TR 93/17 - Income tax: income tax deductions available to superannuation funds

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Generated on: 4 November 2026, 10:11:57 PM

Taxation Ruling
Income tax: income tax deductions available to superannuation funds

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IT 2672

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*This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**, is a public ruling for the purposes of that Part. Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.*

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What this Ruling is about

Class of person/arrangement

1. This Ruling explains the general principles governing the tax deductibility of expenditure incurred by superannuation funds, particularly for income tax deductions allowable under section 8-1 of the *Income Tax Assessment Act 1997*. The principles expressed in this Ruling also apply to approved deposit funds and pooled superannuation trusts.

Ruling

General principles

2. The tax deductibility of expenditure incurred by a superannuation fund is determined under section 8-1 unless a specific deduction provision in the income tax law, such as section 25-5, applies.

3. Expenditure of a superannuation fund, which is not of a capital, private or domestic nature, is deductible under section 8-1 to the extent that:

(a) it has the essential character of an outgoing incurred in gaining or producing assessable income; or

(b) it has the character of an operating or working expense of a business or is an essential part of the cost of the fund's business operations.

Specific expenditure

4. Subject to the possible need to apportion expenditure (as explained in paragraph 6), the following types of expenses typically incurred by a superannuation fund are ordinarily deductible under section 8-1:

(a) actuarial costs;

(b)accountancy fees;

(c) audit fees;

(d) costs of complying with the *Occupational Superannuation Standards Act 1987* and Regulations (unless the cost is a capital expense) - see also Taxation Ruling IT 2672;

(e) trustee fees and premiums under an indemnity insurance policy;

(f) costs in connection with the calculation and payment of benefits to members (but not the cost of the benefit itself) e.g., interest on money borrowed to secure temporary finance for payment of benefits, medical costs in assessing invalidity benefit claims and costs in calculating and testing reasonable benefit limits of members;

(g) investment adviser fees and costs in providing pre-retirement services to members;

(h) subscriptions for membership paid by a fund to The Association of Superannuation Funds of Australia Limited; and

(i) other administrative costs incurred in managing the fund.

5. As for other types of expenses commonly incurred by a superannuation fund, the following comments are made:

(a) the lodgment levy for an annual return to the Insurance and Superannuation Commission (ISC) is deductible under section 25-5 as a tax-related expense (however, the late lodgment amount of the levy is not deductible: subsection 51(8);

(b) the deductibility of legal expenses is determined under the section 8-1 and usually depends on whether the expenses are of a capital or revenue nature;

(c) up-front fees incurred in investing money are of a capital nature and are not deductible under section 8-1;

(d) investment or administration charges levied by a life assurance company or pooled superannuation trust will generally not be deductible to the fund; and

(e) the cost of amending trust deeds are allowable as a deduction provided the expenditure is not of a capital nature (Taxation Ruling IT 2672).

Apportionment

6. Expenditure incurred in gaining or producing exempt income only is not deductible. Expenditure (e.g. general administrative expenses of managing a superannuation fund) which is incurred partly in producing assessable income and partly in gaining exempt income must be apportioned. The expenditure is deductible only to the extent to which it is incurred in producing assessable income. Each of the expenses listed in paragraph 4 would need to be apportioned if it is incurred partly in producing assessable income and partly in producing exempt income.

7. The correct method for apportioning expenditure between assessable income and exempt income depends on the particular circumstances of the case. If there is a single outlay in respect of a thing or service, only part of which is used for gaining or producing assessable income, then the following principles apply:

(a) If a distinct and severable part of the thing or service is devoted to gaining or producing assessable income and part is not, the expenditure can be apportioned according to the ratio of those parts. Where possible a superannuation fund should apportion its expenditure in this way.

(b) If an outlay serves both objects indifferently, another method must be used to apportion the expenditure which gives a fair and reasonable assessment of the extent to which it relates to assessable income.

8. Since each case depends on its own facts, it is not possible to prescribe a single method for apportioning expenditure of a superannuation fund so as to give a fair and reasonable assessment of the extent to which the outlay relates to assessable income. The following methods of apportionment are two approaches which are generally accepted as fair and reasonable methods for apportioning the part of a superannuation fund's expenditure which is not divisible into two distinct and severable parts, one devoted to gaining assessable income and one devoted to producing exempt income. However, it must be emphasised that these are not the only methods of apportionment which can be used. Other methods are acceptable provided it can be demonstrated that they give a fair and reasonable assessment of the extent to which the outlay relates to assessable income. The two generally accepted methods of apportionment are:

(a) Non-capital expenditure incurred in gaining or producing investment income only (e.g. investment manager fees) can generally be apportioned according to the formula:

$$\text{Expenditure} \times \frac{\text{Assessable investment income}}{\text{Total investment income}}$$

(b) General administrative expenses relevant to the operation of the fund as a whole can generally be apportioned according to the formula:

$$\text{General administrative expenses} \times \frac{\text{Assessable income}}{\text{Total income}}$$

Total income means assessable income plus exempt income. Assessable income for apportionment purposes includes all contributions to the fund (section 277), net capital gains (section 160ZO), imputation credits (section 160AQT) and foreign income 'gross ups' (section 6AC). Exempt income for these purposes includes amounts received on the disposal of units in pooled superannuation trusts.

