Deloitte.

18 June 2015
2015/19

Tax insights

Fly-in-fly-out arrangement held to be otherwise deductible

Snapshot

The Full Federal Court (FFC) has allowed the John Holland group's appeal against a fringe benefits tax (FBT) liability for costs incurred in flying employees between Perth and Geraldton to work on the Midwest rail project. The flights are residual fringe benefits, but as a result of the FFC holding that the otherwise deductible rule applied to the Midwest project's fly-in fly-out arrangement, the value of those fringe benefits is reduced to nil: *John Holland Group Pty Ltd v Commissioner of Taxation* [2015] FCAFC 82.

The FFC's decision is expected to have widespread implications for the resource and infrastructure sectors. Certain "fly-in fly-out" arrangements to remote areas, such as a number of projects in the Pilbara region are specifically exempt from fringe benefits tax. Less remote destinations, such as Geraldton do not fall within that exemption.

Companies that have paid FBT in connection with fly-in fly-out arrangements may be able to seek a refund.

The issue

The issue before the court involved residual fringe benefits provided by members of the John Holland group of companies as a result of flying employees between Perth and Geraldton to work on a rail upgrade construction project located east of Geraldton (the Midwest Project).

Specifically, the issue was whether the employees would have been entitled to a deduction under section 8-1 of the *Income Tax Assessment Act 1997* (Cth) ("ITAA 1997") for the cost of the air travel under the hypothesis that the employees themselves incurred those costs. If the employees would have been entitled to a deduction, the "otherwise deductible rule" eliminates the FBT liability in respect of the fly-in fly-out benefits.

If the employees would have been entitled to a deduction, the "otherwise deductible rule" eliminates the FBT liability in respect of the fly-in fly-out benefits.

Background

Members of the John Holland group of companies operated a rail construction and maintenance business in Australia. The business employed, trained and maintained its own skilled labour force available for deployment on a project-by-project basis. Most of the projects were in remote and regional areas where employees were generally rostered-on for periods of two to four weeks at a time. The majority of the labour force lived in Perth.

For the Midwest Project, the John Holland group, controlled, organised and paid for flights between Perth and Geraldton, accommodation and all other transfers. The employees paid for their own travel costs between their homes and Perth airport. In the project's terms and conditions of employment documents, Perth airport was designated as the "point of hire". Flights were undertaken on the employers' time - the employees were rostered on and they were paid for the time they were travelling. While travelling, the employees were bound to comply with all of the employers' directives and policies, and disciplinary action could result if an employee breached any such requirement during a flight.

At first instance

The key issue before the court was whether the employee's air travel between Perth airport and Geraldton was travel between the employee's residence and a place of work or whether that travel was undertaken in the course of the employee's employment.

In the Commissioner's view, it has long been established that an employee is not entitled to a tax deduction for the cost of travel between home and work notwithstanding that the travel to work might be a prerequisite to the derivation of income or that the travel is connected with the derivation of income by the employee: *Lunney v Commissioner of Taxation* [1958] HCA 5 (*Lunney*).

At first instance Jagot J, having regard to previous case law concluded that the employees were travelling to and from their place of work, the Midwest Project location. The cost of the flights arose because the employees had chosen to live away from the Midwest Project location, their place of work. According to *Lunney*, such costs would not be deductible as they were incurred for the purpose of travelling from home to work and back.

On appeal to the FFC

On appeal to the FFC, the taxpayer successfully argued how Lunney's case should be applied to the present case. Specifically, Mr Lunney earned his income as an employee and claimed a deduction for the cost of his travel from home to work. The cost of that travel was held to be non-deductible. The travel undertaken by Mr Lunney from his employer's office to various work locations to carry out his work would have been deductible had the cost of that travel been incurred by Mr Lunney.

Applying the decision in Lunney's case, the non-deductible travel in the John Holland case would be the cost of travel between the employees' home and Perth airport. However, because the employees were considered to be working from the moment of their arrival at Perth airport, the flight to the Midwest Project located near Geraldton should be deductible.

Importantly, travel does not have to be the primary activity for which the person is employed, but if it is a necessary incident of the employment and undertaken in, and as part of, the employment for which the employee may be remunerated, it should be deductible.

