Income Tax-Exempt Not-for-Profit Employers and Entertainment Benefits with Respect to End-of-Year Staff Functions and other Fringe Benefits Provided to Employees During the Festive Season

Introduction

The fringe benefits tax (FBT) consequences of income tax-exempt not-for-profits (NFPs) providing their employees with entertainment benefits is an area which is often misunderstood, incorrectly applied, or overlooked entirely. This relevantly includes how FBT applies to end-of-year staff parties and other benefits provided to employees over the festive season.

This might be because many income tax-exempt NFPs simply don't know that FBT can apply to the provision of such non-cash benefits, or it may be because they or their tax advisers are not aware that (or how) FBT applies differently to the provision of entertainment benefits by income tax-exempt entities.

The General FBT Landscape for NFPs

Before considering FBT specifically as it applies to benefits NFPs provide their employees* in the context of end-of-year celebrations, an understanding of the broader FBT landscape for NFPs is necessary. This article will not cover this in detail, but the following high-level overview is provided as a refresher.

Income tax-exempt NFPs are not necessarily also exempt from FBT. This is the case regardless of whether the NFP is an ACNC registered charity endorsed as income tax-exempt by the ATO, or a non-charitable NFP who has self-assessed their income tax-exempt status.

An income tax-exempt NFP employer will generally have one of the following three statuses for FBT purposes:

- *FBT-exempt*: Broadly limited to public benevolent institutions (PBIs), health promotion charities (HPCs), and other specific types of NFP organisations.
- *FBT-rebatable*: Broadly includes registered charities not already included in the FBT-exempt category, and other specified non-government NFPs.
- *FBT-taxable*: All other income tax-exempt NFP employers.

Non-cash benefits that an *FBT-exempt* NFP provides employees are not subject to FBT. This exemption is capped at a grossed up amount of $30,000 per employee for PBIs & HPCs, and $17,000 per employee for other *FBT-exempt* NFPs.

Non-cash benefits that an *FBT-rebatable* NFP provides their employees are subject to FBT, but an FBT rebate of 47% then applies. This concession is also capped at a grossed up amount of $30,000 per employee.

Salary packaged meal entertainment and entertainment facility leasing expense benefits, provided by both *FBT-exempt* and *FBT-rebatable* NFPs, are also capped at a grossed up amount of $5,000 per employee. This is a separate cap and applies in addition to the above caps. Unless any benefit an NFP provides in the context of end-of-year celebrations is salary sacrificed by the employee as part of their salary package, the salary packaged entertainment rules that apply only to NFPs are not relevant to the issues being considered here.

Whilst there are exceptions, including those this article addresses, non-cash benefits an *FBT-taxable* income tax-exempt NFP provides their employees are subject to FBT in much the same way as benefits provided by a taxable entity.

*For simplicity this article refers to benefits being provided by *employers* to *employees*, but should be read to include benefits provided to associates of employees and by other relevant entities, to the extent provided for (and as specified) in the relevant FBT provisions.

NFP End-of-Year Celebrations and Entertainment Benefits

Exemptions and rebates aside, when FBT applies to a benefit provided by an employer, the taxable value of the benefit subject to FBT is generally calculated in much the same way for income tax-exempt entities as for taxable entities. One notable exception to this is the special rules that apply to income tax-exempt entities with respect to the provision of *Entertainment Benefits*.

This is particularly relevant in the context of employers hosting Christmas parties or other end-of-year celebrations for their employees as, because such functions typically involve providing employees with food or drink in a social setting for the purposes of their enjoyment, they will almost always amount to the provision of *Entertainment Benefits*.

The two main ways that FBT applies differently when the employer providing such benefits is income tax-exempt are:

- *Entertainment Benefits* provided by income tax-exempt employers with respect to end-of-year celebrations will generally be subject to FBT regardless of their value, whereas such benefits provided by employers who are taxable entities will often be exempt from FBT under the minor benefit exemption provided that the value per employee is less than $300.
- Benefits provided by income tax-exempt employers with respect to food and drink provided at end-of-year celebrations will generally be subject to FBT regardless of location, whereas such benefits provided and consumed on their business premises are often exempt from FBT for taxable entities.

This article largely focuses on the provision of *Entertainment Benefits* by way of food or drink. However, consideration should also be given to whether end-of-year celebrations also involve the provision of *Entertainment Benefits* by way of recreation. For example, an employer hiring out an entertainment facility such as a bowling alley, yacht, or corporate box for the enjoyment of their employees as

part of end-of-year celebrations is likely to amount to the provision of *Entertainment Benefits* by way of recreation.

