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## ***In-house fringe benefits under salary packaging arrangements***

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### **Outline of chapter**

7.1 Schedule 7 to this Bill amends the *Fringe Benefits Assessment Act 1986* (FBTAA) to remove the concessional fringe benefits tax (FBT) treatment for in-house fringe benefits accessed by way of salary packaging arrangements.

7.2 All references to legislative provisions in this Chapter are references to the FBTAA unless otherwise stated.

### **Context of amendments**

7.3 The FBT system was introduced in 1986 to ensure that all forms of employee remuneration are taxed, whether provided as salary and wages or in a non-cash form. However, to ensure that the system was fair, and recognising the practicalities of taxing non-cash employee remuneration, a number of concessions and exemptions were provided for in the FBT law.

7.4 Most relevantly for this measure, there are a number of concessions in the FBT law that apply to in-house fringe benefits. An in-house fringe benefit is broadly a benefit that is provided either by the employer, an associate of the employer or a third party to an employee where the provider of the benefit carries on a business that consists of, or includes, providing identical or similar goods or services to customers at arm's length.

7.5 These concessions were originally included in the FBT law to reflect, amongst other things, the true cost of the benefits to the employers and are provided in the law by way of special valuation rules, specific exemption provisions and reductions of aggregate taxable value.

7.6 The concessions were not intended to allow employees to access goods and services by agreeing to reduce their salary and wages (through salary packaging arrangements) in order to buy goods and services out of pre-tax income.

7.7 Since the in-house fringe benefits concessions were included in the FBT law, changes in technology have increased access to salary sacrifice arrangements.

7.8 As a result of expansion in the availability of salary sacrifice arrangements, employees are increasingly accessing concessionally taxed fringe benefits under these arrangements and receiving tax-free non-cash remuneration benefits for goods and services.

7.9 In comparison, other employees or self-employed persons who acquire these items are required to pay for them out of their after-tax income. This is because FBT applies to virtually all employers, including government and is designed to be as inclusive as possible in the coverage of benefits received by employees in respect of their employment.

## **Summary of new law**

7.10 Schedule 7 to this Bill removes concessions for in-house fringe benefits where those benefits are accessed by way of a salary packaging arrangement.

7.11 In particular, these amendments:

- remove the concessional taxable value calculation method for particular benefits;
  - The concession associated with the valuation of particular in-house expense payment benefits, in-house property benefits or in-house residual benefits no longer applies where the benefit is accessed by way of a salary packaging arrangement.
  - Instead, the taxable value of the benefit is based on the ‘notional value’ of the benefit.
- remove the exemption that applies for residual benefits that are provided for transport from home to work (for employers in the transport business) and accessed through a salary packaging arrangement; and
- remove the annual \$1,000 reduction of aggregate taxable value in respect of in-house fringe benefits where they are provided under a salary packaging arrangement.

7.12 However, these amendments do not affect the concessions relating to in-house benefits provided by employers where those benefits

are provided outside of a salary packaging arrangement or are paid for out of after-tax income.

### **Comparison of key features of new law and current law**

<i>New law</i>	<i>Current law</i>
Concessions that apply to the valuation rules in respect to in-house expense payment benefits, in-house property benefits and in-house residual benefits do not apply to benefits where the employee accesses the benefit under a salary packaging arrangement.	Concessions apply to the valuation of in-house expense payment benefits, in-house property benefits and in-house residual benefits.
The specific exemption that applies to residual benefits in respect to private home to work travel through public transport (where the employer and associate are in the business of providing transport to the public) does not apply where the benefit is provided in-house and where the employee accesses the benefit under a salary packaging arrangement.	Specific exemptions apply to particular residual benefits where the benefit is for work-related travel through public transport (where the employer and associate are in the business of providing transport to the public).
The annual reduction of aggregate taxable value of \$1,000 does not apply to in-house benefits where the employee accesses the benefit under a salary packaging arrangement.	An annual reduction of aggregate taxable value of \$1,000 applies to in-house benefits provided to employees.

### **Detailed explanation of new law**

7.13 Under the FBT law, there are different types of benefits that may be provided by employers in-house where the employer is in the business of providing the same goods and services to their clients. Concessions are granted in the law to change the way those benefits are valued and to reduce the extent to which they are taxed.

7.14 Under this measure, these concessions no longer apply where the in-house benefits are accessed under a salary packaging arrangement.

## **What is a ‘salary packaging arrangement’?**

7.15 The concept of a ‘salary packaging arrangement’ has been introduced to the FBT law as a defined term as part of these amendments. *[Schedule 7, item 12, subsection 136(1)]*

7.16 The defined term of ‘salary packaging arrangement’ has been modelled closely on the wording that was used in subsection 41(2) which essentially captured the concept of a salary packaging arrangement (also commonly referred to as salary sacrifice or total remuneration packaging).

