CR 2001/41 - Income tax: Approved Early Retirement Scheme - South Australian Water Corporation

Class Ruling
Income tax: Approved Early Retirement Scheme - South Australian Water Corporation

Contents Para

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 dealt with in this Ruling is section 27E of the *Income Tax Assessment Act 1936.*

Class of persons

3. The class of persons to whom this Ruling applies is

- all employees of the South Australian Water Corporation who have been declared surplus,

and who receive a payment under the Targeted Voluntary Separation Package (TVSP) described below in paragraphs 10 to 26.

An employee is considered to be surplus when they become excess to requirements either as a result of contracting out initiatives or because their position is no longer required. They may either be redeployed or invited to request an offer of a separation package.

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 10 to 26 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(b) this Ruling may be withdrawn or modified.

7. A Class Ruling may only be reproduced in its entirety. Extracts may not be reproduced. Because each Class Ruling is subject to copyright, except for any use permitted under the Copyright Act 1968 no Class Ruling may be reproduced by any process without prior written permission from the Commonwealth. Requests and enquiries concerning reproduction and rights should be sent to:

The Manager

Legislative Services, AusInfo

GPO Box 1920

CANBERRA ACT 2601.

Date of effect

8. This Ruling applies from 29 August 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 92/20).

Withdrawal

9. This Ruling is withdrawn and ceases to have effect after 30 June 2002. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

The Scheme

10. 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:

- correspondence from the South Australian Water Corporation dated 22 February 2001;
- correspondence from the South Australian Water Corporation dated 6 July 2001.

11. The South Australian Water Corporation is seeking the Commissioner of Taxation's approval to implement a Targeted Voluntary Separation Package (TVSP) as an early retirement scheme under section 27E of the *Income Tax Assessment Act 1936*.

12. The scheme is offered to all employees of the South Australian Water Corporation who have been declared surplus.

13. An employee is declared surplus where they become excess to requirements either as a result of contracting out initiatives or because the position is no longer required. They may either be redeployed or invited to request an offer of a separation package.

14. Casual, fixed or defined term employees, and employees engaged by the South Australian Water Corporation from outside the South Australian Public Sector after 16 December 1999 are not eligible to participate in the scheme.

15. The scheme is designed to assist the South Australian Water Corporation in the management of employees declared excess to their business needs. The identified purpose is to ethically achieve a net workforce reduction.

16. Refusal by the South Australian Water Corporation of an employees offer to accept a TVSP is limited only to circumstances where the person's skills are essential to the ongoing operation of the South Australian Water Corporation.

17. The enterprise agreement is 18 months and the South Australian Water Corporation request that approval be granted for the period of the enterprise agreement.

18. The calculation of a TVSP is based on staged levels of payment depending on separation date and time spent by the employee pursuant to the redeployment policy:

TVSP entitlements detailed below are available to employees only for the periods of time (Stages) specified. Stage 1 entitlement commences immediately from when an employee is advised that they are 'surplus to requirements' and that a TVSP is available to them. All stages of entitlement are continuous and consecutive in operation.

Stage 1: Where an employee accepts an offer of a TVSP within six (6) weeks of the South Australian Water Corporation notifying them that they are surplus to requirements and that a TVSP is available to them, and leaves their employment within that six (6) week period, the employee will be paid:

(i) $10 000 and

(ii) a minimum further payment of eight (8) weeks pay plus three (3) weeks pay for each year of completed service to a maximum payout of 104 weeks pay.

Stage 2: Where an employee is not entitled to Stage 1 separation package but accepts a TVSP and leaves their employment within twenty (20) weeks of the South Australian Water Corporation initially notifying them that they are excess to requirements and that a TVSP is available to them, the employee will be paid a minimum payment of eight (8) weeks plus three (3) weeks pay for each completed year of service to a maximum payout of 104 weeks pay.

Stage 3: Where an employee is not entitled to a Stage 1 or Stage 2 separation package, but accepts a TVSP and leaves their employment within fifty two (52) weeks of the South Australian Water Corporation initially notifying them that they are excess to requirements and that a TVSP is available to them, the employee will be paid a minimum payment of eight (8) weeks pay plus two (2) weeks pay for each completed year of service to a maximum payout of 104 weeks pay.

The amount arrived at after applying the formula for the appropriate Stage is referred to as the "separation package".

Part-time employees:

where an employee has worked part-time for any period of at least one calender month at any stage during their "years of service" (irrespective of whether there have been any breaks in service or not) their service is converted to "Full-Time Equivalent Service" so as to take into account their part-time service. To calculate the TVSP payment, Full-Time Equivalent Service (expressed as a percentage of the employee's total year of service) is multiplied by the employee's full-time equivalent week's pay.

