

# Reform to deductions for education expenses

Discussion Paper  
May 2013

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Manager  
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The Treasury  
Langton Crescent Parkes ACT 2600  
Email: [medialiaison@treasury.gov.au](mailto:medialiaison@treasury.gov.au)

## CONSULTATION PROCESS

### Request for feedback and comments

The Australian Government seeks your feedback and comments on the proposals outlined in this discussion paper.

All information (including name and address details) contained in submissions will be made available to the public on the Treasury website, unless you indicate that you would like all or part of your submission to remain confidential. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as such in a separate attachment. A request made under the *Freedom of Information Act 1982* for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please email responses in a Word or RTF format. An additional PDF version may also be submitted.

### Closing date for submissions: 12 July 2013

Email: selfeducationtaxreform@treasury.gov.au

Mail: The Manager  
Individuals Tax Unit  
Personal and Retirement Income Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Enquiries: Enquiries can be initially directed to Simone Abbot

Phone: 02 6263 3816

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## INTRODUCTION

On 13 April 2013 the Government announced reforms to better target education expense deductions as part of a package of measures that will support the National Plan for School Improvement.

To help deliver these reforms and ensure that they are sustainable, a \$2,000 cap on work-related education expense deductions will be introduced from 1 July 2014. When this measure was announced, the Government made it clear that it would consult. Part of this consultation process is the release of this discussion paper.

Deductions for work-related expenses are the most common claims among employees. Most work-related expenses are deductible for a taxpayer in a particular income year if the expense is incurred in the course of gaining or producing their assessable income and the expense is not 'private, domestic or capital' in nature. As such, education expenses incurred as a result of the performance of a taxpayer's employment are generally tax deductible.

However, education also delivers significant private benefits to the employee. An individual who undertakes education is first and foremost investing in themselves and in their own earning capacity. Many Australians studying at universities or completing training courses, but not yet receiving a source of income in that field, do not receive deductions for the expenses related to that education. This reflects that the cost of such an investment should not be borne by all taxpayers.

Many professionals and employees are required to undertake further training to ensure their knowledge remains up to date. This provides a benefit not only to those professionals, but also to their employers and the wider Australian community. In recognition of this and of the fact that many professionals are required to undertake continuing professional development to maintain their licence or registration, a \$2,000 deduction has been retained.

Furthermore, to encourage business to provide their employees with all necessary education, amendments are proposed to ensure these expenses do not incur a fringe benefits tax liability, except where the benefit is accessed by way of a salary packaging arrangement.

This discussion paper examines the current treatment of education expenses including what qualifies as an education expense, and works through a range of issues related to this cap, such as the effect of the cap on the depreciation of capital assets relating to education, the current \$250 no-claim threshold and personal services income. The proposed changes in the income tax legislation and fringe benefits tax legislation are also outlined.

The Government welcomes views on this measure, and comments on this paper in the form of written submissions will be accepted until 12 July 2013.



# 1. CURRENT TREATMENT

## 1.1 EXISTING LAW

1. Under Australian income tax law, a deduction is allowed for the costs incurred in producing income. This recognises that people with the same level of income may incur very different costs in earning that income.
2. In the case of employment income, there are a range of work-related expenses that are deductible, including tools, travel, uniforms and occupational specific clothing and education expenses.
3. In order for an expense to be deductible, a direct connection must exist between the incurring of the expense and the production of the taxpayer's assessable income, and the expense must not be of a private or domestic nature.

### **Section 8-1 of *Income Tax Assessment Act 1997* (ITAA 1997)**

1. You can deduct from your assessable income any loss or outgoing to the extent that:
  - a. it is incurred in gaining or producing your assessable income; or
  - b. it is necessarily incurred in carrying on a business for the purposes of gaining or producing your assessable income.
2. However, you cannot deduct a loss or outgoing under this section to the extent that:
  - a. it is a loss or outgoing of capital, or of a capital nature; or
  - b. it is a loss or outgoing of a private or domestic nature; or
  - c. it is incurred in relation to gaining or producing your exempt income or your non-assessable non-exempt income;
  - d. or a provision of this Act prevents you from deducting it.
4. With respect to education expenses, a deduction may be claimed when the education activity is directly connected to the taxpayer's current employment by either maintaining or improving the specific skills or knowledge required for the employment, or results in, or is likely to result in, an increase in income.

5. No deduction is allowable where the education activity is to enable the taxpayer to become employed, to obtain new employment or to open up a new income earning activity (even in the taxpayer's present employment).<sup>1</sup>
6. Education expenses that can currently be claimed include expenses for both:
  - **formal education** — from a school, college, university or other place of education; and
  - **informal education** — including seminars, conferences, workshops and other training.
7. However, a deduction is not available for the first \$250 of certain kinds of self-education expenses.

