



CR 2005/112 - Income tax: tax treatment of payments to members of the Australian Construction Industry Redundancy Trust

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Class Ruling

Income tax: tax treatment of payments to members of the Australian Construction Industry Redundancy Trust

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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) 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;
 - section 27C of the ITAA 1936;
 - section 27F of the ITAA 1936;
 - section 97 of the ITAA 1936; and
 - section 99A of the ITAA 1936.

Class of persons

3. The class of persons to which this Ruling applies are members of the Australian Construction Industry Redundancy Trust (ACIRT).

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- this Ruling may be withdrawn or modified.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. This Ruling applies from 1 July 2000 until it is withdrawn. 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:

- 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. This Ruling is withdrawn and ceases to have effect after 30 June 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

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 from the applicant for the Ruling to the Australian Taxation Office.

11. The Australian Construction Industry Redundancy Trust (ACIRT) is an Australian resident trust fund governed by a trust deed, which established the fund in Australia. The central management and control of the fund is in Australia.

12. The trustee of ACIRT is ACIRT Pty Ltd (the trustee), an Australian resident company.

13. The trustee has appointed an administrator of ACIRT and an investment manager to manage the investments of ACIRT on behalf of the trustee.

14. ACIRT is an approved worker entitlement fund for fringe benefits tax (FBT) purposes.

15. Employers can fund member redundancy entitlements that they are required to make under various industrial awards and enterprise agreements (Industrial Instruments) for the benefit of employees through the payment of contributions to ACIRT.

16. As outlined in clause 4.1 of the ACIRT Trust Deed, ACIRT accepts the following contributions from employers to fund each member's redundancy benefit:

- the minimum contribution (see Deed of Adherence); or
- to fund the employees redundancy benefit as provided in an Industrial Instrument; or
- such higher contribution specified in the Deed of Adherence (executed by Employers on applying to ACIRT for it to accept contributions on behalf of its employees); or
- such contribution specified in the Deed of Adherence until the total amount as specified in the Deed of Adherence has been contributed.

17. As outlined in clause 5.1 of the Trust Deed, all contributions made to ACIRT by employers are placed into separate member (employee) accounts identifying contributions for that member.

18. On becoming redundant, as defined in the Trust Deed, an employee is entitled to be paid a redundancy benefit of the amount held in the member's account.

19. ACIRT distributes all its income each year after payment of expenses to members.

20. The income available for distribution is divided amongst members in proportion to the members' account balances (subject to a minimum balance requirement).

21. Redundancy payments from ACIRT have been treated as eligible termination payments (ETPs) and subject to the relevant ETP tax rates (including Medicare levy), which have been deducted by the administrator of ACIRT. If an ETP is rolled over into the superannuation fund of a member, no tax is deducted by ACIRT.

22. Members can transfer the benefits they have accumulated with another redundancy fund into ACIRT where permitted by the other fund.

23. Members can transfer benefits to another redundancy fund that is an 'approved worker entitlement fund'.

Ruling

24. The 'redundancy' payment in terms of the Trust Deed made to a member of ACIRT is made 'in consequence of' the termination of the employment of the member and constitutes an ETP as defined under paragraph (a) of the definition of 'eligible termination payment' in subsection 27A(1) of the ITAA 1936.

25. However, section 27F of the ITAA 1936 will not apply to the 'redundancy' payment as the payment will not exceed the amount of an ETP that could reasonably be expected to have been made in relation to the member had they voluntarily retired from that employment at the termination time.

26. Where a distribution by the trustee of a share of net income of the trust is made to a member, it will be assessable income in the hands of the member under subsection 97(1) of the ITAA 1936. Such a distribution to the employee is not an eligible termination payment.

27. Trust income that is not distributed to a member is assessable income of the trustee under section 99A of the ITAA 1936.

