



Class Ruling

Income tax: tax treatment of payments to members of the Mechanical and Electrical Redundancy Trust

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① This publication provides you with the following level of protection:

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

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- paragraph (a) of the definition of an 'eligible termination payment' in subsection 27A(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 27F of the ITAA 1936;
- section 97 of the ITAA 1936; and
- section 99A of the ITAA 1936.

All subsequent legislative references are to the ITAA 1936 unless indicated otherwise.

Class of entities

3. The class of entities to which this Ruling applies is members of the Mechanical and Electrical Redundancy Trust (MERT).

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 13 to 31 of this Ruling.

6. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

8. This Ruling applies from 1 July 2000 to 30 June 2007. However, the Ruling continues to apply after this date to all entities within the specified class who entered into the specified scheme during the term of the Ruling, subject to there being no change in the scheme or in the entities involved in the scheme.

9. 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. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. If this Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

11. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

12. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

13. The following description of the scheme is based on information provided by the applicant.

14. MERT is an Australian resident trust fund governed by a trust deed (the Trust Deed), which established the fund in Australia. The central management and control of the fund is in Australia.

15. The trustee of MERT is MERT Pty Ltd (the Trustee), an Australian resident company.

16. MERT is an approved worker entitlement fund for fringe benefits tax (FBT) purposes.

17. Employers can fund member redundancy entitlements that they are required to make under a Deed of Adherence or Industrial Instrument for the benefit of employees through the payment of contributions to MERT.

18. MERT accepts contributions from employers, to fund each member's employee entitlements as provided in a Deed of Adherence or Industrial Instrument.

19. This minimum contribution rate in respect of each member employed or whose services are used by that employer is \$25 per week per member. Higher rates will usually be agreed by the industrial parties.

20. In accordance with clause 10 of the Trust Deed, all employer contributions made to MERT are credited to separate member (employee) accounts identifying contributions for that member.

21. This Class Ruling applies in respect of payments made under clause 27.1 of the Trust Deed.

22. Clause 27.1 provides for payments of a 'Redundancy Benefit' to the members of MERT. This clause states:

On a Member being made Redundant, the Trustee shall pay an amount not exceeding the Redundancy Benefit to the Member.

23. Redundancy is defined in clause 1.2 of the Trust Deed as:

'Redundancy' means, in relation to a Member, a situation where that Member's Employer has made a definite decision that the Employer no longer wishes the job the Member has been doing, done by anyone, and that decision leads to the termination of employment of that Member and Redundant has a corresponding meaning.

24. Redundancy Benefit is also defined in clause 1.2 of the Trust Deed as:

'Redundancy Benefit' means in respect of a Member, the whole of the amount standing to his or her Member Account.

25. Clause 28 of the Trust Deed provides for other payments to be made to the members of MERT. This clause states:

If a Member:

- (a) retires from the workforce on or after age 55;
- (b) suffers financial hardship during a period of unemployment;
- (c) dies;
- (d) becomes Totally and Permanently Disabled; or
- (e) leaves the Industry,

THEN, following receipt of an application from the Member or, if the Member is deceased, the spouse, dependents or the Legal Personal Representative (or, in the Trustee's discretion, the next of kin) of the Member and completion of whatever inquiries the Trustee considers necessary to ensure that the application is true and correct, the Trustee shall pay to the applicant the amount standing to the credit of the relevant Member Account less (in the Trustee's discretion) any amount paid by the relevant Employer (other than pursuant to statute) to the relevant Member or estate in respect of that event.

26. Therefore, under clauses 27.1 and 28, the Trustee distributes the capital to pay benefits to the member in consequence of the member's termination of employment.

27. A redundancy payment may be paid by the employer. Where the employer pays the member a redundancy payment directly, MERT will reimburse the employer for the amount paid to the particular member accordingly.

28. Payments from MERT under clauses 27.1 and 28 have been treated as eligible termination payments (ETPs) and subject to the relevant ETP tax rates (including Medicare levy), which have been deducted by the administrator of MERT. If an ETP is rolled over into the superannuation fund of a member, no tax is deducted by MERT.

29. This Class Ruling also applies to clause 10(c) of the Trust Deed whereby the Trustee has discretion to distribute net income of MERT to the individual members.

