

# Cover sheet for: TD 94/D103

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## Draft Taxation Determination

### **Income tax: are fees paid for obtaining investment advice an allowable deduction under subsection 51(1) of the *Income Tax Assessment Act 1936* for taxpayers who are not carrying on an investment business?**

1. When a taxpayer seeks advice in relation to the most appropriate investment or investments to make, the taxpayer may participate with an investment advisor in developing an investment plan. After making the investment(s), in many cases there will be a continuing relationship with the investment advisor. An initial fee is payable upon drawing up the plan or making the investment(s) and a 'management' fee or 'annual retainer' fee is payable over the period of the investment(s), usually upon an annual or semi-annual review of the performance of the investment(s).
2. In discussing what makes expenditure deductible under subsection 51(1), Lockhart J said in *FC of T v. Cooper* 91 ATC 4396; 21 ATR 1616 (at ATC 4399, ATR 1620):

'The phrase "incurred in gaining or producing assessable income" in the first limb of s. 51(1) has been construed to mean incurred in the course of gaining or producing assessable income...'

'For expenditure to be an allowable deduction as an outgoing incurred in gaining or producing the assessable income, it must be incidental and relevant to that end;...This test of deductibility has been explained in subsequent judgments of the High Court, so that to be deductible the expenditure must be incidental and relevant in the sense of having the essential character of expenditure incurred in the course of gaining or producing assessable income...The essential character test is also applied to determine if the expenditure is of a capital, private or domestic nature...'
3. In view of the above, we do not think that the initial fee is deductible for income tax purposes. This is because it is not expenditure incurred in the course of gaining or producing the assessable income from the investment(s). It is too early in time to be an expense that is part of the income producing process. It is an expense that is associated with putting the income earning investment(s) in place, in the same way as certain kinds of investments attract entry fees, and has, therefore, an insufficient connection with earning income from the investment(s). See *FC of T v. Maddelana* 71 ATC 4161; (1971) 2 ATR 541 and the discussion of that case by Hill J in *Cooper*, (supra), at ATC 4412, ATR 1635.
4. The expenditure is also capital or of a capital nature. In *Sun Newspapers v. Federal Commissioner of Taxation* 5 ATD 87 Dixon J discussed the distinction between capital and revenue expenditure. At p. 95 he said:

'...Courts have relied to some extent upon the difference between an outlay which is recurrent, repeated or continual and that which is final or made "once for all," and to a still greater extent upon a distinction to be discovered in the nature of the asset or advantage obtained by the outlay. If what is commonly understood as a fixed capital

asset is acquired the question answers itself. But the distinction goes further. The result or purpose of the expenditure may be to bring into existence or procure some asset or advantage of a lasting character which will enure for the benefit of the organisation or system "or a profit earning subject".'

5. Expenditure on initial advice in relation to what investment(s) to make is incidental and relevant to *outlaying the price of acquiring the investment(s)*, and is so associated with the making of the investment(s) as to warrant the conclusion that it is capital or capital in nature. However, the expenditure may qualify as an incidental cost to the taxpayer of the acquisition of the asset(s) [i.e., the investment(s)] for capital gains tax purposes. See subsections 160ZH(1) and 160ZH(5).

6. On-going management fees or retainers are deductible under subsection 51(1). In Taxation Ruling IT 39 we discussed expenditure incurred in 'servicing' an investment portfolio. The Ruling discussed the decision in *FC of T v. Green* (1950) 81 CLR 313 which allowed a taxpayer a deduction in relation to the management of the income producing enterprises of the taxpayer. The Ruling concluded that expenditure in 'servicing' the portfolio should be regarded as incurred in relation to the management of income producing investments and thus as having an intrinsically revenue character. However, to be wholly deductible, all of a management fee must relate to gaining or producing assessable income. If the advice covers other matters or relates in part to investments that do not produce assessable income, only a proportion of the fee is deductible.

7. Some investment advisors charge a relatively small initial fee compared to what might normally be expected (say, \$500 rather than a more standard industry fee of \$5,000). They then invoice their client for a considerably larger management fee in the first year of the investment plan (say, \$5,000) and only charge a standard management fee in subsequent years (say, \$500). Others seem to charge a much higher management fee in the first few years of the investment compared to the later periods. For example, some may charge \$2000 per annum for the first 3 years and only \$500 per annum in later years. On the face of it, this sort of fee structure seems to be an attempt to disguise non-deductible initial fees as on-going management fees. We do not accept that by simply altering the fee structure a change occurs in the essential character of the expenditure. Accordingly, taxpayers should make sure that any amounts that are claimed as deductions really are on-going management fees and not simply deferred initial fees. If the facts of the case are that the amount paid represents a deferred initial fee, the amount paid is not deductible.

8. Over the period of an investment plan the advice received may suggest that changes be made to the mix of investments in a portfolio. Provided this is part and parcel of managing the investments in accordance with the plan and not a fundamental restructuring of the portfolio so as to make it a new, different portfolio, we accept that the expenditure continues to be deductible. However, we think that if the expenditure relates to a fundamental restructuring of the portfolio it will be capital or capital in nature and, therefore, non-deductible.

## Commissioner of Taxation

10/11/94

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Related Determinations:

Related Rulings: IT 5; IT 39; IT 2168; IT 2536; IT 2684

Subject Ref: investment advice fees; financial planning

Legislative Ref: ITAA 51(1); ITAA Pt IIIA ; ITAA 160ZH

Case Ref: FC of T v. Cooper 91 ATC 4396; 21 ATR 1616; Sun Newspapers v. Federal Commissioner of Taxation 5 ATD 87; FC of T v. Maddelana 71 ATC 4161; (1971) 2 ATR 541; FC of T v. Green (1950) 81 CLR 313

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