


TR 98/D12 - Fringe benefits tax: employee benefit trusts and non-complying superannuation funds - meaning of 'associate'

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Draft Taxation Ruling

Fringe benefits tax: employee benefit trusts and non-complying superannuation funds - meaning of 'associate'

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What this Ruling is about

Class of person/arrangement

1. This Ruling considers in what circumstances a trustee of a trust or non-complying superannuation fund (whether resident or non-resident), which has been set up to provide benefits to employees, is an associate of the employee for the purposes of the *Fringe Benefits Tax Assessment Act 1986* ('the FBTA').
2. An employee benefit trust or non-complying superannuation fund is a trust established for the purpose of providing benefits to employees. Typically, the trust or fund is established and a contribution is made by the employer to the trustee in respect of potential beneficiaries who have sufficient connection with the income producing activities of the business. The trustee then makes an employee a beneficiary (or admits the employee as a member of the fund or, in the case of a unit trust, issues units to the employee). In other words, there is a plan or course of action designed to provide benefits to employees and obtain a tax deduction under section 8-1 of the *Income Tax Assessment Act 1997* ('the 1997 Act').
3. This Ruling specifically deals with the question of whether the introduction of an employee as a beneficiary or member subsequent to the contribution means that the trustee falls outside the definition of associate.
4. To be subject to fringe benefits tax ('FBT'), there must be a 'fringe benefit' (as defined in subsection 136(1) of the FBTA) that is provided to an employee or an 'associate' of an employee, in respect of

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the employment of the employee. This Ruling does not consider what constitutes a 'fringe benefit'.

5. This Ruling does not consider the application of the provisions of the *Income Tax Assessment Act 1936* ('the 1936 Act') or the 1997 Act to transactions or arrangements in connection with trusts set up to provide benefits to employees.

6. Section 136 of the FBTAA provides that the term 'associate' has the same meaning as that expression has in section 26AAB of the 1936 Act. Where the person is a natural person, other than a person in the capacity of trustee, subparagraph 26AAB(14)(a)(iv) provides that an associate in relation to that person means:

'a trustee of a trust estate where the taxpayer [the person] or another person who is an associate of the taxpayer by virtue of another subparagraph of this paragraph benefits or is capable (whether by the exercise of a power of appointment or otherwise) of benefiting under a trust, either directly or through any interposed companies, partnerships or trusts;'.

Date of effect

7. This Ruling applies to income years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Ruling

8. A trustee of a trust or non-complying superannuation fund that is constituted to provide benefits to employees can be an associate of an employee (as defined in subsection 136(1) of the FBTAA) notwithstanding that no employee (or associate of the employee) is a beneficiary or member when the benefit is provided to the trustee. It is sufficient if, at the time the benefit is provided to the trustee, an employee is subsequently made a beneficiary as part of, or in connection with, an arrangement to benefit employees.

9. Alternatively, where the trustee is not an associate of the employee (as defined in subsection 136(1)), it is considered that the trustee can fall within the extended definition of 'associate' in subsection 148(2) of the FBTAA. Subsection 148(2) deems a third party to be an associate of an employee where the third party receives

a benefit from a provider 'under an arrangement' between the employer (or associate) and the employee (or associate).

Explanations

Context

10. In the case of an employee benefit trust, the essential feature is a plan to benefit certain employees or their associates, under a trust, either by way of income, capital, or an exercise of a power of appointment. The following example is an illustration of a common unit trust arrangement. It does not limit the range of benefit arrangements that this Ruling seeks to address. Under the arrangement, contributions are made to the trustee, who then lends amounts to nominated employees who, in turn, purchase units in the trust. Some common steps include:

- | | |
|--------|--|
| Step 1 | A special purpose unit trust is established under, or subsequently becomes part of, the arrangement to benefit employees. |
| Step 2 | The employer determines which employees, and the relevant amounts by which they are potentially to benefit, and pays a contribution to the trustee. |
| Step 3 | The trustee lends (whether directly or pursuant to an acceptance of an offer made to the employees), to the employees, amounts equivalent to the expected future benefit that will be payable to those employees, on the basis that the loan will be used to subscribe for units in the trust. (There may or may not be a discretion in the trustee to reject the applications.) |
| Step 4 | The employees accept invitations to subscribe for units in the trust, either by using the loan funds provided by the trustee or their own funds. |
| Step 5 | The trustee invests the subscription proceeds on behalf of the employees. |

