



# ***CR 2004/49 - Income tax: National Entitlement Security Trust payments to members - character of payments made to members***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *1 June 2002*



## Class Ruling

# Income tax: National Entitlement Security Trust payments to members – character of payments made to members

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### **Preamble**

*The number, subject heading, **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**

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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 are:

- Subsection 10-5(1) Schedule 1 of the *Taxation Administration Act 1953* (TAA 1953);
- Section 12-35 Schedule 1 TAA 1953;
- Section 26AC of the *Income Tax Assessment Act 1936* (ITAA 1936);
- Subsection 101A(2) ITAA 1936;
- Section 26AD ITAA 1936;
- Subsection 27A(1) ITAA 1936;
- Section 27AAA ITAA 1936;
- Section 27F ITAA 1936; and
- Subsection 159SA(1) ITAA 1936.

## Class of persons

3. The class of persons to which this Ruling applies is all employee members of the National Entitlement Security Trust (NEST) who, upon satisfying the requirements to receive employee entitlements under their relevant industrial agreement, receive a payment of employee entitlements from the Trustee of NEST.

## 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 actually carried out is carried out in accordance with the arrangement described in paragraphs 10 to 17.

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

- 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
- this Ruling may be withdrawn or modified.

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## Date of effect

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8. This Ruling applies from 1 June 2002 to 30 June 2006. Further, the Class Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*;
- it is not taken to be withdrawn by an inconsistent later public ruling; or
- the relevant tax laws are not amended.

## **Withdrawal**

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9. This ruling is withdrawn and ceases to have effect after 30 June 2006. However, the Ruling continues to apply after its withdrawal in respect of the tax laws ruled upon, to all persons within the specified class who entered into the specific arrangement during the term of the Ruling, subject to there being no change in the arrangement or in the person's involvement in the arrangement.

## **Arrangement**

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10. The arrangement that is the subject of this Ruling is described below. This description is as described in the following document:

- National Entitlement Security Trust Deed dated 1<sup>st</sup> June 2002.

This document, or relevant parts of it, as the case may be, form part of and are to be read with the description.

### **Description of Arrangement**

11. NEST will accept employee entitlements which an employer is required to pay under their industrial agreement.

12. NEST accepts 'employee entitlements', which are defined in clause 32.1 as:

'any dollar amount payable to a Member under an Industrial Agreement to which that Member has a right and which is identified as such in the Industrial Agreement including the following entitlements:

- (a) annual leave and annual leave loading;
- (b) sick leave;
- (c) long service leave;
- (d) redundancy;
- (e) severance; or
- (f) any other amount from time to time payable by an Employer to a Member accepted by the Trustee.'

13. An employer is required to sign a deed of adherence to ensure that the employer pays the minimum contribution required to be paid to NEST on a monthly basis. Clause 7.1 of the trust deed outlines that the minimum contribution amount is calculated with reference to the employee's future leave entitlement.

**'Employee Entitlement Contributions**

Each Employer must pay to the Trustee, or as directed by it, on such dates as agreed with the Trustee an amount equal to the Minimum Contribution for each Member employed or whose services are used by that Employer, in accordance with the terms of the Relevant Industrial Agreement in relation to the Employees of that Employer.'

14. As outlined in clause 7.9 all contributions made to NEST will be placed into separate member (employee) accounts.

**'Payments and credits/Members Account**

All contributions by any Employer will be allocated as directed by it and credited to personal accounts opened in the names of the Members and styled the Members' Account.'

15. Payments may be made by the Trustee of NEST to the employer and/or directly to the employee, as outlined in the NEST administrative provisions.

'Employers will pay a claim for Employee Entitlements in the same manner that Employers currently pay these employee entitlements. Employers will however, be entitled to reimbursement from the Trust for an amount calculated in accordance with clause 26 of the Deed.

The Fund Administrator will reimburse the Employer immediately upon receipt and completion of a signed NEST claim form available from the Fund Administrator, in accordance with clause 28. Reimbursements to Employers are paid by direct credit or by cheque. An Employer must exhaust its existing accrued Employer entitlements before claiming from the Fund.

Employees may claim directly from the Fund, in accordance with the Deed if:

1. The current Employer becomes insolvent (see clause 26).
2. The Employee is claiming Entitlements transported from a previous Employer (see clause 9 or clause 26).
3. The Employer's relevant industrial agreement specifically requires Employees to claim directly from the Fund.'

