


# ***TR 2001/D5 - Income tax: fringe benefits tax and superannuation guarantee: salary sacrifice arrangements***

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This document has been finalised by TR 2001/10.



## **Draft Taxation Ruling**

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

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#### ***Preamble***

*Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office. DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings that represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling.*

## **What this Ruling is about**

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### **Class of persons/arrangement**

1. Providers of personal services and the entities that receive those services have long concerned themselves with how the service providers are appropriately remunerated for the services that they provide. Various arrangements have been developed to deal with this issue, including what are known commonly as salary sacrifice arrangements (SSAs).

2. For the purposes of this ruling, we regard SSAs as remuneration arrangements involving PAYG withholding amount payers and payees covered by sections 12-35 (salary, wages, commission, bonuses or allowances paid to an individual as an employee), 12-40 (remuneration of company directors) or 12-45 (salary, wages, etc. paid to certain office holders) of Schedule 1 to the *Taxation Administration Act 1953* (TAA). This Ruling does not address whether remuneration arrangements involving PAYG withholding amount payers and payees covered by sections 12-115 (Commonwealth education or training payments) or 12-120 (compensation, sickness or accident payments) of Schedule 1 to the TAA can be the subject of a SSA.

3. For the purposes of this ruling:

- the relevant PAYG withholding amount payers are called employers;

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- the relevant PAYG withholding amount payees are called employees; and
  - the withholding amount payments paid under sections 12-35, 12-40 and 12-45 of Schedule 1 to the TAA are called salary or wages.
4. This Ruling considers:
- if amounts received by employees, or dealt with by employers on behalf of their employees, under a SSA, should be included in the employees' assessable income under section 6-5 or 6-10 of the *Income Tax Assessment Act 1997* (ITAA 1997) (formerly section 19 and subsection 25(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)) or paragraph 26(e) of the ITAA 1936;
  - the implications for employers under the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) and Part 2-5 of Schedule 1 to the TAA (collection of PAYG withholding amounts from particular withholding payments) of entering into SSAs with any of their employees;
  - if superannuation contributions made by an employer under a SSA to a complying superannuation fund or to a retirement savings account (RSA) qualify as employer contributions for the purposes of the *Superannuation Guarantee (Administration) Act 1992* (SGAA); and
  - if the superannuation contributions made by a taxpayer under a SSA *qualify* as allowable deductions under sections 82AAC to 82AAF of the ITAA 1936.
5. The views set out in this Ruling apply both to employers and employees whose personal service relationship is governed by appointments, statute and award conditions and to those whose personal service relationship is governed by individual contracts, collective contracts, enterprise workplace agreements or similar agreements or a combination of these.
6. 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 8 of this Ruling). However, it 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 (q) (the second)

of the definition of fringe benefit in subsection 136(1) of the FBTAA, with the exception of paragraph (j) (see paragraphs 8 and 11).

7. The implications under Part 3-1 of the ITAA 1997 (capital gains tax) of entering into SSAs are not addressed.

## **Legislative Framework**

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8. Employers (being persons who pay, or are liable to pay, 'salary or wages' for the purposes of the FBTAA) 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 (being persons who receive, or are entitled to receive, 'salary or wages') 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' or a payment that would be 'salary or wages' if 'salary or wages' included exempt income for the purposes of the ITAA 1936 (paragraph (f) of the definition of fringe benefit in the FBTAA); or a payment to a complying superannuation fund, to a non-resident superannuation fund, (in limited circumstances), or to a RSA (paragraph (j) of the definition), in respect of an employee.

9. 'Salary or wages' is defined in subsection 136(1) of the FBTAA and means a payment, to the extent that it is assessable income, from which an amount must be withheld under either section 12-35, 12-40, 12-45, 12-115 or 12-120 of Schedule 1 to the TAA. Whether a person is an employee at common law, for the purposes of section 12-35, depends on the nature of the relationship between the person who engages another to perform work and the person who is engaged. Taxation Ruling TR 2000/14 provides a detailed explanation of the circumstances in which a person is an employee for the purposes of section 12-35 of Schedule 1 to the TAA.

10. If a 'fringe benefit', as defined by subsection 136(1) of the FBTAA, is ordinary income or statutory income derived under the ITAA 1997, 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 subsection 6-15(2) of the ITAA 1997 ensures that it does not form part of the assessable income of the employee under section 6-5 or 6-10 of the ITAA 1997.

11. 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 a taxpayer'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

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complying superannuation funds, payments to non-resident superannuation funds in respect of persons who are exempt visitors to Australia for the purposes of section 517 of the ITAA 1936 and payments to a RSA from the definition of a fringe benefit (see paragraph 8 of this Ruling). *Taxation Laws Amendment (Superannuation Contributions) Bill 2000* was introduced to Parliament on 7 September 2000. This Bill, if passed, will amend the law so that payments for the benefit of associates of an employee are not excluded from the definition of fringe benefit. This Ruling, therefore, considers the application of paragraph 26(e) to superannuation contributions made by taxpayers in respect of employees.

12. An employee's taxable income for a year of income is his or her assessable income less allowable deductions (refer subsection 4-15(1) of the ITAA 1997). 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 on behalf of the employee.

