

27 January 2012

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

By email: FBT@treasury.gov.au

Dear Sir/Madam

Consultation Paper - Fringe Benefits Tax (FBT) Reform - Living-away-from-home benefits

BDO welcomes the opportunity to provide submissions on the matters raised by Treasury in the Treasury Consultation Paper: "*Fringe Benefits Tax (FBT) Reform - Living-away-from-home benefits*", (the Consultation Paper) released for public consultation on 29 November 2011.

Our submissions on the first and second of the questions posed by the Consultation Paper are attached as an Appendix.

Should you have any questions, or wish to discuss any of the comments made in the submissions, please do not hesitate to contact me on (02) 9286 5527.

Yours sincerely,



Matthew Wallace
National Tax Counsel
Corporate & International

APPENDIX

This document sets out the submissions of BDO in relation to the Treasury Consultation Paper: “*Fringe Benefits Tax (FBT) Reform - Living-away-from-home benefits*”, (the Consultation Paper) released for public consultation on 29 November 2011.

References to:

- the ITAA 1936, are to the *Income Tax Assessment Act 1936*
- the ITAA 1997, are to the *Income Tax Assessment Act 1997*; and
- the FBTA, are to the *Fringe Benefits Assessment Act 1986*.

Executive Summary

As explained below, we make the following submissions in respect of the Consultation Paper and Media Release:

Unintended consequences

- In order to identify unintended consequences of the proposed changes, it is necessary to correctly identify and articulate:
 - The policy motivating the provision of taxation concessions in respect of the giving and receipt of living-away-from-home (LAFH) benefits;
 - The policy which the Federal Parliament has identified in respect of the Australian taxation treatment of temporary residents, and
 - The policy which the Assistant Treasurer has identified in the foreword to the Consultation Paper as motivating changes to the existing tax treatment of LAFH benefits
- The second step in identifying unintended consequences of the proposed changes is to benchmark the changed taxation law against such identified policies, together with, to the extent not already addressed, the conventional tax policy criteria of equity, efficiency and simplicity.
- The policy of the existing LAFH tax concessions is to provide taxation relief in respect of benefits provided to an employee whose employment is located away from his or her usual place of abode, where such benefits are aimed at compensating such employee for the additional expenditure he or she is obliged to incur in providing board and accommodation for himself or herself at his or her place of employment while, at the same time, maintaining his or her home elsewhere. Such policy does not discriminate by reference to the location of such usual place of abode.

- The policy identified by the Federal Parliament in relation to the taxation treatment of temporary residents, in the context of the introduction of the “temporary resident” provisions in Subdivision 768-R of the ITAA 1997 is to:
 - Attract internationally mobile skilled labour to Australia
 - Promote Australia as a business location, by reducing the costs to Australian business of bringing skilled expatriates to work in Australia
- The two concerns identified by the Assistant Treasurer in the foreword to the Consultation Paper are:
 - Misuse of, or “rorting” of LAFH concessions (thus raising integrity concerns); and
 - The inappropriate differential provision of benefits to different taxpayers in like positions (thus raising horizontal equity concerns).
- The restriction of concessions in respect LAFH benefits provided to temporary residents by Australian employers only to temporary residents travelling away from another home established in Australia is at odds with all of the policy drivers identified above, including those articulated by the Assistant Treasurer as motivating the proposed changes.
- The provision of tax concessions in respect of LAFH benefits provided to temporary residents, who have a bona fide residence overseas, in order to compensate them for the additional expenditure they are obliged to incur in providing board and accommodation for themselves at their place of employment in Australia while, at the same time, maintaining their home overseas, if appropriately articulated in the relevant legislation, is entirely in keeping with the policy:
 - Motivating the provision of LAFH benefit tax concessions, generally;
 - Articulated by Parliament in respect of the Australian tax treatment of temporary residents; and
 - Articulated by the Assistant Treasurer as being the motivation for the proposed changes.
- If there is widespread “rorting” or “misuse” of tax concessions in respect of LAFH benefits, there is no evidence provided that this is restricted to, nor more common in respect of, temporary residents. If there are concerns about the integrity of the measures, whether as they apply to temporary residents, or more generally, this should be addressed by more appropriately defining the circumstances where the relief would be available, not by denying the concessions to a whole class of legitimate beneficiaries.
- Far from advancing horizontal equity, the measures will, in fact, significantly derogate from existing levels of horizontal equity. Temporary residents who are stationed in a location in

Australia away from an ordinary residence that they maintain outside Australia, will be treated in a penal manner when compared with permanent residents or other temporary residents stationed in a location in Australia (or outside Australia) away from an ordinary residence that they maintain in another location in Australia.