30. Members can transfer the benefits they have accumulated with another redundancy fund into MERT where permitted by the other fund.

31. In accordance with clause 10A members can transfer benefits to another redundancy fund that is an 'approved worker entitlement fund'.

Ruling

32. A payment made under terms of clauses 27.1 and 28 of the Trust Deed to a member of MERT is made 'in consequence of' the termination of the employment of the Member and constitutes an eligible termination payment (ETP) as defined under paragraph (a) of the definition of an ETP in subsection 27A(1).

33. It is not possible to conclude whether the termination of employment is by reason of the bona fide redundancy of the Member as required under paragraph 27F(1)(a) except on a case by case basis.

34. However, section 27F will not apply to a payment made under clause 27.1 of the Trust Deed. That is, a payment made in consequence of the dismissal of the Member from employment by reason of bona fide redundancy as the payment will not exceed the amount of an ETP that could reasonably be expected to have been made in relation to the member had they voluntarily retired from that employment at the termination time.

35. Where a distribution by the trustee of a share of net income of the trust is made to a member's account under clause 10(c) of the Trust Deed, it will be assessable income in the hands of the Member under subsection 97(1). Such a distribution to the employee would not be an ETP.

36. Trust income that is not distributed to a Member is assessable income of the trustee under section 99A.

Commissioner of Taxation

13 June 2007

Appendix 1 – Explanation

❶ *This Appendix 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.*

Eligible termination payment

37. An eligible termination payment (ETP) is defined in subsection 27A(1). There are a number of different payments that qualify as an ETP. One such payment is that made on termination of employment. Paragraph (a) of the definition of an ETP in subsection 27A(1) states in part:

'eligible termination payment', in relation to a taxpayer, means:

- (a) any payment made in respect of the taxpayer in consequence of the termination of any employment of the taxpayer other than a payment...

38. The phrase 'in consequence of' is not defined in the ITAA 1936. However, the words have been interpreted by the courts in several cases. The Commissioner has also issued Taxation Ruling TR 2003/13 which discusses the meaning of the phrase.

39. The Full High Court of Australia considered the expression 'in consequence of the termination of any employment' in *Reseck v. Federal Commissioner of Taxation* (1975) 49 ALJR 370; 6 ALR 642; 5 ATR 538; 75 ATC 4213; 133 CLR 45 (*Reseck*). The relevant issue in that case was whether amounts paid to a taxpayer by his employer at the end of two periods of employment, to which the taxpayer was entitled under an agreement between the employer and the taxpayer's union, was an allowance paid in a lump sum 'in consequence of retirement from, or the termination of, any office or employment ...'. Justice Gibbs concluded that the amounts were made in consequence of the termination of the taxpayer's employment. His Honour said that:

Within the ordinary meaning of the words, a sum is paid in consequence of the termination of employment when the payment follows as an effect or result of the termination ... It is not in my opinion necessary that the termination of the services should be the dominant cause of the payment ... In the present case the allowance was paid in consequence of a number of circumstances, including the fact that the taxpayer's service had been satisfactory and that the industrial agreements provided for the payment, but it was none the less paid in consequence of the termination of the taxpayer's employment.

40. Justice Jacobs also concluded that the amounts constituted an allowance that was paid in consequence of the termination of the taxpayer's employment. His Honour said:

It was submitted that the words 'in consequence of' import a concept that the termination of the employment was the dominant cause of the payment. This cannot be so. A consequence in this context is not the same as a result. It does not import causation but rather a 'following on'.

41. The different interpretations of 'in consequence of' adopted by Justices Jacobs and Gibbs were considered by the Full Federal Court in *McIntosh v. Commissioner of Taxation* (1979) 25 ALR 557; 10 ATR 13; 45 FLR 279; 79 ATC 4325. The matter before the court concerned a taxpayer who one week after retirement commuted part of the pension, to which he became entitled upon his retirement, into a lump sum. The commuted payment was made out of a provident fund established by a bank for the payment of benefits to bank officers on their retirement. The issue being considered by the court was whether the commuted lump sum payment came within former paragraph 26(d).