13. Subject to the recent law changes referred to in paragraphs 17 and 18 of this Ruling, taxable income forms the basis for calculating certain liabilities, e.g.,:

- for individual taxpayers including employees - Medicare levy (paragraph 251S(1)(a) of the ITAA 1936) and Medicare Levy Surcharge (*Medicare Levy Act 1986*);
- for individual taxpayers including employees - child support liability (sections 36 and 38 of the *Child Support (Assessment) Act 1989*);
- for individual taxpayers including employees - HECS debts (section 106Q of the *Higher Education Funding Act 1988*);
- 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.

14. The taxable income of an individual taxpayer including an employee also forms the basis for determining the individual'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, subject to the changes referred to in paragraphs 17 and 18 of this Ruling, is used in the calculation of entitlement to some social

security benefits such as AUSTUDY. Entitlement to the personal superannuation contributions rebate (section 159SZ of the ITAA 1936) and the rebate for superannuation contributions made in relation to a spouse (section 159T of the ITAA 1936) are based respectively in part on the assessable income of the individual taxpayer and spouse.

15. Amounts which must be withheld under either section 12-35, 12-40 or 12-45 of Schedule 1 to the TAA form the basis for calculating any PAYG withholding liability which the employers as PAYG payers may have.

16. An employer which is a taxpayer 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.

#### ***A New Tax System changes to the law***

17. Changes to the law resulting from changes announced in the Government's tax reform plan, *Tax reform: not a new tax, a new tax system* have altered the legislative framework that affects SSAs. The *A New Tax System (Fringe Benefits Reporting) Act 1999* requires employers, from 1 April 1999, to allocate the taxable value of certain benefits provided to recipient employees or their associates. When the total taxable value of such benefits relating to an employee exceed \$1 000 for a FBT year, the employer must gross-up that value and include the grossed-up amount on the employee's group certificate or payment summary for the corresponding year of income. The amount is not included in the employee's assessable income. However, it is included in a number of income tests used for determining liability for various tax charges, levies and other income related obligations.

18. Under the *A New Tax System (Fringe Benefits) Act 2000*, from the 2000-01 FBT year, the concessional treatment given to benefits provided to an employee of a public hospital, a non-profit hospital or a non-government public hospital is limited to \$17 000 of the total grossed up value per employee. Any benefit provided above this limit will be subject to normal FBT treatment. Under that same Act, from the 2001-02 FBT year, the concessional treatment given to benefits provided to an employee of a public benevolent institutions (other than a hospital) or an FBT rebatable organisation will be limited to \$30 000 of total grossed-up value per employee.

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## Terms used

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19. **‘Salary sacrifice arrangement’** - in this Ruling, the term salary sacrifice arrangement means an arrangement under which employees agree to forego part of their total remuneration, that they would otherwise expect to 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 income tax laws only on the reduced salary or wages and that the employer is liable to pay FBT, if any, on the benefits provided.
20. The type of benefits provided in SSAs by employers to employees includes superannuation contributions, the provision of motor vehicles and expense payment fringe benefits, such as payment of school fees, childcare costs or loan repayments.
21. **‘Effective SSA’** - effective SSAs involve employees agreeing to receive part of their total amount of remuneration as benefits before the employee has earned the entitlement to receive that amount as salary or wages.
22. **‘Ineffective SSA’** - ineffective SSAs involve employees directing that an entitlement to receive salary or wages that has been earned (see paragraph 23 of this Ruling) is to be paid in a form other than as salary or wages.
23. **‘Entitlement to receive salary or wages that has been earned’** – personal services remuneration arrangements 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. To the extent that services for that period have been performed, everything has been done by the employee in earning the entitlement to salary or wages. Personal services remuneration arrangements may also provide that employees may become entitled to be paid salary or wages such as bonuses or commissions if particular events occur or conditions are satisfied. The condition precedent to earning such variable salary or wages is met when those events occur or those conditions are satisfied. An entitlement to be paid has been earned even if the employees will not be paid until a later time. For annual and long service leave, an entitlement to be paid salary or wages is earned as the leave accrues, being when the relevant qualifying period of service is completed.

## Date of effect

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24. 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 a 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**

25. Employees do not derive ordinary or statutory income from the provision of personal services 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 employer deals with the amount in some other way on behalf of the employees. Once employees have earned an entitlement to receive an amount of salary or wages, any ordinary or statutory income later received by employees from that entitlement or taken to be received on behalf of the employee is derived as salary or wages income. By section 11-5 of Schedule 1 to the TAA, salary or wages are taken to be paid to the employee when the employer deals with the amount in any way on the employee's behalf.

26. An effective SSA may provide that an employee's entitlement to salary or wages is reduced below the minimum entitlement under industrial law. Benefits so provided are exempt income under section 23L of the ITAA 1936 if derived as ordinary or statutory income. However, as employees may retain their minimum entitlement to salary or wages under industrial law, notwithstanding the terms of an effective SSA, any balance of that entitlement is, if later derived, assessable income of the employee under section 6-5 or 6-10 of the ITAA 1997.

### **Ineffective SSA**

27. Payments made under ineffective 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 paragraph 25 above. Benefits provided under ineffective SSAs are assessable income of the employees under section 6-5 or 6-10 of the ITAA 1997 and they are not exempt income under section 23L of the ITAA 1936. Remuneration that relates to leave that has accrued can only be the subject of an ineffective SSA.