19. The following formula is used for Stage 1, Stage 2, and Stage 3 TVSPs

(8 + [x YS]) x (FTES x WP) = SP

where:

WP = Weeks Pay

YS = Years of Service

FTES = Full-Time Equivalent Service

SP = Separation package

Payments made under the Scheme

20. For a payment made under the above mentioned scheme to qualify as an approved early retirement scheme payment, the following conditions must be met. Please note, any payment made under the scheme that does not satisfy these requirements is not covered by this Ruling.

21. The payment must be an eligible termination payment (ETP) made in relation to the employee in consequence of his or her employment being terminated under the approved early retirement scheme.

22. The payment must not be made from an eligible superannuation fund.

23. The payment must not be made in lieu of superannuation benefits.

24. The employee terminated his or her employment before the earlier of:

- Age 65; or
- The date on which his or her employment would have necessarily terminated under the terms of employment because of the taxpayer attaining a certain age or completing a certain period of service.

25. Where the employee and the employer are not dealing with each other 'at arm's length' (for example, because they are related in some way), the payment does not exceed what would have been paid to the employee had they been dealing at arm's length.

26. At the termination time, there is no agreement in force between the employee and the employer or the employer and another person, to re-employ the employee after the date of termination.

Ruling

27. The Targeted Voluntary Separation Package offered by the South Australian Water Corporation is an approved early retirement scheme for the purposes of section 27E of the *Income Tax Assessment Act 1936*.

28. Accordingly, so much of the eligible termination payment (ETP) as exceeds the amount of an ETP that could reasonably be expected to have been made in relation to the taxpayer if the termination of employment had occurred at the termination time otherwise than in accordance with the approved early retirement scheme, is an approved early retirement scheme payment in relation to the taxpayer.

Explanations

29. Where a scheme satisfies the requirements of section 27E of the *Income Tax Assessment Act 1936* (the Act) that scheme will be an 'approved early retirement scheme.'

30. The Commissioner of Taxation (the Commissioner) has issued Taxation Ruling TR 94/12 titled: 'Income tax: approved early retirement scheme and bona fide redundancy payments' which sets out guidelines on the application of section 27E.

31. Paragraph 14 of TR 94/12 states that:

'Three conditions need to be satisfied for a scheme to qualify as an approved early retirement scheme. Those conditions are:

(i) the scheme must be offered to all employees within a class identified by the employer (paragraph 27E(1)(a));

(ii) the scheme must be entered into with a view to rationalising or re-organising the operations of the employer with an identified purpose in mind (paragraph 27E(1)(b)); and

(iii) the scheme must be approved by the Commissioner prior to its implementation (paragraph 27E(1)(c)).'

1. The scheme must be offered to all employees within a class identified by the employer.

32. In order to satisfy the first condition, the scheme must be offered to all employees within one of the categories specified in subparagraphs 27E(1)(a)(i) to (v).

33. The class of employees to whom the scheme is proposed to be offered is:

- all employees of the South Australian Water Corporation who have been declared surplus.

34. This class of employees does not come within any of subparagraphs 27E(1)(a)(i) to (iv), therefore it must be considered under subparagraph 27E(1)(a)(v), namely, all employees of the employer who constitute a class of employees approved by the Commissioner for the purposes of this paragraph. In approving this class of employees the Commissioner has considered the nature of the rationalisation or re-organisation of the operations of the employer. It is therefore considered that these employees meet the requirements of an approved class of employees for the purposes of subparagraph 27E(1)(a)(v).

35. It is noted, however that the South Australian Water Corporation retains a limited right of veto to be applied to applications by key personnel who cannot be readily replaced and whose loss would impair the efficiency of the South Australian Water Corporation business operations. The limitation of the scheme in this way is acceptable to the Commissioner.

2. The scheme must be entered into with a view to rationalising or re-organising the operations of the employer with an identified purpose in mind

36. The proposed scheme must be implemented with a view to rationalise or re-organise the operations of the employer by means of one or more of the objectives set out in subparagraphs 27E(1)(b)(i) to (vi).

37. The purpose of the scheme is to assist the South Australian Water Corporation in the management of employees declared excess to their business needs. The proposed scheme meets the requirements set out in subparagraph 27E(1)(b)(vi). Accordingly the second condition for approval has been met.

3. The scheme must be approved by the Commissioner prior to its implementation

38. The scheme is proposed to operate for a period from 20 January 2001 to 30 June 2002. Since the implementation date has already passed, the scheme fails to meet the requirement of paragraph 27E(1)(c).

39. However, subsection 27E(2) allows the Commissioner to overlook the failure to comply with any of the three conditions if special circumstances exist in relation to the scheme. South Australian Water Corporation had previously received approval for an early retirement scheme on 20 January 2000. This approval operated to 19 January 2001. South Australian Water Corporation initially applied for an extension of the 19 January 2001 finishing date however as there is no discretion in section 27E to extend the date, a new approval was required. This caused delays in the processing of the application.

