

12-1-2008

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### Recommended Citation

Tretola, John (2008) "A Loan by Any Other Name Would Smell So Sweet," *Revenue Law Journal*: Vol. 18 : Iss. 1 , Article 3.  
Available at: <http://epublications.bond.edu.au/rlj/vol18/iss1/3>

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## A Loan by Any Other Name Would Smell So Sweet

### **Abstract**

Determining whether a loan from the company to a shareholder/employee is received in his or her capacity as an employee or as a shareholder is important. The capacity of the recipient alters the taxation treatment of the loan. A loan to an employee on favourable terms attracts fringe benefits tax (FBT). A loan to a shareholder may be taxed under Division 7A of the Income Tax Assessment Act 1936.

### **Keywords**

loans from company to shareholder/employee, FBT, Div 7A of ITAA

## A LOAN BY ANY OTHER NAME WOULD SMELL SO SWEET

‘That which we call a rose by any other name would smell so sweet’

Shakespeare’s *Romeo and Juliet*, Act II, Scene ii.

JOHN TRETOLA\*

Determining whether a loan from the company to a shareholder/employee is received in his or her capacity as an employee or as a shareholder is important. The capacity of the recipient alters the taxation treatment of the loan. A loan to an employee on favourable terms attracts fringe benefits tax (FBT). A loan to a shareholder may be taxed under Division 7A of the *Income Tax Assessment Act 1936*.

### INTRODUCTION

When a taxpayer is both a shareholder and an employee of a corporation, and the taxpayer obtains a loan from that corporation, how do we determine whether it has been provided to the taxpayer in their capacity as an employee or as a shareholder?

This question is an important one, as the answer will alter the taxation treatment of the loan. A loan to an employee on favourable terms will be subject to fringe benefits tax (FBT). A loan to a shareholder may be subject to taxation under Division 7A of the *Income Tax Assessment Act 1936* (ITAA).

Two decisions of the Federal Court bear on this question: *Commissioner of Taxation v Slade Bloodstock Pty Ltd* [2007] 65 ATR 832 (*Slade*) and *J & G Knowles v Commissioner of Taxation* [2000] 44 ATR 22 (*Knowles*). *Knowles* has long been a leading authority on the test to be applied when determining whether a benefit is ‘in respect of’ employment – a requirement for FBT to apply to the benefit. The recent matter of *Slade* involved apparently similar facts to *Knowles*, but Heerey J, sitting as a single judge on appeal from the AAT, arrived at different conclusion.

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## LOANS TO EMPLOYEES

The Full Court's decision in *Slade* has, by overturning the trial judge's decision, returned an important measure of certainty that was threatened by that decision. However the lack of discussion by the Full Court of the trial judge's reasoning (no doubt a case of judicial economy) has left the uncertainty wrought by the apparent inconsistency between *Knowles* and the single judge decision in *Slade* unresolved. An understanding of these decisions is also important in any assessment of whether a benefit is being provided 'in respect of' employment.

Part I of this paper will discuss the background, rationale for and application of FBT. Part II will examine *Knowles* and *Slade*.

### THE RATIONALE FOR A FRINGE BENEFITS TAX

Fringe benefits tax was introduced to apply from 1 April 1986 as part of a raft of tax reform changes proposed in the Commonwealth Government's White Paper, *Reform of the Australian Taxation System*, published 19 September 1985.

In the words of the then Treasurer Paul Keating<sup>1</sup> a goal of these proposed tax reform measures was to improve the fairness of the Australian taxation system. Without a fringe benefits tax, many Australians were able to escape their fair share of tax. They were able to do this by receiving employment benefits in a non-cash form which was difficult to tax. Taxpayers who were not able to do this therefore bore a higher incidence of taxation.

Prior to the introduction of FBT the Australian Tax Office (ATO) had tried to tax non-monetary benefits provided in respect of employment under s26 (e) of *Income Tax Assessment Act 1936* (ITAA36). Section 26(e) included in 'statutory income' the value to the taxpayer of:

all allowances, gratuities, compensations, benefits...given or granted...in respect of, or for or in relation directly or indirectly to, any employment of or services rendered...

