TR 2009/2 - Income tax: genuine redundancy payments

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Taxation Ruling

Income tax: genuine redundancy payments

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What this Ruling is about

1. This Ruling outlines the requirements to be satisfied before any payment made to a person whose employment is terminated qualifies for treatment as a genuine redundancy payment under section 83-175 of the *Income Tax Assessment Act 1997* (ITAA 1997).[1] Genuine redundancy payments are tax-free up to a limit worked out under section 83-170.

2. The Ruling also discusses the interaction between the tax treatment of genuine redundancy payments and the tax treatment of other termination payments provided for by Divisions 82 and 83.

3. This Ruling does not deal with early retirement scheme payments, the treatment of which is provided for in section 83-180.[2]

[1] All legislative references in this Ruling are to the ITAA 1997 unless otherwise specified.

[2] Approval for an early retirement scheme can be sought by requesting a class ruling. For further information on class rulings refer to Class Ruling CR 2001/1 Class Rulings system.

4. Section 27F and other provisions in the *Income Tax Assessment Act 1936* (ITAA 1936) that dealt with the treatment of bona fide redundancy payments were rewritten in section 83-175 and other provisions in Part 2-40 of the ITAA 1997. Unless specifically noted, the Commissioner considers the treatment of genuine redundancy payments under the ITAA 1997 to be identical to the treatment of bona fide redundancy payments under the ITAA 1936. This Ruling may therefore be relied upon to this extent when applying the relevant ITAA 1936 provisions to the 2006-07 income year and prior income years.

Ruling

Genuine redundancy payments and Part 2-40

5. The matter of what is a genuine redundancy payment is defined by section 83-175. The section identifies:

- the conditions that must be satisfied for at least a part of a payment to be treated as a genuine redundancy payment;
- how to work out what amount of the payment is a genuine redundancy payment; and
- what payments are excluded from being a genuine redundancy payment.

6. Section 83-175 is located within Part 2-40. Part 2-40 seeks to deal cohesively with all payments made in consequence of the termination of a person's employment as a common law employee.[3] The treatment of genuine redundancy payments must therefore be determined in this context.

7. Given this, and in particular the tax treatment afforded to genuine redundancy payments,[4] the Commissioner's view is that a genuine redundancy payment must be made **in consequence of** a termination of employment. Accordingly, genuine redundancy payments are payments made in consequence of a particular type of termination from employment (dismissal)[5] that is attributable to a particular reason (redundancy).[6]

[3] This is also known as employment under a contract of service. A common law employee can be contrasted with an independent contractor engaged under a contract for services. For the Commissioner's views on the distinction between employees and independent contractors, see Superannuation Guarantee Ruling SGR 2005/1: Superannuation guarantee: who is an employee?, in particular paragraphs 24 to 60 of that Ruling.
[4] See paragraphs 55 to 78 of this Ruling.
[5] See paragraphs 16 to 22 of this Ruling.
[6] See paragraphs 23 to 30 of this Ruling.

8. There are various circumstances in which an employee may be dismissed due to redundancy. Such circumstances range across a spectrum of employees (from senior executives to entry level salary and wage workers) and across a spectrum of possible relationships between the employer and the employee (in particular, whether the relationship between the employer and the employee is at arm's length). The genuine redundancy payment provisions can apply to all of these variations.

9. A close examination and evaluation of the particular circumstances of each employment relationship and how this impacts on the dealings between the parties will influence whether and to what extent a payment made on termination is a genuine redundancy payment.[7] Different outcomes under the law are attributable to the variations in these circumstances and how these impact on the conditions that need to be met under the genuine redundancy provisions.

The basic requirement for a genuine redundancy payment

10. Under subsection 83-175(1), a genuine redundancy payment is one 'received by an employee who is dismissed from employment because the employee's position is genuinely redundant'.

11. There are four necessary components within this requirement:

- The **payment** being tested must be **received *in consequence of* an employee's termination**.
- That termination must involve the employee being **dismissed from employment**.
- That dismissal must be **caused by** the **redundancy** of the employee's position.
- The redundancy payment must be made **genuinely** because of a redundancy.

12. The satisfaction of this requirement establishes the essential character of the payment. However, there are further conditions that must also be satisfied before a payment can be treated as a genuine redundancy payment.[8]

[7] See paragraphs 40 to 49 of this Ruling for the impact of non-arm's length dealings on the application of section 83-175 and paragraphs 79 to 94 for the application of section 83-175 to 'dual capacity' employees.
[8] See paragraphs 33 to 54 of this Ruling.

Component 1: Payment 'in consequence of' termination

13. As discussed above,[9] the Commissioner considers that any payment must be made 'in consequence of' the employee's termination before it can be a genuine redundancy payment. Taxation Ruling TR 2003/13[10] sets out the Commissioner's views on when a payment is made 'in consequence of' termination of employment.

14. It follows that any payment that meets the requirement identified at paragraph 11 of this Ruling will satisfy the 'in consequence of' condition for employment termination payments under paragraph 82-130(1)(a).

15. Some other payments, such as unused annual leave and unused long service leave, may also be made in consequence of termination. Any such payments that receive a more specific tax treatment are excluded from being genuine redundancy payments by subsection 83-175(4).[11]

Component 2: 'Dismissal' from employment

16. Subject to the exception recognised in paragraph 17 of this Ruling, the loss of a particular position with an employer is not a dismissal for the purposes of subsection 83-175(1) unless all employment with the employer is severed. The Commissioner's view is that a genuine redundancy payment can only arise where there is no suitable job available for the employee with the employer, meaning that he or she must therefore be dismissed.

17. The exception to this general principle is the case of a person holding an office with the employer at the same time as having a common law employment relationship[12] with the same employer. In this case dismissal from either the office or common law employment involves a dismissal from employment for the purposes of subsection 83-175(1). An example is a person who is both a director of the employer company and a common law employee of the company who is terminated from one of these two capacities.[13]

18. Dismissal is a particular mode of employment termination. It requires a decision to terminate employment at the employer's initiative without the consent of the employee. This stands in contrast to employment that is terminated at the initiative of the employee, for example in the case of resignation.

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[9] See paragraph 7 of this Ruling.
[10] 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'.
[11] See paragraph 55, 228 and 229 of this Ruling.
[12] See SGR 2005/1.
[13] See paragraphs 79 to 94 of this Ruling. In these cases, the question of whether any payment made is a genuine redundancy payment is assessed in the circumstances relating to the capacity in which the employee is terminated. There will also be circumstances where a single decision terminates employment in both capacities.

19. Consent in this context refers to the employee freely choosing to agree to or approve the act or decision to terminate employment in circumstances where the employee has the capacity to make such a choice. Determining whether an employee has consented to their termination requires an assessment of the facts and circumstances of each case. Consent may be either expressly stated by the employee or implied by their behaviour or conduct.

20. A dismissal can still occur even where an employee has indicated that they would be interested in having their employment terminated, provided that the final decision to terminate employment remains solely with the employer. Such a case may arise where expressions of interest in receiving a redundancy package are sought from employees as part of a structured process undertaken by the employer as a means of promoting industrial harmony.

21. Where an employee is given notice from their employer that they will be terminated at a specified time in the future due to genuine redundancy, that employee will be dismissed because of redundancy for the purposes of section 83-175. This will be the case even where an employee, following notification, negotiates with the employer or nominates to end their employment at an earlier time. Negotiation or nomination of the earlier date relates to the timing of the termination and not to the character of the termination as a dismissal. In determining whether any payment made in these circumstances would qualify as a genuine redundancy payment, the other conditions in section 83-175 would still need to be met.

22. Cases of 'constructive dismissal' are a dismissal for the purposes of subsection 83-175(1). Constructive dismissal is currently recognised to occur where the actions or behaviour of the employer in relation to the employment relationship effectively curtails the element of consent on the employee's behalf. The simplest example of constructive dismissal is where an employee resigns under threat (explicit or implicit) of dismissal. Another example is where the employee resigns after the employer offers work in an alternative position which is inappropriate given the employee's particular circumstances (for example, their skills or experience). While in form this appears to be a termination at the employee's initiative, it is recognised at law[14] to be a dismissal.

Component 3: Dismissal caused by 'redundancy'

23. As noted in paragraph 18 of this Ruling, dismissal is a particular mode of employment termination. Section 83-175 further requires that the dismissal be caused by redundancy of the employee's position, and not for some other reason.

[14] See paragraphs 256 to 258 of this Ruling.

24. As is the case in determining if there is a dismissal, the reason for a dismissal is to be established in light of the facts and circumstances of each case. The redundancy of the relevant position must be the prevailing or most influential reason for the dismissal if there is more than one contributing cause.

25. An employee's position is redundant when an employer determines that it is superfluous to the employer's needs and the employer does not want the position to be occupied by anyone. Accordingly, it is fundamentally the employer's decision that a position is redundant. On occasion the decision may be unavoidable due to the circumstances surrounding the employer's operations.

26. In some circumstances, an employer may reallocate the duties and functions attached to a particular position to another position within the employer's organisational structure. In such cases, the former position is redundant. However, if the employee who had been working in that position is still employed by the employer following the reallocation of duties and functions, there will not be a dismissal.[15]

27. On the other hand, if an employer decides after downsizing or some other structural reorganisation to terminate an employee, the former position of the employee is redundant as long as the downsizing or reorganisation is the prevailing or most influential cause of the termination.

28. A dismissal is not caused by redundancy where personal acts or default are the prevailing or most influential cause for the termination. For example, a person may be dismissed due to unsatisfactory performance or behaviour.

29. In some cases, an employer may decide to restructure their organisation at the same time as identifying underperformance of particular members of staff or areas within the existing organisational structure. In the event that employees are dismissed in these circumstances, careful consideration will need to be given to what was the prevailing or most influential cause of dismissal.

30. In circumstances where an employee resigns after being offered alternative employment with an employer following an organisational restructure, it will be necessary to assess whether the termination of employment amounts to a constructive dismissal.[16]

Component 4: 'Genuine' redundancy

31. Contrived cases of redundancy will not meet the conditions in section 83-175. Whether a redundancy is 'genuine' is determined on an objective basis.

[15] See paragraph 16 of this Ruling.
[16] See paragraph 22 of this Ruling.

32. The fact that an employer and employee have an understanding that a payment on termination is caused by redundancy or that the employer treats the payment as a redundancy payment for tax purposes does not of itself establish genuine redundancy.

Further conditions for a genuine redundancy payment

33. In addition to the basic requirement for a genuine redundancy payment found in subsection 83-175(1),[17] the further conditions for genuine redundancy payment treatment in subsections 83-175(2) and (3) require that:

- the dismissed employee is not older than specified age limits (paragraphs 34 and 35 of this Ruling);
- the termination is not at the end of a fixed period of employment (paragraphs 36 to 39 of this Ruling);
- the actual amount paid is not greater than the amount that could reasonably be expected had the parties been dealing at arm's length, in the event that the employer and employee are in fact not dealing at arm's length in relation to the dismissal (paragraphs 40 to 49 of this Ruling);
- there is no arrangement entered into between the employer and the employee or the employer and another entity to employ the dismissed employee after the termination (paragraphs 50 to 52 of this Ruling); and
- the payment is not in lieu of superannuation benefits (paragraphs 53 and 54 of this Ruling).

Age-based limits

34. Under paragraph 83-175(2)(a), an employee must be less than 65 years old at the time of dismissal for a redundancy payment to qualify as a genuine redundancy payment.

35. However, if the employment of a particular employee would have otherwise terminated at a younger age than 65, the employee must be dismissed before that time. This younger age becomes the employee's age-based limit in these circumstances.

[17] See paragraphs 10 to 32 of this Ruling.

Not the end of a particular period of employment

36. Under subparagraph 83-175(2)(a)(ii), a payment made at the end of a fixed period of employment cannot normally be a genuine redundancy payment.

37. However, some 'rolling' fixed-term contracts may, as a matter of fact, establish an ongoing employment relationship. The reference to 'rolling' contracts contemplates the situation where fixed-term contracts are renewed on one or more occasions following the expiry of the contracted term. The completion of a stipulated term in these circumstances does not necessarily disqualify a payment made at the end of the period from being a genuine redundancy payment. It is therefore possible that a genuine redundancy payment may be paid in these types of cases. However, where a contract is not renewed at the end of a contractually stipulated term, evidence is required to displace the express terms of the contract and establish an ongoing employment relationship.[18] This is likely to be the exception rather than the rule.

38. In some cases, particularly those involving multi-disciplinary project-based work, an employee's period of service may be determined by reference to the achievement of a particular outcome rather than a specified period of time. The employee's period of service in these circumstances concludes on the achievement of that outcome.

39. In some industries, 'rolling' outcome or project-based contracts are offered. Based on the same principles discussed at paragraph 37 of this Ruling, an ongoing employment relationship may, as a matter of fact, be established in these cases. A genuine redundancy payment may be paid in exceptional cases where the evidence supports the existence of an ongoing employment relationship, despite employment being terminated on the achievement of an outcome or the completion of a project.

Arm's length amount

40. The arm's length amount requirement in paragraph 83-175(2)(b) stipulates that the actual payment made should not exceed what could reasonably be expected if the parties had been dealing at arm's length. This condition only needs to be met if it is established that the employer and employee are not **dealing** at arm's length in relation to the dismissal.

41. If the **relationship** between the employer and employee is not at arm's length, it will not necessarily follow that any **dealing** between the parties is not at arm's length. Nevertheless, the relationship between the parties is a significant factor in assessing the nature of the dealing in relation to the dismissal.

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[18] However, the fact that an additional payment is made on not renewing a fixed-term contract would not of itself establish that there had been an ongoing employment relationship. Such a payment is still likely to be an employment termination payment.

42. If the parties are not dealing at arm's length, then it must be the case that the amount paid was no more favourable to the employee than what could reasonably be expected had the parties been dealing at arm's length.

43. This condition contrasts the actual non-arm's length dealing with a hypothetical arm's length dealing. Apart from this change, all other circumstances surrounding the termination of the employment relationship are assumed to be the same.

44. If the original employment arrangement (for example, an employment contract, award or other form of industrial agreement) involves an arm's length dealing, the amount that could reasonably be expected under an arm's length termination dealing is usually the redundancy entitlement, if any, under that arrangement. Special circumstances peculiar to the employee would be required to establish a reasonable expectation of an amount greater than the entitlement under the employment arrangement.

45. It does not necessarily follow that what could reasonably be expected at arm's length is zero if there is no contractual or other entitlement to a redundancy payment under an arm's length employment arrangement. It is reasonable in some circumstances to expect ex gratia redundancy payments to be made.

46. In any case, the years of service provided by the dismissed employee and the value of their remuneration package at the time of the dismissal are the most influential factors in determining what could reasonably be expected under an arm's length dealing.

