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FBT audits: the ATO takes aim at employers

The statistics from the recent ATO FBT audit and compliance activities don't lie. With 70% of employers non-compliant and 69% of employers failing to lodge an FBT return, the ATO has taken a greater aim at employers. The ATO is broadening its approach to the SME and large business sectors. Along with this is an in-depth focus on cars, car parking, living-away-from-home allowances, entertainment, and employee contributions.

The Australian Taxation Office (ATO) has ramped up its FBT compliance and audit activities. For employers, this increased activity is a clear warning to review their FBT obligations sooner rather than later. The level of FBT compliance activity that we are seeing is unprecedented.

With a particular focus on cars, car parking, living-away-from-home allowances (LAFHAs), entertainment and minor benefits, the ATO has signaled an increased level of scrutiny on FBT across all business segments. The ATO has identified specific areas of ongoing risk, and for each of these areas, a designated project approach has been formalised. In the lead up to the end of the 2011 FBT year, employers need to be aware of the ATO activities already undertaken, current activities and planned activities.

In a world of taxes, FBT is often faced with neglect — this is due to real or perceived complexity, priority of tax issues, and a long-held belief that FBT audits do not exist. This neglect can eventually lead to a world of problems.

This article reviews the key findings that have been released by the ATO. The initial findings were released in early 2009. In late 2010, the findings from the lapsed lodger project were released. Following this, the specific areas of project focus by benefit category are discussed. Finally, in light of this unprecedented ATO activity, some areas for consideration when planning the 2011 FBT return preparation and related obligations are discussed.

NON-COMPLIANCE AT 70%

The initial findings from the ATO's early risk work found that 70% of taxpayers were non-compliant. These findings were achieved via data matching, followed by compliance verification.

In dollar terms, the average additional taxation liability was more than \$70,000, with a general interest charge of just under \$20,000. Where cases were escalated and assessments issued, the average penalties were \$38,000 per case. Penalties were not applied to cases where a voluntary disclosure was made.

The ATO was strongly encouraged by these results, and began developing new risk strategies or further developing existing risk strategies to review compliance. While the dollar amounts expressed above may not appear significant for a large business, it is worrying to note that the above statistics were confined primarily to the small business sector.

UP TO 69% OF LAPSED LODGERS REQUIRED TO SUBMIT A RETURN

The ATO undertook a pilot project focused on employers who have lapsed in their FBT lodgments. The aim was to establish the extent to which employers were continuing to employ staff and provide benefits but were no longer lodging an FBT return. The ATO described this as "dropping-out" of the FBT system. The results from the pilot established that over 50% of the contacted employers had continued to provide benefits and had an obligation to

lodge. Given the low level of compliance, the ATO expanded the compliance focus in this area.

In the next phase, following the pilot, 330 employers were contacted directly or through their tax agent. More extensive questioning was employed, including specific questions on cars and employee contributions. From this, it was found that 228 employers (69%) agreed that they had an obligation to lodge and made an undertaking to do so. A further 11% confirmed that they did not have an obligation to lodge an FBT return. The remaining 20% were uncontactable and the ATO is pursuing them.

These results proved that a decline in compliance was due to a major failure by employers to report car fringe benefits.

Data matching, followed by initial compliance reviews, has proven to be a highly effective and successful approach and will be an ongoing feature of the way that the ATO manages compliance risks.

The next phase of the lapsed lodger project was due to commence prior to the end of 2010. Alarming, 203 large segment clients have not yet lodged their 2010 FBT return. The ATO was keen to follow up these large businesses as a priority in order to understand the reasoning behind the non-lodgment and timeframe expectations for lodgment.

LAFHAS TO BE A SIGNIFICANT FOCUS

The ATO has made it clear that LAFHAs will be a significant focus, and there is an intention to pursue a number of cases.

The ATO has always taken a keen interest in LAFHAs. Within business, LAFHAs can often be viewed controversially, usually because the rules are difficult to understand or, where there is an understanding of the rules, businesses are often confronted with challenges in the

practical application. Commercially driven objectives can get in the way of the law.

There seems to be a view within the ATO that there is widespread abuse of the living-away-from-home (LAFH) concession treatment. With the ongoing requirement to disclose gross LAFHAs on the FBT return form, this provides good visibility to the ATO on the extent of the perceived problem.

Therefore, it is advisable to review your LAFH policies against the practical application. Often, the watching brief on LAFHAs is unclear and the responsibility or accountability falls between the human resources, payroll and tax groups.

CARS AND FBT: DRIVEN TO NON-COMPLIANCE

Given that cars are the largest benefit overall by numbers and revenue, it is not surprising that cars have been at the centre of the compliance activities. The focus on cars has broadly been on luxury cars, cars with high business use, logbooks, and exempt vehicles.

