TR 2009/2EC - Compendium

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Ruling Compendium – TR 2009/2

This is a compendium of responses to the issues raised by external parties to draft Taxation Ruling TR 2008/D6 – Income tax: genuine redundancy payments

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft Ruling.

Where appropriate, paragraph references to TR 2008/D6 are given in brackets after the reference to TR 2009/2. Paragraph references without any brackets following indicate that the paragraph was newly inserted into TR 2009/2.

Summary of issues raised and responses

Issue No.	Issue raised	Tax Office Response/Action taken
1	Is an arrangement to employ someone under subsection 83-175(2)(c)[1] limited to contracts of service or does it extend to self-employment as a contractor or to employment by a contracting entity that employs the previously terminated employee?	***Material added to clarify (footnote 3, paragraphs 52, 307 to 309)*** The Tax Office's position is that Part 2-40 deals generally with contractual relationships between an employer and an employee (also known as common law employment or contracts of service). Therefore, on considering the issue raised here, the Tax Office considers that the better view of the scope of the words 'arrangement to employ' in paragraph 83-175(2)(c) is that they only extend to common law employment arrangements or contracts of service). This position is set out in paragraph 52 and explained in paragraph 307. Paragraph 6 (6) has also been amended and footnote 3 added to clarify the distinction between common law employment and independent contractor arrangements for the purposes of section 83-175. It has been judicially recognised that the terms 'employ' or 'employment' can take different meanings depending on context. Accordingly, in some circumstances, these terms may contemplate independent contractor arrangements. However, here the Tax Office considers that these terms take a consistent meaning throughout Part 2-40, which is limited to common law employment relationships.

[1] All legislative references are to the *Income Tax Assessment Act 1997* unless otherwise indicated.

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2	Can subsection 83-175(2)(c) apply where the former employee is employed by an interposed company or trust in light of paragraph 13 of SGR 2005/1 and section 12-7 of the TAA by which the relationship between the old employer and the interposed entities does not give rise to superannuation guarantee and PAYG withholding obligations?	***No change*** Yes. As set out in paragraph 50 (46), paragraph 83-175(2)(c) only contemplates that an arrangement be in place between the original employer and another entity that involves the employee being employed after the termination time. The fact that the original employer has no ongoing superannuation guarantee or PAYG withholding obligations in respect of the employee does not impact on this outcome.
3	Clarify in what circumstances in the building and construction industry a genuine redundancy payment might be made. A common form of employment in the building industry is a daily or weekly hire. Put an extra example in about the 'normal' outcome for the construction industry: *A labourer is hired by a construction company and works on a specific project at a specific building site. The labourer's employment is governed by their relevant industrial award. The labourer's employment is terminated at the end of the project on 1 day's notice under the industrial award. The labourer is out of work for a short period of time until another project commences at another building site. The labourer would not be made genuinely redundant in theses circumstances.* Clarify whether fixed term, project or casual is the appropriate characterisation of building and construction industry employment contracts. The example offered is one where a worker is employed for an extended period (5 years) on a rolling series of projects and is also retained for short periods for odd job work between projects and there is a downturn in the building industry that results in a termination of employment because there are is no further work on offer in the industry.	***Material added to clarify (paragraphs 37 (36) and 39; Example 11 (paragraphs 148 to 154), and paragraphs 287, 288 (248), 289 and 290)*** The Tax Office considers these types of arrangements to be a variation of the 'rolling' fixed-term contracts scenario discussed at paragraph 37 (36) of the Ruling. The Tax Office's view is that the same principles expressed in that paragraph apply here. Paragraph 39 and Example 11 (paragraph 148 to 154) have been added to illustrate the application of the principles to the types of arrangements identified. This position has been further explained by way of changes reflected in paragraphs 287, 288 (248), 289 and 290. There are many variations in the facts and circumstances that might apply in these types of cases. As identified in paragraph 287, the question of whether there is a termination of an ongoing employment relationship at what would otherwise have been the expiry of a contract necessarily turns on all the surrounding facts and circumstances. However, as also noted at paragraph 287, if employment ceases at a point contemplated under the contract, those facts and circumstances must provide sufficient evidence to override the express terms of the contract. Example 11 recognises that while some contracts may in form provide for a short set period of employment (for example, a day or a week), the mutual intention of the parties may be that the relationship will continue for a longer period of time (for example, the duration of the project). Where employment is terminated before the end of this longer period, the conditions for a genuine redundancy payment may be met.

