



Class Ruling

Income tax: deductibility of employer contributions to the Professional Employees Entitlements Trust

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① This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997); and
 - section 8-1 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is all employers who make contributions on behalf of employees to the Professional Employees Entitlements Trust (Protrust).

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.
5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 13 to 24 of this Ruling.
6. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:
 - this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
 - this Ruling may be withdrawn or modified.
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Date of effect

8. This Ruling applies from 9 October 2006 to 9 October 2009. However, the Ruling continues to apply after this date to all entities within the specified class who entered into the specified scheme during the term of the Ruling, subject to there being no change in the scheme or in the entities involved in the scheme.
9. The Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling. Furthermore, the Ruling only applies to the extent that:
 - it is not later withdrawn by notice in the *Gazette*; or
 - the relevant provisions are not amended.
10. If this Class Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

11. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

12. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

13. The scheme that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form and are part of and are to be read with the description. The relevant documents or parts of documents incorporated into this description of the scheme are:

- Class Ruling application from Professional Financial Solutions dated 11 July 2006;
- Protrust Trust Deed;
- additional information provided in correspondence dated 14 September 2006; and
- additional information provided in correspondence dated 24 October 2006.

14. Protrust will accept 'employee entitlements', which are defined in clause 1.1 of the Trust Deed as:

any dollar amount payable to a Member under an Employment Contract to which that Member has either an absolute right or a contingent right and which is identified as such in the Employment Contract including the following entitlements:

- (a) annual leave and annual leave loading;
- (b) sick leave;
- (c) long service leave;
- (d) redundancy and severance; or
- (e) any other amount from time to time payable by an Employer to a Member accepted by the Trustee.

15. 'Employment Contract' is defined in the Trust Deed to mean:

any agreement, arrangement or undertaking (whether documented or not) under which an employee is employed and is or may become entitled to Employee Benefits in accordance with its terms and includes an Industrial Agreement as defined in this Deed.

16. The Trust Deed defines 'industrial agreement' as:

an agreement:

- (a) between an Employer or an Employer association and a union of Employees; or
- (b) between an Employer and its Employees; or
- (c) an Award,

whether or not it has been certified by, approved by or registered with an Industrial Authority.

17. Clause 7 of the Trust Deed sets out the rules relating to contributions by employers to Protrust. Clause 7.1 in particular requires that:

7.1 Employee Entitlement Contributions

Each Employer may pay to the Trustee, or as directed by it, on such dates as may be agreed with the Trustee such amount as the Employer may determine.

As well, clause 7.2 of the Trust Deed allows employers to make additional payments:

7.2 Other Payments

An employer may pay to the Fund on behalf of its Employees who are Members any additional amount agreed with the Trustee.

18. Each employer must ensure that a written statement accompanies all contributions made by it, setting out in respect of each Member:

- (a) the amount of the Contribution;
- (b) the Employee Entitlement or Entitlements that the Contribution is to secure;
- (c) how and when each Contribution is to vest in the Member;
- (d) the length of the Relevant Service, if appropriate; and
- (e) any other matters relevant to the calculation or making of the Contribution.

19. As outlined in clause 7.8 all contributions made to Protrust will be placed into separate member (employee) accounts as directed by the employer:

7.8 Payments and credits/Member Accounts

The contributions by any Employer in respect of a Member will be allocated as directed by it. The trustee may adopt rules from time to time regarding the allocation of contributions in the absence of a direction from the relevant Employer.

20. Except where there is an exception under the Trust Deed, employers must pay an employee's relevant entitlements directly to that employee, and then apply to Protrust for reimbursement of that amount in accordance with the provisions of the Trust Deed as set out in clause 22.

21. The exceptions are set out in clauses 21.2 (insolvency of the Employer) and 21.3 (Member otherwise entitled to receive the Benefit directly from the Fund).

22. In order to be reimbursed the employer must lodge a properly completed claim form with the Trustee and satisfy such requirements and provide such information as the Trustee may reasonably require (clause 22.1). The Trustee has no obligation to pay an amount to an employer until it receives satisfactory evidence of the employee's or employer's entitlement and that the relevant employment contract permits the payment. The Trustee may also require the payee to execute documents and do other acts and things as may be appropriate for the Trustee to obtain a good release before paying any claim (clause 22.2).

23. The amount of any benefit payable in respect of a Member will be the amount specified by the relevant employer in the claim made under clause 22.1 of the Trust Deed. The amount payable cannot exceed the amount standing to the credit of the Member's Account (clause 22.3)

24. This Ruling will not consider the application of section 58PA of the *Fringe Benefits Tax Assessment Act 1986* to contributions made by employers to Protrust.

Ruling

25. An employer who makes a contribution of employee entitlements to Protrust can claim a deduction under section 8-1 of the ITAA 1997 for the amount of the contribution made.

