


CR 2002/1 - Income tax: Eligible Termination Payment - FreightCorp Sale and Transfer of Employment

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 This document has changed over time. This is a consolidated version of the ruling which was published on *31 December 2001*



Class Ruling

Income tax: Eligible Termination Payment - FreightCorp Sale and Transfer of Employment

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Preamble

*The number, subject heading, and the **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains **Class Rulings** and **Taxation Rulings TR 92/1** and **TR 97/16** together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax law dealt with in this Ruling is paragraph (a) of the definition of an 'eligible termination payment' in subsection 27A(1) of the *Income Tax Assessment Act 1936* ('ITAA 1936').

Class of persons

3. The class of persons to whom this Ruling applies is all Award Employees (Employees) of FreightCorp who, upon the sale of the FreightCorp business, cease employment with FreightCorp to take up employment with the purchaser of the FreightCorp business, who receive a payment under the arrangement described below at paragraphs 10 to 26.

Qualifications

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

5. The class of persons defined in this Ruling may rely on its contents provided the arrangement described below at paragraphs

10 to 26 is carried out in accordance with the details of the arrangement provided in this Ruling.

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

- (a) this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement on which the Commissioner has ruled; and
- (b) this Ruling may be withdrawn or modified.

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Date of effect

8. This Ruling applies from 31 December 2001. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Withdrawal

9. This Ruling is withdrawn and ceases to have effect after 30 June 2002. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

10. The arrangement that is the subject of the Ruling is described below. The description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of the documents incorporated into this description of the arrangement are:

- correspondence between the Public Sector Management Office of the Premier's Department of New South Wales and the Labor Council of NSW detailing the terms of the offer;
- the *Freight Rail Corporation (Sale) Act 2001*;
- the FreightCorp Enterprise Agreement 3 2001;
- correspondence from the applicant for the Ruling to the Australian Taxation Office (ATO); and
- record of telephone conversations between a representative of the applicant for the Ruling and an officer of the ATO.

Note: certain information from the applicant has been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information Legislation.

11. The title given to the arrangement is the 'FreightCorp Sale and Transfer of Employment Agreement 2001'.

12. The Freight Rail Corporation (FreightCorp) is a State Owned Corporation constituted by the *Transport Administration Act 1988*, and also operates subject to the terms of the *State Owned Corporations Act 1989*.

13. FreightCorp is seeking confirmation as to whether certain transfer payments made to the class of employees described in paragraph 3 above, constitute 'eligible termination payments' as defined in subsection 27A(1) of the ITAA 1936.

14. As at 30 June 2001, FreightCorp had approximately 2050 Award Employees.

15. The NSW Government is selling the business undertaking conducted by FreightCorp.

16. The method of sale will be by direct sale of the business undertaking to the purchaser in accordance with Part 3 of the *Freight Rail Corporations (Sale) Act 2001* ('the Sale Act').

17. All Employees of FreightCorp at the time of the sale will become employed by the purchaser.

18. The transfer package provides, amongst other benefits, for the payment of a 'transfer payment' with a maximum payment of 30 weeks provided in accordance with the following formula:

Length of Continuous Service by Employee in NSW Public Service	Rate of calculation of transfer payment
Less than 1 year	Nil
1 year and less than 2 years	7.5 weeks pay
2 years and less than 3 years	13.125 weeks pay
3 years and less than 4 years	18.75 weeks pay
4 years and less than 5 years	22.5 weeks pay
5 years and less than 6 years	26.25 weeks pay
6 years and more	30 weeks pay

19. The payment, outlined in paragraph 18 above, is given the title of transfer payment in keeping with descriptions used for similar payments made in other privatisations.

20. The transfer payment is an amount, which has been determined to reflect certain public sector employment conditions which will eventually be lost following cessation of employment with the NSW public sector, including no forced redundancy, current entitlement of FreightCorp staff to indefinite salary maintenance and public sector mobility opportunities.

21. The transfer payment is an amount in addition to any other benefits or statutory leave entitlements. Employees will have the option of cashing out their accrued Annual Leave, Long Service Leave and Accrued Public Holidays entitlements, prior to the transfer of their employment.

22. Employees who do not voluntarily resign before the sale has been completed, will be taken to have ceased employment with FreightCorp upon the completion of the sale, and will be automatically entitled to receive the transfer payment.

