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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAX AND SUPERANNUATION LAWS AMENDMENT (2015 MEASURES No. 5) BILL 2015

EXPLANATORY MEMORANDUM

(Circulated by the authority of the Minister for Small Business and Assistant Treasurer,
the Hon Kelly O'Dwyer MP)

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

Abbreviation	***Definition***
AIIR	Annual income investment report
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
CGT	capital gains tax
Commissioner	Commissioner of Taxation
DICTO	Dependant (Invalid and Carer) Tax Offset
FATCA	*Foreign Account Tax Compliance Act*
FBT	fringe benefits tax
FBTAA 1986	*Fringe Benefits Tax Assessment Act 1986*
FIFO	fly-in fly-out or drive-in drive-out workers, including employees and contractors
GST	goods and services tax
ICCPR	International Covenant on Civil and Political Rights
ITAA 1936	*Income Tax Assessment Act 1936*
ITAA 1997	*Income Tax Assessment Act 1997*
NFP	not-for-profit
TAA 1953	Taxation Administration Act 1953
ZTO	Zone Tax Offset

General outline and financial impact

Modernising work-related car expenses

Schedule 1 to this Bill modernises the methods for calculating work-related car expense deductions. Currently, taxpayers have an option of using one of four methods to determine their work-related car expense deductions.

These methods, each with differing compliance obligations, are:

- 12 per cent of original value method;
- one-third of actual expenses method;
- cents per kilometre; and
- logbook method.

Schedule 1 will repeal the 12 per cent of original value method and the one-third of actual expenses method.

Further, this Schedule will provide a streamlined process for calculating the cents per kilometre method by providing a single rate of deduction which more accurately reflects the actual running expenses of a vehicle.

Date of effect: This measure applies to the 2015-16 income year and later income years.

Proposal announced: This measure was announced in the 2015-16 Budget.

Financial impact: This measure has the following revenue impact:

2015-16	***2016-17***	***2017-18***	***2018-19***
–	$270m	$280m	$295m

Human rights implications: This Schedule does not raise any human rights issues. See *Statement of Compatibility with Human Rights*, Chapter 1, paragraphs 1.41 to 1.44.

Compliance cost impact: The annual compliance burden has been costed at around $750,000 (total impact on individuals).

Better targeting of the Zone Tax Offset

Schedule 2 to this Bill amends the *Income Tax Assessment Act 1936* to ensure that the Zone Tax Offset (ZTO) is appropriately targeted to people genuinely living in the designated geographical Zones by limiting access to the ZTO to those people whose usual place of residence is within a Zone.

This ensures that the ZTO is appropriately targeted to those people genuinely living in the designated Zones. It excludes those people who work in the Zones but fly or drive into those Zones from their usual place of residence that is located outside of the Zone. Those people are assessed as residing at their usual place of residence and not their residence while working.

Date of effect: This change applies to the 2015-16 year of income and later years of income.

Proposal announced: This measure was announced in the 2015-16 Budget.

Financial impact: This measure has the following financial impact.

2015-16	*2016-17*	*2017-18*	*2018-19*
–	$105m	$110m	$110m

Human rights implications: This Schedule does not any human rights issues. See *Statement of Compatibility with Human Rights* — Chapter 2, paragraphs 2.15 to 2.18.

Compliance cost impact: Nil.

Limiting fringe benefits tax concessions on salary packaged entertainment benefits

Schedule 3 to this Bill amends the *Fringe Benefits Tax Assessment Act 1986* to limit the concessional treatment of salary packaged entertainment benefits by:

- removing the reporting exclusion in respect of salary packaged entertainment benefits;
- removing access to elective valuation rules when valuing salary packaged entertainment benefits to prevent unintended

and excessively concessional values being applied to those benefits; and

- introducing a cap on the total amount of salary packaged entertainment benefits that certain employees can be provided that are exempt from or subject to fringe benefits tax at concessional rates.

Date of effect: This measure applies to the 2016-17 fringe benefits tax year and all later fringe benefits tax years.

Proposal announced: This measure was announced in the 2015-16 Budget.

Financial impact: This measure has the following financial impact:

2014-15	***2015-16***	***2016-17***	***2017-18***	***2018-19***
–	$20m	$85m	$90m	$100m

Human rights implications: This Schedule does not raise any human rights issues. See *Statement of Compatibility with Human Rights,* Chapter 3, paragraphs 3.94 to 3.97.

Compliance cost impact: This measure has a small compliance cost impact of $0.69 million each year on the community sector. This cost has been fully offset within the portfolio.

Summary of regulation impact statement

Regulation impact on business

Impact: This measure will impact employees of organisations who salary package meal entertainment and entertainment facility leasing expenses benefits ('entertainment benefits') and the salary packaging industry.

Main points:

- Currently, most salary packaged fringe benefits provided to certain employees of not-for-profit (NFP) employers are reportable and fringe benefits tax exempt, or rebatable, only up to a set cap. However, all entertainment benefits are specifically excluded from this requirement.

- Salary packaging has facilitated this uncapped benefit, including through 'meal entertainment cards'.

- Entertainment benefits were originally excluded from reporting and the fringe benefits tax caps on compliance costs grounds because, at the time, many of the benefits were not easily attributable to individuals. However, this rationale is no longer appropriate for salary packaging arrangements.

- Non-salary packaged entertainment benefits, such as in-house canteens, are not be affected by this measure.

- There are around 5,700 NFP employers entitled to the exemption and around 3,400 NFP employers entitled to the rebate. Around 20 per cent of exempt employers and around 16 per cent of rebatable employers did not have any reportable fringe benefits in 2012-13. Based on Australian Taxation Office data for 2012-13, the proposed cap is expected to affect around 7,400 employers. For affected NFP employers, there will be regulatory start-up costs associated with education, notifying their employees of the proposed change, and implementing any changes.

The introduction of a separate $5,000 cap on entertainment benefits strikes a balance between the Government's objectives to improve fairness in the tax system and repairing the budget. By not completely eliminating the uncapped benefits, the preferred option retains concessional treatment and reduces the potential adverse effects on the not-for-profit sector.

Third party reporting

Schedule 4 to this Bill amends Schedule 1 to the *Taxation Administration Act 1953* to improve taxpayer compliance by increasing the information reported to the Commissioner of Taxation by a range of third parties. The Schedule creates a new reporting regime requiring third parties to report on the following transactions:

- payments of government grants;

- consideration provided for services to government entities;

- transfers of real property;

- transfers of shares;

- transfers of units in unit trusts; and

- business transactions made through payment systems.

Date of effect: This measure applies to some transactions that happen on or after 1 July 2016 and other transactions that happen on or after 1 July 2017. Several minor amendments apply from Royal Assent.

Proposal announced: The Government announced that it would proceed with these amendments in a Media Release titled, 'Restoring integrity in the Australian tax system' on 6 November 2013.

The Government extended the start date of this measure to 1 July 2016 in a Media Release titled 'More progress in restoring integrity in the tax system' on 13 May 2014.

This measure was first announced by the previous Government in the 2013-14 Budget as 'Tax compliance – Improving compliance through third party reporting and data matching'.

Financial impact: This measure has the following financial impact:

2014-15	***2015-16***	***2016-17***	***2017-18***	***2018-19***
–			$36.6m	$86.4m

Human rights implications: This Schedule raises human rights issues. See *Statement of Compatibility with Human Rights* — Chapter 4, paragraphs 4.87 to 4.97.

Compliance cost impact: Medium. This measure requires companies, trusts, administrators of payment systems, government related entities at the Commonwealth, state, territory and local levels, and other entities to make changes to their record collection and reporting practices. Ongoing obligations are placed on these entities to report information to the Commissioner of Taxation.

Chapter 1
Modernising work-related car expenses

Outline of chapter

1.1 Schedule 1 to this Bill modernises the methods for calculating work-related car expense deductions. Currently, taxpayers have an option of using one of four methods to determine their work-related car expense deductions.

1.2 These methods, each with differing compliance obligations, are:

- 12 per cent of original value method;
- one-third of actual expenses method;
- cents per kilometre; and
- logbook method.

1.3 Schedule 1 will repeal the 12 per cent of original value method and the one-third of actual expenses method.

1.4 Further, this Schedule will provide a streamlined process for calculating the cents per kilometre method by providing a single rate of deduction which more accurately reflects the actual running expenses of a vehicle.

Context of amendments

1.5 Taxpayers are allowed a deduction for the costs associated with operating a motor vehicle in the course of deriving assessable income or in carrying on a business. However, the current methodology used to determine these deductions does not necessarily reflect the costs of running a motor vehicle.

1.6 Of the four methods available for taxpayers to calculate their work-related car expense deductions, three are considered to be somewhat arbitrary. The 12 per cent of original value method, the one-third of actual expenses method and the cents per kilometre method, applying to business travel up to 5,000 kilometres, do not accurately reflect the actual running costs of cars. The fourth method is more substantive: the logbook method.

1.7 These changes will tighten the nexus between operating costs and the allowable deduction by removing the more arbitrary methods and providing a single rate for the cents per kilometre deduction. Rather than providing taxpayers with an option of choosing between four methods and basing their choice on the method which generates the highest deduction for them, the new arrangements will still enable choice, however the outcome will more closely align with the costs associated with work-related car use.

1.8 These changes are not expected to adversely affect the vast majority of taxpayers who currently utilise the two methods which will be retained; the cents per kilometre method and the logbook method. Based on the *ATO 2011-12 Taxation Statistics*, the removal of the 12 per cent of original value and one-third of actual expenses methods is expected to affect only 2 per cent of taxpayers.

1.9 The current cents per kilometre rates are based on the engine capacity of the vehicle being driven. The law provides for three cents per kilometre rates applying to vehicles with ordinary engines. Those cars with an engine capacity of up to 1.6L claim 65 cents per litre; taxpayers whose vehicle engine capacity is between 1.601L and 2.6L claim a rate of 76 cents per litre; and the third rate of 77 cents per litre applies to vehicles with an engine capacity of above 2.601L.

1.10 The cents per kilometre method was introduced in the 1980s as an arbitrary method to determine deductions for employee car expenses which reduced compliance costs associated with substantiating work related car expenses. The three cents per kilometre rates were based on the private motor vehicle allowances paid to Australian public service officers as determined by the Public Service Board. Since introduction, the rates have been indexed by movements in the private motoring sub-group of the consumer price index.

1.11 Since the 1980s there have been major changes to the design of cars including the introduction of hybrid and electric cars and, therefore the operating costs have also changed. Data from peak motoring bodies such as the NRMA and RACQ indicates that the average per kilometre running cost of the top five selling cars (a mix of small to large cars) in Australia is 66 cents. This is much lower than the current rate applying to medium and large vehicles.

1.12 As these rates do not reflect the operating cost of cars, transferring the setting of the rate to the Commissioner of Taxation (Commissioner) will ensure the rate better reflects the operating cost of a vehicle. The rate will also be set at the beginning of the income year rather than at the end of the year, as occurs under the current legislation.

As a result, taxpayers will be able to make more informed choices at the commencement of the income year.

1.13 Further, the changes to the cents per kilometre method will enable taxpayers who drive electric and hybrid cars to access the cents per kilometre method as those cars do not qualify to use the current rates that are based on rotary engine size.

Summary of new law

1.14 This Schedule amends the law applying to work-related car expenses by removing the two least used options.

1.15 Subdivision 28-D of the *Income Tax Assessment Act 1997* (ITAA 1997), containing the 12 per cent of original value method, will be repealed. This method allowed taxpayers to claim a deduction for their work-related car expenses at a rate of 12 per cent of the original value of the vehicle, or 12 per cent of the market value of the vehicle when you first began to lease it.

1.16 This Schedule also removes Subdivision 28-E of the ITAA 1997 which contained the one-third of actual expenses method. This method allowed taxpayers to deduct one-third of each car expense that qualified for a deduction under another provision of the ITAA 1997, or would qualify, had the car only been used in producing assessable income. As noted above in paragraph 1.6, this method does not accurately reflect the operating cost of cars.

1.17 This Schedule will modernise the cents per kilometre method by providing a single cents per kilometre rate for the 2015-16 income year. Taxpayers will continue to be able to choose to apply the cents per kilometre method (for up to 5,000 business kilometres travelled), or the logbook method, depending on which method in their view best captures the actual running costs of their vehicle.

1.18 In the 2015-16 income year the cents per kilometre rate will be set at 66 cents per kilometre. The Commissioner will be provided with the power to set the cents per kilometre rate for later years via legislative instrument.

1.19 This Schedule makes other consequential amendments to the ITAA 1997 to remove reference to provisions in the repealed Subdivisions 28-D and 28-E.

Comparison of key features of new law and current law

New law	*Current law*
The law will contain two methods for calculating your work-related car expense deduction; the logbook method and the cents per kilometre method.	The law currently provides four methods for calculating your work-related car expense deduction; the 12 per cent of original value method, the one-third of actual expenses method, the logbook method and the cents per kilometre method.
The new law will provide for a single rate of deduction and provide the Commissioner with authority to set the cents per kilometre rate, taking in to account the average operating costs of a vehicle. The Commissioner will consider factors including the fixed costs, such as depreciation, registration and insurance as well as variable costs including maintenance, repairs and fuel costs of running a vehicle. The Commissioner will publish the cents per kilometre rate in a legislative instrument.	The current cents per kilometre rate is calculated by reference to a vehicle's engine capacity. There are three rates under the current law applying to vehicles with an engine capacity of up to1.6 litres; between 1.601 litres and 2.6 litres and an engine capacity greater than 2.601 litres. These rates are indexed to movements in the private motoring sub-group of the consumer price index.

Detailed explanation of new law

1.20 By repealing Subdivision 28-D, taxpayers who relied on the 12 per cent of original value method will now have a choice of using the cents per kilometre method or the logbook method, depending on which method better reflects the cost of running their vehicle.

1.21 The 12 per cent of original value method required taxpayers to determine the cost of their vehicle when they acquired it or 12 per cent of the market value when the vehicle was first leased. If the vehicle was only owned for part of a year, the deduction would be reduced to reflect the percentage of the year the vehicle had been owned or leased. ***[Schedule 1, item 3]***

1.22 The repeal of Subdivision 28-E removes the option to claim a deduction for work-related car expenses using the one-third of actual expenses method. The one-third of actual expenses method applies to expenses that are otherwise deductible under the ITAA 1997 or expenses

that would qualify, had the vehicle been used only in producing assessable income.

1.23 If only part of an expense qualified for a deduction under another method, one-third of that part is deductible under Subdivision 28-E. In addition, for a deduction to be claimed under this Subdivision, over 5,000 business kilometres must have been travelled in the relevant income year. The complexity of this method made it one of the least utilised methods.

