CR 2007/2 - Income tax: leave - Deferred Salary Arrangements for employees of the City of Canning in Western Australia

Class Ruling

Income tax: leave – Deferred Salary Arrangements for employees of the City of Canning in Western Australia

Contents Para

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provision dealt with in this Ruling is section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Class of entities

3. The class of entities to which this Ruling applies is employees of the City of Canning in Western Australia who participate in Deferred Salary Arrangements, being Purchase Leave and/or the 80/20 Leave Arrangement. In this Ruling, these employees are referred to as Participants.

Qualifications

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

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 13 to 27 of this Ruling.

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

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- this Ruling may be withdrawn or modified.

Date of effect

8. This Ruling applies from 10 January 2007. The Ruling applies to all entities within the specified class who enter into the specified scheme, subject to there being no change in the scheme or in the entities involved in the scheme.

9. 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. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. If this Class Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

11. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

12. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

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

14. The City of Canning is a local government council. The council will be introducing optional leave arrangements that will allow employees to defer an entitlement for salary in return for either:

- Purchase Leave – additional annual leave; or
- 80/20 Leave Arrangement – a paid year of leave.

15. The leave arrangements are available to all permanent employees of the City of Canning and, subject to agreement with the City of Canning, certain employees engaged on fixed term contracts.

Purchase Leave

16. The Purchase Leave arrangement allows Participants to defer an entitlement to salary in return for up to 4 additional weeks paid annual leave per annum.

17. This arrangement runs over the calendar year ending 31 December.

18. The purchase leave is funded by the Participant deferring the payment of salary. The amount of the deferred salary is dependent upon the number of weeks being purchased.

19. The Participant receives a reduced salary whilst participating in the arrangement, being normal salary less the deferred salary.

20. The Participant's deferred salary will be accounted for by the City of Canning in a general ledger account. The amount will be recognised as a future liability to pay the Participant. The monies are not held in separate bank accounts on behalf of individual Participants and no interest accrues to the Participant.

21. The deferred salary will be paid to the Participant when:

- the Purchase Leave is taken;
- the Participant terminates employment or withdraws from the Purchase Leave arrangement prior to the leave being taken; or
- the Participant fails to take the Purchase Leave prior to the last pay period in January of the next calendar year.

Participants cannot otherwise access the funds.

22. The Purchase Leave rules:

- enable a Participant to withdraw from the arrangement effective from the end of each quarter (31 March; 30 June and 30 September); and
- do not allow Purchase Leave to accrue beyond the calendar year.

80/20 Leave Arrangement

23. The 80/20 Leave Arrangement allows Participants to defer an entitlement to salary during the first four years of their participation in return for a paid year of leave during their fifth year of the arrangement.

24. The 80/20 Leave Arrangement is funded by the Participants' deferment of 20% of their salary entitlement before any salary packaging over four years. The Participant, therefore, receives a reduced salary whilst participating in the arrangement, being normal salary less the deferred salary.

25. The Participants' deferred salary will be accounted for by the City of Canning in a general ledger account. The amount will be recognised as a future liability to pay the Participant. The monies are not held in separate bank accounts on behalf of individual Participants and no interest accrues to the Participant.

26. The deferred salary will be paid to the Participant when:

- the leave under the 80/20 Leave Arrangement is taken;
- the Participant terminates employment or withdraws from the 80/20 Leave Arrangement prior to the leave being taken; or
- the Participant fails to take the leave within six months of it becoming due.

Participants cannot otherwise access the funds.

27. The 80/20 Leave Arrangement rules enable a Participant to:

- withdraw from the arrangement;
- be suspended from the arrangement for a period of up to six months (or twelve months if paternal leave is granted) by agreement; and
- seek an early return to work once leave has commenced.

Ruling

28. The deferred salary paid to Participants during the taking of Purchase Leave or the paid leave under the 80/20 Leave Arrangement is included in their assessable income in the year in which it is received under section 6-5 of the ITAA 1997.

29. As the deferred salary is not considered to be an amount that has been applied or dealt with at the direction of the Participants for the purposes of subsection 6-5(4) of the ITAA 1997, it is not included in their assessable income in the year of deferral.

Commissioner of Taxation
10 January 2007

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.

30. Employees of the City of Canning in Western Australia who participate in the Purchase Leave or 80/20 Leave Arrangements have varied their employment contracts. In return for accepting a reduced salary for future employment services they will provide to the employer, they will have an entitlement to receive a deferred salary while on leave.

31. Subsection 6-5(1) of the ITAA 1997 provides that the assessable income of a taxpayer includes income according to ordinary concepts, which is called ordinary income. Subsection 6-5(2) of the ITAA 1997 provides that the assessable income of Australian residents includes ordinary income derived directly or indirectly from all sources.

32. Income from employment is generally derived only when received.

33. A Participant receives a reduced salary under both the Purchase Leave and 80/20 Leave Arrangements. This reduced salary amount is included in their assessable income under subsection 6-5(1) of the ITAA 1997 in the income year of receipt.

34. Under the Purchase Leave and 80/20 Leave Arrangements the Participants defers receipt of an amount of salary until a later income year. The amount of the deferred salary of a Participant is included in their assessable income in the income year of receipt being the year in which they:

- take their period of leave;
- withdraw from the Purchase Leave or 80/20 Leave Arrangement;
- terminate their employment; or
- are paid out due to the Participant's failure to utilise the leave within the period required under the leave arrangement rules.

35. The deferred salary is not considered to be an amount that has been applied or dealt with in any way on behalf of, or at the direction of the Participant at the time it is accounted for in the City of Canning general ledger account. While the City of Canning recognises that it has a future obligation to make the payment, the Participant does not have the right to draw on the amount until one of the events in paragraph 21 or 26 of this Ruling occurs. In these circumstances subsection 6-5(4) of the ITAA 1997 does not apply.

Pay as you go (PAYG) withholding

36. At the time of paying the deferred salary to the Participant, the City of Canning is required to withhold amounts from these payments under its PAYG withholding obligations under Division 12 of Schedule 1 to the TAA.

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Subject references:

- assessable income
- deferred income
- deferred salary payment
- employment contract
- income derived

Legislative references:

- ITAA 1997 6-5
- ITAA 1997 6-5(1)
- ITAA 1997 6-5(2)
- ITAA 1997 6-5(4)
- TAA 1953
- TAA 1953 Sch 1 Div 12
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968

ATO references
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