

Fringe Benefits Tax + Deductions 1

Fringe Benefits Tax

1.1 Fringe Benefits Tax Assessment Act

Fringe Benefits Tax Assessment Act 1986 (FBTAA) is A separate tax - s66 imposes obligation to tax. The relevant tax period is 1 April – 31 March. 'Reportable Fringe Benefits Amount' included on employee's payment summary where individual fringe benefits amount is \$2000 or more

- Employee's Individual fringe benefits amount (s5E)
- Excluded fringe benefits (s5E(3))
- Quasi fringe benefits (s135Q)
- Self-assessment
- Employers are generally required to pay FBT in quarterly instalments, unless their FBT liability in the previous year of tax was below \$3,000
- FBT instalments credited against their actual FBT liability for the year

1.2 Outline of Key Steps

1. Has a fringe benefit been provided?
2. Determine the taxable value of each benefit
3. Aggregate by type
4. Gross-up
5. Aggregate totals and apply FBT rate

1.3 What is a 'Fringe Benefit'

S136, FBTAA:

A fringe benefit is a benefit provided during year of tax in respect of any year to an employee/associate by an employer participating in or facilitating the provision or receipt of the benefit in respect of the employment of the employee. Exclusion: salary/wages, exempt benefits e.g., taxi travel, provision of work-related items and superannuation contributions by employers

1.4 S136 - Definitions

- Benefit = any right (including a right in relation to, and an interest in, real or personal property), privilege, service or facility including where provided under arrangements
- Provide = allow, confer, give, grant or perform
- Current employee = means a person who receives, or is entitled to receive, salary or wages
- Current employer = means a person... who pays, or is liable to pay, salary or wages
- Salary or wages = means a payment from which an amount must be withheld under s12-35 to s12-120 Taxation Administration Act 1953

1.5 How to Calculate Fringe Benefits Tax

FBT = Fringe Benefits Taxable Amount x FBT Rate

- Fringe Benefits Taxable Amount = Type 1 aggregate fringe benefits amount * 2.0802 + Type 2 aggregate fringe benefits amount * 1.8868 + Aggregate non-exempt amount

- FBT Rate = 47% (17/18) and 49% (16/17)

Note:

- s5B(1B) Type 1 - GST creditable, i.e. employer is entitled to claim GST credits
- s5B(1C) Type 2 - not GST creditable, i.e. employer is not entitled to claim GST credits

Why gross up?

- To put the employee in a position where they would have the same salary to obtain the benefit. This is meant to provide equality
- The taxable employer is entitled to claim a deduction for the FBT paid.

Aggregate non-exempt amount – only for employers that provide benefits falling within exemption in s57A, ie, certain public/non-profit hospitals, public ambulance services providers, health promotion charities, public benevolent bodies. Calculated as the sum of the grossed-up value of benefits provided to each individual employee that exceeds certain thresholds.

1.6 Valuation

Each kind of fringe benefit has its own valuation rules. Concessional treatment sometimes applies to 'in-house' benefits. Unreimbursed contributions by employee excluded. Otherwise deductible rule – if the employee had acquired the benefit directly, would they have been entitled to a deduction for the expenditure? Taxable value is reduced by this notional deduction

Reduction amounts – eg, s62 the first \$1000 of the aggregate of any 'in-house fringe benefits' (not provided under a salary-packaging agreement) provided to an employee in a particular year of tax is not subject to FBT

1.7 Types of Fringe Benefits

Car benefits s7(1), Debt waiver benefits s14, Loan benefits s16, Expense payment benefits s20, Housing benefits s25, Living Away From Home Allowance s30, Airline Transport Benefits s32, Board Benefits s35, Meal Entertainment Benefits s37AC, Car Parking Benefits s39A, Property Benefits s40, Residual Benefits (**any leftover that does not fit above goes here**) s45

Example: Car Fringe Benefit

s9 FBTA Method: **ABC/D – E**

- A is the base value of car
- B is the statutory fraction (**now generally 0.2**)
- C is the number of private days ↑ D is the number of days in the year
- E is the recipient's contribution

s10 FBTA Method: **(C x (100% - BP)) – R**

Tom's employer provides him with a new Honda as part of his salary package. Each night the car is garaged at Tom's house. The leased car value of the Honda was \$22,000. The lease costs are \$750 per month. The other running costs including registration, insurance etc are

\$300 per month. Assume the car travelled 20,000 km during the year, 25% of which was on business. Assume this is a Type 1 fringe benefit.

