Payroll – Withholding on redundancy payments: Not as simple as it seems

Employers need to be aware of their taxation obligations when calculating redundancy payments paid to employees. Here, we highlight some aspects that cause difficulties for employers.

Employers may decide to terminate an employee's employment for a variety of reasons. To the extent the termination results from the employer determining that the role/employee is no longer required, the employer may offer a termination or redundancy package to the employee. Often, these packages are more generous than those that would be paid if the employee had simply resigned.

From a taxation perspective, the payment of such packages results in various taxation obligations arising for the employer across the different employment tax regimes (e.g. Pay-As-You-Go Withholding, superannuation, Payroll Tax *etc.*). This article focuses on the Pay-As-You-Go Withholding (PAYG Withholding) obligations arising from the payment of termination/redundancy packages and some of the complexities that can be easily missed by employers.

Overview

Generally, termination/redundancy packages are lump sum payments comprised of various components, such as:

- **unused annual leave and unused long service leave amounts;**
- **gratuity or *ex gratia* payments;**
- **payments in lieu of notice;**
- **severance pay;**
- **unused sick leave;**
- **etc.**

These payments are generally included in an employee's assessable income, with a PAYG Withholding obligation arising for the employer, similar to that applicable to ordinary salary and wages.

The taxation treatment of termination/redundancy payments is guided by Divisions 80 to 83 of the ITAA 1997. The provisions also inform the employer's PAYG Withholding obligation.

Generally, these provisions separately identify and apply a concessionary rate of taxation to amounts that qualify as 'employment termination payments' (ETPs), unused annual leave payments and long service leave payments. However, this concessional treatment is generally only applied up to a specific limit or 'cap', with the balance taxed at the top marginal rate.

Additionally, where part of a payment qualifies as a 'genuine redundancy payment', a portion may be treated as tax-free.

Accordingly, employers paying termination/redundancy packages need to consider the following when determining their withholding obligation:

- **the extent to which the payment qualifies as a genuine redundancy payment, ETP or leave payment (as defined);**
- **whether any portion of the payment will be tax-free;**
- **the application of the caps.**

Depending on the components of the payment, this process may be relatively straightforward. However, there are a number issues that are often overlooked by employers. The comments below cover some of the more common issues and are not intended to be a comprehensive list.

'Payments'

Under the termination payment and withholding provisions, an employer's obligation arises in relation to the total 'payment' made. Accordingly, a question arises regarding what constitutes a 'payment' for these purposes.

The answer is that 'payment' includes not only cash payments, but also the market value of any property transferred to the employee and any payments made by the employer to third parties at the employee's direction.

For example, if an employee's termination package includes a $150,000 cash payment and a car worth $40,000, the total 'payment' to be considered is $190,000.

Accordingly, employers need to ensure that they withhold an amount referable to not only the cash portion of a termination/redundancy package, but also to the value of property which is transferred and in relation to indirect payments made.

'Genuine redundancy payments'

Employers will often refer to termination packages as 'redundancy' packages.

However, this does not automatically mean that the payment will qualify as a 'genuine redundancy payment' for taxation purposes. This is a key distinction because the correct categorisation affects whether a portion of the payment can be treated as tax-free, as well as how the caps apply (discussed further below).

For a payment to qualify as a 'genuine redundancy payment', a number of requirements must be satisfied.

The one that employers generally focus on is whether the redundancy is a 'genuine redundancy'. In essence, this requires the position (rather than the staff member) to no longer be required by the employer. This issue has received substantial attention from the Commissioner of Taxation, and his views are outlined in Taxation Ruling TR 2009/2. Accordingly, this issue is not considered further.

However, employers often overlook the requirement that the amount paid must *also* exceed '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'.

Accordingly, if the employee is entitled to an amount regardless of whether they resign or are made redundant, the amount will not qualify as a genuine redundancy payment for these purposes. In these circumstances, the amount cannot be treated as tax-free, and will be taxed as an ETP.

