UP2Date

FBT and work vehicles

Most business owners are aware that if a car is provided to an employee for the private use of the employee, Fringe Benefits Tax ("FBT") is usually payable. For this purpose, "private use" means that the vehicle is applied to the private use by the employee or their associate. Also, private use occurs where the car is taken to be available for the private use of the employee or an associate of the employee. On each day such private use occurs, FBT is payable. The amount of FBT payable depends on factors that include whether the statutory formula method or operating cost ("log-book") method has been chosen to calculate the FBT taxable value.

However, there is a class of vehicles on which no FBT is payable if the private use of the vehicle is limited in a certain way.

Some definitions

For the purposes of the FBT law a "car" is defined to be a motor vehicle (except a motor cycle or similar vehicle) designed to carry a load of less than 1 tonne and fewer than 9 passengers.

"Private use" of a motor vehicle occurs when the vehicle is not exclusively used for producing the assessable income of the employee.

"Work related travel" has a special definition for the purposes of the FBT law. This includes travel from home to work (and vice-versa). It also includes travel by an employee in a vehicle that is incidental to travel in the course of performing the duties of the employment.

Eligible vehicles

To obtain the FBT exemption for the use of a car or other motor vehicle, the vehicle must be of a type designated for the purpose of the exemption. The ATO website says such vehicles are:

- A single cab ute
- A dual cab ute that is designed to either:
  - Carry a load of 1 tonne or more;
  - Carry more than 8 passengers (including the driver)
  - Carry a load of less than 1 tonne but is not designed for the principal purpose of carrying passengers.
- A panel van or goods van.
- A modified vehicle (such as a hearse) if, for the entire FBT year when the car is used by the employee, the modification permanently affects the inherent design of the vehicle.
- A taxi.
- Any 4-wheel drive vehicle that is designed either;
  - To carry a load of 1 tonne or more
  - To carry more than 8 passengers (including the driver)
  - For a principal purpose other than carrying passengers, as indicated by its appearance, marketing specification or carrying capacity.
- Any other roead vehicle that is designed to carry either:
  - A load of 1 tonne or more
  - More than 8 passengers.

The carrying load

From the above, it can be important to know the designed carrying load of a vehicle. It can also be important to know whether a vehicle is designed principally to carry passengers, or not.

An ATO tax ruling says: "...the designed load capacity of a motor vehicle is to be taken as the gross vehicle weight as specified on the compliance plate by the manufacturer (broadly, the maximum all-up loaded weight), reduced by the basic kerb weight of the vehicle.

For this purpose, basic kerb weight is synonymous with unladen weight, as specified in the Australian Design Rules, being the weight of the vehicle with a full tank of fuel, oil and coolant together with spare wheel, tools (including jack) and installed options. It does not include the weight of goods or occupants."

When conducting this calculation, the ATO considers that the number of seats available in the vehicle should be multiplied by 68 kg to determine the amount of the carrying load that is devoted to people. Here is an example:

Assume a vehicle has a gross vehicle weight of 2,000 kgs. It has a basic kerb weight of 1,400 kgs and a designed seating capacity of 5. The vehicle would be considered to be a vehicle designed principally for the carriage of passengers. This is because the total load capacity is 600 kgs of which the majority, 340 kgs [5 x 68], would be absorbed by its designed passenger carrying capacity.

Here's another example. A vehicle has a gross vehicle weight of 3,800 kg and an unladen mass/kerb weight of 2,720 kg. This means its designed carrying capacity is 1,080 kg. Let's assume that this vehicle is a dual cab vehicle that seats 5 people. This means that the carrying capacity devoted to goods is 1,080 – (5 x 68) = 740 kg. As 740 is 68.5% (more than 50%) of the designed carrying capacity, the vehicle is not principally for the purpose of carrying passengers.

The private use condition

The other important part of the FBT exemption is that the vehicle is used for private use that is work-related travel (see above) or other private use by the employee or an associate of the employee that is "minor, infrequent and irregular". The terms "minor, infrequent and irregular" are not defined. Put broadly, the private use must be limited to travel to and from work and any other use of the vehicle for private use needs to be relatively small.

The policy behind this FBT exemption/concession was to alleviate from FBT the many employers that use "work-horse" vehicles in their business from having to pay FBT. It is often more efficient for employees to drive the vehicle to and from home and garage the vehicle at the employee's home after work so that it can be used as soon as the employee leaves home each day. However, the ATO has become concerned that the use of these vehicles for private purpose is not within its required parameters.

PCG 2018/3

In 2018 the ATO released a practical compliance guideline in relation to private use of the eligible vehicles. The purpose of this guideline was to provide employers with a "safe harbour". If employers satisfied the various requirements of the ATO, they could be assured that the ATO would not investigate/audit the use of the vehicles. There are a number of requirements that employers must satisfy to come within this safe harbour. The ATO says:

"You may choose to rely on this Guideline if:

1. You provide an eligible vehicle to a current employee.
2. The vehicle is provided to the employee for business use to perform their work duties.
3. The vehicle had a GST-inclusive value less than the luxury car tax threshold at the time the vehicle was acquired. [For the 2023-24 Financial Year, the luxury car tax thresholds are $89,332 for fuel efficient vehicles and $76,950 for other vehicles.]
4. The vehicle is not provided as part of a salary packaging arrangement and the employee cannot elect to receive additional remuneration in lieu of the use of the vehicle.
5. You have a policy in place that limits private use of the vehicle and obtain assurance from your employee that their use is limited to use as outlined in points 6 and 7 below.
6. Your employee uses the vehicle to travel between their home and their place of work and any diversion adds no more than two kilometres to the ordinary lengths of that trip.
7. For journeys undertaken for a wholly private purpose (other than travel between home and place of work), the employee does not use the vehicle to travel:
   a. More than 1,000 kilometres in total, and
   b. A return journey that exceeds 200 kilometres.

