

# ***The supply of non-cash remuneration: Employer responses***

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## **ABSTRACT**

This paper compares and contrasts the federal Coalition government's system of taxing non-cash remuneration with its industrial relations system based on agreement making between employers and employees. It was anticipated that synergies between the two policies would be detected because of the government's assertions to having simplified both systems. Analysis of over 10,000 enterprise agreements revealed that flexible remuneration clauses are rare. However, employee level data shows that the supply of non-cash remuneration is extensive. Moreover, analysis of a survey of businesses located in Sydney found the compliance costs of processing employee remuneration had increased. While the employer respondents expressed a readiness to supply non-cash remuneration to their staff, the taxation of such arrangements was found to be a considerable impediment. The results suggest that if flexible remuneration is supplied, it is probably done informally to avoid taxation compliance costs, and this accounts for the greater incidents of employer provided fringe benefits found with the employee level data. We argue, therefore, that the conflict between the government's two policies denies employers and employees the capacity to achieve their industrial relations aspirations. Consequently, the government's claim of having simplified the industrial relations system must be questioned because of this additional form of regulation.

## ***Introduction***

Part of the process in shifting work relationships from been conceptualised by the 'status' of the parties – such as slavery, feudalism, and master-servant – to having a basis in a promissory exchange to form contractual rights and obligations – the employment relationship – is the shift from payment 'in kind' to payment in cash (Macken et al. 1997). Payment 'in kind' under the truck system was considered to have connotations with slavery and inconsistent with the concept of 'free labour' (Stevens 2001). One of the justifications for proscribing the truck system was, in Western Australia at least, that money wages would advantage small businesses (Stevens 2001, p. 94). Generally, under Australian truck legislation (e.g. *Truck Act 1900* (NSW); ss. 117-121 *Industrial Relations Act 1996* (NSW)) non-cash payments can only be made if agreed to by the respective employee. Prior to 1986, if an employee agreed to have part of their remuneration paid in non-cash form they could easily reduce the amount of income tax payable. As a result, it was estimated that in 1985 about two million Australians were in receipt of some type of non-cash remuneration, or fringe benefit (Woellner et al. 1999, p. 1487). Accordingly, the Fringe Benefits Tax (FBT) was introduced in 1986 to overcome the ability of higher income employees to avoid income tax obligations by converting some of their remuneration into non-cash 'perks' (Gumley 1996, p. 85).

## ***The Fringe Benefits Tax***

The FBT obligations were imposed on employers in order to reduce the number of 'taxpayers' in administering the system (Gumley 1996, p. 90). According to Burgess (2000), imposing the FBT obligations on employers makes its administration unequitable and complex. The method adopted by governments to reduce the FBT compliance burden on employers is to limit the type of benefit that can be converted into non-cash remuneration (Bernhardt 1999, p. 104). Thus, with the exception of superannuation, some share ownership schemes, and cars, the taxation advantages of non-cash remuneration are limited (Hart 1998). The 1999 review of business taxation recommended that FBT be imposed on employees and not employers, except in the case of entertainment and car parking benefits (Ralph 1999, pp. 42-6, 217-227).

Prior to the commencement of the 'A New Tax System' (ANTS) in 2000, the employer only had to determine their overall FBT obligation (Martin 1999). However, the changes to the FBT introduced by the ANTS (e.g. *A New Tax System (Fringe Benefits Reporting) Act 1999* (Cth)) have added to the administrative burden on employers (Beharis 2000), partly due to the uncertainty surrounding the application of the Goods and Services Tax (GST) on fringe benefits supplied to employees (see also Mann 2000) and partly due to the requirement to determine the FBT obligation payable for each employee (and include this amount on group certificates).

