

# ***TR 1999/D7 - Income tax, fringe benefits tax and superannuation guarantee: salary sacrifice arrangements***

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## Draft Taxation Ruling

### Income tax, fringe benefits tax and superannuation guarantee: salary sacrifice arrangements

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Contents	Para
What this Ruling is about	1
Legislative framework	6
Terms used	16
Date of effect	21
Ruling	22
Explanations	33
Examples	97
Your comments	120

#### ***Preamble***

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## **What this Ruling is about**

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### **Class of person/arrangement**

1. This Ruling considers the taxation consequences for employees and employers of entering into salary sacrifice arrangements (SSAs).
2. This Ruling considers:
  - if amounts received by employees, or dealt with by employers at the direction of their employees under a SSA, should be included in the employee's assessable income under section 6-5 or 6-10 of the *Income Tax Assessment Act 1997* (ITAA 1997) (formerly subsection 25(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)) and section 19 and paragraph 26(e) of the ITAA 1936;
  - the implications for employers under the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) and Division 2 of Part VI of the ITAA 1936 (collection of tax instalment deductions from employees' salary or wages) of entering into SSAs with any of their employees;
  - if superannuation contributions made by an employer under a SSA qualify as employer contributions for the purposes of the *Superannuation Guarantee (Administration) Act 1992* (SGAA); and

# TR 1999/D7

- if the superannuation contributions made by an employer qualify as allowable deductions for employers under sections 82AAC to 82AAF of the ITAA 1936.

3. This Ruling applies both to employers and employees whose employment relationship is governed by award conditions and to those whose relationship is governed by individual contracts, collective contracts, enterprise workplace agreements or similar agreements or a combination of these.

4. This Ruling explains when benefits provided are considered to be 'salary or wages' and, therefore, not subject to fringe benefits tax (FBT) because of the operation of paragraph (f) of the definition of a 'fringe benefit' in subsection 136(1) of the FBTAA (refer paragraph 6 of this Ruling). This Ruling does not consider the position where benefits provided by employers fall outside the application of the FBTAA because of the operation of paragraphs (g) to (p) of the definition of fringe benefit in subsection 136(1) of the FBTAA, with the exception of paragraph (j) (see paragraphs 6 and 9 of this Ruling).

5. This Ruling does not consider the implications under Part 3-1 of the ITAA 1997 (capital gains tax) of entering into SSAs.

## Legislative framework

6. Employers are liable to pay FBT on the taxable value of all fringe benefits provided during a year of tax. In general terms, a fringe benefit is defined in subsection 136(1) of the FBTAA as a benefit provided to an employee or an associate of the employee by the employer or an associate of the employer in respect of the employment of the employee. The definition of 'fringe benefit' in subsection 136(1) does not, however, include either a payment of salary or wages within the meaning of that term in section 221A of the ITAA 1936 (paragraph (f) of the definition of fringe benefit in the FBTAA) or a payment to a complying superannuation fund (paragraph (j) of the definition).

7. 'Salary or wages' is defined in subsection 221A(1) of the ITAA 1936 and, in general terms, means salary, wages, commission, bonuses or allowances paid to an eligible person. An 'eligible person' is defined in subsection 221A(1) to include an employee at common law. Whether a person is an employee at common law depends on the nature of the relationship between the person who engages another to perform work and the person who is engaged.

8. If a 'fringe benefit', as defined by subsection 136(1) of the FBTAA, is income derived under the ITAA 1936, section 23L of the ITAA 1936 provides that the income is exempt income. Therefore,

even though the benefit may be income in nature, it is exempt income and does not form part of the assessable income of the employee under section 6-5 or 6-10 of the ITAA 1997.

9. Subparagraphs 26(e)(iv) and 26(e)(v) of the ITAA 1936 specifically exclude amounts that are fringe benefits or exempt benefits from being included in an employee's assessable income under paragraph 26(e). However paragraph (j) of the definition of fringe benefit in subsection 136(1) of the FBTAA excludes payments to complying superannuation funds from the definition of a fringe benefit (see paragraph 6 of this Ruling). This Ruling, therefore, considers the application of paragraph 26(e) to employer contributions to complying superannuation funds.

10. An employee's taxable income for a year of income is the employee's assessable income less allowable deductions. Employees may derive income directly when it is paid to them or income may be taken to have been received under subsection 6-5(4) or 6-10(3) of the ITAA 1997 because it is otherwise dealt with as directed by the employee.

11. Taxable income currently (see paragraph 15) forms the basis for calculating certain liabilities, e.g.:

- for employees - Medicare levy (paragraph 251S(1)(a) of the ITAA 1936) and Medicare Levy Surcharge (*Medicare Levy Act 1986*);
- for employees - child support liability (sections 36 and 38 of the *Child Support (Assessment) Act 1989*);
- for employees - HECS debts (section 106Q of the *Higher Education Funding Act 1988*); or
- for superannuation providers - liability under the *Superannuation Contributions Tax (Assessment and Collection) Act 1997* (subsections 7(2), 10(2), 15(1) and section 43) for the superannuation contributions surcharge.

12. An employee's taxable income also forms the basis for determining the employee's entitlement to certain tax concessions, e.g., the low income rebate (section 159N of the ITAA 1936), the private health insurance incentive tax offset (Subdivisions 61-G and 61-H of the ITAA 1997) and family tax assistance (Division 5 of the *Income Tax Rates Act 1986*), and is currently (see paragraph 15) used in the calculation of entitlement to some social security benefits such as AUSTUDY.

13. Salary or wages paid to employees forms the basis for calculating any liability for PAYE deductions that their employers may have to make (subsection 221C(1A) of the ITAA 1936).

# TR 1999/D7

14. An employer may be entitled to claim deductions under sections 82AAC to 82AAF of the ITAA 1936 for payments made to a superannuation fund for the purpose of making provision for superannuation benefits for employees, or for deposits made to small superannuation accounts under the *Small Superannuation Accounts Act 1995* for employees.

