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Are superannuation contributions on behalf of directors deductible?

The recent Full Federal Court decision in *Kelly v FCT* [2013] FCAFC 88 has shed light on the circumstances in which a superannuation contribution made on behalf of a director of the trustee of a family trust will be deductible. It confirms that taxpayers need to take appropriate steps to ensure contributions to family trusts are deductible.

Family trusts are typically established with companies acting as trustees. The corporate trustee will generally serve no role other than acting as corporate trustee. Consequently it will have no income and rarely any substantial assets. Key family members will own shares in the trustee company and also act as its directors. This ensures the family members retain control and day-to-day management of the trust.

A common tax planning strategy is to have the trustee of the family trust make superannuation contributions on behalf of individuals who act as directors of its corporate trustee. This raises the question of whether the trust can claim a deduction for the contribution. *Kelly* clarifies that it can, but only if the corporate trustee's constitution contains appropriate provisions, and the trustee has passed resolutions authorising payment.

The decision in *Kelly*

Kelly involved a partner in a law firm who had established a family trust to hold his interest in the partnership. The taxpayer and his wife acted as directors of the corporate trustee. One aspect of the case concerned the treatment of his interest in the partnership – particularly whether he had effectively assigned his interest in the partnership to the trust. However, the trust had also claimed a tax deduction for a superannuation contribution made on behalf of the taxpayer and his wife. The Commissioner of Taxation disallowed this deduction.

The critical question before the court was whether the taxpayer and his wife fell within the expanded definition of 'employee' for the purposes of the *Superannuation Guarantee (Administration) Act 1993* (Cth). This is because the income tax provision that permits

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a deduction[1] restricts deductions to contributions made in respect of employees and individuals falling within the expanded definition of employee. The taxpayer and his wife could only fall within the expanded definition if they were people entitled to payment for being directors of the corporate trustee. It has long been recognised that directors of companies are not entitled to payments for their services unless such payments are authorised by:

- the company's constitution; or
- a meeting of shareholders.

In *Kelly* the relevant company constitution permitted payments to directors, but only if the payments were approved by a meeting of the company's shareholders. No such meeting had been held, and consequently neither the taxpayer nor his wife was entitled to payment for acting as a director.

As a result they did not fall within the expanded definition of 'employee' for the purposes of the *Superannuation Guarantee (Administration) Act 1993* (Cth), and the trust could not claim a deduction for the superannuation contributions.

Key lessons from *Kelly*

Following *Kelly*, it is clear that a family trust can deduct superannuation contributions made on behalf of the directors of its corporate trustee. However, the deductions will only be allowed if payments are permitted by the relevant constituent documents and supported by appropriate resolutions.

1 *Income Tax Assessment Act 1997* (Cth) s 290-60

In our view, taxpayers should take the following steps to ensure deductions are not challenged:

1. The trust's trust deed should be reviewed to ensure that trustees can be paid for their services.
2. The corporate trustee's constitution should also be reviewed to ensure that it permits payments to directors, and to determine the procedure for approving such payments.
3. The corporate trustee should follow the procedure outlined in its constitution for authorising payments to directors. This will probably involve having its shareholders pass a resolution authorising the payment.

Unless these steps are taken, family trusts will probably find their deductions challenged by the Australian Taxation Office.

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