


CR 2007/32 - Income tax: tax treatment of payments to members of the South Australian Building Industry Redundancy Scheme Trust

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Class Ruling

Income tax: tax treatment of payments to members of the South Australian Building Industry Redundancy Scheme Trust

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ⓘ This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

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 provisions dealt with in this Ruling are:

- paragraph (a) of the definition of an 'eligible termination payment' in subsection 27A(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 27F of the ITAA 1936;
- section 97 of the ITAA 1936; and
- section 99A of the ITAA 1936.

All legislative references are to the ITAA 1936 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is members of the South Australian Building Industry Redundancy Scheme Trust (BIRST).

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 32 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.

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Date of effect

8. This Ruling applies from 1 July 2000 to 30 June 2007. However, the Ruling continues to apply after this date to all entities within the specified class who entered into the specified scheme during the term of the Ruling, 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 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 Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the 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 South Australian BIRST is an Australian resident trust fund governed by a trust deed (the Trust Deed), which established the fund in Australia. The central management and control of the fund is in Australia.

15. A board of trustees (the Trustee) manages BIRST with equal representation by union and employer representatives. All persons that comprise the Trustee are natural persons.

16. The Trustee has appointed an administrator of BIRST and an investment manager to manage the investments of BIRST on behalf of the Trustee.

17. BIRST is an approved worker entitlement fund for fringe benefits tax (FBT) purposes.

18. BIRST was established to facilitate employers providing construction industry employees with a secure benefit at the time of retirement, death, permanent disablement or other termination of employment (Employee Entitlements).

19. Employers can fund Employee Entitlements that employers are required to make under various industrial awards and enterprise bargaining agreements (Industrial Instruments) or Agreements of Adherence for the benefit of employees through the payment of contributions to BIRST.

20. BIRST accepts contributions from employers, to fund each member's employee entitlements as provided in a Deed of Adherence or Industrial Instrument.

21. The current contribution is \$40 per week per employee. However this may vary due to Industrial Instruments and Agreements of Adherence. Higher rates will usually be agreed by the industrial parties.

22. As outlined in clause 3.2 of the Trust Deed, all contributions made to BIRST by employers are placed into separate member (employee) accounts identifying contributions for that member.

23. This Ruling applies in respect of payments made under clause 18.1 of the Trust Deed. Clause 18.1 states that the Trustees shall hold the capital upon trust as follows:

Until the Date of Distribution to pay each Employee whose employment is terminated who is entitled to receive a payment in consequence of that termination of employment his/her Employee's Benefit.

24. Therefore, under clause 18.1, the Trustees distribute the capital to pay benefits to the member in consequence of their termination of employment.

25. The Trustee maintains that a payment made to a member under clause 18.1 of the Trust Deed is made directly in consequence of the termination of the employment of the member.

26. Redundancy is defined in the National Building and Construction Award 2000 as 'a situation where an employee ceases to be employed by an employer, respondent to this award, other than for reasons of misconduct or refusal of duty'.

27. A redundancy payment may be paid by the employer. Where the employer pays the member a redundancy payment directly, BIRST will reimburse the employer for the amount paid to the particular member accordingly.

28. Payments from BIRST under clause 18.1 have been treated as eligible termination payments (ETPs) and subject to the relevant ETP tax rates (including Medicare levy), which have been deducted by the administrator of BIRST. If an ETP is rolled over into the superannuation fund of a member, no tax is deducted by BIRST.

29. This Ruling also applies to clause 16.1.3.2 of the Trust Deed whereby the Trustee has discretion to distribute income of BIRST to the individual members.

