

Genuine redundancy payments - conditions & tax treatment

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24 April 2009

The ATO issued *Taxation Ruling* TR 2009/2 in final form on 22 April 2009, to replace its earlier *Draft Taxation Ruling* TR 2008/D6. The new final Ruling discusses the requirements of a genuine redundancy payment (**GRP**) and its tax treatment. In this article, we consider the ATO's position in relation to GRPs in two parts, firstly, the basic requirements of a GRP and secondly, the interaction between the tax treatment of GRPs and the tax treatment of other termination payments provided for under Divisions 82 and 83 of the ITAA 1997.

Tax concessions

A termination payment made upon the redundancy of an individual may qualify for tax concessions, if certain conditions are met. In particular, if a termination payment is a GRP within the meaning of section 83-175 of the *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**), that part of the termination payment that is a GRP will be tax-free as non-assessable non-exempt income of the recipient taxpayer (section 83-170 of the ITAA 1997). This preserves the concessional treatment of redundancy payments in the now repealed section 27F of the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**), which provided concessional tax treatment for *bona fide* redundancy payments.

What is a GRP?

A GRP is a "payment received by an employee who is *dismissed* from employment because the employee's position is *genuinely redundant* 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 the dismissal" (section 83-175(1) of the ITAA 1997).

According to the ATO, a payment is a GRP if it is made **in consequence of** a particular type of termination from employment that is attributable to a particular reason. The type of termination from employment must be a dismissal and the reason for termination must be the redundancy of the position (TR 2009/2, paragraph 7).

Basic requirements of a GRP

The ATO then considers the 4 cumulative conditions for a GRP as follows:

- the payment being tested must be **received in consequence of a termination**;
- that termination must involve an employee being **dismissed from employment**;
- that dismissal must be **caused by** the **redundancy** of the employee's position;
and
- the redundancy payment must be made **genuinely** as a result of redundancy (TR 2009/2, paragraph 11).

Payment in consequence of termination

The ATO previously issued *Taxation Ruling* TR 2003/13 on what "payment made **in consequence of** termination" means in the context of eligible termination payments. A payment that meets the basic requirements of a GRP will also satisfy the conditions for employment termination payments (section 82-130(1)(a) of the ITAA 1997).

Certain payments, such as unused annual leave and unused long service leave, that may also be made as a consequence of a termination, however, will not be GRPs if the payments have a more specific tax treatment under another provision of the tax legislation (section 83-175(4) of the ITAA 1997).

Dismissal from employment

Dismissal is a particular mode of termination. Usually, a dismissal has the following features:

- there must be complete severance of employment of the employee with the employer;
- the termination is without the consent of the employee; and
- a dismissal may or may not necessarily be initiated by the employer, provided the final decision rests with the employer.

Deciding whether an employee has given their consent, with respect to a termination, requires an assessment of the facts and circumstances of the case. In particular, the employee will be taken to have given their consent to a termination if they expressly state their consent or if it can be implied from their conduct (TR 2009/2, paragraph 19). An expression of interest by an employee in having their employment terminated may still be a dismissal if the employer retains the *final* decision as to whether to terminate the employee (TR 2009/2, paragraph 20).

Constructive dismissals are also considered to be dismissals for the purposes of determining whether a payment is a GRP. An employee who is constructively dismissed, is in fact being dismissed by the employer without the employee's consent, even though the termination may actually be 'initiated' by the employee (TR 2009/2, paragraph 22).

Dismissal caused by redundancy

The redundancy of the employee's position must be the prevailing or most influential cause of the dismissal. An employee's position is redundant when an employer determines that the position is superfluous to the employer's needs and the employer does not wish the position to be occupied anymore (TR 2009/2, paragraphs 24 to 25). It is fundamentally the employer's decision that a position is redundant.

The basic requirements of a GRP will not be met if the employer decides that employee's position is redundant and the employee remains employed by the employer following the redundancy. In such a case, the employee will not have been dismissed though the employee's position is redundant (TR 2009/2, paragraph 26).

