



CR 2009/59 - Income tax: deductibility of employer contributions to the National Entitlement Security Trust

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 This document has changed over time. This is a consolidated version of the ruling which was published on *29 May 2013*



Class Ruling

Income tax: deductibility of employer contributions to the National Entitlement Security Trust

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① This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner’s opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner’s opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:
- section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997); and
 - section 26-10 of the ITAA 1997.

All legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is all employers who are required by an industrial instrument to make contributions on behalf of a worker to the National Entitlement Security Trust (NEST).

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.
5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 11 to 19 of this Ruling.
6. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:
 - this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
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Date of effect

8. This Ruling applies from 1 July 2009. However, this Ruling will 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 this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Previous Rulings

9. This Ruling replaces CR 2004/40 which was withdrawn from 30 June 2009.

Scheme

10. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them form part of and are to be read with the description:

- Application for Class Ruling dated 28 May 2009;
- National Entitlement Security Trust Deed dated 1 June 2002;
- Email from applicant dated 12 August 2009.

Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

Description of Arrangement

11. Employers are required by various industrial instruments to make contributions for employee entitlements to NEST. NEST will accept these contributions and hold them until they become payable under the terms of the Trust Deed (Deed).

12. 'Employee entitlements' are defined in clause 32.1 of the Deed as:

any dollar amount payable to a Member under an Industrial Agreement to which that Member has a right and which is identified as such in the Industrial Agreement including the following entitlements:

- (a) annual leave and annual leave loading;
- (b) sick leave;
- (c) long service leave;
- (d) redundancy;
- (e) severance; or
- (f) any other amount from time to time payable by an Employer to a Member accepted by the Trustee.

13. An employer is required to sign a deed of adherence to ensure that the minimum contribution rate as prescribed in each industrial instrument is paid to NEST on a monthly basis. Clause 7.1 of the Deed outlines the minimum contribution requirement:

7.1 Employee Entitlement Contributions

Each Employer must pay to the Trustee, or as directed by it, on such dates as agreed with the Trustee an amount equal to the Minimum Contribution for each Member employed or whose services are used by that Employer, in accordance with the terms of the Relevant Industrial Agreement in relation to the Employees of that Employer.

14. In accordance with clause 7.9 of the Deed, all employer contributions to NEST are credited to separate member (employee) accounts identifying the contributions for that member:

7.9 Payments and credits/Members Account

All contributions by any Employer will be allocated as directed by it and credited to personal accounts opened in the names of the Members and styled the Members' Account.

15. While Employer contributions are credited to personal accounts of the Members, clause 28.1 of the Deed provides that Members have no entitlement to payment of an amount until the conditions set out in the Deed have been satisfied.

16. When an employee is entitled to their worker entitlements under the relevant industrial instrument the Trustee may pay the entitlement to the employer or directly to the employee. The rules in relation to the payment procedure are contained in the administrative provisions in the trust deed (Schedule 2 to the Deed):

Employers will pay a claim for Employee Entitlements in the same manner that Employers currently pay these employee entitlements. Employers will however, be entitled to reimbursement from the Trust for an amount calculated in accordance with clause 26 of the Deed.

The Fund Administrator will reimburse the Employer immediately upon receipt and completion of a signed NEST claim form available from the Fund Administrator, in accordance with clause 28. Reimbursements to Employers are paid by direct credit or by cheque. An Employer must exhaust its existing accrued Employer entitlements before claiming from the Fund.

Employees may claim directly from the Fund, in accordance with the Deed if:

1. the current Employer becomes insolvent (see clause 26);
2. the Employee is claiming Entitlements transported from a previous Employer (see clause 9 or clause 26); and/or
3. the Employer's relevant industrial agreement specifically requires Employees to claim directly from the Fund.

17. Clause 27 of the Deed provides that in the event of the death of an employee, the employee's entitlements will form part of their estate and will be paid to their legal personal representative.

18. The employer may obtain a reimbursement of their contributions from NEST after they have paid the employee their entitlement/s.

19. In the event of dissolution or vesting of the trust, the amount standing to the credit of the employer would be returned to it.

Ruling

20. An employer who has an obligation under an industrial instrument to make a contribution of employee entitlements to NEST can claim a deduction under section 8-1 for the amount of the contribution.

Commissioner of Taxation

7 October 2009

Appendix 1 – Explanation

① *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Application of section 8-1

21. Section 8-1 provides that you can deduct from your assessable income any loss or outgoing to the extent that it is incurred in gaining or producing assessable income and is not:

- capital, private or domestic in nature;
- incurred in gaining or producing exempt income; or
- prevented from being deductible by a provision of the Act.

Positive Limbs

Nexus to gaining and producing assessable income

22. In carrying on business activities an employer is required to fulfil their obligations in respect to the entitlements of their workers. These entitlements may be contained in the governing award, enterprise bargaining agreement, or other industrial instrument negotiated between the employer and the relevant union on the employee's behalf.

23. In addition to the employer's obligations under their relevant industrial instrument/s the employer is also required to meet the obligations contained in the Administration provisions of NEST. The administrative provisions require the employer to make monthly contributions to NEST in respect to worker entitlements.

24. It is accepted that there is a nexus between the business activities being carried on by the employer and the employer's obligation to provide for worker entitlements, such that payment of the employee entitlements is incidental and relevant to the production of the assessable income of the business.