For example, if under the employee's contract, they are entitled to severance payment equal to two week's pay regardless of the method of termination, this portion of their redundancy package cannot qualify as a genuine redundancy payment for tax purposes and will be taxed as an ETP.

ETP concessional treatment and the caps

As outlined above, the concessional treatment of ETPs is restricted to the amount of the cap, with the excess taxed at top marginal rate.

The application of the cap is often an area of consternation and frustration for employers as there are two caps – the 'ETP cap' (refer s. 82-10(4)(a) and (b) ITAA 97) and the 'whole-of-income cap' (s. 82-10(4)(c)) – and it is not always clear which one is to be used.

The ETP cap is a set amount that is indexed ($205,000 for the 2019 income year), adjusted for any ETPs paid earlier in the same income year (s. 82-10(4)(a) or, as the case may be, by any ETPs paid for the same termination (s. 82-10(4)(b)).

The whole-of-income cap is equal to $180,000 (unindexed) less certain taxable payments received by the employee in the same income year (including unused leave payments paid on termination). However, the amount of the ETP to which the cap is to be applied is not included in the calculation of the cap.

For example, assume an employee received the following during the year:

- **$40,000 of salary;**
- **$5,000 bonus;**
- **$30,000 of unused annual and long service leave on termination;**
- **$115,000 ETP representing a severance payment that did not qualify as a genuine redundancy payment or any other type of ETP subject to s. 82-10(6) (refer below).**

In this instance, the employee's whole-of-income cap would be $180,000 – $40,000 – $5,000 – $30,000 = $105,000.

The applicable cap is determined by reference to the type of ETP paid:

- **'Excluded' ETPs, such as the taxable portion of a genuine redundancy payment (and certain other payments also listed in s. 82-10(6) ITAA 1997), are only subject to the ETP cap.**
- **'Non-excluded' ETPs, vis. payments which are not listed in s. 82-10(6), are subject to the lesser of (i) the ETP cap/reduced ETP cap and (ii) the whole-of-income cap. Generally, the whole-of-income cap will be lower. An example of a payment which is not listed in s. 82-10(6) would be a severance payment that would have been paid even if the employee had resigned (i.e. cannot qualify as a genuine redundancy payment) and is not made as a consequence of a dispute or for personal injury.**

Note, as mentioned above, unused annual and long service leave payments are not ETPs and, therefore, the above caps have no application in relation to this portion of the payment. Instead, such unused leave payments are subject to taxation/withholding under Subdivisions 83-A and 83-B ITAA97.

Applying the above in relation to the prior example, the employee received an ETP of $115,000 plus $30,000 of unused leave on termination.

Withholding on the unused leave amount would be calculated pursuant to Subdivisions 83-A and 83-B ITAA97.

In calculating the amount of withholding on the ETP, as the amount is neither a genuine redundancy payment nor other listed payment, it would be a non-excluded ETP and the lower of the ETP cap and whole-of-income cap would apply.

As determined above, the employee's whole-of-income cap would be $105,000, which is lower than their ETP cap of $205,000 (assuming the employee did not receive any other ETP in the income year or a prior income year). Therefore, the former is the relevant cap to apply.

Applying the cap, $105,000 of the ETP will be taxed at the concessional rate, with the remaining $10,000 taxed at top marginal rate. This amount of 'tax' is the amount to be withheld by the employer in relation to the ETP.

If the above was not sufficiently complex, additional complications arise where a single ETP with excluded and non-excluded payments is paid (in which case special ordering and calculation rules apply and employers will be required to issue two ETP payment summaries).

Accordingly, applying the caps can be confusing and employers will need to take care when determining their withholding obligations.

The employee's age

Another factor employers need to consider is the employee's age. This is important for a couple of key reasons.

Firstly, if the employee is aged 65 or over at the time of dismissal, the payment will not qualify as a genuine redundancy payment, despite meeting all the other requirements. Accordingly, the payment will be taxed as an ETP. A lower age may apply in some cases, such as where the employee's employment could be terminated at that lower age.

