrimination' because employees are being financially penalised for working for a tax exempt rather than a corporate taxpayer.

At a more basic level, the principles of good tax law design suggest that to have rules imposing unnecessary administrative burden and discriminating against different classes of taxpayer is inappropriate.

d) This apparent inequity could be easily rectified by amending the scope of the 'tax exempt body entertainment fringe benefit' rules in the FBT legislation to exclude NTER entities.

Alternatively, it could also be rectified by amending the reportable fringe benefit rules such that benefits that would otherwise be exempt, if provided by a corporate taxpayer, are not reportable for NTER employees. However, this is not ideal from a policy or practical perspective, as it does not remove the costly and inefficient additional administration experienced by NTER entities.

3. Detailed submission

3.1. FBT exemptions for minor entertainment benefits

For corporate taxpayers, there are FBT exemptions for ad hoc "minor benefits"[1] and property benefits provided on work premises.[2]

Where the benefit is entertainment in nature (food/drink, sporting and recreational activities), a tax deduction is instead denied.[3] In certain situations it is treated as a normal business expense, that is, no FBT and tax deductible, for example entertainment incidental to a 4+ hour seminar.[4]

This more streamlined approach of removing these minor benefits from the FBT net and simply denying a tax deduction is routinely utilised by private and corporate employers of all sizes. It significantly simplifies the tax compliance administration otherwise associated with, for example, the staff Christmas party and similar work functions, low cost recreational activities for the purpose of team building or client entertainment, and 'reward & recognition' type gifts or team activities.

Accepting the underlying policy intent of denying deductions for entertainment unless subject to FBT, and the current structure of Australia's income tax and FBT legislation, this is a sensible and practical outcome for both the employer and its employees:

- *For employees*, except in the case of meal entertainment, these benefits would otherwise be a "reportable fringe benefit" (explained below).

  These benefits are of only transitory value, if any, to the employee and certainly not a substitute for remuneration. The employee generally has no discretion as to whether, or in what form, they receive the benefit. In the case of sporting or recreational activities undertaken as team building or client entertainment, participation is generally a work requirement and the employee will often not view it as a "benefit" and hence the application of the FBT Law and the reportable fringe benefits measures in these circumstances is potentially harsh and onerous on both the employer and the employee.

  However, these FBT concessions available to corporate taxpayers in these circumstances are not available to tax exempt bodies including participants in the NTER.

- *For corporate taxpayers,* the more streamlined approach which arises because of the availability of various FBT concessions, offers very significant administrative advantages. An ancillary consideration is that, it also provides a tax saving as the denied tax deduction on entertainment of 30% [for companies] costs less than FBT at 48.5%. In this regard, for a corporate taxpayer, the after tax cost of non-deductible entertainment is 100% of the cost of the entertainment, whereas for entertainment that is subject to FBT and thus deductible it is 136% of the cost of the entertainment.

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1 Section 58P *Fringe Benefits Tax Amendment Act 1985* (FBTAA). Broadly, it exempts from FBT benefits valued at less than $100 provided to an employee on a minor and infrequent basis. This concession is not available for "salary sacrificed" benefits.

2 Section 41 FBTAA. Broadly, this exempts from FBT property benefits (eg food & drink) provided to and consumed by a current employee on a working day and on business premises.

3 Division 32 *Income Tax Assessment Act 1997* (ITAA 1997), particularly subdivision 32-B.

4 Sections 32-35 (Item 2.1) ITAA 1997.

3.2. The reportable fringe benefits regime

The stated policy objective of the reportable fringe benefits measures is:

> *"[T]o enhance the fairness of the taxation and social security systems by enabling the value of fringe benefits to be taken into account in income tests for determining entitlement to government benefits, and liability to tax surcharges and income related obligations. This will minimise the opportunities available to employees to swap cash salary for fringe benefits to avoid surcharges and levies and to access rebates to which they would not otherwise be entitled on the basis of their total remuneration."*[5]

Where the value of reportable fringe benefits received by an employee in an FBT year exceeds $1,000 (broadly, most fringe benefits other than meal entertainment, car parking, corporate boxes and similar facilities, certain benefits provided to employees in remote locations and exempt benefits), the "grossed up" value of the benefits received is disclosed on the employee's PAYG Payment Summary (previously called their Group Certificate).

While the employee does not pay tax on these fringe benefits (the employer has already paid the FBT), it is effectively treated as part of their remuneration when applying income-tested government benefits, surcharges and obligations. In essence, because of the reportable fringe benefits gross up of 1.94175, the "pre-tax" value of the benefit – calculated as if the employee pays the top marginal tax rate of 48.5% - is attributed to the employee as if they received it as salary irrespective of the recipient's actual marginal tax rate.

While we do not question the appropriateness of the regime, we do note, however, that it can potentially have inequitable outcomes that are contrary to the stated policy objective.