16. The employer may obtain a reimbursement of their contributions from NEST after they have paid the employee their entitlement/s, but at no stage can the employer obtain a refund of their contributions from NEST.

17. The Trustee of NEST will not accept redundancy and severance amounts in excess of the mandatory requirements contained in the employer's industrial instrument/s. As a result the Trustee of NEST will not make the following types of payments to employees:

- a bona fide redundancy payment (an amount in excess of the amount expected on termination);
- an invalidity payment; and
- an approved early retirement scheme payments.

## **Ruling**

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18. Payments of employee entitlements by the Trustee of the National Entitlement Security Trust to a member will retain the following types of concessional treatment, which would have been applicable had the payment of employee entitlements been made directly by the employer to the employee:

- a tax offset under item 9 of the table in subsection 159SA(1) of the ITAA 1936 for payments of unused annual leave to a terminating employee such that the rate of tax payable on the eligible assessable income will not exceed 30%;
- a tax offset under item 9 of the table in subsection 159SA(1) of the ITAA 1936 for payments of long service leave to a terminating employee such that the rate of tax payable on the eligible assessable income will not exceed 30%;
- a tax offset under one or more of items 4, 5, 6 or 8 of the table in subsection 159SA(1) of the ITAA 1936 for payments of unused sick leave to a terminating employee that will limit the rate of tax that is payable on the ETP;
- a tax offset under one or more of items 4, 5, 6 or 8 of the table in subsection 159SA(1) of the ITAA 1936 for payments of redundancy amounts to terminating employees that will limit the rate of tax that is payable on the ETP; and
- concessional treatment under section 27AAA of the ITAA 1936 for death benefits that are paid in relation to dependants of the employee.

## Explanation

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19. NEST receives contributions from employers who are required by their industrial instruments to make contributions to the fund in respect to their workers entitlements.

20. NEST may receive contributions for annual leave, sick leave, long service leave and redundancy and may, depending on the circumstances, be required to make payments of entitlements to continuing or terminating employees.

### **Entitlements paid by the trustee of NEST to a continuing employee**

21. In certain circumstances an employee may claim their entitlements directly from NEST (refer to the administrative provisions for NEST). As such NEST may be required to make the following payments directly to a continuing employee:

- annual leave and annual leave loading;
- long service leave; and
- sick leave.

### ***Payment of annual leave and annual leave loading to an employee***

22. A payment of annual leave or annual leave loading to a continuing employee by the Trustee of NEST is treated the same as a payment of annual leave or annual leave loading made by an employer to a continuing employee.

23. The payment of the annual leave and annual leave loading is a payment of assessable income to the employee. As such, this is a payment from which an amount of tax must be withheld (refer to subsection 10-5(1) Schedule 1 of the TAA 1953). The Trustee who is making this payment to the employee will withhold an amount of tax as required by section 12-35 Schedule 1 of the TAA 1953.

24. Payments of annual leave and leave loading received by a continuing employee do not give rise to any tax concessions.

### ***Payment of long service leave to an employee***

25. A payment of long service leave to a continuing employee by the Trustee of NEST is treated the same as a payment of long service leave made by an employer to a continuing employee.

26. The payment of long service leave is a payment of assessable income to the employee, as such this is a payment from which an amount of tax must be withheld (refer to subsection 10-5(1) Schedule 1 of the TAA 1953). The Trustee who makes this payment

to the employee will withhold an amount of tax as required by section 12-35 Schedule 1 of the TAA 1953.

27. Payments of long service leave received by a continuing employee do not give rise to any tax concession.

***Payment of sick leave to an employee***

28. A payment of sick leave to a continuing employee by the Trustee of NEST is treated the same as a payment of sick leave made by an employer to a continuing employee.

29. The payment of sick leave is a payment of assessable income to the employee, as such this is a payment from which an amount of tax must be withheld (refer to subsection 10-5(1) Schedule 1 of the TAA 1953). The Trustee who makes this payment to the employee will withhold an amount of tax as required by section 12-35 Schedule 1 of the TAA 1953.

