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# Redundancy – A guide to the right choices

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employment termination payment

# Asgard

This guide relates to redundancies received after 1 July 2007

“This guide provides a reference for employees facing the prospect of redundancy, retrenchment or other terminations of employment and identifies some of the issues that need to be considered.”

# Introduction



**Redundancy and early retirement involve important financial decisions that can only be made with consideration of an individual's circumstances.**

This guide provides a reference for employees facing the prospect of redundancy, retrenchment or other terminations of employment and identifies some of the issues that need to be considered. However, it is highly recommended that you consult your financial adviser who can assess your particular circumstances.

You may leave your employment for a variety of reasons. You may leave to take another job or to retire, you may be made redundant or you may be offered early retirement. In some instances, employees may be offered a lump sum payment when they leave voluntarily, perhaps to encourage them to leave or perhaps in recognition of many years of loyal and valuable service. Such a payment is commonly known as a 'golden handshake' and may be subject to special taxation rules.

Payments made to employees under an 'approved early retirement scheme' or as a 'genuine redundancy' generally qualify for concessional tax treatment as the employee is considered to have been dismissed through no cause of their own. This may apply even when the scheme is offered to employees as part of a voluntary package.

## **Genuine redundancy payments**

These payments are made when your job is made redundant and will generally qualify for concessional taxation treatment. The concept of redundancy primarily refers to the job ceasing rather than you losing your job for other reasons. If the tasks that you perform are no longer required, or are required in a different form or at a different location, then your position can reasonably be termed 'redundant'.

To receive a concessional tax payment, certain conditions have to be met. Broadly, these are:

- you must be dismissed from your job before your normal retirement date;
- your job has been made redundant;
- you must be under 65 or the normal retirement age for your position (whichever is the earlier); and
- at the time of termination, there must be no agreement between you and your employer for reemployment at a later date.

## **Approved early retirement schemes**

Approved early retirement schemes are implemented by the employer and must be submitted to the Australian Taxation Office (ATO) to be approved on a case by case basis. Primarily, the conditions required for classification as an approved early retirement scheme are:

- the scheme must be offered to all employees in the same class identified by the employer;
- it must be implemented with a view to rationalising and/or re-organising the employer's operations; and
- it must be approved by the Commissioner of Taxation before retirement occurs.

Whilst these schemes must apply to all employees in a particular category (e.g. all with a particular job skill or of a particular age), a scheme may be targeted narrowly such that only a small number of employees, perhaps just one, is offered early retirement.

Essentially, it does not matter whether your cessation of employment is due to a genuine redundancy or an approved early retirement scheme as they each lead to the same tax and social security treatment of the benefit paid. Your employer will tell you if either of these apply to you.

# What benefits will you receive?



Upon leaving your employment you may receive a range of payments that relate to your current employment and, in some instances, compensation for your dismissal.

The value of these payments is often set out in industrial awards or employment contracts. You may also have to leave your employer-sponsored super scheme and roll your accumulated super entitlements to a new super fund.

The following summary relates to payments received after 1 July 2007.

## Payments

The payments that you receive at termination will probably include some or all of the following:

- accrued annual leave;
- accrued long service leave;
- rostered days off;
- sick leave;
- payment in lieu of notice; and
- ex-gratia payment.

## Payments from your employer

Part of the payment you receive from your employer as compensation for dismissal may be tax-free. Some or all of the remainder is an employment termination payment or directed termination payment (formerly known as Employer ETPs).

## Employment termination payment

In most circumstances it will only be possible to receive this as a cash payment although some transitional rules apply. An employment termination payment will comprise tax free and taxable components and can be a:

- life benefit termination payment – which are payments made to a living person; and
- death benefit termination payment – which are payments made because of a person's death.

Refer to the payments table on page 3 for more information about the tax free and taxable components.

## Transitional rule – transitional termination payment

Transitional rules enable life benefit termination payments to be rolled into a super fund up to 30 June 2012. These are called directed termination payments. This transitional rule applies where there is a pre-existing contractual agreement dated on or before 9 May 2006 specifying an amount capable of calculation at that time to be paid upon termination.

A directed termination payment must be rolled into super within 30 days and you must be eligible to contribute to super. The taxable component that exceeds \$1 million will count towards the concessional contributions cap.

## Tax treatment – taxable component

Age at 30 June	Amount	Tax rate
Less than 55	Within cap	31.5%
	Above cap	46.5%
55 or over	Within cap	16.5%
	Above cap	46.5%

The most common benefits you may receive upon leaving your employer are outlined on the next page.