The ATO's efforts were thwarted as courts were reluctant to interpret this provision so broadly as to tax all non-cash employment related benefits, but consistently read down the words 'all benefits related to employment'<sup>2</sup>.

FBT is a separate tax from income tax and is administered under its own Act, the *Fringe Benefits Tax Assessment Act 1986* (FBTAA). Section 23L of *Income Tax Assessment Act 1936* (ITAA36) specifically exempts the value of any fringe benefits from liability

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<sup>1</sup> Second Reading speech of the *Fringe Benefits Tax Assessment Bill 1986*, 2 May 1986, Hansard, House of Representatives at 3018.

<sup>2</sup> See, e.g. *Smith v FC of T* 87 ATC 4883; *Scott v FCT* (1966) 117 CLR 514 and *FCT v Holmes* (1995) 31 ATR 71.

to income tax. Fringe benefits are also now clearly outside the ambit of s26(e) of ITAA36.

The Explanatory Memorandum to the FBT Bill noted above states<sup>3</sup> that FBT is intended to apply to the value of benefits specified that are provided to an employee or an employee's associates (typically, the employee's spouse or children) by an employer in respect of the employee's employment activities. In all cases it is the employer who is liable for the tax.

#### **THE REQUIREMENTS FOR FBT TO APPLY**

There are 5 essential elements needed for there to be a fringe benefit:

1. There must be a benefit;
2. Provided at some point during the year;
3. Given to an employee or an associate of an employee;
4. Given by an employer (or another party on behalf of the employer);
5. In relation to the employment of the employee.<sup>4</sup>

The term 'benefit' is widely defined in s136(1) of FBTA to include any right, privilege, service or facility. Non-cash business benefits are not fringe benefits but are taxed under s21A of ITAA36. Salary and wages and allowances are also not fringe benefits and so are taxable to the employee (as a reward for the services they have provided).

For FBT purposes, employees are not limited to current employees and can include former employees and future employees. The term 'associate' is defined to take the same meaning as that term has in s318 of ITAA36 and so includes a spouse (whether legally married or not) or other relative, including the spouse or child of a relative.

The taxable value of a loan fringe benefit is the amount by which the notional interest calculated on the loan for the year of tax exceeds the amount of interest that has actually accrued on the loan during the year, s18 FBTA.

Notional interest is calculated by reference to the 'benchmark interest rate', which for the FBT year ending 31 March 2007 was 7.30%.

The fifth element, that a fringe benefit must be given 'in respect of the employment' of the employee, formed the crux of the disputes in *Knowles* and *Slade*.

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<sup>3</sup> At page 4 under the heading of general application of fringe benefits tax.

<sup>4</sup> Section 136(1) FBTA.

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### **PART II – KNOWLES AND SLADE**

#### **KNOWLES<sup>5</sup>**

The decision in this case was handed down on 3 March 2000 by the Full Court of the Federal Court (Heerey, Merkel and Finkelstein JJ).

The case involved four individual directors of the company, J & G Knowles & Associates Pty Ltd, a private company and trustee of the Knowles Investment Unit Trust. Each director established a discretionary trust in which he and his family were beneficiaries and each of these family discretionary trusts held 25% of the units in the Unit Trust.

For the relevant period each director was paid a salary and each director also drew on the company's bank account to meet ongoing living expenses for themselves and their respective families. There was held on the facts to be no relationship between the amount paid to any director and the personal efforts of each director in working for the company.

These amounts drawn from the company's bank account were not subject to any interest payments.

The ATO audited the taxpayer company and determined that the amounts provided interest-free and drawn from the company's bank account were loans and therefore subject to FBT. The taxpayer company appealed that decision first to the Administrative Appeals Tribunal (AAT), then to the Federal Court and finally to the Full Federal Court.

