REFORMING FRINGE BENEFITS TAXATION

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In most OECD countries with a high degree of reliance on personal income tax as a means of financing government spending, erosion of the tax base has become a major problem. Revenue has been lost through resort to the 'black economy' and through legal tax planning. For wage and salary earners and their employers the most fruitful legal manoeuvre has been the provision of fringe benefits.

Australia has been no exception to this trend and evidence abounds of the increasing use of fringe benefits as a means of employee remuneration especially for those on higher incomes who are, therefore, in higher tax brackets.[1] It came as no surprise when as part of the Labor Government's tax reform measures a fringe benefits tax (FBT) was announced in September 1985, to apply from the 1986-1987 income year. The legislation itself appeared in April 1986. An unusual feature of FBT was its imposition on employers rather than on employees, though New Zealand had done the same in 1984. But the most pronounced characteristic of FBT is its complexity which, paradoxically, has come about through the designers' desire to impose a tax which will give its administrators a quiet life.

In this article the prior law relating to fringe benefits is briefly reviewed and its defects analysed. Then the FBT is examined and criticised. It is contended that an opportunity to both strengthen and simplify the tax law was lost. The international aspect of FBT is particularly obscure. The equity of the Australian tax system has not been notably enhanced but FBT has proved a successful money-raiser.

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1 See J. Elmgreen, "Reform of Fringe Benefits Taxation" (1986).

I. THE TAXATION OF EMPLOYEE BENEFITS PRIOR TO FBT

Non-monetary benefits which could not be converted to cash were not taxed under the general concept of income, either because they were not of an income nature or because, not being convertible, they were income of no value.[2] The fact that such benefits might save the employee the expense of providing them for himself was generally ignored.[3] If a benefit was derived by an employee in capital form it escaped tax also. Normally, benefits provided by an employer to his employee were assumed to be in respect of the employment and hence a reward for it, but this was not always so.[4] Even if a benefit was found to be convertible into money its value for tax purposes was the amount the taxpayer could obtain for it in a market transaction which might be much less than the cost of providing it.[5]

This situation was clearly unsatisfactory and had received some attention from the legislature. Section 26(e) of the Income Tax Assessment Act taxed employees on the value to them of all benefits they obtained from their employment, however derived. This section, in the Act since 1936 and having earlier counterparts, had proved to be largely ineffective, for two reasons. First, there was, in most cases, no obligation on employers to disclose to the tax office that non-monetary benefits had been provided. Second, although tax returns had a question on such benefits, it was usually not answered by employees, partly because of the difficulty of valuation of many of them, for example, the use of the employer's car for private purposes. It was also recognised by taxpayers generally that the tax office had no effective means of detecting benefits in kind, which usually came to light only as a result of an investigation.[6]

During the 1970s, attempts were made to catch particular employment benefits, with varying degrees of success:

1. A tax payable by the employee on the stand-by value of a employer-provided car was enacted in 1974, but, owing to political opposition, never came into force.[7]
2. Share options were rendered a less attractive form of employee benefit in 1973 by legislation valuing the benefit at the time of the option's exercise instead of at the time of its granting.[8]

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2 *Tennant* v. *Smith* [1892] AC 150; *Abbott* v. *Philbin* [1961] AC 352; *Federal Commissioner of Taxation* v. *Cooke and Sherden* (1980) 80 ATC 4140.

3 Though Bowen CJ recognised savings as being of an income nature in *Donaldson* v. *Federal Commissioner of Taxation* [1974] 1 NSWLR 630.

4 *E.g.*, *Hochstrasser* v. *Mayes* [1960] AC 376, where reimbursement of a loss suffered on a house sale was found not to constitute income from employment.

5 Thus the suit provided to an employee in *Wilkins* v. *Rogerson* [1961] Ch 133 was taxed at its second hand value.

6 *E.g.*, as in *Black* v. *Federal Commissioner of Taxation* 86 ATC 4113.

7 Former s.26AAB ITA Act.

8 S.26AAC ITA Act.

3. Attempts by the tax office in 1978 to collect more tax on the value of housing provided to employees in remote areas resulted in a six week strike on the Central Queensland coalfields, during which the Treasurer was jostled (on television) by angry miners. The resulting legislation which valued for tax purposes such accommodation at derisory values represented a humiliating back-down.[9]
4. Termination allowances paid in a lump sum, formerly given favourable treatment (only 5% was included in assessable income), were more heavily taxed from 1 July 1983.

Left out of these reforms were employer's contributions to superannuation funds which remain deductible to the employer (within limits) and the exemption from tax of the funds themselves. Superannuation thus remains a significant tax concession.

The piecemeal approach to reform prior to 1985 concentrated on perceived abuse. It did not address the equity issues involved, nor did it tackle the problem of distinguishing between benefits and conditions of employment. Those in occupations where fringe benefits were not prevalent and who earned the same gross income as those who took their salary in cash and non-monetary benefits were disadvantaged ('horizontal inequity'). Higher income employees who received a substantial part of their salary in the form of non-monetary benefits were avoiding the impact of higher marginal tax rates otherwise applicable ('vertical equity'). There was evidence that the proportion of fringe benefits increased with the amount of salary.[10] Clearly, a maximum marginal rate of 60% applying to income in excess of $35 000 was a strong incentive to arrange for remuneration in non-cash form which was likely to escape taxation. Generous entertainment allowances were difficult to apportion into work and non-work components and in practice went untaxed, quite apart from any theoretical difficulty as to the valuation of benefit to the employee. Lastly, neither section 26(e) nor the specific provisions dealt comprehensively with the diversion of benefits to third parties such as spouses or families.

