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Bulletin

That much-desired corporate largesse may leave an ugly hangover

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A large corporate may provide a benefit, comprised of an all-expenses-paid multi-day trip to a major sporting event, to a key dealership or to an employee of that dealership. The large corporate will provide the benefit with a view to enhancing key commercial relationships.

The large corporate benefit provider may have incurred outgoings of $1 million to provide the benefit, while the value of the benefit to any single benefit recipient may exceed $10,000. The value of the benefit in the hands of the recipient will be magnified if the benefit is extended to an associate.

From a tax perspective the benefit provider will be concerned about:

- the deductibility of the outgoings incurred to provide the benefit; and
- any liability it will incur for fringe benefits tax (FBT).

For the purposes of this article it is assumed:

- the benefit provided falls within the definition of entertainment in s 32 of the Income Tax Assessment Act 1997 (Cth) (ITAA); and
- the taxable value of the benefit cannot be reduced under the otherwise deductible rule.

The manner in which corporate largesse of this type is provided may diminish, rather than enhance, the commercial relationship, and leave your client, who may be any of the benefit provider, the benefit recipient or the employer of the benefit recipient, with an ugly hangover.

The frequency of events around which corporate largesse is focused (the Rugby Lions Tour, the ICC Cricket World Cup, the Commonwealth Games, the Winter Olympics, the upcoming Ashes series and even the 2016 Olympics) makes the issues highlighted in this article topical and relevant.

If the benefit provider had provided the benefit to its own employee

If the benefit provider had provided that benefit to its own employee, the benefit would be classified as entertainment and the outgoings would be treated as non-deductible unless the exception at s 32-20 of the ITAA 1997 applied.[1]

The exception at s 32-20 enables the benefit provider to claim a deduction to the extent that the provider incurred the outgoings in respect of providing entertainment by way of providing a fringe benefit.

If the benefit provider provided the benefit to its own employee (or an associate of that employee), the benefit provider generally would treat the benefit as a meal entertainment benefit, thereby ensuring the deductibility of the expenditure incurred in providing the benefit.

The para (ea) amendment

When a large corporate provides a benefit to a person other than one of its employees (the "benefit recipient"), the employer of the benefit recipient may be taken to provide a fringe benefit to the benefit recipient.

The Howard Government passed Taxation Laws Amendment Act (No 1) 1999 to amend the Fringe Benefits Tax Assessment Act 1986 (Cth) (FBT Act) by adding sub-para (ea) to the definition of "fringe benefit" (the "para (ea) amendment") so that after the amendment the definition relevantly read as follows:[2]

> **fringe benefit**, in relation to an employee, in relation to the employer of the employee, in relation to a year of tax, means a benefit:
>
> (a) provided at any time during the year of tax; or
>
> …
>
> being a benefit provided to the employee or to an associate of the employee by:
>
> (c) the employer; or
>
> (d) …
>
> (e) a person (in this paragraph referred to as the arranger) other than the employer or an associate of the employer under an arrangement covered by paragraph (a) of the definition of arrangement between:
>
> (i) the employer or an associate of the employer; and
>
> (ii) the arranger or another person; or
>
> (ea) a person other than the employer or an associate of the employer, if the employer or an associate of the employer:
>
> (i) participates in or facilitates the provision or receipt of the benefit; or
>
> (ii) participates in, facilitates or promotes a scheme or plan involving the provision of the benefit;
>
> and the employer or associate knows, or ought reasonably to know, that the employer or associate is doing so;

in respect of the employment of the employee, but does not include:
(f) …

The effect of the para (ea) amendment is to make an employer liable, in certain circumstances, for FBT in respect of benefits provided to its employees by others:

- if an employer promotes opportunities to its sales force to "win", it is clear that the employer participates in a plan involving the provision of the benefit and knows that the benefit would be provided;
- if an employer selects the "winner" of a benefit, the employer clearly knew to whom the benefit will be provided;
- if an employer allows an employee time off to enjoy the benefit, the employer facilitates a plan involving the receipt of the benefit; and
- if an employer, such as a legal firm, or government department (or Minister's office) runs a benefits register, to protect the employer against unwitting conflicts of interest, it is clear that the employer knows, or ought reasonably to know, that the benefit was provided to its employee by the third party.

