

Final Assessment Regulation impact
statement – Introducing a cap for salary
sacrificed meal entertainment and
entertainment facility leasing expenses

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Background

In the 2015-16 Budget, the Government announced that it would introduce a separate single grossed-up cap of \$5,000 for salary sacrificed meal entertainment and entertainment facility leasing expenses ('meal entertainment benefits') for certain employees of not-for-profit (NFP) organisations, and that all use of salary sacrificed meal entertainment benefits will become reportable, with effect from 1 April 2016.

1. The problem

Currently, most salary sacrificed fringe benefits provided to certain employees of NFP organisations are reportable and FBT exempt, or rebatable, only up to a set cap. However, meal entertainment benefits are specifically excluded from this requirement. That is, these benefits are not required to be reported (including for certain tax and transfer payment income tests) and are not taken into account when considering whether an employee has exceeded the FBT caps. This means that such benefits are uncapped, limited only by the employee's salary.

These 'excluded' meal entertainment benefits apply to:

- employees of public benevolent institutions and health promotion charities that are currently entitled to FBT exempt benefits up to a \$30,000¹ cap;
- employees of public hospitals, non-profit hospitals, and public ambulance services that are currently entitled to FBT exempt benefits up to a \$17,000 cap; and
- employees of NFP organisations that are eligible for an FBT rebate (up to a \$30,000 cap, with the rebate capped at 48 per cent).

The uncapped benefits that can be salary sacrificed are very broad, and include holiday accommodation, cruises, weddings, and meals and alcohol at restaurants. The expenditure does not need to be incurred in Australia. Employees of affected NFP organisations are able to reduce their income tax liability by salary sacrificing these meal entertainment benefits, which is not available to other employees.

The uncapped benefit meal entertainment is also inequitable, with greater benefits for employees on higher salaries and those who have greater financial freedom to forgo higher proportions of their salaries on eligible items. Over time, the convenience and marketing of meal entertainment cards has also led to increased take up, increasing the cost to revenue.

Salary packaging companies have widely promoted and facilitated this uncapped benefit, including through 'meal entertainment cards'. For instance, the quotes below, taken from a sample of salary packaging websites (accessed in August 2015), provide a sense on how this benefit is being promoted:

¹ These caps do not take into account the temporary increase in these caps associated with the Temporary Budget Repair Levy.

- *'Want tasty tax savings for breakfast, lunch and dinner? Whenever you dine out with friends, family or colleagues, simply swipe your card and enjoy tax-free meals!' – PBI Solutions*
- *'All you need to do to package this item is go out for a meal – there are savings in every bite you take!' – Smartsalary*
- *'The EPAC Meal Entertainment Card allows you to set aside money from each pay to put exclusively towards dining out. This money is transferred to your card before it's subjected to income tax, so it effectively grants you tax free dining!' – EPAC*

Treasury has estimated the cost to revenue, in terms of revenue forgone, in its annual Tax Expenditure Statement (TES) arising from the FBT exemption for meal entertainment benefits. According to the latest TES, released in January 2015, the estimated revenue forgone was \$350 million in 2010-11 and is projected to rise to \$545 million in 2017-18.

2. Case for government action / Objective of reform

The case for action is based on the Government's commitment, as outlined in the 2015-16 Budget, to return the budget to surplus as soon as possible, and forms part of the Government's objective to improve the fairness of tax rules and benefits systems.

The objectives of the reform are:

- reflect developments that no longer warrant continued uncapped exemptions for meal entertainment benefits that are salary sacrificed; and
- limiting the use of salary sacrificed meal entertainment benefits, to improve the fairness of the FBT system.

Meal entertainment benefits were originally excluded from reporting and the FBT caps on compliance costs grounds because, at the time, many of the benefits were not easily attributable to individuals. However, this rationale is no longer appropriate for salary sacrificing arrangements that allow benefits to be easily valued and attributed to an individual employee, such as the through the use of meal entertainment cards.

3. Policy options

There are four options to deal with meal entertainment benefits:

- **Option 1:** Maintain the status quo.
- **Option 2:** Include salary sacrificed meal entertainment benefits under the existing FBT exemption/rebate caps.
- **Option 3:** Introduce a separate cap and allow salary sacrificed meal entertainment benefits up to \$5,000 to be exempt. Benefits exceeding \$5,000 would be counted in calculating whether an employee exceeds their FBT exemption/rebate caps.

- **Option 4:** Introduce a separate cap and allow salary sacrificed meal entertainment benefits up to \$2,000 to be exempt. Benefits exceeding \$2,000 would be counted in calculating whether an employee exceeds their FBT exemption/rebate caps.

