

CR 2004/40 - Income tax: deductibility of employer contributions to the National Entitlement Security Trust

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 This document has changed over time. This is a consolidated version of the ruling which was published on *1 June 2002*



Class Ruling

Income tax: deductibility of employer contributions to the National Entitlement Security Trust

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Preamble

*The number, subject heading, **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains Class Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax laws dealt with in this ruling are:

- Section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997); and
- Section 26-10 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is all employers who are required by an industrial instrument to make contributions on behalf of a worker to the National Entitlement Security Trust (NEST).

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

5. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the arrangement described in paragraphs 10 to 19.

6. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement 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- this Ruling may be withdrawn or modified.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 1 June 2002 to 30 June 2005. Further, the Class Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*;
- it is not taken to be withdrawn by an inconsistent later public ruling; or
- the relevant tax laws are not amended.

Withdrawal

9. This ruling is withdrawn and ceases to have effect after 30 June 2005. However, the Ruling continues to apply after its withdrawal in respect of the tax laws ruled upon, to all persons within the specified class who entered into the specific arrangement during the term of the Ruling, subject to there being no change in the arrangement or in the person's involvement in the arrangement.

Arrangement

10. The arrangement 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 part of and are to be read with the description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Class ruling application from the Trustee of the National Entitlement Security Trust dated 10 December 2003; and
- National Entitlement Security Trust Deed dated 1 June 2002.

11. NEST will accept employee entitlements which an employer is required to pay by their industrial instrument.

12. The amount of the required contribution may be notified from time to time by the Trustee of NEST.

13. NEST accepts 'employee entitlements', which are defined in clause 32.1 as:

'any dollar amount payable to a Member under an Industrial Agreement to which that Member has a right and which is identified as such in the Industrial Agreement including the following entitlements:

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

14. As stated in clause 7.1 of the trust deed the employer is required to make contributions to the Trustee of NEST in respect to their employee's worker entitlements.

7.1 Employee Entitlement Contributions

Each Employer must pay to the Trustee, or as directed by it, on such dates as agreed with the Trustee an amount equal to the Minimum Contribution for each Member employed or whose services are used by that Employer, in accordance with the terms of the Relevant Industrial Agreement in relation to the Employees of that Employer.

15. When the employer initially applies to NEST to accept contributions on behalf of its employees, the employer executes a deed of adherence. This deed requires the employer to make the contributions of employee entitlements monthly in arrears.

16. As outlined in clause 7.9 all contributions made to NEST will be placed into separate member (employee) accounts as directed by the employer.

7.9 Payments and credits/ Members Account

All contributions by any Employer will be allocated as directed by it and credited to personal accounts opened in the names of the Members and styled the Members' Account.

17. When an employee is entitled to their worker entitlements under the relevant industrial instrument the Trustee may pay the entitlement to the employer and/ or directly to the employee. The rules in relation to the payment procedure are contained in the administrative provisions in the trust deed.

Claims

Employers will pay a claim for Employee Entitlements in the same manner that Employers currently pay these employee entitlements. Employers will however, be entitled to reimbursement from the Trust for an amount calculated in accordance with clause 26 of the Deed.

The Fund Administrator will reimburse the Employer immediately upon receipt and completion of a signed NEST claim form available from the Fund Administrator, in accordance with clause 28. Reimbursements to Employers are paid by direct credit or by cheque. An Employer must exhaust its existing accrued Employer entitlements before claiming from the Fund.

Employees may claim directly from the Fund, in accordance with the Deed if:

1. The current Employer becomes insolvent (see clause 26).
2. The Employee is claiming Entitlements transported from a previous Employer (see clause 9 or clause 26).
3. The Employer's relevant industrial agreement specifically requires Employees to claim directly from the Fund.

18. The employer may obtain a reimbursement of their contributions from NEST after they have paid the employee their entitlement/s.

19. In the event of dissolution or vesting of the trust, the amount standing to the credit of the employer would be returned to it.

Ruling

20. An employer who has a legal obligation under an industrial instrument to make a contribution of employee entitlements to NEST, can claim a deduction under section 8-1 of the ITAA 1997 for the amount of the contribution which is required to be made under the industrial instrument.

Explanation

Application of section 8-1 of the Income Tax Assessment Act 1997

21. 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 and is not:

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

Positive Limbs

Nexus to gaining and producing assessable income

22. 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.

23. In addition to the employer's legal obligations under their relevant industrial instrument/s the employer is also required to meet the obligations contained in the Administration provisions of NEST. The administrative provisions require the employer to make monthly contributions to NEST in respect to worker entitlements.