When, as occurs reasonably regularly, a member of the C-suite[3] expresses, to a supplier (or potential supplier), an expectation that a benefit will be provided to that person or that person's associate[4] (perhaps a ticket for an overseas flight or a significant discount on a new motor vehicle), and the benefit is subsequently provided by the supplier, it is hard to avoid the conclusion that the employer ought reasonably to have known that the benefit was being provided.

Daily newspaper reports from the ongoing Independent Commission Against Corruption (ICAC) and Independent Broad-based Anti-corruption Commission (IBAC) enquiries show that government departments and employees of those departments are players in the "expectation" space.

Similarly daily newspaper reports about the Construction, Forestry, Mining and Energy Union Royal Commission and also the Hospital Union Corruption Inquiry show that some union employees are players in the "expectation space" and that the relevant unions may have facilitated the receipt of benefits, perhaps even by providing authorities for credit cards or bank accounts.

The Explanatory Memorandum to the Taxation Laws Amendment Bill (No 1) 1999 (Cth) quickly dispels any doubt that these seemingly harsh and uncommercial conclusions are intended:

> 2.40 In general terms, a fringe benefit will arise under new paragraph (ea) of the definition of fringe benefit where an employer … participates, facilitates or promotes the provision or receipt of a third party benefit. A third party benefit will be a fringe benefit only if the employer knew, or ought to have known, that he or she was participating, facilitating or promoting the provision or receipt of the benefit.
>
> 2.41 A benefit will be a fringe benefit if the employer knowingly:
> - participates in or facilitates the provision or receipt of the benefit;
> - participates in, facilitates or promotes the scheme involving the provision of the benefit.
>
> 2.42 An employer will be liable to FBT for the third party benefit where the employer, or the associate of the employer, actually knew that he or she was involved in the above way in relation to the benefit.
> Alternatively, if the employer, or the associate of the employer, does not actually realise that they are involved, for example:
> - participating in or facilitating the provision or receipt of a third party benefit;
> - participating in, facilitating or promoting the scheme involving the provision of the benefit;
> - liability to FBT for the third party benefit may still arise. It will arise where it is reasonable to conclude that the employer should have known that he or she was involved in a relevant way in relation to the benefit.
>
> 2.43 An employer will not be liable for FBT in respect of a third party benefit if the employer did not agree and is not involved in relation to the provision or receipt of the benefit, regardless of whether the employer knew that the benefit had been provided. For example, entertainment by way of meals provided to employees by a third party would not give rise to a fringe benefit unless the employer agreed to the benefit being provided or the employer was involved in a relevant way in providing the benefit.
>
> 2.44 An employer would not necessarily be liable for FBT for a third party benefit merely because the employer was involved in relation to the benefit. A third party benefit would be a fringe benefit only if the employer knew, or ought to have known, that he or she was involved in relation to a third party benefit. For example, an employer will not be able to avoid liability for a third party benefit simply by claiming that he or she did not know or realise that their involvement resulted in a third party providing benefits to the employer's employees or associates of employees and that any involvement in the provision or receipt of the benefit was unintentional. If it would be reasonable to conclude that the employer or associate of the employer should have known that he or she was involved in relation to the benefit because for example it is customary in the industry concerned, a fringe benefit would arise.

Circumstances in which the benefit provider will not provide a fringe benefit

Although an entity can provide a *benefit* to any person, the definition of "fringe benefit" within the FBT Act ensures that an employer can only provide a fringe benefit to its employee or an associate of its employee.

Many entities have express policies in relation to giving or receiving benefits or particular types of benefits, but the ingenuity of a person intent on beating written policies to gain a personal advantage cannot be underestimated. Not every third party benefit will be a fringe benefit.

When a drug company provides a golf junket to a pharmacist or an international holiday to a medical practitioner, the benefit recipient is unlikely to be an employee but will receive a non-cash business benefit. However, the pharmacist or doctor may be an employee of a hospital or health service or government department.

Some examples

How then would you identify the problems buried in the following examples?

> ***Example 1:*** An international electronics corporation offered its top performing Australian dealerships two packages, each package consisting of two business class tickets, five star accommodation for four nights, all transfers, all meals, all refreshments for two persons, two World Cup match tickets, all internal transfers to get to the matches and sundry other recreational activities for two persons.
>
> The package was extensively promoted by sales representatives and business development managers to all dealerships. The top quartile of dealerships would receive two packages which they could allocate in their discretion. The next quartile of dealerships would receive one package.
>
> ***Example 2:*** An advertising agency pitching for a job for a resort is advised that while the price is low, the resort will fly all the agency staff (whether or not involved in the commission) and associates to the resort and accommodate them at heavily discounted rates.
>
> Over the course of the next 12 months all agency employees take up the offer, some on multiple occasions and most with their spouse.
>
> ***Example 3:*** A car manufacturer sponsors an AFL club and as part of the deal provides luxury vehicles for each of the club executives, the coach and members of its leadership group.
>
> ***Example 4:*** An advertising agency, on winning a job for a car manufacturer, is offered luxury vehicles for each of its account executives.

