


CR 2010/49 - Income tax: treatment of transfer payments to employees in connection with the NSW Energy Reform Strategy

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Class Ruling

Income tax: treatment of transfer payments to employees in connection with the NSW Energy Reform Strategy

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① 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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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 identified below applies 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 82-130 of the *Income Tax Assessment Act 1997* (ITAA 1997).

All subsequent references in this Ruling are to the ITAA 1997 unless otherwise stated.

Class of entities

3. The class of entities to whom this Ruling applies is employees of all relevant New South Wales Electricity Industry (NSW Electricity) retail state owned corporations (SOCs) (that is, EnergyAustralia, Integral Energy and Country Energy) and NSW Electricity generation SOCs (that is, Macquarie Generation, Delta Electricity and Eraring Energy) who, at the time of the commencement of the proposed transaction structures under the NSW Energy Reform Strategy cease employment with NSW Electricity and accept an offer to take up new employment with a purchaser of a NSW Electricity retail business or the wholesale electricity trading rights and receive a 'transfer payment' from NSW Electricity under the scheme described in paragraphs 10 to 28 of this Ruling.

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 in accordance with the scheme described in paragraphs 10 to 28 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 December 2010 to 28 February 2014. This Ruling continues to apply after 28 February 2014 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. 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).

Scheme

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

10. Pursuant to the proposed NSW Energy Reform Strategy, the NSW Government is in the process of selling the retail businesses of three NSW Electricity SOCs and contracting the wholesale electricity trading rights of the Government owned power stations of three other NSW Electricity SOCs to the private sector. Employees of these SOCs who choose to transfer to a purchaser on the completion of these transactions will receive a transfer payment.

11. The NSW Government will maintain public ownership of existing power stations, as well as the electricity transmission and distribution networks (the poles and wires).

12. The scheme is to be known as 'Income tax: treatment of transfer payments to employees in connection with the NSW Energy Reform Strategy'.

13. The purpose of the NSW Energy Reform Strategy is to separate the task of wholesale and retail electricity trading from the major task of producing and delivering reliable and affordable electricity to the public.

14. The most important aspect of this strategy is the elimination of the risk the private sector perceives it faces from unfair and uncommercial competition from the NSW Government owned electricity trading businesses.

15. Under the proposed NSW Energy Reform Strategy, the NSW Government intends to sell the retail businesses in their current configuration, that is, as currently conducted by each of the three NSW Electricity retail SOCs.

16. Sales of the NSW Electricity retail businesses are to be structured as the transfer of the key assets and liabilities of the relevant NSW Electricity retail business directly to the purchaser. The purchaser of a retail business may, at their discretion, make offers of employment to existing employees of the retail business.

17. The wholesale electricity trading rights of the state-owned power stations will also be contracted to the private sector (referred to as the generation trader or 'Gentrader' model).

18. The NSW Electricity industry is currently comprised of seven SOCs (that is, three generation companies, three retail/network companies and one transmission company) whose employees have a range of public sector entitlements. The purchasers of the NSW Electricity retail businesses and wholesale electricity trading rights are likely to be private sector bodies.

19. NSW Electricity currently employ a number of retail and generation staff who will be affected by the NSW Energy Reform Strategy, including a number of employees who are employed on the terms of the Energy Australia Consent Award 2008, Integral Energy Award 2008 and Country Energy Enterprise Award 2007.

20. NSW Electricity award staff who are offered a position with a purchaser will be able to elect whether to remain in the public sector or transfer to the purchaser on completion of the sale.

21. Upon the sale of the NSW Electricity retail businesses or wholesale electricity trading rights, all permanent (full or part-time) employees with more than one year's service with a NSW Electricity retail SOC or a NSW Electricity generator SOC, who accept an offer to commence employment with the purchaser, will receive a transfer payment.

22. It is also intended that the terms of transfer for NSW Electricity award employees who choose to transfer to a purchaser (whether retail business or wholesale electricity trading rights) will include:

- continuation of employment guaranteed for five years with respect to Award employees;
- NSW Electricity human resource policies will continue to apply for three months post completion;
- existing superannuation arrangements will be continued;
- accrued annual leave and long service leave entitlements (except to the extent employees are able to elect to cash out leave entitlements) and accrued sick leave entitlements will be recognised by the purchaser; and
- a transfer payment based on the length of service.

23. Employees who accept the offer to transfer to a purchaser will give up a wide range of public sector entitlements, including:

- no forced redundancies and voluntary redundancy provisions;

- access to redeployment provisions, including salary maintenance (a period up to 12 months on full salary if an employee's position is made redundant) professional career transition support with external providers and priority assignment of eligibility for vacancies within the public sector;
- paid maternity leave provision;
- sick leave provisions;
- extended leave (long service leave) provisions;
- broader range of paid leave and leave without pay provisions;
- mandatory flexible working hours arrangements;
- access to provisions regarding the management of conduct and performance;
- access to provisions regarding the advertising, eligibility, selection and appointment to positions; and
- access to government and Related Appeals Tribunal – ability to dispute promotions and disciplinary action.