Secondly, if the employee is aged above their preservation age at the time of the payment, then a lower concessional tax rate may apply to the ETP.

Accordingly, when calculating the withholding amount, employers must consider how the employee's age will impact the calculation.

12-month rule

The concessional treatment for ETPs is restricted to amounts paid within 12-months of the employee's employment being terminated.

For most employers, termination/redundancy packages will be paid out in entirety shortly after termination, and this rule will not need to be considered.

However, to the extent that all or part of the ETP is paid outside of the 12-month period, then the concessional treatment cannot be accessed and the payments will be taxed at the employee's marginal rates (with corresponding withholding rates for the employer).

While this issue will rarely arise, it is something of which employers should be aware.

Conclusion

The rules regarding the taxation of termination/redundancy payments, which also inform the employer's PAYG Withholding obligation, can be more complex than they initially appear and can negatively affect the net package received by the employee in unintended ways.

Accordingly, employers should carefully consider the rules and ensure that they understand all the potential traps and complexities that can arise.

Car fringe benefits: Recipient payments received after FBT year-end but before lodgement. What can I do?

Can the taxable value of a car fringe benefit be reduced by a recipient's payment that has been made after the end of the Fringe Benefits Tax (FBT) year but prior to the lodgment of the FBT return?

Under a proposed salary sacrifice agreement, an employee will be required to make a payment to their employer from their 'after tax' salary in order to reduce the taxable value of a car fringe benefit to zero.

The car is to be provided on a fully maintained basis – i.e. the employer is to pay all running costs associated with the car. As such, it is not possible for the exact amount of this payment to be calculated until after the end of the FBT year.

Sections 9 and 10 of the FBTAA provide two alternative methods for calculating the taxable value of a car fringe benefit. Both methods enable the taxable value to be reduced by the amount of the recipient's payment.

A recipient's payment is defined in paragraphs 9(2)(e) and 10(3)(c) of the FBTAA. Both definitions provide that the recipient's payment will include:

***'…* in the case where expenses were incurred to the provider or employer during the holding period by recipients of the car fringe benefits by way of consideration for the provision of the car fringe benefits – the amount of those expenses paid by the recipients less any amount paid or payable to the recipients by way of reimbursement of those expenses…'.**

This definition does not require the payment to be made by any particular time. However, the definition expressly requires that the payment by the employee must be by way of consideration for the benefit. That is, the employee must be required to make the payment in return for obtaining the benefit.

This test would be satisfied, for example, where at the time the benefit is provided, it was intended that the employee would make a future payment for the benefit equal to its taxable value as calculated before deducting the employee contribution.

By applying the above requirements to a payment by the employee in accordance with the proposed salary sacrifice agreement, it can be concluded that the payment will reduce the

taxable value of the car fringe benefit. It is sufficient that the payment will be made in accordance with a written agreement which requires the employee to reimburse their employer from their 'after tax' income.

In conclusion, the employee can make a recipient's payment after the end of the FBT year and prior to the lodgement of the FBT return in order to reduce the taxable value of the car fringe benefit provided.

GST – GSTR 2018/1: Supplied of real property connected with Australia

The ATO has released GSTR 2018/1 dealing with supplies of real property connected with Australia. While the ATO view does not appear to have changed, the ruling is a useful reminder of the need to consider relevant definitions, the characterisation of the supply and the specific facts of transactions.

The ATO recently released GSTR 2018/1 which deals with 'supplies of real property connected with the indirect tax zone [i.e. Australia]'.

Readers will recall that the concept of 'connected with the indirect tax zone' is a concept that pervades the GST Act and, most notably, is one the pre-conditions for a supply being a 'taxable supply'.

GSTR 2018/1 replaces the Commissioner's view on supplies of real property as provided in GSTR 2000/31 ('supplies connected with Australia') and replaces GSTD 2004/3 ('Is a supply of rights to accommodation a supply of real property for the purposes of the A New Tax System (Goods and Services Tax) Act 1999?').