## Payments from your superannuation fund

This payment represents the superannuation benefits accumulated during your period of employment at the company and may also include amounts previously rolled into the fund from other sources. These payments are known as super lump sum benefits.

Your ability to either cash in any super benefits from your employer-sponsored super fund will depend upon whether the amounts are 'preserved' or 'non-preserved' and whether you meet a condition of release. Preserved funds will generally have to be rolled over and retained in super until you reach preservation age or meet another condition of release.

Unrestricted non-preserved benefits can be received as a lump sum at any time without meeting a condition of release. Benefits from a super fund that are paid as a lump sum are subject to special taxation rates. Benefits from a super fund that are rolled over are generally not subject to tax.

Your superannuation benefit will be comprised of the following components:

- tax free component
- taxable component.

The taxation of the above components will be discussed in more detail in the following section.

## Payments

Benefits you may receive upon leaving your employer are detailed in the table below.

Payments from your employer	
<b>Accrued annual leave</b>	Upon ceasing employment you may have accrued annual leave. This payment must be cashed in – it cannot be rolled over as it is not a directed termination payment.
<b>Accrued long service leave</b>	Upon ceasing employment you may still have some long service leave owing to you. This payment must be cashed in – it cannot be rolled over as it is not a directed termination payment.
<b>Tax free amount of genuine redundancy or approved early retirement</b>	Where termination of your employment occurs as a result of a genuine redundancy or an approved early retirement scheme, a portion of the balance of any payment you receive will be tax free. The first \$7,020 plus \$3,511 for each year of service is tax free. This payment must be cashed in – it cannot be rolled over as it is not a directed termination payment.

### Employment termination payment

<b>Tax free component</b>	This component will generally consists of components previously known as, pre-July 83 , concessional, undeducted, post June 94 invalidity and capital gains tax exempt.
<b>Taxable component</b>	This component is the balance of your account after subtracting the tax free component.

## Employment termination payment caps

Employment termination payment caps apply and the tax rate that's applied differs depending on whether the payment falls within or exceeds the cap. So we'll firstly detail the caps that apply to the different payments.

Employment termination payment cap	
<b>Life benefit termination payment</b>	<b>Non transitional</b> An annual cap of \$140,000 applies to the taxable component. This cap is a yearly limit that applies to all payments received in a single year.
	<b>Transitional</b> Two different caps apply: <ul style="list-style-type: none"> <li>• Lower cap - \$140,000 for all payments received during the transition period (1 July 2007 to 30 June 2012); and</li> <li>• Upper cap - \$1m (not indexed).</li> </ul>
<b>Death benefit termination payment</b>	An annual cap of \$140,000 applies to the taxable component. This cap is a yearly limit that applies to all payments received in a single year.

These are the caps as at 2007/08 and are indexed to AWOTE each year but increase in \$5,000 increments

# How are these benefits taxed?



Employer payments		
<b>Accrued annual leave</b>	<p>If employment ceases due to a genuine redundancy or approved early retirement scheme:</p> <ul style="list-style-type: none"> <li>100% assessable, but subject to a maximum tax rate of 31.5%.</li> </ul> <p>If not covered by the above:</p> <ul style="list-style-type: none"> <li>portion relative to pre 18 August 1993 service fully assessable, but subject to a maximum tax rate of 31.5%</li> <li>balance fully assessable and taxed at your marginal tax rate.</li> </ul>	This payment cannot be rolled over into super.
<b>Accrued long service leave</b>	<p>If employment ceases due to a genuine redundancy or approved early retirement scheme:</p> <ul style="list-style-type: none"> <li>5 % of portion relative to pre-16 August 78 service assessable at your marginal tax rate</li> <li>balance fully assessable but subject to a maximum tax rate of 31.5%.</li> </ul> <p>If not covered by the above:</p> <ul style="list-style-type: none"> <li>5 % of portion relative to pre-16 August 78 service assessable at your marginal tax rate</li> <li>portion relative to service between 16 August 1978 and 17 August 1993 fully assessable but subject to a maximum tax rate of 31.5%</li> <li>balance fully assessable and taxed at your marginal tax rate.</li> </ul>	This payment cannot be rolled over into super.

## Employment termination payments

The tax free component of employment termination payments do not incur tax but tax is applied to the taxable component. The tax applied depends on whether you're within or have exceeded the employment termination payment cap. The tax rates that apply are detailed below.