30. Clause 16 states that:

Until the date of distribution the Trustees shall hold the Trust Fund upon trust to pay divide apply or set aside the whole of the Income as follows:

16.1.1 Firstly, to defray the costs and expenses incurred by the Trustees or their servants or agents in the administration of the Trust Fund (and for the purpose of this sub-clause but without limiting the generality of the foregoing any income tax or other tax imposed upon or levied against the Trustees in respect of the Trust Fund or any part thereof shall be treated as an expense of the Trust Fund); and

16.1.2 Secondly, to the extent it is not income as ordinarily understood to the recoupment of any loss of Capital; and

16.1.3 Thirdly, subject to Clause 16A at the Trustees' discretion, either:

16.1.3.1 to the payment of insurance premiums and other costs and expenses relating to funeral, ambulance and journey accident cover and such other cover as the trustees determine from time to time for Financial Members and their family members; or

16.1.3.2 by a distribution among the Employees by paying amounts of Income to them or crediting it to their respective Employee's Contribution Accounts in shares which the Trustees consider fair and equitable having regard to the various amounts held in those accounts and the period or periods over which contributions have been made to each of those accounts.

31. In accordance with clause 8AA members can transfer the benefits they have accumulated in another redundancy fund into BIRST where permitted by the other fund.

32. In accordance with clause 8A members can transfer benefits to another redundancy fund that is an 'approved worker entitlement fund'.

Ruling

33. A payment made under the terms of clause 18.1 of the Trust Deed to a member of BIRST is made 'in consequence of' the termination of the employment of the member and constitutes an ETP as defined under paragraph (a) of the definition of 'eligible termination payment' in subsection 27A(1).

34. It is not possible to conclude whether the termination of employment is by reason of the bona fide redundancy of the member as required under paragraph 27F(1)(a) except on a case by case basis.

35. However, section 27F will not apply to a payment made under clause 18.1. That is, a payment made in consequence of the dismissal of the member from employment by reason of bona fide redundancy as the payment will not exceed the amount of an ETP that could reasonably be expected to have been made in relation to the member had they voluntarily retired from that employment at the termination time.

36. Where a distribution by the Trustee of a share of net income of the trust is made to a member under clause 16.1.3.2, it will be assessable income in the hands of the member under subsection 97(1). Such a distribution to the employee is not an ETP.

37. Trust income that is not distributed to a member is assessable income of the trustee under section 99A.

Commissioner of Taxation

2 May 2007

Appendix 1 – Explanation

❶ ***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.***

38. An ETP is defined in subsection 27A(1). There are a number of different payments that qualify as an ETP. One such payment is that made on termination of employment. Paragraph (a) of the definition of an ETP in subsection 27A(1) states in part:

eligible termination payment, in relation to a taxpayer, 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...

39. The phrase 'in consequence of' is not defined in the ITAA 1936. However, the words have been interpreted by the courts in several cases. The Commissioner has also issued Taxation Ruling TR 2003/13 which discusses the meaning of the phrase.

40. The Full High Court of Australia considered the expression 'in consequence of the termination of any employment' in *Reseck v. Federal Commissioner of Taxation* (1975) 49 ALJR 370; (1975) 6 ALR 642; (1975) 5 ATR 538; (1975) 75 ATC 4213; (1975) 133 CLR 45 (*Reseck*). The relevant issue in that case was whether amounts paid to a taxpayer by his employer at the end of two periods of employment, to which the taxpayer was entitled under an agreement between the employer and the taxpayer's union, were an allowance paid in a lump sum 'in consequence of retirement from, or the termination of, any office or employment ...'. Justice Gibbs concluded that the amounts were made in consequence of the termination of the taxpayer's employment. His Honour said that:

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 present case the allowance was paid in consequence of a number of circumstances, including the fact that the taxpayer's service had been satisfactory and that the industrial agreements provided for the payment, but it was none the less paid in consequence of the termination of the taxpayer's employment.

41. Justice Jacobs also concluded that the amounts constituted an allowance that was paid in consequence of the termination of the taxpayer's employment. His Honour said:

It was submitted that the words 'in consequence of' import a concept that the termination of the employment was the dominant cause of the payment. This cannot be so. A consequence in this context is not the same as a result. It does not import causation but rather a 'following on'.

42. The different interpretations of 'in consequence of' adopted by Justices Jacobs and Gibbs were considered by the Full Federal Court in *McIntosh v. Commissioner of Taxation* (1979) 25 ALR 557; (1979) 10 ATR 13; (1979) 45 FLR 279; (1979) 79 ATC 4325 (*McIntosh*). The matter before the court concerned a taxpayer who one week after retirement commuted part of the pension, to which he became entitled upon his retirement, into a lump sum. The commuted payment was made out of a provident fund established by a bank for the payment of benefits to bank officers on their retirement. The issue being considered by the court was whether the commuted lump sum payment came within former paragraph 26(d).