47. If an employee's overall remuneration package reflects a non-arm's length dealing and is less than what would be expected to be provided to an arm's length employee, this should properly be taken into account in working out an arm's length redundancy payment. While it is considered appropriate to take into account an arm's length remuneration package as part of the hypothetical arm's length dealing, the Commissioner's view is that a proper basis does not exist for the arm's length redundancy payment to provide compensation to the employee for the shortfall in remuneration over the course of the employment relationship.

48. Ensuring that the amounts paid under any actual arm's length dealings are worked out on a comparable basis to those conducted other than at arm's length is also an important factor to take into account in establishing that this condition is satisfied.

49. If the payment is more than the arm's length amount, then the entire payment is disqualified from being a genuine redundancy payment. Like the other tests in subsection 83-175(2), the arm's length amount requirement is a condition for a payment to be treated as a genuine redundancy payment.

No stipulated arrangement to employ

50. Under paragraph 83-175(2)(c), an arrangement to employ an employee after his or her termination prevents a dismissal giving rise to a genuine redundancy payment if that arrangement is entered into between either:

- the employer and the dismissed employee; or
- the employer and another entity.

51. In the second of these two cases, the other entity would commonly be the new employer, although this need not necessarily be the case. For instance, there could be an arrangement between a subsidiary company, the employer, and a holding company, the other entity, to employ the terminating employee in another subsidiary company within the group.

52. The Commissioner considers that the phrase 'arrangement… to employ' in paragraph 83-175(2)(c) refers to common law employment only. This condition does not contemplate a situation where there is an arrangement to engage the former employee as an independent contractor.

Payments not in lieu of superannuation benefits

53. Under subsection 83-175(3), a payment is not a genuine redundancy payment to the extent that it is made in place of superannuation benefits due at the time or in the future.

54. Superannuation benefits, as defined, are generally made by reason of a person's entitlement under a superannuation fund, a similar superannuation plan or superannuation-related legislation.[19] Superannuation benefits are also specifically excluded from being genuine redundancy payments under subsection 83-175(4). Therefore, a payment that is excluded under subsection 83-175(3) would have to be made by an entity other than in respect of a person's superannuation entitlement (for example, by the employer instead of the employee's superannuation fund) which seeks to take the place of such an entitlement.

[19] See the definition of 'superannuation benefit' in subsection 307-5(1).

Tax treatment of genuine redundancy payments

Division of termination payments on redundancy into elements for tax purposes

55. If each of the conditions (that is, the basic and further requirements) for genuine redundancy payment treatment are satisfied,[20] the following steps are taken to work out the tax treatment of the payments that are consequently made:

Step 1

Identify and exclude any amounts that are subject to a more specific tax treatment than employment termination payments or genuine redundancy payments.

A full list of such payments is set out in section 82-135.[21] These payments include: superannuation benefits; pensions or annuities; unused annual leave payments; unused long service leave payments; and foreign termination payments.

Step 2

Determine the extent to which the remaining amounts (some or all) may be genuine redundancy payments.

To do this, deduct the amount that could reasonably be expected if the employee had voluntarily terminated their employment.

Step 3

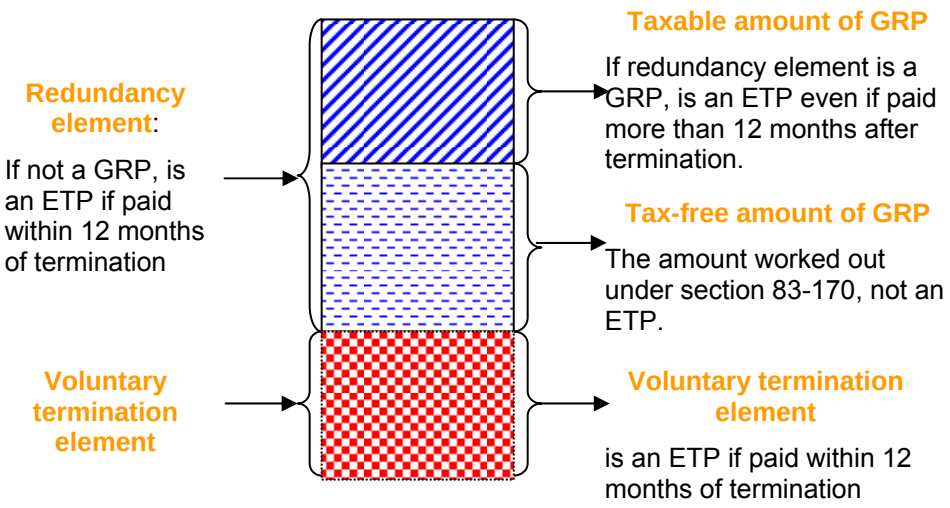
Apply section 83-170 to work out the extent to which any genuine redundancy payment so identified is tax-free.

Step 4

After going through this process there are two possible remaining amounts. One is any assessable part of the genuine redundancy payment in excess of the tax-free amount. The other is the amount that could reasonably be expected on voluntary termination. These amounts are generally treated as employment termination payments.

56. Therefore, a payment meeting the conditions in section 83-175 can be divided into a number of elements, as represented in the diagram below (the height of the rectangle representing total payments made on redundancy identified at step 2 under paragraph 55 of this Ruling).[22]

[20] See paragraphs 10 to 54 of this Ruling.
[21] Paragraph 82-135(e) is ignored to the extent that it covers the tax-free amount of a genuine redundancy payment.
[22] In the diagram, GRP stands for genuine redundancy payment and ETP stands for employment termination payment.



The voluntary termination element

57. Assuming that the genuine redundancy payment requirements in section 83-175 are satisfied in relation to a payment, subsection 83-175(1) identifies that part of the payment that is specifically attributable to the fact that employment has been terminated because of redundancy. Only this part of the payment can receive tax-free treatment.

58. Subsection 83-175(1) identifies the amount attributable to redundancy by deducting the amount that could reasonably be expected to be received by the employee if he or she had voluntarily terminated employment at the time of being dismissed. In this Ruling, this is referred to as the **voluntary termination element** of a redundancy payment.

59. Apart from this hypothetical change in circumstances to a voluntary termination instead of a dismissal caused by redundancy, all other circumstances surrounding the termination are assumed to be the same.

60. Accordingly, if the employer and the employee were not dealing with each other at arm's length in relation to the dismissal, this must form part of the circumstances for the purposes of working out the voluntary termination element.

61. It would generally be expected that a greater amount would be paid on redundancy than voluntary termination. This recognises the purpose of redundancy payments, being primarily to compensate for loss of non-transferable entitlements (for example accrued sick leave and accrued long service leave prior to 10 years service) and the peculiar hardship associated with being made redundant.

62. Contractual or other entitlements payable by an employer on voluntary termination are generally a sound guide as to what might reasonably be expected. However, this would be less so if the employer and employee are not dealing at arm's length.

63. There may be industry norms that could be used as a guide as to what payments would be made on voluntary termination. It may also be appropriate to compare standard payments made on voluntary termination within a particular company. However, these comparisons must take account of the actual nature of the dealings as influenced by the relationship between the parties.

64. A payment in lieu of notice can be a genuine redundancy payment provided that such a payment would not be expected on voluntary termination.

65. The voluntary termination element of a genuine redundancy payment is subject to tax as an employment termination payment if it is received no later than 12 months after the termination.[23] Otherwise, this element of the payment is taxed as an ordinary amount of assessable income under section 83-295, unless the Commissioner decides to treat it as an employment termination payment.

The remaining redundancy element

66. The remaining part of the payment (referred to in the diagram at paragraph 56 of this Ruling as the 'redundancy element') is a genuine redundancy payment for the purposes of Part 2-40 if all of the relevant conditions in section 83-175 are satisfied.[24]

67. In the event that the requirements in section 83-175 are not met in relation to the payment, this remaining element is treated in an identical manner to the voluntary termination element. That is, it is an employment termination payment if it is received no later than 12 months after the termination, but is otherwise included in assessable income under section 83-295.

Tax-free amount of a genuine redundancy payment

68. Some or all of a genuine redundancy payment may be non-assessable non-exempt income, and accordingly tax-free, under section 83-170.

69. The extent to which the payment is tax-free will depend on the amount of the payment and the total number of whole years of employment to which the payment relates. There is no requirement for the years of service to be continuous when applying the threshold in section 83-170.[25]

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[23] There was no requirement that the payment be made within 12 months to be an eligible termination payment under the ITAA 1936.
[24] As discussed at paragraphs 10 and 54 of this Ruling.
[25] The payments made to the employee should take account of any special circumstances that arise because of discontinuous service, such as impact on leave entitlements and the amount of any payouts attributable to earlier terminations.

70. If earlier years of service with a previous employer are carried over and acknowledged on commencement with a new employer that later makes a redundancy payment to an employee, those years of service can be included in working out the tax-free amount of the genuine redundancy payment.

71. For example, this enables earlier years of service with employers within a group of entities to be recognised when an employee is ultimately terminated from one of the employers in the group. Recognition of previous service within the group in working out the termination payment should be documented by the terminating employer.

Taxable amount of a genuine redundancy payment

72. Any amount of a genuine redundancy payment in excess of the tax-free amount worked out under section 83-170 will be taxable as an employment termination payment. This is so even where the amount is received more than 12 months after the termination.[26]

Multiple payments for one dismissal due to redundancy

73. There will be cases where an employee receives payments in consequence of their dismissal due to redundancy other than as one amount paid at a single point of time. For example, an employee's redundancy payout may be paid as a series of amounts, whether by way of structured instalments or due to cash flow constraints of the payer. It is also possible that amounts paid in consequence of dismissal due to redundancy may be made by more than one payer, which may or may not include the terminating employer.

74. While it may be possible to identify more than one 'payment' in some of these circumstances according to the ordinary meaning of that term, the Commissioner considers that the provisions of Part 2-40 operate to unify any such payments as a single sum attributable to redundancy when working out the tax treatment of the payments.

75. Therefore, in these circumstances, it is necessary to properly take account of all other redundancy payments made at the same or an earlier time when working out how to treat a given redundancy payment. The structure of Part 2-40 and provisions governing the tax treatment of the payments contemplates that this cumulative approach be adopted.

76. This requires that all payments made in consequence of the dismissal up to and including the time of the payment in question are assessed against a single voluntary termination element worked out at the time of the dismissal. Similarly, the tax-free amount of a genuine redundancy payment can only be claimed once for any given termination of employment because of redundancy.

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[26] See subsection 82-130(4).

77. Where multiple redundancy payments are made over more than one income year, this cumulative approach does not require that the payments be brought to account in a single income year. To the extent that the payments are taxable, they are brought to account in the year that they are received.

78. The elements in working out the tax-free amount threshold for a genuine redundancy payment under section 83-170 are indexed annually. In bringing amounts to account in the year that they are received, the total tax-free amount applied under this cumulative approach is that in the latest income year an amount is received.[27]

Dual capacity employees

79. A **dual capacity employee** is a person who, in addition to being engaged as an employee of an employing entity, is also a directing mind of, or holds an office, with that entity. The most common example is a person who is a director of the employer while also being a common law employee of that company. In many cases a dual capacity employee will have made or actively participated in a decision to terminate their own employment in either or both capacities.

80. Under section 80-5, the concept of employment for the purposes of Part 2-40 is extended to include the holding of an office. Therefore, termination of a dual capacity employee in either employment capacity will be sufficient to be a termination of employment for Part 2-40 purposes, even if the person continues to hold employment with the employer in the other capacity.

81. Otherwise, the same principles apply to a dual capacity employee as they apply to a single capacity employee when working out whether a termination payment is a genuine redundancy payment. There are no special rules applying to dual capacity employees. The separate discussion of the application of the law to such an employee in this Ruling recognises the impact of the employee's ability to act or make a decision to terminate their own employment (either directly or indirectly),[28] or to actively participate in or influence such an act or decision, on the satisfaction of the conditions in section 83-175.

82. As noted earlier,[29] dismissal requires termination of employment without the employee's consent. Because a dual capacity employee can terminate their own employment or actively participate in or influence such an act or decision, careful consideration of all the facts and circumstances is required to determine whether a dual capacity employee has not consented to their termination.

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[27] Examples 20 to 23, set out at paragraphs 192 to 210 of this Ruling, illustrate the practical operation of the cumulative approach described here where more than one amount is received in respect of a single termination caused by redundancy.
[28] An example of an indirect termination decision is one made to close all businesses or operations carried on by the employing entity.
[29] See paragraph 18 of this Ruling.

83. As consent is reflected in a person's state of mind, the Commissioner considers that is not possible for a person to consent to a decision in his or her capacity as a director of the employer, yet not consent to the same decision in his or her capacity as an employee.

84. It follows that the question of consent for a dual capacity employee can be addressed by considering the following two matters:

- First, did the person agree to or approve the employer's act or decision to terminate their own employment? If not, the termination is without the person's consent and is therefore a dismissal.
- Secondly, if the person did agree to or approve the employer's act or decision to terminate their own employment, were the circumstances surrounding the act or decision such that the person did not have any real or practical choice in terminating their own employment. If so, the termination is without the person's consent and is therefore a dismissal.

85. In relation to the first of these two matters, the agreement or approval of a dual capacity employee to the relevant decision may be express (for example, by actively participating in the decision-making process and assenting to the ultimate decision) or implied by behaviour or conduct.[30]

86. In contrast, a dual capacity employee may be dismissed where the decision to terminate employment is not a unanimous decision of the directing minds of the employer. If it can be demonstrated that a dual capacity employee did not consent to the decision to terminate their employment, the person is dismissed.

87. In relation to the second of these two matters, a dual capacity employee, who, in their capacity as a directing mind of the employer, actively agrees to a decision of the employer to terminate their own employment, may nevertheless be dismissed if he or she does not freely consent to that termination decision. This will be evident where the influence of external circumstances is such that there is no apparent choice to be made or there is no awareness from those circumstances that consent or refusal is called for.

88. Such external circumstances include a termination decision that is dictated by legal or economic compulsion originating from outside the business. An industry specific or a general economic downturn is also more likely to give rise to these types of circumstances.

89. This recognises a form of constructive dismissal[31] for dual capacity employees where they participate in and agree to a decision to terminate their own employment. While it appears that the dual capacity employee has consented to the termination, the reality is that the consent was not freely given.

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[30] See paragraph 19 of this Ruling.
[31] See paragraph 22 of this Ruling.

90. An example of a dismissal of this type is where a company loses the contract that is the only source of its business. Nevertheless, circumstances of no real or practical choice for dual capacity employees are not limited to business closure scenarios. It may also be the case that an identified part of a business must cease operations, for example because a particular product or service is obsolete. In these circumstances, the directors may have no choice but to terminate themselves and the other employees from the jobs that they had performed for the company.

91. In contrast, there will be other circumstances where it is clear that a dual capacity employee consents to the termination of their own employment. While the termination decision may be made under some constraints, the making of a real choice by the dual capacity employee establishes consent to that decision. These cases do not give rise to dismissal from employment for the dual capacity employee.

92. Making or agreeing to a decision to terminate one's own employment because it is the best available business option is not in itself sufficient to give rise to the absence of consent. The availability of options often reflects a real element of choice between genuinely competing approaches.

