

Salary Packaging Update

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OUTLINE

- Provisions and terms of fringe benefits tax legislation
- Determining what is deemed as a fringe benefit and what is not
- FBT rules for common benefits
- Defining salary packaging – what can and cannot be included
- Effective salary packaging structures
- Reviewing and evaluating salary packages to ensure the best deal between employee and employer

The Structure of the Fringe Benefits Tax Act 1986

- Refer: www.austlii.edu.au
- Commonwealth Consolidated Acts
- 16 Parts
- The Major Part is **PART III-FRINGE BENEFITS**
- with 19 divisions covering the Types of Fringe Benefits

PART III--FRINGE BENEFITS

DIVISION	Chapter FBT Guide
Division 2- Car fringe benefits	7
Division 3- Debt waiver fringe benefits	8
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Important Sections of the Act

Div isi on	Section	Title
9a	37AC	Meal Entertainment Benefits
9a	37AD	Meaning of provision of meal
10	38	Tax-exempt body entertainment
13	57	Exempt benefits--employees of religious institutions
	57a	Exempt benefits--public benevolent institutions, health promotion charities, some hospitals and public ambulance services
2	9 & 10	Taxable value of Car Fringe Benefits

FBT Fundamentals

- The Objective of Salary Packaging in the Not for Profit Sector
- For an Employee is
- Legally pay less tax
- because you work for
- A Public Benevolent Institution (PBI)
- Health Promotion Charity (HPC)
- Religious Institution
- Other Charity (rebate able employers)

FBT Fundamentals

- Why would the agency do this?
- to attract and retain valued employees
- A Remuneration Strategy
- To maximise personal value to Employee
- Within funds available
- Offer comparable remuneration with other industries

The Benefits of Salary Packaging ?

- Improve remuneration by allowing significant Tax savings to pass to staff
 - Packaging Up
- Save Salary Costs by reducing gross salary yet maintaining net salary
 - Packaging Down
 - The agency retains all the tax savings
- Share the Tax Savings with staff
 - Packaging shared
 - increase net remuneration by X%
 - Saving Y % in Gross Salary to agency
 - use enterprise agreement or AWA

Salary Packaging

“Contract salary”

(Less)

“Sacrifice amount”

(Equals)

“Taxable salary”

Lower than Contract salary

Outcome: Less tax paid

Can all staff benefit? PBI Example

Contract	Unpackaged	\$16,000 Credit Card Packaged	RESULT
Gross	Net Cash	Net Cash + Fringe Benefits	Advantage
100,000	71,244	77,848	6,604
90,000	65,404	71,956	6,552
80,000	59,512	65,128	5,616
70,000	53,204	58,248	5,044
60,000	46,376	51,420	5,044
50,000	39,496	44,540	5,044
40,000	32,668	36,880	4,212
30,000	25,840	28,752	2,912
20,000	17,556	20,000	2,444