28. This ruling does not extend to funeral benefits payable in terms of the Trust Deed at the discretion of the trustee.

Explanation

Eligible termination payment

29. An eligible termination payment is exhaustively defined in subsection 27A(1) of the *Income Tax Assessment Act 1936* (ITAA 1936). There are a number of different payments that qualify as an ETP. One such payment is that made on termination of employment. Paragraph (a) of the definition of an ETP in subsection 27A(1) of the ITAA 1936 states in part:

eligible termination payment, in relation to a taxpayer, 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...

30. The phrase 'in consequence of' is not defined in the ITAA 1936. However, the words have been interpreted by the courts in several cases. The Commissioner has also issued Taxation Ruling TR 2003/13 (TR 2003/13) which discusses the meaning of the phrase.

31. The Full High Court of Australia considered the expression 'in consequence of the termination of any employment' in *Reseck v. Federal Commissioner of Taxation*¹ (*Reseck*). The relevant issue in that case was whether amounts paid to a taxpayer by his employer at the end of two periods of employment, to which the taxpayer was entitled under an agreement between the employer and the taxpayer's union, were an allowance paid in a lump sum 'in consequence of retirement from, or the termination of, any office or employment ...'. Gibbs J concluded that the amounts were made in consequence of the termination of the taxpayer's employment. His Honour said at 4216-17 that:

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 present case the allowance was paid in consequence of a number of circumstances, including the fact that the taxpayer's service had been satisfactory and that the industrial agreements provided for the payment, but it was none the less paid in consequence of the termination of the taxpayer's employment.

32. Jacobs J also concluded that the amounts constituted an allowance that was paid in consequence of the termination of the taxpayer's employment. His Honour said at 4219:

It was submitted that the words 'in consequence of' import a concept that the termination of the employment was the dominant cause of the payment. This cannot be so. A consequence in this context is not the same as a result. It does not import causation but rather a 'following on'.

¹ (1975) 133 CLR 45; (1975) 49 ALJR 370; (1975) 6 ALR 642; (1975) 5 ATR 538; (1975) 75 ATC 4213.

33. The different interpretations of 'in consequence of' adopted by Jacobs J and Gibbs J were considered by the Full Federal Court in *McIntosh v. Commissioner of Taxation*² (*McIntosh*). The matter before the court concerned a taxpayer who one week after retirement commuted part of the pension, to which he became entitled upon his retirement, into a lump sum. The commuted payment was made out of a provident fund established by a bank for the payment of benefits to bank officers on their retirement. The issue being considered by the court was whether the commuted lump sum payment came within former paragraph 26(d) of the ITAA 1936.

34. Brennan J considered the judgments of Gibbs J and Jacobs J in *Reseck* and concluded that their Honours were both saying that a causal nexus between the termination and payment was required, though it was not necessary for the termination to be the dominant cause of the payment. Brennan J said at 4328 that:

Though Jacobs J. speaks in different terms, his meaning may not be significantly different from the meaning of Gibbs J... His Honour denies the necessity to show that retirement is the dominant cause, but he does not allow a temporal sequence alone to suffice as the nexus. Though the language of causation often contains the seeds of confusion, I apprehend his Honour to hold the required nexus to be (at least) that the payment would not have been made but for the retirement.

35. In the same case, Lockhart J stated at 4336:

In my opinion, although the phrase is sufficiently wide to include a payment caused by the retirement of the taxpayer, it is not confined to such a payment. The phrase requires that there be a connection between the payment and the retirement of the taxpayer, the act of retirement being either a cause or an antecedent of the payment. The phrase used in section 26(d) is not 'caused by' but 'in consequence of'. It has a wider connotation than causation and assumes a connection between the circumstance of retirement and the act of payment such that the payment can be said to be a 'following on' of the retirement.

36. The Commissioner in TR 2003/13 considered the phrase 'in consequence of' as interpreted by the Courts. Paragraph 5 of TR 2003/13 states:

...the Commissioner considers that 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.

37. 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.

² (1979) 25 ALR 557; 10 ATR 13; 45 FLR 279; 79 ATC 4325.

