



Class Ruling

Income tax: Deferred Salary Payment Agreement for Sabbatical Leave Scheme by Employees of the Department of Agriculture

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Preamble

*The number, subject heading, and the **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains **Class Rulings** and **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.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:

- sections 26AC, 26AD and 101A of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- subsection 136(1) of the *Fringe Benefits Tax Assessment Act 1986* ('FBTAA 1986'); and
- section 12-35 of Schedule 1 to the *Taxation Administration Act 1953* ('TAA 1953').

Class of persons

3. The class of persons to whom this Ruling applies are full time and part time employees of the Department of Agriculture in Western Australia who derive salary or wages which is assessable income in Australia.

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.
5. The class of persons defined in this Ruling may rely on its contents provided the arrangement described below at paragraphs 9 to 21 is carried out in accordance with the details of the arrangement provided in this Ruling.
6. If the arrangement described in this Ruling is materially different from the arrangement that is actually carried out:
 - (a) this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement on which the Commissioner has ruled, and
 - (b) this Ruling may be withdrawn or modified.
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Date of effect

8. This Ruling applies from 1 July 2001. 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 94/20).

Arrangement

9. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:
 - Request for Opinion dated 18 December 2000;

- Application for Class Ruling dated 31 May 2001.

10. The Department of Agriculture is a department of the Public Service in Western Australia. The Agriculture Western Australia Enterprise Agreement 2000 and the Agriculture Western Australia Enterprise Agreement 1998 provide the basis for a scheme whereby full time and part time employees of the Department of Agriculture can enter into an agreement with the Department of Agriculture where the employee defers an entitlement to salary in return for the right to receive salary while taking sabbatical leave. The employee is expected to pursue academic and professional development opportunities related to their career within the Public Service while on the sabbatical leave.

11. Eligible employees of the Department of Agriculture who wish to participate in the scheme to obtain employee funded sabbatical leave require:

- The initial approval of their immediate manager who shall consider:
 - impact upon the delivery of business outcomes;
 - impact on the work unit and the needs of the individual;
 - the individual's accrued leave balances; and
 - the degree of employee specialisation.
- The final approval of the Director General of the Department of Agriculture or his/her delegate.

12. Having been approved to enter the scheme, the employee must remain in it for the specified period unless due to extenuating circumstances, the employee receives managerial approval to withdraw from the scheme. An employee who withdraws from the scheme is not able to re-enter the scheme for at least 12 months.

13. The Department of Agriculture has the right to withdraw from the scheme in respect of an employee should:

- the employee be internally promoted or transferred;
- the employee become eligible for workers' compensation payments; or
- there are business related reasons warranting such action.

14. The sabbatical leave is funded by the employee who defers the payment of salary by either:

- reducing his or her normal annual wage or salary by 20%; or

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- sacrificing a percentage of his or her annual salary or wage expressed as an equivalent number of days. This percentage is elected by the employee annually on a prospective basis.

15. Normal salary does not include higher duties allowances, shift allowances, overtime and other allowances of a temporary or ad hoc nature. Employees receiving such allowances continue to be paid such allowances at the full (non-discounted rate).

16. The employee continues to work the full number of hours specified in the applicable Enterprise or Workplace Agreement.

17. The salary differential sacrificed by the employee is recognised by the Department of Agriculture as a future liability to pay the employee and provision will be made in the accounts of the Department of Agriculture under the name of each employee. Interest does not accrue to the employee on the amount for which the Department of Agriculture has made provision. The Department of Agriculture does not open bank accounts or similar investments on behalf of the employees.

18. The amount for which provision has been made will be paid to the employee as a lump sum at the earlier of the following events:

- commencement of the sabbatical leave;
- termination of employment;
- circumstances arising which result in the employee being given permission to withdraw from the scheme;
or
- the employer withdraws from the scheme in respect of an employee.

19. Should the employee die before one of the events in the previous paragraph has occurred, the amount set aside as a provision will be paid to the legal representative of the deceased employee's estate.

20. Sabbatical leave accumulated under the scheme must be taken within 12 months of the employee accruing the right to take it. The employee's immediate manager must approve the taking of the sabbatical leave.

