TR 96/D1 - Income tax: eligible termination payments (ETP): payments in consequence of the termination of any employment: meaning of the words 'in consequence of'

This document has been finalised by TR 96/13.

Draft Taxation Ruling

Income tax: eligible termination payments (ETP): payments in consequence of the termination of any employment: meaning of the words 'in consequence of'

other Rulings on this topic

IT 2255; IT 2286; IT 2490; IT 2620; TR 94/12

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What this Ruling is about

Class of person/arrangement

1. This Ruling considers the meaning of the expression 'in consequence of the termination of any employment' used in subdivisions A and AA of Division 2 of Part III of the *Income Tax Assessment Act 1936* (the Act).

2. The Ruling may affect a taxpayer seeking to claim that a payment, received in advance of the termination of employment, is an eligible termination payment (ETP).

3. This Ruling considers situations where payments are made prior to the termination of employment, and discusses the decision of the Administrative Appeals Tribunal in the case reported as *Case 44/94* 94 ATC 394; *AAT Case 9667* 29 ATR 1130.

4. The Ruling does not consider the circumstances that may constitute a termination of employment.

Ruling

5. Where a relevant payment is made at about the same time, or after, a termination of employment it will generally be accepted that

the relevant payment is made in consequence of the termination of employment.

6. On the other hand, where a relevant payment is made well in advance of a termination of employment which has not occurred at the date the payment is made, it would not be accepted to be 'in consequence of' that termination.

Date of effect

7. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does 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 the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

8. The term 'eligible termination payment' as defined in subsection 27A(1) of the Act includes any payment made 'in consequence of the termination of any employment' of a taxpayer other than certain specified payments.

9. The Full High Court of Australia considered the expression 'in consequence of the termination of any employment' in the case of *Reseck v. FCT* (1975) 133 CLR 45; 75 ATC 4213; 5 ATR 538. Jacobs J (CLR at 56; ATC at 4219; ATR at 545) (*Reseck's* case) said:

> '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".'

10. In the same case Gibbs J (CLR at 51; ATC at 4216 ; ATR at 541) 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.'

11. This case came to be considered by the Full Federal Court in *McIntosh v. FC of T* 79 ATC 4325; 10 ATR 13 (*McIntosh's* case) which concerned a taxpayer who became entitled to a payment subsequent to his retirement. The Full Federal Court emphasised the importance of the causal connection between a payment and the

termination of employment. However, this emphasis was founded upon the basis that a 'temporal progression of events' (ATC at 4336; ATR at 25) from the termination of employment to payment could be shown.

12. Lockhart J in *McIntosh's* case (ATC at 4335; ATR at 23-24) examined the dictionary meaning of the word 'consequence' and said:

> '...*Shorter Oxford English Dictionary*..."1. A thing or circumstance which follows as an effect or result from something preceding. 2. The action, or condition, of so following; the relation of a result to its cause or antecedent." The word "antecedent" is defined in the same dictionary as a "thing or circumstance which goes **before in time or order,** often also implying causal relation with its consequent".' (emphasis added)

13. Lockhart J considered the views of Jacobs J quoted at paragraph 9 of this Ruling (ATC at 4336; ATR at 25):

> 'In my opinion his Honour did not use the words "following on" as referring merely to a temporal progression of events. Rather His Honour had in mind a connection between the retirement from or the termination of employment and the payment in question **as well as** a temporal progression of events.' (emphasis added)

14. Where a relevant payment is made at about the same time, or after termination, it is generally accepted that the payment is made in consequence of the termination of employment. Although a decision must be made on the facts of each case, it is likely to have been so made. For example, where it is the employer's policy to pay the ETP to retiring employees shortly before their last day of employment, the payment would be regarded as in consequence of termination and therefore an ETP.

15. In contrast, it would be difficult to conclude that a relevant payment made well in advance of the termination of any employment 'follows on' from the anticipated event. For example, where a termination date is clearly contracted, payments made under that contract (prior to the termination) would 'follow on' from:

- entering into the agreement; or
- the fulfilling of contractual obligations.

