APPENDIX E TO TIB NO.3, SEPTEMBER 1989

EXPLANATION OF INCOME TAX AMENDMENT ACT (No.5) PART IV: THE FRINGE BENEFIT TAX AMENDMENTS

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A. EXTENSION OF FRINGE BENEFIT TAX TO MAJOR SHAREHOLDER-EMPLOYEES

The fringe benefit tax amendments contained in Part IV of the Income Tax Amendment Act (No. 5) 1988 relate to the treatment of benefits provided to shareholders who are employed by a private company.

Scope and Effect of the Amendments

The Amendment Act amends the fringe benefit tax and income tax provisions of the Income Tax Act. The effect of the amendments is to extend from 1 April 1989 the application of the fringe benefit tax regime to all shareholder-employees of private companies. Therefore, where a private company provides a benefit to a shareholder-employee, that company will be subject to the provisions governing the taxation of fringe benefits contained in Part XB of the Income Tax Act.

Under the legislation that existed prior to the amendments contained in this Amendment Act, the income tax and fringe benefit tax treatment of fringe benefits provided to shareholder-employees was dependent upon the extent of their shareholding with the company. Those shareholder-employees who held less than 10 per cent of the shares or voting rights were treated in the same manner as those employees who held no shares at all. For those who held 10 per cent or more of the shares or voting rights ("major shareholders"), the private company was subject to the income tax "add back" adjustments and was not liable for fringe benefit tax in respect of benefits provided to those shareholders.

Shareholders Who Are Not Employees

These amendments remove the percentage of shareholding distinction in respect of benefits provided to shareholders who are also employees of the company. The amendments do not affect the FBT treatment of shareholders who are not employees. It should be noted, however, that the Income Tax Amendment Act (No 2) 1989, assented to on 26 July 1989, provides for the scope of the FBT regime to be extended to include certain non-cash dividends paid to all shareholders on or after 1 October 1989. In the meantime benefits provided to such shareholders will still not be subject to FBT and will continue to be non-deductible to the company for income tax purposes.

Benefits to Which the FBT legislation Applies

The legislation concerning the treatment of benefits provided to employees (including shareholder-employees) applies to all benefits that come within the definition of the expression "fringe benefit" in section 336N of the Income Tax Act.

Where a benefit in the form of -

- the private use or enjoyment of a motor vehicle,
- the availability for private use or enjoyment of a motor vehicle,
- a low interest loan,
- subsidised transport,
- discounted goods and services,
- a monetary contribution to a non-approved or overseas superannuation scheme,
- a non-monetary contribution to an approved superannuation scheme,
- a lump sum payment by way of bonus, gratuity, or retiring allowance,
- a lump sum redundancy payment in excess of specified sum calculated in accordance with section 68, and
- any other benefit

is provided to a shareholder-employee, the company will be subject to FBT on the value of that benefit.

To the extent that the costs incurred by a private company in providing benefits to an employee who is a "major shareholder" are subject to FBT. Such costs are no longer subject to the various income tax adjustments they were formerly subject to (refer to explanation below of amendments to relevant income tax provisions).

When Does the new Legislation Apply?

For FBT purposes the legislation applies to the quarter that commenced on 1 April 1989, in respect of which the first payment of FBT was due on 20 July 1989, and every subsequent quarter, for which FBT is due on the 20th day of the next month after the end of the quarter.

Deductibility of FBT

Note that the Income Tax Amendment Act 1989 (enacted on 22 March 1989) amends the principal Act to provide that FBT in respect of fringe benefits provided on or after 1 April 1989 is tax deductible (refer to commentary on page 7 of Public Information Bulletin No. 181 of June 1989). The FBT is deductible in the income year the benefits that give rise to the FBT liability are provided. This will not necessarily be the same income year as the income year in which the FBT is paid. Therefore, in the case of a company with a late balance date (e.g. 30 June 1989) the FBT paid on 20 July 1989 in respect of fringe benefits provided in the June quarter is deductible in the 1989 income year.

