

# ***TD 2023/D3 - Income tax: trustee risk reserves - deductibility of payments made by a superannuation fund to its trustee***

! This cover sheet is provided for information only. It does not form part of *TD 2023/D3 - Income tax: trustee risk reserves - deductibility of payments made by a superannuation fund to its trustee*. This document has been finalised by TD 2024/6.

! There is a Compendium for this document: **TD 2024/6EC** .

! This document has changed over time. This is a consolidated version of the ruling which was published on *23 January 2024*



Status: **draft only – for comment**

## Draft Taxation Determination

# Income tax: trustee risk reserves – deductibility of payments made by a superannuation fund to its trustee

### **📌 Relying on this draft Determination**

This publication is a draft for public comment. It represents the Commissioner’s preliminary view on how a relevant provision could apply.

If this draft Determination applies to you and you rely on it reasonably and in good faith, you will not have to pay any interest or penalties in respect of the matters covered, if this draft Determination turns out to be incorrect and you underpay your tax as a result. However, you may still have to pay the correct amount of tax.

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### **What this draft Determination is about**

1. Section 56 of the *Superannuation Industry (Supervision) Act 1993* (SISA) was amended effective from 1 January 2022, such that any provision in the governing rules of a superannuation entity ('fund') is void in so far as it would have the effect of exempting or indemnifying a trustee of the fund from certain penalties (referred to in this draft

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Determination<sup>1</sup> as a ‘penalty’ or ‘penalties’). Impacted funds and their trustees have taken differing approaches to address the risk of exposure to penalties arising from the amendments, including the funds making payments to establish or build a trustee risk reserve for this purpose.

2. This Determination sets out the Commissioner’s views on the deductibility for the fund, under section 8-1 of the *Income Tax Assessment Act 1997* of payments that are made by the trustee of the fund (in its capacity as trustee) to the trustee in its own capacity as outlined in this Determination.

3. This Determination should be read together with Taxation Ruling TR 93/17 *Income tax: income tax deductions available to superannuation funds*, which explains the general principles governing the deductibility of expenditure incurred by superannuation funds, particularly for income tax deductions allowable under section 8-1.

4. All legislative references in this Determination are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.

## **Ruling**

### ***A lump sum, lump sum instalments or charges of an ongoing amount***

5. A payment by the fund to the trustee **will not** be deductible to the fund under section 8-1 where it is objectively determined on the facts that:

- the trustee is charging the fund the amount for the purpose of building or maintaining a reserve to address the trustee’s risk because of the amendments to section 56 of the SISA (referred to as ‘additional risk reserve payments’), and
- the amount is charged by the trustee as a lump sum or a number of lump sum instalments or an ongoing amount that is separate and distinct from its existing ongoing and recurrent charges for trustee services.

This is because the payments made by the fund are capital, or capital in nature, and excluded under paragraph 8-1(2)(a).<sup>2</sup>

### ***Increase in existing ongoing and recurrent charges for trustee services***

6. A payment by the fund to the trustee **will** be deductible to the fund under section 8-1 where it is objectively determined on the facts that the:

- fund is making a payment to the trustee for trustee services (referred to as ‘increased trustee fees’), and
- trustee has merely increased its existing ongoing and recurrent charges for those services (in accordance with its powers and terms of its engagement) to reflect the increased cost of providing those services.

7. However, where some of the expenditure incurred by the fund is in relation to gaining or producing exempt income or non-assessable non-exempt income, a reasonable

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<sup>1</sup> For readability, all further references to ‘this Determination’ refer to the Determination as it will read when finalised. Note that this Determination will not take effect until finalised.

<sup>2</sup> Where a fund can demonstrate that the payment satisfies the requirements of section 40-880, the fund will be able to deduct the expense in equal proportions over 5 years. See Taxation Ruling TR 2011/6 *Income tax: business related capital expenditure - section 40-880 of the Income Tax Assessment Act 1997 core issues*.

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apportionment will be required by the fund in respect of its deduction due to the operation of paragraph 8-1(2)(c).