42. Justice Brennan considered the judgments of Justices Gibbs and Jacobs in *Reseck* and concluded that their Honours were both saying that a causal nexus between the termination and payment was required, though it was not necessary for the termination to be the dominant cause of the payment. Justice Brennan said that:

Though Jacobs J. speaks in different terms, his meaning may not be significantly different from the meaning of Gibbs J... His Honour denies the necessity to show that retirement is the dominant cause, but he does not allow a temporal sequence alone to suffice as the nexus. Though the language of causation often contains the seeds of confusion, I apprehend his Honour to hold the required nexus to be (at least) that the payment would not have been made but for the retirement.

43. In the same case, Justice Lockhart stated:

In my opinion, although the phrase is sufficiently wide to include a payment caused by the retirement of the taxpayer, it is not confined to such a payment. The phrase requires that there be a connection between the payment and the retirement of the taxpayer, the act of retirement being either a cause or an antecedent of the payment. The phrase used in section 26(d) is not 'caused by' but 'in consequence of'. It has a wider connotation than causation and assumes a connection between the circumstance of retirement and the act of payment such that the payment can be said to be a 'following on' of the retirement.

44. The Commissioner in TR 2003/13 considered the phrase 'in consequence of' as interpreted by the Courts. Paragraph 5 of TR 2003/13 states:

...the Commissioner considers that a payment is made in respect of a taxpayer in consequence of the termination of the employment of the taxpayer if the payment 'follows as an effect or result of' the termination. In other words, but for the termination of employment, the payment would not have been made to the taxpayer.

45. The question of whether a payment is made in consequence of the termination of employment will be determined by the relevant facts and circumstances of each case.

46. Clause 27.1 of the Trust Deed of the MERT provides for the payment of an amount not exceeding the 'Redundancy Benefit' to the Member on the Member being made redundant. The term 'redundancy' is defined under clause 1.2 of the Trust Deed as:

'Redundancy' means, in relation to a Member, a situation where that Member's Employer has made a definite decision that the Employer no longer wishes the job the Member has been doing, done by anyone, and that decision leads to the termination of employment of that Member and 'Redundant' has a corresponding meaning.

47. Payments may also be made pursuant to clause 28 of the Trust Deed if a Member:

- retires from the workforce on or after 55;
- suffers financial hardship during a period of unemployment;
- dies;
- becomes Totally and Permanently Disabled; or
- leaves the Industry.

48. It is considered that there is sufficient nexus between the making of the payments under either clause 27.1 or 28 and the termination of the relevant Member's employment to characterise the payments as ETPs as defined under paragraph (a) of the definition of an ETP in subsection 27A(1).

Bona fide redundancy payment

49. Section 27F of the ITAA 1936 provides for certain termination payments to be concessionally taxed as a bona fide redundancy payments (BFRPs) provided they meet all of the following requirements:

- there must be an ETP made in relation to a taxpayer in consequence of the dismissal of the taxpayer from employment by reason of the taxpayer's bona fide redundancy (paragraph 27F(1)(a));
- if the ETP is made after 1 July 1994, it must not be made from an eligible superannuation fund (paragraph 27F(1)(aa));
- the time of termination must be before the date that the taxpayer attains 65 years of age, or such earlier date on which the taxpayer's employment would necessarily have had to terminate under the terms of employment (paragraph 27F(1)(b));
- the amount of the ETP must not be greater than the amount that could reasonably be expected to have been paid if the employer and the taxpayer had been at arm's length (paragraph 27F(1)(c)); and

- there must not be, at the termination time, any agreement between the taxpayer and the employer, or between the employer and another person, to employ the taxpayer after the termination time (paragraph 27F(1)(d)).

50. Additionally, where all of the above requirements are met, section 27F imposes a further requirement that only so much of the ETP as exceeds the amount of an ETP 'that could reasonably be expected to have been made in relation to the taxpayer had he voluntarily retired from that employment at the termination time will be treated as a BFRP in relation to the taxpayer'.

51. The terms 'dismissal' and 'redundancy' are not defined in the ITAA 1936. Therefore, it is necessary to consider the common law or ordinary meaning of the terms and the meaning the judicial authorities have ascribed to each word.

