# Review of Tax Office's management of complex issues — Case study on living-away-from-home allowances

A report to the Minister for Revenue and Assistant Treasurer

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**Reviewer**

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The Hon Peter Dutton MP
Minister for Revenue and Assistant Treasurer
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Dear Minister

I am pleased to present to you my report on findings and recommendations in respect of the review of the Tax Office's ability to identify and deal with issues concerning living-away-from-home allowances (LAFHAs). This review was announced as one of the three case studies which I would examine pursuant to my review into the Tax Office's ability to identify and deal with major, complex issues within reasonable timeframes. This report has been prepared under section 10 of the *Inspector-General of Taxation Act 2003*.

I have provided the Commissioner of Taxation with the opportunity to respond to the report's findings and recommendations. The Tax Office's response, including the relevant covering letter, is in Appendix 2 to the report.

The Tax Office has acknowledged that the technical and compliance issues arising in this case study took far too long to resolve. The Tax Office has also agreed with the two recommendations in respect of LAFHAs.

This report also signals possible recommendations for more systemic changes arising from this review. As I foreshadowed some time ago, it is my intention that these broader recommendations will, together with others arising from the Research and Development Syndication and Service Entity case studies, be issued as part of my final and overall report on the Tax Office's ability to deal with complex issues within reasonable timeframes. This report will be finalised once the two other case studies which form part of this overall review are completed. The Tax Office has agreed to further dialogue on this and other recommendations. This dialogue will be undertaken as part of the process leading up to the finalisation of the fourth report.

I offer my thanks to the Tax Office staff who were of assistance in this particular review, and for the support of the government bodies, professional bodies, business groups and individuals that contributed to this review. The willingness of many to provide their time in preparing submissions and discussing issues with me and my staff is greatly appreciated.

Yours sincerely

David Vos

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Inspector-General of Taxation

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# CHAPTER 1 — INTRODUCTION

1.1 This is the report on the review conducted by the Inspector-General of Taxation (the 'Inspector-General') into the Tax Office's ability to identify and deal with major, complex issues within reasonable timeframes in respect to arrangements involving the payment of living-away-from-home allowances to foreign nationals, including working-holiday visitors or 'backpackers'. This report is pursuant to section 10 of the *Inspector-General of Taxation Act 2003* (the 'IGT Act').

1.2 On 31 October 2005 the Inspector-General announced terms of reference for this review. The terms of reference followed concerns expressed by tax professionals and certain sectors of the community that the Tax Office takes too long to come to grips with and satisfactorily resolve major, complex issues. They argued that the Tax Office appeared to allow significant periods of time to elapse before an issue is seen to have accumulated enough potential revenue leakage to initiate compliance action. This, they argue, causes significant uncertainty and unnecessary costs.

1.3 The terms of reference were as follows:

- the timeframes to identify and deal with the issue;
- the nature and cause of those timeframes, and if they were reasonable in the circumstances;
- the extent and cause of uncertainty to affected taxpayers, including any initial Tax Office guidance or representations;
- the Tax Office's approaches to the issue, the reasons for them, and if they were reasonable in the circumstances, including:
  - its compliance, legal and resolution approaches, and
  - its communications with members of the community; and
- the adverse impacts and costs that the Tax Office's approaches and timeframes may have had on businesses and other areas of the community.

1.4 The objective of the review was to identify and recommend systemic improvements that would help the Tax Office to manage complex issues better into the future.

1.5 The review was conducted pursuant to subsection 8(1) of the IGT Act, being a review conducted on the initiative of the Inspector-General.

## ACKNOWLEDGEMENTS

1.6 Sincere thanks are extended to the Institute of Chartered Accountants in Australia and the Taxation Institute of Australia who prepared written submissions for this review. The Inspector-General would also like to thank other tax practitioners and lawyers who participated in this review.

1.7 The Inspector-General of Taxation acknowledges the timely cooperation of the Commissioner of Taxation and his staff in this review.

## STRUCTURE OF THE REPORT

1.8 Chapter 2 sets out a background summary and provides contextual information relevant to the Tax Office's role in the administration of the tax system. It also sets out the review conclusions and the Inspector-General's key recommendations for this review.

1.9 Chapter 3 provides a more detailed discussion of the review findings and conclusions.

1.10 Chapter 4 sets out an agreed detailed chronology of the key events and facts in the Tax Office's handling of this issue.

1.11 Appendix 1 examines in more detail the legislative and administrative background to this case study.

# CHAPTER 2 — OVERVIEW

## BACKGROUND

### What is a LAFHA and how is it taxed?

2.1 A living-away-from-home allowance ('LAFHA') is paid to an employee to compensate for additional expenses or disadvantages suffered through the employee having to live away from home in order to perform duties for his or her employer.

2.2 With the move to the fringe benefits tax ('FBT') regime in 1986, the liability for taxation on benefits provided to employees, such as LAFHAs, shifted to the employer. This means that where an allowance satisfies the definition of being a LAFHA benefit, then it is taxable to the employer.

2.3 Under the FBT regime, a LAFHA will be tax-free (exempt) to both employer and employee to the extent that it is for the reasonable cost of additional accommodation and the increased expenditure for food. An employer can effectively give tax-free income to cover additional accommodation and food expenses for extended periods to an employee who claims to have to live away from their usual place of residence to do their job. The employee will not be liable to tax as a LAFHA is not assessable income in the hands of the employee and the employer will not be liable to FBT on the LAFHA to the extent that it qualifies as exempt.

### Brief legislative and administrative history

2.4 A fully documented chronology of the administration and management of LAFHAs between 1992 and 2006 has been agreed with the Tax Office as part of the review and is at Chapter 4. The following is a brief summary of the legislative background and salient points from the chronology.

2.5 The concept of living-away-from-home was first introduced into the tax system in 1945. From around 1945 to 1986 LAFHAs were part of the income tax system. Under former section 51A of the *Income Tax Assessment Act 1936* (ITAA 1936) the amount of any LAFHA was an allowable deduction from the assessable income of an employee taxpayer. The nature of a LAFHA was set out in the Explanatory Note:

> Various wage-fixing authorities have granted away-from-home allowances to employees whose places of employment are located away from their usual places of abode. The allowance is paid to compensate the employee for the additional expenditure he is obliged to incur in providing board and accommodation for himself at his place of employment while, at the same time, maintaining his home elsewhere.

2.6 With the introduction of the *Fringe Benefit Tax Assessment Act 1986* (the 'FBTAA'), the taxation treatment of LAFHAs was moved from the income tax regime to the FBT regime.

2.7 The FBTAA sets out the definition of a LAFHA benefit and the valuation rules for calculating its taxable value. The essential conditions for an allowance to qualify as a LAFHA benefit are set out in section 30 of the FBTAA and are as follows:

1. The payment is an allowance paid by the employer to an employee in respect of the employee's employment; and

2. It would be concluded that the whole or a part of the allowance is in the nature of compensation to the employee for:

   - additional expenses (not being deductible expenses) incurred by the employee during a period; or

   - additional expenses (not being deductible expenses) incurred by the employee, and other additional disadvantages to which the employee is subject, during a period,

by reason that the employee is required to live away from the employee's usual place of residence in order to perform the duties of employment.

2.8 Where an allowance satisfies the definition of being a LAFHA benefit, then it is a fringe benefit. Section 31 of the FBTAA then applies to determine the taxable value of the LAFHA benefit that is taxed in the hands of the employer. A LAFHA benefit is not taxed in the hands of the employee. Where an allowance, or part of an allowance, is not a LAFHA benefit then it will be taxed in the hands of the employee under the income tax laws.

2.9 The taxable value of a LAFHA benefit is often minimal or nil as the value of the LAFHA benefit is reduced by any reasonable amounts paid in compensation for accommodation and for increased expenditure on food.

2.10 The essence of the LAFHA policy, as reported to Parliament in 1995 and still current, appears to be:

> The objective of the existing LAFHA provisions in the Fringe Benefits Tax Assessment Act (FBTAA) is to provide a special tax exemption to cover additional expenses incurred by an employee on accommodation and food, as a result of living away from his or her usual place of residence in order to perform employment duties. The LAFHA provisions are not intended to provide a tax exemption where the employee is not incurring additional expenses on accommodation and food under these circumstances.
>
> … In order to maintain the equity of the tax system and to achieve the objective of the LAFHA provisions, it is necessary to ensure, as far as practicable, that a tax exemption is not available where an employee is not genuinely living away from home or where an employee is not incurring additional accommodation or food expenses as a result of living away from home.

2.11 The Tax Office's Miscellaneous Taxation Ruling MT 2030, which issued on 30 September 1986, sets out the Tax Office's view on LAFHA benefits including references to case law (mostly involving section 51A of the ITAA 1936. It provides guidelines for determining the circumstances in which an allowance is to be treated as a LAFHA.

2.12 Between 1986 and 1995 the Tax Office was concerned by the difficulties faced by tax officers, employers and their professional advisers in interpreting and applying the LAFHA provisions. The Tax Office was particularly concerned with the uncertainty around the term 'usual place of residence' and the need to provide guidance to taxpayers. It also considered that aspects of its advice in MT 2030 were inadequate.

2.13 In 1992, internal Tax Office documents re-capped upon the factors considered by the then Government at the time of moving LAFHAs into the FBT regime. They record that it was noted in 1986 that employees would not have to demonstrate that they actually incurred additional personal expenses through having to maintain two places of abode in order to attract the concessional treatment.

2.14 In 1995, the then Government sought to introduce new conditions that needed to be satisfied before a LAFHA benefit arose as a means to address uncertainty and compliance problems with LAFHAs. The Parliament was advised that many employers found it difficult to apply the guidelines issued by the Tax Office in MT 2030.

2.15 Internal Government papers prepared in the lead up to the proposed 1995 amendments discuss the current position in relation to LAFHAs. It was noted that the current provisions do not require that an employee demonstrate that he or she actually incurred additional personal expenses. It was also noted that foreign employees working in Australia could receive a LAFHA and free accommodation valued in the order of $20,000 to $50,000 a year, effectively free of income tax and FBT. The papers went on to state that the tax treatment of LAFHA was very generous, given that it allowed taxpayers to receive a large part of their remuneration tax-free, even if they incurred no additional costs from living away from home. The papers concluded that the proposed changes, despite increasing compliance costs, would impose a limit to the FBT exemption and be an improvement compared to the current open-ended exemption.

2.16 The proposed provisions sought to clarify whether a person was living-away-from-home by specifying time limits. For example, they provided that a payment would not be a LAFHA where an employee stayed in a location for more than 12 months (employees in remote areas were to have a two year limit and expatriate employees a four year limit). The proposed changes also sought to require both the employer and employee to make declarations.

2.17 The amendments also proposed to redefine the term 'exempt accommodation component' by limiting it to the amount actually incurred by the employee on accommodation. There was also to be an added requirement that the amounts be fully substantiated before the taxable value of a LAFHA could be reduced.

2.18 In late 1995 the then Government announced that it was not proceeding with changes to the LAFHA provisions. This was as a result of the substantial concerns expressed by industry groups about the effect of the proposals and the effect that they might have on business, including increased compliance costs.

2.19 In 1998 the Tax Office commenced enquiries as a result of community information relating to the alleged misuse of LAFHAs by a labour hire organisation within the IT and computer consulting industries. This initial investigative work was focussed on gathering information as to the arrangements in place.

2.20 In 1999 a media report on national television focussed on foreign visitors, predominantly 'backpackers', and alleged that tax was not being paid on income earned in Australia. A dominant theme in the segment was that Australian tax revenue losses were substantial. The media report alleged that foreign visitors, many of them on working holidays in Australia, were taking local jobs and paying virtually no income tax.

2.21 In 1999 the tax officers involved in the enquiries prepared a project plan. One of the risks identified in the project plan was the diversion of personal services income to an Australian based umbrella company that then payed a service provider a salary or wage and a LAFHA. The project plan noted that the Tax Office's risk management systems had identified this issue as a high risk in terms of revenue consequences and the possibility that the practice may become more widespread in the community if the Tax Office failed to act quickly. The Tax Office estimated that there were approximately 10,000 employees receiving a LAFHA but with no entitlement to do so, representing $170 million in revenue forgone each year.

2.22 In the course of the investigations a number of technical issues, including the application of Part IVA, were considered by the Tax Office and a number of proposed taxation determinations and a taxation ruling were considered by the Rulings Panel which led to the release of Draft Taxation Determination TD 2000/D5. The Tax Office also publicly released Taxpayer Alert TA 2002/7. A range of compliance strategies were also developed by the Tax Office, but they were not pursued to finality to resolve the issue. These strategies included running test cases, discussing law changes and, at one point, a proposal to issue up to 6,000 amended assessments to individual taxpayers. In 2001 the Tax Office issued the only two amended assessments arising from the investigations. There was also a meeting held between Tax Office compliance officers, technical officers and the Treasury to discuss how the Tax Office should deal with LAFHAs both generally and in the context of the project.

2.23 In 2002 the responsibility for the design of tax laws and regulations was relocated from the Tax Office to the Department of the Treasury.

2.24 Throughout much of this period the Tax Office was dealing with a number of co-operative taxpayers, representative of the industry, who incurred substantial costs in relation to these dealings.

2.25 The Tax Office's approach during much of the 10-year period to 2005 was characterised by internal debate and disagreement, often at very senior levels, about how the LAFHA provisions apply. This resulted in an ongoing inability to conclude a corporate view of the law as a basis for resolving the issue in a timely way.

2.26 In May 2003, the Tax Office concluded that Pt IVA did not apply to the arrangements under investigation. Despite numerous taxpayer requests, the Tax Office did not withdraw Taxpayer Alert TA 2002/7 until July 2005.

2.27 In 2005, after a meeting between the Second Commissioner Law and the Deputy Commissioner Small Business, the Tax Office adopted the following approach:

- Withdraw Taxpayer Alert TA 2002/7 on the basis that there had been improvements in practices within the industry.

- Institute a compliance program from within the Small Business line to check that improvements within the industry continued.

- Adopt a 'usual place of residence' approach consistent with MT 2030, that is, an 'intention to return' test (an intention to return to the same city or district in their home country) rather than a 'bricks and mortar' approach (an actual residence must exist in their home country).

- In respect to the meaning of the word 'additional', a new taxation determination to clarify that all reasonable expenses are considered to be additional.

- In respect to causation, adopt an approach consistent with MT 2030 which requires direct causation, that is, taking up the job required the travel.

- Set out in a Practice Statement what a reasonable allowance would be and what would be expected in terms of the process that an employer would go through to assess what is a reasonable allowance.

2.28 In July 2005, the Tax Office again discussed its concerns about the operation of the LAFHA provisions with Treasury. The Tax Office considered that difficulties arose with the practical administration of LAFHAs due to the lack of certainty in the use of such terms as 'usual place of residence', 'additional expenses', 'reasonableness' and issues such as the length of time an employee may be entitled to concessional LAFHA treatment. The Tax Office advised that external legal analysis and submissions were not able to be rebutted and that the practices subject to the audit project were acceptable under the current law. The Tax Office indicated that the risks and difficulties identified in 1995 had not abated and may have increased. The Tax Office also advised that the reasons for the proposed 1995 amendments and the acceptance at that time of the administrative difficulties faced by the Tax Office, employers and employees were still present. The Tax Office advised that it would continue to monitor LAFHAs and would, as necessary, inform Treasury of further developments. In the absence of such advice, the Treasury file note stated that Treasury considered the current FBT law as giving effect to government policy.

2.29 The Tax Office has not at any time since 1995 formally approached Treasury or the Government seeking changes to the LAFHA provisions.

2.30 In late 2005, after ongoing discussions with industry members and their representatives, the Tax Office reached an agreed outcome with the taxpayers including the withdrawal of Taxpayer Alert TA 2002/7 and a return to the original view expressed in MT 2030. The Tax Office also announced the withdrawal of Draft Taxation Determination TD 2000/D5 following a letter from the Inspector-General that noted that taxpayers had been seeking its withdrawal for some time since the change in the Tax Office's view.

## Current administration of the LAFHA provisions

2.31 The current administrative outcome and legal position appears to be that anyone, including backpackers, who claims to be living away from their usual place of residence can, as part of their remuneration agreement with their employer, receive tax-free remuneration to cover their accommodation and food expenses for extended periods. In simple terms, some employees including overseas visitors to Australia who find employment after they arrive, can effectively salary sacrifice for normal living expenses if their employer agrees.

2.32 The following example of a case that the Tax Office has recently allowed shows how it currently administers LAFHAs:

> The taxpayer came to Australia on a working holiday visa in 1998. After 12 months he decided to extend his stay. He obtained sponsorship, found a job and over three years received a substantial part (31 per cent) of his remuneration as a tax exempt LAFHA on the basis that he was living away from home in order to undertake employment duties and was incurring additional expenses. The Tax Office sought to amend his assessable income to include the LAFHA, but subsequently allowed the taxpayer's objection in late 2005 on the basis that the circumstances met the requirements of MT 2030. From a total income over the three years of $170,169 the taxpayer received over $52,000 tax-free.

2.33 From the taxpayers perspective the current situation is that the Tax Office has accepted that the practices it was previously concerned about are permissible under the law. However, this has come after significant time delays and costs.

2.34 The Tax Office has advised that the issues arising in this case study only relate to situations involving foreign nationals and that it was undertaking targeted compliance activity. It considers by implication that its administration of LAFHAs in the domestic setting has been adequate. The Inspector-General notes that the key issues, principles and laws relating to these arrangements are equally relevant to all other employers, including those employing Australian employees. These include the meaning of the key legal terms 'usual place of residence', 'additional costs' and 'required to live away'. The Inspector-General also notes that the Tax Office has done very little, if any, field work as a basis for its view.

## Principles of good tax administration and issue resolution

2.35 In a self assessment system, audit investigations are a necessary element in ensuring that taxpayers fully and accurately comply with the taxation laws. The Tax Office has a responsibility to undertake help and enforcement activities both to influence taxpayer behaviour towards voluntary compliance and to address non-compliance. It must assure the community that there is an acceptable level of compliance with the taxation laws.

2.36 However, taxpayers selected for audit investigations also bear the compliance cost associated with achieving these outcomes. They also have other regulatory and commercial imperatives that can be affected by prolonged periods of uncertainty in their tax affairs. It is therefore important that the Tax Office's conduct and approaches to audit investigations minimise excessive delays to taxpayers, particularly where issues are novel, complex or the law is uncertain.

2.37 Where the Tax Office encounters such issues, then principles of good tax administration require, amongst others:

- timely identification of issues;
- timely resolution of issues including an early objective view of how the law applies, and approaches and processes that are objective, fair and transparent;
- timely communication of issues to taxpayers;
- provision of objective guidance to the community on technical and administrative issues — how to comply — at the earliest possible time; and

- recognition that, if resolution and guidance are not provided within a reasonable timeframe, the area of the law is by definition difficult and that this should be reflected in the compliance strategies.

## Protocol between the Tax Office and Treasury

2.38 Under the current arrangements, there are a number of different agencies involved in the development and administration of the tax laws. The Treasury has the primary responsibility for advising Government on tax policy and designing the tax laws, with Government having ultimate responsibility for determining tax policy. The Office of Parliamentary Counsel is responsible for drafting the law, with the Treasury responsible for instructing legislative drafters and for the production of explanatory materials. A bill becomes an Act — a law — only after it has been passed by Parliament and receives Royal Assent. The Commissioner of Taxation is then responsible for the administration of the taxation laws. This includes the requirement that the Tax Office provides, subject to the guidance of the Courts, the official interpretation of the enacted law.

2.39 Despite the distinct roles of each agency, there is a protocol in place for the Treasury and the Tax Office to work cooperatively to ensure that the administrative, compliance and interpretative experience of the Tax Office fully contributes to policy and legislation development processes. This protocol is set out in Practice Statement PS CM 2003/14.

2.40 The protocol that has been in place since 2003 enables the Tax Office to provide formal advice where it identifies significant issues that need to be drawn to the attention of the Treasury or Government, such as where the Tax Office identifies problems in the operation of the tax system like anomalies or unintended consequences in the legislation. The protocol also states that where the Tax Office seeks to make a specific recommendation to change a policy approach or law design, it is highly desirable that the Tax Office advice is comprehensive. This requires the Tax Office to provide a full assessment of all the impacts and this advice is required to be expressed in the form of an Administrative Impact Statement. Such a statement should include the Tax Office's understanding of client impacts, revenue impacts and the administrative impacts, including such things as questions of interpretation, compliance and operational issues. The Practice Statement states that the Tax Office advice should be in the form of a recommendation with a full assessment of all the administrative impacts should the recommendation not be acted upon.

2.41 If the Tax Office is not satisfied that Treasury has adequately dealt with issues raised in formal advice, existing processes provide for the matter to be escalated to the Tax Policy Coordination Committee — a regular meeting of senior officials from the Tax Office and Treasury. Notwithstanding these processes, the Tax Office can, at any time, raise issues directly with the Government.

2.42 In relation to pre-existing (that is, enacted) law, the protocol states that the enacted law itself is ultimately the statement of intent of the Parliament, and that the Tax Office has the exclusive role of determining the official interpretation of the law. In these cases, Treasury does not provide statements of policy intent, but, where matters are uncertain, may engage in dialogue with the Tax Office in terms of the implications of its view in interpreting and administering the law.

## Purposive approach in the interpretation of the law

2.43 The Tax Office is also obliged to adopt a purposive approach in the interpretation of the tax laws and has stated that it does. Such an approach requires that the interpretation

delivers the intention of the law even where alternative interpretations are possible. A purposive approach therefore requires that the underlying purpose or object of the provision and policy intention are clear and discoverable through the words of the Act, legitimate extrinsic materials and relevant case law.

2.44 The Tax Office also has access to information that is not available publicly as extrinsic references including background material to the design and creation of tax laws, and access to Treasury advice. These sources can also legitimately assist the Tax Office in concluding a purposive interpretation.

2.45 If extrinsic materials and other information legitimately available to the Tax Office for a purposive approach do not adequately clarify the purpose or intent, then the Tax Office may face difficulties in settling its view internally and also be unable to defend its interpretations when faced with challenges by taxpayers and their advisers with alternative interpretations available on the words. It also follows that taxpayers will be adversely impacted, through ongoing uncertainty and costs where the Tax Office struggles over a long period of time to deal with a perceived compliance risk in an environment of ambiguous or uncertain law.

2.46 There are, however, a number of courses open to the Tax Office in these circumstances including running test cases and formally seeking legislative changes through the Treasury or, if necessary, by raising the matter directly with the Government.

## Risk management approaches

2.47 The Tax Office is not resourced to chase every last dollar payable under the law nor is it able to review every last transaction or event that may have tax consequences. Rather, the Tax Office has to adopt a risk management approach to compliance that involves making informed risk based assessments about the allocation of its resources to optimise compliance with the tax laws.

2.48 The Tax Office adopts an end-to-end process for risk management based on a conceptual model that encompasses the complete cycle of risk management from identification to treatment and review.

2.49 The end-to-end process involves the following deliverables:

- identification of risks through intelligence capture and analysis;
- analysis of the issues arising and risk assessment of those issues;
- early warning to the community and stakeholders as appropriate;
- development of the Tax Office view on the substantive tax issues involved in the scheme or arrangement;
- implementation of strategies to treat the risks to the revenue and to the integrity of the system; and
- review to improve procedures and treatments.

2.50 Such an approach means that the level of scrutiny of taxpayers' affairs depends on their level of non-compliance with the law. Where the Tax Office identifies a serious or widespread risk, then it will increase and intensify its scrutiny.

2.51 The Inspector-General considers that before determining the level of risk and non-compliance with the law the Tax Office must be able to arrive at the following:

- an objective view of taxpayer conduct, including behaviour, arrangements, facts and contemporary commercial circumstances;
- an objective view of the law; and
- an objective view of what outcomes the law should be achieving.

2.52 After having objectively analysed the risk, the Inspector-General considers that the Tax Office must seek to objectively implement the Tax Office view. This should involve establishing and communicating a treatment strategy appropriate to the confirmed risk. That strategy may involve a set of actions, which can include making determinations under Part IVA, litigating the substantive issues about the legal efficacy of the arrangement, audits or where there is uncertainty in the law running test cases or negotiating individual or widely-based settlements. In implementing a treatment strategy it is important that the Tax Office actions are consistent with the taxpayer's behaviour and risks, and the Tax Office's own past actions (or lack of action).

## Current Tax Office practices

2.53 Over the past few years the Tax Office has introduced a number of initiatives to improve the quality and timeliness of its review, audit programs and decision-making processes relevant to managing significant issues. These include:

- The establishment of a framework for risk and issues management, as set out in Practice Statement PS CM 2003/02.
- The better management of priority technical issues through the procedures set out in Practice Statement PS LA 2003/10.
- The introduction of case leadership roles for the large business and small to medium enterprise segments.
- The implementation of the priority private binding ruling process, as set out in Practice Statement PS LA 2005/10.
- New Practice Statement PS LA 2005/24 that provides instruction and practical guidance to tax officers on the application of Part IVA and provides an opportunity for a taxpayer (and/or a representative of the taxpayer at the taxpayer's election) to attend a Part IVA Panel meeting and address the Panel.

## REVIEW CONCLUSIONS

1. The Tax Office had reason to be concerned about the potential revenue impacts where there was evidence of potentially excessive LAFHA payments as identified in the 1999 media reports. It had to investigate them.

2. The Tax Office takes a risk management approach to its compliance activities. Inherent in this approach is that some identified risks may not be addressed until their relative significance (in terms of either revenue or risks to the system or a combination of factors) rises above other priorities. This is inevitable, but could be the reason behind perceptions that the Tax Office appeared to allow significant periods of time to elapse before an issue is seen to have accumulated enough potential revenue leakage to initiate compliance action.

3. The Tax Office took far too long to resolve the technical and compliance issues arising from this project and has acknowledged that. Resolving the technical issues and establishing a corporate technical view were on the critical path of developing an effective resolution strategy. The Inspector-General concludes that the time frames for resolving the technical and compliance issues arising from this project were excessive and not reasonable in the circumstances.

4. The Tax Office had adequate extrinsic and other information for it to decide within a reasonable timeframe a technical view that would have been a sound basis for moving forward to resolution.

5. The Inspector-General concludes that the following factors contributed to the excessive timeframes in resolving the technical and compliance issues:

    a. An inability to conclude in a timely manner a corporate position on how the law should apply.

    b. Prolonged internal differences of opinion on the legal position and compliance strategies, sometimes at very senior levels.

    c. Objective interpretation of the law clouded by attempts to deliver particular enforcement strategies. There appeared to be a great reluctance by the Tax Office to objectively appraise the strengths of taxpayers' technical position due to the underlying belief that foreign nationals on working-holiday maker visas should not be entitled to a LAFHA.

    d. Lengthy, delaying diversions to consider the potential application of Part IVA as a silver bullet compliance strategy. This process was eventually abandoned when it was realised that the primary tax laws (income tax and FBT) provided an adequate framework for compliance (provided an interpretation could be arrived at).

    e. On again-off again test case strategies that were eventually all abandoned (at the cost of more timely and objective resolution).

    f. Plans to pursue one-size-fits-all, anti-avoidance enforcement action against a large number of working-holiday visa employees based on a view of the law that the Tax Office subsequently withdrew and on very little casework that examined the individual circumstances of those taxpayers receiving LAFHAs.

g. There was no single senior tax officer that had overall ownership of the technical and compliance issues until late in the dispute. Once a senior tax officer was allocated to the dispute with overarching ownership of the resolution of the dispute this provided a central focal point for internal discussion, a more co-ordinated approach by the Tax Office and a senior contact point for the taxpayers and their representatives. These aspects helped improve the relationship between the taxpayers and the Tax Office and progress the dispute towards resolution.

6. The Tax Office continues to believe that there are compliance and administrative difficulties with LAFHAs. For example, in discussions with the Treasury the Tax Office again expressed its concern with the ongoing administrative difficulties faced by the Tax Office, employers and employees. It also stated that the risks and difficulties associated with the LAFHA provisions had not abated since 1995 and may have increased.

7. Issues such as LAFHA may have broader implications that may increase complexity from a Tax Office viewpoint. The need to be cognisant of the potential compliance burdens on employers and the possible impact that the Tax Office's interpretation of these provisions could have had on the movement of employees both into and out of Australia are examples. However these considerations should not colour the process of reaching an objective, purposive interpretation of the law.

8. The Tax Office is charged with the administration of the tax system, which includes interpreting and applying the law. In most instances the Tax Office fulfils its interpretive obligations in a timely way; but there is a need for a circuit breaker process or intervention when reasonable timeframes have been exceeded. This is especially relevant when faced with issues that are complex, novel or where there is some uncertainty in the law.