40. It is considered that this case falls within special circumstances as set out in subsection 27E(2), and the Commissioner will waive compliance with the third requirement of subsection 27E(1).

41. The scheme will be in operation for approximately 18 months. Although this is outside the period, of 12 months, recommended in paragraph 28 of TR 94/12, it is considered that the scheme should remain open for the requested period to enable the desired objective to be attained.

Other relevant information

42. Under section 27E, so much of the payment received by a taxpayer under the approved early retirement scheme, that exceeds the amount that would ordinarily have been received on voluntary retirement or resignation is an approved early retirement scheme payment.

43. It should be noted that, in order for a payment to qualify as an approved early retirement scheme payment, it must also satisfy the following requirements (as set out in subsections 27E(4) and (5) of the Act):

- the payment must be an ETP made in relation to the taxpayer in consequence of the taxpayer's employment being terminated under an approved early retirement scheme;
- the payment must not be from an eligible superannuation fund;

- the payment must not be made in lieu of superannuation benefits;
- if the taxpayer and the employer are not dealing with each other at arm's length (for example, because they are related in some way) the payment does not exceed what would have been paid to the taxpayer had they been dealing at arm's length;
- the date of termination was before age 65 or such earlier date on which the taxpayer's employment would necessarily have had to terminate under the terms of employment because of the taxpayer attaining a certain age or completing a certain period of service, whichever occurs first; and
- there was no agreement at the date of termination between the taxpayer and the employer, or the employer and another person to re-employ the taxpayer after the date of termination.

44. The term 'agreement' is defined in subsection 27A(1) as meaning 'any agreement, arrangement or understanding whether formal or informal, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings.'

45. An approved early retirement scheme payment made on or after 1 July 1994 that falls within the specified limits will be exempt from income tax, and called the "tax-free amount."

46. For the year ending 30 June 2001, the tax-free amount is limited to $5062 plus $2531 for each whole year of completed employment service to which the approved early retirement scheme payment relates. The tax free amount for the year ending 30 June 2002 is limited to $5 295 plus $2 648 for each whole year of completed employment service to which the approved early retirement scheme payment relates. Please note that 6 months, 8 months or even 11 months do not count as a whole year for the purposes of this calculation. The $5 295 and $2 648 limits will be indexed to rise in each subsequent year in line with increases in average weekly ordinary time earnings.

47. Furthermore, the tax-free amount will:

- not be an ETP;
- not be able to be rolled-over;
- not include any amount from a superannuation fund or paid in lieu of a superannuation benefit; and
- not count towards the recipient's Reasonable Benefit Limit.

48. Any payment in excess of this limit will be an ordinary ETP and split up into the pre-July 83 and post-June 83 (untaxed element) components. This ETP can be rolled-over.

49. It should be noted that the amount of an approved early retirement scheme payment that is over the tax-free amount may be subject to the provisions of the superannuation surcharge legislation, whether it is taken in cash or rolled-over.

50. The following payments qualify as an approved early retirement scheme payment and are exempt from tax within the limits described above:

- payments in accordance with paragraph 18 of this ruling including payments to part time employees calculated in accordance with paragraph 19.

51. A copy of this Ruling must be given to all employees eligible to participate in the approved early retirement scheme.

Detailed contents list

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

Commissioner of Taxation
29 August 2001

Previous draft:
Not previously issued in draft form

Related Rulings/Determinations:
CR 2001/1; TR 92/1; TR 92/20; TR 97/16; TR 94/12; TR 94/12E

Subject references:
- approved early retirement scheme payments;
- eligible termination payments;
- eligible termination payment components

Legislative references:
- ITAA 1936 27A(1)
- ITAA 1936 27E
- ITAA 1936 27E(1)
- ITAA 1936 27E(1)(a)
- ITAA 1936 27E(1)(a)(i)
- ITAA 1936 27E(1)(a)(ii)
- ITAA 1936 27E(1)(a)(iii)
- ITAA 1936 27E(1)(a)(iv)
- ITAA 1936 27E(1)(a)(v)
- ITAA 1936 27E(1)(b)
- ITAA 1936 27E(1)(b)(i)
- ITAA 1936 27E(1)(b)(ii)
- ITAA 1936 27E(1)(b)(iii)
- ITAA 1936 27E(1)(b)(iv)
- ITAA 1936 27E(1)(b)(v)
- ITAA 1936 27E(1)(b)(vi)
- ITAA 1936 27E(1)(c)
- ITAA 1936 27E(2)
- ITAA 1936 27E(4)
- ITAA 1936 27E(5)

ATO References:
NO T2001/14069
FOI number: I 1023132
ISSN: 1445 2014