38. Clause 19.2 of the Trust Deed of the ACIRT provides for the payment of an amount to the Member not exceeding the amount standing to the credit of the Member Account upon the Member being made redundant. The term 'redundant' is defined under clause 1.1 of the Trust Deed as:

'Redundancy' or **'Redundant'** means, the termination or cessation of employment of a Member for any reason other than where paragraphs (a) or (b) of clause 17.1 applies.

39. Paragraph (a) of clause 17.1 deals with the situation where a participating employer is dissolved or wound up and another company, person or firm agrees to undertake the obligations of the participating employer in respect of the ACIRT. Paragraph (b) deals with the situation where another company, person or firm acquires all or part of the undertaking and assets of a participating employer and agrees to undertake the obligations of the participating employer in respect of the ACIRT.

40. It is considered that there is sufficient nexus between the making of the payments under clause 19.2 and the termination of the relevant Member's employment to constitute the payments as being ETPs as defined under paragraph (a) of the definition of an ETP in subsection 27A(1) of the ITAA 1936.

Bona fide redundancy payment

41. Section 27F of the ITAA 1936 provides for certain termination payments to be concessional taxed as a bona fide redundancy payment (BFRP) provided they meet all of the following requirements:

- there must be an ETP made in relation to a taxpayer in consequence of the dismissal of the taxpayer from employment by reason of the taxpayer's bona fide redundancy (paragraph 27F(1)(a));
- if the ETP is made on or after 1 July 1994, it must not be made from an eligible superannuation fund (paragraph 27F(1)(aa));
- the time of termination must be before the date that the taxpayer attains 65 years of age, or such earlier date on which the taxpayer's employment would necessarily have had to terminate under the terms of employment (paragraph 27F(1)(b));
- the amount of the ETP must not be greater than the amount that could reasonably be expected to have been paid if the employer and the taxpayer had been dealing at arm's length (paragraph 27F(1)(c)); and

- there must not be, at the termination time, any agreement between the taxpayer and the employer, or between the employer and another person, to employ the taxpayer after the termination time (paragraph 27F(1)(d)).

42. Additionally, where all of the above requirements are met, section 27F of the ITAA 1936 imposes a further requirement that only 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 had he voluntarily retired from that employment at the termination time' will be treated as a BFRP in relation to the taxpayer.

43. The terms 'dismissal' and 'redundancy' are not defined in the ITAA 1936. Therefore, it is necessary to consider the common law or ordinary meaning of the terms and the meaning the judicial authorities have ascribed to each word.

44. The Explanatory Memorandum to the Income Tax Assessment Amendment Bill (No. 3) 1984 which inserted section 27F into the ITAA 1936 states at page 91:

The terms 'dismissal' and 'redundancy' are not defined in the legislation and, therefore, should be given their ordinary meanings. 'Dismissal' carries with it the concept of the involuntary (on the taxpayer's part) termination of employment. 'Redundancy' carries the concept that the requirements of the employer for employees to carry out work of a particular kind, or for employees to carry out work of a particular kind in the place where they were so employed, have ceased or diminished or are expected to cease or diminish. Redundancy, however, would not extend to the dismissal of an employee for personal or disciplinary reasons or for reasons that the employee was inefficient.

45. Taxation Ruling TR 94/12 (TR 94/12), which outlines the Commissioner's view of the requirements for a payment to qualify as a bona fide redundancy payment under section 27F expands upon and provides additional clarification as to what constitutes a 'dismissal' and 'redundancy'.

35. *Dismissal* carries with it the concept of the involuntary (on the employee's part) termination of employment. The termination of an employee's employment will usually be instigated or initiated by the employer.

40. Dismissal also includes the notion of constructive dismissal. Constructive dismissal arises if an employer places an employee in a position in which the employee has little option but to tender his or her resignation. For example, the employer may be reducing the size of his or her operations and may offer a voluntary redundancy package to a selected employee. If the employee refuses the offer he or she may be forced to accept another position which may not be commensurate with his or her qualifications and experience or may involve a lower level of remuneration...The termination of employment in these circumstances would amount to a constructive dismissal.