9. Effective administration requires the timely interpretation of the tax laws and decision-making so as to provide taxpayers with sufficient certainty on the application of the law and allow for disputes to be resolved or, if necessary, progressed to the tribunal and courts. Excessive delays in reaching a corporate technical position erode community confidence in the tax system and fuel perceptions of unfairness.

10. Between 1999 and 2004 the Tax Office adopted at least five different strategies, including the mass application of Part IVA, test case litigation, a re-write of MT 2030 and the release of further taxation rulings and determinations. The Tax Office never pursued a particular strategy to finality because of its inability to conclude and maintain a corporate position on how the law should apply. The audit project team appropriately escalated technical issues, but these took far too long to be resolved. Ultimately, the Tax Office sought to work with particular industry groups to develop self-regulatory guidelines.

11. Taxpayers involved in the Tax Office's compliance processes incurred higher than necessary costs as a result of the Tax Office's protracted and prolonged timeframes.

12. The Tax Office's actions in managing this issue, as set in the chronology in Chapter 4, support taxpayer concerns including:

- That the Tax Office's position has been driven by its view of what the policy should be regarding the payment of LAFHA and its efforts have been largely directed to finding ways that the law can be applied to support that policy.

- That if the law supported the Tax Office's attack, then the issue would not have been outstanding and debated for 7 years at a great cost to the taxpayers involved.

- That part of the Tax Office delay may be attributed to it seeking to address arrangements it did not like where the law did not adequately support the Tax Office view of who should be entitled to a LAFHA.

13. There were also instances where the taxpayers were treated unfairly, not only through the excessive timeframes in resolving the dispute, but also in the Tax Office's handling of various aspects of the disputes, contrary to the Tax Office's stated values. This included:

    - Despite numerous taxpayer requests, the Tax Office refused to withdraw Taxpayer Alert TA 2002/7 even though its view on the application of Part IVA had changed.

    - The Tax Office refusing to acknowledge that the taxpayers were under audit even though internally it had decided to seek legal advice on a number of issues arising from the audit project, issue Part IVA determinations and issue amended assessments to individual taxpayers.

    - Seeking to limit the disclosure of information to taxpayers regarding its approaches.

    - An absence of a sense of urgency on the Tax Office's part to resolve its technical view despite ongoing taxpayers requests to work with the Tax Office to resolve the dispute.

14. The Inspector-General found that the file management by the audit project team was good with detailed file notes and all relevant documents kept chronologically on file.

15. In recent years the Tax Office has improved its processes for identifying and resolving issues that are complex, novel or where there is some uncertainty in the law. One example is the Tax Office's initiative in allowing taxpayers to attend Panel meetings which the Inspector-General believes promotes openness and transparency in the tax system. The Tax Office has also introduced a number of recent processes and procedures, such as the management of priority technical issues and the introduction of case leadership roles for the large business and small to medium enterprise segments. These are positive steps forward in improving the quality and management of active compliance activities. However these processes could be strengthened, by introducing appropriate circuit breakers, to further reduce the likelihood that significant issues such as LAFHA will take too long to resolve.

16. Where you have a dispute unresolved for a period of seven years with no clear guidance from the Tax Office as to their technical view and compliance approach, especially where you have ongoing changes in approach and strategy, then there will obviously be uncertainty amongst taxpayers. The Tax Office did make some attempts to provide further guidance, but these were met with significant external criticism, with many believing that the Tax Office was going beyond what was stated by the law.

17. The Tax Office has recently sought to provide greater guidance to taxpayers including the development of industry guidelines and the additions to the FBT Employers Guidebook. These provide a good starting point for broader community guidance on the Tax Office's view, in particular, the practical application of that view.

18. To date MT 2030 continues to represent the Tax Office's view on LAFHAs despite its numerous identified shortcomings in providing clear guidance to taxpayers. Taxpayers and stakeholders have also expressed concern at the adequacy of MT 2030 in providing community-wide guidance on the Tax Office's view on the interpretation, administration and practical application of the LAFHA provisions.

## RECOMMENDATIONS

2.54 The following key recommendations seek to ensure that the Tax Office provides greater certainty to taxpayers on the key technical issues relating to its administration of the LAFHA provisions.

### KEY RECOMMENDATION 1

*The Commissioner of Taxation should conclude a corporate view on whether the Tax Office should formally advise the Treasury, in accordance with Practice Statement CM 2003/14, that legislative change is required or not.*

### KEY RECOMMENDATION 2

*In the absence of the Tax Office providing such formal advice to Treasury or any legislative change, then the Tax Office should issue a new public ruling to replace Miscellaneous Taxation Ruling MT 2030. The new public ruling should provide community-wide guidance and certainty on the Tax Office's interpretation, administration and practical application of the LAFHA provisions, and should include clarification of the key technical issues arising from this review such as:*

- *usual place of residence;*
- *meaning of the term 'additional';*
- *factors the Tax Office would take into consideration in determining what was 'reasonable' for the purposes of a LAFHA including guidance on methods which would be acceptable to the Tax Office;*
- *causation between employment and entitlement to receive a LAFHA, in particular, whether there is a requirement for a pre-existing employee/employer relationship for a LAFHA entitlement.*

2.55 Guidance on the key technical issues raised during this case study will also ensure a clear, established Tax Office view being available to all taxpayers and minimise prolonged timeframes in resolving such disputes should they re-emerge in the future.

2.56 This report also signals possible recommendations for more systemic changes arising from this review. These broader recommendations will, together with others arising from the Research and Development and Service Entity case studies, be issued as part of the fourth report foreshadowed by the Inspector-General. These possible recommendations seek to minimise excessive delays in the resolution of complex technical and compliance issues through:

- Improving the development of technical, compliance and resolution strategies by:
  - Setting reasonable time limits for the Tax Office to resolve its view of how the law applies in respect of priority technical issues and other issues requiring precedential views.
  - Introducing appropriate circuit-breakers in the pre-existing processes and procedures where they are not leading to the timely resolution of technical issues. For example, with priority technical issues this may include the escalation of the issue to the Priority Technical Issue Committee so as to form the Tax Office view after a reasonable time has elapsed.
- Improving taxpayer access to senior technical management and key decision-makers by:
  - Providing formal avenues for escalation, review or comment of the Tax Office's resolution strategies where they are not leading to timely resolution of a dispute. This could include the escalation of cases involving priority technical issues to case leaders after a reasonable time has elapsed and taxpayers having mandatory rights of representation to these case leaders.
- Improving its communication with members of the community by:
  - Revising its publications, such as its Taxpayers Charter booklet dealing with audit, to clearly set out when a taxpayer is under audit.
  - Ensuring that taxpayers have access to all the relevant information before the Part IVA Panel and not just of that contained in the position paper.
  - Making publicly available, in an edited format, the PTI Register including the topic, its date of inclusion of the PTI Register and the due date for completion of the technical view.
  - Developing and applying a set of guidelines as to the form, content and purpose of a position paper.
  - Ensuring that the Tax Office promptly withdraws taxation rulings, taxation determinations or other interpretative decisions where it has changed or is uncertain with its view.

# CHAPTER 3 — REVIEW FINDINGS AND CONCLUSIONS

## BACKGROUND

3.1 The review examined the Tax Office's ability to identify and deal with major, complex issues within reasonable timeframes in respect to arrangements involving the payment of living-away-from-home allowances to foreign nationals, including working-holiday visitors or 'backpackers'.

3.2 The review sought to assess the following themes in relation to the Tax Office's ability to identify and deal with major, complex issues:

- The timely identification of issues.
- The timely resolution of issues including a treatment attitude, approach and processes are objective, fair and transparent.
- The timely communication of issues to taxpayers.
- The provision of timely and objective guidance to the community including an appropriate responsiveness to providing certainty on technical and administrative issues at the earliest point in time as possible.

## TIMELY IDENTIFICATION OF TECHNICAL AND COMPLIANCE ISSUES

### The timeframes to identify the issue

#### Stakeholder concerns

3.3 The Institute of Chartered Accountants in Australia (ICAA) submitted that the salary sacrificing LAFHAs is not a new issue and has been a relatively standard practice since FBT was first introduced in 1986. In addition, the practice of salary sacrificing LAFHAs in the labour hire industry is also not new and has also been in existence for many years.

3.4 The ICAA submitted that it appeared that the Tax Office initially expressed some interest in this particular topic in late 1998 and that arguably therefore, it may have taken the Tax Office 12 years to 'identify the issue'.

3.5 The ICAA indicated that it was their understanding that the issue has now been clarified, and as it was first identified in 1998, it has taken seven years for the matter to be concluded.

#### Review Findings and Conclusions

3.6 An examination of the audit case files confirmed that the Tax Office initiated its review activity in August 1999 with the establishment of an audit project team. This was as a result of the risks identified in a project plan prepared by the Small Business line in April 1999. The Inspector-General also notes the earlier concerns expressed by the Tax Office, going back to the proposed 1995 amendments, that tax officers, employers and their

professional advisers were facing numerous challenges when interpreting the LAFHA provisions.

3.7 The Inspector-General found no evidence that the Tax Office allowed significant periods of time to elapse before the issue was seen to have accumulated enough potential revenue leakage to initiate compliance action.

3.8 From early on in the project the Tax Office sought to identify the relevant technical and compliance issues. For example, it adopted a project plan which set out the key objectives for the project and the issues for resolution. There was also the early involvement of the Tax Counsel Network and the FBT Specialist Cell with the aim of developing the Tax Office view on the key technical issues. There was an ongoing involvement of various technical areas within the Tax Office throughout the project providing technical input to the project team. The project team, together with the Tax Counsel Network, and consistent with Tax Office procedures, also sought to refer a number of technical issues, including the application of the general anti-avoidance provisions, to the Part IVA Panel and the Public Rulings Panel.

## TIMELY RESOLUTION OF TECHNICAL AND COMPLIANCE ISSUES

## The timeframes to deal with the issue

### The nature and cause of those timeframes, and if they were reasonable in the circumstances

#### Stakeholder concerns

3.9 The ICAA was of the view that the question of salary sacrificing LAFHA is not a complex one and that seven years is not a reasonable timeframe within which to deal with the matter. It submitted that whilst the Tax Office needs to satisfy itself that the positions that have been taken within the industry are reasonable, the matter could have been concluded in a much shorter time frame. The ICAA comments that the dominant reasons for the delay in concluding the matter revolve around the Tax Office's apparent unwillingness to act quickly where the correct interpretation of the law gives rise to a favourable position for taxpayers.

### Review Findings and Conclusions

3.10 In 1998, following media reports of alleged misuse of LAFHAs by a labour hire organisation, the Tax Office commenced investigations into these arrangements. Of particular concern to the Tax Office was the taxation treatment of LAFHAs paid to foreign nationals working in Australia. In the course of the investigations a number of technical issues, including the application of Part IVA, were considered by the Tax Office and a number of proposed taxation determinations and a taxation ruling were considered by the Rulings Panel which led to the release of Draft Taxation Determination TD 2000/D5. The Tax Office also publicly released Taxpayer Alert TA 2002/7. The Tax Office only issued two amended assessments arising from these investigations.

3.11 In late 2005, after ongoing discussions with industry members and their representatives the Tax Office reached an agreed outcome including the withdrawal of Taxpayer Alert TA 2002/7 and a return to the view expressed in Miscellaneous Taxation Ruling MT 2030.

3.12 To date, the Tax Office has discontinued retrospective amendment action and is seeking to develop self-regulatory guidelines with particular industry members.

3.13 The Tax Office has acknowledged that it took far too long to resolve the technical and compliance issues arising from this project. The Inspector-General found that the resolution of the technical issues and the establishment of a corporate technical view were on the critical path of developing an effective mitigation strategy. Given this, the Inspector-General believes that the time frames for resolving the technical and compliance issues arising from this project were excessive and not reasonable in the circumstances. The Inspector-General believes that the following factors contributed to the excessive timeframes in resolving the technical and compliance issues:

- An inability to conclude in a timely manner a corporate position on how the law should apply.
- Prolonged internal differences of opinion on the legal position and compliance strategies, sometimes at very senior levels.
- Objective interpretation of the law clouded by attempts to deliver particular enforcement strategies — for example, there appeared to be a great reluctance by the Tax Office to acknowledge the strengths of the taxpayers technical position due to the underlying belief that foreign nationals on working-holiday maker visas should not be entitled to a LAFHA.
- Lengthy, delaying diversions to consider the potential application of Part IVA as a silver bullet compliance strategy. This process was eventually abandoned when it was realised that the primary tax laws (income tax and FBT) provided an adequate framework for compliance (provided an interpretation could be arrived at).
- On again-off again test case strategies that were eventually all abandoned (at the cost of more timely and objective resolution).
- Plans to pursue one-size-fits-all, anti-avoidance enforcement action against a large number of working holiday visa employees based on a view of the law that the Tax Office subsequently withdrew and on very little casework that examined the individual circumstances of those taxpayers receiving LAFHAs.

3.14 The following are examples of how these factors contributed to the excessive timeframes in this project:

### Time taken to prepare and release position paper

- The Tax Office released a draft position paper in September 1999 to the taxpayer entities examined as part of the project. The taxpayers' representatives were critical of the draft position paper and it was subsequently withdrawn in October 1999.
- The Tax Office released a further position paper in November 2002, where it expressed the view that the amounts said to be LAFHA benefits did not satisfy the criteria in section 30 of the FBTAA and, alternatively, the Commissioner contended that the general anti-avoidance provisions of Part IVA of the ITAA 1936 would apply. Following external criticism of the position paper by the taxpayer entities and their representatives the Tax Office withdrew its position paper in May 2003.

- Throughout this period a number of persons, both internal tax officers and external taxpayers and their representatives, expressed some concern about the delay in finalising the Tax Office view and the position paper.

### Time taken to have issues considered by Part IVA Panel and Public Rulings Panel

- In October/November 1999 the Tax Counsel Network advised that the argument for Part IVA was not strong enough to take before the Part IVA Panel.

- In December 2000 the Tax Office received counsel's advice on the application of Part IVA on a number of arrangements. The advice indicated that there was a strong argument for the application of Part IVA in the arrangements set out in the brief to counsel. The Tax Counsel Network decided that Part IVA applied to the factual circumstances and that a submission should be prepared for the Part IVA Panel.

- The Part IVA issue first went to Part IVA Panel in September 2001, nearly two years after commencement of the project. The Part IVA Panel examined the arrangement set out in the submission and indicated that there was a strong argument for the application of Part IVA and requested the audit project team to put forward a further submission. The taxpayers were not provided with an opportunity to comment on the submission put to the Part IVA Panel.

- The Part IVA issue went back to the Part IVA Panel in July 2002, nearly one year after the 1st Part IVA Panel meeting. The Part IVA Panel again considered the audit project team's submission that set out a number of factual scenarios for three different categories of arrangements. The Part IVA Panel concluded that Part IVA would apply in two of the arrangements. The Part IVA Panel requested that the audit project team process assessments and Part IVA determinations, complete the rewrite of MT 2030 and draft a Taxpayer Alert directed primarily at the individuals and not the promoter companies. The taxpayers were not provided with an opportunity to comment on the submission put to the Part IVA Panel.

- In September 2002 the Tax Office released Taxpayer Alert TA 2002/7, which was met with external criticism for the lack of consultation prior to its release and its inaccurate characterisation of the majority of the arrangements. The Taxpayer Alert described employment relationships that involved a labour hire firm, a special purpose company and a foreign national employed in Australia. It also expressed the Tax Office view that these arrangements attempted to re-characterise a substantial amount of the foreign national's Australian sourced salary as a tax free LAFHAs. The Taxpayer Alert outlined the taxation issues that arose from the features of the arrangements including whether the amounts described as LAFHA payments received by the foreign national employee were exempt and the application of the general anti-avoidance provisions of Part IVA.

- The third Part IVA Panel meeting was held in April 2003. The taxpayers and their representatives were allowed to put forward a submission on the application of Part IVA. The Part IVA Panel concluded that there was no need to apply Part IVA to include amounts in assessable income. The Part IVA Panel also set out a forward resolution strategy noting that although there was some concern with the compliance and administrative burdens of examining each taxpayer on a case by case basis, this was the outcome according to the law.

- The redraft of MT 2030 was first considered by the Public Rulings Panel in February 2003. It was reconsidered by Public Rulings Panel in May 2003 and again in November 2004.

3.15 The Inspector-General believes that the consideration and application of Part IVA is a serious matter, with potential adverse consequences for taxpayers both in terms of administrative penalties and reputation. The Inspector-General considers that, as demonstrated in this case study, the propensity for the Tax Office to consider the application of Part IVA so as to deliver leveraged approaches to compliance, especially where there is a potentially wide group of taxpayers involved, can contribute to significant delays.

3.16 The Inspector-General notes that the Tax Office has a number of processes and procedures regarding the application of Part IVA, some of which are quite recent, including:

- A new Practice Statement PS LA 2005/24 that provides instruction and practical guidance to tax officers on the application of Part IVA. Recent changes include the opportunity for a taxpayer (and/or a representative of the taxpayer at the taxpayer's election) to attend a Panel meeting and address the Panel.

- The referral of the proposal to apply Part IVA to the Tax Counsel Network for consideration and approval.

- The referral of Part IVA applications to the General Anti-Avoidance Rules Panel.

3.17 The Inspector-General notes the role of the Panel in assisting the Tax Office in its administration of Part IVA by providing independent advice. The Panel does not investigate or find facts, or arbitrate disputed contentions. The Panel provides its advice on the basis of the contentions of fact which have been put forward by tax officers and by the taxpayer.

3.18 The Tax Office's Practice Statement states that a taxpayer invited to attend the Panel meeting will, by a reasonable time prior to the meeting, be informed of the contentions of fact giving rise to the issue referred to the Panel, and of the substance of the Tax Office's proposed approach to the application of Part IVA. The Practice Statement indicates that generally, this advice will be by way of reference to a position paper already provided to the taxpayer or by an updated paper prepared following consideration of a response by the taxpayer to the position paper. However, matters brought to the Panel by tax officers must be supported by a submission signed off by the relevant Tax Counsel Network officer. The submission must set out:

- the relevant facts;

- the operation of the relevant tax law, other than general anti-avoidance regime;

- the operation of any relevant non-tax law;

- the scheme or arrangement as identified by the Tax Office;

- the relevant counterfactuals;

- the tax benefits and the taxpayers as identified by the Tax Office; and

- the weighing each of the factors in applying the applicable purpose test.

3.19 The Inspector-General welcomes the Tax Office's recent initiative in allowing taxpayers to attend Panel meetings and believes this represents a positive step forward in promoting openness and transparency in the tax system. The Inspector-General also notes the positive results achieved by the taxpayers and their representatives in this case study after being permitted to put a written submission to the Part IVA Panel.

3.20 The Inspector-General believes that to ensure that taxpayers may effectively assist the deliberative process of the Panel in providing advice to the decision-maker, they must have access to all relevant information before the Panel which may not be included in the position paper. This would include information that goes to the facts of the scheme or arrangement and the conclusions or inferences to be drawn from the facts.

### Time taken for decisions concerning the Tax Office's technical view and compliance approach

3.21 The Inspector-General found that the Tax Office struggled over many years to interpret and administer the LAFHA provisions. There were ongoing discussions, which included prolonged internal differences of opinion on the legal position and compliance strategies, sometimes at very senior levels at times. For example:

- In May 2003 the then Second Commissioner Law indicated that in interpreting the meaning of the term 'additional' there was no presumption that additional expenses would be incurred simply because an individual was required to relocate. The view was also taken that ideally this amount should be attributable to the net difference between the cost of living at their former place of residence and the cost of living in the locality to which they have temporarily moved.

- In December 2003 the then Commissioner of Taxation expressed the view that the exempt accommodation component was to be read as an allowance paid to compensate for the full amount of rent likely to be incurred (that is, the gross approach should be adopted instead of the net approach) and that rent saved at the usual place of residence was not to be taken into account.

- External legal opinion obtained by the Tax Office in 2004 was also equivocal on this point but appeared to suggest an alternative position on the meaning that should be attributed to the term 'additional'.

- It was not until April 2005 that the current corporate decision was made on how to finalise the technical and compliance issues relating to the meaning of the term 'additional' arising from this project.

3.22 In this context, it may be that views about the term 'additional' have been influenced by attempts to achieve administrative alignment between section 21 (which deals with exempt expense payments for accommodation) and section 31 (LAFHAs). To be exempt from FBT, reimbursement or expense payments under section 21 do not require costs to be 'reasonable' or 'additional' whereas exemption under section 31 includes such requirements.

## The Tax Office's approaches to the issue, the reasons for them, and if they were reasonable in the circumstances, including its compliance, legal and resolution approaches

### The adverse impacts and costs that the Tax Office's approaches and timeframes may have had on businesses and other areas of the community

#### Stakeholder concerns

3.23 The ICAA submitted that feedback received from members suggested that the Tax Office's approach to the issue had been one-sided, failing to recognise the strength of the taxpayers' position despite being reasonable in the circumstances.

3.24 The ICAA was of the view that the Tax Office's unwillingness to accept merit in counter arguments gave rise to considerable professional costs to the industry. The ICAA submitted that it was not possible to quantify these costs without a great deal of effort but clearly over the period of seven years involved, the costs incurred by various taxpayers in professional fees, let alone in senior management time, would have been material. The ICAA also submitted that the perception raised has been that the Tax Office has been unwilling to change its position regardless of the facts before it, nor on a reasonable interpretation of the law.

3.25 The Taxation Institute of Australia (TIA) submitted that the Tax Office's approach during 2002 and 2003 appeared to be an over reaction to an aggressive use of the LAFHA provisions by a small group of labour hire firms, and also appeared, in part, to be driven by tax officers who had limited FBT experience. The TIA expressed the view that the solutions being suggested created considerable uncertainty and left the majority of businesses with even more uncertainty as to when the LAFHA concession could apply.

3.26 The TIA was also of the view that the LAFHA story demonstrated the Tax Office making de facto law by administrative pronouncement. It submitted that while the Tax Office clearly has the role of administering the law, and announcing the interpretations that it considers are expressed in the Act, it is not appropriate for the Tax Office to make de facto law by announcement where the announcement is a novel and strained interpretation of the Act. The TIA suggested that the withdrawal of various Tax Office announcements demonstrates the problematic nature of the means of 'solving' difficult problems.

#### Review Findings and Conclusions

3.27 The Inspector-General accepts that the Tax Office had reason to be concerned about the potential revenue impacts, in particular where there was evidence of potentially excessive LAFHA payments. However, as discussed previously, this review has found that the timeframes for resolving the technical and compliance issues arising from this project were excessive and not reasonable in the circumstances. This resulted in taxpayers involved in the Tax Office's compliance processes incurring higher than necessary costs as a result of these protracted and prolonged timeframes.

3.28 The Inspector-General considers that there were two features of the Tax Office's compliance and resolution strategies that contributed to the excessive timeframes in dealing with this dispute — namely, the ongoing changes in strategy and the adoption of global approaches to resolve the dispute.

## Ongoing changes in strategy

3.29 The Tax Office had a number of options available to it to progress the resolution of the ongoing dispute. For example, it may have:

- Pursued a litigation strategy with test cases selected from a wide spectrum of factual scenarios.
- Issued amended assessments to taxpayers and allowed them to then exercise their review and appeal rights.
- Duly recognised the taxpayers' entitlement to a LAFHA under the current law, discontinued any further audit activity and then either have:
  - formally approached the Treasury seeking law change or law clarification, or
  - issued further guidance to the community in the form of a taxation ruling or taxation determination setting out its technical views and its compliance responses.

3.30 Between 1999 and 2004 there were no fewer than five different strategies adopted by the Tax Office, ranging from the mass application of Part IVA to test case litigation to a re-write of MT 2030 and the release of further taxation rulings and determinations. Ultimately, the Tax Office sought to work with particular industry groups to develop self-regulatory guidelines.

3.31 An important consequence of these ongoing changes in compliance and resolution approaches was that the Tax Office never pursued a particular strategy to finality. For example, in May 2002, after meeting with Treasury, it was agreed that the Tax Office should pursue a litigation strategy. Despite initial work to identify potential test cases, this strategy was abandoned once the Part IVA Panel decided that Part IVA may apply to the factual circumstances outlined in the auditor's submission. Ultimately, this strategy was also abandoned in favour of again selecting representative cases to test the Tax Office view of the law in respect of the particular factual circumstances and issue a taxation determination or some other form of advice communicating the Tax Office's view of the application of the income tax law and FBT law to the particular factual circumstances. Again, this strategy was also not pursued with the Tax Office accepting to review guidelines for self-regulation prepared by industry representatives for use by its members when providing LAFHA fringe benefits to employees.

3.32 The Inspector-General believes that the ongoing changes in strategy reflected an inability within the Tax Office to conclude in a timely manner a corporate position on how the law should apply. Although the audit project team appropriately escalated technical issues these took far too long to be resolved. This was primarily caused by:

- Prolonged internal differences of opinion on the legal position and compliance strategies, sometimes at very senior levels and between different Tax Office areas.
- Objective interpretation of the law clouded by attempts to deliver particular enforcement strategies — for example, there appeared to be a great reluctance by the Tax Office to acknowledge the strengths of taxpayers technical positions due to the underlying belief that foreign nationals on working-holiday maker visas should not be entitled to a LAFHA.

- A lack of guidance in the relevant extrinsic materials on the purpose and scope of the LAFHA provisions so as to assist in the interpretation of the provisions. The Inspector-General notes that in December 2000 the Tax Office first sought independent legal advice on a number of issues including 'secondment' and 'usual place of residence'. In August 2003 the Tax Office subsequently sought further advice seeking legal clarification on a number of key issues relating to the operation of the LAFHA provisions. The Inspector-General considers that the obtaining of independent advice assisted the Tax Office in ultimately arriving at a corporate view on these key technical issues.

3.33 In its business model the Tax Office has stated that:

> …while tax law is a matter for government, the Tax Office's responsibility is to administer the law in a way that builds community confidence and encourages high levels of voluntary compliance.

3.34 The Inspector-General acknowledges the complexity of the technical issues and notes the Tax Office's concerns in July 2002 that the tests set out in LAFHA provisions are difficult to apply and further guidance from judiciary was required. In July 2005 the Tax Office again expressed concern with the ongoing administrative difficulties faced by the Tax Office, employers and employees.

3.35 The Inspector-General also acknowledges the broader implications of the Tax Office's interpretation of the LAFHA provisions on other taxpayers. This includes the potential compliance burdens on employers, for example, in having to examine the individual circumstances of each employee to ensure that they satisfy the requirements of the LAFHA provisions. Equally, the Inspector-General recognises the broader environment and possible impact that the Tax Office's interpretation of these provisions could have had on the movement of employees both into and out of Australia.

3.36 However, ultimately the Tax Office is charged with the administration of the tax system, which includes interpreting and applying the law. In most instances the Tax Office does this well, but when faced with issues that are complex, novel or where there is some uncertainty in the law, as is demonstrated by this case study, the Tax Office must take appropriate steps to ensure that active compliance activities are resolved in a manner that is timely and minimises taxpayer uncertainty. The Inspector-General found that it was not until April 2005 that the Tax Office had a clear, finalised corporate view on the key technical issues and compliance strategies. The Inspector-General found that this clear, finalised direction allowed the Tax Office to move to a position where it could effectively work with the taxpayers to resolve the dispute and that it is presently doing so.

3.37 Effective administration requires the timely interpretation of the tax laws and decision-making so as to provide taxpayers with sufficient certainty on the application of the law and allow for disputes to be resolved or, if necessary, progressed to the tribunal and courts. Excessive delays in reaching a corporate technical position erode community confidence in the tax system and fuel perceptions of unfairness.

3.38 The Inspector-General notes the Tax Office's recent initiatives to improve the quality and timeliness of its review and audit programs, such as:

- the better management of priority technical issues through the procedures as set out in Practice Statement PS LA 2003/10; and

- the introduction of case leadership roles for the large business and small to medium enterprise (SME) segments.

3.39 However, the Inspector-General believes that these processes could be strengthened so as to minimise prolonged delays in finalising significant technical issues and provide adequate avenues for comment or review available to taxpayers where the current processes and procedures are not leading to a timely resolution of a dispute.

### Improvements in timeliness of technical decision-making

3.40 The Inspector-General notes that the Tax Office has introduced specific procedures in relation to priority technical issues. These procedures are designed to ensure that processes for the identification and resolution of priority technical issues are aligned with the Tax Office Risk Management Policy and are managed according to Tax Office policy and processes for project management.

