



TAXATION CIRCULAR

Internal Revenue Commission - Circular

Taxation Circular TC 2013/2

Subject

Who is entitled to the concessional rate of tax on a redundancy payment received as part of a termination payment?

PURPOSE

1. This Circular explains the requirements to be satisfied before any payments made to an employee will qualify for the concessional rate of tax of 15% under Section 46CA of the *Income Tax Act 1959* (“the Act”). This provision can only apply to an employee whose employment is terminated as a result of their position having been made genuinely redundant.
2. The circular also shows the calculation of the concessional component of the redundancy payments.
3. This Circular also sets out the components of a termination payment which are not entitled to the concessional tax treatment.

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BACKGROUND

4. The Government introduced the *Rationalisation of the Public Service (Budget Provisions) Act (“RPSA 1995”)* to facilitate the rationalisation of the Public Service and some Public authorities. Public servants receiving termination payments under the *RPSA 1995* were eligible for the concessional rate of up to 15% on redundancy payments received. These arrangements ceased to have effect after 31 December 2008.
5. Subsequent to this, all termination payments are required to have had tax deducted at the applicable marginal rate for the individual under the Salary & Wages Tax regime and section 46B of the Act.
6. Introduced in the 2012 budget, section 46CA provides a limited concession in certain circumstances to those made redundant, regardless of whether they are public servants or employees in the private sector.
7. Section 46CA also provides a special rule whereby public servants who have still not been paid their entitlements arising from a termination prior to 31 December 2008 under the *RPSA 1995*, will remain able to access the 15% rate on the entirety of their termination payment, when it is ultimately paid. However, all new termination payments to public servants made redundant after 2008, will be taxed in accordance with the new regime explained in further detail below.

INTERPRETATION

8. Section 46CA will apply to tax the income of an eligible taxpayer to the extent that it forms the “concessional component” of a “redundancy payment”, at the concessional rate of 15% as set out in subsection 1(4) of the *Income Tax (Salary & Wages Tax) Rates Act 1979*.
9. The application of Section 46CA will also apply to a termination payment received under the *RPSA 1995* (i.e one that arose prior to 31 December 2008, but which has not yet been paid), even though that Act is no longer in force.
10. There are three definitions which are critical to the operation of the redundancy concession:
 - “Eligible Taxpayer
 - “Redundancy Payment” and

- “Concessional component”

11. Each of these are defined in section 46CA and are explained in detail below.

Eligible Taxpayer

12. To qualify for the concessional treatment, you must be an “eligible taxpayer”. That is, you must be a resident of PNG:

- with at least 5 years continuous employment with an employer or associated employer. This means that there must;
 - be no break in employment;
 - not be retirement; and
 - not previously redundant from that employer;
- who receives a redundancy payment upon termination of their employment with the employer under an “approved redundancy scheme”; and
- who is dismissed before;
 - the day he or she reached 65 years; or
 - if the taxpayer’s employment would have been terminated when he or she reached a particular age or completed a particular period of service or completed the period of service; and
 - who has not previously received an amount taxed under the concessional rate under subsection 46CA from the employer.

Redundancy Payment

13. A redundancy payment is defined to mean so much of a payment that:

- is made under an approved redundancy scheme;
- is received by an employee who is dismissed from employment because the employee’s position is genuinely redundant and, at the time of the dismissal, there was no arrangement between the employee and employer, or between the employer and another person, to employ the employee after the dismissal;
- exceeds the amount that could reasonably be expected to be received by the employee as a voluntary termination; and

- if the dismissal is not at arm's length, an amount that does not exceed the amount that could reasonably be expected to have been made if the dismissal were at arm's length.

Approved Redundancy Scheme

14. An approved redundancy scheme is a scheme for which an employer has applied in writing to the Commissioner General and the Commissioner General is satisfied that;
 - a minimum of 30 employees are to be genuinely made redundant under that scheme, or
 - the employee or employees are genuinely made redundant in the public sector.
15. Accordingly, any redundancies in the public service will qualify (providing it meets the other requirements) even if there are less than 30 redundancies. This differs from the rule which applies to all other employees requiring a minimum of 30 positions to be made redundant.
16. The approval process is set out below at paragraphs 45-50.

