



CR 2003/79 - Income tax: Approved Early Retirement Scheme - Loy Yang Power Management Pty Ltd

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Class Ruling

Income tax: Approved Early Retirement Scheme - Loy Yang Power Management Pty Ltd

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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.
2. Broadly, this Ruling approves the particular early retirement scheme and acknowledges the availability of tax concessions for persons receiving payments under the scheme. There are many conditions attached to this Ruling and readers should be careful to ensure that these conditions are met before relying on this Ruling.

Tax law(s)

3. The tax laws dealt with in this Ruling are sections 27E and 27CB of the *Income Tax Assessment Act 1936* (ITAA 1936).

Class of persons

4. The class of persons to which this Ruling applies is all employees of Loy Yang Power Management Pty Ltd who receive a payment under the arrangement described below in paragraphs 13 to 30.

Qualifications

5. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

6. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the arrangement described below at paragraphs 13 to 30 in this Ruling.

7. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling:

- 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- b) this Ruling may be withdrawn or modified.

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

Date of effect

10. This Ruling applies from 1 September 2003 unless and until it is withdrawn (see paragraph 12 of this Ruling). However, this 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 this Ruling (see paragraphs 21 to 22 of Taxation Ruling TR 92/20). Furthermore this Ruling applies to the extent that the relevant tax laws are not amended.

Previous Class Ruling

11. The tax benefits set out in Class Ruling CR 2002/87 continue to apply to participants who are within the specified class of person to which the Ruling applied and who entered into the arrangement between 13 December 2002 and 31 August 2003. This ruling applies

to the same arrangement and applies to participants who enter into the arrangement between 1 September 2003 and 31 December 2003.

Withdrawal

12. This Ruling is withdrawn and ceases to have effect after 31 December 2003. 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

13. 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 Loy Yang Power Management Pty Ltd;
- record of telephone conversation with a representative of Loy Yang Power Management Pty Ltd on 22 November 2002;
- correspondence from Loy Yang Power Management Pty Ltd on 22 November 2002;
- correspondence from Loy Yang Power Management Pty Ltd on 3 December 2002;
- record of telephone conversation with a representative of Loy Yang Power Management Pty Ltd on 5 December 2002; and
- correspondence from Loy Yang Power Management Pty Ltd on 7 August 2003.

14. Loy Yang Power Management Pty Ltd is seeking approval for an early retirement scheme.

15. The electricity industry within Victoria has undergone significant restructuring commencing in the late 1980s with the outsourcing of non-core functions followed by privatisation of the core functions.

16. Loy Yang Power Management Pty Ltd was purchased by a partnership effective from 12 May 1997 with personnel transferring to Loy Yang Power Management Pty Ltd from other employers as of that date.

17. Shortly after privatisation Loy Yang Power Management Pty Ltd was granted an approved early retirement scheme which operated from 29 September 1997 until 31 December 1998 which although resulting in some downsizing did not achieve the restructuring targets envisaged at that time. A further approved early retirement scheme which operated from 12 November 2001 until 28 February 2002 resulted in some further downsizing but did not achieve what is considered the optimal workforce size.

18. Downsizing which has previously occurred with Loy Yang Power Management Pty Ltd has been a result of significant cross skilling and job redesign and it is proposed that this process should continue together with the consideration of outsourcing options in order to achieve the personnel reductions sought. Given the significant changes already achieved it is anticipated that negotiation with appropriate unions regarding job redesign and retraining will take some time.

19. Loy Yang Power Management Pty Ltd intends to invite offers from all employees.

20. Loy Yang Power Management Pty Ltd pursues a policy that it will not enter into agreements or guarantees of employment with either third parties or employees wishing to take a voluntary departure package.

21. If an employee in a key position applies for an early retirement package, Loy Yang Power Management Pty Ltd will retain the right of veto in respect of that key employee.

