

# ***TD 2024/6 - Income tax: trustee risk reserves - deductibility of payments made by a superannuation fund to its trustee***

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Status: **legally binding**

## Taxation Determination

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

### **❶ Relying on this Determination**

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

If this Determination applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Determination. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Determination.

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### **What this 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<sup>1</sup> (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 Determination as a ‘penalty’ or ‘penalties’). Impacted funds and their trustees may take differing approaches to address the risk of exposure to penalties arising from the amendments,

<sup>1</sup> ‘Superannuation entity’ is defined in section 10 of the SISA to mean a regulated superannuation fund; or an approved deposit fund; or a pooled superannuation trust.

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including the trustee of the fund (in its capacity as trustee) making payments to the trustee in its own capacity 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*. TR 93/17 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 separate 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 losses or outgoings of capital, or of a capital nature, and excluded under paragraph 8-1(2)(a).<sup>2</sup>

#### ***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 'trustee fees'). These trustee fees are ongoing and recurrent charges for the services provided by the trustee to the fund, which may be increased from time to time in accordance with the powers and terms of the trustee's engagement to reflect the increased cost of providing its services to the fund.

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 fair and reasonable apportionment will be required by the fund in respect of its deduction due to the operation of paragraph 8-1(2)(c). TR 93/17 outlines the Commissioner's views on acceptable methods of apportionment of expenses in this context.

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<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. For further guidance on the operation of section 40-880, 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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**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 by the fund, it is concluded that Greendove Superannuation Fund is receiving an enduring benefit in respect of the stability of its income-producing 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 income-producing 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 of a capital nature, and are therefore excluded from deductibility under section 8-1 due to the operation of paragraph 8-1(2)(a).

**Example 2 – trustee 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.

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 by the fund, it is concluded that Whitequail Superannuation Fund is making the outgoing to

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*receive current and ongoing trustee services. The payments are recurrent in nature and are not made in respect of the income-producing structure. This is an ongoing payment by Whitequail Superannuation Fund for trustee services provided over the period for which the charges relate, 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 trustee fees of \$600,000 will be deductible to Whitequail Superannuation Fund under section 8-1. These payments are not capital, or of a capital nature, and therefore are not excluded from deductibility under section 8-1 due to the operation of paragraph 8-1(2)(a).*

18. *A fair and 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. This Determination applies 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**

24 July 2024

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## Appendix – Explanation

**❗** *This Explanation 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.*

### 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 may take 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. The amount charged in respect of any 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.

22. This is differentiated from existing ongoing and recurrent charges for the services provided by the trustee.

23. The issue for the fund is whether the trustee fees or the additional risk reserve payments (or both) 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
  - (d) a provision of this Act prevents you from deducting it.

<sup>3</sup> Subsections 56(2) and 57(2) of the SISA, as amended by the *Financial Sector Reform (Hayne Royal Commission Response) Act 2020*.

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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 is 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 – paragraph 8-1(1)(a)***

27. In *Commissioner of Taxation v Day* [2008] HCA 53, 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 (footnotes omitted):

Section 8-1(1)(a) is couched in terms intended to cover any number of factual and legal situations 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 on 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 trustee fees or additional risk reserve payments (or both), are productive of, 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.<sup>4</sup>

#### ***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. However, paragraphs 8-1(2)(a) and (c) need to be considered.

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

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<sup>4</sup> As the Commissioner accepts paragraph 8-1(1)(a) is satisfied, it is unnecessary to consider the application of paragraph 8-1(1)(b) in this Determination.

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32. In *Sun Newspapers Limited v Federal Commissioner of Taxation* [1938] HCA 73, Dixon J outlined the following 3 matters to be considered in determining whether expenditure is on capital or revenue account:

... (a) the character of the advantage sought, and in this its lasting qualities may play a part, (b) the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part, and (c) the means adopted to obtain it; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment.

33. In identifying the character of the advantage sought, Dixon J further commented:

The distinction between expenditure and outgoings on revenue account and on capital account corresponds with the distinction between the business entity, structure, or organization set up or established for the earning of profit and the process by which such an organization operates to obtain regular returns by means of regular outlay, the difference between the outlay and returns representing profit or loss.

...

The result or purpose of the expenditure may be to bring into existence or procure some asset or advantage of a lasting character which will enure for the benefit of the organization or system or 'profit-earning subject'. It will thus be distinguished from the expenditure which should be recouped by circulating capital or by working capital.

34. More recently, in *Commissioner of Taxation v Sharpcan Pty Ltd* [2019] HCA 36, 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.

