

Audit Report No. 34

Fringe benefits tax

Introduction

Fringe benefits tax

- 3.1 Fringe benefits tax (FBT) was introduced in 1986 to ensure that tax was paid on all income, including benefits obtained through salary packaging. There are thirteen categories of fringe benefits, each with valuation rules.
- 3.2 In 1997–98, the Australian Taxation Office (ATO) collected \$3.3 billion in FBT. This represented 3 per cent of total ATO tax revenue. FBT was then administered by the Small Business Income business line in the ATO.¹ The ANAO found that there ‘...is a high level of complexity in the application of FBT law and the estimated cost of compliance for FBT is relatively high.’²
- 3.3 The ATO’s strategic objectives in the administration of FBT are:

1 *Audit Report No. 34* (p. 11) observed that ‘On 1 March 1999, the Small Business Income business line ceased to exist and the administration of FBT was placed in the newly-created Small Business line. This organisational change came into operation during the final reporting phase of the audit and after the ATO provided its response. This report comments on the administrative arrangements which were current during the audit process.’

2 *Audit Report No. 34, 1998–99*, p. 13.

...to ensure that the Government and community have full confidence in the integrity and equity of FBT and that employers providing benefits meet their FBT obligations, with any risks to revenue identified and managed effectively by the ATO.³

The audit

- 3.4 The objective of the audit was to ‘...ascertain and report to Parliament on the ATO’s administration of FBT and to identify opportunities for improvement.’⁴
- 3.5 The audit suggested the following measures in order to enhance the administration of FBT:
- strengthening the ATO’s knowledge of the FBT taxpayer base;
 - educating clients about FBT legislation;
 - improving client service;
 - broadening the range of enforcement measures; and
 - monitoring overall FBT performance against Taxpayers’ Charter service standards.^{5, 6}

This review

- 3.6 The ATO informed the Committee that it accepted all of the ANAO’s recommendations. Each recommendation had either been implemented or was in the process of being implemented.⁷ The ATO expressed confidence that all of the recommendations would be implemented by July 2000.⁸
- 3.7 The ANAO informed the Committee of a number of initiatives by the ATO to improve its administration of FBT. These included: the creation of FBT business teams; the use of national projects and research to assess compliance risks; the introduction of a new compliance model; increased

3 *Audit Report No. 34, 1998–99*, p. 11.

4 Ian McPhee, ANAO, *Transcript*, p. 39.

5 The ATO’s Taxpayers’ Charter was established following the Joint Committee of Public Accounts inquiry into the ATO in 1983. It outlines the rights and obligations of the ATO and taxpayers, and service standards that can be expected. (*Audit Report No. 34*, p. 28.)

6 *Audit Report No. 34*, pp. 19–20.

7 Graham Daniel, ATO, *Transcript*, p. 33.

8 Graham Daniel, ATO, *Transcript*, p. 47.

attention to understanding the FBT taxpayer base; and greater education of taxpayers.⁹

- 3.8 At the public hearing, the Committee sought more information in relation to:
- community knowledge of FBT;
 - the ATO's knowledge of its client base; and
 - compliance costs.

Community knowledge of FBT

- 3.9 The community's knowledge of FBT was the main issue discussed at the hearing. The ANAO noted that 'Over 50 per cent of employers do not fully understand their obligations, and some small tax agents also have inadequate knowledge.'¹⁰ Increasing the level of knowledge in the community is a major challenge given that 'There are in excess of 800,000 employers who could be providing benefits to employees...'¹¹ Of these, approximately 64 000 pay FBT.¹² The remainder are either compliant non-lodgers or non-compliant non-lodgers. While it is difficult to quantify the revenue lost due to non-compliant non-lodgers, research by the ATO indicates that the amount is likely to be significant.¹³
- 3.10 The ATO recognised that the level of knowledge among small business operators was low. However, despite repeated questioning by the Committee, it did not appear to be able to identify whether this was more marked in particular industry sectors.¹⁴
- 3.11 Poor understanding of FBT requirements was seen to have implications both for the quantity of revenue raised, and for equity between employees of compliant and non-compliant firms. For example, the employee of a non-compliant firm might receive a higher family allowance payment than the employee of a compliant firm, even though their real income is the same.

