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Senator the Hon Eric Abetz
Minister for Employment
PO Box 6100
Parliament House
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Dear Minister

LEGISLATIVE CHANGES WHICH ADVERSELY IMPACT LIVING AWAY FROM HOME ALLOWANCE IMPLICATIONS AND FRINGE BENEFIT TAX

The Air Conditioning and Mechanical Contractors' Association of Victoria (AMCA) is writing to you advising of significant cost implications Living Away From Home Allowance (LAFHA) regulatory changes have with the completion of rural and essential construction projects. The industry recognises that the Commonwealth Government objectives are to cut red tape and promote behaviour that supports the mantra of being open for business. To support these objectives, reform with current LAFHA requirements must be a high priority for the Commonwealth Government.

The Changes

The legislative changes to the LAFHA were implemented on 1 October 2012. Please refer to a *Technical overview of the legislative changes – An Employment Perspective* document at Attachment A.

Recognising the significant cost implications of these regulatory changes to the completion of a number of rural and essential building and construction projects a workgroup was formed with the major employer Associations in the sector. Industry intention is to collaborate with the Commonwealth Government and Australian Taxation Office (ATO) to remedy this unintended consequence which has materialized from this regulatory reform. On a separate level the AMCA is currently supporting the ATO through the development of an employers' guide to ensure there is clarity with the issue. However, without meaningful dialogue amongst all parties this regulatory change will affect the delivery of a number of rural projects in an efficient and economical manner and distort the cost of delivery throughout the supply chain.

Prior to these legislative changes, the majority of LAFHA was not taxable either to the employer or the employee, and the LAFHA was a deductible expense to the employer. As such, LAFHA has been historically utilised as a form of compensation for those working and living away from home.

The changes have altered the very essence of LAFHA, and limits the circumstances in which a reduction of taxable value of LAFHA will be available to employers.

Employers must now pay fringe benefit tax (FBT) on the entire amount of all LAFHA benefits payable to employees unless the new legislative conditions are met (which are extremely onerous on employers).

This is, of particular concern for Victoria, given the State is sparsely populated, with the majority of the skilled workforce being located in Melbourne and a huge proportion of workers required to live away from home when working on interstate and rural projects.

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We note that these legislative changes do not significantly impact on fly-in/fly-out or drive-in/drive-out arrangements, but particularly cause issues for those employers providing LAFHA.

The Effects

1. Cost

The changes have already started causing serious economic harm in the Victorian construction sector. We estimate that the cost implications using 18 employees as a guiding *example* is approximately $280,117. This means that for any additional sub-contracting firms (e.g. electrical contractors' and various specialist trades) engaged on an interstate / regional project, the aggregate cost implications are in the millions of dollars. This cost burden is simply unacceptable, and unmanageable, particularly in an already struggling economy.

2. Apprentices

Further, we are particularly concerned about the impact of these changes on apprentices working within the sector. Under the legislation, if an apprentice does not own or rent a house (commonly they live with their family when not on site) the employer will be liable to pay FBT on the entire amount of LAFHA payable to the apprentice. This would discourage the promotion of apprentices' working on rural and regional projects. As such, we fear that the cost implication will be too great for businesses to absorb, and we have serious concerns that this will adversely impact the use of apprentices in the sector.

3. Substantiation Requirements

Significant changes have been made to the reporting obligations for food and drink expenses to be reimbursed for employees on LAFHA arrangements.

Recent tax rulings relating to food and drink benefits payable in relation LAFHA arrangements set a "reasonable amount" which is payable to the employee for these expenses. If employees claim more than the "reasonable amount", strict requirements regulate the reporting requirements for these expenses.

Workers in the construction sector largely receive above the specified "reasonable amount" and employers will need to ensure their employees comply with the substantiation requirements to obtain FBT concessions.

Employers in the construction industry will face difficulties in ensuring that their employees comply with the substantiation requirements (i.e. production of receipts to justify expenditure on food and accommodation). This is largely due to the commonality of employees utilising the allowance to boost their rate of pay, and not obtaining and retaining the required receipts when paying for food / accommodation. Again, the impact is an enormous cost implication on employers.

