


CR 2011/50 - Income tax: early retirement scheme - Loy Yang Power Management Pty Ltd

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Class Ruling

Income tax: early retirement scheme – Loy Yang Power Management Pty Ltd

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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(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:
- section 83-170 of the *Income Tax Assessment Act 1997* (ITAA 1997); and
 - section 83-180 of the ITAA 1997.

All legislative references are to the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is those employees of Loy Yang Power Management Pty Ltd who receive a payment under the scheme described in paragraphs 10 to 31 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 carried out in accordance with the scheme described in paragraphs 10 to 31 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 25 May 2011 to 24 May 2012. The Ruling continues to apply after 24 May 2012 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. Loy Yang Power Management Pty Ltd is seeking approval for an early retirement scheme (ERS).

11. The ERS is known as the Loy Yang Power Management Pty Ltd early retirement scheme.

12. Loy Yang Power Management Pty Ltd operates Loy Yang Power's (LYP) base load power station and associated brown coal mine at the Latrobe Valley in Victoria.

13. Due to the highly competitive nature of the electricity market, wholesale electricity prices received by base load electricity generators such as LYP are not keeping pace with increasing cost pressures. These include higher borrowing costs, increasing input costs such as labour, contractors and materials costs.

14. In recent years LYP's costs have risen well in excess of the Consumer Price Index (CPI) and revenues have failed to keep pace with the CPI.

15. LYP have initiated an extensive cost review process to review all costs at every level of the business with the objective of locking in real and ongoing savings. Part of the process will be to reduce the labour costs of LYP.

16. Currently LYP has a contracts department that handles long term service contracts and plant manufacturing contracts and a procurement function that manages the purchase of consumables and spare equipment. LYP proposes to amalgamate the 2 functions. The same service will be provided with less employees. This would be achieved through better use of systems, retraining and job redesign.

17. LYP also proposes to reduce the labour costs as follows:

- A reduction of the number of employees in the IT functions. The reduction would be achieved through improved systems, outsourcing, and/or redistribution of the functions of existing employees.
- A reduction in the number of employees managing the warehouses containing spare parts and consumables used internally. The reduction would be achieved by job redesign and systems improvements.
- A reduction in the number of employees in operational activities in the mine and station. This would be achieved by reducing manning agreements and modifying some work practices.
- A reduction in the number of employees in other support/overhead functions achieved via rationalisation of functions and system improvements.
- A reduction in the number of employees in engineering and maintenance functions achieved through changed systems, work reallocation and job redesign.

18. Staff who choose not to participate in the early retirement scheme may be redeployed to other roles in the business including those vacated by successful early retirement scheme applicants.
19. The employment of staff who chose not to participate in the early retirement scheme will not be terminated.
20. The class of employees who are to be offered an early retirement scheme is all employees of LYP.
21. Applications will be processed on a 'first in first approved' basis. However, LYP retains a limited right of veto to be applied on applications from operational areas. There are fixed manning agreements in operational areas where a specific number of employees have to be maintained. The number of employees in those areas can only change if the fixed manning agreements are renegotiated. Therefore applications from employees in operational areas will only be approved if the positions in those areas do not need to be replaced.
22. LYP will allow approximately 40 employees to retire under the early retirement scheme.
23. Applications will initially be open for a period of 2 months.
24. An employee will have one month to accept the offer.
25. All employees whose applications are accepted will retire by 24 May 2012.
26. Employees will receive the following payments on the termination of employment:
 - 6 months salary for employees with not more than 10 years of service, or
 - 12 months salary for employees with greater than 10 years of service.
27. Employees will also receive any unused annual and long service leave entitlements. These payments will not form part of the early retirement scheme payment.
28. The early retirement scheme payment does not include any payment in lieu of superannuation benefits.
29. The payments made under the early retirement scheme are at arm's-length.
30. The retirement of employees under the early retirement scheme will occur before they turn 65 years of age.
31. There is no agreement in place between the employee and LYP, or between LYP and another person to employ the employee after retirement.

Ruling

32. The early retirement scheme to be implemented by Loy Yang Power Management Pty Ltd is an early retirement scheme for the purposes of section 83-180.

33. Accordingly, so much of the payment received by an employee that exceeds the amount that could reasonably be expected to be received by the employee in consequence of the voluntary termination of his or her employment at the time of the retirement will be an early retirement scheme payment.

34. In addition, so much of the early retirement scheme payment as falls within the threshold calculated in accordance with section 83-170 is not assessable income and is not exempt income.

Commissioner of Taxation

25 May 2011

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.*

35. Where a scheme satisfies the requirements of section 83-180 that scheme will be an 'early retirement scheme'.

36. Subsection 83-180(3) states that:

A scheme is an **early retirement scheme** if:

- (a) all the employer's employees who comprise such a class of employees as the Commissioner approves may participate in the scheme; and
- (b) the employer's purpose in implementing the scheme is to rationalise or re-organise the employer's operations by making any change to the employer's operations, or the nature of the work force, that the Commissioner approves; and
- (c) before the scheme is implemented, the Commissioner, by written instrument, approves the scheme as an early retirement scheme for the purposes of this section.