Most of these difficulties were recognised by the authors of the Tax Reform White Paper which appeared in June 1985 and devoted a chapter to fringe benefits.[11] In proposing a solution to the fringe benefits problem, the White Paper rejected better enforcement of the existing law as being not cost-effective and considered instead two other options:

1. Taxing the employee by providing valuation rules for different kinds of benefits and compelling the employer to report them to the Commissioner.

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9 S.26AAAB ITA Act, enacted in 1981 but applicable from 1 July 1977. Note also the rules for valuing non-remote area housing in s.26AAAA. Both sections have been repealed with the introduction of FBT.

10 Note 1 *supra.*

11 "Reform of the Australian Tax System" June 1985 Ch.8.

2. Introducing a tax on employers in respect of non-cash fringe benefits while exempting them in the hands of employees, following the example of New Zealand.

The White Paper favoured the second option. It was thought to be simpler and administratively cheaper to impose the legal burden on employers. Left unsaid was the far more important point that a tax on employers was likely to be politically more acceptable, although FBT turned out to be controversial enough even in this form. Its acceptance was announced in the Treasurer's Statement of September 1985 and legislation introduced in May 1986. It did not have a smooth passage and several modifications had to be made to the original proposals, most notably a reduction in the scale for calculating FBT on cars, to ensure passage through the Senate. FBT came into force on the lst of July but the agitation did not die down and more modifications were announced, first on 26 August and then on 29 October. Legislation to implement these changes was slow to appear, but was finally introduced into Parliament on 29 October 1987.[12]

During the 1987 federal election campaign FBT was raised as an issue by the Liberals whose tax policy called for its abolition. However they would have re-imposed it on employees (with some new exemptions).

FBT has proved to be a substantial source of revenue (which, it is suggested, is one of its defects). The Treasurer's Statement estimated a revenue gain in 1986-1987 of $320 million and for 1987-1988 $515 million. The 1987 Budget Papers show FBT receipts as $535 million and estimate $750 million for 1987-1988, or nearly 50% more than originally planned. To put this in perspective, FBT will raise 1.0% of Commonwealth revenue in 1987-1988. Net PAYE collections are expected to raise 38.5%. By way of contrast, New Zealand raised less than $100 million in the first full year of FBT's operation and less than 10% of employers lodged returns.[13]

II. THE SCHEME OF FRINGE BENEFITS TAX

FBT is closely associated with two other parts of the 1985 reforms, the disallowance of entertainment expenses as deductions and the provisions requiring documentary substantiation of certain types of work-related expenses. Both these measures are contained in the Income Tax Assessment Act.[14] FBT itself has its own Fringe Benefits Assessment Act setting out the basis for liability and the procedure for its collection. In accordance with Australian constitutional tradition the tax is actually imposed by a separate Act, the Fringe Benefits Tax Act. Another Act applies it notionally to the Commonwealth.

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12 Taxation Laws Amendment (Fringe Benefits and Substantiation) Bill 1987.

13 Half of $NZ150-200 million; R.J. Stephens "Tax Reform in New Zealand" (1987) 4 *A T Forum* 327, 339.

14 Entertainment, s.51AE; substantiation, ss 82KT-82KZB.

As mentioned above, FBT is imposed on employers in respect of benefits provided to employees. If an employer has to deduct PAYE income tax from a payment to a person an FBT liability may arise also. Some unlikely persons thus become "employees" including parliamentarians and judges. The Act also applies in respect of former and prospective employees though the cost of travel to job interviews is exempt. Benefits to persons outside the PAYE net may be caught by section 26(e), which has not been repealed, or by the amendments promised in February 1985 to overcome the effect of *Federal Commissioner of Taxation* v. *Cooke and Sherden*.[15] Once an income benefit comes within FBT it is not taxable to the employee.[16] In order for a benefit to be subject to FBT it must be given in respect of employment as defined by section 148 but, as will be seen, this is such a broad definition as to be devoid of content.

The heart of the FBT legislation are the rules dealing with valuation of different kinds of benefits. There are eleven categories including a residual one. A number of exemptions and concessions are also provided. If an employer pays for something received by the employee which would have been a deductible expense if incurred by the employee FBT is not payable (the "otherwise deductible" rule). To achieve this, however, paperwork largely similar to that required under the income tax substantiation provisions must be completed.