A particular concern for government is that non-cash remuneration can reduce an employee's reported taxable income, thus reducing their statutory obligations payable for superannuation, Medicare, and Higher Education Contribution Scheme levies and charges while at the same time bringing their income within the threshold to access government payments and rebates such as the Child Care Benefit (Lucas 1999, p. 153). The requirement of employers to report the total remuneration of employees on group certificates – cash and fringe benefits – was introduced to circumvent this problem. State governments have also amended their payroll tax legislation so that the employer's obligation is based on the total employees' remuneration and not just the cash component (Mann et al 2001, p. 223).

From a human resources perspective, flexibly tailoring individual employee remuneration has a number of advantages and disadvantages. While they can moderate the employer's risk in terms of the 'principal-agent problem', they can also be administratively burdensome to design, supervise and enforce (Kent et al. 2001, pp. 108-9). While they can improve individual performance, particularly for senior managers (Jensen & Murphy 1990), this is not a straightforward outcome (Izan et al. 1998). One of the potential issues with performance related remuneration is that the reward can too easily be regarded as entitlement (Isaac 2001), and thus be converted into an 'economic rent' (Norris 2000). Further, smaller businesses are not always able to offer the same flexible remuneration packages as larger firms (Oetomo & Swan 2002). In addition, remunerating staff with a combination of cash and non-cash fringe benefits is a considerable burden for small and medium sized businesses (Honan 1998, p. 298). For example, a study conducted by the University of New South Wales's 'ATAX' in 1997 found that about 90 percent of taxation 'compliance costs' are endured by smaller businesses (cited in Chittenden et al. 2003).

### ***FBT and industrial relations***

Just as the revenue policy of the federal government is set out in its taxation legislation, its policy towards industrial relations is set out in the *Workplace Relations Act 1996* (Cth). The principal objectives of the Act include encouraging employers and employees to agree on their own industrial arrangements at the workplace level (s. 3(b)) and in doing so choose the most appropriate form of agreement to give effect to the relationship (s. 3(c)). However, there is the potential for taxation policy – particularly with respect to non-cash remuneration – to be at odds with industrial relations policy. For instance, one potential danger with employee 'salary sacrificing' arrangements is that they may be inconsistent with an employer's obligation under industrial instruments (awards and agreements) to pay their staff at a prescribed amount (Latham 1999; Mann et al. 2001, p. 221). Indeed, Creighton and Stewart (2000, p. 235) argue 'any fringe benefit [employees] might receive would normally have to be provided on top of the wage payments required by that instrument, rather than in substitution for them, for otherwise the award or agreement would be breached'. Consequently, industrial instruments need to contain clauses explicitly allowing non-cash remuneration for employees to avoid this danger (Bernhardt 1999, p. 105). From the employer's perspective non-cash remuneration can be used to increase the levels of motivation and performance of employees. While an employer might desire to supply such fringe benefits via 'salary sacrificing' arrangements with employees the taxation implications could impede the formation of such bargains.

**TABLE 1**  
Scope of fringe benefits, by industry & sector (%)

<i>Industry / sector</i>	<i>Employees 1992</i>	<i>Agreements 1991-2003</i>
Agriculture, forestry and fishing	52.9	1.3
Mining	70.3	0.3
Manufacturing	41.5	1.2
Electricity, gas & water supply	41.2	9.0
Construction	49.2	0.9
Wholesale & retail trade	58.4	0.6
Transport & storage	55.6	2.4
Communication services	56.8	3.6
Finance, property & business services	53.3	8.0
Government administration & defence	28.6	17.8
Education, health & community services	21.8	28.4
Cultural, recreational, personal & other services	36.1	7.0
Private sector	46.4	3.5
Public sector	32.0	16.7

Source: ABS catalogue no. 6334.0 (August 1992); acirrt (2004).

Notes: (1) the acirrt data has been re-categorised to conform with the ABS's Australian Standard Industrial Classification (ASIC) 1983; (2) the 1992 employee data measures the provision by the employer of at least one of the following fringe benefits: holiday expenses, low-interest finance, goods or services, housing, household energy, telephone, transport, medical or hospital expenses, union or professional association fees, club fees, entertainment allowance, share options or rights, child care or education expenses, and personal study leave; & (3) the agreements data comes from 10,472 registered collective agreements contained in the ADAM database.