Only salary sacrificed meal entertainment benefits will be affected by these options. Non-salary sacrificed meal entertainment benefits, such as in-house canteens, will not be affected.

Option 1 would preserve the current FBT treatment of meal entertainment benefits. Option 2 would mean that salary sacrificed meal entertainment benefits would be taken into account under the standard FBT caps and no longer treated separately. Options 3 and 4 are closely related to each other; the only difference is the size of the cap. These options would retain concessional FBT treatment for meal entertainment benefits.

With the exception of Option 1, all of the proposed options require legislative amendments and would apply prospectively from 1 April 2016 to coincide with the start of the new FBT year. This start date ensures that affected employees have time to adjust to the new arrangements, without existing arrangements being affected.

4. Cost benefit analysis of each option / Impact analysis

If the status quo is not maintained, the proposed options will overwhelmingly impact employees of certain NFP organisations who salary sacrifice meal entertainment benefits. Although the costings make certain assumptions on the uptake of meal entertainment benefits, the likely impact of this proposal on affected employees is difficult to verify, as meal entertainment benefits are not reportable for FBT purposes. However, some insights can be gained from examining the data relating to the current FBT caps based on tax returns for individuals employed by NFP organisations.

In relation to the FBT *exemptions* cap, the data indicates:

- Of the approximately 920,000 individuals employed by eligible NFP organisations, 53 per cent had reportable fringe benefits in 2012-13, meaning that 47 per cent of individuals had no reportable fringe benefits. As individuals that do not report any fringe benefits are unlikely to utilise meal entertainment benefits, almost half of eligible NFP employees will not be affected by the proposed options that would eliminate or cap meal entertainment benefits. Even if they happen to do so, they will be able to claim these benefits up to the relevant caps.
- For those employed in public benevolent institutions and health promotion charities, around 40 per cent are close (that is, within \$500) to breaching the exemption cap. A further 11 per cent have a buffer of up to \$2,000 before they exceed the cap. Around one third of individuals had a buffer of more than \$5,000 before they exceed the cap.
- For those employed in public, non-profit hospital and public ambulance services, around 67 per cent are close (that is, within \$500) to breaching the exemption cap. A further 11 per cent have a buffer of up to \$2,000 before they exceed the cap. Around 10 per cent of individuals had a buffer of more than \$5,000 before they exceed the cap.

For individuals with a reportable fringe benefit from a *rebatable* NFP employer in 2012-13, around 9 per cent are close (that is, within \$500) to breaching the \$30,000 cap. However, around 73 per cent have a buffer of more than \$5,000 before they breach the cap.

This suggests that for employees of NFP organisations that are eligible for an FBT rebate, the proposed options are only likely to adversely affect a small percentage of individuals, particularly as the meal entertainment benefits for this group is less attractive due to the partial rebate.

Anecdotal evidence indicates that the take up of salary packaged meal entertainment benefits appears to be lower than salary packaging items under the existing exemption caps, although take up rates vary between eligible NFP organisations. Voluntarily provided data by salary packaging providers indicates that meal entertainment benefits can range from an average of \$2,400 to as high as \$8,500 per annum, with a simple average of around \$5,500.

Option 1 would not meet the Government's objectives to repair the budget nor improve the fairness of the tax system.

Option 2 means employees currently claiming meal entertainment benefits that are already close to breaching their current exemption caps will be most adversely affected as they will be unable to absorb any additional fringe benefits without exceeding the FBT caps. These individuals are likely to reconsider whether it is in their interests to continue with claiming meal entertainment benefits as FBT applies at the highest marginal tax rate. Options 3 and 4 mitigate these adverse impacts by providing scope for affected employees to continue to claim meal entertainment benefits by retaining concessional treatment for these benefits.

As the salary packaging industry has promoted the utilisation of these meal entertainment benefits, they are also likely to be adversely affected by these proposed options. However, they have previously indicated that should meal entertainment benefits be reformed, rather than removing the benefit entirely, a cap on meal entertainment benefits should be imposed.

Compliance cost impacts

In terms of tax compliance obligations, however, it is employers that are responsible for reporting and paying FBT even though employees are the main beneficiaries of the FBT reporting exemption for salary sacrificed meal entertainment benefits, as they are able to reduce their income tax liability.

Options 2, 3 and 4 also make salary sacrificed meal entertainment benefits reportable for all employers, not just NFP organisations, to ensure consistency in treatment. However, it is understood that outside the NFP sector, there is very little, if any, uptake of salary packaging arrangements for meal entertainment benefits given the lack of financial advantages from doing so. Given this, the focus of the compliance costs impacts will be on NFP employers.