## Recently passed and proposed changes to the law

15. Recently passed and proposed changes to the law will alter the legislative framework for SSAs. *A New Tax System (Fringe Benefits Reporting) Act 1999* amends the tax laws to require employers, from the 1999-2000 year of income, to identify on group certificates the grossed-up taxable value of certain employee fringe benefits. This value will be included in the income tests used to determine liability for various tax surcharges, levies and other income related obligations. *A New Tax System (Medicare Levy Surcharge-Fringe Benefits) Act 1999* imposes the Medicare levy surcharge on the reported amounts. Also, under proposed legislation, from the 2000-2001 FBT year, fringe benefits eligible for concessional treatment of employees of public benevolent institutions and certain not-for-profit organisations will be limited to \$17,000 of grossed-up taxable value per employee. Any amount above this limit will be subject to normal FBT treatment.

## Terms used

16. **‘Salary sacrifice arrangement’** - in this Ruling, the term ‘salary sacrifice arrangement’ (SSA) means an arrangement under which employees agree contractually to forego part of the remuneration, that they would otherwise receive as salary or wages, in return for their employer or someone associated with their employer providing benefits of a similar value. The main assumption made by the parties is that the employee is then taxed under the tax laws only on the reduced salary or wages and that the employer is liable to pay FBT, if any, on the benefits provided.

17. The type of benefits provided in SSAs by employers to employees includes employer superannuation contributions, the provision of motor vehicles and expense payment fringe benefits, such as payment of school fees, childcare costs or loan repayments.

18. **‘Prospective SSA’** - prospective SSAs involve employees contractually foregoing a **future** entitlement to salary or wages before that entitlement becomes presently existing.

19. **‘Retrospective SSA’** - retrospective SSAs involve employees directing that a presently existing entitlement to salary or wages (see

paragraph 20 of this Ruling) is to be paid in a form other than as salary or wages.

20. **‘Presently existing entitlement to salary or wages’** - contracts of employment usually provide that employees are entitled to be paid salary or wages at fixed intervals when they have performed services for their employer over a fixed period. The entitlement to salary or wages for a fixed period or part of the period becomes presently existing to the extent that services for that period have been performed. A presently existing entitlement exists even if the employees will not be paid until a later time.

## **Date of effect**

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21. This Ruling applies to 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 the terms of 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**

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### **Employees - derivation of income**

22. Employees do not derive ordinary or statutory income from their employment until the income either has been received by them or is taken by subsection 6-5(4) or 6-10(3) of the ITAA 1997 to have been received when the employees direct that the amount be dealt with in some other way. We consider that, once employees have a presently existing entitlement to be paid an amount of ‘salary or wages’, any ordinary or statutory income later derived by employees from that entitlement under the terms of their employment is derived as ‘salary or wages’ income.

23. To the extent to which a prospective SSA provides that an employee’s entitlement to salary or wages is reduced below the minimum entitlement under industrial law, any such benefits are assessable income of the employee under section 6-5 or 6-10 of the ITAA 1997. They are not exempt income under section 23L of the ITAA 1936.

### ***Retrospective SSA***

24. We consider payments made under retrospective SSAs to, or on account of, employees are ordinary or statutory income derived by the employees at the time of payment for the reasons stated in

# TR 1999/D7

paragraph 22 above. Because of the conclusion reached in paragraph 28 of this Ruling, we also consider that benefits provided under retrospective SSAs are assessable income of the employees under section 6-5 or 6-10 of the ITAA 1997 and that they are not exempt income under section 23L of the ITAA 1936.

## ***Prospective SSA***

25. Benefits provided to or at the direction of employees under prospective SSAs may be derived as ordinary or statutory income by the employees. We consider any such benefits that are convertible to money are derived by the employees as ordinary or statutory income. However, we accept these benefits are not assessable income of the employees under section 6-5 or 6-10 of the ITAA 1997 because they are exempt income under section 23L of the ITAA 1936. Leave that will accrue from the provision of future services may be the subject of a prospective SSA, subject to the restriction noted at paragraph 23 above.

26. An entitlement to a bonus or other performance remuneration may be the subject of a prospective SSA, provided the SSA is entered into prior to the employee gaining a presently existing entitlement to the bonus.

27. A prospective SSA has the same effect for tax law purposes in relation to benefits provided, as noted at paragraph 25 above, even though it may provide that any residual amount not taken as benefits can be paid as cash. Such cash payments would be assessable as salary or wages to the employee under section 6-5 or 6-10 of the ITAA 1997 when they are paid to the employee.

28. We also accept that employers' contributions under prospective SSAs to complying superannuation funds on behalf of their employees are not assessable income of the employees under paragraph 26(e). This is because the sums contributed have not been allowed, given or granted to the employees but, instead, are paid to the administrators of the funds.

## **Employers - income tax, fringe benefits tax, PAYE and superannuation guarantee**

29. We consider benefits paid under prospective SSAs are not 'salary or wages' within the meaning of that term in subsection 221A(1) of the ITAA 1936 and subsection 136(1) of the FBTAA and employers, therefore, are not liable to make PAYE deductions from the payments (subsection 221C(1A) of the ITAA 1936).

30. However, we consider benefits paid under retrospective SSAs are 'salary or wages' for the purposes of subsection 221A(1) of the

ITAA 1936 and subsection 136(1) of the FBTAA. Therefore, employers are liable to make PAYE deductions from the payments, provided the other conditions of subsection 221C(1A) are met.

31. We consider superannuation contributions made by an employer under a prospective SSA are properly considered as employer contributions to the superannuation fund for the purposes of the SGAA and sections 82AAC to 82AAF of the ITAA 1936.

32. However, we consider superannuation contributions made by an employer under a retrospective SSA do not represent employer contributions to the superannuation fund for the purposes of the SGAA and do not entitle the employer to a deduction under sections 82AAC to 82AAF of the ITAA 1936.

## **Explanations**

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### **Employees - derivation of income**

#### ***Industrial Law***

33. One method by which State and Federal Industrial Relations Commissions establish employment rights is by an award. An award is a legal instrument, usually taking the form of a binding pronouncement, dealing with rates of pay and conditions of employment.