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**Example 1 – payments to establish and build a risk reserve – not deductible**

8. *Greendove Superannuation Fund is a large complying superannuation fund regulated by the Australian Prudential Regulation Authority (APRA). Following the legislative changes to section 56 of the SISA, the trustee obtains an actuarial report which highlights that they would be exposed to a significant risk of insolvency in the event they become liable to a penalty and recommends the establishment of a trustee risk reserve.*

9. *The trustee obtains court approval to amend the terms of Greendove Superannuation Fund's trust deed. The amended deed allows the establishment of a \$14.8 million trustee risk reserve to cover potential penalties.*

10. *The trustee decides to charge Greendove Superannuation Fund an initial lump sum fee of \$10 million to establish the reserve with a new ongoing monthly fee of \$100,000 per month for 4 years to build the reserve. The new risk reserve fees are separate and in addition to the trustee's existing monthly trustee service fees and are reported separately in Greendove Superannuation Fund's financial statements.*

11. *When the fund pays the \$10 million initial lump sum fee and the \$100,000 ongoing monthly fee for the next 4 years to build the \$14.8 million trustee risk reserve, the character of the payments made by the fund to the trustee needs to be examined in that context to determine deductibility under section 8-1. Since Greendove Superannuation Fund is already remunerating its trustee for the provision of their services, the new payments represent something other than the provision of ongoing trustee services.*

12. *In objectively considering what Greendove Superannuation Fund's outgoings are paid for, that is, why the additional risk reserve payments are made and the advantage that is being sought, it is concluded that Greendove Superannuation Fund is receiving an enduring benefit in respect of the stability of its profit-making structure by enabling its trustee to build a sufficient reserve to meet any risk arising from the amendments to section 56 of the SISA. The initial lump sum fee and the ongoing monthly fees are once and for all payments towards the profit-yielding structure of Greendove Superannuation Fund.*

13. *The additional risk reserve payments by Greendove Superannuation Fund to the trustee will not be deductible under section 8-1 because they are capital, or capital in nature, and are therefore excluded from deductibility under section 8-1 due to the operation of paragraph 8-1(2)(a).*

**Example 2 – increase in existing trustee service fees – deductible**

14. *Whitequail Superannuation Fund is a complying superannuation fund regulated by APRA. The trustee for Whitequail Superannuation Fund, under its trust deed powers and terms of engagement, charges Whitequail Superannuation Fund a monthly fee of \$500,000 for the provision of the trustee's professional services.*

15. *In reviewing the amount it charges for the provision of the trustee's professional services, the trustee for Whitequail Superannuation Fund determines that its costs for providing those services will increase. It subsequently decides to increase its existing monthly service fees (in accordance with its powers and within the terms of its engagement) of \$500,000 to \$600,000, payable by Whitequail Superannuation Fund.*

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16. *In objectively considering what Whitequail Superannuation Fund's outgoings are for, that is, why the payment to the trustee is made and the advantage that is being sought, it is concluded that Whitequail Superannuation Fund is making the outgoing to receive current and ongoing trustee services. The payments are recurrent in nature and are not made in respect of the profit-making structure. This is an ongoing payment by Whitequail Superannuation Fund for trustee services, the fee for which has been increased to factor in the increased costs incurred by the trustee in providing its services.*

17. *As such, the increased trustee fees of \$600,000 will be deductible to Whitequail Superannuation Fund under section 8-1. These payments are not capital, or capital in nature, and therefore are not excluded from deductibility under section 8-1 due to the operation of paragraph 8-1(2)(a).*

18. *A reasonable apportionment is required where some of the expenditure by Whitequail Superannuation Fund is incurred in relation to gaining or producing exempt income or non-assessable non-exempt income, due to the operation of paragraph 8-1(2)(c).*

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#### **Date of effect**

19. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination 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 Determination (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10 *Public Rulings*).

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**Commissioner of Taxation**

6 December 2023

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## Appendix 1 – Explanation

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**❶** *This Explanation 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.*

### Legislative context

20. From 1 January 2022, the indemnification prohibitions in sections 56 and 57 of the SISA were expanded to prevent a superannuation trustee or a director of a superannuation trustee from using trust assets to pay a criminal, civil or administrative penalty incurred in relation to a contravention of a Commonwealth law.<sup>3</sup>

21. Impacted funds and their trustees have taken different approaches to address the risk of exposure to penalties arising from the amendments. Funds and trustees may manage the risks arising for the trustee by the trustee:

- seeking an additional specific payment, or sequence of payments (whether as a lump sum, over time or ongoing), for the purpose of enabling the trustee to build up a sufficient reserve to pay any potential penalty that it can no longer be indemnified for by the fund, and/or
- increasing its existing ongoing and recurrent charges for trustee services (in accordance with its powers and terms of its engagement) to reflect the increased cost of providing those services.