The key challenges for employers in satisfying the above conditions is having a vehicle private use policy and obtaining the necessary assurance from employees in relation to points 6 and 7.

Stop press! Instant asset write-off level (probably) to be increased

The instant asset write-off level is the amount of expenditure a small business can spend on the acquisition or improvement of an asset and get an instant tax deduction for the whole amount.

Over recent years this level of expenditure has varied a number of times. During the COVID period, for most businesses, the expenditure amount was unlimited.

For the current financial year, the instant asset write-off level was to be $20,000 (excluding GST). However, recent amendments to the proposed law are set to increase the amount to $30,000 (excluding GST). At the time of writing, this level of expenditure has still not yet passed parliament, but it is very likely to do so during May 2024.

It is further proposed that any business with a turnover of less than $50 million (not $10 million) will be able to access the $30,000 write-off amount.

But here's the important part – the asset must be installed and ready for use by midnight on 30 June 2024. So, if you want to make use of the concession, get your skates on! You must make sure that your asset is delivered and set up for use by this time. You don't need to have paid for the asset by this time, but it must be capable of being used by this time.

Under the current law, the instant asset write-off level will revert to just $1,000 as at 1 July 2024. Nevertheless, watch out for changes to investment tax incentives in the Federal Budget which will be announced on 14 May 2024.

"It is far better to buy a wonderful company at a fair price than a fair company at a wonderful price"
Warren Buffett

How a small business got into trouble with the ATO

This is the story of a case decided in the Administrative Appeals Tribunal ("AAT") in April 2024.

Dennis and Nina (spouses) were partners in a building partnership in Queensland. The partnership was a licenced builder that undertook construction and building maintenance work.

Dennis and Nina also owned a private company called Beta Leigh Pty Ltd. This company conducted a business of land development. Sometimes it constructed and sold new housing built on land the company purchased. Sometimes the company bought and sold vacant land. Other times the company constructed housing on land it had purchased and rented out the new housing.

The case concerned a number of transactions that mostly occurred between the partnership and the company. The ATO audited the company and made a number of amendments to prior year assessments of the company. The total tax, penalty and interest bill was over $1 million. The company objected to the amended assessments. The ATO disallowed those objections and Beta Leigh then appealed that ATO decision to the AAT.

The bookkeeping

The general ledgers and bookkeeping were maintained by Nina for both the partnership and the company. Although Nina was honest and tried her best, it seems that everything didn't tie in or reconcile properly. Dennis and Nina were serviced by external accountants, but it also seems that these accountants did not insist on all of the necessary reconciliations to ensure that Nina's bookkeeping work in the two MYOB files was correct.

What the ATO didn't like

The company had trading stock (inventory) of land and construction costs. Where an entity purchases and develops land for sale as part of a business, the entity will have trading stock, being the land and the costs of construction. Effectively, a tax deduction for the costs of the trading stock is not available to be claimed until the developed land is sold. At that time, a percentage of the costs is claimed as a tax deduction in accordance with what percentage of the land has been sold.

The ATO said that, in one year, Beta Leigh had understated its taxable income by $704,000 due to an error it had made in the way it calculated the cost of the land sold. Beta Leigh argued that if it got the calculation wrong in one year, there would be a compensating adjustment in the prior year such that, overall, the cost of sales was calculated correctly and, therefore, the ATO was not out of pocket.

The AAT did not accept this argument. Beta Leigh had to show that in the particular year in question the ATO was wrong. Beta Leigh was not able to do this because of problems with the accounting records.

Another issue related to management fees that were paid from Beta Leigh to the partnership. In the year in question, Beta Leigh paid $350,000 to the partnership as "management fees". This was said to be for the expertise that Dennis and Nina (as partners) supplied to the company to manage its business. The fee was said to be back-pay for many years of expertise for which the partnership had not been compensated.

The AAT did not allow the deduction to the company. This was because there were no contemporaneous records of why the fee was charged or how it was calculated. There was no contract or agreement between the partnership and the company as to what services were to be provided and at what price. Accordingly, the AAT was not convinced that the amount paid by the company was incurred in deriving the income of the company.

Although not mentioned in the AAT decision, it is likely that the $350,000 received by the partnership would still have been income to it even though the company paying the money did not get a tax deduction for the amount.

The moral of the story

This small business got itself into trouble because there were not proper reconciliations of the general ledger accounts to source data. Even though undertaking bank reconciliations, stock reconciliations and other checking procedures can be tiresome, it really pays off when the tax man comes knocking.

If you are a small business, take the time to ensure that every asset and liability that is listed in your balance sheet exists and is correctly valued. There should be source records that the account balances in your balance sheet reconcile to. If the ATO thinks there is a tax problem in your business, this will be first thing it asks for.

Undertaking these reconciliations can be time consuming and will usually cost you some more accounting fees. However, it is money well spent to know that you have the peace of mind that your affairs are in order and that you won't be hit with a bill of over $1 million (or some other amount) like Dennis and Nina.

Also, where there are transactions between entities in a small business group, it is highly recommended that you have written agreements that set out why the transactions have been entered into and when payments for the goods or services are to be made. When the ATO comes knocking, it will ask for such agreements. If you can't produce them readily, you know you are heading for a problem.