#### **DECISION OF THE FULL FEDERAL COURT**

The dispute centred around the question of whether the loans were benefits 'in respect of' the directors' employment, or alternatively their indirect ownership of the company. The AAT found they were provided in respect of the directors' employment, and an appeal to a single judge of the Federal Court was dismissed. However the subsequent appeal to the Full Federal Court was successful, on the basis that the AAT had applied the 'in respect of employment' test incorrectly. The court<sup>6</sup> referred to section 148(1) FBTAA which has the effect of broadening the application of the phrase 'in respect of employment':

A reference in this Act to the provision of a benefit to a person in respect of the employment of an employee is a reference to the provision of such a benefit-

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<sup>5</sup> 44 ATR 22.

<sup>6</sup> Ibid at page 25.

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- (a) whether or not the benefit is also provided in respect of, by reason of, by virtue of, or for or in relation directly or indirectly to, any other matter or thing;
- (b) whether or not the benefit is provided as a reward for services rendered, or to be rendered, by the employee.

FBT is payable when a benefit is paid to the director or his associate and so it did not matter in this instance whether the benefit was paid direct to the director or the unit-holder of the unit trust (as each unit-holder of the trust was clearly an associate of each respective director).

The Full Court stated that the words 'in respect of' have no fixed meaning<sup>7</sup> and that they are capable of having a very wide meaning denoting a relationship or connection between two things or subject matters.

However, as with all statutory interpretation, the words should be given a meaning that depends upon the context in which the words are found.<sup>8</sup>

The Full Court accepted that the AAT applied the correct test in that the phrase 'in respect of' requires a 'nexus, some discernible and rational link, between the benefit and employment'. However, the Full Court stated that this test does not take the matter far enough as what is also required is a sufficient link for the purposes of the particular legislation.<sup>9</sup>

The Full Court continued 'it cannot be said that any causal relationship between the benefit and the employment is a sufficient link'. In this respect the court used the analogy of a discretionary trust with a corporate trustee that might be established to purchase a family home for the benefit of its directors and their family. The court noted that it would not follow that the rent free occupation of the home on the authority of the directors would be a benefit provided 'in respect of' their employment for the purposes of the FBTA. The rent free occupation would arise because the trust was established for that purpose and this would not be due to the employment of the directors.<sup>10</sup>

The Full Court readily accepted that it was difficult to state the test to determine whether the requisite relationship or connection exists, however what was necessary

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<sup>7</sup> 44 ATR 22 at page 28 at [22].

<sup>8</sup> Ibid, citing with approval *State Government Office v Rees* (1979) 144 CLR 549. For a further reference quoting Justice Hill's views see 'The interpretation of taxation legislation by the courts- a reflection on the views of Justice Graham Hill', *Revenue Law Journal* Vol 16 at page 73.

<sup>9</sup> Ibid at p28 at [23] and reference was made to *Commissioner of Taxation v Scully* [2000] 42 ATR 718 at 724 and 725.

<sup>10</sup> Ibid at p28 at [23].

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was that there be a sufficient or material connection, rather than merely a causal relationship.<sup>11</sup>

The court noted<sup>12</sup> that there is a danger in placing too much emphasis on causation and it quoted with approval the comments of Lord Hoffman in *Environment Agency v Empress Car Co Ltd*<sup>13</sup>, where his Lordship stated that the answer to the question of whether A has caused B will differ according to the purpose for which the question is asked.

Whether there is a sufficient or material connection or relationship between a benefit and employment must be judged by reference to the purpose of imposing FBT on employers<sup>14</sup> and that that purpose was as stated by the then Treasurer, Mr Keating, in the Second Reading speech<sup>15</sup> to ensure that all forms of remuneration paid to employees bear a fair measure of tax.

In interpreting this purpose the court stated<sup>16</sup> it must consider whether the benefit was a product or incident of employment. This means that just because a benefit is provided to a director will not of itself be sufficient to characterise the benefit as one which is provided 'in respect of employment'. 'Without more, it is not a product or incident of that office.'<sup>17</sup>

The court was thereby saying that questions of fact or degree will always be relevant but that it is not sufficient for the purposes of the Act merely to enquire whether there is some causal connection between the benefit and the employment.<sup>18</sup> What is required is 'some discernible and rational link'<sup>19</sup>, and the connection must be material.

