IT 2286 - Income tax : assessment of eligible termination payments - approval of early retirement schemes - approved early retirement scheme payments - bona fide redundancy payments

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TAXATION RULING NO. IT 2286

INCOME TAX : ASSESSMENT OF ELIGIBLE TERMINATION PAYMENTS
- APPROVAL OF EARLY RETIREMENT SCHEMES
- APPROVED EARLY RETIREMENT SCHEME PAYMENTS
- BONA FIDE REDUNDANCY PAYMENTS

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I 1077988	ELIGIBLE TERMINATION PAYMENTS EARLY RETIREMENT SCHEMES - APPROVAL OF AND PAYMENTS UNDER BONA FIDE REDUNDANCY PAYMENTS	27E 27F

OTHER RULINGS ON TOPIC: IT 2157, IT 2168, IT 2255, IT 2256, IT 2272

PREAMBLE The Income Tax Assessment Amendment Act (No. 3) 1984 (Act No. 47 of 1984) inserted into Division 2 of Part III of the Income Tax Assessment Act 1936 (the Act) a new Subdivision AA (sections 27A to 27J) dealing with the assessment of superannuation, termination of employment and kindred payments. The Subdivision was subsequently amended by the Income Tax Assessment Amendment Act 1985 (Act No. 129 of 1985).

2. Taxation Rulings IT 2157, IT 2168, IT 2255, IT 2256 and IT 2272 provided information relating to the application and interpretation of certain provisions of the Subdivision. This ruling provides guidelines for the approval of early retirement schemes under section 27E and explains the application of that section and of section 27F to, respectively, approved early retirement scheme payments and bona fide redundancy payments. By the definition in sub-section 27A(1), any such payments, as well as invalidity payments (section 27G), constitute a "concessional component" of an eligible termination payment (ETP). That component is, unless rolled over, included in assessable income as to no more than 5% thereof (see Taxation Ruling IT 2168 - particularly paragraphs 38 and 74-76).

3. Like the earlier rulings referred to, this ruling does not purport to explain aspects of the legislation already covered in other documents. An outline of the provisions of section 27E and section 27F can be found at pages 87-92 of the

explanatory memorandum that accompanied the introduction of the Income Tax Assessment Amendment Act (No. 3) 1984 and at pages 17-20 of the explanatory memorandum accompanying the introduction of the Income Tax Assessment Amendment Act 1985. Further explanations are contained in the Non-Business Assessing Handbook, Volume 1, Part 1, Chapter 2, paragraphs 1.2.85 - 1.2.98, which deal generally with eligible termination payments.

RULING Approved Early Retirement Schemes

4. Sub-section 27E(1) contains 3 conditions, each of which must be met for a scheme to qualify as an approved early retirement scheme. Those conditions are set down in paragraphs (a), (b) and (c) of the sub-section.

Paragraph 27E(1)(a) - Category of employees eligible to participate

5. Participation in an early retirement scheme must be available to all employees constituting one of the categories of employees mentioned in sub-paragraphs 27E(1)(a)(i) to (v). They are -

(i) all of the employer's employees;

(ii) all employees of a particular age;

(iii) all employees with a particular occupational skill;

(iv) all employees with a particular occupational skill and of a particular age;

(v) all employees in a class of employees approved by the Commissioner for the purposes of paragraph 27E(1)(a).

The purpose of this requirement is to ensure that the scheme is available to employees generally, rather than to a select few.

6. Where the employees to whom early retirement is made available are not in one of the specific categories in sub-paragraphs 27E(1)(a)(i) to (iv) but the class of employees is sufficiently wide, having regard to the nature of the rationalisation or reorganisation of the operations of the employer, consideration should be given to approving, under sub-paragraph 27E(1)(a)(v), those employees as a special class for the purposes of the concession. Consistent with the specific categories of employees, sub-paragraph (v) requires only that there be a particular class of employees. The number of employees concerned is not normally relevant. For example, all of a small number of employees in one location might be offered early retirement as an alternative to dismissal or transfer to the place of employment of the majority of the employer's employees. Those employees would constitute a class of employees that warranted approval under sub-paragraph (v). On the other hand, an offer of early retirement to all employees at a particular level in the employer's organisation, say those

occupying positions of executive director, would not, in ordinary circumstances, constitute a sufficiently wide class of employees, having regard to the fact that an approved early retirement scheme should not be restricted to a select few employees. In any event, such a limited early retirement offer would be unlikely to satisfy the requirements of sub-paragraph 27E(1)(b).