34. Awards regulate the future conduct of employees and employers by setting out their rights and obligations at the workplace. Awards usually provide for minimum rights only. Employers and employees can, however, agree to employment conditions that are more favourable than an award.

35. Some jurisdictions provide that employers can, by agreement with employees, modify the rights and obligations existing under an award. The agreements must be certified by the relevant Industrial Relations Commission or similar body before they come into operation.

36. Apart from awards, the industrial relations system also provides for a separate process by which employment conditions can be determined outside the award system. The formal name of these agreements varies between jurisdictions and includes certified agreements, enterprise flexibility agreements, workplace agreements, enterprise agreements and individual and collective employment agreements. The process involves employers and their employees or a single employee reaching a binding agreement at the workplace on wages, conditions and work practices.



# TR 1999/D7

37. In most jurisdictions, provided award employees are not disadvantaged by a reduction of any entitlements or protection under an award, a certified agreement prevails over the terms of the award.

38. In most jurisdictions, workplace or similar agreements must be registered or certified with a supervising body before the agreements can be binding on the parties involved.

39. Thus, where the parties to an award agree to substitute an employee's award based remuneration with conditions in a workplace or similar agreement, the employee's contractual right to salary, wages or allowances are then governed by the certified agreement.

40. However, not all employees are covered by workplace or similar agreements and awards. In such cases, the relationship between the employer and their employees will be governed solely by the contract of employment entered into between the parties.

41. There is also industrial legislation in each jurisdiction that establishes a range of employment rights. These rights, generally, include minimum conditions and, in some jurisdictions, the right to the payment of remuneration other than in cash.

## ***Contracts of employment***

42. The contractual relationship between employers and their employees commences with the entering into of a contract of employment between the employer and the employee prior to services being performed. An employment agreement can be entered into between the employer and one employee or a group of employees. The employment contract is usually in writing, although it may be entered into orally.

43. A contract of employment may include the fixed remuneration the employee is entitled to receive; any variable remuneration component such as bonuses, commissions and other performance payments; an agreed amount of cash remuneration and the value of non-cash remuneration.

44. Employment contracts may be amended during the course of an employee's employment to reflect changes made to employment conditions and remuneration arrangements, such as by SSAs.

## ***Conflict between employment agreements and industrial law, awards or workplace agreements***

45. Awards set minimum employment terms and conditions, but do not stop an employment contract from providing additional benefits (see *Kilminster v. Sun Newspapers Ltd* (1931) 46 CLR 284; (1931) 5 ALJ 285). A similar position applies to a workplace or

similar agreement. If the employment agreement is reached in breach of the relevant industrial law, award or workplace agreement and non-cash payments are made, the employee retains a legal entitlement to receipt of salary or wages.

46. As a consequence of industrial reforms in recent years, awards in a number of industries have been amended to allow employees and employers to enter into agreements to change part of their salary or wages into non-cash benefits. It is necessary for award employees, however, that their amended entitlements, when viewed objectively, are no less favourable than their entitlements under the relevant awards or agreements.

47. There is no restriction under industrial relations law on the extent of benefits that can be provided to an employee if there is no limit on the provision of benefits in the applicable industrial law, award or workplace or similar agreement.

### ***Interaction between the FBTAA and the ITAA***

48. The second reading speech of the then Treasurer, Mr Keating, in introducing the Fringe Benefits Tax Assessment Bill 1986, acknowledged that the introduction of the Bill was designed to overcome problems in applying the ITAA 1936 to taxing fringe benefits in the hands of employees. In particular, there had been difficulty in making case by case subjective judgments under paragraph 26(e) about the taxable value of fringe benefits provided to individual employees (see Hill J in *Roads and Traffic Authority of NSW v. FC of T* 93 ATC 4508 at 4510; (1993) 26 ATR 76 at 79-80).

49. The FBTAA recognises that employees are often rewarded for their services with both cash and non-cash benefits. The effect of section 23L (see paragraph 8 of this Ruling) and subparagraphs 26(e)(iv) and 26(e)(v) of the ITAA 1936 (see paragraph 9 of this Ruling) is to ensure the FBTAA deals exclusively with certain benefits. The benefits affected are those that meet the definition of a 'fringe benefit' in subsection 136(1) of the FBTAA or benefits that would be a fringe benefit under subsection 136(1) but for the operation of paragraph (g) of the definition of fringe benefit.

### ***Assessable income derived by employees from their employment***

50. Section 6-5 of the ITAA 1997 includes in the assessable income of a person income according to ordinary concepts, termed 'ordinary income', 'derived' by that person during the year of income. Section 6-10 includes in the assessable income of a person 'statutory income', being amounts included in assessable income under other provisions about assessable income. Subsection 6-15(2) of the ITAA

# TR 1999/D7

1997 provides that if an amount is exempt income it is not assessable income.

51. As discussed in paragraph 20 of this Ruling, contracts of employment usually provide that employees are entitled to be paid at fixed intervals when they have performed services for their employer over a fixed period. This ordinary or statutory income from employment is derived by employees, usually, at the time of receipt (see *Brent v. FC of T* (1971) 125 CLR 418; 71 ATC 4195; (1971) 2 ATR 563; *Case U 152* 87 ATC 894; *Case R 23* 84 ATC 215; *Case 77* (1984) 27 CTBR (NS) 604; and *Case V49* 88 ATC 381; *AAT Case 4,188* (1988) 19 ATR 3336).

52. However, an employee may direct that payments of employment income should be dealt with in some other way by the employer after it has been derived by the employee. In this situation, we consider that subsection 6-5(4) or 6-10(3) of the ITAA 1997 applies so that the amounts paid or benefits provided are taken to have been received as soon as they are applied or dealt with as the employee directs.

53. Support for this view can be found in the statements in *obiter dicta* of Latham CJ in *Gair v. FC of T* (1944) 71 CLR 388 at 393-4; (1944) 7 ATD 443 at 446-7. His Honour provided an example of the operation of the former section 19 of the ITAA 1936 (now subsections 6-5(4) and 6-10(3) of the ITAA 1997) to the redirection of salary or wages, in which he stated that, if a right to salary or wages is transferred by an employee to another person, then the employee would be assessable on the amount of salary at the time the employer makes the payment to the other person.