The court concluded that the AAT had applied the 'in respect of employment' test incorrectly: it had simply established that there was a causal link between the loans and employment, and enquired no further. The AAT should have established whether there was a discernible and rational link between the loans and employment, and that the link was material. Had the AAT applied the correct test, it

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<sup>11</sup> Ibid at pages 29 and 30 at [26].

<sup>12</sup> Ibid at page 30 at [26].

<sup>13</sup> [1999] 2 AC 22 at 29.

<sup>14</sup> 44 ATR 22 at page 30 at [27].

<sup>15</sup> 2 May 1986, Hansard, House of Representatives at 3020.

<sup>16</sup> 44 ATR 22 at page 30 at [28].

<sup>17</sup> Ibid.

<sup>18</sup> Ibid at page 30 at [29], and quoting with approval the test as set out in *Commissioner of Taxation v Rowe* (1995) 60 FCR 99 at 114.

<sup>19</sup> As stated by Brennan, Deane and Gaudron JJ in *Technical Products Pty Ltd v State Government Insurance Office (Qld)* (1988) 167 CLR 45 at page 47.

would have been open to it to conclude that the loans were not 'in respect of' employment, but rather arose from the establishment of and the directors' interest in the trust. In that event, FBT would not have been payable in respect of the loans.

**SLADE<sup>20</sup>**

Robert and Corinna Slade (the Slades) were the sole shareholders and employees of Slade Bloodstock Pty Ltd (the taxpayer). Through a trust structure, with the company as the trustee of a unit trust, they were also the effective beneficiaries of a racehorse syndication business carried on by the taxpayer.

The Slades made loans to the taxpayer and the taxpayer made loans back to the Slades, either by way of reimbursement of expenditure or direct payments of their personal expenses. These loans were made on commercial terms and the Slades received no other remuneration from the taxpayer.

For each of the years in question (years ended 30 June 2000 to 2002), the Slades had credit balances with the company but for the year ended 30 June 2003, they had a debit balance with the company.

Following an audit the Commissioner assessed that the loans made by the taxpayer to the Slades were loan fringe benefits and so subject to FBT for the FBT year ended 31 March 2003. In addition, a 50 per cent tax shortfall penalty was applied. The Slades applied to the AAT for review.

**BEFORE THE AAT**

On review the AAT found that the loan payments constituted a 'benefit' and that the Slades were employees of the taxpayer company. However, the AAT held that the repayments were not 'in respect of the employment' of the Slades but rather were related to the ultimate beneficial ownership held in units of the unit trust and so were not subject to FBT.

In finding that the loans were not in connection with the employment of the Slades, the AAT stated:

Whilst there is a superficial attraction in concluding that the payments were necessarily an incident of employment...the tribunal does not accept that was in fact the case. The payments were at all times regarded by...the applicant, as nothing more than a loan repayment. They would have been entitled to such repayments regardless of the existence of the employment relationship...the benefits were not connected to with the employment...but rather they were related to the ultimate beneficial ownership held in the units of the unit trust.

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<sup>20</sup> 65 ATR 832.

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There was no material relationship between the employment...and the provision of the benefits.<sup>21</sup>

Clearly the AAT decision echoes the approach taken by the Full Federal Court in *Knowles*.

### DECISION OF THE FEDERAL COURT (SINGLE JUDGE)

On appeal the Federal Court (Heerey J) set aside the AAT's decision and held that the loans provided to the Slades were loan fringe benefits and subject to FBT.

There was no dispute that the Mr and Mrs Slade were employees of the taxpayer and that the loans they received constituted a benefit. The only issue at stake was whether the loan repayments were in 'respect of' the employment of the Slades.