22. The amount charged in respect of the additional payment is generally determined by an actuary who measures and manages the risk and uncertainty in respect of potential penalties that could be incurred by the trustee for which they can no longer be indemnified. The risk is monitored regularly, and adjustments are to be made in respect of the trustee’s charge to the fund to reflect any increased risk. For example, the trustee’s charge will be reviewed when undertaking new activities that increase risks, funds under management increase or a penalty is incurred.

23. The issue for the fund is whether the increased trustee fees and/or the additional risk reserve payments are deductible to the fund under section 8-1.

### Deductibility under section 8-1

24. Section 8-1 states:

- (1) You can deduct from your assessable income any loss or outgoing to the extent that:
  - (a) it is incurred in gaining or producing your assessable income; or
  - (b) it is necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income.
- (2) However, you cannot deduct a loss or outgoing under this section to the extent that:
  - (a) it is a loss or outgoing of capital, or of a capital nature; or
  - (b) it is a loss or outgoing of a private or domestic nature; or
  - (c) it is incurred in relation to gaining or producing your exempt income or your non-assessable non-exempt income; or

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<sup>3</sup> Subsections 56(2) and 57(2) of the SISA.

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(d) a provision of this Act prevents you from deducting it.

25. Paragraph 4(e) of TR 93/17 outlines the Commissioner’s view in respect of the deductibility of trustee fees, where it states:

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...trustee fees and premiums under an indemnity insurance policy.

26. The use of the word ‘ordinarily’ acknowledges that expenditure labelled trustee fees are not always deductible under section 8-1 and that an examination of what the payment is for is still required.

### ***Incurred in gaining or producing assessable income***

27. In *Commissioner of Taxation v Day*<sup>4</sup>, Gummow, Hayne, Heydon and Kiefel JJ stated at [21] that paragraph 8-1(1)(a) refers to (footnotes omitted):

...a relationship between expenditure incurred and what is productive of assessable income, which is to say the connection necessary for deductibility. The words “incurred in gaining or producing...assessable income”, appearing in the section, have long been held to mean incurred “*in the course of*” gaining or producing” income, as was observed in *Payne*.

28. Further, it is stated in that case at [30] that:

Section 8-1(1)(a) is couched in terms intended to cover any number of factual and legal situation in which expenditure is incurred by a taxpayer. Its language and breadth of application do not make possible a formula capable of application to the circumstances of each case. Cases are helpful to show the connection found in the facts there present, but not always to explain how the search for the requisite connection is to be undertaken. *Payne* directs attention to the statement made in *Ronpibon Tin*, as to the question posed by a provision such as s 8-1(1)(a), as correct and appropriate to be applied. The question, as restated in *Payne*, is: “is the occasion of the outgoing found in whatever is productive of actual or expected income?” That inquiry will provide a surer guide to ascertaining whether a loss or expenditure has been “incurred in [the course of] gaining or producing ... assessable income”.

29. In this instance, the occasion of the outgoing incurred by the fund, being either the increased trustee fees and/or additional risk reserve payments, are productive and have a sufficient connection with the operations and activities of the fund in which it gains or produces its assessable income. As such, it is considered that paragraph 8-1(1)(a) is satisfied.

### ***Negative limbs – subsection 8-1(2)***

30. Paragraphs 8-1(2)(b) and (d) of the negative limbs, outlined in paragraph 24 of this Determination, are not relevant to this issue.

31. The courts have identified the following factors that may be taken into consideration to determine whether a loss or outgoing is capital, or capital in nature, and excluded from deductibility under paragraph 8-1(2)(a).

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<sup>4</sup> [2008] HCA 53.

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32. In *Commissioner of Taxation v Sharpcan Pty Ltd*<sup>5</sup> (*Sharpcan*), Kiefel CJ, Bell, Gageler, Nettle and Gordon JJ stated at [18] that (footnotes omitted):

Authority is clear that the test of whether an outgoing is incurred on revenue account or capital account primarily depends on what the outgoing is calculated to effect from a practical and business point of view. Identification of the advantage sought to be obtained ordinarily involves consideration of the manner in which it is to be used and whether the means of acquisition is a once-and-for-all outgoing for the acquisition of something of enduring advantage or a periodical outlay to cover the use and enjoyment of something for periods commensurate with those payments. Once identified, the advantage is to be characterised by reference to the distinction between the acquisition of the means of production and the use of them; between establishing or extending a business organisation and carrying on the business; between the implements employed in work and the regular performance of the work in which they are employed; and between an enterprise itself and the sustained effort of those engaged in it. Thus, an indicator that an outgoing is incurred on capital account is that what it secures is necessary for the structure of the business.