- It picks up benefits that are not salary sacrificed, and which could not be regarded as a form of remuneration. These benefits are provided to employees in the course of them doing their job and have only transitory, if any, value to the employee.

- Further, the "grossed up" value effectively treats every taxpayer as being on the top marginal tax rate of 48.5%, whereas the vast majority of employees are not.

The inequity of the 1.94175 FBT gross-up applying under the reportable fringe benefits measures is exacerbated given that from 1 July 2006, the top the marginal tax rate will only be for employees earning $125,000 or more – that is, the vast majority of employees fall below this rate. To illustrate, an employee receiving reportable fringe benefits of $1,500 including GST will have $2,913 disclosed on their Payment Summary. If that employee has a marginal tax rate of 31.5% (earning less than $70,000 from 1 July 2006) and had they received that $2,913 as salary they would have received $1,995 after tax. Or in other words, to purchase $1,500 of benefits themself the employee would have to earn only $2,190 before tax, yet they are being treated as having received $2,913.

Additionally, the impact of the reportable fringe benefits measures are further exacerbated for employees of NTER participants as a range of low value fringe benefits including ad hoc rewards and team building events of an entertainment nature, normally exempt from FBT, are required to be disclosed on employees' payment summaries because of the operation of the tax exempt body entertainment provision.

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[5] Explanatory Memorandum to *A New Tax System (Fringe Benefits Reporting) Act 1999*

3.3. FBT exemptions denied to tax-exempt employers

The FBT exemptions outlined above for minor benefits and benefits provided on work premises are not available for entertainment provided by tax-exempt employers. This affects "traditional" exempt bodies such as charities as well as GOCs.

Tax exempt body entertainment fringe benefits'[6] are specific types of fringe benefits which are excluded from the various exemptions outlined above.

It could be argued that such an approach is necessary because tax-exempt organisations would otherwise have a cost advantage over corporate taxpayers (as denying a tax deduction imposes no cost to them).

Our members accept this policy outcome. We do, however, note that as a result of the introduction of the reportable fringe benefit measures this policy disadvantages tax exempt employers and their employees disproportionately assuming the intention is simply to counter or balance the inability to deny the employer a tax deduction worth only 30%. This disadvantage is further exacerbated by the fact that FBT is levied at the top marginal rate.

This inequity is also further magnified in the case of NTER entities and their employees and this is the focus of our submission. Despite, for all practical purposes, operating in an identical business and taxation environment, NTER entities suffer an additional significant administration and tax burden, and their employees can suffer financially by virtue of the reportable fringe benefits measures, compared to their corporate taxpayer counterparts, in otherwise identical circumstances.

More specifically, unlike corporate taxpayers, NTER entities are required to:

- identify low value benefits costing less than $100 of an entertainment nature which are provided in conjunction with team building or reward schemes on an infrequent and irregular basis;
- value each individual benefit;
- identify every employee recipient;
- calculate, report and pay the resulting FBT; and
- calculate and disclose the reportable fringe benefit amount for every employee who receives reportable fringe benefits exceeding $1,000.

This is Irrespective of the size of the perceived benefit. For example, if an NTER employer rewards employees and their families who have worked 12 hours a day for a period of time on a project by inviting them to a movie costing $8 per head, the employer is required to maintain:

- a list of the names of the attendees;
- include it in their FBT return;
- determine whether each employee received more than $1,000 in fringe benefits inclusive of the $8 cost of attending the movie and, if so, include the grossed up aggregate value of fringe benefits received by employees where they exceed $1,000 inclusive of the $8 cost of attending the movie on their employees' payment summaries.

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[6] Sections 38 – 39 FBTAA.

Importantly, corporate taxpayers providing identical benefits in identical circumstances can generally treat them as tax exempt for FBT purposes. Hence they are not subjected to an equivalent administrative burden. Additionally, they are not required to report the value of those benefits on their employees' payment summaries.

3.4. The National Tax Equivalents Regime

3.4.1. Background information about the NTER

The NTER can be traced back to the review of national competition policy undertaken by the Hilmer Committee in the early 1990s. The Commonwealth and State and Territory governments endorsed a national competition policy framework intended to improve the competitiveness of the public and private sectors of the economy.

The fundamental principle underpinning the competition policy framework is one of "competitive neutrality" between government and privately owned businesses. The inherent advantage in the tax-exempt status of State and Territory GOCs and commercialised business units was addressed by introducing a tax equivalents regime.

> *The primary objective of the NTER is to promote competitive neutrality, through a uniform application of income tax laws, between the NTER entitles and their privately held counterparts.*[7]

State administered in the 1990s, and on a national basis by the ATO since 1 July 2001, the NTER means GOCs should be subjected to the same income tax imposts, administrative burdens and ATO audit scrutiny as corporate taxpayers.[8]

The NTER applies to more than 240 entities, typically GOCs operating in the electricity industry, water authorities, railways, and investment, insurance and forestry commissions. Many of these organisations employ thousands of employees.