- The proposed measures would also impose substantial economic efficiency or neutrality costs due to the higher effective cost of employing skilled temporary residents. This will have a negative impact on the supply of labour with specialised skills in some geographic locations in Australia and have a negative resulting impact on the international competitiveness of affected industries. It may also put wage level driven pressure on the rate of inflation.
- Concerns about the integrity of the measures would be better and much more appropriately addressed by defining the circumstances when a temporary resident is, in fact, taken to be bona fide living away from an overseas home. This could have regard to defined factors such as:
 - The duration of the stay in Australia;
 - The presence of a bona fide residence overseas; and
 - A fixed commitment to return to a particular employment position overseas at the end of the temporary stay in Australia.

The drafting of such measures might be informed, in part, by reference to the United Kingdom “temporary workplace” concept addressed in s338 and s339 of the Income Tax (Earnings and Pensions) Act 2003 (United Kingdom) as it is administered by HM Revenue and Customs.

Practical aspects needing further consideration

- The removal of LAFHAs from the scope of the FBTAA (with the resulting assessment of such LAFHAs to recipient employees and deductibility of specified substantiated outlays by such employees) and the limitation of FBT relief to the reimbursement of substantiated relevant expenses, will impose additional material and potentially, onerous, compliance burdens on affected employees and employers. Consideration should be given to measures aimed at alleviating these compliance burdens. These might include:
 - Providing statutory ceiling amounts, by reference to work locations, where allowances that do not exceed such amounts do not require substantiated outlays (with similar operation to the “travel allowance” substantiation relief provided under ss900-50 and 900-55 of the ITAA 1997); and/or
 - Limiting substantiation requirements to a “sample” period (say, 12 weeks), which can then be extrapolated over the remainder of the income year.

Detailed submissions

1. Unintended consequences

1.1. Policy underpinnings

In order to ascertain the nature and extent of unintended consequences, it is first desirable to identify and examine:

- The underlying policy of tax concessions in respect of living-away- from-home (LAFH) benefits;
- The policy, previously articulated by Parliament, in respect of the approach to be adopted in the taxation of temporary residents; and
- The purpose or tax policy motivating the proposed changes, as articulated in the Consultation Paper

It is then desirable to ‘benchmark’ the proposed changes against such identified policies, together with, to the extent not already addressed, the conventional tax policy criteria of equity, efficiency and simplicity.

1.2. Unintended consequences - Proposed changes benchmarked against underlying policy of LAFH concessions in the Australian taxation law

LAFH concessions were first introduced into the Australian tax law (in the form of an allowable deduction in respect of the amount of a LAFH allowance (LAFHA) under s51A of the ITAA 1936 in 1945, by operation of the *Income Tax Assessment Act 1945*. The policy behind such introduction is articulated in the Explanatory Memorandum which accompanied the introduction into Parliament of the Bill that became that Act:

"This clause is designed to provide a measure of taxation relief to employees in receipt of living-away-from-home allowances.

Various wage-fixing authorities have granted away-from-home allowances to employees whose places of employment are located away from their usual places of abode. The allowance is paid to compensate the employee for the additional expenditure he is obliged to incur in providing board and accommodation for himself at his place of employment while, at the same time, maintaining his home elsewhere.

...

These allowances, in substance, represent additional remuneration paid to the employee to meet higher costs of living. They, therefore, form part of the assessable income of the employees. The income tax law, however, specifically prohibits a deduction for expenses of a private or domestic nature. The consequence is that the employees are not permitted deduct the additional living expenses incurred by them, even though the allowance is granted specifically for the purpose of meeting such expenses. The amount of tax payable by the employees is accordingly increased, and a substantial part of the special allowance paid away in income tax.

...

Having regard to the purpose of the away-from-home allowance and the fact that, generally speaking, it is actually expended by the employee in meeting additional LAFH expenditure incurred by him, it is considered that some deduction should be allowed to the recipients." (emphasis added).

The EM in respect of the introduction of the Bills that became the FBTA and related legislation which moved the concessions in respect of LAFH benefits from the ITAA 1936 to the FBTA, in no way qualifies or restricts such an understanding of the underlying policy for such taxation concessions.

