



THE TAX INSTITUTE

13 July 2012

Mr Stephen Boyd
Committee Secretary
House of Representatives
Standing Committee on Economics
PO Box 6021
PARLIAMENT HOUSE ACT 2600

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

Dear Mr Boyd

TAX LAWS AMENDMENT (2012 MEASURES NO. 4) BILL 2012 – LIVING AWAY FROM HOME ALLOWANCE RULES

The Tax Institute is pleased to have the opportunity to make a submission to the House of Representatives Standing Committee on Economics (**Committee**) in relation to Schedule 1 of *Tax Laws Amendment (2012 Measures No. 4) Bill 2012 (Bill)*.

Schedule 1 of the Bill contains amendments to the *Income Tax Assessment Act 1997* (Cth) (**ITAA97**), *Fringe Benefits Tax Assessment Act 1986* (Cth) (**FBTAA**) and the *Taxation Administration Act 1953* (Cth) (**TAA**) in relation to the Reform of Living Away From Home (**LAFH**) Allowance and Benefit Rules.

We do not seek to make any comments in relation to Schedule 2 or Schedule 3 of the Bill.

Overview

Our submission below is set out in the following sections:

- **Section 1:** Policy intention (and the extent to which that intention is achieved by the Bill).
- **Section 2:** Administration of the Food Allowance component in two tax systems.
- **Section 3:** The 'variation of employment arrangements' and the transitional rules.
- **Section 4:** Recommendations.

SUBMISSION**Section 1: Policy Intention**

As noted in our submission on the Exposure Draft of the Bill (attached as Appendix B), the original policy intent behind the introduction of the LAFH concession in 1985 was to exempt from Fringe Benefits Tax (**FBT**) a reasonable amount of compensation provided to an employee by an employer (whether as an allowance or benefit) who required the employee to live away from home to perform their employment duties.

The allowance/benefit was to compensate the employee for additional expenses or disadvantages suffered through having to live away from home. However, excessive amounts of allowances/benefits were to be subject to FBT. Therefore, the focus of the provision of a LAFH allowance/benefit is compensatory in nature for additional private or domestic expenses incurred due to employment purposes.

The reason for the inclusion of this concession in FBT rather than income tax was to reflect the fact that these are essentially employment-related costs for the employer arising as a result of resourcing requirements for their business activities (by requiring employees to relocate).

In contrast, the stated purpose of the Bill in moving this allowance back into the income tax sphere is to treat this kind of allowance in line with other allowances provided to employees that, broadly, are subject to income tax and rely on the availability of an income tax deduction to the employee to reduce the net income tax effect.

Employers meet these private expenses of their employees for legitimate business reasons (not as a reward for service, but in connection with relocating employees to meet the legitimate operational needs of the business) hence the current FBT concession. The exception to this situation is where an employee salary sacrifices for such expenses in the event the employer is unwilling to fully meet the cost of additional expenditure.

Policy intention of LAFH reforms

According to the Treasurer's press release of 29 November 2011, the policy intention of the changes to the LAFH rules announced as part of the Mid-year Economic and Fiscal Outlook was to 'introduce reforms to stop individuals from being able to exploit the tax exemption for living-away-from-home allowance and benefits.' The press release went on to note that 'These changes will ensure that a level playing field exists between temporary residents and permanent residents, and that Australian taxpayers are not funding the unfair exploitation of concessions.'

In addition, the policy intention of the further LAFH changes announced on 8 May 2012 jointly by the Treasurer and Assistant Treasurer was as follows: [to] 'further reform the tax concession for living-away-from-home allowances and benefits, by better targeting it at people who are legitimately maintaining a home away from their actual home for an initial period.'

The Assistant Treasurer's press release of 15 May 2012 on the release of the Exposure Draft states that the policy intention of the amendments contained within the Bill currently before the Committee is to 'ensure Australian taxpayers are not funding the unfair exploitation of [the LAFH] concessions by both employers and employees' as well as ensuring the concession is not misused.

Actual effect of the Bill vs policy intention

In our view, the effect of this Bill will be far wider than to simply effect this stated policy intention, which as set out above appears to be to ensure that the LAFH concessions are only accessible in-line with their original policy intent on introduction in 1985. Specifically, it is our view that the effect of the reforms is to change the range of taxpayers and circumstances in which the LAFH concessions will and should apply (as compared to the original intention of the rules on introduction in 1985).