23. Subsection 42(3) of the Sale Act states that the following provisions are to apply in the event of the transfer of an employee's employment to the purchaser:

- (a) the employee ceases to be an employee of FreightCorp and becomes an employee of the new employer on the same terms and conditions of employment as applied to the employee immediately before the transfer of employment, and those terms and conditions are to continue to have effect until varied either by agreement or otherwise in accordance with law;

- b) the continuity of the employee's contract of employment is taken not to have been broken by the transfer of employment, and service of the employee with FreightCorp (including service that is taken to be service with FreightCorp) is taken for all purposes to be service with the new employer;
- c) without limiting paragraph (b), the employee retains any rights to sick leave, annual leave or long service leave accrued or accruing immediately before the transfer (except accrued leave for which the employee has, on ceasing to be an employee of FreightCorp, been paid the money value in pursuance of any other entitlement of the employee);
- d) the employee is not entitled to receive any payment or other benefit (including in the nature of severance pay or redundancy compensation) merely because the employee ceased to be an employee of FreightCorp as a result of the transfer of employment.'

24. These provisions are designed to ensure that Employees' accrued entitlements and conditions of employment are preserved upon the sale of FreightCorp.

25. Note that paragraph (d) of subsection 42(3) above, appears to contradict the terms of the transfer payment offer described above. However, the applicant states the intent of paragraph (d) is to confirm that FreightCorp Employees do not have an entitlement to claim for any other form of payment merely because they cease to be an employee of FreightCorp and transfer to the purchasing entity – that is, Employees do not have any rights to make a claim for any entitlement for redundancy etc.

26. The transfer payment will be paid at the earliest possible time after completion of the sale.

Ruling

27. The proposed transfer payment payable to FreightCorp Employees upon the sale of its business, and their transfer to the purchaser, is an eligible termination payment under paragraph (a) of the definition of 'eligible termination payment' in subsection 27A(1) of the ITAA 1936.

Explanations

28. In the context of payments made by an employer, paragraph (a) of the definition of an 'eligible termination payment' in subsection 27A(1) of the ITAA 1936 means:

- '(a) any payment made in respect of the taxpayer in consequence of the termination of any employment of the taxpayer, other than a payment –
 - (i) made from a superannuation fund in respect of the taxpayer by reason that the taxpayer is or was a member of the fund;
 - (ii) of an annuity, or supplement, to which section 27H applies;
 - (iii) from a fund in relation to which section 121DA, as in force at any time before the commencement of section 1 of the Taxation Laws Amendment Act (No 2) 1989 has applied in relation to the year of income commencing on 1 July 1984 or any subsequent year of income;
 - (iv) from a fund that is or has been a non-complying superannuation fund in relation to any year of income;
 - (v) of an amount to which section 26AC or 26AD applies; or
 - (vi) of an amount that, under any provision of this Act, is deemed to be a dividend paid to the taxpayer'.

The proposed transfer payment does not fall within any of these exclusions, nor is it covered by the further exclusions in paragraphs (ja) to (s) of the definition.

29. In determining whether the payment constitutes an eligible termination payment it is necessary to determine whether:

- there has been a termination of employment; and
- the payment is 'in consequence of the termination of employment'.

Is there a termination of employment?

30. Paragraph 9 of Taxation Ruling IT 2152 titled: 'Income Tax: Retiring allowances paid to employees upon restructuring of a business' states:

‘Where a company or other employer ceases carrying on a business which has been transferred to an associated entity, it will be accepted that the employees of the company have had their employment terminated. This will apply in cases similar to the *Paklan Case* where it is clear that the business in question has been transferred to another entity and it is also clear that the employee’s employment has, in fact, been terminated...’

31. Taxation Determination TD 93/140 titled: ‘Income tax: if a company ceases carrying on a business which has been transferred to an associated entity, will a payment made by that company to a former employee be an eligible termination payment as defined in subsection 27A(1) of the ITAA 1936?’ confirms the view expressed in IT 2152 that employees of an entity ceasing business have had their employment terminated.

32. The facts in *Paklan Pty Ltd and others v. FCT (1983) 14 ATR 457, 83 ATC 4456 (Paklan’s Case)* can be summarised as follows:

- The taxpayers were directors and shareholders of a company (‘the old company’) which carried on business as consulting engineers.
- On 30 June 1977 the company ceased to carry on business and the next day sold the business to another company (‘the new company’) also controlled by the taxpayers.
- The new company commenced carrying on the business from the same premises and subject to the same arrangements for occupancy as the old company.
- The entire staff, including the taxpayers, became employees of the new company.
- Six months later, it was decided to pay a lump sum to former directors. The payments were actually made a year after the company ceased business and out of outstanding fees received after the business had ceased.

33. The taxpayers in *Paklan’s Case* did not succeed in having the lump sums in question treated as a ‘payment in consequence of termination’ as they were paid under circumstances and at a time too remote to the termination. However, the Full Federal Court did not dispute the fact employment had terminated when the old company had ceased business on 1 July 1977.