B. AMENDMENTS TO FRINGE BENEFIT TAX PROVISIONS OF THE INCOME TAX ACT

Section 51 of the Amendment Act amends various provisions of the fringe benefit tax legislation contained in section 336N of the Income Tax Act. The purpose of the amendments is to remove the exemption from fringe benefit tax in respect of benefits provided on or after 1 April 1989 to major shareholder-employees of private companies. Prior to 1 April 1989 employees who owned 10 per cent or more of the shareholding in a company were not subject to the FBT regime. From 1 April 1989 any benefits provided by a private company to such shareholder-employees will be subject to FBT.

Subsection (1)(a) of section 51 amends section 336N(1) by repealing paragraph (f) of the definition of the term "fringe benefit". The effect of this amendment is to remove the exclusion of benefits provided to a "major shareholder" in a private company.

Subsection 1(b) consequentially repeals the definitions of the terms "major shareholder" and "private company" in section 336N(1).

Subsection (2) repeals subsection (2A) of section 336N. Subsection (2A) referred to the shareholding interest in a company held by a relative or nominee of the shareholder in determining the percentage of shares held by a shareholder. With the removal of the distinction between "major shareholders" and other shareholders for FBT purposes subsection (2A) is no longer necessary

Subsection (3) repeals the proviso to subsection (3) of section 336N.

The effect is that from 1 April 1989 a fringe benefit provided directly by an employer (or indirectly by some other person under an arrangement with the employer) to a person associated with any employee or shareholder-employee of the employer is deemed to be provided by the employer to the employee. Under the repealed proviso a fringe benefit provided directly or indirectly to a person associated with a "major shareholder" of the employer was not subject to FBT.

Subsection (4) amends section 336N by repealing subsection (3A) and inserting a new subsection (3A). The amendment removes the reference to subsection (2A) (now repealed) but otherwise provides a similar treatment as previously, i.e., that benefits granted by a company to an employee who holds shares in the company are deemed to have been granted to that employee as part of the employee's remuneration and not by reason of the employee's shareholding

Subsection (5) consequentially repeals amendment provisions of previous Amendment Acts.

Subsection (6) provides that the above amendments apply in respect of benefits provided on or after 1 April 1989. Note that the application date is subject to subsection (7) (refer next paragraph).

Subsection (7) provides special rules in relation to companies that -

- are in the course of winding up, and
- the Commissioner is satisfied that the company has paid, or will pay, the correct amount of winding up distribution tax in accordance with sections 27 to 29 of the Income Tax Amendment Act (No.3) 1989.

In the case of such companies the amendments relating to major shareholder-employees will not apply and the company will not be subject to FBT in respect of benefits provided to major shareholder-employees between 1 April 1989 and the date of winding up or 30 September 1989, whichever date comes first.

It should be noted that under section 6(3) of the Income Tax Amendment Act 1989 the exemption provided in subsection (7) of this amendment does not apply in respect of any benefit that is an employer superannuation contribution made on or after 1 April 1989 and before 1 October 1989 to a non-approved superannuation scheme.

It should also be noted that where a benefit is not subject to FBT it may be taxable to the shareholder as a dividend in terms of section 4(1)(b) to (e) and (k) of the principal Act if it is provided on or before 30 September 1989. From 1 October 1989 such dividends will be classified as **non-cash dividends** and will generally be subject to FBT (refer to sections 2 and 14 of the income Tax Amendment Act (No. 2) 1989).

Under **subsection (8)**, in order for the exemption provided in subsection (7) to apply either

- the liquidator of the company is required to furnish the company's final accounts to the Registrar of Companies on or before 30 September 1989, and
- the company has to pay the correct amount of winding up distribution tax on or before 30 September 1989 (including any penalty for late payment) .

If neither of these conditions are met the company will be subject to FBT in respect of any benefits provided on or after 1 April 1989 to employees who are "major shareholders".

Subsection (9) allows the Commissioner to recover from the shareholder any FBT liable to be paid by the company in accordance with subsection (8) This would apply where the company

- has distributed all its funds to shareholders and not paid the correct amount of winding up distribution tax, or
- has wound up and not paid the correct amount of winding up distribution tax.