Genuine redundancy

Whether a redundancy is genuine needs to be determined objectively. A contrived case of redundancy is unlikely to meet the basic requirement of a GRP (TR 2009/2, paragraph 31).

Further conditions for a GRP

In addition to the basic requirements of a GRP, further conditions must be met before a payment is a GRP, as follows:

- the dismissed employee is not older than specified age limits;
- the termination is not at the end of a fixed period of employment;
- the actual amount paid is not greater than the amount that could reasonably be expected had the parties been dealing at arm's length, in the event that the employer and employee are in fact not dealing at arm's length in relation to the dismissal;
- there is no arrangement entered into between the employer and the employee or the employer and another entity to employ the dismissed employee after the termination; and
- the payment is not in lieu of superannuation benefits.

Aged-based limits

An employee must be less than 65 years old at the time of dismissal for a payment to be a redundancy payment.

Not the end of a fixed term contract or a project

A payment made at the end of a fixed period of employment is typically not a GRP. However, some exceptions apply if the payment is made on the following circumstances:

- rolling fixed-term contracts where there is an ongoing employment relationship and a payment made at the end of the period of service (TR 2009/2, paragraph 37); or
- in multi-disciplinary project-based work, the employee's period of service is determined by reference to the achievement of a particular outcome, rather than a specified period of time (TR 2009/2, paragraph 38).

Arm's length amount

If it can be established that the employer and employee are not dealing with each other on an arm's length basis in relation to the dismissal, the arm's length test stipulates that the actual payment made should not exceed what could reasonably be expected if the parties had been dealing at arm's length. This creates a hypothetical arm's length dealing and contrasts it to the actual non-arm's length dealing. If the payment made is greater than the hypothetical arm's length dealing amount, then the whole of the payment will be disqualified from being a GRP (rather than just the excess), as the arm's length requirement is not met (TR 2009/2, paragraph 49).

No stipulated arrangement to employ

If an arrangement is entered into between:

- the employer and the dismissed employee; or
- the employer and another entity;

to employ the employee after their dismissal, then the GRP requirements will not be met (TR 2009/2, paragraph 50).

Payments not in lieu of superannuation benefits

A payment is not a GRP to the extent that it is made in place of superannuation benefits due at the time or in the future (section 83-175(3) of the ITAA 1997). In

general, superannuation benefits are benefits paid by reason of a person's entitlement under a superannuation fund (see section 307-5(1) of the ITAA 1997 for a list of superannuation benefits).

Taxation of termination payments made on redundancy

If a GRP is made upon redundancy, the payment will be dissected into the following components to determine the tax treatment of the payment:

- any amounts that are subject to a more specific tax treatment other than employment termination payments (**ETP**) or GRP are identified and excluded (section 82-135 of the ITAA 1997);
- the **voluntary termination element**. That is, the amount that could reasonably be expected if the employee had voluntarily terminated his or her employment;
- the remaining **redundancy element** that may comprise of:
 - a **tax-free component** and a **taxable component** of a GRP (section 83-170 of the ITAA 1997); or
 - a **voluntary termination element** if the requirements of a GRP are not met.

Voluntary termination element

The voluntary termination element is the amount that could reasonably be expected to be received by an employee if they had voluntarily terminated employment at the time of being dismissed (section 83-175(1) of the ITAA 1997). Generally, it would be expected that a payment made on redundancy would be greater than upon a voluntary termination. As such, the voluntary termination element could be determined by reference to the following:

- if the parties were not dealing at arm's length, the payment forms part of the voluntary element, as the payment would not qualify as a GRP;
- contractual or other entitlements payable by the employer upon voluntary termination; and
- industry norms.

The amount that is the voluntary termination element of a payment is subject to tax as an ETP, if it is received no later than 12 months after the termination

(section 82-130 of the ITAA 1997). Otherwise, the amount is taxed as an ordinary amount of assessable income (section 83-295 of the ITAA 1997).