9. No apportionment is necessary for non-capital expenditure incurred solely in gaining contributions made to the fund.

Date of effect

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

Explanations

General principles

11. Section 8-1 allows a deduction for losses and outgoings to the extent that they are incurred in gaining or producing assessable income or necessarily incurred in carrying on business for the purpose of gaining or producing assessable income. However, the subsection disallows expenditure of capital or of a capital, private or domestic nature or expenditure incurred in gaining or producing exempt income.

12. A superannuation fund is a trust fund and is bound by the ordinary principles of trust law. It is a well established principle of trust law that a trustee cannot carry on a business unless expressly

authorised to do so by the trust instrument or by statute (*Kirkman v. Booth* (1848) 50 ER 821 at 824).

13. A superannuation fund has as its sole purpose the provision of benefits to members on retirement or attainment of a certain age, or the provision of benefits to dependants on the death of a member. Therefore, superannuation funds are generally prohibited from undertaking speculative activities or carrying on an active business such as operating a retail shop, motel or primary production business. However, the activities of a superannuation fund in holding shares and other investments and from time to time realising them may, in some cases, amount to the carrying on of a business (cf. *FC of T v. Radnor Pty Ltd* 91 ATC 4689; (1991) 22 ATR 344).

14. There is no single factor that can be isolated as determinative of the question whether a superannuation fund is carrying on an investment business or a business of buying and selling shares. A significant (though not conclusive) factor is that its activities are undertaken by a trustee with an obligation of prudence (*Radnor* case 91 ATC at 4700; 22 ATR at 356). This obligation puts trustees in a different position to trading companies (*London Australia Investment Co. Ltd v. FC of T* (1977) 138 CLR 106 at 118; 77 ATC 4398 at 4404; 7 ATR 757 at 763). In many cases, therefore, the activities of a superannuation fund in dealing with shares and investments will not amount to carrying on a business but will simply be the performance of a fiduciary duty to preserve the assets of the fund for the benefit of members (*Charles v. FC of T* (1954) 90 CLR 598 at 612; 6 AITR 85 at 92). However, other factors may indicate that the fund is in fact carrying on a business; for instance:

- the volume, frequency and scale of activities (bearing in mind the size of the portfolio);
- a systematic course of buying and selling for the purpose of producing profits; and
- the intention of the trustee.

Ultimately, the question is one of fact and degree, a question of impression (*Radnor* case 91 ATC at 4702; 22 ATR at 359).

15. A superannuation fund that does not carry on a business, either of investing for the purpose of producing income (in which the buying and selling of shares is a part) or of dealing or trading in shares, must rely on the first limb of section 8-1 to claim income tax deductions (the first limb of the subsection covers expenditure incurred in gaining or producing assessable income).

16. On the other hand, a superannuation fund that carries on such a business may rely on the second limb of section 8-1, which covers

expenditure necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.

17. For an outgoing to be deductible under the first limb of section 8-1, the relationship between the outgoing and the fund's assessable income must be such as to impart to the outgoing the character of an outgoing incurred in gaining or producing assessable income. According to decisions of the courts, an outgoing is not characterised as having been incurred in gaining or producing assessable income unless it is 'incidental and relevant to that end': *Ronpibon Tin NL & Tongkah Compound NL v. FC of T* (1949) 78 CLR 47 at 56; 8 ATD 431 at 436. It has also been said by the courts that the test of deductibility under the first limb of the subsection is that:

> 'it is both sufficient and necessary that the occasion of the loss or outgoing should be found in whatever is productive of the assessable income or, if none be produced, would be expected to produce assessable income'. (*Ronpibon Tin* case 78 CLR at 57; 8 ATD at 436).

18. The end which the trustees of the fund subjectively had in view in incurring the outgoing may constitute, at least in a case where the outgoing is voluntarily incurred, an element in characterising the whole or part of the outgoing for the purposes of section 8-1. However, it is ordinarily possible to characterise an outgoing as being wholly incurred in gaining or producing assessable income without any need to refer to the trustee's subjective thought processes where the outgoing gives rise to the receipt of a larger amount of assessable income.

19. For an outgoing to be deductible under the second limb of section 8-1, it must have the character of a working or operating expense of the superannuation fund's business or be an essential part of the cost of its business operations.

20. In the *Ronpibon Tin* case, the Full Court of the High Court of Australia said (78 CLR at 56; ATD at 435):

> 'The word "business" is defined by subsection 6(1) to include profession, trade, employment, vocation or calling, but not occupation as an employee. The alternative in subsection 51(1) therefore covers a wide description of activities. But in actual working it can add but little to the operation of the leading words, "losses or outgoings to the extent to which they are incurred in gaining or producing the assessable income". No doubt the expression "in carrying on a business for the purpose of gaining or producing" lays down a test that is different from that implied by the words "in gaining or producing". But these

latter words have a very wide operation and will cover almost all the ground occupied by the alternative.'

