# *TR 2009/D3 - Income tax: superannuation contributions*

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# Draft Taxation Ruling

## Income tax: superannuation contributions

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# What this Ruling is about

1. This draft Ruling is about contributions made to a superannuation fund, an approved deposit fund or a retirement savings account. It explains the Commissioner's views as to the ordinary meaning of the word 'contribution' in so far as 'contribution' is used in relation to a superannuation fund, approved deposit fund or retirement savings account in the *Income Tax Assessment Act 1997* (ITAA 1997).[1] Aspects of this draft Ruling are also relevant to the meaning of 'contribution' in the *Superannuation Industry (Supervision) Act 1993* (SISA) and the Superannuation Industry (Supervision) Regulations 1994 (SISR). However, it should be noted that the SISR contain a definition of 'contribution' that modifies its ordinary meaning.

2. Part A of this draft Ruling considers the ordinary meaning of contribution, how a contribution can be made and when a contribution is made.

3. Part B of this draft Ruling explains some aspects of the rules in Division 290 that apply when a superannuation contribution for an employee or a personal contribution is deducted.

[1] All legislative references in this draft Ruling are to the ITAA 1997 unless otherwise indicated.

# Ruling

## Part A – General superannuation contributions concepts

### *Ordinary meaning of contribution*

4. Whether an amount is a superannuation contribution is determined having regard to the character of the amount in the hands of a receiving superannuation provider.[2]

5. An amount will be a superannuation contribution if it increases the capital of a superannuation fund. However, an amount received by the superannuation provider will not be a superannuation contribution if it is derived or received as income, profit or gain from the investment, or realisation of an investment, of the existing capital of the fund or account.

### *How a superannuation contribution can be made*

6. A superannuation contribution can be made in money, money equivalent or by transferring an asset to the superannuation provider (an *in specie* contribution). A contribution may also be made by increasing the value of an existing asset of the fund whether that increase occurs by making an improvement to the asset or by shifting the value of interests in the asset held by both a person and the superannuation provider to the interest held by the superannuation provider.

#### *Money or money equivalent*

7. A contribution of money, or money equivalent, includes a contribution of cash (Australian or foreign), a money order, an electronic transfer of funds, a bank cheque, a personal cheque or similar negotiable instrument.

8. A cheque, promissory note or similar negotiable instrument will be taken to be a contribution of money subject to the following exceptions.

9. First, no contribution will be made if payment of the cheque, promissory note or similar negotiable instrument is not honoured.

[2] In subsection 995-1(1), a superannuation provider is defined, in relation to a superannuation plan, to mean the trustee of a superannuation fund, the trustee of an approved deposit fund or the provider of a retirement savings account.

10. Secondly, an investment-related promissory note will be taken to be the contribution of an asset (not money). In this draft Ruling, an investment-related promissory note is a promissory note made by an entity (the maker) that is not related to, or associated with, the superannuation provider or any member of the fund. The investment-related promissory note is payable to another entity (the payee or bearer) and is acquired by the payee or bearer at a discount from its face value. The face value is payable to the payee or bearer at a fixed or determinable future time. Such investment-related promissory notes are used by the maker as a means of raising finance and are commonly traded in secondary financial markets as a commodity in their own right. These kinds of investment-related promissory notes will usually be contributed by the payee or another entity who acquired it as a holder for value.

11. When a superannuation provider receives an investment-related promissory note, it acquires a debt that is legally enforceable against the maker.[3]

*Other forms of contribution*

12. A person who contributes an asset to a superannuation provider may receive consideration from the provider for the transfer of that asset where the consideration received is less than the market value of the asset. In these circumstances, the transfer of the asset is both a contribution by the person and the purchase of an asset by the superannuation provider.[4]

13. A person may pay an amount to a third party to satisfy a liability of a superannuation provider on behalf of the provider. The person will usually be a member of the fund or an employer (or associate of the employer) of a member of the fund. The payment to the third party is treated for all tax purposes as though the person had made a contribution to the superannuation provider and the provider had separately paid an equal amount to the third party.

14. A person will also make a contribution to a superannuation fund in circumstances where the person pays an amount to the superannuation provider under an agreement to reimburse the superannuation provider for a liability previously satisfied by the provider.

15. A contribution will be made to a superannuation fund if a loan entered into by the superannuation provider is forgiven by the lender.

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[3] See *Coles Myer Finance Ltd v. Federal Commissioner of Taxation* 93 ATC 4214. But note that a superannuation provider may breach section 66 of the SISA when an asset is acquired from a related party of the fund, such as a member.

[4] A superannuation provider may breach section 66 of the SISA when an asset is acquired from a related party of the fund, such as a member. However, a superannuation provider is able to acquire certain assets such as business real property and listed securities from a related party – in the context of a self managed superannuation fund see Self Managed Superannuation Funds Ruling SMSFR 2008/D2, which deals with the application of subsection 66(1) of the SISA to assets acquired by a self managed superannuation fund from a related party.

16. A contribution will be made to a superannuation fund if a guarantor satisfies a loan obligation of the superannuation provider in circumstances where the guarantor has no, or forgoes their right of, redemption against the superannuation provider.

17. A distribution made by the trustee of a discretionary trust to the trustee of a superannuation fund is a contribution to the fund because the fund does not have an interest in the discretionary trust that can be said to be an investment in the trust. A distribution of either trust income or trust capital from a discretionary trust will be a contribution.

18. A roll-over superannuation benefit[5] is also a contribution.[6] A transfer of a person's benefits from an overseas superannuation fund to an Australian superannuation provider is also a contribution.

### *When a superannuation contribution is made*

19. A superannuation contribution is made when it is received by the superannuation provider. An amount cannot increase the capital of the fund until it is received by the fund.

#### *Money or money equivalent*

20. A contribution of money, or money equivalent such as a money order or an electronic transfer of funds, is made when it is received by the fund.

#### *Cheques and promissory notes*

21. A contribution by cheque or promissory note (other than an investment-related promissory note) is made when the cheque or promissory note is received by the trustee of the fund, unless it is subsequently dishonoured. As stated in paragraph 9 of this draft Ruling, if the cheque or promissory note is dishonoured no contribution will have been made by the person.

22. A contribution by a cheque that is post-dated (that is, is payable on a date later than the date on which it is received by the superannuation provider) or promissory note that is payable in the future is made on the later of the day the cheque or note is received and the date on which payment can be demanded as shown on the cheque or promissory note. A post-dated cheque cannot be presented before the date shown. Payment cannot be demanded on a promissory note prior to the date for payment.

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[5] As defined in section 306-10.

[6] Note however, the definition of contribution in subregulation 1.03(1) of the SISR specifically excludes benefits that have been rolled over or transferred as those terms are defined in subregulation 5.01(1) of those regulations.

23. In the case of a related party cheque or related party promissory note, the Commissioner will only apply the rules in paragraphs 21 and 22 of this draft Ruling if:

- the trustee presents the related party cheque for payment, or demands payment on the related party promissory note, promptly after:
  - for a related party cheque or related party promissory note that is immediately payable – the date on which the that cheque or that note is received, or
  - for a post-dated related party cheque or related party promissory note that is payable in the future – the date on which payment can be demanded on that cheque or that note; and
- the related party cheque or related party promissory note is honoured with cash (or its electronic equivalent).

24. A related party cheque or related party promissory note is a personal cheque or promissory note that is made by a member of the fund or a party related to, or associated with, a member.

25. Payment of a related party cheque or related party promissory note will be taken to have been demanded promptly if payment is demanded within a few business days. The Commissioner expects a trustee to obtain payment on any cheque or promissory note as soon as possible having regard to reasonable commercial practice.

26. Where it is clear to the Commissioner that payment has not been promptly sought on a related party cheque or related party promissory note the contribution will, in the absence of extenuating circumstances, be taken to be made if, and when, a payment of cash (or its electronic equivalent) actually occurs.

27. A contribution in the form of an investment-related promissory note is made at the same time as for any other property (see paragraphs 28 to 34 of this draft Ruling).

*Property*

28. A contribution of property will be received by a superannuation provider when either legal or beneficial ownership of the property passes from the contributor to the superannuation provider. The time that the contribution is made is the same time as the contribution is received by the superannuation provider.

29. For many classes of property, there is no formal registration process that evidences ownership. For such property, the ownership of property will pass when the provider acquires [physical] possession of the property. However, the Commissioner accepts that ownership of property may pass on execution of a deed of transfer of the property.

30. By contrast, legal ownership of some classes of property is evidenced by a system of formal registration (for example shares in a publicly listed company or Torrens title land). For such property, legal ownership of the property will pass when the superannuation provider is registered as the owner of the property.

31. However, in some circumstances the formal registration of the change of legal ownership occurs some time after beneficial ownership of the property passes. Therefore, the Commissioner accepts that a contribution of property is made when beneficial ownership of the property is obtained by the superannuation provider.

