

Taxing Times: Getting taxation of termination payments right

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Abstract

Where a lump sum is paid on termination of employment there are a number of tax consequences that may arise. The tax treatment of a lump sum will depend on the circumstances surrounding the payment and what the payment refers to. In some circumstances a lump sum will give rise to tax treatment that is concessional in nature while in other circumstances the tax treatment of the lump sum will be more in the nature of a penalty. This paper discusses the circumstances in which a lump sum may arise and explores the nature of the tax treatment that applies in each circumstance from the perspective of both the employee and the employer.

Introduction

Despite some early signs of economic recovery, rising unemployment is the current trend in Australia.¹ This requires careful consideration of the payment of lump sum amounts on termination of employment as the rising unemployment figures belie the tax effects of the termination payments arising in this economic environment. A number of different circumstances may arise in which a lump sum is paid on termination of employment. The circumstances in which such a payment is made will dictate the tax treatment of the payment. In some circumstances this treatment will be concessional in nature. In other circumstances the tax treatment will constitute more of a penalty. The most common treatment of a lump sum will arise where a payment is made 'in consequence of the termination of employment' which constitutes an employment termination payment. This is not, however, the only treatment that will apply to a lump sum relating to termination of an employee's employment. The specific treatment that applies will depend on a number of factors that affect the payment. These factors may be such things as the circumstances in which the payment is made, what the payment relates to and the age of the employee at the time of the payment. Consideration of these factors will lead to the correct tax treatment of the amount. This paper discusses the circumstances in which a lump sum may arise and explores the nature of the tax treatment that applies in each circumstance from the perspective of both the employee and the employer. The importance of this issue in the current environment of rising unemployment cannot be understated as it is vital, from the perspective of both the employee receiving the payment and the employer making the payment that the correct amount of tax payable is determined on lump sum termination payments.

¹ *Rising unemployment will be around for a while: Rudd* (2009) Australian Financial Review <http://www.afr.com/home/viewerSearch.aspx?ATL://1249969164837&keywords=unemployment+data> at 18 August 2009

Employment termination payment

Many of the lump sum payments paid when an employee terminates their employment will be subject to concessional tax treatment as they will constitute an employment termination payment (ETP) for the purposes of the *Income Tax Assessment Act 1997* (ITAA 1997). From 1 July 2007 the provisions relating to employment termination payments are contained in Div 82 ITAA 1997 having been rewritten and substantially simplified from the earlier provisions contained in Subdiv AA of Div 2 of Pt III *Income Tax Assessment Act 1936* (ITAA 1936). The earlier provisions referred to eligible termination payments and contained lengthy and complicated rules whereby such payments consisted of eight possible components. These components were subject to complicated rules and 'intricate calculations'² resulting in a system that was complex and difficult to work with. This complexity constituted one of the reasons underlying the rewrite of the provisions³ although this was part of a bigger project involving the simplification and revision of a whole raft of provisions relating to superannuation and termination payments. Payments covered by the ETP provisions are those that arise in consequence of the termination of an employee's employment.⁴ This term has been considered in a number of cases⁵ with interpretation being broad enough to cover most payments made by an employer where termination of employment is one of the factors giving rise to the payment being made.

Judicial Consideration

Judicial consideration of the term 'in consequence of' the termination of employment has been such that the termination of employment need not even be the dominant cause of the payment. A payment will still be considered to be in consequence of the termination of employment where it is one of several reasons for the payment arising.⁶ In fact, it was recognised by Gibbs J in *Reseck v FCT* (1975) 133 CLR 45 (*Reseck*) that termination payments are often made as a result of a number of different circumstances in addition to that of retirement. These circumstances may include the provision of satisfactory service while employed or payments made subject to the provisions of an industrial award. What is important is that the payment must 'follow on' as a result of the termination of the employment. Justice Gibbs discussed the issue of the term 'follow on' in *Reseck* at p51 considering that:

Within the ordinary meaning of the words, a sum is paid in consequence of the termination of employment, when the payment follows on as an effect or result of the termination.