**Section 82A (1) of Income Tax Assessment Act 1936 (ITAA 1936)**

Where a deduction is, or but for this section would be, allowable to the taxpayer under section 8-1 of the Income Tax Assessment Act 1997 in respect of a year of income in respect of expenses of self-education, the deduction, or the aggregate of the deductions, so allowable to the taxpayer in respect of those expenses shall not be greater than the amount by which the net amount of expenses of self-education exceeds \$250.

8. Section 82A of the ITAA 1936 operates in such a way that the first \$250 of a 'prescribed course of education' expense is not deductible; that is, formal education that is an organised course of study, full-time or part-time, provided by a school, college or university.
9. However, the \$250 can include expenses that are compulsory and unavoidable but are not otherwise deductible, for example bus fares or child care costs. This means that the \$250 no-claim amount can be 'used up' by such non-claimable expenses and the taxpayer can then claim all of their deductible expenses.
10. Section 82A results from a number of amendments in the tax legislation. Since 1972 deductions for self-education expenses have been explicitly included in the income tax law. In 1975 the then Government decided to replace the system of concessional deductions with one of concessional rebates. As the concessional rebate was \$250, section 82A of ITAA 1936 provided that deductions for self-education expenses under the general provisions would only be available to taxpayers who spent more than \$250 in a year and then only for the excess of the expenses over \$250. In 1985 the concessional rebate was removed but section 82A (no-claim amount) was retained.

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1 Commissioner of Taxation's Taxation Ruling TR98/9: Income Tax: deductibility of self-education expenses incurred by an employee or person in business <http://law.ato.gov.au/atolaw/view.htm?docid=TXR/TR989/nat/ato/00001>.



## Apportionment

11. Where an expense has both a work/business and a private element, the expense must be apportioned and only the work or business-related element claimed as a deduction.<sup>2</sup> For example, if a computer is used for work purposes for 40 per cent of its total use and private use for 60 per cent of its use, only 40 per cent of the expenses can be claimed as a deduction.
12. However, there are some exceptions to the requirement to apportion. For example, travel expenses may be claimed in full where the primary purpose of travel is work or business-related, even where there may be incidental private benefit.<sup>3</sup> Similarly, if the primary purpose of a conference is work or business-related then registration fees may be claimed in full, even where there are significant private benefits through sight-seeing and other activities.

## Prepayment

13. Expenses that are prepaid must also be apportioned in accordance with the prepayment rules.<sup>4</sup> That is, where an expense is incurred in an income year for goods or services that are for use in later income years, a deduction will not be available in the current income year for that expense.
14. For example, if a student pays for two years of course fees at the beginning of the course, they will only be able to claim the fees that relate to subjects that will be undertaken in the current income year. In the second income year, they will be able to claim the fees that relate to subjects undertaken in that year.

## Depreciation

15. A deduction is also available for the decline in value of a 'depreciating asset' that is held by the taxpayer at any time during the year.<sup>5</sup> The deduction is reduced to reflect the extent to which the asset was used during the income year for a purpose other than a 'taxable purpose'.
16. To reduce compliance costs, taxpayers may pool low-cost or low-valued assets<sup>6</sup>. The low-value pool is then depreciated as a whole and taxpayers are not required to track the decline in value of individual assets within the pool. Taxpayers must make a reasonable estimate of the percentage of use of the asset that will be for a taxable purpose over the effective life of the asset.

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2 Section 8-1 of ITAA 1997 ensures expenses are apportioned as expenses are deductible 'to the extent that' they are incurred in gaining or producing your assessable income are deductible.

3 Commissioner of Taxation's Taxation Ruling TR98/9: Income Tax: deductibility of self-education expenses incurred by an employee or person in business.

4 Subdivision H of Division 3 of Part III of the ITAA 1936.

5 Division 40 of ITAA 1997. A 'depreciating asset' is defined as an asset that has a limited effective life and that is reasonably expected to decline in value over the time it is used.

6 Sections 40-420 to 40-445 of ITAA 1997.

## **Employer provided education**

17. There are interactions between personal expense deductions when incurred by employees and where these expenses are provided by employers.
18. Where an employer provides education to an employee, either directly or through reimbursement of costs, the employer is able to claim a deduction for their business expense. Where the education is work related, the employer will generally not be liable to fringe benefits tax as the expense would be 'otherwise deductible' by the employee. Additional discussion of the fringe benefits tax implications of the cap are discussed later in this paper.

## **Personal services income**

19. Much of this discussion paper refers to 'employer provided' circumstances. For many individuals, however, those circumstances do not apply, as they fall under the personal services income rules.
20. Section 84-5 of ITAA 1997 provides that income which is mainly a reward for an individual's personal efforts or skills is the individual's personal services income (PSI), regardless of whether it is income of another entity (for example a company, trust partnership or other individual), whether it is for doing work or producing a result or whether it is payable under a contract.
21. The PSI rules are designed to prevent individuals from reducing their tax liability by alienating their PSI to an associated company, partnership, trust or individual, or by claiming inappropriate business deductions. There are restrictions on the deductions that can be claimed by the individual or interposed entity, so that they broadly correspond to the deductions available to employees.
22. The rules mean that taxpayers who are generating PSI as a contractor but are not carrying on a personal services business may only claim deductions that they would have been able to claim if they had been an employee. For example, in the absence of the PSI rules, the taxpayer could deduct rent, mortgage repayments, rates or land tax if they generate their PSI from their home, whereas these expenses are of a 'private or domestic' nature and therefore not deductible to employees.

