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Client Information Newsletter - Tax & Super September 2014

Novated leases and FBT explained

Wrapping a car into a salary package is a very popular choice, and doing so as part of a salary sacrifice arrangement often raises the topic of novated leases.

Explained simply, a novated lease is a way for an employee to buy a new or used car and have their employer assist in the organised repayment for that car to an agreed financial supplier. (To "novate", by the way, is defined by the dictionary as "to replace by something new", especially an old obligation by a new one.)

The way this is done is by the employer agreeing to make the repayments out of the employee's pre-tax salary in a salary sacrifice arrangement which, like any such arrangement, reduces the employee's taxable income. The terms of the lease repayments are calculated according to the employee's earnings and the amount salary sacrificed.

A novated lease is therefore a three-way deal – between an employee, a financier, and the employer. The employee owns the car, and the employer agrees to make the lease repayments to the financier for that car as a condition of employment.

One obvious such condition is to remain an employee. In the event that employment ceases, the obligations and rights under the lease revert to the (former) employee. This can suit the person involved, as they keep the car (and there are no tax consequences), but can also suit the employer as they are not saddled with an extra vehicle or a financial commitment for it.



During the period of the novated lease, the employer is entitled to a deduction for lease expenses where the car is provided as part of a salary sacrifice arrangement (up to the luxury car limit). But it does give rise to a car benefit under fringe benefits tax (FBT) rules.

Fringe benefits tax

Fringe benefits that fall under the FBT regime can be provided directly by the employer, by an "associate" of the employer, or by a third party who has an arrangement with the employer (in this case, the finance supplier). A car provided by novated lease is considered a fringe benefit to an employee, and gives rise to an FBT liability for the employer.

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Contact Us

Welcome to Collison Accounting's client information newsletter, your monthly tax and super update keeping you on top of the issues, news and changes you need to know. Should you require further information on any of the topics covered, please contact us.

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Novated leases (cont)

A basic principle of salary sacrifice arrangements is that an employer is no better or worse off from having offered an employee a form of remuneration other than straight cash salary.

However as the leased car potentially gives rise to an FBT liability, and as FBT is an employer's obligation, it is generally the case that any FBT amount arising as a result of the novated lease is charged to the employee's salary package post-tax (which effectively balances each other out to end up with a zero outcome).

Generally, the value of the car benefit (on which the amount of FBT is based) is taken on the actual purchase price of the car. Working out its "taxable value" for FBT can be done using two methods – the "statutory formula" method (the most commonly used), or the "operating cost" method.

The latter requires working out the total operating costs of the car (fuel, oil, servicing, etc) and reducing that total amount by the portion of private kilometres travelled (which attracts FBT) as compared to the total kilometres. It is most often used where business kilometres travelled are high, but is more complicated and requires more records (logbooks) to be kept and calculations to be made.

With the "statutory formula" method, the taxable value is based on a percentage rate of the total number of kilometres travelled during the year (both business and private), which the Tax Office used to divide into different "bands" of kilometres recorded. However, with effect from July 1, 2014, this is now calculated at a flat rate of 20% of total kilometres for all post-May 11, 2011, contracts (the date from which amendments were made to the legislated methodology for valuing such benefits — between then and July 1, 2014, a transitional scale applied, but this has now ended).

Leases that still exist and that started before 7.30pm, May 11, 2011 and that have no material change still operate under the rates that applied before the change to the statutory percentage rules, as per the following.

Total kilometres travelled during the FBT year	Statutory percentage
Less than 14,999km	26%
15,000 to 24,999km	20%
25,000 to 39,999km	11%
Over 40,000km	7%

As you can see, the more kilometres travelled, the less tax applies. This produced an unfortunate incentive to clock up enough distance to move into the next band of kilometres and gain a reduced FBT liability.

For example, where an employee uses a car valued at $34,000, a taxable value of $6,800 would arise if they drove 24,000km, but that taxable value would drop to only $3,740 if they drove more than 25,000km. This anomaly in valuation methods was the reason behind the government making the change to how calculations were made.