Statutory formula method: A base value \$22,000, B statutory fraction 0.2, C number of private days 365, D number of days in the year 365, E recipient's contribution 0

Taxable value of car fringe benefit = $((A \times B \times C) / D) - E = (22,000 \times 0.2 \times 365) / 365 - 0 = 4400$

Gross up, ie multiply by 2.0802 (Type 1 fringe benefit) $4400 \times 2.0802 = 9,152.88$ FBT payable = $9,152.88 \times 47\%$ (FBT rate) = \$4,301.85

Operating Costs Method C operating costs $(\$750 + \$300) \times 12 = \$12,600$ BP business percentage 25% R recipient's contribution 0

Taxable value of car fringe benefit = $[C \times (100\% - BP)] - R = 12,600 \times 75\% - 0 = 9,450$ Gross up, ie multiply by 2.0802 (Type 1 fringe benefit) $9,450 \times 2.0802 = 19,657.89$ FBT payable = $19,657.89 \times 47\%$ (FBT rate) = \$9,239.21

1.8 S67 Anti-Avoidance

s 67 FBTA general anti-avoidance rule

- Commissioner can rely on s 67 where an arrangement is entered into for the sole or dominant purpose of reducing an employer's FBT liability
- Commissioner may cancel the tax benefit arising under the arrangement and impose penalty tax

1.9 Interaction with Other Tax Legislation

FBT takes priority over s15-2 ITAA97

See 23L(1) ITAA36 – fringe benefits are NANE income (to the employee). Similarly, see 23L(1A) ITAA36 – Exempt benefits are exempt income (to the employee)

FBT/the cost of benefits is generally deductible to Employer under s8-1 ITAA97.

Generally, GST is not paid on supplies that constitute the provision of fringe benefits unless a 'recipient's contribution' is involved

Deductions 1

Context:

- Income Tax = (Taxable Income * Rate) – Tax Offsets [s4-10(3)]
- Taxable Income = Assessable Income – **Deductions** (s4-15)
- Deductions = General Deductions (s8-1), Specific Deductions (s8-5)

1.10 S8-1 General Deductions

s8-1 Two Positive Limbs:

- (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 purpose of gaining or producing your assessable income.

s8-1 Four Negative Limbs:

- (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; or
 - (d) a provision of this Act prevents you from deducting

1.11 S8-10 No Double Deductions

Where a loss/outgoing may be deductible under more than one provision, use the most appropriate provision. Thus, no double deductions

1.12 Key Requirements

1. Nexus test: is there a sufficient connection between the loss/outgoing and either one of the positive limbs?
2. If so, the loss/outgoing is NOT capital?

1.13 Loss or Outgoing

Loss - taxpayer's financial resources have been diminished, for example:

- taxpayer's money has been stolen (Charles Moore & Co (WA) Pty Ltd (1956) 95 CLR 344)
- write off bad debts (AGC (Advances) Ltd v FCT (1975) 132 CLR 175)

Outgoing- usually involves some form of payment, outlay or expenditure, or the taxpayer is committed to spend money eg, has received invoice

1.14 In Gaining or Producing

In = in the course of

'Incidental and Relevant' test

- Ronpibon Tin NL v FCT (1949) 78 CLR 47: "For expenditure to form an allowable deduction as an outgoing incurred in gaining or producing the assessable income it must be incidental and relevant to that end...In brief substance, to come within the initial part of the subsection it is both sufficient and necessary that the occasion of the loss or outgoing should be found in whatever is productive of the assessable income or, if none is produced, would be expected to produce assessable income."

Herald & Weekly Times: a newspaper publisher was allowed deductions for costs incurred in defending/settling an action brought against it for alleged defamatory articles that had been published in its newspaper. Unavoidable incident of publishing a newspaper.

W Nevill & Co: a company was allowed a deduction for amounts paid to one of its managing directors in consideration of him agreeing to resign, where the payment was made for the purpose of increasing the efficiency of the company

1.15 Pre-Commencement

Losses/outgoings which are preliminary to the commencement of an income producing/business activity are not incurred 'in the course of' such activity and are not deductible under general provision 8-1

Softwood Pulp & Paper: company incurred feasibility study and other costs to determine whether or not to establish a new paper production mill. Ct held that the costs were NOT deductible as everything that was done was preliminary to the commencement of an income producing activity/ business.