Particular areas giving rise to non-compliance read like a high-level checklist for cars, and include:

- luxury cars with a high business use percentage;
- cars that are garaged at home;
- record-keeping requirements, for example; odometer readings, log books, purchase documentation, calculation of cost price, maintenance and running cost records;
- determination of the business use percentage;
- calculation of the correct liability;
- accounting for employee contributions;
- employee declarations to substantiate employee paid costs;
- timely and correctly documented debiting of loan accounts to bring contributions to account;
- correct and timely compliance with the GST and income tax implications associated with employee contributions;
- incorrect practice of reducing company income tax deductions to the extent of “perceived” private use, rather than reporting FBT or applying employee

contributions to eliminate the FBT liability; and

- incorrect application of the luxury car threshold to determine the deemed interest and depreciation for the operating cost method.

Data matching against state road authority records, questionnaires and compliance verification have been the key trigger points in the focus on cars.

INVESTMENT ALLOWANCE RAISES FBT CONCERNS

The ATO has commissioned a project to data match between businesses that claimed the investment allowance and also registered a new business vehicle. The broad intent behind the project is educational.

The ATO is concerned that businesses may have unknowingly commenced providing benefits as a result of the introduction of the investment allowance. A key example for vehicles is the rules that apply to home garaging.

Depending on the specific circumstances, it appears that the ATO will employ a degree of latitude where it can be proven that there was a lack of awareness of the FBT rules. In these situations, the ATO will allow self-correction and concessions to penalties will likely apply.

Where the ATO can establish that the employer has knowingly failed in their obligations, penalty concessions will not apply.

HIGH FAILURE RATE IN REPORTING EMPLOYEE CONTRIBUTIONS

The ATO has had a strong focus on employee contributions for a number of years, and more recently, the net has widened significantly. The rapid increase in the top marginal tax rate threshold from \$70,000 to \$180,000 within four years from 2005 to 2009 has broadened the attractiveness of the contribution method to the employee population. The contribution method is advantageous for employees earning less than \$180,000.

Based on the earlier work undertaken by the ATO, it was clear that employers struggle with the “back office” compliance duties required by the contribution method. These struggles brought audit success

for the ATO and, once again, the ATO was encouraged to broaden its focus.

The ATO focus is to determine whether the income tax and GST obligations have been correctly fulfilled. First, there is the requirement to report the GST exclusive value of the contribution in employer income tax returns at the appropriate label. Second, there is the requirement to report and remit the 1/11th GST liability on the business activity statement. In addition, the ATO has reported instances where the contribution applied to reduce the fringe benefits taxable value is greater than the actual contribution paid.

Simply data matching between the FBT return and the income tax return provides the ATO with a list of verification targets. As acknowledged by the ATO, in many cases, the correct amount of tax has been paid. However, due to the employer inadvertently not using the correct label, the employer has been selected for further follow up.

ATO ENTERTAINS CONCERNS WITH MINOR BENEFITS

The ATO is reviewing a large entity’s FBT treatment of corporate box facility hire, together with the meal entertainment provided at the same time. It appears that the entity has claimed the minor benefit exemption in respect of both the corporate box hire and the related food and drink cost.

The ATO considers that, while the per head cost is less than \$300 per head for each benefit category, the benefits are associated and therefore the minor benefit exemption may not apply.

Without knowing the full facts of this situation, it is difficult to analyse further. However, ATO ruling TR 2007/12 on minor benefits would seem to provide support for the ability to separate benefits that are associated in nature by location and time and to apply the minor benefit exemption separately, or with a certain degree of isolation.

One can only assume that the facility hire is over a period of time, perhaps over a sporting season, and may therefore involve the same employees attending on a regular basis. If this were the case, then it would seem a difficult argument (to claim

exemption) when applying the tests around frequency, regularity and similarity.

Most would agree that the practical application of the minor benefits exemption remains nothing short of an FBT mystery, shrouded in uncertainty and clouded by the lack of commercial guidance for businesses.

While, at an individual employee level, the amounts involved are small, across all employees (and their spouse and family, if applicable) of an organisation, and over a period of time, the dollars involved usually become significant. This fact is not lost on the ATO and it has identified a potential risk issue and will be looking to review the treatment applied by other entities in similar circumstances for FBT purposes.

Notwithstanding the above, genuine consideration should always be given to claiming the exemption.

AND IF THAT'S NOT ENOUGH ...

The ATO has also expressed concerns in respect of arrangements giving rise to debt waiver fringe benefits. These can lead to adjustments in a review of FBT compliance.

Car parking has also been a focal point. While it is unclear what the specific underlying concerns relate to, it would be safe to assume that non-reporting/failure to identify could well be the area of ATO interest. It goes without saying that valuation issues will always be on the agenda for car parking.

FBT YEAR END MATTERS

With the FBT year end fast approaching, some serious planning and preparation prior to 31 March is required.

Good FBT risk management requires a level of commitment throughout the FBT year. However, the lead up to the 31 March year end demands an intense focus to ensure that the compliance deadline (either in May or June, depending on lodgment arrangements) is met. More importantly and prior to lodgment, the public officer is required to sign off that the information in the FBT return is "true and correct". Be prepared to answer the question, "can I sign this return as true and correct?"