54. For an amount received to be income according to ordinary concepts, it must be money or something that can be converted into money (see *Alexander Tennant v. Robert Sinclair Smith* [1892] 3 TC 158; [1892] AC 150; *FC of T v. Cooke & Sherden* 80 ATC 4140; (1980) 10 ATR 696). Accordingly, if a benefit provided in a prospective SSA is convertible into money the amount will form part of the employee's ordinary or statutory income.

## ***Derivation of 'salary or wages' assessable income***

55. Employees derive ordinary and statutory income from their employment according to the principles discussed in paragraphs 50 to 54 above. That income can either be derived as 'salary or wages' assessable income under section 6-5 or section 6-10 of the ITAA 1997 or as 'fringe benefits' exempt income under section 23L of the ITAA 1936. We consider the character of the ordinary and statutory income is determined by whether the income is 'paid' as 'salary or wages' (within the meaning of those terms in subsections 221A(1) and

221C(1A) of the ITAA 1936) or is 'provided' as 'fringe benefits' (within the meaning of those terms in subsection 136(1) of the FBTA) at the time it is derived.

*Payment of salary or wages*

56. The decision of Dixon J in *FC of T v. Steeves Agnew & Co (Vic) Pty Ltd* (1951) 82 CLR 408; (1951) 9 ATD 259 considers when there is a 'payment' of 'salary or wages'. In that case, the managing director of the taxpayer company was entitled to remuneration that consisted wholly of a share of profits from the taxpayer's insurance broking business. Under his first employment contract, there was no provision for advances or drawings on account of the remuneration. The second contract enabled the manager to make monthly drawings in anticipation of his remuneration, with the necessary balancing adjustments to be made on a half-yearly basis. The issue was whether the taxpayer was liable, under the then form of section 221C, to make deductions from the drawings when they were made.

57. His Honour had no difficulty (at 82 CLR 414; 9 ATD 262) with considering the manager's remuneration to be in the nature of 'salary or wages' under subsection 221A(1). However, (at 82 CLR 414-6 and 418; 9 ATD 262-4) his Honour found that the character of the payments actually made (the drawings) was properly considered to be advances made in anticipation of an expected, but then uncertain, entitlement to salary or wages. His Honour then went on to hold (82 CLR 416-9; 9 ATD 263-5) that the taxpayer was not liable to make deductions from the drawings, as the manager was not entitled to receive salary or wages 'in respect of any week or part thereof', as was required by the then form of section 221C.

58. The Commissioner put a further argument to Dixon J that, after the ascertainment of the amount of remuneration to which the manager had become entitled, there was a 'payment' of 'salary or wages' when the taxpayer and the manager made the balancing adjustments in the accounts. His Honour held (82 CLR 421; 9 ATD 266) that there was no definite transaction between the parties that would amount to such a 'payment'. His Honour noted that section 221C appeared to be directed to the making of deductions from sums of money paid over and not to the discharge of an obligation for salary or wages by other means. However, his Honour commented (at 82 CLR 421-2; 9 ATD 266-7) that there could be definite transactions after remuneration is ascertained that might amount to payments of 'salary or wages' under section 221C.

59. The *Steeves Agnew* case was referred to in *Temple Wholesale Flower Supplies Pty Ltd v. FC of T* 90 ATC 4610; (1990) 21 ATR 556. In that case, the eight related employees of the taxpayer company became entitled, by resolution of the directors, to receive a

# TR 1999/D7

bonus. Later, entries were made in the taxpayer's accounts, which credited the loan accounts maintained by the employees with the taxpayer. The issue was whether 'salary or wages' had been 'paid' to the employees when the crediting occurred. Davies J held that 'payment' had occurred, as it effected an agreement between the taxpayer and its employees as to the 'payment' of the taxpayer's obligation. His Honour rejected a submission from the taxpayer's counsel that 'payment' means payment in cash or equivalent and said that, unless the context so requires, 'payment' may include the passing of a benefit in discharge of an obligation for services performed. He concluded that the *Steeves Agnew* case did not require him to find that the crediting did not constitute payment.

60. Although the decision of Davies J was later overturned by the Full Court of the Federal Court of Australia, on the basis that mere journal entries do not amount to payment (91 ATC 4387; (1991) 21 ATR 1606), his more general discussion of what might amount to 'payment' was not disturbed by the Full Court. In particular, the Full Court referred to the passage from the *Steeves Agnew* case about the need to have a definite transaction after remuneration was ascertained before there could be 'payment'.

61. We consider the *Steeves Agnew* case supports the view that a presently existing entitlement to be paid salary or wages can be properly characterised as an entitlement to be paid 'salary or wages', within the meaning of that term in subsection 221A(1) of the ITAA 1936. We also consider the *Temple Wholesale Flower Supplies* case recognises there could be definite transactions, after that entitlement arises, that might amount to 'payments' of 'salary or wages' for the purposes of section 221C.

62. Therefore, under a retrospective SSA, when services are performed under an employment contract for which the reward is salary or wages, any subsequent payment or provision of a benefit in lieu of payment has the character of 'salary or wages', within the meaning of that term in subsection 221A(1).

63. However, if employees enter into a prospective SSA, they forego a future entitlement to an amount of salary or wages before that entitlement becomes presently existing, in return for being provided with benefits of a similar value. We accept that, when employment services have been performed by employees in that situation, they become presently entitled to receive or have dealt with at their direction the agreed value of benefits. If the benefits, when provided, are found to be ordinary or statutory income derived, we accept that they are 'provided' as 'fringe benefits' (within the meaning of those terms in subsection 136(1) of the FBTAA). The benefits, therefore, are not assessable income under section 6-5 or 6-10 of the ITAA 1997.

64. We consider that the character of employment services remuneration is governed by the employment contract under which work is performed. As employment services are performed and the employees gain a presently existing entitlement to the income, any attempt by the employees to deal later with their entitlement will not change its salary or wage character.

*Payments and set-offs of cross liabilities between employers and employees*

65. The most common situation that would amount to 'payment' is where the benefits are paid directly by the employer to an employee.

