


CR 2015/70 - Income tax: treatment of transfer payments to employees in connection with the sale of the Home Care Service business

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Class Ruling

Income tax: treatment of transfer payments to employees in connection with the sale of the Home Care Service business

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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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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 provision identified below applies to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision

2. The relevant provision dealt with in this Ruling is section 82-130 of the *Income Tax Assessment Act 1997* (ITAA 1997). All subsequent references in this Ruling are to the ITAA 1997 unless otherwise stated.

Class of entities

3. The class of entities to which this scheme applies are all permanent full time and part time employees of the State of New South Wales (the State) currently working within the Home Care Service Staff Agency (Staff Agency) or the Department of Family and Community Services (FACS) who:

- are engaged in providing services supporting older people and younger people with a disability and their carers for the Home Care Service of New South Wales (HCS), and

- at the time of the sale of HCS' operations (HCS business) cease employment with the State, and
- commence employment with the new service provider, and
- receive a 'transfer payment' under the scheme described below.

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 in accordance with the scheme described in paragraphs 9 to 26 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.

Date of effect

7. This Ruling applies from 2 September 2015 to 31 December 2016. This Ruling continues to apply after 31 December 2016 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

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

9. HCS is a NSW statutory corporation established under the *Home Care Service Act 1988* (NSW) and is a controlled entity of FACS.

10. HCS is a not-for-profit entity and provides services including, but not limited to, supporting older people and younger people with disability and their carers to live independently at home and be part of the community. Employees of the State who are working within the Staff Agency and FACS support HCS to provide these services.

11. The New South Wales Government (NSW Government) is preparing for the implementation of the full roll out of the National Disability Insurance Scheme (NDIS) across NSW from 2015 along with the future reforms to the aged care sector that are being implemented by the Commonwealth Government.
12. The State has decided that in the future, the services currently provided by HCS will be provided by the non-government sector.
13. As part of this process, the employees currently engaged in the provision of services by HCS (directly or indirectly) will move to the non-government sector.
14. The State will transfer employees working within the Staff Agency and those providing HCS services in FACS to the new service provider following the sale 'transaction'.
15. The NSW Government has indicated that the 'transaction' will be structured as one of the following scenarios:
 - (a) The State will incorporate a new company (ImpCo) in accordance with the *Corporations Act 2001* to be acquired by the new non-government sector services provider. The assets and liabilities of HCS will be vested in ImpCo and the affected employees will cease their existing employment with the State, and will transfer to ImpCo by way of enabling legislation. This transfer under the enabling legislation will be by way of an order at the initiative of the State. The vesting of the assets/liabilities and the transfer of employees to ImpCo will occur as part of, and contemporaneously with, the scenario completion steps. Upon completion, the new service provider will own the shares in ImpCo and commence the provisions of the services.
 - (b) The key assets and liabilities of the HCS business, as well as the affected employees, will transfer directly to the successful applicant. In this scenario, the employees will cease their existing employment with the State, and will transfer directly to the successful applicant, again by way of order at the initiative of the State.
16. The class of entities to which this scheme applies are those specified in paragraph 3 in this Ruling.
17. The 'transfer payment' is an amount in addition to any other benefits transferring employees will receive on termination of their employment with the State.
18. The employment of all transferring employees with the State will necessarily terminate upon completion of the sale. As such, the transfer payment will be made in recognition of the employees ceasing employment with the State and the individuals foregoing their working conditions when they leave the public sector.

19. The transfer payment will be made by the State and is calculated by reference to each employee's years of service as set out in the following table:

Continuous years of service	'Transfer payment' schedule (weeks of base rate of pay)
Less than one year	0
1 year or more, but less than 2 years	2
2 years or more, but less than 3 years	3.5
3 years or more, but less than 4 years	5
4 years or more, but less than 5 years	6
5 years or more, but less than 6 years	7
6 years or more	8

20. The transfer payment for part-time employees will be calculated based upon the average hours worked in the 12 month period prior to the transfer date, or contracted hours, whichever is higher excluding any overtime worked.