7. The concession provided by section 27F in relation to bona fide redundancy payments (dealt with in later paragraphs of this ruling) does not extend to employees who have been dismissed for personal or disciplinary reasons or because of their inefficiency. Similarly, an early retirement scheme should not be accepted as satisfying the requirements of paragraph 27E(1)(a) where it is evident, in light of the terms and conditions of the scheme - particularly the basis on which participation is available - and the way in which it is to be implemented, that the scheme is directed mainly at ensuring the retirement of employees who are inefficient. In this context, the fact that employees do not possess relevant technical skills - for example, because of technological advances in their industry - is not of itself to be taken as representing inefficiency.

8. There have been cases where the employer, although ostensibly offering an option of early retirement to all employees in one of the relevant categories, has retained the right to refuse an application for early retirement in certain circumstances. A common example is where early retirements are restricted by number to the surplus positions arising from a reorganisation or rationalisation of the employer's operations. In other cases employers have, under the terms of the schemes, a right of veto on applications by key personnel who cannot readily be replaced and whose loss would impair the efficiency of the employer's business operations.

9. In considering such cases, it should be kept in mind that section 27E is designed to provide a concession for employees who retire under genuine early retiring arrangements, as opposed to employees who are retrenched (in which case section 27F may apply to provide a similar concession). It will often be the case that the scheme has, for various reasons (e.g. for industrial relations reasons), been implemented as an alternative to retrenchments, where the employer has found it necessary to reduce staff numbers or to alter the make-up of the workforce following a rationalisation or reorganisation of the employer's operations. The existence of conditions on the acceptance of early retirement applications is not, therefore, necessarily to be taken as the basis for not approving an otherwise acceptable scheme.

10. However, where an employer has retained an unlimited right of veto on acceptance of applications, the scheme should not, as a general rule, be approved. On the other hand, if a right of veto is clearly expressed under the terms and conditions of the scheme as being limited in an acceptable way - for example, limited to ensuring that the scheme does not result

in the retirement of all employees in particular key areas, to the detriment of the employer's operations - the scheme may be approved. In the case of a scheme that was implemented before the issue of this ruling, the terms and conditions of which provide an unlimited veto, a written undertaking should, before the scheme is approved, be obtained from the employer that the veto will be applied in a particular (and acceptable) way. Where a scheme has been approved on the basis that a veto will have limited application (as expressed under the terms and conditions of the scheme or in a written undertaking) and that veto is exercised in a way that is inconsistent with its stated purpose or the stated purpose for which the scheme was implemented, approval of the scheme should be withdrawn.

Paragraph 27E(1)(b) - Purpose of implementation of the scheme

11. The second condition for approval of an early retirement scheme requires that the scheme be implemented by the employer with a view to rationalising or reorganising the operations of the employer by means of one or more of the arrangements referred to in sub-paragraphs 27E(1)(b)(i) to (vi). They are -

(i) the replacement of employees possessing a particular occupational skill with those possessing a different such skill;

(ii) the replacement of employees of a particular age or ages (not less than 55 years) with younger employees;

(iii) the cessation of, or the reduction in output of, the whole or part of the employer's operations;

(iv) the relocation of the whole or part of the employer's operations;

(v) the introduction of new technology, processes or systems or productivity increases;

(vi) any other change to the employer's operations or to the nature of the employer's workforce, being a change approved by the Commissioner for the purposes of paragraph 27E(1)(b).

12. To satisfy the condition, an employer will need to establish that the scheme has been implemented with a specific objective in mind - e.g., to alter the make-up of the workforce with a view to the rationalisation or reorganisation of operations. Section 27E does not extend to early retiring arrangements that become part and parcel of the employees' ordinary terms of employment. For instance, some employers, including the Commonwealth Government, have instituted programmes which provide employees generally with an option to retire before attaining what might be regarded as the normal retiring age of 65. It will often be the case that retirees under such arrangements would be replaced by employees of a

younger age as sub-paragraph 27E(1)(b)(ii) envisages. However, such arrangements would not be early retirement schemes of the type contemplated by section 27E, as they would not meet the test that they are for the purpose of the rationalisation or reorganisation of the employer's operations. That is not to say that an employer who has instituted such a programme could not, with a view to achieving a specific short-term objective connected with a rationalisation or reorganisation of operations, implement a separate approved early retirement scheme offering early retirement to those employees who have passed the optional retirement age, on a basis more advantageous than for the "ordinary" retirement available to them at that time.