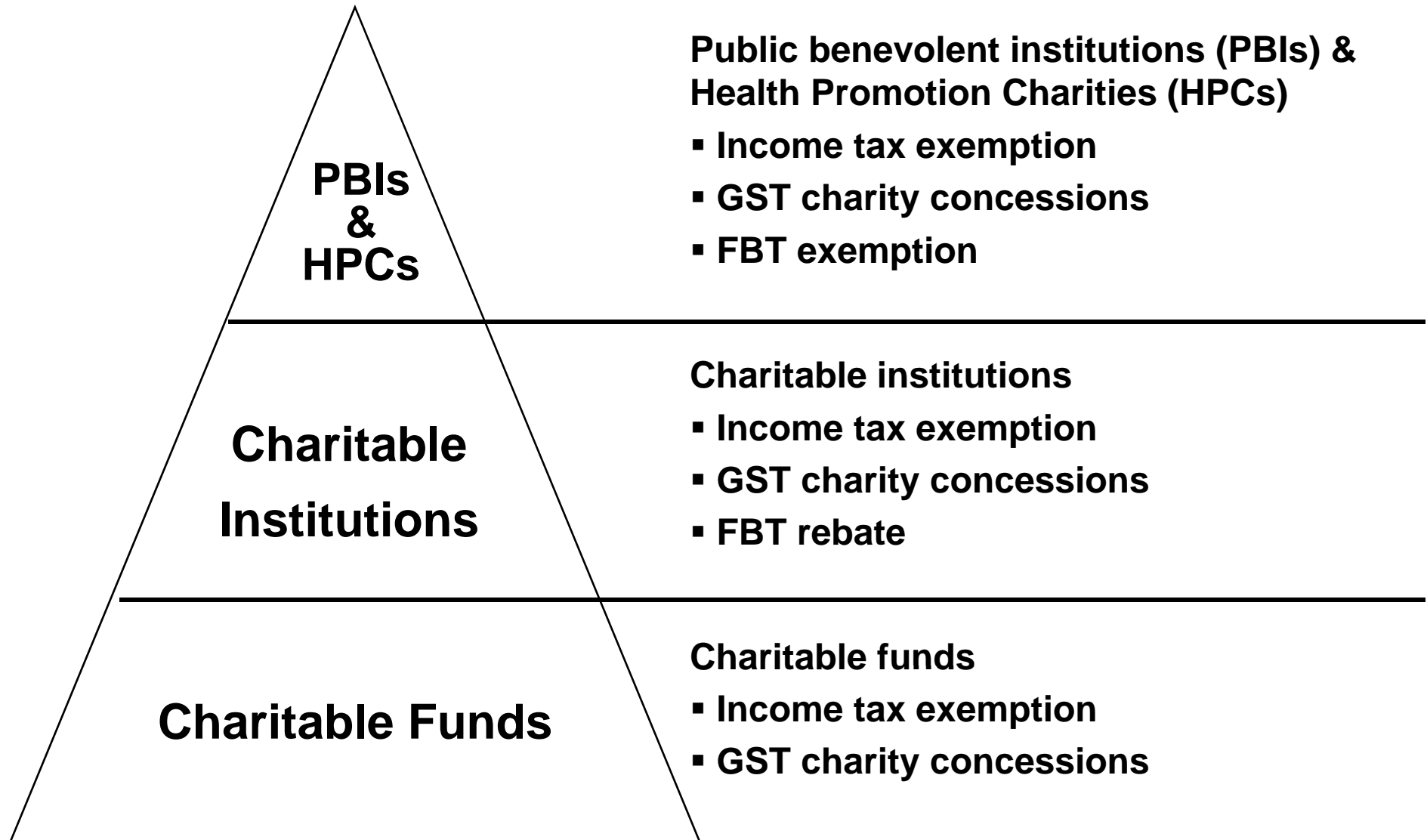
Can all staff benefit? Charity Example

	Unpackaged	\$16K to Credit Card Packaged	
Gross	Net Cash	Net cash + Benefits	Advantage
100,000	71,244	73,632	2,596
90,000	65,404	67,012	1,608
80,000	59,512	60,132	620
70,000	53,204	53,304	100
60,000	46,376	46,424	48
50,000	39,496	38,972	No Savings
40,000	32,668	31,052	No Savings
30,000	25,840	22,612	No Savings
20,000	17,556	12,768	No Savings

Can you Salary package?

- Yes but you are restricted to normal commercial arrangements and subject to FBT of 48.5% unless
- You are a Charity
 - With access to FBT rebate of 48%
 - And THEN
- You are a PBI or HPC
 - with exemption from FBT up to \$30,000 grossed up of Fringe Benefits provided
- Consequently to gain access to PBI or HPC advantages you must first be a Tax Concession Charity

Overview of charity types and related concessions



Religious Institutions

- Characterised as Charities under the advancement of religion “head of charity”
- FBT rebate for lay staff
- Section 57 of FBTAA 1986
- FBT exemption – uncapped for Ministers of Religion and Members of Religious Orders
- Taxation Ruling TR 92/17 - Income tax and fringe benefits tax: exemptions for 'religious institutions'

TR 2005/21

Income tax and fringe benefits tax: charities

- Commissioner's views on meaning of
- 'charitable institution'
- 'Commercial purposes are not charitable'
- Commissioner of Tax V Word Investments Ltd
- Full Federal Court held that raising money by commercial means for exclusively charitable purposes
- Entitled the Company to be a charitable entity and income tax exempt
- Uncertain if ATO will appeal to High Court.