These three conditions are now considered.

All employees within a class approved by the Commissioner may participate in the scheme

37. In order to satisfy the first condition, the scheme must be offered to all employees in a class approved by the Commissioner under paragraph 83-180(3)(a).

38. The class of employees to whom early retirement will be offered is set out in paragraph 3 of this Ruling.

39. The Commissioner considers that this is an appropriate class of persons for the scheme to be offered to. In approving this class of employees the Commissioner has considered the nature of the rationalisation or re-organisation of the operations of the employer. It is therefore considered that these employees meet the requirements of an approved class of employees for the purposes of paragraph 83-180(3)(a).

The employer's purpose in implementing the scheme is to rationalise or re-organise the employer's operations in a way approved by the Commissioner

40. The proposed scheme must be implemented by the employer with a view to rationalising or re-organising the operations of the employer as described in paragraph 83-180(3)(b).

41. Paragraphs 13 to 17 of this Ruling describe the nature of the rationalisation or re-organisation of the employer's operations. In approving the scheme, the Commissioner has had regard to the changes in the operations and nature of the workforce of the employer. It is therefore considered that the scheme is to be implemented by the employer with a view to rationalising or re-organising the operations of the employer for the purposes of paragraph 83-180(3)(b). Accordingly, the second condition is satisfied.

The scheme must be approved by the Commissioner prior to its implementation

42. The scheme is proposed to operate for a period from 25 May 2011 to 24 May 2012. Approval was granted prior to implementation therefore, for the purposes of paragraph 83-180(3)(c), the third condition is satisfied.

43. The scheme will be in operation for 12 months. This is considered to be appropriate in this case due to the circumstances of the restructure and for those employees that will be given the option of early retirement under the scheme.

Other relevant information

44. Under subsection 83-180(1) so much of the payment received by an employee because the employee retires under an early retirement scheme as exceeds the amount that could reasonably be expected to be received by the employee in consequence of the voluntary termination of his or her employment at the time of termination is an early retirement scheme payment.

45. It should be noted that, in order for a payment to qualify as an early retirement scheme payment, it must also satisfy the following requirements (as set out in subsections 83-180(2), 83-180(5) and 83-180(6)):

- the retirement occurred before the employee turned age 65 or such earlier date on which the employee's employment would have terminated under the terms of employment because of the employee attaining a certain age or completing a particular period of service (as the case may be);
- if the employee and the employer are not dealing with each other at arm's length (for example because they are related in some way) the payment does not exceed the amount that could reasonably be expected to be made if the retirement was made at arm's length;

- at the time of retirement there was no arrangement between the employee and the employer, or between the employer and another person, to employ the employee after the retirement;
- the payment must not be made in lieu of superannuation benefits;
- it is not a payment mentioned in section 82-135 (apart from paragraph 82-135(e)).

46. The term 'arrangement' is defined in subsection 995-1(1) as meaning 'any arrangement, agreement, understanding, promise or undertaking, whether express or implied, and whether or not enforceable (or intended to be enforceable) by legal proceedings'.

47. From 1 July 2007, an early retirement scheme payment that falls within the specified limit is referred to as the 'tax-free' amount and will not be assessable income and will not be exempt income.

48. For the 2010-11 income year, the tax-free amount is limited to \$8,126 (base amount) plus \$4,064 (service amount) for each whole year of completed employment service to which the early retirement scheme payment relates. It should be noted that, 6 months, 8 months or even 11 months do not count as a whole year for the purposes of this calculation. In accordance with section 960-285, the base limit and service amount limits will be indexed in line with average weekly ordinary time earnings each income year.

49. The total of the amount received on the termination of employment calculated in accordance with paragraph 26 of this Ruling may qualify as an early retirement scheme payment.

50. The total of the payments in the previous paragraph will be measured against the limit calculated in accordance with the formula detailed at paragraph 48 of this Ruling to determine the 'tax-free' amount of the early retirement scheme payment.

51. The 'tax-free' amount will:

- not be an employment termination payment; and
- not be able to be rolled-over into a superannuation fund.

52. Any payment in excess of this limit will be an employment termination payment and split up into tax free and taxable components. The tax free component of an employment termination payment includes the pre-July 83 segment of the payment. The tax free component is not assessable income and is not exempt income.

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

- ITAA 1997 83-170
- ITAA 1997 83-180
- ITAA 1997 83-180(1)

Related Rulings/Determinations:

TR 2006/10

- ITAA 1997 83-180(2)
- ITAA 1997 83-180(3)
- ITAA 1997 83-180(3)(a)

Subject references:

- early retirement scheme payment

- ITAA 1997 83-180(3)(b)
- ITAA 1997 83-180(3)(c)
- ITAA 1997 83-180(5)
- ITAA 1997 83-180(6)

Legislative References:

- ITAA 1997
- ITAA 1997 82-135
- ITAA 1997 82-135(e)

- ITAA 1997 960-285
- ITAA 1997 995-1(1)
- TAA 1953
- Copyright Act 1968

ATO references

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