93. Equally, a dual capacity employee may consent to a decision to terminate their own employment when acting in the best interests of the company (as he or she is required to under corporations law) in making or agreeing to that decision. For example, this may occur in a situation where a viable ongoing business receives a generous offer for its sale.

94. Other issues that need to be considered under section 83-175 where a dual capacity employee is terminated include:

- whether the employee's position is genuinely redundant;[32]
- whether the amount paid to the employee is in excess of what could reasonably be expected if the employer and employee had been dealing at arm's length;[33]
- whether there is a stipulated arrangement to employ the employee in the future at the time of the dismissal;[34] and
- what the voluntary termination element is, given the non-arm's length dealing that may have taken place in relation to the termination of employment.[35]

[32] See paragraphs 31 and 32 of this Ruling.
[33] See paragraphs 40 to 49 of this Ruling. Where a dual capacity employee is also actively involved in deciding on their own termination, including the amount he or she is to be paid on termination, it will often follow that the dealing will be considered to be not at arm's length.
[34] See paragraphs 50 to 52 of this Ruling.
[35] See paragraphs 57 to 65 of this Ruling.

Examples

Examples involving dual capacity employees

Example 1 – Dual capacity employees, loss of business source[36]

95. Edsel Design Pty Ltd (Edsel Design) provides car design services to Aussie Autos, a large car manufacturing company. Bill and Mary Edsel are directors of Edsel Design, which employs 20 people in its car design operations. Bill is the Administration and Marketing Manager and Mary is the Design Manager.

96. Aussie Autos decides to cease operations immediately as a consequence of several years of losses. Bill and Mary have an emergency meeting with their accounting and business advisers and also decide to cease the operations of Edsel Design immediately.

97. Their advisers explain that there would be severe costs and risks associated with continuing operations without a source of business as Aussie Autos is Edsel Design's sole client and other opportunities are not available in the short to medium term.

98. Redundancy payments are made to all employees, including Bill and Mary, equal to eight weeks pay over and above unused leave entitlements and payment in lieu of notice equal to four weeks pay. None of the employees have an entitlement to redundancy payments under the employment arrangements that are in place.

99. In the past, any employee who retired had habitually received an amount as a retirement bonus. The amount of the bonus is six weeks pay for service of more than 15 years.

100. As Bill and Mary are in their late 50s, they both decide to retire. Edsel Design has been in business under Bill and Mary's guidance for 25 years.

101. While Bill and Mary are dual capacity employees, it is clear from the circumstances surrounding their termination that they are dismissed from their employment because of redundancy. In their capacity as directors they had no real or practical choice but to terminate their own employment along with that of all the other employees.

102. Although it may be demonstrated that Bill and Mary are not dealing with each other at arm's length in relation to their dismissal, their years of service and the equivalent treatment of other employees dealt with at arm's length demonstrates that the amount that they received is not greater than what could reasonably be expected had they been dealing with Edsel Design at arm's length.

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[36] The circumstances giving rise to the termination of employment are broadly similar to those in *Re Long and Commissioner of Taxation* (*Long*) [2007] AATA 1269; 2007 ATC 2155; (2007) 66 ATR 806 – see paragraphs 361 to 365 of this Ruling.

103. The amount that Bill and Mary could reasonably be expected to be paid on voluntary termination is equal to six weeks pay. Accordingly, the amount of the genuine redundancy payment received by Bill and Mary is the equivalent of 6 weeks pay (comprising of the remaining two weeks pay over and above unused leave entitlements and a payment in lieu of notice equal to four weeks pay).

Example 2 – Dual capacity employees continuing employment

104. Assume the same facts as in Example 1, except that Bill and Mary seek and find design work before Aussie Autos cease operations. The work involves providing short-term consultative services to various firms in the car industry.

105. If this work were carried out through Edsel Design, the employment of Bill and Mary would not be terminated. On the other hand, Bill and Mary might do the work through another entity which they control. In circumstances where there is a real or practical choice to have the work done by a controlled entity other than Edsel Design, Bill and Mary will have consented to the decision to terminate their employment and it would therefore not be considered a dismissal.

106. Alternatively, their redundancy with Edsel Design may not be considered to be genuine in these circumstances. Depending on the facts, it may also be established that there is an arrangement between Edsel Design and the new employing entity to employ Bill and Mary.

107. Therefore, in these circumstances, no part of the payment received by Bill and Mary is a genuine redundancy payment.

Example 3 – Dual capacity employee, dismissal where part of business continues

108. Assume the same facts as in Example 1 except that Edsel Design provides both car design and business consultancy services as part of its business prior to Aussie Autos ceasing operations. Also assume that Bill is exclusively employed in the business consultancy work while Mary is exclusively employed in the design work.

109. As a consequence of Aussie Autos ceasing operations, Mary's employment is terminated, although the company continues to provide business consultancy services. Mary is involved in and agrees with the decision to terminate her own employment.

110. In these circumstances, a termination payment received by Mary is a genuine redundancy payment. As in Example 1, the circumstances surrounding Mary's termination establish that it is without her consent, despite her apparent agreement to the termination decision.

Example 4 – Dual capacity employee, legal compulsion to cease business

111. Michelle Ozoile is the sole director of Soft Transformations Pty Ltd (Soft Transformations), a company that supplies a range of products based on an oil that softens the skin and is reputed to prevent aging. Michelle manages all the business of the company. The company has operated the business since 2004 and has continuously employed three other staff since opening.

112. The State Government passes a law in 2008 prohibiting the sale of the oil because there is medical evidence that it causes skin diseases. Michelle decides to discontinue the business after a meeting with her lawyer makes it clear that she has to abide by the new law. She terminates the employment of all of her employees (including herself) and pays all unused leave entitlements.

113. Michelle's lawyer had drawn up an employment contract for her when the business commenced operations that provided that she would be entitled to the equivalent of two years salary as a redundancy payment in the event that the company could not continue operations. No other employee is entitled to a redundancy payment. Michelle is paid the amount provided for under the contract.

114. In these circumstances, Michelle is dismissed from employment. Her termination is legally compelled and therefore she has no real or practical choice in terminating her own employment and that of her employees

115. However, Soft Transformations and Michelle are not dealing at arm's length in relation to her termination. The amount Michelle receives is in excess of what could reasonably be expected if the parties had been dealing at arm's length. In Michelle's case, two years salary is an excessive redundancy amount for a person who has been engaged in any employment for four years.[37] The original contract giving rise to the payment entitlement was not itself made at arm's length so it cannot be relied on to support that the payment is an arm's length amount. The fact that employees dealt with at arm's length received no redundancy payment further supports this conclusion.

116. Accordingly, no part of the payment received by Michelle is a genuine redundancy payment.

Example 5 – Dual capacity employees, economic compulsion to wind-up business

117. Angelina and Maria Marionetti are directors and the sole employees of a company, Marionetti Kinetics Pty Ltd (Marionetti Kinetics), which manufactures puppets. The company employs Angelina and Maria to design and make the puppets.

[37] Evidence (such as industry standards) would be required to establish this as an arm's length amount.

118. The profitability of the business is affected over a number of years by declining sales. This trend impacts to the point where there is only a small amount of working capital left in the company. After meeting outstanding liabilities, Angelina and Maria decide to pay out all remaining capital as redundancy payments.

119. These amounts are equal to approximately four weeks salary each for Angelina and Maria. They have carried on the puppet manufacturing business for 10 years.

120. A written agreement is in place between Angelina and Maria to the effect that any capital is to be retained in the company in the event that either Angelina or Maria voluntarily decides to leave the business.

121. Following the closure of the business, Angelina and Maria actively seek employment in the job market. They each find jobs with arm's length employers shortly after the business closes.

122. The entire amounts received by both Angelina and Maria are genuine redundancy payments. The overall state of the business at the time of its closure indicates that Angelina and Maria had no effective choice other than to cease operations. They were therefore dismissed from employment.

123. While the dealing with Marionetti Kinetics is likely not to be at arm's length, the amounts they received do not exceed what could reasonably be expected under an arm's length dealing given their years of service. All other conditions in section 83-175 are satisfied. The voluntary termination element is zero given the arrangement to retain capital in the event that either Angelina or Maria voluntarily terminates their employment.

Example 6 – Dual capacity employees, voluntary sale of business

124. Assume the same facts as in Example 5, except that Angelina and Maria decide to sell the business when sales and profits indicate a viable ongoing business. There is significant capital retained in the business at the time. The ultimate purchaser pays an amount for the business that is greater than what Angelina and Maria were prepared to sell it for, based on their own valuations. Before transferring the business to the purchaser, Angelina and Maria pay themselves four weeks salary each.

125. In these circumstances, Angelina and Maria consent to the decision to sell the business and terminate their employment. They are not dismissed from employment. The fact that a decision is made to terminate employment, which can be argued to be the best available or the most rational in the circumstances does not indicate that there is no real or practical choice present in the decision-making process.

126. This is so even where the directing minds have a fiduciary duty to act in the best interests of the employing entity. This duty is operative at all levels of decision-making on behalf of the entity. Fulfilling this duty will involve an effective lack of consent only where external circumstances mean that that there is no real or practical choice being exercised.

127. Accordingly, no part of the payments received by Angelina and Maria are genuine redundancy payments in these circumstances.

Example 7 – Dual capacity employees, loss of key employee

128. Ming Lee and Leong Chung conduct a business importing antique vases through a discretionary trust, of which Oriental Vases Pty Ltd (Oriental Vases) is the trustee. Oriental Vases employs two employees in addition to Ming and Leong. Ming and Leong are also the two directors of the trustee company.

129. Oriental Vases make supplies to a number of retailers. Ming has particular expertise in sourcing and assessing the value and quality of the vases. Leong is responsible for maintaining relationships with retailers.

130. Following a dispute regarding the operations of the business, Ming resigns and sells his stake in the business to Leong, before setting up his own importing business. Leong seeks to find a replacement for Ming but, due to the specialised nature of Ming's skills, Leong is unable to find a new business partner. Retail clients of the business soon commence dealing with Ming's new business.

131. Leong decides to wind up the business. He is paid a redundancy amount precisely equal to the tax-free amount of a genuine redundancy payment for Leong under section 83-170 (which is equal to approximately 16 weeks pay). Leong has worked in the business for seven years. The other two employees, who have worked for two and five years respectively, each receive a redundancy payment equal to one weeks pay.

132. Leong is dismissed from employment due to redundancy in these circumstances. He had no real or practical choice other than to cease business when it became clear that ongoing operations were critically dependent on Ming's expertise.

133. While Leong could reasonably be expected to receive a greater amount on redundancy than the two arm's length employees (due to the higher value of his services and his longer period of service), the extent of the discrepancy in their treatment suggest that the amount received by Leong is in excess of what could reasonably be expected had he been dealing at arm's length with Oriental Vases in relation to his termination. The exact payment of the tax-free amount is not a proxy for the arm's length amount.

134. As the arm's length amount requirement is a condition for the payment to be a genuine redundancy payment, no part of the payment received by Leong is a genuine redundancy payment.

Example 8 – Dual capacity employee of subsidiary – new position offered within company group – arrangement to employ

135. William Scribe is the editor of Businessday, a current affairs magazine. William is also the Executive Director of Newsworth Pty Ltd (Newsworth), the company that conducts the publishing operations for the Businessday magazine. The directors of Global Journals Ltd (Global Journals), the holding company that owns Newsworth, decide to close the company due to the Businessday magazine having incurred losses over successive years. William holds no position or office with Global Journals. The board of Newsworth, including William, vote for the winding up of the company, in accordance with the directions of the board of Global Journals.

136. Global Journals owns other magazine and newspaper interests. William is offered a position as the Washington editor of a daily newspaper, The National, when Newsworth is informed of its impending closure.

137. The directors of Newsworth pay William a lump sum of $100,000 because of the redundancy of his position with the company. William accepts the new position as editor of The National.

138. In these circumstances, William does not consent to his own dismissal as both director of Newsworth and editor of the Businessday magazine (that is, employee of Newsworth). The decision of the board of Newsworth to wind up the company is compelled by the decision of Global Journals, such that there is no real choice to continue the operations of the company. Both positions are redundant.

139. However, the facts indicate that there was an arrangement in place between Newsworth and one or more entities within the Global Journals group to employ William at the time of his dismissal. Accordingly, the payment of $100,000 is not a genuine redundancy payment and is therefore assessable as an employment termination payment.

Example 9 – Dual capacity employee of entities within a company group

140. Assume the same facts as Example 8, except that William is a director of both Global Journals and Newsworth and is not immediately offered new employment at the time the decision is taken to close Newsworth.

141. If William does not approve the decision to close the Businessday magazine, he would be taken not to consent to his own dismissal as a director of Newsworth and employee of Newsworth (that is, editor of the Businessday magazine).

142. However, if William, as a director of Global Journals, approves the decision to close Newsworth, he would ordinarily be taken to consent to his own dismissal and there can be no genuine redundancy payment.

143. William will not consent to the decision to close Newsworth where external circumstances mean that the decision of Global Journals involves no real or practical choice. On the other hand, if the decision is one where the best business opportunities for the group are assessed and the decision to close the Businessday magazine is one involving the weighing up of viable alternatives, there is a real or practical choice available for William and the other board members when Global Journals effectively makes William's positions with Newsworth redundant.

144. A payment of the order of $100,000 on redundancy is found to be common practice in the industry. Therefore, in the event it is found that William and Newsworth are not dealing at arm's length, the amount paid is not in excess of what could be could be reasonably expected to be paid if the dismissal were at arm's length.

145. However, it will also be necessary to consider what could reasonably be expected on voluntary termination in these circumstances to determine the quantum (if any) of any genuine redundancy payment.

Example 10 – Dual capacity employee of entities within a company group – new position offered – no arrangement to employ

146. Assume the same facts as in Example 9, except that a month after William's termination with Newsworth, the position of editor of Rich Life, a style magazine, becomes vacant. Directors of the company publishing this magazine, some of whom are also directors of Global Newsworth, decide to offer the position to William.

147. As there was no arrangement at the time of William's termination of employment for him to be employed by another person, the amount he is paid may still be considered a genuine redundancy payment.

Examples illustrating need for redundancy to cause termination

Example 11 – Project-based contracts

148. Buildcorp makes contributions to an industry trust on behalf of its workers to cover the company for future termination payments (other than unused annual leave payments) it might be required to make under industry awards. The workers are all employed on a daily hire basis.

149. Buildcorp has a major construction contract to build an office block. Buildcorp's employees, its subcontractors and their employees have all been advised that they can expect to be employed on the project for at least six months, depending on their trade or other qualifications.

150. Three months into the project, all workers are terminated with a day's notice as required under their contracts because Buildcorp becomes insolvent and cannot meet its ongoing commitments.

151. The mutual intentions of the parties is that Buildcorp's employees will be employed until the completion of their tasks on the project, even though in form the contracts are made on a daily hire basis. Accordingly, in these circumstances, there is a dismissal caused by redundancy prior to the expiration of a fixed period of employment.