To inform a more detailed explanation of the above ways in which FBT applies differently to *Entertainment Benefits* provided by income tax-exempt entities, its necessary to first have a look at their FBT treatment more broadly.

Broader FBT Treatment of Entertainment Benefits

In the absence of the modified FBT treatment for income tax-exempt NFPs, and prior to considering the *Meal Entertainment* provisions in Division 9A of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA), the FBT provisions apply to *Entertainment Benefits* in the same way they apply to any other benefit.

That is, their taxable value for FBT purposes is established under whichever general provision of the FBTAA is relevant to the specific class of benefit being provided (i.e. Division 5 for *Expense Payment Fringe Benefits*, Division 11 for *Property Fringe Benefits*, or Division 12 for *Residual Fringe Benefits*).

Interaction between FBT, Income Tax, and GST

Section 32-5 of the *Income Tax Assessment Act 1997* (ITAA 1997) excludes expenses with respect to providing *entertainment* from being allowable general deductions for tax purposes under Section 8-1 of the ITAA 1997.

Entertainment for this purpose means:

- Entertainment by way of food, drink or recreation, or
- Accommodation or travel connected with providing the above.

This exclusion prevents deductions for income tax purposes with respect to the cost of providing entertainment to any person (i.e. not just to employees), and such costs are so prevented even when in the context of business discussions.

Entertainment costs that are not allowable deductions for income tax purposes because of Section 32-5 of the ITAA 1997 are also excluded from being creditable acquisitions for GST purposes, the effect being that GST input tax credits (ITCs) cannot be claimed with respect to entertainment expenses. (See: Section 69-5 of *A New tax System (Goods and Services Tax) Act 1999* (GSTA)).

The above provision of the GSTA also prevents an income tax-exempt entity from claiming ITCs on entertainment costs for GST purposes, provided that they would have been prevented by Section 32-5 of the ITAA 1997 from claiming a tax deduction for the entertainment costs if they were a taxable entity.

There are some limited exceptions to the above, relevantly including that expenses for providing entertainment which is a fringe benefit remain allowable deductions for income tax purposes (See: Section 32-20 of the ITAA 1997). This has the effect

that both income tax-exempt and taxable entities are able to claim ITCs for GST purposes for costs of entertainment that are fringe benefits.

An employer providing food and drink to an employee will not always amount to entertainment. Why, what, when, and where the food and drink are provided are relevant to determining whether such a provision is entertainment. See Taxation Ruling TR 97/17 for more on this. However, because food and drink an employer provides in connection with end-of-year celebrations will usually amount to entertainment, the distinction will not be covered further here.

Entertainment Costs: General FBT, Income Tax, and GST consequences

(Prior to considering relevant exemptions or the *Tax-Exempt Body Entertainment Benefit* provisions)

Recipient of Entertainment	**Taxable value of benefit is subject to FBT** (For both taxable entities and income tax-exempt entities not also FBT-exempt)	**Deductible for income tax purposes** (For taxable entities)	**Able to claim ITCs for GST purposes** (For both income tax-exempt and taxable entities)
Entertainment provided to an employee and/or their associate.	Yes	Yes	Yes
Entertainment provided to volunteers.	No	No	No
Entertainment provided to clients or business associates.	No	No	No

Tax-Exempt Body Entertainment Benefits

Tax-Exempt Body Entertainment Benefits are a special category of fringe benefits which are relevant when an income tax-exempt employer incurs *non-deductable exempt entertainment expenditure*.

Non-deductable exempt entertainment expenditure for this purpose means expenses which are not incurred in producing assessable income and which:

- Are with respect to providing entertainment such that, if the employer were not income tax-exempt, the costs would have been excluded from allowable deductions under Section 32-5 of the ITAA 1997, and
- Would have otherwise been allowable general deductions (i.e. under Section 8-1 of the ITAA 1997).

This test effectively requires an income-tax exempt employer to establish whether, if they were a taxable entity, Section 32-5 of the ITAA 1997 would prevent a relevant expense from being an allowable deduction for income tax purposes.

The operation of Section 32-20 of the ITAA 1997 is ignored for the purposes of applying this test. In other words, an entertainment expense that is also a fringe benefit is not excluded from *non-deductable exempt entertainment expenditure.*

The taxable value of *Tax-Exempt Body Entertainment Benefits* is determined under Division 10 of the FBTAA and, broadly speaking, will be the amount of the *non-deductable exempt entertainment expenditure* incurred.

The *Tax-Exempt Body Entertainment Benefits* provisions are only applicable to entertainment benefits provided by income tax-exempt employers. The taxable value of all other benefits they provide continue to be determined under the relevant categories of the general FBT provisions.

