

FBT Audits & LAFHA: What you need to know



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Part 1

This article was going to be all about FBT audits...and then the Government announced sweeping reforms to the Living Away From Home (LAFH) rules, so here is a summary of the changes (and we'll get to the audit & compliance activity further on) ...

LAFH Reform – proposed law changes announced

On Tuesday 29 November 2012, the Government announced proposed measures to address inappropriate exploitation of the tax exemption for LAFH benefits as follows:

- The tax exemption for temporary residents (for example 457 visa holders) will be limited to those who maintain a residence for their own use in Australia, which they are living away from home for work purposes. For example 'fly-in fly-out' workers

- Permanent residents will be required to substantiate their actual expenditure on accommodation and food beyond a statutory amount (yet to be defined).

We look at these proposed reforms in more detail:

Temporary Residents

- The proposed changes will significantly limit the availability of LAFH benefit tax concessions for foreign nationals who are working on temporary assignments in Australia. Access to the LAFH benefits for foreign nationals will be limited to those employees that maintain a home for their own use in Australia (the home must be available at all times and not be rented out) and are required to live away from that home for employment
- From 1 July 2012, very few foreign nationals will be eligible to receive LAFH benefits and those who con-

tinue to receive such benefits will be taxed on the allowances, or their employer liable for FBT on the benefits

Australian citizens and permanent residents

- Access to LAFH benefits will continue for Australian citizens and permanent residents, with no equivalent requirement to maintain a home for their use.
- However, all such employees will now be required to substantiate food and accommodation costs in order to access the tax concessions. (No documentation will be required for food expenses that are below a statutory amount yet to be defined).
- LAFH allowances will now be taxed as income to the individual, whilst reimbursements of accommodation and food expenses will continue to be taxed as employer fringe benefits.
- An income tax deduction for the individual or Fringe Benefits Tax exemption for the employer will be available for citizens and permanent residents provided the accommodation and food costs can be substantiated

- Temporary residents who maintain a home in Australia but are required to live away from that home will be eligible for the same concessions.

The proposed changes to LAFH eligibility for temporary residents will increase the cost for Australian employers of attracting highly skilled workers from overseas

In addition to the increased tax cost, there will be additional payroll tax and Superannuation Guarantee implications

The proposals will apply to all new and existing arrangements from 1 July 2012.

Where to from here with the LAFH Reform?

Whilst it's not all doom and gloom, the changes are significant (and we'll get to it later, but don't forget the ATO have ramped up their LAFH audit activity – so don't think for one minute that any past or current LAFH exposures can be ignored).

Treasury has set a deadline of 3 February 2012 for submissions. Given that the intended start date for the

reforms is 1 July 2012, and there are no transitional or grandfathering provisions in the proposed measures, it would seem highly unlikely that any transitional arrangements will be introduced.

Treasury has said that they will undertake consultation with stakeholders to understand transitional and implementation issues and to identify any unintended consequences.

Well I can think of plenty of consequences and plenty of headaches in the making....

Unintended (?) consequences

Easily the majority of temporary visitors will have employment contracts that go beyond 1 July 2012. Therefore, negotiations will need to start sooner rather than later with those employees around their remuneration post 30 June 2012. There are likely to be some very unhappy employees and some equally very unhappy employers.

Similarly, the same contractual issues will exist for local employees. For example, a local employee in receipt of an accommodation allowance, if the allowance happens to be greater than the actual rental

expense, then additional tax will be payable from 1 July 2012.

Some allowance for transition would be nice. April 1 2013 sounds nice, but only a fool would have such wishful thinking.

What should an employer do?

Firstly, its best to assume that the new law will be introduced as it currently stands. That is the worst but most likely scenario.