43. Justice Brennan considered the judgments of Justices Gibbs and Jacobs in *Reseck* and concluded that their Honours were both saying that a causal nexus between the termination and payment was required, though it was not necessary for the termination to be the dominant cause of the payment. Justice Brennan said that:

Though Jacobs J. speaks in different terms, his meaning may not be significantly different from the meaning of Gibbs J... His Honour denies the necessity to show that retirement is the dominant cause, but he does not allow a temporal sequence alone to suffice as the nexus. Though the language of causation often contains the seeds of confusion, I apprehend his Honour to hold the required nexus to be (at least) that the payment would not have been made but for the retirement.

44. In the same case, Justice Lockhart stated:

In my opinion, although the phrase is sufficiently wide to include a payment caused by the retirement of the taxpayer, it is not confined to such a payment. The phrase requires that there be a connection between the payment and the retirement of the taxpayer, the act of retirement being either a cause or an antecedent of the payment. The phrase used in section 26(d) is not 'caused by' but 'in consequence of'. It has a wider connotation than causation and assumes a connection between the circumstance of retirement and the act of payment such that the payment can be said to be a 'following on' of the retirement.

45. The Commissioner in TR 2003/13 considered the phrase 'in consequence of' as interpreted by the Courts. Paragraph 5 of TR 2003/13 states:

...the Commissioner considers that a payment is made in respect of a taxpayer in consequence of the termination of the employment of the taxpayer if the payment 'follows as an effect or result of' the termination. In other words, but for the termination of employment, the payment would not have been made to the taxpayer.

46. The question of whether a payment is made in consequence of the termination of employment will be determined by the relevant facts and circumstances of each case.

47. Clause 18.1 of the Trust Deed provides for the payment of an amount to the member of the Employees Benefit in consequence of termination of employment. The 'Employees Benefit' is defined under clause 2.7 as meaning, in respect of each employee at any time, either:

2.7.1 the total amount credited in that Employees Contribution Account; or

2.7.2 that proportion of the Capital of the Trust Fund which bears to the total of the Capital of the Trust Fund the same proportion as that Employee's Contribution Account bears to the aggregate of all the Employee's Contribution Accounts whichever is the lesser amount.

48. It is considered that there is sufficient nexus between the making of the payment under clause 18.1 and the termination of the relevant member's employment to characterise the payments as ETPs as defined under paragraph (a) of the definition of an ETP in subsection 27A(1).

Bona fide redundancy payment

49. Section 27F provides for certain termination payments to be concessional taxed as a bona fide redundancy payments (BFRPs) provided they meet all of the following requirements:

- there must be an ETP made in relation to a taxpayer in consequence of the dismissal of the taxpayer from employment by reason of the taxpayer's bona fide redundancy (paragraph 27F(1)(a));
- if the ETP is made after 1 July 1994, it must not be made from an eligible superannuation fund (paragraph 27F(1)(aa));
- the time of termination must be before the date that the taxpayer attains 65 years of age, or such earlier date on which the taxpayer's employment would necessarily have had to terminate under the terms of employment (paragraph 27F(1)(b));
- the amount of the ETP must not be greater than the amount that could reasonably be expected to have been paid if the employer and the taxpayer had been at arm's length (paragraph 27F(1)(c)); and
- there must not be, at the termination time, any agreement between the taxpayer and the employer, or between the employer and another person, to employ the taxpayer after the termination time (paragraph 27F(1)(d)).

50. Additionally, where all of the above requirements are met, section 27F imposes a further requirement that only so much of the ETP as exceeds the amount of an ETP 'that could reasonably be expected to have been made in relation to the taxpayer had he voluntarily retired from that employment at the termination time is a bona fide redundancy payment in relation to the taxpayer'.