IT'S ALL IN THE PLANNING

To fail to plan is to plan to fail — the nature of FBT is a myriad of data sources, internal and external, requiring tenacity and the ability to ask the right questions. This is quickly followed by valuation challenges. Some initial planning steps include:

- (1) Prepare a high-level project plan including a timeline — plan for contingencies.
- (2) Identify the people who are required to be responsible and ensure that you get their "buy in" to the process.
- (3) While it will vary from business to business, logically, the people involved would include representatives from finance, tax, payroll, purchasing, human resources, sales and marketing, sponsorships and events, facilities management, and fleet management. By involving these people, this should go some way to reducing what may be the biggest key FBT risk, that is, "it's not *what's in the* FBT return that's the problem, it's *what's not in the* return that's the problem".
- (4) Undertake a review of FBT-sensitive accounts for the nine months to 31 December 2010. This will reduce the workload in the April/May period and allow time to identify and resolve issues.
- (5) How will the return be prepared — spreadsheets or customised software? If customised software, when will the latest version be available, who can use it (is training required?) and how does it or can it interact with your systems? What output do you need? If spreadsheets are used, who will update the format and formulas and how do you know that the spreadsheets calculate the right amount of FBT payable and correctly allocate/calculate the individual employee reportable amounts?
- (6) Will the review/sign off be done internally or externally? Either way, check that the relevant people are available — understand their expectations and communicate your own expectations.
- (7) What were the big issues in last year's return/s? Hopefully these have been well documented in the prior year's file. An issue can be technical, logistical,

accounting or systems based or just plain "in the too hard basket". More importantly, how have these issues been managed following lodgment of last year's FBT year? Chances are, last year's issues will remain as this year's issues.

- (8) Are there any carried forward items from last year's FBT return that need to be considered for this year's FBT? These may include deposits paid for events held in the 2011 FBT year, employee contributions rolled forward from the 2010 FBT year, and prepaid corporate box hire straddling two FBT years.

If real concerns exist at the end of the initial planning phase (whether they be lack of appropriate resourcing, significant problems with general ledger categorisation or prior year technical treatment issues), it may be worth considering outsourcing as an option. You may find that, over the medium to long term, the cost of a short-term outsource can deliver a positive outcome and help to create a positive framework for the future.

WHAT'S NEW THAT NEEDS TO BE CONSIDERED

Meaning of "cost price" of a car for the purpose of calculating the taxable value of car fringe benefits

At the time of writing this article, the ATO was due to release the above draft ruling. The ATO has carried concerns for a long time with regard to calculating the cost price. Issues include trade-ins, cash contributions, manufacture rebates and incentives, and extended warranties.

Changes to section 23AG of the Income Tax Assessment Act 1936

While the changes to the tax status of non-residents are to some extent old news (having been introduced with effect from 1 July 2009), there remains a degree of confusion. What is important is to identify the tax status of employees working overseas and, if necessary, to make sure that benefits provided locally or overseas are identified and tracked.

POST-LODGMET TASKS

Unfortunately, the lodgment of the FBT return does not signal the end of the

process. Following lodgment, there are other considerations, including:

Payroll: reporting of individual fringe benefits amounts on employee payment summaries (also, don't forget the new superannuation reporting requirements on payment summaries).

Income tax: there must be consistency of treatment between income tax and FBT. This is especially true for entertainment benefits.

GST: special rules exist in the GST law to ensure consistency of treatment in relation to entertainment expenditure and certain minor benefits.

Salary packaging: reconciling of packages – not just the lease payments and running costs, but also the FBT charge.

Payroll tax: while harmonisation has helped to align the rules across each state and territory, care still needs to be taken when valuing fringe benefits for payroll tax purposes. Be aware that the NSW Office of State Revenue, in particular, has a key focus on fringe benefits.

Workers compensation: fringe benefit values are required to flow through to workers compensation calculations.

Remuneration reporting of taxable executive benefits.

Probably the most important post-lodgment task is to reflect on the challenges and identify the areas that require improvement. This task needs to be completed while the issues are still fresh and will require involvement from the representatives identified in the planning stage.

CONCLUSION

The ATO has taken aim at FBT and you need to understand if your organisation is likely to be in its sights. If your benefit offerings sit within the key areas of focus, then you will need to satisfy yourself that all is in order. If you detect problems, consider making a voluntary disclosure. You may even find you've actually overpaid FBT and you have grounds for seeking a refund.

Based on the findings to date, the ATO has identified a high rate of non-compliance

in a number of areas. The focus on FBT will continue. What will be of interest, and probably concern for employers, is the future strategies that the ATO will employ in relation to LAFHAs, car parking, entertainment and other benefits. The ATO has experienced enough "upside" to further develop compliance strategies throughout 2011.

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