Chapter 38

TOWARDS A BETTER REGIME FOR TAXING FRINGE BENEFITS

A case for reform

Concerns with current arrangements

38.1 The Review has chosen to include taxation of fringe benefits within its coverage because it believes present arrangements are unduly complex, inequitable in some cases and a source of dissatisfaction as far as business is concerned.

38.2 The Government has already addressed a number of fringe benefit tax (FBT) issues in its 1998 reform package. To a large extent those measures (outlined in Appendix A) sought to deal with the growing practice of 'salary packaging' personal taxable income in order to avoid income tax, to reduce an individual's liability for certain obligations (for example, child support and the Medicare levy surcharge) and/or to qualify for certain benefits. Though the 1998 measures will make the system more comprehensive, a variety of problems remain in relation to inequity, administrative complexity and inefficiency.

Inequity

38.3 At present, unlike wages and salaries, the tax on income in the form of non-cash fringe benefits is levied on the employer rather than the employee. And FBT applies at the top marginal income tax rate regardless of the appropriate rate of personal income tax for the individual receiving the fringe benefit. This deters some employees from taking a portion of their income in a non-cash form even though there might be a legitimate advantage available to them in doing so (for example, bulk buying discounts or gains from sharing the fixed costs of a car or a phone with the employer).

38.4 For example, say an employee with a salary packaging arrangement faces a choice between taking $100 as salary or applying it to the cost of a fringe benefit. In the fringe benefit case, the employer would pay $48.50 in FBT and the employee would get $51.50 worth of fringe benefits. This is the same as paying tax at the top marginal rate of 48.5 per cent (including Medicare levy). If the employee were on the bottom marginal rate under the Government's income tax proposals of 18.5 per cent (Medicare levy included), he or she could receive $81.50 in cash rather than $51.50 worth of fringe benefits. Table 38.1 sets out the disadvantage of taking fringe benefit income for all the proposed marginal rates.

Table 38.1: The fringe benefit disadvantage on $100 of gross salary

Employee's marginal rate %	Net disadvantage $
18.5	30
31.5	17
41.5	7
48.5	0

Administrative complexity

38.5 The administrative load imposed by the current regime for taxing fringe benefits is regarded by business as complex and costly. There is a general issue of whether the administrative and compliance costs associated with taxation of some fringe benefits are justified by the gains to equity and efficiency achieved. Business representatives have also frequently voiced objections to the employer (rather than the recipient of the benefit) paying the tax.

Inefficiency

38.6 Current FBT arrangements allow for the concessional valuation or exemption of certain fringe benefits received by employees. And that can lead to distortions in demand. The most significant example is the concessional valuation of car fringe benefits. These concessional arrangements provide a strong incentive for some employees to take a car as part of their remuneration package and to skew their consumption toward motor vehicle services. The concessions also represent a very significant cost to revenue. This paper does not address the issue of the explicit stimulus to the vehicle industry.

Strategies for reform

To improve equity, transfer tax liability from employer to employee

38.7 One obvious option for overcoming the equity drawbacks of taxing fringe benefits at the employer level is to dispense with FBT and attribute the taxable value of fringe benefits to the relevant employee. The employee would then be liable directly for the tax on the benefit and the appropriate marginal rate would apply. This would bring the taxing of these benefits into line with the taxing of all other elements of remuneration. It would also mean that the same approach was adopted in Australia for the levying of tax on fringe benefits as is followed in nearly all other developed economies.

Implications

Administration and revenue

38.8 Imposing tax on the employee rather than the employer would be a relatively small additional administrative step for those fringe benefits which are to be reportable on group certificates from fiscal year 1999-2000. However, the currently proposed reporting measure will not require the reporting of benefits if, in total, they fall below $1,000, nor will meal entertainment nor certain car parking be reportable. To retain the $1,000 limit while taxing only reported benefits in the employee's hands would involve a significant revenue cost. Every employee currently not in receipt of fringe benefits would have an incentive to convert up to $1,000 of cash income into fringe benefits and thereby avoid tax on this amount. The cost to revenue of retaining the $1,000 minimum could be of the order of $1.6 billion per annum.

38.9 Extending the coverage to all fringe benefits (that is, eliminating the $1,000 minimum) would overcome the revenue loss concern. But it could increase compliance and administration costs. Still, the extent of additional compliance effort involved with full coverage may not be large if employers already plan to comprehensively allocate benefits on a per-employee basis in order to determine who exceeds the proposed $1,000 limit.

38.10 Nevertheless, even if there were no significant threshold, the option of taxing benefits in the hands of employees involves a significant revenue reduction, in the order of $435 million, because some benefits currently attracting 48.5 per cent tax will attract lower rates in the hands of the employee.

Remuneration packages

38.11 The transition from FBT to a personal-income-tax-based system would also involve renegotiation and restructuring of remuneration arrangements where fringe benefits are currently involved. Employees would have their income tax liabilities increased while employers would have their FBT liabilities eliminated. Employees would presumably seek to have a compensating increase in cash income to at least cover the increase in income tax liability. Some disputation may possibly arise where employers seek to appropriate some (or all) of the FBT gain. Also, if the car formula (see below) were made less favourable, there would be an increased tax take from the car benefits, which would have to be effectively borne by either the employer or the employee.