As far as ATO rulings go, this is a relatively short ruling but is summarises some key concepts rather well, so it is worth reproducing key paragraphs below.

Paragraphs 6, 7 and 8 deal with the definition of real property:

'Supplies of real property

A supply of real property is connected with Australia if the real property, or the land to which the real property relates, is in Australia. 'Land' in this context means the physical land.

Real property is defined to include:

a. **any interest in or right over land**
b. **a personal right to call for or be granted any interest in or right over land, or**
c. **a licence to occupy land or any other contractual right exercisable over or in relation to land.**

The reference in subsection 9-25(4) to 'land to which the real property relates' means that an interest in, or right over land is connected with Australia if the physical land to which the interest or right over it relates, is in Australia. The test is the location of the land and not the location of the right.'

Paragraph 9 sets out a neat summary of the typical types of transactions dealing with real property. The final bullet point refers to rights to occupy accommodation in Australia, and paragraphs 10 and 11 expand on this concept with specific reference to tour operators.

'9. A supply of real property[5] is connected with Australia if it involves, for example:

- **the sale of land situated in Australia**
- **the grant, assignment or surrender of a lease or licence of land situated in Australia**
- **a personal right to call for or be granted any interest or right over land in Australia**
- **the grant of a put or call option over land situated in Australia**
- **a licence to occupy land in Australia, or**
- **the grant of contractual rights to occupy or stay at accommodation in Australia. This would include a stay at a hotel or motel on presentation of a voucher or travel document.[6]**

Supplies of rights to accommodation in Australia

10. There are a variety of different means by which accommodation in Australia may be provided. The supply of such accommodation, including a supply of rights to the accommodation, will be a supply of real property connected with Australia when the accommodation is in Australia. This is because the supply is:

- **the supply of a licence to occupy property situated in Australia, or**
- **a contractual right exercisable over or in relation to land situated in Australia.**

11. The supply of rights to accommodation will be a supply connected with Australia irrespective of whether it provides any actual accommodation to the guest. For example, the supplier could be a tour operator which grants a traveller the right to stay at a hotel in Australia, where the hotel is operated by a different entity.[7] The tour operator is making a supply of rights to accommodation in Australia which is a supply of real property connected with Australia.'

We have left the footnote references in the above extract, as one of the comments made in the Ruling Compendium for this ruling (GSTR 2018/1EC) in relation to paragraph 10 is that it only provides some examples but does not provide any clarity regarding whether transactions such as (i) a licence to use a corporate box, (ii) a booth at a convention, or (iii) a ticket to enter a stadium, would be a supply of real property. Footnote 5 makes reference to comments in GSTR 2003/7 which deals with the characterisation of a supply of real property.

For instance, GSTR 2003/7 notes the supply of a ticket to attend the cinema or a sporting event is not characterised as a supply of real property:

'*Purchase of a ticket to obtain entry to a cinema or sporting event*

103. The dominant part of the supply is the presentation of the event or film and the permission to enter upon the land and occupy a particular seat is ancillary. This is not a supply of real property.'

Understanding the Transaction/Facts

As noted above, it is important to identify the true characterisation of the supply and determine the precise contractual terms between the parties. This concept and approach is significant when dealing with transactions taxes such as the GST.

In this regard, and by way of example, we note that paragraph 10 makes reference to two different types of supplies: (1) the supply of the actual accommodation, and (2) the supply of rights to the accommodation.

1. Supply of Accommodation

In the context of a hotel room, the only entity that can supply the actual accommodation is the hotel operator. As referred to in paragraph 10, when a customer makes a booking at a hotel the supply made by the hotel operator is either the supply of a licence to occupy property located in Australia or a contractual right exercisable over land situated in Australia.

If the hotel operator makes a supply of a hotel room through an agent, the nature of the supply does not change – the supply of the actual accommodation will still be done by the hotel operator. However, such a supply would be made through or via the agent. This outcome will be the same irrespective of whether the agent is acting on behalf of the hotel or the customer.

The agent would be making a separate supply being a supply of agency services.