### **Effective SSA**

28. Benefits provided to or on behalf of employees under effective SSAs may be derived as ordinary or statutory income by the

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employees. Any such benefits that are convertible to money are derived by the employees as ordinary or statutory income. However, 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 an effective SSA.

29. An entitlement to a bonus or other performance remuneration may be the subject of an effective SSA, provided the SSA is entered into prior to the employee earning the entitlement to be paid the bonus.

30. An effective SSA has the same effect for tax law purposes in relation to benefits provided, as noted at paragraph 28 above, even though it may provide that any residual amount not taken as expense payment fringe benefits can be paid as cash. Any such residual 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. Where the residual amount is otherwise applied or dealt with on behalf of the employee the amount may constitute a fringe benefit.

31. Employers' contributions under effective SSAs to superannuation funds on behalf of employees are not assessable income of the employees under paragraph 26(e). The sums contributed have not been allowed, given or granted to the employees, but are paid to the administrators of the fund. Also, the scheme of superannuation and taxation law is such that the contributions are not assessable income of the employees. The proposed amendment referred to in paragraph 11 will have no effect on whether a SSA is effective or ineffective.

## **Employers - income tax, fringe benefits tax, PAYG withholding liabilities and superannuation guarantee**

32. Benefits paid under effective SSAs are not 'salary or wages' within the meaning of that term in subsection 136(1) of the FBTAA and employers, accordingly, have no PAYG withholding liabilities in relation to the payments.

33. However, benefits paid under ineffective SSAs are 'salary or wages' for the purposes of subsection 136(1) of the FBTAA. Accordingly, employers have PAYG withholding liabilities in relation to the payments, provided the other conditions of Part 2-5 of Schedule 1 to the TAA are met.

34. Superannuation contributions made by an employer (who derives assessable income or is engaged in a business) under an effective SSA are properly considered as employer contributions to the superannuation fund or RSA for the purposes of the SGAA and

sections 82AAC to 82AAF of the ITAA 1936. Superannuation contributions made by an employer (who does not derive assessable income or is not engaged in a business) under an effective SSA are properly considered as employer contributions to the superannuation fund or RSA for the purposes of the SGAA.

35. However, superannuation contributions made by an employer (whether or not deriving assessable income or engaged in a business) under an ineffective SSA do not represent employer contributions to the superannuation fund or RSA for the purposes of the SGAA. As the contributions are undeducted member contributions of the employee, the employer is not entitled to a deduction under sections 82AAC to 82AAF of the ITAA 1936.

36. However, the conclusions reached in paragraph 34 above will be affected if *Taxation Laws Amendment (Superannuation Contributions) Bill 2000* is passed, as it will omit section 82AAE of the ITAA 1936 in respect of superannuation contributions made after 4 PM (by legal time in the Australian Capital Territory) on 30 June 2000. From that time, superannuation contributions to non-complying superannuation funds will not be deductible to the taxpayer that makes the contribution. As such contributions are not excluded from the definition of 'fringe benefit' in subsection 136(1) of the FBTA, the employer may have a FBT liability in relation to the making of the contributions.

37. Superannuation contributions made under an effective SSA after 7 September 2000 for the benefit of persons other than an employee will no longer be excluded from the definition of 'fringe benefit' in subsection 136(1) of the FBTA by paragraph (j) of that definition if *Taxation Laws Amendment (Superannuation Contributions) Bill 2000* is passed.

38. If *Taxation Laws Amendment (Superannuation Contributions) Bill 2000* is passed, it will remain possible for an employee to enter into an effective SSA where the employer makes a superannuation contribution in respect of someone other than the employee, e.g., spouse. However, any such superannuation contribution will be a fringe benefit.

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## **Explanations**

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

#### ***Industrial law***

39. 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

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pronouncement, dealing with rates of pay and conditions of employment.

40. 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.

41. 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.

42. 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.

43. 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.

44. 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.

45. 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 is then governed by the certified agreement.

46. 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.

47. 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.

***Remuneration agreements with employees, directors and office holders***

48. The relationship between employers and their employees commences with the entering into of a contract of employment between the employer and the employee prior to personal 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.

49. 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; and an agreed amount of cash remuneration and the value of non-cash remuneration.

50. 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.

51. As the term 'director' is not a defined term for the purposes of section 12-40 of Schedule 1 to the TAA, it should take its ordinary meaning. As a guide, the term is widely defined in section 9 of the *Corporations Law* as follows: '*Director of a company or other body means:*

- (a) *a person who:*
  - (i) *is appointed to the position of a director; or*
  - (ii) *is appointed to the position of an alternate director and is acting in that capacity; regardless of the name that is given to their position; and*
- (b) *unless the contrary intention appears, a person who is not validly appointed as a director if:*
  - (i) *they act in the position of a director; or*
  - (ii) *the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes.'*

The terms of remuneration that a director receives will usually be set out in a written agreement between the director and the company. With smaller companies, especially where the directors are directly or indirectly the controlling shareholders of the company, the terms of remuneration often may be agreed to orally.

52. A director's entitlement to remuneration may include fixed remuneration; a variable remuneration component such as bonuses,

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commissions and other performance payments; and an agreed amount of cash remuneration and the value of non-cash remuneration.

53. The remuneration agreements may be amended during the director's term of office to reflect changes made to responsibilities and remuneration arrangements, such as by SSAs.