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	This is considered to be comparable to the situation where a casual worker might be considered to be redundant: *A labourer is hired by a construction company 1 June 2003. Between 1 June 2003 and 1 June 2008, the labourer works for the construction company on five specific projects at five specific building sites. At the end of each of the first four projects, the labourer's employment is not terminated. At the end of the first and second projects, the construction company moves the labourer directly onto the second and third projects. At the end of the third project, the construction company asks the labourer to perform odd jobs, such as servicing plant & equipment, until the fourth project commences. At the end of the fourth project, the construction company asks the labourer to take leave until the fifth project commences. Following completion of the fifth project, the construction company terminates the labourer's employment as a result of serious work shortage, i.e. the construction company does not have sufficient new projects commencing in the near future to maintain the company's workforce. The labourer would be made genuinely redundant in these circumstances, despite any informal understanding between the labourer and the construction company that the labourer may be re-employed in the future subject to work availability.*	
4	The Ruling places far too much focus on avoidance concerns, hence the concentration on dual capacity issues, and not enough consideration to the broad business community. The additional rules that apply to dual capacity employees will have an adverse impact on small and medium enterprises. We recommend that in order to promote equity and upheld the legislative intention of genuine redundancy tax concessions the additional rules applicable to dual capacity employees should be reviewed.	***Material added to clarify (paragraphs 8 (8), 9 (9), 81 (75), 83, 84 (77), 87 (80), 88, 89, 90 and 353 (308), 354 (309), 355 (310), 356 (311), 357 (314), 358, 359 (312) and 360 (312))*** Paragraphs 8 (8), 9 (9) and 81(75) clarify that special rules are not being applied to dual capacity employees, but rather that their circumstances, especially their ability to make decisions on behalf of the employer, raise particular issues in meeting the conditions under section 83-175.

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		The requirement for any employee (whether dual capacity or not) to not consent to their termination is based on the ordinary meaning of the term 'dismissal' as used in subsection 83-175(1). (Note that in Taxation Ruling TR 94/12, this requirement was described in terms of whether the termination was 'involuntary'. The Tax Office considers that the 'involuntariness' requirement identified in that Ruling is substantively equivalent to the 'without consent' requirement identified in the industrial law cases cited in this Ruling.) The Tax Office considers that any perception that additional rules apply to dual capacity employees reflects the fact that the 'without consent' requirement is more readily established, as a matter of evidence, in the case of an employee who is not directly involved in the employer's decision-making process. The purpose of identifying the two questions at paragraph 84 (77) is to elaborate and provide further practical guidance on the circumstances where a dual capacity employee will not consent to the termination of their employment. The identification of these questions is not intended to suggest nor do they imply additional requirements to be satisfied for dual capacity employees. Instead, the questions seek to identify circumstances where a dual capacity employee's termination is truly without consent, even where that employee has actively taken or agreed to that decision. However, on reviewing the position expressed in the draft Ruling, the Tax Office does consider that the concept of 'legal or economic compulsion' may be narrower than the 'without consent' requirement under the law. Changes have been made throughout the Ruling to instead highlight whether any real or practical choice has been exercised in making the termination decision. The addition of *paragraph 83* seeks to make clear the Tax Office's position regarding the state of mind of dual capacity employees in the ruling section. This view was only reflected in the explanation section of the draft ruling. Additions and changes to paragraphs 353 (308), 354 (309), 355 (310), 356 (311), 357 (314), 358, 359 (312) and 360 (312) further elaborate on these matters.

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5	The 'no consent' rule has an unintended consequence that places a three-director company in a better position than a two-director company to achieve majority votes for making a dual capacity employee redundant.	***Material added to clarify (paragraph 358)*** Paragraph 358 deals with the specific issue of the status of two director companies. This paragraph clarifies the Tax Office's position in relation to two director companies, stating a view that it is quite conceivable that a dual capacity employee in a two director company may be dismissed from their employment.
6	The draft Ruling seems to suggest that in order to satisfy the legal or economic compulsion test the business must terminate as a result of such compulsion. Although business cessation is not explicitly stated in the draft ruling as a requirement, it is implied in paragraph 82 and the examples of the draft ruling. We recommend that the final ruling clarifies that business cessation is not a requirement for satisfying the legal or economic compulsion test. ***Suggested example***: *Mr and Mrs Banks established Front Line Pharmaceuticals Pty Ltd (Front Line) thirteen years ago when they saw an opportunity in wholesale and distribution of pharmaceutical products. Mr and Mrs Banks are and have been the only directors of the company for the last fifteen years. Mrs Banks is also employed by Front Line as the company accountant. She manages four staff members in the accounting and administration division. Over the years, the business has grown substantially. Its annual sales have reached $20m. It employs over 50 sales representatives nationwide. However, many strong competitors have emerged in the last few years and slowly take away Front Line's market share in the industry.* *As a result of fierce competition Front Line's sales results and profit margins have declined significantly and its net profit is trailing behind its major competitors. Mr and Mrs Banks realise that if Front Line is to survive in the Pharmaceutical sales business, it must reassess its business structure and achieve major efficiencies. For this purpose, they decide to engage a consultant to find an appropriate business solution.*	***Material added to clarify (paragraph 90, Example 3 at paragraphs 108 to 110)*** Business cessation is *not* required to establish a conclusion that a dual capacity employee has not consented to their termination. The relevant question is whether the employee has consented to their termination, which, based on practical tests set out in paragraph 84(77), looks to whether a real or practical choice has been exercised in making the termination decision. Additions have been made to *paragraph 90* to clarify the Tax Office's position and Example 3 seeks to identify a case where a dual capacity employee is dismissed in the absence of a complete business closure. The Tax Office notes that it will be relatively common for a business (or an identified part of a business) to close when the employment of a dual capacity employee is terminated. This reflects the central role that dual capacity employees invariably have in the establishment and maintenance of the business rather than it being a requirement for the conditions in section 83-175 to be satisfied.