Incurring the amount

25. At the point at which an employer makes the contribution to the Trustee of NEST the amount is placed into member accounts and the amount/s are no longer owned by the employer. This differs from the situation in *Walstern v. Federal Commissioner of Taxation* [2003] FCA 1428 where at the time the employer made contributions to a superannuation fund none of its employees were members of the fund. As the employer remained the sole owner in equity of the funds contributed, Hill J found that at the time of making the contributions it did not incur outgoings for the purposes of the relevant general deductions provision.

26. The ability for amounts to be reimbursed and returned to the employer under the trust deed (a factor which must be possible to satisfy paragraph 58PB(4)(c) of *the Fringe Benefits Tax Assessment Act 1986*) does not effect whether the monthly contributions are incurred by the employer.

27. Notwithstanding the ability to be reimbursed in the future, the contributions to NEST are definite payments which the employer is required to make to meet its obligations under industrial instruments which are a normal incident of carrying on a business. As such the contributions are incurred when made (for employers accounting on a cash basis) or when the liability to make the payment each month arises (for employers accounting on an accruals basis).

Conclusion

28. The employer's monthly contribution/s to NEST are outgoings incurred in carrying on a business for the purposes of section 8-1.

Negative Limbs

Is the contribution revenue or capital in nature?

29. Whether the payment of worker entitlements to NEST is revenue or capital in nature depends on the character of the payment when made by the employer. As stated in *G.P. International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation* 1990 ATC 4413 at 4419; (1990) 21 ATR 1 at 7:

The character of expenditure is ordinarily determined by reference to the nature of the asset acquired or the liability discharged by the making of the expenditure, for the character of the advantage sought by the making of the expenditure is the chief, if not the critical, factor in determining the character of what is paid: *Sun Newspapers Ltd v. FC of T* (1938) 61 CLR 337 at p 363.

30. In making the monthly contribution/s to NEST, the employer meets their immediate obligation under the relevant industrial instrument. The employer discharges their obligation in respect to their employees each month.

31. The employer is making regular monthly contributions to discharge an immediate obligation which is directly connected to the income earning capacity of the business. Accordingly, the payment of the contribution/s is revenue in nature.

Is the contribution precluded from deduction by section 26-10?

32. Section 26-10 provides that an outgoing for leave is not deductible except where the outgoing is an amount which is:

- paid in the income year to the individual to whom the leave relates (or if the individual is deceased to their dependant or legal representative); or

- an accrued leave transfer payment that is made in the income year.

33. The employer contributions made to NEST not only discharge the employer's immediate obligations in respect to worker entitlements but also ensures that the employer is making adequate provision for the leave entitlements (sick leave, annual leave and long service leave) which will accrue under the relevant industrial instrument. This differs from the situation in which an employer sets aside a provision to meet the future revenue contingencies of their business.

34. The employer is incurring an expense at the point at which the contribution is made. That is, the employer is not making a provision by an accounting entry, but is discharging their immediate obligation to provide for worker entitlements.

35. The contributions which the employer is required to make to NEST (as outlined in clause 7.1 of the trust deed) are calculated with reference to the minimum contribution required to meet the employer's future obligation under the relevant industrial agreement. The fact that the minimum contribution is calculated with respect to future leave entitlements does not change the nature of the payment from discharging an immediate obligation in respect to leave, to a payment for leave.

36. As stated by Brennan J in *Nilsen Development Laboratories Pty Ltd v. Federal Commissioner of Taxation* 79 ATC 4520 at 4522; (1979) 10 ATR 255 at 258, an obligation to make a leave payment does not completely come into existence until the point in time that the leave is taken. It follows that to be a payment for leave requires the leave entitlement for the employee to have already crystallised:

A pecuniary liability could not arise before the time when an employee went on leave (cl 7), or his employment was terminated (cl 8(2)(b)). Though it was clear that a pecuniary liability would be imposed by the Award so soon as one of these events occurred, no pecuniary liability was imposed during the income year. Though it was certain that a liability to pay money to these employees or their respective personal representatives would at some future time be imposed by the Award, the time when that would occur and the quantum of the payment which would then have to be depended upon further events. In these circumstances, it was proper for the respondent to make provision in its 1974 accounts for a liability which was both foreseeable and inevitable. It did so by raising a provision for the payment of long service leave, calculated by reference to the respective employees' entitlements to leave (based on their respective years of service), and to the rate of wage then currently prescribed. The sum provided was the amount which, if leave had been taken on 30 June 1974, would then have become payable.

37. An outgoing will be for leave when it has the purpose of making a payment to an employee while on leave. Therefore, an outgoing will be for leave where it discharges the obligation of an employer to make a payment to a current employee while that employee is on leave.

38. Therefore the contributions made by the employer, being outgoings calculated with reference to future leave entitlements is not a payment for leave, and will not be excluded from deduction by the operation of section 26-10.

Conclusion

39. The employer's contribution to NEST is not capital in nature, and is not an outgoing for leave. As such the outgoing is not prevented from deduction under section 8-1 by being capital in nature, or by the operation of section 26-10.

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10; CR 2004/40

Subject references:

- deductions and expenses
- worker entitlement funds

Legislative references:

- ITAA 1997 8-1
- ITAA 1997 26-10
- FBTAA 1986 58PB(4)(c)
- TAA 1953
- Copyright Act 1968

Case references:

- GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation 1990 ATC 4413; (1990) 21 ATR 1
- Nilsen Development Laboratories Pty Ltd v. Federal Commissioner of Taxation 79 ATC 4520; (1979) 10 ATR 255
- Sun Newspapers Ltd v. FC of T (1938) 61 CLR 337
- Walstern v. Federal Commissioner of Taxation [2003] FCA 1428; 54 ATR 423

ATO references

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