32. Further, the Commissioner accepts that a superannuation provider acquires the beneficial ownership of real property when the provider obtains possession of the requisite transfer forms provided that there is no legal impediment preventing the superannuation provider from affecting registration of legal ownership of the property.

33. Beneficial ownership of shares or units in an Australian Stock Exchange listed company or unit trust may also pass prior to legal ownership, particularly where a contributor transfers title to the shares off-market. The Commissioner accepts that a superannuation provider acquires beneficial ownership of such shares or units when the provider obtains a properly completed off-market share transfer form from the contributor.

34. A contributor or superannuation provider who seeks to argue a contribution of property occurs when beneficial, not legal, ownership of property passes must retain sufficient evidence of the relevant transactions and events to accurately identify when the change of beneficial ownership occurs.

*Debt forgiveness and guarantees*

35. A contribution by way of debt forgiveness will be taken to occur when a lender executes a deed of release that relieves a superannuation provider from the obligation to repay a loan from the lender.[7]

36. When a guarantor makes a contribution by paying a debt of a superannuation provider the timing of the contribution will be determined by whether or not the guarantor has a right to be indemnified by the superannuation provider. If the guarantor has no right of indemnity, the contribution is made on satisfying the provider's liability. If the guarantor has a right of indemnity, a contribution is only made when the guarantor takes formal steps to forgo that right, for example by executing a deed of release.

[7] Under section 67 of the SISA, the trustees of superannuation funds can only borrow money in a limited range of circumstances.

### *Amount of an in specie superannuation contribution*

37. The amount of an in specie contribution is the market value of the asset at the time the contribution is received by the superannuation provider.[8]

38. Where a person contributes an asset to a superannuation provider that provides consideration for the transfer of that asset, the contributed amount is the amount by which the market value of the asset exceeds the consideration paid by the superannuation provider.

## Part B – Specific rules about deducting superannuation contributions

### *Purpose of the contributor*

39. Whether a superannuation contribution is deductible is determined by regard to the purpose of the contributor. The contributor's purpose must be to provide superannuation benefits for a particular person or class of persons.

40. A person's purpose is the object which they have in view or in mind. Generally, a person will be said to intend the natural and probable consequences of their acts and likewise their purpose may be inferred from their acts. A person's purpose may be inferred from objective evidence.

41. Providing superannuation benefits must be the person's sole purpose. However, it does not matter that a person takes account of the incidental consequences of making a contribution such as obtaining a tax deduction.

### *Deducting superannuation contributions for own employees*

42. You can claim a deduction for the amount of a contribution that you make to a superannuation provider for the purpose of providing superannuation benefits for another person who is your employee at the time that the contribution is made.[9]

43. The employee must be a member of the superannuation fund when you make the contribution. If the employee is not a member of the fund, it cannot be said that the contribution is for the benefit of the employee.

44. A contribution will provide superannuation benefits to an employee if it will benefit a particular employee, or if it will benefit all or identifiable employees who are members of the fund.

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[8] For guidance in determining market value refer to *Market valuation for tax purposes* (NAT 72508) available on the ATO website www.ato.gov.au.

[9] Section 290-60. Section 290-85 contains rules for contributions for former employees.

45. The employee must have fully secured rights to the benefit. It is not sufficient that an employee is entitled to their superannuation benefits only through the exercise of a discretion by a superannuation provider.

### *Deducting superannuation contributions for another's employees*

46. You can claim a deduction for a superannuation contribution for another person who, when the contribution is made, is an employee of a company in which you have a controlling interest.[10] The term 'controlling interest' is not defined and will take its common law meaning.

47. A shareholder who has a bare majority, more than one half, of the voting power will have a controlling interest in a company.

48. However, a shareholder may still have a controlling interest notwithstanding it does not have bare majority if it has the power, by the exercise of voting rights, to carry a resolution at a general meeting of the company or is more powerful than all other shareholders put together in a general meeting.

49. If two directors hold equal shares of 50% neither of the directors has a controlling interest.

50. However, a shareholder in a company may be able to deduct a contribution for an employee of the company in other circumstances.[11]

### *Employment activity conditions*

51. Employee means a common law employee and any other person who is treated as an employee by section 12 of the *Superannuation Guarantee (Administration) Act 1992* (SGAA).[12] If a contribution for an employee is to be deductible, the employee must (among other requirements) satisfy the employment activity condition.[13]

52. A person who is an employee because of the operation of subsection 12(2) to 12(10) of the SGAA automatically satisfies the employment activity condition.

53. To satisfy the employment activity condition, a common law employee must be either:

- engaged in producing the employer's assessable income; or
- an Australian resident who is engaged in the employer's business.

[10] Subsection 290-90(1).
[11] See subsection 290-90(5).
[12] Section 290-65
[13] Subsection 290-60(2) and section 290-70.

54. The term 'engaged' is not defined and takes its ordinary meaning of 'busy or occupied; involved'.[14]

### *Deducting personal contributions*

*Maximum earnings test*

55. Those persons who are engaged in an 'employment' activity in the income year need to meet an earnings test if they are to deduct their contribution.[15]

56. A person will be engaged in an 'employment' activity if they are engaged in an activity in the income year that results in them being treated as an employee for the purposes of the SGAA.[16] The term 'engaged' is not defined and takes its ordinary meaning of 'busy or occupied; involved'.

57. However, for the majority of persons who are treated as employees for the purposes of the SGAA, the person need not be physically engaged in the activity. For example:

- a common law employee will be engaged in the activity while they remain employed;
- a member of the executive body of a body corporate (for example a director) who is entitled to payment for their services in that capacity will be engaged in the activity while they remain a member of the executive body;
- a member of a Parliament of the Commonwealth or a State or of a Legislative Assembly of a Territory will be engaged in the activity while they hold their seat in the Parliament; and
- a person who is engaged under a contract wholly or principally for labour is engaged in the activity throughout the duration of the contract.

58. At common law, directors have no right to remuneration and cannot receive benefits from corporate assets, unless authorised by the company's constitution or by the general meeting of the company.[17]

59. An artist, musician, sportsman etcetera engaged to perform or present or participate in a performance etcetera will be engaged in the activity only while they participate in the relevant activity.

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[14] Macquarie Dictionary, 3rd edition, 1998.
[15] Subsection 290-160(1).
[16] See generally Superannuation Guarantee Ruling SGR 2005/1 Superannuation guarantee: who is an employee? for the meaning of 'employee' for these purposes.
[17] Section 202A of the *Corporations Act 2001* states that directors shall be paid such remuneration as is from time to time determined by the company in general meeting. That is a replaceable rule under the *Corporations Act 2001*.

60. Those persons who have not engaged in an eligible activity in the income year, such as persons who although receiving workers' compensation payments are no longer employed, are not subject to the maximum earnings test.

61. Where the person engages in any 'employment' activities in the income year a deduction can only be claimed where the sum of assessable income and reportable fringe benefits attributable to the 'employment' activities is less than 10% of the person's total assessable income and reportable fringe benefits in the income year that the contribution is made.

62. Assessable income and reportable fringe benefits are to be given their statutory meaning. All amounts that are attributable to an 'employment' activity are taken into account as assessable income in the 10% test. These include:

- the salary or wages (as used in its ordinary meaning) from the activity;
- the other payments, such as commission, director's remuneration and contract payments, that are treated as salary or wages by section 11 of the SGAA for those persons who engage in an 'employment' activity in a capacity other than a common law employee;
- an employment termination payment received by a person in consequence of the termination of their employment; and
- workers' compensation payments made because of an injury suffered while engaging in an 'employment' activity where the payments are received by a person while holding the employment, office or appointment the performance of which gave rise to the entitlement to the compensation payments.

63. In the application of the maximum earnings test, the relevant 'employment' activity need not be an activity in Australia. For a non-resident, the income attributable to employment outside Australia is not assessable income in Australia and so will not be counted in the maximum earnings test. A non-resident with Australian sourced income that is not attributable to 'employment' activities may therefore be able to deduct a personal superannuation contribution made to an Australian superannuation provider against their Australian sourced income.

64. However, the 'employment' income of an Australian resident employed overseas by a foreign employer will be counted in the maximum earnings test if the income is assessable income.

*Notice of intention to claim a deduction*

65. A person may choose how much of their personal contributions to deduct. For example, a person may choose not to deduct a portion of their personal contributions to ensure they are entitled to the superannuation co-contribution.

66. A person who intends to deduct their personal superannuation contributions must give the superannuation provider a valid notice in the approved form.

67. Usually, an individual would personally give the notice to their superannuation fund. However, an agent may also do this for the individual.

