

SPR 2007/1 - Explanatory statement -



Employment Termination Payments (12 month rule) Legislative Instrument 2007

Explanatory Statement

General Outline of Instrument

1. This instrument extends the definition of employment termination payment to include certain payments that are received more than 12 months after the termination of a person's employment.
2. This instrument is made by the Commissioner of Taxation pursuant to subsection 82-130(7) of the *Income Tax Assessment Act 1997* (ITAA 1997).
3. The instrument is a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

Date of effect

4. The instrument commences on the day after it is registered. It will apply to a payment received after 30 June 2007.

What is this instrument about?

5. This instrument makes a payment received more than 12 months after termination of a person's employment an employment termination payment, if the delay in the payment was due to the commencement of legal action concerning either or both:
 - (a) the person's entitlement to the payment;
 - (b) the amount of the person's entitlement.
6. Termination of a person's employment includes retirement from employment and cessation of employment because of death as stated in section 80-10 of the ITAA 1997.
7. The legal action must have commenced within 12 months of the termination of a person's employment. Legal action is intended to cover any Court, Tribunal and other proceedings of a judicial or quasi-judicial nature which may result in the payment of an amount in consequence of the termination of a person's employment.
8. This instrument also makes a payment received more than 12 months after termination of a person's employment an employment termination payment if it

was made by a liquidator, receiver or trustee in bankruptcy of an entity. The entity in liquidation, bankruptcy or receivership must have otherwise been liable to make the payment. The liquidator, receiver or trustee must have been appointed no later than 12 months after the termination of employment. The date of appointment is that day that the liquidator, receiver or trustee in bankruptcy of an entity takes possession of assets.

What is the effect of this instrument?

9. This instrument extends the tax law definition of employment termination payment by removing the requirement that a payment is made within 12 months of a person's termination of employment in the two circumstances explained above. This will extend the kinds of payments that receive the concessional tax treatment applying to employment termination payments.

Background

10. As part of the Government's *Simplified Superannuation* reforms new provisions commenced from 1 July 2007 to deal with payments made by an employer in consequence of the termination of a person's employment. The new provisions are contained in the ITAA 1997 and replace similar rules that were contained in the *Income Tax Assessment Act 1936*. The old rules dealt with payments from both superannuation funds and employers. Under the new rules, payments made by superannuation funds as a consequence of the termination of a person's employment are dealt with under separate provisions to those made directly by an employer.
11. Payments made in consequence of the termination of a person's employment will be employment termination payments if they are not specifically excluded from the definition of an employment termination payment by being listed in section 82-135 of the ITAA 1997. A superannuation benefit is specifically excluded. Payments that meet the definition of employment termination payment qualify for concessional taxation treatment.
12. In order to qualify as an employment termination payment, the law requires the payment to be received no later than 12 months after a person's termination of employment under paragraph 82-130(1)(b) of the *Income Tax Assessment Act 1997*. This can be referred to as the 12 month rule.
13. However, provision is made for the Commissioner to allow a payment made after the 12 month period to still be treated as an employment termination payment. Accordingly, the Commissioner has the power to make determinations covering a class of payments or recipients or in respect of an individual taxpayer to exclude the requirement of the 12 month rule.
14. The Explanatory Memorandum to the Tax Laws Amendment (Simplified Superannuation) Bill 2006 (the Explanatory Memorandum) provides:
 - 4.19 The 12-month rule exists to prevent abuse of the tax concession offered for these payments by using a series of payments over a number of income years. The provisions dealing with the Commissioner's ability to issue a determination are provided to allow flexibility where delays in payment are reasonable and not constructed with the intent of delivering taxation advantages.

15. As indicated in the Explanatory Memorandum, the Commissioner will only issue a determination where the delay of more than 12 months for receipt of payment is reasonable and not constructed with the intent to deliver taxation advantages.
16. Accordingly, the Commissioner may make a determination on a case by case basis pursuant to subsection 82-130(5) of the *Income Tax Assessment Act 1997*. Furthermore, in recognition of the likelihood that there could be more than one individual receiving the same type of payment, the Commissioner also may make a determination for a class of payments or recipients under subsection 82-130(7) of the *Income Tax Assessment Act 1997*.
17. This determination, made under subsection 82-130(7) *Income Tax Assessment Act 1997*, will provide an exception to the 12 month rule for a class of payments where:
 - (a) legal proceedings are commenced by the person to establish either or both:
 - the persons entitlement to the employment termination payment, or
 - the amount of the employment termination payment.
 - (b) the payment is made by a liquidator, receiver or trustee in bankruptcy of an entity that is otherwise liable to make the employment termination payment.

Example 1

18. An individual lodges a valid application to the Queensland Industrial Relations Commission (the Commission) for unfair dismissal under section 74 of the *Industrial Relations Act 1999* (Qld). The applicant receives a settlement offer from their former employer before a determination is made by the Commission. The applicant accepts the settlement offer, of which two thirds of the settlement amount is in consequence of the person's termination. The applicant signs a settlement deed and receives the settlement amount 14 months after termination of employment.
19. The two-thirds of the settlement payment paid in consequence of the person's termination will not meet the definition of an employment termination payment because the requirement in paragraph 82-130(1)(b) of the *Income Tax Assessment Act 1997* has not been met. However, the payment will meet the extended definition of employment termination payment under this determination.

Example 2

20. A company experiencing cash flow problems enters liquidation. The appointed liquidator ceases the company's trading activities and terminates the employment of all employees. The liquidator makes payments in consequence of the termination of employment to each employee more than 12 months after their termination date.
21. The termination payment will not meet the definition of an employment termination payment because of the requirement in paragraph 82-130(1)(b) of the *Income Tax Assessment Act 1997* has not been met. However, the payment will meet the extended definition of employment termination payment under this determination.

Consultation

22. Consultation was undertaken with peak accounting, superannuation and financial services bodies, including CPA Australia, National Institute of Accountants (NIA), National Tax and Accountant's Association (NTAA), Association of Super Funds Australian (ASFA), Investment and Financial Services Association (IFSA), SMSF Professionals' Association of Australia (SPAA), Australian Prudential Regulation Authority (APRA) and Australian Securities and Investments Commission (ASIC).
23. Draft copies of the legislative instrument and explanatory statement were sent electronically on 16 May 2007 to individual representatives of these professional bodies for feedback and comment by 30 May 2007. No adverse feedback or comments were received.

Deputy Commissioner of Taxation
12 November 2007

Legislative references:

Income Tax Assessment Act 1997

Legislative Instruments Act 2003