54. An office may be created under the Constitution or a law of the Commonwealth, a State or a Territory. The duties of the office may be set out in the instrument that creates the office or may be determined by the entity to whom the office holder reports.

55. However appointed, terms of remuneration that an office holder is to receive will usually be set out in either the instrument that creates the office or more likely in a written agreement between the office holder and the entity to whom the office holder reports.

56. If the terms of remuneration for the office holder are set out in the instrument that creates the office, it may not be possible for the office holder to enter into an effective SSA. Where the instrument permits the relevant entity to enter into a remuneration agreement with the office holder, the agreement may be amended during the period that the office holder occupies the office to reflect changes made to responsibilities and remuneration arrangements, such as by SSAs.

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

57. 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 provides that salary or wages entitlements are below the minimum entitlements under the relevant industrial law, award or workplace agreement and non-cash payments are made, the employee may retain a legal entitlement to receipt of the minimum level of salary or wages. Where an employer and employee enter into a SSA that so provides, we accept that the income tax law takes the factual situation that exists between the two parties as it finds it. For example, the Federal Court of Australia in *Poletti v. Ecob (No. 2)* (1989) 31 IR 321 gave a direction for the payment of an under payment of wages where the appellant (employer) had provided the respondent (employee) a package of benefits rather than the salary or wages as required by the relevant award. Where a Court gives an order concerning payment of under paid wages, the amounts awarded are assessable income of the employee under either section 6-5 or 6-10 of the ITAA 1997.

58. 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.

59. 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***

60. 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 judgements 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).

61. 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 10) and subparagraphs 26(e)(iv) and 26(e)(v) of the ITAA 1936 (see paragraph 11) is to ensure that 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.

### ***Ordinary or statutory income derived by employees from their employment***

62. 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 1997 provides that if an amount is exempt income it is not assessable income.

63. As discussed in paragraph 23, personal services remuneration arrangements usually provide that employees are entitled to be paid at fixed intervals when they have performed services for their employer

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over a fixed period. This ordinary or statutory income from the provision of personal services 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 U152* 87 ATC 894; *Case R23* 84 ATC 215; *Case 77* (1984) 27 CTBR (NS) 604; and *Case V49* 88 ATC 381; *AAT Case 4188* (1988) 19 ATR 3336).

64. However, an employer may deal with payments of income in some other way after it has been derived by the employee. In this situation, 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 by the employee as soon as they are applied or dealt with.

65. 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 dealing with 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.

66. 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 an effective SSA is convertible into money, the amount will form part of the employee's ordinary or statutory income and, as discussed in paragraphs 67 to 77, will be derived as either 'salary or wages' assessable income or 'fringe benefits' exempt income.

## ***Derivation of salary or wage assessable income or 'fringe benefit' exempt income***

67. Employees derive ordinary and statutory income as employees according to the principles discussed in paragraphs 62 to 66 above. That income can either be derived as salary or wage 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. The character of the ordinary and statutory income is determined by whether the income is paid as salary or wages or is provided as 'fringe benefits' (within the meaning of that term in subsection 136(1) of the FBTAA) at the time it is derived.

***Payment of salary or wages***

68. Generally, salary or wages are paid at the time that money or money's worth is received by the employee. If the salary or wages are applied or dealt with by the employer on behalf of the employee or as the employee has directed, subsections 6-5(4) and 6-10(3) of the ITAA 1997 ensure that the salary or wages are taken to have been derived at the time of that application or dealing. Section 11-5 of Schedule 1 to the TAA treats payments that have been applied or dealt with by the employer on behalf of the employee or as the employee has directed as having been paid to the employee at the time of the application or dealing.

69. The decision of Dixon J in *FC of T v. Steeves Agnew & Co (Vic) Pty Ltd* (1951) 82 CLR 408; (1951) 9 ATD 259 considered when there was a payment of salary or wages for the purposes of the PAYE provisions in the ITAA 1936. 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 of the ITAA 1936, to make deductions from the drawings when they were made.

70. 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) of the ITAA 1936. 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.

71. 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

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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.

72. 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, eight related employees of the taxpayer company became entitled, by resolution of the directors, to receive a 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.

73. 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.

74. We consider the *Steeves Agnew* case supports the view that an entitlement to be paid salary or wages that has been earned can be properly characterised as an entitlement to be paid salary or wages for the purposes of sections 12-35, 12-40 and 12-45 of Schedule 1 to the TAA. 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.

75. Therefore, under an ineffective SSA, when services are performed under a personal services remuneration arrangement 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.

76. However, if employees enter into an effective SSA, they forego an expected entitlement to an amount of salary or wages, before that entitlement has been earned, in return for benefits of a similar value. We accept that, when personal services have been performed by employees in that situation, they become entitled to the

agreed value of benefits. The benefits, when provided, are ordinary or statutory income provided by way of 'fringe benefits' within the meaning of subsection 136(1) of the FBTAA. The benefits, therefore, are not assessable income under section 6-5 or 6-10 of the ITAA 1997.

77. The character of personal services remuneration is governed by the arrangement under which work is performed. As personal services are performed and the employees earn an 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***

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

79. 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'.

80. 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.

81. An example of where a set-off arrangement could arise in an ineffective SSA context is where an employee has a debit balance in a loan account with the employer. 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 liability to pay 'salary or wages' to the employee.

