

## Redundancy payments and their different tax treatment

As many companies downsize in the wake of the global financial crisis it's inevitable even more Australians will be faced with redundancy.

Nobody wants to lose their job but in some cases, substantial redundancy payments are made to compensate employees for their years of service. If you're one of these people, you need to know how to make the most out of your payment.

### REDUNDANCY PAYMENTS CAN BENEFIT FROM CONCESSIONAL TAX TREATMENT COMPARED TO NORMAL SALARY

Although tax rules for genuine redundancy payments changed back in 2007 under the Simple Super regime, significant tax concessions are still available. However the termination payment must be what's termed a 'genuine redundancy payment'.

Determining what constitutes a genuine redundancy payment isn't always clear. The basic requirement for a genuine redundancy payment is one "received by an employee who is dismissed from employment because the employee's position is genuinely redundant".

There are four necessary components within the basic genuine redundancy requirement:

- the payment being tested must be received in consequence of a termination;
- that termination must involve an employee being dismissed from employment;
- that dismissal must be caused by the redundancy of the employee's position; and
- the redundancy payment must be made genuinely because of a redundancy.

Beyond these basic genuine redundancy requirements, the further conditions for genuine redundancy payment treatment require that:

- an employee must be less than 65 years old at the time of dismissal;
- the termination is not at the end of a fixed period of employment – such as the conclusion of a contract;
- the actual amount paid is not greater than the amount that could reasonably be expected had the parties been dealing at arm's length;
- there's no arrangement entered into between the employer and the employee (or the employer and another entity) to employ the dismissed employee after the termination; and
- the payment is not in lieu of superannuation (super) benefits.

A genuine redundancy can still occur where expressions of interest are sought from employees to receive a redundancy package as part of a structured process. However, the final decision to terminate employment must remain solely with the employer.

### TAX PAYABLE ON A GENUINE REDUNDANCY PAYMENT - IT CAN BE LESS THAN YOUR MARGINAL TAX RATE

The first part of a genuine redundancy payment is tax-free (and can't be rolled over into your super) – see the limits below. This tax-free part is excluded from your assessable income for tax purposes.

- **2009-10 financial year tax-free threshold - \$7,732 plus \$3,867 for each completed year of service.**

The amount of redundancy payment, if any, above the tax-free threshold, is taxed as an employment termination payment. In case you wanted to, this payment cannot be rolled over into super.



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**Tax treatment 2009/10**

**Tax-free component**  
(post-June 1994 invalidity and pre-July 1983)

Tax-free

**Taxable component**  
(balance above tax-free component)

Under preservation age (55\*):

- first \$150,000 at 31.5%;
- balance at 46.5%

Preservation age (55\*) and over:

- first \$150,000 at 16.5%;
- balance at 46.5%

\*Age is determined at the end of the financial year, in which termination is made.

**CASE STUDY**

Jason is 32 years old and has been an employee of Big Bank Pty Ltd for the past six years. Due to the global slowdown and cost cutting, The Board of Big Bank decides to reduce staff numbers making Jason's position redundant. Big Bank pays Jason a lump sum payment of \$40,000 which includes an unused annual leave entitlement of \$5,000. Unused annual leave payments and unused long service leave payments are not genuine redundancy payments and are taxed at maximum rate of 31.5%. The balance of \$35,000 is left as a genuine redundancy payment. The tax free component of the genuine redundancy payment is calculated by taking the base rate of \$7,732 plus \$3,867 p.a. for six years or service (i.e. \$30,934) The tax treatment of the termination payment is summarised as follows.

Component	Amount (\$)	Tax (%)	Tax (\$)	Net (\$)
Unused annual leave	5,000	31.5	1,575	\$3,425
Genuine redundancy – tax-free	30,934	Nil	Nil	\$30,934
Genuine redundancy – taxable	4,066	31.5	1,281	\$2,785
<b>Total</b>	<b>40,000</b>	<b>7.1</b>	<b>2,856</b>	<b>\$37,144</b>

Therefore, of the total termination payment received (\$40,000), Jason will be liable for just \$2,856 in tax and receives net proceeds of \$37,144.

The circumstances involved in every redundancy case will differ. As more businesses attempt to cut costs in response to the current financial crises and reduce staff numbers, you need to understand if any payment you may receive is a genuine redundancy payment. Receiving a termination payment as a genuine redundancy payment instead of as a voluntary redundancy may save you a significant amount of tax. If you are in the situation where you receive or are about to receive a redundancy payment, we recommend that you consider talking to a financial adviser or a professional tax adviser.

