



Salary Packaging Manual

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Manual Content

Introduction

- Salary Packaging Defined
- Studies and Survey Results
- Cost/Benefit Analysis of Salary Packaging
- Twenty Common Questions on Salary Packaging
- Factors to Consider When Entering into a Salary Packaging Arrangement
- Common Terminology/ Concepts of Packaging

Fringe Benefits Tax

- Role of the FBT System in Salary Packaging Arrangements
- Benefits Provided in Respect of Employment
- Concept of Grossing-Up the Value of a Fringe Benefit
- Questions the ATO May Ask
- Questions Relating to Motor Vehicle Benefits
- Common FBT Return Errors
- FBT and BAS completion

Concessional Employers

- Employers That Can Provide Benefits Exempt from Fringe Benefits Tax
- Public Benevolent Institutions and Health Promotion Charities
- Impact of Salary Packaging at Various Employee Salary Levels
- Rebatable Employers
- Impact of the \$30,000 Cap on a Rebatable Employer's FBT Liability
- Public and Non-Profit Private Hospitals

Commonly Packaged Benefits

- Motor Vehicle Benefits
- Superannuation
- Expense Payment Benefits
- Entertainment Benefits
- Miscellaneous FBT - Exempt Benefits
- Car Parking Benefits
- Property Benefits
- In-House Benefits

Other Packaging Opportunities

- Packaging of Employee Bonuses
- Packaging of Leave Entitlements
- Living-Away-From-Home Allowances
- Loan Benefits
- Employee Entitlement Trusts and Share Schemes

Documentation Requirements

- Employee Declarations
- Salary Sacrifice Agreements
- ATO Attitude to Salary Packaging
- Record Keeping Requirements - FBT and Salary Packaging
- Sample Salary Sacrifice Agreement

Miscellaneous Taxation Issues

- Salary Packaging and Employment On-Costs
- Entitlements Under Industrial Law
- Expatriate Employees and Salary Packaging
- Taxation Ruling and Taxation Determination Listing

Section 1.1 - Salary Packaging Defined

The concept of ‘salary packaging’ or ‘salary sacrificing’ (the two terms are interchangeable) has existed for many years. In a standard employment situation, an employee receives a salary or wage as a reward for the services that they provide to their employer. The level of salary or wage received is dependent on a variety of factors including the skill level of the employee, the demand for the employee’s services, the level of salary financially payable by the employer, and requirements in applicable industrial instruments (such as awards and enterprise agreements) and relevant legislation.

In today’s working environment, some employees are seeking more from their employer-provided remuneration than merely a direct cash salary or wage. One of the key ways of retaining valuable employees is to offer them some flexibility in how they are paid. The alternatives to cash salary or wages are known as “benefits”.

The term ‘salary packaging’ is used to describe a situation where an employee receives non-salary remuneration benefits in addition to cash salary or wages. This concept is defined in the final Taxation Ruling*, TR 2001/10 (issued on 10 October 2001) as:

“an arrangement under which employees agree to forego part of their total remuneration that they would otherwise expect to receive as salary and wages, in return for their employer or someone associated with their employer providing benefits of a similar value”.

The purpose of this Manual is to look at the implications from both an employer’s and employee’s perspective of including such benefits in an employee’s remuneration.

By receiving a portion of their remuneration through non-salary benefits, the employee may be able to access concessional tax benefits, rather than receiving their total remuneration in the form of fully assessable salary. For salary packaging to be tax-effective, the salary and non-salary benefits need to be structured in such a way as to reduce the overall tax burden attributable to the employee’s remuneration.

The potential advantage of salary sacrificing is therefore that the total net return to the employee from their salary package may well increase, particularly if the benefits provided are not subject to Fringe Benefits Tax (FBT) or receive concessional FBT treatment. The fact that the employee may receive less cash in their direct pay packet does not mean that they are worse off, but that some of the cash has been redirected to pay for the non-salary benefits the employee has asked to include in their package. A properly structured and administered salary packaging arrangement can be a win/win situation for both the employee and employer.