But beware: If a change is made to the pre-existing contract or lease terms of a pre-May 2011 contract, and the change qualifies as a "material variation", this may push the arrangement into the new rate.

Post-tax contributions to reduce FBT

The tax liability that arises from the fringe benefit of salary packaging a car through a novated lease can be reduced by the employee making contributions towards, say, the running costs of the car from after-tax dollars. It is important that these contributions come from after-tax salary, as every dollar so contributed reduces the taxable value dollar-for-dollar up to the total.

By an employee doing this, rather than the employer paying the FBT tax rate, which is 47% for the 2014-15 year, and passing it on to the employee, they will be paying their own marginal rate which for many would be much less than that. The difference between the taxable value and the total cost of the benefit will not be subject to FBT or income tax.

Novated car lease employer outcomes:

- An employer will need to agree to the salary sacrifice arrangement that allows a staff member to obtain a vehicle through a novated lease
- The employer makes lease repayments to the finance supplier on behalf of the employee from their pre-tax salary
- Being a fringe benefit, the arrangement gives rise to an FBT liability, which the employer pays
- Expenses incurred in arranging and maintaining the lease (not the lease repayments) are tax deductible for the employer for the period the lease is active

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Novated leases (cont)

- The amount of the FBT liability should have a nil dollar consequence for the employer where post-tax contributions are made
- The end of the employment relationship also ends the repayment commitment, as lease obligations revert to the (former) employee
- When you lease the vehicle from the finance company, you can claim a GST credit for the GST included in the lease charges. However you generally can't claim GST credits if you make input taxed supplies.

Employee outcomes:

- The vehicle is of the employee's choice, and the employee has exclusive use and ownership
- Salary sacrificing reduces one's taxable income, as the amount is assigned from pre-tax salary (you may even find yourself in the next lower tax bracket)
- As the car is a fringe benefit, FBT must be paid, although the employer is liable for this payment (which is however balanced-out within the arrangement)
- Generally, FBT is based on the purchase price of the vehicle, as the statutory formula is the most commonly utilised method. The operating cost method applies to running costs with a percentage usually determined by logbook
- Making post-tax contributions to the costs of owning the vehicle can reduce the FBT liability by the same amount contributed
- Usually the vehicle is obtained more cost effectively, as there is:
  - No GST on purchase (claimed by employer)
  - Leasing companies usually get fleet discounts
  - The employer may also get a corporate discount. ■

How to turn tax into more superannuation

Because of the way that tax is applied to superannuation, savvy employees can actually turn what would have been a tax liability into extra super by making use of a salary sacrifice arrangement.

Many workers can, by agreement with their employer, have money paid into their super fund from their salary before income tax is taken out. These before-tax contributions to a super fund can reduce their tax bill and also boost their super savings.

And the boss should generally be happy to do so, as any amounts contributed to super in this way (to a "complying" super fund) are not considered by the Tax Office as a fringe benefit, so your employer will not have to pay fringe benefits tax on that money.

Amounts directed to a super fund via a salary sacrifice arrangement will be taxed in the hands of the fund, at the rate of 15%. So however much you can put away will escape being taxed at your marginal rates, which in most cases will be more than the rate levied on the super fund.

Put more into super, and save tax

By way of example, let's consider the case of Michael, who earns an annual salary of $90,000 (excluding the super guarantee). If he makes before-tax contributions to his super fund of $10,000 through salary sacrifice, not only will he significantly boost his retirement savings but will save $2,400 in tax.

Of course, in the no-salary-sacrifice scenario, Michael has a higher take-home pay of $66,953. But with salary sacrifice there is less tax and more super – a very handy annual boost to Michael 's super fund. He would of course need to make sure his total super contributions (which would include the compulsory super guarantee amounts) stay under the contribution caps.