Immediate Action Required

Many of our members are tendering for work on major projects across Australia and particularly in rural areas (e.g. Ararat Prison, Bendigo Hospital, Tasmania Hospital, and Adelaide Cricket Ground). There would be numerous other Australian wide projects which will be impacted adversely.

Employers will be increasingly sending employees to live away from home in remote areas, or areas in which the work cannot be carried out by local residents.

The cost implications of these legislative changes are already being felt, and will increasingly impact on tendering and project costs going forward, affecting the entire supply chain from the sub-contractors, the builders and those that they engage to work on the projects.

Further, the changes provide a disincentive to train and utilise apprentices – clearly in contra to the intent of the legislation and the future of the industry.

These legislative changes put in jeopardy the construction industry as a whole, at a time when the Australian economy is relying on significant projects to provide a much needed productivity boost.

The AMCA seeks a meeting with you, Commonwealth Treasurer and the formulation of a building and construction whole-of-industry employers' workgroup to include (and not limited to), AMCA, Australian Construction Industry Forum, Australian Constructors Association, Master Builders' Association, National Electrical and Communications Association, National Fire Industry Association and Master Plumbers and Mechanical Services Association of Australia to assist with resolving this issue.

We seek that you urgently review our concerns. The sector, and the Australian economy, needs change fast. Representatives of the whole-of-industry employers' workgroup would be available to meet with you at your earliest convenience to discuss how we can resolve this issue in a responsible manner.

Could you please advise of some potential dates in order for industry to make joint representation. Please note I have also advised the Commonwealth Treasurer. In the interim should you require any further advice please contact me on (03) 8831 2815, or alternatively via email: sumitoberoi@amca.com.au

Yours sincerely

Sumit Oberoi
Executive Director
AMCA Victoria

Attachment A:

Living Away From Home Allowance (LAFHA)

Technical Overview of the Legislative Changes – An Employment Perspective

1. Executive Summary

1.1. The recent legislative changes to the Living Away From Home Allowance (**LAFHA**) were implemented on 1 October 2012.[1]

1.2. The concept of providing tax-free housing and food to an employee who is living away from home has largely been removed.

Tax exposure for food and accommodation

1.3. As at 1 October 2012, the provision of a LAFHA will be treated as a taxable benefit for employers if they meet the criteria for LAFHA (as set out in detail below) and there will be no tax exposure for food and accommodation provided employers can substantiate the expenditure.

1.4. The majority of employees working in the construction sector will not meet the criteria for LAFHA when it comes to food and accommodation as they are being provided with allowances in excess of those deemed 'reasonable' by the Australian Taxation Office (**ATO**).

1.5. Further, it will be extremely difficult for employers in the construction industry to ensure that employees comply with the substantiation requirements (ie production of receipts to justify expenditure on food and accommodation). This is largely due to the commonality of employees utilising the allowance to boost their rate of pay, as opposed to covering living expenses whilst working away from home. The likely result will be an increase in wage and compliance costs for employers. We explore this in further detail below.

Deductions can only be claimed for the first 12 months

1.6. The ability to claim deductions for living away from home is now only available for the first 12 months that the employee is living away from home. After this, the employee will be liable to be taxed on the full amount of the allowance, which may make relocation unattractive for some employees.

Substantial cost and administrative burden on employers

1.7. The changes impose a substantial cost burden on employers.

1.8. To compensate employees for the removal of the tax concession, employers are likely to be forced to pay additional salary and wages.

1.9. Further, employers are going to have to overhaul their administrative processes (financial and administrative), and update their policies and procedures, so as to attempt to fulfil the requirements of the substantiation obligations.

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[1] Please note: This summary provides a general overview of LAFHA requirements and recent legislative changes.

Transitional provisions

1.10. The transitional provisions have been put in place so as to transition in the legislation for both permanent residents already operating under a living away from home arrangement, and temporary residents who maintain a home in Australia. For the purpose of this summary we have focussed on permanent residents, and those working domestically. Please advise if you require further information regarding temporary residents.

1.11. However, it is important to note that the requirement to substantiate expenditure against the allowance came into effect immediately, as at 1 October 2012 for ALL employees.

1.12. There are inconsistencies in the interpretation of the transitional provisions which has led to uncertainty regarding their applicability, and the taxation implications. In particular, there are interpretation issues with the following two concepts:

1.12.1. what is an 'employment arrangement'; and

1.12.2. what is a 'material variation' of an existing contract.