7.17 ‘Salary packaging arrangements’ means arrangements 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
- 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.

7.18 This most commonly covers situations where the employee enters into an agreement with their employer to have their salary and wages reduced (or ‘sacrificed’) in order to receive a benefit.

### **Example 7.1: Negotiated salary packaging arrangement**

Felicity has just started working for a car company and in negotiating her remuneration package agrees with her new employer to forego \$25,000 of her yearly salary in order to receive the use of a car.

As she has entered into an agreement to reduce her salary and wages, Felicity would be taken to have entered into a salary packaging arrangement.

7.19 However, it also covers situations where a reduction in salary might not have been negotiated but the employee is given a benefit as part of their employment contract, and it is reasonable to assume that the salary and wages they would have received would have been greater without that benefit being provided.

### **Example 7.2: Implicit salary packaging arrangement**

McKenzie has started employment with an IT firm. His job was previously advertised as having a total remuneration package of \$100,000 per year.

McKenzie only receives \$95,000 in salary and wages but is given by his employer, free of charge, gaming and photography software of which the notional value would be \$5,000.

In this case, whilst McKenzie has *not* entered into a separate agreement to reduce his salary and wages, the salary and wages he would have received would clearly have been greater if the benefit had not been provided. Therefore, McKenzie has entered into a salary packaging arrangement.

### **Amendments to in-house property fringe benefits**

7.20 In general, a property fringe benefit includes:

- goods (including gas and electricity, unless provided through a reticulation system) and animals;
- real property, such as land and buildings; and
- rights to property, such as shares or bonds.

7.21 These benefits can be provided in-house by an employer most commonly where those goods are manufactured or produced by the provider or purchased and sold as part of the employer's business.

7.22 Different valuation rules apply to in-house property fringe benefits depending on whether the goods are made by the employer or sold as part of the employer's business.

7.23 These amendments modify the operation of section 42 so that the taxable value of an in-house property fringe benefit provided under a salary packaging arrangement is its 'notional value'. [*Schedule 7, item 2, paragraph 42(1)(aa)*]

7.24 The 'notional value' of an in-house property fringe benefit accessed through a salary packaging arrangement takes its meaning from subsection 136(1) and means the amount that the employee could reasonably be expected to have been required to pay to obtain the property from the provider under an arm's length transaction (that is, market or fair value).

#### **Example 7.3: Taxable value of an in-house property fringe benefit**

Kane works at the Geelong Meat Works abattoir and as part of his annual remuneration negotiations agrees to a reduction in his salary in exchange for a meat pack for Christmas which includes hams, steaks and other choice cuts. This meat pack is an in-house property fringe benefit.

The taxable value of the benefit would have previously been 75 per cent of the lowest price paid for the meat, which would have been the wholesale price.

However, under this measure the taxable value of the benefit provided to Kane would be the notional value of the meat, which is its market value. As Kane is not a wholesaler the taxable value would therefore be the retail price of the meat.

### **Amendments to in-house residual fringe benefits**

7.25 Residual benefits are benefits that are not a specific type of benefit covered by any other provision of the FBTAA. They often include intangible benefits such as services.

7.26 Residual benefits will be an in-house residual fringe benefit if the employer (or an associate) provides a benefit to the employee that is identical or similar to rights, services or facilities provided to the public in the ordinary course of its business.

7.27 These amendments alter two concessions that apply to in-house residual benefits:

- the valuation rule for all in-house residual fringe benefits; and
- the exemption that applies for public transport from home to work (provided by employers and associates of the employer in the public transport business).
  - But only to the extent that the benefit is provided in-house and under a salary packaging arrangement.

### ***Changes to the valuation rules for in-house residual fringe benefits***

7.28 Under sections 48 and 49, different valuation rules apply to in-house residual fringe benefits depending on whether the benefits are provided on an ongoing periodical manner and whether they are provided on an identical basis to members of the public or not.

7.29 These amendments modify sections 48 and 49 so that the taxable value of an in-house residual fringe benefit provided under a salary packaging arrangement is its 'notional value' at the comparison time (see paragraph 7.22) reduced by any recipient's contribution. [*Schedule 7, items 7 and 9, paragraphs 48(aa) and 49(aa)*]

**Example 7.4: Taxable value of an in-house residual fringe benefit**

Cecilia works for an appliance rental franchise and as part of her remuneration, she agreed to salary package the rental of a flat screen television and video gaming console for a six month period.

Ordinarily her employer would value the rental for the purposes of FBT at 75 per cent of the lowest price paid by other customers.

However, under this measure, the employer would instead determine the taxable value on the basis of its notional value which is its market value and is therefore determined to be the retail price of the rental contract.