And even after pumping up his super contributions, there are further tax savings for Michael because the earnings his money is making from investments via the super fund are taxed at 15%. The tax on investment earnings outside of super are taxed at his marginal tax rate of 39% (including 2% Medicare levy). ■

Michael's boost	Does nothing	Salary sacrifices $10,000
Take-home pay	$66,953	$60,853
Tax	$23,047	$19,147
Extra money into super	$0	$8,500
Net benefit	$66,953	$69,353 ($2,400 up)

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The small business concessions

The small business sector has variously been described as the engine room of the economy as well as the biggest employer in the country – and it's not hard to see why. Research shows that small businesses were responsible for generating around half of private sector employment.



The Tax Commissioner Chris Jordan says that there are about three million small businesses in Australia, including primary production businesses, which represents around 96% of all business.

What is a "small business"?

The definitions of what constitutes a small business are not consistent however. The Australian Bureau of Statistics defines a small business as having less than 20 employees, while for the purposes of corporations law it is set at fewer than 50. From a tax perspective, the bar is set at having annual turnover of less than $2 million and "carrying on a business".

The law stipulates that turnover (which is gross income, excluding GST) needs to be the "aggregated" amounts, which means from every "connected" or "affiliated" business, to stop businesses splitting activities so they can slip under the threshold.

The one thing that everyone agrees on however is the central role that small business plays in the economy. Just how important can be underlined by the fact that the government has seen fit to give the small business sector a break on a range of tax matters.

Simplified depreciation

The advantage of this concession is that it is easier to do the depreciation calculations and make adjustments to assets. Simplified depreciation concessions mean that small businesses can:

- immediately write-off depreciating assets valued at less than $6,500, such as photocopiers, laptops, fridges and desks
- immediately write-off up to $5,000 for motor vehicles acquired after July 1, 2012, with the remainder to be written-off at a rate of 15% in the first year and 30% in following years*, and
- write-off other assets in a single depreciation pool at a rate of 30% (15% in the first year).

** If the vehicle costs less than $6,500, the full cost can be immediately written off as per the first point.*

Note however that these measures were introduced as part of the introduction of the Minerals Resource Rent Tax (MRRT, or "mining tax"). The proposed repeal of the MRRT means that some of these simplified depreciation measures may be abolished in their current form. They are also likely to be retrospective and mainly date back to January 1, 2014. Ask this office for updates.

Trading stock

To make the business of business even easier, the tax law provides a set of simplified trading stock rules where, if your trading stock has not changed in value over the tax year, either up or down, by more than $5,000, you can choose not to do an end-of-year stocktake and merely include the same stock value at year-end as at the start of the year – that is, as if no change had occurred.

Pre-paid expenses

A small business can also get an immediate tax deduction for certain pre-paid business expenses. If a payment covers an expense that goes over into the next financial year (like insurance premiums, membership to an organisation, or rent) you can claim that deduction in the current income year if the period of service is 12 months or less.

Car parking and FBT exemption

If you are a small business employer, car parking benefits you provide are exempt if all the following conditions are satisfied:

- it is not provided in a commercial car park
- you are not a government body, a listed public company, or a subsidiary of a listed public company

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Small business concessions (cont)

- you were either a small business entity for the last income year before the relevant FBT year, or your total income for that year was less than $10 million – for this purpose, your income includes ordinary income and "statutory income", that is, total assessable income before any deductions.

Goods and services tax

Eligible businesses are only required to account for GST once payment is received (with cash basis accounting). You can also pay GST in instalments and, if using some items for private use, choose to claim full GST credits and make one single adjustment for the percentage of private use at the end of the tax year.

Another concession available concerns pay-as-you-go tax instalments, where you can pay a quarterly instalment that is worked out based on your most recently assessed tax return. The income recorded is adjusted to align with the latest increase in gross domestic product, saving time having to do calculations.

Help for capital gains tax

There are four CGT concessions that may be available to eliminate or reduce capital gains made by a small business.

1. The 15 year exemption.
Where a taxpayer who is at least 55 years of age and is retiring disposes of a CGT asset that has been owned for a minimum of 15 years.