Public Benevolent Institutions

TR 2003/5

- Without PBI status then not FBT exempt
- Major cost in replacing benefits with cash
- Major risk of losing staff if shift down to FBT rebate status.
- May still self assess in line with TR 2003/5 to risk manage current salary packaging
- Requires Board Resolution on Self Assessment
- A significant problem SINCE July 1, 2005
- Onus on agency to inform ATO if no longer PBI

A PBI division within a Charity

- Only Part of the work of a Charity may be benevolent
- See **“Fringe benefits tax and public benevolent institution employment arrangements”**
- Endorsement of an organisation for a PBI employer that it operates
- The Division must have
- Its own ABN
- Separate management
- Separate payroll function

Health Promotion Charities

TR 2004/8

- Opportunity to re-classify a doubtful PBI
- Full FBT exemption up to Cap
- principal activity must promote the prevention **or** the control of diseases in human beings.
- treating, caring ,education, prevention
- In practice requires a Medical Diagnosis
- Much wider avenue than PBI

Reminder

- Annual Self Assessment in line with issued tax rulings
- Resolution that you continue to be a Charitable Institution within the meaning of TR 2005/21
- Resolution that you continue to be a Public Benevolent Institution within the meaning of TR 2003/5 or a Health Promotion Charity within the meaning of TR 2004/8

What are you Packaging?

- Often uncertainty on current remuneration
- EG : Cash , car, laptop, mobile, additional super
- What is the value of the Car? Other item?
- Starting Point
- Agree on the total cash value of the Contract
- Issue new employment contract
- Allow Salary Sacrifice within stated Policy on Salary packaging

What is Flexible Salary Packaging?

- In many cases, organisations allow individual staff to “salary sacrifice”.
- That is, they can choose the mix and value of remuneration items as long as:
 - The cost does not exceed the allocated total contract
 - All tax liabilities are met
 - Policy limits are not exceeded

Your Total Employment Cost

Equals

Contract Salary

Paid As

Any Salary Sacrifice Plus

Taxable Cash Salary (PAYG) Plus

Statutory Benefits based on Contract
salary

(e.g. super, guarantee & leave loading)

Tax Concessions to a PBI/ HPC

- May pay benefits to staff and not pay Fringe Benefits Tax if: -
- Some benefits are exempt
- Other benefits known as “Fringe Benefits”
- Are less than the Limit allowed
- This enables approximately at least \$30,000 grossed up or up to **\$16,050** in actual value received as tax free in package.

Tax Concessions For A Charity

- May pay benefits to staff and not pay FBT if: -
- The benefits are exempt OR
- The benefits have a Nil taxable value
- OTHERWISE:
- FBT is payable but a 48% rebate is given
- Up to \$30,000 Grossed up or up to \$16,050 in actual benefits
- Above that limit no Rebate applies

Types of Fringe and Exempt Benefits

Types of Benefits

- Fringe Benefits
 - Sometimes called Quasi Fringe Benefits (for PBI / HPC)
 - Have a taxable value
 - Some are concessionally treated
 - e.g. cars, remote area rents & mortgage interest
- Exempt Benefits
 - Not taxable
 - Not reportable

Fringe Benefits Examples

- Limit of up to **\$16,050 from 1 April**
- Mortgage
- Rent
- Credit Card
- Health Insurance
- Expense Payments
- If all fringe benefits are expenses including GST then it reduces limit to **\$14,530 from 1 April**

Expense Payments

- Where an employer reimburses an employee for expenses incurred by the employee, OR
- Where an employer pays a third party in satisfaction of expenses incurred by an employee
- Examples – electricity, telephone etc

Calculating The Grossed Up Value of a Fringe Benefit

1. Apply a gross up factor to the taxable benefit
 - If Input Tax Credits available (Type 1)
 - Factor = **2.0647 from 1 April 2006**
 - e.g. car, expense payments
 - If Input Tax Credits not available (Type 2)
 - Factor = **1.8692 from 1 April 2007**
 - e.g. mortgage, rent, health insurance
2. Type 2 Factor (**1.8692**) used when grossing up for Payment Summary

What Is A Car Fringe Benefit?