C. AMENDMENTS TO OTHER PROVISIONS OF THE INCOME TAX ACT

Prior to 1 April 1989 benefits provided to employees who were "major shareholders" were deemed not to be fringe benefits and were therefore not subject to FBT. The costs involved in providing such benefits were deemed to be of a private or domestic nature and were not deductible to the company. With the extension of FBT to all shareholder-employees amendments have been made to those provisions of the principal Act that allowed for the separate treatment of expenditure incurred in providing fringe benefits to a "major shareholder".

Subsection (3) of section 30 of the Amendment Act amends paragraph (d) of the definition of the term "expenditure on account of an employee" contained in section 2 of the principal Act. The effect is that where a company makes a payment on or after 1 April 1989 in respect of expenditure incurred by an employee who is a shareholder, such expenditure may be treated as "monetary remuneration" of the shareholder-employee.

Therefore, where a company pays for a shareholder-employee's private purchases via an expense account the amount paid by the company is assessable income in the hands of the employee as monetary remuneration. However, the amount paid by the company is not assessable income to the employee where the expense account is operated as a **loan account**, i.e., the employee is required to refund any expenditure incurred by the company in acquiring private purchases via the expense account. (Refer to the explanation relating to shareholder-employee current accounts in Part D of this commentary for the treatment where an expense account operated as a loan account runs into debit.)

Section 31 redefines the term dividends in the principal Act by inserting a new section 4, which provides a comprehensive definition of the term "dividends", and a new section 4A which provides exclusions from "dividends". It should be noted that section 4A(1)(i) excludes from the definition of "dividends" any benefits provided to shareholders where such benefits are subject to FBT.

Section 34 amends section 105A of the principal Act to also allow, from 1 April 1989, a deduction for expenditure incurred by a company in providing a benefit to any employee who is a shareholder. Previously, such expenditure was not deductible in respect of a benefit provided to a "major shareholder".

Under section 105A such expenditure is in effect deemed not to be expenditure of a private or domestic nature and is deductible as if it were expenditure allowable under section 104 of the Act. This removes any argument that the expenditure was not incurred in the production of the company's assessable income because it was incurred in providing a private benefit to a shareholder.

Section 35(1) amends section 106(1)(j) of the principal Act. The amended paragraph (j) prohibits any deduction to the extent that the expenditure or loss is of a private or domestic nature. Therefore, from 1 April 1989, any expenditure or loss incurred in the providing of a benefit to a "major shareholder" will no longer be deemed to be expenditure or loss of a private nature.

Section 36 amends section 106B(2) of the principal Act so that from 1 April 1989 the record keeping obligations in respect of motor vehicles used for both business and private purposes no longer apply to private companies where any shareholder thereof was deemed to be a "major shareholder". *In effect this does away with the requirement to maintain a log book where a company makes available a motor vehicle for the private use of a shareholder-employee* as there will be no requirement to make a private use adjustment in view of the amendments to section 105A and section 106(1)(j) as described above.

However, refer to Part E (Motor Vehicles) of this commentary for circumstances in which a company may nevertheless choose to maintain a log book.

Section 37 amends section 108 of the principal Act to allow a deduction in respect of any repairs, maintenance or depreciation of any asset to the extent that the asset on which the expenditure or loss was incurred is used in providing from 1 April 1989 a benefit to an employee who is a shareholder. Prior to 1 April 1989 no such deduction was allowable where the asset was used in providing a benefit to a "major shareholder".

Section 52 amends section 374E(1) of the principal Act by inserting a definition of "major shareholder" and removing the reference to the definition of major shareholder (now repealed) in section 336N. The effect of the amendment is to continue to treat major shareholders the same as self-employed persons for the purposes of the Family Support Tax Credit and the Guaranteed Minimum Family Income Tax Credit.

D. SHAREHOLDER-EMPLOYEES' LOAN ACCOUNTS

Included in the definition of fringe benefit is any loan that is owing, by the employee, at any time during the quarter in respect of which there is a concessional rate of interest. A loan includes an advance, a deposit, money otherwise let out, and a credit given (including the forbearance of a debt), whether on current account or otherwise.

Therefore, in relation to the current account of a shareholder-employee, FBT will be payable by the company where there is a debit balance in the current account (i e. current account is overdrawn) and the interest charged (if any) to the shareholder-employee is less than the interest that would be charged at the prescribed rate for the quarter in which there is a debit balance. In such a case the debit balance or amount overdrawn would represent a low-interest loan to the shareholder-employee and FBT in respect of a loan to a shareholder-employee will be calculated in the same way as for any other employee loan account.

