

sharptax

Grant Thornton periodical
reporting on taxation issues
for business owners.

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With the festive season rapidly approaching, businesses may want to consider the real cost of providing Christmas parties and staff lunches. This edition of Sharp Tax provides an overview of **FBT costs and responsibilities associated with entertainment.**

Staff Functions

The weather is quickly warming up as summer is almost upon us. With summer comes the festive season, including numerous Christmas parties and staff functions.

The cost of these functions, particularly the annual Christmas party, can be quite a tender topic among employers without your tax advisors then informing you of the Fringe Benefits Tax ("FBT") liability that results.

As you may well be aware, the provision of any benefit by an employer, an associate of an employer or under an arrangement with the employer, to an employee or associate of the employee may be subject to FBT. A benefit in this regard will include any benefits provided by way of entertainment, be it with or without clients being present.

Where an employee of a business attends any lunch or dinner function, including the staff Christmas party, and the employer foots the bill, the benefit will constitute a property fringe benefit. In this regard, unless otherwise elected to be a meal entertainment fringe benefit (see below), the employer must keep detailed records for each benefit provided (i.e. each lunch, dinner or other function) in relation to the following:

- the cost of the benefit
- the total number of attendees
- the total number of attendees being either employees or associates.

Where there are a significant number of functions or lunches provided, the record keeping requirements may be quite onerous. Accordingly, it is possible for an employer to elect for concessional valuation methodologies to apply with respect to the provision of meal entertainment. These concessions include:

- The 50/50 method, where only 50% of the total meal entertainment benefits is subject to FBT
- The 12-week register method, where a detailed register must be maintained for a period of 12 weeks, the percentage of staff benefits is then applied to total benefits throughout the year to determine the total meal entertainment subject to FBT.

These concessions do not apply to all entertainment benefits, rather just meal entertainment benefits. Meal entertainment benefits are those benefits that include the provision of entertainment by way of food or drink, or travel connected with the provision of entertainment by way of food or drink.

Items of sustenance, i.e. sandwiches in a meeting on premises or biscuits, are not meal entertainment benefits and hence are not included in the total meal entertainment amount to which the above percentages are applied. Where the meal entertainment concessions are not elected, sustenance is likely to be considered an exempt property benefit as it is consumed on the employer's premises, again, not taxed.

One anomaly that arises concerns the \$100 minor and infrequent benefit exemption. Very generally, where unrelated benefits are provided to employees on an infrequent basis and the cost of the benefits for a particular employee is less than \$100 (including GST), the benefit may be an exempt benefit (note, this rate may be higher for certain costs in relation to Christmas parties) - If you are interested in the operation of this exemption, we recommend that you speak to your advisor. However, this exemption is only available where the entertainment benefit is actually a property fringe benefit. Where the meal entertainment



concessions are elected, what is taxed is the total value of meal entertainment (as discounted), without regard to exemptions. Accordingly, care should be taken in this regard.

For income tax purposes, where meal entertainment is provided an income tax deduction is only available for that entertainment on which FBT has been paid. The balance remains non-deductible. Note, special deductions may be available for eligible seminars and in other very specific circumstances.

The GST treatment follows this income tax treatment, i.e. GST credits cannot be claimed for that part of entertainment that is not deductible. Adjustments in this regard may be made on an annual basis once the FBT treatment has been determined.

Accordingly, in budgeting for your entertainment this festive season, ensure you take account of the full cost, being FBT, income tax associated with any non-deductible component, and the GST on that non-deductible component. Furthermore, plan your systems regarding entertainment expenditure to ensure that you can utilise whichever method will give you the best tax consequences - this may be achieved through simply retaining substantiation as outlined above.

The Tax Office gets a new Tax Man

Recent weeks have seen a changing of the guard at the Australian Taxation Office ("ATO"). With effect from 1 January 2006 Mr Michael D'Ascenzo will replace Mr Michael Carmody as the Commissioner of Taxation.

Mr Carmody leaves the ATO to take up the position of CEO of Customs. Mr Carmody has served with the ATO for numerous years, including almost 13 years as the Commissioner of Taxation. Mr D'Ascenzo has been serving in the ATO as a Second Commissioner of Taxation and Chief Tax Counsel and is well qualified to assume the role of the Commissioner of Taxation.

Mr D'Ascenzo is known to many of us at Grant Thornton and we congratulate him on his new appointment and look forward to working with him in his new role.

Update on Service Entities

You may have been following the progress of the various issues relating to service entities through both the financial press and earlier editions of Sharp Tax. However, since the ATO's release of the service entity Draft Ruling in May 2005 and the associated service entity booklet in June 2005, there has been very little progress on the issues relating to service entities.

As you may be aware, Grant Thornton was involved in preparing a submission to the ATO in response to the contents of both the Draft Ruling and associated service entity booklet. Unfortunately, to date, we have yet to hear any feedback from the ATO in this regard. However, in a Senate Committee Meeting held on 3 November 2005 the Commissioner made some brief comments regarding service entities. The Commissioner appears to have conceded to the point that the net mark up approach as adopted by the service entity booklet may not be useful for businesses. To this end, the Commissioner has advised that a review of the rates would be undertaken in light of an approach considering gross profits to determine whether it is possible to provide gross mark ups rather than net profit benchmark figures.

Furthermore it should be noted that no change has been announced regarding the Commissioner's intention to audit those entities which breach the threshold tests as previously announced, being:

- Arrangements where more than \$1m of fees are paid to the service entity
- Where those fees paid represent more than 50% of the gross fee income of the professional entity.

An additional test has recently been added to this, being where the net profit in the service entity represents more than 50% of the total profit of the professional entity.

We are awaiting more formal documentation in this regard.

Board of Tax - Small Business Compliance Costs

The Board of Taxation has recently completed its review of the CGT Small Business Concessions. The report is now with the Federal Treasurer awaiting his response before any details of the report are made public.

However, the Treasurer has announced that a further review affecting small businesses will be conducted. The review will identify and analyse the main costs small business face in complying with taxes administered by the Tax Office. The Board will undertake a scoping study of tax compliance costs facing the small business sector and identify the more important areas where compliance costs might be reduced.

Grant Thornton welcomes the announcement of the review and hopes that the many issues that will arise will be appropriately dealt with in a constructive and practical matter - finally reducing the compliance costs for small businesses.

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For further information on any of the stories in this issue of Sharp Tax contact your local Grant Thornton office.

Adelaide
Philip Paterson
67 Greenhill Road
Wayville SA 5034
T 08 8372 6666
F 08 8372 6677
E info@gtsa.com.au

Brisbane
Bob Lunney
Grant Thornton House
102 Adelaide Street
Brisbane QLD 4000
T 07 3222 0200
F 07 3222 0444
E info@gtqld.com.au

Melbourne
Mark Cummings
Rialto Towers
525 Collins Street
Melbourne VIC 3000
T 03 9611 6611
F 03 9611 6666
E info@gtvic.com.au

Sydney
Robert Quant
383 Kent Street
Sydney NSW 2000
T 02 8297 2400
F 02 9299 4445
E info@gtnew.com.au

Perth
Peter Fallon
256 St George's Terrace
Perth WA 6000
T 08 9481 1448
F 08 9481 0152
E pfallon@gtwa.com.au

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