1.24 By repealing these provisions, this Schedule removes these two arbitrary methods of determining a deduction for work-related car expenses. ***[Schedule 1, item 3]***

1.25 This Schedule also modernises the cents per kilometre method by removing the three rates which were set according to the engine capacity of the taxpayers' vehicle. The new law will provide for a single rate of cents per kilometre in the first year with flexibility for the Commissioner to consider whether a further rate or rates would be appropriate for later years. ***[Schedule 1, item 1]***

1.26 The Commissioner is to set the rate taking into account the average running costs of a car. The Commissioner should consider the fixed and variable costs of operating a vehicle including such matters as fuel costs, servicing costs and the cost of replacing tyres, registration and insurance expenses. The Commissioner, at his or her discretion, may determine more than one rate if he or she wishes to set different rates for different classes of car in later income years. ***[Schedule 1, item 2]***

1.27 By providing the Commissioner with the power to set the cents per kilometre rate, the Commissioner will be able to ensure that the rate better reflects the average running expenses of cars and publication of the rate at the beginning of the income year will enable taxpayers to make a more informed choice between the logbook or cents per kilometre method, depending on which method they feel better captures the running costs of their vehicle.

1.28 The Commissioner will publish his or her determination in a legislative instrument. ***[Schedule 1, item 2]***

1.29 These changes may also affect the way untaxed allowances are calculated. For example, if an employer currently pays their employee an allowance in respect of their motor vehicle use and the allowance is calculated using one of the methods which will be repealed by this Schedule, the employer will need to update the method of calculating the allowance.

1.30 Further, if the rate of the allowance paid by an employer is higher than 66 cents per kilometre, then the employee will need to report this allowance in their tax return. The employee will be entitled to claim a deduction for the amount, up to 66 cents per kilometre and be subject to tax on amounts exceeding 66 cents per kilometre. Alternatively, an employee may utilise the logbook method to claim for their work-related car expenses.

Consequential amendments

Income Tax Assessment Act 1997

1.31 Consequential amendments are required to the ITAA 1997 to remove reference to the repealed Subdivisions 28-D and 28-E, references to the 'four methods', and to retain reference to the remaining two methods only; those being the cents per kilometre rate method and the logbook method. ***[Schedule 1, items 21 to 44]***

Fringe Benefits Tax Assessment Act 1986

1.32 Consequential amendments will also be made to the *Fringe Benefits Tax Assessment Act 1986* (FBTAA 1986) to remove reference to the repealed methods.

1.33 This Schedule removes certain provisions within the FBTAA 1986 which relate to the one-third of actual expenses method of deducting an employee's work-related car expenses (if the employee had claimed the deduction under income tax) from the provisions relating to the otherwise deductible rule. ***[Schedule 1, items 6, 10, 14 and 18]***

1.34 For example, section 19 of the FBTAA 1986 applies in order to enable an employer to calculate the amount of fringe benefit provided to an employee where the employee has received a loan fringe benefit. In the context of the amendments this Schedule makes to the income tax laws, it is important to ensure consistency between methods available to determine an employee's deductions under income tax law and the calculation of an employer's liability under the fringe benefits tax laws.

1.35 These amendments mean an employer will continue to be able to apply the otherwise deductible rule for work-related car expenses using the 'logbook method', for example in paragraph 19(1)(f) of the FBTAA 1986. If logbooks have not been maintained an employer can apply the otherwise deductible rule by using the alternative 'business use declaration method', for example in paragraph 19(1)(g) of the

FBTAA 1986, which provides a deduction based on the business use of the car which is capped at 33.33 per cent of the value of the fringe benefit.

1.36 References to the previous declaration method that provided a fixed 33.33 per cent reduction, based on a car exceeding 96 business kilometres a week, will be removed. ***[Schedule 1, items 5, 9, 13 and 17]***

1.37 These amendments do not affect car fringe benefits and are limited to reimbursement for expenses incurred in work-related use of a private motor vehicle.

1.38 Other minor consequential amendments will be made to the FBTAA 1986. ***[Schedule 1, items 4, 7, 8, 11, 12, 15, 16, 19 and 20]***

Application and transitional provisions

1.39 The cents per kilometre rate set for the 2015-16 income year will be determined as 66 cents per kilometre. The Commissioner will determine the rate for later income years. ***[Schedule 1, item 46]***

1.40 Changes to the FBTAA 1986 will operate from 1 April 2016 and later fringe benefits tax years. ***[Schedule 1, item 45]***

STATEMENT OF COMPATABILITY WITH HUMAN RIGHTS

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

Modernising work related car expenses

1.41 This Schedule 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

1.42 This Schedule modernises the calculation of work related car expense deductions by removing the two least used methods available to taxpayers and applying a single rate for the calculation of the cents per kilometre rate.

Human rights implications

1.43 This Schedule does not engage any of the applicable rights or freedoms.

Conclusion

1.44 This Schedule is compatible with human rights as it does not raise any human rights issues.

Chapter 2
Better targeting of the Zone Tax Offset

Outline of chapter

2.1 Schedule 2 to this Bill amends the *Income Tax Assessment Act 1936* (ITAA 1936) to ensure that the Zone Tax Offset (ZTO) is appropriately targeted to people genuinely living in the designated geographical Zones, by limiting access to the ZTO to those people whose usual place of residence is within a Zone.

2.2 Consequently, people who work in the Zones but fly or drive into those Zones from their usual place of residence that is located outside of the Zone. Those people are assessed as residing at their usual place of residence and not their residence while working.

Context of amendments

2.3 The ZTO is a non-refundable tax offset available to taxpayers who reside in specified remote areas. The ZTO, when introduced in 1945, was intended to compensate recipients for the disadvantages of living in remote areas including distance, uncongenial climate and the higher cost of living.

2.4 There are two designated Zones for claiming the ZTO, Zone A and Zone B, as well as 'special areas' (representing particularly isolated areas) within these Zones. Claimants of the ZTO are entitled to a base amount per year of $338 in Zone A, $57 in Zone B, $1,173 in the special areas, as well as a 20 per cent loading (for Zone B) or 50 per cent loading (for Zone A and special areas). Loading is based on relevant dependency offsets where applicable.

2.5 Section 79A of the ITAA 1936 provides that to be eligible for the ZTO, a taxpayer must reside or work in a specified remote area for 183 days or more in an income year.

2.6 The residency test does not require a ZTO recipient to spend 183 days continuously in the relevant Zone. As a result, the current law allows fly-in fly-out or drive-in drive-out (FIFO) workers to claim the offset if they spend 183 days or more in the Zone in an income year. This is the case even when their usual place of residence is not located within a Zone.

2.7 This is inconsistent with the intention of the ZTO which is designed to compensate for the difficulties associated with living in a remote area. When the ZTO was enacted, it was not anticipated that people living in capital cities, flying into and out of the relevant Zones for their employment, would have an entitlement to claim. Further, many FIFO workers are compensated by their employer for their out of pocket expenses and other adversities associated with their workplace being located in a remote area. Providing additional monetary compensation in these circumstances is not an appropriate use of the ZTO.

2.8 Under the new law, taxpayers will be taken to be a resident of the area incorporating their usual place of residence rather than being considered a resident of the area incorporating their place of employment should that area be located within a Zone or a special area of a Zone.

2.9 However, where a taxpayer has their usual place of residence within a Zone (for 183 days or more) and travels to a workplace outside of the Zone, these taxpayers will retain their entitlement to the ZTO (see example 2.2 below).

2.10 Recent changes to offsets have made the Dependant (Invalid and Carer) Tax Offset (DICTO) part of the ZTO if taxpayers meet the eligibility requirements for accessing the DICTO.

Example 2.1

A taxpayer whose spouse is unable to work due to invalidity or carer obligations may be eligible for the DICTO. Such a taxpayer may be eligible for an additional 20 or 50 per cent of the DICTO entitlement as a component of their ZTO. For example, Matt and Leila live in Darwin in Zone A. Matt travels to Kununurra (Zone A special area) for work on a FIFO basis and Leila stays at home where she cares for Matt's disabled father in their residence.

Matt is able to claim the ZTO for Zone A, but not for the Zone A special area where he works. Matt is also able to claim the DICTO as Leila is unable to work due to her carer responsibilities caring for Matt's father.

Summary of new law

2.11 Under the new law, a taxpayer's usual place of residence will be relevant along with other eligibility tests in section 79A of the ITAA 1936 to determine their eligibility for the ZTO. This is in contrast to the current law which tests where a taxpayer has spent a minimum of 183 days; whether as a result of their employment, in attending their workplace or if they actually maintain their usual place of residence in that area.

2.12 The current law enables taxpayers to claim ZTO even where they do not maintain their usual place of residence in a Zone, provided that they spend 183 days or more in the Zone. This means that FIFO workers are able to access the ZTO even though their usual place of residence is not within a Zone.

Comparison of key features of new law and current law

New law	*Current law*
Where a person's usual place of residence is not within a prescribed area, they will be unable to claim the ZTO.	The ZTO does not require that a person's usual place of residence is within a prescribed area.

Detailed explanation of new law

2.13 In order to ensure that the offset is not claimed by people who work in remote areas, but who ordinarily live outside of those areas, eligibility for the ZTO will be restricted. Under the new law, to be eligible for the ZTO, a taxpayer's usual place of residence must be within a prescribed area (Zone). The Zones are described in Schedule 2 in the ITAA 1936. ***[Schedule 2, items 1 to 14, subsection 79A(2), paragraphs 79A(2)(b) and (c), paragraphs 79A(3B)(a), (b) and (c), subparagraphs 79A(3B)(d)(i), (ii) and (iii), 79A(3B)(e)(i) and (ii), 79A(3B)(e)(iv) and (v), subsection 79A(3C), paragraphs 79A(3C)(a) and (b) of the ITAA 1936]***

Example 2.2

Jonte is an engineer who lives in Darwin (located within Zone A) and travels to Kununurra in Western Australia (located in a Zone A special area) where he is employed in the mining industry. The distance between Darwin and Kununurra is approximately 830km which takes Jonte 10 hours to drive to work from his usual place of residence in Darwin. In his usual shift, Jonte drives to Kununurra, works 14 days at the mine and drives back to Darwin where he remains for 16 days.

Under the existing law, Jonte would be able to claim ZTO for the Zone A special area of Kununurra, even though he lives in Darwin because he is in Kununurra for 183 days or more in a year of income. As a result of these changes, Jonte is no longer able to access the ZTO special area loading because, as a FIFO worker, his usual place of residence is outside of the prescribed area even though, as a result of his employment, he spends 183 days or more within a prescribed special area. Jonte is still able to claim ZTO as his usual place of residence is in Darwin but he cannot access the special area Zone A offset.

Example 2.3

Levi is an engineer who lives in Adelaide. He flies to Alice Springs for twelve day shifts at an engineering firm and then travels back to Adelaide for his days off (which vary between four and eight days in a row). As Levi does not have his usual place of residence within a prescribed Zone, even though he is in Alice Springs for 183 days or more, Levi is unable to claim the ZTO.

Example 2.4

Angela is a doctor who works in Darwin Hospital Emergency Department. She flies into Darwin from Auckland, New Zealand and works on a regular rotational basis in Darwin Hospital. Usually, Angela works for ten days and then has a break of between eight and ten days, during which she travels back to Auckland to see her friends and family. Angela stays in accommodation provided for her by the hospital when she is in Darwin. She is purchasing a house in Auckland and she also has a car which she leaves at her Auckland home for use when she is there. She has bills sent to her Auckland home and she is registered to vote in New Zealand. Under the previous law, because Angela usually spent 183 days or more in Darwin, she claimed the ZTO. Under the new law Angela will no longer be eligible for ZTO because her usual place of residence is in Auckland.

Application and transitional provisions

2.14 The measure in this Schedule will apply from the 2015-16 year of income and later years of income. ***[Schedule 2, item 15]***

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

Better targeting of the Zone Tax Offset

2.15 This Schedule 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

2.16 Schedule 2 to this Bill amends the *Income Tax Assessment Act 1936* to restrict the application of the Zone Tax Offset to people

whose usual place of residence is within a Zone or a prescribed area within a Zone.

Human rights implications

2.17 This Schedule does not engage any of the applicable rights or freedoms.

Conclusion

2.18 This Schedule is compatible with human rights as it does not raise any human rights issues.

Chapter 3
Limiting fringe benefits tax concessions on salary packaged entertainment benefits

Outline of chapter

3.1 Schedule 3 to this Bill amends the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) to limit the concessional treatment of salary packaged entertainment benefits by:

- removing the reporting exclusion in respect of salary packaged entertainment benefits;
- removing access to elective valuation rules when valuing salary packaged entertainment benefits to prevent unintended and excessively concessional values being applied to those benefits; and
- introducing a cap on the total amount of salary packaged entertainment benefits that certain employees can be provided that are exempt from or subject to fringe benefits tax at concessional rates.

3.2 All references are to the FBTAA unless otherwise stated.

Context of amendments

Budget announcement

3.3 The Government announced in the 2015-16 Budget that it would improve fairness in the tax system by introducing a limit on the use of salary packaged meal entertainment and entertainment facility leasing expense benefits.

3.4 All salary packaged meal entertainment and entertainment facility leasing expense benefits will become reportable and included on an employee's payment summary.

3.5 The announced changes also involve introducing a separate single grossed-up cap of $5,000 for salary packaged meal entertainment and entertainment facility leasing expense benefits for employees of

employers able to access a general fringe benefits tax (FBT) exemption or rebate. Affected benefits exceeding the separate grossed-up cap of $5,000 would then be counted in calculating whether an employee exceeds their existing FBT exemption or rebate cap.

Previous reviews and inquiries

3.6 The FBT treatment of meal entertainment and entertainment facility leasing expense benefits has been reviewed by a number of different inquiries.

3.7 Most recently, the Final Report of the Not-for-profit Sector Tax Concession Working Group[1] included the following recommendation:

> ***Recommendation 13: Include uncapped meal entertainment and entertainment facility leasing benefits in existing caps***
>
> *As soon as practicable and independently of the implementation of Recommendation 12 [about broader reform of FBT], the uncapped concessions in relation to salary sacrificed meal entertainment and entertainment facility leasing fringe benefits should be removed. These benefits should be treated consistently with other fringe benefits, that is, included within existing caps.*

3.8 The Not-for-profit Sector Tax Concession Working Group summarised that:

> *Uncapped access to meal entertainment and entertainment facility leasing benefits has raised concerns about the legitimacy of such concessions, especially since the rest of the community are not able to access such concessions or claim a deduction for such expenses. The benefit of this concession is also not evenly spread among [not-for-profit (NFP)] employees, tending to be more highly utilised by eligible employees on higher salaries.*

3.9 The Productivity Commission in a Report in 2010 noted that the ‘meal entertainment benefit is particularly inequitable, with greater benefits flowing to employees with higher salaries, and those who have greater financial freedom to spend their salaries on eligible items.

