

IT 2490 - Income tax : eligible termination payments - approved early retirement scheme payments and bona fide redundancy payments - concessional component and forgone benefit part of eligible termination payment.

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TAXATION RULING NO. IT 2490

INCOME TAX : ELIGIBLE TERMINATION PAYMENTS - APPROVED
EARLY RETIREMENT SCHEME PAYMENTS AND BONA FIDE
REDUNDANCY PAYMENTS - CONCESSIONAL COMPONENT AND
FORGONE BENEFIT PART OF ELIGIBLE TERMINATION PAYMENT.

F.O.I. EMBARGO: May be released

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| REFERENCE NO: | SUBJECT REFS: | LEGISLAT. REFS: |
|---------------|--|-----------------|
| | ELIGIBLE TERMINATION PAYMENTS | 27A |
| I 1010741 | CONCESSIONAL COMPONENT | 27E |
| | FORGONE BENEFIT PART OF ELIGIBLE TERMINATION PAYMENT | 27F |

OTHER RULINGS ON TOPIC : IT 2157, IT 2168, IT 2255,
IT 2256, IT 2272, IT 2286,
IT 2341

PREAMBLE

Subdivision AA of Division 2 of Part III of the Income Tax Assessment Act (the Act) provides for the assessment of eligible termination payments (ETPs). For the purposes of subsection 27A(1) of the Act, so much of an ETP as consists of, or is attributable to, a bona fide redundancy payment, an approved early retirement scheme payment or an invalidity payment is treated as a "concessional component". The concessional component of an ETP 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).

2. Section 27E of the Act contains rules for determining whether any part of an ETP qualifies as an approved early retirement scheme payment. Section 27F contains similar rules for determining whether any part of an ETP qualifies as a bona fide redundancy payment. The amount which may qualify as a concessional component of these kinds is so much of the ETP received as exceeds the amount of an ETP that could reasonably be expected to have been received by the taxpayer, if his or her employment had terminated at that time otherwise than in accordance with the approved early retirement scheme or the bona fide redundancy (for example, on resignation). Only 5% of that amount is included in a taxpayer's assessable income.

3. Subsections 27E(5) and 27F(2) exclude from the concessional component of an ETP that part (referred to as the forgone benefit part) of an approved early retirement scheme payment or bona fide redundancy payment made in lieu of superannuation benefits to which the taxpayer may have become entitled at the

termination time or at a later time. The forgone benefit part is assessed as an ETP.

RULING Lump Sum Funds

4. It is often the case that the deed of a superannuation fund or the rules of a superannuation scheme may have special rules relating to retrenchment. In such cases, it may be that additional superannuation benefits (over those available to the employee on resignation) will be payable in circumstances which would give rise to an approved early retirement scheme payment or a bona fide redundancy payment were it not for the provisions of subsection 27E(5) or 27F(2).

5. As an example, a person may, ordinarily, be entitled to full vesting of the employer-funded benefits only on reaching a particular age or completing a particular period of service. On resignation, therefore, the person would not receive the full amount of the benefits accrued for him or her. However, the deed or rules may provide that, in retrenchment situations, the full amount accrued would be payable. The amount of the excess of that benefit over the resignation benefit, although paid as a consequence of the retrenchment is, however, also payable to compensate the retrenched employee for the superannuation benefits forgone due to retrenchment. In such cases, the amount of the concessional component (if any) is limited to the excess of the payment received over the accumulated superannuation benefits.

6. The following examples may help to illustrate the application of the provisions of subsection 27E(5) and 27F(2):

Example 1

- . Taxpayer A, aged 53, is retrenched on bona fide redundancy grounds after 22 years service with his employer.
- . Under the rules of his employer's superannuation fund, benefits accrue at the rate of 2 months' salary per year of service.
- . On resignation if the person has not attained age 55, a member's benefit is restricted to his or her own contributions plus interest.
- . In the event of retrenchment, the age 55 requirement is waived.
- . At the date of A's retrenchment his resignation benefit was \$81,000.
- . Payment from the fund was \$132,000 (that is 22 times his salary for 2 months of \$6,000)

But for the application of subsection 27F(2), the concessional component of the ETP of \$132,000 would be \$51,000 -

the excess of the ETP over the resignation benefit. However, as that amount is in lieu of the benefit, accrued at the rate of 2 months' salary per year of service, forgone by A as a result of his retrenchment, it is appropriate to regard the \$51,000 as the forgone benefit part to be included in the termination amount for the purposes of section 27F. Accordingly, the concessional component would be NIL.

7. Example 2

- . Taxpayer B, aged 58, elects to retire under an approved early retirement scheme after 35 years of service with her employer.
- . Under the rules of her employer's non-contributory superannuation fund, her employer contributes to the fund each year an amount equal to 10% of her salary at 30 June.
- . The following rules relate to vesting of the "employee's accumulation account" (viz. accumulated employer contributions plus income earned thereon):

Up to 10 years - NIL
Over 10 Years - 2 1/2% per year of employment

- . Under the terms of the early retirement scheme, the employer agrees to the superannuation fund paying whatever is required for employees to receive the equivalent of the following vesting of the employee's accumulation account:

Up to 10 years service - 25%
10 years - 20 years - 50%
20 years - 30 years - 75%
over 30 years -100%

- . The employee's accumulation account at the date of her election to retire contains \$100,000.
- . Her resignation benefit would have included 87 1/2% of that amount viz. \$87,500.
- . At her compulsory date of retirement (age 60) she would have been entitled to receive 92 1/2% of that amount viz. \$92,500.
- . Under the approved early retirement scheme, she receives the amount of \$100,000.

But for the application of subsection 27E(5), the concessional component of the ETP of \$100,000 would be \$12,500 - the excess of the ETP over the resignation benefit. However, had she continued to retirement she would have become entitled to a further \$5,000, forgone by B in electing to take early retirement. It is appropriate to regard that \$5,000 as a forgone benefit part included in the termination amount for the

purposes of section 27F. Accordingly, the concessional component of the ETP is reduced to \$7,500 (\$100,000 - \$92,500).

8. An amount included in an ETP received in approved early retirement scheme or bona fide redundancy circumstances in lieu of superannuation benefits need not, however, be paid from a superannuation fund. The amount could be paid as the whole, or part, of a payment made by the retrenched person's employer or an associate of that employer. For example, in the circumstances of Example 2 above, the additional payment of \$12,500 over the resignation benefit payable from the superannuation fund could have been paid direct from the employer. Although it would be an ETP to which paragraph (a) of the definition of eligible termination payment refers, it is still capable of containing a forgone benefit part for the purposes of subsection 27E(5) or 27F(2).

Pension funds

9. It is proposed that a further Ruling would issue shortly dealing with the application of subsections 27E(5) and 27F(2) to ETPs received by members of the Commonwealth Superannuation Scheme and similar superannuation pension funds or schemes in consequence of the retrenchment or involuntary retirement of such members.

COMMISSIONER OF TAXATION

28 July 1988