While we have repeatedly acknowledged that a tightening of the concession is a policy decision open to the Government (see for example our submission on Treasury's Consultation Paper, attached at Appendix A), it is our view that where the Government is seeking to effect such a change in policy, the change should be clearly articulated and communicated to the taxpayer community.

In contrast, the Government's press releases to date as well as the Explanatory Memorandum (**EM**) to the Bill merely state the effect of the reforms as being to counter 'exploitation' of the current rules.

While some level of exploitation may be countered by these reforms (an outcome that we support), the clear perception created by the Government's statements as to policy intention is that previously available access to the concessions (that will be curtailed as a result of these reforms) has constituted exploitation.

This perception is incorrect. Many taxpayers, especially temporary residents, have to the present day been legitimately accessing the concessions within the bounds of the policy intent underpinning the current LAFH rules in a manner that does not constitute exploitation.

We note that the Bill provides a clear advantage to permanent Australian residents as compared to temporary residents and non-residents, whereas the current provisions are consistent across all types of residents. As a result of the Bill, the aforementioned "level playing field" will cease to exist, as the effect of the Bill as it stands will be to give a significant advantage to permanent residents living away from home compared with temporary residents and non-residents living away from home.

As such, we submit that the Bill represents a change in the policy intention underpinning the LAFH rules rather than a mere countering of exploitation of the current rules, and that this intention should be clearly stated in the EM as a change in the circumstances in which the Government views it appropriate for LAFH concessions to be accessed.

Section 2: Administration of the Food Allowance component in two tax systems

As currently drafted, the Bill requires the tax treatment of the first \$42 of a weekly food allowance (as provided in the simplest case to an employee) to be determined with reference to the **FBT system** and the tax treatment of the remainder of the food allowance to be determined according to the rules in the **income tax system**.

This requirement effectively splits the responsibility for determining the tax treatment of a food allowance that is paid as part of a LAFH between the employer and the employee, where the food allowance exceeds the \$42 per week limit. That is, the liability for the tax on, and the responsibility of reporting, the \$42 component lies with the **employer**. The liability for the tax on, and the responsibility of reporting, the

remainder of the food allowance lies with the **employee** in receipt of the allowance as well as the ability to claim a deduction for actual expenses incurred.

In our view, this circumstance is likely to occur on a routine basis, resulting in an unnecessarily high level of complexity, both as a result of:

- the splitting of responsibilities and regimes for components of the same allowance; and
- an additional burden being placed on employees with respect to determining the correct tax treatment of their allowance.

The Bill requires employers to apportion allowances between amounts subject to FBT and amounts subject to income tax. With this comes added risk of errors by employees and employers trying to comply in good faith. In addition, it likely presents an additional compliance burden to the Australian Taxation Office in administering this concession.

We submit that, not only is the incidence of tax much higher under the Bill, the outcomes under the Bill are also much more complicated than those previously contemplated and perhaps also result in some unintended reporting outcomes.

As such, we strongly recommend that the tax treatment of LAFH allowances is determined either in the context of the income tax laws, or the FBT laws, but not both (as is currently the case under the Bill).

Further, we note that the Bill is likely to result in a higher amount being reported as income for the employee than under the current rules, which in turn could impact on various means tested levies and benefits, such as the Family Tax Benefit. We recommend that Treasury undertake further investigation into such likely impacts and provide additional detail to the wider community for consideration and consultation.

Section 3: 'Variation of Employment Arrangements' and the Transitional Rules

The Tax Institute also notes the potential impact of a variation to an employment arrangement that may cause an employee who is receiving LAFH benefits (under an arrangement that pre-dates the announced changes) to inadvertently lose their benefits during the transitional period (1 October 2012 to the earliest of 30 June 2014, the time an employee's eligible employment arrangement ends or is varied or renewed).

In relation to employment arrangements being 'varied', the EM contemplates a 'material variation' is required to trigger the cessation of the arrangements being subject to the transitional rules and falling under the new LAFH Rules (paragraph 1.81 of the EM). Examples such as a name change are, rightly, not considered to be a material variation. However, a change, such as a change in salary, is considered to be a material change. Often, in the case of salary variations, these occur independently of and irrespective of LAFH arrangements. In our view, a salary variation to which the LAFH arrangement is inherently tied (such as an increase in the value of LAFH benefits) may amount to a material change. Circumstances falling outside of this example should not unfairly trigger a loss of the benefit of the transitional rules at an earlier stage than should otherwise arise.

