



CR 2004/142 - Income tax: Eligible Termination Payment - The NSW Department of Commerce sale of cmSolutions and Q Stores - Transfer of Employment Agreements 2004

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 This document has changed over time. This is a consolidated version of the ruling which was published on *15 November 2004*



Class Ruling

Income tax: Eligible Termination Payment – The NSW Department of Commerce sale of cmSolutions and Q Stores – Transfer of Employment Agreements 2004

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Preamble

*The number, subject heading, **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 laws 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 27B of the ITAA 1936; and
- section 27C of the ITAA 1936.

Class of persons

3. The class of persons to which this Ruling applies is all full time and part time permanent, non-SES employees of cmSolutions and Q Stores who, at the point of sale of the two business units, cease employment with the NSW Department of Commerce, accept an offer to take up new employment with the purchaser(s) of the businesses and receive a transfer payment. Employees who choose to take up employment with the new owner(s) of the business units and subsequently resign from cmSolutions and Q Stores will be entitled to receive the transfer payment as described in paragraphs 10 to 23.

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 actually carried out is carried out in accordance with the arrangement described in paragraphs 10 to 23.

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

- 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
- this Ruling may be withdrawn or modified.

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Date of effect

8. The Ruling applies from 15 November 2004. 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 to 22 of Taxation Ruling TR 92/20).

Furthermore the Ruling applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*;
- it is not taken to be withdrawn by an inconsistent later public ruling; or
- the relevant tax laws are not amended.

Withdrawal

9. The Ruling is withdrawn and ceases to have effect after 30 June 2005. 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

10. The arrangement that is the subject of this 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 dated 1 September 2004 from the applicant for the Ruling to the Australian Taxation Office; and
- Record of a telephone conversation on 14 October 2004 with a representative of the applicant.

11. Q Stores and cmSolutions are two businesses currently conducted by the NSW Government, through the NSW Department of Commerce.

12. Q Stores is a provider of a diverse range of stationery, business consumables and specialty products.

13. cmSolutions comprises the State Mail Service and the Government Printing Service.

14. As a result of the Government's decision to privatise these businesses, the NSW Department of Commerce will be selling the business undertakings conducted under the name of Q Stores and cmSolutions. The method of sale will be by direct sale of the business undertakings (including relevant assets and liabilities) to the purchaser.

15. Expressions of Interest (EOI) in the purchase of the business have been sought and the timetable for the sale is as follows:

- Request for EOI released – 26 June 2004;
- Final date for submission of EOI – 27 July 2004;
- Short listed parties invited to conduct due diligence – mid September to mid October 2004;
- Final Bids – mid October 2004;

- Finalise all documentation and announce successful bidder – mid November 2004; and
- Financial Completion – mid December 2004.

16. As at 30 August 2004, the NSW Department of Commerce had 250 employees in the 2 business units. Working conditions for them are regulated by a combination of the Department of Public Works & Services Award and the *Public Sector Employment and Management Act 2002*. These include the following:

- no forced redundancies and voluntary redundancy provisions;
- access to redeployment provisions, including salary maintenance (a period of up to 12 months on full salary if an employee's position is made redundant), professional career transition support with external providers and priority assessment of eligibility for vacancies within the sector;
- paid maternity leave provision;
- sick leave provisions;
- extended leave (long service leave) provisions;
- broader range of paid leave and leave without pay provisions;
- mandatory flexible working hours arrangements;
- access to provisions regarding the management of conduct and performance;
- access to provisions regarding the advertising, eligibility, selection and appointment to positions; and
- access to Government and Related Appeals Tribunal – ability to dispute promotion and disciplinary action.

17. The new purchaser will make unconditional offers of equivalent employment to all full time and part time permanent employees except SES officers. As a result, all employees of cmSolutions and Q Stores at the time of the sale who choose to do so will become employed by the purchaser. As a result of transferring to a private sector employer, employees will cease employment with the Government and lose their status as Public Sector employees. They will be required to forego the conditions stated above. Further, employment terms and conditions may change subject to negotiation with staff and their unions.