1.13. We explore these issues in detail below.

2. General Overview

The key concept of LAFHA

2.1. LAFHA are a specific form of Fringe Benefit that are paid by employers to employees who are required to live away from their normal place of residence to perform work for the employer. The scheme is designed to compensate employees for the additional expenses incurred and the disadvantages suffered when an employee is living away from home.

2.2. A LAFHA benefit has historically been income-tax free for the employee and is not included as assessable income in the employee's tax return.

2.3. The concessional tax treatment offered by LAFHA have for many years been seen as a tax beneficial arrangement for employees who are required to live away from their usual residence. Under the previous legislation, LAFHA was treated as a fringe benefit and taxable to employers under the FBT regime, subject to concessions allowable for the "exempt accommodation" and "exempt food" component of a LAFHA (on which no FBT was payable). Under the previous law, any part of a LAFHA that was taxable was reduced by any reasonable costs incurred for food and accommodation. Therefore, the majority of any LAFHA ended up not being taxable either to the employer or the employee, and the LAFHA was a deductible expense to the employer.

2.4. The new legislation has now changed this and unfortunately contradicts the commonly held notion that LAFHA exists as a form of compensation.

2.5. LAFHA benefits are a fringe tax benefit (**FBT**) issue for employers to the extent that the concessional conditions for each employee are not satisfied. This means that employers must now pay FBT on the entire amount of all LAFHA benefits payable to employees unless the new legislative conditions are met or the transitional rules apply.

Government concerns with LAFHA

2.6. The Assistant Treasurer, David Bradbury MP, in the consultation paper setting out the proposed reforms highlighted concerns with LAFHA that had been raised at the 2011 Tax Forum by various parties. These concerns appear to be the catalyst for the proposed changes. The consultation paper specifies:

> "*One of the issues raised at last October's Tax Forums was the increasing exploitative and misuse of this tax concession by a narrow group of people, particularly highly-paid executives and foreign workers, at the expense of Australian taxpayers.*"
>
> and...
>
> "*These changes will ensure that Australian taxpayers are not funding the unfair exploitation of concessions by employers and employees.*"

2.7. Reform of LAFHA was targeted by the Federal Government in its Mid-Year Economic Outlook in 2012. Further details emerged in the 2012-2013 Federal Budget handed down on 8 May 2012.

2.8. On 28 June 2012 the *Tax Laws Amendment (2012 Measures No 4) Bill 2012* (**LAFHA Bill**) was tabled in Federal Parliament. After a significant amount of consultation and several amendments to the legislation, the *Tax Laws Amendment (2012 Measures No 4) Act 2012* (**LAFHA Amendments**) received Royal Assent on 28 September 2012.

2.9. The third explanatory memorandum (**Revised EM**) asserts that the cost impact for employers is low, and states:

> *"Employers will have some compliance costs in familiarising themselves with the reforms, particularly during the transitional period. There will be some on-going compliance costs for employers in line with their existing obligations under the fringe benefits tax law."*

2.10. This is obviously incorrect and potentially misleading. If an employer is required to guarantee an employee's net income and wishes to reduce the tax impact on the employer and employee, it will need to (within the constraints of existing contracts and industrial instruments) increase the employee's salary or another type of allowance that is more cost effective than pay FBT (at 46.5%) on a LAFHA or benefit.

2.11. This will have significant implications for parties re-negotiating industrial instruments (such as enterprise bargaining agreements and contracts) in the workplace.

2.12. Employers must also update their administrative systems to ensure compliance with their FBT obligations. This will have a cost implication and an adverse effect on employers.

3. Intended Operation

3.1. Initially the LAFHA rules were to be largely removed from the Fringe Benefits Tax Assessment Act 1986 (**FBTAA**) and replaced with new rules in the Income Tax Assessment Act (**ITAA**). However, changes that occurred to the draft legislation prior

to its implementation modified this operation such that the rules largely remain within the FBTAA.

3.2. The effect of the current changes is to limit the circumstances in which a reduction of taxable value of LAFHA will be available.