**Protecting what's most important**

For most of us, our income from paid employment is one of the most important factors in determining our quality of life. If you were unable to work due to injury or illness, would you be able to keep up with your financial commitments and protect the assets you've worked hard to accumulate?

You might already have insurance to protect your home, car or valuable possessions from damage or theft, but if you become seriously ill or injured those assets could still be lost if you are unable to work.

It's estimated that less than 10 percent of Australians have insurance against loss of their income, yet it's often considered to be the most important type of insurance cover needed for income earners<sup>1</sup>.

A lack of income protection cover is a real issue. In 2005-06, the Australian Bureau of Statistics reported 43% of people suffering a work-related injury did not receive any financial assistance for time off work<sup>2</sup>. Those who become ill or injured away from work cannot even access workers compensation, making their financial situation even more precarious.

**INCOME PROTECTION INSURANCE**

Income protection insurance can help support you financially if you suffer an illness or injury that prevents you from undertaking your normal employment. It provides you with an income based on your usual earnings, so that you can continue to support yourself and your family financially.

Income protection is important for all working Australians but is considered to be an essential type of insurance for those under age 50, who are generally more reliant on their salary than someone who has been able to build up assets over the course of their working life.

Income protection can ensure you are paid up to 75% of your normal salary if you are disabled and unable to work. A good policy should also:

- pay for rehabilitation programs,
- provide cover if you are overseas, and
- supplement your income if you are only able to return to work in a reduced capacity.

Should you be injured or too ill to work, income protection insurance can provide you with pre-determined, regular payments based on your income. It's different to health insurance which covers medical expenses, but does not compensate you for time spent recuperating at home. Unlike other forms of insurance, you can access income protection benefits when you most need them, not only upon your death. Put simply, it's 'insurance for living'.

**WHY YOU NEED IT**

You should consider this type of insurance if the loss of your salary or wage would cause you or your family significant distress, and you couldn't get by on government benefits alone. For example, if you are paying a mortgage, or your partner is reliant on your salary, income protection could be an important consideration for you.

One way you may be able to access income protection cover is through your superannuation (super) fund. Income protection (or 'salary continuance cover' as it is often called) offered by super funds is usually cheaper than purchasing an individual policy as the super fund trustee/s normally arrange cover at concessional (group) premium rates. You also have the convenience of having the premiums deducted from your super account automatically, eliminating the need to make arrangements to pay your premiums separately.

It can be difficult to find an insurance policy that covers everything you might need at a reasonable price. Your financial adviser can offer expert advice and take the time to gain a full understanding of your situation to ensure they recommend the most appropriate policy to match your needs and budget.

1 MoneyManagement.com.au article, refer: [http://www.moneymanagement.com.au/Articles/A-matter-of-life-and-death\\_0c037a25.html](http://www.moneymanagement.com.au/Articles/A-matter-of-life-and-death_0c037a25.html)

2 ABS, refer: [http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/4C1F7A19EF4AEEA9CA2572490018107D/\\$File/63240\\_2005-06.pdf](http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/4C1F7A19EF4AEEA9CA2572490018107D/$File/63240_2005-06.pdf)

## Avoiding your own credit crunch



A survey by the Financial Literacy Foundation<sup>1</sup> has found most Australians are confident at managing debt, despite the fact that debt and bankruptcy levels continue to climb.

It seems that the gap between personal perception and financial reality is widening.

According to the Reserve Bank, credit card debt in Australia has blown out to a record \$41 billion. The average card now has an outstanding balance of over \$3,000<sup>1</sup>.

In the financial year to June 2007, a record 32,000 Australians went bankrupt – a jump of 17 per cent on the previous year. Another 6,500 people entered formal debt agreements with their creditors – up about 30 per cent on the previous year.

When it comes to gender, research by credit reference agencies, Veda Advantage and Dun & Bradstreet, have found men are more likely to miss repayments on their loans than women.

More worrying is that younger Australians seem to be struggling with credit. Veda found that 45 per cent of all debt defaults occur among people aged 18 to 30.

### THE BASICS OF BORROWING

Borrowing money is easy – it's making the repayments that can sometimes be difficult. If you get into debt trouble, don't ignore the problem because it won't go away.

### WHAT TO WATCH OUT FOR

Debt problems don't strike without warning. Here are some of the signs...

- Do you worry about checking the mailbox for fear of finding another bill?
- Are you still paying off credit card bills from last Christmas?
- Have you gone through two or more mobile phone providers?
- Are you only paying off the minimum monthly credit card balance?
- Do you have outstanding personal loans that you used for holidays?
- Have you maxed out all your credit cards and applied for another?
- Is there nothing left in your pay once your debt repayments have been made?