18. They will then receive a 'transfer package' payment from the Government. This package will include a 'transfer payment' paid in addition to other benefits or statutory leave entitlements and consists of the following components:

Category	Entitlement
Payment in lieu of notice	4 weeks pay (5 weeks for employees aged 45 years and over with at least 5 years completed service).
Incentive payment	Less than 5 years service = 4 weeks pay. 5 years but less than 10 years service = 6 weeks pay. 10 years service and over = 8 weeks pay.
Service-Based Payment	2 weeks per year of continuous service, capped at 26 weeks. Pro-rata payments for incomplete years of service (to be on a quarterly basis).
Early Acceptance Payment	6 weeks pay if offer accepted within 2 weeks of offer being made.
Annual Leave	Cashed-out or transferred (full or partial) at employee's option. Maximum transfer of 20 days.
Extended Leave (Long Service Leave)	Less than 5 years service: balance transferred. 5 years but less than 10 years service: cashed out or transferred (full or partial) at employee's option. 10 years service and over: cashed-out down to Long Service Leave Act level of entitlement, then cash out or transfer balance (full or partial) at employee's option.
Sick Leave	Transfer full balance.

19. The transfer payment has a maximum value of 45 weeks pay and is in addition to any other benefits or statutory leave entitlements. The transfer payment is an amount determined to reflect certain public sector employment conditions which will be lost including no forced redundancy, entitlements to indefinite salary maintenance and public sector mobility opportunities.

20. The employees will have the option of cashing out their accrued annual leave, long service leave and accrued public holiday entitlements prior to their new employment.

21. The transfer payment will be paid at the earliest possible time after the completion of the sale and no later than 30 June 2005.

22. All employees have a choice of whether to accept new employment with the purchasers. Permanent employees who choose not to accept employment will become displaced and subject to procedures outlined in Industrial Relations Commission Direction (IRC) 04/2906. The employee has the option to express an interest in voluntary redundancy but no permanent Public Sector employee can be forced to accept redundancy.

23. The following documents have been provided:
- Proposal for Terms and Conditions of Employment – cmSolutions and Q Stores;
 - The NSW Treasury/NSW Department of Commerce – Market Testing of Q Stores and cmSolutions – ‘Accepting a job offer from the new employer – the transfer offer’, dated 31 August 2004;
 - IRC Direction 04/2906 (the transfer payment entitlements set out in this document were subsequently superseded);
 - Crown Employees (Department of Public Works And Services Wages Staff) Award 2002/2003;
 - Crown Employees (Department of Public Works & Services) Reviewed Award 1998 – summary table; and
 - Crown Employees (Public Service Conditions of Employment) Award 2002 – summary table.

Ruling

24. The proposed transfer package payment (excluding the annual leave and long service leave components) which is only payable to eligible employees of cmSolutions and Q Stores following termination of employment with the employer and their appointment to a position with the purchaser is an eligible termination payment (ETP) under subsection 27A(1) of the ITAA 1936.

25. Accordingly, the ETP received by an employee is included as assessable income under sections 27B and 27C of the ITAA 1936 to the extent that the ETP is not rolled-over.

Explanation

26. The eligible termination payment (ETP) provisions are contained in Subdivision AA of Division 2 of Part III of the ITAA 1936. ETPs are defined in subsection 27A(1) of the ITAA 1936 and include any payments made in consequence of the termination of employment.

27. In the context of payments made by an employer, paragraph (a) of the definition of an ‘eligible termination payment’ in subsection 27A(1) of the ITAA 1936 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:
 - (i) made from a superannuation fund in respect of the taxpayer by reason that the taxpayer is or was a member of the fund;

- (ii) of an annuity, or supplement, to which section 27H applies;
- (iii) from a fund in relation to which section 121DA, as in force at any time before the commencement of section 1 of the *Taxation Laws Amendment Act (No. 2) 1989* has applied in relation to the year of income commencing on 1 July 1984 or any subsequent year of income;
- (iiia) from a fund that is or has been a non-complying superannuation fund in relation to any year of income;
- (iv) of an amount to which section 26AC or 26AD applies; or
- (v) of an amount that, under any provision of this Act, is deemed to be a dividend, or a non-share dividend, paid to the taxpayer.

28. Two of the components of the transfer payment, that is annual leave and long service leave, are covered by the exclusions in subparagraph (iv) of the paragraph (a) definition above and therefore will not be ETPs.

29. Section 26AC covers amounts received on retirement or termination of employment in lieu of annual leave and section 26AD covers amounts received on retirement or termination of employment in lieu of long service leave.

30. The remaining components of the proposed transfer payment do not fall within any of the above exclusions, nor are they covered by the further exclusions in paragraphs (ja) to (s) of the definition. In determining whether the payment constitutes an eligible termination payment it is necessary to determine whether:

- there has been a termination of employment; and
- the payment is 'in consequence of the termination of employment'.

Is there a termination of employment?

31. Paragraph 9 of Taxation Ruling IT 2152 titled '*Income tax: retiring allowances paid to employees upon restructuring of a business*' states:

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...