Minor Benefits Exemption for Income Tax-Exempt NFPs

Broadly speaking, Section 58P of the FBTAA provides that a benefit provided to an employee by a taxable entity employer will be a minor benefit, and therefore exempt from FBT, if:

- The GST inclusive notional taxable value is less than $300, and
- It is provided on an irregular and infrequent basis.

However, for income tax-exempt employers, and with respect to *Tax-Exempt Body Entertainment Benefits* specifically, in addition to needing to satisfy the above criteria, a benefit will only be a minor benefit if either:

- The entertainment provided to the employee is merely incidental to providing entertainment to outsiders, and is not a meal (or in connection with a meal) other than light refreshments, or
- The entertainment is provided to the employee on the employer's premises, and for the sole purpose of recognising employment-related special achievements of the employee.

In the context of staff end-of-year celebrations or parties, this means that the provision of entertainment by income tax-exempt employers will be subject to FBT regardless of the notional taxable value of the benefit.

Example: Minor Benefits Exemption

Aetos Pty Ltd, who are a taxable entity for income tax purposes, hosts an-end-of year party for their staff at the Riders Quadrant, a local brew pub. The GST-inclusive cost per head for a two-course meal with drinks is $220. The end-of-year party is the only benefit of its type that Aetos Pty Ltd have provided their employees during the FBT year. Because the benefit provided is under $300 per employee, and is irregular and infrequent, the minor benefits exemption applies such that there will be no FBT consequences for Aetos Pty Ltd.

Riorson Incorporated, an ACNC registered charity endorsed by the ATO as income tax-exempt, heard about the end-of-year party at the Riders Quadrant and decided to host an end-of-year party there for their own employees. The cost per head was the same as for Aetos Pty Ltd. Despite the GST inclusive cost per head being under $300, and their situation being otherwise comparable to Aetos Pty Ltd, the full cost of hosting the end-of-year party will be subject to FBT for Riorson Incorporated, as it is a *Tax-Exempt Body Entertainment Benefit* and neither of the specific circumstances where an income tax-exempt employer can access the minor benefits exemption are applicable.

No On-Premises Exemption for Income Tax-Exempt Entities

Where an employer who is a taxable entity provides a property benefit, both on a working day and on their business premises, to an employee who also consumes it on those premises, regardless of the cost, it will be an exempt property benefit and not subject to FBT. This can include entertainment by way of food and drink, but does not extend to an employee's associates (See Division 11 of the FBTAA).

This means that an employer who is a taxable entity can host an end-of-year celebration on their business premises during work hours, for their employees but not their spouses or other associates, and the cost of providing the benefit will be FBT exempt even if the GST inclusive value exceeds $300.

Because the *Tax-Exempt Body Entertainment Benefit* provisions in Division 10 of the FBTAA apply to income tax-exempt entities for all expenses they incur in providing entertainment to employees, Division 11 of the FBTAA has no application to such costs. Therefore, if they hosted an end-of-year celebration for employees on their business premises on a work day, the above FBT exemption will not apply, and such entertainment will be subject to FBT under Division 10 of the FBTAA.

Example: On-Premises Exemption

Whoville Incorporated, an ACNC registered charity endorsed by the ATO as income tax-exempt, has an end-of-year party for employees and their spouses during business hours and held at their head office. Whoville Incorporated provides attendees with a three-course buffet meal, soft drinks, and alcohol. The GST-inclusive cost to Whoville Incorporated of hosting the party is $170 per head.

The end-of-year party is an entertainment benefit, as Whoville Incorporated has provided their employees and associates of their employees (spouses) with food and drink at a function held for the purpose of enjoyment. The party being held on their own premises does not change this outcome.

Because Whoville Incorporated is an income tax-exempt NFP, and the cost of providing the entertainment would not have been deductible if they were a taxable entity, the end-of year party amounts to the provision of a *Tax-Exempt Body Entertainment Benefit* and FBT applies to the taxable value of providing the benefit (to both employees and their spouses). Because the entertainment is subject to FBT, Whoville Incorporated can claim ITCs on these entertainment costs for GST purposes.

Despite the GST-inclusive cost per head being less than $300, the minor benefits exemption again does not apply as neither of the specific circumstances enabling an income tax-exempt employer to qualify for the minor benefits exemption are applicable to the circumstances.

If Whoville were instead a taxable entity, the benefit provided to employees would likely be exempt from FBT under the on-premises exemption, and this would be the case even if the GST inclusive value per head were more than $300. Whilst the benefit provided to the employee's spouses would not qualify for the on-premises exemption. However, given the GST inclusive value was less than $300 per head, they would likely still be exempt from FBT under the minor benefits exemption.

