

LAFH changes increase employer compliance burden

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Abstract: Preparing the fringe benefits tax (FBT) return for 2013 and calculating individual employee reportable fringe benefit amounts is likely to be far more challenging than usual. With significant reform over the last few years, including recent measures targeting the effectiveness of salary packaging and changes to the living-away-from-home (LAFH) benefit, the checklist of things to watch out for and things to do is longer than ever. Importantly, the Australian Taxation Office has ramped up activities around FBT significantly and will no doubt be watching closely how employers manage (in particular, with the transition to the new LAFH rules and the management of cars from an FBT perspective). This article looks at the key changes to the law, the challenges which employers and their advisers will face, and how to manage these changes when preparing the FBT return.

Introduction

If you weren't already aware, preparing the FBT return for 2013 and calculating individual employee reportable fringe benefit amounts is likely to be far more challenging than usual. With significant reform over the last few years, including measures targeting the effectiveness of salary packaging, the checklist of things to watch out for and things to do is longer than ever. These changes should make employers really sit up and take stock of their policies and procedures, not just in relation to FBT, but all employer obligations, including superannuation, payroll, payroll tax, and the treatment of contractors.

Ironically, many employers, particularly in relation to the living-away-from-home (LAFH) benefit changes, may find themselves a bit like the government with a budget deficit, once they've prepared the FBT returns. Without doubt, the question of "why we are paying so much more FBT this year" will arise.

This article will look at the key law changes, the challenges faced, and how to manage these changes when preparing the FBT return. Importantly, the Australian Taxation Office (ATO) has ramped up activities around FBT significantly and will no doubt be watching closely how employers manage with the transition to the new LAFH rules.

The changes

After the roller-coaster of announcements since November 2011 about changes to

the LAFH allowances laws, the government finally provided some certainty in September 2012 by confirming that the taxing of LAFH benefits remained in the FBT law, and significantly narrowing the availability of the LAFH concessions. However, with the 1 October 2012 start date for the new law, the government didn't allow employers and their employees (or the ATO, for that matter) much time to understand, absorb, manage and communicate the changes or determine which employees did or didn't qualify for the transition.

From 1 October 2012, certain LAFH allowances became taxable to an employer. The law changes limit the concessional tax treatment of LAFH allowances and benefits to those provided to employees (other than those working on a "fly-in fly-out" or "drive-in drive-out" basis) for a maximum period of 12 months who:

- maintain a home in Australia (at which they usually reside) for their immediate use and enjoyment at all times while living away from that home for their work; and
- have provided their employer with a declaration about living away from home.

Special rules apply to employees who are working on a fly-in fly-out or drive-in drive-out basis. Certain conditions must be satisfied to be one of these employees, and to receive the concessional tax treatment. These employees do not have to maintain a home in Australia and the 12-month time limit on concessional tax treatment does not apply.

What are the transitional rules?

Transitional rules apply to permanent residents who have employment arrangements for LAFH allowances and benefits in place prior to 7.30 pm (AEST) on 8 May 2012. These employees are not required to maintain a home in Australia for their immediate use and enjoyment at all times for the concessional treatment to apply, and the concession is not limited to a maximum period of 12 months until the earlier of 1 July 2014 or the date when a new employment contract is entered into, or the existing contract is varied in a material way.

Transitional rules also apply to temporary residents who maintain a home in Australia for their immediate use and enjoyment at all times and have employment arrangements for LAFH allowances and benefits in place prior to 7.30 pm (AEST) on 8 May 2012. These employees will have until the earlier of 1 July 2014 or the date when a new employment contract is entered into, or the existing contract is varied in a material way before the concessional treatment is limited to a maximum period of 12 months.

What are the compliance challenges?

While the government has tightened the eligibility rules, it has also restricted the exemption basis for accommodation and increased the substantiation requirements for accommodation and food.

Accommodation

By ensuring that the FBT exemption applicable to accommodation is limited to the actual employee expense, the reasonableness test that existed prior to 1 October 2012 has been removed. In addition, it is necessary for substantiation to be maintained by the employee or the employer. This may be problematic and, at this early stage, it would appear preferable for the employer to maintain the supporting evidence of accommodation expenses and to retain it for the required five years.

Food

Where an employer provides a LAFH food benefit in excess of the ATO reasonable amount, it will be necessary for the employee to provide substantiation to support all of the food expenses, not just the excess (based on FBT law and ATO guidelines as at 22 February 2013).

Employee agreements

By now, most employers should have considered the LAFH arrangements for each employee, including the application of the transitional rules, and determined what would be paid or provided to the employees from 1 October 2012. Contractually, whether by individual or collective agreement, many employers will be left with an FBT liability.

What are the FBT return challenges?