152. In contrast, if the workers had all completed their allotted tasks in keeping with the mutual intentions of the parties, any payments accruing on their termination of employment would not be eligible to be genuine redundancy payments. In these circumstances, the employees are terminated at the expiry of a fixed period of employment.

153. If Buildcorp has a core group of employees whom they retain indefinitely and are terminated on the company becoming insolvent, then the termination payments may also be genuine redundancy payments if the other conditions in section 83-175 are satisfied.

154. However, as the trust is established to meet Buildcorp's obligations to make termination payments in a variety of circumstances, it will be necessary to establish that the amount paid exceeds what could reasonably be expected on voluntary retirement. If the entitlements of the workers are the same regardless of the nature of the termination, the amount of the payment will equal the voluntary termination element. Accordingly, no part of the payment will be a genuine redundancy payment.

Example 12 – Negotiation of termination date

155. Siobhan is employed by Perpetual Plastic Co (Perpetual Plastic), a company that manufactures plastic bags. Siobhan's position in Perpetual Plastic is to take plastic bag orders over the phone. Due to a global decline in demand for plastic bags and the gradual implementation of an automated ordering service, Perpetual Plastic provides Siobhan with notice that she will be made redundant in 12 months time. Perpetual Plastic deems Siobhan's position to be superfluous, and does not wish to have the position occupied by anyone else.

156. Perpetual Plastic notifies Siobhan of the redundancy 12 months in advance in order to manage the transition to the new automated telephone ordering service and to give her as much notice as possible so as to assist her in securing alternative employment.

157. Shortly after being notified of her redundancy, Siobhan negotiates with her manager at Perpetual Plastic to end her employment in 2 months, rather than 12 months, time. Given that Perpetual Plastic expects the new automated system to be partially operational by that time, Perpetual Plastic agrees to bring forward the timing of the termination by 10 months.

158. At the time her employment ends, a termination payment is made to Siobhan, which comprises of the following components:

- two weeks pay under the employment arrangement in place;
- two weeks pay as an additional redundancy amount; and
- payment in lieu of notice.

159. On the facts as stated here, this new negotiated date for termination is not a relevant factor in determining whether Siobhan is being dismissed because of redundancy. The character of the termination as a dismissal is established when Perpetual Plastic notified Siobhan of her impending dismissal – negotiation of the termination date relates only to the timing of the termination.[38]

160. Therefore, in these circumstances, the payment to Siobhan qualifies as a genuine redundancy payment if all other conditions are satisfied. However, any amount that Siobhan would have received had she voluntarily resigned or retired will need to be excluded from being a genuine redundancy payment.

Example 13 – Business acquisition leading to redundancy, constructive dismissal

161. Dave Dolphin works as the Sales Manager for the Big Fish Company (Big Fish) which sells swimwear.

162. Big Fish acquires Plankton Pty Ltd (Plankton), a company that sells leisure clothing. As part of the acquisition, Big Fish employs Plankton's Sales Manager, Marion Minky. Marion assumes the role of Sales Manager in respect of all of Big Fish's expanded operations. Dave is offered a role as a swimwear sales representative for a particular district. This offer involves a considerable pay cut. As Dave sees his experience is better suited to the management of a team of salespeople rather than in front line sales, he decides to resign.

163. While Dave may have the skills to do the job he is offered, the job has significantly different duties and functions to that he performed previously. Accordingly, the synergies created by the acquisition of Plankton make Dave's former position redundant.

164. Therefore, a termination payment received by Dave in these circumstances may be characterised as a genuine redundancy payment on the basis that Dave was constructively dismissed due to redundancy.

[38] For the purposes of section 83-170, the years of service would be worked out on the basis of the negotiated termination date.

Example 14 – Business acquisition, acceptance of demotion

165. Assume the same facts as Example 13, except Dave chooses to accept the swimwear sales representative position together with a lump sum payment to compensate him for the loss of his Sales Manager position.

166. In these circumstances, Dave's employment with Big Fish is not terminated. Therefore, the lump sum payment cannot be characterised as a genuine redundancy payment.

Example 15 – Dismissal caused by underperformance, not redundancy[39]

167. Isis Nefertiti is the Chief Executive of a beauty product and weight reduction company called the Thin Line Corporation Ltd (Thin Line).

168. The company's profits have been decreasing for some time so the company's Board engage a strategic management consultant, who advises them to reorganise the corporate structure. The directors decide to follow the advice of the consultant.

169. However, because the directors are also concerned about the performance of Isis, they decide to terminate her employment as Chief Executive. An acting Chief Executive is appointed to manage the organisational change in lieu of the appointment of a new permanent Chief Executive.

170. A generous payment is made to Isis on her termination, which is stated to be and treated as a redundancy payment by Thin Line's Human Resources Department.

171. No part of this payment qualifies as a genuine redundancy payment as the position of Chief Executive is not redundant. The prevailing or most influential reason for Isis' termination is the Board's concerns with her performance. Thin Line's treatment of the payment as one made due to redundancy does not impact on the proper characterisation of the payment.

Example 16 – Dismissal for mixed reasons

172. Joe Kuhl is the sole director of an ice cream machine manufacturer, Arctic Dreams. The company has five employees who are involved in tasks related to the manufacture of the machines.

[39] The circumstances in this example are broadly similar to those in *Cowling* – see paragraphs 275 and 276 of this Ruling.

173. Joe had previously tried to dismiss one employee for disciplinary reasons but the employee had taken legal action to prevent this. Joe accepted the decision at the time but six months later he finds that there has been a drop in orders for the machines such that the company has one surplus employee. Joe decides to dismiss the employee he had previously tried to dismiss for disciplinary reasons.

174. Though the previous problem with the dismissed employee can be considered relevant to Joe's decision to dismiss him it is also the case that the more immediate reason for the dismissal is the redundancy of the position occupied by the employee. Therefore the prevailing or most influential reason for the dismissal is the redundancy of the position.

175. Accordingly, any termination payment made to the employee qualifies as a genuine redundancy payment if all other conditions are satisfied.

Examples of redundancy processes

Example 17 – Redundancy packages offered following employee expressions of interest – case 1

176. Implosion Corp is downsizing, and therefore a number of employee positions will no longer be required. Implosion Corp decides to implement a redundancy process and dismiss a number of employees equivalent to the number of positions that are being made redundant.

177. With a view to maintaining industrial harmony, Implosion Corp enters into discussions with the employees as to who would like to nominate for a redundancy package. Following those discussions Implosion Corp dismisses the selected number of employees.

178. Most of the dismissed employees had expressed an interest in receiving a redundancy package. However, some key employees who had expressed an interest in packages were not dismissed.

179. Those employees whose employment is terminated in these circumstances are still considered to be dismissed from employment as they have no ultimate control over who the employer chooses for termination, as evidenced by the fact that there are some key employees whom the employer chooses not to dismiss. Assuming all other conditions are met, payments made to the terminated employees under the packages are genuine redundancy payments.

Example 18 – Redundancy packages offered following employee expressions of interest – case 2

180. Sell Out Pty Ltd (Sell Out) has a team of 20 salespersons who sell promotional material at venues on behalf of entertainers. With a slowdown in the economy there are fewer concerts and other events that provide selling opportunities for the company.

181. The directors of the company have a meeting at which it is decided that it is not be possible to keep five of their salespersons on retainers. Minutes of the meeting record the sales data and live performance statistics that were used to arrive at this staff reduction figure. The directors decide to offer all sales staff the opportunity to volunteer for a redundancy package but also decide that they reserve the right to terminate the existing employment contracts of any sales staff whether or not they have expressed an interest.

182. It transpires that the directors decide to terminate the existing employment contracts of the five salespersons with the lowest sales figures and offer a redundancy package equivalent to 25% of gross sales figures for each of those salespeople in the previous year. Three of these salespersons had expressed an interest in the packages.

183. As an alternative to being made redundant, the salespersons identified could choose to stay on with the company on a purely commission basis. One salesperson decides to stay on as a commission salesperson. He also receives a payout, but of a lesser amount than the four who choose to take the redundancy package.

184. As the main reason for reducing the sales staff is the downturn in sales associated with a slowdown in the economy the payments made to the employees can be considered to be genuine redundancy payments even though it was the poorest performers whose employment contracts were terminated and even though some of the employees nominated themselves as being willing to take a redundancy package.

185. The package provided for the one employee who stays on as a commission salesperson does not represent a genuine redundancy payment as he is not dismissed from employment.

Examples illustrating genuine redundancy payment calculations

Example 19 – Working out the components of a termination payment

186. Anne Jones has been an employee of EX Pty Ltd (EX) for 20 years. The Board of EX decides that competitive pressures are such that staff numbers have to be reduced by 50%. Anne is subsequently dismissed from her employment.

187. Anne receives a lump sum payment of $200,000 from EX during the 2007-08 income year. Of this amount, $50,000 represents an unused annual leave entitlement and $50,000 represents an unused long service leave entitlement. Anne's employment contract also provided for a lump sum payment of $20,000 in the event of her resignation or retirement.

188. Subsection 83-175(4) provides that payments mentioned in section 82-135, which includes unused annual leave payments and unused long service leave payments, are not genuine redundancy payments.

189. Accordingly, the first step in working out the tax treatment of the $200,000 is to apply the rules for unused annual leave payments and unused long service leave payments[40] to the respective amounts of $50,000.

190. The balance of $100,000 is a genuine redundancy payment except to the extent of any amount Anne would have received had she voluntarily retired or resigned. As Anne would have received $20,000 in these circumstances, this voluntary termination element is excluded from being a genuine redundancy payment.

191. Therefore, the remaining $80,000 is a genuine redundancy payment. Under section 83-170, the base amount is $7,020 and the service amount is $3,511 for the 2007-08 income year. Therefore, the tax-free amount of her genuine redundancy payment is $77,240 ($7,020 + (20 x $3,511)). The remaining $2,760 is an ordinary employment termination payment.

Example 20 – Redundancy payment made in fixed monthly instalments over two years

192. Iris Novello writes jingles for an advertising agency called Inspirations & Insights (I&I). Due to a decline in profits, I&I make a strategic decision to specialise in computer graphics and therefore in July 2005, the Board of I&I decides that they no longer require her services.

193. Iris has been with I&I for 10 years and is entitled to $24,000 if she voluntarily resigns and $120,000 if she is made redundant.

194. An agreement is reached between I&I and Iris that she will be paid her termination payment over two years from July 2005 to June 2007 in 24 equal monthly instalments of $5,000.

195. The tax-free amount, as worked out under section 83-170, is $38,951 in the 2005-06 income year; and $40,703 in the 2006-07 income year. Her voluntary termination element is $24,000.

196. The total amount paid in the 2005-06 income year is $60,000. Of this amount $24,000 is the voluntary termination element, which is an employment termination payment. The balance of $36,000 is tax-free, being less than the tax-free amount in that year of $38,951.

197. In the 2006-07 income year, there is no voluntary termination element to be applied, as it has been exhausted in the 2005-06 income year. Of the $60,000 paid, $4,703 is tax-free ($40,703 – $36,000). The balance of $55,297 is an employment termination payment. This is because it remains a genuine redundancy payment and the 12 month rule for employment termination payments under paragraph 82-130(1)(b) does not apply to genuine redundancy payments because of paragraph 82-130(4)(b).

[40] See Subdivisions 83-A and 83-B respectively.

Example 21 – Redundancy payment made in uneven annual instalments over three years

198. Assume the same facts as in Example 19 except that due to a lack of funds, I&I pay Iris her termination entitlements in annual instalments of $25,000, $35,000 and $60,000 in each of the ensuing three income years (that is the 2005-06, 2006-07 and 2007-08 income years).

199. The tax-free amount for the 2007-08 income year is $42,130.

200. In the 2005-06 income year, $24,000 of the amount paid is the voluntary termination element, which is an employment termination payment. The remaining amount of $1,000 is tax-free.

201. In the 2006-07 income year, Iris receives a tax-free genuine redundancy payment only, as the whole amount of $35,000 falls within the potential tax-free amount of $39,703 for that year (the tax-free amount of $40,703 for the 2006-07 income year less the $1,000 tax-free amount received in the 2005-06 income year). The voluntary termination element is not applied again as it has been applied against the amount Iris received in the 2005-06 income year.

202. In the 2007-08 income year, the tax-free amount for Iris increases to $42,130. Of this amount, $36,000 has already been exhausted in relation to the 2005-06 and 2006-07 income years. Therefore, of the final amount of $60,000, only $6,130 ($42,130 – $36,000) is a tax-free genuine redundancy payment.

203. The balance of $53,870 ($60,000 – $6,130) is assessed as an employment termination payment even though it is paid more than 12 months after the termination. The 12 month rule for employment termination payments under paragraph 82-130(1)(b) does not apply to genuine redundancy payments because of paragraph 82-130(4)(b).

Example 22 – Redundancy payment made in instalments, for different reasons and by different but related payers

204. Assume the same facts as in Example 21 except that Iris also receives an additional ex gratia payment of $10,000 on termination from a related entity to I&I in the 2005-06 income year.

205. Therefore, in the 2005-06 income year, Iris receives a total of $35,000 — $25,000 from her employer and $10,000 from the related entity. As in Example 20, $24,000 of this amount is the voluntary termination element, which is treated as an employment termination payment, and $11,000 is a tax-free genuine redundancy payment.

206. In relation to $35,000 paid in the 2006-07 income year, $29,703 ($40,703 – $11,000) is tax-free and the balance of $5,297 ($35,000 – $29,703) is an employment termination payment.

207. In the 2007-08 income year, the tax-free amount increases to $42,130. Of this amount, $40,703 has already been used in relation to the first and second amounts. Therefore, $1,427 of the $60,000 amount received in this year is tax-free, with the remainder of $58,573 being treated as an employment termination payment.

Example 23 – Separate redundancy payments made by unrelated payers

208. On winding up its operations in the Big Desert, Dig It Mining Corp dismisses staff because of the redundancy of their positions. Redundancy payments are made by the company to these staff.

209. Bill Brown receives a genuine redundancy payment of which part is in excess of the tax-free amount. A little later in the same income year the State Government decides to pay all of the workers laid off by Dig It Corp $10,000 because their positions have been made redundant.

210. As any voluntary termination element and tax-free amount has already been applied to the amount paid to Bill by Dig It Corp, the amount paid by the State Government is a genuine redundancy payment in excess of the tax-free amount and is therefore treated as an employment termination payment.

Example 24 – Genuine redundancy payment on termination and further termination payment as a result of litigation[41]

211. In the 2006-2007 income year, Natalie Jones is dismissed from her position as a Centre Manager within the Reliable Child Care Company (Reliable) after 10 years of service. At this time, Reliable made a strategic decision to have individual child care centres operate as stand-alone businesses and accordingly wished to change the duties and functions undertaken by Centre Managers. Reliable considered that Natalie's skills were not suited to the redefined role.