Exempt or concessionally-treated employers

38.12 Employees of public benevolent institutions (PBIs), not-for-profit organisations and the like, which are currently exempt or concessionally treated for FBT would face a different adjustment because they would face higher taxation while their employers would not reap an equivalent additional cash flow from which to provide a compensatory increase in money income. Were these concessions not continued in some form, there would be a revenue increase of about $290 million per annum after the transition. This would be collected as increased personal income tax on employees of exempt organisations (like charities, religious institutions) and rebatable institutions (like community clubs, sporting organisations, trade unions).

38.13 These exemptions and FBT rebates have attracted increased usage that was not intended at the time they were provided. If government wished to compensate some or all of these bodies for the loss of this benefit, it could do so by explicit subsidy. Alternatively, a concessional deduction could be allowed to employees of qualified institutions. This would be recognising explicitly that this category of employee is provided with their benefit in order to reduce the cost of employment for these institutions.

Expatriates

38.14 The application of FBT to expatriates working in Australia is an important issue for foreign firms. An expatriate can be taxable in his or her home country on benefits provided in Australia. Some home jurisdictions regard the benefits as income but do not allow a credit for the FBT as it is legally a tax on the employer and not personal income tax. A change from FBT to taxing the value of benefits in the hands of employees would address this problem.

To simplify compliance and address key administrative issues

Adopt a system of specific inclusion

38.15 Much of the complexity of the FBT system derives from the fundamental approach of including all fringe benefits unless they are specifically excluded. This approach has led to a range of exemptions and/or special valuations made for policy or practical reasons. Industry groups have frequently argued that the existence of the present exemption system unduly complicates the tax and have noted that other countries adopt the positive inclusion approach which leads to less complex rules and greater certainty.

38.16 To cover only a specified list of benefits might be feasible, provided all fringe benefits of significance for equity, efficiency or revenue were included. Were the inclusions list to leave any significant gaps, there could be substantial growth in use of the benefits not captured and a growing loss to revenue. Income tax authorities would need to closely monitor such developments and adjust the inclusions list to counter any widespread and significant changes in behaviour.

Deal separately with entertainment and on-premises parking

38.17 There are particular items which would be difficult to assign to individuals and/or are subject to complex taxation rules. The prime examples are entertainment and on-premises parking. Meal entertainment, though not to be reportable on group certificates under the 1998 reforms, is nonetheless a complex matter for employers; they have to identify the circumstances of events and to subdivide the costs into fringe benefit costs (which attract FBT and are deductible), entertainment other than meal entertainment (which can attract FBT and be reportable if provided to an employee and be deductible), guest-related costs (which face no FBT but are non-deductible) and non-entertainment costs (which are deductible and may or may not be FBT-taxable).

38.18 Car parking provided on-premises by an employer can be a taxable fringe benefit if commercial alternatives are available nearby. In the absence of FBT, employers would seldom need separately to identify the value of this parking and so the requirement to value this benefit imposes an extra administrative load.

38.19 An option suggested for dealing with these difficult categories of fringe benefit would be to remove them from FBT coverage.

38.20 The removal of entertainment (or meal entertainment) from FBT coverage would return treatment of all entertainment to its pre-1995 non-deductible status. The cost to revenue would be approximately $305 million per annum.

38.21 Car parking at the workplace is unlikely to be abused; and applying special taxation is an annoyance to business. So, for administrative simplicity, it could be removed from fringe benefits coverage and it could remain deductible. The revenue cost of this option would be around $80 million per annum.

Alignment of the FBT and income tax years

38.22 The FBT year runs from April 1 to March 31. Business has long discussed the pros and cons of aligning the FBT and personal income tax years. The current misalignment adds to the complexity of tax compliance and may make group certificate reporting additionally complex. However, it is possible that inclusion of fringe benefit information in group certificates would itself delay the issuance of certificates and this suggests that having the fringe benefit year end three months ahead of the normal income year would aid the timely issuance of group certificates. The Review would welcome further guidance from business on where the balance of these considerations lies.

To improve efficiency, remove distortions in valuation of benefits

38.23 In principle, the best way to promote efficient decisions about fringe benefits is to ensure that tax does not distort the relative costs faced by decision makers. For most fringe benefit items, the approach under the present law to determining the taxable value seeks to approximate the market value of the benefit. The principal exception is the statutory formula available for valuing car benefits.

The concessional valuation of cars

38.24 The purpose of statutory formulas is to reduce the compliance and administration costs of applying a particular tax without significantly detracting from revenue, efficiency or equity. The current statutory rules applying to FBT on cars are clearly concessional and there is a case for rules which provide a closer approximation to the value of the fringe benefit involved while still constraining compliance and administration costs.

38.25 Under the statutory formula for car benefits the taxable value of private usage of the vehicle is calculated as a percentage of the vehicle's price; and the percentage varies according to the number of kilometres travelled in the FBT year (1 April to 31 March). The scale of percentages is set out in Table 38.2.