Specific expenditure

21. In *FC of T v. Green* (1950) 81 CLR 313 at 319; 4 AITR 471 at 479, the High Court held that the expenses of engaging an accountant to keep and audit books were deductible under the first limb of section 8-1 because they were incurred in relation to the management of the taxpayer's income-producing enterprises (see also *Ronpibon Tin*). *Ronpibon Tin* and *Green* also provide authority for the proposition that audit fees are deductible under the first limb of section 8-1.

22. The other expenses enumerated in paragraph 4 are also deductible under section 8-1 either:

(a) in the case of a superannuation fund that does not carry on a business - because they are incidental and relevant to the gaining or producing by the fund of its assessable income and because the occasion of the expenses may be found in the fund's activities that produce its assessable income; or

(b) in the case of a superannuation fund that does carry on a business of investing or of trading in shares - because they are working or operating expenses of the fund's business or are an essential part of the cost of its business operations.

23. In relation to other types of expenses of a superannuation fund:

(a) Section 25-5 provides a deduction for expenditure in respect of a tax-related matter. Because the ISC's lodgment levy for an annual return relates to management and administration of a superannuation fund's tax affairs it is deductible under section 25-5.

(b) [Deleted]

(c) Up-front fees incurred in investing money are of a capital nature and therefore not deductible under section 8-1 (see Taxation Ruling IT 5).

(d) Investment or administration charges levied by a life assurance company or a pooled superannuation trust are generally of a capital nature and therefore not deductible to the superannuation fund. Moreover, expenditure incurred in investing in a life assurance company will not be deductible if the income derived from the company is exempt from tax (e.g. under paragraph 26AH(7)(b) or section 282A).

(e) The costs incurred by a trustee of a superannuation fund in amending the fund's trust deed are, as a general rule, not deductible because they are expenses of a capital nature. Taxation Ruling IT 2672 pointed out that costs incurred in amending a trust deed where the amendments are necessitated by changes in government regulations and are made to ensure that the fund's day to day operations continue to satisfy the Occupational Superannuation Standards Regulations are deductible. However, that is not the only situation in which costs associated with amending trust deeds are deductible. For example, such costs will be deductible if the amendments simply make the administration of the fund more efficient and do not amount to a restructuring of the fund. That is, amendments of a trust deed which:

- facilitate day to day trading operations of a fund, and/or
- improve its ability to compete in the superannuation fund market

are not of a capital nature where no new tangible or intangible asset is acquired or no new branch of the fund's existing trading activity is created (*Commissioners of Inland Revenue v. Carron Company* (1968) 45 TC 18; *FC of T v. Consolidated Fertilisers Ltd* 91 ATC 4677; (1991) 22 ATR 281).

Apportionment

24. The assessable income of a superannuation fund includes, for the purpose of determining the deductions allowable from the assessable income, all contributions made to the fund (section 277).

25. On the other hand, the assessable income of a complying superannuation fund does not include amounts that accrued before 1 July 1988 (section 282) or non-reversionary bonuses on life assurance policies (section 282A). In addition, income from assets which, when the income is derived, are segregated current pension assets (section 282B) is exempt from tax. An exemption is also provided for complying superannuation funds calculated by reference to unsegregated current pension liabilities (section 283).

26. Expenditure is deductible under section 8-1 *to the extent* that it is incurred in gaining or producing assessable income or necessarily incurred in carrying on a business for that purpose (and is not of a capital, private or domestic character). Therefore, some apportionment is necessary if expenditure is incurred partly in deriving assessable income and partly in deriving exempt income:

Ronpibon Tin; *Fletcher & Ors v. FC of T* 91 ATC 4950 at 4957; (1991) 22 ATR 613 at 621).

27. Exempt income is defined in section 6-20 to mean income which is exempt from tax and includes income which is not assessable income. Each of the amounts referred to in paragraph 25 is therefore exempt income for the purpose of apportionment.

28. In *Ronpibon Tin* the High Court held (CLR at 59; AITR at 247) that the correct method for apportioning an expense is a question of fact. In all cases, the method employed must be fair and reasonable.

NOTE: Sections 6-20, 8-1 and 25-5 of the *Income Tax Assessment Act 1997*, to which this Ruling refers, express the same ideas as subsection 6(1) (in relation to 'exempt income'), subsection 51(1) and section 69, respectively, of the *Income Tax Assessment Act 1936.*

Commissioner of Taxation

17 June 1993

ISSN 1039 - 0731

ATO references
NO 90/9759-7
BO

Previously released in draft form as EDR 77

Price $0.90

FOI index detail
reference number
I 1013750

subject references
- income tax deductions
- superannuation funds

legislative references
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- ITAA 1936 64A
- ITAA 1936 69
- ITAA 1936 277
- ITAA 1936 282A
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- London Australia Investment Co Ltd v. FC of T (1977) 138 CLR 106; 77 ATC 4398; 7 ATR 757
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