## 2. CONTEXT

23. Education and training is an important investment people make in their own skills. The Government recognises the benefits, to both individuals and the broader economy, which result from investing in human capital, making us a more productive economy. Allowing deductions for education expenses recognises this benefit.
24. However, deductions for such expenses are currently not available in many circumstances (for example when new skills are not related to current employment) and yet are unlimited in other circumstances. In some cases current arrangements allow people to enjoy significant private benefits. For example, attendance at an overseas conference with a short holiday on the side could make an overseas airfare fully deductible if the primary purpose of the trip was to attend the conference.
25. Deductions under Australian income tax law are also generous compared with most countries.<sup>7</sup> In particular, New Zealand, Canada and the United Kingdom have far greater limits on claimable education expenses.
26. In the United Kingdom, there is generally no deduction for education expenses, even where the education is closely relevant to the nature of employment, as it is not incurred in the performance of the duties of the employment. However, a deduction is available where there is an expense for the external education when it is an integral part of the duties of employment. Typically, this will be where the taxpayer's employment involves research or an employee who is undertaking a training phase of their career, during which the attendance at external courses represents an intrinsic part of the duties of the employment.
27. In 2010-11, 8.3 million individuals claimed a deduction for work-related expenses, totalling \$18.27 billion<sup>8</sup>, while 638,000 taxpayers, or 5 per cent of all individuals, claimed a deduction for an expense incurred in gaining a formal education, that is from a school, college, university or other place of education.<sup>9</sup>
28. Around 87 per cent of individuals who lodged a return and claimed these expenses had a taxable income below \$80,000. The median claim for expenses relating to formal education in 2010-11 was \$905, but higher income earners tended to claim larger amounts. Chart 1 below shows the estimated median claim by income range.

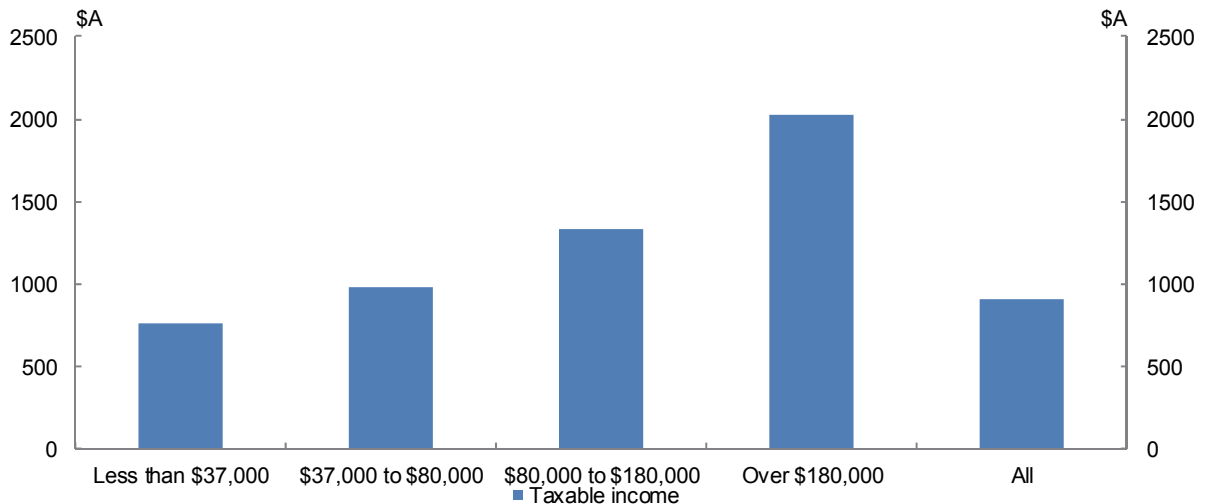
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<sup>7</sup> Australia's Future Tax System Tax Review, Report to the Treasurer, 2009, p54.

<sup>8</sup> Taxation Statistics 2010-11.

<sup>9</sup> Expenses claimed at label D4 of the Individuals tax return. Education expenses are claimed in two places on the Individuals Tax return – at label D4 'Work-related self-education expenses' (for expenses relating to formal qualifications from a school, college, university or other place of education) and label D5 'Other work-related expenses' (for other expenses, including conferences, journals and reference books, depreciation of computers). Other work-related expenses also claimed at D5 include union fees, overtime meal expenses, reference books, tools and home office expenses. The expenses at D5 are not itemised.