3.3. If an employee maintains a home in Australia and began a living away from home arrangement after 8 May 2012, an employer will receive a reduction in taxable value (in the same way it has historically) but for 12 months only, and so long as it meets the conditions of the legislation. After that 12 month period[2], the employer will have to pay fringe benefits tax on any LAFHA payment or benefit given to the employee.

3.4. An employee may be eligible for LAFHA benefits if they maintain a home in Australia that they are required to live away from or they work on a fly-in fly-out or drive-in drive-out basis.

3.5. Each element of the requirements is examined in detail below.

Living away from home & maintaining a home in Australia

3.6. Employees must provide a declaration that they "maintain a home in Australia". For the purpose of being eligible for LAFHA payments, maintaining a home in Australia means that:

3.6.1. The employee (or their spouse) must have an ownership interest in a home (either owning or renting); and

3.6.2. The home must be available for the employee's immediate use and enjoyment at all times while the employee is living away from it; and

3.6.3. The employee expects to resume living at that home when they return.

Fly-in/fly-out or drive-in/drive-out arrangements

3.7. If an employee works on a fly-in/fly-out or drive-in/drive-out arrangement, the employee is **not** required to maintain a home in Australia.

3.8. Further, the 12 month period for the concessional tax rate for employers also does **not** apply, which means that FBT is not payable even after the initial 12 month period has expired.

Employees who do not maintain a home in Australia and do not work on a fly-in/fly-out or drive-in/drive-out arrangement

3.9. If an employee falls under this category, the employer does not receive concessional treatment on any LAFHA payment/benefits paid to the employee. Further, the LAFHA or other benefit may be a reportable FBT amount on the employee's payment summary.

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[2] The 12 month period can be paused and recommenced if an employee returns home for a period of time within that 12 month period, including during periods of personal, annual and long service leave.

Changes for Employers

3.10. Significant changes will mean a change in the way both employees and employers approach LAFHA and FBT.

3.11. Changes have been made to the reporting obligations for food and drink expenses to be reimbursed for employees on LAFHA arrangements. Accommodation, food and drink expenses are relevant to all LAFHA employees.

3.12. Recent tax rulings relating to food & drink benefits payable in relation LAFHA arrangements set a "reasonable amount" which is payable to the employee for these expenses. If employees claim more than the "reasonable amount", strict requirements regulate the reporting requirements for these expenses.

Records to be kept by employees

3.13. An employee must complete an employee declaration regarding their eligibility requirements and additional expenses payable in relation to their LAFHA arrangement. This must be requested of the employee by the employer prior to the lodgement of the employer's FBT return.

3.14. The declaration is required to be in a form approved by the ATO and includes (among other things):

3.14.1. the employee's address in Australia;

3.14.2. the address of the place, or places where the employee actually resided while living away from home; and

3.14.3. a statement that the employee has satisfied the requirements of maintaining a home in Australia for the place in Australia where they usually reside.

3.15. In order to satisfy the substantiation requirements for food expenses, the employee (before the declaration date for the relevant FBT year) must give the employer:

3.15.1. documentary evidence of the expense (being the actual receipt or other evidence such as bank statements etc); or

3.15.2. a declaration in the approved form.

3.16. An employee must keep any declaration (and any supporting documentary evidence) for a period of 5 years from the date of the declaration.

3.17. Where an employee does not or is not able to complete a declaration, the employee must provide direct documentary evidence to the employer regarding their related expenses (including food and drink expenses if they exceed the "reasonable amount").

3.18. The ATO has approved declaration forms for use by employers on the ATO website.

Records to be kept by employers

3.19. Employers should ensure that:

3.19.1. up-to-date records are kept in relation to each employee on a LAFHA arrangement (including relevant time period information and other details);

3.19.2. employee declarations are required to be produced by each employee; and

3.19.3. a clear LAFHA policy is in place which sets out the obligations of employees and managers relating to declarations, expenses, required forms and reporting requirements.

3.20. Employers who cannot substantiate relevant expenses will not be able to obtain the available tax concessions.

Reasonable food & drink expenses

3.21. The designated "reasonable amount" is a weekly expenditure total for food & drink expenses that includes expenditure on all meals (including expenses in restaurants, take-away food and alcoholic beverages). The Commissioner of taxation sets the "reasonable amount". Substantiation is not required for amounts that fall within the "reasonable amount".