1. Availability of a car for private use means: -
 - It is actually used for private purposes by the employee; or
 - The car is not at the employer's premises, and the employee is allowed to use it for private purposes (including travel to and from work)
 - A car that is garaged at an employee's home is treated as being available for the private use of the employee

Calculating Car Fringe Benefit

The Statutory Formula Method

- The taxable value = % of the car's value. This % varies with the total distance traveled by the car during the FBT year whether or not private travel
- The greater the distance traveled, the lower will be the taxable value.
- Less than 15,000 klms 26%
- 15,001-25,000 klms 20%
- 25,001-40,000 klms 11%
- More than 40,000 klms 7%

Calculating Car Fringe Benefit

□ The Operating Cost Method

- The taxable value = % of the total costs of operating the car during the FBT year. The % varies with the extent of actual private use.
- The lower the incidence of actual private use, the lower will be the taxable value.

The value of a vehicle in the Package

- The value to whom?
 - To the employee
 - The minimum \$\$\$\$ related to private use
 - To the client agency
 - Often the maximum \$\$\$\$ to reduce costs
 - The taxable value depends on the behaviour of the driver
 - Hence needs close review during the year & adjustments to preserve a nil impact.

The value of a vehicle in the Package

- Example
- What is the package value of VY Commodore ?
- if the staff member lives a long distance from work compared to around the corner?
- The same car will have different values to different staff
- & different taxable values with the 2 Methods
- Operating Cost and Statutory Method
- The Taxable value using operating method gives the better estimate of Cost to agency
- Which value is chosen ???
- Value to agency ? Value to Staff?

In Practice: Novated Car Leases

- paid from after tax earnings,
- Increasingly used tactic
- The lower of statutory or operating cost is sacrificed from after tax salary to
- Reduce taxable value to zero
- Additional Strategy
- Employee pays lease & operating costs
- Receives agreed reimbursement for business use
- Up to 5000 klms no PAYG withholding

Use Of Other Concessional Fringe Benefits

- Regional housing assistance for charities receive 50% reduction in taxable value of rent or mortgage interest
 - Live in a designated Remote Area

Remote area housing assistance (section 60)

- In a remote area (no special rule for Charities)
- **The extension of the remote area test** for hospitals, charities and the police force that applies to the remote area housing exemption **DOES NOT APPLY** to remote area housing assistance concessions
- This means the accommodation must be located at least 40 kilometres from a town with a census population between 14,000 to less than 130,000, or at least 100 kilometres from a town with a census population of 130,000 or more (population figures based on the 1981 Census)

Remote area housing assistance (section 60)

- taxable value arising from housing assistance may be reduced by 50%
- Examples
 - a payment or reimbursement of rent
 - the making of a housing loan by employer
 - a payment or reimbursement of the interest accrued on an external housing loan

Substantiation

- Where is burden of proof?
- On the Agency
- Reasonable Belief bona fide arrangement
- Substantiate that no FBT or PAYG is payable resulting from the arrangement
- EXAMPLE:
- Reimburse / Pay Rent expense to a private account
- Evidence :
- Rent Receipt for reimbursement
- Copy of rental agreement

Substantiate a Mortgage / Loan

- Evidence:
- Loan statement showing receipt of funds paid by agency
- Not a Mortgage Offset account
 - ATO ID 2002/614 "Expense payment fringe benefit - payments made to a home mortgage offset facility account"
- Line of Credit Facility
- The full amount borrowed by the employee is viewed as the obligation of the employee, which has been partially met by the employer.
 - ATO ID 2001/532 "Salary sacrifice arrangements involving loans with redraw facilities"

