TD 2007/D22 - Fringe benefits tax: where an employer recognises they mistakenly paid to their employee an amount that the employee is not legally entitled to, but is obliged to repay, and afterwards allows the employee time to repay the amount, is there a 'loan benefit' under subsection 16(1) of the Fringe Benefits Tax Assessment Act 1986?

This document has been finalised by TD 2008/10.

Draft Taxation Determination

Fringe benefits tax: where an employer recognises they mistakenly paid to their employee an amount that the employee is not legally entitled to, but is obliged to repay, and afterwards allows the employee time to repay the amount, is there a 'loan benefit' under subsection 16(1) of the *Fringe Benefits Tax Assessment Act 1986*?

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Ruling

1. Yes. In these circumstances there is a 'loan benefit' under subsection 16(1) of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA). By allowing time for the repayment of the mistakenly paid amount the employer is making a 'loan' (as that term is inclusively defined in subsection 136(1) of the FBTAA) to the employee.

2. A loan benefit can arise and continue even where the obligation to repay an amount or part of it is not enforceable by legal proceedings. The employee will cease to be under an obligation to repay the whole or any part of the loan once the loan is fully repaid or that obligation is waived by the employer.

3. The loan benefit will not be excluded from being a 'loan fringe benefit' by reason of paragraph (f) of the definition of 'fringe benefit' in subsection 136(1) of the FBTAA, as the benefit is not a payment of salary or wages or a payment that would be salary or wages if salary or wages included exempt income for the purposes of the *Income Tax Assessment Act 1936*.

4. However, the loan benefit may in some circumstances be excluded from being a loan fringe benefit because the benefit is an exempt benefit.

Example

5. *Julia works as a public servant in a government department (the employer). Julia is paid her salary on a fortnightly basis by direct credit into her bank account. During the 2006-07 income year (2006-2007 FBT Year) Julia temporarily performed duties at a higher pay scale level. A subsequent review of payments by the employer's human resources section showed that Julia had mistakenly been paid a number of amounts totalling $7,200 during the 2006-07 income year (2006-2007 FBT year) to which she was not legally entitled. Julia has an obligation to repay the $7,200 paid to her by mistake. On 1 April 2007 Julia's employer agrees to allow her one year to repay the $7,200 interest-free by 12 monthly instalments of $600 payable on the last day of each month commencing on 30 April 2007. Julia adheres to the repayment schedule over the 12 month period.*

6. *The employer's allowing of time for Julia to repay the $7,200 gives rise to a loan benefit in the 2007-2008 FBT year under subsection 16(1) of the FBTAA. The benchmark interest rate for the 2007-08 FBT year is 8.05% and as such the 'notional amount of interest' on the loan is calculated as $312 for the 2007-08 FBT year. The actual interest on the loan is nil for the 2007-08 FBT year. The loan benefit cannot be an exempt benefit under section 58P of the FBTAA as the 'notional taxable value' of the benefit is not less than $300.*[1]

Date of effect

7. It is proposed that when the final Determination is issued, it will apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that if conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination.

8. **Note:** this Determination only applies to those cases where the recipient of the payment in question is obliged to repay this amount. Whether or not a recipient of a payment claimed to have been made under a mistake of fact or law fits this description can be a difficult legal question to resolve, however. For example, the recipient, an employee, may be able to establish a defence to the claim for restitution (see for example, the defences discussed in *David Securities Pty Ltd v. Commonwealth Bank of Australia* (1992) 175 CLR 353; 92 ATC 4658; (1992) 24 ATR 125), and so establish a right to retain the money in question. Where it is established that an employee recipient is under no obligation to repay the amount in question, no loan benefit in respect of that amount can arise for fringe benefits tax purposes.

Commissioner of Taxation
12 December 2007

[1] Assuming that the 'otherwise deductible rule' in section 19 of the FBTAA does not apply so as to reduce the notional taxable value to less than $300.

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.

Explanation

9. The employer's allowing of time for the employee to repay the mistakenly paid amount to which the employee is not legally entitled, but is obliged to repay, gives rise to the making of a 'loan' as that term is inclusively defined in subsection 136(1) of the FBTAA. 'Loan' is defined to include:

(a) an advance of money;

(b) the provision of credit or any other form of financial accommodation;

(c) the payment of an amount for, on account of, on behalf of or at the request of a person where there is an obligation (whether express or implied) to repay the amount; and

(d) a transaction (whatever its terms or form) which in substance effects a loan of money.