Taxation Treatment

Where a shareholder-employee's current account has a debit balance a potential liability for FBT arises. Subject to the treatment outlined in subsequent paragraphs below, in this case a company has the following alternatives:

(a) charge a non-concessional interest rate on a daily basis on the current account debit balance. The interest is to be charged at the end of each quarter, i.e., 30 June, 30 September, 31 December and 31 March, and the amount charged is to be debited to the shareholder-employee's current account on the first day of the next quarter; or

(b) pay FBT quarterly in respect of any concessional interest calculated on a daily basis on the current account debit balance. If no interest is charged, or interest is charged at a rate below the prescribed rate for the quarter, the debit balance represents a low interest loan made to the shareholder employee.

In recognition of the practical difficulties faced by companies and to minimise compliance costs in maintaining current accounts on a daily basis a further amendment to the FBT provisions of the Income Tax Act has been made in the Income Tax Amendment Act (No 2) 1989 enacted on 26 July 1989. The main effect of the amendment to section 336O of the principal Act is that companies will, in general, not need to maintain a daily record of current accounts on an ongoing basis.

Section 33 of the Amendment Act (No. 2) amends section 336O to ensure that where salary or wages or other provisional income of the shareholder-employee is determined after the end of an income year the amount of the salary or wages is deemed to have been credited to the current account of the shareholder-employee on the later of either:

- *the first day of that income year, or*
- *the day the balance of the current account first went into debit during that income year.*

Therefore where the amount of salary or wages credited to the current account after the end of the income year exceeds the amount of any debit balance in that account during that income year there will be no FBT liability provided the salary or wages is taxed in the hands of the shareholder-employee as income derived in that income year.

Example

Assume a company with a 31 March 1990 balance date votes a salary of $50,000 to a shareholder-employee on 30 June 1990.

The salary will be deemed to have been credited to the current account of the shareholder-employee on the later of:

(i) the first day of the income year (i.e. 1 April 1989), or
(ii) the day the balance of the current account first went into debit during the year ended 31 March 1990.

In the case of a late balance date company the salary voted is included in the assessable income of the shareholder-employee in the income year to which the accounting year relates. A salary declared in August 1989 in respect of the year ended 30 June 1989 will be deemed to be credited on 1 July 1988 only if the salary is included in the shareholder-employee's 1989 return.

However, where the amount of salary or wages so credited is insufficient to offset the amount of any debit balance arising during the year the amount of the debit balance will be regarded as a low-interest loan unless interest has been charged to the shareholder-employee at the rate prescribed for any quarter during which the current account is in debit. The amount of interest charged for any quarter will be regarded as having been debited to the current account on the first day of the following quarter.

Interest will be required to be charged by the company on the amount of the debit balance calculated on a daily basis during the period the current account

is overdrawn. It is expected that the amount of interest to be charged will be determined at year end when it is established that a current account has a debit balance during the year. Any interest charged to the shareholder-employee will be regarded as assessable income of the company.

Interest is not charged in respect of a debit balance in a current account for any quarter the company will be required to pay FBT on the benefit that arises by way of concessional interest. The company will be required to furnish an FBT return or an amended FBT return, as appropriate, in respect of each quarter affected and additional tax will be charged on any FBT liability unpaid by the due date in respect of the quarter (i.e. 20th of the following month). No additional time will be granted for payment of FBT beyond the original due date.

Example 1

Allocation of Salary

7 July 1989 $30,000

Current Account Entries

1989	Debits	Credits	Balance	Interest
Salary O/s				
01 April		Opening Bal.	20,000	0.00
30 April	2,000		18,000	0.00
31 May	2,000		16,000	0.00
15 June	1,000		15,000	0.00
30 June	4,500		10,500	0.00
07 Jul	2,500	30,000	38,000	0.00
31 Jul	9,000		29,000	0.00
30 Sep	7,000		22,000	0.00
31 Oct	3,000		19,000	0.00
31 Dec	8,500		10,500	0.00
1990				
10 Jan	2,000		8,500	0.00
10 Feb	2,000		6,500	0.00
01 Mar	3,500		3,000	0.00
31 Mar	2,000		1,000	0.00
	49,000	30,000		

In this example there would be FBT liability for FBT as there is no debit balance in the current account at any stage during the income year.