32. Taxation Determination TD 93/140 titled '*Income tax: if a company ceases carrying on a business which has been transferred to an associated entity, will a payment made by that company to a former employee be an eligible termination payment as defined in subsection 27A(1) of the ITAA 1936?*' confirms the view expressed in IT 2152 that employees of an entity ceasing business have had their employment terminated.

33. The facts in *Paklan Pty Ltd and others v. Commissioner of Taxation (Cth)* (1983) 14 ATR 457; (1983) 67 FLR 238; 83 ATC 4456 (*Paklan's Case*) can be summarised as follows:

- The taxpayers were directors and shareholders of a company ('the old company') which carried on business as consulting engineers.
- On 30 June 1977 the company ceased to carry on business and the next day sold the business to another company ('the new company') also controlled by the taxpayers.
- The new company commenced carrying on the business from the same premises and subject to the same arrangements for occupancy as the old company.
- The entire staff, including the taxpayers, became employees of the new company.
- Six months later, it was decided to pay a lump sum to former directors. The payments were actually made a year after the company ceased business and out of outstanding fees received after the business had ceased.

34. The taxpayers in *Paklan's Case* did not succeed in having the lump sums in question treated as a 'payment in consequence of termination' as they were paid under circumstances and at a time too remote to the termination. However, the Full Federal Court did not dispute the fact employment had terminated when the old company had ceased business on 1 July 1977.

35. The facts in *Case Q118* 83 ATC 610 were similar to those in *Paklan's Case* and again involved the sale of a company's business as a going concern to a new company. All the staff of the old business were transferred across to the new company. The Board of Review (at 618), did not dispute the fact that employees of the old company had ceased to be employees of the old company immediately before taking up employment with the new company.

36. In *Case K76* 78 ATC 703, where a taxpayer ceased work with a subsidiary company due to a corporate restructure and immediately re-commenced work with the parent company on the same terms and conditions, it was held the taxpayer's employment with the subsidiary company had been terminated.

37. Those employees who accept an offer with the purchasers of cmSolutions and Q Stores will be transferring to a private sector employer and will cease employment with the NSW Government. Accordingly, there is a termination of employment with cmSolutions/Q Stores.

Is the making of the transfer payment 'in consequence of' the termination of employment?

38. A payment can be considered to be in consequence of termination where it follows from the termination, or the termination is a condition precedent to the payment. In *Reseck v. Federal Commissioner of Taxation* 75 ATC 4213; (1975) 133 CLR 45; (1975) 49 ALJR 370; (1975) 6 ALR 642; 5 ATR 538 (*Reseck*) Gibbs J said at pp 4216-7:

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 same case, Jacobs J said that 'in consequence of' did not import causation but rather a 'following on' (p 4219).

39. The decision in *Reseck* was considered by the Full Federal Court in *McIntosh v. Commissioner of Taxation (Cth)* 79 ATC 4325; (1979) 25 ALR 557; (1979) 45 FLR 279; 10 ATR 13 (*McIntosh*). The case concerned a taxpayer who became entitled to a payment subsequent to his retirement. In finding that the payment was in consequence of the taxpayer's termination, Brennan J said (at p 4328):

...if the payment is made to satisfy a payee's entitlement, the phrase 'in consequence of retirement' requires that the retirement be the occasion of, and a condition of, entitlement to the payment. A sufficient causal nexus between the payment and the retirement is thus established.

40. The phrase 'in consequence of' and the decisions in *Reseck* and *McIntosh* were also considered more recently by the Federal Court in *Le Grand v. Commissioner of Taxation* (2002) 195 ALR 194; (2002) 2002 ATC 4907; (2002) 51 ATR 139; (2002) 124 FCR 53; [2002] FCA 1258 (*Le Grand*).

41. *Le Grand* involved a payment by the taxpayer as a result of accepting an offer of compromise in respect of claims brought by him against his former employer, in relation to the termination of his employment. The taxpayer had made claims for common law damages for breach of the employment agreement and for statutory damages for misleading and deceptive conduct to procure the taxpayer's employment with the employer. The payment was found to be in consequence of the taxpayer's termination. Goldberg J said (at p 4914):

I do not consider that the issue can simply be determined by seeking to identify the 'occasion' for the payment. The thrust of the judgments in *Reseck* and *McIntosh* is rather to the effect that payment is made 'in consequence' of a particular circumstance when the payment follows on from, and is an effect or result, in a causal sense, of the circumstance. ... there need not be identified only one circumstance which gives rise to a payment before it can be said that the payment is made 'in consequence' of that circumstance. ... it can be said that a payment may be made in consequence of a number of circumstances and that, for present purposes, it is not necessary that the termination of the employment be the dominant cause of the payment so long as the payment follows in the causal sense referred to in those judgments, as an effect or result of the termination.