1 Not-for-profit Tax Concession Working Group, *Fairer, Simpler and More Effective Tax Concessions for The Not‑for‑profit Sector: Final Report*, May 2013, http://www.treasury.gov.au/~/media/Treasury/Access%20to%20Information/Disclosure%20Log/2014/1447/Downloads/PDF/NFP%20Sector%20WG%20Final%20Report.ashx

Similarly, those employees with large one-off entertainment expenses benefit relatively more in that year.'[2]

3.10 The Productivity Commission also observed that:

> *The meal entertainment exemption for public and NFP hospitals was originally introduced because of the difficulty of accounting for the provision of meals to hospital employees when most hospitals had a subsidised staff canteen. However, in recent years it appears that the use of these concessions has grown much wider than the original intent. The salary packaging providers are actively promoting the use of meal entertainment cards for dining and holidays – domestic and overseas*
>
> *There appears to be a strong case to limit or eliminate the meal entertainment benefit.*

3.11 Similar concerns have also been raised in other reports including in Australia's Future Tax System Review, released in 2010.

Operation of existing law

3.12 FBT is a tax that employers pay on certain benefits they provide to their employees, including their employees' family or other associates. The benefit may be in addition to, or part of, their salary or wages package. Benefits provided to some other individuals who are not employees may also be subject to FBT, such as directors of a company or statutory officeholders. FBT is imposed by the Fringe Benefits Tax Act 1986 and assessed under the FBTAA.

3.13 FBT is separate to income tax and is calculated on the grossed-up taxable value of the fringe benefits provided. The FBT year runs from 1 April to 31 March.

3.14 The FBTAA satisfies a number of policy objectives. It reports the grossed-up taxable value of benefits on an employee's payment summary (which affects various entitlements and surcharges); it grosses-up taxable values using a higher goods and services tax (GST) inclusive formula where there are entitlements to GST credits but no GST collection point; and it applies FBT on the resultant sum of the grossed-up taxable values.

2 Productivity Commission, *Contribution of the Not-for-profit Sector*, January 2010, http://www.pc.gov.au/inquiries/completed/not-for-profit

3.15 It also assists entities such as registered charities and public hospitals to attract staff and reduce their costs of employment.

3.16 In order to achieve these policy objectives, the following method applies to calculate FBT under the FBTAA. The employer:

- determines the taxable value of a benefit (Divisions 1 to 13 of Part III);
  - this taxable value forms the employee's individual fringe benefits amount (subsection 5E(2)) or excluded fringe benefit (subsection 5E(3));
- reports an employee's individual fringe benefits amount (grossed-up to the reportable fringe benefits amount) on the employee's payment summary (section 135P – if in excess of the $2,000 de minimisthreshold);
- adds up all employee's individual fringe benefits amounts (ignoring the de minimis threshold) and excluded fringe benefit amounts for those benefits with a GST credit entitlement (subsection 5C(3)) the result being the type 1 aggregate fringe benefits amount;
- adds up all employee's individual fringe benefits amounts (ignoring the de minimis threshold) and excluded fringe benefit amounts for those benefits with no GST credit entitlement (subsection 5C(4)) the result being the type 2 aggregate fringe benefits amount;
- grosses-up the type 1 aggregate fringe benefits amount using the higher type 1 gross-up rate (subsection 5B(1F));
- grosses-up the type 2 aggregate fringe benefits amount using the lower type 2 gross-up rate (subsection 5B(1G));
- adds up grossed-up types 1 and 2 aggregate fringe benefits amounts which forms the fringe benefits taxable amount upon which tax is imposed (subsection 5B(1A) and section 66).

3.17 The method in paragraph 3.16 (including reporting) applies to employers who are subject to FBT in the normal fashion, including rebatable employers such as registered charities. Section 65J provides a

capped rebate of tax of up to $30,000 per employee to rebatable employers but otherwise the method stays the same.[3]

3.18 The FBTAA provides certain employers with a 'blanket' exemption on all benefits provided to their employees so that they are not required to apply all of the items listed in paragraph 3.16. However, this 'blanket exemption' is limited or capped. Section 57A exempts benefits provided by public hospitals and ambulance services (subject to a standard $17,000 cap per employee) and registered public benevolent institutions and registered health promotion charities (subject to a standard $30,000 cap per employee) have their exemptions capped using a quasi-reportable system (subsection 135Q(3)) and quasi-taxing system (subsections 5B(1D) to 5B(1L)).

3.19 Currently benefits arising from meal entertainment, car parking and entertainment facility leasing expenses are excluded from reporting for all taxpayers (paragraphs 5E(3)(a), (b) and (c)). These types of benefits are also excluded from the caps allowing for an unlimited tax exemption for employers covered by section 57A (subsection 5B(1L)) or unlimited rebates for tax-exempt employers (subsection 65J(2H)).

3.20 There are other 'blanket exemptions', such as for religious practitioners conducting pastoral duties that are unaffected by the budget measure as benefits received by these employees are not currently capped. In addition, section 135Q (about reporting) only applies to employers described in section 57A or 58, so that employees of exempt employers not covered by those sections will not have amounts reported on their payment summaries.

Certain employers provided with concessions

3.21 Some organisations are exempt from FBT where the total grossed-up value of certain benefits (which are benefits that are not otherwise excluded) provided to each employee during the FBT year is equal to, or less than, the capping threshold. If the total grossed-up value of fringe benefits provided to an employee is more than that capping threshold, an organisation will need to pay FBT on the excess.

3.22 Table 3.1 outlines the types of organisations that are eligible for an FBT exemption, the capping thresholds that apply and whether the

3 Section 135Y increases the capping threshold for certain years to compensate for the temporary budget repair levy. During the temporary budget repair levy years the $30,000 capping threshold is increased to $31,177 and the $17,000 capping threshold is increased to $17,667.

organisation needs to be endorsed by the Commissioner of Taxation to access the FBT exemption.

Table 3.1

Types of organisation eligible for FBT exemption	***Standard capping threshold***[4]	***Does the employer need to be endorsed to access FBT exemption?***	***Exemption provision [Capping provision]***
Registered public benevolent institution (other than hospitals)	$30,000 per employee	Yes	Section 57A [step 3 of the method statement in subsection 5B(1E)]
Registered health promotion charity	$30,000 per employee	Yes	Section 57A [step 3 of the method statement in subsection 5B(1E)]
Public and not-for-profit hospitals	$17,000 per employee	No	Section 57A [step 2 of the method statement in subsection 5B(1E)]
Public ambulance service	$17,000 per employee	No	Section 57A [step 2 of the method statement in subsection 5B(1E)]

3.23 Some employers qualify for an FBT rebate and are referred to as ‘rebatable employers’.

3.24 The FBT rebate is an entitlement to a rebate equal to 48 per cent of the gross FBT payable, subject to a capping threshold.5

3.25 Rebatable employers are entitled to have their liability reduced by a rebate equal to 48 per cent of the gross FBT payable (subject to a $30,000 standard capping threshold). If the total grossed-up taxable value of fringe benefits provided to an employee is more than $30,000 a rebate cannot be claimed for the FBT liability on the excess amount. The

4 See note 3.

5 Section 6A of the *Fringe Benefits Tax Act 1986* increases this rebate rate to 49 per cent for certain years to compensate for the temporary budget repair levy.

$30,000 capping threshold applies even if the rebatable employer did not employ the employee for the full FBT year.

3.26 The capping thresholds apply to each employee of an FBT concessionally taxed employer regardless of whether:

- the employee is employed for the full FBT year or only part of that year;
- the employee is employed on a full-time or part-time basis; and
- the employee received any concessional taxed benefits from another employer or employers.

Reportable fringe benefits

3.27 The FBTAA determines whether the taxable value of a fringe benefit forms part of an employee's individual fringe benefits amount or is an excluded benefit. It does this so as to calculate an employee's reportable fringe benefit total for publication on an employee's payment summary in the following income tax year (sections 135M to 135Q). An amount is reported only if it exceeds a $2,000 de-minimis threshold.

3.28 The reportable fringe benefits total of an employee is used to assess the employee's eligibility for transfer payments and other tax concessions as well as an employee's liability to certain levies and surcharges. This ensures that employees with remuneration consisting entirely of salary are treated equally, when compared to those in receipt of fringe benefits. The introduction of FBT was designed to ensure that all forms of cash and non-cash remuneration for employees receive equivalent treatment.

3.29 An employer currently does not have to allocate the following excluded benefits to employees or report them on payment summaries (subsections 5E(2) and (3)):

- entertainment by way of food and drink, and benefits associated with that entertainment, such as travel and accommodation, regardless of which category is used to value the benefit;
- car parking fringe benefits, not including car parking expense payment benefits;
- hiring or leasing entertainment facilities such as corporate boxes;

- remote area residential fuel where the value of the benefit is reduced under the FBTAA;
- remote area housing assistance where the value of the benefit is reduced under the FBTAA;
- remote area home ownership schemes where the value of the benefit is reduced under the FBTAA;
- remote area home repurchase schemes where the value of the benefit is reduced under the FBTAA;
- costs of occasional travel, being that which occurs from time to time and not at regular intervals, to a major Australian population centre by employees and their families living in a remote area;
- freight costs for food provided to employees living in a remote area; and
- fringe benefits provided to address certain security concerns relating to the personal safety of an employee, or an associate of the employee, arising from the employee's employment.

3.30 The following are further excluded by the *Fringe Benefits Tax Regulations 1992* (made for the purposes of paragraph 5E(3)(i) of the FBTAA):

- emergency or other essential health care provided to an employee or associate who is an Australian citizen or permanent resident, while the employee is working outside Australia and no Medicare benefit is payable;
- certain Australian Government overseas living allowance payments, for example cost of living adjustments, post adjustments, child supplements, and child reunion supplements;
- certain benefits provided to Defence Force members, for example particular forms of housing assistance, reunion travel, assistance provided for removing and storing household effects, allowances paid to families with special needs, education assistance for children in critical years of schooling, elements of overseas living allowances, and removal expenses of a spouse due to marriage breakdown;

- certain benefits provided to police officers, for example particular forms of housing assistance, assistance provided for removing and storing household effects, certain relocation assistance and certain car benefits arising from travel between home and work by police officers using unmarked police vehicles that are fitted with a police radio and concealed or portable warning lights and sirens;

- certain car benefits arising from travel between home and work by police officers, ambulance officers and fire fighters using marked emergency vehicles; and

- car benefits arising from an employee's private use of pooled or shared cars (subject to certain conditions).

3.31 The nature of most excluded benefits is that they are either difficult or costly to attribute to particular employees or are difficult or costly to allocate part of the taxable value of the benefit to a particular employee.[6]

3.32 However, some of the excluded benefits have now become part of some employee's salary packaging arrangements (as defined in section 136) undermining the rationale for the exclusion and undermining the integrity of the FBT system.

Alternative valuation rules for meal entertainment benefits (compliance cost savings methods)

3.33 Generally, when an employer provides entertainment to both employees and non-employees (for example, clients), only the part of the entertainment that relates to employees and their associates is subject to FBT.

3.34 However, those employers mentioned in Table 3.1 do not pay FBT on any of the meal entertainment benefits they provide to their employees.

3.35 The taxable value of the food or drink, and the associated accommodation or travel, is calculated using the respective valuation rule according to whether the benefit is an expense payment, property, residual or tax-exempt body entertainment fringe benefit.

6 Paragraph 1.28 of the Explanatory Memorandum to A New Tax System (Fringe Benefits Reporting) Bill 1998.

3.36 If an employer cannot easily determine the actual expenditure, they can use a 'per head' basis of apportionment.

3.37 Alternatively, an employer may instead elect to value the food, drink and associated accommodation or travel as a 'meal entertainment fringe benefit'. If they make this election, they cannot use the per head basis of apportionment and the taxable value is calculated under the meal entertainment rules.

3.38 Where an employer elects to classify a fringe benefit as a meal entertainment fringe benefit, they have to classify all fringe benefits arising from the provision of meal entertainment during the FBT year as meal entertainment fringe benefits.

3.39 Specifically, the provision of meal entertainment under Division 9 of Part III means:

- providing entertainment by way of food or drink;
- providing accommodation or travel in connection with, or to facilitate the provision of, such entertainment; and
- paying or reimbursing expenses incurred by the employee for the above.

3.40 The provision of meal entertainment does not include the provision of entertainment by way of recreation.

3.41 If an employer elects to classify the provision of meal entertainment as a meal entertainment fringe benefit, the meal entertainment provided does not give rise to an expense payment fringe benefit, property fringe benefit, residual fringe benefit or tax-exempt body entertainment fringe benefit.

3.42 An employer cannot include meal entertainment provided by someone other than the employer (that is, someone who is not the employer) in the election.

3.43 This means that if a fringe benefit arises from meal entertainment provided by someone other than the employer, the employer must value the fringe benefit according to the rules for that type of fringe benefit. It could, for example, be an expense payment fringe benefit, a property fringe benefit, a residual fringe benefit or a tax-exempt body entertainment fringe benefit.

3.44 There are two methods an employer can use to calculate the taxable value of meal entertainment fringe benefits:

- 50-50 split method; and
- 12-week register method.

3.45 These options are also available to income tax-exempt employers, who may be exempt from income tax but may have a liability for FBT.

3.46 Both methods are based on an employer's total meal entertainment expenditure. This includes expenditure that might otherwise be exempt from FBT or not normally subject to FBT.

3.47 Under the 50-50 split method, the taxable value is 50 per cent of an employer's total meal entertainment expenditure.

3.48 The 12-week register method is based on the total meal entertainment expenditure and an appropriate percentage, as evident from the 12-week register.

3.49 Under the 50-50 split method, the total taxable value of meal entertainment fringe benefits is 50 per cent of the expenses an employer incurs in providing meal entertainment to all people (whether employees, clients or otherwise) during the FBT year. An employer's total meal entertainment expenditure includes expenditure that might otherwise be exempt from FBT or not normally subject to FBT.

3.50 The 50-50 split method was introduced to assist in reducing compliance costs in employers not having to apportion different types of meal entertainment to different benefits and different recipients. However, the method can produce the wrong result (a concessional result) in respect of salary packaged entertainment which is easily valued and attributable to a particular individual. If the method is adopted, the value of a salary packaged benefit provided to an employee is effectively halved.

Entertainment facility leasing expense benefits – alternative valuation rules (compliance cost saving method)

3.51 Similar rules also apply in respect of entertainment facility leasing expense benefits. The taxable value of recreational entertainment is calculated using the respective valuation rule according to whether the benefit is an expense payment fringe benefit, property fringe benefit or residual fringe benefit.

3.52 Where an employer provides recreational entertainment by hiring or leasing entertainment facilities, they may elect to use the 50-50 split method.

3.53 Entertainment facility leasing expenses are the expenses incurred in hiring or leasing:

- a corporate box;
- boats or planes for providing entertainment; and
- other premises or facilities for providing entertainment.

3.54 Expenses, or parts of expenses, that are not entertainment facility leasing expenses for these purposes are:

- expenses attributable to providing food or beverages; and
- expenses attributable to advertising that would be an allowable income tax deduction.