The underlying policy for taxation relief in respect of LAFH benefits could thus be synthesised to be, paraphrasing from the EM to the ITAA 1945, to provide taxation relief in respect of benefits provided to an employee whose employment is located away from his or her usual place of abode, where such benefits are aimed at compensating such employee for the additional expenditure he or she is obliged to incur in providing board and accommodation for himself or herself at his or her place of employment while, at the same time, maintaining his or her home elsewhere.

Viewed thus, it is entirely in keeping with the underlying policy of the LAFH tax concessions provided by Australia for them to extend to temporary residents, subject to the proviso that such temporary residents must be maintaining an additional home elsewhere from their place of employment, whether such home is in Australia or overseas. It thus follows that, benchmarked against such underlying policy, the changes to the law proposed in the Consultation Paper produce an unintended consequence in the denial of concessional tax treatment in respect of LAFH benefits provided to temporary residents where such temporary residents maintain a home outside Australia. Such denial, as elaborated upon below, also contravenes each of the fundamental tax policy tenets of equity, efficiency and simplicity.

1.3. Unintended consequences - Proposed changes benchmarked against underlying policy of temporary resident measures in Subdivision 768-R of the ITAA 1997

In 2006 the "temporary resident" taxation measures were introduced as Subdivision 768-R of the ITAA 1997 by operation of the *Tax Laws Amendment (2006 Measures No. 1) Act 2006*. These measures were enacted largely in response to *Recommendation 22.18 in A Tax System Redesigned*, the final report of the *Review of Business Taxation* completed in July 1999, and provided a number of concessional income tax outcomes for temporary residents. The policy motivation for these changes is articulated in pages 4-5 of the applicable EM, which provide:

- *'The foreign income exemption for temporary residents is designed to achieve two related objectives. The measure seeks to attract internationally mobile skilled labour to Australia. It also seeks to assist in the promotion of Australia as a business location, by reducing the costs to Australian business of bringing skilled expatriates to work in Australia.*
- *The New Business Tax System provides Australia with an internationally competitive business tax system that will create more jobs and improve*

savings. This measure will contribute to an environment for achieving higher economic growth by reducing the tax burden on people who are considered to be temporary residents of Australia for taxation purposes. It will also have the effect of reducing business costs (fewer or no normalisation payments) where foreigners are employed temporarily in Australia. Australia should then benefit from the dynamic effects of having business located here, as well as from the expenditure, profits and local employment that such businesses may generate. In addition, the bringing to Australia of foreign executives and skilled employees will facilitate the transfer of new management techniques and information and skills to the Australian economy.”

Having regard to the above, the proposed changes contradict both the effect and purpose of the temporary resident measures. It would follow that unintended consequences of the proposed measures, when benchmarked against the policy intent of the “temporary residents” measures, would be to:

- Discourage internationally skilled labour from coming to Australia;
- Detract from the promotion of Australia as a business location by increasing the costs to Australian business of bringing skilled expatriates to work in Australia
- Detract from the creation of new jobs and improvement in savings;
- Detract from an environment for achieving higher economic growth by increasing the tax burden on temporary residents
- Increase business costs where foreigners are employed in Australia.

Thus benchmarked against the policy intent of the temporary resident measures, the changes produce many undesirable consequences which it is hoped are unintended. To these should be added the additional discouragement of foreign investment in, and business transactions involving, Australia, where our tax measures:

- Lack policy consistency and coherency; and
- Discriminate against temporary residents.

1.4. Unintended consequences - proposed measures benchmarked against their objectives as identified in the Consultation Paper

By reference to the foreword to the Consultation Paper, the Assistant Treasurer identified two concerns as motivating the changes proposed in the Consultation Paper, being:

- Misuse, or “rorting”, of the LAFH tax concessions (thus raising integrity concerns); and

- The inappropriate differential provision of concessions to different taxpayers in like positions (thus raising horizontal equity concerns).

As these are the identified policy motivations for the measures, any outcome which did not advance either or both of the integrity of the LAFH measures and the horizontal equity outcomes of the LAFH measures, must be seen as an unintended consequence.

Looking first to the integrity concern; there is little evidence presented in the Consultation Paper of widespread “rorting” or “misuse” of tax concessions in respect of LAFH benefits, and little evidence provided that such “misuse” or “rorting” is restricted to, or more common in respect of, temporary residents. Indeed the implicit message in the Consultation Paper that “rorting” and “misuse” of the measures is somehow restricted to temporary residents and will be prevented if temporary residents are substantially excluded from the measures is not only inaccurate but conveys a very unhelpful message to the potential skilled temporary residents, in circumstances where there is a very real need and demand for them in parts of the economy.

