



TD 94/8 - Income tax: how is the proportion of a lump sum payment on termination of employment that relates to unused annual leave that accrued in respect of service before 18 August 1993 calculated for the purposes of section 159S of the Income Tax Assessment Act 1936 ?

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 This document has changed over time. This is a consolidated version of the ruling which was published on *20 January 1994*

This Determination, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the *Taxation Administration Act 1953*, is a public ruling for the purposes of that Part. Taxation Ruling TR 92/1 explains when a Determination is a public ruling and how it is binding on the Commissioner. Unless otherwise stated, this Determination applies to years commencing both before and after its date of issue. However, this Determination does 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 the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Taxation Determination

Income tax: how is the proportion of a lump sum payment on termination of employment that relates to unused annual leave that accrued in respect of service before 18 August 1993 calculated for the purposes of section 159S of the *Income Tax Assessment Act 1936*?

1. The definition of *eligible assessable income* in section 159S was amended by the *Taxation (Deficit Reduction) Act (No 1) 1993*. The relevant Bill was amended during its passage through Parliament to ensure that lump sum payments in respect of unused annual leave that accrued to a taxpayer in respect of service before 18 August 1993 would continue to be *eligible assessable income* and therefore taxed subject to a maximum rate of 30% plus medicare levy.
2. The taxation treatment of payments in respect of unused annual leave can be summarised as follows:
 - (a) if the taxpayer's termination of employment is as a consequence of bona fide redundancy or invalidity or is under an approved early retirement scheme, the whole amount of any payment in respect of unused annual leave is included in assessable income and subject to tax at a rate not exceeding 30% plus medicare levy;
 - (b) if the taxpayer's termination of employment is not in one of these circumstances:
 - that portion of any such payment which relates to leave accrued in respect of service prior to 18 August 1993 is included in assessable income in full and subject to tax at a rate not exceeding 30% plus medicare levy; and
 - that portion of any such payment which relates to leave accrued in respect of service on or after 18 August 1993 is included in assessable income in full and taxed at marginal rates.
3. When determining the amount of unused annual leave that accrued in respect of service before 18 August 1993, any leave taken after 17 August 1993 is applied on a first in first out basis. That is, any annual leave used is taken off the earliest period of accrual first. Therefore, the portion of any payment in respect of unused annual leave that accrued in respect of service before 18 August 1993 can be calculated using the following formula:

$$\text{Payment} \times \frac{\text{Number of days in the Accrual Period that occurred before 18 August 1993}}{\text{Number of days in the Accrual Period.}}$$

The **Accrual Period** is the number of whole days over which the unused annual leave accrued, assuming that the leave accrues in accordance with the employee's ordinary conditions of employment and that it relates to the last period of service.

4. A major advantage of this approach is that employers will not need to keep any additional records. The portion of unused leave that accrued in respect of service before 18 August 1993 can be determined at the time the employer makes the payment.

Example 1

Bridget resigns from her employment on 17 March 1994 after 10 years of service and receives a payment of \$5 000 in respect of 6 weeks unused annual leave. Under the conditions of her employment Bridget is entitled to 4 weeks annual leave for each year of service. Therefore, 6 weeks unused annual leave is accrued in respect of 18 months service (ie. the period 18 September 1992 to 17 March 1994). Consequently, the total number of days in the accrual period in respect of Bridget's unused annual leave is 546 days (ie. the period 18 September 1992 to 17 March 1994). The number of days in the accrual period that occurred prior to 18 August 1993 is 334 days (ie. the period 18 September 1992 to 17 August 1993). Therefore, the amount of Bridget's payment which accrued prior to 18 August 1993 and will qualify as eligible assessable income is:

$$(\$5\,000 \times 334/546) = \$3\,059.$$

The amount of Bridget's payment which accrued on or after 18 August 1993 is \$1 941 (ie. \$5 000 - \$3 059).

Therefore, \$3 059 of Bridget's payment will be included in assessable income in full and subject to tax at a rate not exceeding 30% plus medicare levy. \$1 941 will be included in her assessable income and taxed at marginal rates.

Example 2

David resigns from his employment on 31 October 1994 after 23 years of service and receives a payment of \$2 000 in respect of 4 weeks unused annual leave. Under the conditions of his employment David is entitled to 4 weeks annual leave for each year of service. Therefore, the accrual period in respect of David's unused annual leave is 1 November 1993 to 31 October 1994. As the whole of that period relates to service after 17 August 1993, all of David's payment will be included in his assessable income and taxed at marginal rates.

Commissioner of Taxation

20/1/94

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