3.41 Once an issue or risk is identified as a priority technical issue a senior tax officer is allocated as the Risk Owner and a tax officer is allocated as the Priority Technical Issue Owner (PTI Owner). The responsibilities of the Risk Owner include:

- managing the overall mitigation strategy/project for the relevant risk (of which resolution of the priority technical issue is a part) including, for example, Taxpayer Alerts, call centre scripts, communication strategies, systems requirements, follow up compliance strategies, advice to Government;

- ensuring that the PTI Owner is given every assistance in resolving the technical issue;

- liaising with the PTI Owner and stakeholders in planning the technical issue resolution strategy and establishing milestones and deadlines;

- in consultation with the PTI Owner, engaging as early as possible all relevant stakeholders; for example, Aggressive Tax Planning, International Strategy & Operations, Policy Management Division, Office of the Chief Tax Counsel branches, Goods and Services Tax or other business lines or parties external to the Tax Office (including consultative processes, as necessary);

- regularly reviewing progress of resolution of the technical issue (with the PTI Owner and stakeholders) to ensure that milestones and deadlines are being met and/or updated;

- advising the PTI Owner of any new intelligence, changes to the importance of resolution of the technical issue to risk mitigation strategy or changes to the rating of the associated risk;

- ensuring that any related cases are maintained in the appropriate case management systems and finalised once the technical issue is resolved (ensuring also that cases are delayed only where absolutely necessary); and

- determining any residual risk and evaluating the risk mitigation strategy on completion, in accordance with proper risk and project management methodology.

3.42 These procedures also establish a Priority Technical Issues Committee. This Committee is chaired by the Second Commissioner Law and provides guidance and

direction to the PTI and Risk Owners, and monitors the management of PTIs within the established corporate framework.

3.43 The Inspector-General believes these recent improvements are a positive step forward in the management of issues that are complex, novel, or where there is some uncertainty in the law. The Inspector-General considers that these processes could be strengthened so as to minimise prolonged delays in finalising such issues and provide a circuit-breaker in the resolution of key technical issues. The Inspector-General believes that the Priority Technical Issues Committee is well-placed to take on this role and ensure that key technical issues are managed and resolved in a timely and effective manner.

## Improvements in case management and development of resolution strategies

### Adoption of a global approach

3.44 From the initial stages of the audit project the Tax Office adopted a global approach in dealing with the compliance issues arising from this dispute. For example, the Tax Office sought to deny LAFHA entitlement on the basis of the type of visa. When that position was criticised it then sought to apply Part IVA until that strategy was eventually dropped following comments by the then Second Commissioner Law. This took from April 1999 until April 2003 to achieve. Part of this strategy also involved potentially issuing around 6,000 amended assessments to taxpayers on the basis that the particular arrangements identified by the Tax Office were wide-spread amongst all taxpayers involved, yet denied by the industry as being representative of the factual circumstances.

3.45 The Inspector-General considers that the Tax Office's compliance and resolution strategies were initially geared towards a one-size-fits-all approach, given the involvement of a large number of taxpayers and the lack of adequate resources required to adopt a case-by-case approach. However, the Inspector-General believes that where you have a potentially wide group of taxpayers, the development of compliance and resolution strategies should consider how the Tax Office will ensure that it adequately differentiates between taxpayers, especially where the legislative provisions require a case-by-case analysis.

3.46 In these instances it is important that the Tax Office's compliance and resolution strategies duly recognise the balance that needs to be achieved between considerations of administrative efficiency in dealing with groups of taxpayers and examining the conduct and circumstances of a taxpayer.

### Compliance-focussed approach

3.47 In its business model the Tax Office has stated that it is required to operate variously as:

- a trusted authority on the law;
- a professional advisor and educator, ensuring people have the information and support they need to meet their obligations under the law;
- a firm enforcer of the law; and
- a fair administrator who recognises people's circumstances in meeting their obligations.

3.48 In most cases, these roles are complimentary, in the sense that the application of the law is clear and the Tax Office assists taxpayers to meet their tax obligations. However, it is where the application of the law is uncertain, or the outcome is inconsistent with what the Tax Office believes was intended or an interpretation of the law gives rise to an unintended revenue consequence that there is potential for tension between these roles. The consequence of such tension is the introduction of uncertainty for taxpayers and unfairness in the tax system. Taxpayers need to see that the Tax Office's compliance strategies are being shaped by an objective consideration of the law rather than driven by a belief that a taxpayer should not be entitled to a particular tax benefit. Taxpayers also need to see that the Tax Office is willing to acknowledge the strengths of a taxpayer's arguments and take those into account in its decision-making. But it is important to note that this is not to suggest that the Tax Office should simply roll over each time it is challenged. Taxpayers and their representatives must also understand and appreciate the various roles of the Tax Office and how particular technical and compliance approaches may be important in achieving wider voluntary compliance.

3.49 In the course of this review the Inspector-General found that the Tax Office has been forced to concede that the law does not support the key compliance tests that it believed should have given effect to the policy intentions. Taxpayers expressed the concern that the position of the Tax Office has consistently been driven by its view of what the policy should be regarding the payment of LAFHA and its efforts have been largely directed to finding ways that the law can be applied to support that policy. Taxpayers also allege that there is little doubt that if the law supported the Tax Office's attack, then the issue would not have been outstanding and debated for seven years at a great cost to the taxpayers involved.

3.50 The Inspector-General considers that the taxpayers' concerns have some validity. The Inspector-General believes that part of the Tax Office delay may be attributed to it seeking to address a perceived, and escalating, compliance risk in an environment where the law did not adequately support the Tax Office view. The Inspector-General believes that this resulted in an objective consideration of the law being clouded by attempts to deliver particular enforcement strategies.

3.51 After seven to ten years of to-ing and fro-ing, the Tax Office appears now to have given up, and acknowledged that the legal analysis and submissions from the taxpayers in question were not able to be rebutted. Accordingly, the Tax Office has accepted that the arrangements entered into are acceptable under the current law.

3.52 The Inspector-General believes that when faced with issues that are complex, novel or there is some uncertainty in the law or the Tax Office is seeking to address a wider compliance risk then the Tax Office must be more proactive and take additional steps to demonstrate to the community that it is balancing its different roles in the tax system. For example, where the law is uncertain, then the Tax Office should actively seek to run test cases so as to obtain judicial guidance on the interpretation of the tax laws. In circumstances of complexity or uncertainty it is important that the Tax Office demonstrates to taxpayers and the community that it has a real interest in also achieving certainty and clarity rather than just being seen to be seeking a compliance outcome.

3.53 In deciding its compliance and enforcement strategies, the Tax Office also needs to consider if it has contributed to the situation by not adequately fulfilling its role in ensuring people have the information and support they need to meet their obligations under the law.

## Case management

3.54 The Inspector-General considers that the audit project team were not adequately resourced to undertake a case-by-case analysis or to properly consider taxpayers' individual circumstances. Although there were potentially 10,000 employees involved and the Part IVA Panel had noted the requirement according to the law to examine each taxpayer on a case-by-case basis, the audit project team comprised of only four tax officers. In effect the absence of appropriate resources also dictated the necessity of seeking to adopt blanket or global approaches in dealing with this dispute.

3.55 The Inspector-General also considers that despite the involvement of many senior tax officers in the audit project, there was no single senior tax officer that had overall ownership of the technical and compliance issues until late in the dispute. The Inspector-General found that once a senior tax officer was allocated to the dispute with overarching ownership of the resolution of the dispute this provided a central focal point for internal discussion, a more co-ordinated approach by the Tax Office and a senior contact point for the taxpayers and their representatives. These aspects helped improve the relationship between the taxpayers and the Tax Office and progress the dispute towards resolution.

3.56 The Inspector-General notes that the Tax Office has recently introduced a number of initiatives to improve the quality and management of active compliance activities. For example, case leadership roles involve senior tax officers reviewing major cases and determining lines of investigation so as to progress cases, especially some of the older cases. The process includes workshopping cases with tax office experts — and industry specialists as necessary — to ensure that they have identified the right tax risks and technical issues. The case leadership roles also work with teams to progress cases, including guiding its information gathering processes.

3.57 The Inspector-General believes that the case leadership roles provide a good framework for the management of resolution strategies where the issues are complex, novel, or where there is some uncertainty in the law. However, the Inspector-General is concerned that there are no formal avenues for escalation, review or comment of the Tax Office's resolution strategies where they are not leading to a timely resolution of a dispute. For example, this may be in circumstances where there is no clear Tax Office view and no amendment action to generate objection and appeal rights to allow the Tax Office view to be challenged. In such situations, taxpayers are left in limbo with potentially adverse consequences on their business and personal lives caused by unnecessary delays in resolving the dispute.

3.58 The Inspector-General believes that these processes may be strengthened by requiring the escalation of cases involving priority technical issues and other issues requiring precedential views to case leaders after a reasonable time has elapsed. The Inspector-General also believes that taxpayers should then have mandatory rights of representation to these case leaders. The Inspector-General considers that this will allow taxpayers, who feel that they have reached a stalemate in respect to their dispute, to have an opportunity to discuss their concerns at a more senior level within the Tax Office. This should be in the spirit of reaching a common understanding of the facts and technical issues arising from the dispute and seeking to resolve the dispute without recourse to litigation.

3.59 The Inspector-General also found that the file management by the audit project team was good with detailed file notes and all relevant documents kept chronologically on file.

## TIMELY COMMUNICATION OF ISSUES TO TAXPAYERS

3.60 The Inspector-General notes that the relationship between the Tax Office and the industry members and their representatives was generally co-operative throughout the audit project. The majority of the industry members provided information to Tax Office and sought to cooperate with Tax Office to obtain guidance regarding LAFHA entitlement and quantum. Furthermore, the Tax Office provided the industry members and their representatives an opportunity to provide a written submission to the Part IVA Panel and to appear before the Public Rulings Panel.

3.61 However, the Inspector-General also found some examples of where the conduct or approach of either the Tax Office or the industry members and their representatives strained the generally co-operative relationship, including:

- Initial reluctance on the part of the Tax Office to clearly articulate their views on the application of the LAFHA provisions and Part IVA to the factual circumstances despite taxpayer requests.

- Concerns by members of an industry association and their representatives that the Tax Office was not interested in understanding their industry.

- The Tax Office released Taxpayer Alert TA 2002/7, which was met with external criticism for the lack of consultation by the Tax Office prior to its release and its inaccurate characterisation of the majority of the arrangements. The taxpayers' representative was particularly incensed at the Tax Office's failure, after repeated requests, to withdraw the Taxpayer Alert which said that the anti-avoidance provisions applied to their arrangements even though the Tax Office had informed them that their view had changed and those provisions did not apply. There was also concern that the Tax Office did not withdraw Draft Taxation Determination 2000/D5 even though its view had changed. (This Draft was only withdrawn after the Inspector-General wrote to the Commissioner during the course of this review indicating that such action would be appropriate.)

- Some taxpayers either were not able to or failed to provide the Tax Office with requested information.

- Repeated attempts by the industry association members and their representatives to work with the Tax Office to arrive to a workable solution.

- Industry association members and their representatives expressed disappointment with the adequacy of the Tax Office's position paper and its failure to properly address or respond to the technical issues and merit of their arguments. The taxpayers' representative also expressed the view that the position paper did not provide guidance on the Tax Office's view on key principles despite ongoing delays in issuing the position paper.

3.62 Professional associations have noted the different purposes of a position paper. They indicate that sometimes position papers are issued at a time when the Tax Office's views are advanced and assessments are about to issue. On other occasions, position papers

are issued at a time when the facts are far from certain and the Tax Office wants the taxpayer to comment on the facts and technical views. They submit that the Tax Office should identify the purpose of the position paper at the outset of the audit so as to improve transparency.

3.63 The Inspector-General agrees with these general views noting the difference in expectations between the Tax Office and the taxpayers as to the function and role of the position paper in the audit project. The Inspector-General believes that the position paper is an important part of the current dispute resolution process. Not only does its serve to set out what the Tax Office believes are the facts, issues and its view of the application of the law but it also demonstrates whether the Tax Office has listened and appropriately dealt with the taxpayers views and arguments. It also shapes the relationship between taxpayers and the Tax Office.

3.64 In a recent speech the Commissioner of Taxation noted the importance of the Tax Office being open, transparent and accountable including sharing Tax Office approaches with the community, inviting feedback on the Tax Office's decisions, being open to constructive criticism, accepting mistakes and recognising where it needs to make changes.

3.65 The Inspector-General supports the Tax Office's vision in seeking to develop a 'community-first culture'. Maintaining a taxation ruling, taxation determination or other interpretative decision in the market place to attain a particular compliance response where the Tax Office has changed or is uncertain with its view does not promote a community first culture. The Inspector-General considers that this review demonstrates the need for the Tax Office to improve its responsiveness in withdrawing taxation rulings, taxation determinations and other interpretative decisions where there is a change in the Tax Office's view. This is especially so where there is potential for adverse impact on taxpayers.

### Clear guidance on when under audit

3.66 Taxpayers and their representatives, in both this review and in past instances, have raised concerns with the considerable confusion about whether a Tax Office compliance activity constitutes an audit or not, with ramifications on whether a taxpayer can make a voluntary disclosure and seek to minimise the impact of any penalties.

3.67 In this case study the Inspector-General found that while the Tax Office was informing members of an industry association that they were not under audit and seeking their assistance as part of the project, the Tax Office was proposing to issue individual taxpayers with amended assessments, issue Part IVA determinations and impose administrative penalties.

3.68 For example, the Tax Office received an email from a taxpayer requesting that the Tax Office issue them with a formal audit letter. The taxpayer stated that this was being requested as, in their view, the Tax Office's intended outcome of the investigation was the issuing of prior year amended assessments which was consistent with what occurred as part of a formal audit. The taxpayer also requested whether, once the Tax Office has determined its position, it would seek to apply this on a retrospective or prospective basis.

3.69 In a reply the Tax Office stated that they were not in a position to issue a formal audit letter. The reply mail indicated that the Tax Office had earlier informed the taxpayer that they were not formally auditing their business but have been conducting interviews with several of their clients. The Tax Office also stated that its requests for payroll records in relation to individual taxpayers who have or had connection with the taxpayer should not be

interpreted as the initiation of an audit. The Tax Office stated that, on this basis, it would be most inappropriate for it to issue a formal audit letter.

3.70 The Inspector-General notes that the Tax Office's reply was after it had decided to internally:

- seek legal advice on a number of issues arising from the audit project;
- seek direction from the Aggressive Tax Planning Steering Committee which advised the audit project team to take a 'slowly, slowly approach' and issue only a small manageable number of amended assessments;
- issue amended assessments in respect of an individual taxpayer; and
- refer an application to the Part IVA Panel with the Panel noting that there was a strong argument for the application of Part IVA.

3.71 In its reply, the taxpayer stated that it was not convinced by the Tax Office's conclusions that the project was not an audit of the entity and its clients or that the information gathered under the name of the umbrella project would not be used by the Tax Office to issue amended assessments. In order to protect its rights under the law, the taxpayer again requested that the Tax Office issue a formal audit letter and a formal legal indemnity to protect it from the Tax Office taking any retrospective amendment action against the taxpayer and its clients in respect of LAFHAs.

3.72 The Inspector-General also found some evidence in this case study of the Tax Office, especially at more senior levels, seeking to limit the disclosure of information to taxpayers regarding its approaches. For example, a taxpayer requested that the Tax Office view be documented in respect of its treatment of LAFHAs. The audit project team prepared a draft letter referring to MT 2030 and providing some details on the deliberations of the Part IVA Panel on the application of the general anti-avoidance provisions to the identified arrangements. The draft letter also indicated that the Tax Office proposed to shortly commence issuing amended assessments to reflect its view and that a new ruling was also being prepared.

3.73 The release of this draft letter to the taxpayer was stopped on the basis that it was inappropriate to quote minutes of the Part IVA Panel, there should be no mention that a new public ruling was being drafted and there should be no mention that assessments may issue after the ruling was drafted.

3.74 The Inspector-General notes and welcomes the recent statements by the Commissioner of Taxation emphasising a values-based administration to better meet the needs and expectations of the community. In particular, the Commissioner of Taxation stated that:

> Being open and transparent is not just about sharing good news stories with the community. It's about sharing our approaches with the community and inviting feedback on the decisions we make, being open to constructive criticism, accepting mistakes and recognising where we need to make changes. Sure, 'a warts and all' approach can be uncomfortable, but I believe that it helps to build trust in the Tax Office.

3.75 The Inspector-General believes that in the spirit of being open and transparent, where the Tax Office contemplates issuing amended assessments, issuing Part IVA

determinations or imposing administrative penalties as a result of active compliance activity it should notify taxpayers that they are subject to audit.

## THE PROVISION OF TIMELY AND OBJECTIVE GUIDANCE TO THE COMMUNITY

## The extent and cause of uncertainty to affected taxpayers, including any initial Tax Office guidance or representations

### Stakeholder concerns

3.76 The ICAA submitted that the Tax Office's inquiry into this matter caused considerable uncertainty within the industry. During the course of this matter, the Tax Office issued and then retracted Taxpayer Alert TA 2002/7, and similarly issued and subsequently withdrew Draft Taxation Determination TD 2000/D5. The disruption and uncertainty that this type of action gives rise to is difficult to estimate. However, the ICAA submitted that it stands to reason that the disruption and uncertainty would have been significant.

3.77 The TIA submitted that throughout the entire period, employers have had to deal with the continuing uncertainty as to when the LAFHA treatment legitimately applies, and this has added to the cost for employers because this needs to be established on a case by case basis (that is, taking account of the particular circumstances of the employee) when there is an increasingly mobile workforce (much of the mobility being at the request of the employer). The TIA submitted that in these circumstances, employers end up taking a variety of views.

3.78 The TIA submitted that given the extent of global and national transfers, it is a sufficiently significant problem to have been raised in the cost of compliance submission. The relationship between the LAFHA provisions and the travel provisions under the Income Tax Assessment Act are difficult to navigate for an employer.

3.79 The TIA noted that the combination of old FBT legislation, with Tax Office Determinations/Rulings filling the gaps, has led to significant uncertainties as to the requirements for FBT-free LAFHAs. Practitioners have argued that the rules need to be updated and clarified so as to avoid unnecessary cost to business, and this will probably require legislative changes. The TIA expressed the view that it would have expected the Tax Office to have again pressed for a change in legislation, rather than adopting the approach that was taken which, in the end, seems to have achieved nothing.

3.80 Representations by legal and accounting advisers also noted the general uncertainty regarding the Tax Office's approach to LAFHAs. Many said that they were taking a very conservative approach so as to minimise any future Tax Office compliance response. They indicated that this is not an appropriate situation — namely one where uncertainty in the law and the Tax Office position is used to effect compliance and make taxpayers adopt a conservative approach. One legal adviser submitted that the current Tax Office view, as set out in MT 2030, did not provide sufficient guidance to the community around what factors the Tax Office would take into consideration in determining what was 'reasonable' for the purposes of a LAFHA. It was suggested that a taxation determination on this matter would provide some guidance on methods which would be acceptable to the Tax Office.

3.81 Stakeholders also referred to a cost of compliance submission to Government on 4 August 2004, on behalf of the professional bodies, consisting of the ICAA, Law Council of

Australia, National Tax & Accountants Association, National Institute of Accountants, Taxpayers Australia and the TIA.

3.82 The submission outlined the cost of compliance and other difficulties faced by employers as a consequence of the fringe benefits tax legislation. The submission noted that a common and consistent theme in feedback received from members of all the professional bodies was the excessive and inappropriate compliance burden for business due to the fringe benefits tax.

3.83 The submission noted that small and large business as well as tax practitioners continued to experience real problems in complying with the requirements imposed under the FBT legislation. The submission indicates that it is the employer and not the employee that is continually under pressure to get it right and it is the employer that is ultimately left exposed in terms of record keeping errors and any fraud perpetrated by the employee.

3.84 Relevantly, the submission noted that many of the FBT provisions have failed to keep up with business change and often result in employers having to make decisions using legislation that does not reflect modern practices, technology or the intention of other legislation. The submission also raised concerns with the Tax Office resorting to applying administrative solutions to overcome legislative defects in the FBT law, noting that this was not an ideal way to address problems in the law.

## Review Findings and Conclusions

### Current environment

3.85 The current administrative outcome and legal position appears to be that anyone, including backpackers, who claims to be living away from their usual place of residence can receive tax-free remuneration to cover their accommodation and food expenses for extended periods. In simple terms, some employees including overseas visitors to Australia who find employment after they arrive, can effectively salary sacrifice for normal living expenses.

3.86 The following example of a case that the Tax Office has recently allowed shows how it is currently administering LAFHA.

> The taxpayer came to Australia on a working holiday visa in 1998. After 12 months he decided to extend his stay. He obtained sponsorship, found a job and over three years received a substantial part (31 per cent) of his remuneration as a tax exempt LAFHA on the basis that he was living away from home in order to undertake employment duties and was incurring additional expenses. The Tax Office sought to amend his assessable income to include the LAFHA, but subsequently allowed the taxpayer's objection in late 2005 on the basis that the circumstances met the requirements of MT 2030. From a total income over the three years of $170,169 the taxpayer received over $52,000 tax-free.

| Year | Tax-free LAFHA | Salary returned as taxable | Total remuneration |
|---|---|---|---|
| 2001 | $26 061 | $63 849 | $89 910 |
| 2000 | $18 978 | $41 977 | $60 955 |
| 1999 | $ 7 615 | $11 689 | $19 304 |
| Total | $52 654 | $117 515 | $170 169 |

3.87 In July 2005, the Tax Office discussed its concerns about the operation of the LAFHA provisions with Treasury. The Tax Office considered that difficulties arose with the

practical administration of LAFHAs due to the lack of certainty in the use of such terms as 'usual place of residence', 'additional expenses', 'reasonableness' and issues such as the length of time an employee may be entitled to concessional LAFHA treatment. The Tax Office advised that external legal analysis and submissions were not able to be rebutted and that the practices subject to the audit project are acceptable under the current law. The Tax Office indicated that the risks and difficulties identified in 1995 had not abated and may have increased. The Tax Office also advised that the reasons for the amendments being introduced and the acceptance at that time of the administrative difficulties faced by the Tax Office, employers and employees were still present. The Tax Office advised that it would continue to monitor LAFHAs and would, as necessary, inform Treasury of further developments. In the absence of such advice, the Treasury file note stated that Treasury considered the current FBT law as giving effect to government policy.

### Tax Office attempts to provide further guidance

3.88 The stakeholder concerns do suggest general uncertainty amongst practitioners and advisers in the operation of the LAFHA provisions and the Tax Office's administration of these provisions. The Inspector-General considers that where you have a dispute unresolved for a period of seven years with no clear guidance from the Tax Office as to their technical view and compliance approach, especially where you have ongoing changes in approach and strategy, then there will obviously be uncertainty amongst taxpayers.

3.89 The Inspector-General notes that the Tax Office did make some attempts to provide further guidance to taxpayers regarding their technical view. For example, in April 2000 the Tax Office released a draft taxation determination on its view on the term 'usual place of residence'. However, this draft taxation determination was met with significant external criticism, with many believing that the Tax Office was going beyond what was stated by the law. This draft tax determination was later withdrawn.

3.90 The Inspector-General also notes the recent positive steps made by the Tax Office to provide greater guidance to taxpayers including the development of industry guidelines and the additions to the FBT Employers Guidebook. The Inspector-General believes that these provide a good starting point for broader community guidance on the Tax Office's view, in particular, the practical application of that view.

### Current Tax Office guidance – MT 2030

3.91 The shortcomings of MT 2030 in providing adequate guidance to taxpayers were first identified in an internal Tax Office report covering issues associated with LAFHAs including problems encountered by employers, by employees, the Tax Office as well as problems with MT 2030 itself.

3.92 The internal report made a number of recommendations for consideration by senior tax officers including issuing an updated Ruling to be read in conjunction with MT 2030, providing additional guidelines regarding the calculation of LAFHAs, the wording to be used in declarations and the application of the LAFHA provisions to specific industries. The report also considered alternatives including the withdrawal of MT 2030 and approaching the Government to change the current manner of taxing LAFHAs.

3.93 The shortcomings of MT 2030 were again highlighted in February 1995, with the proposed amendments to the LAFHA provisions. The Explanatory Memorandum noted that the guidelines issued by the Commissioner of Taxation in MT 2030 had been difficult for many employers to apply.

3.94 Following the then Governments announcement that they were not proceeding with the proposed amendments to the LAFHA provisions, there was internal Tax Office consideration of how to clarify the current state of the law and MT 2030. Various issues and options were considered at an internal Tax Office Technical Network meeting, where it was concluded that doing nothing and relying on the current version was not an option. The discussion group concluded that the best course of action would be for a project to be initiated that would include the drafting of a comprehensive ruling on the subject to replace MT 2030 and ultimately to put forward a proposal for legislative change. However, no further action was taken by the Tax Office to revise MT 2030 as there were insufficient technical resources available at the time to handle the matter.

3.95 During the course of the audit project, concerns were also expressed with the adequacy of MT 2030 in providing adequate guidance to taxpayers. It was noted that although MT 2030 provided suitable guidelines for LAFHA issues, there were cases, such as those being investigated by the audit project team, where MT 2030 fell short of providing definitively 'clear' guidelines.

3.96 The Inspector-General also notes that throughout the audit project, steps were taken to re-write MT 2030 or to issue further taxation rulings and taxation determinations on LAFHA to supplement MT 2030. For example:

- In December 2003 the Tax Office decided to release a series of taxation rulings and taxation determinations on LAFHA. The Tax Office view on the law was to be progressed by releasing approximately four taxation determinations. It was decided that at some later stage these documents could be combined into one single ruling to replace MT 2030. The proposed taxation determinations were:

  - a replacement of Draft Taxation Determination TD 2000/D5,

  - a taxation determination dealing with the switch from a 417 visa to a 457 visa and where a person enters Australia on a 457 visa,[1]

  - a taxation determination dealing with usual place of residence, and

  - a taxation determination dealing with additional expenses.

1 A 417 visa is a Working Holiday Visa, while a 457 visa is a Temporary Business Long Stay — Standard Business Sponsorship. The latter is a program for employers to sponsor approved skilled workers to work in Australia on a temporary visa. Information obtained from the Department of Immigration and Multicultural Affairs' website at http://www.immi.gov.au/index.htm.

- In August 2004, at an NTLG-FBT Sub-committee meeting, the Tax Office informed practitioners that a review of certain matters concerning LAFHAs, including issues arising from Draft Taxation Determination TD 2000/D5 and Taxpayer Alert TA 2002/7, was drawing to a conclusion. As a result of the review, the Tax Office indicated that it proposed to issue two draft taxation determinations and one draft taxation ruling and that these were being progressed within the Tax Office. These would be released as drafts, at which time the peak bodies and other interested parties would have the opportunity to provide comments and/or formal submissions.

- In May 2005 the Tax Office indicated to the affected taxpayers that it would no longer be issuing the proposed draft ruling and determinations and that the Tax Office view continued to be set out in MT 2030. However, the Tax Office identified the need to provide some practical guidance concerning quantum associated with LAFHAs and indicated that there would be the development of guidelines, in the form of a Law Administration Practice Statement, for Tax Office compliance staff.

- In July 2005 the Tax Office advised the Treasury that MT 2030 would, in essence, remain the Tax Office's broad position on LAFHAs.

- In November 2005, at an NTLG-FBT Sub-committee meeting, the Tax Office informed practitioners that sufficient guidance for a case by case application of the LAFHA provisions was contained in the long standing ruling MT 2030. The Tax Office advised practitioners that MT 2030 provided the broad guidelines necessary to apply those provisions. The Tax Office indicated that it would continue to monitor LAFHA issues and suggested that there may, in the future, be a case that raised issues of significant concern relating to 'reasonableness' which may provide an opportunity to seek clarification from the Federal Court on the interpretation of sections 30 and 31 of the FBTAA.

3.97 To date, MT 2030 continues to represent the Tax Office's view on LAFHAs despite its numerous identified shortcomings in providing clear guidance to taxpayers and practitioners. However, the Tax Office is also reviewing guidelines for self-regulation prepared by industry association members for use in providing LAFHA fringe benefits to employees.

3.98 The Tax Office has provided the Inspector-General with material on the number of private binding rulings on LAFHAs issued during the period of the LAFHA project. The Tax Office advised that from 1 January 2006 to 18 October 2006, there were 74 written requests actioned where LAFHA was an issue. From the available information, 21 cases were requests from employers, with the balance of requests from employees.

3.99 For the 2005 calendar year, the Tax Office advised that there were 109 written requests actioned where LAFHA was an issue, with 26 requests from employers and the balance of requests from employees. For the 2004 calendar year, the Tax Office advised that there were 57 written requests actioned where LAFHA was an issue, with 31 requests from employers.

3.100 The Tax Office also advised that during this period cases were finalised, in the majority of instances, within Taxpayers' Charter requirements and in cases where a ruling was provided, the Tax Office view relied upon was either MT 2030 or the FBT Employer Guide.

3.101 The Tax Office asserts that the low number of applications for written advice on LAFHA and the fact that the applications are dealt with within the Taxpayers' Charter requirements demonstrates that the Tax Office does not struggle to interpret or administer the FBT law relating to LAFHAs generally. Rather, the Tax Office asserts that it is more correct to say that is has struggled for a long time with some arrangements which are pitched at the extreme points of the law. The Tax Office also asserts that it could be presumed that if there was greater uncertainty in the community generally around the LAFHA provisions, there would have been many more requests for written advice than the low number of request previously noted.