Table 38.2: Statutory formula percentages

Distance travelled (kms)	Percentage of acquisition cost
Less than 15,000	26
15,000 to 24,999	20
25,000 to 40,000	11
More than 40,000	7

38.26 Under this formula a 'family six' costing $32,700 and travelling 15,000 km would actually cost around $11,930 to run for the year but the statutory valuation would be about $6,540 and the FBT tax on that is around $6,160. (See Table 38.3 below for calculation of statutory valuation and Table C.1 in Appendix C for explanation of the calculation of the FBT liability). So, if the car is used almost exclusively for private purposes (as applies with many 'salary sacrifice' arrangements) an employee needs to give up about $18,090 of before-tax income as salary sacrifice to get the car as a fringe benefit. In contrast, an employee in the 48.5 per cent marginal rate bracket, would have to give up more than $23,165 of before-tax income to obtain the same car directly. Overall, the top bracket taxpayer has about $5,075 of before-tax income freed up, which converts to about $2,615 of after-tax income. As kilometres increase, the net income benefit also increases; at 25,000 kilometres the net income benefit increases to around $4,800, assuming exclusive private use.

38.27 An alternative way of judging the concessionality of the formula is to calculate what proportion of business use is required to make the formula non-concessional. For example, in Table 38.3, the FBT formula estimates the private value as $6,540 while the total cost of the vehicle is $11,930. So, if business usage accounted for around 45 per cent of these services the formula's result would be appropriate. In practice such a level of business usage would be the exception rather than the rule for many classes of employee. At more common, lower percentages of business usage, the statutory formula is clearly concessional.

Table 38.3: The 'family six' choice — to package or to buy

	Actual cost to provide $	Statutory formula
Depreciation	6,000	
Interest	2,095	
Insurance and registration	1,455	
Maintenance (15,000km)	815	
Petrol (15,000 km)	1,565	
Total	11,930	20% of $32,700= $6,540
		FBT payable p.a. =$6,159

Note: Throughout this chapter, examples referring to the 'family six' are based on *Vehicle Operating Costs* (NRMA, June 1997) and Review calculations.

38.28 The statutory formula, typically provides an effective tax rate of around 34 per cent on the income sacrificed to obtain a private use vehicle as part of a salary package, if that vehicle travels just over 15,000km in the FBT year and is used solely for private purposes. The effective tax rate becomes even lower as the kilometres travelled rise.

Table 38.4: The effective rate of tax and revenue cost of the 'family six' travelling 15,000km in the FBT year

Marginal rate of recipient %	Effective rate on benefit %	Tax forgone $	After-tax income gained $
31.5	34.1	-674	-461
41.5	34.1	2,303	1,347
48.5	34.1	5,075	2,613

38.29 Were the current formula not changed, then ascribing and taxing income in fringe benefit form to individual taxpayers would increase the attractiveness of taking a fringe benefit car for many. Employees would face their correct marginal tax rate rather than the FBT rate of 48.5 per cent. Demand for vehicles and vehicle-related services would be even greater than it is now and the salary packaging industry would continue to attract economic resources for taxation reasons alone. Table 38.5 illustrates the increased net income that would be available under the current formula if benefits were taxable in the hands of the employee.

Table 38.5: Net after-tax income change from packaging a 'family six' doing 15,000km p.a.

Taxpayer's marginal rate %	Net income advantage (disadvantage) under current FBT $	Net income advantage (disadvantage) if benefits taxed in employee's hands $
18.5	-2,813	997
31.5	-461	1,697
41.5	1,347	2,236
48.5	2,613	2,613

Options for reform

38.30 Two approaches to changing the statutory rule are explored in Appendix B to this chapter. The first is a schedular approach. It would offer the employer a schedule of running costs, based on motoring organisation surveys or upon an Australian Taxation Office (ATO) commissioned survey. The employer could adopt that schedule and simply declare a business-use percentage for apportioning the costs between business and private use. A minimum level of business usage would be allowed without any need for detailed substantiation. Any claim above the minimum level would require justification, if requested by the ATO. Two levels of minimum (or presumed) business usage are analysed — 20 per cent and 50 per cent. Though 50 per cent might seem very generous if the vehicle is not actually used much for business purposes, even that rule is less concessional than the current statutory formula for such vehicles driven more than 25,000 km.

38.31 The second approach, which is given in two illustrative versions, retains the basic form of the present statutory formula which determines taxable value as simple percentages of the vehicle's price. The alternative scales of percentages examined in Appendix B reduce the concessional element available to most employees who have little business use for a vehicle and eliminate the present incentive to sometimes travel unnecessary kilometres.

Implications of varying the car formula

38.32 The implications of the suggested options for reform of the current car formula in the context of assigning and taxing benefits to individuals are illustrated in Table 38.6. These estimates assume that the concessions available to exempt and rebatable employers remain and the tax continues to be collected on entertainment and on-site car parking. The revenue implications of those elements are provided elsewhere in this chapter.