Example 2

The following is an example of a shareholder-employee's current account for the year ended 31 March 1990 where the current account goes into debit during the year

Allocation of Salary

7 July 1990 $20,000
3 July 1991 $18,000

Shareholders' contributions

10 August 1989 $3,000
11 November 1989 $6,000

Interest charged at 15%

Current Account Entries

1989	Debits	Credits		Balance	Days O/s	Interest	
		Salary	S/holder contrb'n				
01 April						0.00	
30 April	2,000.00	20,000		18,000.00		0.00	
31 May	2,000.00			16,000.00		0.00	
15 June	1,000.00			15,000.00		0.00	
30 June	4,500.00			10,500.00		0.00	
01 Jul				10,500.00		0.00	0.00
07 Jul	2,500.00			8,000.00		0.00	
31 Jul	9,000.00			- 1,000.00		0.00	
10 Aug			3,000	2,000.00	10	0.00	
10 Sep	4,000.00			- 2,000.00		0.00	
30 Sep				- 2,000.00	20	16.44	20.55
01 Oct	20.55			- 2,020.55		0.00	
31 Oct	2,000.00			- 4,020.55	31	25.74	
11 Nov			6,000	1,979.45	11	18.18	
15 Dec	2,500.00			- 520.55		0.00	
31 Dec				- 520.55	16	3.42	47.34
1990							
01 Jan	47.34			- 567.89		0.00	
10 Jan	2,000.00			- 2,567.89	10	2.33	
10 Feb	2,000.00			- 4,567.89	31	32.71	
07 Mar	2,000.00			- 6,567.89	25	46.93	
31 Mar				- 6,567.89	24	64.77	146.74
	35,567.89	20,000	9,000				
01 Apr	146.74	18,000		11,285.37		0.00	

This example illustrates the potential liability for FBT In where the total amount of debits arising to the current account in the year (assuming a nil opening balance) exceeds the amount of salary voted after the end of the year

Total amount of debits	($35,567.89)
Shareholder contributions	$ 9,000.00
Salary voted at year end	$20,000.00
	($ 6,567.89)

In such a situation a record of the current account balance on a daily basis will be required to determine the interest chargeable or the FBT payable.

NOTE: Where the current account goes into debit in any quarter interest is calculated and charged on the first day of the following quarter. Any provisional income received by a shareholder-employee in respect of an income year is treated as having been received on the later of -

- 1 April in that income year, or
- the day the current account first went into debit.

In the above example interest has been charged at a non-concessionary rate in respect of the current account debit balances so there is no FBT liability. If no interest was charged or if interest was charged at a concessionary rate then FBT would be payable.

In relation to the above example, where no interest is charged FBT would be payable as follows:

June 1989 quarter	Nil
September 1989 quarter	9% of 20.55 = 10.06
December 1989 quarter	49% of 47.34 = 23.19
March 1989 quarter	49% of 146.74 = 71.90

E. MOTOR VEHICLES

Fringe Benefit

A fringe benefit arises in respect of a benefit provided to employees (including shareholder-employees) in the form of the private use or enjoyment of a motor vehicle or the availability of a motor vehicle for private use or enjoyment.

In relation to a motor vehicle, private use or enjoyment includes travel by a person in the motor vehicle in the course of proceeding to or from home and also includes any other travel by a person in the motor vehicle where that travel confers on the person a benefit of a private or domestic nature. Days on which a motor vehicle is used for emergency calls or on certain extended periods of absence are not

counted as days during which the vehicle is available for private use.

Taxable Value

Fringe benefit tax is payable on the taxable value of the benefit that arises from the private use or enjoyment of a motor vehicle.

The taxable value is calculated having regard to the Tenth Schedule to the Income Tax Act. The Tenth Schedule outlines how a benefit in the form of a motor vehicle is to be valued for the purposes of fringe benefit tax. In general, where a motor vehicle is owned by the company the value of the benefit, in relation to any quarter, is 6 per cent of the cost price of the vehicle to the company. For FBT purposes the Department regards the cost price as being inclusive of GST.

