


TR 2000/5 - Income tax and fringe benefits tax: costs incurred in preparing and administering employment agreements

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Taxation Ruling

Income tax and fringe benefits tax: costs incurred in preparing and administering employment agreements

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Preamble

*The number, subject heading (the title), **Class of person/arrangement**, **Date of effect** and **Ruling** parts of this document are a ‘public ruling’ for the purposes of Part IVAAA of the **Taxation Administration Act 1953** and are legally binding on the Commissioner. The remainder of the document is administratively binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

[**Note:** This is a consolidated version of this document. Refer to the ATO Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

What this Ruling is about

Class of person/arrangement

1. This Ruling sets out the Commissioner’s view of the application of section 8-1 of the *Income Tax Assessment Act 1997* (‘the Act’) to costs incurred by employees and employers in preparing and administering employment agreements. An employment agreement is a reference to an agreement between an employee and an employer regarding employment. The agreement may have been reached on an individual basis or collectively. The Ruling also considers fringe benefits tax issues that arise where the employer meets the employee’s costs. **NOTE:** Section 8-1 of the Act, to which this Ruling refers, expresses the same ideas as subsection 51(1) of the *Income Tax Assessment Act 1936*.

1A. This Ruling does not consider the application of section 8-1 of the Act to the costs incurred by an employee in preparing and administering an employment agreement that forms part of a business being carried on by the employee. The High Court held in *Spriggs v. Federal Commissioner of Taxation*; *Riddell v. Federal Commissioner of Taxation* (2009) 239 CLR 1; [2009] HCA 22 that each professional football player carried on a business of commercially exploiting their sporting prowess and associated celebrity, which included playing activities undertaken as an employee. The Court confirmed that the fees paid by each player to a manager to negotiate a new playing contract were an allowable deduction in the circumstances where:

- each business was well established and conducted in a commercial and business-like way;
- the player was not exclusively an employee;
- there was a synergy between the various income producing activities of the player; and
- the conduct of each business was anticipated in the framework provided by the playing contracts and the competition rules.

Ruling

Employee costs

2. The following costs incurred by an employee are an allowable deduction:

- costs of drawing up an employment agreement with an existing employer to replace an award or in accordance with a provision in the existing agreement;
- costs associated with settlement of disputes arising out of an existing employment agreement including the cost of representation;
- costs of changing the conditions of an existing employment agreement with the same employer – providing the existing agreement allows for changes – be it a variation, re-negotiation of an existing agreement or upon a promotion; and
- costs of renewing or extending a fixed term agreement which has a provision allowing for renewal or an extension at the end of a term.

3. The following costs incurred by an employee are not an allowable deduction:

- costs of drawing up an employment agreement with a new employer; and
- costs of drawing up an employment agreement upon re-employment with an employer following termination of a fixed term employment contract where the agreement makes no provision for renewal or extension.

Employer costs

4. The following costs incurred by an employer are an allowable deduction:

- costs of drawing up employment agreements for existing employees and new employees of an existing business; and
- costs incurred in the settling of disputes arising out of existing employment agreements.

5. Costs incurred by an employer in drawing up employment agreements for a new business are not an allowable deduction.

Fringe benefits tax

6. Where an employer reimburses an employee for costs the employee incurs in preparing or administering an employment agreement, the employer is providing a fringe benefit. The employer is entitled to a deduction for the costs (see paragraph 4). The value of the benefit can be reduced if the 'otherwise deductible' rule (section 24 of the *Fringe Benefits Tax Assessment Act 1986*) applies. The otherwise deductible rule applies if the employee is entitled to a deduction (see paragraph 2).

Date of effect

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

Previous Rulings

8. This Ruling consolidates the principles contained in Taxation Determinations TD 93/161, TD 93/162, TD 93/163, TD 93/164 and TD 93/165. These Determinations only applied to the *Employee Relations Act (Vic)* 1992 but the principles contained in them have general application to all employment agreements. This Ruling applies to all employment agreements presently in existence, whether executed before or after the commencement of the *Workplace Relations Act (Cth)* 1996. These Determinations have been withdrawn.