In respect of the LAFH allowance changes, the following require consideration when planning for and preparing the 2013 FBT returns:

- (1) the application or not of the transitional rules (generally only applies to permanent residents);
- (2) the application of the fly-in fly-out and drive-in drive-out concessional rules;
- (3) in relation to accommodation, the substantiation requirements are such that it will be necessary to obtain evidence of actual payment. This will apply under all LAFH scenarios;
- (4) where the accommodation allowance is greater than the actual expense, the excess is subject to FBT;
- (5) contracts will need to clearly show the split between accommodation and food components;
- (6) where the food component is greater than the ATO reasonable amounts,

it will be necessary to obtain full substantiation from the employee;

- (7) where the food component is greater than the ATO reasonable amounts, future restructuring should be contemplated; and
- (8) where the accommodation component is greater than the actual expense, future restructuring should be contemplated.

Finally, obtaining a declaration from each employee prior to lodging the FBT returns is a must. And don't forget, a declaration is required from those whose

LAFH allowances may have ended on 30 September 2012.

LAFH scenarios

From 1 October 2012, it is possible that organisations will have a variety of LAFH allowance scenarios to analyse in order to determine the FBT implications. Some likely common examples are set out in Table 1.

The reason for setting out the four scenarios in Table 1 is to illustrate some of the complexities brought about by the law changes and the need to manage these

Table 1

Scenario	Potential LAFH allowance treatment
<p><i>Fully exempt from FBT</i> LAFH allowance accommodation is equal to or less than actual rental expense. LAFH allowance food is equal to or less than the ATO reasonable amounts.</p>	<p>LAFH allowance accommodation – exempt. LAFH allowance food – exempt/statutory food amounts may incur FBT.</p>
<p><i>Fully taxable</i> The employee doesn't qualify for the transition or is not eligible from 1 October.</p>	<p>LAFH allowance accommodation – taxable. LAFH allowance food – taxable.</p>
<p><i>Partially taxable accommodation</i> Accommodation allowance in excess of actual cost. Therefore, the amount of the allowance up to the actual cost is exempt, and the excess is taxable and subject to FBT.</p>	<p>LAFH allowance accommodation up to actual expense – exempt. Excess LAFH allowance accommodation – taxable.</p>
<p><i>Fully exempt/fully taxable</i> The employee qualifies for the transitional LAFH allowance arrangements on 1 October 2012, and then on 1 December 2012 has a material change in contract. From 1 December 2012, it is determined that the employee does not qualify for the concession.</p>	<p>From 1 October to 30 November: LAFH allowance accommodation – exempt. LAFH allowance food – exempt. From 1 December to 31 March: LAFH allowance accommodation – taxable. LAFH allowance food – taxable. Don't forget that the period prior to 1 October must also be assessed.</p>

scenarios carefully. It must be noted that other scenarios will exist.

The challenge for most employers, though, is determining each scenario based on obtaining records and other information from employees.

Change over challenges

Employers are taking a variety of approaches to managing the change over to the new rules and/or applying the transitional rules. A common, but generally unintended, approach due to time pressures has resulted in at least three separate LAFH allowance time periods across the 2013 FBT return year, as follows:

- (1) LAFH allowances paid from 1 April 2012 to 30 September 2012;
- (2) LAFH allowances paid from 1 October 2012 to the date when an internal decision is made to amend the LAFH arrangements or a material change in the employee’s contract occurs (which may be prior to 1 October 2012); and
- (3) the remaining period up until 31 March 2013.

Careful analysis of the above will be required and, in all likelihood, will create some unintended outcomes, including additional FBT liabilities. The reason for this is due to a number of factors, including:

- (1) the short time frame available to employers from the date of the law change to the start date of 1 October;
- (2) employers require time to develop and agree to a policy, and determine the appropriate treatment to apply to each employee;
- (3) employers require time to discuss individually with each employee in order to understand the employer and employee impact; and
- (4) some employers were/are constrained by workplace agreements and other business needs

And in addition to the above, many employers often struggle generally with allocating responsibility for FBT management on a day-to-day basis, let alone when managing responsibility for a significant change. Therefore, at a minimum, all of the following need to be involved: tax group; human resources; payroll; finance; business unit managers; and legal.

LAFH declarations

The ATO has issued four approved LAFH declaration formats. It is vital that the

Table 2

Thresholds	Old rates	New rates after 10 May 2011			
	2012	2012	2013	2014	2015
0–15,000 km	26%	20%	20%	20%	20%
15,000–25,000 km	20%	20%	20%	20%	20%
25,000–40,000 km	11%	14%	17%	20%	20%
More than 40,000 km	7%	10%	13%	17%	20%

correct declaration is completed by each employee.

Importantly, for many employers who stopped paying LAFH allowances to temporary residents as at 30 September, declarations up until that date are required. While it may feel like rubbing salt in to the wound, it is preferable to go through that process sooner, rather than later. If an employee leaves and a signed declaration is not available, then, come FBT return time, the employer will be faced with additional FBT liabilities.