FBT is self assessed, that is, it is for the employer taxpayer to calculate his own liability and send in the amount due, on a quarterly basis. In order to stagger tax agents' and tax office workloads somewhat the FBT year runs from April to March. The Commissioner has issued Rulings on FBT but the only litigation on it so far has been two unsuccessful challenges to the tax's constitutional validity.[17]

The rate of tax is the company rate, which currently coincides with the top individual rate of 49%. In theory this provides a disincentive against providing non-cash benefits where the employee has a maximum marginal rate of less than 49%, but the methods of valuation adopted often lead to the opposite effect even in the case of employees whose taxable income is below the 49% threshold.[18]

Because FBT is based on the PAYE system it brings into its net foreign employers in respect of benefits provided abroad, in some cases. If the employer has no Australian assets the tax is not likely to be enforced, given the reluctance of the courts in most countries to enforce foreign revenue laws. This feature of the tax evidences a certain lack of regard its designers have had towards its international implications.

15 Note 2 *supra*.
16 ITA Act s.23L.
17 *State of Queensland* v. *Commonwealth* 87 ATC 4029; *State Chamber of Commerce and Industry* v. *Commonwealth* 87 ATC 4745.
18 Below $35 000 in 1987-1988.

III. INTERPRETING THE FBT ASSESSMENT ACT

This is a very long piece of legislation of 167 sections drafted in the peculiar prolix yet particular style Australian lawyers have become accustomed to in the revenue area which assumes the courts are not to be trusted in interpreting legislation. Thus every possibility is provided for in the most difficult and obscure fashion imaginable. It is also accompanied by a 'plain English' version, the Treasurer's explanation, which in the writer's view would for the most part have been adequate for enactment as the statute. In the light of section 15AB of the Acts Interpretation Act perhaps the courts will concentrate on the Explanatory Memorandum for finding the law and only refer to the statute when all else fails!

Central to interpreting the Fringe Benefits Tax Assessment Act are the definitions in section 136, some thirty four pages of them. In the case of some key terms definition is by reference to their meaning in the Income Tax Assessment Act, for example "salary or wages" (section 221A ITA Act) "current employee" (Part V Div.2 ITA Act) and "documentary evidence" (section 82KU ITA Act). Some terms pick up their Income Tax Assessment Act meaning but are modified for FBT purposes, for example, "associate" the meaning of which is amplified by section 159 of the Fringe Benefits Tax Assessment Act. At least two definitions "spouse" and "related" companies are different in some respects from their Income Tax Assessment Act meaning. For fringe benefits tax purposes spouse includes a de facto (section 136 Fringe Benefits Tax Assessment Act) whilst "related companies" (and others) are deemed to be "associates".

"Benefit" is not exhaustively defined but the following appears in the 'plain English' version (the Treasurer's explanation):

> "benefit", wherever it is used, will include any right, privilege, service or facility, including a right relating to real or personal property, whether provided under an arrangement in relation to –
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> * the performance of work;
> * the provision of entertainment, recreation or instruction, or the use of facilities therefore; or
> * the conferring of rights, benefits or privileges for which remuneration is payable by way of royalty, tribute or levy, or provided under an insurance contract or a money-lending arrangement.

Conceivably this definition could include such things as pleasant working conditions but no doubt the Tax Office is not about to assess the value of pot plants, harbour views and handsome or attractive fellow employees. In the case of most benefits (loans – section 19, expense payments – section 23, airline transport – section 34, board – section 37, property – section 44 and the residual category – section 52), if the employee would have obtained a tax deduction had he or she provided it himself or herself, the taxable value is reduced by the amount of the notional deduction (the "otherwise deductible" rule). Car expense payments for business use, extended domestic travel (over five days) benefits and overseas travel benefits require substantiation before their value can be reduced for fringe benefit purposes.

Other benefits which fall within the "otherwise deductible" rule require varying amounts of documentation before their value can be reduced or eliminated for FBT purposes. The general thrust is to require similar documentation as that required under the Income Tax Assessment Act if the employee were to actually incur the expenditure. However, expenses which are incurred by the employee exclusively in the course of his or her employment duties with the employer, or a benefit falling within the "otherwise deductible" rule are partially relieved from the paperwork requirement.

A very wide definition is given by section 148 to provision of a benefit to a person in respect of the employment of an employee. Clearly, this section has been drafted to eliminate a number of arguments used in the case law to divorce the benefit from employment. But the central definition in FBT is undoubtedly that of "fringe benefits". Its meaning is expressed in the Explanatory Memorandum as follows:

> [a] fringe benefit means a benefit provided at any time during the year of tax, or deemed (by specific clauses of the Bill) to be so provided to the employee by the employer, an associate of the employer or by another person ... under an arrangement with the employer or an associate of the employer. Alternatively, the employer or associate may arrange for a third person to provide the benefit. In all cases the benefit must be "in respect of" the employment of the employee. That expression is in turn defined to include by reason of, by virtue of, or for or in relation directly or indirectly to, the employee's employment.