212. Reliable pay Natalie a termination payment of $50,000 in addition to her unused leave entitlements and treat the payment as a genuine redundancy payment. Natalie is contractually entitled to $20,000 on voluntary termination.

213. Natalie sues Reliable for unfair dismissal and a year and a half after her termination, during the 2007-2008 income year, Reliable settles the case by making a further payment of $100,000 to Natalie.

214. As Natalie's position has effectively been made redundant because of the change in the duties attached to it, all or part of the payment is eligible to be treated as a genuine redundancy payment.

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[41] The facts relating to the termination in this example are broadly similar to those in *Dibb v. Commissioner of Taxation* [2004] FCAFC 126.

215. The voluntary termination element is equal to $20,000, so only $30,000 of the amount paid immediately on termination is a genuine redundancy payment in that year.

216. However, the total payment made in consequence of dismissal because of redundancy once the litigation has been settled is $150,000. Accordingly, $130,000 of this is a genuine redundancy payment.

217. In the year Natalie's employment is terminated, the total tax-free amount of the genuine redundancy payment is $40,703, of which $30,000 ($50,000 – $20,000) is applied.

218. In the year the litigation is settled, the total tax-free amount applying to Natalie is $42,130. As $30,000 of this amount has already been applied in respect of the first payment, $12,130 of the settlement funds is tax-free. Therefore, in respect of the entire genuine redundancy payment of $130,000, $42,130 is tax-free and the balance of $87,870 is an employment termination payment.

Date of effect

219. This Ruling applies to years of income commencing both before and after its date of issue. 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).

Commissioner of Taxation
22 April 2009

Appendix 1 – Explanation

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.

Overview of the termination payment regime – Part 2-40

220. Part 2-40, incorporating Divisions 80, 82 and 83, deals with payments made on termination of employment. Division 80 sets out some general rules for the termination payment regime. Division 82 provides for the tax treatment of employment termination payments. Broadly speaking, treatment as an employment termination payment is the default for payments made in consequence of termination of employment. Division 83 provides for the tax treatment of other termination payments, including genuine redundancy payments.

221. It is the Commissioner's view that Part 2-40 seeks to provide a comprehensive and cohesive treatment of payments made in consequence of the termination of a person's employment. The treatment of genuine redundancy payments, principally provided for in sections 83-170 and 83-175, is to be understood in the context of the overall termination payment regime.

222. Genuine redundancy payments (together with early retirement scheme payments) are unique among the termination payments treated under Division 83, in that they are capable of being treated as employment termination payments to some extent. That is, genuine redundancy payments are not a mutually exclusive category of payment.[42] The Commissioner considers that this feature is critical in determining the tax treatment of genuine redundancy payments as it points to an integrated approach to the payments made in consequence of a particular termination.

How do genuine redundancy payments fit within the termination payment regime?

223. An employee whose position becomes redundant and is consequently dismissed from employment may receive a variety of termination payments.

224. The payments may be sourced from legal entitlements of the employee or may be made gratuitously. Payment entitlements may arise under:

- the employee's employment contract;
- an industrial agreement that applies to the employee;
- statute or some other form of special Government funded scheme; or

[42] A payment is not an employment termination payment to the extent that it is a tax-free genuine redundancy payment – paragraph 82-135(e).

- legal proceedings instituted following termination, whether under a court award or settlement.

225. While redundancy payments would ordinarily be made by the employer of the terminating employee, the character of a payment as a 'genuine redundancy payment', or indeed as a termination payment more generally under Part 2-40, does not depend on whether an employer makes the payment.

226. It is also possible that payments may be received over a period of time in respect of a particular termination of employment. This period may extend over a number of income years for the employee.

227. Part 2-40 provides for the interaction of all such payments, including those payments that can be characterised and identified as genuine redundancy payments. The rules in Part 2-40 provide a mechanism by which the various payments made when an employee is terminated because of redundancy can be separated for tax treatment purposes.

228. Practically speaking, the first payments that need to be identified are those payments that receive a more specific treatment than redundancy payments and employment termination payments. In the case of redundancy payments, this is reflected in subsection 83-175(4), which excludes any payment mentioned in section 82-135, apart from paragraph 82-135(e), from being a genuine redundancy payment. Section 82-135 comprehensively lists any payment that may be made in consequence of termination of employment but is nevertheless excluded from being an employment termination payment.[43]

229. Some of the payments mentioned in section 82-135 are listed in the table below. The more specific treatment received by these payments is listed in the second column:

Payment type	Tax treatment
Superannuation benefits	The taxation of superannuation benefit rules – Divisions 301 to 307
Pensions or annuities that are not superannuation benefits	Section 27H of the ITAA 1936
Unused annual leave payments	Subdivision 83-A
Unused long service leave payments	Subdivision 83-B
Foreign termination payments	Subdivision 83-D

[43] Paragraph 82-135(e) deals in part with a genuine redundancy payment to the extent that it is tax-free. This is why paragraph 82-135(e) is disregarded under subsection 83-175(4).

230. While the circumstances in which such payments are made may be that of redundancy, the scheme of Part 2-40 characterises them for tax purposes as payments other than redundancy payments.

231. The remaining payments will generally receive concessional tax treatment as either a genuine redundancy payment or an employment termination payment.

232. Although separately defined from an employment termination payment, it is the Commissioner's view that a genuine redundancy payment is an employment termination payment unless and to the extent that it is tax-free, as worked out under section 83-170 and section 83-175. The primary feature that distinguishes the tax treatment of a genuine redundancy payment from that of an employment termination payment is that an identified part of a genuine redundancy payment may be tax-free. Once any tax-free amount is separated, the balance is treated as an employment termination payment.

The basic requirement for a genuine redundancy payment

233. The basic requirement for a genuine redundancy payment is described in the following terms in subsection 83-175(1):

> …so much of **a payment received by an employee who is dismissed from employment because the employee's position is genuinely redundant** as exceeds the amount that could reasonably be expected to be received by the employee in consequence of the voluntary termination of his or her employment at the time of the dismissal. [Emphasis added]

234. The Commissioner considers that there are four necessary components embodied in the basic requirement for a genuine redundancy payment. Each of these concepts are considered and explained in turn below:

- The **payment** being tested must be **received *in consequence of*** **an employee's termination**.
- That termination must involve an employee being **dismissed from employment**.
- That dismissal must be **caused by** the **redundancy** of the employee's position.
- The redundancy payment must be made **genuinely** because of a redundancy.

Component 1: Payment 'in consequence of' termination

235. It is the Commissioner's view that a payment must be **in consequence of** termination (by way of dismissal caused by redundancy) before any part of that payment can be treated as a genuine redundancy payment.

236. The purpose of subsection 83-175(1) is twofold – to identify what gives a redundancy payment its essential character; and to identify the amount that can be attributed to the fact of redundancy. The bolded words in paragraph 234 of this Ruling give effect to the first purpose. The second purpose is given effect by contrasting any payment that has this essential redundancy character with an amount that could reasonably be expected on voluntary termination.[44]

237. Once both of these purposes are taken into account, it is clear that the bolded words in paragraph 234 of this Ruling import the need for a causal relationship to exist between the payment and the particular form of termination contemplated by section 83-175. The reference to 'in consequence of' in relation to the voluntary termination element supports the view that the same 'in consequence of' test will establish the necessary causal relationship between the payments being tested and dismissal due to redundancy. The Commissioner's views on the meaning and application of the 'in consequence of' test are set out in Taxation Ruling TR 2003/13.[45]

238. Former section 27F of the ITAA 1936 stated that a bona fide redundancy payment was made in consequence of the dismissal of the taxpayer. There is no explicit requirement in section 83-175 of the ITAA 1997 that a genuine redundancy payment must be made in consequence of termination. However, as explained in paragraph 4.53 of the Explanatory Memorandum to the Tax Laws Amendment (Simplified Superannuation) Bill 2006, it was not intended to make substantive changes to the tax regime in respect of genuine redundancy payments. The provisions relating to these payments were intended to retain their existing application but were redrafted to reflect current drafting approaches.

239. It is also stated in section 83-1, the Guide to Division 83, that the Division sets out the treatment of payments other than employment termination payments that are made in consequence of termination.

240. These materials support the dual treatment of redundancy payments as either tax-free genuine redundancy payments or employment termination payments. The requirement that a payment be made in consequence of dismissal caused by redundancy means that the 'in consequence of' condition in the subsection 82-130(1) definition of employment termination payment will be met.[46] As it may transpire that part of a genuine redundancy payment is an employment termination payment, the whole of the redundancy payment must have been in consequence of termination.

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[44] See further paragraphs 313 to 338 of this Ruling.
[45] 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'.
[46] Paragraph 82-130(1)(a).

Component 2: 'Dismissal' from employment

Ordinary meaning of 'dismissal'

241. For a payment to qualify as a genuine redundancy payment, the employee must be dismissed from employment. It is not sufficient that the person loses a particular position with an employer but continues on in some other capacity. Subject to one particular exception discussed below,[47] all employment with the employer must be severed.

242. In the context of the former section 27F of the ITAA 1936 dealing with genuine redundancy payments,[48] the Full Federal Court in *Dibb v. Federal Commissioner of Taxation* (*Dibb*) stated that:[49]

> It is only if the employer considers that **there is no available job for which the employee is suited, and that he or she must therefore be dismissed**, that the question of redundancy arises. [Emphasis added]

243. Therefore, demotion within an organisation will not constitute a dismissal for the purposes of section 83-175.

244. Dismissal is not synonymous with termination but involves an action to terminate employment taken by the employer irrespective of the wishes of the employee. In *Smith v. Director-General of School Education (Smith)*, it was stated:[50]

> we find no difficulty in accepting the ordinary meaning of 'dismissal' … as being 'the termination of services by the employer without the employee's consent'; we would add that where an employee does not freely consent to the termination, understood in a broad sense, then the circumstances may still amount to a dismissal by the employer as a constructive dismissal…

245. In *Advertiser Newspapers Pty Ltd v. Industrial Relations Commission of South Australia (Advertiser Newspapers)*,[51] Bleby J noted that the word 'dismissal' was concerned with the consequences of action taken by the employer. His Honour quoted and adopted the definition of 'dismissal' expressed by the Full Industrial Court of New South Wales in *Smith*, and held that:[52]

> It follows that where an employee voluntarily abandons employment or lawfully terminates the contract (for example by giving the requisite notice) or where the contract of employment terminates by effluxion of time or by agreement, there is no dismissal…

246. It follows from these principles that the question of whether an employee consents to their termination is one of fact. All circumstances of a given case must be assessed to determine whether the employee consents to their termination.

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[47] See paragraphs 347 to 369 of this Ruling.
[48] Section 27F of the ITAA 1936.
[49] [2004] FCAFC 126; 2004 ATC 4555; (2004) 55 ATR 786 at paragraph 43.
[50] (1993) 31 NSWLR 349 at 366.
[51] [1999] SASC 300; (1999) 74 SASR 240; (1999) 90 IR 211.
[52] [1999] SASC 300; (1999) 74 SASR 240; (1999) 90 IR 211 at paragraph 28.

247. Consent in this context refers to the employee choosing to agree to or approve the act or decision to terminate employment in circumstances where the employee has the capacity to make such a choice.[53] Such agreement or approval may be express or implied.

248. The American case of *Mercier v. Holmes*[54] considered the meaning of consent in an employment setting. This case involved an employee being injured in a work accident. In determining workers' compensation liability, the issue was whether the employee was employed by the occupant of the premises on which he was injured or his regular employer. The occupant of the premises and the regular employer had entered into a so-called 'exchanging labour' arrangement. It was necessary to consider whether the employee had consented to being employed by the occupant of the premises instead of his regular employer.

249. In delivering the decision of the Court, which found that the employee had not consented to the change of employer, Hulburd J stated:[55]

> Ordinarily, in order to consent one must be confronted with a proposition or situation calling for consent. *There can be no consent where there is no apparent choice and no awareness from the circumstances or otherwise that consent or refusal is called for*. [Emphasis added]

250. Hulburd J later continued:[56]

> It is not to be understood, of course, that the employee must expressly consent to a change of employer…So in this case it was a question, first, of whether there actually had been express consent by Mercier to become the employee of [the occupant of the premises], or if that was lacking, whether such consent could fairly be implied under the circumstances.

251. Consent is a broader concept than agreement:[57]

> The distinction between consent and agreement is that consent does not necessarily result in a binding contract, it may take the form of party A proposing something and party B indicating that he will go along with it.

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[53] See *Butterworth's Australian Legal Dictionary,* 1997, Butterworths, Sydney, p.249.
[54] (1956) 125 A2d 790.
[55] (1956) 125 A2d 790 at 794.
[56] (1956) 125 A2d 790 at 794.
[57] Young, P, (1986), *The Law of Consent*, The Law Book Company Limited, Sydney, p.24.

252. On the other hand, mere passive acquiescence, while closely related, will of itself not establish consent. Shaw LJ in the English case of *Bell v. Alfred Franks & Bartlett Co Ltd* drew the distinction between consent and acquiescence in the following terms:[58]

> ... the only practical and sensible distinction that can be drawn is that if acquiescence can arise out of passive failure to do anything, consent must involve a positive demonstrative act, something of an affirmative kind.

253. In circumstances where an employee volunteers to accept a redundancy package, there may still be a dismissal. This will occur where the decision to terminate employment is still ultimately that of the employer. The termination of employment is a dismissal here because the employer initiates the process and has the final say in whose employment is to be terminated.

254. Where an employee is given notice that they will be terminated at a specified time in the future due to genuine redundancy, that employee will be dismissed because of redundancy for the purposes of section 83-175. Once an employee has been notified of their termination in these circumstances, any negotiation between the employee and employer or nomination by the employee to end the employee's employment at an earlier time does not bear on whether the employee has been dismissed. This is because dismissal is a particular mode of employment termination, which is concerned with the character of the decision to terminate employment. As discussed in paragraph 244 of this Ruling, dismissal is not synonymous with termination, but rather involves an action to terminate employment taken by the employer irrespective of the wishes of the employee.

255. Whether an amount paid in these circumstances qualifies as a genuine redundancy payment depends on the other conditions in section 83-175 being met. In particular, it will be necessary to ensure that the payment made exceeds what could reasonably be expected on voluntary termination.[59] It may also be necessary to establish that the dismissal is in fact due to genuine redundancy, particularly if the length of the notice period is significant.[60]

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[58] [1980] 1 All ER 356 at 360.

[59] For example, the employee's entitlements to redundancy benefits under their employment arrangements may be impacted by the decision to end the employment relationship earlier than the notified time. See Example 12 at paragraphs 155 to 160 of this Ruling.

[60] See Example 12 at paragraphs 155 to 160 of this Ruling.