² Woellner R et al, *Australian Taxation Law*, (18th ed, 2008) p 188.

³ Wollner R, et al, n 2, p 188.

⁴ *Income Tax Assessment Act 1997* (Cth), s82-130(1)(a)(i).

⁵ See *Reseck v FCT* (1975) 133 CLR 45, *McIntosh v FCT* (1979) 10 ATR 13.

⁶ *Reseck v FCT* (1975) 133 CLR 45, 51.

Justice Jacobs also discussed the concept of 'following on' in the *Reseck* case although his comments, on the face of them, seem to have a slightly different focus to Gibbs J as Jacobs J stated that:

It was submitted that the words 'in consequence of' import a concept that the termination of employment was the dominant cause of the payment. This cannot be so. A consequence in this context is not the same as a result. It does not import causation but rather a 'following on'.⁷

The term 'in consequence of' was further considered in the later case of *McIntosh v FCT* (1979) 10 ATR 13 (*McIntosh*) in the Full Federal Court. In this case Brennan J considered that although the comments made by Jacobs J were made 'in different terms' they were not 'significantly different'⁸ in meaning to those made by Gibbs J. Consequently, it can be argued that the court is settled in that the requirement is that there exists some nexus between the incidence of retirement and the payment made for the provisions to apply and any concessional treatment to be obtained.

The term in consequence of has been retained in the latest legislation considering employment termination payments with employment termination payments now being separately treated depending on whether they arise while the employee is still alive or after the employee's death.

Life Benefit Termination Payment

Differing tax treatment applies for lump sum payments that constitute ETP's depending on whether the amount is received by a taxpayer that is still living or whether the payment is received in consequence of the termination of employment due to the death of the employee. A payment made in consequence of the termination of employment while the employee is still living is referred to as a life benefit termination payment.⁹ Unlike the earlier treatment of eligible termination payments which could potentially consist of eight different components, from 1 July 2007 life benefit termination payments only consist of two components. These two components are the tax free component and the taxable component.

Tax free component

The tax free component is made up of two of the former components of the eligible termination payment which are the pre-July 1983 segment and the invalidity segment.

The invalidity segment of the tax free component is determined under the provisions in s82-150 ITAA 1997. These provisions require that an invalidity segment be included where an employee stops being gainfully employed due to ill health prior to their normal date of retirement. This is referred to as the last retirement day. The ill health may constitute physical or mental ill health and must be certified by two legally qualified

⁷ *Reseck v FCT* (1975) 133 CLR 45, 56.

⁸ *McIntosh v FCT* (1979) 10 ATR 13, 16.

⁹ *Income Tax Assessment Act 1997* (Cth), s 82-130(2).

medical practitioners. Such certification must be to the extent that the employee can no longer be gainfully employed in the capacity for which he or she is reasonably qualified because of education, experience or training. Calculation of the invalidity segment is then detailed in s82-150(2) by a formula multiplying the amount of the ETP by the number of days from the termination of employment to the normal date of retirement divided by the number of days to which the employment relates added to the days to retirement. This invalidity segment constitutes part of the tax free component of the payment therefore no tax will be levied on this part of the payment.

The pre-July 1983 segment relates to the portion of the payment relating to employment that occurred prior to 1 July 1983. Calculation of this segment is set out in s82-155(2) ITAA 1997 as consisting of two steps. The first step requires the separation of the invalidity segment from the payment by subtracting this invalidity segment from the ETP. The second step requires the remaining amount to be multiplied by a fraction consisting of the number of days of employment relating to the payment that occurred before 1 July 1983 divided by the total number of days to which the payment relates. Once calculated, this segment of the payment then constitutes an amount of non-assessable non-exempt income which is therefore not included in the assessable income of the taxpayer.¹⁰

