



## Précis Paper

### Salary Packaging and the Employment Relationship

This presentation canvasses options for salary packaging schemes, considerations when drafting a salary packaging policy, and the relevant regulatory and legislative framework.

#### **Discussion Includes**

- How does salary packaging work?
- Legislative and regulatory considerations
- Salary sacrificing vs salary packaging
- Considerations in drafting salary packaging policies
- Salary packaging elements
- How to approach salary packaging
- The importance of end of year reconciliation

# Précis Paper

## Salary Packaging and the Employment Relationship

1. In this edition of BenchTV, Dr Peter Klomp (Barrister, Federation Chambers - Bungendore) and Ian Benson (Solicitor, AR Conolly & Company) discuss issues that companies should consider when instituting salary packaging schemes and policies.

### How does Salary Packaging Work?

2. At the very heart of any employment contract is the issue of consideration. Salary packaging is one method of compensating an employee, and there is a growing trend for salary packages to include items other than cash, including cars, laptop computers, or public transport tickets.
3. The rationale for salary packaging is that it allows the employee greater take-home pay. In a properly established salary packaging scheme, the employer will pay the same amount to the employee, but the employee will ultimately have greater net pay.
4. Unfortunately, Dr Klomp considers that salary packaging is often not done well in workplaces. There are many reasons for this, including the following points:
  - It is difficult to have satisfactory knowledge of and compliance with the relevant taxation laws;
  - The *Fringe Benefits Tax Assessment Act 1986* (Cth) was written in an era where the extent of salary packaging that occurs today was not envisaged;
  - Employers and employees are not aware of the consequences of ss 323 and 324 of the *Fair Work Act 2009* (Cth);
  - Employers fail to have comprehensive salary packaging policies in place;
  - Employment contracts are often poorly drafted with respect to salary packaging; and
  - Employees and employers lack the knowledge to put together a sound package.

### Salary Sacrificing Versus Salary Packaging

5. Dr Klomp notes that technically, salary sacrificing and salary packaging should be the same. However, Dr Klomp prefers to use salary packaging schemes.

#### **Graphic 1**

Salary	\$80,000
Superannuation Guarantee 9.5%	\$7,600

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6. Salary sacrificing focuses on the top figure of \$80,000 in Graphic 1 and reduces the cash component of that salary in exchange for something else. Salary packaging, in contrast, starts at the total remuneration figure of \$87,600, and then determines how that salary package will be allocated across different components. The total must ultimately add up to \$87,600.
7. In Dr Klomp's opinion, the use of salary sacrificing, which focuses on the top figure, is more prone to error.

#### Salary Packaging Policies

8. Salary packaging effectively commences with the company's policies. The case of *Goldman Sachs JBWere Services Pty Limited v Nikolich* [2007] FCAFC 120; 163 FCR 62 determined that a company policy can form part of an employment contract. Therefore although some companies may choose not to allow salary packaging at all, where a salary packaging policy is in place in the company, the scope of salary packaging will depend on the policy in place.
9. Dr Klomp advises practitioners not to be too specific in the employment contract when referring to company policies, because if only certain policies are identified in the contract, this may mean, by implication, that other policies that are not explicitly mentioned are excluded from the employment contract. A proposed term of the employment contract is suggested in Graphic 2:

#### **Graphic 2**

*The Employer and employee both agree that, to the extent possible, policies of the employer that from time to time exist or prevail in the workplace form part of this employment contract.*

10. Salary packaging policies must be comprehensive to avoid legal issues arising. Important considerations include:
  - To whom should you offer salary packaging? A policy that offers salary packaging to everyone is not advised, as it is preferable to avoid offering salary packaging to new employees who are on probation. It is also important to avoid policies that may run foul of discrimination laws, and salary packaging policies aimed at only a particular salary level could constitute indirect discrimination if, for example, only a certain gender of employees is able to take advantage of the policy.


- What is the company prepared to package as part of the policy?
  - What is the company *not* prepared to package? For example, American Express may not wish to allow employees to salary package a Diners credit card.
  - What will the company recognise as part of the employee's remuneration? For example, will car parking or certain recreational facilities be included in the employee's salary or provided in addition to salary?
  - What is the remuneration period?
  - How will the company package certain items? For example, when packaging cars, will the package include a novated lease, an associated lease, or just paying the employee's car expenses?
  - What if a car that was purchased or leased through salary packaging is used for business trips?
  - How does the policy take into account overtime, bonuses, or leave and termination payments?
  - What happens if something goes wrong? For example, if an audit by the Australian Taxation Office (ATO) determines that more Fringe Benefits Tax (FBT) is payable, who is responsible for that payment? Can the employer recover from the employee?
11. When putting in place a salary sacrifice scheme, it is important to remember that the ATO will only accept *prospective* salary sacrificing arrangements; see Australian Taxation Office *Taxation Ruling TR 2001/10: Income tax: fringe benefits tax and superannuation guarantee: salary sacrifice arrangements*.