Constructive dismissal

256. As recognised in *Smith*,[61] the concept of dismissal extends to 'constructive dismissal'. This refers to a termination that gives the appearance of employee consent, but in substance reflects the same circumstances as would have been the case if the employee had been dismissed – that is, an employer initiated termination without the employee's consent. In *Blaikie v. South Australian Superannuation Board,* Olsson J, quoting his own decision in *R v. Prince Alfred College*[62] stated:[63]

> The fact that the act of resignation subsumed the act of dismissal does not alter the essential character of the transactions between the parties. By virtue of the implicit waiver of the original act of formal dismissal by the employer, the applicant was, in reality, in a position in which he had resigned because he had been given virtually no option but to do so ...

257. For example, if an employer is reorganising or downsizing their business or company, an employee may be offered alternative employment that is not appropriate given the employee's qualifications or experience,[64] or is in a particularly inconvenient location for the employee.

258. An employee who chooses to resign in these circumstances may not be considered to freely consent to their resignation as they had no other option other than to resign. This would be an instance of constructive dismissal.

Component 3: Dismissal caused by 'redundancy'

Ordinary meaning of 'redundancy'

259. The concept of redundancy broadly refers to situations where something is superfluous and therefore unnecessary. 'Redundancy' refers to a state of being redundant and 'redundant' is defined in *The Australian Oxford Dictionary*[65] to mean:

1. superfluous; not needed
2. that can be omitted without any loss of significance
3. (of a person) no longer needed at work and therefore unemployed.

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[61] See paragraph 244 of this Ruling.
[62] (1979) 46 SAIR 598.
[63] (1995) 65 SASR 85 at 104; (1995) 64 IR 145 at 164.
[64] See for example, *Case 12/98; AAT Case 12,997* 98 ATC 183; (1998) 39 ATR 1073, where Senior Member Muller found that the employee was assigned 'practically meaningless tasks'.
[65] Australian Oxford Dictionary 2002 edition.

260. In subsection 83-175(1) the thing that must be redundant for the provision to apply is an employee's position. This contrasts with former subsection 27F(1) of the ITAA 1936, where it was the bona fide redundancy of the taxpayer that was at issue. The drafting of section 83-175 of the ITAA 1997 more accurately reflects the nature of redundancy in industrial law.[66]

261. In *R v. Industrial Commission (SA); Ex parte Adelaide Milk Co-operative Ltd*, Bray CJ stated that:[67]

> …a job becomes redundant when an employer no longer desires to have it performed by anyone.

262. Ryan J in *Jones v. Department of Energy and Minerals* expanded on Bray CJ's description in the following terms:[68]

> However, it should be noted that Bray CJ's description of what can constitute redundancy is not expressed to be exclusive. His Honour's description was cast in terms of a 'job' in the sense of a collection of functions, duties and responsibilities entrusted, as part of the scheme of the employer's organization, to a particular employee. However, it is within the employer's prerogative to rearrange the organizational structure by breaking up the collection of functions, duties and responsibilities attached to a single position and distributing them among the holders of other positions, including newly-created positions. It is inappropriate now to attempt an exhaustive description of the methods by which a reorganization of that kind may be achieved. One illustration of it occurs when the duties of a single, full-time, employee are redistributed to several part-time employees. What is critical for the purpose of identifying a redundancy is whether the holder of the former position has, after the re-organization, any duties left to discharge. If there is no longer any function or duty to be performed by that person, his other position becomes redundant in the sense in which the word was used in the Adelaide Milk Co-operative case.

263. Accordingly, this approach focuses on the underlying reality or substance of the position, that is, the existence of the functions, duties and responsibilities attached to a position. It does not focus on whether the position, in terms of a name or position number, has been abolished.[69] A position is redundant when the functions, duties and responsibilities formerly attached to the position are determined by the employer to be superfluous to the current needs and purposes of the organisation.

264. Paragraph 18 and the passage cited at paragraph 244 of this Ruling make clear that the decision to make an employee's position redundant is made by the employer. This accords with dismissal being termination of employment at the employer's initiative.

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[66] This issue in the drafting in section 27F of the ITAA 1936 was recognised by the Full Federal Court in *Dibb v. Federal Commissioner of Taxation* [2004] FCAFC 126; 2004 ATC 4555; (2004) 55 ATR 786 at paragraph 43.
[67] (1977) 16 SASR 6 at 8.
[68] (1995) 60 IR 304 at 308
[69] *Dibb v. Federal Commissioner of Taxation* [2004] FCAFC 126; 2004 ATC 4555; (2004) 55 ATR 786 at paragraphs 43-44.

Casual or contracted workers

265. Where an employer decides to bring the employment of a casual employee to an end because the work being performed is not required to be performed for the time being, the termination of the employee may not be because of the redundancy of the position. For instance, the work may be required to be performed at the same time in the following year.

266. A contracted employee may also be employed for a particular project. The completion of the work required to be performed by the employee for the purposes of the project may give rise to a termination payment. This will not ordinarily qualify as a genuine redundancy payment.[70]

267. However, in some cases an employee may be formally employed as a casual or contracted employee but may, in fact, occupy an ongoing position in the same way as permanent employees.[71] In that case, the position of the employee could be made redundant.

Determining the cause of dismissal

268. There are various reasons why an employee may be dismissed from employment. Redundancy may be only one of these reasons.

269. In circumstances where more than one reason can be identified for the dismissal, the Commissioner considers that redundancy must be the prevailing or most influential cause of the dismissal.[72] This question is answered in light of the circumstances of each case.

270. The classic context for redundancy is the closure, downsizing or reorganisation of part or all of the employer's operations. Redundancy can readily be established as the prevailing or most influential cause of dismissal in the first two of these scenarios.[73]

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[70] The particular period of employment condition, discussed at paragraphs 284 to 290 of this Ruling, is also of particular relevance for casual or contracted workers.
[71] See paragraph 290 of this Ruling.
[72] *Hart and Another v. Commissioner of Taxation* [2002] FCAFC 222; (2002) 121 FCR 206; 2002 ATC 4608; (2002) 50 ATR 369 at paragraph 52 per Hill J relying on the High Court decision in *Federal Commissioner of Taxation v. Spotless Services Ltd* (1996) 186 CLR 404 at 416. These authorities were considering the meaning of dominant purpose for the purposes of Part IVA of the ITAA 1936.
[73] See for example *Case 12/98; AAT Case 12,997* 98 ATC 183; (1998) 39 ATR 1073 where five original positions were reduced to two.

271. Where an employer dismisses an employee after a reorganisation of duties, functions and responsibilities, a more careful analysis is required. A restructure of an organisation does not necessarily import redundancy where employees are dismissed following the reallocation or restructure.[74] In these circumstances, it is necessary to consider what impact the restructure had on the duties, functions and responsibilities formerly fulfilled by the dismissed employee.[75]

272. In *Re Marriott and Federal Commissioner of Taxation*[76] the employer did not see fit to dismiss the employee after a reallocation of duties, functions and responsibilities within the organisation. In this case, the employee was carrying out duties of a legal nature in the Australian Taxation Office. These duties changed upon the reorganisation, in that he was not continuing to directly negotiate settlements or train junior advocates. After carefully considering the evidence before him, Senior Member Lindsay found that there was not a dismissal (in particular there was not a constructive dismissal) and further commented that:[77]

> Whether an employee's termination is by reason of redundancy will require an assessment of the changes to determine if they were beyond or beneath the employee's qualifications, skills or experience.

273. In this case it was considered that the prevailing or most influential cause of termination was the employee's own desire not to undertake the duties, functions and responsibilities he was offered following the reorganisation.

274. Another common reason for a dismissal is the personal acts or default of the employee.

275. In *Re Cowling and Federal Commissioner of Taxation (Cowling)*,[78] the taxpayer was the Chief Executive Officer of a government business enterprise. He was dismissed in a context where there was to be a reorganisation of the corporate structure of that enterprise. This reorganisation was partly precipitated by a government decision to redistribute the functions of various enterprises.

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[74] *Fosters' Group Limited v. Wing* [2005] VSCA 322 at paragraph 47.
[75] Constructive dismissal may occur in these circumstances – see paragraphs 256 to 258 of this Ruling.
[76] [2004] AATA 806; 2004 ATC 2191; (2004) 56 ATR 1265.
[77] [2004] AATA 806; 2004 ATC 2191; (2004) 56 ATR 1265 at paragraph 47.
[78] [2006] AATA 646; 2006 ATC 2395; (2006) 64 ATR 1025.

276. While it was alleged that the employer considered the taxpayer's termination to be caused by redundancy, the evidence indicated that the termination of the taxpayer was principally related to his performance. In particular, evidence tendered before the Tribunal clearly showed that the Board did have ongoing concerns about the taxpayer's performance. An acting Chief Executive Officer was also appointed to replace the taxpayer.[79]

Component 4: 'Genuine' redundancy

277. Whether a redundancy payment is genuine is to be determined on an objective basis. It is not sufficient that an employer and employee have an understanding that a payment is a redundancy payment or that the employer calls the payment a redundancy payment to give the employee a better taxation outcome. The nature of the termination of an employee does not depend on what was communicated to that employee in relation to the termination.

278. This approach is supported by the decision in *Fosters' Group Limited v. Wing*,[80] where the reasons communicated to the employee for his termination were not seen to determine the question of whether the termination was by reason of redundancy.

279. The need for the employee's position to be genuinely redundant establishes that contrived cases of redundancy will not meet the conditions in section 83-175. The following scenarios illustrate cases of contrived redundancy:

- Where an employing entity is wound-up and some or all of the employees are immediately re-engaged by a new employing entity.
- Where an employer terminates an employee on outsourcing particular duties and functions and immediately engages that employee to perform the outsourced duties and functions.

280. These scenarios may also be stipulated arrangements to employ the employees after the dismissal and therefore breach the condition under paragraph 83-175(2)(c).[81]

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[79] In the context of the ongoing existence of an organisation, the Commissioner considers that it would be rare or peculiar for a person occupying a leadership position such as a Chief Executive Officer to be made redundant. In this regard, see *Cowling* [2006] AATA 646; 2006 ATC 2395; (2006) 64 ATR 1025 at paragraph 62.

[80] [2005] VSCA 322.

[81] See paragraphs 306 to 309 of this Ruling.

Further conditions for a genuine redundancy payment

281. Before a payment that meets the basic redundancy requirement in subsection 83-175(1) qualifies as a genuine redundancy payment, all other conditions in section 83-175 must be met. These conditions are:

- the dismissal must be made before the person turns 65 or an earlier mandatory age of retirement - paragraph 83-175(2)(a);
- the payment must be made before the end of a fixed period of employment - subparagraph 83-175(2)(a)(ii);
- the payment must not exceed an arm's length amount in the event that the employer and employee are not dealing at arm's length - paragraph 83-175(2)(b);
- there must be no stipulated arrangement to employ the person after the termination - paragraph 83-175(2)(c); and
- the payment must not be in lieu of superannuation benefits - subsection 83-175(3).

Age-based limits

282. An employee receiving a genuine redundancy payment must, at the time of dismissal, be aged less than 65 or less than a younger age of compulsory retirement for the particular position in question. For example, if an employee in a particular position is required to retire at age 60, then the person can only receive a genuine redundancy payment if he or she is less than 60 years old when the dismissal occurs.

283. A termination payment made to a person who has reached age 65 or another age of compulsory retirement at the time of dismissal would be an employment termination payment if the conditions in section 82-130 are satisfied.

Not the end of a particular period of employment

284. It would normally be the case that someone employed on a contract for a set period could not be dismissed at the end of that period. Their employment would simply terminate because the arrangement stipulated that the employment would cease at that time.

285. Senior Member Sweidan in *Winsen v. Commissioner of Taxation*[82] found this to be the case where a person was employed for a succession of fixed periods at the end of the last of which there was no continuation of employment and no renewal of the contract for a further fixed period. While the Senior Member left open the possibility that there could be circumstances in which a rolling series of employment contracts might be of indeterminate duration, the mere fact of past renewal of the contracts could not give rise of itself to such an outcome.

286. Senior Member Sweidan summed up the position on the facts of the case in the following terms:[83]

> Further, in the Tribunal's view, as contended by the respondent, the applicant's argument is misconceived as it is quite clear that the applicant's employment with her employer would necessarily have terminated on 31 December 2002 under the terms of the contract. The applicant's contention that absent a decision by the employer to not renew or extend the contract, termination of the employment would not necessarily have occurred, appears to the Tribunal to be without any foundation in fact or in law. As noted in the decision in *Fisher v. Edith Cowan University (No 2)* (1997) 72 IR 464:
>
> > *Facts such as the continuation of the employment position after the expiration of the period of Ms Fisher's contract and Ms Fisher's expectation that she would continue in the position would have been relevant.*

287. The question of whether an employment relationship continues to exist after what would otherwise be its expiration is a question of fact.[84] If a set term is expressly stipulated in an employment contract, the Commissioner considers that this will govern the relationship, and through it the application of paragraph 83-175(2)(a), unless implied terms to the contrary can be established.[85]

288. In some industries workers are employed on a project basis. The fact that a project is completed, even where the project is completed before a designated time, is not a situation where the workers are redundant. For these purposes, the Commissioner considers that termination on completion of a particular task or outcome represents a particular period of service for the purposes of subparagraph 83-175(2)(a)(ii). If the completion of the task or outcome gives rise to a payment, such a payment would normally be an employment termination payment, not a genuine redundancy payment.[86]

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[82] [2006] AATA 119.
[83] [2006] AATA 119 at paragraph 7.
[84] *Byrne v. Australian Airlines Ltd* (1995) 185 CLR 410 at 428 per Brennan CJ, Dawson and Toohey JJ.
[85] *Fisher v. Edith Cowan University (No 2)* (1997) 72 IR 464 at 472.
[86] The Explanatory Memorandum to the Income Tax Assessment Amendment Bill (No. 3) 1984 states (at p.92) that the concept of 'a particular period of service … would be relevant … to the case where the employment of the taxpayer was for a limited period'.

289. It is also common in these types of project based industries for workers to be employed on a weekly or daily hire basis. Once again, the outcome here may be that there is not a genuine redundancy payment because a termination payment is made at the end of a limited period of time of employment. This is so even if payments are referred to as redundancy payments[87]. However, all the circumstances of a particular arrangement will need to be assessed to determine whether a termination payment qualifies as a genuine redundancy payment.[88] These circumstances include the length of the period for which the worker is employed and the number of times the worker's employment is renewed on this basis.

290. However, if the worker's employment extends over a number of projects, including interim periods between projects where the worker is retained, then a termination payment could be a genuine redundancy payment depending on the circumstances of the arrangements. This reflects the principles set out at paragraphs 284 to 288 of this Ruling.

Arm's length amount

291. The need to satisfy the arm's length amount condition in paragraph 83-175(2)(b) arises only where it is established, as a matter of fact, that the employee's dismissal from employment by the employer was other than at arm's length.

292. The question of whether parties have dealt with one another at arm's length has been considered in a wide range of statutory contexts. The general principles set out at paragraphs 189 to 199 of Taxation Ruling TR 2006/7[89] can be applied in determining whether an employer and an employee are dealing with each other at arm's length for the purposes of paragraph 83-175(2)(b).

