IT 2067 - Superannuation - deductions for contributions to exempt employer/employee superannuation funds

TAXATION RULING NO. IT 2067

SUPERANNUATION - DEDUCTIONS FOR CONTRIBUTIONS TO EXEMPT EMPLOYER/EMPLOYEE SUPERANNUATION FUNDS

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OTHER RULINGS IN TOPIC IT 294
IT 2026

PREAMBLE

Since the release of the earlier Rulings a number of enquiries have been received in this office seeking clarification of certain matters dealt with in the Rulings. The purpose of this Ruling is to explain the various matters which have been raised.

RULING

Salary

2. Paragraphs 8 to 10 of IT 294 refer to the salary paid to a particular employee. In many cases the actual salary paid to an employee for a year, whether an associated employee or not, would be less than the rate of salary applicable to the employee as at the end of the year of income. The practice of permitting contributions to be based on the annual rate of salary as at the date of contribution will continue provided that salaries for associated employees are not artifically inflated towards the end of the year of income.

3. In determining an employee's salary for superannuation purposes it is permissible for certain payments of a recurrent nature, other than the actual salary or wage, to be taken into account. Recurrent payments for shift work, commissions, bonuses and payments of a like nature with a history of payment over at least three years may be treated as salary. Payments in respect of overtime and non-recurrent amounts should not be so treated. Allowances paid to cover motor vehicle, entertainment and similar expenses should be excluded from remuneration when determining superannuation contributions.

Retirement Benefits

4. Paragraph 16 of IT 294 sets out the maximum benefits which may be currently paid at normal retirement age to a member of an exempt section 23F superannuation fund. It has been the practice to accept that members of such funds who retire at normal retirement age may receive an additional benefit from the fund calculated at the rate of .5 percent for each year of service in excess of 40 years, subject to a maximum of 5 percent.

5. This practice will continue subject to the proviso that deductions will not be granted in respect of contributions made towards advance funding of such additional benefits.

6. Where an employee continues in employment past his normal retiring age there will be no objection to the payment on actual retirement of a benefit which represents the reasonable benefit at normal retirement age plus the actual earnings which have accrued thereon between the normal retirement date and the date of actual retirement.

7. Paragraph 17 of IT 294 refers to the necessity for a pro-rata reduction in benefits where an associated employee will have completed less than 20 years service at normal retirement age. It is stressed that this reduction is required in both lump sum and pension funds. When determining the allowable contribution for an employee in respect of whom such a reduction is required, the pro-rata reduction should be applied in the first instance to the percentage shown in the Ready Reckoner and the contribution which results from the application of this reduced percentage to the current salary then adjusted in the light of balances presently held in the fund or amounts received from other funds.

The Calculation of the Deductible Contribution

8. Where a member specifically nominates a retiring age greater than normal, subject to a maximum of 75 years of age, contributions may proceed on the basis of the Ready Reckoners reflecting the period of service to that later age. Should the member continue in employment past age 75 deductions for contributions from that time would be limited to the greater of $400 and 5% of the employee's annual remuneration.

9. In the generality of cases it would be expected that, where superannuation funds are providing less than maximum benefits, the contributions actuarially certified as being necessary to provide the benefits will be allowable as income tax deductions. It is not possible, however, to give blanket approval to such a proposition. Paragraph 22 of IT 294 states that where there is no significant departure in the actuarial calculation from the 8%/9% rule it may be expected that the amounts actuarially certified as required to provide the benefit will normally be allowed as deductions. If in any particular case there is a significant departure from the basic rule that case will have to be examined on its merits. There would simply be no justification for allowing funds of this nature a departure from the general rule.

10. Paragraphs 21 and 33 of IT 294 set out acceptable long term net of charges earning rates to be applied in the calculation of deductible contributions. It is stressed that contributions based on an earning rate which has been reduced below that stipulated to take account, for example, of administration charges will not be accepted.

11. Reimbursements by the sponsoring employer of actual administration expenses of a superannuation fund would qualify for deduction under sub-section 51(1) of the Income Tax Assessment Act as losses and outgoings necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.

12. Paragraph 26 of IT 294 refers to the position where excess benefits funds have been established to house assets transferred from existing exempt section 23F funds. In such cases contributions on the basis of the guidelines will not be permitted until the assets in the excess benefits funds have been transferred back to the exempt section 23F fund without endangering the exemption of the fund.