In Example 1:

- a winning dealership may have promoted a competitive scheme internally to determine which of its sales staff would receive the package(s);
- a winning dealership was aware of, participated in and facilitated the provision of the receipt of the package(s);
- the international electronics corporation will have no FBT liability in relation to the packages provided to a winning dealership;
- a winning dealership will be taken to have provided a fringe benefit within paragraph (ea) to its employees — even though the international electronics corporation provided the benefit — and will incur the FBT liability;
- the fringe benefit that a winning dealership is taken to have provided cannot be treated as entertainment expenditure;
- the fringe benefit that a winning dealership is taken to have provided will be a reportable fringe benefit; and
- the value of the fringe benefit is included as wages for the purposes of the harmonised payroll tax legislation.

In Example 2:

- the advertising agency clearly facilitated the provision of the benefit to its employees;
- the advertising agency will be taken to have provided a fringe benefit within para (ea) to its employees and will incur the FBT liability;
- the residual fringe benefit that the advertising agency is taken to have provided will be a reportable fringe benefit;
- the value of the fringe benefit is included as wages paid by the advertising agency for the purposes of the harmonised payroll tax legislation; and
- the advertising agency has a time consuming administrative task in valuing the benefits it is taken to have provided.

In Example 3:

- the club clearly facilitated the provision of the cars to its employees;
- the club will be taken to have provided a fringe benefit within para (ea) to its employees and will incur the FBT liability;
- the car fringe benefit that the club is taken to have provided will be a reportable fringe benefit;
- the value of the fringe benefit is included as wages paid by the club for the purposes of the harmonised payroll tax legislation; and
- the club has a time consuming administrative task in valuing the car fringe benefits it is taken to have provided.

In Example 4:

- the recipients of the cars may or may not be employees of the advertising agency;
- if the recipients of the cars are not employees of the advertising agency the benefit will be a non-cash business benefit; and
- to the extent that the recipients are employees, the outcome will be as for Example 3.

Non-cash business benefit

If a benefit recipient is not an employee, perhaps because the recipient receives trust distributions or dividends, or because the recipient is the member of a partnership, the dealer principal may receive a non-cash business benefit.

If an entertainment benefit is not provided as a fringe benefit

If a benefit, consisting of entertainment, is not provided by way of providing a fringe benefit, the provider is not entitled to a deduction for the outgoings incurred in providing the benefit.

The 50:50 rule

When an employer, in relation to whom a benefit is taken to arise, is not the actual provider of the benefit, there will be no meal entertainment fringe benefit.[5]

The operation of s 37BA of the FBT Act prevents an employer, taken to have provided a fringe benefit, from treating the benefit as a meal entertainment fringe benefit.

Top-down or bottom-up benefits

It is more common for the benefits to be provided openly by a bigger corporate to employees of smaller entities.

However, benefits are commonly provided, less openly and perhaps less willingly, by smaller entities to employees of bigger entities. This is an area of significant risk for bigger employers. Of real concern are those benefits extracted and kept hidden by members of the C-suite who at law may be considered to be the mind of the corporate entity.

Audit risk

The audit of any participant can lead to the audit of all participants:

- if the benefit provider is audited, the Australian Taxation Office (ATO) has an easy pathway to all benefit recipients and the employers of those benefit recipients;
- if an employer of a benefit recipient is audited, the ATO has an easy pathway to all employers of those benefit recipients and the benefit provider; and
- if a benefit recipient is audited, the ATO has an easy pathway to all employers of other benefit recipients who received the same benefit and also to the benefit provider.

The consequences

Where a corporate entity provides the largesse to enhance a commercial relationship, the para (ea) amendment may cause all parties an unanticipated degree of discomfort.

Unless the internal guidelines used by benefit providers are comprehensive enough to deal with benefits provided to employees of third parties, the provision of the benefit is likely to cause a hangover for one or more of the benefit provider, the benefit recipient and the employer of the benefit recipient. No amount of vetting or auditing by external advisers will identify the issue if they are not specifically looking for the issue.