13. As may be the case with the employee categories discussed in paragraphs 5 and 6, the nature of the rationalisation or reorganisation of the employer's operations might not fit within one of the specific arrangements identified in sub-paragraphs 27E(1)(b)(i) to (v) but may still be seen to be implemented with a view to a restructuring, of some kind, of the work-force or the operations of the employer. For example, an employer may decide that employee numbers are excessive having regard to seasonal variations in the level of operations and, to effect a suitable reduction in numbers, the employer might offer all employees an early retirement incentive. An arrangement for such a purpose would be consistent with the specifically identified arrangements for rationalisation or reorganisation and could form the basis of approval of the employer's early retirement scheme.

14. It is generally a feature of early retirement schemes that the offer of early retirement remains open only for a specified period connected with the rationalisation or reorganisation objective. A period not in excess of 12 months would be usual. Where there is no period specified or the period specified is excessive, the scheme should be subjected to careful scrutiny. However, provided the employer has a specific objective of rationalisation or reorganisation that is to be attained, there would be no conflict with the provisions of section 27E if the scheme were one under which the early retirement option remained open to employees until the desired objective is achieved.

Paragraph 27E(1)(c) - Approval by Commissioner

15. The final requirement for qualification as an approved early retirement scheme is that the scheme be approved by the Commissioner, for the purposes of section 27E, before it is implemented.

Commissioner's discretion under sub-section 27E(2)

16. Sub-section 27E(2) provides for non-compliance with any of the requirements of sub-section 27E(1) to be overlooked where special circumstances exist in relation to the scheme. By virtue of sub-section 27E(3), "special circumstances" includes the circumstance that the scheme was implemented prior to the

commencement of section 27E. Another relevant special circumstance would be that a scheme has been implemented before approval of the scheme has been obtained because, for example, there has been a delay in processing an application made for its approval. The fact that a scheme has been implemented without approval because the employer did not realise that section 27E could affect the income tax treatment of payments made under the scheme would also be a special circumstance. However, where an employer has implemented a scheme and represented it to employees as being an approved scheme even though approval had not been sought, sub-section 27E(2) should not be applied unless other extenuating circumstances exist. The fact that a scheme has already been implemented is not, of itself, to be taken as constituting a special circumstance.

Approval of schemes

17. Applications for approval of early retirement schemes, accompanied by suitable documentation, should be lodged for approval at the Taxation Office at which the employer lodges income tax returns. Where an employer is not required to lodge income tax returns, applications should be lodged at the Taxation Office in the capital city of the State in which the relevant operations of the employer are carried on or, where the operations are carried on in more than one State, in the capital city of the State in which the employer resides or, in the case of a company, has its place of central management and control. Documentation accompanying an application should include copies of the terms and conditions applying under the scheme, any advice or information regarding the scheme given by the employer to employees, relevant industrial agreements or awards and, in every case, a statement by the employer as to the objectives of the rationalisation or reorganisation of operations to be achieved by the scheme.

Bona Fide Redundancy

18. Redundancy arrangements do not have to be approved in advance for bona fide redundancy payments to qualify for the concessional taxing treatment provided by section 27F. The one test to be satisfied as to the termination of the taxpayer's employment is that the taxpayer was dismissed by reason of his or her bona fide redundancy.

19. "Dismissal" carries with it the concept of the involuntary (on the employee's part) termination of employment. In ordinary circumstances, it will be evident that the termination of an employee's employment was instigated by the employer, for example, by the employer giving the employee notice. In some cases, however, there may be a "constructive dismissal" if an employer places an employee in a position in which the employee has little option but to tender his or her resignation. For instance, the manager of a factory might be advised that his employment in that position will not continue but that he may remain in employment as a worker on the production line. The employee might consider that the reduction in status and remuneration is not acceptable and, therefore,

tender his resignation. The termination of employment in such circumstances would amount to "constructive dismissal" and satisfy the relevant requirement of section 27F.

20. "Redundancy" may be described as being 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. In some cases, it will be seen that redundancy arrangements have a purpose similar to those mentioned in sub-paragraphs (i) to (v) of paragraph 27E(1)(b). As mentioned earlier, redundancy does not, however, extend to a situation where an employee is dismissed for personal or disciplinary reasons or because the employee was inefficient. Generally, the bona fide redundancy of an employee will be evidenced by the accompanying dismissal of other employees of the employer in similar occupational groups, although as with early retirement schemes the number of employees concerned is not, of itself, necessarily significant. Where a dismissed employee is soon replaced by another employee with a similar occupational skill or of a similar age, the conclusion might reasonably be reached, in the absence of information to the contrary, that the employee was not dismissed for reasons of bona fide redundancy but for other reasons.