The denial of tax concessions in respect of LAFH benefits to temporary residents who are **bona fide** LAFH must thus be seen as an unintended consequence of the proposed measures, as such temporary residents could not be said to “misusing” or “rorting” such concessions. Indeed, far from misusing the concessions, we would submit that, as addressed above, they are utilising such concessions exactly in the manner that they were intended to. It would follow that, provided the provision of such tax concessions do not offend against the horizontal equity tax policy criterion, the proposed changes, as they apply to deny the concessions to such temporary residents, do not advance their stated objectives. Indeed, if instead of increasing horizontal equity, the measures, to any extent, reduced it, this must again be seen as an unintended consequence of the proposed measures.

The proposed measures as they would apply to temporary residents with an ordinary abode outside Australia would offend against horizontal equity principles. While a permanent resident living away from their ordinary abode (whether within Australia or overseas) or a temporary resident with an ordinary abode in Australia who was living away from that ordinary abode, can access the benefits of the concessions, the proposed changes would deny the concessions to a temporary resident compelled by their work, to live away from their ordinary abode, overseas. Thus, contrary to horizontal equity ideals, while some taxpayers with two lots of household expenses would be able to access the concessions; others in a like economic position, would be denied them. It follows that the proposed measures, to that extent, directly contradict the horizontal equity objective identified by the Assistant Treasurer in the foreword to the Consultation Paper as motivating them and must thus be seen as being productive of unintended outcomes.

1.5. Unintended consequences - benchmarking against the economic efficiency criterion

The temporary visas that most temporary residents enter Australia under are most commonly issued to individuals with skills in respect of which demand exceeds the available supply in the context of the Australian economy. The changes will have an efficiency cost to Australian businesses through an increase in the cost structure of such businesses, due to:

- Temporary residents demanding, or employers under tax indemnification arrangements, being required to pay, higher amounts to compensate such temporary residents for the additional tax payable in respect of LAFH benefits provided to them;
- Remuneration demanded by the existing Australian skilled work force being “bid up” due to increased competitive demand for the limited supply of such workforce.

Such efficiency costs will have an impact on Australia’s international competitiveness and may also impose inflationary pressures

1.6. A better alternative - testing the bona fides of temporary residents

It would appear that the concerns about integrity and horizontal equity expressed by the Assistant Treasurer in the foreword to the Consultation Paper can be better addressed, not by denying tax concessions to all temporary residents, other than those that have a separate ordinary abode in Australia, but instead imposing conditions aimed at ensuring that the relevant LAFH arrangement of a temporary resident is bona fide. Such conditions might resemble those imposed in the United Kingdom in respect of the “temporary workplace” measures addressed in s338 and s339 of the Income Tax (Earnings and Pensions) Act 2003 (United Kingdom) as they are administered by HM Revenue and Customs. To this end, conditions for relief might require that:

- The duration of the stay in Australia not exceed a specified maximum period;
- The temporary resident maintain a bona fide residence overseas; and
- The temporary resident demonstrates a fixed commitment to return to a particular employment position overseas at the end of the temporary stay in Australia.

2. Practical aspects needing further consideration

Benchmarked against the tax policy criterion of simplicity, the proposed changes fare poorly. The removal of LAFHAs from the scope of the FBTA (with the resulting assessment of such LAFHA to recipient employees and deductibility of specified substantiated outlays by such employees) and the limitation of FBT relief to the reimbursement of substantiated relevant expenses, will impose additional material and potentially, onerous, compliance burdens on affected employees and employers.

Consideration should be given to measures aimed at alleviating these compliance burdens without materially undermining their integrity driven intent. Models for such measures can be found in the existing taxation law as it is currently administered.

One form of relief might be modelled on the approach adopted under ss900-50 and 900-55 of the ITAA 1997 in respect of the substantiation requirements imposed in relation to travel allowances. Thus, employees could be relieved of substantiation requirements in respect of LAFH expenses to the extent that the relevant LAFHA did not exceed a “reasonable” threshold which would be determined by reference to the location where such employee was LAFH.



An additional relief that might be considered would be to deem substantiation requirements for a 12 month period where expenses incurred were extrapolated from a shorter substantiated period. Thus Subdivision C of Division 9A of the FBTA authorises the determination of the proportion of total value of meal entertainment which comprises meal entertainment fringe benefits for a 12 month period by reference to a 12 week period.
