Global Watch
International Assignment Services

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Australia

Employment Termination Payment reforms to “golden handshakes”

In Brief
The Government has now introduced a Bill into Parliament which proposes adverse tax changes to certain “golden handshakes”. The Federal Treasurer announced the changes to Employment Termination Payments (ETPs) in the Budget Speech on May 8, 2012.

Employment Termination Payments
An ETP is made as a consequence of termination of employment. It is compensation for employees whose employment is terminated due to redundancy, early retirement, invalidity and many other reasons. ETPs also include death benefits, retirement gratuities and separation payments. ETPs are eligible for “tax offset” concessions such that tax on the first A$175,000 is taxed at no more than 31.5% and 16.5% for persons aged 55 and over. Above the “ETP cap”, the tax rate is fixed at 46.5%.

Generally it is high income earners who are perceived to benefit most from “golden handshakes”.

The Government therefore wishes to impose a “whole of income” test whereby that part of a “golden handshake” which exceeds the A$180,000 whole of income test will be denied the ETP concession and taxed at 46.5%. Redundancy, early retirement, invalidity and death benefits will be exempted from the new rules as well as certain employment-related dispute payments.

The Announcements
The Federal Treasurer announced in the Federal Budget Speech on May 8, 2012, the Government will better target tax breaks for golden handshakes. To reduce this concession, which currently provides a greater benefit to high income earners, the tax break will only apply to that part of a payment that, when combined with other taxable
income, does not exceed A$180,000.

Budget Paper No 2 provided more detail stating that from July 1, 2012, only that part of an affected ETP, such as a golden handshake, that takes a person’s total annual taxable income (including the ETP) to no more than A$180,000 will receive the ETP tax offset. Amounts above this-whole-of-income cap will be taxed at marginal rates. The whole of income cap will complement the existing ETP cap (A$175,000 in 2012-13 indexed) which ensures that ETPs up to the ETP cap are taxed at a maximum tax rate of 15% for those over preservation age and 31.5% for those under preservation age.

Treasury stated “existing arrangements will be retained for certain ETPs relating to genuine redundancy (including those aged 65 and over), invalidity, compensation due to an employment-related dispute and death.

Tax Laws Amendment (2012 Measures No.3) Bill 2012 was introduced to Parliament on May 24, 2012 and Schedule 5 contains the changes to employment termination payment offset rules in Division 82 of the Income Tax Assessment Act 1997.

In detail (the Explanatory Memorandum explains the changes and provides examples)

The scheme of the changes is to scale back the tax offset applying to ETPs, such as gratuities, while keeping the existing offset for ETPs relating to hardship.

Eligibility for the tax offset for termination payments, is dependant from July 1, 2012 on an individual’s total taxable income including the ETP in a year they receive an ETP.

That part of a taxable component of an ETP that, when added last to an individual’s other taxable income, is equal to or below a “whole-of-income” cap of A$180,000 will continue to be eligible for the ETP tax offset. Any amount of a taxable component of an ETP that takes a person’s total taxable income over A$180,000 will be taxed at marginal rates.

While the ETP cap (A$175,000 in 2012-13) is indexed, the A$180,000 whole of income cap will not be indexed.

What ETPs are not affected?

People who:

- Receive genuine redundancy payments (or who would have but for the existing age 65 or retirement restrictions on genuine redundancy payments);
- Lose their job due to invalidity (regardless of how close to retirement); or
- Receive compensation due to a genuine employment related dispute relating to personal injury, harassment, discrimination or unfair dismissal (where the payment is currently considered an ETP); or
- Receive a non-superannuation death benefit;

Would continue to receive the current tax treatment (ETP tax offset up to existing ETP cap, excluding other income, of A$175,000 in 2012-13 indexed) and continue to have access to the full benefit of the ETP tax offset.

The “tax-free” components of an ETP, such as invalidity or pre-July 1983 employment components, will continue to be tax free. This includes tax free components of genuine redundancy and early retirement scheme payments,
as well as tax free components of death benefit ETPs.

Foreign termination payments and the offset for unused annual and long service leave will also be unaffected by these amendments.

The “ETP” cap will continue to apply limiting the maximum portion of an ETP that could receive concessional tax treatment to A$175,000.

Additionally any tax free components including genuine redundancy and pre 1983 service components will continue to be tax free.

**Employment related dispute payments**

The Budget Night announcement and the Treasury Paper did not explain what payments under this heading will be “excluded ETPs”.

While redundancy, early retirement, invalidity and death benefit payments have a relatively high degree of certainty about them, the question of when is an ETP excluded because it is an “employment-related dispute” will inevitably require legal opinions.

The amending legislation defines “excluded payments” as being inter alia, life benefit termination payments paid in connection with a genuine dispute; and are principally compensation for personal injury, unfair dismissal, harassment, discrimination or a matter prescribed by the regulations; and exceed the amount that could, at the time of termination of your employment, reasonably be expected to be received by you in consequence of the voluntary termination of your employment.

The Explanatory Memorandum confirms that a payment does not need to be made as a consequence of proceedings before a court in order to be compensation.

**Other considerations**

There will be many cases where an employee receives both a “golden handshake” (either because of an entitlement in the employment contract etc or an ex gratia amount etc) and an “excluded payment” (for example a redundancy payment).

The amending legislation provides rules for determining the order of application of the tax offset and the manner in which payments are applied against the whole-of-income cap. The Explanatory Memorandum provides examples and also explains the position where more than one ETP is made including excluded and “non-excluded” payments in more than one year of income.

The EM explains also that where a single payment is made containing both an excluded payment part and a not-excluded part, then the amount of the payment eligible for the ETP tax offset is worked out as if the excluded payment part were paid first.

**PAYG problems for employers?**

At this point it is not known what, if any, arrangements will be made to accommodate the PAYG rules which currently withhold PAYG at the prescribed rates of 31.5% (or 16.5% for persons aged 55 and over) on the first A$175,000 of an ETP and at 46.5% above that amount.

The introduction of whole-of-income caps may not necessarily result in any PAYG changes and this means inevitably that a taxpayer who is impacted by these rules will have an end-of-year tax liability.
While these amendments will complicate the position for higher income earners and may unduly affect the timing of affected employment terminations (for example, so that affected ETPs are paid in a year after the termination of employment), it will also impact employers and Human Resource directors where genuine redundancy and/or early retirement schemes are being contemplated.

**The Bottom Line**

Australian employers (and some foreign employers too) will be well aware that June 30, 2012 marks the end of the Transitional Termination Payment rules (such that ETP entitlements arising from an employment contract, award or law etc arising from just before May 10, 2006 are subject to an ETP cap of A$1 million and may be partly or wholly rolled over into superannuation so long as payment is made by June 30, 2012).

Although these proposed new laws do not apply until July 1, 2012, it adds one more complication for employers and their advisers to deal with. In the current economic environment with the statistically high level of “employment”: in Australia, terminations and downsizing are seemingly hidden but are nonetheless very real to many employers and employees.

While this change constitutes the end of any tax concessions for “golden handshakes” for higher income earners, it should not be forgotten that Australia relies upon a steady supply of highly paid foreign workers, professionals and executives as well as our own Australian talent to maintain our position in the global economy.

This is just one more increase in personal taxation and one more complication to add to a tax system which is complex and unnecessarily complicated.

Employers will need to carefully consider terminations of employees with “excluded payments” and “not-excluded” payments.

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