Taxable component

The taxable component of a life benefit termination payment is the amount left over after subtracting the tax free component from the total of the payment. The treatment of this component differs according to the age of the employee receiving it. The age of the employee is considered as being under preservation age or over preservation age. Preservation age is currently determined to be 55 but this is being increased over time so that by 2025 the preservation age will be 60 for those born after 30 June 1960.¹¹ This component is included in assessable income but it is subject to a tax offset operating to limit the tax rate that applies. The operation of the offset is determined by the ETP cap amount applying to payment. The ETP cap amount is set at \$150 000 in 2009/10 and this amount is indexed in \$5 000 increments.¹²

For those who receive an ETP when they are over preservation age the amount under the ETP cap amount will be subject to a tax offset to ensure that maximum rate of tax is 15%. Any amount over the ETP cap amount will be subject to tax at the top marginal rate. Those receiving an ETP when under preservation age will be subject to a less concessional tax offset on the amount under the ETP cap amount to ensure that the maximum rate is limited to 30%. Any amount exceeding the \$150 000 cap will be subject to a 45% rate. The Medicare levy of 1.5% will also apply to

¹⁰ Deutsch, R, *Australian Tax Handbook* (2008), 316.

¹¹ *Superannuation Industry (Supervision) Regulations* 1994 (Cth), reg 6.01(2).

¹² *Income Tax Assessment Act 1997* (Cth), s960-285.

amounts over 0% thus effectively increasing the maximum rate on those amounts by an additional 1.5%.

The operation of the taxing regime to the amount over the ETP cap amount will be such that this amount will be split from the rest of the taxable income and referred to as the employment termination remainder.¹³ The amount under the ETP cap will be treated as ordinary taxable income and taxed under the ordinary scale as if it were the only taxable income. The employment termination remainder will be taxed separately at the top marginal rate.¹⁴

12 month rule

There is a restriction applying to life benefit termination payments in terms of the time within which they must be paid. This qualification allows for the concessional treatment of employment termination payments to apply only to those payments received within 12 months of the termination.¹⁵ This may be extended in such circumstances as the Commissioner considers that the time that has elapsed is reasonable.¹⁶ The Commissioner has issued a determination in relation to these provisions providing that an exemption from the 12 month rule will apply to legal disputes in relation to termination.¹⁷ A payment which falls outside the 12 months will either be treated as ordinary income and therefore included in assessable income and taxed at marginal rates or treated as a payment of capital and therefore excluded from assessable income.¹⁸

Transitional arrangements

Prior to 1 July 2007 ETP's were able to be rolled over into superannuation and therefore retain their concessional treatment until such time as they were taken out of superannuation. Under the arrangements discussed above this option is no longer available. ETP's must now be taken in cash and taxed in the above manner. However, as this was a major change from the previous treatment it was feared that this would affect people's retirement plans and encourage people out of the workforce prematurely to take advantage of the more concessional treatment available under the previous regime. To counter these fears transitional arrangements have been put in place for entitlements that arise from 9 May 2006. These arrangements apply to termination payments made under a written

¹³ *Income Tax Rates Act 1986* (Cth), s3.

¹⁴ *Income Tax Rates Act 1986* (Cth), Pt I, Sch 7.

¹⁵ *Income Tax Assessment Act 1997* (Cth), s82-130(1)(b).

¹⁶ *Income Tax Assessment Act 1997* (Cth), s82-130(4) – (8).

¹⁷ *Employment Termination Payments (12 month rule) Legislative Instrument 2007*, registered 16 November 2007.

