TD 2005/29 - Income tax: will Part IVA of the Income Tax Assessment Act 1936 always apply if a taxpayer who carries on a business (including a personal services business) pays superannuation contributions that do not exceed the age-based limits but are considerably in excess of the value of the services provided by the employee?

Taxation Determination

Income tax: will Part IVA of the *Income Tax Assessment Act 1936* always apply if a taxpayer who carries on a business (including a personal services business) pays superannuation contributions that do not exceed the age-based limits but are considerably in excess of the value of the services provided by the employee?

Preamble

The number, subject heading, date of effect and paragraphs 1 to 3 of this document are a 'public ruling' for the purposes of Part IVAAA of the ***Taxation Administration Act 1953*** *and are legally binding on the Commissioner.*

1. No. The application of Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) to a particular scheme depends on the particular facts and circumstances of the case. However, in light of the Administrative Appeals Tribunal's (AAT's) decision in *Ryan v. Commissioner of Taxation* (2004) 56 ATR 1122; 2004 ATC 2181 (*Ryan's case*), the Tax Office accepts that, absent unusual features (and subject to the qualification in paragraph 2 of this Determination), Part IVA of the ITAA 1936 will not apply to a case where a company, trust, partnership or individual conducting a personal services business (as defined in Division 87 of the *Income Tax Assessment Act 1997* (ITAA 1997)) pays superannuation contributions up to the age-based limits (as prescribed in subsection 82AAC(2A) of the ITAA 1936) to a complying superannuation fund in respect of the associate of the main service provider. This is the case even if contributions up to the maximum age-based limits are also provided for the main service provider.

2. The qualification referred to in paragraph 1 of this Determination is that the provision of personal services through the entity or as a sole trader must be commercially justified (for example, because the relevant service acquirers will not contract with individuals but with entities only, or an employment relationship is not otherwise open to the sole trader). (If the use of the entity is not commercially justified, it would be necessary to consider factors such as those considered in *Tupicoff v. Federal Commissioner of Taxation* (1984) 15 ATR 1262; 84 ATC 4851, *Egan v*. *Federal Commissioner of Taxation* (2001) 47 ATR 1180; 2001 ATC 2185 and *Federal Commissioner of Taxation v. Mochkin* (2003) 52 ATR 198; 2003 ATC 4272.)

3. An example of a case having unusual features of the type referred to in paragraph 1 might include a situation where objectively it is clear that the associate is engaged by the entity or sole trader solely to allow the diversion of superannuation contributions from the main service provider. Depending on the particular facts such a situation may give rise to different considerations. Cases which have unusual features which remove them from the general guidance provided by this Determination will need to be considered in light of their own particular facts and circumstances.

Background

4. The deductibility of superannuation contributions for employees is expressly covered by section 82AAC of the ITAA 1936 rather than the general deduction provision of section 8-1 of the ITAA 1997. Deductibility under section 82AAC of the ITAA 1936 is not determined by whether the superannuation contributions represent the cost of obtaining an employee's services, but by whether the contributions are made for the purpose of making provision for superannuation benefits. Deductibility under the provision is limited by the age of an employee, not by his or her salary. Although there are provisions in the income tax law that limit deductions for excessive payments such as salary to associates (for example section 109 of the ITAA 1936 and section 26-35 of the ITAA 1997) those provisions do not apply in the circumstances contemplated by this Determination. Nor can Part IVA of the ITAA 1936 operate to impose arm's length pricing by parties to a transaction (although of course the payment of non-arm's length amounts in certain schemes could be relevant to determining purpose).

5. *Ryan's case* is an example of a situation where a company conducting a personal services business paid superannuation contributions in excess of the value of the services provided by the employee in circumstances where the AAT held that Part IVA did not apply.

6. The case was an alienation of personal services income (income splitting) case involving the provision of the taxpayer's personal services as a computer consultant through a company that he and his wife controlled. The company conducted a personal services business and therefore was not subject to the alienation of personal services income measures in Part 2-42 of the ITAA 1997. The company paid the taxpayer's wife a small salary for her secretarial assistance but made large superannuation contributions on her behalf. Those contributions exceeded the value of her work for the company but were within the age-based limits prescribed in subsection 82AAC(2) of the ITAA 1936. The Tax Office argued that section 177F of the ITAA 1936 allowed the Commissioner to include the amount of the excess contributions in the taxpayer's assessable income.

7. The AAT found for the taxpayer on the grounds that, in the circumstances of the case, it could not reasonably be expected that the amount paid to the superannuation fund in respect of the taxpayer's wife would otherwise have been paid to him personally. Rather, it found that if the company had not made superannuation contributions in respect of his wife it would have made superannuation contributions in respect of him – that is, no additional income would have been paid directly to either of them. The AAT also observed that, even if this were not the case, a consideration of the matters listed in section 177D of the ITAA 1936 did not reveal a dominant purpose of obtaining a tax benefit. In these circumstances Part IVA could not apply.

8. In reaching its conclusion the AAT accepted that the company was necessary to enable the taxpayer to obtain the work and that the salary to his wife was fair and reasonable. It also noted that if the superannuation contributions had been made for him then there would have been only a very small increase in the amount of tax that was actually paid.