30. Payments of sick leave received by a continuing employee do not give rise to any tax concessions.

**Entitlements paid by the Trustee of NEST to a terminating employee**

31. Entitlements may be paid by the Trustee of NEST when an employee is terminated. The trustee of NEST may make the following payments directly to the employee:

- unused annual leave and annual leave loading;
- unused long service leave;
- unused sick leave; and
- a redundancy payment.

***Payment of unused annual leave to a terminating employee***

32. A payment of unused annual leave by the Trustee of NEST to a terminating employee is treated the same as an unused leave payment made by the employer to the employee.

33. To be a payment of unused annual leave the payment must satisfy the factors of section 26AC of the ITAA 1936. This section provides that any amount which is:

- paid after 15<sup>th</sup> August 1978;
- paid in consequence of retirement or termination; and
- in respect to unused annual leave,

is to be included in the assessable income of the taxpayer in the year of income in which it is paid.

34. The payment of unused annual leave is a payment of assessable income to the employee, as such this is a payment from which an amount of tax must be withheld (refer to subsection 10-5(1) Schedule 1 of the TAA 1953). The Trustee who makes this payment to the employee will withhold an amount of tax as required by section 12-35 Schedule 1 of the TAA 1953.

35. Payments of annual leave and leave loading received by a terminating employee will be eligible assessable income as defined in section 159S of the ITAA 1936 where:

- the payments are in respect of unused annual leave and leave loading paid because the termination of employment was due to bona fide redundancy, invalidity or under an approved early retirement scheme; or
- the unused annual leave and leave loading accrued before 18 August 1993 and the termination of employment was not due to bona fide redundancy, invalidity or under an approved early retirement scheme.

36. Item 9 of the table in subsection 159SA(1) of the ITAA 1936 provides for a tax offset such that the rate of tax payable on the eligible assessable income will not exceed 30%. Payments of eligible assessable income by NEST to terminating employees will be entitled to this tax offset.

### ***Payment of unused annual leave in the event of employee death***

37. In the event of an employee's death a payment of unused annual leave by the Trustee of NEST to an employee's legal representative is treated the same way under subsection 101A(2) of the ITAA 1936 as a payment of unused annual leave made by the employer to the legal representative.

38. Subsection 101A(2) of the ITAA 1936 ensures that if an employee dies, any amount which would have been included in the assessable income of the deceased under section 26AC of the ITAA 1936 will not form part of the assessable income of the deceased's estate.

***Payment of unused long service leave by NEST to a terminating employee***

39. A payment of unused long service leave by the Trustee of NEST to a terminating employee is treated the same as a payment of unused long service leave made by the employer to a terminating employee.

40. To be a payment of unused annual leave the payment must satisfy the factors of section 26AD of the ITAA 1936. This section provides that any amount which is:

- paid after 15 August 1978;
- paid in consequence of retirement or termination; and
- in respect of unused long service leave,

that amount, or part of it (if the eligible service period commences before 16 August 1978) will be included in the assessable income of the taxpayer in the year of income in which it is paid.

41. The payment of unused long service leave is a payment of assessable income to the employee, as such this is a payment from which an amount of tax must be withheld (refer to subsection 10-5(1) Schedule 1 of the TAA 1953). The Trustee who makes this payment to the employee will withhold an amount of tax as required by section 12-35 Schedule 1 of the TAA 1953.

42. NEST as the payer of the long service leave should identify that part of the payment of unused long service leave that accrued before 16 August 1978, and that part that accrued after 15 August 1978 onwards.

43. Subsection 26AD(2) of the ITAA 1936 requires that where the eligible service period of the taxpayer commenced after 15 August 1978, the amount of long service leave paid on termination of employment be returned as assessable income.

44. Where the eligible service period of the taxpayer commenced before 16 August 1978, subsections 26AD(3), (3A) and (4) sets out how to calculate that part of the payment that is in respect of eligible service period that commenced after 15 August 1978. That part of the payment that accrued in respect of long service leave accruing after 15 August 1978 should be returned as assessable income.