* A Taxation Ruling is an official interpretation of legislation by the Australian Taxation Office (ATO) and the views contained within such a Ruling are binding on the ATO.

Section 2.2 - Role of the Fringe Benefits Tax System in Salary Packaging Arrangements

The concept of salary packaging, and the effectiveness thereof, is largely dependent on the tax charged or imposed on the non-salary benefits that an employee may wish to access. The benefits provided to an employee through salary packaging are not taxed through the income tax regime, but through the Fringe Benefits Tax (FBT) regime.

Generally, the following items **will not** be subject to the FBT regime as they are either taxed under separate legislation or are exempt from being deemed to be a 'fringe benefit':

- > salary and wages taxed under the Pay As You Go (PAYG) Withholding Tax system;
- > most superannuation fund contributions;
- > payments from most superannuation funds;
- > benefits provided under employee share schemes;
- > payments on termination of employment;
- > capital payments for personal injury or restraint of trade agreements; and
- > payments deemed to be dividends for income tax purposes.

'Fringe Benefits Tax' is a tax payable by the employer on the value of non-salary benefits, known as 'fringe benefits', that have been provided to an employee or to associates of an employee, in respect of their employment.

In order for a fringe benefit to be subject to FBT, the benefit must have been provided to the employee in respect of their employment. For example, a birthday present given to a child is not subject to FBT merely because the child happens to be employed in the family business. Similarly, FBT would not apply to benefits granted to directors of a family company where they are provided a benefit by virtue of their shareholding rather than their status as employees. This distinction of capacity is one of continuing debate in various cases brought before the courts.

FBT only applies to benefits provided in respect of employment where the salary or wages earned or otherwise earned from that employment would be subject to income tax. This means that an expatriate employee who may be exempt from PAYG Withholding Tax on salary and wages while in Australia, under a double tax agreement or some other form of exemption, may not be subject to FBT on any non-salary benefits provided to them whilst employed in Australia. This latter point may be complex in that it involves international tax law and therefore specialist advice may be required in this area.

This means that if salary and wages earned from the employment activity are exempt from income tax in Australia, any benefits provided because of that employment will correspondingly be exempt from FBT. Such a scenario may arise for expatriate employees who are no longer deemed to be residents of Australia for income tax purposes or secure Australian income tax exemption under a specific provision of the relevant income tax legislation.

Section 3.4 - Impact of Salary Packaging at Various Employee Salary Levels

This Section addresses the tax advantage that can be gained by employees of public benevolent institutions if they package their salary with non-salary benefits. The advantage, as can be seen from the following example, is not restricted to high-income earning employees only.

In Example 1 in this Section, each public benevolent institution employee has only taken non-salary benefits to a grossed-up taxable value of \$30,000 or under. This means that no Fringe Benefits Tax (FBT) will be incurred.

The example assumes that the employer will continue to pay the compulsory 9 per cent superannuation contributions required under the *Superannuation Industry (Supervision) Act 1993* based on the employee's pre-packaged gross cash salary, i.e. the employee's compulsory superannuation is not decreased by entering into a salary sacrifice arrangement in this instance.

Example 1

Employee	Total Salary	Benefits	Actual \$ Value	Gross-Up Rate	Grossed-Up Value	FBT Due
Peter	\$30,000	Mortgage	\$12,000	1.8692	\$22,430	
		Gym membership	\$2,000	2.0647	\$ 4,129	
Total					\$26,559	Nil
Jennifer	\$40,000	Car	\$12,000	1.8692	\$22,430	
		Health insurance	\$2,000	1.8692	\$ 3,738	
Total					\$26,168	Nil
Ben	\$50,000	Holiday costs	\$7,000	2.0647	\$14,452	
		Credit card payments	\$7,000	2.0647	\$14,452	
Total					\$28,904	Nil

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For example, a business buying a new \$35,000 car will be entitled to GST credits of \$3,182 as a result of the claiming back of the GST. If the employer passes on their input-tax credit entitlements/cost savings to their employees via their salary packaging arrangements, then this will also add value to an employee's total remuneration package.