66. Between the employer and the employee, there may be some scope for the operation of the doctrine of 'set-off' referred to in the *Steeves Agnew* case. As Dixon J recognised (82 CLR 420; 9 ATD 266):

'If cross-liabilities in sums certain of equal amounts immediately payable are mutually extinguished by an agreed set-off, that amounts to payment for most common law and statutory purposes'.

67. For the doctrine of 'set-off' to apply there has to be mutual liabilities of equal amounts presently payable between two parties. It is not enough, as held in *FC of T v. P Iori & Sons Pty Ltd* 87 ATC 4775; (1987) 19 ATR 201 and in *Lend Lease Corporation Ltd v. FC of T* 90 ATC 4401; (1990) 21 ATR 402, that there be a liability on one hand and a voluntary payment on the other. In addition, as the Full Court recognised in the *Temple Wholesale Flower Supplies* case, there must be agreement between the parties to adopt the set-off method of payment of debts. A unilateral action by one of the parties, such as a mere entry in books of account, does nothing to change the liabilities between the parties.

68. It is most likely that a set-off arrangement would arise in the two following situations in a retrospective SSA context. The first is where an employee has a debit balance in a loan account with the employer. The second is where an employee has a presently existing liability to pay for shares acquired in the employer under an employee share acquisition scheme. The employer and the employee might agree to set off the value of the liabilities owed by the employee to the employer against the employer's presently existing liability to pay 'salary or wages' to the employee.

69. We consider that such a set-off would amount to a 'payment' of 'salary or wages'. The above situations are to be contrasted with the situation where the payment of the employee's liability is made under a prospective SSA, in which case the set-off would amount to an expense payment fringe benefit.

# TR 1999/D7

## *Payments to employees by associates of the employer*

70. We consider that amounts paid to an employee under a retrospective SSA by someone associated with the employee's common law employer are payments of 'salary or wages'. It is our view that an 'employer' under the PAYE provisions is a person who pays 'salary or wages' to employees for services rendered to their common law employer under their employment contracts, regardless of whether or not the person making the payment is the common law employer. An 'employer' is defined in subsection 221A(1) of the ITAA 1936 as a person who pays or is liable to pay 'salary or wages'. 'Salary or wages' are paid to an employee as remuneration for employment services rendered.

71. The decision of Merkel J in *McLean & Anor v. FC of T* 96 ATC 4443; (1996) 32 ATR 647, supports this view. His Honour found that the employee retention payments made by a company associated with the common law employer were 'salary or wages' and agreed with comments by Hill J in *Newcastle Club Ltd v. FC of T* 94 ATC 4594 at 4595; (1994) 29 ATR 216 at 218-9 that the definition of salary or wages clearly contemplates payments from persons other than the common law employer.

## *Payments by employers to a person at the direction of an employee*

72. We consider that amounts paid under a retrospective SSA that are not paid directly to the employee, but to someone else at the direction of the employee, are payments of 'salary or wages'. Payments can only be payments of 'salary or wages' under subsections 221A(1) and 221C(1A) of the ITAA 1936 if paid to employees 'as such', i.e., payments to employees for employment services rendered.

73. We believe the recipient is merely receiving a payment of salary or wages to which the employee is already presently entitled. The recipient merely 'stands in the shoes' of the employee, such that receipt by the recipient is effectively receipt by, or discharge of the liability to, the employee.

## *Reduction of entitlement to salary or wages below minimum conditions under industrial law*

74. Arrangements in which employees seek to forego future salary or wages in exchange for benefits will not be effective for taxation purposes to the extent to which they reduce the employees' salary or wage entitlement below the employees' minimum entitlement under the relevant industrial award or workplace or other agreement. This is

because employees cannot contractually forego an entitlement to salary or wages below the minimum entitlement under industrial law (see paragraph 45 above). Accordingly, benefits provided in such circumstances form part of the employees' assessable income under section 6-5 or 6-10 of the ITAA 1997 and are not exempt income under section 23L of the ITAA 1936.

*SSAs involving leave entitlements*

75. Salary or wages may be paid to employees representing the payment of an entitlement to leave. Entitlement to annual, long service and sick leave generally accrues under employment contracts as employees perform services. While employees cannot take such leave until a later period, e.g., after 1 January each year for annual leave for some employees, after 10 years' service for long service leave for some employees and after conditions for eligibility for sick leave arise, the entitlement still becomes presently existing as the leave accrues.

76. If an employee enters into a SSA to deal with an entitlement to leave that is accruing or has accrued for past services performed under an employment contract that provides for the payment of salary or wages when leave is taken, then the SSA is retrospective. As stated at paragraph 72 above, benefits paid under a retrospective SSA are payments of salary or wages.

77. If an employee enters into a SSA to exchange any future entitlement to leave that will accrue for future services rendered under the employment contract, then the SSA is prospective. Benefits provided under a prospective SSA may be derived as ordinary or statutory income by the employee (see paragraph 63 above). However, in such cases, the income is exempt because of the operation of section 23L of the ITAA 1936.

*SSAs that involve bonus entitlements*

78. An entitlement to a bonus under an employee performance payment plan may be satisfied by the provision of salary or wages by the employer or the provision of other benefits. Bonuses under such plans that will be paid in the form of salary or wages, or for which the choice exists for payment to be made in such a form, may be the subject of a prospective SSA, provided no presently existing entitlement to the bonus exists. In accordance with the position stated at paragraph 63 above, benefits provided in exchange for bonuses payable in the form of salary or wages under a prospective SSA do not form part of the assessable income of the employee under section 6-5 or 6-10 of the ITAA 1997.



# TR 1999/D7

79. Once there is an entitlement to a bonus, which under the employment contract is to be paid as salary or wages, then such amounts cannot be the subject of a prospective SSA. Any provision of benefits in lieu of payment would be a retrospective SSA and the amount of the benefit would have the character of 'salary or wages' under section 221A(1).

## *SSAs in which employees retain a residual entitlement to salary or wages*

80. Some SSAs may also provide that employees are able to be paid cash for any unspent portion of any benefit entitlement of their salary package.