The Federal Court again sought to define the phrase 'in respect of' and found it to mean<sup>22</sup> 'in relation to the employment of an employee by reason of, by virtue of, or for or in relation directly or indirectly to that employment.'<sup>23</sup>

Although Heerey J accepted the reasoning of the AAT that the payments here had a connection with the Slades in their capacity as ultimate beneficial owners of the business via the trust structures and company, he criticised the AAT for not taking the further step required by section 148(1)(a).<sup>24</sup> That is, it is not a conclusive answer to the question whether a benefit was 'in respect of the employment' to say that it was in respect of something else. On the facts of the case, Heerey J found that the repayments were also by reason (directly or indirectly) of the employment of the Slades.<sup>25</sup>

In reaching his conclusion, it seems that Heerey J was persuaded by the fact that the Slades did not receive any other form of remuneration from the taxpayer and that there were no other employees and that the business could not have operated without their work as employees.<sup>26</sup> His Honour also took into account the fact that the Slades had earlier entered into a loan agreement with the taxpayer<sup>27</sup> and so had contemplated that one of the reasons that they were to get repayments of their loans was to discharge their own personal obligations.

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<sup>21</sup> 64 ATR 1058 at [49].

<sup>22</sup> 65 ATR 832 at 835.

<sup>23</sup> Citing from section 148(1) of the FBTAA.

<sup>24</sup> 65 ATR 832 at page 836 at [17].

<sup>25</sup> *Ibid.*

<sup>26</sup> *Ibid.*

<sup>27</sup> *Ibid* at page 836 at [18].

But was the payment truly 'remuneration' to the Slades? The FBTAA does not contain a definition of the term 'remuneration', although section 137 does define 'salary and wages'. Nor is there any definition of the term in the *Income Tax Assessment Acts* 1936 or 1997. The High Court considered the meaning of the word remuneration in *Chambers v the Commonwealth*<sup>28</sup>; Williams J stated<sup>29</sup> that 'the ordinary meaning of remuneration is pay for services rendered.'

While Heerey J considered it relevant that the Slades received no other form of remuneration from the taxpayer company and that the company could not have operated without their services, it is submitted that a shareholder who is also an employee of a company is entitled to choose between drawing down on capital from funds contributed to the company and the payment of a wage or salary. It is submitted that in treating the draw down of capital contributed to the company by the Slades as remuneration, even where their respective loan accounts remained in credit, is a quasi application of the 'profits first' principle.<sup>30</sup>

Of greater concern is that this decision raised the possibility of an extension of the application of the FBT rules (for loan fringe benefits at least) beyond simple loan repayments to possibly capital repayments and hence also, arguably, to even possibly share buybacks and capital reductions.

This is not consistent with the original intention of FBT which was to ensure all forms of remuneration paid to employees bore a fair measure of tax. It would be absurd to think of a share buy-back or capital reduction or even capital repayment as a form of remuneration to an employee<sup>31</sup>, although this could have been the logical outcome to the application of the approach adopted in the *Slade* case, had it not been appealed.

Heerey J in *Slade* did recognise that employees in a large public company would be treated differently than employees such as those in the *Slade* case as any such repayment of capital in that public company scenario would have nothing to do with the employment. However by raising this limit to the applicability of FBT, it is questionable where the limit between the applicability of the FBT rules and their non-applicability should be drawn.

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<sup>28</sup> [1946] 73 CLR 19.

<sup>29</sup> Ibid at page 37.

<sup>30</sup> A point also made by Gordon Cooper in his article, 'How Alice was slade', *Taxation Institute of Australia*, Volume 42/1 July 2007 at page 20. The profits first principle was a feature of the now shelved entity taxation proposal that was to apply to trusts.

<sup>31</sup> Ibid at page 21.

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### THE SLADE CASE – FULL COURT DECISION<sup>32</sup>

An appeal was lodged against the single judge decision of Heerey J.

The appeal was consented to by the Commissioner, and allowed by the Full Court. Essentially, because the Slade's accounts with the taxpayer were in credit a payment from the taxpayer to the Slades was more accurately characterised as repayment of a loan, not a new loan. The Full Court considered that the repayment of a loan owed by an employer to an employee is not a benefit that is 'provided in respect of employment'. A loan repayment is the product of a creditor/debtor relationship, and the entitlement to repayment derives not from the position as an employee but from the position as creditor.<sup>33</sup>

Furthermore, the Full Court doubted whether the repayment of the funds held in credit against the shareholder's loan account was even a 'benefit' (as opposed to a discharge in whole or in part of a pre-existing right).<sup>34</sup>

The Full Court concluded that this outcome was the only conclusion consistent with the purpose and policy underlying the fringe benefits tax legislation since fringe benefits tax was only ever intended to tax the provision of benefits where, if the benefits had been provided in cash, there would have been a derivation of income.<sup>35</sup> Apart from correcting this error, the Full Court did not comment further on Heerey J's reasoning.