Goodman Fielder Wattie: company was collaborating in a research project re development of monoclonal antibodies. Ct denied deductions for its initial r&d expenditure on the project as its activities were of a provisional kind only, taxpayer had not yet committed itself to the project nor made a final definitive decision to do so

Steele: A woman borrowed money, bought land & wanted to build hotel on it, but the deal fell through. Ct held the interest expenditure was deductible. Ct looked at: what did she do with the borrowed money? Taxpayer had no plans to use the land for any purpose other than gaining assessable income.

Maddalena: re 1st positive limb, expenses to get new employment are not in the course of gaining/producing assessable income. Football player who played for one club and was trying to get a contract with another club, incurred expenses in travelling to 2nd club, payments to his manager to negotiate on his behalf. Ct said expenses were not deductible as incurred at a point too soon.

1.16 Post-Cessation

May be deductible if the occasion of the loss/outgoing is found in business operations that were formerly carried on by the taxpayer for the purpose of gaining assessable income

AGC (Advances) Ltd v FCT (1975) 132 CLR 175: the company had restructured its business as a result of a scheme of arrangement & had subsequently been taken over by another company. Deductions were allowed for losses incurred in relation to bad debts arising from its previous business activities. A loss constituted by the writing off of a bad debt is incurred at the time when the debt is written off (which may occur after the taxpayer has ceased to carry on as a going concern the business in which the debt was created). Look at 'whether the occasion of the loss/outgoing could be found in the carrying on of the taxpayer's business' for the purpose of producing assessable income. Note: AGC declined to follow Amalgamated Zinc case.

Placer Pacific Management Pty Ltd 95 ATC 4459: Several years after the taxpayer had sold its conveyor belt business, it incurred expenditure in settling a customer dispute concerning a faulty conveyor belt it had supplied. The occasion of the outgoing was to be found in the business operations directed towards the gaining/producing of assessable income (doesn't matter outgoing was in a year later than the year in which the income was incurred, nor that in the meantime business in the ordinary sense may have ceased, the Division had been

sold & its active manufacturing business terminated.) The occasion of the loss/outgoing was the business arrangement entered into between taxpayer/customer for the supply of the conveyor belt, and deduction was allowed.

“...provided the occasion of a business outgoing is to be found in the business operations directed towards the gaining or production of assessable income generally, the fact that that outgoing was incurred in a year later than the year in which the income was incurred and the fact that in the meantime business in the ordinary sense may have ceased will not determine the issue of deductibility.”

FCT v Brown 99 ATC 4600: taxpayer & wife borrowed money from bank to fund purchase of a deli business which they operated in partnership. Subsequently sold the business but continued to pay interest on the loan, as the sale proceeds were insufficient to discharge the outstanding debt. Ct allowed deduction and said the occasion for the interest payments was found in the loan entered into by the partnership in carrying on its business for the purpose of producing assessable income.

Jones 2002 ATC 413: Taxpayer & husband had taken out loans to acquire equipment used in a trucking business they had carried on in partnership since 1967. After the husband died, the taxpayer returned to her former employment as a nurse. In the meantime she continued to be liable to pay interest on an outstanding loan from ANZ bank. A few years later, she refinanced the loan with another institution at a lower interest rate. Ct held that the taxpayer was entitled to a deduction for the interest payments she incurred after cessation of the partnership business when the husband died. Refinancing of the loan did not break the nexus between the interest outgoings & the business. When an original borrowing is refinanced, the new financing takes on the same character as the original borrowing.

Distinguish outgoings that relate to the ‘disposal’ of the bss – NOT deductible

- **Peyton v FCT (1963) 109 CLR 315:** Sale of taxpayer’s hotel business. Taxpayer incurred certain outgoings which the court held were not incurred in gaining/producing assessable income but in parting with the business, and therefore were not deductible.

1.17 To The Extent

In some circumstances loss/outgoing may need to be apportioned, i.e. only partly deductible

Ronpibon Tin NL v FCT (1949) 78 CLR 47: Administrative expenses & director’s fees paid by certain companies that had to close down their mining operations in Siam and Malaya during WWII. Ct said need to determine what proportion of the expenses were incurred in gaining assessable income. Not arbitrary.