Credit Cards

- This is an expense payment fringe benefit.
- The taxable value is the amount you reimburse.
- This will be regardless of the items of expenditure incurred under the credit card agreement, that is purchases of goods, services or cash advances.
- Source: FBT Guide to Employers (Update 2006)

Use of Credit Cards

- Cash withdrawals permissible BUT Our advice: replace cash withdrawn with personal payments
- NTLG FBT Sub-committee Minutes 2003-02-20
- regardless of the items of expenditure incurred under the credit card agreement, that is purchases of goods, services or cash advances ...the amount outstanding as a debt to the credit provider.
- employers, particularly in the PBI and charity sectors, should ensure that such cash advances are not construed as being arrangements that abuse the concessional treatment currently available under the FBTAA.
 - example \$500 weekly cash advances,

Credit Card Payments

- The reimbursement is a reduction of a debt and as such is a Type 2 benefits grossed up by **1.8692**.
- Be careful not to change the benefit to a Type 1 benefit by claiming the GST evident in a tax invoice provided to you.
- If this occurs the amount reimbursed should be grossed up by **2.0647**.
- Thus creating a risk of exceeding the Cap

Major Exempt Benefits

- Meal Entertainment (for PBIs ,Health Promotion Charities only)
- THE WORK RELATED ITEMS
- A mobile phone or a car phone
- An item of protective clothing that is required for employment
- A briefcase
- A Calculator
- A tool of trade; internet use
- An item of computer software for use in the employee's employment
- An electronic diary or similar item
- A notebook computer, a lap computer or a similar portable computer
- Professional membership fees and subscriptions

Other Exempt Benefits

- Newspapers and periodicals for business purposes
- Travel for compassionate reasons
- Occupational health and migrant language training: -
 - Work related health and counselling benefits
- Emergency assistance arising from disaster
- Minor benefits
 - Irregular benefits less than \$100 – increase to \$300 from April 1 , 2007
- Long Service Awards
 - Granted in recognition of 15 years or more service are exempt provided the value of the award does not exceed a specified maximum amount.
- Safety awards less than \$200

Meal Entertainment

37AD FBTA 1986...:

- (a) entertainment by way of food or drink; or
- (b) accommodation or travel in connection with, or for the purpose of facilitating, entertainment; or
- (c) the payment or reimbursement of expenses incurred in providing something covered by paragraph (a) or (b);
- whether or not:
- (d) business discussions or business transactions occur; or
- (e) in connection with the working of overtime or otherwise in connection with the performance of the duties of any office or employment; or
- (f) for the purposes of promotion or advertising; or
- (g) at or in connection with a seminar.

Example PBI Meal Entertainment

Sacrifice Amount	\$6,000
Taxable value	\$ 0
Tax Savings	\$2,790
Net Cost	\$3,210
Discount Achieved (The Tax rate)	46.5%

Meal Entertainment for Charities

Assuming the sacrifice amount is at the top marginal rate

Amount	\$6,000
Taxable Value 50%	\$3,000
Grossed up	\$6,194
FBT Payable Notional	\$2,880
Less Rebate 48%	\$1,383
FBT Payable	\$1,497
Sacrifice Amount	\$7,497
Tax Savings	\$3,486
Net Cost	\$4,011
Discount Achieved (the effective Tax rate)	33%

Meal Entertainment & Associates

- Who is an Associate??
- Associates included **TAXATION RULING NO. MT 2044**
FRINGE BENEFITS TAX: REDUCTION OF AGGREGATE TAXABLE VALUE OF FRINGE BENEFITS - APPLICATION TO ASSOCIATES
- "As a benefit provided to an associate of an employee must be in respect of the employment of the employee, the provision of the benefit is therefore connected to or associated with the employee."

Meal Entertainment Substantiation

- TR 97/17 Income tax and fringe benefits tax: entertainment by way of food or drink
- **why** the food or drink is being provided;
- **what** type of food or drink is being provided;
- **when** that food or drink is being provided; and
- **where** the food or drink is being provided.