The income tax payable under the NTER is paid to the relevant State government, essentially maintaining the 'status quo' as regards GOCs being a source of revenue for the State and Territory governments. This is, and remains, an accepted aspect of Federal and State inter-governmental financial relations.

3.4.2. Perspective of an NTER taxpayer

From a GOC's perspective, being a NTER taxpayer is the same as being subjected to the corporate tax regime. There is no sense of the NTER being a "pretend" regime with GOCs "going through the motions". Indeed, the ATO is currently systematically undertaking Client Risk Reviews (with the potential for full-scale audits) of a significant number of large GOCs, using experienced auditors from the Large Business & International (LB&I) section of the ATO.

Like their corporate taxpayer counterparts, GOCs generally employ professional accountants and utilise external tax advisors to manage their tax compliance obligations (which in addition to the NTER include Federal GST, FBT, PAYG-Withholding as regards employee wages and other payments, and State taxes such as payroll tax and stamp duty).

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[7] NTER Manual, which sets out the administrative and technical operating features of the NTER.

[8] Subject to some minor variations, which, for example, recognise activities which may be regarded as unique to public sector enterprises.

3.5. Anomaly for employers subject to the National Tax Equivalents Regime

A potential anomaly arises in the FBT legislation as it applies to NTER entities because the rules regarding tax exempt body entertainment fringe benefits have not been updated to recognise the existence of the NTER. Nor do those rules properly reflect the increased compliance difficulties in relation to tax exempt body entertainment and the disparate impact on employees receiving the identical benefit but working for different employer types. We also note that the disparate impact on employees is calculated because the FBT rate is equivalent to the top marginal tax rate which, with effect from 1 July 2006, will only apply to an extremely small percentage of employees earning more than $125,000.

In this regard, because the more onerous FBT rules applying to tax-exempt employers have not been updated to recognise the existence of NTER regime and the fact that GOCs are for all practical purposes akin to corporate taxpayers, NTER entities and their employees are at a distinct disadvantage compared to their corporate taxpayer counterparts.

- From an NTER employer's perspective, the resulting tax exempt body entertainment rules – excluding the practical and useful concessions available to corporate taxpayers - go beyond simply negating the apparent financial benefit of being a tax exempt employer.

  NTER entities suffer a significant administrative burden, and pay more tax, than a corporate taxpayer providing identical benefits.

  In our members' opinion, this potentially represents "reverse discrimination" from a competitive neutrality perspective – it goes against the competition policy framework agreed to between the Commonwealth and States and Territories, as NTER entities are being disadvantaged and penalised due to their public ownership compared to their corporate taxpaying counterparts.

  At a more basic level, it also potentially goes against basic principles of good tax law design to have tax rules imposing unnecessary administrative burden and discriminating against different classes of taxpayer.

- Employees of NTER entitles are disadvantaged because non-meal entertainment benefits of less than $100 which are provided to recipients on an infrequent and irregular basis are reportable fringe benefits, whereas identical benefits provided by a corporate taxpaying employer generally are not (due to the opportunity they have to use the minor benefit exemption to obtain a "no FBT/non-deductible" outcome).

  This is a particularly inequitable outcome when, as noted above, it is potentially difficult to conclude that the types of benefits involved can be regarded as remuneration of the employee and vast majority of employees pay tax at a marginal tax rate significantly below the 48.5% *used to "gross up" the reportable amount.*

  The examples below illustrate, the potentially inequitable impact on employees of NTER participants who are affected by the reportable fringe benefits regime, as the types of benefits involved cannot be regarded as remuneration and arguably have only an extremely limited transitory benefit, if any, to the employee.

- A team of employees of an NTER entity have their annual planning day out of the office. They do team building activities to foster team cooperation and leadership skills, which involves archery and the use of canoes on a lake. The cost of the archery and use of canoes is a reportable fringe benefit for the employees, regardless of the "per head" cost.

- Relations between an NTER entity and a regional community are tense. At the NTER employer's urging, an employee agrees to attend a theatrical event celebrating the opening of

the new community hall, specifically with a view to mingling with locals and improving relations. The cost of the ticket is a reportable fringe benefit.

- Employees of a NTER electricity GOC have worked extremely hard in very difficult circumstances during some severe storms. In recognition of their efforts, and the impact this has on their families, the NTER entity books out a local cinema so employees and their families can have a private viewing of a popular movie.

  This is a reportable fringe benefit, notwithstanding the relatively small per head cost associated with this benefit and an employee who attends with their spouse and three children is attributed with five times the amount of a single employee. If the employer had been a corporate taxpayer, this would be likely to have been an exempt fringe benefit and have no impact on the employees.