For example, the female labour force participation rate in Australia is approaching 60 percent (ABS cat. no. 6203.0) and projected to increase over the next decade (ABS cat. no. 6260.0). Therefore, the issue of work related child care arrangement takes on considerable importance. Approximately half of all child care arrangement are due to work related reasons (ABS cat. no. 6106.0.55.001). Consequently, there should be a high demand by employees for their employer to provide some form of child care facility as part of non-cash remuneration. However, the FBT consequences of such a 'fringe benefit' skew the supply of employer sponsored child care in a number of ways. Prior to 1999 the employer needed to have either exclusive occupancy rights of the facility's premises or exclusive proprietary rights, thus effectively restricting the supply of management sponsored child care places to large employers (Bernhardt 1999, p. 107). While this rule has been relaxed as a result of a Federal Court decision, for the provision of tax 'effective' child care as part of a salary package (and hence reduce the after-tax cost of child care to some employees) it appears that the main beneficiaries are employees with high incomes. Moreover, the revised FBT ruling is silent on the number of employers that can share the one centre and thus puts in doubt the utility – for both employers and employees – of 'salary scarified' child care places. Furthermore, child care is only GST 'free' if the facility receives government funding or if the child care provider is a registered carer for the purposes of the Child Care Benefit (IBISWorld Pty Ltd 2003). In short, even with the increasing demand for child care places from working parents, employer initiatives on this front, in Wooden's words (2002, p. 177), 'remain highly under developed' to the extent that only three percent of Australian firms offer a child care facility at or near the workplace, while 17 percent of United States business supply such a 'benefit' (Russell & Bourke 1999, p. 238). Arguably, the government's taxation regime accounts for employer inertia in this context.

### *The supply of non-cash remuneration*

According to the Australian Bureau of Statistics, non-cash benefits constitute the remuneration packages for about 12 percent of Australian workers, and one third of managerial employees (ABS cat. no. 6106.0.55.001). Nevertheless, there appears to be a discrepancy between the number of employees who report being in receipt of a fringe benefit and clauses in industrial agreements permitting 'salary sacrificing' arrangements. Table 1 shows the proportion of employees in the major industry classifications who indicated being in receipt of at least one fringe benefit in 1992 (the last occasion this data series was collected). This data shows that *more* than 12 percent of the respective industry workforces received some form of non-cash benefit from their employer. Yet when the employee responses are compared with the proportion of formal collective agreements made between 1991 and 2003 that contain a 'salary sacrifice' clause recorded in the Australian Centre for Industrial Relations Research and Training's (acirrt) ADAM database (Agreements Database and Monitor), a totally different picture emerges. While the employee data suggest that non-cash remuneration is widespread in the private sector, the agreements data suggests the supply of non-cash remuneration is more or less restricted to the public sector. Put another way, the industries with the highest share of public sector workers have the lowest incidents of employees receiving a fringe benefit, whereas the same industries have the highest incidents of 'salary sacrificing' clauses according to the agreements data. A possible explanation for this discrepancy is that the taxation costs (both compliance and money) dissuades employers and employees from formalising their flexible remuneration arrangements by including clauses in industrial agreements.

Such conjecture appears to be supported by Table 2. The table shows the extent of the supply of individual fringe benefits according the size of the business. The employee data shown is, in many respects, remarkable for there is little variation in the supply of the benefits across the different sized firms. If anything, the employee data shows that smaller workplaces are more likely to provide non-cash remuneration. Moreover, the employee data challenges the research evidence that small firm are reluctant to provide fringe benefits to staff because of the compliance costs involved.