¹⁸ Deutsch R et al, above n 10, p 314.

contract, legal instrument or workplace agreement where the person has an entitlement as at 9 May 2006 and that payment is made prior to 1 July 2012.¹⁹

As with the new provisions the taxable component is included in the taxable income of the taxpayer but subject to a tax offset to limit the maximum rate of tax. However, the limits in relation to the transitional provisions are much more generous than those available under the new provisions. In addition, these payments may be rolled over into superannuation until 30 June 2012, referred to as a directed termination payment, an allowance that is no longer available under the new provisions. The more generous allowances that are available under these provisions are for those aged over preservation age a 15% limit applies to amounts under the ETP cap amount of \$150 000. For amounts between \$150 000 and \$1 000 000 a 30% rate limit applies and the top marginal rate does not apply until the payment is over \$1 000 000. This is a substantial concession compared to the new provisions. For those aged under preservation age a 30% limit applies to amounts up to \$1 000 000 with the top marginal rate of 45% applying to amounts above that cap. As mentioned previously the Medicare levy of 1.5% will also apply in addition to these rates.

An employment termination payment that is received upon the death of an employee is referred to as a death benefit termination payment.²⁰ These payments will arise in consequence of the termination of employment in circumstances where the payment is being made to relatives upon the death of an employee.

Death Benefit Termination Payment

The taxation consequences of death benefit termination payments will differ depending on whether they are received by a dependant of the deceased or by someone who is classified as a non-dependant of the deceased. A death benefits dependant in relation to these provisions may be a spouse or former spouse of the deceased, a minor child of the deceased or a person who had an interdependency relationship with the deceased.²¹ Any person who was a dependant of the deceased just before death will also constitute a death benefits dependant. Dependant in this case refers to the ordinary meaning of the term which includes someone who was financially dependant on that person.²²

These death benefit termination payments will consist of a tax free component and a taxable component, as do life benefit termination payments, with the tax free component being made up of the pre-July 1983 segment and the invalidity segment as detailed above. In addition, the taxable component of a death benefit termination payment paid to a

¹⁹ *Income Tax (Transitional Provisions) Act 1997* (Cth), Div 82.

²⁰ *Income Tax Assessment Act 1997* (Cth), s82-130(3).

²¹ *Income Tax Assessment Act 1997* (Cth), s302-195.

²² *AAT Case [1999] AATA 678, Re Malek and FCT 42 ATR 1203.*

dependant will be subject to a tax offset effectively making the payment tax free up to the ETP cap amount of \$150 000. Any amount over this ETP cap amount will be subject to tax at the top marginal rate plus Medicare levy. The taxable component of a death benefit termination payment paid to a non-dependant of the deceased will be subject to an offset limiting the tax rate to 30% plus the Medicare levy for the amount up to the ETP cap amount. Again, the amount exceeding this ETP cap amount of \$150 000 will be subject to tax at the top marginal rate of 45% plus Medicare levy making the total rate of tax on this amount 46.5%.

Where the death benefit termination payment is paid to the trustee of a deceased estate and that payment is made on behalf of another person the payment will be taxed as if it had been paid to that other person.²³ This has the effect of applying the treatment applicable to either a dependant or a non-dependant to the trustee as the case may be.²⁴

Wrongful dismissal

Termination payments that arise as a result of an employment dispute such as in the case of unlawful or wrongful dismissal give rise to some uncertainty as to their treatment.²⁵ These payments will generally be characterised as employment termination payments as they are made in consequence of the termination of employment.²⁶ Such payments will therefore be subject to the rates dictated by the ETP provisions. However, there is some argument that this treatment, rather than being concessional in nature, actually amounts to a penalty, as these payments would otherwise constitute amounts of capital and therefore be exempt from tax under the capital gains tax regime.²⁷

Discussion of the application of the term 'in consequence of' the termination of employment was applied earlier in this paper. The application of this term to settlement disputes for wrongful dismissal arose in the Federal Court case of *Le Grand v Federal Commissioner of Taxation* (2002) 51 ATR 139 (*Le Grand*). The taxpayer in this case argued that a lump sum payment made in compromise for a claim for wrongful termination was not an ETP as it was paid as a consequence of the settlement of litigation rather than as a consequence of the termination of employment. Following consideration of authority in the preceding cases Goldberg J stated:

I do not consider that the issue can be simply determined by seeking to identify the "occasion" for the payment. The thrust of the judgements in *Reseck* and *McIntosh* is rather to the effect that a payment is made "in consequence" of a

²³ *Income Tax Assessment Act 1997* (Cth), s82-75.