52. The Explanatory Memorandum (the EM) to the Income Tax Assessment Amendment Bill (No. 3) 1984 which inserted section 27F into the ITAA 1936 states at page 91:

The terms 'dismissal' and 'redundancy' are not defined in the legislation and, therefore, should be given their ordinary meanings. 'Dismissal' carries with it the concept of the involuntary (on the taxpayer's part) termination of employment. 'Redundancy' carries the concept that the requirements of the employer for employees to carry out work of a particular kind, or for employees to carry out work of a particular kind in the place where they were so employed, have ceased or diminished or are expected to cease or diminish. Redundancy, however, would not extend to the dismissal of an employee for personal or disciplinary reasons or for reasons that the employee was inefficient.

53. Taxation Ruling TR 94/12, which outlines the Commissioner's view of the requirements for a payment to qualify as a bona fide redundancy payment under section 27F expands upon and provides additional clarification as to what constitutes a 'dismissal' and 'redundancy'.

35. *Dismissal* carries with it the concept of the involuntary (on the employee's part) termination of employment. The termination of an employee's employment will usually be instigated or initiated by the employer.

...

40. Dismissal also includes the notion of constructive dismissal. Constructive dismissal arises if an employer places an employee in a position in which the employee has little option but to tender his or her resignation. For example, the employer may be reducing the size of his or her operations and may offer a voluntary redundancy package to a selected employee. If the employee refuses the offer he or she may be forced to accept another position which may not be commensurate with his or her qualifications and experience or may involve a lower level of remuneration...The termination of employment in these circumstances would amount to a constructive dismissal.

54. Paragraphs 41 to 42 of TR 94/12 provide the following in relation to the meaning of redundancy:

41. Redundancy can be described as the situation where an employer no longer requires employees to carry out work of a particular kind or to carry out work of a particular kind at the same location. Bray CJ in *R v. The Industrial Commission of South Australia; ex parte Adelaide Milk Supply Co-operative Ltd & Ors* (1977) 44 SAIR 1202 at page 1205; (1977) 16 SASR 6 at page 8 defined redundancy as follows:

'... a job becomes redundant when an employer no longer desires to have it performed by anyone. A dismissal for redundancy seems to be a dismissal, not on account of any act or default of the employee dismissed or any consideration peculiar to him, but because the employer no longer wishes the job the employee has been doing to be done by anyone.'

42. Redundancy refers to a job becoming redundant and not to an employee becoming redundant (*Short v F W Hercus Pty Ltd* (1993) 40 FCR 511; (1993) 46 IR 128; (1993) 35 AILR 151). An employee's job is considered to be redundant if:

- an employer has made a definite decision that the employer no longer wishes the job the employee has been doing to be done by any one;
- that decision is not due to the ordinary and customary turnover of labour;
- that decision led to the termination of the employee's employment; and
- that termination of employment is not on account of any personal act or default of the employee.

55. As noted above, clause 27.1 of the MERT Trust Deed provides for the payment of an amount not exceeding the 'Redundancy Benefit' to the Member on the Member being made redundant. The term 'redundancy', which is defined in clause 1.2 of the Trust Deed, corresponds with the meaning ascribed in paragraphs 41 and 42 of TR 94/12.

56. Consequently, the first requirement under paragraph 27F(1)(a) would be satisfied.

57. The MERT is not an eligible superannuation fund so the second requirement under paragraph 27F(1)(aa) would be satisfied.

58. It is not possible to conclude whether or not the other three requirements under paragraphs 27F(1)(b), (c) and (d) would be satisfied. This would have to be determined by the relevant facts and circumstances of each case.

59. Even if these requirements are satisfied, only so much of the ETP as exceeds the amount of an ETP 'that could reasonably be expected to have been made in relation to the taxpayer had he voluntarily retired from that employment at the termination time will be treated as a BFRP in relation to the taxpayer'. This then raises the question as to whether the 'redundancy payment' under clause 27.1 of the Trust Deed satisfies this further requirement.

60. As already noted clause 27.1 of the Trust Deed provides for the payment of an amount not exceeding the 'Redundancy Benefit' to the Member on the Member being made redundant. The term 'Redundancy Benefit' is defined under clause 1.2 of the Trust Deed as:

'Redundancy Benefit' means in respect of a Member, the whole of the amount standing to his or her Member Account.

61. However, as has also already been noted, clause 28 of the Trust Deed provides for payments to be made to a Member for various events including retirement from the workforce on or after age 55, leaving the industry, financial hardship during a period of unemployment, etc.