Point 4.2.5 of this Chapter highlights the variation in the impact of salary packaging by using the Statutory Formula Method as opposed to the Operating Cost Method of FBT calculation.

The Australian Taxation Office website includes a FBT car calculator, this is available at: http://calculators.ato.gov.au/scripts/axos/axos.asp?CONTEXT=&KBS=FBT_car.xr4&go=ok.

This calculator assists in the calculation of the taxable value of a car fringe benefit under either method.

4.2.5 Two methods

Statutory Formula Method

Steps involved

- Step 1 Determine the base value* of the car, broadly, the original cost of the owned car or the market value of a leased car. [Refer to Table 1 in this Point.]
- Step 2 Find the taxable percentage applicable to the number of kilometres travelled during the tax year. [Refer to 'Determining the Taxable Percentage' in this Point.]
- Step 3 Multiply the base value by the taxable percentage.
- Step 4 Reduce the taxable value determined in Step 3, according to the number of days when the car was not used or available for private use.
- Step 5 Subtract from that figure any contribution made by the employee towards the costs of the vehicle.

$$\text{Taxable Value} = \frac{(1 \times 2 \times 3) - 5}{4}$$

- 1 = Base value* of car
- 2 = Taxable percentage
- 3 = Number of days car available for private use of employee
- 4 = Number of days in FBT year (365)
- 5 = The employee contributions

* The base value is determined at the time the employer first holds a car provided to an employee.

Diagrammatic representation of transaction flow for a novated lease arrangement

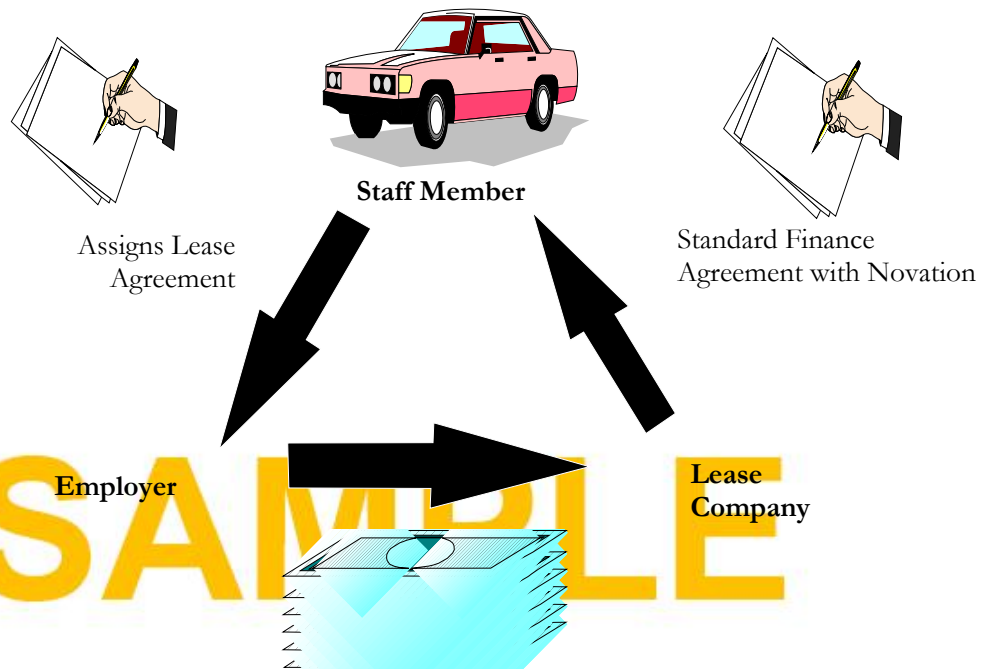


Table 1 : Novated Leases

Novated Lease Issues	Impact
Amounts allocated to employee salary package	> Lease payments, fuel card charges, registration, insurance and repairs
Type of fringe benefit	> Motor vehicle
Documents required	> Deed of Novation > Finance schedule > Dealer invoice > Fuel card in name of employer > Receipts for expense reimbursements > Employee declaration regarding business use each year > Employee declaration for employee cost contributions to reduce taxable value of benefit
Payments structure	> Employer pays lease payments direct to finance company > Employer to fund running costs via direct payment to supplier or > Reimbursement of employee-incurred running costs upon obtaining of tax invoice from supplier > Motor vehicle fuel card to be used for all fuel purchases