Salary packaged in-house benefits – removal of concession

From 22 October 2012, the government has removed the concessional FBT treatment for in-house fringe benefits accessed by way of a salary sacrifice arrangement. A transitional measure will allow salary sacrifice arrangements already in place at 22 October 2012, to access the concession up until 1 April 2014.

In-house fringe benefits arise when employees receive goods or services from their employer or an associate of their employer that are identical or similar to those provided to customers by the employer or an associate of the employer in the ordinary course of business. Under the existing FBT concession, the taxable value of in-house fringe benefits is 75% of either the lowest price at which an identical benefit is sold to the public or under an arm’s length transaction, depending on the nature of the benefit, reduced by a further \$1,000.

Cars in transition and under attention

Cars usually represent the biggest risk area for employers. With a continuing and elevated level of attention from the

ATO, management of cars from an FBT perspective must always be a priority.

Car reform and transition

While the car reforms commenced back on 10 May 2011, we mustn’t lose sight of the transitional rules and these will require continued monitoring until 1 April 2014 when the flat rate of 20% applies. Therefore, only two FBT return periods (2013 and 2014) remain where employers (and employees) will need to worry about such things as odometer readings and annualising of kilometres when valuing the car benefit using the statutory formula method.

Cars provided prior to 10 May 2011, or where a pre-existing commitment was in place to prior to that date, will continue to use the old statutory fractions unless there has been a change in commitment. Changes made after 10 May 2011 to commitments existing prior to 10 May 2011, such as re-financing a car, altering the duration of an existing contract or changing employers, *are new commitments and will therefore be subject to the new arrangements*. Under the transitional rules, if the amendments (new commitments) do not apply at the start of an FBT year (or from the time the car was first held if that happens after the beginning of the FBT year), the amendments will instead begin to apply from the start of the next FBT year as set out in Table 2.

Therefore, the key point is that, while a car may be subject to the new rates, the application of the new rate may not occur until the first day of the next FBT year. This requires the 2013 FBT return preparers to flag these changes for the 2014 FBT return. And, hopefully, this requirement has been flagged by the 2012 FBT return preparer for the 2013 FBT return. Use of annual rotation of the FBT return preparer can often lead to confusion.

Table 3

Thresholds	Grandfathered rates	Transitional rates
0 – 15,000 km	26%	20%
15,000–25,000 km	20%	20%
25,000–40,000 km	11%	17%
More than 40,000 km	7%	13%

When preparing your 2013 FBT return, the choice of rates will depend on whether the old grandfathered rates continue to apply as a pre-10 May 2011 contract or if the car is included in the new transitional rates.

Table 3 illustrates this.

ATO focus

Cars are the single largest FBT revenue item for the government (although LAFH allowances may well challenge for the title in 2013!). As mentioned, cars remain a major ATO focus. The ATO are targeting cars on a number of fronts, as discussed below.

Luxury cars and use of logbook

The ATO has focused closely on the use of logbooks in general, but particularly in respect of luxury vehicles, especially high-end luxury sports cars.

Exempt cars

The ATO has undertaken a campaign targeting employers who have claimed exemption for vehicles and are not lodging FBT returns. There is a general lack of understanding on the application of car exemptions and often this is due initially to lack of clear policy and then poor compliance procedures. It is an area that requires careful management as cars are highly visible benefits and their related costs run clearly through the financials.

Employee contributions project

Australian Taxation Office analysis has identified that a high percentage of employers who report employee contributions in their FBT returns, with the effect of reducing the taxable value of benefits, are failing to report those employee contributions as assessable amounts in their income tax returns and related GST liabilities in the periodic BAS.

The ATO has been issuing letters to employers where the ATO has identified discrepancies between income tax returns

and FBT returns. The ATO is reminding employers of their responsibilities with contributions, and that they must be reported as income in the correct label on the income tax return. If the employer has not reported the income, then an amended return will be necessary.

Next steps

First, in relation to the FBT returns, if you have LAFH arrangements in place, a request to the ATO for an extension of time to lodge is probably a wise move. Ordinarily, FBT return extensions are commonplace, and there has certainly been much discussion with the ATO about extending the lodgment date on a permanent basis — 51 days to identify, value and calculate a year's worth of FBT is a tough ask.

Second, cars and LAFH allowances represent significant FBT challenges. These challenges are often exacerbated by the lack of policy, procedure and records in place. Therefore, post-lodgment of the 2013 FBT return, it is highly recommended that employers consider a thorough review of their obligations. With contractor reporting, increased payslip disclosure and greater focus by the ATO and the Offices of State Revenue, among other things, an employer obligations review is timely.

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This article is based on FBT law and ATO guidelines as at 22 February 2013.