Secondly, as a starting point, commence looking at each of the following:

1. Understand your current employee LAFH population and contractual terms
2. Engage with your current employees in receipt of LAFH benefits
3. Amend (or create if you don't have one) your LAFH policy

4. Revisit procedures and policies
5. Amend standard contact terms
6. Advise related offshore entities of the change
7. Be aware of the final legislative changes – likely to be announced close to the 1 July 2012 start date

There is a lot of work that needs to be done between now and 1 July, and don't forget there are also FBT returns to be prepared and lodged between now and then

And now, back to the original article

FBT Audits: What you need to know

With the ramp up in FBT compliance and audit activities, the ATO have targeted LAFHA along with a continued focus on cars, employee contributions and lodgments. We expect the focus to broaden over time.

LAFHA is seen overall as a high risk area and the ATO have acted accordingly. As we are now aware, the

Government has also acted swiftly off the back of less than one year's focus on LAFH arrangements by the ATO, to introduce the sweeping measures outlined above.

The ATO has also identified a number of high risk cases through data matching, and case officers will focus on addressing these issues as part of their visits.

The ATO have issued revised case management procedures to their Employer Obligations Workforce (EOW) team. Historically the EOW have focused on PAYG and Superannuation compliance. The EOW now have revised case management procedures which are designed to ensure substantially greater scrutiny of employer FBT obligations.

FBT is often way down the list of priorities for employers and this can create some real headaches for them, their employees and ex-employees. There is no room for complacency now. Often these issues (and the related headaches) will reside firmly within Payroll and Human Resources.

LAFHA – what are the ATO doing?

The ATO's approach to Living Away From Home Allowances has been in the too hard basket for a long

time. This has all changed over the last 12 months with the ATO issuing questionnaires to understand more closely the extent and nature of the provision of LAFHA. More recently the ATO have issued audit letters.

The ATO has been concerned about the rate of growth of LAFHA benefits for some time now. Due to the increased FBT return disclosure requirements, the growth in LAFHA over the last 5 years has been significant. Of more concern though, to the ATO, is the increased proportional growth in the value of reductions over the same time frame. The ATO's report on LAFHA last year indicated that the majority of LAFHA benefits were in respect of the employment of temporary, overseas skilled workers.

The ATO and the Department of Immigration and Citizenship (DIAC) have been collaborating to identify remuneration packages which are heavily weighted towards LAFHA. In some instances the LAFHA component exceeds 90% of the total remuneration package value, in respect of employees receiving multi-million dollar sums. The ATO will be continuing this collaboration with DIAC data-matching to individual employees to determine the extent to which reductions have been used to minimise the taxable value of the LAFHA benefit. Where such cases are identified the ATO intend to review the employment records of the em-

ployer, along with the FBT documentation.

The ATO is undertaking two project streams of work in relation to living away from home allowances. The first project initially focuses on clients who have been identified as high risk and potentially providing excessive living away from home allowances that have been treated as exempt from FBT. The project involves direct contact with employers, review of relevant documentation and an assessment of whether the employers exempt treatment is considered 'reasonable' given the specific facts and circumstances of those employers and their employees. This project is currently on-going.

In regards to the second project, the ATO undertook and completed a major risk assessment which was designed to gain a detailed understanding of how the living away from home allowance provisions are being applied in practice. The findings from this second project will help the ATO to develop and refine LAFHA compliance strategy.

LAFHA Reasonable Compensation Project

The ATO has been reviewing the records of 50 employers who have claimed exemption for LAFHA. In

particular the ATO has been trying to determine if the exempt amounts meet what the ATO call a standard of 'reasonable compensation'. Where the ATO has concluded that this standard has been exceeded they have or will be undertaking further investigations. These concerns are with the structure of employee remuneration packages.

LAFHA Intelligence Gathering Project

This project involved the ATO writing to a total of 770 employers who pay LAFHA to their employees. The ATO requested specific details of the employee remuneration arrangements (see below). In addition, the ATO has also written to salary packaging and labour hire firms and requested that they provide details of all remuneration packages they administer which include LAFHA. As mentioned earlier, this information is being analysed and the intelligence gained used in the development of future compliance strategies.