46. The subject of 'bona fide redundancy payments' was discussed in *AAT Case 4287* (1988) 19 ATR 3443; *Case V67 88 ATC 505*. In concluding that the dismissal amounted to a 'constructive dismissal', Deputy President Dr Gerber stated:

I am satisfied that a provision which, put crudely, means 'resign or else' has all the hallmarks of leaving a loaded pistol in the hands of an officer and gentleman and telling him that he is about to be court-martialled for hocking the regimental silver.

Applied to the instant case, I have 'concluded' that the option of a voluntary retirement is a Faustian bargain equivalent to a constructive dismissal; it is not the voluntary retirement referred to in sec.27F(1).

47. Paragraphs 41 to 42 of TR 94/12 provide the following in relation to the meaning of redundancy:

41. Redundancy can be described as the situation where an employer no longer requires employees to carry out work of a particular kind or to carry out work of a particular kind at the same location. Bray CJ in *R v. The Industrial Commission of South Australia; ex parte Adelaide Milk Supply Co-operative Ltd & Ors* (1977) 44 SAIR 1202 at page 1205; (1977) 16 SASR 6 at page 8 defined redundancy as follows:

'... a job becomes redundant when an employer no longer desires to have it performed by anyone. A dismissal for redundancy seems to be a dismissal, not on account of any act or default of the employee dismissed or any consideration peculiar to him, but because the employer no longer wishes the job the employee has been doing to be done by anyone.'

42. Redundancy refers to a job becoming redundant and not to an employee becoming redundant (*Short v. F W Hercus Pty Ltd* (1993) 40 FCR 511; (1993) 46 IR 128; (1993) 35 AILR 151). An employee's job is considered to be redundant if:

- an employer has made a definite decision that the employer no longer wishes the job the employee has been doing to be done by any one;
- that decision is not due to the ordinary and customary turnover of labour;
- that decision led to the termination of the employee's employment; and
- that termination of employment is not on account of any personal act or default of the employee.

48. As noted above, clause 19.2 of the ACIRT Trust Deed provides for the payment of an amount to the Member not exceeding the amount standing to the credit of the Member Account upon the Member being made redundant. However, the term 'redundancy', which is defined in clause 1.1 of the Trust Deed, simply refers to the termination or cessation of employment of the Member for any reason and thus does not correspond with the meaning ascribed in paragraphs 41 and 42 of TR 94/12.

49. Consequently, it is not possible to conclude whether or not the first requirement under paragraph 27F(1)(a) of the ITAA 1936 would be satisfied. This would have to be determined by the relevant facts and circumstances of each case.

50. The ACIRT is not an eligible superannuation fund so the second requirement under paragraph 27F(1)(aa) of the ITAA 1936 would be satisfied.

51. It is not possible to conclude whether or not the other three requirements under paragraphs 27F(1)(b), (c) and (d) of the ITAA 1936 would be satisfied. This would have to be determined by the relevant facts and circumstances of each case.

52. Even if the requirements of paragraphs 27F(1)(a), (aa), (b), (c) and (d) are satisfied, only 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 had he voluntarily retired from that employment at the termination time will be treated as a BFRP in relation to the taxpayer'.

53. As already noted clause 19.2 of the Trust Deed provides for the payment of an amount to the Member not exceeding the amount standing to the credit of the Member Account upon the Member being made redundant.

54. However, as also already noted, clause 1.1 of the Trust Deed which defines the terms 'redundancy' and 'redundant' simply refers to the termination or cessation of employment of the Member for any reason. Thus payments may be made to a Member for various events including retirement from the workforce on or after age 55, leaving the industry, death, and so on.

55. This means that, for example, where an employee of a participating employer resigns and leaves the Industry, that employee would receive the balance of their Member Account.

56. Consequently, no part of the amount payable under clause 19.2 of the Trust Deed would exceed the amount of an ETP 'that could reasonably be expected to have been made in relation to the taxpayer had he voluntarily retired from that employment at the termination time'. Thus, there will not be a BFRP in relation to the Member.

57. Amounts payable under clause 19.2 of the Trust Deed would be assessable income of the recipient in terms of sections 27B and 27C of the ITAA 1936.