293. In particular it should be noted that while the ability of one party to control or influence another party is an important issue to consider in working out whether there is an arm's length dealing, it may not of itself determine that such a dealing is not at arm's length.

294. Identifying the nature of the relationship between the parties is merely a step (albeit an important one) in the course of reasoning whether parties are dealing at arm's length.[90]

295. In the event that the employer and employee are not dealing at arm's length, it is necessary that the actual redundancy amount paid to the employee be no greater than the amount that could reasonably be expected had the parties been dealing at arm's length. Any excess will cause the condition in paragraph 83-175(2)(b) to be breached.

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[87] See paragraph 287 of this Ruling.
[88] See Example 11 at paragraphs 148 to 154 of this Ruling.
[89] Taxation Ruling TR 2006/7 Income tax: special income derived by a complying superannuation fund, a complying approved deposit fund or a pooled superannuation trust in relation to the year of income.
[90] *Re Hains (deceased); Barnsdall v. Federal Commissioner of Taxation* 88 ATC 4565 at 4568; (1988) 19 ATR 1352 at 1355 per Davies J.

Accordingly no amount of the redundancy payment will be a genuine redundancy payment. The condition in paragraph 83-175(2)(b) does not operate to reduce the amount eligible for genuine redundancy payment treatment to the arm's length amount.

296. The condition in paragraph 83-175(2)(b) is based on determining a hypothetical arm's length amount. The determination of this hypothetical amount proceeds on the basis that all circumstances associated with the termination of the particular person's employment are the same, other than for an assumption that the employer and employee were dealing at arm's length. The comparative amount must assume that there had been real bargaining between the parties. This is to be contrasted with the actual situation, where the parties were not dealing at arm's length.

297. The amount that could reasonably be expected to have been made had the parties been dealing at arm's length in relation to the dismissal is a matter to be established by evidence. That evidence must be sufficient to identify an amount that, on a reasonable basis, is not less than the actual amount paid.[91] All relevant factors need to be assessed and balanced to determine what could reasonably have been expected in arm's length circumstances.

298. Whether the actual amount paid is reasonable given the circumstances associated with the terminated employee's employment is a significant evidentiary factor in determining what could reasonably be expected under paragraph 83-175(2)(b).

299. In a redundancy context, these circumstances principally contemplate:

- the number of years of service provided by the terminated employee to the employer; and
- the arm's length value of the employee's services at the time of termination.[92]

300. Other relevant matters include:

- what the employee's contract provides for in the event of redundancy (to the extent any such provision reflects an arm's length dealing);
- standard redundancy payment practices within the industry;
- the overall financial position of the employer at the time of the dismissal; and
- the nature of the work undertaken by the employee.

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[91] *Federal Commissioner of Taxation v. Peabody* (1994) 181 CLR 359 at 385; *Federal Commissioner of Taxation v. Consolidated Press Holdings Ltd and Ors (No. 1)* (1999) 91 FCR 524 at 550.

[92] Although it may often be the case that the remuneration package of an employee who is ultimately terminated other than at arm's length will also not reflect an arm's length dealing.

301. The Commissioner considers that it is also important to take into account any arm's length dealings entered into by the employer in respect of employees who are made redundant.[93] Of particular relevance are arm's length dealings involving other employees whose employment is terminated at the same time as the employee in question. While not determinative for these purposes,[94] such dealings must, in the Commissioner's view, be weighed in assessing what amount could reasonably be expected to be made had the parties been dealing at arm's length.

302. When comparing any arm's length dealings entered into with the relevant non-arm's length dealing for these purposes, it is necessary to properly recognise the different circumstances that apply to the respective employees. For example, some of the factors highlighted at paragraphs 299 and 300 of this Ruling are likely to vary from employee to employee. The payment of different redundancy amounts to arm's length and non-arm's length employees can often be readily explained by reference to these factors.

303. However, if the dealings at arm's length have taken place on a clearly different basis to those other than at arm's length, the Commissioner considers it highly likely that paragraph 83-175(2)(b) will not be satisfied in relation to the non-arm's length dealing.

304. Further, the Commissioner does not consider the relevant tax-free amount for a particular employee, as worked out under section 83-170, to be a proxy for the amount that could reasonably be expected to be paid had the parties been dealing at arm's length. While this amount takes into account an employee's years of service with the employer, it does not take any account of other important factors, in particular the value of the services provided by the employee or the comparable treatment of employees who are made redundant in the same set of circumstances.

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[93] *Bob Jane T-Marts Pty Ltd v. Commissioner of Taxation* [1999] FCA 1366; (1999) 94 FCR 457; 99 ATC 5100; (1999) 43 ATR 98, in particular at paragraphs 31 to 33 and 39 to 40; *Optus Mobile Pty Ltd v. Federal Commissioner of Taxation* [1999] FCA 519; 99 ATC 4492; (1999) 42 ATR 105, in particular at paragraphs 29 to 37; *Optus Mobile Pty Ltd v. Federal Commissioner of Taxation* [1999] FCA 1403; 99 ATC 5070; (1999) 43 ATR 21, in particular at paragraphs 14 and 15.

[94] *Re Long and Commissioner of Taxation* [2007] AATA 1269; 2007 ATC 2155; (2007) 66 ATR 806.

305. The Commissioner also considers that recognition of previous unpaid or outstanding service (for example, if the employee received less than market value remuneration over the course of employment) or the failure to make other payments to which an employee is entitled on termination (for example unused leave payments) is not to be taken into account for these purposes. Even if these factors were found to be relevant for the purposes of paragraph 83-175(2)(b), contrary to the Commissioner's position, the Commissioner considers that the factors would also be relevant in working out the voluntary termination element under subsection 83-175(1)[95] and therefore would not impact on the calculation of the genuine redundancy payment amount.

No stipulated arrangement to employ

306. Under paragraph 83-175(2)(c), an arrangement to employ an employee after his or her termination may prevent a dismissal giving rise to a genuine redundancy payment. An arrangement in this context is defined widely:[96]

> ***arrangement*** means any arrangement, agreement, understanding, promise or undertaking, whether express or implied, and whether or not enforceable (or intended to be enforceable) by legal proceedings.

307. In the Commissioner's view, the phrase 'arrangement…to employ' is confined to common law employment relationships.[97] The apparent purpose of paragraph 83-175(2)(c) is to limit access to concessional tax treatment where an employee is terminated but is certain of continuing remuneration in the future under a common law employment contract because of an arrangement to which the employer is a party.

308. For the condition in paragraph 83-175(2)(c) to fail, it is necessary for the employment arrangement to be entered into between either:

- the employer and the employee; or
- the employer and another entity.

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[95] See paragraphs 319 to 329 of this Ruling.
[96] Subsection 995-1(1).
[97] For the Commissioner's views on the meaning of common law employment, see SGR 2005/1.

309. Accordingly, if the employee has independently entered into an arrangement with another entity for that entity to employ him or her after the time of the dismissal from the original employer, the condition in paragraph 83-175(2)(c) will still be met. On the other hand, given the breadth of the meaning of 'arrangement', an implied understanding between two related companies at the time of an employee's dismissal with one of those companies to the effect that the employee will be employed at a later time with the other is sufficient for this condition not to be met.

Payment in lieu of superannuation benefits

310. Subsection 83-175(3) provides that a genuine redundancy payment does not include any part of a payment that was received by an employee in lieu of superannuation benefits to which the employee may have become entitled at the time the payment was received or at a later time.

311. Paragraph 82-135(a) and subsection 83-175(4) together provide that a superannuation benefit is not a genuine redundancy payment. Payments from a superannuation fund to a fund member because of that membership are a superannuation benefit. Payments made pursuant to entitlements in similar superannuation plans or under superannuation-related legislation are also defined to be superannuation benefits.[98]

312. For subsection 83-175(3) to apply, the payment in lieu of superannuation benefits would generally be made by an employer or some other entity instead of the employee's superannuation fund. The words 'in lieu' indicate that the subsection intends to cover redundancy payments to the extent that they are being substituted for payments covered by the table in subsection 307-5(1).

Tax treatment of redundancy payments

Elements of a redundancy payment

313. The first step in working out the tax treatment of redundancy payments is to exclude any payments that receive a more specific tax treatment.[99] Subsection 83-175(4) gives effect to the exclusion of these amounts from the concept of a genuine redundancy payment.

[98] See generally the table in subsection 307-5(1).
[99] See paragraphs 55, 228 and 229 of this Ruling.

314. Once these payments have been excluded and it is established that any remaining amounts meet the conditions for genuine redundancy payment treatment, those amounts may be divided into three elements for the purposes of tax treatment:

- The **voluntary termination element:** this is the amount up to that which could reasonably have been expected to be paid on voluntary termination in comparable circumstances to those applying at the time of the redundancy. This generally will be an amount that could be expected to be paid in the case of resignation as relevant to the particular circumstances of the employee. For instance, a person resigning after many years with a particular employer might expect an amount well in excess of that expected to be paid to a short-term employee.
- The **tax-free amount of the redundancy element:** any excess of the redundancy payment made above the voluntary termination element, but only up to the amount worked out under section 83-170 for the particular employee concerned.
- The **taxable amount of the redundancy element:** any further excess of the redundancy payment made above the total of the voluntary termination element and any tax-free redundancy element.

315. The voluntary termination element is subject to tax as an employment termination payment if it is received no later than 12 months after the termination. As this payment would ordinarily have been made on termination, it is treated as an employment termination payment under section 82-130 as a payment made in consequence of termination.

316. Where this payment is made more than 12 months after the termination of employment it is assessable as ordinary income under section 83-295.[100]

317. The tax-free element of any amount in excess of the voluntary termination element is worked out under section 83-170 as the base amount plus the service amount by the years of service. These amounts are indexed. The tax-free amount of the redundancy element is neither assessable income nor exempt income. Under paragraph 82-135(e) it is not an employment termination payment.

318. However, any amount in excess of the sum of the voluntary termination element and the tax-free amount is an employment termination payment. The 12 month rule does not apply to it because of paragraph 82-130(4)(b), which excludes genuine redundancy payments from its operation.

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[100] Employment termination payments are treated more generously than ordinary income, as set out in Subdivisions 82-A and 82-B.

Working out the voluntary termination element

319. The voluntary termination element is an integral part of working out the amount of a genuine redundancy payment. The apparent purpose of deducting this element from the payments otherwise made in consequence of the employee's termination[101] is to identify the extent to which those payments are specifically attributable to termination because of redundancy.

320. For example, some employers make contributions to trust arrangements to cover an employee's termination entitlements in a variety of circumstances, including redundancy. If an employee is entitled to a payment from such a trust, it is likely the case that the voluntary termination amount reduces the genuine redundancy payment to zero. This would be because the same payment would be made to the employee had he or she voluntarily resigned.

321. Like the arm's length amount worked out under paragraph 83-175(2)(b), the voluntary termination element is a hypothetical amount.[102] All the circumstances associated with the termination of the person's employment are the same other than for an assumption that the employee voluntarily resigned. This is to be contrasted with the actual situation, where the employee was dismissed because of redundancy.

322. The principles that apply in working out the voluntary termination element are in many respects similar to those applying to working out the arm's length amount under paragraph 83-175(2)(b). All relevant factors need to be assessed and balanced to determine what might reasonably be expected in the hypothetical circumstances. Some of the factors that may be taken into account for the purposes of arm's length amount test, particularly those listed at paragraphs 299 and 300 of this Ruling applied to a voluntary termination context,[103] may also be relevant.

323. Nevertheless, there are important differences between the voluntary termination element test and the arm's length amount test.

324. The hypothetical test for the arm's length test amount assumes an arm's length dealing. In contrast, if the dealings between employer and employee on termination are not arm's length, this factor must remain constant when working out the voluntary termination element. The Commissioner does not consider it appropriate in these circumstances to make a comparison with amounts paid to arm's length employees who voluntarily terminated their employment for these purposes.

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[101] Not including those amounts that receive a more specific tax treatment, as set out under section 82-135.
[102] See paragraph 296 of this Ruling.
[103] See also paragraph 305 of this Ruling regarding the potential recognition of previous unpaid or outstanding service or the failure to make payments other than redundancy payments to which the employee is entitled.

325. In addition, the contractual entitlements of an employee on voluntary termination are less significant if the dealing between an employer and an employee on termination is other than at arm's length. In contrast, if the dealings between employer and employee are at arm's length, the contractual entitlements of the employee on voluntary termination will be the most important factor in working out what could reasonably be expected.

326. Overall, it would generally be expected that the amount paid to an employee in the event of redundancy would be greater than that paid in the event of voluntary termination. This recognises that the purpose of redundancy payments is in part to compensate the employee for the inconvenience and hardship caused by the particular circumstances associated with redundancy.[104]

327. The purpose of a payment in lieu of notice is to help in adjusting to new circumstances. Nevertheless, such a payment may still be treated as a genuine redundancy payment, on the basis that it may not have been reasonably expected on voluntary termination of employment.

328. Finally, the Commissioner considers that the amount that could reasonably be expected in the event of voluntary termination is not as heavily dependent, as is a redundancy package, on the number of years of service provided by the employee or the arm's length value of the employee's services at the time of termination. The common practice across a wide range of industries is to calculate redundancy packages based on these two factors. It is noted that these factors will particularly impact on the extent to which an employee is inconvenienced or suffers hardship in the event of redundancy.

329. Nevertheless, it is reasonable to expect that employees who have provided extensive service to an employer or whose services are significantly valued by the employer are more likely to receive an ex gratia payment on voluntary termination.

Only one voluntary termination element and one tax-free amount applied per termination caused by redundancy

330. In the simplest case, a redundancy payout would be made by one payer (typically the employer) as a single amount based on one payment source (for example, a contractual or industrial agreement entitlement of the employee or in some cases an ex-gratia payment).

331. However, it is also conceivable that amounts paid in consequence of dismissal due to redundancy could be paid in instalments or as a series of payments, have different sources or be made by more than one payer.

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[104] See *Westfield Holdings v. Adams* (2001) 114 IR 241 at 274-275.

332. The Commissioner's view is that, of their nature, termination payments, including genuine redundancy payments, are tied to the particular termination to which they relate. This relationship is embodied in the 'in consequence of' test.

333. Therefore, the treatment of all termination payments that are not specifically excluded from being either genuine redundancy payments or employment termination payments is determined by treating all amounts paid in consequence of the termination as a single bundle of payments referable to that termination. This is consistent with the legislatively enshrined principle of interpretation that the singular includes the plural unless the contrary intention appears.[105]

334. The Commissioner considers the overall statutory context of Part 2-40 supports this approach. The need to cover a termination payment made in instalments was originally the basis on which the term 'payment' was used in the original eligible termination payment provisions. 'Payment' was then used in preference to 'lump sum'. The Commissioner considers that this evidences an intent that a series of termination payments that was not an annuity should be seen to form part of an overall payment on termination.

