


TD 2007/D23 - Fringe benefits tax: where an employer mistakenly pays to their employee an amount that the employee is not legally entitled to, but is obliged to repay, does the employer's subsequent waiver of that obligation constitute a 'debt waiver benefit' under section 14 of the Fringe Benefits Tax Assessment Act 1986?

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This document has been finalised by TD 2008/11.



Draft Taxation Determination

Fringe benefits tax: where an employer mistakenly pays to their employee an amount that the employee is not legally entitled to, but is obliged to repay, does the employer's subsequent waiver of that obligation constitute a 'debt waiver benefit' under section 14 of the *Fringe Benefits Tax Assessment Act 1986*?

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This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation provision applies, or would apply to entities generally or to a class of entities in relation to a particular scheme or a class of schemes. You can rely on this publication (excluding appendixes) to provide you with protection from interest and penalties in the way explained below. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

Ruling

1. Yes. Where an employer mistakenly pays to their employee an amount that the employee is not legally entitled to, but is obliged to repay, the employer's subsequent waiver of that obligation constitutes a 'debt waiver benefit' under section 14 of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) provided by the employer to the employee at the time of the waiver.

Example

2. Sam works as a public servant in a government department (the employer). She 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) Sam temporarily performed duties at a higher pay scale level. A subsequent review of payments by the employer's human resources section established that Sam had, in error, been mistakenly paid three amounts of \$500 that is, a total of \$1,500 during the 2006-07 income year (2006-2007 FBT year) to which she was not legally entitled. The circumstances are such that Sam has an obligation to repay the three amounts paid by mistake. In the following FBT year Sam's employer waives her obligation to repay the three mistakenly paid amounts of \$500.

TD 2007/D23

3. *Each waiver gives rise to a ‘debt waiver benefit’ under section 14 of the FBTA provided by Sam’s employer to Sam at the time of the waiver.*

Date of effect

4. 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 it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination.

5. **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 debt waiver benefit in respect of that amount can arise for fringe benefits tax purposes.

Commissioner of Taxation

12 December 2007

Appendix 1 – Explanation

① *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

6. Under subsection 136(1) of the FBTA, “debt waiver benefit” means a benefit referred to in section 14. Pursuant to section 14 of the FBTA, a debt waiver benefit arises at the time a person waives the obligation of another person to pay or repay an amount to the first person. ‘Waive’ is defined in subsection 136(1) of the FBTA to include release.

7. The waiver by the employer of the employee’s obligation to repay all or part of the amount of the payment made by mistake gives rise to a debt waiver benefit under section 14 of the FBTA provided by the employer to the employee at the time of the waiver.

8. The debt waiver benefit will be a ‘debt waiver fringe benefit’ where it satisfies the definition of ‘fringe benefit’ in subsection 136(1) of the FBTA. 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 FBTA 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’.

9. The leading case on the phrase ‘in respect of the employment of the employee’ in subsection 136(1) of the FBTA 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)

10. 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 debt waiver benefit taken under section 14 of the FBTA to be provided by the employer to the employee in the circumstances that are the subject of this ruling 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’.

11. Facts that may indicate such a contrary conclusion would include where the employee’s obligation to repay the amount of the payment made by mistake is waived because it is a bad debt (for example, the amount cannot be recovered because the employee has no assets) rather than by reason of the employment relationship. That fact could be established by showing that reasonable efforts were made to recover the amount from the employee and that the waiver was in line with the employer’s policy in relation to the waiver of debts owing by non-employees.

12. Other facts that may also indicate a contrary conclusion would include where the employee's obligation to repay the amount of the payment made by mistake is waived because it is uneconomic to recover the amount from the employee. That fact could be established by showing that the employer adheres to a policy of not pursuing any debts owed to it that are below a certain amount (because the employer has reasonably assessed that it is uneconomic for them to do so) and that the waiver of the employee's obligation to repay the amount of the payment made by mistake occurs under that policy, rather than by reason of the employment relationship. Such a policy would have to apply to all debts owed to it, not only debts owed by employees.

13. The debt waiver benefit may in some circumstances be excluded from being a debt waiver 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 debt waiver 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 debt waiver benefit because the satisfaction of several of the requirements for the exemption will depend upon the particular circumstances being considered, including whether 'the notional taxable value of the minor benefit in relation to the [relevant] year of tax is less than \$300'¹ so as to satisfy paragraph 58P(1)(e).

14. Where the employer gives the employee a bonus equal to the amount of the debt outstanding and agrees to set-off this bonus against that debt these actions will not be a debt waiver. The principles in *Re Harmony and Montague Tin and Copper Mining Company (Spargo's Case)* (1873) 8 Ch. App. 407 establish that a payment can occur by way of set-off. As a bonus is a payment to which Division 12 of Schedule 1 to the *Taxation Administration Act 1953* (TAA) applies, the exclusion in paragraph (f) in the definition of 'fringe benefit' in subsection 136(1) of the FBTAA is satisfied. Either section 6-5 or subsection 15-2(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) will apply to include the amount of the bonus in the assessable income of the employee.

15. The taxable value in relation to a FBT year of a debt waiver fringe benefit provided in that year is the amount the repayment of which is waived: section 15 of the FBTAA.

¹ Paragraph 58P(1)(e) of the FBTAA 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'.