²⁴ *Income Tax Assessment Act 1997* (Cth), s82-75(2), s82-75(3).

²⁵ Deutsch et al, above n 10, 316.

²⁶ *Le Grand v FCT* (2002) 51 ATR 139.

²⁷ Celeste Black, 'Employment Disputes: The Implications of Taxing of Settlement Receipts as Eligible Termination Payments' (2007) 10 *Journal of Australian Taxation* 1, 2.

particular circumstance when the payment follows on from, and is an effect or result, in a causal sense, of that circumstance.²⁸

In applying that test to the facts *Goldberg J* held:

I am satisfied that the payment was an effect or result of that termination in the sense that there was a sequence of events following the termination of the employment which had a relationship and connection which ultimately led to the payment.²⁹

The approach adopted by *Goldberg J* in *Le Grand* was affirmed in the Full Federal Court decision in *Dibb v Federal Commissioner of Taxation* (2003) 53 ATR 290. Taxation Ruling TR 2003/13 refers to these cases and confirms this approach has been adopted by the Commissioner.

Unused leave

Where an employee has their employment terminated and a lump sum is paid out for unused annual leave or unused long service leave these amounts are specifically excluded from the definition of an employment termination payment.³⁰ These amounts attract specific treatment under the ITAA 1997 with provisions that were also rewritten with application from 1 July 2007.

An unused annual leave payment is defined in s83-10(3) ITAA97 as being a payment that is made for annual leave that has not been used, including a bonus paid for such a purpose. An unused annual leave payment for these purposes includes amounts that the employee was not entitled to at the time of termination of employment but which would have become available at some later time if the employment had not been terminated, such as pro rata payments which only become available once a particular service requirement has been satisfied.³¹ The general rule for unused annual leave payments is that they are included in assessable income and taxed at marginal rates. However a tax offset is available to limit the rate of tax that applies to the portion of the payment that consists of a genuine redundancy payment, an early retirement scheme payment or the invalidity segment. This tax offset also applies to the portion of the payment that was made in respect of employment prior to 18 August 1993 with a formula provided for determining the amount applicable to this period.³² The tax offset limits the amount of tax paid in respect of these amounts to 30%.³³ Although with the passing of time the situations in which this will apply are becoming less likely.

²⁸ *Le Grand v FCT* (2002) 51 ATR 139, 148.

²⁹ *Le Grand v FCT* (2002) 51 ATR 139, 148.

³⁰ *Income Tax Assessment Act 1997* (Cth), s82-135.

³¹ Deutsch et al, above n 10, p 326.

³² *Income Tax Assessment Act 1997* (Cth), s83-95.

³³ *Income Tax Assessment Act 1997* (Cth), s83-15.

Where a payment made on termination of employment includes an amount representing unused long service leave the taxation treatment of this amount is prescribed in Subdiv 83-B ITAA1997. An unused long service leave payment is a payment representing long service leave that has not been used. Similar conditions apply to those applying to annual leave payments including those amounts which the employee is not entitled to just before the termination of employment but which would have become available at a later date if the employment had not been terminated.³⁴ The treatment of the payment is determined by the period to which the payment relates and the classification of the payment.³⁵ Amounts which relate to a genuine redundancy payment, early retirement scheme payment or invalidity payment which relate to employment prior to 15 August 1978 will have only 5% of the amount included in the employee's assessable income and taxed at marginal rates. The remaining 95% of these amounts will be received tax free. Amounts which relate to a genuine redundancy payment, early retirement scheme payment or invalidity payment in relation to employment after 15 August 1978 will be fully included in assessable income but subject to a tax offset limiting the rate to 30%. Similar treatment will apply to any other amounts of unused long service leave paid in relation to employment between 16 August 1978 and 17 August 1993. Any amount relating to employment after 18 August 1993 that is not in respect of one of the abovementioned schemes will be fully included in assessable income with no concessions applying. That is, such amounts will be taxed at the applicable marginal rate.