***Changes to the specific exemption for in-house residual fringe benefits***

7.30 These amendments modify subsection 47(1) so that a residual benefit is not exempt where the benefit was provided in-house and was accessed by way of a 'salary packaging arrangement'. [*Schedule 7, item 6, paragraph 47(1)(f)*]

7.31 The exemption in subsection 47(1) covers the provision of a benefit in respect to work-related travel of an employee through public transport where the employer operates a business of providing transport to the public. Or, where the benefit is provided by an associate of the employer, and both the employer and the associate operate a business of providing transport to the public.

7.32 This exemption covers residual benefits that are provided in-house because it requires both the employer and any associate of the employer to be in the business of providing public transport services for the exemption to apply and the benefit specifically relates to the provision of work-related travel by public transport.

7.33 Consequently, where this benefit is accessed under a salary packaging arrangement, the exemption will no longer be available. [*Schedule 7, item 6, paragraph 47(1)(f)*]

**Example 7.5: No exemption for a residual benefit provided in-house and through a salary packaging arrangement**

The McGahee Bus company provides public transport in an inner city community. Willis is a bus driver for the company and lives in a neighbouring town which is serviced by BJGE Buses (an associate of the McGahee Bus company).

In order to get to work Willis salary packages his bus travel to and from work and the benefit is exempt so the McGahee Bus company pays no FBT.

Under this measure, the exemption will not apply as Willis has a salary packaging arrangement in place.

### **Changes to in-house expense payment fringe benefits**

7.34 An expense payment benefit arises when a payment is made in discharge of an obligation of an employee or when a reimbursement is made to an employee for expenditure incurred by him or her.

7.35 An in-house expense payment fringe benefit arises where the expenditure reimbursed or paid for was incurred by the employee (or family member) in purchasing goods or services that the employer (or an associate) sells in the ordinary course of business.

7.36 In-house expense payment fringe benefits are either in-house property expense payment fringe benefits or in-house residual expense payment fringe benefits.

7.37 Consequently, as the concessions related to in-house expense payment fringe benefits are co-located with the relevant in-house property or residual benefits, no amendments are needed for the in-house expense payment fringe benefit provisions.

7.38 Rather, the concessions are appropriately limited where they are accessed under a salary packaging arrangement through the amendments that are detailed above.

### **Amendments to the reduction of the aggregate taxable value of certain fringe benefits**

7.39 Section 62 reduces the aggregate taxable value of in-house fringe benefits provided by an employer to an employee in an FBT year by up to \$1,000. This reduction is applied after the taxable values are calculated under the relevant sections depending on the type of in-house fringe benefits provided.

7.40 These amendments modify section 62 so that the \$1,000 reduction for aggregate taxable value of the in-house fringe benefits does not apply to benefits provided by way of a salary packaging arrangement. *[Schedule 7, item 11, paragraph 62(2)(a)]*

#### **Example 7.6: Reduction of aggregate taxable value of salary packaged and non-salary packaged in-house benefits**

Ronita works for an electricity and gas provider and receives two types of in-house benefits. The first is an in-house residual expense payment benefit in respect to her quarterly electricity bill. The taxable value of



the benefit is \$500 a year and it is provided under a salary packaging arrangement.

The second benefit is the provision of bottled gas and is an in-house property benefit. The taxable value of the benefit is \$500 and it is not provided under a salary packaging arrangement.

Under this measure, Ronita's employer would not reduce the aggregate taxable value of the electricity bill benefit because it is provided under a salary packaging arrangement and therefore would only reduce the aggregate taxable value of the gas bottle benefit to zero (as the sum of the taxable value of the non-salary packaged in-house benefits is less than \$1,000).

## **Application and transitional provisions**

7.41 These amendments will apply in relation to benefits provided on or after the day that this measure was announced, which was 22 October 2012. *[Schedule 7, item 13]*

7.42 However, there are transitional arrangements that apply to certain salary packaging arrangements that were entered into by the employer and employee before 22 October 2012 ('existing salary packaging arrangements'). *[Schedule 7, subitems 13(2) and (3)]*

7.43 Benefits under such an arrangement that are provided before 1 April 2014 continue to apply the law as it applied before the amendments. All benefits provided on or after 1 April 2014 to employees will be subject to this measure.

## **Meaning of 'existing salary packaging arrangement'**

7.44 An 'existing salary packaging arrangement' means a 'salary packaging arrangement' (as introduced by these amendments) that was both agreed to (employer and employee agree to conditions of arrangement) and was entered into (the arrangement was given legal force) before 22 October 2012.

7.45 There is no requirement for the actual reduction of salary and wages or provision of the benefit to occur prior to 22 October 2012, only that the arrangement to do so was entered into and had legal force prior to 22 October 2012.