Dismissed from Employment

17. The loss of a particular position with an employer is not a dismissal for the purposes of section 46CA unless all employment with the employer is severed. The Commissioner General's view is that a genuine redundancy payment can only arise where there is no suitable job available for the employee with the employer, meaning that he or she must therefore be dismissed.
18. The exception to this general principle is the case of a person holding an office with the employer at the same time as having an employment relationship with the same employer. In this case, dismissal from either the office or employment involves a dismissal from employment for the purposes of section 46CA. An example is a person who is both a director of the employer company and an employee of the company who is terminated from either of these capacities.
19. Dismissal is a particular mode of employment termination. It requires a decision to terminate employment at the employer's initiative without the consent of the employee. This stands in contrast to employment that is terminated at the initiative of the employee, for example in the case of resignation.
20. A dismissal can still occur even where an employee has indicated that they would be interested in having their employment terminated, provided that the final decision to terminate employment remains solely with the employer. Such a case may arise where expressions of interest in receiving a redundancy package are sought from employees as

part of a structured process undertaken by the employer as a means of promoting industrial harmony.

21. Where an employee is given notice from their employer that they will be terminated at a specified time in the future due to genuine redundancy, that employee will be dismissed because of redundancy for the purposes of section 46CA. This will be the case even where an employee, following notification, negotiates with the employer or nominates to end their employment at an earlier time. Negotiation or nomination of the earlier date relates to the timing of the termination and not to the character of the termination as a dismissal. In determining whether any payment made in these circumstances would qualify as a genuine redundancy payment, the other conditions in section 46CA would still need to be met.
22. Section 46CA further requires that the dismissal be caused by redundancy of the employee's position, and not for some other reason, such as on grounds of disciplinary action.
23. As is the case in determining if there is a dismissal, the reason for a dismissal is to be established in light of the facts and circumstances of each case. The redundancy of the relevant position must be the prevailing or most influential reason for the dismissal if there is more than one contributing cause.
24. An employee's position is redundant when an employer determines that it is superfluous to the employer's needs and the employer does not want the position to be occupied by anyone. Accordingly, it is fundamentally the employer's decision that a position is redundant. On occasion, the decision may be unavoidable due to the circumstances surrounding the employer's operations.
25. In some circumstances, an employer may reallocate the duties and functions attached to a particular position to another position within the employer's organisational structure. In such cases, the former position is redundant. However, if the employee who had been working in that position is still employed by the employer following the reallocation of duties and functions, there will not be a dismissal.
26. On the other hand, if an employer decides after downsizing or some other structural reorganisation to terminate an employee, the former position of the employee is redundant as long as the downsizing or reorganisation is the prevailing or most influential cause of the termination.
27. A dismissal is not caused by redundancy where personal acts or default are the prevailing or most influential cause for the termination. For example, a person may be dismissed due to unsatisfactory performance or behaviour.

28. In some cases, an employer may decide to restructure their organisation at the same time as identifying underperformance of particular members of staff or areas within the existing organisational structure. In the event that employees are dismissed in these circumstances, careful consideration will need to be given by the employer as to what was the prevailing or most influential cause of dismissal.
29. In circumstances where an employee resigns after being offered alternative employment with an employer following an organisational restructure, it will be necessary to assess whether the termination of employment amounts to a constructive dismissal

Genuine Redundancy

30. The Commissioner General's view is that any redundancy payment must be made in consequence of the employee being dismissed from employment because the employee's position is genuinely redundant. The *Employment Act 1978 Chapter 373* governs terminations of contracts of employment in the private sector including statutory bodies not covered by the *Public Service (Management) Act ("PSMA 1995")*.
31. Contrived cases of redundancy will not meet the conditions in section 46CA. Whether a redundancy is 'genuine' is determined on an objective basis.
32. The fact that an employer and employee, or an employer and a union have an understanding that a payment on termination is caused by redundancy, or that the employer treats the payment as a redundancy payment for tax purposes, does not of itself establish genuine redundancy.
33. Where there is any doubt as to the tax treatment, the parties are encouraged to seek guidance from the Commissioner General before they enter into any agreement, or have such an agreement with the Industrial Registrar within the Department of Labour.