The Tenth Schedule also provides for the value of a benefit in the form of a motor vehicle to be determined in the following circumstances:

- lease or rental of a motor vehicle, in which case market value applies,
- where the motor vehicle forms part of a pool of vehicles.

When the cost price or market value is established, the value of the fringe benefit for the quarter is calculated in accordance with the following formula:

$$\frac{\text{No. of days vehicle conferred as fringe benefit}}{90} \times 6\% \text{ of cost price}$$

The resulting value is then reduced by the amount of any contributions made by the employee or shareholder-employee in relation to the quarter towards the private use of the motor vehicle.

As explained in Part C of this commentary there is now no requirement to make a private use adjustment in respect of expenditure that constitutes a benefit for FBT purposes. However, a company is still permitted to make a private use adjustment (e.g. by way of a quarterly or year end debit to the shareholder-employee's current account) should it choose to do so. This would be regarded as a contribution made by the shareholder-employee towards the private use of the vehicle (refer previous paragraph). Where a private use adjustment is made a **log book or similar** record of the amount of private use may be useful in determining the amount of the adjustment. There is no deduction allowable to the company in respect of the amount of any private use adjustment.

For the purposes of the above calculation, where a motor vehicle is used by or made available to a shareholder-employee who has a controlling interest the company it is generally to be treated as being used or made available for the full 90 days (however, refer next paragraph). In other words in a private company situation it is expected that there would normally be no restriction on such a shareholder-employee's private use of the vehicle.

However, the Department will consider on a case by case basis situations where there may be genuine restrictions on the availability of a vehicle for private use. Where it is clear that there are genuine restrictions in relation to the availability of a vehicle for private use on any particular day, the vehicle will no be regarded as being available for private use on such day or days.

Motor Vehicle Owned by Shareholder-Employee

Where a motor vehicle is owned by a shareholder-employee and used for the purposes of the company's business it is unlikely that there will be any fringe benefit tax liability. There may, however, be income tax and GST implications. A fringe benefit tax liability may arise where a vehicle is being leased or rented to the company by the shareholder-employee and is available for the private use or enjoyment of the shareholder-employee.

Income derived by a shareholder-employee by way of salary or wages is regarded as income from employment for the purposes of section 105 of the Act. From the income year commencing 1 April 1989 there is now no deduction allowable under subsection (2) of that section for any expenditure to the extent it is incurred in gaining or producing income from employment. Therefore a shareholder-employee is not allowed a deduction for expenditure incurred in relation to a motor vehicle used tor business purposes.

Where a company is making payments to a shareholder-employee in respect of a motor vehicle the question of whether the payments are:

- a reimbursement of expenditure, or
- lease or rental payments

is relevant in determining whether the company has to pay FBT on the private use of the vehicle. This would depend on the nature of the arrangement.

Reimbursement

Reimbursement by the company of motor vehicle expenditure incurred by the shareholder-employee for business purposes is treated the same as reimbursement of any other expenditure under section

73(2) of the Act. To the extent that any allowance relating to employment or service constitutes reimbursement of expenditure incurred in gaining or producing assessable income it is exempt from income tax in the hands of the employee.

The amount of a reimbursement of expenditure is exempt from tax where

- the reimbursement is based on public service mileage rates and the identified annual business running does not exceed 2,000 km,
- the reimbursement is based on the amount of actual expenditure attributable to business mileage in cases where the identified annual business running exceeds 2,000 km. For this purpose depreciation cannot be taken into account in determining the amount of actual expenditure.

Where the annual business running exceeds 2,000 km, reimbursement on the basis of public service mileage rates on the first 2,000 km and on the basis of actual expenditure incurred in respect of the business running in excess of 2000 km is **not** acceptable for the purposes of the exemption.

To the extent that the amount of the reimbursement exceeds either of the above bases, as appropriate, the amount of the excess is treated as assessable income in the hands of the shareholder-employee. A **log book** or similar verifiable record may be necessary to identify the amount of annual business running.