The language used in the last sentences is similar to that used in section 26(e) of the Income Tax Assessment Act and the cases on the degree of connection between benefit and employment required for taxability will be relevant to its interpretation. Remember though that section 148 indicates that the draftsman has read those cases too. Thus, to quote again from the Explanatory Memorandum:

> [By subsection] 148(1) the meaning of the term in relation to a benefit provided in respect of employment is not to be narrowed by any considerations of the following factors:
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> * that a benefit may also be provided in respect of some other matter or thing; [compare the housing payment in *Hochstrasser* v. *Mayes*.[19]]
> * whether the employment is in the present, past or future [compare the ex gratia pension payments in *Federal Commissioner of Taxation* v. *Harris*.[20]]
> * that the benefit may be surplus to the needs or wants of the recipient;
> * that the benefit may also be provided to another person;
> * that there may be some offsetting inconvenience or disadvantage;
> * whether or not the benefit has a use in connection with the employment;
> * whether or not the provision of the benefit is in the nature of income; [compare the gift of shares to a valued former employee in *Hayes* v. *Federal Commissioner of Taxation*.[21]]
> * whether or not the benefit is a reward for services rendered. [Compare *Federal Commissioner of Taxation* v. *Dixon*.[22]]

19 Note 4 *supra*.
20 80 ATC 4238.
21 (1956) 96 CLR 47.
22 (1952) 75 CLR 540.

It may be, however, that some of these criteria will still be relevant to valuation, for example, where market value is the basis of the amount of taxable benefit, offsetting inconvenience or disadvantage will reduce the amount of the benefit.

The extremely wide meaning given to the term "in relation to a benefit provided in respect of employment" by section 148 led to considerable public concern, especially amongst primary producers. In response, the Commissioner produced two rulings in June 1986 setting out his views on its meaning. In MT 2016 dated 16 June 1986 he considered accommodation and meals, personal gifts and interest free loans provided by parents to children who also happened to be employees of the parents. He came to the unsurprising conclusion that such benefits might well arise because of the family relationship rather than the employment relationship, but he did not explain how this conclusion put the benefits outside the scope of section 148, which clearly applies where the motives of the provider are mixed. This, in fact, is an example of all-encompassing drafting, never intended to be applied according to its terms, but which has the virtue of meaning, from the Commissioner's point of view, what he chooses it to mean.

The second ruling on the question is MT 2019, dated 30 June 1986. It deals with benefits provided to shareholder employees of private family companies and directors of corporate trustees. Loans provided to employees and associates at less than the prescribed rate of interest are a fringe benefit (sections 16-19) and some consternation had been caused by the possible application of FBT to loan accounts. The ruling states that a benefit will not be subject to FBT if it is provided to the recipient solely by reason of that person's position as a shareholder. This is a reasonable enough proposition, but the ruling goes on to state that the best evidence of this will be the non-claiming of a deduction in respect of the expenditure by the company. If a deduction is claimed, this will indicate the benefit was provided in respect of employment. Uppermost in the minds of the drafters of the ruling is, of course, the maximisation of revenue, but they have forgotten that two distinct questions are involved, whether the company can claim a deduction under section 51 of the ITA Act and whether there is a fringe benefit within sections 136 and 148 of the FBT Assessment Act. Some benefits to shareholders may well be deductible, for example, the cost of goods sold to them at a discount while the cost of some fringe benefits may not, for example, entertainment, capital items. In other situations it may be difficult to identify whether a deduction has been claimed to fund the benefit, for example, a loan, which could be funded from the company's debt or equity. According to the ruling an interest-free loan would not give rise to an FBT liability, if paid out of accumulated profits. How this is to be determined is left unsaid, but the ruling does say that if the value of loan benefits provided to shareholder/employees varied in line with their services to the company rather than with their shareholdings this would be an indication that the loan was provided in respect of employment. Again, however, the width of drafting has ensured that the Commissioner's views, which are not binding

on him, operate as a concession rather than as an extension of the Act's ambit. It should also be remembered that shareholders in private companies receiving loans from their companies can be treated under section 108 of the ITA Act as having received dividends.

Lastly on interpretation, because of the close policy and drafting connection between FBT provisions and the ITA Act substantiation provisions; the scope and terms of each will be relevant to the other. The two measures are not symmetrical, however, for example, the differing exemption levels. Often, a choice will need to be made as to which statute should apply, and care will need to be taken to ensure that both are not applicable.

IV. TREATMENT OF SPECIFIC BENEFITS

1. *Cars (sections 7-13)*

As mentioned above, the specific valuation rules are the essential feature of this legislation. In the case of cars a window of opportunity for the tax planner has been provided so that tax may be saved by providing a car instead of cash. This was not so evident in the Government's original proposal, but came about from the efforts of Democrat senators in reducing the value of car benefits for FBT purposes as the Bill was passing through Parliament.

A benefit arises when a "car" (as defined) provided in respect of employment of the employee is used for private purposes by the employee or his or her family or is regarded as being available for private use on that day by such a person; section 7. It is sufficient that the car is garaged at or near the employee's residence for it to be available for private use even if the employer forbids the employee to use it.

There are two alternative methods for valuing benefit, the statutory formula and operating cost. Two examples comparing them appear as Appendix "A". Which method is right for a particular taxpayer is very much a question of arithmetic. The statutory formula is based on the assumption that the further a car is driven in the year the more likely the use has been for business purposes. However, where the use of the car is wholly or substantially private, it is clearly better to adopt the statutory method even in the lowest annual kilometre category where the tax factor is 24% of cost. Not only is the FBT less but there is no need to keep a log book.