3.55 Generally, the transport to and from an entertainment facility will be a separate benefit that will not be part of the entertainment facility leasing expense.

3.56 However, the transport may be part of the entertainment facility leasing expense where the transport is provided as part of an all-inclusive package.

3.57 Expenses incurred in hiring or leasing a boat or plane in their entirety for the purposes of providing entertainment will be 'entertainment facility leasing expenses'. For example, the hiring or leasing of a houseboat or a charter flight where the whole plane is hired for entertainment purposes would meet the definition of entertainment facility leasing expenses.

3.58 When an employer gives an employee a plane ticket for travel to a holiday destination, the expense may relate to entertainment but will not be an entertainment facility leasing expense because the purchase of an airfare is not the hiring or leasing of a plane.

3.59 However, if the plane ticket is part of an all-inclusive package that includes holiday accommodation, the taxable value of the benefit may be partly attributable to an entertainment facility leasing expense being the cost of hiring the holiday accommodation. For example, providing an all-inclusive holiday package to an employee organised through a travel agent that includes both flights and the hire or lease of holiday

accommodation will be a single benefit whose taxable value is partly attributable to entertainment facility leasing expenses. As the benefit is partly attributable to entertainment facility leasing expenses, the whole of the package will be treated as an entertainment facility leasing expense.

3.60 The phrase ‘other premises or facilities’ has a wide meaning. In the same way that a corporate box is a part of larger premises or a facility (being the sporting stadium), items that satisfy this category of entertainment facility leasing expense must be either:

- an entire premises or facility; or
- a distinct area or separate room of a larger premises or a facility.

3.61 The following are examples of ‘other premises or facilities’ for providing entertainment:

- a function room in a club or hotel that has been hired to the exclusion of others;
- a hotel/motel room;
- a room in a bed and breakfast facility;
- a cabin on a cruise ship;
- a cabin or on-site van at a caravan park;
- a marquee;
- a golf course that is hired or leased for a set time or full day to the exclusion of others, for example for a corporate golf day; and
- a tennis court that is hired to the exclusion of others, for example for a corporate tennis day.

3.62 The following would not be ‘other premises or facilities’ for providing entertainment:

- a seat on a plane;
- a seat at a sporting event;
- a table in the dining room of a club or hotel;

- golf green fees or memberships; and
- caravan site fees.

3.63 An employer may elect to use the 50-50 split method so that the total taxable value of fringe benefits arising from the use of entertainment facilities an employer hires or leases is 50 per cent of all entertainment facility leasing expenses.

3.64 The minor benefits exemption does not apply if an employer elects to use the 50-50 split method for valuing entertainment facility leasing expenses.

3.65 The 50-50 split method for entertainment facility leasing expenses only applies to expenses an employer incurs. It does not include, for example, those expenses incurred by an employee that an employer reimburses.

Summary of new law

3.66 Schedule 3 to this Bill amends the FBTAA to limit the concessional treatment of salary packaged entertainment benefits.

3.67 Entertainment benefits are those benefits that are meal entertainment benefits (those relating to the provision of meal entertainment) or entertainment facility leasing expense benefits.

3.68 Salary packaging is generally an arrangement by which an employee reduces his or her salary and wages in return for receiving a non-cash benefit.

3.69 Schedule 3 to this Bill limits the concessional treatment of salary packaged entertainment benefits by making three core changes.

3.70 Firstly, Schedule 3 ensures salary packaged meal entertainment and entertainment facility leasing expense benefits will always appear as part of an employee's reportable fringe benefits total which is included on their payment summaries. This is achieved through the removal of an existing reporting exclusion.

3.71 Secondly, Schedule 3 removes access to elective valuation rules when valuing salary packaged entertainment benefits to prevent unintended and excessively concessional values being applied to those benefits.

3.72 Lastly, Schedule 3 introduces a cap on the total amount of salary packaged entertainment benefits that employees can be provided by exempt employers (covered by section 57A) and rebatable employers (covered by section 65J) that are subject to a reduced amount of FBT.

Comparison of key features of new law and current law

New law	***Current law***
Meal entertainment benefits and entertainment facility leasing expense benefits are only excluded from forming part of an employee's individual fringe benefits amount and reportable fringe benefits total where they are *not* provided under a salary packaging arrangement.	Meal entertainment benefits and entertainment facility leasing expense benefits are excluded from forming part of an employee's individual fringe benefits amount and reportable fringe benefits total.
An employer can elect to calculate the taxable value of all meal entertainment benefits under the 12 week register method or the 50/50 split method. However, the methods do not apply to calculate the taxable value of meal entertainment benefits *not* provided by an employer or where the benefit is provided under a salary packaging arrangement.	An employer can elect to calculate the taxable value of all meal entertainment benefits under the 12 week register method or the 50/50 split method. However, the methods do not apply to calculate the taxable value of meal entertainment benefits *not* provided by an employer.
An employer can elect to calculate the taxable value of all entertainment facility leasing expense benefits under the 50/50 split method. However, the method does not apply to calculate the taxable value of entertainment facility leasing expense benefits provided under a salary packaging arrangement.	An employer can elect to calculate the taxable value of all entertainment facility leasing expense benefits under the 50/50 split method.

New law	***Current law***
Employers covered under section 57A (public benevolent institutions, health promotion charities, public and not-for-profit hospitals, and public ambulance services) are exempt from FBT where the total grossed-up value of benefits provided to each employee during the FBT year is equal to, or less than, the capping threshold (the standard threshold is either $30,000 or $17,000 depending on the employee and employer). If the total grossed-up value of fringe benefits provided to an employee is more than that capping threshold, the employer will need to pay FBT on the excess. However, in calculating the value of fringe benefits for the purposes of the capping threshold *non-salary packaged entertainment benefits* (amongst other benefits) are *not* taken into account. Salary packaged entertainment benefits previously excluded are now included in the standard capping threshold. If, however, the total value of fringe benefits for the purposes of the standard capping threshold is exceeded in a particular year, it is raised by the *lesser* of: • $5,000; and • the total grossed-up taxable value of salary packaged entertainment benefits.	Employers covered under section 57A (public benevolent institutions, health promotion charities, public and not-for-profit hospitals, and public ambulance services) are exempt from FBT where the total grossed-up value of benefits provided to each employee during the FBT year is equal to, or less than, the capping threshold (the standard threshold is either $30,000 or $17,000 depending on the employee and employer). If the total grossed-up value of fringe benefits provided to an employee is more than that capping threshold, the employer will need to pay FBT on the excess. However, in calculating the value of fringe benefits for the purposes of the capping threshold *salary packaged* and *non-salary packaged entertainment benefits* (amongst other benefits) are *not* taken into account.

New law	***Current law***
Rebatable employers are entitled to have their FBT liability reduced by a rebate equal to 47 per cent of the gross FBT payable (subject to a $30,000 standard capping threshold). If the total grossed-up taxable value of fringe benefits provided to an employee is more than $30,000 a rebate cannot be claimed for the FBT liability on the excess amount. However, in calculating the value of fringe benefits for the purposes of the capping threshold *non-salary packaged entertainment benefits* (amongst other benefits) are *not* taken into account. Salary packaged entertainment benefits previously excluded are now included in the standard capping threshold. If, however, the total value of fringe benefits for the purposes of the standard capping threshold is exceeded in a particular year, it is raised by the *lesser* of: • $5,000; and • the total grossed-up taxable value of salary packaged entertainment benefits.	Rebatable employers are entitled to have their FBT liability reduced by a rebate equal to 47 per cent of the gross FBT payable (subject to a $30,000 standard capping threshold). If the total grossed-up taxable value of fringe benefits provided to an employee is more than $30,000 a rebate cannot be claimed for the FBT liability on the excess amount. However, in calculating the value of fringe benefits for the purposes of the capping threshold *salary packaged* and *non-salary packaged entertainment benefits* (amongst other benefits) are *not* taken into account.

Detailed explanation of new law

3.73 Schedule 3 to this Bill amends the FBTAA to make a number of small changes to limit the concessional treatment of salary packaged entertainment benefits.

Including entertainment benefits in an employee's reportable fringe benefits total

3.74 Schedule 3 amends the definition of excluded fringe benefit to remove the provision of meal entertainment (as currently defined in section 37AD) provided under a salary packaging arrangement and a benefit wholly or partly attributable to entertainment facility leasing expenses (currently defined in subsection 136(1)) provided under a salary packaging arrangement (salary packaged entertainment benefits). ***[Schedule 3, items 4 and 5, paragraphs 5E(3)(a) and (c)]***

3.75 By removing salary packaged entertainment benefits from the definition of 'excluded fringe benefit', entertainment fringe benefits will form part of an employee's individual fringe benefits amount and reportable fringe benefits total.

3.76 'Salary packaging arrangements' (currently defined in subsection 136(1)) are arrangements under which an employee receives a benefit and either agrees to forgo salary or wages in return for a benefit or receiving the benefit is part of the employee's remuneration package and it is reasonable to conclude that the employee's salary or wages would be greater if the benefit were not provided.

Removing access to elective valuation rules when valuing salary packaged entertainment benefits

3.77 Schedule 3 prevents Division 9A of Part III (about elective valuation rules for meal entertainment benefits) and section 152B (about elective valuation rules for entertainment facility leasing expense benefits) applying to value salary packaged entertainment benefits. ***[Schedule 3, items 6, 10 and 11, section 37AC and subsection 152B(2)]***

3.78 The elective valuation rules can provide an unintended and excessively concessional value being applied to salary packaged entertainment benefits, particularly in relation to employers who are generally exempt from FBT.

3.79 To ensure that entertainment fringe benefits are allocated an appropriate taxable value (as determined under the core FBT rules), the elective valuation regimes cannot be applied to determine the taxable value of salary packaged entertainment benefit. However, the elective valuation rules will remain available to calculate the value of other benefits that fall within their current scope.

3.80 The elective valuation regimes are provided so as to reduce compliance costs in relation to apportionment and valuation of individual entertainment benefits, which in some cases can be considerable. However, the compliance costs in relation to valuing a salary packaged entertainment benefit are not subject to the same issues due to the existence of the agreement between the employer and employee to reduce salary and wages in return for providing/receiving the entertainment benefit.

3.81 Retaining access to the current elective valuation rules for salary packaged entertainment benefits would undermine these changes by reducing the reporting of these benefits and effectively raising the proposed new cap on the maximum amount of these benefits that can be accessed at concessional FBT rates.

Introducing a cap on the total amount of salary packaged entertainment benefits that certain employees can be provided that are exempt from or subject to fringe benefits tax at concessional rates

FBT exempt employers (section 57A employers)

3.82 Currently, certain specified employers are exempt from FBT where the total grossed-up value of certain benefits (which are benefits that are not otherwise excluded, known as 'excluded fringe benefits') provided to each employee during the FBT year is equal to, or less than, the capping threshold. If the total grossed-up value of fringe benefits provided to an employee is more than that capping threshold, an employer will need to pay FBT on the excess.

3.83 As Schedule 3 removes salary packaged entertainment benefits from being an excluded fringe benefit, without further changes, the grossed-up taxable value of those benefits will be taken into account in determining whether, and by how much, the capping threshold has been exceeded.

3.84 Rather than remove in full the concessional treatment of salary packaged entertainment benefits for these employers, Schedule 3 limits the existing concession by increasing the existing capping threshold by the lesser of:

- $5,000; and
- an employee's total grossed-up taxable value of salary packaged entertainment benefits (i.e., those benefits relating to the provision of meal entertainment or entertainment facility leasing expenses).

[Schedule 3, items 2 and 3, subsection 5B(1E) (step 3A in the method statement) and subsection 5B(1M)]

3.85 This effectively provides each employee of those employers a separate single grossed-up cap of $5,000 each FBT year for salary packaged entertainment benefits which remain eligible for the current FBT exemption. Where this cap is exceeded, any benefits may be taken into account under the existing caps before determining whether there is any excess to be taxed.

Example 3.1: New Step G for determining the employer's *aggregate non-exempt amount* under subsection 5B(1E)

A public hospital[7] provides an employee, Lee, with the following benefits during the 2016-2017 FBT year[8]:

Salary packaging arrangement

- a television with taxable value of $1,000 (GST creditable);[9]
- domestic air travel with taxable value of $2,000 (GST creditable);[10]
- reimbursed child care fees with a taxable value $3,000 (not GST creditable);
- reimbursement of restaurant meals with taxable value of $1,800 (not GST creditable);[11]
- reimbursement of cost of Canadian holiday accommodation with taxable value of $1,200 (not GST creditable);[12] and

Not through a salary packaging arrangement

- food and drink provided by a third party while attending a corporate event with taxable value of $400 (GST creditable).[13]

The employer does *not* elect under section 37AA (about meal entertainment) or section 152B (entertainment facility leasing expenses) to value entertainment benefits under any of the elective valuation rules.

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7 The employer (a public hospital) provides benefits exempt under subsection 57A(3) and the benefits would have a taxable value if subsection 57A(3) was disregarded.

8 Note: during the 2016-2017 FBT year, the FBT rate of tax is 49%; the FBT 'cap' for hospitals is $17,667 general cap plus a $5,000 entertainment cap.

9 'GST creditable' indicates entitlement to GST input tax credits (type 1 gross-up applies) and 'not GST creditable' indicates no entitlement to GST input tax credits (type 2 gross-up applies).

10 The example assumes the benefit does not meet the definition of 'entertainment' in subsection 32-10(1) of the *Income Tax Assessment Act 1997*.

11 Salary packaged restaurant meals for $1,800 constitute the provision of meal entertainment as defined in subsection 37AD(1) and forms part of the employee's individual fringe benefits amount under subsection 5E(2).

12 Salary packaged holiday accommodation for $1,200 has a taxable value which is wholly or partly attributable to entertainment facility leasing expenses and forms part of the employee's individual fringe benefits amount under subsection 5E(2).

13 Non-salary packaged food and drink for $400 constitute the provision of meal entertainment as defined in subsection 37AD(1) and are excluded fringe benefits under subsection 5E(3) and are also excluded from the employers taxation liability under subsection 5B(1L).

The employer's ***aggregate non-exempt amount*** (under subsection 5B(1E)) for the 2016-2017 FBT year is calculated in the following way:

Step A

The employer works out what would be the individual fringe benefits amount for each employee, if section 57A did not apply. This is determined by adding the taxable values of the benefits provided in respect of the employee's employment, except for any excluded fringe benefits. The notional 'individual fringe benefits amount' for Lee is calculated as:

$$= \$1{,}000\ (tv) + \$2{,}000\ (travel) + \$3{,}000\ (child\ care) + \$1{,}800\ (restaurant\ meals) + \$1{,}200\ (holiday)$$

$$= \$9{,}000$$

The notional individual fringe benefits amount is now broken down into 2 components. Those where GST input tax credits were available to the employer and those where no GST input tax credits are available.