Such payments would not 'follow on' from the termination itself.

The decision in *Case 44/94*; *AAT Case 9667*

16. In *Case 44/94; AAT Case 9667* the Tribunal considered a set of circumstances where the taxpayer wished to take up an approved early retirement scheme offer without suffering a significant reduction in superannuation benefits. To meet the requirements of the superannuation scheme rules, the taxpayer contracted to take leave of absence for thirty-one months, from 28 February 1992 to 30 September 1994, at which time he would attain the age of 55 and retire. Long service leave entitlements continued to accrue during his leave of absence. Under the terms of the contract the taxpayer received his voluntary separation payment and related amounts on 28 February 1992, his last day at work.

17. The Tribunal found, notwithstanding the terms of the contract, that the taxpayer had terminated his employment on 28 February 1992, when he ceased providing services to the employer. With respect, reservations are held as to the Tribunal's conclusion that the taxpayer had terminated his employment on 28 February 1992. It is the Commissioner's view that the taxpayer had in fact terminated his employment on 30 September 1994, and that therefore the Tribunal's conclusion on this point is not well founded.

18. The Tribunal went on to say that, even if the termination of employment is regarded as not occurring until 30 September 1994, the payment was made as a consequence of the termination of the employment of the taxpayer. However, for the reasons outlined in paragraphs 8 to 15 above, we doubt whether the Tribunal's *obiter dicta* is correct, notwithstanding the connection in this case between the payment and the later termination of employment.

19. An appeal to the Federal Court of Australia is possible only in relation to a question of law. In the particular case, the amount of tax was not substantial and it was decided not to appeal against the Tribunal's decision.

20. It is our view that, even if there is a connection between the payment and the termination of employment, except where the payment and the termination occur at about the same time, an ETP always takes place after retirement.

Examples

Example 1

21. A taxpayer attends a farewell function which has been organised by his colleagues to take place a week prior to his last working day.

At the function, a presentation of a cheque representing an ETP is made by a representative of the employer company.

22. In such a case, the lump sum would be treated as being 'in consequence of the termination of employment'. In effect, the payment has been made at about the same time with the termination of employment. On the facts of this particular case the payment could therefore be said to 'follow on' from such termination.

Example 2

23. A taxpayer enters into an employment contract with an employer for a period of three years, ending 30 September 1998. The contract specifies that the employee will be paid $20,000 per annum on a fortnightly basis, as well as a lump sum amount of $40,000 in respect of the pre-determined termination of employment. The lump sum is paid one year into the term of employment.

24. In such a case, the lump sum will be treated as income according to ordinary concepts, and not in consequence of termination of employment. The payment does not 'follow on' from any termination of employment; it follows on from entering into the employment contract.

Example 3

25. A taxpayer, aged 53 at 30 June 1995, wishes to take up the employer's offer of early retirement, but finds that the terms of the staff superannuation fund make early retirement financially undesirable. The employer proposes that the taxpayer enter into an agreement to go on leave until the age of 55 (30 June 1997), which will satisfy the terms of the superannuation fund. One clause of the agreement provides that long service leave will continue to accrue until 30 June 1997. Another clause states that the employee will return to work on the 30 June 1997. In all other respects, however, it is as if that agreement had not been entered into: the employee ceases providing services and receives the voluntary separation payment under the early retirement scheme on 30 June 1995.

26. In this scenario, the termination of employment took place on 30 June 1997. The payment does not 'follow on' from the termination of employment, and accordingly does not satisfy the description of a payment 'in consequence of the termination of any employment'.

Your comments

27. If you wish to comment on this Draft Ruling, please send your comments by Friday 1 March 1996 to:

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- McIntosh v. FC of T 79 ATC 4325; 10 ATR 13
- Reseck v. FC of T (1975) 133 CLR 45; 75 ATC 4213; 5 ATR 538
- Case 44/94 94 ATC 394; AAT Case 9667 29 ATR 1130