## Life benefit termination payments

### Non transitional tax rates

Age at 30 June	Amount	Tax rate
Under 55	Within cap	31.50%
	Above cap	46.50%
55 or over	Within cap	16.50%
	Above cap	46.50%

### Transitional tax rates

#### Lump sum

Age at 30 June	Amount	Tax rate
Under 55	Within upper cap	31.50%
	Above upper cap	46.50%
	55 or over	Within lower cap
	Between lower and upper cap	31.50%
	Above upper cap	46.50%

## Directed termination payment - rollover

The taxable component of the directed termination payment is taxed at 15% in the super fund.

But where the rollover exceeds \$1m the excess will count towards the concessional contribution cap and any amounts that exceed this cap will be applied additional tax of 31.5%.

## Death benefit termination payment

Age at 30 June	Amount	Tax rate
Under 55	Within cap	Tax free
	Above cap	46.50%
55 or over	Within cap	31.50%
	Above cap	46.50%

### Tax treatment of a super benefit payment

The taxation of a super or pension benefit differs depending on the components, whether the benefit is taken as a lump sum or pension and the age of the member. This is detailed in the table below.

Age	Taken as a lump sum	Taken as a pension
Below Preservation age	Taxable component is subject to 21.5% tax.	Marginal tax rates (no tax offset).
Preservation age to age 59	0% tax up to low rate cap of \$140,000 (indexed).  Any amount above low rate cap is subject to 16.5% tax.	Marginal tax rates and 15% tax offset.
Aged 60 and above	Tax free	Tax free

### Multiple super interests

Withdrawals from a super fund will need to proportionally draw down the tax free and taxable components held in multiple super accounts within the same fund. This applies to lump sum or rollovers from super.

So where you hold multiple super accounts your taxable and tax free components will be aggregated and proportionally drawdown when you withdraw funds from one of these accounts<sup>1</sup>.

<sup>1</sup> At the time of publication, the requirement to aggregate multiple interests was under review by the government.

### Example

David holds 2 separate super accounts within Asgard with the following taxable and tax free components

	Super account 1	Super account 2	Total	%
Tax free component	\$100,000 - 20%	\$0	\$100,000	15%
Taxable component	\$400,000 - 80%	\$150,000 - 100%	\$550,000	85%
Total	\$500,000	\$150,000	\$650,000	

### Withdrawal from super account 1

David requests a withdrawal of \$200,000 from super account 1 and because he holds multiple super accounts we'll proportionally drawdown from the taxable and tax free components from both funds.

The components of his \$200,000 withdrawal are:

- tax free component - \$30,000
- taxable component - \$170,000

After this withdrawal the components of his super accounts will be:

	Super account 1	Super account 2	Total	%
Tax free component	\$70,000 - 20%	\$0	\$70,000	15%
Taxable component	\$230,000 - 80%	\$150,000 - 100%	\$380,000	85%
Total	\$300,000	\$150,000	\$450,000	

# What to consider when receiving an employment termination payment



Once you know what payments you'll be receiving you should address the following questions:

- Do you hope to find work in the near future?
- Do you have a reasonable expectation of finding work in the near future?
- How long before you would normally expect to retire?
- What is the level of your debts?
- What are your existing financial resources?
- How much do you need to meet your normal living expenses?
- What are your plans for the future?

From 1 July 2007, an employment termination payment must be taken as cash. There are a number of issues that you will need to consider.

1. The lump sum tax payable
2. Social Security implications
3. Insurance continuation.

## 1. Lump sum tax and contributions tax

Generally, super benefits cashed by those aged under 55 will incur a higher lump sum tax liability than when cashed by those aged between 55 and 60. Lump sum payments to those aged over 60 are tax free.

For details on the taxation implications, see page 4 'How are these benefits taxed?'

## 2. Social Security implications

If you are made redundant, you and your partner may be eligible for income support payments.

Each of these payments has its own rules and conditions. You should consult with your financial adviser or Centrelink officer to check which payments, if any, you may be eligible to receive. In most cases you will be eligible for some form of payment, but importantly the 'means test' may restrict the amount payable and waiting periods may delay the commencement of any payment.

This publication does not fully discuss all the payment types available and their requirements. However, some of the more common benefits are described below:

- **Newstart allowance** – you must be available for work, actively seek work and accept work if offered. You will need to meet an activity test.
- **Age pension** – men must be over 65 and women over 63 ½ unless claiming through Department of Veteran Affairs. The pension age for women is increasing progressively until it reaches 65 in 2014.
- **Disability support pension** – must be indefinitely unable, through mental or physical ill health, to hold down a full time job. If you are eligible to receive a social security payment, you may be subject to a waiting period before payment commences.