Where a GST input tax credit is available – the taxable values of the benefits identified are added together to give what is referred to as the ***step 3 of subsection (1K) amount*** (see subsection 5B(1K)), which in Lee's case is:

$$= \$1{,}000\ (tv) + \$2{,}000\ (travel)$$

$$= \$3{,}000$$

The difference between the notional 'individual fringe benefits amount' and the 'step 3 of subsection (1K) amount' calculated for each employee is referred to as the ***step 4 of subsection (1K) amount*** (see subsection 5B(1K)),which in Lee's case is:

$$= \$9{,}000 - \$3{,}000$$

$$= \$6{,}000$$

Step B

The employer (because they are covered by section 57A) is also required to allocate each employee's share of the taxable value of certain benefits which would qualify as excluded fringe benefits (other than car parking fringe benefits, non-salary packaged meal entertainment benefits and non-salary packaged entertainment facility leasing expense benefits). The employee's share of such excluded

fringe benefits must also be divided into two parts based on whether GST input tax credits were available, and are referred to as the ***step 3 and step 4 of subsection (1L) amounts***, respectively (see subsection 5B(1L)).

As Lee does not have a share of any excluded benefits other than non-salary packaged meal entertainment,[14] the value of the step 3 and step 4 of subsection (1L) amounts for Lee is nil.

Step C

Each employee's step 3 of subsection (1K) and (1L) amounts (i.e., benefits in respect of which GST input tax credits were available) are added together to determine the ***type 1 individual base non-exempt amount*** (see subsection 5B(1H)). For Lee this is:

$$= \$3{,}000 + \$0$$

$$= \$3{,}000$$

Similarly, the ***type 2 individual base non-exempt amount*** (see subsection 5B(1J)) is calculated as the total of an employee's step 4 of subsection (1K) and (1L) amounts. For Lee this is:

$$= \$6{,}000 + \$0$$

$$= \$6{,}000$$

Step D

Each employee's type 1 and type 2 individual base non-exempt amount is grossed-up (see subsections 5B(1F) and 5B(1G)).

The ***individual grossed-up type 1 non-exempt amount*** (see subsection 5B(1F)) for Lee is:

$$= \$3{,}000 \times \frac{0.49 + 0.1}{(1 - 0.49) \times (1 + 0.1) \times 0.49}$$

$$= \$6{,}439$$

The ***individual grossed-up type 2 non-exempt amount*** (see subsection 5B(1G)) for Lee is:

$$= \$6{,}000 \times \frac{1}{(1 - 0.49)}$$

14 see note 13.

$$= \$11,765$$

Step E

For each employee, the employer adds the individual grossed-up type 1 non-exempt amount and the individual grossed-up type 2 non-exempt amount to determine the ***individual grossed-up non-exempt amount*** (see step 1 in the method statement in subsection 5B(1E)) and for Lee this is:

$$= \$6,439 \ + \$11,765$$

$$= \$18,204$$

Step F

The employer must now apply the threshold test for Lee by subtracting $17,667 from each employee's individual grossed-up non-exempt amount. This is the ***step 2 of subsection 5B(1E) amount*** (see step 2 in the method statement in subsection 5B(1E)). For Lee this is:[15]

$$= \$18,204 \ - \$17,667$$

$$= \$537$$

Step G

If the Step F result is positive[16], the employer must now calculate how much of the individual grossed-up non-exempt amount (or Step E amount) relates to benefits covered by subsection 5B(1M) (about salary packaged entertainment benefits) for each employee.[17] For Lee the Step E amount includes the following:

Grossed-up GST creditable salary *packaged* entertainment benefits

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15 As this is a temporary budget repair levy year the standard $17,000 cap has been increased to $17,667.

16 If the Step F result if zero or negative, then the aggregate non-exempt amount under subsection 5B(1E) for that particular employee is also zero.

17 One way to do this is to:

- determine the benefits provided under a salary packaging arrangement by way of meal entertainment benefits or entertainment facility leasing expense benefits in the step 3 and step 4 subsection 5B(1K) amounts;
- gross-up the resultant step 3 of subsection 5B(1K) amount using the type 1 gross-up rate;
- gross-up the resultant step 4 of subsection 5B(1K) amount using the type 2 gross-up rate; and
- add the two grossed-up amounts together.

$$= \$0^{18} \times \frac{0.49 + 0.1}{(1 - 0.49) \times (1 + 0.1) \times 0.49}$$

$$= \$0$$

Grossed-up not GST creditable salary packaged entertainment benefits

$$= \$1{,}200\ (holiday) + \$1{,}800\ (restaurant\ meals)^{19} \times \frac{1}{(1 - 0.49)}$$

$$= \$5{,}882$$

Grossed-up value of subsection (1M) benefits included in the individual grossed-up non-exempt amount

$$= \$0 + \$5{,}882$$

$$= \$5{,}882$$

Therefore, the individual grossed-up non-exempt amount (or Step E amount) of $18,204 includes an amount of $5,882 as relating to benefits covered by subsection 5B(1M).

Step H

Each employee's amount calculated under Step F, if it is a positive amount, is reduced by the *lesser* of $5,000 and the result of Step G (but not below zero) in order to determine the employee's ***aggregate non-exempt amount*** (see subsection 5B(1E)) for the 2016-2017 FBT year.

The ***aggregate non-exempt amount*** for Lee is:

$$= \$537 - \$5{,}000\ (lesser\ of\ \$5{,}882\ and\ \$5{,}000)$$

$$= \$0\ (as\ the\ result\ is\ less\ than\ \$0)$$

This amount of $0 will be included in the employer's fringe benefits taxable amount when calculating the FBT liability in relation to Lee for the 2016-2017 FBT year.

Step I

18 There is no relevant benefit from the step 3 of subsection (1K) amount.

19 The relevant benefit is the salary packaged Canadian holiday and restaurant meals from the step 4 of subsection (1K) amount.

Lee's reportable fringe benefits amount to be reported on his payment summary is his individual fringe benefits amount grossed-up by the type 2 formula.

$$= \$9{,}000\ (see\ Step\ A) \times \frac{1}{(1\ - 0.49)}$$

$$= \$17{,}647$$

FBT rebatable employers (section 65J)

3.86 Rebatable employers (certain specified tax-exempt entities) are entitled to have their liability reduced by a rebate of the gross FBT payable (subject to a capping threshold). If the total grossed-up taxable value of certain fringe benefits provided to an employee (which are benefits that are not otherwise excluded, i.e., excluded benefits) is more than the capping threshold a rebate cannot be claimed for the FBT liability on the excess amount.

3.87 As Schedule 3 removes from being an excluded benefit, salary packaged entertainment benefits, without further changes, the grossed-up taxable value of those benefits would be taken into account in determining whether, and by how much, the capping threshold has been exceeded.

3.88 Rather than remove in full the concessional treatment of salary packaged entertainment benefits for these employers, Schedule 3 limits the existing concession by increasing the existing capping threshold by the *lesser* of:

- $5,000; and
- an employee's total grossed-up taxable value of salary packaged entertainment benefits (i.e., those benefits relating to the provision of meal entertainment or entertainment facility leasing expenses).

[Schedule 3, items 7 and 8, subsection 65J(2B) (step 2A in the method statement) and subsection 65J(2J)]

3.89 This effectively provides each employee of those employers a separate single grossed-up cap of $5,000 each FBT year for salary packaged entertainment benefits which remain eligible for the current FBT rebate. Where this cap is exceeded, any benefits may first be taken into account under the existing caps before determining whether there is any excess which will be ineligible for rebate.

Consequential amendments

Definitions

3.90 The definition of 'salary packaging arrangement' has been amended to ensure it captures both benefits provided to employees and benefits provided to associates of an employee where the employee has reduced their salary and wages in return for the benefit. ***[Schedule 3, item 9, definition of 'salary packaging arrangement' in subsection 136(1)]***

3.91 This removes possible ambiguity as to whether the definition was limited to benefits provided only to employees or also covers benefits provided to associates of employees. The intended operation of the definition was to cover benefits provided to both employees and their associates.

Repealing inoperative provisions

3.92 A number of inoperative provisions have been repealed from the FBTAA in order to reduce the overall volume of the Commonwealth statute book. These changes have no substantive effect on the operation of the law. ***[Schedule 3, items 1, 2 and 7, subsection 5B(1), step 3 (paragraph (a)) of the method statement in subsection 5B(1)(e) and step 2 (paragraph (a) of the method statement in subsection 65J(2B)]***

Application and transitional provisions

3.93 Schedule 3 to this Bill applies to the 2016-17 FBT year and later FBT years. ***[Schedule 3, item 12]***

STATEMENT OF COMPATIBILITY WITH HUMAN RIGHTS

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

Limiting fringe benefits tax concessions on salary packaged entertainment benefits

3.94 Schedule 3 to this Bill 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

3.95 Schedule 3 to this Bill amends the *FBTAA* to limit the concessional treatment of salary packaged entertainment benefits by:

- removing the reporting exclusion in respect of salary packaged entertainment benefits;
- removing access to elective valuation rules when valuing salary packaged entertainment benefits to prevent unintended and excessively concessional values being applied to those benefits; and
- introducing a cap on the total amount of salary packaged entertainment benefits that certain employees can be provided that are exempt from or subject to fringe benefits tax at concessional rates.

Human rights implications

3.96 Schedule 3 does not engage any of the applicable rights or freedoms.

Conclusion

3.97 Schedule 3 is compatible with human rights as it does not raise any human rights issues.

REGULATION IMPACT STATEMENT

Background

3.98 In the 2015-16 Budget, the Government announced that it would introduce a separate single grossed-up cap of $5,000 for salary sacrificed meal entertainment and entertainment facility leasing expenses ('entertainment benefits') for certain employees of NFP organisations, and that all use of salary sacrificed meal entertainment benefits will become reportable, with effect from 1 April 2016.

The problem

3.99 Currently, most salary sacrificed fringe benefits provided to certain employees of NFP organisations are reportable and FBT exempt, or rebatable, only up to a set cap. However, entertainment benefits are

specifically excluded from this requirement. That is, these benefits are not required to be reported (including for certain tax and transfer payment income tests) and are not taken into account when considering whether an employee has exceeded the FBT caps. This means that such benefits are uncapped, limited only by the employee's salary.

3.100 These 'excluded' entertainment benefits apply to:

- employees of public benevolent institutions and health promotion charities that are currently entitled to FBT exempt benefits up to a $30,000[20] cap;
- employees of public hospitals, NFP hospitals, and public ambulance services that are currently entitled to FBT exempt benefits up to a $17,000 cap; and
- employees of NFP organisations that are eligible for an FBT rebate (up to a $30,000 cap, with the rebate capped at 48 per cent).

3.101 The uncapped benefits that can be salary sacrificed are very broad, and include holiday accommodation, cruises, weddings, and meals and alcohol at restaurants. The expenditure does not need to be incurred in Australia. Employees of affected NFP organisations are able to reduce their income tax liability by salary sacrificing these entertainment benefits, which is not available to other employees.

3.102 The uncapped entertainment benefit is also inequitable, with greater benefits for employees on higher salaries and those who have greater financial freedom to forgo higher proportions of their salaries on eligible items. Over time, the convenience and marketing of meal entertainment cards has also led to increased take up, increasing the cost to revenue.

3.103 Salary packaging companies have widely promoted and facilitated this uncapped benefit, including through 'meal entertainment cards'. For instance, the quotes below, taken from a sample of salary packaging websites (accessed in August 2015), provide a sense on how this benefit is being promoted:

'*Want tasty tax savings for breakfast, lunch and dinner? Whenever you dine out with friends, family or colleagues, simply swipe your card and enjoy tax-free meals!'* – PBI Solutions

20 These caps do not take into account the temporary increase in these caps associated with the Temporary Budget Repair Levy.

'All you need to do to package this item is go out for a meal – there are savings in every bite you take!' – Smartsalary

'The EPAC Meal Entertainment Card allows you to set aside money from each pay to put exclusively towards dining out. This money is transferred to your card before it's subjected to income tax, so it effectively grants you tax free dining!' – EPAC

3.104 Treasury has estimated the cost to revenue, in terms of revenue forgone, in its annual Tax Expenditure Statement arising from the FBT exemption for entertainment benefits. According to the latest Tax Expenditure Statement, released in January 2015, the estimated revenue forgone was $350 million in 2010-11 and is projected to rise to $545 million in 2017-18.

Case for government action / Objective of reform

3.105 The case for action is based on the Government's commitment, as outlined in the 2015-16 Budget, to return the budget to surplus as soon as possible, and forms part of the Government's objective to improve the fairness of tax rules and benefits systems.

3.106 The objectives of the reform are:

- reflect developments that no longer warrant continued uncapped exemptions for entertainment benefits that are salary sacrificed; and
- limiting the use of salary sacrificed entertainment benefits, to improve the fairness of the FBT system.

3.107 Entertainment benefits were originally excluded from reporting and the FBT caps on compliance costs grounds because, at the time, many of the benefits were not easily attributable to individuals. However, this rationale is no longer appropriate for salary sacrificing arrangements that allow benefits to be easily valued and attributed to an individual employee, such as the through the use of meal entertainment cards.

Policy options

3.108 There are four options to deal with entertainment benefits:

- *Option 1*: maintain the status quo;
- *Option 2*: include salary sacrificed entertainment benefits under the existing FBT exemption/rebate caps;

- *Option 3*: introduce a separate cap and allow salary sacrificed entertainment benefits up to $5,000 to be exempt. Benefits exceeding $5,000 would be counted in calculating whether an employee exceeds their FBT exemption/rebate caps; and

- *Option 4*: introduce a separate cap and allow salary sacrificed entertainment benefits up to $2,000 to be exempt. Benefits exceeding $2,000 would be counted in calculating whether an employee exceeds their FBT exemption/rebate caps.

3.109 Only salary sacrificed entertainment benefits will be affected by these options. Non salary sacrificed entertainment benefits, such as in-house canteens, will not be affected.

3.110 Option 1 would preserve the current FBT treatment of entertainment benefits. Option 2 would mean that salary sacrificed entertainment benefits would be taken into account under the standard FBT caps and no longer treated separately. Options 3 and 4 are closely related to each other; the only difference is the size of the cap. These options would retain concessional FBT treatment for entertainment benefits.

3.111 With the exception of Option 1, all of the proposed options require legislative amendments and would apply prospectively from 1 April 2016 to coincide with the start of the new FBT year. This start date ensures that affected employees have time to adjust to the new arrangements, without existing arrangements being affected.

Cost benefit analysis of each option / Impact analysis

3.112 If the status quo is not maintained, the proposed options will overwhelmingly impact employees of certain NFP organisations who salary sacrifice entertainment benefits. Although the costings make certain assumptions on the uptake of entertainment benefits, the likely impact of this proposal on affected employees is difficult to verify, as entertainment benefits are not reportable for FBT purposes. However, some insights can be gained from examining the data relating to the current FBT caps based on tax returns for individuals employed by NFP organisations.