#### How to Approach Salary Packaging

12. When advising on salary, Dr Klomp starts with the bottom line, that is, what is the total remuneration? In considering Graphic 3 below, start, therefore, with the total remuneration figure of \$87,600.


#### **Graphic 3**

##### ***Salary (and Superannuation) Only***

Salary	\$80,000
Superannuation Guarantee 9.5%	\$7,600
 Total Remuneration	<u>\$87,600</u>

##### ***Package***

Cash	\$76,164
Super 9.5%	7,236
Fringe Benefits	11,000

<i>Fringe Benefits Tax</i>	0
<i>GST Credits</i>	-1,000
<i>Employee Contributions Paid to Employer</i>	-5,500
<i>GST on Employee Contributions</i>	500
<i>Package Credits</i>	-1,000
<i>Admin Fees</i>	220
<i>GST on Admin Fees</i>	-20
 <i>Total Remuneration</i>	<u>\$87,600</u>

13. Starting with total remuneration creates a common denominator by which all employees' salaries can be assessed. In addition, this approach eliminates inconsistencies between employees. For example where two employees take home the same amount of cash plus have a package that allows for a fully maintained car, there might be significant differences in the cost required to finance the cars of different employees who have different uses of a car. This approach also forces the employer to do an end-of year reconciliation, as the only way to ensure that the employee has been paid the correct amount of total remuneration is to check all payments made to them, including salary, superannuation, and any other benefits such as car payments.
14. This total remuneration approach also eliminates clauses such as the following contained in Graphic 4:

**Graphic 4**

1. *Your salary will be \$... per annum.*
2. *We will also pay superannuation to the extent required by law.*

15. The problem with clauses such as this is that superannuation is only required to be paid on the cash component of salary. Therefore, an employee who receives other benefits by way of a salary package will end up with less total remuneration if superannuation is only paid to the extent required by law. This is illustrated by Graphic 5 below: for an employee who earns a salary of \$80,000 per annum, the amount of superannuation required to be paid by law is \$7,600 on the cash component of the salary. However, if the employee elects to salary sacrifice \$10,000 of his or her salary towards superannuation, that amount becomes more employer-paid superannuation, which means that at that point, the employer is not obliged by law to pay any additional superannuation. The employer is meeting the superannuation guarantee requirements under the relevant legislation through the employee's \$10,000 salary sacrifice, but the employee ultimately ends up with less total remuneration.

**Graphic 5**

<i>Salary</i>		<i>\$80,000</i>	<i>\$70,000</i>
<i>Superannuation Guarantee</i>		<i>\$7,600</i>	
<i>9.5%</i>			
<i>Salary Sacrificed Super</i>			<i>\$10,000</i>
<i>Total Remuneration</i>		<i>\$87,600</i>	<i>\$80,000</i>

16. Alternatively, in Graphic 6, on the same salary, the employer decides to pay the superannuation guarantee on the \$70,000 cash component of the salary. However, the employee still ends up with less total remuneration than had he or she received all of their salary in cash.

**Graphic 6**

<i>Salary</i>		<i>\$80,000</i>	<i>\$70,000</i>
<i>Superannuation Guarantee</i>		<i>\$7,600</i>	<i>\$6,650</i>
<i>9.5%</i>			
<i>Salary Sacrificed Super/Exempt FBs</i>			<i>\$10,000</i>
<i>Total Remuneration</i>		<i>\$87,600</i>	<i>\$86,650</i>

17. Instead, by adopting Dr Klomp's approach of focusing on the total remuneration, the total remuneration remains the same, and the employer will work backwards to calculate how much superannuation should be paid.

**Graphic 7**

<i>Salary</i>		<i>\$80,000</i>	<i>\$70,000</i>
<i>Superannuation Guarantee</i>		<i>\$7,600</i>	<i>\$7,600</i>
<i>9.5%</i>			
<i>Salary Sacrificed Super</i>			<i>\$10,000</i>
<i>Total Remuneration</i>		<i>\$87,600</i>	<i>\$87,600</i>

18. Graphic 8 demonstrates how a package can be broken down in order to ensure that an employee receives the correct total remuneration when receiving fringe benefits. As always, Dr Klomp reminds viewers to start with number 1, i.e. the total remuneration.