Meal Entertainment Substantiation

- **Why**
- 'purpose test'
- "to enjoy themselves has the character of entertainment"
- **When**
- Outside work - Not during work time
- Whilst on leave??
- **What**
- Substantial meal not morning and afternoon teas and light meals
- Not take away ??

Meal Entertainment Substantiation

- **Where**
- Food or drink at a restaurant – a sit down experience
- function room, hotel, restaurant, cafe, coffee shop
- Travel & Accommodation must have provable link
- International ? Cairns?
- Suggest a Proximity Test of same day
- Petrol expense???

Meal Entertainment Substantiation

- Problems
- Linking receipts to the meal
- Advance payments of travel & accommodation
- Regular review required
- If not substantiated then treated as Fringe Benefit
- Possibly exceeding the Cap
- Potential FBT Liability

Meal Entertainment Expenses

- Excluded from reporting arrangements
- Includes you and your associates
- Entertainment by way of food or drink
- Accommodation or travel in connection with, or to facilitate the provision of such entertainment.
- Fully exempt for PBIs and HPCs

TAX Exempt Body Entertainment

- Entertainment facility leasing expenses are exempt from FBT
- when incurred by PBIs, health promotion charities, public hospitals, non-profit hospitals and public ambulance services
- Be careful of the rules around Christmas parties & Recreation issues

Remote Area Housing Benefit section 58ZC

- Exempt Benefit.
- **Special Rule for Charities:**
- If in a remote area at least 100 kilometres from a town with a census population of 130 000 or more.
- If a current employee, and
- the usual place of employment of the employee is in the remote area;
- From April 1 2006 It will no longer have to be customary to provide the Housing Benefit in the industry.

Remote Area Housing Benefit section 58ZC

- Rules:
- if necessary for the employer to provide free or subsidised accommodation for employees or to arrange for the provision of such accommodation for any of the following reasons:
 - employees are liable to move frequently from one residential location to another
 - there is insufficient suitable residential accommodation
- Employer must own or lease – (no lease back)

Laptop Computers Tax Planning

- If the employee purchases the Laptop and is reimbursed by the employer in an effective salary sacrifice agreement
- The employee may claim the depreciation expense on the Laptop as a tax deduction without breaching the “otherwise deductible rule”
- since depreciation of the asset is not the purchase of the asset

Otherwise Deductible Rule

- If a benefit is “otherwise deductible” to an employee in their individual tax return
- only if the recipient of the benefit is the employee
- The benefit is an **exempt benefit** if the employee provides a declaration in the required format
- And the employee does not claim the deduction
- This has the effect of shifting the tax risk to the employee

Morning & Afternoon Tea & Light Meals

- Not Meal Entertainment
- Taxation Ruling IT 2675 (2 April 1992)
- "9. The provision of morning and afternoon tea and light meals to employees is an exempt benefit under section 38 (income tax-exempt body entertainment benefits) of the FBTAA."
- "7. Light meals are treated in the same way as morning and afternoon tea."
- ".. to provide sandwiches and other 'hand food', salads, orange juice, etc" – no alcohol

Accelerating Benefits

- Some employers are allowing staff a one off opportunity to reach the Cap amount of Fringe Benefits provided in a shorter period than one FBT year
- This may be because the employee has just joined the agency or the agency has just commenced salary packaging and wants to provide an initial benefit to participating staff

Bonuses & Termination payments

- May be paid as exempt or Fringe Benefits
- Be careful of the Cap
- The timing of a resignation creates tax planning opportunities
- Example : resign April 1 working for PBI / HPC
- The Termination payment may include \$15,450 of Fringe Benefits and unlimited exempt benefits all of which are untaxed
- Movement to another PBI or HPC means new Cap – start again
- ENSURE THE LEAVE EARNT PRIOR TO COMMENCEMENT OF THE SAL SAC AGREEMENT
- TR 2001/10

Reporting Implications?