**Example 7.7: Existing salary packaging arrangement where salary deductions start after 22 October 2012**

An employer offers a salary packaging arrangement to employees which must be taken up prior to 22 October 2012. The benefits will be available to employees during the months of December 2012 and January 2013. However, the pre-tax salary deductions do not commence until the employee has submitted a claim for expenses incurred during the relevant period.

Assuming that an employee accepted the offer prior to 22 October 2012 and the employee receives the reimbursement for expenses prior to 1 April 2014, this arrangement would be covered by the transitional provisions.

**Example 7.8: Existing salary packaging arrangement where employer offers arrangement and employee takes it up prior to 22 October 2012**

A retail employer provides its employees with the option to salary package certain in-house property fringe benefits. There is no end date for the offer to salary package and no details on the terms or conditions that apply to particular employees.

Harold works for the retail employer and has previously utilised the salary packaging offer to purchase a coffee machine that his employer sells. He is now deciding whether to take up the offer to salary package a kayak which his employer sells. On 18 October 2012, he decides to take up the offer and fills in the requisite forms that lock him into the salary packaging arrangement.

As he has entered into the pre-existing offer for salary packaging (in respect to the kayak) and has an agreement that is binding prior to 22 October 2012, Harold's benefits would be covered by the transitional provisions.

**Example 7.9: Existing salary packaging arrangement where employer offers arrangement and employee does not take it up prior to 22 October 2012**

As per Example 7.8 above, with the exception that Harold delays his decision and decides on 24 October 2012 (after the announcement date) that he wants to take up the salary packaging offer.

In this case, whilst his employer has offered a salary packaging arrangement prior to 22 October 2012 and despite the fact that he entered into a previous arrangement for the purchase of the coffee machine, Harold does not have a binding agreement in place in respect to the packaging for a kayak. For that reason, Harold's benefits would not be covered by the transitional provisions.

### **Material alteration or variation to an existing salary packaging arrangement**

7.46 Where an existing salary packaging arrangement is materially altered or varied on or after 22 October 2012, it will no longer be subject to the transitional arrangements. *[Schedule 7, subitem 13(2)]*

7.47 In determining whether an alteration or variation is material to the existing salary packaging arrangement, regard must be had to the particular wording of the agreement and what constitutes material will often depend on the facts and circumstances of the arrangement.

7.48 Alterations or variations of an existing salary packaging arrangement that would more than likely be considered material include, but are not limited to:

- a change of employer;
- alteration of the fixed end date of the arrangement; and
- variation to the types of benefits covered under the arrangement.

### **Consequential amendments**

7.49 There are a number of minor consequential amendments that are made to update cross references in provisions that are amended to give effect to this measure. *[Schedule 7, items 1, 3 to 5, 8 and 10]*

## **STATEMENT OF COMPATIBILITY WITH HUMAN RIGHTS**

### **Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011***

#### **In-house fringe benefits under salary packaging arrangements**

7.50 Schedule 7 is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

## **Overview**

7.51 Schedule 7 to this Bill amends the FBT law to remove the concessional FBT treatment for in-house fringe benefits accessed by way of salary packaging arrangements.

7.52 These amendments apply retrospectively to benefits provided on or after the announcement date of the measure, which was 22 October 2012. However, those arrangements entered into prior to that date will receive transitional treatment until 1 April 2014.

## **Human rights implications**

7.53 Article 15 of the *International Covenant on Civil and Political Rights* requires that laws must not impose criminal liability for acts that were not criminal offences at the time they were committed. This Article prohibits retrospective criminal laws.

7.54 However, these amendments do not engage with this human right because whilst they apply retrospectively they do not impose a criminal liability for acts that were not criminal offences at the time they were committed.

7.55 The retrospective application of these amendments may, however, be considered to trespass unduly on personal rights and liberties, in breach of principle 1(a)(i) of the Standing Orders of the Senate.

7.56 However, retrospective application dates for revenue measures are both common and necessary because, as with this measure, it is important that the measure apply from the date of announcement to ensure that entities do not change their arrangements or behaviour to take advantage of a timing gap between the announcement of a new tax treatment and the existing law which will undermine the integrity of the tax system.

7.57 These amendments are consistent with the position of the Senate Standing Committee for the Scrutiny of Bills in so far as retrospective application of the amendments is legitimate because the amendments are both a revenue measure and they have been introduced within six months of announcement (as required under Senate Resolution No. 40 of 8 November 1988).

7.58 Moreover, entities affected by these amendments were provided with sufficient detail about the proposed changes on the day of announcement in order to manage their affairs. Furthermore, those entities that have pre-existing arrangements affected by these amendments

have been given a sufficient transitional period to bring those arrangements to a close.

## **Conclusion**

7.59 This Schedule is compatible with human rights because the aim of protecting the integrity of the tax system is legitimate. To the extent that this Schedule may limit those rights, those limitations are reasonable, necessary and proportionate to the aim.

**Assistant Treasurer, the Hon David Bradbury**