**Chart 1 Median claim for formal education expenses by taxable income range, 2010-11**



Source: Estimates derived by Treasury using unpublished data.

29. There are a range of other education expenses that are able to be claimed, including conferences, training through professional associations and informal training. These other education expense deductions are expected to be claimed at the D5 label of the income tax return. Other work-related expenses also claimed at this label include union fees, overtime meal expenses, reference books, tools and home office expenses.
30. In 2009-10, it is estimated that around 600,000 people claimed a deduction of other education expenses. The median education claim in the 'other work-related expenses' category is estimated to be around \$296 in 2009-10.<sup>10</sup>
31. Training and education requirements vary considerably across industries and occupations. Employees undertake training in varying forms and incur variable costs. For example, an employee may undertake a first aid training course or responsible service of alcohol course, complete a Masters degree or attend vocational training as part of an apprenticeship. This education may be provided by an employer, reimbursed by an employer or an employee may incur the costs.
32. While some employees may be able to claim a tax deduction for these expenses, other employees may not be able to claim a deduction as the requisite nexus to their employment does not exist. For example a student studying for a law degree that may allow them to practise law who works as a paralegal may be able to claim their study expenses as a tax deduction, while a student who is studying the same degree who works in a retail store cannot claim a deduction.
33. On the other hand, other taxpayers are able to claim a deduction for large expenses. For example, an architect could undertake a study tour to Europe, the United Kingdom and South America for a number of months to further their knowledge of architecture, studying developments in the field. The Courts have held that this taxpayer could claim a deduction for their travel, accommodation and related costs relating to that trip, as the study tour enabled

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<sup>10</sup> Estimate derived using unpublished data from the Australian Taxation Office from its compliance activities for 'other work-related expense' claims at label D5 for the 2009-10 income year.

the taxpayer to maintain their skills and knowledge.<sup>11</sup> The Courts also held that a flight engineer could claim a deduction for flying lessons, as the lessons enabled the engineer to increase their proficiency in their occupation.<sup>12</sup>

34. The current rules allow some people to claim large deductions for expenses that, while having some connection with their employment, provide a significant private benefit, which is paid for by taxpayers.
35. However, a large majority of people who undertake education or training have expenses well below \$2,000.

### Consultation questions

1. In your industry or field, are there studies or courses that are compulsory and must be completed in order to meet licence requirements or other continuing professional development training?
  - a. What is the average amount of the expense?
  - b. What is the highest amount of the expense?
  - c. What is the nature of these courses?
2. Is training undertaken in your industry predominantly held in Australia or overseas? Can you provide examples?
3. In employment relationships, are employees largely obliged to incur work-related education expenses themselves or are they employer provided? Do you anticipate this changing in response to this measure?
4. Are you aware of examples where education expense deductions can be claimed under the current arrangements, even where significant private benefits are enjoyed?
5. Are there any lessons for Australia in the experiences of other countries with restrictions on education expenses deductions?

### Other forms of Government assistance

36. Recognising the benefits of training, the Government provides significant assistance and support to employers and employees.
37. The Government also provides significant support to help people retrain or gain qualifications for which they are not entitled to a tax deduction.

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<sup>11</sup> FC of T v. Finn (1961) 106 CLR 60; (1961) 12 ATD 348.

<sup>12</sup> FC of T v Studdert (1991) 91 ATC 2007.

38. Australian citizens or permanent humanitarian visa holders and permanent visa holders who are undertaking bridging study for overseas-trained professionals and resident in Australia for the duration of study can access FEE-HELP to assist with the tuition fees for tertiary education courses delivered through approved providers, including at public universities and TAFEs.
39. Commonwealth funding for university places has increased by 75 per cent between 2007 and 2013, with an extra 149,000 places over the same time period, or a 35 per cent increase. The Government is expanding this investment by providing an additional \$97 million from 2014 to 2017 for additional Commonwealth supported places for sub-bachelor and post-graduate degrees.
40. In the 2013-14 Budget, the Government announced \$135.3 million for 150 four year Future Fellowships to attract and retain the best Australian and international mid-career researchers in areas of crucial national importance. An Alternative Pathways Program will be established with funding of \$68.8 million over four years, to deliver more flexible pathways for 4,000 Australians completing a trade or technical qualification in high-demand industries facing skills shortages.
41. Researchers, in submitting their grant applications, are able to seek funding for costs associated with attending conferences through the Australian Research Council (ARC) and the National Health and Medical Research Council (NHMRC) grants. Research funds can potentially be made available if the conference and associated travel costs are directly related to the research objective.
42. From 2010-11, the Government has invested \$1.1 billion in expanding post-university medical training places. This includes funding for prevocational training placements for interns and junior doctors in general practice (\$195.2 million over five years to 2014-15 to fund 975 places a year), additional vocational training places for GPs (\$656.9 million over five years to 2014-15, resulting in 5,500 new GPs or GPs in training over 10 years) and funding for more specialist vocational training in private and community settings (\$210.7 million over five years to 2014-15, to increase the annual number of funded training posts from 360 to 900 a year).
43. At least fifty per cent of these additional prevocational placements and vocational training posts are located in or involve rotations to rural and regional areas of Australia. The Government also announced additional funding for specialist training places to boost the Tasmanian medical workforce as part of the Tasmanian Health Assistance Package (\$40 million over three years from 2013-14).