- A group of NTER employees enter a weekend charity golf day and they pay their own entry fee. As the charity does good work in the community within which the NTER entity operates, the NTER entity agrees to hire a minibus to transport the employees out to the golf course which is some distance away.

  The cost of the minibus hire is a reportable fringe benefit, prorated across the employees involved. If the employer had been a corporate taxpayer, this may have been an exempt fringe benefit and have no impact on the employees.

In each case the employer would have to determine:

- who participated, including the number of spouses etc;
- the cost of the "entertainment" received per employee;
- include it in the FBT return;
- allocate that cost on a "per head" basis to the particular employees; and
- determine which employees had reportable fringe benefits exceeding $1,000 and include it on their payment summaries.

This is arguably a reasonably onerous administrative outcome, particularly given that the dollar value of the relevant benefits (ie movie tickets) can be insignificant. In many cases, the compliance cost could far outweigh the actual cost of the event. The reportable benefit could be as little as a few dollars.

We note that a "Big 4" accounting firm has confirmed that benefits provided in such situations would be a reportable fringe benefit if provided by a NTER entity.

It is worth emphasising that is not uncommon for "ordinary" employees in "ordinary" jobs to receive reportable fringe benefits in the course of doing their job and which are not salary sacrificed. For example, NTER entities may encourage employees to upgrade their skills through part-time university study and pay the associated HECS (~$500 per subject).

Many of these "ordinary" employees rely on Family Tax Benefit or may be subject to income-tested obligations. As such, while treating these 'minor' entertainment benefits as reportable may at first glance seem insignificant, for those affected the impact can be anything but insignificant. This is particularly so if the employee would otherwise be just under the $1,000 threshold and a minor entertainment benefit that is of no benefit to them personally (that is, attendance at a team building event) puts them over the threshold and results in $2000+ being disclosed on their payment summary

with a resultant reduction in their family tax benefit. **Importantly, we do not question the appropriateness of the reportable fringe benefits regime but do have concerns about the inequitable impact it has on employees in this type of situation.**

As will be appreciated, it causes real angst for the employee if they did not view the "benefit" as being of value to them or have any discretion as to their receipt of it – and knowing they would not be in this situation had they been working for a corporate taxpayer employer.

These rules also place an extraordinary onus on NTER employers to put in place measures to anticipate when these minor reportable fringe benefits will be provided and to warn potentially affected employees and, in some cases, give them the option of not participating. This is particularly difficult as it involves sensitive and personal details of the employees and, in most cases, the staff involved will not recognise at the outset the potential impact of their initiative, it is only later when the FBT return is prepared that this will be identified.

3.6. Possible solutions to the problem

A possible solution noted above would be to amend the relevant definitions associated with the 'tax exempt body entertainment fringe benefit' provisions in sections 38-39 of the FBTAA, such that its scope does not extend to entertainment provided by an NTER entity.

We believe this amendment can be achieved relatively simply and we would be happy to liaise with the Department of the Treasury in this regard.

We also note that this could be partially rectified by amending the reportable fringe benefit rules such that benefits that would otherwise be exempt, if provided by a corporate taxpayer employer, are not reportable where they are provided by NTER participants or, indeed more broadly tax exempt bodies. Importantly, we note that this would and should exclude all salary sacrifice benefits[9]. This position is not ideal from a policy or practical perspective, as it does not resolve the current double taxation and the costly and inefficient additional administration, experienced by NTER entities which, we consider, are contrary to the principles of competitive neutrality promoted by the successive Commonwealth, State and Territory Governments.

Either of these possible solutions could be implemented without significant impact on revenue and could result in real administrative savings to our members and remove a burden on our members' employees.

3.7. Policy considerations

As outlined above, our understanding is that the impact of the tax exempt body entertainment rules on both NTER entities and their employees is an unintended anomaly arising because the FBT legislation has not been updated to recognise the NTER. There is, in our view, no policy basis for it to continue.

The current outcome of the tax exempt body entertainment rules distort and discriminate against NTER entities compared to their corporate taxpayer counterparts and are contrary to the principles of competitive neutrality that successive Commonwealth, State and Territory Governments have pursued so vigorously. It also imposes additional administrative burden – costly inefficiency that ultimately flows through to electricity and gas prices – on hundreds of NTER entities, particularly the larger ones employing thousands of employees.

Importantly, rectifying the situation by excluding NTER entities from the scope of the tax exempt body entertainment rules will, in our opinion, only result in marginally less FBT being paid to the

[9] Refer to the operation of Section 58P(1)(f) which excludes from the Section 58P exemption benefits provided to employees where it would be unreasonable to treat the benefit as a minor benefit.

Commonwealth, however it would significantly reduce the FBT administrative burden on NTER participants (and other tax exempts if the requested amendment was extended to other tax exempt).