Long established guidelines are unlikely to provide the correct result when the benefit is provided to a person other than an employee (or associate of the employee) of the benefit provider, or to provide that any vetting will identify an incorrect outcome at first instance.

Alternatively the guidelines and related systems may be out of date or irrelevant for third party benefits.

Guidelines and related processes may be out of date because there has been little ongoing collaboration between the business development team that designs the benefits, and those who develop and maintain the guidelines or those that apply the guidelines.

If the benefit provider has not correctly classified the benefit, or correctly identified and classified the status of the benefit recipients, the accounting firm dealing with either of the benefit recipient or the employer of the benefit recipient has little or no chance of getting their client's tax affairs correct without embarking upon a comprehensive series of questions directed to their client and the benefit provider.

Other impacts for the employer of the benefit recipient

The employer of the benefit recipient is obliged to include on the payment summary, for each employee to whom it is taken to have provided a fringe benefit, not only the value of any reportable fringe benefit it is taken to have provided to the employee, but also the value of any reportable fringe benefit it is taken to have provided to an associate of the employee.

Employers of benefit recipients rarely have the relevant information at the time they are required to produce payment summaries or lodge FBT returns.

Has the employer of the benefit recipient lodged an incorrect FBT return because they didn't have the necessary information?

How does the benefit provider deal with ensuring the employer of the benefit recipient has the necessary information to provide accurate payment summaries?

Can the employer of the benefit recipient compel the benefit provider to deliver the relevant tax metrics?

Impacts for the employee

"Soft commissions" provided by financial institutions to financial planners, international holidays provided by mobile phone or laptop manufacturers and cars provided by manufacturers to advertising account executives or television celebrities may result in the benefit recipient having an increased adjusted taxable income.

The implications for the employee can be severe, particularly where the value of the benefit is high and/or an associate shares the benefit:

- the value of reportable fringe benefits is included in calculating the employee's adjusted taxable income;
- the value of reportable fringe benefits will impact on their entitlement to some government benefits;
- the value of reportable fringe benefits may impact on child support obligations;
- the value of reportable fringe benefits may trigger the quarantining provisions of the non-commercial loss rules.

Impacts for the benefit provider

The outcomes identified are not commercial, are unlikely to be the outcomes that the provider intended, and will do nothing to enhance the commercial relationship.

How does the provider deal with the FBT impost incurred by the employer of the benefit recipient?

How does the provider deal with the administrative penalties, including non-lodgment penalties, imposed on the employer of the benefit recipient under the Taxation Administration Act 1953 (Cth) or payroll tax legislation?

The hangover is likely to undermine the commercial relationship that the benefit provider intended to enhance.

Conclusion

The hangover, like all hangovers, is avoidable.

There is little evidence of benefit provider awareness or even external adviser awareness of the issues facing employers of recipients of third party benefits.

A large corporate will generally have internal systems, often outdated legacy systems, which set out guidelines for internal staff to determine the tax outcomes. Chiefly, those guidelines were developed to track benefits provided by the entity to its employees, rather than benefits received by employees of the entity or benefits provided by the entity to employees of third parties.

The guidelines, if correctly applied, may secure the correct outcome for the issues that they were intended to address.

Hospitals, universities, and government departments, including the ATO, are at just as much risk of under-reporting fringe benefits that they are taken to have provided as any other employer.

State governments are unable to ensure that the benefits provided by third parties are included by the relevant entities for payroll tax purposes — they are as much in the dark as the benefit recipients and the employers of those benefit recipients.

There is increasing evidence that benefits provided in response to the express but unwritten expectations of members of the C-suite are simply not reported by the employer of the benefit recipient as fringe benefits, although not reporting could reflect ignorance rather than deceit.

Smaller entities rely heavily on external advisers who are required to carry out the task without the ability to compel the provision of the necessary information.

Even when an employer has a benefit register and employees routinely report all the benefits they receive, there is too often a disconnect between the purpose for which the register is maintained and the requirements of FBT compliance.

The practice of including what is effectively an operative provision such as the para (ea) amendment within a definition has little to commend it and has resulted in an administratively heavy system, tied up with masses of red tape, which does nothing to promote compliance and nothing to ensure that the participants are entitled to the information required to comply with the requirements of that system.

In any tax review the first tax to be reviewed ought to be FBT — there must be a simpler and more efficient way of collecting the revenue.

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