2. The retirement exemption.
A taxpayer may apply capital gains from the disposal of a CGT asset to the retirement exemption, up to a lifetime maximum of $500,000 – as it is not necessary to actually retire, the concession can be utilised more than once. A taxpayer under 55 years is only exempt if this is rolled over into a complying super fund. A company or trust also qualifies if it pays the capital gain to a "CGT concession stakeholder" or their super fund.

3. The 50% active asset reduction.
The capital gain arising from the disposal of a CGT asset may be discounted by 50% (on top of the general 50% discount accessible to individuals and trusts).

4. The CGT roll-over.
A capital gain arising from the disposal of a CGT asset may be deferred provided a replacement asset is acquired within a two year period – the gain is deferred until disposal of the replacement asset.

One of the alternative conditions of eligibility for these concessions is to pass a "maximum net asset value test". There is a limit of $6 million on the net value of the CGT assets that you and certain related entities can own and still qualify. It is not indexed for inflation.

You satisfy the maximum net asset value test if the total net value of CGT assets owned by you and those related entities does not exceed $6 million just before the CGT event that results in the capital gain for which the concessions are sought. If you fail it, you may still get the concessions under other tests. ■

Did you know… Can self-funded retirees get a concession card?

The Commonwealth Seniors Health Card can give self-funded retirees who do not qualify for a government Age Pension or Department of Veteran Affairs payment the entitlements that others receive from the Pensioner Concession Card. The concessions and discounts that may be available include Pharmaceutical Benefit Scheme discounts, cheaper out-of-hospital medical expenses, concessional rail travel and extra health, household and transport discounts on offer at the discretion of state, territory or local governments and sometimes private businesses.

Many self-funded retirees can maintain their assets (there is no assets test) and continue to make quality investments rather than work out ways to reduce assets to "get on the pension" (and there are stories of some even chasing mere dollars a fortnight just to qualify for a Pensioner Concession Card).

The Commonwealth Seniors Health Card is available for people who have attained their Age Pension age and have an adjusted annual taxable income not exceeding $50,000 for a single person or $80,000 a year combined for a "couple living together". The adjusted taxable income limit for a "couple separated by illness" is $100,000 a year (a limit which also applies to couples separated through respite care or where one partner is in prison). These income limits are fixed in legislation and not subject to any form of indexation, and also increase by about $640 for each dependent child.

Apply to Centrelink only after attaining Age Pension age, but check with this office for more information, including what makes up "adjusted taxable income". ■

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Can the Small Taxation Claims Tribunal help?



Now and then it may be the case that you will have legitimate reason to complain about how the Tax Office has dealt with your tax affairs, and of course you have every right to do so. But disputes about tax assessments do not always have to end up in a court or a major tribunal.

For taxpayers who have smaller disputed amounts (less than $5,000), an alternative avenue to settle your dispute is the Small Taxation Claims Tribunal. This provides a cheaper and quicker process than the full Administrative Appeals Tribunal (AAT) or the vexatious option of litigation.

The Small Taxation Claims Tribunal provides access to a quick and inexpensive review of some decisions made by the Tax Office — for example if it amends your tax assessment to include extra income that it claims you made. It is also independent of the Tax Office.

Before the tribunal can review decisions, a taxpayer must first have asked the Tax Office to look at the decision again by lodging an objection (which you ideally will have this office do for you). The tribunal is then able to review the decision made by the Tax Office on this objection. It can also review decisions made by the Tax Office that refuse a request for an extension of time to make an objection to a taxation decision.

It cannot however review a decision about how much tax you must pay if the amount of tax in dispute is $5,000 or more. Such a review is required to be conducted by the AAT's Taxation Appeals Division.

How do you know if it can help you?

If you receive a decision from the Tax Office that you think is wrong, the document should tell you the appropriate body where it can be reviewed. You can always bring this document into us if this is unclear. An application form is available from the Small Taxation Claims website (ask this office for a copy if you like), or a letter will also suffice. A copy of the decision document that you want reviewed is also needed.