51. The terms 'dismissal' and 'redundancy' are not defined in the ITAA 1936. Therefore, it is necessary to consider the common law or ordinary meaning of the terms and the meaning the judicial authorities have ascribed to each word.

52. The Explanatory Memorandum to the Income Tax Assessment Amendment Bill (No. 3) 1984 (the EM) which inserted section 27F into the ITAA 1936 states at page 91:

The terms 'dismissal' and 'redundancy' are not defined in the legislation and, therefore, should be given their ordinary meanings. 'Dismissal' carries with it the concept of the involuntary (on the taxpayer's part) termination of his employment. 'Redundancy' carries the concept that the requirements of the employer for employees to carry out work of a particular kind, or for employees to carry out work of a particular kind in the place where they were so employed, have ceased or diminished or are expected to cease or diminish. Redundancy, however, would not extend to the dismissal of an employee for personal or disciplinary reasons or for reasons that the employee was inefficient.

53. Taxation Ruling TR 94/12, which outlines the Commissioner's view of the requirements for a payment to qualify as a bona fide redundancy payment under section 27F expands upon and provides additional clarification as to what constitutes a 'dismissal' and 'redundancy'.

35. *Dismissal* carries with it the concept of the involuntary (on the employee's part) termination of employment. That is, the termination of an employee's employment will usually be instigated or initiated by the employer.

...

40. Dismissal also includes the notion of constructive dismissal. Constructive dismissal arises if an employer places an employee in a position in which the employee has little option but to tender his or her resignation. For example, the employer may be reducing the size of his or her operations and may offer a voluntary redundancy package to a selected employee. If the employee refuses the offer he or she may be forced to accept another position which may not be commensurate with his or her qualifications and experience or may involve a lower level of remuneration... The termination of employment in these circumstances would amount to constructive dismissal.

54. Paragraphs 41 to 42 of TR 94/12 provide the following in relation to the meaning of redundancy:

41. Redundancy can be described as the situation where an employer no longer requires employees to carry out work of a particular kind or to carry out work of a particular kind at the same location. Bray CJ in *R v. The Industrial Commission of South Australia; ex parte Adelaide Milk Supply Co-operative Ltd & Ors* (1977) 44 SAIR 1202 at page 1205; (1977) 16 SASR 6 at page 8 defined redundancy as follows:

... a job becomes redundant when an employer no longer desires to have it performed by anyone. A dismissal for redundancy seems to be a dismissal, not on account of any act or default of the employee dismissed or any consideration peculiar to him, but because the employer no longer wishes the job the employee has been doing to be done by anyone.

42. Redundancy refers to a job becoming redundant and not to an employee becoming redundant (*Short v. F W Hercus Pty Ltd* (1993) 40 FCR 511; (1993) 46 IR 128; (1993) 35 AILR 151). An employee's job is considered to be redundant if:

- an employer has made a definite decision that the employer no longer wishes the job the employee has been doing to be done by any one;
- that decision is not due to the ordinary and customary turnover of labour;
- that decision led to the termination of the employee's employment; and
- that termination of employment is not on account of any personal act or default of the employee.

55. As noted above, clause 18.1 of the Trust Deed provides for the payment to the member of the Employees Benefit in consequence of termination of employment. Termination of employment may occur on resignation, age retirement, permanent disability and death as well as in consequence of dismissal of the member from employment by reason of the bona fide redundancy of the member.

56. Consequently, it is not possible to conclude whether or not the first requirement under paragraph 27F(1)(a) would be satisfied. This would have to be determined by the relevant facts and circumstances of each case.

57. The BIRST is not an eligible superannuation fund so the second requirement under paragraph 27F(1)(aa) would be satisfied.

58. It is not possible to conclude whether or not the other three requirements under paragraphs 27F(1)(b), (c) and (d) would be satisfied. This would have to be determined by the relevant facts and circumstances of each case.

59. Even if the requirements of paragraphs 27F(1)(a), (b), (c) and (d) are satisfied, only so much of the ETP as exceeds the amount of an ETP 'that could reasonably be expected to have been made in relation to the taxpayer had he voluntarily retired from that employment at the termination time is a bona fide redundancy payment in relation to the taxpayer'.