81. The arrangements outlined in paragraph 80 above are prospective SSAs to the extent that employees have benefits provided to them, or for their benefit, by their employers. The benefits provided do not form part of the assessable income of the employees under section 6-5 or 6-10 of the ITAA 1997. Any benefit entitlements that are satisfied by the payment of cash form part of their salary or wages under section 6-5.

## *Application of paragraph 26(e)*

82. We consider that paragraph 26(e) does not apply to salary sacrificed amounts received by employees under prospective SSAs. There is a view that, as paragraph (j) of the definition of 'fringe benefit' in subsection 136(1) of the FBTAA excludes employer contributions to complying superannuation funds, those payments are outside the exclusion of subparagraph 26(e)(iv) and could be assessable to an employee under paragraph 26(e) (see paragraph 9 of this Ruling). In our view, however, an employer's contributions under a prospective SSA to a complying superannuation fund on behalf of an employee are not assessable income of the employee under paragraph 26(e).

83. We consider that the comments of the majority of the High Court of Australia in *Constable v. FC of T* (1952) 86 CLR 402; (1952) 5 AITR 371; (1952) 10 ATD 93 to the effect that, because the sums contributed have not been allowed, given or granted to an employee but instead are paid to the administrators of the fund, support the view that paragraph 26(e) does not apply to the making of contributions to a superannuation fund by an employer for the employee's benefit.

84. We note that Webb J in *Constable* (86 CLR at 422; 5 AITR at 378; 10 ATD at 98) commented that contributions by the employer to the superannuation fund were assessable to the employee under

paragraph 26(e). This view was not favoured by the other judges in the case.

***Alternative view - application of paragraph 26(e)***

85. The structure and operation of superannuation funds have altered significantly since *Constable* was decided. In *Constable*, members did not have a vested and indefeasible right to employer contributions. The employer contributions could be forfeited under certain circumstances. The discretion available to the administrator in *Constable* is, however, no longer present under current superannuation legislation. The current superannuation legislation provides for definite vesting and a largely predetermined payout to fund members in the future.

86. There is an alternative view that paragraph 26(e) may include within the assessable income of an employee, superannuation contributions made under a prospective SSA by an employer on an employee's behalf.

87. Support for the application of paragraph 26(e) to superannuation contributions is found in *Case V21* 88 ATC 217; *AAT Case 4,067* (1988) 19 ATR 3081. This case considered whether health insurance cover provided by an employer for the benefit of an employee and his family fell within the employee's assessable income. The taxpayer conceded that the health insurance cover fell within the description to which paragraph 26(e) applied. The taxpayer's main argument was that the provision of insurance cover under a policy of insurance which provided for the payment, was contingent only upon the occurrence of a contingency or an event. This argument was based on the High Court decision in *Constable's* case, which established that such a contingent entitlement would fall outside the application of paragraph 26(e).

88. The Tribunal distinguished the decision in *Constable* because the making of the insurance contributions conferred immediately enforceable rights. Accordingly, the benefit of the insurance cover was assessable under paragraph 26(e).

89. We do not accept the alternative view expressed in paragraph 86 above. The facts of the Tribunal case are significantly different from that of a superannuation fund and do not bring into question the decision in *Constable* in respect of employer contributions to a complying superannuation fund.

# TR 1999/D7

## **Employers - income tax, fringe benefits tax, PAYE and superannuation guarantee**

### ***Salary or wages***

90. As discussed in paragraphs 50 to 73 of this Ruling, we consider that, once employees become presently entitled to receive an amount of 'salary or wages', the 'payment' of that entitlement is a 'payment' of 'salary or wages'. As amounts are paid under retrospective SSAs after the employees become presently entitled to receive an amount of 'salary or wages', we consider that the amounts are paid as 'salary or wages' for the purposes of subsections 221A(1) and 221C(1A) of the ITAA 1936.

91. The existence of a presently existing entitlement to receive salary or wages is contingent on the performance of services by an employee. We recognise that, until services have been performed, the character of an employee's remuneration can be altered with the agreement of the employer and the employee. As benefits provided under prospective SSAs represent salary or wages foregone before services have been performed, we recognise that such benefits are not payments of 'salary or wages' for the purposes of subsections 221A(1) and 221C(1A).

### ***Employer superannuation contributions for the purposes of the SGAA***

92. Section 22 of the SGAA recognises that the notional employer contribution rate for a class of employees in a defined benefit fund is affected by employer superannuation support provided. Contributions made for a class of employees of which the employee is one, will reduce or eliminate the employer's liability to pay the superannuation guarantee charge.

93. Subsections 23(2) and 23(3) of the SGAA recognise that, if an employer is required to make contributions to a superannuation fund other than a defined benefit fund under an industrial award or law, or an occupational superannuation arrangement, those contributions reduce or eliminate the employer's liability to pay the superannuation guarantee charge.

94. As we conclude in paragraph 90 of this Ruling that amounts paid under a retrospective SSA are paid as 'salary or wages', we consider that superannuation contributions made by an employer under a retrospective SSA are not properly considered to be employer contributions to the superannuation fund for the purposes of the SGAA. However, as we recognise in paragraph 91 of this Ruling that benefits provided under a prospective SSA are not paid as 'salary or wages', we recognise that superannuation contributions made by an employer under a prospective SSA count towards the employer's

obligation to provide a minimum level of superannuation support for the employee under the SGAA.

***Employer superannuation contributions for the purpose of sections 82AAC to 82AAF of the ITAA 1936***

95. Sections 82AAC to 82AAF, subject to certain limits, grant a deduction to employers who make contributions to superannuation funds for their employees. For the same reasons as discussed in paragraph 94 above, we accept that superannuation contributions made under prospective SSAs qualify as employer contributions under sections 82AAC to 82AAF.

96. To the extent to which an employer makes contributions to a superannuation fund under a retrospective SSA then, for the same reasons as discussed in paragraph 94 above, we consider that the contributions do not entitle the employer to a deduction under sections 82AAC to 82AAF.