68. In particular, a legal personal representative may give a superannuation provider a notice of intent to deduct on behalf of a deceased person who made a contribution prior to death. The legal personal representative must meet the remaining notice requirements. If the legal personal representative of the deceased intends to lodge a section 290-170 notice of intention to claim a deduction they must do so before lodgment of the deceased's final tax return.

69. A notice is not valid in certain circumstances, including when the notice is given:

- the person is no longer a member of the fund (for example, because the person's benefits have been paid to them or they have rolled over their benefits in full to another fund);
- the trustee no longer holds the contribution (for example, the trustee may no longer hold a contribution where a person has been paid a lump sum superannuation benefit or had part of their benefit rolled over to another superannuation fund and the balance of the account is less than the contribution); and
- the trustee has commenced an income stream based in whole or part on the contribution.

70. A superannuation provider will no longer hold a contribution if the member has chosen to roll-over a part of the superannuation interest held by the provider and the value of the interest after the roll-over is less than the current year's personal contributions. A superannuation provider will no longer hold a contribution if a member's interest in the fund has been transferred to a successor fund.

71. An income stream is based in whole or part on the contribution if it is commenced from the superannuation interest to which the contribution was made.

# Examples

***Example 1 – when in specie contribution of real property is made***

72. Bob owns land on which retail premises have been constructed. Those premises include the site from which Bob runs his pharmacy business. Bob decides to contribute the land (being business real property) to his self-managed superannuation fund. The fund has a corporate trustee, CarPharm Pty Ltd, of which Bob and his wife Janet are directors. The directors of CarPharm Pty Ltd resolve to accept the contribution of the land on 1 June 2009. After obtaining advice from their solicitor, Bob, as owner of the land, and Bob and Janet, as directors of the corporate trustee of the fund, complete the necessary land transfer forms on Monday, 29 June 2009. Janet lodges them with the registrar of land titles on 2 July 2009. CarPharm Pty Ltd is registered as owner of the land on 9 July 2009.

73. In these circumstances, Bob's contribution will be made on 29 June 2009.

***Example 2 – when in specie contribution of shares is made***

74. On 26 June 2009, Cheung signs an off-market share transfer form to effect a contribution of shares from herself to Cho Pty Ltd, the trustee of her self-managed superannuation fund. However, Cheung leaves certain parts of the form blank for completion by her broker, as her shareholdings, and those of Cho Pty Ltd are broker sponsored. Cheung posts the transfer form to her broker on the same day.

75. Cheung's broker adds the omitted information on 2 July 2009 and sends it to the company's registrar. Cho Pty Ltd is registered as a shareholder on 6 July 2009.

76. Cheung's contribution will be made on 2 July 2009.

***Example 3 – invalid notice of intention to deduct***

77. Rachel's superannuation interest is valued at $5,000 (tax free component). She makes a $10,000 personal contribution in March 2008 which would be counted against the tax free component of her superannuation interest at the time it is received. Her total superannuation account balance is $15,000.

78. In June 2008, Rachel requests to roll-over $6,000 leaving her with a balance of $9,000. She then lodges a notice in September 2008 advising that she intends to claim a deduction on the $10,000 contribution made in the 2007-08 income year.

79. As her account balance is only $9,000, all of the $10,000 contribution is no longer held by the trustee and therefore the notice is not valid. However, if Rachel were to lodge a notice for $9,000, this would be valid. The trustee would then convert the $9,000 from a tax free component to a taxable component and include this amount in the fund's assessable income.

***Example 4 – invalid notice of intention to deduct***

80. Libby has a superannuation interest valued at $150,000. Libby makes a $50,000 personal contribution in March 2008 so that her superannuation account balance is $200,000.

81. If, before lodging a section 290-170 notice, she were to commence a pension using $180,000 of her account balance of $200,000, her fund will have commenced to pay a superannuation income stream based in whole or part on the contribution. A notice Libby purports to give her fund to deduct the contribution will be invalid.

82. Further, the outcome will be same even if Libby were to commence a pension of only $140,000 leaving the balance of her account in excess of the amount she intended to deduct.

# Date of effect

83. When the final Ruling is issued, it is proposed to apply:

- Part A of the ruling both before and after its date of issue.
- Part B of the ruling to the 2007-08 and later income years.

84. The Commissioner invites comments on what, if any, transitional arrangements are appropriate in implementing the final Ruling, including arrangements appropriate to cater for circumstances where an entity needs to make systems or process changes to be fully compliant with the views expressed in it.

85. However, the Ruling will 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. The Ruling does not replace the views in Taxation Ruling TR 2005/24 Income tax: deductibility of personal superannuation contributions, with respect to income years up to and including 2006-07.

**Commissioner of Taxation**
3 June 2009

# Appendix 1 – Explanation

***This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.***

## Part A – General superannuation contributions concepts

### *Ordinary meaning of contribution*

86. The ITAA 1997 does not define the term 'contribution'. The ordinary meaning of 'contribution' is '1. the act of contributing 2. something contributed'. The ordinary meaning of 'contribute' is '1. … give [money, time etc.] to a common stock or for a common purpose', ... 3. to make contribution; furnish a contribution'.[18]

87. Consistent with basic principles of statutory interpretation, it is necessary to ascertain the meaning of a 'contribution' to a superannuation fund having regard to the context and underlying purpose of the legislative provisions in which the term appears.[19]

88. In general terms, the Commissioner considers that the matter of whether an amount is a superannuation contribution is determined having regard to the character of that amount in the hands of the superannuation provider. Taking into account the context and purpose of the relevant provisions, as set out below, an amount that is a contribution to a superannuation fund forms part of the capital or property of the trust that constitutes the fund.

89. Accordingly, it is the Commissioner's view that an amount will be a contribution if it increases the capital or property of a superannuation fund that is available to derive real benefits on behalf of members. However, an amount received by the superannuation provider will not be a superannuation contribution if it is derived or received as income, profit or gain from the investment, or realisation of an investment, of the existing capital of the fund or account.

90. Implicit in the ordinary meaning of 'contribute' referred to in paragraph 86 of this draft Ruling is the idea that something is given by a person or entity. In the superannuation context, a superannuation contribution is made when a superannuation provider obtains something given by another person or entity. The person or entity bestowing the benefit to the superannuation fund provider is often referred to the contributor. The identity of a contributor or contributors is established by identifying the persons or entities that suffer a diminution of assets or resources as a result of the contribution that increases the capital or property of the fund.

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[18] Macquarie Dictionary 3rd edition 1998.

[19] *CIC Insurance Limited v. Bankstown Football Club Ltd* [1997] HCA 2; (1997) 187 CLR 384 at 408; *Project Blue Sky Inc. v. Australian Broadcasting Authority* [1998] HCA 28 at paragraphs 69 and 70; (1998) 194 CLR 355 at 381-382.

91. In Australia, the income tax law provides concessions to superannuation funds that comply with the regulatory provisions in the SISA. Such funds are referred to as complying superannuation funds. Many of the references to a contribution in the ITAA 1997 are specifically in the context of complying superannuation funds.

92. A complying superannuation fund must be a regulated superannuation fund under the SISA. In turn, a regulated superannuation fund must have a trustee.[20] Accordingly, in Australia, superannuation funds will almost invariably take the form of a trust.

93. Accordingly, the Commissioner considers that there are two aspects of the surrounding context that are particularly relevant in considering the meaning of a superannuation contribution: first, the nature of a superannuation fund, including the activities it commonly undertakes and the purpose of its establishment and maintenance; and, secondly, the fact that the vast majority of Australian superannuation funds are structured as a trust.

*The nature of a superannuation fund*

94. The trustee of a superannuation fund holds the assets and the income, profits or gains arising from the investment of the assets, or the realisation of those investments, on behalf of the members of the fund. In this regard, the sole purpose test in the SISA requires fund trustees to maintain the fund solely for the purpose of providing retirement or similar types of benefits to or in respect of fund members.[21]

95. While adherence to the sole purpose test is critical in establishing that a superannuation fund complies with the SISA, substantially similar tests define the existence of a superannuation fund. A superannuation fund is a fund that has the sole purpose of providing real monetary benefits, or benefits of a monetary value, to members on retirement, death or other cessation of employment.[22]

96. In the context of determining the ordinary meaning of 'contribution', the purposes identified in the sole purpose test and the authorities considering the meaning of a 'superannuation fund' establish the common purpose for which a superannuation fund is established and maintained and, a contribution will ordinarily be given. Therefore, the Commissioner considers that an amount is a contribution if it augments the size of the fund[23] that is available to provide benefits to members (or others).

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[20] Subsection 19(2) of the SISA.
[21] Section 62 of the SISA.
[22] *Scott v. Commissioner of Taxation (No 2)* (1966) 40 ALJR 265 at 272 per Windeyer J; *Mahony v. Commissioner of Taxation* (1967) 41 ALJR 232 at 232 Per Kitto J; *Walstern v. Federal Commissioner of Taxation* [2003] FCA 1428 at paragraphs 53 and 54; (2003) 138 FCR 1 at 15-16.
[23] As Pincus J put it in *Commissioner of Taxation v. Roche* [1991] FCA 606 at paragraph 24; 22 ATR 828 at 834; 91 ATC 5024 at 5029.