10. The employer's allowing of time for the employee to repay the mistakenly paid amount may be express or implied. The employer may expressly agree (either orally or in writing) with the employee to allow the employee time to repay the amount. Alternatively, the employer's allowing of time to repay the amount may be implied from the employer's conduct, which may include a lack of action to recover the amount or insist upon its repayment in a lump sum, or an acceptance of its repayment by instalments. However, a short delay in requiring repayment would not normally be taken to imply the allowing of time to repay in this context.

11. The circumstances that are the subject of this draft Determination satisfy paragraphs (b) and (d) of the definition of 'loan' in subsection 136(1) of the FBTAA. The employer's allowing of time for the employee to repay the mistakenly paid amount satisfies paragraph (b) of that definition as the 'provision of credit or any other form of financial accommodation'. 'Financial accommodation' is not a technical legal expression so recourse is had to its ordinary meaning. The *Macquarie Dictionary* defines 'accommodation' relevantly as 'anything which supplies a want … a loan or a pecuniary favour' and 'financial' relevantly as 'relating to monetary receipts and expenditures; relating to money matters; pecuniary'. Clearly then, the employer's allowing of time for the employee to repay the mistakenly paid amount, which the employee is obliged to repay immediately, is the provision of a form of financial accommodation.

12. Paragraph (d) expands the definition of 'loan' to include a 'transaction (whatever its terms or form) which in substance effects a loan of money'. 'Transaction' is not defined for the purposes of the FBTAA. In *Grimwade v. Federal Commissioner of Taxation* (1949) 78 CLR 199 at 222, Rich J stated that the ordinary meaning of 'transaction' is 'an act, doing, negotiation or dealing.' The employer's allowing of time for the employee to repay the mistakenly paid amount clearly satisfies that ordinary meaning of 'transaction', in that it is an act of, or the doing of something by, the employer, with respect to the employee. Further, where the employer and employee expressly agree to allow the employee time to repay the amount that is clearly a 'negotiation' or 'dealing' between the two. Paragraph (d) then requires that the transaction be one that 'in substance effects a loan of money'. The essence of a loan of money is the obtaining of the use of an amount of money for a period of time with an obligation to repay the amount. The employer's allowing of time for the employee to repay the mistakenly paid amount 'in substance effects' (that is, brings about or results in) a loan of money in that the employee obtains for a period of time the use of the money mistakenly paid by the employer with an obligation to repay the amount to the employer at the later time than originally obliged to do so. Therefore, the employer's allowing of time for the employee to repay the mistakenly paid amount satisfies paragraph (d) of the definition of 'loan'.

13. The making of a 'loan' by the employer to the employee is taken under subsection 16(1) of the FBTAA to constitute a benefit provided by the employer (the provider) to the employee (the recipient) and that benefit is taken to be provided in respect of each year of tax during the whole or a part of which the recipient is under an obligation to repay the whole or any part of a loan. The employee is under an obligation to repay the relevant 'loan' that is the subject of this draft Determination from the time the employer gives the employee time to repay the mistakenly paid amount. Under the definition of 'obligation' in subsection 136(1) of the FBTAA, in relation to repayment of an amount, the obligation to repay includes an obligation that is not enforceable by legal proceedings. So a loan benefit can arise and continue even where recovery of the amount of the loan or part of it is statute barred that is, the obligation to repay an amount does not cease. The employee will cease to be under an obligation to repay the amount of the 'loan' that is the subject of this draft Determination once the amount of the 'loan' is fully repaid or that obligation is waived by the employer.

14. A loan benefit will be a loan fringe benefit where it satisfies the definition of 'fringe benefit' in subsection 136(1) of the FBTAA. Whether it satisfies that definition depends on, among other things, whether the benefit is provided 'in respect of the employment of the employee'. Subsection 136(1) of the FBTAA provides that ''in respect of', in relation to the employment of an employee, includes by reason of, by virtue of, or for or in relation directly or indirectly to, that employment'.

15. The leading case on the phrase 'in respect of the employment of the employee' in subsection 136(1) of the FBTAA is the Full Federal Court decision in *J & G Knowles & Associates Pty Ltd v. Commissioner of Taxation* (2000) 96 FCR 402; 2000 ATC 4151; (2000) 44 ATR 22. In that case the Full Federal Court relevantly held that:

> the phrase requires a 'nexus, some discernible and rational link, between the benefit and employment'. That, however, does not take the matter far enough. For what is required is a sufficient link for the purposes of the particular legislation … It cannot be said that any causal relationship between the benefit and the employment is a sufficient link so as to result in a taxable transaction. (at FCR 408; ATC 4156-7; ATR 28) … what must be established is whether there is a *sufficient* or *material*, rather than *a*, causal connection or relationship between the benefit and the employment (at FCR 410; ATC 4158; ATR 30).