11. In the case of a non-complying superannuation fund (whether a resident or non-resident), a common plan is to make contributions in respect of employees and potential members of the fund through the following process:

- A. before the trustee accepts a member into the fund, the employer must nominate an employee and make a contribution in respect of that employee;

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- B. the contributions remain unallocated until the employees have been admitted into the fund;
- C. the trustee lends an amount equivalent to the contribution to each employee on condition that the employee uses the funds to lend that back to the fund. This is often referred to as a 'qualifying contribution';
- D. after a qualifying period (for example, 12 months), the employee is admitted as a member and the loans effectively cancel each other out.

In respect of employment

12. In order for the FBT provisions to apply, a benefit must be provided to an employee or an associate in respect of the employment of the employee. The phrase 'in respect of' in relation to the employment of an employee includes 'by reason of, by virtue of, or for or in relation directly or indirectly to, that employment' (subsection 136(1) of the FBTAA).

13. Where a trust is established for the benefit of the employees of an employer, there is a clear nexus between the provision of a benefit to the trustee and the employment of the employee.

Capable of benefiting under the trust

14. Subparagraph 26AAB(14)(a)(iv) of the 1936 Act provides that a trustee will be an associate of a person if that person, or an associate of that person, '... is capable (whether by the exercise of a power of appointment or otherwise) of benefiting under the trust ...'. The circumstances under which a person is **capable** of benefiting are very broad. Furthermore, the phrase 'whether by exercise of a power of appointment or otherwise' and that the capability of benefiting may be either 'directly or through any interposed companies, partnerships or trusts' confirms that the concept extends beyond presently existing beneficiaries.

15. The expression 'capable of' is not a technical term and takes its ordinary meaning. Where a trust is established for the benefit of employees, on a literal construction, the fact that a person is an employee means they fall within a class of persons who are 'capable of benefiting' under the trust.

16. At the very least, whether a person is capable of benefiting depends on all the facts and circumstances. If the following indicia are present, there is a strong inference that the employee is capable of benefiting:

- the potential beneficiaries, in respect of which the contribution has been made to the trust or non-complying superannuation fund, have sufficient connection with the income producing activities of the business so as to give rise to a deduction to the employer;
- the trust deed provides that only employees can become beneficiaries;
- loans to purchase units can only be made to employees nominated by the employer or invited by the trustee as part of an arrangement with the employer;
- employees are nominated by the employer as potential beneficiaries; or
- there are other indicia of a pre-ordained course of action to effect the provision of benefits to contemplated employees.

Power of appointment

17. A power of appointment is a power to create or grant beneficial interests in property (*Snell's Equity*, 29th ed). The objects of a power of appointment do not necessarily have any beneficial interests in the property subject to the power. Also, a trustee with a power of appointment may exercise the power to create new beneficial interests in the trust by appointing new beneficiaries (*Re Manisty's Settlement Trusts* [1973] 2 All ER 1203; *Blausten v IRC* [1972] 1 All ER 41).

18. It is considered that the expression 'capable of ... benefiting under the trust' is not limited to circumstances where a person is a present beneficiary. The use of the words 'whether by exercise of a **power of appointment or otherwise**' [emphasis added] clearly indicate that a person need not be an existing beneficiary under the trust.

19. It is considered that the power to issue units in a unit trust constitutes a power of appointment, as it creates beneficial interests in property.

20. An employee is 'capable ... of benefiting under the trust' if the employee is within a class, the members of which constitute the objects of a power of appointment.