**Graphic 8**

<i>5</i>	<i>Cash</i>	<i>\$76,16</i>
		<i>4</i>

6	Superannuation 9.5%	7,236
3a	Fringe Benefits	11,000
3b	Fringe Benefits Tax	0
3c	GST Credits	-1,000
3d	Employee Contributions Paid to Employer	-5,500
3e	GST on Employee Contributions	500
4	Package Credits	-1,000
2a	Admin fees	220
2b	GST on Admin Fees	-20
1	Total Remuneration	<u>\$87,600</u>
		0

19. Fringe benefits are the opposite of salary. When an individual receives a fringe benefit, it is the same as receiving net pay.

#### Graphic 9

	Gross (Salary)	\$100	Total Remuneration	\$100	
	PAYG Tax	49	FBT	49	
	Net Pay	<u>\$51</u>	Fringe Benefit Received	<u>\$51</u>	

20. An issue arises when an employer provides a benefit to the employee, and then the employee uses the benefit for company business purposes. This arises, for example, where an employee receives car expenses as part of a salary package, but then uses the car for work trips. In this circumstance, the company must give the employee a credit for their use of the salary-packaged car for business purposes. This is required by law: see *Adamson v Jarvis* (1827) 4 Bing 66; *Re Famatina Development Corporations Inc* [1914] 2 Ch 271; *Pupazzoni v Fremantle Fisherman's Co-operative Society Ltd* [1981] AILR 168; and ss 323 and 324 *Fair Work Act 2009* (Cth) (providing that employees must be paid in full and without deduction). An illustration of credits of this nature can be found in item number 4 of Graphic 8 above.

#### End-of-Year Reconciliation

21. Assuming that an employee has the package set out in Graphic 8, it is important to note that on Day 1 of the package, the figures contained in the package are estimates. This is because it is impossible to predict with complete accuracy the running costs, for example, of an employee's car that forms part of the salary package.

22. At the start of the package, an employer must therefore make an estimate of these costs. Dr Klomp emphasises that it is important to check these figures throughout the year, initially after approximately three months. This helps to prevent over- or underpayment to the employee.
23. At the end of the year, the employer will need to confirm that \$86,000 was in fact paid to the employee. In most cases, particularly where a car is involved, it is unlikely that the employer will have paid this amount precisely. Where the employee has been underpaid, the remedy is to simply pay the employer extra in cash and/or super. However if overpayment has occurred, difficulties arise because an employer is not entitled to make a deduction from an employee's pay to recover the amount of the overpayment without their permission: s 323ff, *Fair Work Act 2009* (Cth). Moreover, if superannuation has been overpaid, even greater difficulties arise because in general, superannuation cannot be withdrawn from a super fund and an employer cannot simply pay less super in a following quarter without running foul of their superannuation guarantee obligations. This therefore underscores the importance of regularly checking the progress of a salary package throughout the year, and Dr Klomp suggests that it is better to overestimate the amount of benefits that an employee is receiving than underestimate.
24. The solution proposed by Dr Klomp is to ensure that there is a clear company policy whereby employees agree to any recovery of overpayment that occurs because of the salary packaging. Otherwise, the only course of action may be to commence civil action to recover the debt. Company policy is therefore a critical part of the employment contract when considering salary packaging.



## **BIOGRAPHY**

### Dr Peter Klomp

Barrister, Federation Chambers, Bungendore

Dr Klomp was admitted to legal practice in 1987 and has been a practising barrister at the NSW Bar since 2005. He holds Bachelor degree in Business, Laws and Computer Studies, and a Doctor of Juridical Science. Dr Klomp has had nearly 40 years' experience in employment, business and taxation law in both Australia and overseas, and is also a principal of Seminars Australia through which he conducts professional development seminars.

### Ian Benson

Solicitor, AR Conolly & Company

Ian Benson is a solicitor at AR Conolly & Company and holds a First Class Honours degree in law.

## **BIBLIOGRAPHY**

### Cases

*Goldman Sachs JBWere Services Pty Limited v Nikolich* [2007] FCAFC 120; 163 FCR 62

*Adamson v Jarvis* (1827) 4 Bing 66

*Re Famatina Development Corporations Inc* [1914] 2 Ch 271

*Pupazzoni v Fremantle Fisherman's Co-operative Society Ltd* [1981] AILR 168

### Legislation

*Fringe Benefits Tax Assessment Act 1986* (Cth)

*Fair Work Act 2009* (Cth)