Section 5.3 - Packaging of Leave Entitlements

5.3.1 Issues for consideration

Timing of the accrual of leave entitlements

Leave entitlements can be salary sacrificed like normal salary if the leave entitlements relate to future employment duties and not past duties.

This notion that the employee entitlement arises when the employment duties are performed, rather than when payment to the employee is made, is supported by the Australian Taxation Office's (ATO) view on packaging employee leave entitlements.

The ATO recognises that a Salary Sacrifice Agreement exchanging any expected entitlement to leave that will accrue for future employment duties rendered will be effective. This means that if an employee elects to receive a substitute benefit in place of their leave entitlements this choice must be agreed between the employer and employee before the leave accrues.

An agreement exchanging an entitlement to take leave that is already accruing, or that has accrued, for past services performed in return for benefits is ineffective. Such leave entitlements cannot be paid out in the form of fringe benefits.

Example 1 : Consequences of an ineffective Salary Sacrifice Agreement

Aaron has accrued an entitlement to take 12 weeks annual leave. Aaron's employer directs him to take a minimum of 8 weeks annual leave. Aaron does not wish to take the leave and receives permission from his employer to enter into a Salary Sacrifice Agreement to exchange the remuneration that he would receive if he took 8 weeks leave for a superannuation contribution of equal value. Aaron continues to attend work, his accrued annual leave has been reduced by 8 weeks.

This Salary Sacrifice Agreement which has exchanged an entitlement to take leave for a superannuation contribution is ineffective. The whole amount contributed to the superannuation fund is considered Aaron's salary or wage and forms part of his ordinary income. Accordingly, his employer has a PAYG Withholding obligation. Aaron or his employer should ensure that the superannuation fund is aware that the superannuation contribution is an undeducted contribution so that it can be properly accounted for by the superannuation fund for income tax purposes.

If an employee wishes to exchange their leave entitlements for other benefits, it is imperative that such arrangements are documented prior to the employee becoming entitled to the leave amounts.

Retirement strategies

From 1 July 2007 following the concessional changes concerning the taxation of superannuation benefits, particularly benefits paid out to superannuation fund members after they have turned sixty (60) years of age, there has been an increased interest in an employee's ability to salary sacrifice the value of their annual or long service leave entitlements into additional superannuation contributions. This strategy may be tax effective due to the differential between the superannuation contributions tax at 15 per cent and an employee's personal marginal income tax rate, which may be as high as 46.5 per cent.

Section 6.3 - Salary Sacrifice Agreements

6.3.1 Format and content

There is no set format for a Salary Sacrifice Agreement. However, it is important to be aware of a range of issues that should be addressed in any Salary Sacrifice Agreement that is executed between an employer and employee. By ensuring that at least the majority of possible scenarios that may arise from the Salary Sacrifice Agreement are covered, the likelihood of future dispute or disagreement between the employer and employee is reduced.

The employer may implement a formal Salary Packaging Policy as part of their human resources approach. This Policy should then be adhered to in relation to any Salary Sacrifice Agreement entered into between the employer and the employees.

The employer should also have a formal documented Salary Sacrifice Agreement that is required to be executed by the employer and the employee as at the date of its effect. This Salary Sacrifice Agreement may form part of the employee's employment contract with the employer.

Australian Taxation Office view

It is advisable that the employer and the employee clearly state and agree on all the terms of any salary sacrifice arrangement. If the employee enters into an undocumented salary sacrifice arrangement, they may have difficulty establishing the facts of the agreement.