26. A reimbursement received by an employer from Protrust for an amount paid directly to an employee will be assessable income under section 6-5 of the ITAA 1997 at the time the amount is derived by the employer.

Commissioner of Taxation

7 February 2007

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Application of section 8-1

27. Section 8-1 of the ITAA 1997 provides that you can deduct from your assessable income any loss or outgoing to the extent that it is incurred in gaining or producing assessable income or is necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income and is not:

- capital, private or domestic in nature;
- incurred in gaining or producing exempt income or non-assessable non-exempt income; or
- prevented from being deductible by a provision of the Act.

Positive limbs

Nexus to gaining and producing assessable income

28. In carrying on business activities an employer is required to fulfil their obligations in respect to the entitlements of their workers. These entitlements may be contained in the governing award, enterprise bargaining agreement or other industrial instrument negotiated between the employer and the relevant union on the employee's behalf. The obligation to make provision for leave entitlements may also arise under an employment contract negotiated directly between the employer and an employee.

29. By completing an Employer Application or making a contribution to the Fund, an employer becomes bound by the terms of the Deed (clause 10.3). The employer is required to meet the obligations contained in the Trust Deed of Protrust in addition to the employer's legal obligations under their relevant awards, industrial agreements or employment contracts.

30. It is accepted that there is a nexus between the business activities being carried on by the employer and the employer's obligation to provide for worker entitlements, such that payment of the employee entitlements is incidental and relevant to the production of the assessable income of the business.

Incurring the amount

31. At the point at which an employer makes the contribution to the Trustee of Protrust the amount is placed into member accounts and the amount/s are no longer owned by the employer. This differs from the situation in *Walstern v. Federal Commissioner of Taxation* [2003] FCA 1428 where there were no members of the trust and the contributions were not incurred as they remained funds of the employer.

32. The ability for amounts to be reimbursed and returned to the employer under the Trust Deed (a factor which must be possible to satisfy paragraph 58PB(4)(c) of the *Fringe Benefits Tax Assessment Act 1986*) does not affect whether the contributions are incurred by the employer.

33. Notwithstanding the ability to be reimbursed in the future, the contributions to Protrust are definite payments which the employer is required to make to meet the legal obligations of carrying on business activities. As such the contributions are incurred when made (for employers accounting on a cash basis) or when the liability to make the payment each month arises (for employers accounting on an accruals basis).

Conclusion

34. The employer's contributions to Protrust are outgoings incurred in carrying on a business for the purposes of section 8-1 of the ITAA 1997.

Negative limbs***Is the contribution revenue or capital in nature?***

35. Whether the payment of worker entitlements to Protrust is revenue or capital in nature depends on the character of the payment when made by the employer. As stated in *G.P. International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation* (1990) 90 ATC 4413 at 4419; (1990) 21 ATR 1 at 7:

The character of expenditure is ordinarily determined by reference to the nature of the asset acquired or the liability discharged by the making of the expenditure, for the character of the advantage sought by the making of the expenditure is the chief, if not the critical, factor in determining the character of what is paid: *Sun Newspapers Ltd. v. F.C. of T* (1938) 61 CLR 337 at p. 363.

36. In making the contributions to Protrust, the employer meets their immediate legal obligation under the relevant employment agreement. The employer discharges their obligation in respect to their employees each payment period.

37. The employer is making regular contributions to discharge an immediate obligation, the obligation is directly connected to the income earning capacity of the business. Accordingly, the payment of the contribution/s are revenue in nature.

Reimbursement of payment by employer

38. Where an employer has paid an employee their leave or redundancy entitlement the employer may apply to Protrust for a reimbursement of the amount paid in accordance with clause 22 of the Trust Deed.

39. Where an employer has claimed or will claim a deduction under section 8-1 of the ITAA 1997 for a leave or redundancy entitlement paid to an employee, the reimbursement of this expense must be declared as income. In these cases it is considered that the reimbursement is income received in the ordinary course of business and assessable under section 6-5 of the ITAA 1997 in the income year in which it is derived.

Appendix 2 – Detailed contents list

40. The following is a detailed contents list for this Ruling:

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References

Previous draft:

Not previously issued as a draft

Subject references:

- assessable recoupments
- deductions and expenses
- worker entitlement funds

Legislative references:

- ITAA 1997 6-5
- ITAA 1997 8-1
- FBTAA 1986 58PA
- FBTAA 1986 58PB(4)(c)
- TAA 1953
- TAA 1953 Sch 1 357-75(1)

- Copyright Act 1968

Case references:

- G.P. International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation (1990) 90 ATC 4413; (1990) 21 ATR 1
- Sun Newspapers Ltd. v. Federal Commissioner of Taxation (1938) 61 CLR 337
- Walstern v. Federal Commissioner of Taxation [2003] FCA 1428

ATO references

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