21. Periods of approved leave without pay (including parental leave) will not break continuity of service.

22. Periods of leave without pay for total contracted hours will be excluded for the purpose of calculating the years of completed service. Periods of part-time leave without pay will not affect the calculation of years of service.

23. The transfer payment will be paid by the State at the earliest possible time after the completion of the transaction, which is intended to occur at the same time as:

- employees ceasing employment with the State and being employed by ImpCo, or
- employees ceasing employment with the State and being employed by the new service provider.

24. Regardless of the scenario adopted, the transfer payment will only be payable to employees on the condition that a change of employer occurs and the employee's employment with the State terminates when they transfer to the new service provider.

25. An employment guarantee period with the new service provider of 2 years duration for ongoing employees and a maximum guarantee of 6 months for temporary and casual employees will also apply from the date of transfer.

26. There are no conditions imposed on the employees regarding continued employment with the new service provider.

Ruling

27. The proposed transfer payment is in consequence of the termination of employment and will not be a payment mentioned in section 82-135. Accordingly, it will be an employment termination payment under section 82-130 where the payment is received within 12 months of the employee's termination of employment, or within any longer period allowed by a determination under subsection 82-130(4).

Commissioner of Taxation

2 September 2015

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.*

Employment termination payment

28. A payment made to an employee is an employment termination payment if the payment satisfies all the requirements in section 82-130, and is not specifically excluded under section 82-135.

29. Subsection 82-130(1) states:

A payment is an **employment termination payment** if:

- (a) it is received by you:
 - (i) in consequence of the termination of your employment, or
 - (ii) after another person's death, in consequence of the termination of the other person's employment,
- (b) it is received no later than 12 months after that termination (but see subsection (4)), and
- (c) it is not a payment mentioned in section 82-135.

30. Section 82-135 lists payments that are not employment termination payments. These include (among others):

- superannuation benefits
- unused annual leave or long service leave payments, and
- the tax free part of a genuine redundancy payment or an early retirement scheme payment.

31. For a transfer payment to constitute an employment termination payment, all the conditions in subsection 82-130(1) must be satisfied. Failure to satisfy any of the three conditions under subsection 82-130(1) will result in the payment not being considered an employment termination payment.

32. Even where all the conditions in subsection 82-130(1) have been satisfied, generally, to qualify as an employment termination payment, the payment must be received by the person within 12 months of termination (paragraph 82-130(1)(b)). Generally, any termination payments received outside of the 12 months will be assessable at the person's marginal tax rates (section 83-295), unless the person is covered by a determination exempting them from the 12 month rule (subsection 82-130(4)).

Is there a termination of employment?

33. Paragraph 9 of IT 2152¹ 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...

34. Furthermore, paragraph 2 of TD 93/140² confirms the view expressed in IT 2152 that employees of an entity ceasing business have had their employment terminated.

35. The facts in *Paklan Pty Ltd and others v. Federal Commissioner of Taxation*³ (*Paklan*) 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 old 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.
- All the old company's employees, 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.

36. The taxpayers in *Paklan* 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 that employment had terminated when the old company had ceased business on 1 July 1977.

¹ Taxation Ruling IT 2152 *Income tax: retiring allowances paid to employees upon restructuring of a business.*

² Taxation Determination TD 93/140 *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 Income Tax Assessment Act 1936?*

³ (1983) 67 FLR 328; 83 ATC 4456; (1983) 14 ATR 457.

37. The facts in Board of Review Case Q118⁴ are similar to those in *Paklan* and again involved the sale of a company's business as a going concern to a new company. All the employees of the old business were transferred across to the new company. The Board of Review 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.

38. Board of Review Case K76⁵ involved a taxpayer who 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 by the Board of Review that the taxpayer's employment with the subsidiary company had been terminated.

39. The relevant facts in respect of the sale of the HCS business demonstrate that employees who take up positions with the new service provider will cease employment with the State. Therefore, there is a termination of employment for the purposes of subsection 82-130(1).

