National Tax & Accountants' Association Ltd.
29-33 Palmerston Crescent
South Melbourne
VIC 3205

Phone: 1800 808 105 Fax: 1300 306 351
Email: ntaainfo@ntaa.com.au
Website: ntaa.com.au
ABN: 76 057 551 854

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Gregory Derlacz
Senior Adviser
Small Business Entities and Industries Concessions Unit
The Treasury
Langton Crescent
PARKES ACT 2600

Email: DIV7A@treasury.gov.au

RE: Consultation paper: Targeted amendments to the Division 7A integrity rules

Dear Sir,

We refer to the submission lodged by the National Tax and Accountants' Association Ltd ('NTAA') regarding the *Targeted amendments to the Division 7A integrity rules consultation paper* ('consultation paper'), dated 20 November 2018.

In addition to the issues raised in our initial submission, the NTAA would like to express concern regarding a proposed technical amendment affecting the interaction between Division 7A and the FBT provisions. Specifically, the consultation paper makes the following statement:

> *"To improve the clarity and integrity in relation to the interaction between Division 7A and the FBT provisions, amendments will be made to clarify that:*
>
> - *the exception in subsection 109ZB(3), which provides that Division 7A does not apply to payments made to shareholders (or their associates) in their capacity as an employee (or an associate of such an employee), only applies where that payment would constitute a fringe benefit. In determining if a payment is a fringe benefit within the meaning of subsection 136(1) of the Fringe Benefits Tax Assessment Act 1986, paragraph (r) should be disregarded;"*

Under a separate proposed technical amendment, the consultation paper also makes the following statement:

> *"To provide certainty, section 109Z will be amended to make it clear that a payment that is taken to be a dividend under Division 7A is not an allowable deduction."*

The current position regarding S.109ZB(3)

Currently, S.109ZB(3) provides that Division 7A does not apply to a 'payment' made to a shareholder in their capacity as an employee. As such, the payment is dealt with under the *Fringe Benefits Tax Assessment Act 1986* ('FBTAA').

For these purposes, a payment to a shareholder of a private company in their capacity as an employee includes any of the following:

- The transfer of property by the company to the employee (i.e., the provision of a property benefit) – refer to S.109C(3)(c) of the ITAA 1936.
- The reimbursement by the company of an expense paid by the employee (i.e., the provision of an expense payment benefit) – refer to S.109(3)(a) of the ITAA 1936.
- The provision of an asset by the company for use by the employee (i.e., the provision of a residual benefit) – refer to S.109CA of the ITAA 1936.
- A payment made by the company for the benefit of the employee (e.g., the payment of superannuation contributions for the benefit of the employee) – refer to S.109C(3)(a) of the ITAA 1936.

Therefore, under the current rules, where a private company makes a payment to a shareholder/employee in their capacity as an employee (e.g., by providing a property benefit, an expense payment benefit or residual benefit), the benefit is **not** subject to Division 7A and is only dealt with under the FBTAA.

Unintended consequences of the proposed amendment to S.109ZB(3)

Under the proposed amendment to S.109ZB(3) (noted above), a payment made by a private company to a shareholder in their capacity as an employee (e.g., as a property benefit, expense payment benefit or residual benefit) will only be excluded from Division 7A where that payment constitutes a fringe benefit. One of the problems with this approach is that the definition of 'fringe benefit' in S.136(1) of the FBTAA specifically excludes an exempt benefit. As such, the provision of an exempt benefit to a shareholder of a private company in their capacity as an employee would no longer be dealt with under the FBT rules, but instead, would be dealt with under the deemed dividend rules in Division 7A.

The NTAA believes that the proposed amendment to S.109ZB(3) will result in unintended consequences for private company employers. In particular, the NTAA is concerned that the proposed amendment will result in many legitimate employment-related benefits (that have traditionally been FBT-exempt) triggering a Division 7A liability for private company employers. Common employment-related benefits that could be subject to Division 7A under the proposed amendment include the following:

- The provision of a laptop computer which is primarily for use in an employee's employment and is FBT-exempt under S.58X of the FBTAA.
- The provision of a workhorse vehicle (e.g., a ute) by a private company that is running a primary production business, where the requirements for the FBT exemption under S.8(2) or S.47(6) of the FBTAA are satisfied.
- Certain Living Away From Home ('LAFH') and relocation benefits that are FBT-exempt (e.g., LAFH accommodation under S.21 of the FBTAA, and the removal and storage of household effects under S.58B of the FBTAA).
- Superannuation contributions made by an employer for the benefit of an employee (including Superannuation Guarantee ('SG') contributions), which are FBT-exempt under the definition of 'fringe benefit' in S.136(1)(j)(i) of the FBTAA.