Explanations

Employment agreements

9. Prior to the enactment of new laws regarding industrial relations, most employees were paid under awards negotiated on their behalf by a union that had authority to represent the particular group of workers, regardless of whether the employee was a member of the union. Some employees had employment contracts as they were not covered by any particular award (e.g., senior staff, directors).

10. Legislation now exists, at both the Federal and State level, allowing for employment agreements. These include individual agreements known as Australian Workplace Agreements or, enterprise based agreements which include certified agreements and enterprise flexibility agreements. Such agreements replace any existing award that might otherwise apply to particular employees.

11. Employment agreements are a written, legal and binding confirmation of the employer/employee relationship. The agreements cover rates of pay, working conditions, leave entitlements and other provisions. Although the agreements usually run for a fixed term, the agreements can include a clause allowing for the extension of this term. Where employment continues in the absence of an agreement, the industrial laws set the conditions until a new agreement is reached.

12. Both the employer and employee may incur expenses in setting the conditions for and administering the employment agreement. These costs may include:

- representation (which could be a union, an employer organisation, an accountant, a lawyer or any other representative employed during the negotiation process);
- costs associated with the drawing up of the agreement;

- lodgment fees; and
- costs associated with settlement of disputes.

Costs of obtaining an employment agreement

13. An employment agreement may be required to be obtained in the following circumstances:

- when a new employee is hired;
- when an employee is promoted;
- when an employee enters new employment;
- when a person is re-employed upon termination of a fixed term contract (e.g., many university lecturers and senior public servants are employed on fixed term contracts); or
- as a consequence of the law requiring an award to be replaced by an employment agreement.

14. Both where a business is establishing itself and an employee is entering new employment, a deduction is not allowable to either the employer or the employee as the expense is incurred at a point too soon to be considered as being incurred in the carrying on of the business or the production of assessable income and, further, it is a capital expense (*FC of T v. Maddalena* 71 ATC 4161; (1971) 2 ATR 541).

15. Once a business is established, the costs incurred by an employer in making agreements with new employees, and renewing, extending or renegotiating agreements with current employees, are a normal business expense and therefore an allowable deduction.

16. Similarly, the costs of changing from an award to an agreement or renewing, extending or renegotiating agreements incurred by an employee are an expense of producing the assessable income and, therefore, an allowable deduction unless the expense can be characterised as being capital or in the nature of capital. The expense is characterised as being a capital expense where the agreement was made for a fixed period of time and there is no provision for its renewal. The new agreement is considered a capital expense as it provides an enduring advantage (i.e., re-employment).

Examples

Example 1: costs incurred by an employee in obtaining employment

17. Tim leaves Manufacturing Pty Ltd, to join Wholesaling Pty Ltd. The new job is an advancement for him, as he will be paid a much higher salary and has much better long term prospects. The new employer arranges for an employment agreement to be drawn up to comply with the new legislation. Tim takes the agreement to his lawyer who checks it. He sends Tim an account for \$150 for services rendered.

18. Tim is not entitled to a deduction as the expense was incurred in connection with the conditions of a new job. Despite the fact that he obtained an increase in income, the expense is still an initial expense of a capital nature.

Example 2: costs of drawing up an employment agreement with a new employer

19. James, who has not been employed previously, obtains a job with Retail Pty Ltd in April 1999. Retail Pty Ltd arranges for an employment agreement to be drawn up to comply with the legislation. James takes his agreement to his lawyer who checks the agreement and suggests some alterations. He sends James an account for \$200 for services rendered. James is not entitled to a deduction as the expense was incurred in gaining a new job and establishing conditions for that new job. It is an initial expense of a capital nature.

Example 3: costs of renewing or extending a fixed term employment agreement

20. Andrea obtained a two year contract with Geoffrey to complete a specific project. After two years another project became available and Geoffrey offered the job to Andrea. They negotiated another contract for a further 18 months and Andrea consulted her lawyer who sent her an account for \$350 for services rendered.

21. Andrea is not entitled to the deduction. She had completed her two year contract with Geoffrey and the contract for the other project is another initial contract and, therefore, the expense is not deductible.

Example 4. costs of extending an employment agreement

22. Jimmy has a three year employment agreement with ACME Deliveries, which provides for a new agreement to be renegotiated after two years and nine months. Further, if a new agreement is not reached the current agreement may be extended.