335. The relevant Explanatory Memorandum stated:[106]

> 'eligible termination payment' is to be defined exhaustively in relation to a taxpayer by reference to all of the possible circumstances in which may be made a payment to which the new Subdivision AA is to apply. Whereas paragraph 26(d) of the Principal Act, which is being repealed by this Bill, applies only to amounts paid 'in a lump sum', the term 'eligible termination payment' is not so limited. As a result, the provisions of proposed Subdivision AA will apply where, for example, a taxpayer's entitlement to a benefit from a superannuation fund is paid by way of 2 or more instalments. The definition will accordingly overcome the decision of the Federal Court of Australia in the case *Federal Commissioner of Taxation v. Knight*.

336. It is also the case that employment termination payments and genuine redundancy payments are not primarily identified by their source or limited to payments by the employer of the terminating employee. A payment need only be made in consequence of the termination of employment to qualify.

337. Accordingly, the intended treatment of genuine redundancy payments recognises that only one voluntary termination element and one tax-free amount will be applied in respect of any and all redundancy payments made in consequence of a particular termination.

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[105] Paragraph 23(b) of the *Acts Interpretation Act 1901*.
[106] Explanatory Memorandum to the Income Tax Assessment Amendment Bill (No. 3) 1984, p.65.

338. Where the voluntary termination element is particularly large, a different approach may result in no amount being afforded genuine redundancy payment treatment. Likewise, multiple applications of the tax-free amount may result in differential treatments of taxpayers in comparable positions based merely on the form in which they receive their redundancy payments. The Commissioner considers it unlikely that Parliament would have intended either of these outcomes.

Application of basic principles to dual capacity employees

What is a dual capacity employee?

339. A 'dual capacity' employee is a person who, in addition to being engaged as an employee of a particular entity, is also a directing mind or office holder of that entity.

340. It is a very well established principle of corporations law that a person can act in these two capacities. Authority for the principle can be traced back to the decision in *Salomon v. Salomon & Co Ltd*.[107] This case established the proposition that a company has an existence separate and distinct from its directors and shareholders, even where the company is managed and controlled by one person.

341. In *Lee v. Lee's Air Farming Ltd*,[108] the decision in *Salomon* was relied upon in finding that a person may function in the dual capacities of director and employee in relation to a company. It was held that, as a company is a separate legal entity, a common law employment contract may exist between an individual and the company even where the individual is also the only director of the company and the individual acted as an agent of the company to arrange the employment contract.

342. A directing mind of a corporate entity ordinarily holds an office with that entity. Section 80-5 provides that the holding of an office, which would include holding a position as company director, is considered to be employment for the purposes of Part 2-40. Therefore, a dual capacity employee is considered to have dual employment under Part 2-40 – employment in the capacity of a common law employee and employment in the capacity of a company director.

343. As stated in *Grealy v. Federal Commissioner of Taxation*:[109]

> The word 'office' usually connotes a position of defined authority in an organisation, such as director of a company or tertiary educational body, president of a club or holder of a position with statutory powers.

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[107] [1897] All ER 33.
[108] [1960] 3 All ER 420.
[109] (1989) 24 FCR 405 at 411; 89 ATC 4192 at 4197; (1989) 20 ATR 403 at 409.

344. A managing partner in a partnership also occupies an office.[110]

345. It follows that a 'dual capacity' employee may decide or actively participate in a decision to terminate their own employment in either or both capacities of employment.

346. A particular form of dual capacity employment is a person who holds a position as or akin to a 'managing director' of a company. It is conceivable that such a person may be terminated from their role as managing director, yet retain a role as a 'non-executive' director of the company.[111] This could occur in both small closely held companies and in larger companies.

Termination of employment in one capacity

347. The Commissioner considers that section 80-5 gives effect to a limited exception to the general principle that a person must be terminated from all employment with a particular employer before it can be said that there has been a termination of employment for Part 2-40 purposes.[112]

348. This recognition of dual employment in the case of a dual capacity employee enables the conditions in section 83-175 to be met where such an employee is dismissed from employment in only one of their two capacities. This will be particularly relevant where a person is terminated from their common law employment, but remains a director of the employing entity.

349. If a dual capacity employee has their employment terminated in one capacity but not the other, it is important that any payment made in consequence of that termination reflects the circumstances of the terminated capacity only.

350. However, if the person's dual capacities are effectively integrated such that the loss of the one gives rise to the loss of the other, then there is a dismissal from all employment. This would be the case where a managing director loses their role as manager and the directorship is also lost as a matter of course.

Dismissal of dual capacity employees

351. As discussed earlier,[113] the defining feature of termination of employment by way of dismissal is that the termination occurs *without the employee's consent*. Whether the employee consented to a termination decision is a question of fact to be assessed in light of the circumstances of each case.

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[110] *Federal Commissioner of Taxation v. Sealy* (1987) 78 ALR 387; 87 ATC 5076; (1987) 19 ATR 582.
[111] *Lincoln Mills (Aust) Ltd v. Gough* [1964] VR 193 at 197-198.
[112] The general principle is discussed at paragraph 241of this Ruling.
[113] See paragraphs 241 to 255 of this Ruling.

352. The concept of consent refers to the employee choosing to agree to or approve the act or decision to terminate employment in circumstances where the employee has the capacity to make such a choice. Consent may be express or implied.

353. Where a dual capacity employee terminates their own employment or actively participates in a collective decision to that effect, the question of whether the person consented to the termination requires careful consideration.

354. The Commissioner considers that a person's consent does not depend on the capacity in which they are acting. This is because consent is a state of mind peculiar to a person. Accordingly, in the Commissioner's view, it is not possible for a person to consent to the employer's decision in one capacity (as a director of the employer)[114] yet not consent to the same decision in another capacity (as an employee of the employer). In a different dual capacity situation, it has been suggested that 'it is a little difficult to say that a person is not himself consenting to what he himself does or purports to do'.[115]

355. In any case, it is noted that in many scenarios (particularly those involving businesses run by closely-held companies controlled by a small number of directing mind employees) there is no real distinction between the actions undertaken by a dual capacity employee in each of their two capacities. In these circumstances, it is clear that the decision-making of a director who is also a common law employee does not involve a different state of mind based on the two capacities in which the person acts.

356. In applying these general principles to actual cases, it follows that a dual capacity employee who does not agree to or approve an act or a decision to terminate their own employment will be terminated without their consent. The principal example of such a scenario is where a dual capacity employee is actively involved in the termination decision, but can demonstrate that he or she did not agree with the ultimate decision that was made.

357. Such a termination will be without consent, even where the employee agreed with the circumstances that led to the termination. For example, it may have been unanimously agreed that there is a need to reduce the number of directors of a company (as often occurs in the case of a business merger), but there is disagreement about which directors should remain.

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[114] In this regard, it is recognised that the imputed state of mind of an artificial entity such as a company is reflected in the state of mind of those that control the entity – see *Federal Commissioner of Taxation v. Whitford's Beach Pty Ltd* (1982) 150 CLR 355 at 370 per Gibbs CJ.

[115] *Re Wilmer's Trusts; Wingfield v. Moore* [1910] 2 Ch 111 at 119. This case was concerned with the question of whether a person consented to an action where he held two capacities in relation to a testamentary trust.

358. In the case of a two director company, it is conceivable that a decision to make one director's common law employment position redundant was made without the consent of that director, particularly where the other director effectively makes all the decisions relating to the running of the business.

359. Even if a dual capacity employee makes or agrees with a decision to terminate their own employment, it may still be the case that he or she is dismissed. This will occur where consent is not freely given by the dual capacity employee due to external circumstances influencing the termination decision such that the employee has no real or practical choice in making or agreeing to that decision.

360. Here the termination of employment is a form of constructive dismissal.[116] Despite the appearance of agreement or approval on the part of the dual capacity employee, the absence of a real or practical choice in the employer's decision-making process establishes that the termination is without the dual capacity employee's consent. The decision to terminate is in practical terms a foregone conclusion given the circumstances at the time the decision is taken.

361. The circumstances that existed in *Re Long and Commissioner of Taxation* (*Long)*[117] are illustrative of this type of scenario.

362. In *Long*, the employing company lost the contract that was the underlying source of its business. That contract was terminated by the other party to the agreement.

363. Mrs Long was an active director of the employing company who also performed an office management role within the company's business. When the business source contract was terminated, the directors unanimously decided to wind up the business and retrench all the employees, including Mrs Long. The issue in the case was whether a termination payment that was paid to her was a bona fide redundancy payment (the equivalent of a genuine redundancy payment under the ITAA 1936).

364. Senior Member Pascoe found that Mrs Long had not consented to her own termination of employment but had been obliged, on the particular facts of the case, to terminate her own employment. Therefore, this qualified as a dismissal, as the termination of employment 'was forced on Mrs Long as both a director and employee'.[118]

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[116] See paragraphs 244 and 256 to 258 of this Ruling, in particular the decision of *Smith* identifying constructive dismissal as a case where the employee does not freely consent to the termination decision.
[117] [2007] AATA 1269; 2007 ATC 2155; (2007) 66 ATR 806.
[118] [2007] AATA 1269; 2007 ATC 2155; (2007) 66 ATR 806 at paragraph 13.

365. Whether the decision to terminate employment involves a real or practical choice requires a close assessment of the circumstances of each case. As Senior Member Pascoe stated in *Long*:[119]

> In common with many areas of revenue law, an answer will depend on the particular facts of each case. Here, I am satisfied that where all work of the employer ceased as a result of external circumstances beyond the control of the employer and all employees, including the directors in their capacity as employees, are made redundant, such termination meets the requirements of that paragraph of s 27[F]. The termination was forced on Mrs Long as both a director and employee.

366. Matters that are relevant in assessing whether there is a real or practical choice involved in the termination decision include:

- the chronology of events that led to the termination of employment, particularly those events that were the immediate context for the termination;
- the process by which the directing minds of the employer reached the decision to terminate employment;
- the financial position of the company at the time of the termination;
- any independent advice that was sought around the time of the termination decision;
- the state of the employer's business operations at the time of the termination relative to the time when the alleged compulsion did not exist; and
- the chronology of events following the termination of employment, particularly the timing of any new employment for the dual capacity employee and how that employment came about.

367. Whether and to what extent directors choose to pursue other business opportunities in light of the loss of a particular business does not impact on the question of consent where a dual capacity employee's position is terminated. If the termination decision is genuinely forced on the employer, then a choice about pursuing further business opportunities is not relevant to the question of choice in relation to terminating the employee.

368. However, if the directing minds of the employer decide to continue in a different business, it is possible that the roles and functions related to the positions of the dual capacity employees in the previous business could continue. In those circumstances the relevant positions reflected in those roles and functions may not be redundant.[120]

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[119] [2007] AATA 1269; 2007 ATC 2155; (2007) 66 ATR 806 at paragraph 13.
[120] *Dibb v. Commissioner of Taxation* [2004] FCAFC 126 at paragraph 43.

369. Apart from the circumstances identified in paragraphs 356 (no agreement or approval from the dual capacity employee) and 359 (no real or practical choice available to the dual capacity employee in making the termination decision) of this Ruling, the Commissioner considers that a dual capacity employee will consent to their own termination. Given the ordinary meaning of 'dismissal', consent to the termination decision means that the conditions for a genuine redundancy payment under section 83-175 will not be met.

Arm's length amount

370. Often it can be readily inferred that the employer and the employee are not dealing at arm's length when the employment of a dual capacity employee is terminated. In the case of a company with a single controlling mind, it is possible that a person will in effect be dealing with themselves in respect of their own termination.

371. If the parties are not dealing at arm's length, paragraph 83-175(2)(b) requires a comparison of the actual non-arm's length situation with a hypothetical arm's length situation. The question then becomes what amount could reasonably be expected to be paid to an equivalent employee dealt with at arm's length in the circumstances as they existed at the time of the dismissal?

372. Senior Member Pascoe, in making his decision on this issue in *Long*,[121] had regard primarily to what an employee in similar circumstances to the taxpayer could reasonably expect to be paid. He took particular account of the taxpayer's overall remuneration package and her years of service. The Senior Member found that reference to these matters is especially relevant when working out the arm's length amount.

373. In the Commissioner's view, weight should also be given to:

- What legal entitlements, if any, the employee has to receive a redundancy payment and, if there is an entitlement, whether this reflects an arm's length dealing between the parties;
- The economic circumstances of the employer at the time of the dismissal, particularly where there is no legal entitlement to a redundancy payment (this can be contrasted to looking only to the expectations of the employee in an ideal situation where there is no issue in regard to the employer's capacity to pay); and

[121] [2007] AATA 1269; 2007 ATC 2155; (2007) 66 ATR 806 at paragraph 14.

- Whether any arm's length employees were treated in a consistent manner, taking proper account of the application of other relevant factors to those employees (that is relative levels of salary, years of service, entitlements and the economic circumstances of the company).

No stipulated arrangement to employ and 'genuine' redundancy

374. It is particularly conceivable, given the nature of a dual capacity employee, for there to be an arrangement to employ such an employee after the time at which he or she is terminated. Such an arrangement may be in place between the employee and the original employer or between the original employer and another entity, particularly a related entity to that employer or the dual capacity employee. In either case, this will cause the condition in paragraph 83-175(2)(c) not to be met.

375. Dual capacity employees who are active controlling minds of the original employer may also seek to structure their employment arrangements in a way that entitles them to a genuine redundancy payment even though they remain continuously employed in substance. Contrived cases of this nature are unlikely to give rise to a 'genuine' redundancy.

Voluntary termination element

376. When working out the voluntary termination element in cases where dismissal is not at arm's length, the Commissioner considers that a determination of what could reasonably be expected cannot be made by hypothesising what the amount of the payment would be if the situation was at arm's length. The basis of the voluntary termination hypothesis in subsection 83-175(1) should not be confused with the arm's length amount hypothesis in paragraph 83-175(2)(b). The actual circumstances at the time should be taken into account, including the fact that the parties are not operating at arm's length, if this is the case.

377. The question, then, would be what amount could reasonably be expected to be received by the employee in consequence of his or her voluntary termination at the same time and otherwise in the same circumstances as the dismissal.

378. Senior Member Pascoe in *Long*[122] approached this question on the basis that a voluntary termination would occur 'in circumstances where ongoing employment was available'. The Commissioner considers this approach is appropriate given the nature of the hypothesis.

379. However, adopting this premise should not give rise to an assumed set of facts that differ from the facts of the case. In many cases it would be expected that a dual capacity employee would be paid an amount on voluntarily terminating their employment, even where there is no contractual entitlement to a payment. This is particularly so where the redundancy payment is not based on a contractual entitlement. What a reasonable amount might be would depend on the circumstances of the case, taking into account the factors referred to in paragraphs 319 to 329 of this Ruling.

[122] [2007] AATA 1269 at paragraph 16.

Appendix 2 – Detailed contents list

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

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- genuine redundancy payments
- redundancy & retrenchment
- redundancy or early retirement scheme payments

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