60. As already noted clause 18.1 of the Trust Deed provides for the payment to the member of the Employees Benefit on termination of employment. Also as has already been noted, this can include resignation, age retirement, permanent disability and death as well as bona fide redundancy.

61. This means that, for example, where an employee of a participating employer voluntarily resigns and leaves the Industry, that employee would receive the balance of their Employee's Contribution Account.

62. Consequently, no part of the amount payable under clause 18.1 of the Trust Deed would 'exceed the amount of an ETP that could reasonably be expected to have been made in relation to the taxpayer had he voluntarily retired from that employment at the termination time'. Thus, there will not be a BFRP in relation to the member.

Section 97 income

63. The main provisions of the ITAA 1936 which relate to trust income are found in Division 6 of Part III. In broad terms the purpose of Division 6 is to tax trust income in the year of income in which it is derived by the trust at the level of either trustee or beneficiary.

64. The taxing point of a trust depends on whether the beneficiary is or is not presently entitled and where present entitlement exists, whether the beneficiary is under a legal disability. Generally, the trustee will be taxed on income it retains.

65. When the trustee of BIRST decides to make a trust distribution to members under clause 16.1.3.2 of the Trust Deed, the income available for distribution is divided amongst members in proportion to the member's account balances (subject to a minimum balance requirement). A member is presently entitled to the amount that the Trustee of BIRST distributes to them.

66. Subsection 97(1) provides that where a beneficiary of a trust estate who is not under any legal disability and is presently entitled to a share of the net income of the trust estate, the assessable income of the beneficiary shall include:

- (a) so much of that share of the net income of the trust estate as is attributable to a period when the beneficiary was a resident; and

- (b) so much of that share of the net income of the trust estate as is attributable to a period when the beneficiary was not a resident and is also attributable to sources in Australia.

67. Under section 97 members of the BIRST (except those under a legal disability) are required to include the amount of BIRST net income distributed to them in their assessable income. The distribution should be included in the income year that the present entitlement arises. Present entitlement will arise upon, the declaration of distribution by the BIRST trustee. Such a distribution to the employee is assessable income and not an ETP.

68. If the income of BIRST is not distributed to the members, but is accumulated by the trustee, the trustee will be assessed on the undistributed income under section 99A.

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 94/12; TR 2003/13

Subject references:

- bona fide redundancy payments
- distributions
- eligible termination payments
- ETP components
- income distributions
- present entitlement
- superannuation
- superannuation, retirement and employment termination
- trust beneficiaries
- trust distributions
- trust income
- trusts

Legislative references:

- ITAA 1936 27A(1)
- ITAA 1936 27F
- ITAA 1936 27F(1)(a)
- ITAA 1936 27F(1)(aa)
- ITAA 1936 27F(1)(b)
- ITAA 1936 27F(1)(c)
- ITAA 1936 27F(1)(d)
- ITAA 1936 Pt III Div 6
- ITAA 1936 97
- ITAA 1936 97(1)

- ITAA 1936 99A
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968

Case references:

- McIntosh v. Commissioner of Taxation (1979) 25 ALR 557; (1979) 10 ATR 13; (1979) 45 FLR 279; (1979) 79 ATC 4325
- R v. Industrial Commission (SA); Ex parte Adelaide Milk Supply Co-op Ltd (1977) 16 SASR 6; (1977) 44 SAIR 1202
- Reseck v. Federal Commissioner of Taxation (1975) 49 ALJR 370; (1975) 6 ALR 642; (1975) 5 ATR 538; (1975) 75 ATC 4213; (1975) 133 CLR 45
- Short v. F W Hercus Pty Limited 1993 - 0223A - FCA; No. S 13 of 1992 Fed No. 72; (1993) 46 IR 128; (1993) 35 AILR 151; (1993) 40 FCR 511; (1993) 46 IR 128

Other references:

- Explanatory Memorandum to the Income Tax Assessment Amendment Bill (No. 3) 1984

ATO references

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Income Tax ~~ Assessable income ~~ trust income - beneficiaries
Income Tax ~~ Entity specific matters ~~ trusts