## **Examples**

### **Example 1 - prospective SSA**

97. Andrew Executive was paid \$72,000 in salary plus \$6,500 in employer superannuation contributions in the 1997-98 year of income. On 30 June 1998, Andrew renegotiated his employment contract for the 1998-99 year of income to receive \$65,500 salary and \$13,000 employer superannuation contributions. There is no award, workplace or similar agreement covering Andrew's terms of employment.

98. The renegotiation of the employment agreement is a prospective SSA. This is because Andrew has entered into the arrangement with his employer before performance of services for the following year of income.

99. The superannuation contributions made on Andrew's behalf are not taken by subsections 6-5(4) and 6-10(3) of the ITAA 1997 to be derived as income. Paragraph 26(e) of the ITAA 1936 also does not apply to the contributions.

100. The superannuation contributions of \$13,000 for the 1998-99 year of income qualify for the purposes of the SGAA as employer superannuation contributions. Andrew's employer qualifies for a deduction of \$13,000 in the 1998-99 year of income under section 82AAC of the ITAA 1936. Andrew is 35 years old and, therefore, his employer is entitled to a deduction for contributions up to a maximum of \$29,443 on his behalf for the 1998-99 year of income (subsection 82AAC(2A)).

**TR 1999/D7****Example 2 - prospective and retrospective SSAs**

101. Jane Executive's employment contract (old agreement) provides for \$62,000 in salary plus \$13,000 in employer superannuation contributions (paid by \$4,769.23 wages and contributions of \$1,000 every 4 weeks for the 1998-99 year of income). Jane is paid on the Monday following the end of each 4-week pay period. At the end of the 7th pay period, on 10 January 1999, Jane contracts with her employer (new agreement) to alter her 1998-99 salary package, commencing from 16 December 1998, to \$55,000 salary and \$20,000 employer superannuation contributions. The contract provides that \$3769.23 wages and contributions of \$2,000 are to be paid by Jane's employer every 4 weeks (commencing for the 7th pay period) to ensure that a total of \$20,000 has been contributed by the end of the year of income.

102. Jane is 35 years old and, therefore, her employer is entitled to a maximum deduction of \$29,443 for superannuation contributions on her behalf for the 1998-99 year of income (subsection 82AAC(2A)).

103. On 13 January 1999, Jane is paid wages for the seventh pay period. Her employer makes a superannuation contribution for her benefit of \$2,000 on the same date. The calculation of contributions required under the new agreement for the rest of the year is:

(total amount of superannuation contributions new agreement -  
(amount of 4-weekly superannuation contributions old agreement x  
number of pay periods to 13 December 1998) ÷ number of pay  
periods from 16 December 1998)

$((\$20,000 - (\$1,000 \times 6)) \div 7)$ .

104. The new agreement is a retrospective SSA for the 7th pay period, as the old agreement gave Jane a presently existing entitlement on 10 January 1999 to be paid wages of \$4769.23 and to have an employer contribution of \$1,000 made. Accordingly, the effect of this is that subsection 6-5(4) of the ITAA 1997 provides that \$1,000 of the contribution made by Jane's employer to her superannuation fund on 13 January 1999 is salary or wage income derived by her on that day. The calculation for this is:

(amount of monthly superannuation contributions new agreement -  
(total amount of superannuation contributions old agreement ÷  
number of pay periods for the 1998-99 year of income))

$(\$2,000 - (\$13,000 \div 13))$ .

105. The new agreement operates as a prospective SSA from 13 January 1999 and we accept that subsection 6-5(4) of the ITAA 1997 does not apply to any amount of the superannuation contributions of \$2,000 made by Jane's employer for the eighth or later pay periods.

We also accept that paragraph 26(e) has no application to the contributions either, because the amounts have not been allowed, given or granted to Jane but, instead, are paid to the administrators of the fund. Jane derives income of \$56,000 for the 1998-99 year of income.

106. Jane's employer, for the purposes of the SGAA, is considered to have made employer superannuation contributions on her behalf of:

$((\$1000 \times 6) + (\$2,000 \times 7)) - \$1,000 = \$19,000$   
for the 1998-99 year of income.

107. Jane's employer qualifies for a deduction for the 1998-99 year of income under section 82AAC for superannuation contributions made for Jane of \$19,000.

108. \$1,000 of the superannuation contribution of \$2,000 made by Jane's employer on her behalf on 13 January 1999 is considered to be an employee contribution for the purposes of the SGAA. Similarly, Jane's employer does not qualify for a deduction under section 82AAC for the \$1,000 contribution.

### **Example 3 - provision of a bonus with no entitlement to salary or wages**

109. Lynda Sales-Consultant works for an insurance company. She receives units in a unit trust that her employer manages as an award for achieving 'consultant of the year' for her employer. She has no entitlement to the units until receipt and she has no choice of the form in which the award is paid.

110. Lynda does not need to include the units received in her assessable income as salary or wages because they were not paid in exchange for a presently existing entitlement to salary or wages. Lynda's employer is liable to pay FBT for the benefit provided to her.

### **Example 4 - retrospective SSA involving a bonus**

111. Kerrie Executive is employed by a stockbroker. She is advised that her entitlement to an annual bonus under the corporate performance bonus scheme is \$6,000. She is given the choice of having the amount credited to her bank account, receiving units in a unit trust that her employer manages or additional superannuation contributions. She chooses to receive units in a unit trust.

112. Subsection 6-5(4) of the ITAA 1997 deems that Kerrie has derived income of \$6,000 because she has not contractually foregone her entitlement to salary or wages prior to the presently existing entitlement arising. Kerrie's employer is not liable to FBT on the benefit provided.

# TR 1999/D7

## **Example 5 - prospective SSA involving a bonus**

113. Kerrie Executive must lodge a declaration with her employer, a funds manager, notifying the form in which her annual profit sharing bonus for the 1998-99 year of income will be paid. She is given the choice of having the amount credited to her bank account, receiving units in a unit trust that her employer manages or additional superannuation contributions. She chooses to receive units in the unit trust and lodges the declaration on 1 July 1998.