13. There are other situations, however, where excess benefits funds are established to provide retirement benefits in excess of those provided under the rules of the relevant superannuation deed. They are commonly referred to as "top up" funds and do not involve any transfer of assets from existing exempt section 23F funds. In some cases the aggregate of the retirement benefits payable from both the exempt and the excess benefits fund does not exceed the maximum permissible benefits approved by the Commissioner. In other cases it does.

14. The maximum income tax deduction which will be allowed for contributions to both funds in all of these cases will be determined by reference to the Ready Reckoners bearing in mind the balances in both funds. Where both funds are exempt section 23F funds and the aggregate benefit does not exceed the Commissioner's limits there should be no difficulty in determining the income tax deduction allowable for contributions to the fund; it will be a question of applying the guidelines to each fund.

15. Where the excess benefit fund does not qualify as an exempt section 23F fund the maximum deduction for contributions to the excess benefit fund will be limited to the greater of $400 and 5% of each employee's remuneration provided always that the aggregate of the deductions to both funds does not exceed the amount determined by reference to the Ready Reckoners.

16. Deductions in respect of advance funding for reversionary pensions and/or post-retirement cost of living increases to a maximum of 5% will, as indicated in paragraph 28 of IT 294, and paragraphs 3 and 5 of IT 2026, be granted only in respect of those funds where the amount lent back to the employer does not at any time during the year of income exceed 10% of the assets of the fund. Bearing in mind that the

guidelines issued part-way through the 1982/83 year of income, and to assist those funds who wish to comply with the guidelines and hence have reduced the amount lent back, contributions for the year ended 30 June 1983 which reflect the provision of such benefits will be allowed as income tax deductions where the amount lent back has been reduced below 10% as at the end of the year of income, and the trustee has given an undertaking to retain that position on a permanent basis.

17. In the light of practice in the larger employer/arm's length employee funds no objection would be taken to the individual funding of a reversionary pension for a husband and a wife where both are members of the same fund.

18. Where a superannuation fund is providing the maximum permitted pension of 75% of salary and, in addition, pays post-retirement cost of living adjustments in excess of those specified in the guidelines, contributions by the employer to the fund to make up any deficiency that arises as a consequence would not be allowed as a deduction. On the other hand, where a fund is providing less than the maximum permitted benefit and post-retirement increases in excess of 5% do not cause the level of benefit to exceed that which would result under the guidelines, contributions in respect of the additional post-retirement amounts may be allowed as income tax deductions.

19. In some allocated funds which provide benefits for both associated and arm's length employees amounts lent back to the employer are charged against the balances standing to the credit of some or all of the associated employees and are limited to a certain percentage of those balances. While it is not considered appropriate in such cases to determine a separate weighted earning rate for each employee, there would not be any objection to the use of weighted earning rates calculated separately for associated and non-associated employees. The weighted earning rates where loans back exceed 70% of associated employees' balances will be as follows:-

70 but less than 80%	-	16%
80 but less than 90%	-	17%
above 90%	-	17.5%

Of course, should the amount lent back exceed 70% of the overall assets of the fund, the discretion under paragraph 82AAE(b) will not be exercised.

20. There may be instances where the contribution determined from the Ready Reckoner is less than the statutory amount of $400 and 5% of the employee's remuneration, whichever is the greater. This will be particularly so where the employee is in receipt of high salary with a long period of future service or where a high percentage of the fund's assets are devoted to loan back arrangements. In these cases contributions may be made on the basis of the statutory amount without regard to the apparent excessive amounts being built up in the fund. It would be expected that contributions would fall in line with the Ready Reckoners within a relatively short period. In the

event of the early withdrawal of the member from the fund, the procedures set out in IT 2026 must be followed in determining the amount which may be paid from the fund.

21. Life assurance policies based on constant premium levels, such as endowment assurance policies, would not satisfy the requirements of IT 294 under which contributions should reflect a constant percentage of salary over the years to retirement. It is appreciated, however, that a number of funds established prior to the release of IT 294 were invested solely in endowment assurance or contain both endowment assurance and other investments. To ensure that such funds will not be disadvantaged, it has been decided to accept as deductible premiums paid on endowment policies in force prior to that date provided, of course, that the benefit under the policy does not exceed the guidelines.