If business kilometres are substantial then the cost method might be appropriate, or it might be better to get the employee to take over the lease of the vehicle and reimburse him or her for business kilometres. This does not necessarily relieve the employee of the log book requirement, however, assuming business use is over 5 000 km a year. The statutory method does create some pressure to change cars more frequently, as the statutory percentage remains constant over the first four years the car is held, reducing to two-thirds after that.

It is also worthy of note that, under the statutory method, contributions by the employee to the cost of the car benefit, which reduce the taxable value,

include car expenses incurred directly by the employee; section 9(2)(e). This has the peculiar result that the employee's private running expenses, if properly substantiated, reduce the value of the benefit for fringe benefit tax purposes. In such a case the employee would wish to substantiate the business use also, to obtain an income tax deduction for it.

The log book requirement for fringe benefit tax purposes, which applies if the operating cost method is adopted, has been modified in line with the revised substantiation provisions, and now need be kept for only twelve weeks to evidence the extent of business use. An option to change from one method to the other has been provided in the changes announced in October 1986.

Car parking, originally to be assessed as a "residual benefit" under section 45, is to be exempted from fringe benefit tax according to the October 1986 announcement. This will be so whether or not the parking benefit is provided on the employer's premises. With central business district parking costing $2 000 – $3 000 a year there is scope for a substantial tax free benefit, and an unfortunate encouragement of private motoring in our congested city centres.

Whichever method is adopted for FBT purposes, car odometer readings have to be recorded at the beginning and end of the FBT tax year: section 10 FBT Assessment Act and ruling MT 2026. Log book entries must be signed and the records retained for a six year period; section 123. To paraphrase Napoleon, FBT and the substantiation provisions have forced Australians to become a nation of bookkeepers, albeit with less onerous duties than originally announced.

2. Travel, Accommodation and Expense Payments (sections 29-24)

Leaving aside the special case of airline operators and travel agents, if an employer either reimburses an employee or pays directly for travel, within Australia (and expenses incidental thereto) undertaken by the employee solely for business purposes, no fringe benefit tax complication need arise as long as they are expenses which would not require substantiation under the Income Tax Assessment Act (Fringe Benefits Tax Assessment Act section 24(1)(e) and definition of "eligible incidental travel expense payment benefits" in section 136(1)).

Once the payment falls outside these exceptions a taxable fringe benefit arises unless records of expenditure by the employee are kept and various declarations by him or her made. It would take up too much space to recount these requirements in detail but the records which must be kept are broadly similar to those for substantiation purposes under the Income Tax Assessment Act and the declarations by employees are supposed to link the expenditure and the income producing activity of the employee. The use of a credit card makes no difference (see section 150) and documentation of the expense is not necessarily facilitated since the customer's copy, let alone the monthly statement may not show enough detail to vouch the character of the expense.

Reimbursements for car expenses and extended Australian travel, and overseas travel require their own documentation, in line with the substantiation provisions. It can be seen these latter Income Tax Assessment Act provisions are having a wider effect than appeared to be the case when they were first introduced in late 1985 (applicable of course from July 1 1986).

There seems no great advantage in the employer paying for travel and accommodation direct rather than providing an expense allowance to the employee or allowing him or her to charge it on a company credit card. Direct payment may absolve the employee from making a declaration, but the substantiation provisions, when they apply, (extended Australian travel, overseas travel, car expenses, other expenses not falling within exceptions) will still have to be complied with.

3. Living away from home allowances (sections 30-31)

Closely associated with travel expenses are payments made by employers to compensate employees for the extra cost incurred as a result of having to work away from their usual place of residence. If these expenses are non-deductible by the employee then a fringe benefit exists and sections 30-31 apply. The general scheme is to exempt "a reasonable amount" for accommodation and "a reasonable amount" over a fixed level ($42 for adults) for food. Thus the first $42 for an adult is a taxable fringe benefit and that excess which is "reasonable" is exempt. "Reasonableness" of expenditure is a concept not much relied on by the Commissioner in the past (with the notable exception of payments to associated persons under section 65 of the Income Tax Assessment Act) and no doubt assessors and the more argumentative business taxpayers have room for dispute, but it should be remembered that the onus will be on taxpayers to justify the amount spent, not on the Commissioner to show that it was unreasonable.

There is an interesting wrinkle in those provisions which was no doubt put there in the interests inter alia of the lower echelon of the public service, and which has the effect of reducing the $42 benefit mentioned above. If the employer, in setting the amount of the food allowance made an estimate of the amount the employee would have spent on food which came to less than $42 then the amount of the taxable allowance is reduced. Suppose the food component set by the employer was $60, after estimating the employee's usual home food cost at $20. The taxable value of the allowance is then reduced by $38, the difference between $60 and $22. Hence the taxable value is $22. As usual a declaration on the approved form is required.

4. Attendances At Conferences, Seminars And Training Courses

The wide definition of fringe benefit catches most such events. To the extent that non-deductible entertainment is involved, no FBT liability need arise; Fringe Benefit Tax Assessment Act section 64 and Income Tax Assessment Act section 51AE. If, however, a deduction is available to the employer, section 51 of the Income Tax Assessment Act and the FBT provisions must be considered.