33. Further, it is stated in that case at [26] that:

...The relevant distinction is between a once-and-for-all outgoing for the acquisition of something of enduring advantage and a periodical outlay to cover the use and enjoyment of something for periods commensurate with those payments.

34. It is therefore clear that, to determine whether a loss or outgoing is capital or capital in nature, it must be ascertained why the fund is making the payment to the trustee and what the advantage is that is being sought. This needs to be objectively determined on the facts of each particular arrangement.<sup>6</sup>

#### **Additional risk reserve payments**

35. When the fund is making an additional risk reserve payment to the trustee for the trustee to build a sufficient reserve to be able to pay any relevant penalties (which is separate and distinct from its existing ongoing and recurrent charges for trustee services), whether charged by the trustee as a one-off lump sum, or a number of lump sum instalments or an ongoing amount, the character of the payment being made by the fund needs to be examined in that context.

36. Here, the fund is receiving something other than the mere provision or ongoing provision of trustee services. Since the fund is already separately remunerating the trustee for the provision of their services to the fund, consideration of what the separate payment(s) is or are for is required. It is considered that, in these cases, the fund is receiving an enduring benefit in respect of the stability of its profit-making structure by enabling the trustee to build a sufficient reserve to meet any risk arising from the amendment to section 56 of the SISA. These payments are payments towards the profit-yielding structure of the fund.

37. As such, the Commissioner considers that these payments are capital, or capital in nature, and therefore excluded from deductibility under section 8-1 due to the operation of paragraph 8-1(2)(a).

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<sup>5</sup> [2019] HCA 36.

<sup>6</sup> See *Sharpcan* at [48].

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***Increased trustee fees***

38. When the fund is making a payment to the trustee for trustee services, where the trustee is increasing its existing ongoing and recurrent charges for those services to reflect the increased cost of providing its services, then in considering what the fund's outgoing is paid for – that is, why the fund is making the payment to the trustee and what the advantage is that is being sought – it is clear that the fund is making the outgoing to receive current and ongoing trustee services. The payments are recurrent in nature and are not made in respect of the profit-making structure. This is an ongoing payment by the fund for trustee services, the fee for which has been increased to factor in the increased costs incurred by the trustee in providing its services.

39. Accordingly, the payment of increased trustee fees by the fund is not capital, or capital in nature. It therefore does not fall under the exclusion in paragraph 8-1(2)(a) and is deductible to the fund under section 8-1.

40. However, where some of the expenditure by the fund is incurred in relation to gaining or producing exempt income or non-assessable non-exempt income, a reasonable apportionment will be required due to the operation of paragraph 8-1(2)(c).

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## **Appendix 2 – Your comments**

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41. You are invited to comment on this draft Determination including the proposed date of effect. Please forward your comments to the contact officer by the due date.

42. A compendium of comments is prepared when finalising this Determination, and an edited version (names and identifying information removed) is published to the Legal database on ato.gov.au

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

**Due date:** 29 January 2024

**Contact officer:** Contact officer details have been removed following publication of the final determination.

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## Amendment history

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**23 January 2024**

Appendix 2 – Your comments	Due date extended to from 19 January 2024 to 29 January 2024
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## References

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 93/17; TR 2006/10; TR 2011/6

*Legislative references:*

- ITAA 1997 8-1
- ITAA 1997 8-1(1)(a)
- ITAA 1997 8-1(2)
- ITAA 1997 8-1(2)(a)
- ITAA 1997 8-1(2)(b)
- ITAA 1997 8-1(2)(c)
- ITAA 1997 8-1(2)(d)
- ITAA 1997 40-880

- SISA 1993 56
- SISA 1993 56(2)
- SISA 1993 57
- SISA 1993 57(2)

*Cases relied on:*

- Commissioner of Taxation v Sharpcan Pty Ltd [2019] HCA 36; 269 CLR 370; 93 ALJR 1147; 2019 ATC 20-715
- Commissioner of Taxation v Day [2008] HCA 53; 236 CLR 163; 2008 ATC 20-064; 70 ATR 14

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ATO references

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