The FFC unanimously held that the primary judge had been led into error in holding that the flights would not be deductible to the employees, and accordingly allowed John Holland's appeal.

From the time the employees checked in at Perth Airport they were travelling in the course of their employment, subject to the directions of their employer and being paid for it.

Reasons for the FFC decision

Edmonds J saw no reason why Perth Airport should not be a point at which the employees duties and remuneration for performance of those duties both commences and ceases. That was part of the terms of the contract of employment. The fact that Perth Airport is not an area or premises owned or leased by the John Holland group, was irrelevant. From the time the employees checked in at Perth Airport they were travelling in the course of their employment, subject to the directions of their employer and being paid for it. That situation subsisted until they disembarked the plane at Perth Airport at the end of their rostered-on work time. At no time during that period were they travelling to work; they were travelling on work and the cost of doing so under the otherwise deductible rule would be an allowable deduction to them.

Logan J found that the evidence supported the fact that the employees were on paid duty under the control and direction of their employer on and from their arrival at Perth Airport and during the flight from there to Geraldton.

Pagone J held that the decision in Lunney's case … "was of "ordinary people" paying fares "to enable them to go day by day to their regular place of employment or business and back to their homes"; it was not about the specific demands occasioned by employment that required, as part of the employment, travel to a remote place. The employees in this case are required to travel as part of their employment to a remote location."

The decision affords taxpayers the ability to review historical positions and potentially lodge a request for amended assessments.

Deloitte perspective

- The decision could potentially impact many employers, but we specifically expect the overall FBT paid by organisations under the following scenarios to be reduced:
  - Fly-in fly-out arrangements to remote areas that do not otherwise qualify for the specific FBT exemption (e.g. where the employee does not return to their usual place of residence on days off)
  - Fly-in fly-out arrangements to non-remote areas
  - Employment arrangements where it can clearly be demonstrated that work has commenced prior to travel that may otherwise have been deemed private in nature
  - Employees who work under awards that require travel of the nature described in the case
- In our experience, most employers structure their fly-in fly-out arrangements to remote destinations to ensure they meet the requirements of the specific exemption under the FBT Act. This decision should not have a bearing on these arrangements.
- The amendment period for FBT purposes is limited to three years from assessment date. Accordingly, subject to your lodgement and assessment history, the deadline for lodging an amendment to your 2012 FBT return may be running out quickly. We would recommend a review is completed immediately to ensure all historical savings are accessed.
- Where there are material FBT costs associated with prior year returns, employers may also consider lodging a formal objection (as opposed to an amendment) to request that the Commissioner exercises his discretion to reduce the FBT payable for a period beyond the 3 year timeframe.
- There are various employers across numerous industries who could be impacted by the decision. Given the propensity to use fly-in fly-out arrangements, we expect that infrastructure, construction and aviation based companies will all be impacted. The majority, but not all, of the resources locations in Western Australia are classified as remote for FBT purposes. However, mining and oil and gas projects in other states may be affected by the decision.
- It will be important for employers to consider all relevant costs associated with entering into similar arrangements as those described in the case. The FBT benefit obtained by adopting a fly-in fly out arrangement could be outweighed by the associated flight costs and other employment tax obligations.
- The Commissioner may seek special leave to appeal this decision to the High Court. Given the potential magnitude of revenue involved, we understand that the Commissioner is considering this option.
- Employers should review current contract and award wording. It will be critical to ensure that the employee's terms and conditions align with any assertion adopted by the employer.

Contacts

For more information, please contact

Elizma Bolt
Partner
+61 (2) 9322 7614
ebolt@deloitte.com.au

Steven Batrouney
Partner
+61 (3) 9671 7247
sbatrouney@deloitte.com.au

George Kyriakacis
Partner
+61 8 9365 7112
gkyriakacis@deloitte.com.au

Shelley Nolan
Partner
+61 (7) 3308 7232
shnolan@deloitte.com.au

Megan Field
Partner
+61 (8) 8407 7188
mfield@deloitte.com.au

David Shawcross
Director
+61 (8) 9365 7134
dshawcross@deloitte.com.au

Stewart Williams
Director
+61 (7) 3308 7301
stewwilliams@deloitte.com.au

For further information, visit our website at www.deloitte.com