9 Ian McPhee, ANAO, *Transcript*, pp. 39–40.

10 *Audit Report No. 34, 1998–99*, p. 15.

11 Graham Daniel, ATO, *Transcript*, p. 35.

12 Graham Daniel, ATO, *Transcript*, p. 35.

13 *Audit Report No. 34, 1998–99*, p. 40.

14 *Transcript*, pp. 41–2.

Reasons for the lack of knowledge

- 3.12 In response to the Committee's inquiries, two core reasons were advanced for the poor understanding of FBT in the community—the complexity of the legislation, and the perception that FBT is not a legitimate tax.
- Because the legislation is very complex, small business operators may have difficulty understanding it. Moreover, financial considerations may hinder their access to appropriate advice. Compounding the problem is the fact that not all tax agents fully understand the FBT rules.¹⁵
 - According to the ATO, '...many people question the legitimacy of FBT; with many not even recognising that it is part of the overall taxing regime of the Commonwealth.'¹⁶

Strategies for enhancing knowledge

- 3.13 The ATO utilises several mechanisms to assist the small business sector to better understand FBT. It identified education as its principal means of improving compliance.¹⁷ Initiatives included consultation; publications; seminars and workshops; and record keeping reviews.
- 3.14 The ATO informed the Committee that its '...principal mechanism for working with small business is through the FBT Sub-committee of the National Tax Liaison Group' and that the ATO was '...seeking to expand the number of regular FBT consultative groups in the current financial year from 2 to 4.'¹⁸
- 3.15 The ATO provides a range of relevant electronics and paper-based publications to clients. It also conducts FBT seminars and workshops for clients, including tax agents.¹⁹ The ATO is undertaking research to determine how to effectively target those employers who do not lodge FBT returns.²⁰
- 3.16 The ATO conducts seminars and workshops for clients, including tax agents. This approach was used to inform the business community about FBT initiatives under A New Tax System.²¹ Focus groups of ATO

15 Graham Daniel, ATO, *Transcript*, p. 41.

16 Graham Daniel, ATO, *Transcript*, p. 34.

17 Graham Daniel, ATO, *Transcript*, p. 35.

18 Graham Daniel, ATO, *Transcript*, p. 36.

19 Graham Daniel, ATO, *Transcript*, p. 36.

20 Graham Daniel, ATO, *Transcript*, p. 35.

21 Graham Daniel, ATO, *Transcript*, p. 36.

presenters have been assembled in order to assist the ATO to refine its '...information and presentation packages to better meet the needs of clients.'²²

- 3.17 The ATO also informed the Committee that the ATO was planning to conduct record keeping reviews and real time reviews. These would entail auditors observing how businesses keep their records, and giving them advice on how to do it better.²³
- 3.18 Also, in response to a question from the Committee, the ATO observed that the introduction of the Australian business number was likely to enhance communication between the ATO and businesses. The ATO indicated that there would be '...some flow-on effects to FBT from that.'²⁴
- 3.19 The Committee also raised the issue of educating employees about changes to their group certificates. 'From 1 July 1999, employers will be required to identify on group certificates the grossed up taxable value of employees' fringe benefits, where the taxable value exceeds \$1000.'²⁵ The listing of fringe benefits on group certificates could cause employees concern if they do not understand its implications. The ATO agreed that this was an issue and informed the Committee that the ATO '...had an extensive campaign with employers advising them that they need to talk to their employees and they also need to establish methods of allocation if there are shared benefits.' Fact sheets were available to employers and employees, but the ATO was unable to send them directly to employees.²⁶
- 3.20 The Audit Report concluded that:
- The ATO's communication and education strategy is appropriate, being based on a sound framework which includes client research and a stocktake of products.²⁷
- 3.21 However, the ANAO went on to comment:
- ...we note that the ATO's education delivery program which would show the range of products and how they will be used, is not yet in place. Given the compliance problems for existing taxpayers and the likely impact of the proposed reforms, which mean new requirements and new taxpayers, we consider that it is