2. Supply of Rights to Accommodation

While it is not the purpose of this brief article to review the specific terms and conditions of each different arrangement, broadly it could be said that where hotel room bookings are made via online hotel sites (such as: wotif, Expedia, trivago, *etc.*), would be examples of the supply of rights to accommodation (rather than a supply of accommodation).

Assuming these supplies are made by the relevant parties in their capacity as principals (and not as agents), the supply of such rights would typically be made as follows:

- **The hotel supplies a right to accommodation to the booking site;**
- **The booking site makes a supply of rights to the ultimate customer;**
- **The ultimate customer calls upon this right by turning up to the hotel and being accommodated.**

Conclusion

While the ruling does not appear to make any substantive change to the ATO view, the approach adopted in the ruling regarding the need to understand the underlying definitions, the characterisation of the supply, and the different types of transactions remind and highlight the need to understand the specific transaction being entered into. Once these components are understood, the law can be applied and the GST implications determined.

General – Should we apply for an ATO Class Ruling?

Last month, we discussed the positives and negatives of applying for Private Rulings. Where a specific tax issue affects a group of taxpayers, it may be more effective to apply for a Class Ruling. This article identifies the key considerations for members seeking a Class Ruling.

FBT, GST and other tax issues can be complex and can cause confusion about compliance requirements.

We previously published an article discussing the use of Private Rulings to address this uncertainty.

Sometimes, specific issues can affect a group of taxpayers. Rather than each individual taxpayer applying for their own Private Ruling, the group may prefer to apply for a Class Ruling.

Unlike Private Rulings, Class Rulings are a form of public ruling. Public rulings are binding, so all parties will be bound by the ruling. Class Rulings disclose the name of the parties to which the ruling applies and a description of any agreements, deeds and transactions that are relevant to the ruling. Express consent needs to be obtained from all parties that will be named in the Class Ruling. A Private Ruling would be preferable for taxpayers that would like to keep these details private.

It is important to remember that Class Rulings are binding. However, you can ask to withdraw your Class Ruling application at any time before it is published. Also, the ATO will send you a draft ruling that needs to be approved before it can be published and relied upon by the parties involved.

Class Rulings explain the application of tax law to a scheme that applies to a specific group of taxpayers. Seeking a Class Ruling can be useful in the following scenarios:

- **State or territory councils seeking advice on the tax treatment of council fees and charges.**
- **Employers seeking advice on the tax consequences of schemes that relate to a particular class of employee. Schemes may include redundancy plans and share acquisition plans.**
- **Companies seeking advice on the tax implications for shareholders of restructures, share consolidations or share splits.**

In summary:

Advantages

- **It can be more cost efficient for a group of taxpayers to apply for a Class Ruling rather than each individual taxpayer applying for a Private Ruling.**
- **A favourable ruling provides certainty to all parties of the Class Ruling.**
- **Class Ruling applications can be withdrawn at any time before publication.**
- **A Class Ruling will not be published unless the applicant approves the draft ruling provided by the ATO. The Class Ruling cannot be relied upon by the parties involved unless it is published.**

Disadvantages

- **Class Rulings are public. Information including the names of parties, details of the scheme including agreements, deeds and transaction will be published.**
- **Class Rulings are binding, even if the result is unfavourable.**

Comments and Examples

While published Class Rulings can only be relied on by the specific parties (or class of taxpayers) referred to in the ruling, they can also be a useful tool to other similar taxpayers. While these other taxpayers may not technically be able to rely on the Class Ruling, such rulings would still provide useful guidance to such taxpayers.

Below we have included a brief list of some Class Rulings that have been issued, and due to the nature of the content of the ruling or the class of taxpayers these may be of general interest and guidance to TaxEd members.

CR 2015/67 – Goods and services tax: GST treatment of waste management services supplied by NSW councils

This Class Ruling applies to all councils that are members of the Shires Association of NSW and Local Government Association of NSW.