- Group Certificates (Now Payment Summary) Reports
- The grossed up value of Fringe Benefits Only and The lower taxable Cash Salary
- The grossed up value of Fringe Benefits effects calculation of HECS, Child Support and some other Commonwealth debts
- Commonwealth Pensions & Allowances usually use the ordinary value of the benefits
- Exempt and Excluded Benefits are not reported

Salary Packaging Policy

- the Principle of Cost Recovery to Agency
- Approved by Board understanding FBT risk
- Packaging is a privilege not a right of staff
- Removal of arrangements if abused
- Types of benefits, \$ limits & access
 - Cars, Meal Entertainment, Laptops, Mobiles
- When & How benefits will be paid
- Eligibility for benefits after qualifying period
- The employees responsibilities
- the responsibility for FBT Liability

Dangers of Salary Packaging

- Once you package a person you create an effective rise in remuneration
- More difficult for the person to move
- Equity between staff may be destabilised
 - I have a Commodore , you have a Berlina
- Equivalent staff may have different remuneration outcomes
- One staff member may arrange their package in a more advantageous way

The Strategy for Constructing a Package for PBIs

- Determine the value of the contract
- Sacrifice exempt benefits
- Then sacrifice concessional benefits (e.g. the car if available)
- Then sacrifice the remainder of the **\$16,050** of fringe benefits
- Finally, calculate the remainder for PAYG salary

The Strategy For Constructing a Package For Rebateable Charities

- Determine the value of the contract
- Sacrifice Exempt Benefits
- Sacrifice Concessional Benefits
 - Regional Housing
 - Meal Entertainment
 - Car
- Consider any advantage of sacrificing other Fringe Benefits
 - Usually no advantage if the remainder salary is less than \$60,000

Accounting For Salary Packaging

- In chart of accounts
- Create Fringe Benefits Payable
 - Header and individual staff liability accounts
- Create Exempt Benefits payable
 - Header and individual staff liability accounts
- See MYOB Salary Sacrifice Superannuation example
- On payment Summary
 - Insert grossed up value of Fringe Benefits only

Salary Package software

- Identify the tax savings
- The value of the gross package
- Generate a proposal for the staff member
 - To discuss with private financial advisers
 - To put forward for approval
- Calculate any FBT likely
- Identify correct payroll data
- Eg: The Mistral Salary Packaging program

Salary Packaging Payment Cards

- MacMillan Shakespeare Card
 - CR 2003/111 Salary Packaging Payment Card
- Smart Card CR 2004/44
- for the purposes of subsection 20(a) of the FBTAA, an expense payment fringe benefit arises at the time that the promoter pays an amount to the employee's card account
- Cash advances using the card are not permitted

In house V external agency

■ Internal

- Do you have the expertise?
- Ensure that Admin. Staff have the time to supervise
- Properly funded via
- **Admin Fee as an exempt benefit**
- Admin Fees? How much? Agency can accumulate a benefit

■ External

- liability for FBT still with the Agency
- Contract vital – cater for damages arising
- Errors & Lack of Substantiation