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

40. 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*⁶ (*Reseck*) Justice Gibbs said:

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.

41. In the same case, Justice Jacobs said that 'in consequence of' did not import causation but rather a 'following on'.

42. The decision in *Reseck* was considered by the Full Federal Court in *McIntosh v. Federal Commissioner of Taxation*⁷ (*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, Justice Brennan said:

...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.

⁴ (1983) 27 CTBR (NS) 312; (1983) 83 ATC 610.

⁵ (1978) 23 CTBR (NS) 24; (1978) 78 ATC 703.

⁶ (1975) 133 CLR 45; [1975] HCA 38; 75 ATC 4213; (1975) 5 ATR 538; (1975) 6 ALR 642.

⁷ (1979) 45 FLR 279; 79 ATC 4325; (1979) 10 ATR 13; (1979) 25 ALR 557.

43. 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. Federal Commissioner of Taxation*⁸ (*Le Grand*).

44. *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. Justice Goldberg said:

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.

45. In paragraphs 5 and 6 of TR 2003/13⁹, the Commissioner, after considering the judgments referred to in paragraphs 40 to 44 of this Ruling, stated:

5. ...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.

6. 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.

46. In the present case, whilst the transfer payment is payable only to the relevant transferring employees who take up employment with the new service provider, the transfer payment is payable only on the condition that the employees have terminated their employment with the State. 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.

⁸ (2002) 124 FCR 53; [2002] FCA 1258; 2002 ATC 4907; (2002) 51 ATR 139; (2002) 195 ALR 194.

⁹ Taxation Ruling TR 2003/13 *Income tax: eligible termination payments (ETP): payments made in consequence of the termination of any employment: meaning of the phrase 'in consequence of'.*

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

- the payment will be made by the State,
- the payment is calculated by reference to each transferring employee's years of service with the State, and
- there are no obligations imposed on the relevant transferring employees to continue their employment with the new service provider for any particular period after the transaction.

48. The transfer payment is only payable on the condition that employees have terminated their employment with the State. Although the transfer payment is payable to those who take up employment with the new service provider, it more directly relates to the termination of employment with the State.

49. In view of the above, the proposed transfer payment is in consequence of the termination of employment

50. As the proposed transfer payment will be made in consequence of the termination of employment and will not be a payment mentioned in section 82-135, it will be an employment termination payment under section 82-130 where the payment is received within 12 months of the employee's termination of employment, or within any longer period allowed by a determination under subsection 82-130(4).

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

IT 2152; TR 2003/13;
TR 2006/10; TD 93/140

Subject references:

- dismissal of employees
- employment termination
- employment termination payments
- ETP components
- redundancy or early retirement scheme payments

Legislative references:

- ITAA 1997
- ITAA 1997 82-130
- ITAA 1997 82-130(1)
- ITAA 1997 82-130(1)(b)
- ITAA 1997 82-130(4)
- ITAA 1997 82-135
- ITAA 1997 83-295
- ITAA 1997 995-1
- ITAA 1936 27A(1)
- Corporations Act 2001

- Home Care Service Act 1988 (NSW)
- TAA 1953

Case references:

- Case K76 (1978) 23 CTBR (NS) 24; 78 ATC 703
- Case Q118 (1983) 27 CTBR (NS) 312; 83 ATC 610
- Le Grand v. Federal Commissioner of Taxation (2002) 124 FCR 53; [2002] FCA 1258; 2002 ATC 4907; (2002) 51 ATR 139; (2002) 195 ALR 194
- McIntosh v. Federal Commissioner of Taxation (1979) 45 FLR 279; 79 ATC 4325; (1979) 10 ATR 13; (1979) 25 ALR 557
- Paklan Pty Ltd and others v. Federal Commissioner of Taxation (1983) 67 FLR 328; 83 ATC 4456; (1983) 14 ATR 457
- Reseck v. Federal Commissioner of Taxation (1975) 133 CLR 45; [1975] HCA 38; 75 ATC 4213; (1975) 5 ATR 538; (1975) 6 ALR 642

ATO references

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