Exceeds amount payable under a voluntary termination

34. The redundancy payment is the *extra payment* received by the employee as a result of their position being made redundant which would not have been received if the employment were terminated voluntarily, or for some other reason, for example, misconduct of the employee or for grounds set out in section 36 of the *Employment Act 1978*.
35. The purpose of redundancy payments are to compensate for not being able to claim non-transferrable entitlements such as accrued sick leave and the hardship the redundancy would have on the employee, their family and the community in which they live.
36. Accordingly, the following cannot be included as part of a "*redundancy payment*":
 - Payments received in lieu of Superannuation benefits;

- Superannuation Benefits;
- Payment of pension or annuity;
- Unused annual leave payment;
- Unused long service payment;
- A payment that is an advance or a loan to an employee on terms and conditions that would apply if the employee and the employer were dealing at arm's length;
- A payment deemed to be Dividend under this Act;
- An amount included in your assessable income in relation to an employee share scheme;
- A capital payment for, or in respect of, personal injury to you;
- A capital payment for, or in respect of, a legally enforceable contract in restraint of trade.

Arm's length amount

37. Where a dismissal is not at arm's length, the "Redundancy Payment" eligible for the concessional rate will be limited to the amount that could reasonably be expected to have been paid if the parties had been at arm's length.
38. When an employer and employee are not at arm's length, this does not necessarily mean that the dealing between the employer and employee is not at arm's length.
39. Where the parties are not at arm's length, consideration will have to be given to what payment would have been made if the parties were dealing at arm's length, and only that component will form part of the "redundancy payment" as defined in section 46CA.

Concessional Component

40. Only the concessional component of the redundancy payment will be taxed at the rate of 15%. The concessional component of the redundancy payment means the lesser of the amount calculated using the formula in paragraph 40 up to a cap of K50,000.
41. Section 46CA provides the formula for the calculation of the concessional component of the redundancy payment.
 - $\text{Base Amount} + (\text{Service Amount} \times \text{Years of Service})$

42. The Base Amount and Service Amount are set by the legislation, but may be increased in the future.¹ They are currently set as follows:
- Base Amount – K5,000; and
 - Service Amount – K2,000.
43. In applying the formula, “*Years of Service*” means the number of complete years of continuous service during which the taxpayer was employed by the same, or an associated employer.
44. Generally, the employee must have continuity of service with the same employer during the entire period for it to count as “Years of Service”. Nevertheless:
- where employment has previously been terminated with one employer under arrangements whereby the employee would be re-employed with a related employer, (for example by another company within a wholly owned group of companies) such that the arrangement would be excluded under paragraph (b) of the definition of a redundancy payment; and
 - if that employee is subsequently made redundant from the related employer;

then the IRC would consider the entire period to count towards the “Years of Service” requirement under the definition of the “concessional component” and towards the five years of continuous service requirement under the definition of an “eligible taxpayer”.

The approval Process

45. To be eligible for the concession, an employer must apply in writing to the Commissioner General for approval of their redundancy scheme. The application should include specific details regarding the following:
- The positions to be made redundant;
 - The amounts of the redundancy payments;
 - The amounts of the concessional payments;
 - The amounts of salary and wages of eligible taxpayers; and

¹ Legislation should be checked to confirm the currency of these amounts. It is not envisaged that this tax circular will be re-issued simply to update changes in the thresholds in future budgets.

- The period over which the redundancy scheme is to occur.
46. A scheme can only be approved where;
 - at least 30 positions are to be made redundant in the Private Sector; or
 - the redundancies occur in the Public Service. The requirement for at least 30 positions to be made redundant, does not apply where the redundancies relate to positions covered under the *PSMA 1995*.
 47. The application will be received and reviewed by the Policy & Advice Division and should be addressed to the Assistant Commissioner Policy & Advice.
 48. The Commissioner General may request further information to consider any applications lodged and may also wish to meet with the employer to fully explore some of the issues arising from the application.
 49. Once an application is approved, the employer should apply the concessional rate on the concessional component of a genuine redundancy payment for each of its employees who are eligible taxpayers.
 50. It is advisable to submit your application at least 3 months prior to the commencement of the proposed redundancy scheme. This should provide sufficient time for the Commissioner General to process the application and request any additional information required.