### 3. POLICY DESIGN

44. The Government has announced that it will better target education expense deductions by introducing a \$2,000 annual cap from 1 July 2014.
45. A cap on the amount of education expenses that may be claimed as a deduction retains an incentive to invest in work or business-related education, while ensuring the deduction is fair and does not provide an opportunity for people to enjoy significant private benefits at taxpayers' expense.

#### 3.1 CAP ON INDIVIDUAL'S EDUCATION EXPENSES

46. From 1 July 2014, taxpayers will only be able to claim up to \$2,000 of all their education expenses each year.

#### **What 'education expenses' will be subject to the cap?**

47. All expenses incurred in education activities will be subject to the cap, including expenses for both formal and informal education. The current distinction between formal qualifications and other education or training in section 82A of the ITAA 1936 will not apply.
48. The following expenses are some examples of what will be included in calculating the cap:
  - tuition fees, including fees payable under FEE-HELP<sup>13</sup> and self-education expenses paid with a OS-HELP loan;
  - registration fees for conferences, workshops or seminars;
  - textbooks and professional or trade journals;
  - stationery and photocopying;
  - computer expenses, including decline in value (depreciation);
  - student union fees and student services and amenities fees;
  - accommodation and meals when participating in a course that requires a person to be away from home for one or more nights;
  - running expenses if there is a room set aside for education purposes — such as the cost of heating, cooling and lighting that room while used for studying; and
  - travel expenses for travel from home to a place of education and back, and from work to a place of education and back.<sup>14</sup>

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<sup>13</sup> This does not include expenses paid under HECS-HELP, which are not deductible expenses.

<sup>14</sup> This list is not exhaustive.

49. Where an education expense is included in a payment for broader services, the component relating to education will need to be apportioned and will be included in the calculation of the cap. For example, if the membership fee of a professional association includes a certain number of hours of professional development or training programs that are included in the membership, the education element of the membership fee must be apportioned and included in the cap.
50. In other words, if membership to an organisation contains an allowance for continuing professional development training, the organisation needs to itemise the value of this training component.
51. Deductions for a range of expenses are not affected by this measure. For example, taxpayers will continue to claim deductions, provided they meet the necessary tests, for the following expenses:
- professional membership fees;
  - overtime meal expenses;
  - travel expenses;
  - home office expenses;
  - professional indemnity and income protection insurance; or
  - protective clothing and uniform expenses.

### **Other requirements**

52. There will be no change to the requirements for claiming education expenses or the types of expenses that may be claimed. The education must still relate to the current income producing activities of the taxpayers. Expenses will still need to be apportioned. The current prepayment rules will continue to apply. The cap will not be indexed.

### **\$250 no-claim threshold**

53. The Government is also consulting on the need for section 82A of ITAA 1936, which provides that the first \$250 of some self-education expenses is not deductible.
54. Applying the cap while retaining the \$250 no-claim threshold may mean that some taxpayers would only be able to deduct \$1,750 of education expenses. However, many taxpayers are able to reduce the no-claim threshold through non-deductible expenses, and therefore would be able to claim \$2,000 under the cap.
55. The Government seeks stakeholders' views about the effectiveness of this no-claim threshold. Removing the threshold would have a cost to revenue. Tax expenditure for the threshold was estimated to be \$11 million in 2014-15 in the 2012 Tax Expenditure Statement.<sup>15</sup>

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<sup>15</sup> Tax Expenditure Statement 2012, The Treasury, p40.



### Consultation questions

6. Should the \$250 no-claim threshold under section 82A of the ITAA 1936 be removed when the \$2,000 cap is introduced?
7. How should this be prioritised?

### Sole traders

56. A taxpayer may also operate a business as a sole trader and claim deductions for education expenses. To reduce incentives for people to restructure their affairs to avoid the cap on education expense deductions and ensure equal treatment between employees and sole traders, the cap will apply to sole trader taxpayers with respect to their personal education expenses. However, the cap will not apply to training or education expenses they may incur for their employees.

### Personal services income

57. Where an individual generates PSI as a non-employee (and not as part of a personal services business) the individual's deductions relating to that income are generally restricted to the amount that they would be entitled to deduct if that income had been received as an employee. The \$2,000 cap will apply to those individuals. The PSI that is included in the individual's return may only include a reduction for education expenses up to the taxpayer's total cap of \$2,000 (having regard to the individual's other education expenses). The personal services business will not be able to claim a deduction for any remaining education expenses.