23. A deduction is allowable in respect of the renewed agreement and/or extension of the current agreement as this is provided for by the current agreement. That is, the expense is incurred in earning the employment income.

Example 5: costs of drawing up an employment agreement with an existing employer

24. Mary has been employed by Joe since 1984. In March 1999 they arrange for an employment agreement to be drawn up to comply with the legislation. Mary takes her contract to her lawyer, who checks it. Her lawyer sends her an account for \$350 for services rendered.

25. Mary is entitled to this deduction as the expense was incurred in earning her employment income.

Example 6: expenses incurred in protecting an existing right under an employment agreement

26. Fred was employed under a three year employment agreement with Julie. The agreement provided for a tool allowance of \$750 per year. After two years Julie discovered that the trade only allowed for a tool allowance of \$100 per year. She refused to pay Fred more than \$100 in future. Fred disagreed and took his complaint to the appropriate tribunal for arbitration.

27. Fred was represented by his lawyer who sent him an account for \$250 for services rendered. Fred is entitled to claim the payment as a deduction. It is an expense incurred in protecting an existing right under the employment agreement. It is not an expense of a private or of a capital nature.

28. Julie was represented by her accountant, who charged her \$350 for services rendered. Julie can claim the payment as a deduction because it is an expense incurred in the carrying on of her business.

Example 7: costs of changing the conditions of an existing employment agreement

29. Tom was employed under a three year employment agreement with Jane. The agreement provided for a tool allowance of \$900 per year. After two years Jane discovered that competitors in the trade only provided for a tool allowance of \$200 per year. She discussed the issue with Tom. Following the discussion they varied the agreement. Tom was assisted by his lawyer who sent him an account for services rendered.

30. Tom is entitled to a deduction. The expense was incurred in varying an existing right under the employment agreement with his present employer.

Example 8: costs associated with altering responsibilities with a current employer

31. Charles was employed under a three year employment agreement with Joe. After 18 months another job became available and Joe offered that job to Charles. During the discussions about the change, a new three year employment agreement was drawn up and Charles consulted his lawyer who sent him an account for \$700 for services rendered.

32. Charles is entitled to a deduction. Charles did not find a new job, he merely obtained a change in employment with his current employer.

Example 9: employer pays or reimburses costs incurred by a current employee in preparing an employment agreement

33. Kathy has been employed by Damien since 1984. In March 1999 they arrange for an employment agreement to be drawn up to comply with the legislation. Kathy takes her contract to her lawyer, who checks it. Her lawyer sends her an account for \$350 for services rendered. Damien pays the account.

34. Damien is liable for fringe benefits tax. However, the value of the fringe benefit is reduced by the amount that would otherwise have been deductible to Kathy. As Kathy would have been entitled to a deduction for this amount, the value of the benefit is reduced to nil.

Example 10: employer pays or reimburses costs incurred by a new employee in preparing an initial employment agreement

35. Charles leaves Goldmine Pty Ltd, to join ABC Bank Pty Ltd. The new job is an advancement for him, as he will be paid a much higher salary and has much better long term prospects. Charles and ABC Bank Pty Ltd arrange for an employment agreement to be drawn up to comply with the new legislation. Charles takes the agreement to his lawyer who checks it. He sends him an account for \$150 for services rendered. ABC Bank Pty Ltd reimburses Charles for the \$150 he paid to his lawyer.

36. The taxable value of the fringe benefit is \$150. As the payment would not have been an allowable deduction to Charles (see **Example 1**), the fringe benefit is the full amount of the payment made by ABC Bank Pty Ltd.

Detailed contents list

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Commissioner of Taxation8 March 2000

Previous draft:

Previously issued in draft form as TR1999/D15

Subject references:

- labour expenses
- work related expenses

Legislative references:

- FBTAA 24
- ITAA 1936 51(1)

- ITAA 1997 8-1

Case references:

- FC of T v. Maddalena 71 ATC 4161; (1971) 2 ATR 541
- Spriggs v. Federal Commissioner of Taxation; Riddell v. Federal Commissioner of Taxation (2009) 239 CLR 1; [2009] HCA 22

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