Based on the intention of the transitional rules as communicated, we propose that a reasonable approach is as follows: in determining the ongoing availability of the LAFH

concessions under the transitional rules, reference should be made to the continuation of unchanged LAFH benefit arrangements that existed prior to the 8 May 2012 announcements. Ceasing the availability of these rules based on unrelated events, such as a promotion or a pay rise, is inconsistent with the apparent intention of the transitional rules. As such, The Tax Institute recommends that the Bill and EM be amended so that taxpayers continue to be protected by transitional rules where there is no fundamental change in the underlying LAFH benefit arrangement.

In this regard, the EM should be amended to include more appropriate circumstances that should trigger the application of the new rules where there is a specific intention to vary the LAFH arrangement, rather than cases where there are other variations to an employment contract that occur in the ordinary course of an employee's employment independent and irrespective of any LAFH arrangement.

Section 4: Recommendations

We urge the Committee to recommend that:

- As the Bill represents a change in the policy intention underpinning the LAFH rules, rather than a mere countering of exploitation of the current rules, this intention should be clearly stated in the EM as a change in the circumstances in which the Government views it appropriate for LAFH concessions to be accessed;
- The tax treatment of LAFH allowances is determined either in the context of the income tax laws, or the FBT laws, but not both (as is currently the case under the Bill);
- Treasury undertake further investigation into flow-on impacts (such as the effect of LAFH reforms on access to various means tested levies and benefits) and provide additional information to the wider community for consideration and consultation; and
- The Bill and EM are amended to include more appropriate circumstances that should result in the transitional rules ceasing to apply (i.e. trigger the application of the new rules) where there is a specific intention to vary the LAFH arrangement, but not where other standard changes are made that do not affect the LAFH arrangement.

If you would like to discuss this matter, please contact either me or Senior Tax Counsel, Robert Jeremenko, on 02 8223 0011.

Yours sincerely



Ken Schurgott
President



THE TAX INSTITUTE

14 February 2012

Chris Leggett
Philanthropy and Exemptions Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: FBT@treasury.gov.au

Dear Mr Leggett

Consultation Paper: Fringe Benefits Tax Reform: Living-away-from-home benefits

The Tax Institute is pleased to provide our submission in response to Treasury's Consultation Paper entitled "Fringe Benefits Tax Reform: Living-away-from-home benefits" ("**Consultation Paper**").

In addition to the questions posed in the Consultation Paper, we have also made additional comments in relation to the issues raised in the Consultation Paper and the related Media Release issued by the then Assistant Treasurer on 29 November 2011 ("**Media Release**") as set out below.

Overview

The Tax Institute broadly supports the intention underpinning the current rules governing the Fringe Benefits Tax ("**FBT**") treatment of Living-away-from-home-allowances ("**LAFHA**"), as set out:

- At page 11 of the Explanatory Memorandum to the *Fringe Benefits Tax Assessment Bill 1986* (the "**Bill**"), i.e. to exempt from FBT reasonable compensation to an employee for "additional expenses or disadvantages suffered through the employee (and family) having to live away from home in order to perform duties for his or her employer" ; and
- In the Second Reading Speech to the Bill in which it is noted that "the types of benefits to be taxed include ... excessive living away from home allowances ..."

We also acknowledge that the implementation of the current rules may have in some circumstances resulted in an inappropriate application of the FBT exemption, owing to either:

1. Non-compliance with the existing rules;
2. Lack of guidance from the ATO; and/or
3. A disconnect between the intention and effect of the legislation.

Our submission below focuses on the extent to which the proposed legislative amendments address the third point. In this regard we note that:

- The scope to bring the application of the FBT exemption for reasonable LAFHA in line with its original intent by addressing points 1 and 2 should also be considered as part of this process; and
- In our view, the effect of the proposed reforms extends beyond addressing point 3. To the extent that the proposed reforms will effect a change of policy in comparison to the original policy intent underpinning the LAFHA rules, such shift in policy should be clearly understood and enunciated.

In particular, we consider the following to be areas where the proposed reforms extend beyond addressing the disconnect between the intention of the existing law and current practices:

- The proposed reforms create discrimination against temporary resident employees as compared to Australian permanent resident employees. Rather than creating a level playing field, the reforms make it more difficult for an employee to cover the costs of a temporary move to Australia (or for an employer to cover the costs associated with such a move) compared to an Australian citizen or permanent resident moving temporarily within Australia. If this is the policy intention underpinning the proposed reforms, the intention should be articulated more clearly in order to provide certainty to taxpayers.
- The reforms apply to all visitors to Australia, including “legitimate” living away from home arrangements, i.e. where the employee would not have moved temporarily to Australia but for the requirement to be located here for work purposes. As noted above, the intention of the existing law was to provide a tax concession in this scenario relating to the additional costs that are incurred.