Professional maintenance expenses are deductible by employees and the self employed alike subject, in the case of employees, to the first $250 of "self education" expenses being excluded by section 82A of the Income Tax Assessment Act (another bit of underhand work by Treasury). For FBT purposes they are "residual fringe benefits" if paid in respect of employees but their taxable value is reduced to the extent that they would be deductible if paid by the employee. As the first $250 of "self education" expenses is non-deductible anyway under section 51 of the Income Tax Assessment Act this means that the taxable value must include the first $250. Remember though, that there is exemption of the first $500 of "in house" fringe benefits under section 62 of the Fringe Benefits Tax Assessment Act so if the employer is in the business of providing professional education the benefit will be exempt up to that amount. Once again, more paperwork is required.

5. Professional advice and services

These benefits are dealt with in the "residual benefits" category (sections 45-52) and taxable value arises if they are provided at less than 75% of their public price or market value, if provided by the employer, or less than their "arm's length" cost to the employer, if the benefits fall outside the usual range of services offered by the employer. If the transaction between the employer and supplier of the benefit is not arm's length then the value of the benefit is what the employee would have paid in a market transaction. In such a case the employer could well be taxed on a greater value than if an arm's length transaction had occurred. The Commissioner obviously has a detection problem here. It will be easy for say, solicitors, to give advice to employees and simply not book out the chargeable time, perhaps putting it down to attendance at CLE seminars. There is also the possibility that barter-free tax advice in exchange, for example, for free medical check-ups, could become more prevalent.

6. Offshore Coverage

The territorial link is provided through the Income Tax Assessment Act. Although the Fringe Benefits Tax Assessment Act "extends to every external Territory and ... to acts, omissions, matters and things outside Australia, whether or not in a foreign country" (section 163), FBT applies only to those employees whose salaries and wages are not exempt from income tax. This comes about because "employee" for FBT purposes is someone whose salary or wages are subject to PAYE deductions for income tax purposes, and those in receipt of exempt income are not caught by PAYE (Income Tax Assessment Act, section 221A(1), definition of "salary or wages").

It would seem, therefore, that the residence of the employer is an irrelevance for FBT purposes. What matters is whether the employee, in deriving salary or wages from his employment, is deriving assessable income rather than exempt income. As the writer understands it, the following table represents the incidence of FBT according to the residence of the employee in respect of whose employment a benefit is given.

	Australian Source Salary or Wages	Ex-Australian Source Salary or Wages
1. Employee a resident for Income Tax purposes.		
— FBT Liability?	Yes	(a) Yes, if salary or wages liable to Australian income tax. (b) No, if foreign tax credit exemption applies. (c) Yes, if DTA* allows country of residence to tax income *e.g.* Articles 14 & 15 of Aust-US Agreement.
2. Employee non-resident for Income Tax Purposes		
— FBT Liability?	Yes, unless DTA* allows country of residence to tax income.	No

*Note: DTA = Double Tax Agreement

One obvious problem is where the salary and wages have more than one source. Arguably any benefit for fringe benefit tax purposes is brought into the tax net. The Commissioner is unlikely to accept that that is excluded. Perhaps some apportionment is possible on the basis of the proportion of assessable income to exempt income. There are undoubtedly other similar problems yet to emerge.

Another question is that raised by the foreign tax credit method of dealing with overseas wage and salary income. Under the old system applicable until 30 June 1987, section 23(q) of the Income Tax Assessment Act exempted from Australian income tax foreign source income (excepting dividends) of residents on which foreign income tax was payable. But from 1 July 1987, section 23AG gives a full exemption to foreign source wage and salary income only if the taxpayer is absent from Australia for the entire income year. If he or she is overseas for up to 3 months there is no exemption (but

credit is given for foreign tax paid). If he or she is away between three and twelve months a pro-rata exemption is given. The FBT question is: to what extent must the employer, very likely foreign based, pay FBT on benefits provided to such employees? This matter is not yet dealt with by legislation, but in an announcement dated 26 August 1986, the Treasurer said the fringe benefit tax legislation would be amended

> to reflect the principle that related fringe benefits should be taxable only to the same extent. For example, an employee overseas for six months would bear Australian tax on only one half of his or her income from that overseas employment; the proposed amendment will ensure comparable FBT treatments of benefits provided to that employee.

Presumably this means the taxable benefit would be 50% of its normal value.[23] The Commissioner may have little success in collecting FBT from the employer in such circumstances.

Also in the same announcement it was said that exemption would be given to costs of travel by employees and their families in "prescribed developing countries" to obtain medical treatment for an injury or illness. This exemption will be limited to the travel costs to the nearest location where medical facilities are available. A slightly more generous concession made in the October 1986 announcement gives a 50% discount on the cost of holiday travel for overseas-posted employees, up to an amount equal to 50% of the cost of travel for one return holiday per year to Australia. This applies irrespective of the actual destination of the holiday travel. Also, education costs for children of employees posted overseas will be exempt for the period of overseas service (see sections 65, 65A).