82. Such a set-off would amount to a payment of salary or wages. The above situation is to be contrasted with the situation where the payment of the employee's liability is made under an effective SSA in

respect of salary or wage which is yet to be derived, in which case the set-off would amount to an expense payment fringe benefit.

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

83. Amounts paid to an employee under an ineffective SSA by someone associated with the employee's common law employer are payments of salary or wages. It is our view that an employer includes 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. Section 12-35 of Schedule 1 to the TAA requires that an entity withhold an amount from salary, wages, commissions, bonuses or allowances that it pays to an individual as an employee (whether of that or another entity). Salary or wages are paid to an employee as remuneration for employment services rendered.

84. The decision of Merkel J in *Dean & Anor v. FC of T* 97 ATC 4762; (1997) 37 ATR 52 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 on behalf of an employee***

85. Amounts paid under an ineffective SSA that are not paid directly to the employee, but to someone else on behalf of the employee, are payments of 'salary or wages'. Subsection 6-5(4) of the ITAA 1997 ensures that salary or wages that have been applied or dealt with in any way on behalf of the employee or at the direction of the employee are the employee's ordinary income as soon as it is applied or dealt with. Section 11-5 of Schedule 1 to the TAA treats an amount that has been applied or dealt with on the employee's behalf or as the employee directs as an amount that has been paid by the employer.

86. The recipient is merely receiving a payment of salary or wages to which the employee is already 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. Examples of salary or wages that may be directly remitted include union subscriptions, health fund membership fees and child support payments that are required to be deducted from salary or wages by the *Child Support (Registration and Collection) Act 1988*.

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

87. Arrangements, in which employees seek to forego expected salary or wages in exchange for benefits, may reduce the employees' salary or wage entitlement below the employees' minimum entitlement under the relevant industrial award or workplace or other agreement. Such arrangements may be effective at reducing the employee's assessable income from salary or wages. Depending on the terms of the relevant industrial award or workplace or other agreement, a Court may order the employer to pay the wage entitlement to the extent that it is below the minimum entitlement (see paragraph 57). When complying with the Court order, the employer as a PAYG payer is required to withhold from the payment. The employee will be assessed on the back payment of salary or wages under either section 6-5 or section 6-10 of the ITAA 1997.

***SSAs that involve leave entitlements***

88. Once an employee has completed the relevant qualifying period of employment and has an entitlement to take annual leave, long service and sick leave, the employee has an entitlement to be paid salary or wages. An entitlement to take leave is synonymous with an entitlement to be paid salary or wages because the employee has done everything necessary, apart from taking the leave, to be entitled to be paid.

89. It then follows that a SSA exchanging an entitlement to take leave that is accruing, or that has accrued, for past services performed in return for benefits is ineffective. Benefits paid under an ineffective SSA are payments of salary or wages and form part of the employee's assessable income under section 6-5 or 6-10 of the ITAA 1997.

90. We recognise that a SSA exchanging any expected entitlement to leave that will accrue for future services rendered in return for benefits will be effective. While benefits provided under an effective SSA may be derived as ordinary or statutory income by the employee (see paragraph 28 above), the income is exempt because of the operation of section 23L of the ITAA 1936.

91. Whether the conditions necessary for the taking of leave have been met is a question of fact. Statute, award conditions, individual contracts, enterprise workplace agreements or similar agreements may be relevant to determining whether the conditions have been met. Where there is a lengthy qualifying period which must be completed before any entitlement to leave accrues (as is generally the situation for long service leave entitlements), until that qualifying period has been completed, the conditions have not been met. Most employees

must complete a minimum period of service before any entitlement to long service leave accrues. If the employee terminates employment prior to completing the required minimum period of service, the employee has no enforceable right to payment in lieu of long service leave. Some employees' employment conditions give a pro rata entitlement to be paid salary or wages once a lesser period of service has been completed, if employment terminates after that lesser period but before the full qualifying period. An employee who has not completed sufficient service to be entitled to take long service leave or receive a pro rate entitlement of salary or wages on termination of employment can enter into an effective SSA. Once the conditions for taking long service leave have been met, the employee can only enter into an effective SSA in respect of future entitlements to take long service leave.

***Alternative view - SSAs that involve leave entitlements***

92. There is an alternative view that the entitlement to take annual leave, long service leave and sick leave arises as employees perform services, even though the employees cannot take such leave until the completion of the qualifying period of employment. It is then argued that an employee does not have an entitlement to be paid salary or wages until the leave is taken or some other event, e.g., termination of employment or death of the employee, occurs.

93. *Obiter dicta* comments in *Nilsen Development Laboratories Pty. Ltd. v. Federal Commissioner of Taxation* (1981) 144 CLR 616, 81 ATC 4031, 11 ATR 505 are said to support this view. The issue that the High Court addressed in that case was whether a company was entitled to a deduction in respect of accrued annual leave and long service leave of its employees. At 144 CLR 627-628, 81 ATC 4036-7, 11 ATR 512, Gibbs J said:

*If these principles are applied to the present case, the question is whether the taxpayer was under a present liability to make a payment to its employees in respect of leave. The answer is that it was not. The employees were entitled to leave, but they were not entitled to payment. The entitlement to payment would not arise until the employees took leave (or died or left the employment). The event on which the entitlement of the employees to payment depended had not occurred. There was a certainty that a liability to make payments in respect of leave would arise in the future, but it had not arisen. The present is not a case in which there was an immediate obligation to make payment in the future, or a defeasible obligation to pay, or a present obligation which as a matter of law was unenforceable - there was no accrued obligation to make any payment at all. There was no loss or outgoing "incurred" within s 51(1).*