## Income Maintenance Period (IMP)

The IMP applies to all non-aged pension income support payments except Carers Payment. Centrelink will assess your leave payments (annual and long service leave) and the gross amount of the redundancy payment (including any tax free portion) as income. This income will likely reduce your benefit entitlements (possibly to nil) for the relevant period.

### Liquid Assets Waiting Period (LAWP)

Liquid assets include cash, shares and other financial investments that are readily converted to cash. Liquid assets do not include super benefits or, for example, land. The LAWP is calculated differently depending on whether you are single or a member of a couple or have a child. This is explained in the table below:

If you...	Then the LAWP is calculated by...
are a member of a couple, OR have a dependent child	Liquid assets – \$5,000/\$1,000
are NOT a member of a couple AND do NOT have a dependent child	Liquid assets – \$2,500/\$500

The result of the calculation is the duration of the LAWP in weeks, as explained in the table below.

If the result is...	Then the LAWP is...
13 or more whole weeks	13 weeks
Less than 13 whole weeks	The whole number of weeks, with fractions rounded down to the nearest whole week
Less than one week	Not served at all

### Case study

When George left work he had liquid assets of \$11,000. George is single with no dependent children.

His LAWP is therefore 17  $\{(11,000 - 2,500)/500\}$ .

As this exceeds the maximum, George will have to wait 13 weeks under LAWP after leaving employment before he can receive income support.

If George had a partner, his LAWP would be 6  $\{(11,000 - 5,000)/1,000\}$ . George would only have to wait 6 weeks before receiving income support in this case.

The LAWP applies to Newstart and Sickness Allowances.

### Ordinary Waiting Period (OWP)

The OWP is a period of one week and applies to Newstart and Sickness Allowances. LAWP and IMP are served concurrently. The OWP commences when the LAWP and IMP no longer apply.

### Case study

Harriet was retrenched after 25 years service. Her employer paid her \$211,583 based on 4 weeks, plus 3 weeks per year of service. She also received 10 weeks holiday pay. The IMP would preclude a Centrelink payment for the next 89 weeks. LAWP would also apply, but as LAWP is for a maximum of 13 weeks and is served concurrently with IMP, it would have no effect.

### Means tests

Your entitlements are subject to both an assets test and an income test.

#### Assets test

Virtually all assets with the exception of your home and super (in some circumstances) count towards the assets test. The allowance assets test has a 'sudden death' cut off:

#### Asset test cutoffs

##### Home owner

Single	\$161,500
Partnered	\$229,000

##### Non home owner

Single	\$278,500
Partnered	\$346,000

As at 1 July 2007 (CPI adjusted)

The pension will reduce by \$3 per fortnight for each \$1,000 above these figures. From 20 September 2007, the reduction will be \$1.50 per fortnight.

#### Income test

Income from almost all sources is assessable under the assets test. Generally, the assessed income is before tax although some deductions are allowed. For financial investments, an interest rate is assumed to be earned, whether it is or not. This is called deeming.

If you are eligible for an allowance, your allowance will start to reduce once your income exceeds \$62 per fortnight. If you are eligible for a pension, it will reduce once you earn more than \$128 per fortnight if you are single, or \$228 per fortnight of combined income for a couple.

Income and assets testing of super benefits will not be assessable for Social Security purposes if you are below age pension age. If you are in this situation, contributing your directed termination payment to super may increase your benefit entitlements – but you must remember you lose access to these funds until at least age 55.

### 3. Insurance continuation

In terminating employment, life insurance cover attached to your company super can easily be overlooked. Leaving the employer and the employer super fund effectively means cancelling any life, disability and/or salary continuation insurance that is paid through that fund.

In many instances, insurance policies established outside an employer sponsored super fund will not have the advantage of group underwriting and corporate rates.

Medical examinations may be required and result in premium loadings or even refusal of cover.

Your insurance needs will normally continue after redundancy and should be reviewed at this time to ensure that you and your family are protected. Some employer sponsored super funds may offer an insurance continuation option, so it is worthwhile making inquiries of your employer super fund or payroll office.

If your employer will not continue your current insurance arrangements you should discuss continuing cover with your financial adviser.

**Redundancies can be painful at the best of times and are only complicated further by the differing tax rules that can apply. You should speak to a financial adviser to help you make the right decision with any payments you receive at this time and to assist in planning your future financial situation.**

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