Foreign termination payments

Lump sums paid on termination of employment in a foreign country are excluded from the definition of an employment termination payment.³⁶ These payments will be received free of Australian tax when received by a foreign resident.³⁷ Australian residents may also receive such payments free of tax subject to certain conditions.³⁸ The treatment of these payments has been rewritten from 1 July 2007 but not substantially changed. Amounts received in relation to foreign service should therefore be clearly recognised as such upon payment to ensure tax free treatment as undifferentiated lump sums which do not clearly show the amounts relating to the period of foreign service may be denied the tax free concessions available to these amounts.³⁹

Redundancy

Where an employee is paid a lump sum due to their position within an organisation becoming redundant concessional treatment may apply.

³⁴ *Income Tax Assessment Act 1997* (Cth), s83-75.

³⁵ *Income Tax Assessment Act 1997* (Cth), s83-80.

³⁶ *Income Tax Assessment Act 1997* (Cth), s82-135(f).

³⁷ *Income Tax Assessment Act 1997* (Cth), s83-235.

³⁸ *Income Tax Assessment Act 1997* (Cth), s83-240.

³⁹ *AAT Case [2006] AATA 980* 65 ATR 415.

Such concessions apply where a payment is made in consequence of dismissal of an employee where such an employee has been made genuinely redundant under the terms of the provisions.⁴⁰ Such payment must also be more than the amount such an employee could expect to be paid in the event of a voluntary termination of employment.

There are a number of conditions set out in the legislation that must be met for the concessional treatment to apply.⁴¹ Conditions apply to the time of dismissal where the employee must be dismissed prior to turning 65 or prior to the date which would be considered the normal retirement age of the employee.⁴² Conditions also apply to the relationship between the employer and employee such that payments should be made at arm's length and where this condition does not apply the payment cannot exceed an amount that would be paid if the payment was made at arm's length.⁴³ Further conditions also require that there must not be any arrangement made for future employment of the employee after such time as the dismissal has occurred.⁴⁴ Where these conditions are met the treatment of the redundancy payment will consist of an amount that is tax-free and an amount that is taxable.

The tax-free amount will be determined by a formula contained in the legislation which consists of a base amount and an amount that varies according to the length of time that the employee has worked for that employer. The formula as contained in s83-170(3) ITAA97 is:

$$\text{Base amount} + (\text{service amount} \times \text{years of service})$$

The elements of the formula are indexed annually with the base amount and the service amount being set out in the legislation. For 2009/10 these amounts are \$7 732 and \$3 867 respectively. The tax-free amount will therefore increase in proportion to the length of time that an employee has been in the service of the organisation.

The remaining portion of the payment relating to a redundancy will be assessable for tax purposes with the provisions relating to employment termination payments to apply as this constitutes a payment 'in consequence of the termination of employment'.

Early retirement

Where an employee enters into premature retirement by way of a scheme by an employer which gives rise to a lump sum payment, similar provisions as those applying to genuine redundancy payments will apply. These provisions cover a situation referred to as an early retirement

⁴⁰ *Income Tax Assessment Act 1997* (Cth), s83-175.

⁴¹ *Income Tax Assessment Act 1997* (Cth), s83-175 (2).

⁴² *Income Tax Assessment Act 1997* (Cth), s83-175 (2)(a).

⁴³ *Income Tax Assessment Act 1997* (Cth), s83-175 (2)(b).

⁴⁴ *Income Tax Assessment Act 1997* (Cth), s83-175 (2)(c).

scheme. An early retirement scheme is set out in s83-180(3) ITAA97 as requiring the following:

- The scheme must apply to all employee's of the employer who comprise such a class of employees as the Commissioner approves may participate in the scheme; and
- The purpose of the employer in putting the scheme in place must be to rationalise or re-organise the operations of the employer by making changes as approved by the Commissioner; and
- The scheme must be approved in writing by the Commissioner as an early retirement scheme prior to the implementation of the scheme.