16. Unless there are facts indicating a contrary conclusion (such as some capacity other than as employee in respect of which the benefit was provided by the employer to their employee), the loan benefit taken under subsection 16(1) of the FBTAA to be provided by the employer to the employee in the circumstances that are the subject of this draft Determination would possess a 'sufficient or material' connection with the employee's employment and is therefore considered to be a benefit provided by the employer to the employee 'in respect of the employment of the employee'.

17. A benefit will not be a fringe benefit where the exclusion contained in paragraph (f) of the definition of 'fringe benefit' in subsection 136(1) of the FBTAA is satisfied, that is, where the benefit is 'a payment of salary or wages or a payment that would be salary or wages if salary or wages included exempt income for the purposes of the *Income Tax Assessment Act 1936*'.

18. Since it is the act of the employer in allowing time for repayment once the overpayment has been identified that satisfies paragraph (b) or (d) of the definition of 'loan' and because the benefit provided by the employer to the employee by allowing time to repay is not itself a payment to the employee, that benefit is not a payment of 'salary or wages' within the meaning of that expression in subsection 136(1) of the FBTAA. Therefore that benefit is not excluded from the definition of 'fringe benefit' by paragraph (f) of the definition of that expression in subsection 136(1) of the FBTAA.

19. The loan benefit may in some circumstances be excluded from being a loan fringe benefit by reason of paragraph (g) of the definition of 'fringe benefit' in subsection 136(1) of the FBTAA because the benefit is an exempt benefit. It may be that the loan benefit is a minor benefit that is exempt in relation to the particular FBT year pursuant to section 58P of the FBTAA. It is not possible to make general conclusions about whether section 58P of the FBTAA will apply to the loan benefit because the satisfaction of several of the requirements for the exemption will depend upon the particular circumstances being considered. For example, the amount of the loan and the length of time during which the recipient is under an obligation to repay the whole or any part of the loan will have a great bearing on whether 'the notional taxable value of the minor benefit in relation to the [relevant] year of tax is less than $300'[2] so as to satisfy paragraph 58P(1)(e).

20. Essentially, the taxable value in relation to a FBT year of a loan fringe benefit that arises in the circumstances that are the subject of this draft Determination is, in accordance with section 18 of the FBTAA, the amount (if any) by which the notional interest that would have accrued on the 'loan' during that year (calculated on the daily balance of the loan at the statutory interest rate in relation to that FBT year) exceeds the amount of interest (if any)[3] that actually accrued on the loan in respect of that FBT year.

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[2] Paragraph 58P(1)(e) was amended by *Tax Laws Amendment (2006 Measures No. 5) Act 2006*. With effect from 1 April 2007, the minor benefits exemption threshold was increased from 'less than $100' to 'less than $300'.

[3] In the ordinary case it is unlikely that interest will actually accrue on the loan that arises in the circumstances that are the subject of this draft Determination. However, there may be an obligation on the employee to pay interest as part of an agreement with the employer to allow the employee time to repay the 'loan'.

Appendix 2 – Your comments

21. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date. (Note: the Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel. The Tax Office may use a sanitised version (names and identifying information removed) of the compendium in providing its responses to persons providing comments. Please advise if you do not want your comments included in a sanitised compendium.)

Due date:	**1 February 2008**
Contact officer:	**Lee Beaver**
Email address:	**Lee.Beaver@ato.gov.au**
Telephone:	**(02) 9374 1492**
Facsimile:	**(02) 9374 1802**
Address:	**Law & Practice** **PO Box 9977** **Hurstville BC NSW 1481**

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TD 2007/D21; TD 2007/D23

Subject references:

- exempt benefits
- FBT loan interest
- FBT statutory interest rate
- fringe benefits
- fringe benefits tax
- in respect of employment
- loan fringe benefits
- minor benefits

Legislative references:

- FBTAA 1986 16(1)
- FBTAA 1986 18
- FBTAA 1986 19
- FBTAA 1986 58P
- FBTAA 1986 58P(1)(e)
- FBTAA 1986 136(1)
- ITAA 1936
- Tax Laws Amendment (2006 Measures No. 5) Act 2006

Case references:

- David Securities Pty Ltd v. Commonwealth Bank of Australia (1992) 175 CLR 353; 92 ATC 4658; (1992) 24 ATR 125
- Grimwade v. Federal Commissioner of Taxation (1949) 78 CLR 199
- J & G Knowles & Associates Pty Ltd v. Commissioner of Taxation (2000) 96 FCR 402; 2000 ATC 4151; (2000) 44 ATR 22

Other references:

- Macquarie Dictionary, [Multimedia], version 5.0.0, 1/10/01

ATO references

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