Subject to the terms of any employment contract or industrial instrument (such as an award and enterprise agreement), employees can renegotiate a salary sacrifice arrangement at any time. Where the employee has a renewable contract, they can renegotiate amounts of salary or wages to be sacrificed before the start of each renewal.

The employment contract includes details of the employee's remuneration, including any salary sacrifice arrangement. This contract can be varied by agreement between the employer and employee.

6.3.2 Information and details that should be included in a Salary Sacrifice Agreement

The following information and details should be included in a Salary Sacrifice Agreement:

- > The names and details of each party to the agreement need to be accurately disclosed, e.g. if the employer is a trust, it would be prudent to recognise the trustee details, as well as the trust, in any agreement.
- > The date from which the Salary Sacrifice Agreement will be effective with regard to the intended variation to the employee's remuneration package. This is critical to ensure that there is evidence that the Salary Sacrifice Agreement is concerned with remuneration to be earned by the employee for future employment duties, i.e. the remuneration concerned is yet to be derived by the employee.
- > The fact that the employee should obtain independent professional financial advice prior to entering into the arrangement proposed by the Salary Sacrifice Agreement.
- > That the relevant employee recognises the fact that entry into the salary packaging arrangement is a voluntary decision to be made by the employee.

Section 6.9 - Employee Share Scheme Statements

Employers must provide Employee Share Scheme Statements to employees and the Australian Taxation Office (ATO) where:

- > the employee (or their associate) has acquired an Employee Share Scheme interest under a Taxed-Upfront Scheme at a discount during the financial year;
- > a deferred taxing point for an Employee Share Scheme interest acquired under a Tax-Deferred Scheme has arisen or could have arisen in the financial year; or
- > a cessation time for an Employee Share Scheme interest acquired before 1 July 2009 has arisen or could have arisen in the financial year.

The Statement must be provided to affected employees by 14 July after the end of each financial year and report the following to assist the employee to complete their Income Tax return:

- > discount for interests acquired under Taxed-Upfront Schemes, split into amounts eligible for the \$1,000 tax exemption and amounts not eligible;
- > discount for interests acquired under Tax-Deferred Schemes for which a taxing point arose during the financial year;
- > discount for shares and rights acquired before 1 July 2009 for which a cessation time occurred during the financial year; and
- > any Tax File Number amounts withheld from such discounts.

The following pro forma for reporting to employees is provided by the ATO:

Employee Tax File Number/ABN	_____
Taxed-Upfront Scheme - Eligible for reduction	
Discount from Taxed-Upfront Schemes - eligible for reduction	D \$ <input type="text"/>
Taxed-Upfront Scheme - Not eligible for reduction	
Discount from Taxed-Upfront Schemes - not eligible for reduction	E \$ <input type="text"/>
Deferral Schemes	
Discount from Deferral Schemes	F \$ <input type="text"/>
Discount on ESS interests acquired pre-1 July 2009 and 'cessation time' occurred during the financial year	G \$ <input type="text"/>
TFN amounts withheld from discounts (total includes cents)	C \$ <input type="text"/>

The reporting to the ATO must be by 14 August after the end of each financial year and be on the approved form, providing information for each employee and for each Employee Share Scheme the employee participated in.

Appendix 5 - Living-Away-From-Home Declaration

This Declaration is required in order to reduce the taxable value of the fringe benefit provided in this context.

This Declaration must be provided prior to the lodgement date of the Fringe Benefits Tax return in the relevant year.

Living-Away-From-Home Declaration

I, _____, declare that
[name of employee]

during the period ____ / ____ / ____ to ____ / ____ / ____, I was required to live away from my usual place of residence in order to perform the duties of my employment and that, during that period, my usual place of residence was:

[state place where you usually live]

and the nature of that residence was _____;

and, during that period, the place at which I actually resided was:

[state all addresses at which you resided while away from home in the period stated above.]

Signature _____ Date ____ / ____ / ____

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