Assessment of Approved Early Retirement Scheme Payments and Bona Fide Redundancy Payments

21. The operative provisions of section 27E (approved early retirement scheme payments) are contained in sub-section 27E(4). Subject to the tests in paragraphs (a) to (d) of the sub-section being satisfied and subject to sub-section 27E(5), so much of an eligible termination payment received by a taxpayer in consequence of termination of employment under an approved early retirement scheme as exceeds the amount that could reasonably be expected to have been received on termination of employment at the same time otherwise than under the scheme is an approved early retirement scheme payment and qualifies for a concessional basis of taxing. As noted at paragraph 2 above, the concession applies so that no more than 5% of that part of the payment is included in the taxpayer's assessable income, unless the payment is rolled over.

22. The operative provisions of section 27F (bona fide redundancy payments) are contained in sub-section 27F(1). They essentially mirror those in sub-section 27E(4). Subject to sub-section 27F(2), the excess amount received under redundancy arrangements over the amount that could reasonably be expected to have been received on voluntary retirement at the same time is a bona fide redundancy payment and qualifies for the same concessional taxing treatment as an approved early retirement scheme payment.

23. It may be a feature of an approved early retirement scheme or a redundancy arrangement that terminating employees are paid amounts calculated by reference to annual leave and long service leave entitlements, but which are additional to the amounts which would have been paid in respect of such

entitlements on ordinary resignation. Although the definition of "eligible termination payment" in sub-section 27A(1) of the Act expressly excludes payments in lieu of entitlements to annual leave and long service leave (which are assessable under sections 26AC and 26AD of the Act), the additional payment calculated by reference to such entitlements would qualify as an approved early retirement scheme payment or bona fide redundancy payment (see Taxation Ruling IT 2255).

24. The requirements (contained in sub-sections 27E(4) and 27F(1)) for a payment to qualify as an approved early retirement scheme payment or a bona fide redundancy payment may be summarised as follows -

(a) there must be an eligible termination payment made in relation to the taxpayer -

. in consequence of the taxpayer's employment being terminated under an approved early retirement scheme; or

. in consequence of the taxpayer being dismissed from employment because of his or her bona fide redundancy;

(b) the time of termination or dismissal (called the "termination time") must be before -

. the date on which the taxpayer attained age 65; or

. such earlier date on which the taxpayer's employment would necessarily have had to terminate under the terms of employment because of the taxpayer attaining a certain age or completing a certain period of service;

(c) where it is considered that the taxpayer and employer were not at arm's length in relation to the employment termination, the amount of the eligible termination payment must not be greater than the amount that could reasonably be expected to have been paid if the parties had been at arm's length; and

(d) there must not be, at the "termination time", any agreement between the taxpayer and employer, or between the employer and another person, to employ the taxpayer after that time.

25. The foregoing reflects amendments of sub-sections 27E(4) and 27F(1) made by the Income Tax Assessment Amendment Act 1985 (Act No. 129 of 1985). In relation to paragraphs (b) of those sub-sections, the amendments replaced the previous premature employment termination test (under which access to the relevant concession was not available where a taxpayer's employment terminated after the time at which, before age 65, it

could otherwise have come to an end - e.g., by the exercise of an established early retirement option available to employees who have completed a certain number of years service and unrelated to any rationalisation or reorganisation of the employer's operations). The amending Act provides the authority for assessments to be re-opened to give effect to the amendments of paragraphs 27E(4)(b) and 27F(1)(b) and this should be exercised as appropriate to extend the relevant concession to taxpayers who accepted early retirement under an approved scheme or were dismissed by reason of bona fide redundancy but previously were ineligible for the concession because their employment ceased after a date on which they could otherwise have retired.

26. Under other amendments of sections 27E and 27F made by the Income Tax Assessment Amendment Act 1985 (to insert new sub-sections 27E(5) and 27F(2)), concessional taxing treatment is not available in respect of any part of an eligible termination payment that is made in relation to a termination of employment after 23 May 1985 under an approved early retirement scheme or as a result of dismissal because of redundancy and that should appropriately be regarded as having been made in lieu of superannuation benefits to which the taxpayer may otherwise have been, or have become, entitled. Prior to the amendments, sections 27E and 27F conferred concessional taxing treatment on any part of a relevant eligible termination payment that exceeded the payment the taxpayer could be expected to have received if termination of employment had occurred at the same time otherwise than under the approved early retirement scheme or because of redundancy - i.e., on ordinary retirement or resignation at the same time. The application of sub-sections 27E(5) and 27F(2) will be dealt with in a further ruling.

COMMISSIONER OF TAXATION
30 April 1986

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