42. The Commissioner of Taxation (the Commissioner) has issued Taxation Ruling TR 2003/13 titled '*Income tax: eligible termination payments (ETP): payments made in consequence of the termination of any employment: meaning of the phrase "in consequence of"*'.

43. In paragraphs 5 and 6 of TR 2003/13, the Commissioner, after considering the above judgments, stated:

... 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. The phrase requires a causal connection between the termination and the payment, although the termination need not be the dominant cause of the payment. 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.

44. In Class Ruling CR 2002/1 titled '*Income tax: Eligible Termination Payment – FreightCorp Sale and Transfer of Employment*', the Commissioner considered the question of the taxation of 'transfer payment' payable to employees under a similar arrangement to that proposed by the NSW Department of Commerce. The Commissioner concluded that the transfer payment payable to FreightCorp employees upon the sale of its business was a payment made in consequence of the termination of employment under paragraph (a) of the definition of 'eligible termination payment' in subsection 27A(1) of the ITAA 1936.

45. In the present case, notwithstanding that the transfer payment is payable only to employees who take up employment with the purchasers, the transfer payment is payable only on the condition that these employees have terminated their employment with cmSolutions/Q Stores. The payment follows as an effect or result of the termination and the payment would not have been made to the employees but for the termination of their employment with cmSolutions/Q Stores.

46. The following aspects of the arrangement reinforce the characterisation of the 'transfer payment' as an eligible termination payment (as distinct from, for example, a transfer or sign-on fee):

- the payment is calculated by reference to each employee's years of service with cmSolutions/Q Stores; and
- there are no obligations imposed on the employees to continue their employment with the purchasers for any particular period after commencement of the employment with the purchaser.

47. Further, the transfer payment will be paid at the earliest possible time after completion of the sale and no later than 30 June 2005. The timing of any transfer payments strengthens the connection between the payments and the termination of employment.

48. In view of the above, the transfer payment is in consequence of the termination of employment. The payment (excluding the annual leave and long service leave components) is therefore an eligible termination payment under subsection 27A(1) of the ITAA 1936. The ETP will be split up into the pre-July 83 and post-June 83 (untaxed element) components. This amount can be rolled over.

49. It should also be noted that the amount of an ETP may be subject to the provisions of the superannuation surcharge legislation, whether it is taken in cash or rolled-over.

50. Under subsection 140M(1) of the ITAA 1936, ETPs are required to be reported by the payer to the Commissioner of Taxation for reasonable benefit limits (RBL) purposes if the ETP is more than \$5,000.

Detailed contents list

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

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Commissioner of Taxation

8 December 2004

<i>Previous draft:</i>	- TAA 1953 Pt IVAAA
Not previously issued as a draft	- Taxation LAws Amendment Act (No. 2) 1989 1
<i>Related Rulings/Determinations:</i>	<i>Case references:</i>
CR 2001/1; CR 2002/1; TR 92/1;	- Case K76 78 ATC 703
TR 92/20; TR 97/16; TR 2003/13,	- Case Q118 83 ATC 610
TD 93/140; IT 2152	- Le Grand v. Commissioner of Taxation (2002) 195 ALR 194; (2002) 124 FCR 53; 2002 ATC 4907; (2002) 51 ATR 139; [2002] FCA 1258
<i>Subject references:</i>	- McIntosh v. Commissioner of Taxation (Cth) (1979) 45 FLR 279; 79 ATC 4325; 10 ATR 13; (1979) 25 ALR 557; 10 ATR 13
- eligible termination payments	- Paklan Pty Ltd and others v. Commissioner of Taxation (Cth) (1983) 14 ATR 457; 83 ATC 4456; (1983) 67 FLR 238
- employment termination	- Reseck v. Federal Commissioner of Taxation (1975) 133 CLR 45; 75 ATC 4213; 5 ATR 538; (1975) 49 ALJR 370; (1975) 6 ALR 642
<i>Legislative references:</i>	
- ITAA 1936 26AC	
- ITAA 1936 26AD	
- ITAA 1936 Pt III Div 2 Subdiv AA	
- ITAA 1936 27A(1)	
- ITAA 1936 27B	
- ITAA 1936 27C	
- ITAA 1936 27H	
- ITAA 1936 121DA	
- ITAA 1936 140M(1)	
- Copyright Act 1968	
- Public Sector Employment and Management Act 2002	

ATO references

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