24. The transfer payment provided to an employee will be determined based on length of continuous employment in the NSW Public Service and will be calculated in accordance with the following table:

| Continuous length of service | Transfer payment Week's ordinary time base rate of pay |
|--|---|
| Less than one year | 0 |
| 1 year or more, but less than 2 years | 7.5 |
| 2 years and more but less than 3 years | 13.125 |
| 3 years and more but less than 4 years | 18.75 |
| 4 years and more but less than 5 years | 22.5 |
| 5 years and more but less than 6 years | 26.25 |
| 6 years or more | 30 |

25. NSW Electricity executives are party to common law contracts. Those executives who transfer will do so in accordance with their existing contractual terms. The transfer of the executive to a purchaser may trigger a requirement to make severance payments to the transferring executive. Where this is the case, transferring executives will only be entitled to a correspondingly reduced transfer payment.

26. It is intended that the following will apply to executive employees in relation to their ongoing employment:

- the terms and conditions contained in existing contracts between the executives and NSW Electricity will continue to apply;
- NSW Electricity policies will continue to apply for three months post completion;
- existing superannuation arrangements will be continued;
- accrued annual leave and long service leave entitlements (except to the extent employees are able to and elect to cash out leave entitlements) and accrued sick leave entitlements will be recognised by the purchaser.

27. Pursuant to the sale of NSW Electricity retail businesses or the sale of the wholesale electricity trading rights, the transfer payment will be made at the earliest possible time after completion of sale, which is intended to occur simultaneously with the termination of employment.

28. The transfer payment is an amount in addition to any other benefits or statutory leave entitlements.

Ruling

29. The proposed transfer payment made in accordance with the scheme described in paragraphs 10 to 28 of this Ruling is in consequence of the termination of employment. Unless the employee is covered by a determination exempting them from the 12 month rule, the payment must be received within 12 months of the employee's termination of employment to qualify as an employment termination payment under section 82-130.

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.*

Employment termination payment

30. Section 995-1 states that an employment termination payment has the meaning given by section 82-130.

31. Subsection 82-130(1) states:

A payment is an **employment termination payment** if:

- (a) it is received by you:
 - (i) in consequence of the termination of your employment; or
 - (ii) after another persons death, in consequence of the termination of the other persons employment; and
- (b) it is received no later than 12 months after that termination (but see subsection (4)); and
- (c) it is not a payment mentioned in section 82-135.

32. Section 82-135 lists payments that are not employment termination payments. These include (among others):

- superannuation benefits;
- unused annual leave or long service leave payments; and
- the tax free part of a genuine redundancy payment or an early retirement scheme payment.

33. To determine if a transfer payment constitutes an employment termination payment, all the conditions in section 82-130 must be satisfied. Failure to satisfy any of the three conditions under subsection 82-130(1) will result in the payment not being considered an employment termination payment.

Is there a termination of employment?

34. Paragraph 9 of Taxation Ruling IT 2152 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 ...

35. The facts in *Paklan Pty Ltd and others v. Federal Commissioner of Taxation (Cth)*¹ (*Paklan*) 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 old 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.
- All the old company's employees, 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.

36. The taxpayers in *Paklan* 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 from the termination. However, the Full Federal Court did not dispute the fact that employment had terminated when the old company had ceased business on 1 July 1977.

37. The facts in Board of Review Case Q118² are similar to those in *Paklan* and again involved the sale of a company's business as a going concern to a new company. All the employees of the old business were transferred across to the new company. The Board of Review 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.

38. Board of Review Case K76³ involved a taxpayer who 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 by the Board of Review that the taxpayer's employment with the subsidiary company had been terminated.

¹ (1983) 14 ATR 457; (1983) 67 FLR 238; (1983) 83 ATC 4456.

² (1983) 83 ATC 610; (1983) 27 CTBR (NS) 312.

³ (1978) 78 ATC 703; (1978) 23 CTBR (NS) 24.

39. The relevant facts in respect of the sale of NSW Electricity indicate that the employment of NSW Electricity employees will be terminated. Employees of NSW Electricity will be able to elect whether to remain employed in the NSW Government public sector or to transfer to the purchaser on completion of the sale.

40. Employees who take up positions with a purchaser will cease employment with NSW Electricity. Therefore, there is a termination of their employment with NSW Electricity.

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

41. 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. Federal Commissioner of Taxation*⁴ (*Reseck*) Justice Gibbs said:

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.

42. In the same case, Justice Jacobs said that 'in consequence of' did not import causation but rather a 'following on'.

43. The decision in *Reseck* was considered by the Full Federal Court in *McIntosh v. Federal Commissioner of Taxation*⁵ (*McIntosh*). 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, Justice Brennan said:

... 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.