22 Graham Daniel, ATO, *Transcript*, p. 37.

23 Graham Daniel, ATO, *Transcript*, pp. 44-5.

24 Geoff Miller, ATO, *Transcript*, p. 45.

25 *Audit Report No. 34, 1998-99*, p. 27.

26 Graham Daniel, ATO, *Transcript*, p. 43.

27 *Audit Report No. 34, 1998-99*, p. 48.

vital that the ATO has in place a comprehensive education delivery program.²⁸

Committee comments

- 3.22 The Committee endorses the general thrust of the ATO's approach to education. In particular, the Committee is keen to see that small business operators are assisted to recognise whether they have an FBT liability, and that tax agents are assisted to become better informed about FBT requirements.
- 3.23 In addition, the Committee notes the Auditor-General's comment that there would be:
- ...considerable value in the ATO providing a wider range of products and delivery options than currently exists, to allow taxpayers to choose those products and delivery methods most appropriate to their circumstances.²⁹
- 3.24 The Committee encourages the ATO to explore the potential benefits of working with software groups to highlight FBT requirements in packages designed for small businesses.

The ATO's knowledge of its client base

- 3.25 The FBT client base can be categorised into three groups:
- taxpayers;
 - compliant non-lodgers (employers with no FBT liability); and
 - non-compliant non-lodgers (employers with an FBT liability who do not comply with the FBT legislation).³⁰
- 3.26 The ANAO observed that '...the ATO does not yet have the comprehensive knowledge that it needs in relation to its FBT client groups.'³¹ It is crucial that the ATO develop this knowledge as it underpins the success of the ATO's compliance model for FBT. This model requires ATO staff to respond to different behaviours of taxpayers

28 *Audit Report No. 34, 1998-99*, p. 48.

29 *Audit Report No. 34, 1998-99*, p. 16.

30 *Audit Report No. 34, 1998-99*, p. 34.

31 *Audit Report No. 34, 1998-99*, p. 14.

with the appropriate enforcement strategy.³² Further, a more thorough understanding of the taxpayer base would enable the ATO to ‘...be better able to identify the (compliance) risks and develop methods to treat those risks, with well planned and targeted assistance or other methods.’³³

3.27 The audit report identified the following deficiencies in the ATO’s knowledge of its client base:

- limited information about the types of errors made by businesses in their returns and the areas of FBT legislation about which they require further information;³⁴
- a tendency for projects to stand alone rather than being drawn together;³⁵
- a lack of formal recording by the ATO of the substance of inquiries made to its telephone help line;³⁶ and
- limited use made of the information gained from projects to enforce compliance.³⁷

3.28 The audit report identified several relevant initiatives by the ATO. These included the following:

- the development of an interactive system containing information about the client base (to be shared with FBT Business Teams);³⁸
- the formation of an FBT national compliance working group to collect, analyse and disseminate information; develop compliance and education strategies; and evaluate the results of these actions;³⁹
- a large number of projects examining particular groups, including non-lodging employers who may have an FBT liability;⁴⁰
- a proposed project to monitor common themes coming through the ATO telephone help line;⁴¹

32 *Audit Report No. 34, 1998–99*, p. 26.

33 *Audit Report No. 34, 1998–99*, p. 37.

34 *Audit Report No. 34, 1998–99*, p. 38.

35 *Audit Report No. 34, 1998–99*, p. 38.

36 *Audit Report No. 34, 1998–99*, p. 38.