24. 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

25. At the point at which an employer makes the contribution to the Trustee of NEST 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.

26. 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 (Cwth)*) does not effect whether the monthly contributions are incurred by the employer.

27. Notwithstanding the ability to be reimbursed in the future, the contributions to NEST 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

28. The employer's monthly contribution/s to NEST 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?***

29. Whether the payment of worker entitlements to NEST 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) ATC 4,413 at 4,419; (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 C.L.R. 337 at p. 363.

30. In making the monthly contribution/s to NEST, the employer meets their immediate legal obligation under the relevant industrial instrument. The employer discharges their obligation in respect to their employees each month.

31. The employer is making repetitive monthly 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.

Is the contribution precluded from deduction by section 26-10?

32. Section 26-10 of the ITAA 1997 provides that an outgoing for leave is not deductible except where the outgoing is an amount which is:

- paid in the income year to the individual to whom the leave relates (or if the individual is deceased to their dependant or legal representative); or
- an accrued leave transfer payment that is made in the income year.

33. The employer contributions made to NEST not only discharge the employers immediate legal obligations in respect to worker entitlements but also ensures that the employer is making adequate provision for the leave entitlements (sick leave, annual leave and long service leave) which will accrue under the relevant industrial instrument.

34. The employers contributing to NEST are making periodic payments to make provision for the future leave liability. However they are required to make these periodic payments to meet their immediate legal obligations. This differs from the situation in which an employer sets aside a provision to meet the future revenue contingencies of their business. In this case the employer is incurring an expense at the point at which the contribution is made. That is, the employer is not making a provision by an accounting entry, but is discharging their immediate legal obligation to provide for worker entitlements.

35. The contributions which the employer is required to make to NEST (as outlined in clause 7.1 of the trust deed) are calculated with reference to the minimum contribution required to meet the employer's future obligation under the relevant industrial agreement. The fact that the minimum contribution is calculated with respect to future leave entitlements does not change the nature of the payment from, discharging an immediate legal obligation in respect to leave, to a payment for leave.

36. As stated by Brennan J in *Nilsen Development Laboratories Pty Ltd v. Federal Commissioner of Taxation* (1979) 79 ATC 4520 at 4522; (1979) 10 ATR 255 at 258, an obligation to make a leave payment does not completely come into existence until the point in time that the leave is taken. It follows that to be a payment for leave would require the leave entitlement for the employee to have already crystallised:

A pecuniary liability could not arise before the time when an employee went on leave (cl 7), or his employment was terminated

(cl 8(2)(a)) or he died (cl 8(2)(b)). Though it was clear that a pecuniary liability would be imposed by the Award so soon as one of these events occurred, no pecuniary liability was imposed during the income year. Though it was certain that a liability to pay money to these employees or their respective personal representatives would at some future time be imposed by the Award, the time when that would occur and the quantum of the payment which would then have to be depended upon further events. In these circumstances, it was proper for the respondent to make provision in its 1974 accounts for a liability which was both foreseeable and inevitable. It did so by raising a provision for the payment of long service leave, calculated by reference to the respective employees' entitlements to leave (based on their respective years of service), and to the rate of wage then currently prescribed. The sum provided was the amount which, if leave had been taken on 30 June 1974, would then have become payable.

37. An outgoing will be for leave when it has the purpose of making a payment to an employee while on leave. Therefore, an outgoing will be for leave where it discharges the obligation of an employer to make a payment to a current employee while that employee is on leave.

38. Therefore the contributions made by the employer, being outgoings calculated with reference to future leave entitlements is not a payment for leave, and will not be excluded from deduction by the operation of section 26-10 of the ITAA 1997.

Conclusion

39. The employer's contribution to NEST is not capital in nature, and is not an outgoing for leave. As such the outgoing is not prevented from deduction under section 8-1 of the ITAA 1997 by being capital in nature, or by the operation of section 26-10 of the ITAA 1997.

Detailed contents list

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Commissioner of Taxation

21 April 2004

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Not previously issued as a draft

*Related Rulings/Determinations:*CR 2001/1; TR 92/1; TR 97/16;
TR 1999/5*Legislative references:*

- Copyright Act 1968
- FBTA 1986 58PB(4)(c)
- TAA 1953 Part IVAAA
- ITAA 1997 8-1
- ITAA 1997 26-10

Case references:

- G.P. International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation (1990) ATC 4,413; (1990) 21 ATR 1
- Nilsen Development Laboratories Pty Ltd v. Federal Commissioner of Taxation (1979) 79 ATC 4520; (1979) 10 ATR 255
- 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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