The application form or letter must include:

- your name, address and telephone number
- your date of birth
- the branch of the Tax Office where the decision was made
- the date of the decision and the date you received it
- brief reasons why you think the decision is wrong, and
- if you want the Small Taxation Claims Tribunal to review a decision about how much tax you must pay, the amount of tax in dispute.

This last point is important as if you do not state the amount of tax in dispute, your review will be conducted by the AAT's Taxation Appeals Division.

Time limit for application, and fees

Applications to the Small Taxation Claims Tribunal must be made no later than 60 days after receiving the decision from the Tax Office. If you want to make an application but the time limit has expired, you will need to apply for an extension of time (again another form, but we can help you with that).

There is a non-refundable fee of $85 for applications dealt with in the Small Taxation Claims Tribunal. This must be paid within six weeks before an application can proceed. If you make more than one application for review and they can be dealt with together, the AAT can decide that you only have to pay one fee.

What happens next?

About two weeks after the tribunal accepts your application, you will receive a set of papers in the mail that are put together by the Tax Office. They are a copy of the papers that are relevant to the decision and are called the Section 37 documents, or the T (for tribunal) documents.

If you do not have a professional person representing you, such as a lawyer or someone from this office, the tribunal will call you to talk about the AAT's procedures. Having representation is recommended, but it is not required. In most cases, the first step in a review is an informal meeting with you and your representative if you have one and a representative of the Tax Office.

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Small Taxation Claims Tribunal (cont)

You will have a chance to talk about your case and explain why you think the decision should be changed. This conference is usually held between four and six weeks after the tribunal accepts your application.

Where possible, the tribunal will try to help you and the Tax Office reach an agreement about how your case should be resolved. It may propose a second conference or another type of alternative dispute resolution process (for example conciliation, mediation, case appraisal or neutral evaluation).

If an agreement cannot be reached, the tribunal will hold a hearing and make a decision. The procedures and the amount of time needed to complete the review will vary from case to case, but the Small Taxation Claims Tribunal states that it aims to have cases finalised within three months.

Confidentiality

If you give information to the tribunal that the Tax Office does not have, its usual procedure is to give the Tax Office a copy. Limited information about a case is usually made available to the public on request, and more information is usually made publicly available if a hearing is held.

The tribunal can order that information be kept confidential if it believes there is good reason to do so, but you can apply for an order by writing to the AAT stating what information you want kept confidential and why. In some cases, legislation requires that particular information be kept confidential anyway.

Contact us if you think the Small Taxation Claims Tribunal may be an avenue you wish to explore. ■

Small business CGT concessions, common errors

Small businesses may be eligible for various concessional treatments for transactions that involve capital gains tax (CGT), which can reduce, defer or even eliminate CGT payable (see separate story on page 4). But the Tax Office says that some common mistakes keep occurring on a regular basis in applying the tests for eligibility to the CGT concessions.

Maximum net asset value

The most common error seems to surround the maximum net asset value test. One of a number of alternative tests must be satisfied in order to gain access to the concessions, and this test is one of them. Just prior to the relevant CGT event, the net value of CGT assets that the business (and related parties) owns cannot be more than $6 million at the time the CGT event occurs.

The Tax Office said the net value of the CGT assets of an entity is the total market value of its assets, less any liabilities relating to those assets. The maximum net asset value test allows the net asset value of an entity to be reduced by liabilities such as provisions for annual leave, long service leave, unearned income and tax liabilities.

The maximum net asset total includes the value of assets that are owned by the business itself, but also those owned by any connected entities and affiliates. The Tax Office said that failing to identify connected entities and affiliates is one of the common mistakes, but also:

- the valuation of assets at historical cost rather than market value
- not including in the calculation the CGT asset sold.

The Tax Office added that where market value is required, accepted valuation principles should be applied. For guidance, see the Tax Office's web page "Market valuation for tax purposes" (ask us for a link to the page, which can also be printed out).

