IT 2630 - Income tax: superannuation benefits provided through an administration company or trust

TAXATION RULING NO. IT 2630

INCOME TAX: SUPERANNUATION BENEFITS PROVIDED THROUGH AN ADMINISTRATION COMPANY OR TRUST

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Reference no.:	Subject refs:	Legislative refs:
I 1012588	ADMINISTRATION COMPANIES - DEDUCTIBILITY OF FEES - SUPERANNUATION DEDUCTIONS - SALARY SACRIFICE ADMINISTRATION TRUSTS	19 51

OTHER RULINGS ON THIS TOPIC: IT 25, IT 276, IT 2067, IT 2277, IT 494, IT 2503, IT 2531

PREAMBLE An administration company or an administration trust (in this Ruling referred to as an "administration entity") is one which provides administrative services to a professional partnership for a fee. This Office has accepted for some time that partners may establish, and become employees of, an administration entity set up to provide duties of a non-professional and administrative nature to their professional partnership.

2. The professional practice pays an administration fee to the administration entity to cover the costs of salary and superannuation contributions made on behalf of the partners. The administration entity is intended to break even - making no profit or loss after payment of the salaries and superannuation contributions.

3. One of the purposes for which administration entities have been set up over the years has been to enable employer-sponsored superannuation benefits to be provided to the partners (based upon a reasonable remuneration for services rendered). The tax deductible contributions that funded these benefits have generally exceeded the more limited deductions that have been available for self-employed superannuation contributions. For administration entities to be acceptable, there must be no element of income diversion and the superannuation contributions must be made to a "complying" fund (i.e. a fund in relation to which the Insurance and Superannuation Commissioner ("the ISC") has given a notice under section 12 or 13 of the Occupational Superannuation Standards Act 1987 stating that he is satisfied that the fund satisfied, or should be treated as if it had satisfied, the superannuation fund conditions in relation to the year of income).

4. On and from 1 July 1990, the level of deductions available to unsupported self-employed individuals for superannuation contributions was substantially increased. Contributions are limited, however, to the lesser of:

- the amount required to fund a benefit equal to the individual's reasonable benefit limit; or

- $3,000 plus 75% of the contributions exceeding $3,000.

5. On and from 1 July 1990, however, superannuation guidelines issued by the ISC permitted the reasonable benefit limits for a member of a superannuation fund to be based upon an expanded definition of "salary". "Salary" for this purpose now includes the net income from a business carried on by that person either alone or in partnership. Where, for example, an employee of an administration entity who earns a salary of $20,000 also derives net income of $200,000 from an unrelated business that the employee carries on in his or her own right, the "salary" in terms of the expanded definition would be $220,000.

6. Accordingly, it is now possible for administration entities which employ professional practitioners, either practising alone or in partnership, to calculate in respect of those practitioners increased superannuation contributions in terms of the expanded "salary" definition without the superannuation fund losing its complying status.

7. The purpose of this Ruling is to clarify this Office's view of the deductibility, under subsection 51(1) of the Income Tax Assessment Act 1936 ("the Act"), of administration fees charged by an administration entity in the context of the changed superannuation guidelines.

RULING Administration Entities

8. Although, as mentioned in paragraph 6, an administration entity may now be able to calculate increased superannuation contributions in terms of the expanded "salary" definition, not all outgoings of an administration entity (including superannuation contributions) charged to a professional partnership in the form of an administration fee are necessarily deductible to that partnership. An administration entity, by its very nature, is not a party at arm's length from its professional practice. The deductibility, under subsection 51(1) of the Act, of the fee charged by a non-arm's length administration entity will be limited to an amount that reasonably reflects the level of services provided by the administration entity through its professional employees (referred to in this Ruling as the "reasonable fee"). As stated in paragraph 15 of Taxation Ruling IT 2531, any other amount charged by the administration entity may be assumed to be not wholly payable in respect of the services provided by that entity but for some other purpose and should be disallowed under subsection 51(1) of the Act (F.C. of T. v. Phillips 78 ATC 4361; (1978) 8 ATR 783).

9. In the example outlined in paragraph 5, although the "salary" in terms of the expanded definition would be $220000, a fee charged by an administration entity to a partnership based on superannuation contributions calculated on that "salary" would not, in its entirety, reasonably reflect the level of services provided by the entity through its employees to the partnership. After all, the bulk of the superannuation contributions are attributable to the net income of the employee's business and would have no connection with the services provided by the entity. The fee would not represent a reasonable fee deductible in full under subsection 51(1) of the Act.

10. An example of a reasonable fee that would be deductible under subsection 51(1) of the Act would be one which is based upon:

a. a salary calculated in accordance with Taxation Ruling IT 2531;

b. superannuation contributions calculated on that salary; and

c. any ancillary costs associated with the services rendered (e.g. payroll tax).

11. Where the fee charged by a non-arm's length administration entity to a professional partnership is a reasonable fee, the deductibility of the fee under subsection 51(1) of the Act would not be affected by the proportion of the fee that represents salary or the proportion that represents superannuation contributions. For example, where the reasonable fee is $20,000, the payment of:

a. an administration salary of $10,000 and superannuation contributions of $10,000; or

b. an administration salary of $5,000 and superannuation contributions of $15,000; or

c. the payment of no administration salary and superannuation contributions of $20,000,

would not affect (subject to the ISC guidelines on superannuation contributions being satisfied) the deductibility of the fee under subsection 51(1) of the Act. Nor would any part of the superannuation contributions constitute a salary sacrifice that is assessable income in the hands of the employee. It is not necessary that all administration entity employees adopt the same mix of salary and superannuation contributions. Nor, of course, is it necessary that all partners of any particular partnership be employed by the administration entity.

12. If, however, an employee has an obligation to contribute to a superannuation fund and the administration entity withholds part of the employee's salary to make that contribution on the employee's behalf, then the amount of the contribution is

assessable income of the employee. In this situation the contribution is considered to be a disposition of income after it has been derived by the employee.

Combined Administration/Service Entities

13. As mentioned at paragraph 3 of Taxation Ruling IT 2531, where a combined administration/service entity is being used it is necessary to ensure that the two basic functions being carried out within that entity remain clearly defined, notwithstanding that the fee charged to the partnership will be a single amount. This fee is a combination of the reasonable fee (referred to in paragraph 8 of this Ruling) and the services fee (which is the amount charged, including commercial markups, for the provision of office equipment, premises, clerical services and so on - see Taxation Rulings IT 276 and IT 2277).

14. A question has recently been asked of this Office whether any objection would be raised if the profits being derived from the fee charged by the combined administration/service entity (that is, profits from the services component of the fee) are subsequently used to provide additional employer-sponsored superannuation to the employees of the entity. This Office is of the view that, subject to the ISC guidelines on superannuation contributions being satisfied, such an action would not put in jeopardy the deductibility of the fee under subsection 51(1) of the Act.

COMMISSIONER OF TAXATION
21 March 1991