94. Barwick CJ expressed a similar view at 144 CLR 624, 81 ATC 4035, 11 ATR 509-510:

*It was suggested in argument that a liability to make such a payment was accruing during the time the employee was serving the period qualifying him for leave. But, in my opinion, it is not a precise or proper use of language to so describe the circumstance that an employee is becoming progressively qualified by length of service to be able to require that he be given leave of one sort or another. In my opinion, no liability is "accruing" in a proper sense of the word during the time that the employee is serving his qualifying period nor has it accrued when he has served that qualifying period.*

*All that then can really be said is that it has become certain that, in due course when further events occur, that is to say, the time for the taking of leave is fixed and the period of leave is entered upon, a liability to pay money will arise. It is quite wrong, in my opinion, in this connection to treat any liability as either accruing or having accrued at any time prior to the time when the employee enters upon the leave, whether it be annual or long service.*

95. However, we consider that the obiter comments of Gibbs J and Barwick CJ must be seen in the context of addressing the question as to when the employer was entitled to claim a deduction for a loss or outgoing. As has long been recognised, symmetry of treatment of a transaction is not needed on the income and deductions sides. While an employee does not derive the salary or wages that is associated with the entitlement to leave until the leave is taken, we consider that the comments of Gibbs J and Barwick CJ do not support the proposition that the employee who has served the qualifying period of employment can be paid in a form other than as salary or wages.

### ***SSAs that involve bonus entitlements***

96. 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 an effective SSA, provided no entitlement to be paid the bonus exists. An entitlement to be paid a bonus which is payable where certain conditions are met exists once those conditions are met. Where a bonus is discretionary, the decision to pay a bonus creates an entitlement to be paid salary or wages. In accordance with the position stated at paragraph 76 above, benefits provided in exchange for bonuses payable in the form of salary or wages under an effective

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SSA do not form part of the assessable income of the employee under section 6-5 or 6-10 of the ITAA 1997.

97. Once there is an entitlement to be paid a bonus, which under the employment contract is to be paid as salary or wages, then such amounts cannot be the subject of an effective SSA. That the bonus is not paid for a period of time may effect the time of derivation of income but does not affect its nature as assessable income. If the bonus is held in any reserve or account until released at the direction of the employee, it will be taken to have been received by the employee under subsection 6-5(4) of the ITAA 1997. Any provision of benefits in lieu of payment would be an ineffective SSA and the amount of the benefit would have the character of salary or wages.

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

98. Some SSAs may provide that employees are able to be paid cash for any unspent portion of any benefit entitlement of their remuneration package. Such arrangements are effective 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.

### ***SSAs in which employees retain a residual entitlement to benefits***

99. Some SSAs may provide that employees remain entitled to any unspent portion of any benefit entitlement of their remuneration package. Such arrangements are effective SSAs to the extent that the employees have benefits provided to them, or for their benefit, by their employers. The benefits, when provided, do not form part of the assessable income of the employees under section 6-5 or 6-10 of the ITAA 1997. Benefit entitlements satisfied by the payment of cash will form part of the employee's salary or wages under section 6-5.

### ***Application of paragraph 26(e)***

100. We consider that paragraph 26(e) does not apply to salary sacrificed amounts received by employees under effective 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 11). In our view, however, an employer's contributions under an effective

SSA to a complying superannuation fund on behalf of an employee are not assessable income of the employee under paragraph 26(e).

101. In *Constable v. FC of T* (1952) 86 CLR 402; (1952) 5 AITR 371; (1952) 10 ATD 93, it was only after the administrators of the provident fund in question exercised a discretion to allocate assets of the fund to the employee members' accounts that the members became presently entitled to the moneys credited. In those circumstances, the obiter comments of the majority of the High Court of Australia in that case were to the effect that the sums contributed by the employer to the fund were not allowed, given or granted to an employee but instead were paid to the administrators of the fund. While the members did not have a vested and indefeasible right to the employer contributions in that case (they could be forfeited in certain circumstances), we consider that the Court's comments support the view that paragraph 26(e) does not apply to the making of contributions to a superannuation fund by an employer for the employees' benefit.

102. 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.

103. Since the decision in *Constable*, the scheme of superannuation and taxation law has been prefaced on the view that a contribution by an employer to a superannuation fund is not the income of the employee. Section 23 of the SGAA can only achieve its purpose if an employer can contribute to a complying superannuation fund or RSA for the benefit of an employee. The purpose of the SGAA is to encourage employers to provide a minimum level of superannuation support for employees<sup>1</sup> or pay the Superannuation Guarantee Charge (SGC). If the employer contributions were assessable to the employees under paragraph 26(e) it would not be possible for the employer to reduce the SGC to nil.

104. Subdivision AA of Division 3 of Part III of the ITAA 1936 provides the framework in which an employer can claim a deduction for a contribution to a superannuation fund in respect of an eligible employee. Subdivision AA of Division 2 of Part III of the ITAA 1936, dealing with the taxation of superannuation and kindred payments, implicitly recognises that there is a distinction between employer contributions and undeducted employee contributions to a superannuation fund or RSA in respect of ETP components and the undeducted purchase price of an annuity. Part IX of the ITAA 1936

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<sup>1</sup> Explanatory Memorandum distributed to the House of Representatives by the then Treasurer Hon. John Dawkins, MP.