There are around 5,700 NFP organisations entitled to the FBT exemption and around 3,400 NFP organisations entitled to the FBT rebate. Around 20 per cent of FBT exempt and around 16 per cent of rebatable NFP organisations did not have any reportable fringe benefits in 2012-13. Based on the number of NFP organisations that have reportable fringe benefits in 2013-13, the proposed options that involve changing the status quo are expected to affect around 7,400 NFP organisations.

For Option 2, employers, when completing their FBT tax returns, will have to incorporate any salary sacrificed meal entertainment and entertainment facility leasing expenses. However, as this option utilises existing infrastructure (as this option involves including a previously excluded benefit into the existing FBT calculation) the regulatory impacts are comparatively smaller than Options 3 and 4. Options 3 and 4 will mean that employers would have to deal with a separate cap, adding to administrative and compliance costs, while new ATO forms and software changes to deal with the separate cap will likely need to be implemented.

This qualitative analysis is confirmed by the quantitative costings. Given the similarities between Options 3 and 4, the regulatory costs are identical (which is based on an assumption of an hourly wage rate of \$65.45). Table 1 shows the regulatory costs for Option 3, which is the preferred option. Option 2 is estimated to impose a regulatory burden of \$0.21 million on community organisations.

For affected NFP employers, there will be regulatory start-up costs associated with education, notifying their employees of the proposed change, and implementing any changes. Options 3 and 4 are expected to result in ongoing costs as employers will need to allocate fringe benefits to two separate caps, which will not be required under Option 2.

Table 1: Regulatory costing for Options 3²

Average annual regulatory costs (from business as usual)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in cost
Total, by sector	-	\$0.690	-	\$0.690
Cost offset (\$ million)	Business	Community organisations	Individuals	Total, by source
Treasury	-	-\$0.690	-	-\$0.690
Are all new costs offset? <input checked="" type="checkbox"/> Yes, costs are offset <input type="checkbox"/> No, costs are not offset <input type="checkbox"/> Deregulatory—no offsets required				
Total (Change in costs – Cost offset) (\$ million) = \$0				

5. Consultation

The tax proposals have been informed by three separate independent reviews which have examined the FBT treatment for NFP organisations.

Two of these reviews (*Contribution of the Not-for-Profit Sector*, Productivity Commission Research Report 2010 and the *Not-for-profit Sector Tax Concession Working Group 2013*) found or recommended that the uncapped meal entertainment benefits should either be limited or

² Note: A regulatory offset has been identified from within the Treasury portfolio, relating to the alignment of the legal frameworks for personal and corporate insolvency practitioners.

abolished. While the Australia's Future Tax System Review 2010 did not specifically make a recommendation on this uncapped benefit, the review instead recommended the gradual phase out of the FBT caps.

While limited consultation on the proposals reflects the cabinet-in-confidence nature of the decision making process, it is noted that extensive consultations were a feature of each of these past reviews.

Public consultation took place on the draft legislation. The objective of this consultation was to ensure that the legislation delivered on its policy intent and did not result in any unintended consequences. The exposure draft legislation and explanatory materials were released on the Treasury website in June 2015.

None of the submissions raised technical drafting issues with the exposure draft legislation.

While submissions raised concerns about the impact of the measure on the NFP sector, most submissions were supportive of imposing a cap on meal entertainment benefits. However, there was a general view that the \$5,000 cap was too low and needed to be raised. Figures of between \$10,000 and \$20,000 were the most common suggestions for the revised cap. A few submissions were against the policy of treating entertainment benefits as reportable fringe benefits as they were concerned about the flow on implications from taking into account such benefits for certain calculations such as HELP debts. A few submissions were opposed to the introduction of a cap, as it would affect their ability to attract, recruit and retain quality staff.

6. Option selection / Conclusion

The preferred option is to introduce a separate \$5,000 cap on meal entertainment benefits. This option strikes a balance between the Government's objectives to improve fairness in the tax system and repairing the budget. By not completely eliminating the uncapped benefits, the preferred option retains concessional treatment and reduces the potential adverse effects on the NFP sector. This measure is estimated to have a gain to revenue of \$295.0 million over the forward estimates period.

7. Implementation and evaluation / review

Legislation is required to implement the proposed measure to introduce a separate \$5,000 cap on meal entertainment benefits.

As the Government has set the start date as 1 April 2016, the proposed measure needs to be enacted prior to this start date to provide certainty to affected NFP organisations and their employees.

The ATO would be responsible for administering the tax rules. The ATO will monitor compliance and will advise Treasury if any problems are identified so remedial action, if appropriate, can be considered.