22. In order to determine the reduction to be applied for assets presently held in a fund it is necessary to assign a value to assurance policies, other than term policies, taken out on behalf of the member. While it is appreciated that initially the surrender value of a policy is substantially less than the premiums paid to that time, to base the value of a policy merely on its surrender value would be tantamount to an acceptance that the fund was not indefinitely continuing. On the other hand, valuing policies by reference only to the premiums paid would ignore the substantial reversionary bonuses accumulating on the policy. Accordingly, it has been decided to value whole of life or endowment policies, for the purposes of determining contributions, as the greater of surrender value and premiums paid.

Loan Back Funds

23. There have been a number of enquiries seeking a definitive statement of what constitutes a loan back in terms of paragraph 31 of IT 294. It is not practicable to give an exhaustive definition. Nevertheless, it is a feature of most loan back arrangements that the trustee of a superannuation fund is not free to invest the moneys in the fund as he might otherwise wish. The course of conduct between the employer and the trustee will make it apparent in many cases that there was some agreement, arrangement, understanding, etc., either express or implied, that it will be necessary for the trustee to make moneys available to the employer or at the latter's direction. Where the conclusion is reached that moneys so made available to or at the direction of the employer constitute a loan back it will not make any difference how the loan back is arranged. Moneys lent back by a trustee on the security of mortgage over property owned by the employer or associated entity may well be regarded as a loan back. Similarly an investment by the trustee in shares of the sponsoring employer or a loan by a third party to the employer conditional upon a particular investment being made by the trustee may also be a loan back.

24. There will, however, be other cases where the trustee is absolutely free in the choice of investments and the

investment in the employer will not constitute a loan back. In many cases involving larger public companies the trustee may invest some portion of the moneys of the fund in shares of the employer. Such investment would not be a loan back arrangement. Nor would there be a loan back arrangement where the trustee acquired real property and leased it to the employer or associated entity at a commercial rate of interest.

25. Reference was made in paragraph 32 of IT 294 to a 'net of charges' interest rate on loans back of 17.5%. It is stressed that the fund must receive a net return on any amount lent to the employer of at least 17.5%. By way of example, where a fund borrows money at 17% from a third party and then on-lends the amount to the employer, it would be necessary for the fund to charge at least 34.5% interest so as to achieve the required net rate of return. A fund which borrowed at 17% and on-lent to the employer at 17.5%, thus achieving a net rate of interest of .5%, would not be regarded as satisfying the requirements of the guidelines.

26. There is no objection to the interest rate stipulated in fully documented fixed term loan arrangements entered into before the release of the guidelines continuing to apply for the balance of that term provided that contributions are determined in accordance with the guidelines. This would not be the case where the interest rate could readily be renegotiated, e.g., loans at call.

27. In order to comply with paragraph 32 of IT 294 it is necessary for a fund to receive, or be credited with, interest at the stipulated net rate of interest. It should be noted that while interest remains unpaid to the trustee it will be treated as a loan back. Furthermore, if interest remains unpaid for any length of time, the question will arise whether the fund is being maintained solely for the required purposes.

28. In determining the percentage of loan back regard must be paid to the gross cost of the assets of the fund excluding contributions to be made to the fund in the year. Where the percentage of loan back has been reduced from the level at the commencement of the year of income and it is the trustee's intention to maintain the reduction it would be acceptable for contributions to be based on the percentage lent back at the time the contribution is to be made. Where this is not the trustee's intention it will be necessary to examine each case on its merits. Regard would be paid, inter alia, to the percentage lent back throughout the year of income. Where an employer operates more than one superannuation fund the weighted earning rate should be determined by reference to the proportion that the aggregate of amounts lent back bears to the aggregate of the assets of all funds.

29. Reductions in the deemed earning rate to take account of expected repayments of amounts lent back will not be accepted.

30. Where the assets of a fund include assurance policies, other than term policies the percentage of assets of the fund

involved in loan back should be calculated by reference to the premiums paid on the policy to the present time. Because of the different considerations involved it should be noted that this approach differs from that set out in paragraph 22 for the determination of contributions.

31. It is disturbing to note that following the release of the superannuation guidelines a number of promoters of superannuation funds are recommending to their clients that contributions no longer be made to existing funds and that interest payments on existing loans from the fund cease to be paid. Existing member's rights to benefits would cease with the loan back ultimately being forgiven or, alternatively, distributions would be made from the fund to members still in employment. While each such case would be examined on its merits the correct conclusion to be drawn may well be that the fund had not at all times since its inception been maintained solely for the purpose of providing superannuation benefits. If this is the case no guarantee could be given that the exemption previously granted to the fund, and deductions for contributions allowed to the employer, would not be re-examined.