114. On 1 August 1998 Kerrie's employer notifies her of her entitlement and pays the bonus 1 week later. Accordingly, her entitlement to the bonus does not become presently existing until 1 August 1998. Kerrie's bonus is the subject of a prospective SSA. Kerrie's employer is liable to pay FBT on the benefit provided.

## **Example 6 - SSA involving leave**

115. David Citizen negotiates a SSA for the 1998-99 year of income with his employer at the close of business on 30 June 1998 in relation to his annual leave. The SSA applies to his leave that has already accrued, together with future leave that will accrue. There are no restrictions under the relevant industrial law, etc., that limit the amount of annual leave that David can forego in exchange for other benefits. As at 30 June 1998, David has an entitlement to annual leave of 4 weeks for services performed in the period 1 January 1997 to 31 December 1997. David has also accrued annual leave of 2 weeks for the period 1 January 1998 to 30 June 1998, although he is not entitled to take this leave until 1 January 1999. David would, however, receive payment of the leave entitlement if he were to resign prior to 1 January 1999.

116. Expense payment reimbursements received by David in exchange for his accrued leave of 2 weeks annual leave and the presently available 4 weeks of annual leave represent the payment of a presently existing entitlement to salary or wages. The benefits received accordingly have the character of salary or wages income. David's employer is liable to make PAYE deductions from the payments, provided the other conditions of subsection 221C(1A) of the ITAA 1936 are met.

117. Expense payment reimbursements received by David in lieu of the entitlement that he has foregone for leave accruing after 30 June 1998 represent benefits received under a prospective SSA and do not form part of David's assessable income. David's employer is liable to pay FBT on the benefits provided.

**Example 7 - prospective SSA with a residual entitlement to salary or wages**

118. Elizabeth Highflyer enters into an arrangement with her bank employer in which she is entitled to receive expense payment reimbursements of up to ten percent of her remuneration package for future services rendered. The agreement provides that, if at the end of each quarter she has not received ten percent of her remuneration package as an expense payment reimbursement, she can receive the balance as cash.

119. All the expense payment reimbursements are considered to be benefits received under a prospective SSA. Elizabeth's employer is liable for FBT on the benefits provided to Elizabeth. Any residual payments of cash received have the character of salary or wages.

**Detailed contents list**

120. Below is a detailed contents list for this Ruling:

	<b>Paragraph</b>
<b>What this Ruling is about</b>	<b>1</b>
Class of person/arrangement	1
<b>Legislative framework</b>	<b>6</b>
Recently passed and proposed changes to the law	15
<b>Terms used</b>	<b>16</b>
<b>Date of effect</b>	<b>21</b>
<b>Ruling</b>	<b>22</b>
Employees – derivation of income	22
<i>Retrospective SSA</i>	24
<i>Prospective SSA</i>	25
Employees – income tax, fringe benefits tax, PAYE and superannuation guarantee	29
<b>Explanations</b>	<b>33</b>
Employees – derivation of income	33
<i>Industrial Law</i>	33
<i>Contracts of employment</i>	42
<i>Conflict between employment agreements and industrial law, awards or workplace agreements</i>	45
<i>Interaction between the FBTAA and the ITAA</i>	48



**TR 1999/D7**

<i>Assessable income derived by employees from their employment</i>	50
<i>Derivation of 'salary or wages' assessable income</i>	55
<i>Payment of salary or wages</i>	56
<i>Payments and set-offs of cross liabilities between employers and employees</i>	65
<i>Payments to employees by associations of the employer</i>	70
<i>Payments by employers to a person at the direction of an employee</i>	72
<i>Reduction of entitlement to salary or wages below minimum conditions under industrial law</i>	74
<i>SSAs involving leave entitlements</i>	75
<i>SSAs that involve bonus entitlements</i>	78
<i>SSAs in which employee's retain a residual entitlement to salary or wages</i>	80
<i>Application of paragraph 26(e)</i>	82
<i>Alternative view – application of paragraph 26(e)</i>	85
Employers – income tax, fringe benefits tax, PAYE and superannuation guarantee	90
<i>Salary and wages</i>	90
<i>Employer superannuation contributions for the purposes of the SGAA</i>	92
<i>Employer superannuation contributions for the purpose of sections 82AAC to 82AAF of the ITAA</i>	95
<b>Examples</b>	<b>97</b>
Example 1 – prospective SSA	97
Example 2 – prospective and retrospective SSAs	101
Example 3 – provision of a bonus with no entitlement to salary or wages	109
Example 4 – retrospective SSA involving a bonus	111
Example 5 – prospective SSA involving a bonus	113
Example 6 – SSA involving leave	115
Example 7 – prospective SSA with a residual entitlement to salary or wages	118
<b>Your Comments</b>	<b>120</b>

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## Your comments

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120. If you wish to comment on this draft Ruling, please send your comments promptly by **Friday 16 July 1999** to:

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### Commissioner of Taxation

2 June 1999

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*Previous draft:*

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*Related Rulings/Determinations:*

MT 2050; SGD 93/4; TD 93/229;  
TR 92/15

*Subject references:*

- assessable income
- constructive receipt
- derivation of income
- salary sacrifice

*Legislative references:*

- HEFA 106Q
- ITAA 19
- ITAA 23L
- ITAA 25(1)
- ITAA 26(e)
- ITAA 26(e)(iv)
- ITAA 26(e)(v)
- ITAA 82AAC
- ITAA 82AAC(2A)
- ITAA 82AAD
- ITAA 82AAE
- ITAA 82AAF
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# TR 1999/D7

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Page 26 of 26

FOI status: draft only - for comment

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- Roads and Traffic Authority of NSW v. FC of T 93 ATC 4508; (1993) 26 ATR 76
- Temple Wholesale Flower Supplies Pty Ltd v. FC of T 90 ATC 4610; (1990) 21 ATR 556
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- Alexander Tennant v. Robert Sinclair Smith [1892] 3 TC 158; [1892] AC 150
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- Case R23 84 ATC 215; Case 77 (1984) 27 CTBR (NS) 604
- Case V21 88 ATC 217; Case 4,067 (1988) 19 ATR 3081
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