Appendix 2 – Alternative View

16. Division 12 of Schedule 1 to the TAA deals with payments from which amounts must be withheld. Specifically, section 12-35 of Schedule 1 to the TAA requires an entity to withhold an amount from 'salary, wages, commission, bonuses or allowances' it pays to an individual as an employee.

17. In determining whether a 'debt waiver' by an employer of an obligation to repay an amount mistakenly paid to an employee is a 'payment' for these purposes, subsection 11-5(1) of Schedule 1 to the TAA provides that:

In working out whether an entity has paid an amount to another entity, and when the payment is made, the amount is taken to have been paid to the other when the first entity applies or deals with the amount in any way on the other's behalf or as the other directs.

18. Subsection 11-5(2) of Schedule 1 to the TAA provides that:

An amount is taken to be payable by an entity to another entity if the first entity is required to apply or deal with it in any way on the other's behalf or as the other directs.

19. It is argued that in making the debt waiver the employer has dealt with the obligation to repay on behalf of the employee for the purposes of section 11-5 of Schedule 1 to the TAA. It is argued that it is a payment of a bonus to the employee at the time the waiver is granted to which section 12-35 of Schedule 1 to the TAA applies and therefore the exclusion in paragraph (f) of the definition of 'fringe benefit' in subsection 136(1) of the FBTA is satisfied.

20. Under this view therefore, the debt waiver cannot give rise to a 'debt waiver fringe benefit' (refer to paragraph 8 of this draft Determination). Other consequences of this view are:

- (a) an obligation to 'withhold an amount' from the bonus constituted by the debt waiver, arises at the time of the waiver, under section 12-35 of Schedule 1 to the TAA; and
- (b) where this bonus arises from the provision of services by the employee in their employment, so that it is ordinary income, the amount of the bonus is included in assessable income of the employee, under section 6-5 of the ITAA 1997, or, if section 6-5 does not apply, but the bonus is provided 'in respect of, or in relation directly or indirectly', to this employment, its value is included in the employee's assessable income under section 15-2 of the ITAA 1997.

21. The Commissioner of Taxation does not accept this Alternative View. This Alternative View is not considered to pay sufficient attention to Division 12 and Division 14 of Schedule 1 to the TAA.

22. Even if the waiver by the employer of the employee's obligation to repay all or part of the amount of the payment made by mistake was considered to be a 'payment', it would not be a '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*' within the definition of 'salary or wages' in subsection 136(1) of the FBTA.

23. Essentially, a payment of 'salary or wages' as defined in subsection 136(1) of the FBTAA is a payment from which an amount must be withheld under certain listed sections in Division 12 of Schedule 1 to the TAA. Section 12-10 of Schedule 1 to the TAA provides that Division 12 of Schedule 1 to the TAA does not apply to a payment in so far as it consists of providing a non-cash benefit.² That provision and the provisions of Subdivision 14-A of Schedule 1 to the TAA, whose object is 'to put entities that provide non-cash benefits, and entities that receive them, in a position similar to their position under Division 12 of Schedule 1 to the TAA if payments of money had been made instead of the non-cash benefits being provided',³ clearly indicate that the provision of the benefit on the employer's waiver of the employee's obligation to repay the mistakenly paid amount is not covered by Division 12 of Schedule 1 to the TAA. Therefore, the benefit is not a payment of 'salary or wages' as that term is relevantly defined and, accordingly, the exclusion contained in paragraph (f) of the definition of 'fringe benefit' in subsection 136(1) of the FBTAA is not satisfied.

24. However, as explained in paragraph 14 of this draft Determination, if an employer formally determines to pay a bonus and then agrees with the employee to set off the obligation to pay the bonus against the employee's obligation to repay the overpayment, the payment of the bonus will constitute a payment of 'salary or wages' and no debt waiver fringe benefit will arise. If the decision to pay the bonus and the set off occurs after the employer has allowed the employee time to repay the overpayment, a loan benefit may arise (see draft Taxation Determination TD 2007/D22).

² 'Non-cash benefit' is defined in subsection 995-1(1) of the *Income Tax Assessment Act 1997* as 'property or services in any form except money'.

³ Paragraph 14-1(a) of Schedule 1 to the TAA.

Appendix 3 – Your comments

25. 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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TD 2007/D21; TD 2007/D22

Subject references:

- debt waiver fringe benefits
- exempt benefits
- fringe benefits
- fringe benefits tax
- in respect of employment
- minor benefits

Legislative references:

- FBTAA 1986 14
- FBTAA 1986 15
- FBTAA 1986 58P
- FBTAA 1986 58P(1)(e)
- FBTAA 1986 136(1)
- ITAA 1997 6-5
- ITAA 1997 15-2
- ITAA 1997 15-2(1)
- ITAA 1997 995-1(1)
- TAA 1953 Sch 1 11-5

- TAA 1953 Sch 1 11-5(1)
- TAA 1953 Sch 1 11-5(2)
- TAA 1953 Sch 1 14-1(a)
- TAA 1953 Sch 1 Div 12
- TAA 1953 Sch 1 12-10
- TAA 1953 Sch 1 12-35
- TAA 1953 Sch 1 Div 14
- TAA 1953 Sch 1 Subdiv 14-A
- 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
- J & G Knowles & Associates Pty Ltd v. Commissioner of Taxation (2000) 96 FCR 402; 2000 ATC 4151; (2000) 44 ATR 22
- Re Harmony and Montague Tin and Copper Mining Company (Spargo's Case) (1873) 8 Ch. App. 407

ATO references

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