EXAMPLES

Example 1 – Business winding down operations

51. Mike and 49 other employees are being made redundant from their jobs as a result of ABC Mine winding down operations. The fifty employees that would be made redundant would have served between 10 – 30 years with ABC Mines.
52. Under the redundancy concession, ABC Mines has applied for Authorisation of their Redundancy Program from the Commissioner General and the application has been approved. ABC has undertaken to its employees to pay the maximum allowable payments for the “Base Amount” and “Service Amount” set out under Section 46CA.
53. Mike has worked with ABC Mines for 27 years. He is made redundant on 30 July 2013. He has 3 dependents and is paid a fortnightly salary of K 3,000.00. Mike will receive the following payments under the redundancy:

Money in Lieu of Notice	K 6,000.00
Money in Lieu of Rec Leave	K 12,000.00
Money in lieu of LSL (no pre 1/1/93)	K 14,000.00
K 5,000.00 Lump Sum Payment	K 5,000.00
K 2,000.00 per year service	K 54,000.00

To calculate the concessional component
Base Amount + (Service Amount x Years of Service)
K5,000 + (K2,000 x 27)

Paragraph A	
Concessional component of redundancy payment	K 59,000
Allowable @ 15% (as per cap in paragraph B)	K 50,000.00
Excess to be taxed @ marginal rate	K 9,000.00

Tax Calculation

Tax @ 15 % on Prescribed Redundancy Payment
15% x K 50,000.00 = K 7,500.00

Tax @ marginal rate on excess over prescribed payment and other payments.
K 9,000.00 + K 32,000.00 = K 41,000.00 @ Marginal Rate.

Calculation of Marginal Rate.
Normal Salary Fortnight K 3,000.00

Normal Tax @ 3 Dependents	K 818.46
Lump Sum = K 41,000.00 / 26 = K 1,576.92	
Add to normal ft/nt	K 3,000.00
	<u>K 1,576.92</u> +
Total	<u>K 4,576.92</u>
Tax on K 4,576.92	K 1,449.23
Less normal Tax	K 818.46 –
Difference	K 630.77
Multiply by 26	<u>K 16,400.02</u>
Total Payment	<u>K 91,000.00</u>
Tax @ 15% (K50,000.00)	K 7,500.00 –
Tax @ Marginal (K41,000.00)	<u>K 16,400.00</u> –
Net Payment	<u>K 67,100.00</u>

Example 2 - Loss of business source

54. Kaikai Catering Ltd (KCL) provides catering services to ABC Mines, a large copper mine. John and Maria Kaikai are directors of Kaikai catering, which employs 35 people in its catering operations. Each employee has served 7-15 years. John is the Administration and Marketing Manager and Maria is the catering Manager.
55. John and Maria had an emergency meeting with their accounting and business advisers and decided to cease the operations of KCL immediately as a consequence of several years of losses.
56. Their advisers explained that there would be severe costs and risks associated with continuing operations without a source of business as ABC Mine is their sole client and other opportunities are not available in the short to medium term.
57. As John and Maria are in their late 50s, they both decide to retire. Kaikai Catering has been in business under John and Maria's guidance for 20 years.
58. John writes to IRC requesting Authorisation of their Redundancy Program from the Commissioner General and the application has been approved.
59. While John and Maria are employees and owners of the Kaikai Catering, it is clear from the circumstances surrounding their termination that they are dismissed from their employment because of redundancy. In their capacity as directors they had no real or practical choice but to terminate their own employment along with that of all the other employees.