To the extent that the proposed reforms are intended to create a “level playing field” between Australian residents and temporary residents, regard must also be had to the likely effect of the proposed reforms (in relation to the applicability of the LAFHA rules to temporary residents) on the migration of skilled workers to Australia. This is particularly the case where there are skill shortages and concessions such as those currently available are used to attract workers with the appropriate skills.

As part of this review, we recommend consideration of the possibility of limitation of the LAFHA concessions (for example, for a period of time such as 2 years) or setting a maximum allowable LAFHA amount, either as a dollar value or a percentage of the gross package) rather than the removal of these concessions altogether for temporary resident employees in certain circumstances.

Such a limitation may lessen the impact of the proposed reforms on skilled migration. This would also be consistent with measures implemented offshore. For instance, we understand that:

- The United Kingdom allows a 52 week exemption from National Insurance Contributions;
- The United Kingdom has tax relief called Detached Duty Relief for temporary assignments of less than 2 years; and
- The USA allows a degree of concessional treatment for assignments of less than 12 months).

Question 1. Are there any unintended consequences from the proposed reforms?

The Media Release and Consultation Paper are in our view unclear on what the 'intended' consequences of the proposed reforms are.

In this regard, we understand the intention of the proposed reforms to be:

- To ensure an even playing field between permanent and temporary residents of Australia.
- To eliminate some perceived rorting of the system by way of excessive exempt allowance amount and some "double dipping" by employees in joint living arrangements.

In our view, the reforms will cause the following, possibly unintended, consequences:

- The intention of rectifying the current uneven playing field referred to in the Consultation Paper implies an equality of treatment between permanent residents and temporary residents in every other respect that is not representative of the current situation. For example:
 - Temporary residents often have higher costs in relation to medical expenses (as they do not qualify for Medicare benefits under their visa, and only some would qualify for any Medicare benefits under a reciprocal health care agreement that Australia may have with their country of origin) or school fees for their children, which may offset any tax savings they may have as a result of receiving LAFHA.
 - Whilst temporary residents receive a number of concessions via the temporary resident rules contained in Subdivision 768-R of the *Income Tax Assessment Act 1997*, they cannot access any social security benefits in Australia as they fail the definition of resident within the meaning of the *Social Security Act 1991*.
 - Temporary residents are subject to the Foreign Investment Review Board restrictions in respect of buying property in Australia.
- A greater compliance burden for employees who will now be required to determine themselves if they are "living away from home" with, in many situations, inadequate knowledge of the complex LAFH criteria (which has troubled tax advisors, the ATO and employers alike). It is unclear to us what remains the employer's responsibility in determining living away from home status and paying a LAFHA under the proposed rules. Specifically, it is unclear to us whether:
 - A LAFHA which is taxable under the income tax provisions will require an employer to obtain a LAFH declaration?
 - Whether a LAFHA needs to be separately disclosed as such on PAYG Payment Summaries (or whether it can just be included as a general allowance)?

In this regard, tax advisors, employers and taxpayers alike would benefit from clarification of whether the guidance contained in MT 2030 will remain valid in ascertaining whether an individual is living away from home. If so, we recommend that this ruling be updated to provide additional clarity. In this regard, we note the extensive issues in relation to LAFHA raised at the NTLG FBT Sub-committee for clarification.

- There will also be a further compliance burden on employees in terms of substantiating their expenditure.