62. The payment made under clause 28 is:

the amount standing to the credit of the relevant Member Account less (in the Trustee's discretion) any amount paid by the relevant Employer (other than pursuant to statute) to the relevant Member or estate in respect of that event.

63. This means that, for example, where an employee of a participating employer resigns and leaves the Industry, that employee would receive the balance of their Member Account.

64. Consequently, no part of the 'Redundancy Benefit' payable under clause 27.1 would exceed the amount of an ETP 'that could reasonably be expected to have been made in relation to the taxpayer had he voluntarily retired from that employment at the termination time'. Thus, there will not be a BFRP in relation to the Member.

65. The 'Redundancy Benefit' payable under clause 27.1 of the Trust Deed will, to the extent that it does not include a distribution of a share of the net income of the trust estate, be assessable income of the recipient under sections 27B and 27C.

Section 97 income

66. The main provisions of the ITAA 1936 which relate to trust income are found in Division 6 of Part III. In broad terms the purpose of Division 6 is to tax trust income in the year of income in which it is derived by the trust at the level of either trustee or beneficiary.

67. The taxing point of a trust depends on whether the beneficiary is or is not presently entitled and where present entitlement exists, whether the beneficiary is under a legal disability. Generally, the trustee will be taxed on income it retains.

68. When the trustee of MERT decides to make a trust distribution to members in accordance with clause 10(c) of the Trust Deed, the income available for distribution is divided amongst members in proportion to the member's account balances (subject to a minimum balance requirement). A member is presently entitled to the amount that the Trustee of MERT distributes to them.

69. Subsection 97(1) provides that where a beneficiary of a trust estate who is not under any legal disability and is presently entitled to a share of the net income of the trust estate, the assessable income of the beneficiary shall include:

- (a) so much of that share of the net income of the trust estate as is attributable to a period when the beneficiary was a resident, and
- (b) so much of that share of the net income of the trust estate as is attributable to a period when the beneficiary was not a resident and is also attributable to sources in Australia.

70. Under section 97 members of MERT (except those under a legal disability) are required to include the amount of MERT net income distributed to them in their assessable income. The distribution should be included in the income year that present entitlement arises. Present entitlement will arise upon the declaration of the distribution by the MERT Trustee. Such a distribution to the employee is assessable income and not an ETP.

71. If the income of MERT is not distributed to the members, but is accumulated by the trustee, the trustee will be assessed on the undistributed income under section 99A.

Appendix 2 – Detailed contents list

72. The following is a detailed contents list for this Ruling:

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 94/12; TR 2003/13

Subject references:

- bona fide redundancy payments
- distributions
- eligible termination payments
- ETP components
- income distributions
- present entitlement
- superannuation
- superannuation, retirement and employment termination
- trust beneficiaries
- trust distributions
- trust income
- trusts

Legislative references:

- ITAA 1936 26(d)
- ITAA 1936 27A(1)
- ITAA 1936 27B
- ITAA 1936 27C
- ITAA 1936 27F
- ITAA 1936 27F(1)(a)
- ITAA 1936 27F(1)(aa)
- ITAA 1936 27F(1)(b)
- ITAA 1936 27F(1)(c)
- ITAA 1936 27F(1)(d)
- ITAA 1936 Pt III Div 6
- ITAA 1936 97

- ITAA 1936 97(1)

- ITAA 1936 99A

- TAA 1953

- TAA 1953 Sch 1 357-75(1)

- Copyright Act 1968

Case references:

- AAT Case 4287 (1988) 19 ATR 3443; Case V67 88 ATC 505
- McIntosh v. Commissioner of Taxation (1979) 25 ALR 557; 10 ATR 13; 45 FLR 279; 79 ATC 4325
- R v. Industrial Commission (SA); Ex parte Adelaide Milk Supply Co-op Ltd (1977) 16 SASR 6; (1977) 19 AILR; (1977) 44 SAIR 1202
- Reseck v. Federal Commissioner of Taxation (1975) 49 ALJR 370; (1975) 6 ALR 642; (1975) 5 ATR 538; (1975) 75 ATC 4213; (1975) 133 CLR 45
- Short v. F W Hercus Pty Limited (1993) 40 FCR 511; (1993) 35 AILR 151; (1993) 46 IR 128

Other references:

- Explanatory Memorandum to the Income Tax Assessment Amendment Bill (No. 3) 1984

ATO references

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