CR 2010/24 – Income tax: early retirement scheme – Sunshine Coast Regional Council

This Class Ruling applies to the employees of Sunshine Coast Regional Council receiving an early retirement scheme payment.

CR 2013/1 – Goods and services tax: the GST treatment of rates and annual charges levied by NSW councils

This Class Ruling applies to all councils that are members of the Shires Association of NSW and Local Government Association of NSW.

CR 2013/13 – Goods and services tax: GST treatment of developer contributions and other dedications of land made to NSW councils

This Class Ruling applies to all councils that are members of the Shires Association of NSW and Local Government Association of NSW.

[*Editor's Note:* If you have an issue that would benefit from a ruling and you consider the issues would be applicable to a range of similar taxpayers (e.g. councils or not-for-profits), feel free to contact TaxEd and we can advise or assist in determining whether a Class Ruling may be a viable option.]

FBT Q&A – Gifts made to your employees by third parties

Question

1. Our employees sometimes receive gifts from third party organisations such as suppliers, contractors and cultural/arts/sports/professional association bodies. Gifts received can be tickets to theatre performance/sport event/professional forum, lunches, a box of chocolates, a bottle of wine *etc.*

These gifts are recorded in a gift register with estimated values and signed by divisional managers. However, we do not have any arrangement with the third parties for gifts to be provided to our employees. What would be the FBT implication of these gifts?

Answer

For the gifts to be a fringe benefit the definition of fringe benefit in subsection 136(1) of the FBTAA requires the benefit to be provided by one of the following:

- **the employer;**
- **an associate of the employer;**
- **a person other than the employer, or associate of the employer under an arrangement covered by paragraph (a) of the definition of 'arrangement' between (i) the employer, or an associate of the employer and (ii) the arranger or another person; or**
- **a person other than the employer or an associate of the employer if the employer or associate (i) participates in or facilitates the provision or receipt of the benefit, or (ii) participates in, facilitates or promotes a scheme or plan involving the provision of the benefit and, in either case, the employer, or associate knows or ought reasonably to know that the employer or associate is doing so.**

Paragraph (a) of the definition of 'arrangement' in subsection 136(1) of the FBT Act states the term means:

'any agreement, arrangement, understanding, promise or undertaking, whether express or implied, and whether or not enforceable, or intended to be enforceable, by legal proceedings'.

Accordingly, a fringe benefit will not arise unless there is an agreement of some kind between the employer and a third party. The gifts in your scenario do not appear to meet this condition and so FBT liability should not arise.

Alternatively, in order for FBT liability to arise, it must be the case that you, as the employer:

- **participate in or facilitate the provision or receipt of the gift; or**
- **participate in, facilitate or promote the scheme involving the provision of the gift:**

and, in either case:

- **know or ought reasonably to know that you are so participating, facilitating or promoting the benefit.**

Once again, this does not appear to be the case based on the background facts you have provided.

FBT Q&A – A list of salary-sacrifice benefits?

Question

We are an FBT taxable employer seeking a list of salary sacrificing benefits and limits available to employees, and what FBT implications there may be.

From an FBT and income tax perspective there is no restriction on the types, or amounts, of benefits that can be salary sacrificed by an employee. Refer to Taxation Ruling TR 2001/10 for further guidance.

Answer

As an FBT taxable employer, you are not eligible for the FBT capping thresholds. In consequence, any salary sacrifice arrangement, as a general rule, should be structured in the following order:

1. **Exempt benefits – for example:**

- **Portable electronic devices;**
- **Computer software;**
- **Protective clothing;**
- **Tools of the trade;**
- **Briefcases;**
- **Airport lounge memberships;**
- **Relocation costs; or**
- **Superannuation (be careful not to exceed employees concessional contributions cap – currently $25,000 per annum).**

2. **Otherwise deductible benefits – for example:**

- **Self-education courses and conferences; or**
- **Investment loan interest.**

3. **Concessionally taxed benefits – for example:**

- **Cars;**
- **Living away from home benefits; or**
- **Certain remote area concessions.**