### Depreciation

58. A deduction is available for the decline in value of a 'depreciating asset' that is held by the taxpayer at any time during the year.
59. Depreciation expenses that relate to education will be included in the calculation of the cap. There will be no adjustment to the cost of the depreciating asset where the depreciation expense exceeds the cap.
60. Where taxpayers pool low-value or low-cost assets, they will need to reasonably estimate the percentage of use of the asset that relates to an education activity over the effective life of the asset and a reasonable estimate of the total education expenses. Only the proportion of the assets cost that is used for education that would likely result in capital allowance deductions that would not exceed the cap will be able to be allocated to the pool.
61. A similar approach will need to be taken by sole traders that operate a small business and utilise the small business pools or \$6,500 instant asset write-off under the capital allowance rules for small business entities. In that case, the sole trader will need to make a reasonable estimate of the percentage of use of the asset that relates to an education activity over the effective life of the asset as per the 'reasonable estimation' approach for low-value pools.

### Consultation questions

8. What types of assets that relate to an education activity are placed into a low-value pool or similar small business pool?
9. What are the advantages/disadvantages of the 'reasonable estimation' method proposed above?
10. Is the use of low-value pools under these circumstances appropriate?

## 3.2 INTERACTIONS WITH THE FRINGE BENEFITS TAX SYSTEM

62. The Government will ensure FBT will not apply to training and education provided or reimbursed by an employer, except where part of a salary packaging arrangement. This will help prevent FBT being a barrier to employers investing in the skills of their workforce.

### Otherwise deductible rule

63. Currently, employers providing education and training to employees are generally not liable for fringe benefits tax (FBT) on those benefits through the operation of the 'otherwise deductible rule'.
64. A fringe benefit may arise for education and training where:
  - the employer reimburses expenses incurred by an employee for education and training (expense payment fringe benefit); and
  - the employer provides education and training for employees (residual fringe benefit).
65. The 'otherwise deductible rule' operates to reduce the taxable value of an expense payment benefit or a residual benefit by the amount the employee would have been entitled to claim as an income tax deduction had they not been reimbursed or had they incurred the expenditure themselves.
66. Where education and training is provided by an employer, or an employee is reimbursed for education and training expenses and an income tax deduction would have been available to the employee, the taxable value of the fringe benefit is reduced to nil. The employer is therefore not liable for FBT.
67. For example, an employer is introducing a new accounting system and requires the financial staff to be trained on the use of the software. The employer may either pay for staff to be trained (either in-house or externally) or may reimburse the expenses incurred by the employee to attend external training. This expenditure would be deductible to the employee under section 8-1 of the ITAA 1997; therefore, the otherwise deductible rule applies and no FBT is payable.
68. The Government understands that many employers incur education expenses on behalf of their employees as this training provides benefits to their business. As part of this proposed measure the otherwise deductible rule may no longer apply to education expenses in excess of

the \$2,000 cap. This may result in employers being liable for FBT on any education expenses over the cap of \$2,000, incurred by them on behalf of their employees.

## Salary packaging arrangements

69. Salary packaging arrangements are also commonly referred to as salary sacrificing or total remuneration packaging. These are arrangements between an employer and an employee, where the employee receives a benefit in return for a reduction in salary or wages that would not have happened apart from the arrangement, or, the employee receives a benefit as part of the employee's remuneration package, and the benefit is provided in circumstances where it is reasonable to conclude that the employee's salary or wages would be greater if the benefit were not provided.<sup>16</sup> Where an employee salary packages an expense, they are not able to claim a deduction for that expense.
70. As part of the proposed measure the Government will ensure no FBT liability arises in respect of employer-provided education expense payments.
71. However, the intent of the measure may be undermined if employees can salary package education expenses. If FBT was not payable, the employee would effectively be able to access the deduction in another form. Therefore, the FBT 'otherwise deductible rule' will not apply where the education is provided through a salary packaging arrangement.
72. For example, where an employee is undertaking an MBA with annual course fees of \$25,000, the employee may enter into a salary packaging arrangement with the employer to forgo \$25,000 in salary and wages in exchange for the employer paying the course fees on behalf of the employee (an expense payment benefit). Currently, assuming the MBA meets the income nexus, the expense would be deductible to the employee and, therefore, the otherwise deductible rule would mean that the employer would not be liable for FBT. With the introduction of the cap and associated changes to the FBT law, the employer will be liable to pay FBT. The employer will, however, continue to be able to claim a deduction for their expense.
73. As the cap will not apply until 1 July 2014, there is a significant lead in-time before commencement and therefore transitional arrangements will not be provided for existing salary packaging arrangements. Employees who currently have work-related education expenses as part of a salary packaging arrangement are encouraged to review their affairs.

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<sup>16</sup> Tax Laws Amendment (2012 Measures No. 6) Bill 2012 provides for this definition of salary packaging – Schedule 7 item 12.