22. The voluntary departure package to be paid to employees who accept voluntary retirement as a result of the early retirement scheme is as follows:

- a) separation payment of two (2) weeks pay for each year of completed continuous service and pro-rata for part years;
- b) a lump sum sign on payment of \$40,000;
- c) six months salary as a lump sum; and

- d) if no sick leave is taken from the date of commencement of the early retirement scheme until the agreed departure date an additional \$5,000 will be paid.

23. The employees will also receive the following payments but these do not form part of the approved early retirement scheme payment:

- a) payment of accrued and pro-rata recreation leave;
- b) payment of accrued long service leave; and
- c) superannuation payment.

Payments made under the Scheme

24. For a payment made under the above mentioned scheme to qualify as an approved early retirement scheme payment, the conditions set out in paragraphs 25 to 30 must be met. Please note that any payment made under the scheme that does not satisfy these requirements is not covered by this Ruling.

25. 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.

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

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

28. 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.

29. 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.

30. 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

31. The early retirement scheme offered by Loy Yang Power Management Pty Ltd is an approved early retirement scheme for the purposes of section 27E of the *Income Tax Assessment Act 1936*.

32. Accordingly, 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 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.

33. In addition, so much of the approved early retirement scheme payment as falls within the threshold calculated in accordance with subsection 27A(19) of the ITAA 1936 is non-assessable and is ignored in working out whether a capital gain has been made via the operation of section 27CB of the ITAA 1936.

Explanations

34. Where a scheme satisfies the requirements of section 27E of the ITAA 1936 that scheme will be an 'approved early retirement scheme.'

35. 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.

36. 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

37. 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).

38. The class of employees to which the scheme is proposed to be offered is:

- all employees in Loy Yang Power Management Pty Ltd.

39. This class of employees is considered to have met the requirements of subparagraph 27E(1)(a)(i), that is, all employees of the employer.

40. It is noted, however, that Loy Yang Power Management Pty Ltd 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 Loy Yang Power Management Pty Ltd's 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

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

42. Paragraphs 15 to 18 describe the nature of the rationalisation or re-organisation of Loy Yang Power Management Pty Ltd's operations. The proposed scheme meets the requirements set out in subparagraphs 27E(1)(b)(i) and (iii). The proposed scheme also meets the requirements set out in subparagraph 27E(1)(b)(vi). In approving the objectives of the scheme, the Commissioner has had regard to the fact that the re-organisation is being implemented with a view to a restructuring of the work force or operations of the employer. It is therefore considered that the scheme is to be implemented by the employer with a view to rationalising or re-organising the operations of the employer for the purposes of 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*

43. The scheme is proposed to operate for a period from 13 December 2002 to 31 December 2003. Since the implementation date has already passed, the scheme fails to meet the requirement of paragraph 27E(1)(c).

44. 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. Paragraph 30 of TR 94/12 states:

‘Special circumstances include circumstances where: a scheme is implemented before approval has been obtained because, for example, there has been a delay in processing an application made for its approval....’

45. Based on the full circumstances of the application 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).

46. The scheme will be in operation for less than 13 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

47. 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 resignation or retirement is an approved early retirement scheme payment.

48. 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.

49. 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.'

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

51. For the year ending 30 June 2004, the tax-free amount is limited to \$5,882 plus \$2,941 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.

52. The total of the amount received on termination calculated in accordance with paragraph 22 qualifies as an approved early retirement scheme payment.

53. The total of the payments in the previous paragraph will be measured against the limit calculated in accordance with paragraph 51 to determine the 'tax-free amount'.

54. 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.

55. 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.

56. 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.

Detailed contents list

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Commissioner of Taxation

3 September 2003

Previous draft:

Not previously released in draft form.

Previous Rulings:

CR 2002/87

Subject references:

- approved early retirement scheme payments
 - eligible termination payments
 - eligible termination payments components

Related Rulings/Determinations:

TR 92/1; TR 92/20; TR 94/12;
 TR 97/16; CR 2001/1

Legislative references:

- TAA 1953 Pt IVA
 - ITAA 1936 27A(1)
 - ITAA 1936 27A(19)
 - ITAA 1936 27CB

- 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)
 - Copyright Act 1968

ATO references

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