

CR 2006/50 - Income tax: deductibility of employer contributions to the Mechanical and Electrical Redundancy Trust

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⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *11 July 2007*



Class Ruling

Income tax: deductibility of employer contributions to the Mechanical and Electrical Redundancy Trust

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ⓘ 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 (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and 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.

[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

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 within this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 8-1 of the ITAA 1997;
- section 27A of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 27B of the ITAA 1936;
- section 27C of the ITAA 1936; and
- section 27F of the ITAA 1936.

Class of entities

3. The class of entities to which this Ruling applies is all employers who are required by their Deed of Adherence to make contributions on behalf of employees to the Mechanical and Electrical Redundancy Trust (MERT).

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 12 to 25 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 1 July 2000. However, 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.

9. 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)).

10. 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.

11. 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).

Note: The Partial Withdrawal to this Ruling that issued on 11 July 2007 applies on and from 11 July 2007.

Scheme

12. 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 Phillips Fox dated 9 August 2004;
- MERT trust deed including 2004 FBT amendments;
- MERT Building Industry Redundancy Pay Agreement (Annexure A of the MERT trust deed referred to in the class Ruling application as the Deed of Adherence);
- Electrical, Electronic and Communications Contracting Industry (State) Award (at July 2004);
- Metal, Engineering and Associated Industries Award 1998; and
- Electrics Enterprise Agreement 2004 (Draft 27 January 2004).

13. MERT is an Australian resident trust fund governed by a trust deed, which established the fund in Australia. The central management and control of the fund is in Australia.

14. The trustee of MERT is MERT Pty Ltd (trustee), an Australian resident company.

15. MERT is an approved worker entitlement fund for fringe benefits tax (FBT) purposes.

16. An employer may be required to make regular redundancy contributions to MERT because:

- Under the Metal, Engineering and Associated Industries Award 1998, an employer is required to adhere to the Building Industry Redundancy Pay Agreement made with MERT. In terms of clause 1.1 of this agreement the employer is required to fund award obligations to pay redundancy pay with MERT. As such an employer must, as required by subclause 9.1(a) of the MERT trust deed make a monthly redundancy contribution at the rate of \$25 each week or as otherwise set by the Trustee.
- Under the Electrical, Electronic and Communications Contracting Industry (State) Award, an employer is required to adhere to the Building Industry Redundancy Pay Agreement made with MERT. Under clause 1.1 of this agreement the employer is required to fund award obligations to pay redundancy pay with MERT. As such an employer must, as required by subclause 9.1(a) of the MERT trust deed make a monthly redundancy contribution at the rate of \$25 each week or as otherwise set by the Trustee.

17. MERT will accept contributions from employers, to fund each member's redundancy benefit. As provided in clause 9.1(a) of the MERT trust deed:

Each employer shall on a monthly basis promptly pay to the Trustee, or as directed by the Trustee, contributions in respect of each Member employed or whose services are used by that Employer (other than a Member who is an apprentice) at the rate of \$25 per week per Member, or such other rate as may from time to time be set by the Trustee having regard to the Objectives, for each week or (in the Trustee's discretion) part of a week in which the relevant Member is engage[d] in Relevant Service for that Employer.

18. While the minimum contribution rate in respect of each member employed or whose services are used by that employer is \$25 per week per member, higher rates will usually be agreed by the industrial parties.

19. In accordance with clause 10 of the trust deed, all contributions made to MERT by employers are credited to separate member (employee) accounts identifying contributions for that member.

20. On becoming redundant (as defined in the trust deed) a member is entitled to be paid a redundancy benefit directly from MERT under clause 27.1 of the trust deed. Where there is a balance in the member's account, payments may also be made for other reasons as per clause 27.2 or in respect of retirement, death, disablement and leaving the industry in accordance with clause 28.

21. Where the employer pays the member redundancy benefits directly, MERT will, as allowed under clause 26.1(b) of the trust deed, reimburse the employer for the amount paid to the particular member accordingly.

22. Fund income is not distributed each year. Under clause 26.3 of the trust deed any amounts not distributed (clause 27, 28 and 29 of the trust deed), transferred (clause 30 of the trust deed) or applied by the trustee (under clause 26.1 and 26.2 of the trust deed) are capitalised.

23. The trustee has a discretion under clause 26.1(i) of the trust deed to distribute income of the fund to the individual members.

24. Members can transfer the benefits they have accumulated with another redundancy fund into MERT where permitted by the other fund.

25. Under clause 30 of the trust deed members can transfer benefits to another redundancy fund that is an 'approved worker entitlement fund'.

Ruling

26. An employer who has a legal obligation to make redundancy contributions to MERT under the MERT trust deed, as an employer who is governed by an Award listed in Schedule A of the MERT Building Industry Redundancy Pay Agreement, can claim a deduction under section 8-1 of the ITAA 1997 for the amount of the contribution which is required to be made.

27. Where an employer pays an amount of redundancy entitlement directly to an employee and then seeks reimbursement from MERT, the amount of the payment of redundancy entitlement will be an allowable deduction under section 8-1 of the ITAA 1997.

28. A reimbursement received by an employer from MERT for an amount of redundancy entitlement 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.

29. Where the employer pays an amount of an entitlement directly to a worker and then seeks reimbursement from MERT, the payment of the entitlement will be treated in the same manner as if it were paid by MERT.