- A number of other benefits which currently attract concessional tax treatment and which depend on the employee “living away from home”, such as children’s education, relocation transport (including immigration costs), removal of household effects, to potentially become taxable fringe benefits for temporary residents. The Consultation Paper is unclear as to whether this is an intended consequence. A list of such benefits is attached at Appendix A for information.
- On-costs (such as salary, superannuation, workcover, payroll tax) to rise as a result of the benefits becoming taxable either under the income tax rules or into the FBT sphere. In particular, WorkCover and payroll tax liability is calculated on a fringe benefits inclusive basis so that such changes to the FBT legislation are likely to fundamentally alter the base on which those liabilities are calculated. And even where a LAFHA subject to income tax is fully offset by substantiated deductions, we understand that WorkCover and payroll tax would apply.
- Employers will need to contribute additional superannuation for employees that will have higher taxable incomes compared to under the existing arrangements. This would then be subject to tax in the superannuation fund and, for temporary residents, a further tax will be levied when the funds are withdrawn on the employee’s permanent departure from Australia.
- The requirement to withhold PAYG will become more difficult to manage in relation to knowing whether employees are going to have substantiated offsetting deductions. Employees in receipt of the allowance may begin to unilaterally fill out PAYG variation notices. The possibility of the ATO issuing a blanket variation in relation to all reasonable LAFHAs could warrant examination.
- Under the proposed reforms, accommodation allowances could still be very high and effectively remain tax free where costs up to the amount of the allowance can be substantiated. We understand that a policy driver of the proposed reforms was to curtail the availability of LAFHA concessions for accommodation deemed to be “excessive”. It is unclear whether the ability to substantiate expenditure equal to the allowance amount is sufficient to show it is not excessive or whether a dollar or percentage cap is required for this purpose.
- The tax treatment of arrangements whereby an employee has a usual place of residence away from their workplace (potentially even interstate) and another residence they use during their “working week” closer to the workplace appear to be unaffected by the proposed reforms. Clarification of this intention would be helpful.
- Consideration should be given to the loss of income taxation revenue and additional broader revenue considerations should employers cease expatriate arrangements. Further, wage costs and the availability of specialist skills are key considerations in the decision making process of awarding key contracts within Australia or, alternatively, overseas.

Question 2. What practical aspects of the proposed reforms need further consideration?

- The impact on labour mobility, the labour market, the property (i.e. rental) market and the true incidence of the tax cost of these amendments i.e. whether the cost is borne by the employer or passed onto the employee. In particular, the cost to business and employees where a commitment has been made to current arrangements, such as tax equalised employment contracts and residential lease agreements, etc.

- Transitional arrangements in relation to pre-existing contracts or agreements need to be fully considered and not just for the community sector. Please refer to our comments on this issue under Question 6 below.
- The reasonable cap proposed to be set for food costs should take into account that the costs might be incurred overseas.
- The increased compliance burden on employees, particularly their ability to correctly determine for taxation purposes whether they are “living away from home”.
- Paragraph 2.1.3 of the Consultation Paper makes reference to the substantiation requirements contained in Division 900 of the *Income Tax Assessment Act 1997* and notes that these requirements will not be required for food expenses up to an amount considered reasonable by the Commissioner. The Consultation Paper notes that the ATO will produce administrative guidelines in this regard in order to assist taxpayers.

We note past ATO responses to similar requests for administrative guidelines have been as follows:

The Tax Office advised that the information provided by an independent third party that specialises in providing international compensation data for employees working overseas is an objective method of determining the food component of a LAFHA.

(Source: NTLG FBT Sub-committee minutes of August 2009 meeting, agenda item 6.1)

Any guidelines will need to be in place by 1 July 2012 as employers and employees will seek to use these guidelines in ascertaining the reasonable food component of the LAFHA to be paid going forward.

- The impact on businesses that will need to revise their systems to cope with these allowances being taxed in the income tax sphere rather than FBT.

Question 3. Are there any interactions with other areas of the tax law that need to be addressed?

Please see our comments above in relation to the likely income tax (including PAYG withholding and PAYG Payment Summary reporting obligations) as well as superannuation guarantee, WorkCover and payroll tax impacts of the proposed reforms.

Consideration may also need to be given to ongoing mismatch issues from recent amendments to section 23AG which still flow through into LAFHA arrangements for permanent residents working overseas. Under current FBT laws, there is no ability for an employer to claim an offset for foreign tax paid by the employee on benefits provided to them in an overseas jurisdiction, against any FBT liability.

Question 4. As the statutory food amount is intended to reflect the ordinary costs incurred by an Australian in 2011, what should the statutory food amount be updated to?

The statutory food amount should be established with reference to a costing of an appropriate basket of goods. There should also be a mechanism for establishing an appropriate value in offshore jurisdictions.

Question 5. Should the statutory food amount be indexed annually to ensure it remains up to date?

Yes, as envisaged in the context of the original legislation. The EM to the Bill notes on page 57 “the statutory food amount for an adult is set at \$42 per week. The comparable figure for a child who is less than 12 years of age at the beginning of the relevant year of tax is \$21. *It is intended that these amounts be regularly reviewed by reference to movements in the Consumer Price Index.*” (emphasis added).