### MANAGING DEBT EFFECTIVELY

If you've borrowed money and have not yet repaid the loan in full, then you're in debt. However this isn't necessarily a bad thing. Debt is an accessible tool to help you achieve long-term financial goals such as owning a home or car. As long as you remain in control of your debt – that is, you stay on top of your repayments – it shouldn't be a problem.

Rather than trying to dig yourself out of a debt hole, it's a much better idea to follow some simple rules when talking to lenders so you don't get into trouble in the first place.

Before taking out a loan check:

- The term of the loan.
- The interest rate that will be charged and how often the payments must be made.
- The way the rate is determined - is it variable (the lender can move the rate up and down) or fixed?
- Fees over and above the interest payments, such as monthly "service" fees.
- The actual amount, in dollar terms, that will be paid over the life of the loan. On a house, over 25 years, this will be several times the actual price.
- The type of security required - for example, a mortgage on a house may involve the lender having title over the property.
- Can you repay the loan early? Is there a penalty for early repayment?

- What happens if you experience short-term financial difficulties or are unable to repay the loan?
- Is the contract covered by the Consumer Credit Code?

### KEEPING YOUR DEBTS UNDER CONTROL

When taking on a debt of any kind, it's important to remember that unexpected things can occur that may impact your ability to pay off your debts. If you were unable to work due to injury or illness, would you be able to keep up with your financial commitments and protect the assets you've worked hard to accumulate?

It's estimated that less than 10 per cent of Australians have insurance against loss of income, yet it's often considered to be the most important type of insurance cover needed for income earners. Before taking on a large debt, speak with your financial adviser about preparing for the unexpected through risk management strategies such as income protection insurance.

### CONSIDER THESE TIPS FOR PAYING OFF YOUR DEBTS

- Modify your budget to make sure it accounts for your debt repayments.
- Pay off debts with the highest interest rates first, as these can cost you more in the long run.
- Credit cards require you to pay a minimum amount each month. Consider paying more than the minimum required amount so you can pay off the debt faster and pay less interest.
- Think about consolidating your debts if you have more than one, but only do so if it will help minimise your overall interest payments and the fees and charges you pay.

### THE IMPORTANCE OF PROFESSIONAL ADVICE

If you're having trouble managing your debts or think there might be a better way, ask your financial adviser for help. Your financial adviser can develop a debt management plan and advise on whether consolidating your debts is in your best interest. Speak to your financial adviser today and look forward to a debt-free future.

<sup>1</sup> Financial Literacy, Australians Understanding Money, September 2007

<sup>2</sup> www.rba.gov.au

## Counting the cost of divorce

Divorce inevitably has an emotional and financial toll and in the aftermath it's rare for either party to emerge in a financially better position.

What was once a two-income household moving to a single-income household or losing the full contribution of the main breadwinner will take its toll on the family's finances.

Research by the Australian Institute of Family Studies shows that long after the heartache of separation has eased, it can still cause strain on a family's finances. On average, divorced people are less likely to own their home, have lower levels of per capita assets, less superannuation (super) and are more reliant on income support than married people.

Divorce is likely to have an impact on living standards and wealth accumulation for both parties.

To help you get your finances in order, one of the first things you should do is prepare a budget which will help determine whether you'll have sufficient income to live on. Often during the first two years following a separation, the finances for both individuals will be very tight. However, with a sound budget in place it can be easier to get through this time and establish a solid footing for future financial wellbeing.

Once the budget is under control, future savings and investment opportunities will be easier to identify and implement.

For further information about securing your financial future in the event of a divorce, speak to your financial adviser.



### FINANCIAL CONSIDERATIONS

The following checklist provides a guide to the things that should be considered at the time of divorce.

1. Super can be an issue after divorce, particularly for women who took time out of the workforce during the marriage to have children. Super can be treated as an asset and split as part of the settlement. However there are many complex tax issues related to splitting super so it's wise to seek professional financial advice.
2. Estate planning should be revisited after divorce and a new Will should be prepared. In most states in Australia, any gift you made to a former spouse will usually be revoked on divorce, but the rest of the Will still holds. You should also note that if you die while separated but are not yet divorced, your soon-to-be ex-spouse would still be a beneficiary of your Will.
3. Life insurance policies should also be reviewed to ensure they reflect your new living situation.
4. If you're a single parent, check with your adviser whether you qualify for Government benefits eg. sole parent benefits.
5. Once the divorce settlement has been completed, you'll better understand what assets you have, which makes it a good time to review your personal finances and set goals for the future.
6. If you've received a lump-sum as part of a divorce settlement, you may want to consider investing it to provide an income in the future. Your financial adviser can help you decide which investment best suits your new circumstances and financial needs.

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