21. Employees who do not take the sabbatical leave within the required period forfeit the right to the leave but will be paid a lump sum equal to what would have been paid if the leave had been taken.

Ruling

22. The amount of salary which an employee of the Department of Agriculture defers receiving in return for the right to receive a lump sum payment on the commencement of the sabbatical leave is assessable income in the year in which it is derived.

23. The income is derived in the year in which the deferred amount of salary is received as a lump sum payment as a consequence of one of the following events occurring:

- the sabbatical leave is commenced;
- employment is terminated;
- the death of the employee;
- the Department of Agriculture accepts the employee's request to withdraw from the scheme;
- the Department of Agriculture withdraws from the scheme in respect of the employee; or
- the employee does not commence the sabbatical leave within the required period.

24. The assessable income of the legal representative of the estate of a deceased employee includes any lump sum of salary paid after the death of the employee.

25. The Department of Agriculture as the employer is required to withhold an amount of tax from the lump sum of salary paid to the employee at the time of making the deferred payment.

Explanations

26. The Commissioner's view of the income tax treatment of deferred salary payment agreements is set out in Taxation Determination TD 93/242.

27. The Department of Agriculture employees who enter the scheme described in the Arrangement part of this Ruling have varied their employment contracts. In return for accepting a lesser salary for future employment services they will provide to the employer, they will have an entitlement to receive a salary while on sabbatical leave.

28. Subsection 6-5(1) ITAA 1997 provides that the assessable income of a taxpayer includes income according to ordinary concepts, which is called ordinary income. Subsection 6-5(2) provides that the assessable income of Australian residents includes ordinary income derived directly or indirectly from all sources.

29. Income from employment is generally derived only when received. Where an employee has entered into an agreement to have their salary discounted, it is the amount of discounted salary received that is assessable income and brought to account under subsection 6-5(1).

30. The income that the discounting of salary defers is not considered to be an amount that has been applied or dealt with in any way on behalf of, or the direction of the employee. While the Department of Agriculture recognises that it has a future obligation to make the payment, the employee does not have the right to draw on the amount until one of the events in paragraph 18 occurs. It is considered that subsection 6-5(4) does not apply.

31. If the employee dies before deriving the lump sum of deferred salary, the amount so paid is the assessable income of the legal representative of the deceased employee's estate and is brought to account under section 101A of the ITAA 1936. The deferred salary is not in respect of annual leave or long service leave that would have been included in the assessable of the employee by virtue of either section 26AC or 26AD of the ITAA 1936 if received by the employee before death. Therefore the exclusion of income that subsection 101A(2) provides does not apply.

32. Fringe benefit is widely defined term in subsection 136(1) of the FBTA 1986. Paragraph (h) of that definition specifically excludes a payment of salary or wages from being a fringe benefit. As the deferred salary will be salary when taken, the right to receive salary while on sabbatical leave is not a fringe benefit.

33. At the time of paying the deferred salary as a lump sum to the employee, the Department of Agriculture is an employer that is making a payment of salary to an employee. Section 12-35 of Schedule 1 to TAA requires that the Department of Agriculture withhold an amount from that payment of salary.

34. The legal representative of the deceased estate of an employee is not an employee of the Department of Agriculture. The Department of Agriculture is not required to withhold an amount from a payment to the legal representative.

Detailed contents list

35. Below is a detailed contents list for this Class Ruling:

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Commissioner of Taxation

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Previous draft:

Not previously issued in draft form

- ITAA 1936 26AD

- ITAA 1936 101A

- ITAA 1936 101A(2)

Related Rulings/Determinations:

CR 2001/1; TR 92/1; TR 94/90;

TR 97/16; TD 93/242

- ITAA 1936 159SA(1)

- ITAA 1997 6-5

- ITAA 1997 6-5(1)

- ITAA 1997 6-5(2)

- ITAA 1997 6-5(4)

Subject references

- dividend streaming arrangements

- franking credits

- share buy backs

- TAA 1953 Schedule 1, 12-35

- TAA 1953 Part IVAAA

- FBTAA 1986 136(1)

- FBTAA 1986 136(1)(h)

Legislative references:

- ITAA 1936 26AC

ATO References

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