44. The phrase 'in consequence of' and the decisions in *Reseck* and *McIntosh* were also considered more recently by the Federal Court in *Le Grand v. Federal Commissioner of Taxation*⁶ (*Le Grand*).

⁴ (1975) 133 CLR 45; (1975) 75 ATC 4213; (1975) 5 ATR 538.

⁵ (1979) 45 FLR 279; (1979) 79 ATC 4325; (1979) 10 ATR 13; (1979) 25 ALR 557.

⁶ [2002] FCA 1258; (2002) 124 FCR 53; (2002) 2002 ATC 4907; (2002) 51 ATR 139.

45. *Le Grand* involved a payment by the taxpayer as a result of accepting an offer of compromise in respect of claims brought by him against his former employer, in relation to the termination of his employment. The taxpayer had made claims for common law damages for breach of the employment agreement and for statutory damages for misleading and deceptive conduct to procure the taxpayer's employment with the employer. The payment was found to be in consequence of the taxpayer's termination. Justice Goldberg said:

I do not consider that the issue can simply be determined by seeking to identify the 'occasion' for the payment. The thrust of the judgments in *Reseck* and *McIntosh* is rather to the effect that payment is made 'in consequence' of a particular circumstance when the payment follows on from, and is an effect or result, in a causal sense, of the circumstance. ... there need not be identified only one circumstance which gives rise to a payment before it can be said that the payment is made 'in consequence' of that circumstance. ... it can be said that a payment may be made in consequence of a number of circumstances and that, for present purposes, it is not necessary that the termination of the employment be the dominant cause of the payment so long as the payment follows in the causal sense referred to in those judgments, as an effect or result of the termination.

46. The Commissioner of Taxation has issued 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'.

47. In paragraphs 5 and 6 of TR 2003/13, the Commissioner, after considering the judgments in paragraphs 42 to 46 of this Ruling, stated:

... 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. The phrase requires a causal connection between the termination and the payment, although the termination need not be the dominant cause of the payment. 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.

48. In the present case, notwithstanding that the transfer payment is payable only to NSW Electricity employees who take up employment with the purchaser, the transfer payment is payable only on the condition that employees have terminated their employment with NSW Electricity. The payment follows as an effect or result of the termination and the payment would not have been made to the employees but for the termination of their employment with NSW Electricity.

49. The following aspects of the arrangement reinforce the characterisation of the transfer payment as an employment termination payment (as distinct from, for example, a transfer or sign-on fee):

- the payment is made by NSW Electricity;
- the payment is calculated by reference to each employee's years of service with NSW Electricity; and
- there are no obligations imposed on the employees to continue their employment with the purchaser for any particular period after commencement of the employment with the purchaser.

50. Further, the transfer payment will be paid at the earliest possible time after completion of the sale of NSW Electricity. The timing of the payments further strengthens the connection between the transfer payments and the termination of employment.

51. The transfer payment is only payable on the condition that employees have terminated their employment with NSW Electricity. No entitlement to the payment arises prior to this event. Although the transfer payment is payable to those who take up employment with the purchaser, it more directly relates to the termination of employment with NSW Electricity.

52. In view of the above, the transfer payment is in consequence of the termination of employment. Unless the employee is covered by a determination⁷ exempting them from the 12 month rule, the payment must be received within 12 months of the employee's termination of employment to qualify as an employment termination payment under section 82-130.

⁷ Subsection 82-130(4).

Appendix 2 – Detailed contents list

53. 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:

IT 2152; TR 2003/13;

TR 2006/10;

Subject references:

- employment termination
- eligible termination payments
- superannuation business line
- superannuation retirement & employment termination

Legislative references:

- ITAA 1997
- ITAA 1997 82-130
- ITAA 1997 82-130(1)
- ITAA 1997 82-130(4)
- ITAA 1997 82-135
- ITAA 1997 995-1
- TAA 1953
- Copyright Act 1968

Case references:

- Case K76 (1978) 78 ATC 703; (1978) 23 CTBR (NS) 24
- Case Q118 (1983) 83 ATC 610; (1983) 27 CTBR (NS) 312

- Le Grand v. Federal Commissioner of Taxation [2002] FCA 1258; (2002) 124 FCR 53; (2002) 2002 ATC 4907; (2002) 51 ATR 139
- McIntosh v. Federal Commissioner of Taxation (1979) 45 FLR 279; (1979) 79 ATC 4325; (1979) 10 ATR 13; (1979) 25 ALR 557
- Paklan Pty Ltd and others v. Federal Commissioner of Taxation (1983) 14 ATR 457; (1983) 67 FLR 238; (1983) 83 ATC 4456
- Reseck v. Federal Commissioner of Taxation (1975) 133 CLR 45; (1975) 75 ATC 4213; (1975) 5 ATR 538

Other references:

- NSW Energy Reform Strategy
- Energy Australia Consent Award 2008
- Integral Energy Award 2008
- Country Energy Enterprise Award 2007

ATO references

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