### Providing community-wide guidance and certainty

3.102 During the audit project, the taxpayers' representative repeatedly expressed concern that the Tax Office was not providing clarification or guidance as to how the Tax Office's concerns may be alleviated. The taxpayers' representative also commented that there was uncertainty around what was the Tax Office's view on the terms 'additional' and 'reasonable' for the purposes of paying a LAFHA and suggested that MT 2030 should be rewritten to clarify such issues.

3.103 The TIA was also of the view that the Tax Office's solution of working with industry groups to develop self-regulatory guidelines fails to address the requirements of certainty and equity. It submitted that not only does it open up the possibility of different industry approaches based on the same legislation, it means there will be no established case law, and it does not address the possibility of future Tax Office changes in attitude (particularly by Tax Office auditors) when once again Tax Office officers not familiar with FBT become involved.

3.104 The Inspector-General agrees with those sentiments and believes that more should be done by the Tax Office to provide community-wide guidance and certainty on its interpretation, administration and practical application of the LAFHA provisions. The Inspector-General notes that on particular issues, for example whether there is a requirement for a pre-existing employee/employer relationship for a LAFHA entitlement, there still seems to be inconsistencies between the internal views expressed by some senior tax officers, the manner that the LAFHA provisions are currently being administered and MT 2030. The Inspector-General believes that community-wide guidance on the key technical issues raised during this case study will also minimise prolonged timeframes in resolving such disputes should they re-emerge in the future.

3.105 The Inspector-General notes that the Tax Office has had a number of informal meetings with the Treasury to discuss its concerns with the operation and scope of the LAFHA provisions. The Inspector-General found that the Tax Office has not formally advised the Treasury on issues regarding LAFHAs where the Tax Office has identified problems in the operation of the tax system that may require legislative change.

**KEY RECOMMENDATION 1**

*The Commissioner of Taxation should conclude a corporate view on whether the Tax Office should formally advise the Treasury, in accordance with Practice Statement CM 2003/14, that legislative change is required or not.*

## KEY RECOMMENDATION 2

*In the absence of the Tax Office providing such formal advice to Treasury or any legislative change, then the Tax Office should issue a new public ruling to replace Miscellaneous Taxation Ruling MT 2030. The new public ruling should provide community-wide guidance and certainty on the Tax Office's interpretation, administration and practical application of the LAFHA provisions, and should include clarification of the key technical issues arising from this review such as:*

- *usual place of residence;*
- *meaning of the term 'additional';*
- *factors the Tax Office would take into consideration in determining what was 'reasonable' for the purposes of a LAFHA including guidance on methods which would be acceptable to the Tax Office;*
- *causation between employment and entitlement to receive a LAFHA, in particular, whether there is a requirement for a pre-existing employee/employer relationship for a LAFHA entitlement.*

# CHAPTER 4 — CHRONOLOGY OF KEY FACTS ARISING FROM CASE STUDY

4.1 The following information has been extracted from Tax Office audit and technical files, National Tax Liaison Group FBT-Sub-committee minutes, a Senate Legislation Committee report and the Senate Hansards.

### June 1991

4.2 The Tax Office initiated an internal review of Miscellaneous Ruling MT 2030, with the primary objective of ensuring that there was consistency of treatment of Living-Away-From-Home Allowances ('LAFHAs') between branches. Information was requested from each of the branches on internal guidelines and policies adopted and on aspects of LAFHAs and travel allowances that were providing difficulties in interpretation and application.

### February 1992

4.3 An internal report was prepared by the Internationals area (as it then was) within the Tax Office covering a number of issues associated with LAFHAs including problems encountered by employers, by employees, the Tax Office and with MT 2030 itself.

4.4 For employers, the internal report noted that potential problems included their reliance on information in employee declarations, the need for an incentive to 'get it right' and the difficulty of calculating the taxable value of the benefit. For employees, potential problems identified by the report included understanding of LAFHA concepts such as usual place of residence and the consequences of 'getting it wrong'. For tax auditors, the report noted that potential problems included the subjectivity of a number of LAFHA principles and the administrative difficultly of having to look at the individual circumstances of every employee to determine their status.

4.5 The internal report made a number of recommendations for consideration by senior tax officers including issuing an updated Ruling to be read in conjunction with MT 2030, providing additional guidelines regarding the calculation of LAFHAs, the wording to be used in declarations and the application of the LAFHA provisions to specific industries. The report also considered alternatives including the withdrawal of MT 2030 and approaching the Government to change the current manner of taxing LAFHAs.

### February 1993

4.6 At the NTLG-FBT Sub-committee meeting the Tax Office advised practitioners that there was to be a review of MT 2030. The Tax Office recognised that the ruling may not be adequate in view of a number of court and tribunal decisions, in particular, in respect to the interpretation of term 'usual place of residence'. It was also recognised that the ruling could provide clearer guidance on when an allowance paid to an employee would be treated as a LAFHA. Submissions were invited from practitioners and peak bodies.

4.7 It was also confirmed at that meeting that MT 2030 would continue to apply while it was under review. In response to the query as to whether the proposed ruling would be issued on a prospective basis, the Tax Office indicated that the revised ruling was likely to clarify existing law, not introduce new interpretations. Accordingly, it may not be appropriate to make the ruling prospective. However, it was also indicated that if the ruling resulted in a more restrictive view than that currently adopted, consideration would be given to making it prospective.

### June 1993

4.8 At the NTLG-FBT Sub-committee meeting the Tax Office provided information concerning the draft ruling that was to issue on LAFHAs. It was stressed that the Tax Office was in agreement with most of MT 2030 and subject to the review's conclusion, there was unlikely to be major changes in policy contained in the draft ruling. It was envisaged that the new draft ruling would supplement MT 2030. The Tax Office also stated that auditors had been instructed to continue to apply MT 2030.

### September 1993

4.9 At the NTLG-FBT Sub-committee meeting the Tax Office provided an update on the review of LAFHAs.

4.10 As a result of the LAFHA review, it was anticipated that MT 2030 would not be altered and that the position of the Tax Office outlined in that ruling was to be maintained.

4.11 However, the Tax Office indicated that it was likely that at least two tax determinations would issue providing guidance on the difference between a location allowance and a LAFHA and the meaning of 'usual place of residence'.

4.12 Some practitioners expressed the view that MT 2030 could provide more guidance as to whether an allowance is a LAFHA or a travelling allowance.

### November 1993

4.13 The Tax Office issued Draft Taxation Determination TD 93/D275. The draft Taxation Determination was intended to supplement MT 2030 by providing additional guidelines in relation to how an employees 'usual place of residence' could be determined.

4.14 The draft Taxation Determination stated that an employee's place of residence is not only the place where the employee dwells for a considerable amount of time but includes the place where the employee habitually sleeps even if only on a temporary basis. 'Place of residence' is defined in subsection 136(1). It noted that no one factor will determine whether a particular place of residence is an employee's **usual** place of residence and set out the following factors to be considered when deciding where is an employee's usual place of residence:

- an employee's usual place of residence is normally found near to the employee's fixed or permanent employment base;
- the terms of the employee's employment contract or award may indicate whether the employee's move to a new place of residence is merely temporary or of a more lasting nature, that is, a move to take up a promotion would indicate that the employee's usual place of residence would be where the employee carries on the new duties;

- the longer the employee is required to work at a place, the more indicative it is that the move is not temporary in nature; and
- while it is not necessary for an employee to own or have available a residence, the fact that the employee has:
  - immediate family,
  - assets, or
  - other social, business, or contractual ties.
- at or near a place of residence would strengthen a claim that the place is the employee's usual place of residence.

4.15 Importantly, the draft Taxation Determination also stated that where, after considering the above factors, an employee's usual place of residence still cannot be determined, and the employee has been living at that place for a period of twelve months or more, that place will be taken to be the employee's usual place of residence. The draft Taxation Determination emphasised that this conclusion should only be made where a full consideration of the above factors did not produce a substantive answer as to where the employee's usual place of residence was.

4.16 Numerous lengthy submissions were received regarding the draft determination. In general the submissions were adverse.

4.17 The Tax Office also issued Taxation Determinations TD 93/229 (withdrawn 1 June 2005 due to amendments to the FBTAA) and TD 93/230 to address the issues following the decision in *Road and Traffic Authority v Federal Commissioner of Taxation* 93 ATC 4508, which considered a camping allowance where the allowance was found not to be a living-away-from-home allowance as the expenses would have been deductible under section 51 of the *Income Tax Assessment Act 1936* (ITAA 1936) had they been incurred by the employee.

### December 1993

4.18 At the NTLG-FBT Sub-committee meeting practitioners provided comments on Draft Taxation Determination TD 93/D275. The Taxation Institute suggested that the only way to remove uncertainty as to what constitutes a 'usual place of residence' was to legislate and that as there was some evidence that the tests used have been more lenient in the past, TD 93/D275 should only apply on a prospective basis. In response to the suggestion that a legislative response was required to provide greater certainty, the Tax Office stated that submissions it had received following the release of TD 93/D275 indicated that taxpayers held different views as to the appropriate course of action with some opposed to an amendment that provided an arbitrary rule. The Tax Office confirmed that if there was any material change in direction then that change would be prospective.

### March 1994

4.19 At the NTLG-FBT Sub-committee meeting the Tax Office informed practitioners that Draft Taxation Determination TD 93/D275 was under review and that the review had reached a point where an 'in principle' decision on the direction of TD 93/D275 was imminent. The Law Council of Australia indicated that it considered that legislative change was preferable in this area as it would provide more certainty. The Tax Office also confirmed that the principles set out in MT 2030 should be continued to be applied.

### June 1994

4.20 At the NTLG-FBT Sub-committee meeting the Tax Office informed practitioners that the review of Draft Taxation Determination TD 93/D275 was still with the Assistant Treasurer and a response was expected soon.

### September 1994

4.21 At the NTLG-FBT Sub-committee meeting the Tax Office informed practitioners that in respect to the review of Draft Taxation Determination TD 93/D275, the Government was considering LAFHAs and that it expected that an announcement would be made at the time of the cost of compliance review announcement.

4.22 The Tax Office also advised practitioners that the Government's cost of compliance review was almost complete and that a press release would issue soon from Government to announce the results of the review.

4.23 Practitioners expressed concern about the possibility of new legislation coming out of the FBT cost of compliance review, any delay in announcing any changes and those changes being introduced retrospectively.

### December 1994

4.24 At the NTLG-FBT Sub-committee meeting the Tax Office advised that approximately 50 per cent of audit adjustments to FBT returns related to omitted benefits and the remaining 50 per cent related to the incorrect calculation of the taxable value of the benefits. Examples of commonly omitted benefits included expense payment benefits, car benefits, loan benefits and LAFHA benefits, with LAFHA benefits being incorrectly omitted as fringe benefits primarily because they were considered to be cash allowances.

### February 1995

4.25 Following a review into the FBT regime, the then Treasurer announced changes to the LAFHA provisions with the intention of minimising taxpayers' costs in complying with the tax laws and reducing the compliance costs for employers for employers liable to fringe benefits tax.

4.26 The Taxation Laws Amendment (FBT Cost of Compliance) Bill 1995 sought to modify the fringe benefits tax treatment of LAFHA benefits and other food and accommodation benefits provided to employees who were required to live away from their usual place of residence.

4.27 The Explanatory Memorandum to the Taxation Laws Amendment (FBT Cost of Compliance) Bill 1995, which proposed the amendments to the *Fringe Benefit Tax Assessment Act 1986* (the 'FBTAA'), stated that:

> …simple and certain rules about when an employee is considered to be living away from home will significantly reduce compliance costs. Time limits for when an employee is taken to be living away from his or her usual place of residence will remove the uncertainty that has existed on this issue. The guidelines issued by the Commissioner of Taxation in Taxation Ruling MT 2030 have been difficult for many employers to apply.

4.28 The amendments were to introduce new conditions that needed to be satisfied before a LAFHA benefit arose. The first condition was that the total unbroken residence period for which the employee has lived, or was required to live away from his or her usual place of residence did not exceed a maximum residence period. The amendments set out the maximum residence period for various groups of employees. If the employee was a person working in Australia on a temporary entry permit or an Australian working overseas, the maximum period was to be four years. If the employee was an Australian resident relocated elsewhere in Australia, the maximum residence period was to be 12 months unless the employee was living in a remote area, in which case the proposed period was two years. The amendments also defined the term 'total unbroken residence period'.

4.29 The second condition was that both the employer and employee would have needed to make declarations. An employer would have had to make a written declaration stating that the employee was required to live away from home for a period not exceeding the maximum residence period. In addition, an employee would have had to give the employer a declaration stating that he or she has lived, or intends to live, away from his or her usual place of residence for a total unbroken residence period that did not exceed the maximum residence period. The declaration had to be given to the employer for each year that the expenses were incurred.

4.30 The amendments also proposed to redefine the terms 'exempt food component' and 'exempt accommodation component' so that these amounts could be more easily determined:

- The amount of 'exempt food component' was to be simplified by setting out a formula in the FBTAA for its calculation, namely the difference between a 'reasonable food component' and the 'statutory food component'.

- The definition of 'exempt accommodation component' was to be simplified by limiting it to the amount actually incurred by the employee on accommodation. There was also to be an added requirement that the amounts be fully substantiated before the taxable value of a LAFHA could be reduced.

### March 1995

4.31 At the NTLG-FBT Sub-committee meeting general issues regarding the Treasurer's announcement on the cost of compliance review were discussed. The Taxation Institute of Australia also raised specific issues in relation to the proposed LAFHA amendments on the calculation of the total unbroken residence period requirement.

### August 1995

4.32 The Tax Office announced that Draft Taxation Determination TD 93/D275 was withdrawn. It stated that the basis for the withdrawal was that the topic was not considered to be a high priority and did not justify a public ruling.

### September 1995

4.33 At the NTLG-FBT Sub-committee meeting the Tax Office provided an update on the progress of the Taxation Laws Amendment (FBT Cost of Compliance) Bill 1995. It advised that the Bill had passed the House of Representatives on 20 September 1995 and that the Senate Economics Legislation Committee were to commence hearings of the Bill on 25 September 1995 and report to the Senate by 16 October 1995.

4.34 The Institute of Chartered Accountants also raised a number of issues and questions regarding the definition of 'maximum residence period' set out in the proposed LAFHA amendments.

### October 1995

4.35 The Senate Economics Legislation Committee tabled its Report on the Consideration of Provisions of the Taxation Laws Amendment (FBT Cost of Compliance) Bill 1995 in Parliament. The report states that there was general agreement in evidence presented to the Committee that LAFHAs offer compensation to employees rather than a benefit. A number of witnesses indicated dissatisfaction with the amendments proposed by the Bill which were anticipated to increase the cost and complexity of FBT compliance. There was concern associated with the setting of certain time periods to determine whether a LAFHA was an allowance subject to FBT or income tax. It was submitted to the Committee that the establishment of time frames in relation to LAFHAs was seen to create '…impractical and arbitrary limits which do not reflect commercial practice'. The placing of time limits on LAFHAs was also criticised on the grounds of favouring expatriates (who retained a four year exemption period) over Australian residents and the potential for wage discrimination between like employees subject to the same award conditions.

4.36 The Corporate Tax Association condemned the proposed changes to LAFHAs on the grounds that there would be increased costs to employers. It predicted that employees receiving set amounts based on certain treatment would expect their employer to cover any additional costs arising due to a change in treatment of LAFHAs. It also indicated that the construction and mining industries would be particularly affected by changes to LAFHA arrangements as many projects run for several years in both remote and non-remote areas. It submitted that this would mean that in many instances employees would not satisfy the proposed maximum residence periods and an additional tax burden would result.

4.37 The Institute of Chartered Accountants submitted to the Committee that the existing law concerning LAFHAs was 'not flawed and that the policy of the Commissioner inherent in his non-binding public rulings provides sufficient clarity for taxpayers to determine the circumstances in which employees are truly living away from home.

4.38 In its response, the then Government stated that the legislative provisions to be introduced by the Bill largely reflected existing practice. In response to concerns regarding increased substantiation requirements to be introduced by the Bill the Government argued that 'this is a measure designed to try to ensure that there is an element of equity, even if it is at some cost to simplicity.'

4.39 A more detailed Government response to the issues raised with the Committee appeared as Appendix 1 of the report. Importantly, the Government response sets out the underlying policy and objectives of the LAFHA provisions in the context of the overall taxation system:

> A basic principle of the taxation system is that, with very few exceptions, all forms of remuneration received by employees in respect of their work should be subject to either income tax or, in the case of fringe benefits, Fringe Benefits Tax (FBT). It is generally inequitable for some employees to receive tax free remuneration, while other taxpayers are subject to tax on their income. The LAFHA provisions provide an exception to this general tax principle in that they allow for a tax exemption for cash payments to employees under certain circumstances.
>
> The objective of the existing LAFHA provisions in the Fringe Benefits Tax Assessment Act (FBTAA) is to provide a special tax exemption to cover additional expenses incurred by an employee on accommodation and food, as a result of living away from his or her usual place of residence in order to perform employment duties. The LAFHA provisions are not intended to provide a tax exemption where the employee is not incurring additional expenses on accommodation and food under these circumstances. They are not intended to provide a tax exemption simply because a payment is made under an industrial award.
>
> In this regard, the tax system generally treats accommodation and food expenses of an individual as private expenses that have to be met from an individual's after tax income. Food and accommodation expenses incurred while travelling in the course of employment may be deductible to a taxpayer, but generally over much shorter periods than the periods over which LAFHA are claimed.
>
> Payments to an employee to take account of general disadvantages of living away from home are not exempt from tax under either the existing provisions of the tax law or under the proposed new provisions. There would be no more rationale for providing an exemption for such components than, for instance, providing an income tax exemption for components of wages and salary paid because a particular job was difficult or unpleasant in some way.
>
> In order to maintain the equity of the tax system and to achieve the objective of the LAFHA provisions, it is necessary to ensure, as far as practicable, that a tax exemption is not available where an employee is not genuinely living away from home or where an employee is not incurring additional accommodation or food expenses as a result of living away from home.

4.40 The Government response then went on to deal with the purpose behind the proposed legislative amendments:

> The existing legislation does not provide guidance on how to determine whether an employee living away from his or her usual place of residence. This had to be determined on a case-by-case basis, having regard to all relevant considerations. The new provisions seek to clarify whether a person is living away from home, by specifying time limits in the FBTAA. Accordingly, the new provisions provide a clear statement that a payment will not be a LAFHA where an employee is in a location for a period of more than 12 months (employees in remote areas have a two year limit and expatriate employees have a four year limit).
>
> Having clear limits on the availability of the LAFHA exemption is appropriate, given that the length of time that a taxpayer has lived in a new location is an appropriate benchmark for determining his or her usual place of residence. The Australian Taxation Office has advised that the 12 month limit is broadly equivalent to the way the previous tax provisions have been

interpreted. Where an employee is living in a location for more than 12 months, it appears appropriate to regard that location as the employee's usual place of residence (other than in special circumstances that apply where an employee is working in a remote location or an overseas assignment). This is particularly the case when meeting the test of living away from home allows the individual to receive a tax free allowance that may be worth thousands of dollars a year, when other taxpayers are required to pay tax on their income.

Under existing provisions, a LAFHA is subject to FBT except for so much of the allowance that would be concluded is in the nature of compensation to cover additional accommodation costs and exempt food components. There is no requirement for the employee to substantiate actual accommodation costs. The new provisions provide that, in order to receive an FBT-exempt component to cover additional accommodation costs, the employee will need to substantiate actual accommodation costs. This is appropriate, as there appears to be no grounds for allowing an individual a large tax free allowance over an extended period of time to cover accommodation expenses that are not being incurred. This is consistent with the tax principles that taxpayers are generally required to substantiate expenses (except under some limited circumstances) in order to receive a tax benefit in respect of that expenditure.

4.41 The minority report, in opposing the proposed LAFHA amendments, agreed with the view from the Institute of Chartered Accountants that the existing legislation regime was both efficient and equitable. In examining the principle behind LAFHAs, the minority report took the view that LAFHAs were not intended to be provided as 'forms of remuneration' but rather for additional out of pocket expenses for accommodation and food incurred by employees caused to support more than one household due to working away from home as a result of specific requirements of an employer. The minority report noted that the policy in this area has always been to recognise that such payments or allowances are not remuneration and the tax exemption is not the provision of a concession to certain employees enabling them to receive 'tax free remuneration'. The minority report also expressed concerns with the practical problems for employers in obtaining declarations and substantiation from employees.

### November 1995

4.42 The then Government announced that it was not proceeding with changes to the LAFHA provisions proposed in Taxation Laws Amendment (FBT Cost of Compliance) Bill 1995. At the Second Reading stage in the Senate, the Government indicated that the amendments removing the proposed LAFHA provisions are a result of the substantial concerns expressed by industry groups about the effect of the proposals and the effect that they might have on business.

### February 1996

4.43 Following the then Government's announcement that it was not proceeding with the changes to the LAFHA provisions, there was internal Tax Office consideration of how to best proceed forward to clarify what is the current state of the law and MT 2030. The FBT Cell raised a number of issues for discussion including:

- what is a 'usual place of residence';
- what is the distinction between a travelling allowance and a LAFHA;
- what 'time periods' are acceptable;

- how to determine the cost of the exempt accommodation component;
- what determines that a payment is a LAFHA;
- what are deductible expenses; and
- what will be the nature of the documentary evidence required.

4.44 The FBT Cell identified the following options in response to the current state of the law and examined the pros and cons in adopting each of the options:

- attempt to implement the 'cost of compliance' amendments administratively so as to achieve the same outcome as the proposed legislative change;
- do nothing and rely on the current version of MT 2030;
- promote law clarification by finding cases to test before the courts;
- undertake an audit or project so as to gather further information on the incidence and revenue consequences;
- fix any deficiencies with MT 2030 by redrafting into a new ruling or as an addendum to MT 2030;
- seek an alternative legislative solution, for example, move LAFHAs out of the FBT regime or nominate a place of residence; and
- redraft Draft Taxation Determination TD 93/D275.

4.45 These issues and options were considered at an internal Tax Office Technical Network meeting. The participants all agreed that option 2, that is to do nothing, was not an option. They noted that presently tax officers, employers and their professional advisers are facing many challenges in interpreting the provisions. The participants agreed that option 1 was inappropriate given the then Government's decision not to proceed with the amendments and the perception that the Tax Office would be usurping the role of Parliament. The participants also agreed that option 3, namely law clarification, was a good short term goal and could be undertaken concurrently with other options.

4.46 The discussion group concluded that the best course of action would be for the Assistant Commissioner (FBT) to initiate a project to gather information on the issues associated with LAFHAs, the project person to draft a comprehensive ruling on the subject to replace MT 2030 and ultimately to put forward a proposal for legislative change.

### March 1996

4.47 At the NTLG-FBT Sub-committee meeting the Tax Office indicated that it was keen to develop further initiatives to help reduce the costs of employers complying with FBT legislation. Previous work by the subcommittee in this regard had been most productive. With this in mind, the Tax Office proposed that a joint working party be formed to develop ideas.

4.48 The meeting agreed that from an administrative point of view there was not much further that could be done at this point in time to reduce compliance costs. For further inroads it was agreed that legislative change was necessary. The professions indicated the need for a mindset that has regard to policy — the intention of the law — rather than an over-concentration on the actual words. That better law and policy would be the result if it was developed and written on the basis that it could be understood and actioned by the 'local milk bar owner' without the assistance of their tax agent.

4.49 It was agreed that there was no real value setting up a joint working party just to look at administration options. It was agreed to defer setting up the working party until the Tax Office had clarified the new Government's position.

### October 1996

4.50 At the FBT Cell meeting Assistant Commissioner (FBT) discussed the escalation of the LAFHA matter to Large Business & International (LB&I), a business line within the Tax Office, with their representative on the Cell. The LB&I representative agreed, given a submission from an external representative body concerning LAFHA issues generally was LB&Is responsibility. LB&I subsequently agreed to undertake a review of LAFHAs.

### April 1997

4.51 At the NTLG-FBT Sub-committee meeting the Australian Society of Certified Practising Accountants (ASCPA) submitted:

> The question is often asked as to how long a person can be living away from their usual place of residence to perform their duties of employment and be entitled to the living away from home concessions available under the Fringe Benefits Tax Assessment Act.
>
> In particular, a foreign holding company may send employees to Australia for secondments of two years, three years, four years or even as long as five years. It is always the intention that these employees will fulfil their duties of employment for the time stated in their contract and then return to work in their home country to resume their employment duties at the end of their secondment.
>
> There are various statements of folk law surrounding how long an employee from a foreign country can provide services to a subsidiary in Australia and still be considered to be living away from home. This folk law states that the time is usually four years. It is not uncommon however for a very senior executive within an organisation to take a secondment of greater than four years, for example five years.
>
> In respect of local secondments, that is, an employee being seconded from one state to another to fulfil his duties of employment for a specified time before returning to his home state, such secondment are usually for one or two years, but in some instances can be three to four years.
>
> Folk law states that for a domestic secondment an employee can live away from home for up to two years.

4.52 The ASCPA requested some indication from the Tax Office as to whether it had guidelines as to how long a person can live away from home in the above two circumstances before the Tax Office would consider that the employee was no longer living away from home. The ASCPA noted that all cases would be determined upon the facts, however indicated that a general guidance would be of assistance in determining whether an

allowance paid to an employee for the additional costs of food and accommodation would be considered to be an exempt living away from home allowance under the provisions of the FBTAA.

4.53 In response, the Tax Office stated that there was no set period beyond which it considers an employee no longer to be living away from his or her usual place of residence. The decision as to whether a person is living away from home is one of fact which depends on the person's particular circumstances.

4.54 The Tax Office pointed to paragraphs 11-25 of MT 2030, which it stated satisfactorily set out the Commissioner's view on this issue and to the examples of cases contained in MT 2030 which had been decided on appeal by the Commonwealth Taxation Boards of Review and the Administrative Appeals Tribunal.

4.55 The Tax Office advised that it would remind staff that the issue of LAFHAs was to be treated on a case by case basis and that there are no set time limits.

### July 1997

4.56 The LB&I Property & Construction segment informed FBT Cell that research of LAFHAs was completed concerning the cost of compliance associated with the matter. Although LB&I agreed there was an issue to be addressed, there were insufficient technical resources available at the time to handle the matter. The issue was referred back to the FBT Cell.

### September 1997

4.57 At a FBT Cell meeting LAFHAs were acknowledged as being an area of ongoing review and concern for many years. Following on from the decision by LB&I, the FBT Cell discussed the history of the issues relating to LAFHAs. The minutes of the meeting of the FBT Cell stated that 'the Cell confirmed, subsequent to discussing the above, that at this stage, MT 2030 remains Tax Office policy.' The following was also noted:

- MT 2030 does not appear to be the main problem, rather it is the word 'usual' in section 30 of the FBTAA which is causing difficulty;
- the Tax Office should flag the issue — while audits are not justified, perhaps a suitable extreme case will present itself or law change would be good options;
- neither the draft taxation determination nor legislative amendment is to proceed;
- MT 2030 is government policy;
- three Administrative Appeals Tribunal cases have looked at LAFHAs however MT 2030 is still interpreted as Tax Office policy;
- litigation is still on the agenda if a suitable 'extreme' case arises;
- if large revenue leakage can be identified, the issue could then be raised with government again; and

- if opportunity arises to amend the legislation again, the Tax Office will suggest time limits for section 30 of the FBTAA as per previous submission to Government; 12 months for domestic, 2 years for domestic in remote areas and 4 years for expatriates.

### February 1998

4.58 The Tax Office commenced enquiries as a result of community information relating to the alleged misuse of LAFHAs by a labour hire organisation within the IT and computer consulting industries. This initial investigative work was focussed on gathering information as to the arrangements in place.

### January 1999

4.59 A media report is aired on national television which focussed on foreign visitors, predominantly 'backpackers', and alleged that tax was not being paid on income earned in Australia. A dominant theme in the segment was that Australian tax revenue losses were substantial.

### April 1999

4.60 The tax officers involved in the initial review of the matters prepared a project plan. The project plan outlined an approach to investigating alleged tax avoidance through the use of umbrella companies and trusts in labour hire arrangements. The objectives of the project included:

- to establish the extent of the risk to revenue as a result of the use of umbrella company and trust arrangements;
- to prevent the proliferation of these types of arrangements;
- to establish the Tax Office view on the technical issues involved in these arrangements;
- to communicate the Tax Office view to all stakeholders; and
- to develop an enforcement strategy for future compliance activity.