The 10 percent Practice

32. In general there would not be any objection to the application of the 10% practice to new as well as existing funds nor would there be any objection to the employer also contributing in respect of death and disablement insurance provided that the amount lent back does not at any time during the year of income exceed 10 % of the assets of the fund. The practice of not accepting contributions made on the basis of 10% of remuneration where the employee's balance in the fund is already excessive, or in respect of employees who join the fund with less than 10 years to retirement, will continue.

Professional Sportsmen

33. For some years it has been the practice to limit superannuation contributions to funds established under section 23F of the Income Tax Assessment Act for the benefit of professional sportsmen to the statutory amount provided by paragraph 82AAE(a) of the Act, i.e., the greater of $400 and 5% of the sportsman's remuneration.

34. It has been decided to accept that contributions to section 23F funds for the benefit of professional sportsmen to the extent of 10% of the sportsman's remuneration would not be excessive and would not cause the respective funds to lose their exempt status. Contributions may be increased to reflect past service in respect of those years where no contribution, or a lower percentage contribution, has been made. This decision will apply only in relation to professional sportsmen who derive their professional income as employees.

Accumulation Funds

35. Paragraph 42 of IT 294 indicated that, for accumulation

funds with no more than 10% of their assets lent back, contributions may be reviewed at intervals not exceeding five years so as to ensure that excessive benefits will not become payable. In practice this will mean that once the appropriate contribution as a percentage of salary has been determined, i.e., by reference to the Ready Reckoners and the balance presently held in the fund or amounts received from other funds, the percentage of salary contribution may be applied over the period to the next review. This is always subject to the proviso that nothing occurs in the intervening period to warrant a change in the contribution.

Death or Permanent Disability

36. Paragraph 45 of IT 294 indicated that the maximum amount of death or permanent disablement benefit for which insurance premiums will be allowable deductions, in addition to superannuation contributions, will be the permissible retirement benefit applicable to the member's salary as at the date of death or disability less the amount held in the fund on the member's behalf. In practice this will mean that the maximum death or disability cover which may be taken out for a member of a pension fund would be restricted to the amount required to provide the pension to which the member would have been entitled had he retired at normal retirement age at that time, based on the life expectancy at normal retirement age, less the balance presently held in the fund.

Auditor's Certificate

37. It is not the province of this office to interfere in the exercise of professional judgment by an auditor who must form his own opinion as to whether he is sufficiently independent to conduct an audit and as to the extent of the audit required. By way of general comment, however, an auditor who is a member or trustee of the fund, an employee of the employer, or who provides accountancy and administrative services to the fund, would not be sufficiently independent. On the other hand there would not be any objection to an audit by one partner in a partnership, for example, where another partner is a shareholder/director of a company which is itself trustee of the fund. An auditor who is a member of either the Institute of Chartered Accountants in Australia or the Australian Society of Accountants would be bound by standards of independence established by those bodies. Accordingly, an audit certificate prepared by an auditor who clearly indicates his professional status as a member would be accepted without further query as being prepared by an independent auditor. It is not necessary that an audit of a superannuation fund be performed by a registered company auditor.

38. Having regard to the purpose for which income tax concessions have been granted to superannuation funds, and to the nature of superannuation funds, it would appear almost automatic that an auditor's report would accompany the return of income of each superannuation fund, irrespective of the level of contribution made to the fund. Where the auditor's report is

received prior to the lodgment of the employer's return of income there would not be any objection to the inclusion of the report with that return in support of the amount claimed as a deduction.

39. The effect of non-production of an audit report, or the production of a qualified report, will depend upon the circumstances of each particular case. An unqualified certificate would not necessarily guarantee the exemption from tax of a particular fund. On the other hand, a qualified certificate will not automatically deny exemption. It will be a matter in each case whether the year to year administration of the particular fund has satisfied the requirements of the relevant provisions of the Income Tax Assessment Act. It would be expected that, where a qualified certificate is received, the trustee would make some comment on the deficiencies detected by the auditor including an indication as to the steps proposed to remedy those deficiencies.

