Tax Facts

A knowledge-based series by the Tax and Transfer Policy Institute

What is fringe benefits tax?

A "fringe benefit" is a perk that an employer gives to an employee, in addition to salary or wages, but in-kind instead of in cash. Fringe benefits may also be called "employee benefits" or "benefits in kind". Common fringe benefits include an employer paying for an employee's gym membership or an employer allowing an employee to use a car for private purposes.

Why are fringe benefits taxed? How is the tax calculated? Are there any exemptions?

Why was the fringe benefits tax introduced?

Fringe Benefits Tax (FBT) is a Commonwealth-imposed tax on the taxable value of fringe benefits. It was introduced in 1986 and is administered under the Fringe Benefits Tax Assessment Act 1986. The legal incidence of FBT lies with the employer, however the economic incidence may be shared or passed on to the employee **[see our Tax Fact #11, "Economic fundamentals: "Tax incidence and elasticity"]**. The tax is estimated to raise over $3.9 billion in revenue in 2021-22 and over $12.9 billion in the three years to 2024-25 [1].

Before FBT was introduced, salary packages commonly included a range of tax-free benefits (including cars, travel and restaurant meals). These benefits were claimable by the company as legitimate business expenses and did not have to be declared on an individual's tax return [2]. Taxing fringe benefits ensures that remuneration is not distorted towards these benefits and away from salaries and wages [3]. It can be thought of as an anti-avoidance measure put in place to stop employers providing benefits to employees in an attempt to avoid tax. It also helps to ensure horizontal equity **[see our Tax Fact #21, "Dimensions of tax fairness"]**, by ensuring that individuals who receive the same amount of total compensation (both cash and in-kind) are taxed in a similar way.

How are fringe benefits taxed?

Employers are liable for the payment of FBT. The amount of FBT is intended to reflect the income tax an employee would have paid if they had purchased the benefit themselves with their own after-tax income [4]. In theory, this implies the FBT is equivalent to an employee's marginal income tax. In practice, FBT is calculated based on the highest tax bracket (currently 47 per cent including Medicare levy), regardless of the marginal income tax rate that applies to an employee.

Employers self-assess their FBT liability for the FBT year and lodge an FBT return. The FBT year runs from 1 April to 31 March each year, and is different to the financial and calendar years to ease workload on accountants and the ATO. FBT is payable after 'grossing up' a benefit – a process intended to reflect the gross, before-tax salary employees would have to earn in order to buy the benefits provided by an employer [5].

In summary, FBT is a tax on the employer that is equivalent to tax paid by an employee who received income, was taxed at the highest marginal rate and paid for the benefit out of their after-tax income [6] – this calculation process is explained in detail below.

The basic calculation to calculate the FBT payable on a particular fringe benefit is:

FBT payable = Taxable value of benefit x Gross up factor x FBT rate

The three components of this equation are as follows:

- Taxable value of benefit – the rules for calculating the taxable value of a fringe benefit vary according to the type of benefit, and differ in complexity. The ATO has published guidance on valuing each type of benefit on its website.
- Gross up factor – there are two different gross-up rates used to calculate the amount of FBT payable:
  - The Type 1 (higher) gross-up factor is currently **2.0802**. This factor is applied when the employer is entitled to a goods and services tax (GST) credit for GST paid on the benefit provided to an employee. An example of a benefit that may attract this rate is a camera – as the employer is able to claim a GST credit for the GST paid for the benefit, the Type 1 gross-up factor is applied.
  - The Type 2 (lower) gross-up factor is currently **1.8868**. This factor is applied when the employer is not entitled to a GST credit or if there is no GST in the price of the benefit. An example of a benefit that may attract this rate is rent – as rent is not subject to GST, the Type 2 gross-up factor is applied.
- FBT rate – the rate applicable since 31 March 2018 is 47 per cent (the highest marginal income tax rate for individuals).

For example, if an employer gave an employee a mobile phone for private purposes worth $1,100, the FBT payable would be:

FBT payable = $1,100 x 2.0802 x 47% = $1,075.46

As the employer is able to claim the GST paid on the benefit, the total cost to the employer for providing the mobile phone is:

Total cost = $1,100 - $100 + $1,075.46 = $2,075.46

This value ($2,075.46) is also equivalent to the pre-tax income required for an employee, taxed at the highest marginal income tax rate, to purchase the phone themselves.

Can an employer reduce their FBT liability?

It is possible for employers to reduce their FBT liability. The simplest way is for employees to cover some or all of the cost of the fringe benefit – if an employee makes a payment to an employer as a contribution towards the cost of a benefit, the taxable value of the benefit is reduced for the employer.

Another way for employers to reduce their FBT liability is through application of the "otherwise deductible rule" (ODR). The ODR is a hypothetical question that asks: if the employee had paid for a benefit that they got from their employer, would the employee have received a once-only deduction under income tax law [7]? If the answer is "yes", then the ODR reduces the taxable value of the benefit and the subsequent FBT payable by the employer.

For example, the ODR has recently been used to make employer-provided COVID-19 tests exempt from FBT. As the Commonwealth Government has amended legislation to make tests purchased for work-related purposes tax-deductible for individuals, the ODR can be applied to employer-provided tests, as the individual would have received the deduction if they had purchased the test themselves.

Exemptions, concessions and rebates

Some benefits are exempt from FBT, such as tools of trade and portable electronic devices primarily used for work-related purposes. Minor benefits (benefits that have a value of less than $300) are also exempt from FBT if it is unreasonable to treat is as a fringe benefit under five criteria, including frequency and regularity of the benefit and the circumstances in which the minor benefit and associated benefits were provided. An example of a minor benefit that is exempt from FBT is an annual staff Christmas party if the total cost per head is under $300. Other exemptions include those for retraining and reskilling redundant or soon to be made redundant staff, taxi travel expenses (provided the trip begins or ends at an employee's place of work) and employer-sponsored childcare.

Many benefits also attract concessional treatment that reduce their taxable value. These concessions can be grouped into either "remote area reductions", "transport reductions", "relocation reductions" and "other reductions". Further and more detailed guidance is available in Chapter 19 of the Australian Taxation Office's (ATO) "Fringe benefits tax – a guide for employers". Some not-for-profit organisations are also able to claim a rebate on their FBT paid (up to a total of $30,000 of grossed-up benefits per employee).

Future policy considerations

The Henry Tax Review recommended all fringe benefits remain taxed to employers at the top marginal rate and that exemptions should be reviewed to determine their continuing appropriateness [8].

The Review also recommended consideration be given to excluding benefits from FBT where the costs of compliance outweigh equity and tax integrity considerations. This is a common criticism of the FBT system – that it is over-engineered and unnecessarily complex [9]. Suggested solutions include lifting the $300 minor benefits threshold and clarifying the treatment of minor benefits generally, and bringing some FBT processes online by better integrating them with existing ATO digital systems (including Single Touch Payroll).

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[9] McIlory, T. (2020). Use pandemic to reform fringe benefits tax: accountants. Australian Financial Review.

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