4.61 The Tax Office set up an audit project team as an outcome from the identified risks set out in the project plan, the purpose of which was to review the operations of certain entities.

### May/August 1999

4.62 Following the establishment of the audit project team a number of entities were interviewed and relevant records, including wage records, were gathered. The audit team also prepared a draft letter to be sent to all participants which included a Tax Office position paper concerning the arrangements.

### September/October 1999

4.63 Internal Tax Office discussions involving various technical areas with the aim of developing a Tax Office view on the LAFHA issues regarding umbrella companies and to discuss some of the technical issues with a view of getting clarity in the Tax Office's approach.

4.64 Soon after, the Tax Office issued identified entity representatives with a draft position paper on the arrangements with the view of then circulating it to all affected taxpayers so as to encourage voluntary disclosures. The purpose of the draft position paper was to provide taxpayers with guidance about the views and approach of the Tax Office to LAFHAs paid to foreign nationals working in Australia.

4.65 In the draft position paper the Tax Office took the view that foreign nationals visiting Australia employees travelling on Working Holiday Maker ('WHM') visas did not qualify for LAFHAs regardless of whether they were engaging in casual or professional employment in Australia. However, the Tax Office indicated that foreign nationals entering Australia on permanent visas (that is, non-WHM visas) may qualify for LAFHA fringe benefits and the Tax Office's views on this topic were contained in MT 2030.

4.66 The taxpayers' representatives were critical of the draft position paper.

### October 1999

4.67 The draft position paper was withdrawn on the advice of the FBT Specialist Cell and the Tax Counsel Network within the Tax Office. Both advised that these arrangements should be looked at on a case by case basis and discouraged a global approach to reviewing these arrangements.

4.68 The review of the arrangements by the audit project team continued, and all taxpayers supplied records requested.

### October/November 1999

4.69 The audit project team considered that the argument for the application of Part IVA was strong and approached the Tax Counsel Network on this issue. However, the Tax Counsel Network advised that the argument for Part IVA was not strong enough to take before the Part IVA Panel.

### October 1999 — April 2000

4.70 Audits were commenced on taxpayers receiving a LAFHA through a number of labour hire organisations.

### November 1999

4.71 The audit project team, the FBT Specialist Cell and the Tax Counsel Network discussed a possible taxation determination on foreign nationals receiving a LAFHA while on a working holiday visa.

### February 2000

4.72 At the NTLG-FBT Sub-committee meeting a number of practitioners raised concerns with the apparent absence of any response to cost of compliance issues raised by the forum. The Law Council of Australia questioned the usefulness of discussing cost of compliance issues at these meetings when the matters were not drawn to the attention of Government. It commented that the NTLG-FBT Sub-committee was set up to allow the professional bodies to have meaningful input into the interpretation of the law and to provide feedback on compliance issues. This information would enable the Tax Office to inform the Government

of the way the law was working, whether the law was having an inappropriate impact and whether the policy of the law was appropriate.

4.73 The Tax Office stated the NTLG-FBT Sub-committee was not the correct forum for requesting amendments to the law that impact on clear government policy intent. Rather, it stated that the NTLG-FBT Sub-committee was a forum for forwarding practical ideas on administration issues to the Tax Office and technical corrections. The Tax Office emphasised that ideas brought up at these meetings were not dismissed but go forward as far as the Tax Office can take them given the parameters that it has to work within.

4.74 The Law Council of Australia disagreed and thought it was the Tax Office's role and indeed the Commissioner's role to report to Government where the law is too complex to administer or cost of compliance is too high. It argued that the definition of technical correction depends on what the view of the intended original policy.

4.75 The Tax Office stated that, in relation to issues, the professional bodies have generally already put submissions to Government, the Government has put legislation into place and subsequently the issue is again raised at this forum. In these cases, the Tax Office advised that it is bound by Government policy and intent.

4.76 The ASCPA stated members feel frustrated because of a lack of transparency as they cannot perceive whether the Tax Office is progressing issues and, if so, how strongly were these issues being raised with Government and what were the potential problems.

### April/May 2000

4.77 On 5 April 2000 the Tax Office released Draft Taxation Determination TD 2000/D5 titled *'Income tax: can a foreign national who enters Australia on a working holiday maker visa qualify for living-away-from-home allowance fringe benefits*. The Tax Office's response was 'No' deciding that allowances described as either living-away-from-home, subsistence, location or living allowances which are paid to a foreign national working in Australia on a working holiday maker (WHM) visa did not qualify as LAFHA benefits under section 30 of the FBTAA. The Tax Office took the view that these allowances should be treated as income and were subject to PAYE taxation.

4.78 The Draft Taxation Determination TD 2000/D5 expressed the view that:

> The prime purpose of a WHM visa is for a holiday and this is a requirement for the granting of the visa. Any work undertaken in the course of living in Australia whilst on a WHM visa is meant to be incidental to the holiday and solely to supplement funds of the visitor.
>
> A foreign national who enters Australia on a WHM visa is unable, in view of the conditions of that visa, to demonstrate a causal connection between any additional expenses incurred whilst living in Australia and a requirement to live away from their usual residence overseas to undertake that employment. WHM visas are granted so that a person has an opportunity to holiday in Australia and supplement their funds through incidental work. Any additional expenses incurred by such a person as a consequence of living away from their usual place of residence overseas arise by reason of undertaking a holiday and not as a consequence of their incidental employment.
>
> Foreign nationals working in Australia on temporary visas, which are not WHM visas, may still qualify for LAFHA benefits. Miscellaneous Taxation Ruling MT 2030 outlines the ATO's views on what is necessary for a person to qualify for LAFHA fringe benefits.

4.79 There was critical external feedback, in particular on the global approach taken by the Tax Office. Tax practitioners were of the view that the draft taxation determination should be withdrawn as the question raised could not be answered in a simple 'Yes' or 'No' format. This was because the issue of qualifying for LAFHA fringe benefits was a question of fact and that a foreign national who enters Australia on a WHM visa was not of itself sufficient to determine whether somebody would qualify for a LAFHA. The view was also expressed that a person's visa status is but one of many factors that may be taken into consideration when determining whether one qualifies for a LAFHA benefit.

4.80 One tax adviser provided the Tax Office with a legal opinion on whether, in order to be within the scope of section 30 of the FBTAA, an employee must have been employed by the Australian employer in the employee's home country before coming to Australia. The opinion expressed the view that this was not a requirement of subsection 30(1) of the FBTAA.

### June 2000 — October 2000

4.81 Further audits were undertaken including section 264 interviews with participants and profiling of participants from information provided to the Tax Office and available from the Tax Office's information systems. The audit project team also continued to gather records and information from individual employees and each of the taxpayers' representative members. Interviews were also held with a number of the labour hire firms and some end users.

### November 2000

4.82 A brief to counsel for advice was prepared by the audit project team in conjunction with the LB&I line.

### December 2000

4.83 The Tax Office received counsel's advice on a number of issues arising from the audit project including 'secondment' and 'usual place of residence'. The Tax Office also received counsel's advice on the application of Part IVA on a number of arrangements set out in the brief to counsel. The advice indicated that there was a strong argument for the application of Part IVA in the arrangements set out in the brief to counsel.

### February 2001

4.84 The FBT Technical Leader (Centres of Expertise), in a short internal position paper, provided an overview of relevant FBT considerations in relation to the issues arising for consideration from the Tax Office's audit project. The internal position paper noted numerous matters including the following:

- Section 30 of the FBTAA requires a conclusion to be made about an employee's factual situation making a global approach to different classes of employees difficult.
- There would be a heavy compliance burden in checking the bona fides of all the employees, as strictly speaking, a determination has to be made on the circumstances relating to each employee.

- Although it was generally accepted that MT 2030 provides suitable guidelines for LAFHA issues, there are cases, such as those being investigated by the audit project team, where MT 2030 falls short of providing definitely 'clear' guidelines.

- Since MT 2030 was issued there have been a number of reviews of the Tax Office's policy as well as legislative attempts to amend the LAFHA provisions.

- A 'global' approach was taken in regards to employees on working holiday maker visas in Draft Taxation Determination TD 2000/D5. There have been three submissions from externals in relation to the draft taxation determination, including a joint submission from the peak bodies, that disagreed on the views expressed in the draft on a number of issues including the 'global' approach without due regard for individual employee circumstances.

- One submission included counsel's advice that continuity of employment with an employer is required, that is there does not have to be an element of 'secondment' involved before the LAFHA provisions can apply. This conflicted with counsel's advice obtained by the Tax Office that there must be an 'element of secondment from a permanent employment elsewhere'.

- In working out the exempt components, in the cases under review, conclusions as to what additional expenses might reasonably be expected to be incurred by the employee, not the actual expenses incurred, will need to be undertaken, as it is arguable that the amounts being paid are, in many cases, not reasonable. This would require the employers to provide information on how they calculated the exempt components.

- Employers have not lodged FBT returns on the basis that no amount is subject to FBT.

4.85 An internal Tax Office meeting of officers from the relevant business lines that were involved in the project was held to determine the Tax Office view and approach on these arrangements. However, the forum was unable to agree on a Tax Office position to deal with these arrangements and it was decided that a paper be prepared for forwarding to the Tax Office's Aggressive Tax Planning Steering Committee.

### March 2001

4.86 The Small Business (SB) line expressed concern with the delay in getting the paper that was to go before the Aggressive Tax Planning Steering Committee finalised. A file note indicated that this concern came from the amount of revenue at risk and the expectation by management that the SB line 'put to bed its work on Aggressive Tax Planning in the next 6 months'.

4.87 A further brief was prepared for the LB&I business line to take to the Tax Office's Aggressive Tax Planning Steering Committee for their advice.

### April 2001

4.88 The LB&I business line reported that a member of the Aggressive Tax Planning Steering Committee advised to take a 'slowly, slowly approach' and issue only a small manageable number of amended assessments. The Committee expressed concerns about the number of objections if bulk amended assessments were issued. The audit project team were advised to continue the audits of the foreign national workers and to commence the issuing of amended assessments but in small volumes.

## May 2001 — July 2001

4.89 As part of a Corporate Callover and in describing the strength of the Tax Office view relative to the taxpayers' or industry view, the audit project team indicated that the Tax Office view was that employees had not been seconded to work in Australia but rather had made a lifestyle choice to live here. It stated that most had initially travelled to Australia on WHM visas with no immediate plans to work here but some had subsequently applied for sponsorship to gain long stay business visas and extended their stay. The audit project team also noted that, to date, all barriers had been of a technical nature with disagreement within various technical areas of the Tax Office on certain legal issues, in particular the interpretation of 'usual place of residence'.

4.90 The factual circumstances of two taxpayers were put to the FBT Technical Leader (Centre of Expertise), who agreed on the individual facts that it was arguable that there was no entitlement to a LAFHA in either case. The audit project team proceeded to issue an amended assessment to each of the taxpayers including in their assessable income the payments made to them as LAFHAs.

4.91 The audit project team again approached the Tax Counsel Network, with counsel's advice and further examples, to consider the application of Part IVA. The Tax Counsel Network advised that they were of the view that Part IVA applies to these arrangements and that a submission should be prepared for the Part IVA Panel.

## August 2001

### Tax Office strategy

4.92 The Tax Counsel Network advised that the audit project team should not issue further amended assessments until the Part IVA Panel's decision.

### NTLG-FBT Sub-committee meeting

4.93 At the NTLG-FBT Sub-committee meeting, practitioners noted that the distinction between whether a person is living-away-from home or travelling in the course of his or her duties of employment is often very blurred. They commented that it was important to distinguish whether an allowance paid is a living away from home allowance or a travelling allowance as the decision as whether to treat the allowance under the Fringe Benefits Tax Assessment Act or the Income Tax Assessment Act is dependant on the characterisation of the allowance.

4.94 Practitioners also noted that in today's changing environment it was more common for employees to travel for extended periods of time in performing their duties of employment. To assist with the decision making as to whether an employee is travelling, rather than living away from home, CPA Australia set out three examples where it believed that employees were travelling, rather than living away from home even though their absence from their usual place of residence exceeds 21 days. The Tax Office's views were sought on each of the examples.

4.95 As part of the discussion, CPA Australia sought clarity for employers who at the start of a project have to determine whether an allowance paid to employees is a LAFHA or a travel allowance. It observed that the rule of thumb was to apply Miscellaneous Taxation Ruling MT 2030, including the 21 day rule contained in paragraph 21, and the decision in *Roads and Traffic Authority of NSW v FC of T*.

4.96 However, CPA Australia stated that from both practical and compliance perspectives, at the beginning of a project an employer may not be in a position to know the circumstances of each individual employee. At that time the full term of the project and individual circumstances is not known or will alter. For example, employees may not live in a set area for the period of the project. They may move to different places following the project and the regularity of them returning to their usual place of residence changes. Circumstances may vary for individual employees depending on their marital status. Some employees may choose to return to their usual place of residence regularly, some may not. An employer may decide to provide employees with a travelling allowance, on the basis of known facts at that time, but later becomes aware the entitlement was in fact a LAFHA. There are obvious compliance costs involved in rectifying both the FBT and income tax positions (employer and employee).

4.97 In response, the Tax Office advised that the scenarios contained in the submission were quite factual and would require numerous assumptions and queries to be made when providing a response. However, the Tax Office acknowledged that there are administrative costs for employers in complying with the provisions.

4.98 The Tax Office advised that the individual circumstances of employees must be determined before concluding whether in fact an employee should be in receipt of a 'travel allowance' or LAFHA. The Tax Office stated in circumstances where an employer considered MT 2030 did not provide sufficient guidance the employer should consider lodging a private binding ruling request. In referring to MT 2030, the Tax Office noted that paragraph 41 provided general guidance in situations where an employee was away from his or her home for a brief period. The Tax Office advised that the '21 day rule' is a general practical rule. The rule was meant to apply when it is difficult for the employer to conclude that the employee was living away from home or travelling. The final sentence in paragraph 41 is sometimes overlooked and for longer periods, those in excess of 21 days, it would be necessary to determine the nature of the allowance being paid/to be paid by reference to the guidance provided by MT 2030.

4.99 The Tax Office also provided some background and general discussion concerning attempts, subsequent to the issue of MT 2030, to alleviate concerns raised in relation to the LAFHA provisions. During that period of time, when attempts have been made to 'simplify' the requirements of the LAFHA provisions, due to the number of parties lodging submissions or lobbying against proposed changes, the attempts to date have not been successful.

4.100 For example, the Tax Office noted that in 1993 it had initiated a review of MT 2030. Submissions were invited from practitioners and peak bodies. The Tax Office indicated that the 1993 review identified some administrative issues however the final decision was that the broad principles contained in MT 2030 were correct. The decision as to whether a person is living away from home is one of fact and employers have to obtain sufficient information relating to the individual employee circumstances and determine whether the employee is living away from home or not.

4.101 The Tax Office acknowledged the practical and compliance difficulties for large corporations dealing with LAFHA issues. The Tax Office referred to *Roads and Traffic Authority of NSW v FC of T* and advised that large employers do generally make every effort to comply with the administrative requirements, by having declarations in place and examining individual circumstances in determining whether an employee is living-away-from-home or not.

4.102 At the last meeting of this forum the CPA Australia, on behalf of the group, proposed that a joint submission should be prepared for the purpose of highlighting to Government the complexity of the FBTAA and resulting compliance issues. The Tax Office suggested that if this submission goes forward the practical difficulties around LAFHA and suggested 'simplification' could be incorporated into such a submission.

### Issuing of amended assessments

4.103 The Tax Office issued amended assessments in respect of an individual taxpayer.

4.104 The basis for the amendment was that payments of LAFHA were not LAFHA benefits for the purposes of the FBTAA and thus were assessable to the taxpayer as assessable income. It was concluded that the taxpayer's 'usual place of residence' was considered to be Australia and that he had clearly indicated that his intention in coming to Australia was for a working holiday. Also the taxpayer had arrived in Australia on his own accord under a temporary 417 Working Holiday Maker visa. The taxpayer continued to reside in Australia.

4.105 The taxpayer did not dispute the amended assessments, which were maintained.

4.106 On advice from Tax Counsel, the project team refrained from issuing further amended assessments until after the Part IVA Panel has an opportunity to consider the issues.

## August/September 2001

4.107 The Tax Office staff at an enquiry desk noted an escalating number of enquiries from non-resident backpackers regarding umbrella arrangements. In an email to the audit project team they set out a number of examples of individual taxpayers seeking assistance at the enquiry desk on LAFHA issues. They also indicated that they were so concerned about this issue that they held a special team meeting where they were able to air their views and recent experiences. They expressed concern that the longer the issue remained unresolved, then the greater the risk that this would signal Tax Office acceptance of these arrangements. They requested that the issue be resolved, not only because of the revenue implications, but also to avoid further unnecessary confusion and frustration.

4.108 The audit project team escalated these concerns to the Tax Counsel Network noting that the non-resolution of Draft Taxation Determination TD 2000/D5 would continue to escalate such enquiries. It was also noted that staff had currently been adopting the approach supported by TD 2000/D5, even though it was subject to external criticism. The view was taken that TD 2000/D5 was indicative of the interpretation of the Tax Office view and until such time as it is withdrawn it was proposed to continue to follow the position adopted in this draft taxation determination and encouraged all other sites to adopt a similar approach.

## September 2001

### 1st Part IVA Panel Meeting

4.109 The Part IVA Panel examined an arrangement (which was later characterised by the Tax Office as a Category 1 arrangement[2]) set out in the audit project team's submission and indicated that there was a strong argument for the application of Part IVA. This was based on counsel's advice which took the view there was scope for the operation of Part IVA if it was accepted that the LAFHA which is partly substituted for salary and wages is exempt under section 23L of the ITAA 1936. However, the Part IVA Panel asked the audit project team to put forward a further submission setting out:

- detailed specific cases from three different categories/variations of the scheme;
- draft Part IVA determinations;
- reasons for decision; and
- draft a taxation ruling on these arrangements, including the application of Part IVA. The Tax Counsel Network had undertaken responsibility to prepare the draft Ruling.

4.110 During this time, a number of taxpayers, including those interviewed by the Tax Office, some from as far back as 15 months prior, began enquiring of the Tax Office as to the Tax Office view and whether the Tax Office will be taking further compliance action including issuing amended assessments. The audit project team advised that the Tax Counsel Network was reviewing these arrangements and that they would be informed when the Tax Office view was finalised.

## October 2001

### Letter from taxpayers' representative

4.111 A letter from the taxpayers' representative regarding the Tax Office's ongoing project and outlining its possible unforeseen implications on Australia and the Australian economic environment. The letter also requested that the Tax Office view be documented in respect of its treatment of LAFHAs.

4.112 Draft letter prepared by audit project team referring to MT 2030 and providing some details on the deliberations of the Part IVA Panel on the application of the general anti-avoidance provisions to the identified arrangements. The draft letter also indicated that the Tax Office proposed to shortly commence issuing amended assessments to reflect its view and that a new ruling was also being prepared.

4.113 In a file note prepared by the audit project team leader, it was stated that Tax Counsel advised that the draft letter not be sent as it was inappropriate to quote minutes of the Part IVA Panel, there should be no mention that a new public ruling is being drafted and there should be no mention that assessments may issue after the ruling is drafted. Tax Counsel also advised that as long as there has been an acknowledgement of the receipt of the letter for Taxpayers' Charter purposes, that the Tax Counsel Network will draft an appropriate response. Tax Counsel indicated that a response may be delayed till a time after

2 See paragraph 4.138 for a more detailed description of a Category 1 arrangement.

the election and that no mention should be made of the new ruling as FBT will need to be consulted and approval from the Public Rulings Panel would be required.

4.114 There was also mention of a recent attempt by the Tax Office to suggest legislative change but Government had advised that the legislative program was full and nothing further could be done. Tax Counsel expressed the view that if the Part IVA Panel decided that Part IVA only applies in 2 of the categories of arrangement then this may accelerate the push for legislative change as some employees will be 'still be getting through the net'. The audit project team leader suggested that if the Part IVA Panel decides that Part IVA applies to all 3 categories of arrangement and the Tax Office issues a new ruling, then this may provide an impetus to accelerate legislative change as it would be clear that there was a clear opening for abuse of the current legislation and retrospective action. The audit project team leader also indicated that the current lack of resources may mean that the Tax Office can only 'scratch the surface' and will not guarantee a stop to these arrangements.

### Issuing of amended assessments

4.115 The Tax Office issued amended assessments in respect of another individual taxpayer.

4.116 The basis for amendment was that payments of LAFHA were not LAFHA benefits for the purposes of the FBTAA and thus were assessable to the taxpayer as assessable income. It was concluded by the Tax Office that the taxpayer's 'usual place of residence' was considered to be Australia and that he had clearly indicated that his intention in coming to Australia was for a working holiday. Also, the taxpayer came to Australia on his own his own accord under a temporary 417 Working Holiday Maker visa. After 12 months he decided to extend his stay by seeking and securing sponsorship as he wanted to holiday and travel around Australia. The taxpayer subsequently left Australia permanently. The decision to allow the objections in full was on the basis of a review of the facts and an application of the guidelines provided by MT 2030. It was accepted that the taxpayer was in fact living away from home, that the section 30 was satisfied and therefore s23L of the ITAA 1936 applied such that the 'allowance was excluded from assessable income.

4.117 Subsequently, this taxpayer disputed the amended assessments and duly lodged objections in August 2004. Upon review, the objections were allowed in full in the taxpayer's favour and amended assessments reflecting that decision were issued to the taxpayer in September 2005.

4.118 This was the second taxpayer to receive amended assessments. Following the advice from Tax Counsel, no other amended assessments were issued.

## November 2001

4.119 The Tax Counsel Network officer advised that the draft taxation ruling would not be completed in time and that the LAFHA issue was to be withdrawn from the agenda for the next Part IVA Panel meeting.

## December 2001

4.120 A meeting was held between the audit project team, the Tax Counsel Network and the Business & Personal Taxes Centre of Expertise (FBT) where a timeline and responsibility of tasks was agreed.

4.121 The Tax Counsel Network also advised that it would be required to review the policy, background and relevant history files before any re-draft of Miscellaneous Ruling MT 2030 could move forward.

4.122 The Tax Office received an email a taxpayer requesting that the Tax Office issue them with a formal audit letter. The taxpayer stated that this was being requested as, in their view, the Tax Office's intended outcome of the current investigation was the issuing of prior year amended assessments which is consistent with what occurs as part of a formal audit. The taxpayer also requested whether, once the Tax Office has determined its position, it would seek to apply this on a retrospective or prospective basis.

### January 2002 – March 2002

4.123 The history files are reviewed by the Tax Counsel Network officer before discussions of a draft taxation ruling can commence between the Tax Counsel Network and the Business & Personal Taxes Centre of Expertise (FBT).

### January 2002

4.124 The audit project team's investigations were to continue without making any Part IVA determinations or issuing any amended assessments. The audit project team also commenced new audits on foreign nationals working through particular labour hire organisations.

4.125 The Tax Counsel Network prepares a discussion paper to be presented to Treasury seeking changes in the FBT legislation as it applies to LAFHAs.

### February 2002

4.126 The Aggressive Tax Planning Risk Review Panel recommended that a Taxpayer Alert be prepared as the drafting of a new taxation ruling was taking longer than expected and it was considered important to highlight to the community the Tax Office's concerns with particular arrangements.

4.127 A first draft of the Taxpayer Alert and the accompanying submission was prepared by the audit project team. The Tax Counsel Network instructed that the Taxpayer Alert be held in abeyance and await the redraft of the ruling.

### February 2002

4.128 In a reply to the December 2001 email, the Tax Office stated that they were not in a position to issue a formal audit letter. The reply mail indicated that the Tax Office had earlier informed the taxpayer that it was not formally auditing their business but have been conducting interviews with several individual employees. The Tax Office also stated that its requests for payroll records in relation to individual employees who have or had connection with the taxpayer should not be interpreted as the initiation of an audit. The Tax Office stated that, on this basis, it would be most inappropriate for it to issue a formal audit letter.

4.129 In its reply to the above email, the taxpayer stated that it was not convinced by the Tax Office's conclusions that the umbrella project was not an audit or that the information gathered under the name of the umbrella project would not be used by the Tax Office to issue amend assessments. In order to protect its rights under the law, the taxpayer again

requested that the Tax Office issue a formal audit letter and a formal legal indemnity to protect it from the Tax Office taking any retrospective amendment action.

### March 2002

4.130 The Tax Counsel Network, being responsible for providing strategic direction in relation to the progress of this matter, indicated that the main task was to withdraw and rewrite MT 2030 so that it accords with the law as developed by the courts and tribunal and to get the Tax Office view out as soon as possible. Alternatively, if the task of completely rewriting was too large to be done quickly it was suggested that a taxation determination could be issued on the key points and withdraw wholly or in part MT 2030.

4.131 The Tax Counsel Network advised that resources were to be applied to assist with the task of a rewrite of MT 2030 (or the drafting of any new taxation ruling or taxation determination) and to assist the audit project team in preparing their submission to go before the Part IVA Panel.

### April/May 2002

4.132 An internal Tax Office meeting was held involving the Tax Counsel Network, the Business & Personal Taxes Centre of Expertise (FBT) and the audit project team to ensure a shared understanding of exactly what stage the project was at and to agree on the future direction of the project. Tax Counsel expressed the view that the correct way forward was to firstly rewrite MT 2030 as this would set the foundations prior to undertaking more targeted strategies in the future, such as issuing a Taxpayer Alert and Part IVA determinations. It was also acknowledged at this meeting that despite a Taxpayer Alert being prepared for submission to Tax Counsel for consideration it was unlikely that the Alert would be issued prior to the release of the rewrite of MT 2030. The reason given for this was that following the release of the Alert it would be necessary to release, within 60 days, a Part IVA ruling.

4.133 The following forward strategy was agreed to at the meeting:

- The Tax Counsel Network would commence the rewrite of MT 2030.
- The audit project team would update estimates of revenue leakage and would continue to obtain information relating to gross payments from end users/labour hire firms in order to satisfy the request from the Part IVA Panel.

4.134 It was noted at this meeting that the proposed forward strategy represented a departure from the strategy agreed to in December 2001. Under the new strategy Part IVA submissions would be delayed in going before the Part IVA Panel and, depending on the effectiveness of the redraft of MT 2030 in stopping the umbrella arrangements, there may not be a need to issue Part IVA determinations. The audit project team noted concern with this outcome as Part IVA determinations were considered as an effective means of retrospective action on all cases audited to date.

4.135 The drafting of a new taxation ruling on LAFHA was to be undertaken by the Business & Personal Taxes Centre of Expertise (FBT), with input from the audit project team leader under the direction of the Tax Counsel Network.

## May 2002

### Tax Office meeting with the Treasury

4.136 A meeting was held between Tax Office compliance officers, technical officers and the Treasury to discuss how the Tax Office should deal with LAFHAs both generally and in the context of the project. It was stated that it was the government's intention to encourage skilled foreign nationals to work in Australia. The principle recommendation by the Tax Office was for the existing legislation to be repealed and replaced with a new legislative regime for dealing with LAFHAs, which would include specific time periods over which LAFHAs could be claimed and prescribed percentages of remuneration which could be claimed as LAFHAs. A number of participants, including tax officers, challenged the need for legislative change especially given the absence of any court decisions considering the scope of the existing legislation. In response, it was argued that the existing provisions were difficult to apply and contained onerous factual tests such as what is the recipient's usual place of residence, whether the amount is being paid is in the nature of compensation and after what period of time does a recipient's usual place of residence become Australia. Some in the meeting, including tax officers, also queried why it was necessary to use Part IVA when it could be argued that the arrangements implemented do not satisfy the requirements of section 30 of the FBTAA.

4.137 The consensus of the meeting was that a litigation strategy should be pursued prior to approaching the Government with the recommendation of a new regime. It was suggested that cases should be selected from a wide spectrum of factual scenarios, with cases where the facts are in the Tax Office's favour and also cases where the facts are not in favour of the Tax Office. In response, it was suggested that the Tax Office litigation strategy was to run cases where the facts were in the Tax Office's favour and that the Tax Office should be selecting test cases that gave it the best chance of winning. For example, it was preferable to select cases where the amount of LAFHA claimed is high, no secondment occurred, the employee had initially arrived on a WHM visa and a LAFHA had been claimed for a long period.

4.138 It was recommended that the correct Tax Office strategy for LAFHAs should be to select and litigate 20 or 30 cases where individuals were participating in 'umbrella company' arrangements. A minute was also to be prepared advising the Government of the problems being encountered by the Tax Office with LAFHAs and its proposed strategy of litigating test cases. Further, work on a new taxation ruling was to continue for the purposes of forming a new Tax Office view on LAFHA issues and the release of the taxation ruling may be withheld until a court decision.

4.139 The audit project team recommenced audits on foreign nationals with the intention to complete 50-100 audits over a 6 month period.