Ure v FCT (1981) 11 ATR 484: Taxpayer borrowed money at commercial interest rates of upto 12.5% pa and on-lent the funds to his associates (his wife and a family company) at a much lower non-commercial interest rate 1% pa. The funds were used to discharge mortgages on residential property beneficially owned by the taxpayer’s company and to

purchase a new family home. Ct took into account the taxpayer's subjective purpose for incurring the outgoing. Taxpayer's interest expenditure was only partly deductible, Ct only allowed a deduction for so much of the interest expenditure he incurred that did not exceed the interest income he received.

'There was an air of unreality about the proposition that the borrowed moneys were laid out wholly for the purpose of earning a return of 1% pa'

Contrast **Janmor Nominees** which involved related party transactions with commercial rates, where court held interest expenditure was deductible.

Fletcher (1991) 173 CLR 1: Taxpayers borrowed a large sum for a period of up to 15 yrs to purchase an annuity. Arrangement was structured so that during the first 5 yrs of the scheme the interest outgoings would exceed the annuity income (substantial losses), during the last 5 years the annuity income would exceed the interest outgoings (substantial net income). Arrangement allowed taxpayers to terminate the scheme early. Ct said deductibility depends on whether the overall arrangement was expected to be terminated before substantial amounts of assessable income began to be derived in the final years.

1.18 Second Positive Limb

Snowden & Willson Pty Ltd (1958) 99 CLR 431: Ct allowed a company deduction for costs incurred in defending itself before a royal commission investigating its business practices, and in placing newspaper advertisements telling its side of the story to the public.

Magna Alloys & Research Pty Ltd 80 ATC 4542: Ct allowed a company deduction for legal expenses incurred in defending its directors/agents against charges that they had received secret commissions. Necessarily incurred doesn't mean unavoidable or essentially necessary, what is required is that the expenditure is appropriate and adapted for the ends of the business carried on for the purpose of earning assessable income. The interests of the taxpayer were inextricably involved with those of its directors/agents and it was plainly in the taxpayers' own interests that the directors/agents be properly represented.

1.19 Must Not Be Capital Expenditure

Tests:

- **Once & for all test:** expenditure that is incurred once and for all is usually capital in nature, whereas expenditure incurred regularly is usually revenue in nature
 - **Vallambrosa Rubber Co Ltd v Farmer (1910) 5 TC 529:** Taxpayer owned and operated a rubber estate in Malaya & claimed deductions for its general expenditure re estate eg, weeding, pest control, superintendence. Only one seventh of the trees were producing rubber at the time. However, the Ct allowed a deduction for the entire amount of the general expenditure as it was incurred on items that the taxpayer would have to meet every year.
- **Enduring benefit test:** where expenditure is incurred to bring into existence an asset of a lasting nature, it is usually capital in nature
 - **British Insulated & Helsby Cables (1926) 10 TC 155:** taxpayer established a pension fund for the benefit of its employees. Ct said the sum of 31,784

pounds which the taxpayer had spent to set up the fund, was of a capital nature as it brought into existence an asset of 'enduring benefit'

- **Business Entity test:** Dixon J in Sun Newspapers: 'The distinction between expenditure and outgoings on revenue account and on capital account corresponds with the distinction between the business entity, structure, or organization set up or established **for the earning of profit and the process by which such an organization operates to obtain regular returns by means of regular outlay**, the difference between the outlay and the returns representing profit or loss'
 - Dixon J in Sun Newspapers - Look at: the character of the advantage sought – lasting qualities?; The manner in which the thing is to be used, relied upon or enjoyed – recurrence; The means adopted to obtain the thing – periodic payment for use or enjoyment for commensurate period, or final payment so as to secure future use or enjoyment (do you pay for it over & over again or once?)
 - Sun Newspapers: taxpayer who published newspapers in Sydney, had paid 86,500 pounds by instalments to rival publisher in consideration of the rival selling its interest in a newspaper that it published to the taxpayer and agreeing not to produce a rival newspaper for a period of 3 yrs within a 300-mile radius of Sydney. Ct said the payments were capital as they strengthened and preserved the taxpayer's business organisation which taxpayer feared would be impaired due to competition from rival