### 3.3 APPLICATION OF THE CAP

74. The following examples demonstrate how the cap will apply in practice.

#### Example 1

Yanthe is a dental surgeon and is self-employed. Yanthe is a member of the Australian Dental Association (ADA) in her state, which advertises and conducts a range of seminar sessions to help their members keep up to date with the latest development in the profession. Yanthe attends the annual ADA conference which, while not compulsory for her to maintain her registration to practise as a dentist, allows her to maintain her skills and knowledge and does count towards compulsory continuing professional development requirements.

In 2012-13, Yanthe paid for the following education related expenses:

Annual dental conference (location: home town)	\$1,500
Subscription to dental journals	\$350
TOTAL	\$1,850

As the total falls under the \$2,000 cap, Yanthe can continue to claim all her work-related education expenses.

The next year, Yanthe decides to attend a 5-day clinical conference to be held in Malaysia. All accommodation, meals and travel is included. The total cost of this conference is \$15,000. It also counts towards continuing professional development requirements.

As the total of the conference exceeds the \$2,000 cap, Yanthe can only claim the maximum amount of \$2,000. Yanthe is not able to claim the remainder of the expenses elsewhere.

In the same year, Yanthe sends her dental nurse on training to keep his skills up to date. The workshop costs \$1,200. While Yanthe's personal education costs have exceeded the cap, she may still claim a business deduction for the training for her employee.

#### Example 2

Sam is a professional who needs to meet continuing professional development requirements to maintain a licence. He attends a conference in Costa Rica at a total cost of \$10,000.

Although the conference counts towards his continuing professional development requirements, it involves significant private benefits, with sight-seeing each morning and afternoon and free days either side of the conference. The conference attendees and speakers are all Australian based. Under current arrangements, Sam can claim the full \$10,000 as an education expense.

From 1 July 2014, Sam can only claim at most \$2000 of the cost of this conference.

### Example 3

Maddy is working as a licensed engineer and is required to undertake 30 hours of continuing professional development each year to maintain her licence. She incurs the following expenses:

3 workshops	\$1,000
Journals and reference materials	\$300
TOTAL	\$1,300

From 1 July 2014, Maddy can continue to claim all of her expenses as they fall under the cap.

Maddy also decides to attend the professional association's annual conference, which provides additional continuing professional development credit, at a cost of \$1,500.

Maddy can claim an additional \$700 for the conference, taking her to the \$2,000 cap but will not be able to claim the remaining \$800.

### Example 4

Simran has been designated within his workplace to assist in emergency situations. He completes a first aid course each year to refresh his knowledge and skills in this area. He incurs the \$500 course fee.

From 1 July 2014, Simran can continue to claim his full expenses as they are below the \$2,000 cap.

Simran's employer decides to provide this training in-house, as there are a number of employees who require the training. The employer will be able to continue to provide the training and will not be liable for FBT. The employer can continue to claim a business deduction.

### Example 5

Gus is studying for a Graduate Diploma of Chartered Accounting while working at an accounting firm, which will allow him to become a registered accountant. He incurs the following expenses in one year of study:

Course fees	\$3,600
Text books, stationery	\$500
Computer and Software	\$500
Travel	\$250
TOTAL	\$4,850

From the 2014-15 income year, Gus will only be able to claim \$2,000 of the expenses.

Gus' employer decides to reimburse Gus for the course fees, recognising that the business benefits from Gus' education. The employer pays the \$3,600 in course fees, leaving Gus with \$1,250 in other expenses.

From 1 July 2014, Gus will be able to claim all of his unreimbursed expenses and will not be affected by the cap. The employer will also be able to claim the \$3,600 as a deduction and will not be liable for FBT.

### Example 6

Ann is undertaking an MBA with annual course fees of \$25,000, and she could enter into a salary packaging arrangement with her employer. In this instance Ann may forgo \$25,000 in salary and wages in exchange for her employer paying the course fees on her behalf (an expense payment benefit).

Currently, assuming the MBA meets the income nexus, the expense would be deductible by Ann and, therefore, the otherwise deductible rule would mean that the employer would not be liable for FBT.

With the introduction of the cap and associated changes to the FBT law, the employer will be liable to pay FBT. The employer will, however, continue to be able to claim a deduction for their expense.

Ann could also be eligible for FEE-HELP, which assists fee paying students with all or part of tuition fee costs (up to \$93,204 in 2013).

## 4. PROPOSED CHANGES TO THE TAX LEGISLATION

75. In order to give effect to this reform, a number of amendments will be required to the taxation laws. In particular, this will include amendments to the ITAA 1997 and the Fringe Benefits Tax Assessment Act 1986 (FBTAA).
76. The following paragraphs discuss these potential changes at a high level. Further consultation will be undertaken on the form of the amendments through the release of exposure draft legislation before it is introduced into Parliament.