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	The consultant, amongst other things, identifies that significant benefits can be obtained by outsourcing accounting and administration functions. These benefits include significant cost savings, timely management reports for decision making, less office space and equipment, eliminating problems caused by high staff turnover typical in this division, and freeing up resources in the IT department for implementing and maintaining state of the art IT systems to support Front Line's core business activities in sales, inventory and distribution. *After careful consideration, Mr and Mrs Banks decide to implement most of the recommendations made by the consultant including outsourcing of the accounting and administration functions. In a directors' meeting both Mr and Mr Banks resolve that all positions in the accounting and administration division be made redundant. As a result, all five staff members in the accounting and administration division are made redundant including Mrs Banks in the capacity of the company accountant. No arrangement has been made to reemploy any of these employees (Mrs Banks remains a director of Front Line).* *Mrs Banks receives an arm's length payment in accordance with the terms and conditions applicable to all employees that are made redundant at the same time. Although Mrs Banks remains a director of Front Line, her remuneration as a director is at market value and will not be affected by her redundancy.* *It is clear in this case that if Front Line wishes to remain an economically viable business it has no choice but to restructure its business. The directors, in discharging their fiduciary duties, have made a conscionable decision to outsource the accounting and administrative functions. The redundancy is a result of such critical business decision and therefore is a genuine redundancy.*	

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	In this situation, all evidence indicates that Mrs Banks' redundancy payment is a genuine redundancy payment - she consents to her own termination of employment due to economic compulsion; her redundancy payment is at arm's length; she is not reemployed by Front Line after the termination; and her director's fee is not inflated after her position as the company accountant is terminated.	
7	The draft Ruling gives an example that portrays a situation where a genuine redundancy happens as a result of the company losing its only source of business. However, the draft ruling is silent about whether the company is required to continue to seek other business opportunities. It is also silent about the amount of effort the company needs to demonstrate in order for the termination of the dual capacity employee to be considered a genuine redundancy. We recommend further guidance be provided in the final ruling to clarify the above mentioned issues.	***Material added to clarify (paragraphs 367 and 368)*** Paragraph 367 clarifies that new business opportunities need not be sought in establishing that a dual capacity employee is in fact redundant. Consistent with the approach set out in paragraph 366 (320), actively seeking out alternative business opportunities will be a factor that assists in establishing redundancy of the relevant positions, but it is not a requirement. Consistent with the Full Federal Court decision in *Dibb* (referenced at footnote 119), paragraph 368 explains that taking up a new business opportunity in these circumstances may lead to there being no dismissal and/or redundancy, as the previous roles and functions undertaken by the dual capacity employees may continue.
8	It is not uncommon that business owners (in dual capacity situations) pay themselves below market value remuneration packages. However, the draft ruling does not address how the arm's length redundancy amount can be assessed in this situation. We believe that where the salary package received prior to redundancy was below market value, the calculation of the genuine redundancy amount should be based on: • the market value that the employee would have otherwise received; and • the compensation factor for below market value remuneration received by the employee over the period of their employment.	***Material added to clarify (paragraphs 47, 299 and 305)*** *Paragraph 47* clarifies that while it is appropriate to benchmark against an arm's length redundancy payment that takes into account an arm's length remuneration package for the services rendered by the employee, the Tax Office considers that there is no basis for increasing that benchmark to compensate an employee who received less than market value remuneration over the course of their employment under a non-arm's length dealing. Additions and changes to paragraphs 299 and 305 further elaborate on these matters.

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9	Examples to illustrate how the genuine redundancy rules apply to downsizing a team of staff who carry out similar duties.	***Changes made (Example 18 at paragraphs 180 to 185)*** New Example 18 deals with a structured redundancy process where the employer calls for volunteers for redundancy packages. In terms of establishing the necessary requirements of 'dismissal' and 'redundancy', the most important element of these processes is that the decision as to which employees to terminate clearly rests with the employer, as set out in paragraph 20 (20) of the Ruling. This new example complements Example 17 at paragraphs 176 to 179 (Example 10 at paragraphs 132 to 135).
10	The fact of a termination payment being made at the end of a fixed-term contract points to the ongoing nature of the employment relationship outside the strict fixed-term parameters of the contract.	***Material added to clarify (footnote 18)*** While the Tax Office recognises that facts and circumstances outside the express terms of a fixed-term employment contract may establish an ongoing employment relationship, footnote 18 states that the mere fact that an additional payment is made at the end of a series of rolling fixed-term contract is not sufficient to establish an ongoing employment relationship. The Tax Office notes that while the need for a 'dismissal' and paragraph 83-175(2)(a) may not be met in these cases, a payment made in these circumstances is likely to be an employment termination payment.