### COMPARING THE DECISIONS OF KNOWLES AND SLADE (SINGLE JUDGE DECISION)

Both *Knowles* and *Slade* were concerned with loan fringe benefits. Both decisions concurred that draw downs and expenses paid from a company's capital account were loans provided and that the loans were provided to employees for the purposes of the FBTAA. The *Slade* decision can, however, be criticised in this respect as the benefits being provided were more often reimbursements of actual expenses (drawn against a shareholder's credit loan account).

Both cases also considered that the loan amounts received were 'benefits' as that term is defined in section 136(1) of the FBTAA (defined very broadly to include any right, privilege, service or facility).

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<sup>32</sup> *Slade Bloodstock v Commissioner of Taxation* [2007] FCAFC 173 (23 November 2007).

<sup>33</sup> *Ibid* at paragraph 4.

<sup>34</sup> *Ibid*.

<sup>35</sup> *Ibid* at paragraph 10.

In both cases, the key issue to be determined was whether the loan benefits received were 'in respect of' the employment of any employee as required and defined under section 148(1) of the FBTA. This required the determination of whether the benefit was received by virtue of, or for or in relation directly or indirectly to, any other matter or thing: s148(1)(a).

The court (in both cases) resolved this issue by determining whether there was 'some discernible and rational link'<sup>36</sup> between employment and the benefit received, and whether this connection was material. This is clearly the test to be applied. Questions of fact or degree will always be relevant but that it is not sufficient for the purposes of the FBTA merely to enquire whether there is some causal connection between the benefit and the employment.<sup>37</sup>

This test echoes the test used by courts in determining whether section 26(e) of ITAA36 applied to a benefit received in relation to the employment of the taxpayer. In this regard,

in *Smith v FCT*<sup>38</sup>, Wilson J (with whom the majority agreed) made it clear that it was not sufficient to find that the taxpayer received the benefit at a time when the employment relationship was existing as a mere temporal connection is not sufficient.<sup>39</sup>

In terms of s26(e) the court was looking at whether or not the benefit was given or granted as a consequence of the employment of the taxpayer and that requires determining whether or not there was some connection between the payment/benefit and the employment services rendered. Identifying the nature and degree of this connection was the critical issue that needed to be resolved.<sup>40</sup> The court also considered a helpful question to ask, in this regard, was whether or not the benefit was a product or incident of employment.<sup>41</sup>

Although both *Slade* and *Knowles* applied the same tests, the outcome in both cases was very different. This can be explained by differences in the relevant facts in dispute and therefore as a matter of fact and degree. One key difference in the facts

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<sup>36</sup> As stated by Brennan, Deane and Gaudron JJ in *Technical Products Pty Ltd v State Government Insurance Office (Qld)* (1988) 167 CLR 45 at page 47.

<sup>37</sup> *Ibid* at page 30 at [29], and quoting with approval the test as set out in *Commissioner of Taxation v Rowe* (1995) 60 FCR 99 at 114.

<sup>38</sup> 87 ATC 4883 at 4886.

<sup>39</sup> *Ibid* per Brennan J at 4,887.

<sup>40</sup> *Ibid* per Brennan J at 4,888.

<sup>41</sup> See also Dixon CJ and Williams J in *FCT v Dixon* (1952) 86 CLR 540 at 554 and Fullagar J in *Hayes v FCT* (1956) 96 CLR 47 at 57 and also Windeyer J in *Scott v FCT* (1966) 117 CLR 514 at 525-26.

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included the extent to which the employees/owners were being remunerated in ways other than the 'loans'. However the facts of the cases were similar in all other material respects. Both cases involved amounts provided to the owners of the relevant entities, who, as it is often the case in small private companies, were their only employees. The facts in *Slade* appear to point to the benefits being provided as being more akin to expense payment fringe benefits<sup>42</sup> (rather than loan fringe benefits), which makes the conclusion that there were in fact fringe benefits even less plausible (since the reimbursements were being made from the shareholder's own funds as the payments were coming out of a credit shareholder loan account).

