

Tuesday 3<sup>rd</sup> of March 2009

## Redundancy

There are many reports in the Australian media currently about companies putting off staff due to the economic downturn. One of the often unfortunate side effects of a slowing economy is the contraction of the work force. That is, there are simply not enough new employment opportunities being created and even those of us in employment may be faced with an uncertain future as employers look to tighten their belts.

Media reports announcing staff cuts in both large and small companies are appearing on almost a daily basis. As a result, many people may find themselves out of work.

This highlights the need for sound planning in both the good times as well as the not so good.

During good times people need to ensure they are putting money away for a rainy day. A regular investment program whereby you are saving at least 10% of your available income is highly recommended. If you are lucky enough to have a job currently (and 94% of us are) you should be doing this now. As a nation we do not save enough.

People should also ensure they have a very good income protection policy that offers an unemployment benefit. By this I do not mean a policy that will pay them a wage if they lose their job as this type of cover is not readily available. It means a policy that will continue to offer cover for accident or illness whilst you are not working and quite often the better companies waive the premiums you would have to pay whilst you are unemployed for a period of time.

Regardless of your situation you should ensure your policy offers this benefit. If in doubt, we can help with this.

The effects of redundancy can be devastating both from a personal and a financial perspective. Whilst the **personal toll is extremely significant** in so many ways; it is important that we also understand the financial consequences of redundancy and the types of payments a person in this situation may receive.

When an employer decides to downsize and shed staff, the staff affected may be entitled to a number of types of payment. Often these are set out in an award or agreement, or an employment contract.

Where a person ceases to be employed, they will be entitled to their wage or salary for work done up to the time they cease to be employed. In addition, they may be entitled to payment for any unused rostered days off (RDOs) and any leave they have not taken, be it unused annual leave and/or long service leave.

Payment for unused sick leave does not generally form part of a payment to terminated employees although some employers may offer this.

Awards, agreements and employment contracts may also make provision for the payment of a lump sum on termination of employment as a result of genuine redundancy or an approved early retirement scheme. These payments may be referred to as "severance payments" and are often expressed by way of a formula such as "x" weeks pay for each year of service. In some circumstances the maximum on the amount that can be paid on this basis may be capped.

Let's look at a simple example of Bryan. He has worked with his current employer for the past 15 years. At the time of being made redundant, Bryan was in receipt of a gross salary of \$1,200 per week. He had accumulated annual leave of 6 weeks, and a long service leave entitlement of 10 weeks. Under the terms of his employment contract, both he and his employer are required to give four weeks' notice in the event that either wishes to terminate the employment contract.

In addition to the accumulated leave, Bryan's employment contract provides for two weeks severance pay to be paid for every year of service in the event of genuine redundancy.

In summary, on being made redundant, Bryan will be entitled to the following payments:

Accrued annual leave (6 weeks x \$1,200)	\$ 7,200
Accrued long service leave (10 weeks x \$1,200)	\$12,000
Payment in lieu of notice (4 weeks x \$1,200)	\$ 4,800
Severance pay (2 weeks x \$1,200 x 15years)	<u>\$36,000</u>
	\$60,000

Where a payment such as that mentioned for Bryan is made, special taxation treatment applies. In other words, the redundancy payment is not simply included as assessable income and taxed at Bryan's marginal tax rate.

In Bryan's case, the accrued annual leave and long service leave will be included as part of his assessable income but tax will be limited to a maximum rate of 30% (plus Medicare Levy, and Medicare Surcharge if applicable). Had Bryan been with the same employer since before 15<sup>th</sup> August 1978, the tax treatment of these payments would change.

Bryan's payment in lieu of notice and severance pay of \$40,800 will be tax free. In cases of genuine redundancy and early retirement scheme payments, the first \$7,350, plus \$3,676 for each completed year of service, is tax free. These figures apply to the 2008/09 financial year. Should a redundancy payment exceed the tax free allowance, the balance is treated as an Employment Termination Payment and is taxable. The rate of tax payable is dependant on a number of factors including the age at time of payment and the date the employment contract was signed. Where a person has an employment contract in place that was signed before 10<sup>th</sup> May 2006, they may be entitled to concessional tax treatment in relation to amounts they receive as an Employment Termination Payment.

The management of termination payments can be quite challenging particularly for people on higher salaries with a long standing relationship with their employer.

But irrespective of the length of time employed, or the amount of a termination payment, advice from a financial planner may prove to be invaluable at times of difficulty such as redundancy.

#### Disclaimer

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