

TAXATION RULING NO. IT 2152

INCOME TAX : RETIRING ALLOWANCES PAID TO EMPLOYEES UPON
RESTRUCTURING OF A BUSINESS

F.O.I. EMBARGO: May be released

REF

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SUBJECT REFS:

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RETIRING ALLOWANCES:

RESTRUCTURING OF

EMPLOYER'S BUSINESS

78(1)(c)

LUMP SUM PAYMENTS:

TERMINATION OF

EMPLOYMENT

OTHER RULINGS ON TOPIC IT 2021

PREAMBLE

This ruling discusses the decision of the Federal Court in Paklan Pty Ltd and others v. FCT (1983) 14 ATR 457, 83 ATC 4456. The purpose of the ruling is to provide a basis for resolution of outstanding disputes in similar cases.

FACTS

2. Freeman, Jones and Parkhill were directors of a company which carried on a business of consulting civil and structural engineers. Each was involved with the day to day conduct of the company's affairs.

3. On 30 June 1977 the company ceased carrying on business as consulting engineers. The business was taken over by another company controlled by the same principals. The new company took over the partly performed contracts, staff, etc. and carried on the business of consulting engineers previously conducted by Paklan Pty Ltd. The new company being trustee of a unit trust for the benefit of the directors' families.

4. At first instance Kaye J found that the directors ceased employment with Paklan Pty Ltd on 30 June 1977 and that outstanding fees had been recovered by 28 February 1978. He further found that in the first half of 1978 the Board of Paklan Pty Ltd decided to pay out \$40,000 to the directors as retiring sums, although initially described as salaries. Payment was effected nearly one year after the company ceased carrying on business as consulting engineers.

5. Kaye J found, inter alia, that the termination of employment was not the occasion of the payments by Paklan Pty Ltd. The taxpayers had failed to prove that the sums described as "retiring sums" were paid in consequence of the termination of the directors' employment with the company.

6. The Supreme Court having dismissed the appeals, the taxpayers appealed to the Federal Court.

7. The Federal Court decided, inter alia:-

- (a) payments by the company to the directors were assessable in full under paragraph 26(e) in the hands of the directors;
- (b) the payments were not deductible under section 51; and
- (c) (by majority) the payments by the company were deductible under paragraph 78(1)(c) and the matter was remitted to the Commissioner to form the opinion as to the extent the payments came within the terms of paragraph 78(1)(c).

8. The decision of the Federal Court has been accepted and the case before the Court has been finally resolved by the parties.

RULING

9. Where a company or other employer ceases carrying on a business which has been transferred to an associated entity, it will be accepted that the employees of the company have had their employment terminated. This will apply in cases similar to the Paklan Case where it is clear that the business in question has been transferred to another entity and it is also clear that the employee's employment has, in fact, been terminated (see Case Q118 83 ATC 610, Case 46 27 CTBR(NS) 312). This situation is to be distinguished from the category of cases dealt with in Taxation Ruling IT No 200 which is not altered by this Ruling. It should also be noted that in the Paklan case the directors were assessed under paragraph 26(e) and those assessments were confirmed by the Federal Court because of the particular facts of the case. This will not be the situation in other cases because of different factual circumstances so that paragraph 26(d) will be the appropriate provision. Sub-Division AA, Division 2 of Part III of the Act will apply to retiring allowances derived on or after 1 July 1983.

10. Whether or not a particular payment qualifies for deduction under paragraph 78(1)(c) can only be determined at the time of payment in the light of all the relevant factors applying in each case. In exercising the discretion in the paragraph regard should be had to factors such as the terms of employment, length of service, level of remuneration during the period of service, any other benefits to which the retiring employee may have become entitled, the reason for the payment and any other factors relevant to the circumstances of the particular case.

11. As a general rule, the allowable deduction available to private companies should be confined to an amount which when aggregated with any payment from or interest in a superannuation fund would not exceed the maximum amount permitted in the

Commissioner's lump sum guidelines on superannuation funds. Extra care will be necessary in dealing with cases where the employee enjoys portability rights so that he does not receive any payment in respect of the subject termination of employment, from a superannuation fund.

12. However, when a decision has to be made under paragraph 78(1)(c), or section 109, it is not a sufficient exercise of the discretionary power to simply apply the formula. The decision must take into account the circumstances of the case. There may well be cases, especially in respect of an employee at arm's length from the proprietors of a private company, where a payment in excess of the amount specified in the superannuation guidelines would be the proper deduction for the purposes of paragraph 78(1)(c).

COMMISSIONER OF TAXATION

11 April 1985

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