3.22. The current (ie 1 April 2013 to 31 March 2014) "reasonable amounts" per week for employees living away from home within Australia as follows:[3]

One adult	$233
Two adults	$350
Three adults	$467
One adult and one child	$292
Two adults and one child	$409
Two adults and two children	$468
Three adults and one child	$526
Three adults and two children	$585
Four adults	$584

4. Transitional Arrangements

4.1. The Transitional Rules only apply to LAFHA arrangements either in place prior to 8 May 2012 or not materially changed since that date. If there is a material change or renewal of the LAFHA arrangement between 8 May 2012 and 1 October 2012, the new rules apply from the date of the change.

4.2. If there is a material change to the arrangement after 1 October 2012 then the new rules apply as at the date of the material change.

4.3. If the Transitional Rules do apply, until 1 July 2014:

4.3.1. There is no requirement for permanent residents of Australia to maintain a home in Australia; and

4.3.2. The 12 month period for employer concessions does not apply.

[3] Table 1 of TD 2013/4

4.4. As a general rule:

4.4.1. If an employee was receiving LAFHA payments prior to 8 May 2012, then the transitional provisions will apply to that employee.

4.4.2. If an employee was not receiving LAFHA payments prior to 8 May 2012, then the new rules apply from when they start receiving LAFHA payments.

5. Transitional Problems and Hurdles

5.1. Permanent residents who had employment arrangements in place (including a LAFHA) before 7:30pm on 8 May 2012 will **not** be required to maintain a home in Australia, and will not be subject to the 12 month deduction limit, until the earlier of 1 July 2014; or the date that a new employment arrangement is entered into.

Material change in employment

5.2. One of the major problems in understanding the application of the transitional arrangements is determining what is meant by the phrase "material change in employment".

5.3. The Revised EM provided further clarification on this point. It confirms that annual salary reviews will not constitute a material variation.[4]

5.4. It also states that changes to an 'employment arrangement' to reflect other annual adjustments, such as the food component of LAFHA, do not constitute a material variation.

5.5. However, in its illustration in relation to promotions, the Revised EM states:

> *"In case of promotions, it will be a matter of fact depending on the circumstances of each case. For example if an employee is promoted and the underlying terms of their employment arrangement do not change, there has been no material variation in the employment arrangement. However, if there are fundamental differences to the employment arrangement arising from the promotion, the employment arrangement has been the subject of a material variation."*

5.6. However, as per the Revised EM passage set out above, there is no specific rule in place to assist employers to determine the applicability of the transitional provisions and an employer is required to look at each circumstance / instance to determine applicability. This is potentially unmanageable (particularly when an employer has a large workforce) and causes serious issues for employers in managing the taxation implication of this legislative change.

5.7. Specific interpretation issues have already been raised by employers that require further clarification regarding the applicability of the transitional provisions.

Transitional provisions and the substantiation requirements

5.8. Another difficulty is understanding the substantiation requirements for transitional employees. Prior to the introduction of the LAFHA Amendments substantiation

[4] Paragraph 1.67

requirements were fulfilled by applicable employees providing a relevant declaration. The problem with the way the transitional arrangements have been implemented is that arguably, the former method of substantiation has not been carved out of the new amendments meaning that that there is a hybrid and more onerous transitional substantiation arrangement.

5.9. To understand the issue more fully, the LAFHA Amendment amended the FBTAA by inserting new sections (relevantly ss 31 to 31H). However, the transitional arrangements in the LAFHA Amendments permit certain sections of the amended legislation to be "disregarded" for the transitional period (being the earliest of 30 June 2014 or when the employment arrangement is varied).

5.10. Reading the amended section for the FBTAA for employees that maintain a home in Australia, section 31 requires a transitional employee to only comply with section 31F (declarations) in order to determine taxable value of the fringe benefit for food and accommodation (ie the requirement to maintain an Australian home (s 31C) and the 12 month requirement (s 31D) are disregarded). There is no amendment that requires the substantiation requirements to be disregarded for transitional employees.

5.11. However, the substantiation requirements operate by reference to the period during which the fringe benefit operates. This period, by virtue of the fact that s 31D has been disregarded (which provides a maximum of 12 months) could potentially be the whole of the relevant period of employment (arguably requiring retrospective substantiation). It seems unlikely that this was the legislative intent.