97. It follows from the fact that a fund trustee makes and realises investments on behalf of fund members for these same purposes that returns on or of investments made by the trustee are not a superannuation contribution.

98. As is discussed in further detail at paragraphs 169 to 171 of this draft Ruling the deductibility of a superannuation contribution usually turns on whether it is made 'for the purpose of providing superannuation benefits' for a particular member or class of members. A number of the cases concerned with the deductibility of superannuation contributions emphasise that the purpose of a fund or a contribution is to be determined from an objective analysis of all the surrounding facts.

99. The Commissioner will take a similar approach to determining whether a contribution has been made. That is, it is necessary to objectively analyse whether the size of the fund has been augmented and if so how that occurred. This determination will not be limited to examining whether a contributor intended to benefit a particular person or class of persons.

*Trust structure*

100. Money or other property is required to constitute a superannuation fund.[24] This is consistent with the requirement that regulated funds adopt a trust structure.

101. It is a well established principle of trust law that certainty of subject matter, or identifiable trust property, is necessary to found the existence of a trust.[25]

102. In the Commissioner's view, this property must necessarily be augmented when a contribution is made. The addition or augmentation to the property will in turn enable the trustee to apply the property for the benefit of members, consistent with the purposes of the superannuation fund.

*Purpose of tax treatment of contributions*

103. The purpose of the rules dealing with the tax treatment of superannuation contributions is also relevant in identifying the meaning of the concept. The Explanatory Memorandum to the Tax Laws Amendment (Simplified Superannuation) Bill 2006 (the Explanatory Memorandum) stated:[26]

> The object of [the rules in Division 292 of the ITAA 1997] is to ensure that the amount of concessionally taxed superannuation benefits that a person receives results from superannuation contributions that have been made gradually over the course of the person's life.

[24] *Walstern v. Commissioner of Taxation* [2003] FCA 1428 at paragraphs 49 to 51; (2003) 138 FCR 1 at 14-15.
[25] *Herdegen v. Federal Commissioner of Taxation* (1988) 84 ALR 271 at 277; 88 ATC 4995 at 5000; (1988) 20 ATR 24 at 29; *Jacob's Law of Trusts*, para. [106], p.5.
[26] Paragraph 1.9.

104. The explicit relationship recognised in the Explanatory Memorandum between contributions made and benefits ultimately received by the fund supports the proposition that a contribution, regardless of its form, must enable the fund to derive real benefits on behalf of fund members.

### *How a superannuation contribution can be made*

105. The meaning of 'contribution' is wider than just a direct payment of money. A superannuation contribution can be made in money, in money's worth or a money equivalent, or by transferring an asset to the superannuation provider. Subject to the restrictions in the SISA on a superannuation fund acquiring assets from a related party, a transfer of an asset to a superannuation fund may be a contribution *in specie*.[27]

106. Further illustrations of the form a contribution may take include:

- meeting or reducing an existing liability of a fund;
- paying expenses on behalf of the fund;
- increasing the value of an existing asset of the fund (provided that this increase in value does not reflect a return on an investment made by the fund);
- the making of a distribution from another entity (provided that this distribution does not reflect a return on an investment made by the fund); and
- rendering services to the fund (to the extent that those services are not remunerated at fair market value).

107. These forms of contribution are consistent with the concept that a contribution may be made in money's worth. Money's worth is something material that is the equivalent of a sum of money paid, and may include services provided.[28]

#### *Money or money equivalent*

108. A contribution of money, or of money's worth or money equivalent, includes a contribution of cash, money order, electronic transfer of funds, bank cheque, personal cheque or similar negotiable instrument. A contribution can be denominated in Australian currency or a foreign currency.

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[27] Subsection 285-5(1).
[28] See *Hance v. Commissioner of Taxation* [2008] FCAFC 196 at paragraphs 98 to 100.

109. In a legal context, 'money' has been described as:

> Any generally accepted medium of exchange for goods, services, and the payment of debts…Money confers complete liquidity on its holder. It serves as a medium of exchange, a measure of value, a standard for deferred payments, a store of value, and a commodity whose worth depends upon its resale value.[29]

110. Cheques are negotiable instruments (through commercial practice and statute law) and because ownership of them can pass simply with possession, are sometimes said to be equivalent to money. They are not, however, money: see *Sidney Raper Pty Ltd v. Commonwealth Trading Bank of Australia* [1975] 2 NSWLR 227 where Moffit P said at 233 bank cheques and other negotiable instruments although being treated by many as equivalent to, or as good as cash, is still a cheque and not cash. It is effectively converted to cash on presentation to the relevant financial institution if the drawer of the cheque has sufficient funds available in the account with the institution.

111. As noted in '*Mann on the Legal Aspect of Money*' in the course of discussing the concept of 'payment':

> … the mere acceptance of the cheque or other instrument by the creditor does not of itself constitute 'payment', for it does not have the effect of making funds available to the creditor; such instruments only constitute payment if they are subsequently honoured …[30]

112. In a similar vein, Rich J in *Permanent Trustee Co (Executors of Estate of F H Prior, deceased) v. Federal Commissioner of Taxation*,[31] in discussing whether income was derived for the purposes of the *Income Tax Assessment Act 1936* (ITAA 1936), noted that:

> [t]o see whether income has been derived one must look to realities. Usually payment of interest by cheque involves a receipt of income, but payment by a valueless cheque does not … You do not transform interest into an accretion of capital by writing out words on a piece of paper. There must be some reality behind them. Some accretion of value to corpus.

113. Further, *Chalmers & Guest on Bills of Exchange* states that a cheque, being payable on demand, is intended as an instrument which will immediately be paid. This can be contrasted with a bill of exchange, which is said to be a credit instrument which is frequently drawn payable at a future date.[32]

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[29] Encyclopaedic Australian Legal Dictionary (LexisNexis)
[30] Charles Proctor, *Mann on the Legal Aspect of Money*, 6th edition, Oxford University Press, [7.13].
[31] (1940) 6 ATD 5 at 12 and 13.
[32] See paragraph 1862 of *Chalmers & Guest on Bills of Exchange, Cheques and Promissory Notes* 15th edition, Sweet & Maxwell, London 1998.

114. A promissory note is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person, or to bearer.[33] The maker of the note owes a debt to the holder of the note.[34]

115. A promissory note, will typically fall within one of the following two categories:

- a related party promissory note, that is, one made by a member of the fund or a party related to, or associated with, the member given to the superannuation provider for the benefit of a particular member or members; or
- an investment-related promissory note which is a note issued by an unrelated entity (the maker) to another entity (the payee or bearer) at a discount from its face value with the face value payable to the payee or bearer at a fixed or determinable future time. These kinds of notes will usually be contributed by the payee of the note or another entity who acquired the note as a holder for value.

116. A promissory note payable on demand is also said to usually be intended to be presented and paid within a short space of time. If a promissory note is not intended to be paid speedily, it will normally be expressed to carry interest to the date of payment.[35]

117. Having regard to the principles outlined in paragraphs 108 to 116 of this draft Ruling, where a contribution is made using a negotiable instrument such as a cheque, promissory note or other negotiable instrument the Commissioner will treat the contribution as a contribution of money.

118. However, there are two circumstances in which the Commissioner will not treat the contribution as a contribution of money.

119. First, no contribution will be made if the cheque, promissory note or similar negotiable instrument is not honoured.

120. Secondly, the Commissioner will treat the contribution of an investment-related promissory note as a contribution of an asset (not money).

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[33] Section 89 of the *Bills of Exchange Act 1909*.
[34] For example, see *Coles Myer Finance Ltd v. Federal Commissioner of Taxation* 93 ATC 4214.
[35] See paragraph 2130 of *Chalmers & Guest on Bills of Exchange, Cheques and Promissory Notes* 15th edition, Sweet & Maxwell, London 1998.

121. Investment-related promissory notes are normally issued as a means of raising finance. The funds raised are usually used by the maker as working capital or to improve liquidity. The amount advanced to the issuer is discounted from the note's face value. The discount is equivalent to an interest return for the lender. Typically a note becomes payable on a specified maturity date. A note's marketability depends in part on the credit rating of the issuer. Commercial notes are normally denominated in face value amounts of A$500,000 or A$1,000,000. Further, in the commercial environment the only entities that normally issue promissory notes are those corporations with the highest credit rating and the discount rate reflects the credit standing of the corporation.[36]

122. Negotiating an investment-related promissory note to a superannuation provider is an *in specie* contribution of an asset and not a contribution of money. The note is capable of being traded as a commodity in its own right as a marketable security with an interest-like return. The superannuation provider acquires a debt that is legally enforceable against the maker of the note.[37]

123. The Commissioner would expect very few investment-related notes to be contributed to a superannuation fund, in part because the acceptance of such a contribution from a related party of the fund will contravene section 66 of the SISA (unless an exception applies).