3.113 In relation to the FBT *exemptions* cap, the data indicates:

- Of the approximately 920,000 individuals employed by eligible NFP organisations, 53 per cent had reportable fringe benefits in 2012-13, meaning that 47 per cent of individuals had no reportable fringe benefits. As individuals that do not report any fringe benefits are unlikely to utilise entertainment

benefits, almost half of eligible NFP employees will not be affected by the proposed options that would eliminate or cap entertainment benefits. Even if they happen to do so, they will be able to claim these benefits up to the relevant caps.

- For those employed in public benevolent institutions and health promotion charities, around 40 per cent are close (that is, within $500) to breaching the exemption cap. A further 11 per cent have a buffer of up to $2,000 before they exceed the cap. Around one third of individuals had a buffer of more than $5,000 before they exceed the cap.

- For those employed in public, NFP hospital and public ambulance services, around 67 per cent are close (that is, within $500) to breaching the exemption cap. A further 11 per cent have a buffer of up to $2,000 before they exceed the cap. Around 10 per cent of individuals had a buffer of more than $5,000 before they exceed the cap.

3.114 For individuals with a reportable fringe benefit from a rebatable NFP employer in 2012-13, around 9 per cent are close (that is, within $500) to breaching the $30,000 cap. However, around 73 per cent have a buffer of more than $5,000 before they breach the cap.

3.115 This suggests that for employees of NFP organisations that are eligible for an FBT rebate, the proposed options are only likely to adversely affect a small percentage of individuals, particularly as the entertainment benefits for this group is less attractive due to the partial rebate.

3.116 Anecdotal evidence indicates that the take up of salary packaged entertainment benefits appears to be lower than salary packaging items under the existing exemption caps, although take up rates vary between eligible NFP organisations. Voluntarily provided data by salary packaging providers indicates that entertainment benefits can range from an average of $2,400 to as high as $8,500 per annum, with a simple average of around $5,500.

3.117 Option 1 would not meet the Government’s objectives to repair the budget nor improve the fairness of the tax system.

3.118 Option 2 means employees currently claiming meal entertainment benefits that are already close to breaching their current exemption caps will be most adversely affected as they will be unable to absorb any additional fringe benefits without exceeding the FBT caps. These individuals are likely to reconsider whether it is in their interests to continue with claiming entertainment benefits as FBT applies at the

highest marginal tax rate. Options 3 and 4 mitigate these adverse impacts by providing scope for affected employees to continue to claim entertainment benefits by retaining concessional treatment for these benefits.

3.119 As the salary packaging industry has promoted the utilisation of these entertainment benefits, they are also likely to be adversely affected by these proposed options. However, they have previously indicated that should entertainment benefits be reformed, rather than removing the benefit entirely, a cap on entertainment benefits should be imposed.

Compliance cost impacts

3.120 In terms of tax compliance obligations, however, it is employers that are responsible for reporting and paying FBT even though employees are the main beneficiaries of the FBT reporting exemption for salary sacrificed entertainment benefits, as they are able to reduce their income tax liability.

3.121 Options 2, 3 and 4 also make salary sacrificed entertainment benefits reportable for all employers, not just NFP organisations, to ensure consistency in treatment. However, it is understood that outside the NFP sector, there is very little, if any, uptake of salary packaging arrangements for entertainment benefits given the lack of financial advantages from doing so. Given this, the focus of the compliance costs impacts will be on NFP employers.

3.122 There are around 5,700 NFP organisations entitled to the FBT exemption and around 3,400 NFP organisations entitled to the FBT rebate. Around 20 per cent of FBT exempt and around 16 per cent of rebatable NFP organisations did not have any reportable fringe benefits in 2012-13. Based on the number of NFP organisations that have reportable fringe benefits in 2012-13, the proposed options that involve changing the status quo are expected to affect around 7,400 NFP organisations.

3.123 For Option 2, employers, when completing their FBT tax returns, will have to incorporate any salary sacrificed entertainment and entertainment facility leasing expenses. However, as this option utilises existing infrastructure (as this option involves including a previously excluded benefit into the existing FBT calculation) the regulatory impacts are comparatively smaller than Options 3 and 4. Options 3 and 4 will mean that employers would have to deal with a separate cap, adding to administrative and compliance costs, while new Australian Taxation Office forms and software changes to deal with the separate cap will likely need to be implemented.

3.124 This qualitative analysis is confirmed by the quantitative costings. Given the similarities between Options 3 and 4, the regulatory costs are identical (which is based on an assumption of an hourly wage rate of $65.45). Table 3.2 shows the regulatory costs for Option 3, which is the preferred option. Option 2 is estimated to impose a regulatory burden of $0.21 million on community organisations.

3.125 For affected NFP employers, there will be regulatory start-up costs associated with education, notifying their employees of the proposed change, and implementing any changes. Options 3 and 4 are expected to result in ongoing costs as employers will need to allocate fringe benefits to two separate caps, which will not be required under Option 2.

Table 3.2: Regulatory costing for Option 3[21]

Average annual regulatory costs (from business as usual)				
Change in costs ($million)	Business	Community Organisations	Individuals	Total change in cost
Total, by sector	-	$0.690	–	$0.690
Cost offset ($ million)	Business	Community organisations	Individuals	Total, by source
Treasury	–	–$0.690	–	–$0.690
Are all new costs offset? ☑ Yes, costs are offset ☐ No, costs are not offset ☐ Deregulatory—no offsets required				
Total (Change in costs – Cost offset) ($million) = $0.000				

Consultation

3.126 The tax proposals have been informed by three separate independent reviews which have examined the FBT treatment for NFP organisations.

3.127 Two of these reviews (*Contribution of the Not-for-Profit Sector*, Productivity Commission Research Report 2010 and the *Not-for-profit Sector Tax Concession Working Group* 2013) found or recommended that the uncapped entertainment benefits should either be limited or abolished. While the Australia's Future Tax System Review in 2010 did not

21 Note: A regulatory offset has been identified from within the Treasury portfolio, relating to the alignment of the legal frameworks for personal and corporate insolvency practitioners.

specifically make a recommendation on this uncapped benefit, the review instead recommended the gradual phase out of the FBT caps.

3.128 While limited consultation on the proposals reflects the cabinet-in-confidence nature of the decision making process, it is noted that extensive consultations were a feature of each of these past reviews.

3.129 Public consultation took place on the draft legislation. The objective of this consultation was to ensure that the legislation delivered on its policy intent and did not result in any unintended consequences. The exposure draft legislation and explanatory materials were released on the Treasury website in June 2015.

3.130 None of the submissions raised technical drafting issues with the exposure draft legislation.

3.131 While submissions raised concerns about the impact of the measure on the NFP sector, most submissions were supportive of imposing a cap on entertainment benefits. However, there was a general view that the $5,000 cap was too low and needed to be raised. Figures of between $10,000 and $20,000 were the most common suggestions for the revised cap. A few submissions were against the policy of treating entertainment benefits as reportable fringe benefits as they were concerned about the flow on implications from taking into account such benefits for certain calculations such as Higher Education Loan Program debts. A few submissions were opposed to the introduction of a cap, as it would affect their ability to attract, recruit and retain quality staff.

Conclusion and recommended option

3.132 The preferred option is to introduce a separate $5,000 cap on entertainment benefits. This option strikes a balance between the Government's objectives to improve fairness in the tax system and repairing the budget. By not completely eliminating the uncapped benefits, the preferred option retains concessional treatment and reduces the potential adverse effects on the NFP sector. This measure is estimated to have a gain to revenue of $295.0 million over the forward estimates period.

Implementation and evaluation

3.133 Legislation is required to implement the proposed measure to introduce a separate $5,000 cap on entertainment benefits.

3.134 As the Government has set the start date as 1 April 2016, the proposed measure needs to be enacted prior to this start date to provide certainty to affected NFP organisations and their employees.

3.135 The Commissioner of Taxation would be responsible for administering the tax rules. The Australian Taxation Office will monitor compliance and will advise Treasury if any problems are identified so remedial action, if appropriate, can be considered.

Chapter 4
Third party reporting

Outline of chapter

4.1 Schedule 4 to this Bill amends Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953) to improve taxpayer compliance by increasing the information reported to the Commissioner of Taxation (Commissioner) by a range of third parties. The Schedule creates a new reporting regime requiring third parties to report on the following transactions:

- payments of government grants;
- consideration provided for services to government entities;
- transfers of real property;
- transfers of shares;
- transfers of units in unit trusts; and
- business transactions made through payment systems.

4.2 All references to legislative provisions in this chapter are references to Schedule 1 to the TAA 1953 unless otherwise stated.

Context of amendments

4.3 The objective of an efficient tax administration is to collect the maximum amount of revenue with minimum administration and compliance costs. Since 1986-87, Australia's income tax system has largely operated on a self-assessment basis for individuals, meaning that it is the individual taxpayer who is obliged to self-assess their income tax affairs and report relevant information to the Commissioner. For most people, this means preparing and lodging an annual income tax return.

4.4 Starting in 2007, the Australian Taxation Office (ATO) has offered individual taxpayers a pre-filling service to assist them in voluntarily meeting their obligations when preparing their income tax return. In essence, the ATO provides its pre-filling service by using the information it has received for compliance purposes and adding it directly

to the relevant tax return label or providing additional information in a summary form.

4.5 The ATO now receives sufficient information so that in the majority of cases it is possible to completely pre-fill a simple tax return in relation to:

- wage and salary data from employers;
- government welfare payments from Centrelink and other providers;
- interest income from financial institutions;
- dividend income from share registries; and
- Medicare levy surcharge and private health insurance policy details from private health insurers.

4.6 The usefulness of pre-filling, and therefore the availability of future pre-prepared tax returns, depends on the ATO receiving relevant and timely information from third parties. This can include employers, financial institutions, private health insurance providers and businesses in the building and construction industry. Currently, the ATO receives a range of information from third parties for the purposes of post-lodgement compliance activities through legislated reporting regimes as well as information collected ad hoc under the Commissioner's general information gathering powers in section 353-10. However, whilst information gathered through existing legislative reporting regimes is generally of a high quality, information collected under the Commissioner's general information gathering powers tends to have shortcomings in relation to timeliness, data formats and the ability to readily match it to the relevant taxpayer.

4.7 The introduction of formal third party reporting regimes has the potential to further reduce the compliance costs for individual taxpayers by increasing the range of information reported to the ATO. It also has the ability to be an effective compliance response to deal with some taxpayers omitting or underreporting income.

4.8 Nonetheless, the introduction of such a regime involves a policy trade-off between the compliance benefits to taxpayers of improved ATO data-matching capabilities and the compliance costs imposed on third party reporters. Imposing these reporting obligations only on those entities that already collect relevant information in the ordinary course of their business, or through other activities, and integrating the obligation into existing business systems will minimise compliance costs. To the extent

that these compliance costs are less than the potential compliance benefits to individual taxpayers, and the tax system more generally, there is a persuasive policy case for introducing such a regime.

4.9 Developing a comprehensive and robust third party reporting regime has the potential, over time, to provide opportunities to change how individuals and other self-assessment taxpayers interact with the tax system in the future.

4.10 The Government recognises that this regime complements and expands on existing third party reporting regimes in the tax law, including the Annual Investment Income Report (AIIR) and the obligations relating to the US Foreign Account Tax Compliance Act (FATCA). Accordingly, the Government anticipates the Commissioner will work with reporters to streamline processes, reduce compliance costs and avoid duplication in implementing this reporting regime.

Summary of new law

4.11 Schedule 4 creates a new third party reporting regime. This regime requires certain entities ('third parties') to report information to the ATO on transactions that could reasonably be expected to have tax consequences for other entities.

4.12 The following third parties are required to report under the regime:

- government related entities, other than local governing bodies, must report on government grants;
- government related entities must report on consideration they provide for services;
- states and territories must report on transfers of real property in their jurisdiction;
- the Australian Securities and Investments Commission (ASIC), market participants and trustees of trusts with an absolutely entitled beneficiary must report on transactions relating to shares and units of unit trusts;
- listed companies must report on transactions relating to their shares;
- trustees of unit trusts must report on transactions relating to their units; and

- administrators of payment systems must report on electronic business transactions.

Comparison of key features of new law and current law

New law	*Current law*
Specified entities are required to report on a regular basis according to legislative requirements. This operates in addition to the Commissioner's existing information gathering powers.	The Commissioner can require entities to provide information under various legislative reporting requirements, including the AIIR, the Payment, ABN and Identification Verification System, and the general information gathering powers under section 353-10.

Detailed explanation of new law

4.13 Schedule 4 creates a new third party reporting regime in Schedule 1 to the TAA 1953. This regime requires certain entities ('third parties') to report information to the Commissioner about transactions that could reasonably be expected to have tax consequences for other entities.

4.14 The legislative framework has been designed to create a coherent and flexible third party reporting regime for a wide range of transactions, allowing additional transactions to become subject to third party reporting in the future, as the tax system progresses.

Reporting obligations

4.15 Entities are required to report to the Commissioner under the third party reporting regime if they are a type of entity listed in the legislation. For each type of entity required to report, the transactions about which they must report are also set out. The entities included in the third party reporting regime, and the transactions on which they have to report, are explained in detail at paragraphs 4.42 to 4.81. ***[Schedule4, item 1, section 396-55]***

4.16 Entities must report on the transactions in the 'approved form', which sets out the specific information the Commissioner requires. The concept of approved forms is used in the taxation laws to provide the Commissioner with administrative flexibility to specify the form of information required and the manner of providing it. Section 388-50 of Schedule 1 to the TAA 1953 provides the legislative basis for the use of approved forms.

4.17 The Commissioner may only require information that relates to the identification, collection or recovery of a possible tax-related liability of the parties to the transaction, or information that relates to identifying the parties to the transaction. For example, the third party reporting regime requires states and territories to provide information on real property transfers, which may give rise to an income tax liability for example a net capital gain. ***[Schedule4, item 1, subsection 396-60(1)]***

4.18 A transaction may relate only to a possible tax-related liability because either the Commissioner or the reporting entity (or perhaps both) may not have sufficient information about the tax affairs of the relevant entity being reported on to know whether an actual liability will arise. To continue the example above, the state or territory reporting on a real property transaction may not know whether a seller of the real property could claim the main residence exemption and reduce any income tax liability relating to the real property transfer to nil.

4.19 However, for transactions in relation to which market participants must report information to the Commissioner, the Commissioner may only require information related to identifying the parties to the transaction. This reflects the role of market participants in providing third party information, set out in more detail at paragraphs 4.64 and 4.65. ***[Schedule4, item 1, subsection 396-60(2)]***

4.20 At this stage, most of the information collected under this regime will relate to income tax. However, as noted in paragraph 4.14, the legislative framework supporting this regime may be expanded in the future to collect information relating to all types of taxes that may give rise to a tax-related liability. Accordingly, the amendments adopt the concept of a ***tax-related liability***, as defined in section 255-1, which includes GST, excise duty, various withholding taxes and administrative penalties. The full list of tax-related liabilities is contained in section 250-10.