Use contract date, not settlement date

The Tax Office had also found that business owners had incorrectly used the settlement date instead of the contract date when recording details of the CGT event. This can end up resulting in:

- the active asset test not being met due to it not being "active" for the required period, and
- incorrectly applying the 15 year exemption when the asset had not been held for that time.

The Tax Office advised (and the law states) that a CGT event is generally deemed to occur at the time a contract is entered into, not at the settlement date. For disposals of assets, the time of the CGT event is usually when the disposal contract is signed.

For practical purposes, where contract and settlement dates cross over financial years, the capital gain or loss should be declared in the financial year in which the contract was signed. ■

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An unforeseen fringe benefit (and the tax consequences)

John is an executive sales manager for Fine Foods Pty Ltd, which owns a number of food brands including pre-packaged meals, canned goods and some beverages.

During the year, John attended the following events on behalf of, and provided by, Fine Foods.

1. A golf day including a round of golf (and equipment hire) at a prestigious golf club for the food manufacturing industry at a cost of $200 per person.

2. A "food industry" conference hosted in Sri Lanka over the course of four days. This included three days of workshops and lectures and on the fourth day a visit to a tea plantation including a demonstration of the harvesting and packing procedures conducted at the plantation. Later a half day tour of Colombo and sightseeing arranged by the seminar hosts.

3. A food grower's gala event that was a sponsorship arrangement between Fine Foods and the Food Growers Association under which Fine Foods paid $5,000 towards the event. In return, it had its banner and logo displayed at the event and its logo printed on all event tickets. Additionally, four tickets were given to Fine Foods to have representatives attend ($40 each).

Fine Foods does not believe that there are any FBT implications arising from John participating in these events as it believes they are all business related.

The golf day

The golf day would in fact be classified as recreational entertainment provided by way of an expense payment fringe benefit. This is because the round of golf was for John's personal recreation or enjoyment. This would be the case even though it was an industry event.

Had John purchased a ticket to the golf day himself, it would not have been tax deductible to him in his personal income tax return and therefore the "otherwise deductible" rule cannot apply (ask us if you need clarification on this).

As the ticket for the golf day was under $300, Fine Foods would be able to apply the minor benefits exemption if it can substantiate that benefits of a similar nature are not provided on a regular or frequent basis.

The "food industry" seminar

Based on the facts provided, the initial three days of the seminar do not appear to attract FBT; in addition, the tour of the tea plantation also appears to be specifically relevant to the purpose of the seminar and advancing knowledge in foods and food preparation.

However, the half day tour of Colombo is of a recreational nature which was personally enjoyed by John with no connection to his employment, and would attract FBT.

If Fine Foods could ascertain the cost of the tour component from the seminar registration, it should include that component as an expense payment fringe benefit. Alternatively, it would have to source a market value for the tour. Under the "arranger" provisions, provision of a benefit to an employee via a third party under an arrangement is still deemed to classify as being in respect of employment and would be the liability of the employer.

Note: It is important that where businesses have paid for employees to attend seminars and conferences that agendas for the seminar are reviewed for any recreational components.

The food grower's gala event

Having also met the definition of an expense payment fringe benefit, it would appear that the value of the ticket to the gala event would be taxable for FBT purposes. However, the Tax Office has accepted that in cases where there is a sponsorship arrangement in place, attendance by executives to assess the effectiveness of their sponsorship investment will not attract FBT.

This would need to be assessed on a case-by-case basis, and factors to consider include:

- the value of the sponsorship commitment required
- the value of the tickets or other benefits provided in return, and
- the number and role of the employees attending.

In the circumstances outlined above, it is unlikely that the gala event tickets would be deemed as fringe benefits.

As Fine Foods has a sponsorship arrangement in place with the Food Growers Association and the value of that sponsorship outweighs the value of tickets provided, it appears to be a reasonable value exchange.

As John is a executive of Fine Foods it seems legitimate that he is invited to the event with only three other colleagues to network with any current or potential suppliers and to assess the effectiveness of their sponsorship of the event, especially if the other colleagues are also senior or executive personnel. ■

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