60. The concessional component of the redundancy payments would be calculated as follows:

For John and Maria for the 25 years of service in KCL

K 5,000.00 Lump Sum Payment	K 5,000.00
K 2,000.00 per year service	K50,000.00
To calculate the concessional component	
Base Amount + (Service Amount x Years of Service)	
K5,000 + (K2,000 x 25)	

Paragraph A

Concessional component of redundancy payment	K55,000
Allowable @ 15% (as per cap in paragraph B)	K 50,000.00
Excess to be taxed @ marginal rate	K 5,000.00

For an employee, who has worked for 15 years in KCL

K 5,000.00 Lump Sum Payment	K 5,000.00
K 2,000.00 per year service	K30,000.00
To calculate the concessional component	
Base Amount + (Service Amount x Years of Service)	
K5,000 + (K2,000 x 15)	

Paragraph A

Concessional component of redundancy payment	K35,000
K35,000 below the cap of K50,000	
Tax Calculation	
Tax @ 15 % on Prescribed Redundancy Payment	
15% x K 35,000.00 = K 5,250.00	

61. Although it may be demonstrated that John and Maria are not dealing with each other at arm's length in relation to their dismissal, their years of service and the equivalent treatment of other employees dealt with at arm's length demonstrates that the amount that they received of K55,000 is not greater than what could reasonably be expected had they been dealing with Kaikai Catering at arm's length. The payments received will be regarded as genuine redundancy payments.

Example 3 – New position offered within company group - Arrangements to employ

62. Following on from Example 1, ABC Mines is part of the giant Global mines group. XYZ Mines is also part of the Global mines group and Mike is an expert in the Metallurgy Department. Mike has been offered a position in XYZ mines and he accepts the offer.
63. Mike is paid a redundancy amount of K59,000 as a result of the closure of ABC mines and his position being made redundant.
64. Mike had no choice in the dismissal from his position in ABC Mines because ABC Mines had to wind up operations. However, the facts indicate that there was an arrangement in place between ABC Mines and XYZ Mines to re-employ Mike at the time of his dismissal. Accordingly, the payment of K59,000 is not a genuine redundancy payment under paragraph (b) of the definition of “redundancy payment” and is therefore assessable as an employment termination payment.

Example 4 – Contracts under 5 years

65. Woktasol is a road - works and bridges construction company and is contracted to build roads and bridges. The 100 employees of Woktasol have been advised that they would be expected to be employed for a period of 3 years the expected completion of the project.
66. Woktasol Ltd uses state of the art technology and until highly skilled and knowledgeable employees. The project was completed within 18 months, significantly earlier than anticipated.
67. The employees had to be dismissed as result of the early completion of the project and their positions were genuinely redundant. However, given, they do not meet the time requirement of 5 years of service under paragraph (a) of the definition of “eligible taxpayer”, the payments received would not be eligible for the concession.

Example 5 – Employment based contracts

68. Pintong has served as public servant for 15 years for Raunraun, a Government Department. He was promoted to be the executive officer in 1990. He is currently on a 5 year contract as CEO of Raunraun.
69. At the end of 5 years, his contract was not renewed and he was paid all his entitlements as the CEO of Raunraun. The payment he receives is not a genuine redundancy payment because his position (CEO) is not genuinely being made redundant, but would be assessed as a termination payment.

Example 6 – Redundancy in the Public Service

70. Following the same facts in Example 5 Raunraun Department undertook a major organizational restructure in 2000.
71. The Human Resources Department of Raunraun embarked on recruiting younger persons for all management positions. Fabian is unattached and therefore is made redundant within the public service. However, Fabian did not receive his payment until 2012.
72. The payment he receives is within the *Rationalisation of the Public Services (Budget Provisions) Act 1995* and even though paid after the expiration of those provisions, would still attract the concessional rate of 15% by virtue of paragraph 46CA(4)(b) of the Act.

Authorised by

Betty Palaso - Commissioner General of Internal Revenue Commission

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Subject Reference

- Salary and Wages Tax
- Rationalisation of the Public Service
- Termination payments
- Approved Redundancy Scheme
- Redundancy Payment
- Dismissed from employment
- Genuine redundancy
- Concessional Component

Legislative References

Rationalisation of the Public Service Act 1995

Income Tax Act 1959

- Section 46CA
- Section 46B

Employment Act 1978

Public Service (Management) Act 1995

Other References

- Australian Tax Office Tax Ruling TR 2009/2
- Australian Tax Office Tax Ruling TR 2008/D6