### Revenue Analysis Branch

4.140 The Tax Office's Revenue Analysis Branch estimated that there were approximately 10,000 employees with no entitlement to a LAFHA representing $170 million in revenue forgone. It was also estimated that if there was a move of the remaining employees on WHM visas into these arrangements it would put up to $135 million in revenue at risk.

## July 2002

### 2nd Part IVA Panel Meeting

4.141 The Part IVA Panel considered the Part IVA submission setting out a number of factual scenarios for various cases which fell within three different categories of arrangements. The three categories of arrangements were described as follows:

- Category 1 arrangements involved a labour hire firm (LHF) having found work for the foreign national (the 'employee') and contractual arrangements between the end user, the LHF and the employee. Subsequent to these arrangements an umbrella company is interposed between the LHF and the employee and new contracts are entered into between the employee and the umbrella company and between the umbrella company and the LHF.

- Category 2 arrangements involved an employee being directed to an umbrella company by a LHF or requests that an umbrella company becomes involved before contracting with the LHF. The LHF finds work for the employee but the employee is not employed at any stage by the LHF and is only employed by the umbrella company.

- Category 3 arrangements involved an employee finding an end user of their services without the assistance of a LHF. The employee then entered into a contract of employment with an umbrella company and the umbrella company entered into a contract of employment directly with the end user.

4.142 The Part IVA Panel concluded that Part IVA would apply to the Category 1 and Category 2 arrangements as the dominant purpose of interposing the umbrella company between the employee and the LHF was to characterise the payment as a LAFHA in substitution for salary and wages. The Part IVA Panel concluded that Part IVA may not apply to the Category 3 arrangements. It was considered that Part IVA would not apply if it was apparent that the dominant purpose of dealing with the umbrella company was dictated by reasons other than tax. However, the Part IVA Panel did not rule out the application of Part IVA to some Category 3 arrangements.

4.143 The Part IVA Panel commented that in the majority of the cases under review it was highly likely that the payments were not genuine LAFHAs with the consequence that they would not be a fringe benefit pursuant to section 30 of the FBTAA and not exempt from income tax in the hands of the employees pursuant to section 23L of the ITAA 1936. The Part IVA Panel also noted that the Tax Office compliance strategy should recognise the possibility that the payments may be held to constitute LAFHAs by the courts. To cover this possibility it was suggested that the Tax Office should also issue protective FBT assessments against the umbrella companies on the basis that the requirements for the reduction in taxable value had not been met. One member of the Part IVA Panel commented that the Tax Office had a compliance problem with LAFHAs and that it was clear that MT 2030 was not working.

4.144 The Part IVA Panel requested that the audit project team:

- process assessments for all identified Category 1 and Category 2 cases, including issuing Part IVA determinations with appropriate cases for litigation being determined at the objection stage;

- complete the rewrite of MT 2030; and

- draft a Taxpayer Alert directed primarily at the individuals and not the promoter companies.

4.145 Following the Part IVA Panel meeting it was decided that it was not possible to issue bulk assessments as this would require up to 10,000 visa checks to determine which category of arrangement a taxpayer fell into. The Aggressive Tax Planning team suggested that the audit project team mail out a 'voluntary disclosure package' to all employees, an approach consistent with how other tax planning arrangements had been handled.

### Change in responsibility for tax law design

4.146 From 1 July 2002, responsibility for the design of tax laws and regulations was relocated from the Tax Office to the Department of the Treasury.

### Tax Office minute

4.147 A minute from the Tax Office to the Minister for Revenue and Assistant Treasurer set out the Tax Office's proposed strategy of making Part IVA determinations and issuing amended assessments to include LAFHA payments in the assessable income of foreign nationals working in Australia. The minute indicated that the Tax Office proposed to amend over 6,500 assessments of foreign nationals. It also envisaged that litigation arising from objections and appeals would allow the Tax Office to test the boundaries of the LAFHA provisions. In addition to the Part IVA determinations and amended assessments the Tax Office also proposed to issue protective FBT amended assessments to the umbrella companies.

4.148 The Tax Office stated that sections 30 and 31 of the FBTAA required consideration of several tests in determining whether a payment qualified as a living away from home allowance. In particular, a taxpayer's usual place of residence required determination; whether the amount being paid was in fact compensation for the requirement to live away from home; and the appropriate period for which a LAFHA could be claimed. The Tax Office stated that in practice these tests were difficult to apply and further guidance from the judiciary would be helpful in construing the law. The Tax Office also indicated that as part of the overall strategy it would issue a Taxpayer Alert.

## August 2002

### NTLG-FBT Sub-committee meeting

4.149 At the NTLG-FBT Sub-committee meeting the Tax Office discussed concerns that had arisen concerning some LAFHA arrangements. It noted that typically these were employment arrangements involving a labour hire firm, a special purpose company and a foreign national employed in Australia. The Tax Office expressed the view that these arrangements attempted to re-characterise a substantial amount of the foreign national's Australian sourced salary as a tax free LAFHA.

4.150 The Tax Office noted that the arrangements discussed gave rise to taxation issues which include:

- whether the amounts described as LAFHA payments received by the foreign national employee are exempt income under section 23L of the ITAA 1936;

- whether the amounts said to be LAFHA benefits satisfy the criteria in section 30 of the FBTAA;
- whether the requirements for reduction in taxable value in section 31 of the FBTAA are satisfied; and
- the application of the general anti-avoidance provisions of Part IVA of the ITAA 1936.

### Tax Office strategy

4.151 After a meeting with the Aggressive Tax Planning section of the Tax Office the audit project team's strategy was changed. All audits were stopped and replaced by a 'streamlined' approach involving a mail out to approximately 6,500 employees offering penalty discounts for voluntary disclosures.

4.152 A letter from the Tax Office to particular taxpayers requesting information in relation to LAFHA payments made to particular employees. This included:

- for what particular additional expenses and disadvantages have LAFHA payments been paid;
- how the LAFHA payments were calculated;
- what rent was paid for accommodation for each employee; and
- calculations for the 'exempt accommodation component' and 'exempt food component' in respect of the LAFHA payments made to each employee.

## September 2002

### Release of Taxpayer Alert

4.153 The Tax Office released Taxpayer Alert TA 2002/7, which was met with external criticism for the lack of consultation by the Tax Office prior to its release and its inaccurate characterisation of the majority of the arrangements. Tax advisers acting for the taxpayers' representative also requested that TA 2002/7 be withdrawn.

### Meeting with taxpayers' representative

4.154 A meeting was held between the Tax Office and the 'taxpayers' representative' (an organisation representing the contract management industry) and its tax advisers where the taxpayers' representative sought to provide information on the nature of the industry and its views on to the operation of the LAFHA provisions. At the meeting, the taxpayers' representative stated that:

- Members acted responsibly in the collection and remittance of taxes including PAYG, GST, payroll and superannuation guarantee contributions.
- Major operators were licensed by the Department of Immigration and Multicultural Affairs for sponsorship.
- They were not 'Special Purpose Companies' as they also found work for their employees and had representative offices overseas to facilitate the movement of skilled persons to and from Australia.

- The members were not re-characterising salary as LAFHAs. The packaging flexibility was recognised in the existing law and was designed to allow Australian employers to compensate, amongst others, expatriates for additional costs of living away from home.

- The industry filled a niche. Australia must compete with other countries for a restricted pool of skilled people in the information technology, finance, medical, engineering sectors. Many Australian companies and recruitment companies did not have the financial wherewithal to have worldwide executive searches to source the skills they required.

4.155 A letter from an adviser acting for the taxpayers' representative stated that the members were very appreciative of hearing first-hand what was happening on the project and indicated strong support of the consultative process put into place. The letter also stated that the members were looking forward to working with the Tax Office in the development of the position paper and in finding a resolution to this issue that will satisfy any concerns that the Tax Office may have whilst allowing the industry to operate on a viable basis. The letter also included a summary of the meeting with the Tax Office and sought any comments or correction of that summary.

4.156 The summary of the meeting listed the key outcomes of the meeting as follows:

- The Tax Office would not issue any amended assessments while the consultative process was proceeding. A decision would be taken as to whether such amended assessments were necessary after that process had concluded.

- No further 'audit' activity would be undertaken until the consultative process was concluded. At that time a decision would be taken.

- The taxpayers' representative would be invited to participate in the consultative process and possibly in discussions with Treasury.

- Consultative process would involve stakeholders once all submissions were received.

- Recognition of the taxpayers' representative as a body with which discussions should flow.

4.157 The summary of the meeting also noted the taxpayers' representative's concerns, in particular the uncertainty around the Tax Office's general position and views, the use of the terms such as 'Special Purpose Companies' and the Tax Office's willingness to understand the industry, especially as it relates to its modus operandi and how and why it developed.

### October 2002

4.158 A taxpayer provided information to the Tax Office on umbrella arrangements in response to Taxpayer Alert TA 2002/7. The taxpayer expressed the view that these arrangements should be stopped as they are encouraging foreign nationals to front up and demand work on their terms and that LAFHAs were the driver behind this.

## November 2002

### Tax Office position paper

4.159 The Tax Office released a position paper to the taxpayers' representative. The Tax Office position paper considered a 'Category 1' and 'Category 2' arrangement and described the tax implications for both employers and employees.

4.160 In respect of the employees, the Tax Office view was that:

- The amounts described as LAFHA payments received by the foreign national employee were not exempt income under section 23L of the ITAA 1936 and should be included as assessable income under either subsection 25(1) of ITAA 1936 or section 6-5 of ITAA 1997.
- The amounts said to be LAFHA benefits did not satisfy the criteria in section 30 of the FBTAA.
- Alternatively, the Commissioner contended that the general anti-avoidance provisions of Part IVA of the ITAA 1936 applied.

4.161 In respect of the employers, the Tax Office view was that the taxable value of the LAFHA fringe benefit under section 31 of the FBTAA had been incorrectly reduced to nil.

4.162 The Tax Office observed that:

> …common features of all employees in these arrangements are that they have not been seconded to work in Australia, and have, through lifestyle choices of their own, decided to seek and gain sponsorship in order to extend their stay in Australia. In many cases the foreign nationals have left their country of origin for an indeterminate period, and their Australian residence has become their usual place of residence.
>
> The ATO view is that it is incorrect to conclude that the payment of LAFHA by a SPC [Special Purpose Company] is in the nature of compensation to the employee for additional expenses incurred and other disadvantages as a consequence of being required to live away from their usual place of residence in order to perform the duties of that employment. Rather, the payments are merely remuneration for the services provided by the employee to the end user. The ATO considers that the rate of remuneration negotiated between the employee and the LHF [Labour Hire Firm] on a set dollar per hour (or similar) basis represents the commercial value of the personal services provided by the employee.

4.163 The Tax Office took the view that the applicable penalty rate was 50 per cent of the amount of the primary tax applicable to the adjustment or, if it was reasonably arguable that the amount referred to as a LAFHA was allowable as exempt income, then 25 per cent of the primary tax applicable to the adjustment. In respect to GIC, the Tax Office stated that it did not consider that the circumstances warranted remission in whole or in part.

4.164 The Tax Office invited comments from the taxpayers' representative and their advisers on the position paper. The taxpayers' representative was initially given 28 days to comment on the Tax Office's position paper. The Tax Office granted an extension for comment to February 2003 after a request from the taxpayers' representative members.

### Tax Office minute

4.165 A minute from the Tax Office to the Minister for Revenue and Assistant Treasurer provided an update on developments with the project, indicating that:

- amended assessment action was currently in abeyance;
- a position paper outlining the Tax Office's understanding of the arrangements and a summary of its view had been released to interested parties for comment;
- following the consultative process, and provided the Tax Office's original view was still valid or correct, then amendment action would proceed in accordance with the Part IVA Panel decision; and
- at a later stage, the Tax Office was proposing to release a new LAFHA public ruling to replace MT 2030.

## January 2003

4.166 A taxpayer alleged that the Tax Office breached the Taxpayers' Charter by not adequately responding to requests for information, explanations and clarifications arising from its position paper.

4.167 Taxpayers provided their comments to the Tax Office's position paper. Tax advisers acting for the taxpayers' representative indicated that taxpayers put a huge effort, in terms of time and cost, in putting their comments together with the intention of providing the Tax Office with a very clear view of the industry and a technical analysis of why the LAFHA benefits satisfy the criteria of section 30 of the FBTAA. The tax advisers also indicated that their key expectation was to see that the Tax Office had taken the response seriously and rethought the position paper in light of the industry comments. It also noted that the industry was keen to see that the Tax Office wanted to find a way to move forward that was constructive for both parties.

## February 2003

### Letter from taxpayers' representative

4.168 There was significant external criticism of the Tax Office's approach and view outlined in its position paper in particular for its lack of detail, failure to properly consider the taxation consequences of all the different type of arrangements and inaccurate assessment and understanding of the facts with inappropriate conclusions without evidence.

4.169 A letter from the taxpayers' representative stated that the position paper did not seek to appropriately describe the industry, did not properly outline how participants in the industry are structured and how it came into existence. It also expressed the view that the position paper did not properly analyse the services offered by industry members and the role it performed and that it attempted to paint the industry as purely tax motivated by using inappropriate and undefined expressions such as 'promoter' and 'special purpose company'. The letter alleged that, based on the factual circumstances, the Tax Office had breached the Taxpayers' Charter. It also stated that Tax Office activities following the September 2002 meeting had not been consistent with creating an environment to work with the industry to reach a resolution. Rather, the letter expressed the view that the Tax Office's activities were more consistent with it seeking to materially, and possibly fatally, damage the

industry and its participants and the industry questioned whether it was being dealt with objectively and without bias.

4.170 The taxpayers' representative letter suggested a forward strategy to seek to resolve the industry's concerns arising from the Tax Office's position paper:

- a meeting with senior tax officers to discuss the issues in more detail;
- the Tax Office work with the industry to develop an accurate description of the industry and its members, how they operate and why they exist. This would allow the position paper to be amended and allow the Tax Office to make decisions based on an accurate reflection of the industry; and
- steps taken to withdraw Draft Taxation Determination TD 2000/D5.

4.171 Tax advisers acting for the taxpayers' representative requested also that any new position paper would apply the specific factual circumstances that the Tax Office has examined, provide a detailed examination of the law in relation to LAFHA benefits and provide a detailed application of the alleged factual situations to the law. Tax advisers also requested that for each individual employee considered by the Tax Office that it finalises a definitive view on their underlying eligibility for the LAFHA benefit.

### Meeting with taxpayers' representative

4.172 The Tax Office met with the taxpayers' representative and its advisers to discuss the Tax Office's approach and view on these arrangements. The Tax Office allowed the taxpayers' representative the opportunity to put forward a submission to the Part IVA Panel setting out its opposition to the application of Part IVA to these arrangements.

### 1st Public Rulings Panel Meeting

4.173 The Public Rulings Panel considered a number of issues relevant in the redraft of MT 2030. The most significant issues decided at the meeting were that secondment was not necessary for a payment to qualify as a LAFHA and that a working holiday visa did not automatically preclude a taxpayer's eligibility of a LAFHA.

4.174 The Public Rulings Panel was also of the view that the application of Part IVA to persons who are accessing allowances to which they are entitled was doubtful. The then Second Commissioner Law suggested that the audit project team should be focussing on the promoters, not the employees, and to consider referring these matters to the Director of Public Prosecution.

4.175 The Public Rulings Panel concluded:

- The proposed interpretative approach to secondment was unlikely to succeed.
- Persons on working holiday visas may be eligible for LAFHA.
- The key interpretative issues that needed to be addressed in the LAFHA ruling are the meaning of 'usual place of abode' and whether compensation was assessed on a gross or net basis.

- LAFHAs were an aggressive tax planning matter in which promoters, not LAFHA recipients, should be targeted and the assistance of the Aggressive Tax Planning section of the Tax Office should be sought.

- The audit project team should explore whether there had been a failure to withhold tax or the lodgement of false FBT returns.

### NTLG-FBT Sub-committee meeting

4.176 At the NTLG-FBT Sub-committee meeting, CPA Australia submitted that in respect of expatriate employees who have been seconded overseas (outbound expatriates), the Tax Office had provided no guidelines to assist taxpayers to determine the taxable value of LAFHAs provided to such employees. It also noted that during various telephone discussions with the Tax Office it had been advised that what a reasonable food component was for outbound expatriates must be determined on the individual facts of each case. CPA Australia requested the Tax Office confirm that the reasonable food component of LAFHAs provided to outbound expatriates could be determined by any of the following methods:

- information provided by an independent third-party that specializes in collating and preparing international compensation data designed to protect employees from the excess costs associated with living overseas; or

- a universal price differential measure with respect to the provision of food, such as the MacDonald's Index, when referenced to the Commissioner's reasonable food components from year to year; or

- was as objective as any other measure, for the purposes of determining what a 'reasonable food component' was for outbound expatriates.

4.177 In response, the Tax Office acknowledged that there were no specific Tax Office guidelines to assist employers in determining the reasonable food components of LAFHAs paid to outbound expatriates.

4.178 It noted that the 'food component' of the allowance as defined in subsection 136(1) of the FBTAA was so much of the allowance as was in the nature of compensation for expenses the employee could reasonably be expected to incur on food and drink. It also noted that paragraphs 27 and 28 of MT 2030 provide guidance on the question of whether an employee must have actually incurred additional expenses on food and drink. The ruling states at paragraph 27 that a LAFHA is in the nature of an allowance and that it will not ordinarily be a precise measure of actual expenses of the recipient. The ruling goes on to state at paragraph 28 that an employer may pay an allowance, perhaps on the basis of a survey of accommodation and living costs at the employee's temporary work location, in order to compensate the employee for accommodation and additional living expenses that the employee might be expected to incur.

4.179 The Tax Office also acknowledged that it may be a difficult task for some employers to determine what a reasonable food component of a LAFHA was for employees seconded overseas. The Tax Office advised that the information provided by an independent third party that specialises in providing international compensation data for employees working overseas was an objective method of determining the food component of a LAFHA. As long as the figures produced by the third parties were, in accordance with FBT law, reasonable amounts these would be acceptable. The Tax Office noted that it was the

employer who must be satisfied that the information provided by the third parties was based on acceptable methodologies, was representative of the population from which it was drawn and that the amounts were reasonable, that is a 'reasonable persons' test, given the circumstances of the employee.

### March 2003

4.180 A letter from the taxpayers' representative setting out its comments on the meeting with the Tax Office in February 2003, providing a more detailed explanation of the industry, detail as to the business that was carried on by its members and a copy of the letter from its tax advisers outlining the reasons why Part IVA could not be relevant to the payment of a LAFHA.

4.181 In respect to the February 2003 meeting, the taxpayers' representative expressed concern that the Tax Office did not have an understanding of its industry, the nature of its business and that it did not seem to be interested in seeking such an understanding. The taxpayers' representative suggested that this was highlighted by the fact that the person leading the discussion from the Tax Office had not even read its detailed submission prior to the meeting. The taxpayers' representative provided the Tax Office with a document which outlined the nature of the industry, the services provided by its members and how the members operated. It also provided a list of the fundamental errors in the Tax Office's position paper as to the operation and its understanding of the industry.

4.182 The taxpayers' representative indicated in its letter that it was firmly of the view that Part IVA was not relevant to the LAFHA issues and provided a copy of a letter from its tax advisers outlining its reasons for this view.

### April 2003

#### 3rd Part IVA Panel Meeting

4.183 The Part IVA Panel considered a submission from taxpayers' representative dealing with the application of Part IVA. It submitted that where a tax law specifically allowed for a concession, such as an exemption, then Part IVA did not apply. The submission added that merely claiming that exemption could not result in a 'tax benefit' arising unless the taxpayer has either alone or with others created any circumstances or state of affairs that is necessary to enable the employee to claim the exemption.

4.184 The Part IVA Panel concluded:

- The application of sections 30 and 31 of the FBTAA to the particular arrangements needed to be reviewed to determine whether payments made to taxpayers constituted a LAFHA and, if so, the taxable value of the LAFHA.
- If the amounts paid were not LAFHAs, then those amounts are income under ordinary concepts and are to be included in the individual's assessable income.
- There was no need to apply Part IVA to include amounts in assessable income. The rationale for this view was that the clear intent of Parliament was to subject LAFHAs to tax under the FBT law and to tax amounts received as salary under the income tax law. Accordingly, if a payment was a LAFHA it should be taxed under the FBT law. If the payment was not a LAFHA then it should be taxed as income.

4.185 The Part IVA Panel also set out a forward compliance strategy to resolve the ongoing dispute noting that although there was some concern with the compliance/administration issues of examining on a case by case basis, this was the outcome according to the law:

- Representative cases should be selected to test the Tax Office view of the law relating to these arrangements in respect of both income tax (where the Tax Office was of the view that the payments did not constitute a LAFHA) and also the taxable value of the allowances under the FBT law (where the Tax Office was of the view that amounts paid were excessive).

- A review be undertaken of cases to determine whether action should be taken against relevant employers (particularly interposed umbrella companies) for the failure to withhold tax.

- A taxation determination or some other form of advice should be issues communicating the Tax Office's view of the application of the income tax law and FBT laws to these umbrella company arrangements. The advice should outline what features of these types of arrangements lead to a conclusion that the payments are not LAFHAs and also how the Tax Office would determine the taxable value where a payment is considered to be a LAFHA. The taxation determination or other advice should issue as soon as possible and ahead of the proposed comprehensive draft ruling.

4.186 The Part IVA Panel decision on the application of Part IVA to these types of arrangements and its proposed forward compliance strategy was confirmed in a Tax Office internal Minute.

### Audit project team

4.187 The audit project team stated that following the most recent Part IVA Panel meeting any audits which were undertaken and assessments raised would do no more than attempt to clarify how the law applied against the facts of those particular cases. It was also noted that this would not achieve a considered view of the principles/guidelines which could be applied across a broad range of circumstances. The audit project team also indicated that they did not believe they were in a position to raise assessments given the range of LAFHA technical issues. It also noted that the industry had continually emphasised their strong desire to work with the Tax Office in order to arrive at some agreed principles and guidelines that would allow them to comply with their obligations in a cheaper, easier and more simplified manner. It recommended that it should accept the industry's invitation to engage in dialogue with the view of formulating guidelines for wider consultation.

## May 2003

### Tax Office letter to taxpayers' representative

4.188 A letter from the Tax Office to the tax advisers acting for the taxpayers' representative indicating that:

- After consideration of the taxpayers' representative March 2003 submission, the Part IVA Panel had concluded that the arrangements outlined in the submission did not give rise to Part IVA of the ITAA 1936.

- As a result, the Tax Office had withdrawn its position paper on this issue.

- The Tax Office still had concerns that some of the taxpayers' representative members were paying up to 60 per cent of their employee's remuneration in the form of a LAFHA and requested a meeting with the taxpayers' representative to better understand the current situation so as to move forward. The Tax Office also requested a detailed briefing of how LAFHA was calculated and for taxpayers to make accessible their 2002 payroll details and employee files.

### 2nd Public Rulings Panel Meeting

4.189 The Public Rulings Panel met to discuss the following key issues in the redraft of MT 2030 and agreed that any discussion of the issues and application of MT 2030 needed to be more than simply a question of backpackers:

- a person's usual place of residence;
- the relevant criteria in determining a person's usual place of residence;
- the length of stay and the need for finite duration;
- the treatment of intra-city movements and backpackers; and
- the determination of 'additional expenses' and whether a 'bricks and mortar' or 'locality' approach should be adopted.

4.190 It was decided that a further meeting was required with the Second Commissioner Law, who was not present at the meeting, to resolve some of the key issues, in particular, what was meant by 'usual place of residence' and which was the preferred approach ('brick and mortar' versus 'locality') as the basis to determine additional expenses.

4.191 The Panel discussed whether there was a difference between section 51A of the ITAA 1936 and section 30 of the FBTAA and concluded that the words of section 30, on their face, did not require a pre-existing employment relationship.

4.192 The Panel discussed the issue of usual place of residence but could not agree on whether this required a 'brick and mortar' or 'locality' approach. The Panel noted that all the other elements in determining eligibility for LAFHAs were dependent upon which approach was to be adopted. However, the Panel agreed that the issue of eligibility should be determined on an objective basis. The Panel also agreed that backpackers were probably not eligible, but this depended upon an examination of the factual circumstances. It indicated that there was a need to look at the objective of the employer and payment of allowance.

4.193 The Panel also considered what would be the relevant criteria in determining usual place of residence. It noted that the case law did not provide a definitive answer as the cases were 'all over the place'. It also discussed the need for an employee to be living away from home for a finite period of time and considered the issue of intra-city movements in the context of a number of examples in the draft ruling.

4.194 In relation to the issue of additional expenses the Panel agreed that this was determined by examining the difference between the cost of living between the current and previous places of residence. The Panel agreed that there was no presumption that additional expenses are incurred just because someone moves away. The Panel also discussed what constitutes additional expenses in terms of the payment of costs and entitlements. It noted that where a person was receiving an amount and then obtaining

cheaper accommodation then this does not affect the exempt amount, where the amount was a reasonable approximation and based on reasonable information from each locality. However, the Panel concluded that if a person stopped incurring expenses in their previous place of residence and had lower expenses in their new place of residence, then there would be no additional expenses and the person would not be eligible to a LAFHA.

4.195 The Rulings Panel noted that Treasury was aware of the revenue consequences of these arrangements and the Part IVA implications.

### NTLG-FBT Sub-committee meeting

4.196 At the NTLG-FBT Sub-committee meeting the National Tax & Accountants' Association sought clarification from the Tax Office on whether an employee who was away from his or her home base for a period of more than 21 days could still be considered to be travelling on work rather than living-away-from-home. The National Tax & Accountants' Association indicated that the reason this issue was being raised, was because it was receiving feedback from many members, advising that Tax Office auditors were applying the 21 day test very strictly. That is, once the period of absence exceeded 21 days, it was automatically being concluded that the employee was now living away from home and no longer travelling on work. The National Tax & Accountants' Association commented that this application was in direct contradiction with paragraph 41 of MT 2030 and it was of the view that the 21 day test was merely a 'tie-breaker' or 'rule of thumb' test that should only be applied where it was otherwise difficult to determine whether an employee was travelling on work or living away from home. The National Tax & Accountants' Association also set out an example to illustrate the issue and raised a number of questions for consideration by the Tax Office.

4.197 In response, the Tax Office advised that, as previously stated at this forum, MT 2030 provided guidance, as at paragraph 41, in situations where an employee was away from his/her home for a brief period.

4.198 The Tax Office again advised that the '21 day rule' was a general practical rule. The rule was meant to apply where it was difficult for the employer to conclude that an employee was living away from home or travelling. The individual circumstances of an employee must be determined before concluding whether in fact an employee was in receipt of a 'travel allowance' or a 'living-away-from-home allowance'.

### Briefing to the Second Commissioner Compliance

4.199 In a briefing to the Second Commissioner Compliance a number of concerns were raised by Small Business General Field in bringing to fruition the compliance strategy outlined at the previous Part IVA Panel meeting.[3] The briefing indicated that there was no agreement on the definition of 'usual place of residence' within the Tax Office with divided opinion on whether the term referred to specific lodgings (the 'brick and mortar' approach) or to a general locality. It also indicated that there was no agreement on what constituted 'additional expenses' with different opinions being expressed by a number of senior technical officers and the Part IVA and Public Rulings Panels. The briefing concluded that as the Public Rulings Panel was still formulating the Tax Office view on LAFHAs, which was to

3 See paragraph 4.182 for further detail.

be expressed in a new ruling, then it was not possible to select cases to test the Tax Office view of the law.

### Second Commissioner Law approach

4.200 The then Second Commissioner Law disagreed with the summary of the briefing to the Second Commissioner Compliance. The Second Commissioner Law indicated that Small Business General Field had been instructed to consult with First Assistant Commissioner Aggressive Tax Planning (FAC ATP). The Second Commissioner Law agreed with the approach previously recommended by the FAC ATP. The approach recommended by the FAC ATP was set out in the April Tax Office internal minute which was sent out following the Part IVA Panel meeting.

4.201 In a follow up email from the Business & Personal Tax Centre of Expertise to the Deputy Commissioner Small Business, the Second Commissioner's directions were conveyed as to the actions that should be followed to deal with the issue of LAFHA benefits being provided to 'backpackers' — that is individuals who come to Australia and obtain work during the period they are present in Australia — and to other individuals who have moved to Australia to take up employment. It was stated that the outcome from the Public Rulings Panel meeting was essentially in accordance with paragraph 14 of MT 2030, a person was regarded as living away from their usual place of residence (and potentially entitled to be paid a LAFHA) if, but for having to change residence in order to work temporarily for his or her employer at another locality, the employee would have continued to live at the former place. This meant that for an allowance to constitute a LAFHA benefit, an employee must have been required to physically relocate due to employment. The directions indicated that 'backpackers' generally would not satisfy this requirement because they were transient and any payment that purports to be a LAFHA would in fact be a payment of salary and wages and constitute assessable income of the person to whom it was paid. In the email, it also indicated that the Second Commissioner Law expressed the view that where an employee was genuinely required to move from their usual place of residence to take up temporary employment in Australia, for example, as a result of a secondment by their existing employer or as a result of being engaged by an Australian employer while they are still living at their former place of residence) then the level of compensation paid to the employee for additional expenses should be reasonable. It was stated that ideally this amount should be attributable to the net difference between the cost of living at their former place of residence and the cost of living in the locality to which they have temporarily moved. Importantly, the Second Commissioner Law indicated that there was no presumption that additional expenses would be incurred just because an individual was required to relocate. It was acknowledged that the Tax Office had never clearly stated that section 30 of the FBTAA applied in this way and further work was required on this view and its date of effect.