40. Subject to the general exemption granted under paragraph 47 of IT 294 no exemption from the necessity to provide an auditor's report applies to funds invested in life insurance policies. Bearing in mind that life insurance companies are required to be audited annually there would not be any objection should an auditor of a fund invested in life policies have regard to a certificate issued by the insurance company stating, inter alia, that throughout the relevant period the policies were held as superannuation policies and were not pledged as security in any way. The auditor would, of course, still be required to report whether the conduct of the fund is in accordance with its constituent document and to report in accordance with paragraph 47 of IT 294 in respect of any other assets held in the fund.

Section 79 Funds

41. Paragraph 48 of IT 294 indicated that the guidelines would apply generally to section 79 employer sponsored funds. It would be quite anomalous if the difficulty which the guidelines sought to remove from section 23F funds were allowed to continue in section 79 funds. Accordingly, as a general proposition, the income tax deduction allowable to an employer for contributions to a section 79 fund will not exceed that allowable to a comparable section 23F fund e.g. the discretion in paragraph 82AAE(b) will not be exercised where the assets of a section 79 fund were wholly lent back to the employer.

Ready Reckoners

42. Formulae to determine allowable contributions to both pension and lump sum funds were included in IT 2026. As a general proposition, however, contributions for employees within 10 years of retirement should be determined in the circumstances of each particular case. In some cases, if contributions were to continue until retirement on the basis of the weighted earning rates specified in IT 294, the balance in the fund may well become excessive. Indeed in a number of examples considered the balance in the fund remained excessive

notwithstanding that the employer ceased to contribute.

43. It is necessary, therefore, to repeat that within 10 years of retirement contributions have to be calculated with greater precision. There would be no objection to using the formulae provided where the resultant contribution did not lead to excess benefits in the fund.

44. In some cases employers have purported to establish superannuation funds for associated employees who have only a very limited period of future service. While there would be no objection to this practice where it is a bona fide attempt to provide superannuation benefits it is evident that some employers are attempting to avoid the provisions of section 79C which prevents the carry forward of losses arising from retiring gratuities, etc, claimed under paragraph 78(1)(c).

45. Bearing in mind the provisions of section 82AAD and paragraph 82AAE(b) it has been decided to limit the deductibility of contributions made in an attempt to avoid section 79C to the level that would have been required to produce a reasonable benefit reduced in the proportion that prospective membership bears to 3 years. In practice this will mean that, for a member joining a fund with 2 years to retirement, deductions will be allowed in that and the subsequent year for the amount of contribution required to produce two-thirds of a reasonable benefit. Any additional amount paid over these amounts would fall for consideration as retiring gratuities in the year of retirement. Full deductibility will apply to contributions made towards the provision of a reasonable benefit in respect of an employee who joins a fund with 3 or more years to retirement.

Trust Deeds

46. A fund established by resolution of the directors of the sponsoring company is not accepted by this office as sufficient compliance with section 23F.

47. Section 23F requires that members of a superannuation fund be notified in writing of the existence of their rights to receive benefits from the fund. It follows that they should also be notified in writing of any variation in the superannuation deed which may affect their rights.

48. As a general proposition amendments to a superannuation fund deed would seem to fall into two broad categories, i.e., those of an administration or management nature and those which affect the rights of employees and their dependants. Where a company superannuation fund deed permits it amendment by resolution will be accepted where the subject of the amendment is of an administration or management nature.
A certified copy of the minutes of the meeting confirming the amendment should be furnished to the Deputy Commissioner of Taxation at whose office returns of income of the superannuation fund are lodged.

49. Where an amendment affects the rights of employees and

their dependants it is in the interest of all concerned that the deed itself should be suitably amended. The employees and their dependants should be notified in writing of the amendment. If, in any particular case, it is not practicable to amend the deed immediately amendment by resolution will be accepted provided members and their dependants are notified in writing of the amendment and a certified copy of the resolution is furnished to the Deputy Commissioner of Taxation at whose office the funds returns are lodged together with an undertaking that the deed will be formally amended at the earliest practicable time.

Rate of Interest for Loans Back for 1983/84

50. Bearing in mind the circumstances in which loans to the employer are generally arranged, and commercial rates applying in the market place to similar transactions, it has been decided that the specified rate of interest on loans back will remain at 17.5% net of charges for the 1983/84 year of income.

COMMISSIONER OF TAXATION
2 December 1983