*Other forms of contribution*

124. A person who contributes an asset to a superannuation provider may receive consideration for the transfer of that asset from the provider where the consideration received is less than the market value of the asset. In these circumstances, the transfer of the asset is both a contribution by the person and the purchase of an asset by the superannuation provider.

125. The Commissioner recognises that it has become common within some parts of the superannuation industry for a person to pay an expense on behalf of a superannuation fund. This occurs, for example, for administrative ease, where the fund does not have a cheque account and will usually involve an employer or member of the fund. The practice involves making journal entries after the expense is paid that, in the case of the employer or fund member, re-classifies the expense payment as a superannuation contribution and, in the accounts of the superannuation fund, recognises the making of the contribution and payment of the expense.

[36] Australian Merchant Bankers Association, 'Bills of Exchange and Promissory Notes', page 18.
[37] See *Coles Myer Finance Ltd v. Federal Commissioner of Taxation* 93 ATC 4214.

126. The Commissioner's preferred approach is for all superannuation fund expenses to be paid directly out of the fund itself and for superannuation contributions to be made directly to the fund. This provides clarity because the outgoings of, for example, an employer or member of a fund, and the fund directly match the tax treatment.

127. Where a person pays an amount to a third party to satisfy a liability of a superannuation provider, the payment to the third party is treated for all tax purposes as though the person had made a contribution directly to the superannuation provider and the provider had separately paid an equal amount to the third party.

128. In this situation, the capital of the fund is increased because the person's payment of the superannuation provider's expense extinguishes the liability of the provider.

129. A contribution that takes the form of increasing the value of an existing asset of the fund may involve shifting value from an asset held by the contributor to an asset held by the fund. For example:

- Where a fund holds interests in an entity (commonly shares in a company), an alteration of the rights attaching to the interests held, such as distribution or voting rights, in favour of the interests held by the fund to the detriment of the other interest holders falls within the meaning of a contribution identified in this draft Ruling. The contributors in these circumstances are the persons or entities whose interests have decreased in value as a consequence of the alteration of rights.
- Similarly, where a person or entity transfers an asset without consideration to a second entity in which a fund holds an interest, a contribution is made to the extent that the fund's interest in the second entity increases in value as a consequence of the asset transfer.

130. Alternatively, an existing fund asset, such as real property, may have its value increased by a person or entity making capital improvements to the property for no consideration or less than an arm's length consideration or market value.

131. In each of these cases, the increase in the value of the fund's asset is not attributable to a return on or of an investment.

132. An amount set aside but not actually paid is not a contribution. It is well established that the making of a journal entry in the books of an entity does not alone establish a payment. However, an actual payment, albeit to a creditor of the superannuation fund rather than to the fund itself, may constitute a contribution.

133. An entity, often an employer sponsor of a superannuation fund, may agree to reimburse the trustee of the fund for certain expenses incurred by the fund. For example, the employer may agree to reimburse the trustee for certain insurance premiums or administration costs of the fund. Consequently, the trustee may periodically invoice the employer for an amount of such expenses. This may be a reimbursement of the actual costs incurred and paid by the trustee or be a payment of an amount based on some other figure such as a percentage of the salaries of every employee. This reimbursement is also a contribution to a superannuation fund as it increases the capital of the fund.

134. Although the SISA generally prohibits a trustee of a superannuation fund from borrowing money, there are a few limited exceptions. A question has arisen as to whether a contribution would occur if a lender were to forgive the debt of a trustee, particularly in relation to the limited recourse borrowing arrangements covered by subsection 67(4A) of the SISA.

135. The Commissioner considers a contribution is made where a debt of a superannuation provider is forgiven. The capital of the fund is effectively increased by extinguishing the liability of the superannuation provider to repay the loan.

136. Some of the borrowing arrangements entered into by superannuation providers as a result of the enactment of subsection 67(4A) of the SISA have required a person other than the fund trustees, or a fund trustee in their personal capacity, to provide a guarantee for the repayment of the borrowed amount.

137. A payment pursuant to that guarantee will constitute a contribution to the fund if the guarantor has no right of indemnity against the fund. A contribution will be made by a guarantor who has a right of indemnity only if the guarantor subsequently forgoes that right or is prevented from enforcing that right (for example by the statute of limitations). Clearly, the capital of the fund would not be increased merely if a liability to one party were extinguished in favour of a liability to another party.

138. A distribution made by the trustee of a discretionary trust to a superannuation provider is a contribution to the fund unless the fund's interest in the discretionary trust is an investment. In these circumstances, the receipt clearly increases the capital of the superannuation fund. Further, the amount cannot be characterised as income, profit or gain from the use of the existing capital of the trust because the provider, being a mere object of a trust, does not have an interest in the discretionary trust that can be said to be an investment in the discretionary trust.

139. A distribution from a trust in which the superannuation provider has an interest will not be a contribution to the fund where the distribution is a return on, or of, the investment of fund moneys. In these circumstances, the distribution can be characterised as income, profit or gain arising from the use of the fund's existing capital.

140. A roll-over superannuation benefit is a contribution in the hands of the receiving fund as it increases the capital of the fund.[38] Similarly, a transfer of a person's benefits from an overseas superannuation fund is also a contribution.

141. An amount payable by an insurance company to a superannuation provider under the terms of an insurance policy is not a superannuation contribution as such an amount is considered to arise by way of income, profit or gain from the use of the fund's existing capital.

### *When a superannuation contribution is made*

142. The time at which a contribution is made will determine the period for which the person making the contribution may be eligible to claim a deduction. Subsections 290-60(3) and 290-150(3) prescribe that a contribution made in an income year is deductible in that income year. When a contribution is made is also relevant to the operation of the excess contributions taxes. Further, a contribution that is included in the assessable income of a superannuation fund is normally included in the income year in which it is received.

#### *Money or money equivalent*

143. A contribution of money, or money equivalent such as a money order or an electronic funds transfer, is made when the amount is received by the fund.

144. It has been suggested that a contribution made by electronic funds transfer may occur as soon as the contributor has done everything necessary to effect a payment. The Commissioner does not accept that is sufficient to increase the capital of the fund.

145. Electronic payment systems operate through contractual arrangements between the:

- payer and payer's financial institution;
- payer's financial institution and payee's financial institution; and
- payee's financial institution and payee.

[38] However, as noted in paragraph 1 of this draft Ruling, for the purposes of the SISR a roll-over superannuation benefit is excluded from the definition of contribution.

146. When a financial institution agrees to accept a payment instruction it notifies the receiving institution of the details of the payment. In Australia, there are several different clearing systems for the transferring of information and netting of amounts to be transferred between institutions. The clearing rules of these systems bind the financial institutions but not the customers. Most small payments between institutions are not processed in real time but are subject to deferred net settlement which occurs overnight.[39] As such, it is not until an amount is credited to a bank account of the superannuation provider that a contribution will be taken to be made.

147. A fund's bank statement would normally provide the best evidence as to when a contribution is received. However, in limited circumstances, other evidence may be used to determine when a contribution is made. For example, a transfer of funds between the linked accounts of a member of a self-managed superannuation fund and the fund held at the same financial institution may result in a contemporaneous debit and credit to the respective accounts with the funds being immediately available for use of the self-managed superannuation fund. When such a transfer occurs on a week-end, it is common for bank statements to show the transaction occurring on the next business day. Evidence, such as a computer print-out recording the transaction, may be used to establish the timing of the contribution.

*Cheques and promissory notes*

148. A contribution to a fund by cheque or promissory note (other than an investment-related promissory note) is made when the cheque or note is received by the trustee of the fund.[40] As stated in paragraph 119 of this draft Ruling, if the cheque or note is dishonoured, no contribution will have been made by the person.

149. If a cheque is post-dated (that is, it is payable on a date later than the day on which the cheque is received by the superannuation provider) or a promissory note is payable in the future, the contribution will be made on the later of the day the cheque or note is received and the date on which payment can be demanded as shown on the cheque or note. A post-dated cheque cannot be presented before the date shown.[41] Again, no contribution will have been made if the cheque is dishonoured after presentation. Payment cannot be demanded on a note prior to the date for payment.

[39] Thomson Legal Online, Law Relating to Banker and Customer, paragraphs 4.1860, 4.1980 and 4.2090.
[40] *Tilley v. Official Receiver in Bankruptcy* (1960) 103 CLR 529.
[41] Subsection 61(2) of the *Cheques Act 1986.*

150. In the case of a related party cheque or related party promissory note, the Commissioner will only apply the rules in paragraphs 148 and 149 of this draft Ruling if:

- the trustee presents the cheque for payment, or demands payment on the note, promptly after:
  - for a cheque or promissory note that is immediately payable - the date on which the cheque or note is received, or
  - for a post-dated cheque or promissory note that is payable in the future – the date on which payment can be demanded on the cheque or note; and
- the cheque or note is honoured with cash (or its electronic equivalent).