Table 38.6: The alternative formulas with assignment and taxing to individuals[a] of the benefits to be reportable on group certificates from 1999-2000

Impact	No change to car treatment	Use schedule of costs for cars and presume —		Tighten present statutory car formula[b]	
		50% minimum business use	20% minimum business use	Scale 1	Scale 2
Revenue (full year effect in 2003-4)	-$435m	-$260m	+$400m	+$295m	-$10m
Equity	Equivocal	Equivocal	Equity improvement	Equity improvement	Equivocal
Efficiency	Probably an even greater resort to car benefits and on balance probably lower overall efficiency for the economy.	A substantial concession; probably lower overall economic efficiency than at present.	More administrative load than the 50% presumption but more likely to reduce excessive demand for vehicle services.	Efficiency improvement due to substantial reduction in concession.	Efficiency improvement is uncertain.

(a) Assumes elimination of $1,000 threshold.
(b) See Appendix B.
Note: The estimates of revenue change do not include any allowance for increase in the total number of fringe benefit cars in response to increased or broadened concessionality, where that occurs. Accordingly, there is an upward bias in these estimates.

38.33 The options for reforming the statutory formula and car depreciation (see below) could have varying effects on the composition and size of the new car market. In general, where significant revenue increases are likely to arise, the market might see a decline in the growth of new car numbers. For other options, overall demand might increase if the positive response from lower marginal rate employees (who see an increased concession) offsets any negative response from top marginal rate employees (who see a reduced concession). Such changes, however, may be offset (or magnified) by other changes occurring concurrently, such as the change in new car prices under the proposed GST.

Car depreciation

38.34 At present, there is a maximum initial value deemed for calculating depreciation deductions for cars. The upper limit was introduced to constrain the extent of claims of luxury car costs as business expenses. The application of this upper limit has also had the effect of denying a full depreciation deduction for luxury cars used entirely as business equipment, for example, in providing hire car services to weddings and in the tourism industry. The application of a less concessional statutory formula for valuing car fringe benefits might provide an opportunity for a reconsideration of this upper limit. Provided car benefits to employees are properly valued and taxed, then decisions about whether a luxury car is appropriate to the particular business might properly be left to the managers of that business.

The 1998 FBT reforms

A.1 In its tax reform package *A New Tax System*, the Government has announced a number of significant changes relating to fringe benefits.

Benefits to be reported on group certificates

A.2 The grossed-up value of fringe benefits (where the total of the underlying benefits exceeds $1,000 for the employee) will be reported on group certificates from income year 1999-2000. On-premises car parking and meal entertainment benefits are not to be reportable. Group certificate reporting will have a substantial impact upon the attractiveness to employees of reducing their cash income through fringe benefit remuneration.

A.3 Under the tax scale proposed to apply from 1 July 2000, the top marginal rate (48.5 per cent with Medicare levy) is to apply above $75,000 income and the next lower rate (41.5 per cent) is to apply from $50,000 income. So, a significant number of taxpayers who were previously on the top marginal rate and saw no difference between FBT and personal income tax on the top slice of their income, will now face a higher rate of tax on income received as fringe benefits than on money income. The sensible choice will be to cash out fringe benefits unless they deliver some other offsetting advantage. Since the group certificate reporting of most fringe benefits will indeed neutralise any advantage of having expense items paid by the employer (the second largest FBT category), the number of employees opting for fringe benefits will probably fall significantly.

A.4 Still, there will remain a large group of employees on total incomes above $75,000 whose choice about fringe benefits will not be affected by the rate scale change. And the concessionality of the car fringe benefit will still make that option attractive for many under the $75,000 income level, even in the face of a seven or more percentage point difference between the FBT rate and their marginal rates on cash income.

Restrictions on concessions to certain groups

A.5 The personal rate scale change will not fundamentally alter the impact of exemptions which apply to items like remote area housing. Nor will it alter the attractiveness of fringe benefit remuneration for concessionally treated employers like public hospitals. However, a separate initiative announced in *A New Tax System* addresses the growing use of the latter concessions and from FBT year 2000-01 there will be a limit of $17,000 per employee of grossed-up value of concessionally treated fringe benefits supplied by public benevolent institutions and certain not-for-profit organisations.

A.6 The Government has also announced measures to bring within the ambit of the FBT those benefits provided by trusts and companies to beneficiaries, shareholders and their associates, which are not taxed otherwise.

Car formula options

Statutory formulas — why have them?

B.1 Statutory formulas are a device for simplifying tax compliance and tax collection. They necessarily depart from perfectly accurate valuation. However, there needs to be some correspondence between the real value of the item and the statutory estimation. If a statutory formula is to be used by a large proportion of the relevant taxpayers, it generally needs to err somewhat in favour of the taxpayer in order to be accepted and used.

B.2 The taxation policy issue is not whether there should be some concessionality for some taxpayers, but the appropriate degree of concessionality to balance reasonable equity against reasonable simplicity.

B.3 All of the alternative statutory formulas examined below offer some degree of concessionality to some taxpayers. However, they all offer a reduced level of concession to the top marginal rate taxpayer compared with the current statutory formula, and, by and large, seek to offer a less concessional regime overall.