Remaining redundancy element

If a termination payment made on redundancy satisfies all of the requirements of a GRP, then that part of the payment (excluding the voluntary termination element) is a GRP.

If a termination payment made on redundancy does not satisfy the requirements of a GRP, then that part of the payment is treated in similar manner to the voluntary termination element.

Tax-free component of a GRP

A GRP can consist wholly or partially of a tax-free amount. Accordingly, to determine the part of a payment, which is the tax-free amount of a GRP, the following factors will need to be taken into account:

- the amount of the payment; and
- the number of whole years to which the payment relates that the employee was employed with the particular employer (section 83-170 of the ITAA 1997).

There is no requirement that the years of service with a particular employer be continuous when applying the factors (TR 2009/2, paragraph 69). In particular, if the years of service of an employee with a previous employer is carried over and acknowledged by the new employer, those earlier years will be taken into account in working out the tax-free amount of the GRP (TR 2009/2, paragraph 70).

Taxable component of a GRP

Any amount of a GRP that exceeds the tax-free amount is taxable as an ETP even if the amount is received more than 12 months after termination (section 82-130(4) of the ITAA 1997).

Multiple payments for one dismissal due to redundancy

In some cases, there may be multiple payments made, whether by one or more payers, in relation to a dismissal due to redundancy. In such cases, it is necessary to apply the provisions (Part 2-40 of the ITAA 1997) to work out the tax treatments of the different payments. In working out the tax treatment of the various payments, the payments should be treated as a single sum attributable to the relevant redundancy (TR 2009/2, paragraph 74).

Accordingly, all payments made in consequence of the dismissal are assessed against a single voluntary termination element worked out **at the time of the dismissal**. In addition, the tax-free amount of a GRP can only be claimed once (TR 2009/2, paragraph 76).

In certain circumstances, payments can be made over more than one income year. For consistency purposes, if the payment is taxable in a relevant year, payments are brought to account in the year that they are received (TR 2009/2, paragraph 77). To ensure that the tax-free amount of the GRP is reflected correctly in the year the payment is received, the tax-free amount of the GRP will be indexed accordingly. The tax-free amount applicable for the year the payment is received will take into account any tax-free amount applied in previous years.

Dual capacity employees

A dual capacity employee is a person who, in addition to being engaged as employee of an employing entity, is also the directing mind of or holds an office in the entity. The most common example is a person who is a director of the employer and also a common law employee of the employer (TR 2009/2, paragraph 79).

Invariably, a dual capacity employee may decide or actively participate in a decision to terminate their own employment in either or both capacities. A dismissal requires termination without the consent of the employee. As such, there may be some particular issues in determining whether a dual capacity

employee has in fact consented to their own termination (TR 2009/2, paragraph 82).

In determining whether a dual capacity employee has in fact consented to their own termination, the ATO considers the following issues:

- whether the person agreed to or approved the employer's act or decision to terminate their own employment. If the answer is negative, then the termination is without consent and is, therefore, a dismissal; and
- if the answer to the previous question was positive, then, whether there were other circumstances, such as legal or economic compulsion, that motivated the employer's act or decision, the termination is with the person's consent and is, therefore, not a dismissal.

In any case, careful consideration needs to be given to all the facts and circumstances surrounding the termination of a person's employment. Interrelated to the ATO's proposition above, the following inquiries may assist in determining whether consent has in fact been given:

- whether there was a unanimous decision of the directing minds of the employer in terminating the employment of the person;
- where the decision was made under constraints or in difficult circumstances, whether the dual capacity employee made a real choice; and
- whether the employer had a real or practical choice other than to terminate the employment of the employee in question.

Conclusion

The new final *Taxation Ruling* TR 2009/2, consolidates the ATO's view on bona fide redundancy payments (the earlier *Taxation Ruling* TR 94/12 has, as a result, been withdrawn) and its view on the tax treatment of GRPs. Accordingly, the tax treatment of a termination payment due to a redundancy will be tax-free if the payment is made consistently with the requirements of a GRP.