### 4.1 AMENDMENTS TO INTRODUCE A PROVISION TO CAP INDIVIDUAL'S EDUCATION EXPENSES

77. To introduce a cap on an individual's education expenses, an amendment will be required to Division 26 of the ITAA 1997 to provide that there is a \$2,000 limit on the total of the amounts a taxpayer can deduct on an individual's education expenses for an income year.
78. For the purposes of this provision it is proposed, that an 'education expense' would be defined in the ITAA 1997 along the lines of:

*a loss or outgoing to the extent that it is incurred by the taxpayer to undertake or participate in an educational activity undertaken for the primary purpose of maintaining, improving, gaining or upgrading knowledge or skills (including qualifications, technical expertise, professional competency) for use in carrying on a business or in the course of any employment.*

79. No amendments will be required to section 8-1 of the ITAA 1997 as the provision will operate as it does now to initially permit an entity to make a deduction for an individual's education expenses where the requirements of the provision are met (including a requirement that the expense is sufficiently connected with an income earning activity) before the new capping provision operates to deny deduction for expenses in excess of the cap.

### Consequential amendments arising from the cap on an individual's education expenses

80. A number of consequential amendments will be required to ensure that the cap on an individual's education expenses operates as intended.
81. In particular, an amendment will be required to Subdivision 40-B of the ITAA 1997. Subdivision 40-B of the ITAA 1997 provides the core provisions that apply to deductions for the cost of depreciating assets over the effective life of the asset to the extent that the asset is used for an income producing purpose.
82. The amendment required will ensure that the provision to cap an individual's education expenses applies equally to deductions under Division 40 as it does to general deductions. Other examples of similar kinds of reductions in Division 40 deductions can be found in section 40-25 of the ITAA 1997.
83. Amendments will also be required to Subdivision 40-E and 328-D of the ITAA 1997 to give effect to the 'reasonable estimations' approach for apportioning assets that relate to an

education activity that are to be included in low-value pools or deductible under the capital allowance rules for small business entities.

## 4.2 AMENDMENTS TO THE 'OTHERWISE DEDUCTIBLE RULE' IN THE FBTAA

84. In order to ensure that the 'otherwise deductible rule' continues to apply to education expenses in excess of the \$2,000 cap, amendments will be required to sections 19, 24, 34, 37, 44 and 52 of the FBTAA.
85. It is proposed that these amendments will involve replacing existing references to section 82A of the ITAA 1936 with references to the new provision to cap an individual's education expenses.

### Amendments to carve-out salary packaging arrangements

86. However, to ensure that the effect of the cap on an individual's education expenses will not be avoided by utilising the FBT system, where an employee enters into a salary packaging arrangement for education and training, an amendment will be required to the FBTAA to prevent the application of the otherwise deductible rule to those benefits.

#### Consultation questions

11. Are there any unintended consequences from the legislative approach proposed for these reforms?
12. What practical aspects of the proposed reforms need further consideration?
13. Are there any interactions with other areas of the tax law that need to be addressed?
14. Do you consider that further amendments will be required to the tax law outside of those already mentioned in the discussion paper?
15. Are there alternative approaches that you would like to see considered? How would they work in practice and are there any precedents in Australia or other jurisdictions?

## 5. NEXT STEPS

74. As part of the consultation process, officials from Treasury will meet with a number of stakeholders.
75. The draft legislation will be exposed for public comment before its introduction into the Parliament.



## 6. APPENDIX

### 6.1 SUMMARY OF QUESTIONS

1. In your industry or field, are there studies or courses that are compulsory and must be completed in order to meet licence requirements?
  - a) What is the average amount of the expense?
  - b) What is the highest amount of the expense?
  - c) What is the nature of these courses?
2. Is training undertaken in your industry predominantly held in Australia or overseas? Can you provide examples?
3. In employment relationships, are employees largely obliged to incur work-related education expenses themselves or are they employer provided? Do you anticipate this changing in response to this measure?
4. Are you aware of examples where education expense deductions can be claimed under the current arrangements, even where significant private benefits are enjoyed?
5. Are there any lessons for Australia in the experiences of other countries with restrictions on education expenses deductions?
6. Should the \$250 no-claim threshold under section 82A of the ITAA 1936 be removed when the \$2,000 cap is introduced?
7. How should this be prioritised?
8. What types of assets that relate to an education activity are placed into a low-value pool or similar small business pool?
9. What are the advantages/disadvantages of the 'reasonable estimation' method proposed above?
10. Is the use of low-value pools under these circumstances appropriate?
11. Are there any unintended consequences from the proposed reforms?
12. What practical aspects of the proposed reforms need further consideration?
13. Are there any interactions with other areas of the tax law that need to be addressed?
14. Do you consider that further amendments will be required to the tax law outside of those already mentioned in the discussion paper?
15. Are there alternative approaches that you would like to see considered? How would they work in practice and are there any precedents in Australia or other jurisdictions?