It is submitted that given their similarities, both cases should have had the same outcome. That they did not only generates uncertainty in relation to future disputes of this nature.

### **THE COMMISSIONER'S VIEW ON BENEFITS PROVIDED TO SHAREHOLDERS/EMPLOYEES-MT2019**

Any discussion of this topic would be incomplete without reference to Miscellaneous Tax Ruling 2019 (MT2019). It states the Commissioner's view that a benefit provided to a person by reason of both his or her employment activity and shareholding will be taken to be provided in respect of the person's employment, unless the benefit is provided to a shareholder/employee *solely* by reason of that person's position as a shareholder of the company and not to any extent by reason of that person's employment by the company in which case the benefit will not be subject to FBT.

In this regard the Commissioner's view is stricter than the court's formulation in *Knowles*. For the Commissioner, as long as employment is a contributing cause of the benefit (no matter how slight) the test is satisfied and the benefit subject to FBT (all other requirements being satisfied). *Knowles* on the other hand establishes that it is not enough for there to be a mere connection: the connection between the benefit and employment must be discernible, rational and material.

The Commissioner draws an analogy with the income tax law treatment by noting that employment-related expenses are generally deductible to the company even where the recipient is also a shareholder. The Commissioner then notes that if the expense is not employment-related and instead represents a distribution of income to a shareholder, then the expense would not be deductible (but payment of the expense may trigger Division 7A consequences).

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<sup>42</sup> As defined in section 20 of the FBTAA (payments to discharge obligations of an employee or reimbursements to the employee for expenditure incurred by the employee).

The Commissioner notes that where the benefits provided to shareholder/employees of private companies are not expressly linked to the carrying out of the employee's duties it would be necessary to examine all the facts and circumstances of the case to establish whether the benefit is fairly regarded as having been granted to the shareholder/employee in their capacity as a shareholder or employee.

Finally, it is relevant that in MT2019 the Commissioner accepts that the return of capital (the example refers to a widow who receives an interest-free loan after the death of her husband and the cessation of trading of the company) to a shareholder would not be subject to FBT.

## CONCLUSION

The Full Court decision in *Slade* has clarified the issue that a return of capital to a shareholder (such as a drawing on a credit loan account) does not constitute the receipt of a loan, and more importantly does not constitute a benefit 'in respect of employment' – and hence is not subject to FBT.<sup>43</sup>

However, given the Full Court did not otherwise comment on Heerey J's reasoning, it is submitted that uncertainty remains over the outcome the application of the test in factual circumstances like *Slade* and *Knowles*. This uncertainty can only be resolved by judicial clarification.

Although both *Slade* and *Knowles* applied the same tests to determine whether amounts provided by the employer company to the taxpayer employees were loan fringe benefits, the outcome in both cases was very different. This could be attributed to the differences in the relevant facts. It is submitted that the relevant facts were not so different in the two cases to have warranted different outcomes.

*Knowles* and *Slade* set out how to apply the criteria that a benefit be 'in respect of employment' in s136 FBTAA, and affirmed that it requires a broad inquiry. It is not enough to answer, when asking whether a benefit was provided 'in respect of employment', that the benefit was provided 'in respect of' something else: s148(1) makes that answer insufficient. The relationship between the benefit and employment must be discernible, rational and material. Nevertheless, the test formulated by the court appears to be more generous to the taxpayer than the Commissioner's view in MT2019.

*Knowles* and *Slade* show that it is difficult to assess whether FBT will apply to an employer/employee loan, when the employee is also an owner of the lender. It is easy, but ultimately unsatisfactory, to answer that the applicability of FBT depends

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<sup>43</sup> See further, Gordon S Cooper, 'How Alice was slade', in *Taxation in Australia*, Volume 42/1 July 2007 at pages 20 and 21.

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on questions of fact and degree in each case: until further clarification, a degree of uncertainty will remain in future disputes of this nature.