**TABLE 2**  
*Scope of fringe benefits, by workplace size & benefit (%)*

<i>Fringe benefit</i>	<i>Workplace size (staff numbers)</i>		
	<i>1-19</i>	<i>20-99</i>	<i>100+</i>
Child care or education expenses	0.3	0.2	0.4
Club fees	2.0	2.0	1.7
Entertainment allowance	2.3	2.2	2.3
Goods or services	19.4	15.6	17.7
Holiday expenses	3.1	4.3	6.6
Household energy	4.9	1.2	1.5
Housing	5.9	2.4	2.8
Low-interest finance	3.1	3.4	4.4
Medial or hospital expenses	2.5	2.9	6.1
Personal study leave	2.1	2.6	4.3
Share options or rights	3.3	2.8	4.0
Telephone	13.0	8.0	8.2
Transport	25.6	18.4	16.1
Union or professional association fees	4.5	2.8	2.9
Agreements with fringe benefit clauses, 1991-2003	7.4	7.6	19.6

Source ABS catalogue no. 6334.0 (August 1992); acirrt (2004).

Note The agreements data comes from 4,362 registered collective agreements contained in the ADAM database with workplace size information.

But once again, the agreements data shown in Table 2 implies that taxation costs of non-cash remuneration dissuades employers and employees from formalising their fringe benefits arrangements by including clauses in industrial agreements. There is, though, an alternative explanation for the discrepancy between the employee and agreements data: the volume of employer provided fringe benefits has declined rapidly since 1992 and consequently the agreement data is a true representation of the incidents of flexible remuneration arrangements in Australia over the last decade.

### Survey evidence

In order to assess which of the two plausible explanations is the more accurate we conducted a survey of management canvassing a range of topics connected with the supply of non-cash remuneration. The survey questionnaire was mailed to 1000 businesses located in the Sydney metropolitan area, randomly selected from the list of firms contained in the 'Australia on Disc' business directory. The questionnaires were dispatched in August 2004. We requested that the questionnaire be completed by either the most senior manager, or the employment relations / human resources manager. Surprisingly 211 questionnaires were returned marked 'not at this address', suggesting a high degree of 'churning' of enterprises in and around Sydney. At total of 89 useable surveys were returned, representing an 'effective' response rate of about 11 percent.

The vast majority of replies came from commercial enterprises (84%), 'stand-alone' businesses (76%), and wholly Australian owned firms (91%). Over 80 percent of the respondent firms employed between 1-20 staff, with most staff (74%) employed on a permanent, full-time, basis. Consistent with the 'size' of the businesses, most (79%) indicated they were 'union free' and their industrial relations are regulated by a State or federal award (53%) with a range other arrangements (registered and unregistered collective agreements, Australian Workplace Agreements, and common law contracts) applying in the other firms. Overall, the respondent businesses expressed satisfaction with the industrial award system, with only 14 percent indicating some dissatisfaction. In light of the surveyed firms' characteristics, if they provide flexible remuneration to their employees they would be prone to do so on an informal basis, and not via clauses in statutory agreements. The survey evidence supports this proposition.

**TABLE 3**  
*Factors influencing the supply of non-cash remuneration, survey replies (%)*

	<i>Time &amp; effort</i>	<i>FBT costs</i>
A factor in making the decision	19.1	18.0
A factor, but only a minor factor in making the decision	24.7	15.7
An important factor, but not the major factor in making the decision	32.6	29.2
A major factor in making the decision	12.4	19.1
The <i>only</i> factor in making the decision	4.5	7.9

N = 89

Only a quarter indicated that non-cash remuneration was provided by the business. However, for most staff in the respondent firms no flexible remuneration is supplied. Conceivably, this is due to the compliance costs involved. Two thirds indicated that both the administrative costs and time and effort taken to process employee remuneration has increased over the last five years, and for a quarter of the businesses they had increased significantly. When asked what form of non-cash benefit the enterprises would prefer to supply to their employees, the responses reflected the type of fringe benefit reported by employees in Table 2: goods or services, transport and telephone. The fact that management expressed a willingness to supply some form of non-cash remuneration, yet most do not do so, is evidence that compliance costs are an obstacle.