Meal Entertainment Benefits and Alternative Valuation Methods

The FBT consequences discussed so far assume that an income tax-exempt employer uses the actual value method to account for their entertainment costs. The outcomes detailed above would differ where they have instead made a valid election to use the 50/50 split method, or a further election to use the 12-week

register method. The 50/50 split and 12-week register methods only apply to *Meal Entertainment Benefits*, which are covered by Division 9A of the FBTAA. An entity provides a *Meal Entertainment Benefit* if they provide someone with *Meal Entertainment* (except when provided via a valid salary sacrifice arrangement).

Meal Entertainment for this purpose means:

- Entertainment by way of food or drink, or
- Accommodation or travel in connection with the above, or
- Payment or reimbursement of expenses for either of the above.

Such entertainment will be *Meal Entertainment* even where:

- Business discussions or business transactions occur.
- It is provided in connection with working overtime or otherwise with respect to performing employment related duties.
- It is for the purposes of promotion or advertising.
- It is provided in connection with a seminar.

If an employer has elected to apply Division 9A of the FBTAA, the taxable value of all *Meal Entertainment Benefits* will be either 50% of all costs of providing *Meal Entertainment Benefits* for the FBT year or, if additionally elected, an amount determined with respect to a 12-week register kept by the employer.

Whilst income tax-exempt entities can elect to apply Division 9A of the FBTAA, and doing so will have the effect that the taxable value of *Meal Entertainment Benefits* is determined under Division 9A rather than the *Tax-Exempt Body Entertainment Benefits* provisions, it is important to consider the following:

- The taxable value under Division 9A of the FBTAA is established with respect to the costs of providing all *Meal Entertainment*, and regardless of who the entertainment is provided to (i.e. it is not limited to entertainment provided to employees, or to only amounts already subject to FBT). This can bring costs that would otherwise be exempt from FBT into the taxable value of entertainment benefits for FBT purposes.
- Division 9A of the FBTAA only applies to *Meal Entertainment Benefits,* so only covers entertainment by way of food or drink. The taxable value of entertainment by way of recreation will still be established under the *Tax-Exempt Body Entertainment Benefit* provisions.

End-of-Year Gifts for Employees

Gifts will often fall outside the meaning of entertainment for FBT purposes. Because the modified application of the FBT provisions for income tax-exempt entities is broadly limited to benefits provided with respect to entertainment, they have no effect on how FBT applies to the provision of other benefits employers may provide their employees during the festive season.

For example, gifts that income tax-exempt NFPs provide their employees, which have a GST inclusive value under $300 per employee, will often be exempt from FBT, provided the other conditions of the minor benefit exemption are met.

However, the type of gift provided does needs to be considered. Most types of hampers or retail gift vouchers are unlikely to fall within the meaning of entertainment for FBT purposes, but a gift voucher for a restaurant or theatre tickets will likely still amount to the provision of an entertainment benefit.

Key Take Aways

If you are an income tax-exempt NFP, or have clients who are, you should be aware that FBT applies differently to income tax-exempt entities with respect to the provision of *Entertainment Benefits* to their employees.

Differences include that *Tax-Exempt Body Entertainment Benefits* are a special category of fringe benefit under which income tax-exempt NFPs must determine the taxable value of *Entertainment Benefits* provided (i.e. rather than under the general FBT provisions for property benefits, expense payment benefits, etc).

Income tax-exempt NFPs generally won't be eligible for the $300 minor benefit exemption, or the on-premises property benefit exemption, for end-of-year staff parties. The effect of this is that the provision of entertainment benefits with respect to such functions will be subject to FBT regardless of their cost or location.

If you do not have sufficient expertise in this particular area of FBT (and FBT more broadly), it may be appropriate to consider outsourcing your FBT compliance.

You (or your income tax-exempt clients) should ensure that all transactions are recorded in accounting systems (particularly with respect to food, drinks, and recreational entertainment costs), in a manner that enables potential FBT issues to be easily identified, and FBT compliance to be fully considered and adhered to.

You should consider whether electing to apply the 50/50 split method or 12-week register method, to calculate the taxable value of *Entertainment Benefits,* would result in a more optimal FBT outcome for you or your income tax-exempt clients.

Gifts provided to employees over the festive season with a GST inclusive value less than $300 will often be exempt from FBT under the minor benefits exemption. However, you should be aware (or ensure your income tax-exempt clients are), that the type and cost of the gift can impact whether FBT applies.

Author: **Katy Nesbitt**
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