Section 97 income

58. The main provisions of the ITAA 1936 which relate to trust income are found in Division 6 of Part III. In broad terms the purpose of Division 6 is to tax trust income in the year of income in which it is derived by the trust at the level of either trustee or beneficiary.

59. The taxing point of a trust depends on whether the beneficiary is or is not presently entitled and where present entitlement exists, whether the beneficiary is under a legal disability. Generally, the trustee will be taxed on income it retains.

60. When the trustee of ACIRT makes a trust distribution to members, the income available for distribution is divided amongst members in proportion to the member's account balances (subject to a minimum balance requirement). A member is presently entitled to the amount that the Trustee of ACIRT distributes to them.

61. Subsection 97(1) of the ITAA 1936 provides that where a beneficiary of a trust estate who is not under any legal disability and is presently entitled to a share of the net income of the trust estate, the assessable income of the beneficiary shall include:

- (a) so much of that share of the net income of the trust estate as is attributable to a period when the beneficiary was a resident; and
- (b) so much of that share of the net income of the trust estate as is attributable to a period when the beneficiary was not a resident and is also attributable to sources in Australia.

62. Under section 97 of the ITAA 1936 members of ACIRT (except those under a legal disability) are required to include the amount of ACIRT net income distributed to them in their assessable income. The distribution should be included in the income year that present entitlement arises. Present entitlement will arise upon the declaration of the distribution by the ACIRT Trustee. Such a distribution to the employee is assessable income and not an eligible termination payment.

63. If the income of ACIRT is not distributed to the members, but is accumulated by the trustee, the trustee will be assessed on the undistributed income under section 99A of the ITAA 1936.

Detailed contents list

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

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Commissioner of Taxation

14 December 2005

<i>Previous draft:</i>	- ITAA 1936 97(1)
Not previously issued as a draft	- ITAA 1936 99A
	- TAA 1953 Pt IVAAA
	- Copyright Act 1968
<i>Related Rulings/Determinations:</i>	
CR 2001/1; TR 92/1; TR 92/20;	<i>Case references:</i>
TR 94/12; TR 97/16; TR 2003/13	- AAT Case 4287 (1988) 19 ATR
	3443; Case V67 88 ATC 505
	- McIntosh v. Commissioner of
	Taxation (1979) 25 ALR 557; 10
	ATR 13; 45 FLR 279; 79 ATC 4325
	- R v. The Industrial Commission of
	South Australia; ex parte Adelaide
	Milk Supply Co-operative Ltd & Ors
	(1977) 44 SAIR 1202; (1977) 16
	SASR 6
	- Reseck v. Federal Commissioner
	of Taxation (1975) 49 ALJR 370;
	(1975) 6 ALR 642; (1975) 5ATR
	538; (1975) 75 ATC 4213; (1975)
	133 CLR 45
	- Short v. F W Hercus Pty Ltd
	(1993) 40 FCR 511; (1993) 46 IR
	128; (1993) 35 AILR 151
<i>Subject references:</i>	
- bona fide redundancy payments	
- distributions	
- eligible termination payments	
- ETP components	
- income distributions	
- present entitlement	
- trust beneficiaries	
- trust distributions	
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- trusts	
<i>Legislative references:</i>	
- ITAA 1936 27A(1)	
- ITAA 1936 27B	
- ITAA 1936 27C	
- ITAA 1936 27F	
- ITAA 1936 27F(1)(a)	
- ITAA 1936 27F(1)(aa)	
- ITAA 1936 27F(1)(b)	
- ITAA 1936 27F(1)(c)	
- ITAA 1936 27F(1)(d)	
- ITAA 1936 Pt III Div 6	
- ITAA 1936 97	
	<i>Other references:</i>
	- Explanatory Memorandum to the
	Income Tax Assessment
	Amendment Bill (No. 3) 1984

ATO references

NO: 2005/17583
 ISSN: 1445-2014
 ATOLaw topic Income Tax ~~ Assessable income ~~ eligible termination payments