



CR 2005/111 - Income tax: Approved Early Retirement Scheme - Backwell IXL Pty Ltd

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Class Ruling

Income tax: Approved Early Retirement Scheme – Backwell IXL Pty Ltd

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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.
2. 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 27A, 27CB and 27E 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 Backwell IXL Pty Ltd (Backwell IXL) who receive a payment under the arrangement described in paragraphs 12 to 32.

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 in paragraphs 12 to 32.

7. 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- this Ruling may be withdrawn or modified.

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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 7 December 2005 until it is withdrawn (see paragraph 11). 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.

Withdrawal

11. This Ruling is withdrawn and ceases to have effect after 14 February 2006. 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

12. 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 from a representative of Backwell IXL Pty Ltd (Backwell IXL); and
- records of telephone conversations with a representative of Backwell IXL.

13. Backwell IXL is seeking approval for an early retirement scheme known as The Backwell IXL Pty Ltd Early Retirement Scheme – December 2005 (the scheme).

14. The contracts manufacturing division of Backwell IXL is responsible for the employer's obligations to supply metal stamping products under its present contracts. A major contract which accounts for a significant portion of the output of the division ends in 2006.

15. Due to significant price pressure from local and overseas suppliers Backwell IXL has not been successful in tendering for replacement contracts to the existing levels.

16. In the absence of alternative business opportunities a major restructure of the contracts manufacturing division is required to downsize operations to an efficient level while allowing Backwell IXL to meet existing contract obligations.

17. It is expected temporary employees will replace employees who retire under the scheme for an interim period until the major contract expires. In this way, Backwell IXL will temporarily preserve the current operating capacity while providing the flexibility to promptly reduce capacity upon the expiration of the contract. The temporary staff employed in the interim period will not include any employees who retire under the scheme.

18. The scheme will be offered to all employees of Backwell IXL, employed in the contracts manufacturing division, who are covered by the Backwell IXL Pty Ltd Certified Agreement 2003.

19. The offer of early retirement will be made to employees on 7 December 2005 and will remain open to employees to accept up until 31 January 2006, unless filled prior to that date.

20. The number of employees at each classification category who can retire under the scheme will be limited so that the number of employees remaining at each classification category will be sufficient to meet the reduced level of output required in the downsized operations.

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21. If the employer receives more acceptances at a classification category than required, the employees who first accept the offer will be able to retire.

22. Employees who accept the offer will generally terminate employment two (2) weeks after accepting the offer unless an alternative retirement date is mutually agreed.

23. All employees who accept the offer under the scheme are required to terminate employment and receive the payment by no later than 14 February 2006.

24. The payment to be made under the scheme will consist of the following three components:

- (a) a lump sum amount;
- (b) a payment in lieu of notice; and
- (c) payment of the employee's accrued sick leave balance.

Amounts (a) and (b) above will be determined by reference to the employee's years of service as follows:

<u>Years of Service</u>	<u>Lump Sum Amount*</u>	<u>Payment in lieu of Notice#</u>
1 year or less	2 weeks pay	2 weeks pay
1 to 2 years	6 weeks pay	3 weeks pay
2 to 3 years	8 weeks pay	3 weeks pay
3 to 4 years	9 weeks pay	4 weeks pay
4 to 5 years	12 weeks pay	4 weeks pay

* For each year or part thereof in excess of 5 completed years, employees will receive an additional lump sum amount of 2.5 weeks for each year of service greater than 5 years up to a maximum lump sum payment of 32 weeks.

Employees that are 45 years old or above will receive an additional 1 week payment in lieu of notice.

25. For those employees who are 55 years of age or over only 50% of the payment for accrued sick leave at (c) above can be included as part of an approved early retirement scheme payment under the scheme. The remaining part will be treated as an eligible termination payment (ETP) and taxed accordingly.

Payments made under the Scheme

26. For a payment made under the above mentioned scheme to qualify as an approved early retirement scheme payment, the conditions set out in paragraphs 27 to 32 must be met. Please note, any payment made under the scheme that does not satisfy these requirements is not covered by this Ruling.

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

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

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

30. The employee must terminate 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.

31. 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.

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

Ruling

33. The early retirement scheme offered by Backwell IXL Pty Ltd is an approved early retirement scheme for the purposes of section 27E of the ITAA 1936.

34. 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.

35. 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.

Explanation

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

37. 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.

38. 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)).

These three conditions are discussed below.

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

39. 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).

40. The class of employees to which the scheme is proposed to be offered is set out in paragraph 18.

41. 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).

42. It is noted, however, that Backwell IXL retains a limited right of veto to be applied as set out in paragraphs 20 and 21. The limitation of the scheme in this way is acceptable to the Commissioner.

The scheme must be entered into with a view to rationalising or reorganising the operations of the employer with an identified purpose in mind

43. 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).

44. Paragraphs 14 to 17 of this Ruling describe the nature of the rationalisation or reorganisation at Backwell IXL operations. The proposed scheme meets the requirements set out in subparagraph 27E(1)(b)(iii). Accordingly, the second condition for approval has been met.

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

45. The scheme is proposed to operate for a period from 7 December 2005 to 14 February 2006. Approval was granted prior to implementation therefore the third condition is satisfied.

46. The scheme will be in operation for approximately 2 months which is within the period recommended in TR 94/12.

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)):

- 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 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 2006, the tax-free amount is limited to \$6,491 plus \$3,246 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 the termination of employment calculated in accordance with paragraph 24 qualifies as an approved early retirement scheme payment, except for employees 55 years of age and above. For employees 55 years of age and above the total of the amounts under (a) and (b) and 50% of the amount under (c) in paragraph 24 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 1983 and post-June 1983 (untaxed element) components. This ETP can be rolled-over.

Detailed contents list

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

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Commissioner of Taxation

7 December 2005

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

CR 2001/1; TR 92/1; TR 92/20;
TR 94/12; TR 97/16; TD 2005/21

Subject references:

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

Legislative references:

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

- ITAA 1936 27E
- 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(4)
- ITAA 1936 27E(5)
- Copyright Act 1968

ATO references

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