35. 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.

36. In determining whether a loss or outgoing is of capital, or of a capital nature, it is first necessary to identify what the payment made by the fund to the trustee is for and then to determine the character of the advantage that is being sought. These are matters that need to be objectively determined on the facts of each particular arrangement and, while it is considered from the perspective of the taxpayer, the enquiry does not depend upon the taxpayer's state of mind.<sup>5</sup> As McKerracher and Stewart JJ stated in *Mussalli v Commissioner of Taxation* [2021] FCAFC 71 at [86] and [97]:

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<sup>5</sup> Per Brennan J in *Magna Alloys & Research Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia* [1980] FCA 180.



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86. The character of the advantage sought is generally the chief, if not critical, factor in distinguishing between outgoings of revenue and capital. The proper identification of the advantage sought sometimes arises as a threshold issue to be dealt with prior to characterisation: see *AusNet* per French CJ, Kiefel and Bell JJ (at [23] and [66]). An outgoing may be on capital account even though no asset is acquired: *Mount Isa* (at 147-148) ...

97. The character of the advantage sought to be obtained by a taxpayer in incurring expenditure is to be determined objectively from the perspective of the entity that incurred the expenditure ...

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

37. When the fund is making an additional 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), the character of the payment being made by the fund needs to be examined in that context irrespective of whether the trustee charges the amount as a one-off lump sum payment, a number of lump sum instalments or as an ongoing amount.

38. In these circumstances, 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 is for, or the payments are for, is required.

39. Objectively determined, the advantage sought by the fund in making the payments to the trustee to establish or maintain the risk reserve (or both) is to secure a lasting benefit by strengthening and preserving its operating system that derives income for the benefit of its members. That is, to maintain its operating structure, it requires the trustee to remain in place and perform its functions according to the trust deed.

40. The fund is receiving an enduring benefit in respect of the stability of its income-producing 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 related to the income-producing structure of the fund. If a trustee does not manage the risk arising from the amendments to section 56 of the SISA, then incurring a penalty may render the trustee insolvent and unable to continue to provide its services.

41. Where the additional risk reserve payment is made by way of one or more lump sums, this is consistent with a characterisation that the payment is of capital, or of a capital nature. However, where the additional risk reserve payments are made by instalments, being more recurrent in nature, it is still being paid for an enduring benefit and does not change the character of the advantage sought. It therefore remains a loss or outgoing of capital, or of a capital nature. Further, while additional payments may be required to reflect changes in risk or to top up a trustee's risk reserve after a penalty has been incurred, this also does not change the benefit to the fund in respect of strengthening and preserving its operating system that derives income for the benefit of its members.

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

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***Trustee fees***

43. When it is objectively determined that the fund makes a payment to the trustee for trustee services, the character of the advantage sought by the fund in making the payment is to receive the benefit of those trustee services in undertaking its income-producing activities. This is the case regardless of whether the trustee increases its existing ongoing and recurrent charges for those services to reflect the increased cost of providing those services.

44. Further, the payments are recurrent in nature, being a periodical outlay to cover its receipt of regular and recurrent trustee services made to it under the terms of the trust deed. These payments are not made in respect of the income-producing structure.

45. Accordingly, the payment of trustee fees by the fund is not capital, or of a capital 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.

46. 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 fair and reasonable apportionment will be required due to the operation of paragraph 8-1(2)(c).

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## References

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### *Previous draft:*

Previously issued as TD 2023/D3

### *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 10
- SISA 1993 56
- SISA 1993 56(2)
- SISA 1993 57
- SISA 1993 57(2)

### *Cases relied on:*

- Commissioner of Taxation v Day [2008] HCA 53; 236 CLR 163; 83 ALJR 68; 250 ALR 388; 2008 ATC 20-064; 70 ATR 14
- Commissioner of Taxation v Sharpcan Pty Ltd [2019] HCA 36; 269 CLR 370; 2019 ATC 20-715; 93 ALJR 1147; 373 ALR 414
- Magna Alloys & Research Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia [1980] FCA 180; 80 ATC 4542; 11 ATR 276; 33 ALR 213; 49 FLR 183
- Mussalli v Commissioner of Taxation [2021] FCAFC 71; 284 FCR 516; 2021 ATC 20-792; 113 ATR 124; [2022] ALMD 1442
- Sun Newspapers Limited v Federal Commissioner of Taxation [1938] HCA 73; 61 CLR 337; 5 ATD 87; 44 ALR 498

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### ATO references

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