Where these requirements are not met the Commissioner may nevertheless exercise his discretion to approve the scheme as an early retirement scheme, by written instrument before the scheme is implemented, where it is believed that such special circumstances exist as make it reasonable to approve the scheme⁴⁵. The conditions that were detailed above in the discussion relating to the genuine redundancy scheme in relation to timing of the payment, conditions of the payment and re-employment of the employee also apply to these early retirement scheme payments⁴⁶. Similarly, when these conditions apply, early retirement scheme payments will be broken up into a tax-free portion, determined using the formula outlined above, and a taxable portion which will be assessable as an ETP. Payments in relation to premature retirement which do not meet the conditions to constitute an early retirement scheme payment will be assessable as ETP's as they constitute payments arising in consequence of the termination of employment. Thus, some element of concessional treatment applies to these payments.

Other considerations

While there may be income tax concessions available to employees when they receive lump sums on termination of employment consideration needs to be given to additional tax consequences that affect these payments from the perspective of the employer. Employers paying these lump sums may also have to take into account the operation of the PAYG withholding provisions and the operation of the payroll tax provisions in the State or Territory in which they operate.

The PAYG withholding system is set out in Sch 1 of the *Taxation Administration Act 1953* (TAA) with the aim of facilitating the efficient and timely collection of a number of different taxes and certain social security liabilities. Payments to employees and contractors⁴⁷ are included in the PAYG withholding system with ETP's⁴⁸ and payments for unused leave

⁴⁵ *Income Tax Assessment Act 1997* (Cth), s83-180(4).

⁴⁶ *Income Tax Assessment Act 1997* (Cth), s83-180(2).

⁴⁷ *Taxation Administration Act 1953* (Cth), s12-35.

⁴⁸ *Taxation Administration Act 1953* (Cth), s12-85.

payments⁴⁹ constituting specific inclusions. A discussion of the definition of an employee is outside the scope of this paper however if a lump sum payment is made to an employee that constitutes salary or wages or comes within the other specific inclusions discussed the PAYG provisions will apply. This will require the employer to withhold tax from the payment as calculated under Div 15⁵⁰ at the time the payment is made.⁵¹

The payment of a lump sum amount on termination may also have an effect on the pay-roll tax liability of an employer. Where an employer is liable for pay-roll tax because the taxable wages exceed the relevant threshold then the payment of a lump sum on termination of employment will contribute to the amount of taxable wages on which their liability is determined. The concept of wages has an extended meaning for pay-roll tax purposes and termination payments⁵² are specifically included as wages. The termination payments referred to include employment termination payments but are also extended to include other payments on termination of employment including unused leave payments.⁵³ This would therefore extend to the lump sum payments on termination of employment that have been discussed in this paper.

Conclusion

A number of circumstances may arise where an employee is paid a lump sum on termination of employment. These circumstances may trigger the operation of the income tax provisions for an employee, requiring the amount to be included in assessable income as ordinary income or as amounts of capital that are included as statutory income. This will provide for a situation where the treatment is considered concessional for some lump sum amounts while for other amounts the tax treatment will be considered to be harsh. Payment of these lump sum amounts will also give rise to tax consequences for the employer paying the lump sum where the operation of the PAYG withholding tax provisions and the relevant pay-roll tax provisions will need to be taken into account.

⁴⁹ *Taxation Administration Act 1953* (Cth), s12-90.

⁵⁰ *Taxation Administration Act 1953* (Cth).

⁵¹ *Taxation Administration Act 1953* (Cth), s16-5.

⁵² *Payroll Tax Act 2007* (NSW), s28.

⁵³ *Payroll Tax Act 2007* (NSW), s27.