151. Presentation of a related party cheque or demand for payment of a related party promissory note will be accepted as prompt if it occurs within a few business days consistent with prudent banking practice. Subject to extenuating circumstances, the Commissioner expects a trustee to obtain payment on any cheque or promissory note as soon as possible as such behaviour is consistent with the covenant in paragraph 52(2)(b) of the SISA. Under that covenant, the trustee is required to exercise the same degree of care, skill and diligence as an ordinary prudent person would exercise in dealing with the property of another to whom the trustee felt morally bound to provide.

152. In circumstances where a related party cheque or related party promissory note is not promptly dealt with, the Commissioner will treat a contribution as having been made only once the superannuation provider has obtained payment in cash (or its electronic equivalent).

153. A contribution in the form of an investment-related promissory note is generally made at the same time as for any other property (see paragraphs 154 to 164 of this draft Ruling).

*Property or in specie contributions*

154. A contribution of property will be received by a superannuation provider when either legal or beneficial ownership of the property passes from the contributor to the superannuation provider. The time that the contribution is made is the same time as the contribution is received by the superannuation provider.

155. For many classes of property, there is no formal registration process that evidences ownership of the property. For such property, the ownership will pass when the provider acquires [physical] possession of the property. However, the Commissioner accepts that ownership of property may pass on the execution of a deed of transfer of the property notwithstanding there has been no change in the [physical] possession.

156. By contrast, legal ownership of some classes of property is evidenced by a system of formal registration (for example shares in a publicly listed company or Torrens title land). For such property, ownership of the property will pass when the superannuation provider is registered as the legal owner of the property.

157. However, in some circumstances the formal registration of the change of legal ownership occurs some time after beneficial ownership of the property passes. In recognising this, the Commissioner accepts that a contribution of property can be made when beneficial ownership of the property is obtained by the superannuation provider.

158. When a person contributes real property to a fund, legal ownership will pass with registration of the superannuation provider as owner of the real property. The beneficial ownership may pass earlier.

159. In the case of a sale and acquisition of land, beneficial ownership normally passes when the contract is completed or the purchase is settled.[42]

160. In the case of a gift of land (which is in effect what an *in specie* contribution of land constitutes), case law indicates that an equitable interest in the land will be created once the donor (contributor) has done everything necessary to transfer legal title to the property.[43] This principle is established in the case of High Court case of *Corin and Another v. Patton*:[44]

> [W]e conclude that, if an intending donor of property has done everything which it is necessary for him to have done to effect a transfer of legal title, then equity will recognise the gift. So long as the donee has been equipped to achieve the transfer of legal ownership, the gift is complete in equity. 'Necessary' used in this sense means necessary to effect a transfer. From the viewpoint of the intending donor, the question is whether what he has done is sufficient to enable the legal transfer to be effected without further action on his part
>
> …

[42] Taxation Ruling TR 94/29 Income tax: capital gains tax consequences of a contract for the sale of land falling through contains a detailed discussion of when a contract for the sale of land is completed.
[43] Beneficial ownership will normally be acquired when an equitable interest in the land is acquired.
[44] (1990) 92 ALR 1 at 13-14 per Mason CJ and McHugh J.

> the donee acquires an equitable estate or interest in the subject matter of the gift once the transaction was complete so far as the donor is concerned. So much was acknowledged by the English Court of Appeal in *Re Rose*. There the court concluded that the donor had executed and delivered transfers and share certificates to the donee with the intention of transferring title to the shares to him and had placed him in a position to secure the legal title to the shares by registration subject to an exercise by the directors of their discretion to register the transfers. In this situation the donor could not recall the gift or invoke the aid of the court to prevent registration: see at 516. The court held that the donor had parted with his beneficial interest and had become a constructive trustee for the donee.

161. Having regard to these principles the Commissioner accepts that a superannuation provider acquires the beneficial ownership of real property when the provider obtains possession of the requisite transfer forms, provided that there is no legal impediment preventing the superannuation provider from effecting registration of legal ownership of the property.

162. When a person makes a contribution of shares in a company the superannuation provider has a duty to ensure it holds proper legal title to the shares. Legal ownership of the shares is recognised when the superannuation provider's name is registered in the company's share register – section 1072F of the *Corporations Act 2001*.[45] This will be the case where a contribution of shares in a publicly listed company is effected through the Clearing House Electronic Subregister System, known as CHESS.

163. As with a contribution of real property, the Commissioner accepts that a superannuation provider may acquire beneficial ownership of shares or units in an Australian Stock Exchange listed company or unit trust effected through an off-market share transfer, when the trustee obtains a properly completed off-market share transfer form.

164. Whether a contribution is made when beneficial ownership of property passes will need to be determined on a case by case basis. A contributor or superannuation provider that seeks to argue that a contribution of property is made when beneficial, not legal, ownership of the property passes must retain sufficient evidence of the relevant transactions and events to accurately identify when the change of beneficial ownership occurs. The evidence should show when everything that is required to be done to effect registration of the change of ownership occurs. Such evidence would include relevant minutes of any trustee meeting held to consider the acceptance of the *in specie* contribution, the relevant transfer forms, and any other record of when the relevant transfer took place.

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[45] Section 1072F of the *Corporations Act 2001* is a replaceable rule. This means that ownership of the share may, according to the rules of the company be evidenced in another way.

*Debt forgiveness and guarantees*

165. A contribution by way of debt forgiveness will be taken to occur when the lender executes a deed of release that relieves a superannuation provider from the obligation to repay a loan to the lender.

166. If a guarantor makes a contribution by paying a debt of a superannuation provider, when the contribution is made will be determined by whether or not the guarantor has a right to be indemnified by the superannuation provider. If the guarantor has no right or indemnity, the contribution is made when the superannuation provider's liability is satisfied. If the guarantor has a right of indemnity, a contribution is only made when the guarantor takes formal steps to forgo that right, for example, by executing a deed of release, or the right of indemnity expires, for example, because of the operation of the statute of limitations of actions.

### *Amount of an in specie superannuation contribution*

167. Where an *in specie* contribution is made, the amount of the contribution will be the market value of the property at the time the contribution is made.

168. Where the transfer of the property is a part acquisition, the contribution is the amount by which the market value of the asset exceeds the consideration paid by the superannuation provider.

## Part B – Specific rules about deducting superannuation contributions

### *Purpose of the contributor*

169. Whether a superannuation contribution is deductible is determined by regard to the purpose of the contributor. Subsections 290-60(1) and 290-150(1) of the ITAA 1997 make it clear that the contributor's purpose must be to provide superannuation benefits for a particular person or class of persons. As this element of the test for deduction is the same as in the former sections 82AAC and 82AAT of the ITAA 1936 it is possible to rely on cases that considered the purpose test in those provisions and their predecessors.

170. As Hill J said in *Raymor Contractors Pty Ltd v. Federal Commissioner of Taxation*:[46]

> In the context of section 82AA, purpose is the object which the taxpayer has in view or in mind. There may be a fine distinction between purpose and intention but it is not necessary to explore that distinction, cf *Plimmer v. Commissioner of Inland Revenue (NZ)* (1957) 11 ATD 480 at 483-484. Generally speaking a person will be said to intend the natural and probable consequences of his acts and likewise his purpose may be inferred from them. In the present case the taxpayer's purpose in making the payments in each year of income may be inferred from the objective evidence that in the years of income in question benefits were continually being forfeited and only one person was in fact paid out, that person being a director of the appellant. Coupled with the fact that virtually the whole of the contributions were lent back to the contributing companies these facts suggest that the appellant's purpose was not to benefit those persons who were members of the fund; or certainly that that was not the sole or dominant purpose in making the contributions in the years in question.

171. Hill J elaborated further on purpose in *Walstern Pty Ltd v. Federal Commissioner of Taxation*[47] where he said:

> While I do not think it makes any difference in the present case either, I am inclined to the view that 'the purpose'' as used in section 82AAE refers to sole rather than dominant or principal purpose. This is the view that was accepted also by Pincus J in *FC of T v. Roche & Ors* 91 ATC 5024 at 5030; (1991) 105 ALR 95 at 103. However, I do not think that a deduction would be lost if the directors of a taxpayer/employer took into account in making a contribution, but incidentally, the taxation benefits which the Act makes available where a contribution is made to a fund. The answer may well lie in the fact that the taxation deduction will not, in such a case, be an object of the contribution; rather it will be a consequence of the contribution.