Explanation

9. Having regard to the matters explained in paragraph 4, no presumption arises that Part IVA of the ITAA 1936 applies merely because a superannuation contribution is much greater than the salary paid to an employee, or indeed the value of the employee's services. In considering the application of Part IVA of the ITAA 1936 to the obtaining of a tax benefit in the form of a deduction available under section 82AAC of the ITAA 1936, the fact that the superannuation component of an employee's remuneration is greater than that needed to obtain his or her services is not particularly relevant. This is because section 82AAC of the ITAA 1936 is not concerned with establishing a nexus between the expenditure and the value of any reciprocal advantage. (If section 8-1 of the ITAA 1997 were in issue, this would be a relevant consideration.) However, if the payment was not in substance a contribution for the purpose of making provision for superannuation benefits, or the person on whose behalf the contributions are made was not in substance an employee, then that would tend to indicate a purpose of obtaining a tax benefit.

10. Therefore, generally speaking, a scheme under which 'excessive' superannuation contributions are made in a manner consistent with the purpose of providing superannuation benefits for an employee (who is an employee in substance as well as form) will not permit the inference of a dominant purpose of obtaining a tax benefit to be drawn. For superannuation contributions to be made in a manner consistent with the purpose of providing superannuation benefits, they should in substance be (or 'genuinely' be) for the provision of superannuation benefits for the employee.

11. However, the personal services income may itself be seen to have been derived by an entity under an arrangement where a person has the purpose of omitting assessable income from his or her own assessment. Or the personal services income may have been derived as a sole trader to allow a deduction to be obtained. In these situations, different considerations will arise. In such cases the tax benefit arising from the contribution would be susceptible to cancellation under Part IVA of the ITAA 1936, because it would be seen as merely implementing the purpose of omitting the income from the individual's assessable income or obtaining the deduction.

What arrangements are covered by this Determination?

12. The conclusions reached in this Determination are equally applicable to businesses that do not derive personal services income and therefore are not personal services businesses. Because such businesses do not derive personal services income any special considerations that might arise in relation to the potential application of Part IVA of the ITAA 1936 to the alienation of personal services income do not apply to them. However, entities to which Part 2-42 of the ITAA 1997 applies (that is to say, personal services entities that are not conducting a personal services business) continue to be subject to the limitations set out in Part 2-42 of the ITAA 1997 and are not affected by this Determination.

13. This Determination does not address alienation of personal services income other than by way of making contributions to a complying superannuation fund. For example, it does not apply to cases where income of the entity is paid directly to the main service provider and his or her spouse in such a way that the amounts paid to each are disproportionate to their respective contributions to the personal services business. In this regard, the AAT in *Ryan's case* noted that different considerations may have arisen if the case had involved the payment by the company of equal amounts of income to the taxpayer and his wife (rather than contributions to a superannuation fund).

Example

14. *Mary is a computer consultant who provides her professional services through her private company to a number of clients, all of whom refuse to contract with her personally but insist on obtaining her services through a contract with her company. The company employs Mary to provide programming services to its clients and employs her husband Derek to provide administrative support. Derek obtains a market value salary for his administrative work for the company, but the company provides superannuation contributions on his behalf to a complying superannuation fund up to his age-based limit of $95,980. The company provides the remainder of its fee income, net of expenses, to Mary as remuneration for her services. Mary's remuneration consists of salary and a superannuation contribution of $4,500, representing 9% of her salary (the minimum level of superannuation support required under the superannuation guarantee scheme). Mary's salary is lower than it would have been if the company had not made such a high superannuation contribution on behalf of Derek. However, Derek provides valuable service to the company for which he is fairly remunerated, the company makes genuine superannuation contributions on his behalf, and there are no unusual features to the arrangement. In the circumstances Part IVA does not apply.*

15. *Note that different considerations might arise if, say, Mary was providing her services without administrative support and then took a significant cut in her salary to allow Derek to be employed by the company at his remuneration level to perform tasks that were previously not required.*

Date of effect

16. This Determination applies to years commencing both before and after its date of issue. However, it does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Commissioner of Taxation
28 September 2005

Previous draft:

TD 2004/D82

Related Rulings/Determinations:

TR 92/20; TR 97/16; TR 2001/8

Subject references:

- alienation of personal services income
- income splitting
- Part IVA
- personal services business
- superannuation contributions

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1936 82AAC
- ITAA 1936 82AAC(2)
- ITAA 1936 82AAC(2A)
- ITAA 1936 109
- ITAA 1936 Pt IVA
- ITAA 1936 177D
- ITAA 1936 177F
- ITAA 1997 8-1
- ITAA 1997 26-35
- ITAA 1997 Pt 2-42
- ITAA 1997 Div 87

Case references:

- Egan v. Federal Commissioner of Taxation (2001) 47 ATR 1180; 2001 ATC 2185
- Federal Commissioner of Taxation v. Mochkin (2003) 52 ATR 198; 2003 ATC 4272
- Ryan v. Commissioner of Taxation (2004) 56 ATR 1122; 2004 ATC 2131
- Tupicoff v. Federal Commissioner of Taxation (1984) 15 ATR 1262; 84 ATC 4851

ATO references

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