37 *Audit Report No. 34, 1998–99*, p. 39.

38 *Audit Report No. 34, 1998–99*, p. 42.

39 *Audit Report No. 34, 1998–99*, p. 42.

40 *Audit Report No. 34, 1998–99*, p. 38.

41 *Audit Report No. 34, 1998–99*, p. 38.

- the addition of new labels to the Partnerships, Companies and Trusts Income Tax Return Forms to provide information on the value of employee contributions received in relation to benefits provided to employees;⁴² and
- a proposed project that would provide Key Client Managers for large tax agents.⁴³

Committee comments

- 3.29 The Committee welcomes the ATO's initiatives in this area and encourages it to further strengthen its focus on understanding its client base. In particular, the Committee welcomes the proposed introduction of Key Client Managers for large tax agents. Further, the Committee encourages the ATO to determine whether particular industry sectors within the small business community require specific targeting.

Compliance costs

- 3.30 The ATO observed that a 1997 report by the University of New South Wales '...indicated that the relative cost of compliance for FBT compared with other taxes is perhaps not quite so high as perceived by many taxpayers.'⁴⁴ However, the ATO acknowledged that FBT has high compliance costs, mainly because of its record keeping requirements. This is particularly true for small businesses.
- 3.31 Following the abolition of the Prescribed Payments System, FBT will have the highest compliance costs of any tax.⁴⁵
- 3.32 With respect to record keeping, the Committee was informed of the availability of the Car Guide and Workbook, published in 1999. This was designed to assist small businesses to meet their record keeping requirements for FBT.⁴⁶
- 3.33 Other initiatives, already discussed in this report, are designed to increase overall understanding of FBT and its requirements.

42 *Audit Report No. 34, 1998-99*, p. 39. The ANAO noted that this approach, while valuable, has some drawbacks, including adding to FBT compliance costs.

43 *Audit Report No. 34, 1998-99*, p. 41.

44 Graham Daniel, ATO, *Transcript*, p. 31.

45 *Audit Report No. 34, 1998-99*, p. 29.

46 Graham Daniel, ATO, *Transcript*, p. 36.

Committee comments

- 3.34 The Committee identifies four different, and complementary, ways of enhancing compliance. These are:
- assistance with record keeping requirements;
 - education about FBT;
 - simplification of FBT legislation; and
 - increasing the perception that non-compliance will incur prosecution.
- 3.35 The Committee notes the ATO's initiatives to assist with record keeping and to educate its client base. The Committee encourages the ATO to continue to prioritise these activities.
- 3.36 With respect to the simplification of FBT legislation, the Committee notes that complexity is a significant contributor to non-compliance. Therefore it makes the following recommendation.

Recommendation 2

- 3.37 **The Committee recommends that the Australian Taxation Office continue to monitor the cost of compliance and advise the Treasurer of opportunities to reduce the complexity of fringe benefits tax.**
- 3.38 Finally, the Committee notes that breaches of FBT responsibilities are unlikely to lead to prosecution.⁴⁷ Such a situation undermines the ATO's strategic objectives of securing public confidence in the integrity and the equity of the tax because:
- it is likely to entrench negative perceptions of the tax; and
 - it means that compliant businesses are disadvantaged by obeying the law, while non-compliant businesses may face no penalty, even if their action is discovered.
- 3.39 While the Committee supports the use of assistance and education to enhance compliance, there also needs to be a plausible risk of penalty for non-compliance. The Committee takes the view that, wherever reasonable, breaches of FBT should be prosecuted. The Committee is confident that the ATO takes this issue very seriously and encourages it to explore possible strategies for ensuring that relevant parties, particularly

⁴⁷ *Audit Report No. 34, 1998–99*, p. 63.

tax agents, face a real risk of prosecution if they knowingly flout the law. Further, it is important that this risk is communicated to them in order to maximise its value as a deterrent.