Alternative view

21. An alternative view is that an employee who is not a beneficiary at the time the benefit is provided to the trustee, is not 'capable of

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benefiting under the trust'. We do not accept this view. Without derogating from the foregoing reasons, we consider that an employee is 'capable of benefiting' under a trust where the trust is established or becomes part of a pre-ordained arrangement to benefit employees, who have a sufficient nexus with the income producing activities to give rise to a deduction to the employer for contributions to the trust.

22. Furthermore, depending on the facts and circumstances, if the arrangement is for the sole or dominant purpose of avoiding the associate rules, such as, for example, the contemplation of establishing a new trust annually, the Commissioner may make a determination under section 67 of the FBTAA.

Arrangement

23. Where, in respect of the employment of an employee, a benefit is provided by a person - 'the provider' - to another person (other than the employee or an associate of an employee) - 'the third party recipient' - subsection 148(2) of the FBTAA deems the third party recipient of the benefit to be an associate of the employee where the benefit is provided under an 'arrangement' between the provider and the employee or an associate of the employee.

24. 'Arrangement' is defined in sub-section 136(1) as:

- '(a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied, and whether or not enforceable, or intended to be enforceable, by legal proceedings; and
- (b) any scheme, plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise;'

25. Sub-section 148(2) provides that the arrangement be between:

- '(c) the provider, the employer or an associate of the employer; and
- (d) the employee or a person who, but for this subsection, is an associate of the employee;'

26. It is considered that an arrangement between a provider who is also an employer, and an employee (or associate of the employee), satisfies the terms of sub-section 148(2).

Alternative view

27. It is arguable that for subsection 148(2) to apply, there must be a tri-partite agreement. That is, between the provider, the employer and the employee or associate of the employee. This view depends upon a

construction of paragraph 148(2)(c) that the provider and the employer must be different persons.

28. However, it is considered that the better view of paragraph 148(2)(c) is that it is to be read disjunctively. That is, the agreement must be between the provider **or** the employer **or** an associate of the employer and the employee or an associate of the employee. Such a construction would mean that the employer can also be the provider.

29. The disjunctive reading is consistent with the flexibility needed to be applied to the concept of an arrangement where it is open to the parties themselves to determine their own roles.

Examples

30. In the following examples, it has been assumed that the contributions are allowable deductions to the employer under the 1997 Act and the 1936 Act.

Example 1

31. A unit trust is established in order to provide benefits to the employees of Eugene Pty Ltd. At the time the unit trust is established the only unit holder is Eugene Pty Ltd. The trust deed provides that the only other units that can be issued are to employees at the invitation of the employer. Eugene Pty Ltd then makes a contribution of \$100,000 to the trust. The trust then issues units to employees.

32. The trustee is an associate of the employees as they are a class of persons capable of benefiting under the trust. Alternatively, the trustee is a deemed associate pursuant to section 148 of the FBTAA.

Example 2

33. A discretionary trust is established in order to provide benefits to the employees of Onegin Pty Ltd, the employees being a class of discretionary objects. The trustee has the power to distribute income or corpus to employees. Onegin Pty Ltd makes a contribution of \$10,000 to the trustee.

34. The trustee is an associate of the employees as they are discretionary objects of the trust and are clearly 'capable of benefiting' under the trust by virtue of an exercise of the trustee's power of appointment.

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Example 3

35. Fidelio Pty Ltd establishes a non-complying superannuation fund for the benefit of its employees. Fidelio Pty Ltd makes contributions to the fund. (For example, the fund could be established in a jurisdiction that only taxes domestically sourced income.) The contributions remain unallocated until Fidelio Pty Ltd nominates an employee. The employee will become a member of the fund when the trustee receives a contribution from the employee.

36. The trustee of the non-complying superannuation fund is an associate of the employee for the reasons given in paragraph 32 above.

Your comments

37. If you wish to comment on this Ruling, please send your comments by: 11 December 1998

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- ITAA97 8-1
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- ITAA36 26AAB(14)(a)(iv)

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- FBTAA 67
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- FBTAA 136(1)
- FBTAA 148(2)
- FBTAA 148(2)(c)

case references

- Re Manisty's Settlement Trusts
[1973] 2 All ER 1203
- Blausten v IRC [1972] 1 All ER 41