The total reasonable amount for a food allowance should also be indexed in the same manner as, say, the Housing indexation figures.

Question 6. What transitional arrangements would be appropriate for the community sector?

In our view, transitional arrangements must be fully considered for not only the community sector but for all employers who engage employees who are living away from home and have pre-existing contractual/binding arrangements, e.g. rental agreements.

The proposed reforms will affect the substance of formed bargains between employers and employees (and third parties, e.g. agreements with agents/landlords in relation to accommodation). In most cases, the employee will have already relocated on the basis of the original bargain. Such employees and employers will typically be unable to extract themselves from the bargain already struck.

In the interests of fairness and to prevent adverse outcomes for employees and employers who have entered into employment contracts on the basis of the current law, we recommend that elective transitional measures be made available in respect of **all** employment contracts entered into prior to the date of the announcement of this measure.

If such arrangements cannot be grandfathered indefinitely, we recommend that transitional measures be applied to phase in the changes in relation to existing employment contracts over a number of years, perhaps over the lesser of:

- 4 years (as applicable with respect to the car fringe benefits changes contained in *Tax Laws Amendment (2011 Measures No. 5) Act 2011*); and
- The remainder of the existing visa (which we consider to be a logical period, given that the proposed amendments will primarily affect temporary residents).

* * * * *

Should you have any queries with respect to any of the matters raised above, please do not hesitate to contact me on (02) 8223 0011 or The Tax Institute’s Tax Counsel, Deepti Paton on (02) 8223 0044.

Yours sincerely



Ken Schurgott
President

APPENDIX A

FBT Exemption	Section reference (<i>Fringe Benefits Tax Assessment Act 1986</i>)
Engagement of relocation consultant	58AA
Removals and storage of household effects as a result of relocation	58B
Exempt benefits – sale or acquisition of dwelling as a result of relocation	58C
Connection or re-connection of certain utilities as a result of relocation	58D
Leasing of household goods while living away from home	58E
Exempt benefits – relocation transport	58F
Reduction of taxable value – overseas employment holiday transport	61A
Reduction of taxable value – temporary accommodation relating to relocation	61C
Reduction of taxable value of temporary accommodation meal fringe benefits	61D
Reduction of taxable value – education of children of overseas employees	65A



THE TAX INSTITUTE

29 May 2012

Mr Chris Leggett
Philanthropy and Exemptions Unit
Indirect Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Attn: Ms Raylee O'Neill

By email: fbt@treasury.gov.au

Dear Mr Leggett

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

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

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

Summary

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

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

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

Discussion

1. Policy Intention

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

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

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

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

To the extent the new income tax provisions and amended FBT provisions extend beyond the bounds of the original policy intention of the LAFH provisions when they were first introduced into the FBT provisions, by extending beyond simply addressing some of the exploitation and misuse of the existing tax concession¹, The Tax Institute is concerned this represents a shift from the original policy intent. If this is the case, this should be clearly expressed in the EM. As a result of this shift in policy, there is concern that other LAFH related concessions and permanent relocation concessions may also be withdrawn over time.

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

2. Exposure Draft Aspects

a) Income tax deduction – when you can deduct

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

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

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

¹ As noted in the Assistant Treasurer’s press release of 15 May 2012

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

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

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

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

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

Ownership Interest

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

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

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

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

“For your use and enjoyment”

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

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

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

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

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

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

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

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

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

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

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

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

b) Income tax deduction – how much you can deduct

i) *Accommodation component*

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

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

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

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

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

ii) *Food*

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

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

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

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

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

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

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

3. Other issues

a) Transitional Provisions – Permanent residents

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

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

b) Transitional Provisions – Temporary residents

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

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

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

c) “Fly-in Fly-Out” arrangements – Temporary Residents

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

d) PAYG Withholding variation

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

- How can an employer anticipate/monitor whether an employee is likely to incur expenses up to the amount of the allowance and therefore work out what amount of the allowance they should withhold from for PAYGW purposes? This seems impracticable.
- To avoid significant administrative difficulties in this regard, perhaps employers could be permitted to vary withholding to nil in all cases and for the employees to bear the tax liability of any excess unsubstantiated costs at year end.

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

Yours sincerely

A handwritten signature in black ink, reading "Ken Schurgott". The signature is written in a cursive style with a long, sweeping underline.

Ken Schurgott
President