Apart from the application of FBT to offshore situations, there is also the problem of compliance. How does an Australian airline find out whether its employees are availing themselves of reciprocal rights to standby travel while overseas? The Australian employer is liable to FBT. Must it renegotiate any agreement it has so that the overseas airline advise it of such benefits given? Most relevant to professionals are those situations where Australian domiciled employees go abroad for an indefinite term and are employed by an affiliate of their former Australian employer. Is the former Australian employer to be liable to FBT on any benefits provided by the current overseas employer? The case law indicates that two or three years away may be sufficient to establish that the employee is non-resident for income tax purposes[24] because his or her "permanent place of abode" is now outside Australia. If so, and the employee's income has an ex-Australian source, no FBT problem arises. If not, and the exemption for tax paid foreign source income is not applicable, or no DTA applies, the former Australian employer may be in trouble. (In an attempt to cast the net as wide as possible, "employee" for FBT purposes includes former and prospective employees).

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23 See now FBT Assessment Act, s.65C.

24 *FCT* v. *Applegate* 79 ATC 4307 and *FCT* v. *Jenkins* 82 ATC 4098.

On the subject of who is a resident, it should be noted that there is a definition of "resident" in section 164 of the Fringe Benefits Tax Assessment Act which although similar in part is not identical to that in the Income Tax Assessment Act. This definition (the FBT one) is for the purposes of the Fringe Benefits Tax Assessment Act and the explanatory note says that section 164 is relevant for some of the Act's collection provisions. It seems that the FBT definition of residence does not apply as far as the employee's residence is concerned.

The above discussion merely scratches the surface of the off-shore implications of FBT. Another unanswered question is whether it counts as an income tax for credit purposes under DTA's. Are the Commissioner's valuers going to spend a lot of time in various overseas locations valuing high priced real estate occupied by Australian employees of Australian or foreign employers? What tax does a university pay if one of its professors enjoys the comforts of an Oxford College for a term at a nominal rental?

7. Job Interviews and Relocation Expenses (sections 61B, 61C, 61D, 61E)

Amongst the various concessions announced in August and October 1986 were two of some general practical importance. The first (in August) was recruitment and relocation costs for new and current employees, including travel expenses, temporary accommodation costs and furniture removal expenses. The second (in October) was "costs incurred in the sale or purchase of houses on relocation, such as stamp duties, legal fees and agent's commissions". This is not likely to extend to any capital loss on sale reimbursed by the employer. Nevertheless the costs of buying and selling houses make this a useful concession and it solves the problems experienced by those employees who sought a deduction for those expenses themselves.

8. Restrictive Covenant Payments and Damages for Wrongful Dismissal

Capital amounts paid in respect of a legally enforceable contract in restraint of trade by a person are exempted from FBT (definition of "fringe benefit" in section 136). Under income tax law such amounts were not taxable in the hands of the recipient; *Higgs* v. *Olivier*.[25] But the capital gains provisions, dealing with the disposal of assets acquired since 19 September 1985 may apply. In particular, section 160M(7) of the Income Tax Assessment Act refers to a transaction under which consideration is received for forfeiture or for refraining from exercising a right and it appears from the Treasurer's Explanatory Memorandum to that provision that it is intended to tax consideration received for restrictive covenants under it. As the cost of such an "asset" would be nil, the entire amount would be taxable.

Amounts paid by way of damages for wrongful dismissal are of course paid in consequence of the termination of employment, and it could be argued that the concessional provisions of section 27A are applicable. Such a payment is excluded from FBT and capital gains tax.

25 [1952] 1 Ch 311.

V. CONCLUSION

Fringe benefits tax is an elegant, complex, sophisticated and burdensome solution to what was admittedly a real and growing problem, the erosion of the tax base through the use of fringe benefits. This solution bears out what could be called the Sawyer thesis, although it is likely that Peter Sawyer, who wrote "Dolebludging — A Taxpayer's Guide", is merely the latest in a long line of informed critics who have made the same point about the public service reward structure. Indeed, Lester Thurow, the eminent American management consultant has made the same point about reward structures in large American business corporations. The Sawyer Thesis goes like this. If you have an organisation where the prime imperative is survival and growth of the organisation rather than the efficient supply of goods and services (and hence profit maximisation), then success of an individual in the organisation will be measured by salary in terms not of his/her output but in terms of how many persons he or she controls. Thus in proposing a solution to a problem like welfare fraud, one would reject such alternatives as a few more well-publicised prosecutions of bad cases (which may call into public question the integrity of the welfare system) or tightening of eligibility criteria (why save money, we're not judged on efficiency). Instead, propose a solution like the Australia Card program. At the cost of $X million, we can have a new computer, X 000 new staff and the designers (us), knowing most about the new system, are shoo-ins for the posts at First Assistant Secretary level which are justified by being in charge of such a large operation. The strategy is not without risks of course. Considerable effort is required to sell it to the politicians and as the program requires additional resources, other parts of the public service are going to look critically at it. Once the program is sold and implemented however, it does not matter to its designers that it turns out to be a comparative failure. By the time that has been discovered the bureaucratic entrepreneurs responsible for the idea will probably have moved on.