The following examples illustrate some of the unintended consequences associated with the proposed amendment to S.109ZB(3).

Example 1

A private company provides an employee/shareholder with a laptop computer in their capacity as an employee, either as a property benefit or as an expense payment benefit.

Treatment under the current rules

Division 7A does **not** apply and the benefit (or 'payment') is only dealt with under the FBTAA. Where the benefit satisfies the requirements of S.58X of the FBTAA (including the requirement that the laptop computer is primarily for use in the employee's employment), the benefit is exempt from FBT.

Furthermore, the company is entitled to claim a tax deduction under S.8-1 of the ITAA 1997 for the provision of such a benefit to the employee.

Treatment under the proposed rules

Division 7A will apply (and a deemed dividend will arise) if the benefit is exempt from FBT under S.58X. Furthermore, the otherwise deductible rule would not apply in this case for Division 7A purposes, as the provision of the laptop (i.e., as a property or expense payment benefit) would constituate a 'payment' under S.109C (which does not allow the application of an otherwise deductible rule to reduce the deemed dividend amount).

Where Division 7A applies under the proposed amendment, no deduction will be available to the private company under S.8-1 in respect of the provision of the laptop computer (i.e., in respect of the deemed dividend amount).

The NTAA believes that this outcome is anomalous, given that a laptop computer that is primarily for use in an employee's employment (i.e., FBT-exempt) would trigger a full Division 7A liability for the shareholder under the proposed amendment. On this basis, we do not believe that the proposed amendment is 'improving the clarity and integrity' of the interaction between Division 7A and the FBT provisions.

Example 2

A private company provides a shareholder with a laptop computer in their capacity as an employee, as a residual benefit (i.e., the company retains ownership of the laptop and provides it to the employee for their use).

Treatment under the current rules

Division 7A does **not** apply and the benefit (or 'payment') is only dealt with under the FBTAA. Where the benefit satisfies the requirements of S.58X of the FBTAA (including the requirement that the laptop computer is primarily for use in the employee's employment), the benefit is exempt from FBT.

Furthermore, the company is entitled to claim decline in value (or depreciation) deductions in respect of the laptop computer provided to the employee (including a potential immediate write-off deduction under S.328-180 of the ITAA 1997).

Treatment under the proposed rules

Division 7A will apply (and a deemed dividend will arise) if the benefit is exempt from FBT under S.58X. However, as the provision of the laptop in this case (i.e., as a residual benefit) would constitute a 'payment' under S.109CA, the otherwise deductible rule under S.109CA(5) would apply to effectively reduce the amount that is taken to be a deemed dividend under Division 7A (i.e., by the work-related use portion of the laptop computer).

Where Division 7A applies under the proposed amendment, no deduction will be available to the private company in respect of the deemed dividend amount.

The NTAA believes that this outcome is anomalous, particularly because:

- only the work-related use portion of the laptop computer in this case would avoid a Division 7A liability under the proposed amendment (whereas the entire use of the laptop computer would be FBT-exempt under the current rules); and
- having to apply an otherwise deductible rule for Division 7A purposes (under the proposed amendment) would no doubt impose additional compliance costs, especially where specific records of the actual use of the laptop computer are required to be maintained to establish the work-related use of the computer for this purpose.

On this basis, we do not believe that the proposed amendment is 'improving the clarity and integrity' of the interaction between Division 7A and the FBT provisions.

Example 3

A private company makes superannuation contributions for the benefit of an employee/shareholder (including SG contributions) to a complying superannuation fund.

Treatment under the current rules

Division 7A does **not** apply in respect of the superannuation contributions, and the contributions are exempt from FBT under the definition of 'fringe benefit' in S.136(1)(j)(i) of the FBTAA.

Furthermore, the company is generally entitled to claim a deduction for superannuation contributions made for the benefit of the employee.

Treatment under the proposed rules

Division 7A will apply (and a deemed dividend will arise) as the benefit is exempt from FBT (i.e., the proposed amendment to S.109ZB(3) will not prevent Division 7A from applying) and constitutes a 'payment' under S.109C(3)(a). It would also appear that S.109J and S.109L would not assist to change this outcome.

Furthermore, a deduction would not be allowed to the company in respect of the superannuation contributions made for the benefit of the employee.

The NTAA believes that this is an anomalous outcome which, surely, could not have been intended by the proposed amendment to S.109ZB(3), particularly as the above outcome contradicts the policy intention regarding the making of superannuation contributions for the benefit of employees and how such contributions are dealt with for tax purposes.

Should you have any queries in relation to the comments above, please contact Rebecca Morgan on (03) 9209 9999.

Kind regards,

Geoff Boxer
Chief Executive Officer
National Tax and Accountants' Association