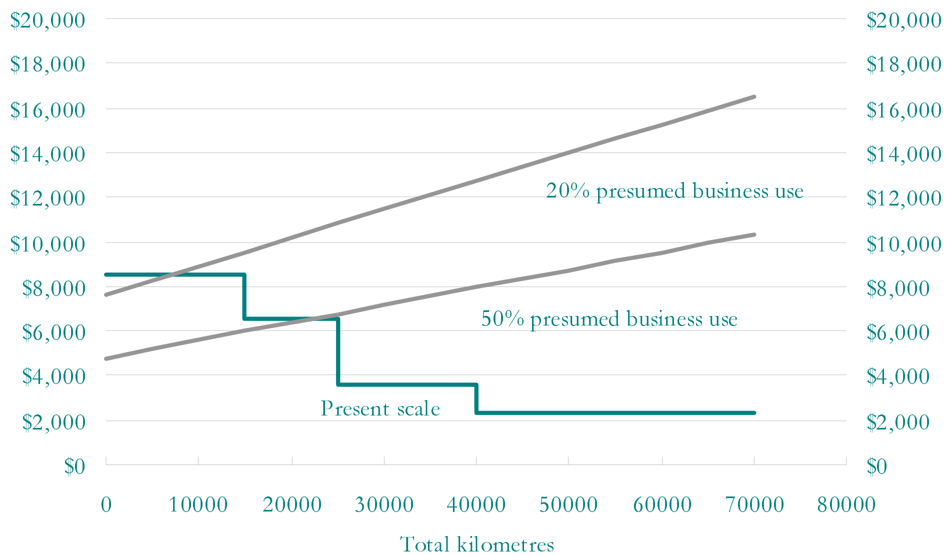
Some options for reforming the statutory formula

Option A: Introduce a schedule of costs and a presumed minimum private use percentage

B.4 The first possible approach considered here is to base all valuations of car benefits on operating costs (but with a schedule available to the employer to use if it wished — the NRMA's estimates for late model cars might provide a convenient starting point). Aggregate annual operating costs would simply be apportioned between business and private use and for simplicity, a certain percentage would be presumed to be business use without any need to substantiate. If the employer/employee wished to specify a business use percentage above the basic presumption then there would be an obligation to substantiate the claim. Under this option, the presumed percentage sets the upper limit to the potential concessional element. It also maintains a smooth relationship between distance travelled and value of benefit, which, in comparison to the current statutory formula, would send more sensible signals in relation to the total distance travelled. The current formula provides significant downward steps in taxation liability at certain distance thresholds and so creates a strong incentive to get over the next threshold if it is not far away.

B.5 We have considered two possible presumed minimum percentages: 20 per cent and 50 per cent. The valuations given by those two minimum percentages are compared with the present formula in Figure B.1.

Figure B.1: Valuation of private component of car usage, 'family six', two schedular approaches



B.6 In essence, the schedular approach with a minimum presumed percentage of business use provides a concessional valuation for any vehicle that is used for business less than the presumed percentage. Even so, if the current FBT approach of taxing benefits at the top marginal rate were retained, there may not be an overall concession available to the employee if he or she is on less than the top marginal rate for personal income tax. On the other hand, if fringe benefits became taxable in the hands of the employee at the appropriate rate, there would be a concession available for any vehicle used less for business than the presumed percentage.

B.7 Table B.1 sets out the concession in terms of increased after-tax income available under these options from taking a fringe benefit car compared with taking money income and providing the same car services privately. The assumptions for the table are:

- the vehicle is wholly used for private purposes;
- the vehicle is driven 15,000km in the year and is fully maintained; and
- the taxpayer has the option of packaging a fixed total salary. That is, money income is reduced exactly by the cost to the employer (including any FBT) of providing the car.

Table B.1: Net after-tax income change from packaging a 'family six' doing 15,000km p.a.

Taxpayer's marginal rate	Net income advantage (disadvantage) with FBT @ 48.5% still applying to employer			Net income advantage (disadvantage) with benefit taxed in the employee's hands		
		Cost schedule			Cost schedule	
	Present scale	20% business use presumed	50% business use presumed	Present scale	20% business use presumed	50% business use presumed
%	$	$	$	$	$	$
18.5	-2,813	-5,118	-2,371	997	441	1,103
31.5	-461	-2,399	-90	1,697	751	1,879
41.5	1,347	-307	1,664	2,236	990	2,475
48.5	2,613	1,157	2,893	2,613	1,157	2,893

Option B: Alter the present percentage-of-car-price scale

B.8 A second approach is to keep the current method of costing the benefit as a percentage of acquisition cost — but to alter the percentage scale. Under the current scale, the percentages decline as kilometres rise. As the percentage is applied to the fixed acquisition price of the car, the declining percentage scale implicitly assumes that the higher the number of kilometres driven, the lower is the actual level of private usage. There is no statistical evidence of this relationship and it seems unlikely. Table B.2 illustrates the relationship implicit in the formula.

