


CR 2007/55 - 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

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	8
Scheme	13
Ruling	29
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
<i>Explanation</i>	34
Appendix 2:	
<i>Detailed contents list</i>	68

① This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- paragraph (a) of the definition of 'eligible termination payment' in subsection 27A(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 27F of the ITAA 1936;
- section 97 of the ITAA 1936; and
- section 99A of the ITAA 1936.

All subsequent legislative references are to the ITAA 1936 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is members of the Australian Construction Industry Redundancy Trust (ACIRT) who receive redundancy payments under the scheme described in paragraphs 13 to 28 of this Ruling.

Qualifications

4. The Commissioner makes this ruling based on the precise scheme identified in this Ruling.

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 13 to 28 of this Ruling.

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

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme 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 2006 to 30 June 2007. However, the Ruling continues to apply after this date to all entities within the specified class who entered into the specific scheme during the term of the Ruling, subject to there being no change in the scheme or in the entities involved in the scheme.

9. 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. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or

- the relevant provisions are not amended.

10. If this Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

11. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

12. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

13. The following description of the scheme is based on information provided by the applicant.

14. ACIRT is an Australian resident trust fund governed by a trust deed (Trust Deed) which established the fund in Australia. The central management and control of the fund is in Australia.

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

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

17. ACIRT is an approved worker entitlement fund for fringe benefits tax (FBT) purposes from 26 February 2004.

18. Employers are obligated by various industrial awards and enterprise agreements (industrial instruments) to provide redundancy benefits for their workers. Employers can fund worker redundancy benefits that they are required to make by the payment of contributions to ACIRT.

19. An employer must apply to the trustee for admission to ACIRT and must complete a Deed of Adherence to participate in ACIRT.

20. ACIRT accepts contributions from employers, on a monthly basis, for each week of service in respect of which contributions are legally payable under an industrial instrument or the Deed of Adherence, to fund each worker's redundancy benefit. Under clause 4.1 of the Trust Deed, the amount to be contributed by the employer in respect of each worker is:

- the minimum contribution (as defined in the Trust Deed);
- an amount required to fund the workers redundancy benefit as provided in an industrial instrument;
- such higher contribution specified in the Deed of Adherence; or
- such contribution specified in the Deed of Adherence until the total amount as specified in the Deed of Adherence has been contributed.

21. 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.

22. In addition to receiving contributions from employers on behalf of workers, ACIRT earns income on the contributions it holds. After payment of fund expenses, ACIRT distributes all of the net income each year to members.

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

24. Clause 19.2 of the Trust Deed of the ACIRT provides for the payment of an amount to a 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.

25. Redundancy payments from ACIRT have been treated as eligible termination payments (ETPs) and Pay As You Go Withholdings (PAYGW) at the relevant ETP tax rates (including Medicare levy) has been deducted by the administrator of ACIRT. If an ETP is rolled over into a superannuation fund of a member, no tax is deducted by ACIRT.

26. Members can transfer the benefits they have accumulated in another similar redundancy fund into ACIRT where such transfer is permitted by the other fund.

27. Members can transfer benefits to another approved worker entitlement fund.

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

Ruling

29. 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).

30. It is not possible to conclude whether the termination of employment is by reason of bona fide redundancy of the member as required under paragraph (a) of the definition except on a case by case basis.

31. However, section 27F 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.

32. 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). Such a distribution to the member is not an ETP.

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

Commissioner of Taxation

20 June 2007

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Eligible termination payment

34. An ETP is exhaustively defined in subsection 27A(1). 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) 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...

35. 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 which discusses the meaning of the phrase.

36. The Full High Court of Australia considered the expression 'in consequence of the termination of any employment' in *Reseck v. Federal Commissioner of Taxation (Reseck)*¹. 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 allowances paid in a lump sum 'in consequence of retirement from, or the termination of, any office or employment ...'. Justice Gibbs 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.

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

37. Justice Jacobs 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'.

38. The different interpretations of 'in consequence of' adopted by Justices Jacobs and Gibbs were considered by the Full Federal Court in *McIntosh v. Commissioner of Taxation (McIntosh)*.² 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).

39. Justice Brennan considered the judgments of Justices Gibbs and Jacobs 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. Justice Brennan 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.

40. In the same case, Justice Lockhart 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.

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

41. 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.

42. 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.

43. Clause 19.2 of the Trust Deed provides for the payment of an amount to a 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.

44. Paragraph (a) of clause 17.1 of the Trust Deed 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.

45. It is considered that there is sufficient nexus between the making of the payments under clause 19.2 of the Trust Deed 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).

Bona fide redundancy payment

46. Section 27F provides for certain termination payments to be concessionally 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)).

47. Additionally, where all of the above requirements are met, section 27F 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.

48. 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.

49. 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.

50. Taxation Ruling 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' at paragraphs 35 and 40.

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.

51. The subject of 'bona fide redundancy payments' was discussed by the Administrative Appeals Tribunal (AAT) in *AAT Case 4287*³. 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).

52. 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;

³ (1988) 19 ATR 3443; Case V67 88 ATC 505.

- 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.

53. As noted above, clause 19.2 of the Trust Deed provides for the payment of an amount to a 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, other than where paragraph (a) or (b) of clause 17.1 applies, and thus does not correspond with the meaning ascribed in paragraphs 41 and 42 of TR 94/12.

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

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

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

57. 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'.

58. As already noted clause 19.2 of the Trust Deed provides for the payment of an amount to a member not exceeding the amount standing to the credit of the member account upon the member being made redundant.

59. 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, other than where paragraph (a) or (b) of clause 17.1 of the Trust Deed applies. 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.

60. 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.

61. 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.

Section 97 income

62. 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.

63. 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.

64. When the trustee 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 distributes to them.

65. Subsection 97(1) provides that where a beneficiary of a trust estate 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.

66. Under section 97 members of ACIRT (except those under a legal disability) are required to include the amount of ACIRT 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 trustee. Such a distribution to the member is assessable income and not an eligible termination payment.

67. If the income available for distribution is not distributed to the members, but is accumulated by the trustee, the trustee will be assessed on the undistributed income under section 99A.

Appendix 2 – Detailed contents list

68. The following is a detailed contents list for this Ruling:

	Paragraph
What this Ruling is about	1
Relevant provision(s)	2
Class of entities	3
Qualifications	4
Date of effect	8
Scheme	13
Ruling	29
Appendix 1 – Explanation	34
Eligible termination payment	34
Bona fide redundancy payment	46
Section 97 income	62
Appendix 2 – Detailed contents list	68

References

Previous draft:

Not previously issued as a draft

- TAA 1953
- TAA 1953 357-75(1)
- Copyright Act 1968

Related Rulings/Determinations:

TR 94/12; TR 2003/13

Case references:

Subject references:

- bona fide redundancy payments
- distributions
- eligible termination payments
- ETP components
- income distributions
- present entitlement
- trust beneficiaries
- trust distributions
- trust income
- trusts

- 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

Legislative references:

- ITAA 1936 26(d)
- ITAA 1936 27A(1)
- 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
- ITAA 1936 97(1)
- ITAA 1936 99A

Other references:

- Explanatory Memorandum to the Income Tax Assessment Amendment Bill (No. 3) 1984

ATO references

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