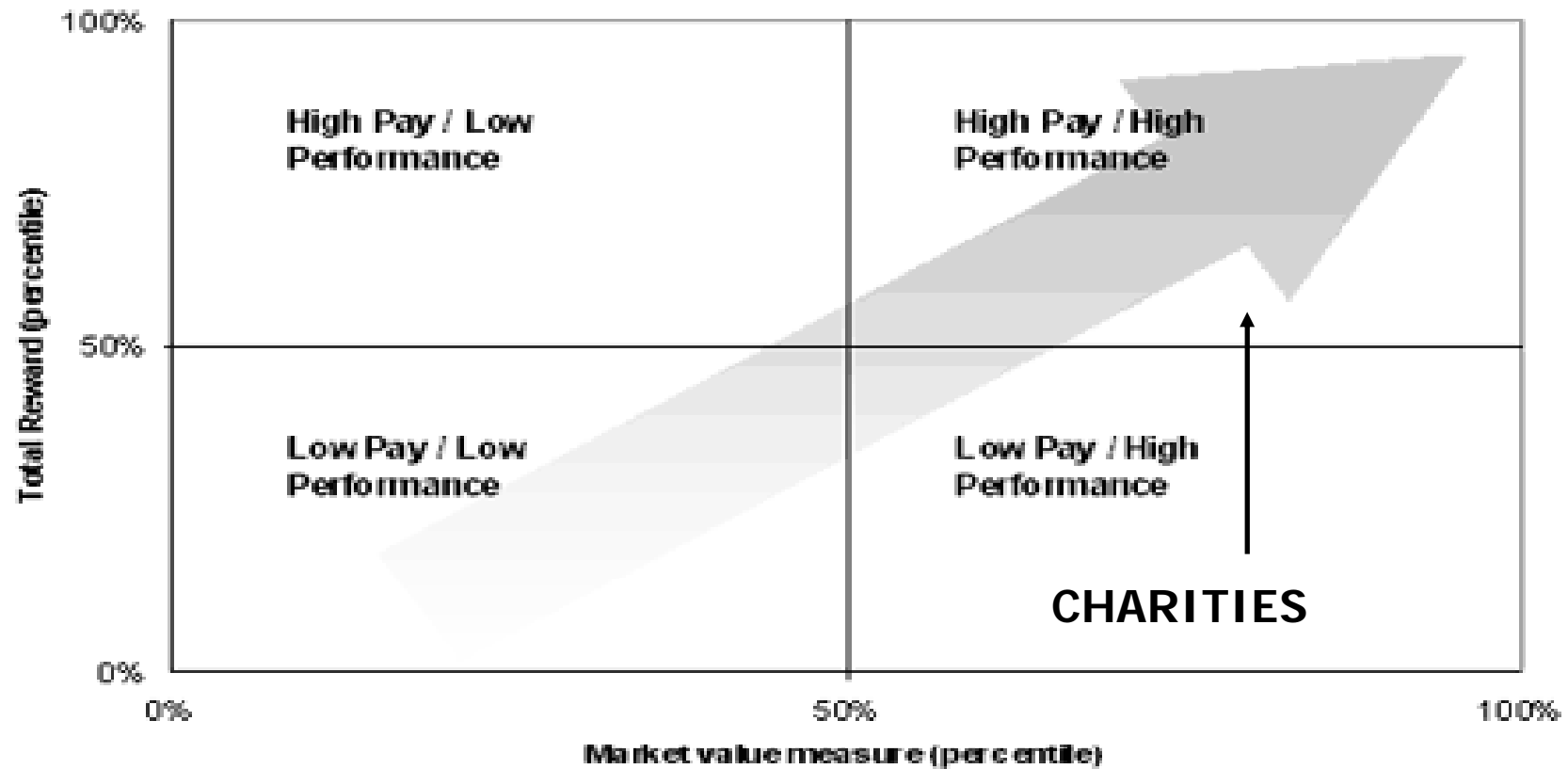
Getting it wrong

- Incorrect reportable benefits
- Child Support
- Commonwealth Debts
- Wrong classification of an exempt benefit means a default to a fringe benefit
- Risk of Exceeding Cap
- Risk of increased FBT Liability
- Risk of necessary FBT Returns

CEO PACKAGE

Remuneration Issues

Calibrating pay to performance



CEO Remuneration Components

- **Base Pay**
 - Cash salary
 - Flexible benefits
 - Statutory benefits
- **Annual Incentives**
 - Linked to business plan
 - Delivered in cash and/or exempt benefits
 - May include deferral
- **Long-term incentives**
 - 3 to 5 year timeframe
 - Cash and/ or exempt benefits
- Additional Employer Contribution to Superannuation
- Contribution to Mission focus
 - Referenced against peer group

Case Study – The CEO

- What is the Contract?
 - Agree value of all benefits to establish true Contract
- Maximum Flexibility
- Salary Packaging Policy – who Benefits?
- Advertising the Package?
- Termination Benefits

Questions