Table B.2: Current formula, implied private usage as kilometres vary, 'family six'

Total kilometres travelled	Implicit private usage %	Implicit private kilometres
15,000	55	8,224
30,000	25	7,542
40,000	14	5,760

B.9 The step-wise nature of the decline in valuation as distance travelled increases can induce some very distorted behaviour. If, toward the end of the FBT year, a car is close to one of the downward steps on the scale, it can be profitable to drive an extra thousand or more kilometres for no other reason than to reduce FBT liability. For example, a $33,000 car on 13,000 km toward the end of the FBT year would be facing an FBT under the statutory formula of $8,080 whereas, if the kilometres can be raised to 15,000, the FBT will be only $6,215, leading to a saving of $1,865. Since an extra 2,000 km would cost about $320 in petrol and maintenance costs, the incentive would be very strong to make a long trip regardless of the actual need for such travel.

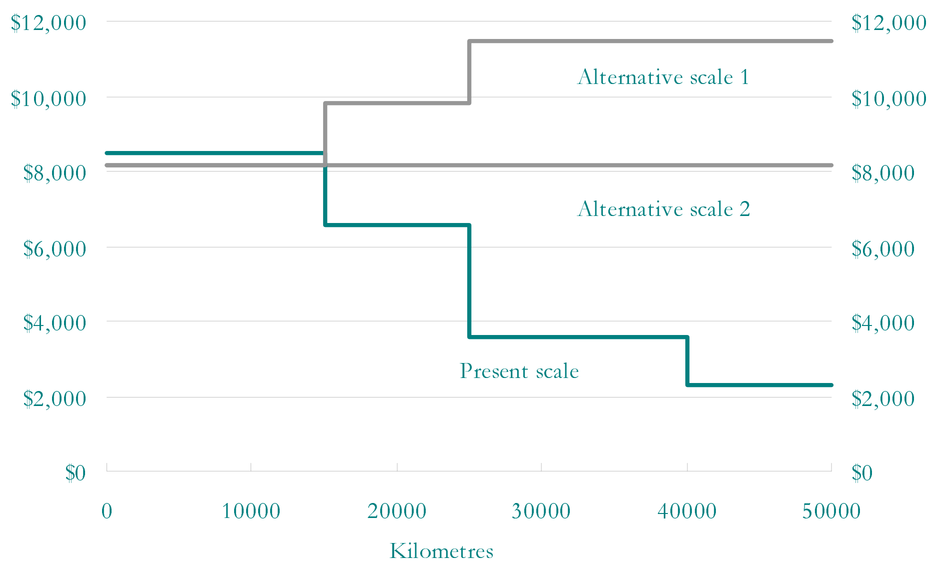
B.10 An alternative to the current scale is to assume that the value of private use also rises (or does not decline) with the increase in total distance travelled in the FBT year. The scales below (Table B.3) reflect that assumption. They provide a reduced level of tax benefit to most purely private car users and avoid any strong incentive to travel more kilometres during any FBT year.

Table B.3: Possible alternative statutory formulas

Distance travelled in year	Present formula percentage of car price %	Scale 1 percentage of car price %	Scale 2 percentage of car price %
0 to 14,999	26	25	25
15,000 to 24,999	20	30	25
25,000 to 39,999	11	35	25
40,000 and up	7	35	25

B.11 The valuation of the private benefit remains within a narrower range as kilometres vary and, for Scale 1, the steps are upward rather than downward (as applies with the present statutory formula). The Scale 1 steps are more even and, because they are upward, there is an incentive at the transition points to limit travel rather than to increase it unnecessarily.

Figure B.2: Valuation of private component of car usage, 'family six', two variations of the present formula



B.12 Table B.4 illustrates the net income benefit available from these two alternatives under the following assumptions:

- the vehicle is wholly used for private purposes;
- the vehicle is driven 15,000 km in the year and is fully maintained; and
- the taxpayer has the option of packaging a fixed total salary. That is, money income is reduced exactly by the cost to the employer (including any FBT) of providing the car.

Table B.4: Net after-tax income change from packaging a 'family six' doing 15,000km p.a.

Taxpayer's marginal rate	Net income advantage (disadvantage) with FBT @ 48.5% still applying to employer			Net income advantage (disadvantage) with benefit taxed in the employee's hands		
	Percentage of car price scale			Percentage of car price scale		
	Present scale	Alternative Scale 1	Alternative Scale 2	Present scale	Alternative Scale 1	Alternative Scale 2
%	$	$	$	$	$	$
18.5	-2,813	-5,323	-4,068	997	392	694
31.5	-461	-2,571	-1,516	1,697	667	1,182
41.5	1,347	-454	447	2,236	879	1,558
48.5	2,613	1,027	1,820	2,613	1,027	1,820

B.13 As can be seen, the benefit in terms of increased after-tax income from either of these scales is less at every marginal tax rate than available from the present statutory formula for a car used entirely for private purposes.

Comparison of the options

B.14 The charts below illustrate the sort of change that would be effected by adoption of the different types of option under consideration. All the charts in this section relate to a 'family six' vehicle driven wholly for private purposes. They plot the amount of after-tax income freed up by obtaining the car through salary sacrifice as part of a salary package compared to not salary sacrificing and obtaining the car privately from take home pay.

B.15 Figure B.3 and Figure B.4 show that to retain the present concessional scale and to make fringe benefits taxable in the hands of the employee, would introduce an incentive for employees on all marginal rates to take a car benefit (as compared with providing the car directly out of after tax salary) while leaving the advantage to the top marginal rate employee unchanged.