### *Deducting superannuation contributions for own employees*

172. You can claim a deduction for the amount of a contribution[48] that you make to a superannuation provider for the purpose of providing superannuation benefits for another person who is your employee at the time that the contribution is made.[49]

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[46] 91 ATC 4259 at 4270 per Hill J.
[47] *Walstern Pty Ltd v. Federal Commissioner of Taxation* 2003 ATC 5076 at 5088 per Hill J.
[48] *Cameron Brae Pty Ltd v. Federal Commissioner of Taxation* [2007] FCAFC 135 per Stone and Allsop JJ at paragraph 43.
[49] Section 290-60. Section 290-85 contains rules for contributions for former employees.

173. The employee must be a member of the superannuation fund when you make the contribution. If the employee is not a member of the fund, it cannot be said that the contribution is for the benefit of an employee. As Hill J said in *Walstern's case*:[50]

> There is another problem for Walstern under section 82AAE. At the time Walstern made the contribution there was no person who was a member of the fund. In law the trustee of the fund held the contribution upon resulting trust for Walstern pending nomination of an employee as member and ultimate acceptance of the person as member after payment of the qualifying contribution. It is true that a deduction would be allowable for a contribution to a fund where there were members of the fund, notwithstanding that at the time the contribution was made there had been no allocation among the members. That was decided in *Raymor*. But the present case goes beyond the issue of allocation which arose in *Raymor*. The fact is that unless and until any person became a member (and this did not happen until the later year of income) it simply was not correct to say that Walstern had made a contribution to a fund for the benefit of a person who was an eligible employee. It remained within the power of Walstern to have the contribution repaid to itself as owner in equity of the money, unless it took the further step of nominating a person as a member.

174. A contribution will provide superannuation benefits to an employee if it will benefit a particular employee, or if it will benefit all or identifiable employees who are members of the fund.[51]

175. The employee must have fully secured rights to the benefit. It is not sufficient that an employee is entitled to their superannuation benefits only through the exercise of a discretion by a superannuation provider.

> These provisions, which reflect the concept in section 66 of the former Act, namely 'individual personal benefits', are concerned to ensure that moneys are set aside or paid for the purpose of providing benefits for individual employees who have rights in the fund and that those rights are fully secured. It is not necessary that an employer should turn his attention to the particular circumstances of each employee when making a contribution for it is sufficient that the contribution is made for the purpose of benefiting all or identifiable members of the fund. If no allocation has been made, the Commissioner may determine a sum deemed to be 'the part of the amount set apart or paid in respect of a particular employee''. It is not, however, sufficient that the employer has in mind that the moneys in the superannuation fund will ultimately go to the benefit, not of the general members of the fund, but of a remaining employee or employees such as a managing director/principal shareholder. Funds which are managed for such an ultimate end are not funds maintained for the benefit of the employees in respect of whom the contributions have, in the formal sense, been set apart or paid into the fund.[52]

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[50] *Walstern Pty Ltd v. Federal Commissioner of Taxation* 2003 ATC 5076 at 5089 per Hill J.
[51] *Raymor Contractors Pty Limited v. Federal Commissioner of Taxation* 91 ATC 4259 at 4261, (1991) 21 ATR 1410 at 1413 per Davies J (Wilcox J agreeing).
[52] *Raymor Contractors Pty Limited v. Federal Commissioner of Taxation* 91 ATC 4259 at 4261, (1991) 21 ATR 1410 at 1413 per Davies J (Wilcox J agreeing).

### *Deducting superannuation contributions for another's employees*

176. You can claim a deduction for a superannuation contribution for another person who, at that time, is an employee of a company in which you have a controlling interest.[53] The term 'controlling interest' is not defined and will take its common law meaning. There are several decisions, particularly in the United Kingdom, in which the expression 'controlling interest' has been considered.

177. For example, a bare majority, more than one half, of the voting power is sufficient to confer a controlling interest.[54] Further, a shareholder has been held to have a controlling interest in a company where the shareholder has the power, by the exercise of voting rights to carry a resolution at a general meeting of the company.[55]

178. Similarly, in another case, a shareholder was also held to have a controlling interest where their shareholding in the company was such that they were more powerful than all other shareholders put together in a general meeting.[56]

179. However, in a company that has two shareholders who each hold 50% of the shares, it is considered that neither of the shareholders has a controlling interest. This is because neither one of them has a majority of the voting power.

180. However, a shareholder in a company may be able to deduct a contribution for an employee of the company in other circumstances.[57]

### *Employment activity conditions*

181. Employee means a common law employee and any other person who is treated as an employee by section 12 of the SGAA.[58] If a contribution for an employee is to be deductible, the employee must (among other requirements) satisfy the employment activity condition.[59]

182. To satisfy the employment activity condition, a common law employee must be either:

- engaged in producing the employer's assessable income; or
- an Australian resident who is engaged in the employer's business.

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[53] Paragraph 290-90(1)(a).
[54] *British American Tobacco Co Ltd v. IR Commissioners* (1942) 29 TC 49.
[55] *IR Commissioners v. J Bibby & Sons Ltd* [1945] 1 All ER 667; *IR Commissioners v.Harton Coal Co Ltd (in liq)* (1960) 39 TC 174 at 183.
[56] *BW Noble Ltd v. Commissioners of Inland Revenue* (1926) 12 TC 911.
[57] See subsection 290-50(5).
[58] Section 290-65.
[59] Subsection 290-60(2) and section 290-70.

183. A person who is an employee only because of the operation of subsection 12(2) to 12(10) of the SGAA automatically satisfies the employment activity condition.

184. For example, a company's director is an employee of the company for the purposes of the SGAA if the director is entitled to payment for the performance of duties as a member of the company's executive body. At common law, directors have no right to remuneration and cannot receive benefits from corporate assets, unless authorised by the company's constitution or by the general meeting of the company.[60]

185. A director entitled to remuneration will satisfy the employment activity test even if not engaged in producing the company's assessable income or its business.[61]

186. A company cannot deduct a superannuation contribution for a member of the executive body who is not entitled to payment for the performance of duties as a member of the company's executive body.

187. It has long been held that the directors of a company are not entitled to payment for the services they provided as directors unless it is specifically provided for in the company's constitution or approved by shareholders (see *Hutton v. West Cork Railway Co* (1883) 23 Ch D 654 and *Re George Newman & Co* [1895] 1 Ch 674). In *Re George Newman & Co* the United Kingdom's Court of Appeal said:

> Directors have no right to be paid for their services, and cannot pay themselves or each other, or make presents to themselves out of the company's assets, unless authorised to do so by the instrument which regulates the company or by the shareholders at properly convened meetings. The shareholders, at a meeting duly convened for the purpose can, if they think proper, remunerate directors for their trouble or make presents to them for their services out of assets properly divisible among the shareholders themselves.

### *Deducting personal contributions*

188. As with deductions for superannuation contributions for employees, an individual who wishes to deduct their personal contributions must satisfy a number of requirements.[62] Matters affecting the maximum earnings test and the notice of intent to deduct contributions are discussed below.[63]

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[60] Section 202A of the *Corporations Act 2001* states that directors shall be paid such remuneration as is from time to time determined by the company in general meeting. That is a replaceable rule under that Act.

[61] So far as directors are concerned, the provisions of the ITAA 1997 operate differently from the ITAA 1936 which deemed a director of a company to be employed by the company. However, the definition of employee used in the ITAA 1936 also required a director to be engaged in producing the company's assessable income or in the company's business.

[62] Subsections 290-150(1) and 290-150(2).

[63] Sections 290-160 and 290-170.

*Maximum earnings test*

189. Those persons who are engaged in an 'employment' activity in the income year need to meet an earnings test.[64]

190. A person will be engaged in an 'employment' activity if they are engaged in an activity in the income year that results in them being treated as an employee for the purposes of the SGAA. The term 'engaged' is not defined and takes its ordinary meaning of 'busy or occupied; involved'.[65]

191. However, for the majority of persons who are treated as employees for the purposes of the SGAA, the person need not be actively engaged in the activity. For example:

- a common law employee will be engaged in the activity while they remain employed;
- a member of the executive body of a body corporate (for example a director) who is entitled to payment for their services in that capacity will be engaged in the activity while they remain as a director;
- a member of a Parliament of the Commonwealth or a State or of a Legislative Assembly of a Territory will be engaged in the activity while they hold their seat in the Parliament; and
- a person who is engaged under a contract wholly or principally for labour is engaged in the activity throughout the duration of the contract.

192. An artist, musician, sportsman etcetera engaged to perform or present or participate in a performance etcetera will be engaged in the activity only while they participate in the relevant activity.

193. Those persons who have not engaged in an eligible activity in the income year are not subject to the earnings test. For example, a person who, although no longer employed but is receiving workers' compensation payments, is not subject to the maximum earnings test.