30. [Withdrawn]

31. [Withdrawn]

Commissioner of Taxation

7 June 2006

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 of the ITAA 1997

32. 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 ITAA 1997.

Positive limbs

Nexus to gaining and producing assessable income

33. 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.

34. 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 MERT. The administrative provisions require the employer to make monthly contributions to MERT in respect to worker entitlements.

35. 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

36. At the point at which an employer makes the contribution to the trustee of MERT 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 Pty Ltd v. Federal Commissioner of Taxation* (2003) 138 FCR 1; [2003] FCA 1428; 2003 ATC 5076; (2003) 54 ATR 423 where there were no members of the trust and the contributions were not incurred as they remained funds of the employer.

37. 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 effect whether the monthly contributions are incurred by the employer.

38. Notwithstanding the ability to be reimbursed in the future, the contributions to MERT 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

39. The employer's monthly contribution/s to MERT 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?

40. Whether the payment of worker entitlements to MERT is revenue or capital in nature depends on the character of the payment when made by the employer, as provided for in *GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation* (1990) 170 CLR 124; (1990) 90 ATC 4413; (1990) 21 ATR 1. Here the Court noted at CLR 137; ATC 4419; ATR 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.

41. In making the monthly contribution/s to MERT, the employer meets their immediate legal obligation under the MERT trust deed (as required by their governing Award listed in Schedule A of the MERT Building Industry Redundancy Pay Agreement).

42. The employer discharges their obligation in respect to their employees each month when the monthly payment is made to MERT as required by clause 9.1(a) of the MERT trust deed.

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

Payments by employer to employee

44. 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 to an employee by an employer is incidental and relevant to the production of the assessable income of the business.

45. Accordingly the payment of a redundancy entitlement to a redundant employee would be an allowable deduction under section 8-1 of the ITAA 1997 as an expense incurred in gaining or producing assessable income or carrying on a business.

Reimbursement of payment by employer

46. Where an employer has paid a worker their redundancy entitlement they may apply to MERT for a reimbursement of this amount. MERT may reimburse the employer for this amount under clauses 29 or 26.1 of the MERT trust deed.

47. Where an employer has claimed or will claim a deduction for a redundancy entitlement paid to a redundant employee under section 8-1 of the ITAA 1997, the reimbursement of this expense must be declared as income. In these cases it is considered that 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.

- 48. [Withdrawn]
- 49. [Withdrawn]
- 50. [Withdrawn]
- 51. [Withdrawn]
- 52. [Withdrawn]
- 53. [Withdrawn]
- 54. [Withdrawn]
- 55. [Withdrawn]
- 56. [Withdrawn]
- 57. [Withdrawn]
- 58. [Withdrawn]
- 59. [Withdrawn]
- 60. [Withdrawn]
- 61. [Withdrawn]
- 62. [Withdrawn]
- 63. [Withdrawn]

- 64. [Withdrawn]
- 65. [Withdrawn]
- 66. [Withdrawn]
- 67. [Withdrawn]
- 68. [Withdrawn]
- 69. [Withdrawn]
- 70. [Withdrawn]
- 71. [Withdrawn]
- 72. [Withdrawn]
- 73. [Withdrawn]
- 74. [Withdrawn]
- 75. [Withdrawn]
- 76. [Withdrawn]
- 77. [Withdrawn]
- 78. [Withdrawn]
- 79. [Withdrawn]

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 94/12; TR 2003/13

Subject references:

- assessable recoupments
- deductions and expenses
- eligible termination payments
- income

Legislative references:

- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- ITAA 1936 26(d)
- ITAA 1936 27A
- ITAA 1936 27A(1)
- ITAA 1936 27B
- ITAA 1936 27C
- ITAA 1936 27F
- ITAA 1936 27F(1)(a)
- ITAA 1936 27F(1)(aa)
- ITAA 1936 27F(1)(b)
- ITAA 1936 27F(1)(c)
- ITAA 1936 27F(1)(d)
- ITAA 1997 6-5
- ITAA 1997 8-1
- FBTA 1986 58PB(4)(c)
- Copyright Act 1968

Case references:

- AAT Case 4287 (1988) 19 ATR 3443; Case V67 88 ATC 505

- GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation (1990) 170 CLR 124; (1990) 90 ATC 4413; (1990) 21 ATR 1

- McIntosh v. Commissioner of Taxation (1979) 25 ALR 557; (1979) 10 ATR 13; 45 FLR 279; (1979) 79 ATC 4325

- R v. The Industrial Commission of South Australia; ex parte Adelaide Milk Supply Co-operative Ltd & Ors (1977) 44 SAIR 1202; (1977) 16 SASR 6

- Reseck v. Federal Commissioner of Taxation (1975) 49 ALJR 370; (1975) 6 ALR 642; (1975) 5 ATR 538; (1975) 75 ATC 4213; (1975) 133 CLR 45

- Short v. FW Hercus Pty Ltd (1993) 40 FCR 511; (1993) 46 IR 128; (1993) 35 AILR 151

- Sun Newspapers Ltd v. FC of T (1938) 61 CLR 337

- Walstern Pty Ltd v. Federal Commissioner of Taxation (2003) 138 FCR 1; [2003] FCA 1428; 2003 ATC 5076; (2003) 54 ATR 423

Other references:

- Explanatory Memorandum to the Income Tax Assessment Amendment Bill (No. 3) 1984

ATO references

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