Figure B.3: Present formula, benefits taxed by FBT at 48.5%

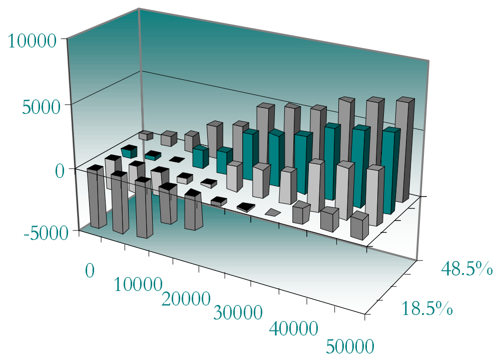
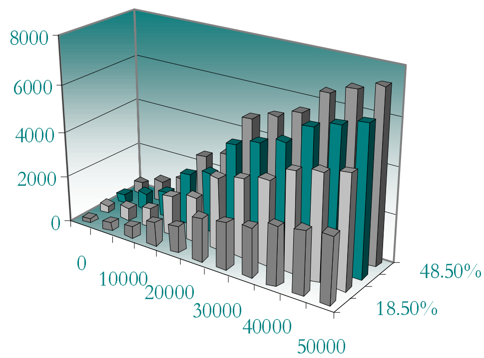


Figure B.4: Present formula, benefits taxed to employee



B.16 Figure B.5 and Figure B.6 illustrate the incidence of the concession available under the 'Scale 1' variation to the existing statutory formula. Figure B.5 shows that low marginal rate employees would be even more deterred from taking a car benefit if the FBT remained, as Scale 1 is less concessional than the present scale and so it offers little offset to the disadvantage suffered by low marginal rate taxpayers when fringe benefits are taxed at the top marginal rate (for example by an FBT). If fringe benefits become taxable in the hands of the employee (Figure B.6), a concession becomes available to all employees. Under Scale 1, the concession, even at its maximum, is less than the typical concession available under the present statutory formula to top marginal rate employees.

Figure B.5: Scale1, benefits taxed by FBT at 48.5%

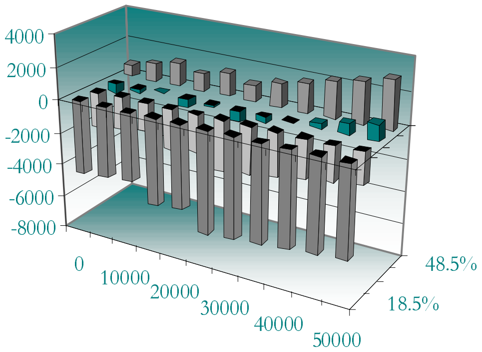
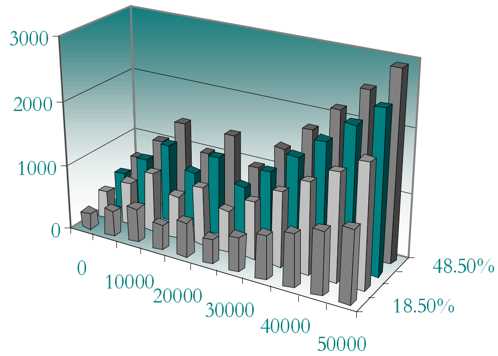


Figure B.6: Scale 1, benefits taxed to employee



B.17 Figure B.7 and Figure B.8 present the incidence of concession under the schedular operating cost approach with a minimum presumed business usage of 20 per cent. They illustrate the smoother relationship to kilometres than either the present scale or 'Scale 1'. The operation of an FBT at the top marginal rate leaves lower marginal rate taxpayers at a sharp disadvantage, while taxing the benefit in the hands of the employee provides some level of concession for the wholly private use vehicle across all marginal rates and all distances travelled. The level of concessionality lies within a fairly narrow range and is modest relative to the present statutory formula.

Figure B.7: Cost scale presuming 20% business use, benefits taxed by FBT at 48.5%

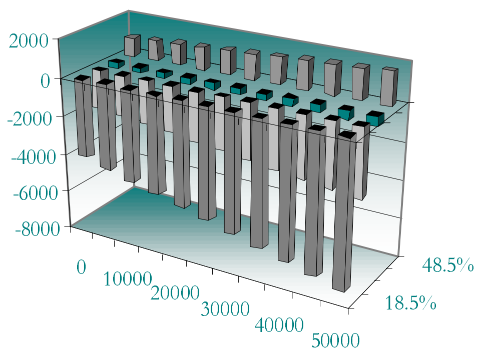
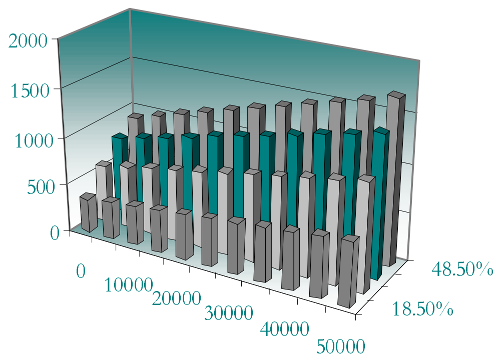


Figure B.8: Cost scale presuming 20% business use, benefits taxed to employee



Appendix C

FBT — some basic information

C.1 The FBT was introduced in 1986 as part of the then government's tax reform package. It sought to apply tax on income being delivered to employees in the form of fringe benefits which was difficult to tax under the then existing income tax law.