45. Subsection 26AD(5) of the ITAA 1936 requires that only 5% of any lump sum payment in respect to amounts accrued before 16 August 1978 is to be returned as assessable income

46. Payments of long service leave received by a terminating employee will be eligible assessable income as defined in section 159S of the ITAA 1936 where:

- the payments are in respect of long service leave that accrued after 15 August 1978 and were paid because the termination of employment was due to bona fide redundancy, invalidity or under an approved early retirement scheme; or
- the payments are in respect of long service leave that accrued after 15 August 1978 and before 18 August 1983 and the termination of employment was not due to bona fide redundancy, invalidity or under an approved early retirement scheme.

47. Item 9 of the table in subsection 159SA(1) of the ITAA 1936 provides for a tax offset such that the rate of tax payable on the eligible assessable income will not exceed 30%. Payments of eligible assessable income by NEST to terminating employees will be entitled to this tax offset.

***Payment of unused long service leave in the event of employee death***

48. In the event of an employee's death a payment of unused long service leave by the Trustee of NEST to an employee's legal representative is treated the same way under subsection 101A(2) of the ITAA 1936 as a payment of unused long service leave made by the employer to the legal representative.

49. Subsection 101A(2) of the ITAA 1936 ensures that if an employee dies, any amount which would have been included in the assessable income of the deceased under section 26AD of the ITAA 1936 will not form part of the assessable income of the deceased's estate.

***Payment of unused sick leave by NEST to a terminating employee***

50. A payment of unused sick leave by the Trustee of NEST to a terminating employee is treated the same as an unused sick leave payment made by the employer to the employee.

51. A payment for unused sick leave is a payment in consequence of termination, as such the amount is an eligible termination payment (ETP) (refer to the definition of an ETP under subsection 27A(1) of the ITAA 1936).

52. The Trustee who makes the payment to the employee will withhold an amount of tax from the ETP in the same way that the tax withheld would have been calculated by the employer making the payment of the ETP.

53. The employee receiving the ETP will be entitled to a tax offset under one or more items 4, 5, 6 or 8 of the table in subsection 159SA(1) of the ITAA 1936 that will limit the rate of tax that is payable on the ETP.

***Payment of redundancy by NEST to a terminating employee***

54. A payment for redundancy is a payment in consequence of termination, as such the amount is an ETP (refer to the definition of an ETP under subsection 27A(1) of the ITAA 1936).

55. The redundancy amount paid by the Trustee on termination of employment will be treated as an ETP, just as if the amount had been paid by the employer. The Trustee who makes the redundancy payment to the employee will withhold an amount of tax from the ETP in the same way that the tax withheld would have been calculated by an employer making the payment of the ETP.

56. The employee receiving the ETP will be entitled to a tax offset under one or more items 4, 5, 6 or 8 of the table in subsection 159SA(1) of the ITAA 1936 that will limit the rate of tax that is payable on the ETP.

57. As NEST only accepts the minimum contributions to meet the expected redundancy amount which will be paid to an employee on termination, NEST will never pay a bona fide redundancy. This is because under section 27F of the ITAA 1936 only the redundancy amount which exceeds that which is expected in the case of termination will be a bona fide redundancy payment. Due to the restriction on accepting employer contributions the NEST redundancy payment will not exceed the amount that the employee is entitled to (the expected amount).

***Special Rules for death benefits***

58. Section 27AAA of the ITAA 1936 provides concessional treatment for a death benefit ETP paid in relation to dependants. Any amount of death benefit ETP paid by the Trustee of NEST to a dependant of the employee will receive the concession.

**Detailed contents list**

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

CR 2001/1; TR 92/1; TR 97/16

*Previous Rulings/Determinations:*

TD 93/17

*Subject references:*

- death benefits
- eligible termination payment
- lump sum payments for unused annual leave
- lump sum payments for unused long service leave
- unused sick leave

*Legislative references:*

- TAA 1953 Pt IVAAA
- TAA 1953 10-5(1) of Sch 1
- TAA 1953 12-35 of Sch 1
- ITAA 1936 26AC
- ITAA 1936 26AD
- ITAA 1936 26AD(2)
- ITAA 1936 26AD(3)
- ITAA 1936 26AD(3A)
- ITAA 1936 26AD(4)
- ITAA 1936 26AD(5)
- ITAA 1936 27A(1)
- ITAA 1936 27AAA
- ITAA 1936 27F
- ITAA 1936 101A(2)
- ITAA 1936 159S
- ITAA 1936 159SA(1)
- Copyright Act 1968

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*ATO references*

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