It should be added that in the case of the Department of Social Security, the Australia Card was not entirely their idea. It appears that the major push for it came from the Health Insurance Commission which had substantial computing facilities and an uncertain future. However, lest anyone should protest that the efficient and dedicated, not to say zealous, staff of the Australian Tax Office are immune from such empire building, consider some relevant statistics. In 1952 the Australian Tax Office had 7 600 staff. This number grew to 8 042 by 1962 and 11 036 by 1972, ninety-five in the executive division. By 30 June 1985, Tax Office staff totalled 15 904 with 227 in the executive division.[26]

26 Source: Commissioners; Annual Reports 1951-1952 to 1984-1985.

In summary, while staff has grown 44% since 1972 the number of senior officers has more than doubled. Remember too that with increasing computerisation the quality (in terms of academic credentials) of Tax Office staff (and hence average salary) has tended to increase, as mechanical jobs once done by unqualified staff are now done by machines. For the FBT it seems that some 590 extra staff were required in 1986-1987 alone (despite its self-assessing nature). Their cost will be high in relation to revenue gain although they do also have the function of protecting the tax base and the revenue gained will help make the promised tax cuts possible, or at least less easy to wriggle out of.

Clearly, the main problem with FBT is the insouciant attitude of its progenitors towards the paperwork burden it creates. Although the Tax Office will require substantial additional resources to administer this new tax it is fair to say that the bookkeeping and return burden placed on employers and employees (including those in the public sector) far exceeds that placed on the bureaucrats (using the word in its pejorative sense) responsible for collecting it. This attitude, whether due to ignorance (the charitable view), lack of foresight, stupidity or worse will do much to undermine the effectiveness of FBT as a means of preventing the erosion of the income tax base. It is of course not the draftsperson's fault that political considerations prevented the framing of a tax which would more strongly discourage the granting of benefits in kind, especially company cars, but what we now have is the world's most complicated 'solution' to the fringe benefit problem which still provides plenty of opportunity for avoidance and evasion. New Zealand, the only other country to impose FBT on employers rather than employees, did so, apparently effectively, in a mere fourteen pages of legislation (and incidentally, managing to bind the Crown). Australia has close on one hundred pages, incomprehensible without reference to other legislation (and incomprehensible to most people anyway) which will require many rulings by the Tax Office before most employers are certain of their obligations. This 'Revenge of the Nerds' may give some short term bureaucratic satisfaction and advance a few people's careers (not to mention the mini-boom in recording systems, explanatory texts and seminars) but may not go very far towards making our tax system more equitable. It has certainly made it more complex.

APPENDIX "A"

FBT on employer-provided car for full year 1987-1988. FBT rate 49%.
Car cost $20 000 new on 1 April 1987.
During 1987-1988 is driven 16 000 km.
Employee pays for all petrol, repairs and maintenance, $1 500 in total.
Real cost (before FBT) to employer of providing car is:

	$
Rego and Insurance	700
Cost of funds (at 18%)	3 600
Depreciation (at 22.5%)	4,500
	8 800
Less income tax benefit (at 49%)	4 312
Real cost (before FBT)	4 499

A. *ASSUME 100% PRIVATE USE*

1. FBT liability if statutory formula method chosen (also applies if no election made)

   Taxable value = $(20 000 x .18) – 1 500 = $2 100
   Tax at 49% = $1 029

   Real cost (including FBT) = $5 517
   (up about 23%)

2. FBT liability if operating cost method chosen.
   Taxable value made up as follows:

	$
Interest at 14.75%	2 950
(CSB base rate)	
Rego and insurance	700
Depreciation	4 500
Taxable value (employee has paid for repairs, maintenance & petrol)	8 150

Tax at 49% = $3 994
Real cost (including FBT) = $8 482

B. *ASSUME 50% BUSINESS USE*

1. FBT liability if statutory formula applies.
   Taxable value = $(20 000 x .18) — 750 = $2 850

   Tax at 49% = $1 397

   Real cost (including FBT) = $5 885
   (not including running costs)

   But 50% of running costs are deductible by employee, if business use substantiated. If employer reimburses 50% of running costs, amount reimbursed is deductible by employer (and not taxable to employee) if business use substantiated.

2. FBT liability if operating cost adopted.

   Taxable value as under A.2. above *reduced* for substantiated business use.

   Taxable value = $8 150 x 50% = $4 075

   Tax at 49% = $1 997

   Real cost (including FBT) = $ 6 485

   The same remarks on running costs as for B.1. above apply.

C. *ASSUME 80% BUSINESS USE*

1. FBT liability if statutory formula applies.

   Taxable value = $(20 000 x .18) — 300 — 300 = $3 000
   Tax at 49% = $1 617
   Real cost (including FBT) = $6 105
   (not including running costs)

   Now 80% of running costs are deductible by employee, if business use substantiated. If employer reimburses 80% of running costs, amount reimbursed is deductible by employer (and not taxable to employee) if business use substantiated.

2. FBT liability if operating cost adopted.
   Taxable value as under A.2. above *reduced* for substantiated business use.

   Taxable value = $8 150 x 20% private use
   = $1 630
   Tax at 49% = $ 799
   Real cost (including FBT) = $5 286
   The same remarks on running costs as for C.1. apply.
   Operating cost is the preferred option here.