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brings to account employer contributions as taxable contributions (subparagraph 274(1)(a)(i)) and, hence, assessable income of the superannuation fund (sections 281 and 288). Much of this income tax law would be largely redundant if employer contributions were the assessable income of employees when the contributions were made.

105. Employer contributions are defined at subregulation 1.03(1) of the *Superannuation Industry (Supervision) Regulations 1994* (SISR) and subregulation 1.03(1) of the *Retirement Savings Account Regulations 1997* (RSAR). Whether a contribution is an employer contribution is relevant to whether it is a mandated employer contribution (SISR regulation 5.01 and RSAR subregulation 3.03(1)) and, therefore, subject to minimum benefit standards (SISR regulation 5.04 and RSAR regulation 3.04), whether the contribution can be accepted (SISR Part 7) and whether the member protection standards (SISR subregulation 1.03(1)) apply. These provisions would be substantially undermined if employer contributions were the assessable income of employees when the contributions were made.

106. In summary, we consider that the scheme of superannuation and taxation law relies on the view that superannuation contributions made by an employer are not the income of the employee and, therefore, contributions of the employee, but are the employer's contributions.

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

107. The structure and operation of superannuation funds have altered significantly since *Constable* was decided. For instance, the discretion available to the administrator in *Constable* is no longer present under current superannuation legislation.

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

109. 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).

110. 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).

111. We do not accept the alternative view expressed in paragraph 108 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.

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

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

112. As discussed in paragraphs 62 to 86, once an employee becomes 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 ineffective SSAs as salary or wages, the employer PAYG payer has a PAYG withholding obligation in relation to the payments.

113. The existence of an entitlement to receive salary or wages is contingent on the performance of services by an employee. 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 effective SSAs represent expected salary or wages foregone before services have been performed, such benefits are not payments of salary or wages for which there is a PAYG withholding obligation.

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

114. 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 to a complying superannuation fund made for a class of employees, of which the employee is one, reduce or eliminate the employer's liability to pay the superannuation guarantee charge.

115. 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.

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116. As outlined in paragraph 112, as amounts paid under an ineffective SSA are paid as salary or wages, superannuation contributions made by an employer under an ineffective SSA are not properly considered to be employer contributions to the superannuation fund for the purposes of the SGAA. However, as outlined in paragraph 113, as benefits provided under an effective SSA are not paid as salary or wages, superannuation contributions made by an employer to a complying superannuation fund under an effective 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 section 82AAC of the ITAA 1936***

117. Sections 82AAC to 82AAF, subject to certain limits, grant a deduction to employers who make contributions to superannuation funds or RSAs for their employees. For the same reasons as discussed in paragraph 116 above, we accept that superannuation contributions made under an effective SSAs qualify as employer contributions under sections 82AAC to 82AAF.

118. Contributions to a superannuation fund under an ineffective SSA do not, for the same reasons as discussed in paragraph 116 above, entitle the employer to a deduction under sections 82AAC to 82AAF.

### ***Employer superannuation contributions into the superannuation fund of an associate of the employee***

119. An employee may enter into an effective SSA which includes an obligation for the employer to contribute to the complying superannuation fund of an associate of the employee. Such a benefit provided in an effective SSA forms part of the employee's ordinary or statutory income, but is not derived as either salary or wages assessable income or 'fringe benefits' exempt income. This is because subparagraph (j)(i) of the definition of 'fringe benefit' in subsection 136(1) of the FBTAA provides that a fringe benefit does not include a benefit constituted by the making of a payment to a complying superannuation fund. However, the employer is not entitled to a deduction under section 82AAC for contributions for an associate who is not an employee of the employer in their own right.

120. *Taxation Laws Amendments (Superannuation Contributions) Bill 2000*, if passed, will amend the definition of 'fringe benefit' in subsection 136(1) so that superannuation contributions made after 7 September 2000 will only be excluded from the definition of 'fringe benefit' if made for the benefit of an employee. The employer will

generally not be entitled to a deduction for the superannuation contribution in respect of an associate of an employee, notwithstanding that FBT is payable. While unusual, this is an intended consequence of the law.

## **Examples**

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### **Example 1 - effective SSA**

121. Andrew Executive was paid \$80 000 in salary plus \$7 500 in employer superannuation contributions in the 1999-2000 year of income. On 30 June 2000, Andrew renegotiated his employment contract for the 2000-01 year of income to receive \$72 500 salary and \$15 000 employer superannuation contributions to a complying superannuation fund. He turns 33 during this year. There is no award, workplace or similar agreement covering Andrew's terms of employment.

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

123. 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.

124. The superannuation contributions of \$15 000 for the 2000-01 year of income qualify for the purposes of the SGAA as employer superannuation contributions. Andrew's employer qualifies for a deduction of \$11 388 in the 2000-01 year of income under section 82AAC of the ITAA 1936. Andrew is under 35 years old and, therefore, his employer is only entitled to a deduction for contributions up to a maximum of \$11 388 on his behalf for the 2000-01 year of income (subsection 82AAC(2A)).