4.202 Finally, the email set out the Second Commissioner's view on the tax consequences arising from adopting the above views. It stated that if it was concluded that no part of the amount paid was in the nature of compensation to the employee for additional expenses, then that amount would be a payment of salary and wages and would constitute assessable income of the individual to whom it was paid. In these circumstances, assessments should be raised against the individual concerned (if they were still in Australia), a demand should be made on the employers for their failure to withhold from those payments and consideration should be given to the imposition of administrative penalties. In the Second Commissioner's view, if it was concluded that part of the allowance was in the nature of compensation to the employee for additional expenses, then the other part of the allowance would be the taxable value of a LAFHA fringe benefit (that is the amount of the allowance reduced by the exempt

components) and the Tax Office could pursue the employer in respect of FBT payable on that benefit.

4.203 The Second Commissioner Law also directed that as a key leverage point, action should be directed towards the few labour hire firms and other employers who have been involved in promoting these arrangements.

### June 2003

#### Tax Office strategy

4.204 The Small Business General Field put forward a compliance strategy to progress the issues arising from the project. The following was agreed to by Small Business General Field and the Business and Personal Tax Centre of Expertise:

- 'Usual place of residence' would be taken to mean a geographical location that the foreign national intended to return to, rather than the requirement for there to be an actual dwelling.
- Additional expenses would refer to absolute amounts expended by the foreign national that was required to live away for his or her usual place of residence, not the differential cost.
- Foreign nationals that arrive in Australia on a WHM visa would not be eligible for a LAFHA regardless of any change in circumstances after their arrival (such as attaining sponsorship and a change in their visa classification to long stay business.
- Where foreign nationals had arrived on a WHM visa, any payments received that were referred to as LAFHAs would be regarded as income assessable to the individual foreign nationals, and the employer would be required to withhold tax.
- The Taxpayer Alert TA 2002/7 would remain in the market place as the Second Commissioner Law indicated that he wished to reserve his power to invoke Part IVA in some arrangements.
- The Tax Office was to seek legal opinion on the past and current policies and whether they were sustainable at law.
- Compliance activities would focus on the 2001/02 income year and on the employers, in particular, their failure to withhold tax from payments to foreign nationals that were described as LAFHAs.
- The audit project team would work with the industry to get some test cases where there was agreement on the facts. A variety of test cases would be selected to test the issues across a range of factual scenarios.

4.205 It was also agreed that there should be a move from an 'audits/slash and burn' strategy to a 'test case' strategy, especially given that the project was now approaching its fifth year. It noted that rather than focus on issuing a large number of amended assessments it was more important to get the correct interpretation of the law.

### Meeting with taxpayers' representative

4.206 The Tax Office met with the taxpayers' representative and their advisers to inform them that Part IVA did not apply to these arrangements. The Tax Office put forward a proposal to work together with the taxpayers' representative and have a number of representative cases proceed to litigation as 'test cases' so as to provide law clarification.

4.207 The advisers indicated that they did not see the need to have representative test cases on these arrangements as they were of the view that their client's members were not in breach of the existing tax laws and ruling. However, the advisers agreed to pass on the Tax Office's request to the taxpayers' representative members. The advisers also requested that the Tax Office withdraw Taxpayer Alert TA 2002/7.

## July 2003

4.208 The FAC ATP expressed concern with the lack of progress and stated that there was a need to gather information on the aggressive end of the industry and raise penalties as soon as possible. The FAC ATP also indicated his satisfaction with the industry involvement and the need to focus on recent years so as to differentiate the aggressive end from those who had an arguable position.

### Letter from taxpayers' representative

4.209 A letter from the Tax Office to a tax adviser acting for the taxpayers' representative noting that, given that the information that the Tax Office currently held was now generally 2 years old, it was considered in everyone's interest that the taxpayers' representative members provide the further detailed information requested at the June 2003 meeting to show the current practices within the industry. The letter also attached a possible final version of Draft Taxation Determination TD 2000/D5.

4.210 The Tax Office stated that their general position remained that the LAFHAs may not meet the tests under the FBTAA as to their nature or quantum. It also stated that these general concerns had not altered since Taxpayer Alert TA 2002/7 was issued but rather the Tax Office view that Part IVA applied had altered.

### Meeting with taxpayers' representative

4.211 The Tax Office met with the taxpayers' representative and their advisers with information being provided detailing their practices, policies and documented examples. The Tax Office advised that it wanted to ensure that there was compliance with section 30 of the FBTAA and that LAFHA payments were reasonable. The Tax Office advised that the information provided would assist it in forming a view on these issues and that if, after reviewing the industry operations, it maintained its concern over whether the arrangements satisfied section 30 of the FBTAA then it may consider getting test cases up before the courts.

4.212 The taxpayers' representative stated that they had gone to great lengths to provide information to the Tax Office and show that its members provide a great contribution to the economy and other services, apart from LAFHAs, to a number of major companies and government agencies. The taxpayers' representative also stated that it wished to work with the Tax Office and requested guidelines regarding LAFHA entitlement and quantum. It also advised that current publicly available Tax Office information on these arrangements was adversely affecting the industry and this was as a direct result of the uncertainty created by the Tax Office's ongoing review of the industry. The taxpayers' representative requested that

the Tax Office issue a taxation determination confirming that the other services provided by the taxpayers' representative members were acceptable and where they exist, and the employees satisfy section 30 of the FBTAA, then the employees would be entitled to a LAFHA. It also requested that Taxpayer Alert TA 2002/7 be withdrawn as the Tax Office had acknowledged that Part IVA did not apply to the arrangements. The taxpayers' representative indicated that it had no concerns with the final Draft Taxation Determination TD 2000/D5 provided to them for comment.

4.213 The taxpayers' representative also provided the Tax Office with a briefing of the taxpayers' representative meeting with the Government. It advised that it had engaged a consultant to determine the economic impact if the contract management companies ceased to operate. The consultant concluded that a 40 per cent interruption of the industry could have implications to the wider economy in the order of $5 billion.

### Proposed Tax Office view

4.214 The Tax Office prepared two draft taxation determinations dealing with LAFHA issues for internal comment. The first considered whether an amount paid to an employee, calculated as a percentage of the hourly rate of wages multiplied by the weekly hours worked, qualifies as a LAFHA fringe benefit. The second considered whether a foreign national who visits Australia on a holiday, but who undertakes incidental employment to supplement funds, qualifies for a LAFHA fringe benefit. The Tax Office's proposed response in both instances was 'No'.

## August/September 2003

4.215 The Tax Office prepared a brief to advise seeking legal clarification on a number of key issues relating to the operation of the LAFHA provisions. In its brief to counsel the Tax Office stated that:

> Cases involving what are considered to be 'excessive' living-away-from-home allowances paid to foreign nationals in circumstances that are considered to be outside the policy intent of the law, have forced the Tax Office to review its current position on the application of sections 30 of the FBTAA. However, no clear consensus has yet been reached on the manner in which those cases should be treated.

## October 2003

4.216 A letter from the taxpayers' representative expressed disappointment with the Tax Office's decision to retain Draft Taxation Determination TD 2000/D5 and Taxpayer Alert TA 2002/7 in their current form notwithstanding that the Tax Office indicated in discussions that these documents no longer correctly stated the Tax Office view or outstanding issues of concern. The taxpayers' representative was of the view that as the statements did not correctly state the position of either party, there appeared to be no justification in leaving them in place and they could only lead to misinformation to the market that continued to cause serious damage to the collective businesses of the taxpayers' representative members. The taxpayers' representative indicated that it had offered the Tax Office several ways in which progress could be made, including the co-operative development of a determination on the level of LAFHA that could be paid to contractors and the circumstances in which it could be paid. The taxpayers' representative stated that it was frustrated with the process and that it was difficult to see any justification for the approach taken by the Tax Office, the rejection of the reasonable suggestions raised to progress the matter and the delays. The

taxpayers' representative stated that there was now an expectation that the Tax Office provide them with a clear direction, including on section 30 issues raised in the legal opinion provided to the Tax Office by a member of the taxpayers' representative and if it had still not reached a position then it should withdraw and replace the Taxpayer Alert and the draft Taxation Determination. It submitted that these should be replaced with a document that provided clear guidance for the industry in accordance with the law and explained the practices that were acceptable to the Tax Office (for example, the level of LAFHA that can be paid) that are consistent with the law.

4.217 In a file note recording the progress of the LAFHA compliance project it was noted that:

- A meeting was held between the Administration, Business & Personal Tax (FBT) Centre of Expertise, the Office of the Chief Tax Counsel and Small Business Field to discuss strategy, technical LAFHA issues and the impact any action may have on the more general application of the LAFHA provisions. Action items were:
  - facts to be obtained on current general industry practices from a small sample of large employers,
  - follow-up with the taxpayers' representative regarding the supply of further information on current practices.
- Senior counsel's advice was being sought on whether the Tax Office's policies and practices in relation to these arrangements were sustainable at law. The threshold question was whether the payments made to employees in these arrangements meet the criteria of section 30 of the FBTAA.
- The taxpayers' representative requested that Taxpayer Alert TA 2002/7 should be withdrawn; however the Second Commissioner Law had indicated that he wanted the Taxpayer Alert to remain in place as he wished to reserve his power to invoke Part IVA on some arrangements.
- The Office of the Chief Tax Counsel was considering finalising Draft Taxation Determination TD 2000/D5 and redrafting MT 2030.

### November 2003

4.218 The Tax Office received counsel's discussion draft advice. Conference between Counsel and Tax Office followed.

### December 2003

#### Counsel's written advice

4.219 The Tax Office received counsel's written advice.

#### Tax Office strategy

4.220 As a consequence of receiving counsel's advice a meeting was held for the purposes of developing a strategic plan to progress the LAFHA project between the Second Commissioner Law, the Tax Counsel Network and the Administration, Business & Personal Tax Centre of Expertise. It was decided to implement a five pronged strategy:

- Release a series of taxation rulings and taxation determinations on LAFHAs. The Tax Office view on the law was to be progressed by releasing approximately four taxation determinations. It was decided that at some later stage these documents could be combined into one single ruling to replace MT 2030. The proposed taxation determinations were:

  - a replacement of Draft Taxation Determination TD 2000/D5,

  - a taxation determination dealing with the switch from a 417 visa to a 457 visa and where a person enters Australia on a 457 visa,[4]

  - a taxation determination dealing with usual place of residence, and

  - a taxation determination dealing with additional expenses.

- The project team would continue its audit, with work to be initiated in gaining fresh information with a view to strategic litigation. It was decided to challenge those cases where the quantum of LAFHA was excessive or where the allowance did not qualify as a LAFHA.

- Examine the activities of the employers and whether there were any Pay As You Go (PAYG) implications.

- Advise Treasury on the policy issues and keep the Assistant Treasurer advised of the Tax Office's LAFHA project activities.

- Make changes to the FBT return form so that LAFHA benefits that are not taxable and any other relevant information are included.

### Commissioner of Taxation's views

4.221 An internal Tax Office discussion involving the Commissioner of Taxation was held to assist in resolving some of the difficult issues that were being considered in interpreting the LAFHA provisions for the purposes of developing a draft ruling and determinations following the receipt of the advice from counsel.

4.222 The Commissioner of Taxation affirmed the view that 'usual place of residence' did not have to be a particular residence but could be a city or district. The Commissioner affirmed that the exempt accommodation component was to be read as an allowance paid to compensate for the full amount of rent likely to be incurred (that is, the gross approach was to be adopted and not the net approach) and rent saved at the usual place of residence was not to be taken into account. The Commissioner also indicated that persons that had previously leased, as opposed to those that still owned a home in their usual place of residence, were not to be treated differently and that both types of persons would potentially be able to satisfy the exempt accommodation component requirements. The Commissioner suggested that in most instances foreign nationals on a working holiday visa would not be entitled to a LAFHA. Senior tax officers also mentioned that Treasury had been approached

4 A 417 visa is a Working Holiday Visa, while a 457 visa is a Temporary Business Long Stay – Standard Business Sponsorship. The latter is a program for employers to sponsor approved skilled workers to work in Australia on a temporary visa. Information obtained from the Department of Immigration and Multicultural Affairs' website at http://www.immi.gov.au/index.htm.

about the difficulties that the Tax Office were having in administering the LAFHA provisions. It was noted that Treasury did not consider there was enough to go to government to amend the legislation. The Tax Office's estimations were that there was approximately $120 million in revenue per annum involved. The Commissioner expressed surprise that this had not gained the attention of Treasury and stated that 'our job is to bring it to Treasury's attention — that's all we can do'.

### February 2004

4.223 In a briefing to the Deputy Commissioner of Taxation, Small Business on the Tax Office's current position on the LAFHA issue, the following forward strategy was proposed to resolve the outstanding dispute:

- It was agreed that it was not practical to address this issue on a case by case approach that the current interpretation of the legislation seemed to dictate.
- The key issue to address was the payment of 'excessive' allowances and in light of the lack of clarity the issue would be examined prospectively. However, the Tax Office reserved the right to address cases retrospectively in blatant cases.
- There would be an attempt to work with the industry to develop guidelines as to what was a reasonable approach and the Tax Office was to conduct reviews, initially as part of the guideline development process, to ascertain current industry practices and rationale for the calculation of payments.
- A number of new taxation determinations would be developed and issued as part of this process including the updating of publications once the guidelines are settled.
- Payments outside the guidelines would need to be justified on the basis of the facts of the payment or they would be subject to audit.
- Any issues of significant different between the Tax Office and the industry would be clarified by way of litigation.

### March 2004

4.224 The Tax Office received a copy of the taxpayers' representative draft LAFHA Guidelines and draft Code of Conduct.

### April 2004

#### Proposed Tax Office view

4.225 The Tax Office provided the taxpayers' representative and its advisers with its comments on the taxpayers' representative proposed LAFHA Guidelines, indicating that the Tax Office did not normally approve general advice in the form of draft guidelines and that it was unable to endorse the document. The Tax Office stated that it considered the general guidelines to be inappropriate as, in any given case, whether or not the requirements of section 30 of the FBTAA were met would turn on the particular circumstances of that case. The Tax Office indicated that its proposed approach was to provide certainty about how it considered the law operated through the established process of outlining its view through the release of public rulings. This process enabled all stakeholders to contribute to the formulation of a final Tax Office view.

4.226 The Tax Office provided the taxpayers' representative and its advisers with two draft determinations for comment, dealing with the following issues:

- For the purposes of section 30 of the FBTAA, whether an employee can have 'additional expenses' in respect of accommodation where the employee did not have any continuing accommodation expenses at the employee's usual place of residence. The Tax Office's proposed response was 'Yes'.

- Whether a foreign national visiting Australia on a holiday, who undertakes employment to supplement his or her funds, could qualify for LAFHA fringe benefits. The Tax Office's proposed response was 'No'.

4.227 The Tax Office also indicated that it was considering a rewrite of MT 2030 to clarify the meaning of 'usual place of residence' and to expand the meaning of the expression 'required to live away' in the context of section 30 of the FBTAA.

### Letter from taxpayers' representative

4.228 A letter from the taxpayers' representative provided comments on the Tax Office's position and technical views and the potential implication of the Tax Office's approach. The letter stated that the taxpayers' representative believed that the Tax Office's application of the FBT law was incorrect and went on to outline its technical view. The letter also noted that the taxpayers' representative had prepared draft LAFHA Guidelines and a Code of Conduct that could be implemented between the taxpayers' representative members for it to self-regulate the payment of LAFHA. The taxpayers' representative members offered to agree with the Tax Office's acceptable principles for the control of payment of LAFHA, including the conditions for qualification and controls over the quantum that could be paid.

4.229 The letter also stated that there was a necessity to bring the project to a close as a matter of urgency for the following reasons:

- The Tax Office has held the industry under review for five years with very limited progress.

- Taxpayer Alert TA 2002/7 remained on issue, asserting that Part IVA could be generally applicable against the industry notwithstanding that this view was rejected over 12 months ago.

- The Tax Office's own senior counsel supported the position of the industry in his advice on most issues raised with him. The Tax Office had chosen to ignore that advice in trying to attack the industry.

- The Tax Office internally escalated this matter in approximately April 2003 and said that the matter was to be resolved 'within weeks and not months'. During that period, the Tax Office had been provided with substantial information. The taxpayers' representative had also prepared several papers and had met with the Tax Office five times. The Tax Office was still contemplating further compliance action.

4.230 The letter concluded by stating that the Tax Office should not be entitled to publicise a Taxpayer Alert that was found to be fundamentally incorrect. The objective of Taxpayer Alerts was to provide warnings of reviews that would be given priority and should not be used to communicate false and misleading messages about a group of taxpayers. It was alleged that the Tax Office was using the damage this was causing as

leverage against the taxpayers' representative members, that this was a contravention of the Taxpayers' Charter and the cause of significant damage to these taxpayers. It was also alleged that such action was not in accordance with the tax law.

4.231 The letter also provided the taxpayers' representative's response to the Tax Office's earlier comments on the proposed taxpayers' representative LAFHA Guidelines.

### Meeting with taxpayers' representative

4.232 A meeting was held between the Tax Office and the taxpayers' representative and its advisers to discuss the outstanding issues in the resolution of the project. The minutes of the meeting, prepared by the taxpayers' representative adviser, noted the following points of agreement:

- The Tax Office accepted that the following qualify for LAFHA:
  - 457 visa holders,
  - those that converted from a 417 visa to a 457 visa qualified at least from the date of conversion,
  - those that convert from a 417 visa to a 457 visa could qualify from the date that they commenced work in Australia where the person entered Australia on a 417 visa with the intention of working in Australia and converted to a 457 visa and the intention as expressed in some way in the agreement they entered with their Australian employer,
  - the Tax Office was prepared to allow 417 visa holders to receive a LAFHA where their principle motivation when entering Australia was to work provided that:
    - : the taxpayers' representative members could find a way to provide evidence to make this distinction very clear; and
    - : that any test that was inserted in the taxation determination on this issue did not open the floodgates for 'fruit pickers' and those 'pulling beers'.
- There was a difference in opinion between the Tax Office and the taxpayers' representative on the application of section 30 of the FBTAA.
- The next steps in bringing this project to a close were as follows:
  - the taxpayers' representative members agreed to provide suggested examples of a 417 visa and a conversion from a 417 visa to a 457 visa for the taxation determination,
  - the taxpayers' representative members agreed to update the draft LAFHA Guidelines,
  - the Tax Office was to look at the information from members to see what thresholds could be put in place around quantum and the parameters to be applied when determining a person's eligibility to be paid a LAFHA, and
  - the Tax Office was to review the rental survey and compare it to others. It was also agreed that the taxation determination should be independent of the LAFHA Guidelines and that once the taxation determination was issued, then the Tax Office would withdraw Taxpayer Alert TA 2002/7.

### May 2004

4.233 Advisers to the taxpayers' representative were provided with copies of updated draft tax determinations.

4.234 A meeting was held between the Tax Office and the taxpayers' representative and its advisers to discuss the draft tax determinations and outstanding issues in the resolution of the project.

### June 2004

#### Tax Office strategy

4.235 Following discussions between Assistant Commissioner Business & Personal Taxes Centre of Expertise, Commissioner and Second Commissioner Law, a change in the approach was endorsed. A short draft taxation ruling was to be prepared which would supplement MT 2030.

4.236 A file note, describing the change in approach, indicated that to date the Tax Office focus had been on the interpretation of certain elements of section 30 of the FBTAA and in particular whether the reason for a foreign national visiting Australia was relevant in determining whether the requisite nexus between the incurrence of additional expenses and the necessity to live away from home in order to perform the duties of the employment was met. The taxpayers' representative had consistently disagreed with this approach as a matter of law and as a result it had not been possible to reach a consensus on guidelines for practical compliance.

4.237 The file note indicated that the Tax Office had determined that the better approach was to move the focus from the reason for a person being away from home (which would have been a difficult to sustain as a proposition of law) to the overriding substance over form test explicit in the provision. This would mean that for an allowance to be a LAFHA for FBT purposes a reasonable person would conclude that the whole or part of the allowance was in the nature of compensation to the employee for additional expenses incurred by the employee (rather than compensation for something else, such as services rendered). Only the part that could be reasonably concluded as being in the nature of compensation for incurrence of additional expenses was a LAFHA with the remaining being salary and wages and subject to PAYG withholding. This would make it difficult to effectively salary sacrifice for a LAFHA irrespective of whether the employee was a foreign national working through a contract management company or an Australian resident directly employed by an end user. The file note stated that the intention of this new approach was to defeat the most blatant cases where the salary or wage component of remuneration was out of proportion to the reasonable value of the services rendered.

4.238 The file note also indicated that the proposed new approach had been endorsed by the Commissioner of Taxation and Second Commissioner Law and that there had been a direction to prepare a short taxation ruling on the issue that would be forwarded to Treasury and to the Assistant Treasurer for information prior to public release.

#### Letter from taxpayers' representative

4.239 A letter from the taxpayers' representative confirming in writing its position in respect of the payment of LAFHA to its employees for submission to the Tax Office's Public Rulings Panel. The letter set out the taxpayers' representative view on the law dealing with

the payment of LAFHAs and its response to the views expressed to date by the Tax Office. Its letter also set out the situations in which the taxpayers' representative considered a person was not entitled to receive a LAFHA and how the Tax Office could provide clarity for those that were entitled to receive a LAFHA. The letter also set out an outline of why the industry developed in Australia and the key services it provided. The taxpayers' representative provided the Tax Office with its suggested changes to one of the proposed draft taxation determinations it had been provided.

### July 2004

4.240 The Tax Office received counsel's further written advice in relation to the proposed draft taxation ruling.

### August 2004

#### NTLG-FBT Sub-committee meeting

4.241 At the NTLG-FBT Sub-committee meeting the Tax Office informed practitioners that a review of certain matters concerning LAFHAs, and that were arising from Draft Taxation Determination TD 2000/D5 and Taxpayer Alert TA 2002/7, was drawing to a conclusion.

4.242 As a result of the review, the Tax Office indicated that it proposed to issue two draft taxation determinations and one draft taxation ruling and that these were being progressed within the Tax Office. The rulings would be released as drafts, at which time the peak bodies and other interested parties would have the opportunity to provide comments and/or formal submissions in relation to the draft rulings.

#### Meeting with taxpayers' representative

4.243 A meeting was held between the Tax Office and the taxpayers' representative and its advisers to discuss the outstanding issues in the resolution of the project. In a letter following the meeting, the taxpayers' representative expressed concern that notwithstanding:

- the level of co-operation from the taxpayers' representative over the last 5 years;
- the volume of information furnished to the Tax Office, which the Tax Office promised at each enquiry would allow a final conclusion to be reached; and
- the endeavours of the taxpayers' representative over the last 2 years to work with the Tax Office to find a practical solution to the Tax Office's problem, culminating in a mutually favoured approach at the last meeting in May 2004;

the Tax Office has decided to disregard all those efforts to make way for a new method of attack on the industry.

4.244 The letter indicated that the Tax Office's new strategy involved ceasing exclusive discussions with the taxpayers' representative on the operation of the LAFHA eligibility rules, issuing a general taxation ruling and specific tax determinations for comment by the general tax community and grouping all contractors as 'backpackers' and asserting that members have taken advantage of a 'loophole' in the law.

4.245 The letter noted that the Tax Office in several discussions has accepted that the law was difficult and did not clearly apply as the Tax Office would like it to. The taxpayers' representative expressed concern that the Tax Office's position had consistently been driven by its view of what the policy should be regarding the payment of LAFHAs and its efforts had been largely directed to finding ways that the law could be applied to support that policy. The letter alleges that there was little doubt that if the law supported the Tax Office's attack, then the issue would not have been outstanding and debated for 5 years at a great cost to the taxpayers involved. The letter also alleged that it was contrary to the Taxpayers' Charter to pursue a tactic aimed at disregarding the valid arguments of affected taxpayers.

4.246 The letter also expressed concern with the Tax Office's approach of continuing to attack the taxpayers' representative while refusing to provide guidance and help on the key issue in dispute, namely how the level of LAFHAs attributable to accommodation should be set.

4.247 Finally, the letter requested that the Tax Office reconsider its latest strategy and that:

- The solution that was arrived at between the Tax Office and the taxpayers' representative at the meeting in May 2004 be reconsidered.
- The taxpayers' representative members have already suffered material damage from the release and promotion of a Taxpayer Alert that has been demonstrated to be flawed (but remained on issue over 18 months hence) and a draft Taxation Determination issued in 2000 that did not accord with the law.
- The treatment of taxpayers by the Tax Office has been very harsh and contrary to the Taxpayers' Charter.
- The financial and reputational damage should not be further compounded by the adoption of the proposed strategy.
- The taxpayers' representative and its advisers are permitted to appear before the Public Rulings Panel and to attend liaison groups where any proposed ruling and determinations are tabled or discussed.

### September 2004

4.248 The draft taxation ruling to supplement MT 2030, that adopted an objective test in considering the eligibility to a LAFHA, and the two draft taxation determinations were finalised in preparation for consideration by the Public Rulings Panel.

### November 2004

#### 3rd Public Rulings Panel Meeting

4.249 A presentation by the taxpayers' representative and advisers to the Public Rulings Panel which included an introduction of their industry, its views on the operation of the LAFHA provisions, comments on the draft ruling and determination and its proposals to 'move forward'. The presentation also set out how a number of the taxpayers went about complying with their obligations under the FBT law. In view of comments made at this meeting, there was some concern by the taxpayers' representative and its advisers on the Tax Office's view on what was 'additional', on what was 'reasonable' for the purposes of paying a LAFHA and that MT 2030 should be rewritten to clarify such issues.

4.250 One issue raised by the Tax Office was the absence of information coming in from the taxpayers' representative in FBT returns regarding LAFHAs where the employer determined that the taxable value of the LAFHA was nil. The tax advisers acting for taxpayers' representative advised that this had already been raised with the Tax Office, but there was no mechanism, at law or otherwise, that required an employer to declare information relating to LAFHAs that are not taxable.

4.251 The taxpayers' representative also expressed the view that although the Tax Office was concerned with the taxpayers' representative practices, it was not providing clarification or guidance to the taxpayers' representative as to how the Tax Office's concerns may be alleviated.

4.252 There was also discussion in relation to the proposed draft taxation ruling and taxation determination, which had been provided to the taxpayers' representative for comment. The taxpayers' representative submitted that:

- The proposed draft taxation ruling not be released.
- The draft taxation determination be replaced with the draft proposed by the taxpayers' representative.
- Any Tax Office decision be made on a prospective basis.
- The Tax Office consider developing a taxation ruling to guide taxpayers on a mechanism for determining a reasonable accommodation component.
- Taxpayer Alert TA 2002/7 should be withdrawn as the Tax Office view had changed since its release and that Draft Taxation Determination TD 2000/D5 be withdrawn.

4.253 The taxpayers' representative and its advisers, having completed their presentation to the Panel, left. The Panel continued its discussion on a number of key issues relevant to LAFHA including the meaning of the word 'additional'. It was also mentioned at the Panel meeting that the Tax Office had approached Treasury twice during the current review of LAFHA. Given the wide range of views amongst members of the Panel on a number of the issues it was directed that an options paper should be prepared for consideration at the next Panel meeting.

4.254 At the meeting, a copy of a letter dated October 1987 was also discussed. This was a Tax Office written response to a letter from a major accounting firm requesting advice as to whether or not, in certain circumstances set out in the letter, there was a taxable fringe benefit. The facts outlined included the statement that the 'employees of a related company in New Zealand are transferred to Australia for a period of not more than four years to work for the Australian company.'

4.255 In scenario 1, a married employee with 2 children owned a private residence in New Zealand and sold it on transfer to Australia. The employee maintained family and economic ties in New Zealand and intended to return to New Zealand at the end of the transfer period. Assuming that all the facts led to the conclusion that the employee was living away from his usual place of residence, the letter asked for confirmation that the fact that the employee had sold his home in New Zealand and no longer owned premises with sleeping accommodation available in that country, would not of itself result in New Zealand not being his usual place

of residence. In scenario 2, the employee was single and was living with his parents before transfer to Australia.