**TABLE 4**  
Remuneration  
processing  
issues for  
management,  
survey replies  
(%)

	<i>Admin effort</i>	<i>Admin costs</i>	<i>FBT effort</i>	<i>FBT costs</i>
Not a issue for this business	33.7	34.8	34.8	31.5
Only a minor issue for this business	47.2	48.3	40.4	40.4
A major issue for this business	14.6	11.2	18.0	21.3

N = 89

To assess what factors might be obstacles for the employers to supply non-cash benefits, we asked what would influence their decision to provide flexible remuneration if a staff member requested it. The results are reported in Table 3. While the administration of non-cash remuneration is a factor, the taxation obligations imposed by the FBT regime are more influential. We also asked what aspects of existing compliance costs have the most impact on the business in processing employee remuneration. The results are reported in Table 4. For a third of the firms, compliance costs are not an issue. Nevertheless, the responses indicated that the FBT regime is more of a burden than the administration of other employment related staff on-costs. The replies concerning the FBT are noteworthy, if not surprising. Approximately 60 percent of the employers nominated FBT compliance as an issue for that business, despite the fact that non-cash remuneration is supplied in only a quarter of the enterprises. Can this be explained? We postulate that it can. The burdens imposed on employers by the complex taxation regime established by the ANTS in 2000 means that even if a business provides no flexible remuneration to its employees, it must calculate if the goods and/or services it supplies to staff incur GST, give rise to a GST input credit, are an 'effective' or 'ineffective' salary sacrificing arrangement, are concessionally treated or a deductible benefit, and calculate the 'grossed-up' remuneration of each individual employee. In addition, they need to calculate the total remuneration of each staff member for State payroll tax purposes.

### **Conclusion**

This paper has examined the intersection of the federal government's taxation policy towards the supply of non-cash remuneration to staff and industrial relations policy that purports to give primacy to the parties in an employment relationship to determine their own industrial rights and obligations. The taxation of non-cash remuneration was introduced to protect the revenue base of the federal income tax system and to establish a more equitable taxation system by denying highly compensated employees from reducing their income tax obligations by being remunerated with non-cash perks. The initial justification for imposing FBT on employers and not the beneficiaries of flexible remuneration, employees, was to simplify the administration of the system by reducing the number of taxpayers. However, this simplicity had been replaced with the complexity of the ANTS introduced by the Coalition government in 2000. So while the Coalition's industrial relations policy is to simplify the procedures employers and employees follow to tailor their employment relationship to suit their respective needs, the FBT regime reduces the ability of the parties to have their anticipated compensation arrangements become a reality.

Our analysis of over 10,000 formal collective agreements made in Australia since the onset of enterprise bargaining in 1991 shows that flexible remuneration clauses are included in only eight percent of agreements, and are skewed towards the public sector and larger workplaces. This agreement level data is at odds with employee level data.

Our survey of businesses in Sydney assessing factors influencing the supply of non-cash remuneration by employees offered insights into the discrepancy between the two levels of data. While a quarter of firms indicated that flexible remuneration was provided at the enterprise, the vast majority indicated that the compliance costs of processing staff remuneration had increased during the term of the Coalition government. Moreover, the impact of FBT compliance was found to be a burden for most business respondents. The survey analysis supports the employee level data; the supply of non-cash remuneration is more widespread than the agreement level data suggests, as the provision of these benefits is conducted on an

informal basis. The implications of the study are clear. The industrial relations policy of the Coalition is more rhetoric than substance because its taxation policy towards flexible employee compensation impedes the parties from realising their desired industrial outcomes. The taxation obstacles to the supply of employer sponsored child care are an obvious example.

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