4.21 In determining whether a possible tax-related liability arises, any exemption under a taxation law that may apply is also disregarded. This recognises that reporting entities may not know whether the entity they are reporting on is exempt from a taxation law. Requiring the reporting entity to find out this information would impose an unnecessary compliance burden. ***[Schedule4, item 1, paragraph 396-60(1)(a)]***

4.22 An administrative penalty may apply under section 284-75 to any false or misleading statements made in reporting.

4.23 Where a reporter becomes aware of a material error in a report they have already given to the Commissioner, then the reporter must give the Commissioner a corrected report in the approved form no later than

28 days after the reporter became aware of the error. This is consistent with the existing obligations in the AIIR regime. ***[Schedule4, item 1, section 396-75]***

Timing of reports

4.24 For pre-filling purposes, it is important that the Commissioner receives the information with sufficient time to process and pre-fill it into taxpayers' returns. However, this objective needs to be balanced against the compliance costs imposed by short timeframes.

4.25 Reporting timeframes have been made sufficiently flexible to accommodate this balance, allowing the Commissioner to make changes where appropriate. These changes can be made in relation to all entities required to report under the regime or, given the diverse nature of entities reporting under the regime, only in relation to specific entities or transactions or types of entities or transactions.

Frequency of reporting

4.26 The regime provides a default reporting period of a financial year, so each entity is required to report to the Commissioner on an annual basis in regards to any transactions that have occurred in the previous financial year. The Commissioner may change this period by legislative instrument. ***[Schedule4, item 1, paragraph 396-55(a)]***

4.27 For most transactions, the Commissioner cannot change the period for transactions that happen before 1 July 2020 (see paragraphs 4.84 to 4.86). This provides certainty to reporters as the regime is being established, while ensuring that, in the future, the Commissioner has the flexibility to receive information in a timely manner as technology and systems evolve. Any legislative instruments changing the reporting period would be disallowable. ***[Schedule 4, item 27]***

4.28 However, the Commissioner may vary the default reporting period by legislative instrument for reports by the states and territories on real property transfers, and for reports by ASIC. This recognises that the ATO has been closely working with these bodies in anticipation of facilitating more frequent reporting prior to 2020. ***[Schedule 4, item 27]***

Dates for reporting

4.29 The regime provides for the report to be given to the Commissioner on or before the 31st day after the end of the reporting period. ***[Schedule4, item 1, subparagraph 396-55(b)(i)]***

4.30 Since information is to be reported via an approved form, the Commissioner may defer the date for lodgement under section 388-55 without the need for a legislative instrument. This gives the Commissioner flexibility between receiving information in time for pre-filling, and the ability of reporters to collect and provide the information in that time. For example, the Commissioner may choose to extend the reporting date in situations where third party reporters would have significant compliance costs in providing information within 31 days after the end of the reporting period.

4.31 The Commissioner may also change the reporting date by legislative instrument. Again, these legislative instruments may be disallowed. ***[Schedule4, item 1, subparagraph 396-55(b)(ii)]***

4.32 As with the ability to change reporting periods above at paragraphs 4.27 and 4.28, the Commissioner cannot change the date via legislative instrument for transactions that happen before 1 July 2020, other than real property transactions and reports by ASIC.
[Schedule 4, item 27]

4.33 If the Commissioner does not modify the reporting dates, each entity is required to report by 31 July each year on transactions that happened during the previous financial year.

4.34 An administrative penalty under subsection 286-75(1) applies to a failure to give the report by the 31st day after the end of the reporting period or, if the Commissioner has changed the reporting date, by that date.

Reporting exemptions

4.35 The Commissioner may exempt entities from their reporting obligations under the third party reporting regime. For example, the Commissioner may exempt a class or classes of entity from reporting information when the information is not necessary to assist the Commissioner. Alternatively, a particular entity may be exempted based on specific circumstances that may impact on that entity's ability to report in a particular year.

4.36 The Commissioner may also choose to exempt entities from reporting on specific classes of transactions.

4.37 The Commissioner may take a variety of circumstances into account when determining whether to exempt an entity or class of entity, including the compliance costs imposed on the entity, the availability of information and the Commissioner's ability to use the information.

Exemptions for particular entities

4.38 The Commissioner may exempt a particular entity from some or all of its reporting obligations through written notice. If an entity is dissatisfied with a decision made by the Commissioner either to give it a notice or not give it a notice, the entity may object against the decision under Part IVC of the TAA 1953. ***[Schedule 4, item 1, subsections 396-70(1) and (2)]***

4.39 A notice exempting an entity from its reporting obligations is not a legislative instrument within the meaning of section 5 of the *Legislative Instruments Act 2003* because it is not legislative in character. ***[Schedule 4, item 1, subsection 396-70(3)]***

General exemptions

4.40 The Commissioner may exempt a specified class of entities from some or all of their reporting obligations through legislative instrument. ***[Schedule 4, item 1, subsection 396-70(4)]***

Exemption for wholesale clients

4.41 A reporting entity does not need to include information about certain transactions to the extent that the information relates to a party to the transaction who is not an individual and who is being provided a financial product or a financial service under the transaction as a wholesale client. These transactions are those in relation to which market participants, companies, trustees of unit trusts and trustees of other trusts must report (see paragraphs 4.64 to .74). ***[Schedule 4, item 1, section 396-65]***

Transactions that entities must report

Government grants

4.42 Many government entities provide grants for a range of purposes. These grants often constitute assessable income in the hands of recipients. The third party reporting regime requires government related entities at the Commonwealth, state and territory level to report information in relation to grants. ***[Schedule 4, item 1, table item 1 in section 396-55]***

4.43 The entities subject to this reporting obligation are those captured by the definition of ***government related entity*** in section 195-1 of the *A New Tax System (Goods and Services Tax) Act 1999*. 'Government related entity' includes a broad range of government entities at the Commonwealth, state and territory level, entities established by the Commonwealth, a state or a territory, and local governing bodies.

4.44 Local governing bodies are exempt from the obligation to report grants because grants made by those entities are rarely assessable for income tax purposes.

4.45 Reporting entities need only provide information on grants made to entities that have an Australian Business Number under the *A New Tax System (Australian Business Number) Act 1999*. Grants paid to entities that do not have an Australian Business Number do not need to be reported, as they are usually of low value and are rarely assessable.

4.46 As noted in paragraph 4.18, reporters are not required to determine whether a grant would constitute assessable income or give rise to a tax-related liability in the hands of the recipient. Grants made by government related entities that are not exempted relate to a possible tax-related liability of the grant recipient, and so must be reported even though the grant may not ultimately be taxable in the hands of the recipient, or the recipient is exempt from taxation.

4.47 'Grant' is not defined in legislation and should take its ordinary meaning. Some factors that may indicate whether a payment constitutes a grant include:

- grants may be explicitly tied to a government policy or goal;
- grants may be disbursed on a one-off or longer term basis, but are not provided as ongoing, permanent funding;
- recipients are usually required to submit applications to receive grants;
- grants typically, but do not always, have conditions attached, such as reporting obligations or the requirement to include government logos on marketing materials; and
- unlike loans, grants usually do not have to be repaid.

4.48 Of note, the *Commonwealth Grants Rules and Guidelines*, an instrument issued by the Minister for Finance under section 105C of the *Public Governance, Performance and Accountability Act 2013,* provide a specific definition of grant as used by the Commonwealth Government.

4.49 The Government anticipates that the ATO will work together with relevant entities to meet their reporting obligations in the most efficient way possible. For example, reporting requirements under the *Commonwealth Grants Rules and Guidelines* may streamline the reporting process by enabling the Department of Finance to report grants to the Commissioner on behalf of other Commonwealth government related

entities, potentially reducing duplicative reporting and administrative costs.

Consideration for services to government

4.50 Government entities provide consideration to suppliers, such as contractors or consultants, for the provision of a range of services. This consideration may give rise to taxable consequences for the supplier.

4.51 Commonwealth, state and territory entities that are government related entities, including local governing bodies, are required to report consideration provided for the supply of services. ***[Schedule 4, item 1, table item 2 in section 396-55]***

4.52 *Consideration* includes any payment, or any act or forbearance, in connection with a supply of anything and any payment, or any act or forbearance, in response to or for the inducement of a supply of anything (as defined in section 9-15 of the *A New Tax System (Goods and Services Tax) Act 1999*). Usually consideration will be a monetary payment, but it may also include other forms of non-cash benefits and constructive payments.

4.53 Only consideration provided wholly or partly for a supply of services must be reported. Consideration provided solely for something other than services, or for a supply of services where the services are merely incidental to the provision of goods, do not need to be reported.

4.54 Consideration provided 'partly' for the supply of services includes consideration provided for both goods and services. A reporting entity is required to report the total benefit provided and should not separate out the proportion of the benefit that went towards the goods.

Example 4.1

A local council orders 1700 black pens from an office supply company and pays an additional fee for delivery.

Delivery of the pens constitutes a service. However, since this service has been provided incidentally to the provision of the goods, it does not need to be reported.

Real property transfers

4.55 Transfers of real property may give rise to several different kinds of tax consequence. A common consequence of a transfer of real property is an income tax liability, based on a net capital gain. Transfers may also have consequences for GST.

4.56 Each state and territory is required to report information on all transfers of freehold or leasehold interests in real property situated in that state or territory to the Commissioner in the approved form. The approved form can include tax file numbers of parties to the transaction that have voluntarily provided their tax file number to the state or territory. States and territories may request the tax file number of a party to the transaction for the purpose of reporting on the transaction, and disclose any tax file numbers provided to the Commissioner. The request for and disclosure of tax file numbers by a state or territory is permitted by an exception to the offences of requesting and disclosing tax file numbers because the states and territories are requesting or disclosing the information to comply with a taxation law (see sections 8WA and 8WB of the TAA 1953). A state or territory is not required to report a party's tax file number to the Commissioner if the party has chosen not to provide this information. The *Privacy (Tax File Number) Rule 2015*, a legislative instrument issued under section 17 of the *Privacy Act 1988* provides protection for the privacy of individuals. Individuals who consider that their tax file number information has been mishandled may make a complaint to the Information Commissioner. ***[Schedule 4, item 1, table item 3 in section 396-55 and subsections 396-60(1) and (3)]***

4.57 Freehold and leasehold interests refer to the type of interest that the Crown has granted the relevant entity in the real property. A freehold interest is perpetual, while a leasehold interest is granted for a limited period of time. An entity holding a freehold interest in land would be colloquially considered to be the 'owner' of the land. An example of a leasehold interest is the 99 year leases granted by the Crown in the Australian Capital Territory.

Example 4.2

Kathy decides to sell her rental property, which she holds under a freehold interest. She signs a contract to sell the property to James on 2 March 2017. James and Kathy settle on 20 April 2017. The sale is registered with her state's Land Titles Office, effecting a transfer of the freehold interest.

The relevant state is required to report information on this sale to the Commissioner after the financial year ending on 30 June 2017. This information must be in the approved form and provided within 31 days after the end of the financial year.

The Commissioner is able to use the information received from the state to pre-fill Kathy's tax return for the 2016-17 income year. Kathy can then review the information and make any necessary adjustments as she completes her tax return. The Commissioner may also use the information to conduct compliance and data-matching activities.

Transfers of shares in a company and units in a unit trust

4.58 Entities transferring shares in a company or units in a unit trust may incur an income tax liability based on a net capital gain. Tax liabilities may also be affected by other transactions, such as a demerger or in specie transfer. Reporting information on these types of transactions will assist in pre-filling tax returns and undertaking compliance activities.

4.59 The Commissioner may collect information on transactions that result in a change to the type, name or number of shares in a company or units in a unit trust held by an entity. This is intended to encompass a broad range of transactions that may either give rise to a tax-related liability or allow the Commissioner to trace the ownership of shares in a company or units in a unit trust until such time as a tax-related liability may arise.

ASIC

4.60 Certain financial markets are required to report on transactions that have taken place on their market to ASIC under the market integrity rules.

4.61 ***Market integrity rules*** are rules made by ASIC under section 798G of the *Corporations Act 2001* that, among other things, require certain financial markets to report information to ASIC on transactions that take place on their market. The rules also require market participants to provide information that assists identification of the person who provided instructions to place an order or enter into a transaction. ***[Schedule4, item 2, subsection 995-1(1) of the Income Tax Assessment Act 1997 (ITAA 1997)]***

4.62 ASIC must provide information collected under those rules to the Commissioner. Therefore, financial markets and market participants that report information to ASIC will not have to also report that information to the Commissioner. ***[Schedule 4, item 1, table item 4 in section 396-55]***

4.63 Legislating this requirement for ASIC to provide information clarifies that the disclosure of this information to the Commissioner is permitted under subsection 127(2) of the *Australian Securities and Investments Commission Act 2001*, which authorises the disclosure of information as required or permitted by a law of the Commonwealth.

Market participants

4.64 The information ASIC receives under the market integrity rules does not contain sufficient detail to identify the parties to each transaction. Information on the identity of each party is held by the entities making

these trades, that is, the brokers allowed to directly participate in the market. These brokers are defined as ***participants*** under section 761A of the *Corporations Act 2001* and, in relation to a financial market, are persons who are allowed to directly participate in a market under that market's operating rules.

4.65 To enable the Commissioner to identify the parties in each transaction, when a transaction involving a participant results in a change to the type, name or number of shares in a company or units in a unit trust held by another entity, the participant is required to report information to the Commissioner. Market participants only need to report on transactions that an Australian financial market must deliver to ASIC under the market integrity rules. ***[Schedule 4, item 1, table item 5 in section 396-55]***

Companies listed on Australian financial markets

4.66 ASIC typically does not receive data on most transactions which take place otherwise than in the ordinary course of trading on an Australian financial market. This includes most off-market transfers and other transactions, such as demergers and in specie distributions. Since these transactions may also affect the income tax liabilities of entities holding the shares in a company or units in a unit trust in relation to which these transactions occur, companies listed on an Australian financial market are required to report on them.

4.67 These companies must report on transactions that result in a change to the type, name or number of shares in the company held by an entity. ***[Schedule 4, item 1, table item 6 in section 396-55]***

4.68 To avoid imposing unnecessary compliance costs and duplication in reporting, companies only need to report on transactions that an Australian financial market is not required to report to ASIC under the market integrity rules (see paragraphs 4.60 to 4.63).