There is no exemption for reimbursement of any capital expenditure relating to the motor vehicle.

Lease or Rental to Company by Shareholder-Employee

As mentioned above the nature of the arrangement is pertinent in determining whether a payment is a reimbursement of expenditure or a payment in respect of lease or rental.

In order to be regarded as a payment for lease or rental of the motor vehicle the payment would have to be made under a lease or rental agreement. In such a case the company would be regarded as having control over the use of the vehicle and, to the extent that the vehicle is privately used or made available for private use, a liability for FBT would arise.

Where the terms of the lease provide that the vehicle is being leased to the company solely for the purposes of the company's business use and not in relation to the use (or available for use) by any employee for private purposes no exposure to FBT will arise. However, there may be circumstances where the arrangement is not a genuine lease arrangement. To be acceptable the lease would have to be a bona fide lease based on commercial terms with rental being charged at market rates and not merely a reimbursing arrangement. The rental would be assessable income of the employee who would be able to claim appropriate deductions. Any depreciation recovered or loss incurred on the sale of the vehicle would be taken into account in determining the employee's assessable income.

Any person entering into a lease arrangement should consider the implications of the specified lease provisions in section 222A - 222E of the principle Act.

Motor Vehicle Owned Jointly by Company and Shareholder-Employee

Where a motor vehicle is owned in part by the shareholder-employee as well as by the company, the taxable value of the fringe benefit is reduced by 2.5% of the cost price of the vehicle to the employee (i.e. shareholder-employee's share of the cost price. Therefore, in addition to deducting contributions by the employee in calculating the value of the fringe benefit for a quarter, the company may deduct a further amount equal to 2.5% of the portion of the cost price of the vehicle that was borne by the shareholder-employee.

There is no scope for treating the employee's contribution as a loan to the company. The company would not be allowed depreciation on the full cost price of the vehicle where it is reducing the taxable value of the fringe benefit to take into account the shareholder-employee's share of the cost price.

GST Implications

Sale of Motor Vehicle to Shareholder-Employee

Where a company sells a motor vehicle to a shareholder-employee who supplies the vehicle to the company for business running the question arises of whether the shareholder-employee can register for GST purposes. This primarily involves two issues:

- Whether the shareholder-employee is employed (see 1 below),
- Under a contract of service (see 1 below), or
- Under a contract for service, (see 1 below).

- Whether a shareholder-employee can register in respect of an activity of leasing a motor vehicle to the company (see 2 below).

(1) <u>How shareholder-employee is employed</u>

Whether a shareholder-employee is employed under a contract of service or a contract for service depends on the circumstances of each case. Generally a

shareholder-employee would be employed under a contract of service and is therefore not carrying on a taxable activity.

(a) Contract of service

Where a shareholder-employee is required as a condition of the contract of service (employment) to provide a motor vehicle and is reimbursed by the company for the business proportion of running costs, the supply of the motor vehicle is an extension of the contract of employment In such a case, as the shareholder-employee is not carrying on a taxable activity, that person cannot register for GST purposes. This is the same treatment which is afforded to other arm's length employees.

Where a company is reimbursing an employee for the business running costs of a motor vehicle, the question of whether the company may claim input tax credits in respect of those running costs is currently under consideration by the Department and will be the subject of a subsequent information bulletin.

(b) Contract for service

If the shareholder-employee is employed under a contract for service that person may register for GST in the same manner as any other sole trader and claim input tax credits. A supply of a motor vehicle, as a condition of the contract for services, to the company is an extension of that taxable activity.

(2) Activity of leasing a motor vehicle

A shareholder-employee who is employed under a contract of service may register for GST in respect of an activity of leasing a motor vehicle to the company providing the leasing arrangement does not constitute an avoidance arrangement and the taxable activity test is met.

The shareholder-employee would be able to claim an input tax credit in respect of the purchase of the motor vehicle. The shareholder-employee's ability to claim input tax credits in respect of running costs and maintenance of the vehicle will depend on the terms of the lease. Most commercial leases provide for the lessee (company) to meet such costs.

As mentioned earlier in Part E of this commentary, it should be noted that an FBT liability may arise in a rental or lease situation as the shareholder-employee has a motor vehicle that "is available for private use".