### **Example 2 - effective and ineffective SSA**

125. Jane Executive's employment contract (old agreement) provides for \$78000 in salary plus \$14300 in employer superannuation contributions (paid by \$6000 wages and contributions of \$1100 every 4 weeks for the 2000-01 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 Friday 5 January 01, Jane contracts with her employer (new agreement) to alter her 2000-01 salary package, commencing from 11 December 00, to \$65000 salary and \$27300 employer superannuation contributions. The contract provides that wages of

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\$5000 and contributions of \$2100 are to be paid by Jane's employer every 4 weeks commencing for the 7th pay period.

126. Jane is 35 years old and, therefore, her employer is entitled to a maximum deduction of \$31631 for superannuation contributions on her behalf for the 2000-01 year of income (subsection 82AAC(2A)).

127. On Monday 8 January 01, Jane is paid wages for the seventh pay period of \$5000. Her employer makes a superannuation contribution for her benefit of \$2100 on the same date.

128. The new agreement is an ineffective SSA for the 7th pay period, as the old agreement gave Jane an entitlement on 5 January 01 to be paid wages of \$6000 and to have an employer contribution of \$1100 made. Accordingly, the consequence of this is that \$1000 of the \$2100 contribution made by Jane's employer to her superannuation fund on 8 January 01 is salary or wage income derived by her on that day.

129. The new agreement operates as an effective SSA from 8 January 01 and subsection 6-5(4) of the ITAA 1997 does not apply to any amount of the superannuation contributions of \$2100 made by Jane's employer for the eighth or later pay periods. 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 \$72000 (7@ \$6000 + 6 @ \$5000) for the 2000-01 year of income.

130. Jane's employer, for the purposes of the SGAA, is considered to have made employer superannuation contributions on her behalf of \$20300 ( $(\$1\ 100 \times 7) + (\$2\ 100 \times 6)$ ) for the 2000-01 year of income. Jane's employer qualifies for a deduction under section 82AAC of \$20300.

131. \$1000 of the superannuation contribution of \$2100 made by Jane's employer on her behalf on 8 January 01 is considered to be an undeducted member contribution for the purposes of the SGAA. Jane's employer is required to make tax instalment deductions in respect of this amount and does not qualify for a deduction under section 82AAC for this amount. Either Jane or her employer should ensure that the superannuation fund is aware that the \$1000 is an undeducted contribution so that it can be properly accounted for by the superannuation fund.

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

132. 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.

133. 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 an entitlement to salary or wages. Linda's employer is liable to pay FBT for the benefit provided to her.

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

134. 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.

135. Subsection 6-5(4) of the ITAA 1997 deems that Kerrie has derived income of \$6 000 at the time of payment of moneys to the unit trust because she has not foregone her entitlement to salary or wages prior to the entitlement arising. Kerrie's employer is not liable to FBT on the benefit provided.

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

136. Kathryn Securities must lodge a declaration with her employer, a funds manager, notifying the form in which she would prefer to be paid any annual profit sharing bonus for the 2000-01 year of income that she might become entitled to receive. The employer will either credit the amount to her bank account, provide units in a unit trust that her employer manages or make additional superannuation contributions. Her preference is to receive units in the unit trust and she lodges the declaration on 30 June 2001.

137. On 1 August 2001 Kathryn's employer decides that she is entitled to a bonus and provides units in a unit trust 1 week later. Accordingly, her entitlement to the bonus does not exist until 1 August 2001. Kathryn's bonus is the subject of a prospective SSA. Kathryn's employer is liable to pay FBT on the benefit provided.

#### **Example 6 – Partially effective SSA involving leave**

138. David Citizen negotiates a SSA for the 2000-01 year of income with his employer at the close of business on 30 June 2000 in relation to his annual leave. The SSA seeks to apply 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

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benefits. As at 30 June 2000, David has an entitlement to annual leave of 4 weeks for services performed in the period 1 January 1999 to 31 December 2000. David has also accrued annual leave of 2 weeks for the period 1 January 2001 to 30 June 2000, although he is not entitled to take this leave until 1 January 2001. David would, however, receive payment of the leave entitlement if he were to resign prior to 1 January 2001.

139. 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 entitlements to leave which have been earned. They cannot be the subject of an effective SSA. The expense payment reimbursements are taken by subsections 6-5(4) and 6-10(3) of the ITAA 1997 to be derived as income. David's employer will have no liability to pay FBT on the benefits provided but will be required to withhold an amount to meet the PAYG withholding obligations.

140. Expense payment reimbursements received by David in lieu of the entitlement that he has foregone for leave accruing after 30 June 2000 represent benefits received under an effective 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 - effective SSA with a residual entitlement to salary or wages**

141. 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.

142. All the expense payment reimbursements are considered to be benefits received under an effective 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.

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**Your comments**

144. We invite you to comment on this Draft Taxation ruling. We are allowing 6 weeks for comment before we finalise the Ruling. If you want your comments to be considered, please provide them to us within this period.

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**Commissioner of Taxation**

18 April 2001

*Previous draft:*

Previously released in draft form as  
TR 1999/D7

*Related Rulings/Determinations:*

MT 2050; SGD 98/2; TD 93/229;  
TR 92/15; TR 2000/14

*Subject references:*

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

*Legislative references:*

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NO 96/10738-2; 97/2503-2

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ISSN: 1039-0731