Importantly, employers should be aware that the outcomes and feedback above are likely to result in representations to Treasury in relation to proposals for law change. Treasury has been closely involved with LAFHA for a long time now.

LAFHA – ATO information requests

The ATO has specifically requested the following information for each employee who received LAFHA, including:

- 1) The employee's name and tax file number
- 2) The work location including post code
- 3) The usual place of residence as declared on the employee's living away from home declaration
- 4) The details of their visa, if the employee's usual place of residence is overseas
- 5) The employee's title/role in the organisation
- 6) The amount of salary and wages paid to the employee in the financial year; and
- 7) The total value of LAFHA paid to each employee including a breakdown between the accommodation and food components

We are aware of a number of employers who have received and responded to the above information requests, but have not received any further communication from the ATO.

However, very recently audit letters have been sent - the ATO are moving to the next stage...

ATO FBT Audit questions

Below is a sample of the questions being asked in these ATO audit letters. As you read through the questions – think about if you, or someone, in your organisation could confidently answer them?

1. Do you have a Living Away From Home policy?
2. Who is responsible for the Living Away From Home policy in your organisation?
3. Who in your organisation decides if an employee is eligible for Living Away From Home Allowance?
4. Who in your organisation determines the amount of Living Away From Home Allowance?

5. Who in your organisation determines the accommodation and food components?
6. Who in your organisation calculates the exempt component?
7. What records are maintained to substantiate the Living Away From Home Allowance being paid?
8. What responsibility, if any, does the employee in receipt of the Living Away From Home Allowance have?
9. Do you undertake regular reviews of each employee's Living Away From Home status?

If you are unable to confidently answer the above questions, we believe your organisation requires urgent assistance. Below we suggest some steps you should consider taking.

LAFHA – what can you do as an employer?

Clearly employers need to really sit up, take notice and act. The ATO activity has highlighted a number

of areas where employers need to be satisfied they are not at risk, including:

Having a clear LAFHA policy

The following should be included in the policy:

1. Eligibility criteria
2. Specific exclusion scenarios
3. Maximum and minimum periods of Living Away From Home
4. Under what circumstances does eligibility cease
5. Distinction between overseas temporary visitors and domestic temporary visitors
6. Employer responsibilities
7. Employee responsibilities

Having documented procedures

Every employer needs to have a well documented procedure for approving a LAFHA - including a clear line of responsibility. This should include an eligibility checklist, template contractual terms and process for determining the accommodation and food components.

Employment contracts

Employment contracts should include the following:

1. Finite length of employment
2. Clear reference to the temporary assignment
3. Clear reference to the living away from home requirement
4. Employee's responsibilities and under what circumstances the eligibility criteria are no longer met
5. Repatriation clause

Declarations

As a bare minimum LAFH declarations should be collected annually and should not be seen merely as a “form filler” or “ticking the box” type process.

It must be made clear to the employee what they are actually declaring. In our experience some employees see the declaration merely as a means to an end of continued tax free income. Worryingly, some employers see the declaration as just part of the FBT return process without understanding the true meaning behind the requirement.

It should also be noted that without a completed LAFH declaration (prior to FBT return lodgment), then FBT is payable in full on the LAFHA.

Working together as a team

It is important that Finance, Tax, HR, Payroll and Recruitment work together in relation to all of the above.

In the next journal, we'll continue our discussion about which Fringe Benefits the ATO is focusing on as part of their compliance program.



About Paul Mather and FBT Solutions

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Paul is the founder of FBT Solutions, Australia and New Zealand's only 100% dedicated FBT Consulting and Compliance Practice.

FBT Solutions assists businesses across all industry sectors in meeting their FBT obligations. Key services provided include full or partial outsourcing of the FBT return preparation, tailored FBT return reviews and post lodgement reviews. Other services include advisory, training, review of policies, salary packaging assistance, manual preparation, and preparing for and managing FBT audits.

Paul is a member of the Institute of Chartered Accountants in both Australia and New Zealand.

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