C.2 Australia's FBT is said to be almost unique in the world insofar as the tax is applied at a single rate and to the employer rather than the employee. The Australian tax also differs from many overseas methods in the way it defines the scope of fringe benefits covered. It seeks to capture all benefits of a non-salary nature — other than those explicitly excluded. In many overseas regimes, a list of specified benefits are defined as fringe benefits and the remainder are not taxed.

C.3 The Australian FBT effectively applies the top marginal personal tax rate (including Medicare levy) to fringe benefit values. The cost of fringe benefits and FBT itself are both allowed as deductions to the employer. The taxing mechanism involves 'grossing up' of the cost of the benefit and then the application of the top marginal rate to the 'grossed up' amount. The grossing up is necessary to produce equivalence between taxation of fringe benefits under the FBT and the taxation of wages under the income tax.

Table C.1: The 'gross up' calculation

Fringe benefit amount	$100.00
Grossed up by a factor of 1.9417 obtained by the formula 1.9417 = 1/(1-0.485)	$194.17
Tax at 48.5%	$94.17

What are the popular benefits?

C.4 The most widely provided fringe benefits are cars and so-called 'expense payments'. These two categories have dominated FBT collections throughout the 1990s. Under 'expense payments' the employer merely pays an expense of the employee, for example, telephone, gas, electricity, school fees, etc. There need not be any business content in the expense, though sometimes there is. The expense payment effects a reduction in taxable personal income in order to obtain other advantages. The Government's proposed changes to FBT operation (see Appendix A) will largely neutralise the advantages of expense payments relative to money income.

C.5 Cars are by far the most used fringe benefit accounting for around half the FBT payable in 1997-98 (see Table C.2). Most cars are valued using the statutory formula and the average payment per vehicle in 1997-98 was about $2,500 which indicates that most cars are travelling sufficient kilometres to get into one of the lower percentages on the statutory scale applying from 15,000 km per year and above.

Table C.2: FBT collections for 1997-98

Item	$ million	Share — %
Cars		
Statutory formula	1432.9	46.1
Operating cost	94.4	3.0
Total cars	**1527.4**	**49.1**
Loan	107.6	3.5
Expense	780.5	25.1
Housing	124.5	4.0
Property	94.1	3.0
Car parking	95.4	3.1
Meal/entertainment	199.2	6.4
Other	180.0	5.8
Total payable	**3108.7**	**100.0**

Key exemptions and concessions

C.6 Some types of benefit are exempt or attract concessional treatment. Remote area housing is generally subject to a 50 per cent exemption. However, remote area housing used in primary production is fully exempt and this exemption is to be extended to the mining industry under the proposals in *A New Tax System*. Concessional valuations apply to a variety of items, for example, goods or services normally produced by the business and provided to employees are valued at 75 per cent of the lowest market value for such goods and services. By and large, the valuations do not lead to large-scale use (with the exception of car benefits).

C.7 Certain employers are exempt altogether from FBT and others receive a rebate of nearly half their FBT liability. Religious institutions, and public benevolent institutions (including some public hospitals) are the principal beneficiaries of the exemption while the rebate concession is available to a wide range of not-for-profit organisations such as sporting clubs, trade unions, community clubs and certain public hospitals.

C.8 The exemption and rebate have been heavily utilised by such organisations. They can significantly reduce their employment costs by simply paying their employee's bills or providing other fringe benefits rather than paying salary. For example, for an employee facing the 41.5 per cent marginal tax rate, a reduction in salary of $100 a week reduces his or her take home pay by $58.50. If an exempt employer makes up for that by paying $58.50 of the employee's bills the employer has reduced its remuneration costs by $41.50 entirely at the expense of the tax revenue. The FBT reforms announced in *A New Tax System* will limit the use of the exemption and rebates to $17,000 of grossed-up taxable value per employee.

Table C.3: Revenue costs of selected FBT concessions, 1996-97[(a)]

Exemption	Amount ($ million)
Business	
Benefits provided by public hospitals to employees	175
Remote area housing and fuels supplied for housing	40
Commuter travel to employees where employer provides public transport	25
Discounted travel for airline employees and travel agents	70
Meals provided as part of board	20
Total business	**330**
Other	
Benefits provided to employees by public benevolent institutions other than hospitals	150
Benefits provided to employees by religious institutions	160
Rebate for certain not-for-profit organisations	55
Total other	**365**
Total	**695**

(a) Based on the Government's foregoing tax receipts at the 48.5 per cent FBT tax rate.
Note: Revenue cost estimates are calculated relative to a benchmark full application of the FBT. If the revenue cost were calculated against a benchmark of taxing in the hands of employees, they would be less than the figures in this table.
Source: *Tax Expenditure Statement 1996-97* (The Treasury).