Example 4.3

On 3 March 2018, Zahra instructs her broker, Koala Stockbroking Ltd, to buy 500 shares in Gumleaf Industries Ltd. Gumleaf Industries Ltd is listed on the Arboreal Securities Exchange. Assume the Arboreal Securities Exchange is required to deliver information on this transaction to ASIC under the market integrity rules. Once Koala Stockbroking Ltd completes the transaction on Zahra's behalf, the Arboreal Securities Exchange would then report the transaction to ASIC under the market integrity rules.

Under the amendments made by this Bill, ASIC would report the transaction to the Commissioner. The Commissioner would also receive identity information from Koala Stockbroking Ltd, enabling

the transaction information to be attributed to Zahra. Gumleaf Industries Ltd would not need to report the transaction to the Commissioner because it has already been reported under the market integrity rules.

Zahra decides to sell the shares on 30 September 2020. Koala Stockbroking Ltd completes the transaction and the same reporting requirements arise. Arboreal Securities Exchange reports the transaction to ASIC under the market integrity rules, who in turn reports it to the Commissioner. Koala Stockbroking Ltd would also report information to the Commissioner so the transaction can be matched to Zahra. Gumleaf Industries Ltd would not need to report the transaction.

The information received by the Commissioner indicates that Zahra has made a capital gain. The Commissioner can pre-fill this information in Zahra's tax return for the 2020-21 income year. Zahra can then review the information and make any necessary adjustments as she completes her tax return. The Commissioner may also use the information for compliance and data-matching activities.

Unit trusts

4.69 ASIC does not receive data on transactions relating to units of unit trusts that take place outside of Australian financial markets. Therefore, trustees of unit trusts must report on transactions that result in a change to the type, name or number of units in the unit trust. ***[Schedule 4, item 1, table item 7 in section 396-55]***

4.70 Similarly to the reporting required of companies, trustees of unit trusts only need to report on transactions that an Australian financial market is not required to report to ASIC under the market integrity rules (see paragraphs 4.60 to 4.63).

Other trustees

4.71 Trusts are used to separate the legal and beneficial ownership of assets. Legal ownership of a trust asset remains with the trustee; however, one or more beneficiaries may have beneficial ownership of that asset. Some trustees may include licensed custodians, financial advisors and family members.

4.72 In some circumstances, the income tax laws provide for the tax consequences relating to a trust asset to pass to a beneficiary rather than a trustee where the beneficiary has beneficial ownership of that asset. This occurs under the capital gains tax (CGT) regime, which frequently gives rise to tax consequences arising from transactions involving shares in a company and units in a unit trust.

4.73 Where an asset of the trust is a CGT asset (as defined in section 108-5 of the ITAA 1997), CGT consequences relating to that asset are attributed to a beneficiary of the trust where that beneficiary is absolutely entitled to the asset. However, in general, the reporting by other entities under these amendments relates to the legal owner of the securities, not the beneficial owner.

4.74 Trustees of trusts (other than unit trusts) that do not lodge a trust income tax return are required to report on any transaction that results in a change to the type, name or number of any shares in a company or units in a unit trust that are held as assets of the trust and to which one or more entities are absolutely entitled as beneficiaries of the trust. This allows the Commissioner to attribute CGT consequences to a beneficiary who is absolutely entitled to an asset of the trust. ***[Schedule 4, item 1, table item 8 in section 396-55]***

Example 4.4

Mateo uses Gumtree Security Services, a custodian acting under an Australian Financial Services Licence, to purchases shares in Burl Design Ltd. Gumtree is recorded as the legal owner of the shares on the Arboreal Securities Exchange, and holds the shares in trust for Mateo. Gumtree did not lodge an income tax return for the trust.

Mateo is absolutely entitled to the shares at all times since the purchase.

As a trustee of a trust with an absolutely entitled beneficiary, Gumtree Security Services is required to report on the purchase transaction to the Commissioner because it results in a change to the number of shares in Burl Design Ltd held in the trust.

Without this information, the Commissioner would only be aware of the transaction information reported by the Arboreal Securities Exchange to ASIC, which lists Gumtree Security Services as the owner of the shares.

Example 4.5

Assuming the same facts as Example 4.4 above, on 4 February 2018 Burl Design Ltd merges with Wombat Holes Ltd to become Womburl Ltd. As a part of the merger, the shares in Burl Design Ltd held by Gumtree Security Services are replaced with shares in Womburl Ltd. This merger caused a change in the number of shares in Burl Design Ltd and Womburl Ltd held by Gumtree Security Services for Mateo.

These changes would not be reported to ASIC by the Arboreal Securities Exchange under the market integrity rules because the transactions were not made on an Australian financial market.

Therefore, both Burl Design Ltd and Womburl Ltd would be required to report to the Commissioner on the share transactions resulting from the merger.

As trustee of a trust with an absolutely entitled beneficiary, Gumtree Security Services would also have to report to the Commissioner on the share transactions resulting from the merger.

Business transactions made through payment systems

4.75 Amounts that a customer or client pays a business for a good or service typically give rise to tax consequences for that business. To allow the Commissioner to collect third party information on these types of transactions, administrators of payment systems are required to report information to the Commissioner about transactions facilitated on behalf of an entity, through a payment system they administer. Administrators only need to report where they reasonably believe that the transactions are for the purpose of a business carried on by the entity. This is limited to information on transactions involving receipts of payments, refunds and cash out facilitated through the payment system. ***[Schedule 4, item 1, table item 9 in section 396-55]***

4.76 In recognition of the continuing evolution of the banking sector, this reporting requirement applies to all administrators of payment systems, providing a level playing field between traditional and emerging methods of doing business in Australia.

4.77 Not all payments facilitated by a payment system give rise to potential tax consequences. For example, transactions made by individuals in their personal capacity would not normally give rise to an income tax liability for that individual.

4.78 Therefore, an administrator of a payment system is only required to report on transactions facilitated on behalf of an entity where it reasonably believes the transactions are for the purposes of a business carried on by the entity. For example, an administrator of a payment system may, in the usual course of facilitating a transaction, hold or collect information which indicates the entity holding an account is a business, and therefore reasonably believe that transactions connected to such an account are for the purposes of a business carried on by the entity. Such information indicating an entity is a business could include the fact that the entity has provided its Australian Business Number, or holds an account which is treated by the administrator's own business practices as a business type account, or that the entity's account has a high annual turnover.

4.79 This test is designed to capture payments that are likely to have tax consequences. However, administrators of payment systems are not

required to determine whether an entity's transactions have tax consequences. Nor are administrators of payment systems required to change their usual business practices to collect additional information to that collected in the usual course of facilitating a transaction, which would enable it to positively determine that transactions are for the purposes of a business carried on by the entity.

4.80 Where appropriate, the Commissioner may further refine which transactions are to be reported through either the power to exempt entities or transactions (see paragraphs 4.35 to 4.40) or the use of approved forms.

Example 4.6

Jane decides to start her own baking business. As part of setting up the business, she establishes a merchant account with a bank. This allows her to receive credit and debit card payments from customers in store and online. Jane also sets up a business account with an online payment service provider to allow an alternative payment option for her customers. As both accounts are of a kind usually marketed at and utilised by businesses, the bank and the online payment service provider would reasonably believe these transactions are for the purposes of a business carried on by Jane.

The bank and the online payment service provider will both report information on transactions facilitated by each payment system for Jane's business to the Commissioner. This will include totals on sales transactions involving receipts of payments, refunds and cash backs.

Jane also holds a personal account with the bank. She has not provided her Australian Business Number in connection with this account. The account has low annual turnover and is of a kind marketed at and utilised by individuals. The bank reasonably believes that the transactions associated with this account are not for the purposes of Jane's business and therefore does not report these transactions to the Commissioner. The bank has met its reporting obligations.

Example 4.7

Michael's personal trainer, Chip, receives his monthly payment through an ongoing direct debit arrangement. Chip has an account with a third party payment system. He uses that payment system to process the direct debit payments for all his customers. This account has an annual turnover of $80,000, made up of regular and consistent payments from a range of sources. This leads the administrator of that payment system to reasonably believe these transactions are for the purposes of a business carried on by Chip and therefore report information on those transactions to the Commissioner.

4.81 Administrators of payment systems are only required to report on electronic transactions, such as those made by credit and debit cards,

and other online payment methods. This does not include payments made by cash or cheque.

Consequential amendments

4.82 This Schedule makes consequential amendments to define the Australian Securities and Investments Commission as ***ASIC***, and standardise that definition throughout Schedule 1 to the TAA 1953 and the *Tax Agent Services Act 2009*. ***[Schedule 4, items 2 to 15 and 22 to 26, paragraphs 20-30(2)(b) and 40-20(3)(b), subparagraphs 60-125(8)(c)(iv) and 60-125(8)(d)(iii) and subsection 70-40(3A) of the Tax Agent Services Act 2009, subparagraph 12-400(3)(b)(ii), paragraphs 355-70(4)(l) and 355-70(7)(d), subsections 12-403(3), 355-65(3) and 355-65(4) and section 269-50 of Schedule 1 to the TAA 1953, and section 995-1 of the ITAA 1997]***

4.83 The title of Part 5-25 is also updated to reflect that third party reporting places obligations on entities relating to other taxpayers. In addition, Division 396 is renamed as 'Third party reporting' with the provisions relating to FATCA, currently comprising Division 396, moved into a new subdivision in Division 396 (Subdivision 396-A). ***[Schedule 4, items 16 to 21, subsection 396-20(1), section 396-1, Subdivision 396-A, Division 396 and Part 5-25]***

Application

4.84 Third party reporting obligations in relation to transfers of real property (reported by states and territories) and ASIC market integrity data (reported by ASIC) apply to transactions happening on or after 1 July 2016. All other third party reporting obligations apply to transactions happening on or after 1 July 2017. ***[Schedule 4, item 27]***

4.85 The Commissioner may change the reporting period and reporting dates by legislative instrument. This applies to transfers of real property (reported by states and territories) and ASIC market integrity data (reported by ASIC) from 1 July 2017. For all other transactions, it applies from 1 July 2020. More detail is at paragraphs 4.24 to 4.34. ***[Schedule 4, item 27]***

4.86 The other amendments made by the Schedule apply from Royal Assent.

Statement of Compatibility with Human Rights

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

Third party reporting

4.87 This Schedule 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

4.88 Schedule 4 to this Bill amends Schedule 1 to the *Taxation Administration Act 1953* to improve taxpayer compliance by increasing the information reported to the Commissioner of Taxation (Commissioner) by a range of third parties. The Schedule creates a new reporting regime requiring third parties to report on the following transactions:

- payments of government grants;
- consideration provided for services to government entities;
- transfers of real property;
- transfers of shares;
- transfers of units in unit trusts; and
- business transactions made through payment systems.

Human rights implications

4.89 The amendments made by this Schedule engage the prohibition on arbitrary or unlawful interference with privacy contained in Article 17 of the *International Covenant on Civil and Political Rights* (ICCPR), as third parties will need to provide a range of personal information to the Commissioner that they collect in the ordinary course of business.

4.90 These reporting obligations are compatible with the prohibition, as they are neither arbitrary nor unlawful. In addition, they are aimed at a legitimate objective of minimising the overall compliance burden on taxpayers and are an effective and proportionate means of achieving that

objective by requiring only the minimum amount of information necessary to identify relevant taxpayers and transactions.

4.91 The United Nations Human Rights Committee has stated, in their General Comment No. 16, that:

- 'unlawful means that no interference can take place except in cases envisaged by the law. Interference authorized by States can only take place on the basis of law, which must itself comply with the provisions, aims and objectives of the Covenant [the ICCPR]'; and

- 'the concept of arbitrariness is intended to guarantee that even interference provided for by law should be in accordance with the provisions, aims and objectives of the Covenant and should be, in any event, reasonable in the particular circumstances'.[22]

4.92 The objective of third party reporting is to reduce the overall compliance burden on taxpayers by gathering information regarding their potential tax-related liabilities from entities that can provide it to the Commissioner at an overall lower cost than taxpayers themselves. The ATO can then use this information to pre-fill the tax returns of those taxpayers and other compliance purposes.

4.93 Legislative reporting regimes, such as third party reporting, provide more certainty and consistency of treatment for entities than the alternative, where the Commissioner collects information under his or her general information gathering powers on an ad-hoc basis. The information to be reported by entities would typically be limited to that information they already hold having collected it in the ordinary course of their business. Taxpayer information held by the ATO is subject to strict confidentiality rules that prohibit tax officials from making records or disclosing this information unless a specific legislative exemption applies.

4.94 These amendments specify that the Commissioner may only require third parties to report information that relates to the identification, collection or recovery of a possible tax-related liability as well as the identity of the taxpayer to which the tax-related liability may arise. The amendments also allow the ATO to exempt entities from reporting where, for example, the Commissioner does not expect to be able to productively

22 United Nations Human Rights Committee, *CCPR General Comment No. 16: Article 17 (Right to Privacy), The Right to Respect of Privacy, Family, Home and Correspondence, and Protection of Honour and Reputation*, 8 April 1988, available at: http://www.refworld.org/docid/453883f922.html.

use the information or where reporting the information places a disproportionately high compliance costs on the third party relative to the benefit of providing the information to the ATO. This is consistent with the broader objective of the third party reporting regime to reduce overall compliance costs.

4.95 The Commissioner also has the flexibility to vary the timeframes for reporting, to achieve a balance between the needs of the Commissioner to receive the information with sufficient time to process and pre-fill it into taxpayers' returns and any increase in compliance costs that short timeframes may impose on entities reporting under the regime.

Conclusion

4.96 This Bill is consistent with Article 17 of the ICCPR on the basis that its engagement of the right to privacy will neither be unlawful (including by virtue of the amendments to Australia's taxation legislation set out in the Bill) nor arbitrary. To this extent, the Bill complies with the provisions, aims and objectives of the ICCPR.

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Schedule 4: Third party reporting

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Item 1, table item 9 in section 396-55	4.75
Item 1, paragraph 396-55(a)	4.26
Item 1, subparagraph 396-55(b)(i)	4.29
Item 1, subparagraph 396-55(b)(ii)	4.31
Item 1, subsection 396-60(1)	4.17
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Item 1, section 396-75	4.23
Item 2, subsection 995-1(1) of the *Income Tax Assessment Act 1997* (ITAA 1997)	4.61

Bill reference	***Paragraph number***
Items 2 to 15 and 22 to 26, paragraphs 20-30(2)(b) and 40-20(3)(b), subparagraphs 60-125(8)(c)(iv) and 60-125(8)(d)(iii) and subsection 70-40(3A) of the Tax Agent Services Act 2009, subparagraph 12-400(3)(b)(ii), paragraphs 355-70(4)(l) and 355-70(7)(d), subsections 12-403(3), 355-65(3) and 355-65(4) and section 269-50 of Schedule 1 to the TAA 1953, and section 995-1 of the ITAA 1997	4.82
Items 16 to 21, subsection 396-20(1), section 396-1, Subdivision 396-A, Division 396 and Part 5-25	4.83
Item 27	4.27, 4.28, 4.32, 4.84, 4.85