34. The facts in *Case Q118 83 ATC 610* were similar to those in *Paklan’s Case* and again involved the sale of a company’s business as a going concern to a new company. All the staff of the old business were transferred across to the new company. The Board of Review (at

618), did not dispute the fact that employees of the old company had ceased to be employees of the old company immediately before taking up employment with the new company.

35. While in *Case K76 78 ATC 703*, where a taxpayer ceased work with a subsidiary company due to a corporate restructure and immediately re-commenced work with the parent company on the same terms and conditions, it was held the taxpayer's employment with the subsidiary company had been terminated.

36. The facts presented in respect of the sale of FreightCorp indicate a termination of employment with the NSW public sector. Upon the sale of FreightCorp to the purchaser, all staff who have not resigned from FreightCorp, will transfer employment to the purchaser. This is notwithstanding paragraph (b) of subsection 42(3) of the Sale Act which states the employment contract of FreightCorp Employees is unbroken by the transfer of employment.

37. Paragraph (b) of subsection 42(3) of the Sale Act does not alter the fact that when FreightCorp is sold, its Employees cease employment with FreightCorp immediately before they take up employment with the purchaser in the process of their transfer. Thus, there is a termination of employment.

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

38. A payment can be considered to be in consequence of termination where it follows from the termination, or the termination is a condition precedent to the payment. In *Reseck v. FC of T*; 75 ATC 4213, (1975) 133 CLR 45, (1975) 49 ALJR 370, (1975) 6 ALR 642, 5 ATR 538 Gibbs J said at pp 4216-7:

‘Within the ordinary meaning of the words a sum is paid in consequence of the termination of employment when the payment follows as an effect or result of the termination....It is not in my opinion necessary that the termination of the services should be the dominant cause of the payment.’

In the same case, Jacobs J said that ‘in consequence of’ did not import causation but rather a ‘following on’ (p 4219).

39. The decision in *Reseck's Case* was considered by the Full Federal Court in *McIntosh v. FCT*; 79 ATC 4325, (1979) 25 ALR 557, (1979) 45 FLR 279, 10 ATR 13. The case concerned a taxpayer who became entitled to a payment subsequent to his retirement. In finding that the payment was in consequence of the taxpayer's termination, Brennan J said (at p 4328):

‘...if the payment is made to satisfy a payee's entitlement, the phrase “in consequence of retirement” requires that the

retirement be the occasion of, and a condition of, entitlement to the payment. A sufficient causal nexus between the payment and the retirement is thus established.’

40. The Commissioner of Taxation has issued Taxation Ruling TR 96/13 titled: ‘Income Tax: eligible termination payments (ETP): payments in consequence of the termination of any employment: meaning of the words “in consequence of”’ which considers the meaning of the phrase ‘in consequence of the termination of any employment’ in the definition of eligible termination payment in subsection 27A(1) of the Act.

41. Paragraph 5 of TR 96/13 states:

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

42. Notwithstanding that the transfer payment is only payable to Employees who take up employment with the purchaser, the transfer payment is only payable on the condition that these Employees have terminated their employment with FreightCorp. No entitlement to the payment arises prior to this event.

43. In the event of a sale, the transfer payment is to be made at the earliest possible time after completion of the sale. The timing of any transfer payments would therefore be consistent with paragraph 5 of TR 96/13. The transfer payment is in consequence of the termination of employment and is therefore an eligible termination payment under subsection 27A(1) of the ITAA 1936.

Detailed contents list

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Commissioner of Taxation

16 January 2002

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Related Rulings/Determinations:

CR 2001/1; TR 92/1; TR 92/20;
TR 96/13; TR 97/16; TD 93/140;
IT 2152

Subject references:

- Eligible termination payments
- Employment termination

Legislative references:

- ITAA 1936 26AC
- ITAA 1936 26AD
- ITAA 1936 27A(1)
- ITAA 1936 27H
- Freight Rail Corporations (Sale) Act 2001 5

- Freight Rail Corporations Sale Act 2001 Part 3
- Freight Rail Corporations Sale Act 2001 42(3)

Case references:

- McIntosh v. Federal Commissioner of Taxation 79 ATC 4325, (1979) 25 ALR 557, (1979) 45 FLR 279, 10 ATR 13
- Paklan Pty Ltd and other v. FCT (1983) 14 ATR 457, 83 ATC 4456
- Reseck v. Federal Commissioner of Taxation 75 ATC 4213, (1975) 133 CLR 45, (1975) 49 ALJR 370, (1975) 6 ALR 642, 5 ATR 538
- Taxation Case K76 78 ATC 703
- Taxation Case Q118 83 ATC 610

ATO References

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