4.256 In its response the Tax Office, with reference to MT 2030, stated that if all other facts of the case, that is the employee's intention to return home and the finite duration of the appointment, led to the conclusion that the employee was living-away-from-home, the fact that the employee's house was sold and therefore the employee had no sleeping accommodation in his or her home country would be irrelevant for determining whether the employee was living-away-from-home. Similarly, in respect to scenario 2 it would be concluded that the employee was living-away-from-home.

4.257 In scenario 3, a New Zealand employee working in Australia and living away from his usual place of residence was provided an allowance as compensation for expected rental expenses. The employee was previously renting in New Zealand and paid rental of approximately $200 per week. He terminated his lease on departing New Zealand and took out a new lease in Australia. The rental costs on his Australian lease also cost approximately $200 per week. The letter requested whether the $200 paid on Australian rental accommodation was an 'additional expense' as referred to section 30 of the FBTAA.

4.258 In its response the Tax Office stated that the $200 paid for Australian rental accommodation would be accepted as 'additional expenses' under section 30 of the FBTAA.

### December 2004

4.259 A meeting was held between the audit project team and Deputy Commissioner, Small Business to discuss the completed options paper and proposed strategy to progress the taxpayers' representative matter prior to meeting with Second Commissioner Law.

### February 2005

4.260 At the NTLG-FBT Sub-committee meeting the Tax Office informed practitioners that the review of certain matters concerning LAFHAs was ongoing and that it would keep members informed as to the progress of the matters raised.

### April 2005

4.261 A meeting was held between the Second Commissioner Law and Deputy Commissioner Small Business, with decisions being made at that meeting as how to progress the finalisation of the LAFHA and the taxpayers' representative matters. These decisions included:

- Withdraw Taxpayer Alert TA 2002/7 on the basis that there had been improvements in practices within the industry.
- Institute a compliance program from within Small Business to check that continued improvements in practices within the industry.
- Adopt a 'usual place of residence' approach consistent with MT 2030, that is, an intention test rather than a 'brick and mortar' approach.
- In respect to the meaning of the word 'additional', a new taxation determination was to make it clear that all reasonable expenses are considered to be additional.

- In respect to causation, adopt an approach consistent with MT 2030 which required direct causation, that is taking up the job required the travel.

- Set out in a Practice Statement what a reasonable allowance would be and what would be expected in terms of the process that an employer would go through to assess what is a reasonable allowance.

### May 2005

#### Tax Office letter to taxpayers' representative

4.262 In a letter from the Deputy Commissioner Small Business to the taxpayers' representative the Tax Office indicated that in view of the extensive dialogue with the taxpayers' representative and the review of the arrangements, the Tax Office was satisfied that the conduct at the time the Taxpayer Alert was issued had apparently moderated and therefore the consequential tax risks had reduced. Based on these circumstances the Tax Office would withdraw Taxpayer Alert TA 2002/7. Also, the letter stated that the Tax Office view on the interpretation of subsection 30(1) of the FBTAA continued to be set out in MT 2030, there would be a continuing monitoring of salary sacrifice for LAFHAs, with a view to keeping Treasury and Government informed, and the Tax Office would develop guidelines, in the form of a law administration practice statement, for its compliance staff.

#### NTLG-FBT Sub-committee meeting

4.263 At the NTLG-FBT Sub-committee meeting the Tax Office informed practitioners that the ongoing review of LAFHAs, as previously noted and discussed at previous meetings, was progressing, with some outcomes being identified.

4.264 The Tax Office noted that at the August 2004 meeting it had advised that it was proposing to issue two draft taxation determinations and one draft taxation ruling and that they were, at that time, being progressed internally. The Tax Office informed practitioners that due to subsequent decisions by the Tax Office the proposed draft determinations and ruling would not issue.

4.265 The Tax Office also advised that the extent to which a LAFHA provided to an employee was tax free was a question of fact to be determined on the facts of each case and that its broad view on the interpretation of subsection 30(1) of the FBTAA would continue to be as set out in MT 2030.

4.266 In relation to Taxpayer Alert TA 2002/7, the Tax Office informed practitioners that given extensive dialogue that the Tax Office has had with certain stakeholders and the review of the arrangements undertaken, the Tax Office was satisfied that the conduct in relation to some arrangements at the time the Taxpayer Alert was issued had moderated and the consequential tax risks had reduced.

4.267 The Tax Office indicated that action would now be put in course to withdraw Taxpayer Alert TA 2002/7.

4.268 The Tax Office stated that there would be a continued monitoring of LAFHA arrangements, with a view to keeping Treasury and the Government informed. The Tax Office also stated that there was an identified need to provide some practical guidance concerning quantum associated with LAFHAs. It indicated that such practical guidelines may be released in the form of a law administration practice statement for the purposes of

providing assistance to Tax Office compliance staff and could include guidelines relating to the determination of eligibility and acceptable processes for determining the reasonableness of a LAFHA.

### June 2005

4.269 The proposed draft taxation ruling to supplement MT 2030, which proposed an objective test to determine whether an allowance is a LAFHA, was removed from the Public Rulings Program.

### July 2005

#### Tax Office meeting with the Treasury

4.270 A meeting was held between the Tax Office and Treasury, with the Tax Office again putting forward its concerns with respect to the operation of the LAFHA provisions, in particular with cash allowances. The Tax Office considered that difficulties arose with the practical administration of LAFHAs due to the lack of certainty in the use of such terms as 'usual place of residence', 'additional expenses', 'reasonableness' and issues such as length of time an employee may be entitled to LAFHA concessional treatment.

4.271 The Tax Office informed Treasury that its ongoing compliance project was being wound up after some 7 years and that Taxpayer Alert TA 2002/7 and Draft Taxation Determination TD 2000/D5 would be withdrawn. It also informed Treasury that the proposed draft taxation ruling was withdrawn from the Public Rulings program and that MT 2030 would, in essence, remain the Tax Office's broad position on LAFHAs. The Tax Office advised that legal analysis and submissions from the taxpayers' representative were not able to be rebutted and the Tax Office has accepted, given that practices in the industry regarding the reasonableness of LAFHAs have abated, that the arrangements entered into are acceptable under the current law.

4.272 The Tax Office indicated that the risks and difficulties identified in 1995, the reasons for the amendments being introduced and the acceptance at that time of the administrative difficulties faced the Tax Office, employers and employees had not abated and may have increased.

4.273 The Tax Office also expressed concern that labour hire firms, including contract management companies, may be interposed to provide LAFHA fringe benefits to a foreign national employee after they have travelled to Australia for private reasons and acquired a job at a point in time after arrival. The Tax Office indicated that the use of contract management companies as employers had highlighted the practice of re-characterising salary and wages income as a LAFHA fringe benefit, through salary sacrifice mechanisms and that it may encourage the proliferation of the practice.

4.274 The Tax Office advised that it was reviewing guidelines for self-regulation prepared by the taxpayers' representative in providing LAFHA fringe benefits to employees. The Tax Office also advised that it would continue to monitor LAFHAs and would, as necessary, inform Treasury of further developments. In the absence of such advice, the Treasury file note stated that Treasury indicated that they considered the current FBT law as giving effect to government policy.

### Withdrawal of Taxpayer Alert

4.275 The Tax Office withdrew Taxpayer Alert TA 2002/7 on the basis that risks inherent in the Alert had abated.

## August 2005

4.276 A meeting was held between the Tax Office and the taxpayers' representative to work towards finalising any outstanding issues.

## September 2005

4.277 The taxpayers' representative provided the Tax Office with its proposed LAFHA Guidelines which would be made available to its members for use in providing LAFHA fringe benefits to employees. These proposed LAFHA Guidelines were broadly based on MT 2030.

## October 2005

4.278 Following a letter from the Inspector-General of Taxation the Tax Office announced the withdrawal of Draft Taxation Determination TD 2000/D5. The draft determination stated that allowances described as LAFHAs which are paid to a foreign national working in Australia on a working holiday maker visa do not qualify as living-away-from-home allowance benefits under section 30 of the FBTAA.

4.279 The notice of withdrawal advised that following a review of the issues raised in the draft determination, it was not considered possible that an answer could be provided to the question that would be applicable in all cases. Rather, the Tax Office expressed the view that whether a payment to an employee who is a foreign national who has entered Australia on a working holiday maker visa could qualify as a LAFHA benefit could only be determined upon a consideration of the facts and circumstances in relation to that employee. For this purpose, sufficient guidance for case by case application of the LAFHA provisions was contained in MT 2030.

## November 2005

### NTLG-FBT Sub-committee meeting

4.280 At the NTLG-FBT Sub-committee meeting the Tax Office informed practitioners that sufficient guidance for a case by case application of the LAFHA provisions were contained in the long standing ruling MT 2030.

4.281 The Tax Office noted that a review of the LAFHA provisions had been discussed at NTLG-FBT Sub-committee meetings on a number of previous occasions. The Tax Office advised practitioners that MT 2030 provided the broad guidelines necessary to apply those provisions. It said:

> For example, issues relating to whether an employer must be satisfied that an employee in fact establishes that the employee has a residence at a place other than the locality at which the employee temporarily resides are set out in paragraphs 22, 29 & 30. A further example of the practical guidance provided by MT 2030 is the acceptance that an employer who pays a living-away-from-home allowance can rely on a survey of accommodation and living costs at

the employee's temporary work location in order to compensate the employee for such costs that the employee might be expected to incur.

4.282 The Tax Office indicated that it would continue to monitor LAFHA issues and suggested that there may, in the future, be a case that raised issues of significant concern relating to 'reasonableness' which may provide an opportunity to seek clarification from the Federal Court on the interpretation of sections 30 and 31 of the FBTAA.

### Meeting with taxpayers' representative

4.283 A meeting was held between the Tax Office and the taxpayers' representative to discuss the proposed the taxpayers' representative LAFHA Guidelines and a process of 'assurance' that the taxpayers' representative members were adhering to the LAFHA Guidelines.

## December 2005

4.284 The Tax Office received updated proposed LAFHA Guidelines from the taxpayers' representative following the November 2005 discussions. The Guidelines set out a number of general principles that would apply for the provision of all LAFHAs. It also provided guidance on the qualification process for eligibility to receive a LAFHA and guidance on how members should determine the quantum of LAFHA payments. The Guidelines outlined the documentation that members should ensure that they seek to confirm and document an employee's eligibility for a LAFHA. The Guidelines finally set out a number of common scenarios which would assist members in applying the LAFHA provisions.

## March 2006

4.285 In an email to an adviser to the taxpayers' representative, the Tax Office attached a draft letter setting out its intended response to the matters arising from the meeting with the taxpayers' representative in November 2005. The letter stated that the Tax Office had reviewed the revised LAFHA Guidelines and that the taxpayers' representative members who comply with the Guidelines would be regarded as 'low risk in respect of their compliance with Division 7 (LAFHA) of the FBTAA'. The Tax Office also confirmed in its letter that the process of assurance would include a review of a sample of a number of employment agreements that include the payment of LAFHAs to ensure the Guidelines are being complied with and that employers have systems in place to ensure ongoing compliance. The Tax Office included the methodology that it would adopt in its sampling of the employment agreements which included the broad areas of investigation, the documents that the Tax Office will wish to examine and the questions it will ask. The Tax Office also stated that the provision of data would assist it to monitor the provision of LAFHAs and the taxation consequences, thereby enabling it to continue to ensure Treasury and the Government remain adequately informed about the issue.

## May 2006

### Tax Office letter to taxpayers' representative

4.286 The Tax Office contacted the advisers to the taxpayers' representative to ascertain the progress following the email to them in March 2006. During the discussion between the advisers to the taxpayers' representative and the Tax Office, the Tax Office was informed that the taxpayers' representative members were 'not happy' with the proposed

sample/assurance methodology. The Tax Office requested that the taxpayers' representative should make a submission to the Tax Office outlining their specific grievances and concerns.

### Response from taxpayers' representative

4.287 The taxpayers' representative provided a letter to the Tax Office, indicating that its members have had an opportunity to review the proposed approach and their concerns are set out in the letter. Based on the facts, the taxpayers' representative stated that the Tax Office plan to prolong its pursuit of these companies was not warranted. It was submitted that the Tax Office activity in respect of these members should be closed and that any audit process focussed on other payers of LAFHAs.

## July 2006

4.288 The Tax Office sent a letter to the taxpayers' representative in response to the taxpayers' representative letter of May 2006. The Tax Office confirmed that the taxpayers' representative members who complied with the revised LAFHA Guidelines (for the payment of a LAFHA) and the Code of Conduct would be regarded as low risk in respect of their compliance with the LAFHA provisions of the FBTAA. It was stated that the guidelines represented a major step forward however in order to afford the low compliance risk status proposed, the Tax Office would require a level of assurance that the self regulatory regime was able to facilitate effective compliance with the law.

4.289 It was further noted that the review process that was outlined in the draft letter in March 2006 represented early thinking, which was shared with the taxpayers' representative in the interests of consultation and collaboration, to develop a mutually acceptable process that would provide the Tax Office with the necessary assurance and at the same time minimise the intrusion into the conduct of their business. Without an acceptable assurance process, a low risk status could not be conferred and LAFHA payments would be subject to standard risk assessment processes.

4.290 However, given efforts by both parties had made in identifying and implementing a practical way forward to date, the Tax Office stated that it was open to further positive discussion covering alternative approaches to the provision of assurance that the guidelines are being followed.

# APPENDIX 1 – LEGISLATIVE AND ADMINISTRATIVE BACKGROUND

## BACKGROUND

### History

A.1.1 Prior to the introduction of the fringe benefits tax regime, living-away-from-home allowances were taxed in the hands of employees under the income tax laws. Section 51A of the *Income Tax Assessment Act 1936* (ITAA 1936) provided that the amount of any living-away-from-home allowance was an allowable deduction from the assessable income of an employee taxpayer.[5]

A.1.2 The fringe benefits tax legislation was enacted in 1986 to overcome the perceived inadequacies of section 26(e) of the ITAA 1936. This section sought to tax, in the hands of the employee, the value of non-cash benefits received by employees as a consequence of their employment. At the time of enactment of the fringe benefit tax legislation the then Treasurer, the Hon Paul Keating, commented that the need for the introduction of a fringe benefits tax was aggravated by the inability of the existing income tax system to exact tax effectively from recipients of fringe benefits. The then Treasurer went on to say:

> Before turning to the main features of the Fringe Benefits Tax, I remind Honourable Members of the background. There has over the years been a very strong movement towards the remuneration of employees — especially higher income earners — by fringe benefits packages which allowed income tax to be avoided on substantial parts of the overall remuneration.
>
> So called tax-free perks came to dominate salary package negotiations and packages were openly advertised in the market place. Increasingly innovative deals were emerging particularly after the demise of the 'paper' tax avoidance schemes in the early 1980s.
>
> All of this was aggravated by the inability of the existing income tax system to exact tax effectively from recipients of fringe benefits. Several factors contributed to this.
>
> First there were deficiencies in the income tax law itself. A major one was that it called for case by case subjective judgments to be made as to the value of fringe benefits in the hands of individual employees.
>
> That kind of requirement is simply incompatible with the efficient assessment and collection of tax on a mass scale and invites disputation.

A.1.3 A fundamental difference between section 26(e) of the ITAA 1936 and the fringe benefits tax legislation is that employers are now liable to taxation in respect of benefits provided to employees.

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5 A living-away-from-home allowance was defined in s 51A(3) as: '…so much of any allowance or benefit paid or granted in money or otherwise as the Commissioner is satisfied is in the nature of compensation to the employee for the additional expenses (not being expenses which are allowable as a deduction under section 51) incurred by him, or which would be incurred by him if the allowance or benefit were not received, through having to live away from his usual place of abode in order to perform his duties as an employee'.

## LEGISLATIVE

A.1.4 Fringe benefits tax (FBT) is a tax payable by employers on the value of certain benefits, known as 'fringe benefits' that have been provided to their employees or to associates of those employees in respect of their employment. The principle legislation dealing with FBT is the *Fringe Benefit Tax Assessment Act 1986* (the FBTAA) and its regulations.

A.1.5 The legislation sets out a number of different categories of 'fringe benefit', including a living-away-from-home allowance (LAFHA) benefit, and the valuation rules for calculating the taxable value of these categories of fringe benefit.

A.1.6 The terms 'benefit', 'fringe benefit', 'living-away-from-home allowance benefit' and 'living-away-from-home allowance fringe benefit' are defined in s 136(1) of the FBTAA. The term 'living-away-from-home allowance fringe benefit' means a fringe benefit that is a living-away-from-home allowance benefit.

A.1.7 Where a living-away-from-home allowance is a fringe benefit and assessable to the employer under the FBTAA the allowance is not taxed in the hands of the employee.[6] However, where an allowance is not a LAFHA benefit it will form part of the employee's income against which appropriate income tax deductions may be claimed.[7]

A.1.8 Section 30(1) of the FBTAA sets out the general requirements for a LAFHA to be subject to FBT. Section 30(2) was later inserted with application after 10 October 1991, to, in effect, include as a taxable LAFHA fringe benefit certain allowances paid to offshore oil and gas rig workers which were found by the Federal Court to not otherwise be a LAFHA benefit under s 30(1).

A.1.9 A LAFHA benefit is a payment of money that satisfies the following conditions:

- the payment is an allowance paid by the employer to an employee in respect of the employee's employment; and
- it would be concluded that the whole or a part of the allowance is in the nature of compensation to the employee for:
  - additional expenses (not being deductible expenses) incurred by the employee during a period; or
  - additional expenses (not being deductible expenses) incurred by the employee, and other additional disadvantages to which the employee is subject, during a period,

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6 Prior to 2003/04, employment related benefits that were fringe benefits were treated as exempt income from the employee perspective: former subsection 23L(1) of the ITAA 1936. From 2003/04, an employment related benefit that is in the form of a fringe benefit within the meaning of the FBTAA is not assessable income and is not exempt income of the taxpayer: subsection 23L(1) of the ITAA 1936.

7 The definition of 'salary or wages' is contained in Schedule 1 of the *Taxation Administration Act 1953* (TAA). Subsection 12-1(2) of Schedule 1 of the TAA, specifically disregards a payment which is a living-away-from-home allowance benefit as defined in the FBTAA. The application of fringe benefits tax to LAFHAs has in effect been made in direct substitution for those benefits being subject to income tax in the hands of the employee. The consequence of this is that if it is determined that an allowance paid does not constitute a LAFHA benefit then the allowance would constitute salary or wages of the individual employee to whom it is paid.

by reason that the employee is required to live away from the employee's usual place of residence in order to perform the duties of employment.[8]

A.1.10 A living-away-from-home allowance is to be distinguished from an allowance that is paid by an employer to cover additional expenses which are 'deductible expenses' under the general deductibility provisions of the tax laws. In *Roads and Traffic Authority v FC of T* 93 ATC 4508, the Federal Court held that a camping allowance paid to employees for additional costs of food and other expenses was not a living-away-from-home allowance benefit because the allowance was intended to compensate for additional outgoings which, had they been incurred by the employees, would have been deductible.

### Value of a LAFHA

A.1.11 In general terms, the taxable value of a living-away-from-home fringe benefit is the amount of the allowance reduced by:

- the reasonable cost of additional accommodation for the employee during the relevant period (the 'exempt accommodation component'); and
- the reasonable cost for food during the period less ordinary food expenses that would be expected to be paid by an employee in any event during that period if the employee were not living away from home (the 'exempt food component').

A.1.12 Section 136(1) of the FBTAA defines the terms 'exempt accommodation component' and 'exempt food component'.

### Exempt accommodation component

A.1.13 The 'exempt accommodation component' of a LAFHA fringe benefit will be nil, unless the employer obtains a declaration in an approved form from the employee before the declaration date (the date of lodgment of the employer's FBT return for the relevant FBT year, although the Commissioner may grant an extension of time).

A.1.14 If the declaration is completed, the amount of the exempt accommodation component by which the taxable value of a taxable LAFHA fringe benefit will be reduced is the amount of the exempt accommodation component in the nature of compensation to the employee for additional expenses that might reasonably be expected to be incurred by the employee in respect of the subsistence during the recipients allowance period of a lease or licence in respect of a unit of accommodation for the accommodation of eligible family members.

### Exempt food component

A.1.15 The 'exempt food component' of a LAFHA fringe benefit will be nil unless the employer has obtained a declaration in an approved form from the employee before the declaration date. The approved form of the declaration is the same as for the 'exempt accommodation component' and therefore only one declaration need be obtained for the period.

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8 Pursuant to section 30(1) of the *Fringe Benefits Tax Assessment Act 1986*.

### Other living away from home benefits

A.1.16 An employer may also provide other accommodation related living away from home benefits, which do not involve the payment of an allowance. Such benefits include:

- The payment or reimbursement of rental costs on accommodation leased by the employee (section 21 of the FBTAA).
- The provision of the use of accommodation that is owned or leased by the employer (subsection 47(5) of the FBTAA).

A.1.17 Both of these benefits are exempt benefits where the employee is living away from home and has provided a living away from home declaration to the employer. Importantly, neither of these exempt benefits requires a 'reasonableness' test nor are they required to be for additional expenses suffered by the employee as is required under the LAFHA benefit provisions.

A.1.18 Similar provisions also apply in relation to food related living away from home benefits where the employer either pays or reimburses an employee for food expenses or directly provides food to the employee.

## ADMINISTRATIVE

A.1.19 Miscellaneous Taxation Ruling MT 2030, which issued on 30 September 1986, sets out the Tax Office's view on LAFHA benefits including references to case law (mostly involving section 51A of the ITAA 1936). It prescribes guidelines for determining the circumstances in which an allowance is to be treated as a living-away-from-home allowance.

### Usual place of residence

A.1.20 'Place of residence' is defined in subsection 136(1) of the FBTAA as a place at which the person resides or a place at which the person has sleeping accommodation, whether on a permanent or temporary basis and whether or not on a shared basis. There is no statutory definition of 'usual place of residence' for FBT purposes.

A.1.21 According to MT 2030 the following principles are relevant:

- Whether an employee is living away from his or her usual place of residence normally involves a choice between two places of residence.
- A person is regarded as living away from his or her usual place of residence if the employee would have continued to live at the former place of residence but for having to change residence in order to work temporarily for their employer at another locality. It is relevant in reaching that view that there is an intention or expectation of the employee returning to live at the former place of residence upon cessation of work at the temporary job locality.
- It is relevant that there is an intention or expectation of the employee returning to live at the former place of residence on cessation of work at the temporary job locality.

A.1.22 Paragraphs 19 to 25 of MT 2030 set out general rules relevant to determining whether an employee is living away from home and arrives at a number of conclusions:

- An underlying theme of the cases is a general presumption that a person's usual place of residence will be close to the place where he or she is permanently employed.

- An employee that changes his or her place of residence because of a change in the location of a permanent job, whether by reason of a transfer with the same employer or a change of employment, would not usually be living away from home on moving to a new place of residence close to the new job location.

- Employees who move to a new locality to take up a position of limited duration with an intention to return to the old locality at the end of the appointment would generally be treated as living away from their usual place of residence unless they have abandoned the former place of residence.

- Some employees may be unable to establish that they are living away from their usual place of residence because the transitory nature of their lifestyle means that their usual place of residence is wherever they happen to sleep at night.

- An employee may be treated as living away from his or her usual place of residence provided the appointment is for a limited period and the employee can be expected in the normal course to return to the same city or district of the home country to live. This would include foreign nationals employed in Australia on a temporary basis and Australian residents, such as overseas appointments and expatriates.

- The same applies where an employee transfers to a new locality within Australia on an appointment of fixed duration provided the permanent job location does not change. Paragraph 25 of MT 2030 sets out a number of situations where an employee would be regarded as living away from a usual place of residence.

- Certain kinds of occupations have a career structure which brings with it the necessity to accept regular transfers from one location to another, for example, police officers, school teachers, members of the defence force and bank employees. Employees in these situations will generally not be treated as living away from home when they move or transfer to live in proximity to the current work place even if the employee owns a home elsewhere in which he or she eventually intends to reside.

### Additional expenses on food and accommodation

A.1.23 Miscellaneous Ruling MT 2030, at paragraphs 26 to 34, gives the following guidelines in determining whether an allowance may qualify as a LAFHA:

- There is no requirement that an employee must actually have incurred additional expenses on accommodation and food before an allowance paid to an employee is regarded as a LAFHA.

- As the payment is in nature of an allowance, it will not ordinarily be a precise measure of actual expenses of the employee as a LAFHA.

- An employer will pay an allowance, perhaps on the basis of a survey of accommodation and living costs at the employee's temporary work location – in order to compensate the employee for accommodation and additional living expenses that the employee might be expected to incur. There is no requirement that the employer must have regard to an individual employee's actual outlays.

- There is no express requirement for an employer to establish, before an allowance paid to an employee may qualify as a LAFHA, whether the employee does in fact have a residence at a place other than the locality in which the employee is temporarily located.

- If the employee is one of a class of employees who could reasonably be expected by the employer to satisfy the test set out in paragraphs 11 to 25 of living away from their usual place of residence, and the allowance is paid to compensate for additional costs that the employees could be expected to incur through living away from home, the allowance will constitute a LAFHA.

- It is necessary that the employer obtain from the employee a declaration, in an approved form, as to the particulars of employee's usual place of residence and actual place of residence. Paragraph 32 of MT 2030 sets out an approved format for such a declaration.

- There may be instances where an employee eligible to make such a declaration will not be able to indicate that residential premises are being kept at the place where he or she usually resides. For example, for financial reasons an expatriate coming to Australia for a limited but substantial period may have terminated the lease on a house, flat or apartment where he or she lived in the home country intending to release it or lease another home on return. Similarly, a home could have been sold with the intention of acquiring another.

- In these instances, provided that the test set out in paragraphs 11 to 25 are satisfied and the expatriate intends to return to the same city or district to live upon resuming residence in the home country, he or she would be entitled to declare that his or her usual place of residence is that city or district.

### Distinction between travelling and living-away-from-home allowances

A.1.24 Living-away-from-home allowances are taxable fringe benefits and therefore exempt from tax in the hands of the employee, whereas travelling allowances form part of the employee's assessable income against which appropriate deductions may be allowed for the costs of meals, accommodation and incidental expenses incurred while the employee is travelling in the course of carrying out the duties of employment. It states that unlike LAFHAs, there is generally no change of employment location in relation to the payment of travelling allowances and that while the expenses that they are intended to compensate may be similar (meals and accommodation) the circumstances in which the allowances are paid are different.

A.1.25 Paragraph 38 of MT 2030 provides further detail on this difference:

> A living-away-from-home allowance is paid where the employee has moved and taken up temporary residence away from his or her usual place of residence so as to be able to carry out employment duties for a time at the new (but temporary) workplace. A travelling allowance, on the other hand, is paid because the employee is travelling in the course of performing his or her job. In the former case, there is a change of job location and an actual change of residence to a place at or near that location. In the latter, the employee does not change job locations but simply travels in order to carry out the requirements of the job.

A.1.26 Miscellaneous Taxation Ruling MT 2030 also indicates that there will be circumstances, when an employee is away from his/her home base for a brief period in which it may be difficult to conclude whether the employee is LAFHA or travelling. As a practical general rule the Commissioner has determined that where the period away does not exceed 21 days the allowance will be treated as a travelling allowance rather than a LAFHA. For longer periods, it will be necessary to determine the nature of the allowance with the guidance provided by Miscellaneous Taxation Ruling MT 2030.

# APPENDIX 2 — TAX OFFICE'S RESPONSE TO REVIEW

Australian Government
Australian Taxation Office

SECOND COMMISSIONER OF TAXATION

Mr David Vos AM
Inspector-General of Taxation
GPO Box 551
SYDNEY NSW 2001

Dear David

Thank you for your report on your review of the Tax Office's ability to identify and deal with issues concerning Living Away From Home Allowances.

We would again acknowledge that these difficult technical and compliance issues took too long to resolve.

As you noted in your conclusions, the Tax Office had reason to be concerned about potential revenue impacts where there were indications of potentially excessive purportedly tax free LAFHA payments being made.

The Tax Office agrees with your two key recommendations and we will act expeditiously on key recommendation 1, the consideration of whether we should formally advise the Treasury of our views, in accordance with our Practice Statement PS CM 2003/14, on the administrative impacts of the legislation and the revenue and equity consequences of the law as interpreted by the Tax Office.

Subject to the outcome of recommendation 1, we will implement Recommendation 2, the potential rewrite or replacement of Miscellaneous Taxation Ruling MT 2030.

We appreciate your acknowledgement that there was 'timely cooperation' of the Tax Office in this review.

Finally, as agreed in recent discussions with the Deputy Inspector-General, we will work with your office in the new year concerning any possible broader recommendations that might be incorporated into your foreshadowed fourth report drawing together your findings from the three case studies.

Yours sincerely

Jennie Granger
Second Commissioner

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