194. In the application of the maximum earnings test, the relevant 'employment' activity need not be an activity in Australia. The SGAA does not contain any territorial nexus that limits which individuals will be treated as employees for the purposes of the SGAA. The practical limits of the SGAA's application are created through the modification of the meaning of salary or wages in section 27 of the SGAA. That section ensures that amounts received, for example, by a non-Australian resident employee working outside Australia or an Australian resident employed by a non-resident employer to work outside Australia are not taken into account as salary or wages when working out whether an employer has an individual superannuation guarantee shortfall for an employee.

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[64] Subsection 290-160(1).
[65] Macquarie Dictionary 3rd edition 1998.

195. Where the person engages in any 'employment' activities in the income year a deduction can only be claimed where the assessable income and reportable fringe benefits attributable to the 'employment' activities are together less than 10% of the person's total assessable income and reportable fringe benefits in the income year that the contribution is made. Further, if the person has more than one period of engaging in 'employment' activities in an income year, the assessable income and reportable fringe benefits attributable to each period of 'employment' is aggregated.

196. The term 'attributable to' in subsection 290-160(2) is not defined. However, the courts have considered the meaning of the term in a number of different cases. For example, in determining whether the plaintiff's loss of employment was 'attributable to' the provisions of the *Local Government Act 1972* (UK), Donaldson J in *Walsh v. Rother District Council* stated:[66]

> These are plain English words involving some causal connection between the loss of employment and that to which the loss is said to be attributable. However, this connection need not be that of a sole, dominant, direct or proximate cause and effect. A contributory causal connection is quite sufficient.

197. Donaldson J's comments were cited with approval by the High Court in *Commissioner of Taxation v. Sun Alliance Investments Pty Limited (in liquidation)*.[67]

198. In *Repatriation Commission v. Law*, the Full Federal Court said:[68]

> It seems clear the expression 'attributable to' in each case involves an element of causation. The cause need not be the sole or dominant cause: it is sufficient to show 'attributability' if the cause is one of a number of causes provided it is a contributing cause ...

199. In *McIntosh v. Federal Commissioner of Taxation*[69] the Full Federal Court considered whether there was a causal connection between a commutation payment and the employee's termination of employment. Brennan J said that:

> Though the language of causation often contains the seeds of confusion, I apprehend his Honour to hold the required nexus to be (at least) that the payment would not have been made but for the retirement.

200. In the case of workers' compensation payments, the 'employment' activities of the recipient are not the direct or proximate cause of the workers' compensation payments. Rather, the direct or proximate cause of the payments is the injury suffered during the course of their employment activities. However, the injury would never have arisen but for those activities. Therefore, there is a contributory cause or connection between the 'employment' activities and the workers' compensation payments to show 'attributability' within the meaning of subsection 290-160(2).

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[66] [1978] ICR 1216 at 1220; [1978] 1 All ER 5101 at 5104.
[67] [2005] HCA 70; 2005 ATC 4955; (2005) 60 ATR 560.
[68] (1980) 31 ALR 140 at 151.
[69] 79 ATC 4325; (1980) 10 ATR 13.

201. A number of decisions of the Administrative Appeals Tribunal (the Tribunal) have considered whether amounts payable to a person in consequence of the termination of their employment are included in the 10% test.[70] The Commissioner considers that the decision of the Tribunal in *Falson*[71] to be the correct view of the law. The Tribunal members concluded that an amount received by Mr Falson after his retirement due to ill health but in the same income year as the retirement was assessable income attributable to his employment activities in the year.[72]

202. For a non-resident, the income attributable to 'employment' activities engaged in outside Australia is not assessable income in Australia and so will not be counted in the maximum earnings test. A non-resident with Australian sourced income that is not attributable to 'employment' activities may therefore be able to deduct a personal superannuation contribution made to an Australian superannuation provider against that income.

203. However, the 'employment' income of an Australian resident employed overseas by a foreign employer will be counted in the maximum earnings test if the income is assessable income.

*Notice of intention to claim a deduction*

204. A person who intends to deduct their personal superannuation contributions must give to their superannuation provider a valid notice in the approved form before lodging their income tax return for the year (or within 12 months of the end of the income year if they have not lodged their return by that time). The trustee must also acknowledge receipt of the notice.[73]

205. It should also be noted that a person may choose how much of their contributions to deduct and this notice is used to give effect to that choice. A person may choose not to deduct a portion of their personal contributions to ensure they are entitled to the superannuation co-contribution.

206. Usually, an individual would personally give the notice to their superannuation fund. However, an agent may also do this for the individual.

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[70] *Thornton v. Federal Commissioner of Taxation* 97 ATC 2117; (1997) 36 ATR 1109, *Edmonds-Wilson v. Federal Commissioner of Taxation* 98 ATC 2276; (1998) 40 ATR 1071, *Northey v. Federal Commissioner of Taxation* [2001] AATA 1035; 2002 ATC 2001; (2001) 49 ATR 1016*, Norris v. Federal Commissioner of Taxation* [2007] AATA 749; 2002 ATC 2091; (2007) 50 ATR 1250, *Falson v. Federal Commissioner of Taxation* [2007] AATA 1668; 2007 ATC 2438; (2007) 68 ATR 299.

[71] *Falson v. FCT* [2007] AATA 1668.

[72] Aspects of the 10% test set out in section 82AAT of the ITAA 1936 were retained in the maximum earnings test set out in section 290-160 of the ITAA 1997.

[73] Subsections 290-150(2) and 290-170(1).

207. In particular, a legal personal representative may give a superannuation provider a notice of intention to deduct on behalf of a deceased person who made a contribution prior to death. The legal personal representative must meet the remaining notice requirements. If the legal personal representative of the deceased intends to lodge a section 290-170 notice of intention to claim a deduction they must do so before lodgment of the deceased's final tax return (or within 12 months of the end of the income year in which the deceased died if that is earlier).

208. As stated in paragraph 204 of this draft Ruling, the notice must be valid. A notice will not be valid in several circumstances.

209. For example, a notice will not be valid if the trustee of the fund no longer holds the contribution when the notice is given. Nor will the notice be valid if the trustee has begun to pay a superannuation income stream based in whole or part on the contribution.

210. The Explanatory Memorandum[74] gives some indication as to when a trustee will not hold a contribution. It states an example is where the member has requested a partial roll-over of a superannuation benefit which includes the contribution covered in the notice. Example 3 in paragraphs 77 to 79 of this draft Ruling is taken from the Explanatory Memorandum.

211. The Explanatory Memorandum also states that a contribution is still held by a fund even if the trustee has transferred its tax liability to a life insurance company or pooled superannuation trust under section 295-260.

212. The Explanatory Memorandum does not explain how the law should be applied in the situation where a superannuation income stream is commenced using only part of a person's account balance. It is the Commissioner's view that any income stream commenced from a superannuation interest will be based in whole or in part on a contribution made to the account. This is so regardless of whether the value of the superannuation income stream is less than the balance of the account as reduced by the relevant year's contributions.

213. This approach is taken because it is consistent with the integrity of the rules that determine how superannuation benefits are taxed. Subsection 307-125(1) states that the tax free and taxable components of a superannuation benefit are worked out by first determining the proportions of the value of the superannuation interest that the components represent and then applying those proportions to the benefit. Paragraph 307-125(3)(a) states that, in the case of superannuation income stream, the value of the superannuation interest and the amount of each of its components is worked out when the income stream commences.

[74] Tax Laws Amendment (Simplified Superannuation) Bill 2006.

214. Therefore, a deduction notice will be invalid if it is given by a member after the components of superannuation interest from which a superannuation income stream has begun to be paid to the member on the basis that the current year's contribution were not deductible.

215. A superannuation provider will no longer hold a contribution if a member's interest in the fund has been transferred to a successor fund.[75] The member cannot give a notice of intention to deduct to the trustee of that fund after the person's interest has been transferred. Nor can the member give the notice to the successor fund.

[75] If all of the members' interests in one fund are transferred to a second fund, the second fund is known as the successor fund. This may occur for example, when there is an amalgamation of funds.

# Appendix 2 – Your comments

216. You are invited to comment on this draft Ruling. Please forward your comments to the contact officer by the due date.

217. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the Tax Office website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

| | |
|---|---|
| **Due date:** | **17 July 2009** |
| **Contact officer:** | **Mr Andrew Lee** |
| **Email address:** | **andrew.lee@ato.gov.au** |
| **Telephone:** | **(07) 3213 3190** |
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| **Address:** | **Australian Taxation Office**<br>**PO Box 9977**<br>**Upper Mount Gravatt**<br>**QLD 4122** |

# Appendix 3 – Detailed contents list

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Not previously issued as a draft

*Related Rulings/Determinations:*

TR 94/29; TR 2005/24;
SGR 2005/1; SMSFR 2008/D2

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- notice
- superannuation contributions
- ten percent test

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